ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application for rate increase in Marion, Orange, Pasco, Pinellas, and Seminole Counties by Utilities, Inc. of Florida.	DOCKET NO. 020071-WS

POST HEARING

STATEMENT OF ISSUES AND POSITIONS

OF

UTILITIES, INC. OF FLORIDA

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POST HEARING STATEMENT OF ISSUES AND POSITIONS OF UTILITIES, INC. OF FLORIDA

UTILITIES, INC. OF FLORIDA, by and through its undersigned attorneys and pursuant to Order No. PSC-03-0935-PHO-WS, files this Post Hearing Statement of Issues and Positions:

CASE BACKGROUND

Utilities, Inc. of Florida (UIF or Utility) is a Class A utility providing water and wastewater service to systems in Marion, Orange, Pasco, Pinellas, and Seminole Counties. The official date of filing in this case was October 3, 2002. This matter proceeded to hearing before Commissioners Deason, Baez and Bradley in Tallahassee, Florida on August 20, 2003, with the active participation of UIF, the Commission Staff, and the Office of Public Counsel (OPC).

ISSUES AND ARGUMENT

ISSUE 1: Is the quality of service provided by UIF satisfactory?

The quality of service provided by UIF was stipulated by the parties to be satisfactory (Tr. 911).

ISSUE 2: Should any amortization of the undepreciated portion of retired plant or demolition costs be included in the test year?

The parties adopted the Commission Staff's position that no amortization should be allowed, as these costs should have been fully recovered. This issue was accordingly deleted by agreement (Tr. 9).

ISSUE 3: Are any additional adjustments necessary to properly reflect the condemnation and resulting retirement of the Lincoln Heights wastewater treatment plant?

*The parties stipulated as follows:

> "No additional adjustments are necessary to properly reflect the condemnation and resulting retirement of the Lincoln Heights wastewater treatment plant." (Tr. 9)*

ISSUE 4: Should any amortization expense be included for the Seminole County wastewater system televideo inspection charges?

POSITION

No.

ARGUMENT:

This expense was fully amortized before the test year.

ISSUE 5: What adjustments, if any, should be made to the Utility's UPIS with respect to common plant allocations from Water Services Corporation?

POSITION

UIF accepts the Commission Staff's adjustments, except for amount of plant for computers, which should be $61,490, with accumulated depreciation of $34,721.

ARGUMENT:

Although Commission Staff Auditor Welch did not specifically recall receiving the supporting documentation from UIF for these computer purchases by Water Services Corporation (Tr. 634), a complete schedule of these purchases and all available invoices were filed with the Commission on March 25, 2003, as an additional response to the Water Services Corporation Audit (Ex. 28). Further, the Commission found that there was adequate support for the allocation of a portion of the expense attributable to these purchases to Cypress Lakes Utilities, Inc., an affiliate of UIF, in Docket No. 020407. (Please refer to Order No. PSC-03-0647-PAA-WS.) The responses of UIF to the audit of Water Services Corporation were incorporated into the rebuttal testimony of Steven M. Lubertozzi as Exhibit 28 (Tr. 880, 881). There was no testimony by OPC or the Commission that this expense should not be included. Accordingly, there is unrebutted evidence to support the allocation of a portion of this expense to UIF. The allocation of $61,490 for computers, with accumulated depreciation of $34,721, should be allowed for utility plant in service.

ISSUE 6: What adjustment should be made to CIAC and amortization of CIAC to reflect the contribution received from the City of Altamonte Springs?

POSITION

None. UIF did not receive any CIAC from the City of Altamonte Springs.

ARGUMENT:

When UIF entered into a contract with the City of Altamonte Springs in 1995 for the City to provide bulk wastewater treatment to UIF for UIF's Weathersfield customers, the City paid $107,000 (Tr. 462). OPC is recommending that the $107,000 be treated as CIAC in the rate base for UIF's Seminole County System (Tr. 462). UIF is required to keep its books in accordance with the NARUC USOA, Rule 25-30.115, Florida Administrative Code. Thus, the $107,000 payment by the City must come within the definition of CIAC in order to be booked as such.

Rule 25-30.515 (3) defines "Contribution-in-aid-of- Construction" as follows:

> Contribution-in-aid-of-Construction (CIAC) means any amount or item of money, services, or property received by a utility, from any person or governmental agency, any portion of which is provided at no cost to the utility, which represents an addition or transfer to the capital of the utility, and which is utilized to offset the acquisition, improvement or construction costs of the utility's property, facilities, or equipment used to provided utility services to the public. The term includes, but is not limited to, system capacity charges, main extension charges and customer connection charges.

The OPC witness admitted that CIAC is monies "received by the utility associated with the construction of some facilities. It's usually either given by the customers and/or sometimes developers contribute property" (Tr. 482). The City of Altamonte Springs is neither a customer nor a developer.

In order for the payment from the City to be CIAC, it must be for the purpose of offsetting the acquisition, improvement or construction costs of the Utility's property, facilities or equipment used to provide utility services to the public. The unrefuted evidence

is that the payment by the City was for none of those purposes and thus is not CIAC and cannot be booked as CIAC under the NARUC USOA. Since no other treatment of that payment was noticed as an issue, or addressed in the final hearing, the payment by the City, which was not made during the test year, is of no consequence in this Rate Case.

ISSUE 7: What adjustments, if any, should be made to the amount of working capital allocated to each of the Utility's operating systems?

POSITION

UIF accepts the Commission Staff's adjustments.

ARGUMENT:

The Staff Auditors recommended certain adjustments to working capital (Tr. 586-588). UIF accepted the Staff Auditors' proposed methodology to calculate working capital in its response to Audit Exception No. 14 (Tr. 880; Ex. 28). OPC Witness DeRonne acknowledged UIF's position in her testimony (Tr. 342). The following adjustments should be made to the amount of working capital allocated to each of UIF's operating systems:

Marion	($102,088)	($40,077)
Orange	($66,622)	$0
Pasco	($209,314)	($226,517)
Pinellas	($23,415)	$0
Seminole	($350,243)	($407,758)

ISSUE 8: If the Commission determines a system or a component of a system to be 100% used and useful in a prior case, is it obligated to keep that system 100% used and useful in a subsequent case?

POSITION

*No. However, the burden is on the party recommending less than 100% to prove that the Commission legally erred in its decision or that the circumstances have

changed from those in the previous case to such a great extent that the result is no longer valid.*

ARGUMENT:

The fact that the Commission, by Final Order, had previously determined certain facilities to be 100% used and useful was undisputed in this case (Tr. 140, 233, 647). Although the issue addresses whether the Commission is "obligated" to be bound by that decision in a subsequent case, the Commission's own orders on the point clearly recognize that the Commission has declined to place such an obligation upon itself. The real issue, as it relates to this case and the evidence presented, is whether the PSC should adopt OPC's position and afford so little dignity and recognition to its prior determinations that it is as if the prior used and useful finding was never made. Clearly, the answer is "no". The Commission should place a significant burden on any party suggesting that the Commission legally erred in its prior decision or that the circumstances have changed to such a significant extent that the result of the prior decision should be merely tossed aside.

In recognizing that orders of administrative agencies must eventually become final and no longer subject to modification, the Commission has opined that an agency may modify an order still under its control, though "that authority is somewhat limited", and that agencies may decide issues relating to a public interest which changes over time as circumstances change. Order No. PSC-96-1517-FOF-EG. While the Commission certainly has some latitude to revisit its used and useful determination in this case, the circumstances and evidence failed to demonstrate that it would be appropriate to do so.

This is not a case where the Commission determined that a particular thing cost a dollar and then subsequently determined that this same particular thing cost, in fact, only fifty cents. Inherent in a used and useful determination is the considered determination by the Commission that a utility's expenditures on a certain facility or

component was reasonably necessary to serve the utility's present and future customers. Predicting the future, even upon reasonable and reasoned facts at hand, lacks the perfection of viewing long ago expenditures with hindsight as OPC Witness Biddy attempts to do. In point of fact, OPC has not produced evidence upon which a used and useful determination of less than 100%, for the particular facilities here at issue, may be made, much less evidence sufficient to overcome the significant burden which the dignity of the Commission's prior Order deserves.

ISSUE 9: If a local jurisdiction requires fire flow, is the Commission obligated to give the Utility a fire flow allowance even if the system provides little or no fire flow?

POSITION

Yes, if the system provides fire flow and the utility requests fire flow consideration.

ARGUMENT:

If a utility, in fact, provides fire flow, the Commission is obligated under Chapter 367 to provide the utility a fire flow allowance.

As the Commission Staff's Expert Engineer correctly pointed out, the Commission has consistently recognized the need for fire flow protection and considers it in its determination of used and useful. (Tr. 668). In that regard, he testified that he disagreed with Mr. Biddy's position (Tr. 668). In both the Orangewood and Oakland Shores systems, fire flow is furnished to only limited portions of the system, but the hydrants are in public areas and the company is responsible for providing the required fire flows and must have the capacity to do so (Tr. 828). To deny the allowance for fire flow would be to deny the utility the ability to recover the cost associated with the service which UIF is obligated to provide (Tr. 828).

The fact of the matter is that whether a utility provides fire flow through only a few hydrants or through numerous hydrants, when the fire department of a given locality utilizes a particular hydrant to fight a fire, the hydrant has to provide the necessary flows. As Mr. Biddy acknowledged, the hydrants that are in the two service areas have been tested upon their installation and deemed sufficient by local government for their intended purpose (Tr. 262-3).

The hydrants on those systems are on lines that are sufficient to provide the needed capacity (Tr. 181) and regardless of whether a utility provides one hydrant or one hundred hydrants, the flows have to be delivered at the time demanded and for the duration required, which is a factor of the capacity of the utility system (Tr. 181). Even in those areas where hydrants are not in close proximity, the existing hydrants are useful to the residents because they are available to replenish water to the fire trucks that come out (Tr. 184). The fire hydrants at issue in these systems are there to fight fires, and not just for flushing (Tr. 183).

ISSUE 10: Should any of the UIF systems be considered as 100% used and useful because they are built out?

POSITION

Yes, assuming that the issue relates only to the distribution and collection systems, all of UIF's systems should be included as 100% used and useful because they are "built out" with the exception of the Summertree system in Pasco County and the Golden Hills/Crownwood system in Marion County.

ARGUMENT:

With the exception of the Summertree system in Pasco County and the Golden Hills/Crownwood system in Marion County, all of UIF's distribution and collection systems are built out and therefore 100% used and useful.

Mr. Redemann testified that the Commission has previously found water systems to be 100% used and useful if the utility service territory is built out and there is no apparent potential for expansion in the surrounding area (Tr. 647). All of the UIF water service territories in Seminole, Pinellas and Orange Counties, and all other water systems in Pasco County except Summertree, are built out in the opinion of the Commission Staff Engineer (Tr. 647). Additionally, the Commission had previously determined used and useful percentages for those water systems (Tr. 647). Only the UIF water systems at Summertree in Pasco County and Golden Hills in Marion County are not built out (Tr. 648). In that regard, the Commission Staff Engineer generally agreed with Mr. Seidman's conclusions on the used and usefulness of the water systems (Tr. 653). Despite the fact that the Commission had previously determined the water distribution and wastewater collection systems in this case to be 100% used and useful, Mr. Seidman conducted an analysis to determine whether there were any significant changes that would warrant a change in the previous determination (Tr. 143).

It is perfectly reasonable for a small, closed system to be considered 100% used and useful even though some lots do not now, or may ever have, customers, simply because all lines are in place and are required as a minimal backbone system (Tr. 833). It is not unreasonable or unusual for the Commission to consider distribution and collection systems that are 80% plus built out and which have virtually no growth potential to be 100% used and useful (Tr. 833).

Mr. Biddy testified that he visually inspected the service areas and drove through some of the subdivisions (Tr. 292). During that review of the service areas, he noticed that some homes occupied more than one lot (Tr. 292) and he did not attempt to quantify whether there were lots in the various service areas which may not have been suitable for development (Tr. 292). Mr. Biddy also acknowledged, in response to cross-examination by the Commission's Staff Counsel, that as to

whether he noticed during his visual inspection of the service areas whether some of the customers had their own wells and septic tanks, that he "did not go into that detail" (Tr. 312). Mr. Seidman testified that if you take a look at the maps of these systems and see how the distribution of the unserved lots are distributed through them, that these systems are virtually built out (Tr. 170).

It was the opinion of the Commission Staff's Expert Engineer that even if he went out and did a lot count check and found out that the system, which had previously been determined to be 100% used and useful, was actually 80% used and useful applying the lot count method, that that would not be a valid basis to set aside the earlier determination by the Commission.

ISSUE 11: What methodology should be employed to calculate the used and useful percentages, and what are the appropriate used and useful percentages for the Utility's water treatment systems, including source of supply and pumping, water treatment plants, and storage and high service pumping?

POSITION

Used and useful for these systems should be calculated using the Commission's standard formula. The availability of well, storage, and pumping capacity should determine whether to evaluate peak demand on the basis of peak day, peak hour or instantaneous demand. All of these systems are 100% used and useful.

ARGUMENT:

UIF's expert witness, Mr. Seidman, used a practical application of the Commission's basic formula for determining used and useful when addressing water supply, pumping, treatment, and storage facilities (Tr. 829). Mr. Seidman's analysis began with the listing of various input parameters, including the number and rating of the wells, type and size of the storage facilities, high service pumping capacity, system demand, fire flow requirements, and unaccounted for water (Tr. 829). If

system growth is relevant, that was addressed in the used and useful formula (Tr. 829). After addressing how each system functions and whether the system component should be evaluated individually or together, Mr. Seidman then made a calculation of used and useful using the Commission's standard formula dividing the sum of (peak demand + fire flow - excess unaccounted for water + property needed to serve 5 years after the test year) by the firm reliable capacity.

Mr. Seidman concluded that these systems should be evaluated on an integrated basis and not on a component basis. To evaluate them on a component basis would fail to recognize the interrelationship of the components (Tr. 842). In his testimony, Mr. Biddy provided a breakdown of used and useful percentages by system components (Tr. 305). Commission Staff Engineer Redemann was of the opinion that used and useful calculations should only be evaluated on a component basis when some portion of the system is oversized relative to the size of other components (Tr. 668). As to the UIF water systems at Summertree in Pasco County and Golden Hills in Marion County, Mr. Redemann noted that the Commission had found water utilities with only one well to be 100% used and useful in other cases (Tr. 648) and that because the demand on the water system is greater than the firm reliable capacity, the Summertree water system should be considered 100% used and useful (Tr. 656). He also testified that because the demand on the water system is greater that the firm reliable capacity, the Golden Hills water system should be considered 100% used and useful (Tr. 656).

For every UIF system that produced treated water with its own facilities (even though nearly all of those same systems had previously been found to be 100% used and useful), Mr. Seidman took the extra precaution of performing a used and useful analysis (Tr. 141). Mr. Seidman, based on the availability of well capacity, storage capacity, and high service pumping capacity, made a determination as to whether demand should be evaluated on the basis of maximum day demand or

instantaneous demand (Tr. 829). In any case where a system had no storage facilities or storage of such little consequence that it would be unable to support even a peak hour demand, Mr. Seidman determined that a system should be evaluated on the basis of instantaneous demand (Tr. 830). In the case of a small water system which has only hydropneumatic storage and no high service pumping, the system demand is served directly from the well pumps (Tr. 830). There is no way to buffer that demand with storage (which does not significantly exist at that particular facility) and therefore the well pumps must respond directly to those changes (Tr. 830). Mr. Seidman's approach of evaluating these systems on the basis of instantaneous demand merely recognizes what is actually occurring on the systems (Tr. 830).

While Commission Staff Engineer Redemann testified that he did not utilize Mr. Seidman's method of using instantaneous flows to determine customer demand (Tr. 653), it was clear that he also did not agree with Mr. Biddy's position that used and useful should be based on pumping wells for a 24 hour period for a small system with little or no storage capacity (Tr. 669) and that his method of determining well capacity based on pumping 12 hours to properly manage the aquifer was an attempt to recognize, just as Mr. Seidman had, the reality of these small systems (Tr. 716-723). When shown an internal Commission Staff Memorandum from Engineer Ted Davis, Mr. Redemann acknowledged that Mr. Davis had expressed concern that the Commission should not have a policy that would deprive engineers of the latitude of considering the dynamics of instantaneous demand with regard to certain such utilities (Tr. 719). Mr. Redemann acknowledged the possibility that the shorter the periods the flows are measured in, the higher the flows are likely to be (Tr. 722). Mr. Redemann also acknowledged that it was the Commission's policy to embrace a new methodology that is shown to be superior to methodologies used in the past (Tr. 722) and expressed his willingness to consider that a shorter period (than max hour)

might be appropriate for these types of systems (Tr. 722, 23). It was Mr. Seidman's expert opinion that the concept of instantaneous demand is a better representation than an application of DEP criteria to what is really happening in such small systems (Tr. 192). Mr. Seidman felt Mr. Redemann's suggestion to use max hours was an attempt to come up with the most accurate approximation of what is really occurring in the system without storage (Tr. 193).

With regard to OPC's attempt to use DEP sizing criteria in the used and useful formula, Mr. Seidman noted that DEP does not take into account in its sizing criteria issues of economics, economies of scale, used and useful, or the nuances of the Commission statutes (Tr. 198). Notably, Mr. Biddy essentially agreed with Mr. Seidman's testimony in that regard (Tr. 274) and testified that he was not aware of anything from any source revealing or indicating any instance in which DEP had instructed someone as to the exact size of plant which they should build (Tr. 276). Mr. Seidman also pointed out the problem of using one specific DEP criteria without looking at the whole picture (Tr. 841). In this case, had Mr. Biddy applied a different (and correct) DEP criteria, his results would have been completely different wtihthe bottom line being that it would not be possible for systems that have no or negligible storage to adequately serve demand with the capacity which Mr. Biddy's approach would allow (Tr. 842). Mr. Biddy's attempt to persuade this Commission to adopt DEP sizing criteria out of context, and admittedly intended by DEP to be applied to brand new systems, both on this issue and elsewhere, is clearly an attempt to depress the percentage of utility facilities which would be considered to be used and useful by this Commission.

ISSUE 12: What methodology should be employed to calculate the used and useful percentages, and what are the appropriate used and useful percentages for the Utility's wastewater treatment plants?

POSITION

The appropriate methodology is set forth in Rule 25-30.432, F.A.C. Based upon that methodology the Crownwood wastewater treatment plant is 68.72% used and useful.

ARGUMENT:

Rule 25-30.432, F.A.C., sets forth the methodology to be employed for the calculation of UIF's wastewater treatment plants. Because the Crownwood system in Marion County is the only UIF wastewater system which does not purchase wastewater treatment and disposal services, it was the only system which required any analysis (Tr. 143). For the other four systems, any plant necessary to tie into the serving utility was considered to be 100% used and useful (Tr. 143). Mr. Seidman utilized the Commission's standard formula of dividing (peak demand minus excess inflow and infiltration + property needed to serve 5 years over the test year) by the rated capacity of the system (Tr. 143). Based upon this analysis, summarized in Composite Exhibit 7, all components of all wastewater treatment systems, except one, were found to be 100% used and useful (Tr. 144). The treatment and disposal facility at Crownwood was determined to be 68.72 used and useful, and all other plant facilities at Crownwood 100% used and useful (Tr. 144).

Commission Staff Expert Redemann testified that he had looked at the Utility's used and useful calculations for its wastewater system (Tr. 663) and that UIF currently only had one wastewater treatment plant, that being the Crownwood plant in Marion County (Tr. 663). Mr. Redmann agreed that UIF's proposed 68.65% used and useful allowance for the Crownwood wastewater treatment plant was consistent with Rule 25-30.432, F.A.C., and that he agreed with Mr. Seidman's conclusion in that regard (Tr. 663). Mr. Redemann also opined that since the wastewater service areas were built out, with the exception of Summertree in Pasco County, that such built-out systems should be considered 100% used and useful (Tr. 664). Mr.

Redemann noted in the last rate case order for Summertree that the Commission found that the wastewater interconnection (master lift station and force main) was 100% used and useful and the collection lines were contributed and therefore a used and useful adjustment was not necessary (Tr. 664). Mr. Redeman also testifed that the Commission had previously determined used and useful for the wastewater collection systems to be 100% used and useful (Tr. 664).

Consistent with the balance of his testimony, Mr. Biddy utilized an approach to this issue which resulted in a lower recommended used and useful percentage (Tr. 234). Initially, Mr. Biddy was of the opinion that UIF had not used "any of the long standing and Commission recognized and approved methodologies for any of its U/U calculations" and that UIF was intent "on breaking new ground"(Tr. 234). It is notable that the used and useful calculations which Mr. Seidman made for the wastewater treatment plant are based upon the same methodology which Commission Staff Expert Redemann testified was consistent with the Commission's Administrative Code Rule and with which he agreed (Tr. 663).

The statutory growth rate Mr. Biddy applied in his wastewater system (as well as his water system and distribution and collection system) used and useful calculations leaned heavily upon the concept of "negative growth". Mr. Biddy opined that his used and useful calculations applied a "negative growth rate" to three of the water systems and one wastewater system for the five year statutory period (Tr. 230). Mr. Biddy candidly acknowledged that he had never had a case in the past where he had attempted to apply the statutory five year horizon to what he perceived to be a negative growth situation (Tr. 270). Mr. Biddy testified that it is his opinion that even when circumstances exist where the utility made an investment that was prudent and reasonable when made, subsequent events (even those that may not have been foreseeable at the time of the investment) could lead to negative growth and that therefore the statute should be applied to disallow a return on certain of the

utility's investments (Tr. 271). Despite his ultimate opinion, Mr. Biddy admitted that he made no determination as to whether UIF should or should not have reasonably anticipated this so-called negative growth (Tr. 272). In response to cross examination questions by the Commission's Staff Counsel, Mr. Biddy also acknowledged that he did not know whether or not this "negative growth" would continue on a going-forward basis for the Oakland Shores system, the Weathersfield water system, or the Park Ridge water system (Tr. 319). Mr. Biddy also acknowledged that he was not aware of any cases in which the Commission had recognized such a negative growth factor and that such a determination would be "breaking new ground" (Tr. 320).

Mr. Seidman was of the opinion that used and useful percentages should never be reduced by negative growth factors (Tr. 835). Negative growth implies that a demand for service once existed which the utility was obligated to serve and did (Tr. 835). Since the utility cannot remove the lines which are committed to serve those areas, the Commission should not penalize the utility for such "negative growth" any more than the utility should be penalized because demand may be reduced due to such factors as conservation (Tr. 835).

Mr. Biddy also disagreed with the conclusions of both UIF's expert and the Commission Staff's Expert with regard to the other UIF wastewater systems. For instance, in his analysis of I/I, Mr. Biddy determined that 4 of 5 wastewater systems had "excessive" I/I. However, Mr. Biddy acknowledged that in fact there are a significant number of source materials which differ in their opinions about what a reasonable amount of I/I is (Tr. 250). See, e.g., Issue 27. For Ravenna, Mr. Biddy proposed a 5% allowance for inflow (Tr. 286) again using the DEP standard for brand new systems constructed under current construction techniques and with new construction materials (Tr. 286-287). Mr. Biddy's novel and unprecedented utilization of negative growth further skews his erroneous opinions in his used and

useful calculations, including those which he made for the Crownwood wastewater treatment plant (Tr. 230).

Mr. Biddy also attempted to uniquely apply DEP standards in order to lower the used and useful percentages. Mr. Biddy acknowledged that he was attempting to apply a design standard (200 gallons per inch of diameter per mile) to the I/I formula which, to his knowledge, the Commission had never accepted (Tr. 256). He also acknowledged that both Mr. Seidman and Mr. Redemann agreed that a 500 gallon per day standard would be the appropriate standard to be applied in this case (Tr. 256-257). Mr. Biddy was of the opinion that this DEP standard for new construction should be strictly applied by the Commission even to systems which were as old as 40 or 50 years, as are some of the systems in this case (Tr. 257). While Mr. Biddy was of the opinion that a utility could, through maintenance efforts, meet the same I/I levels in 2003 which the DEP applies to brand new facilities with brand new construction techniques with facilities that were installed in the 1950's, he had never attempted to determine or make any analysis as to whether the application of the 500 gallon per day per inch diameter per mile standard, as opposed to such repairs as would be necessary to make a system meet the 200 gallon per day standard, actually benefitted the rate payers more (Tr. 255-6).

Another typical approach Mr. Biddy applied to wastewater treatment plant was the way he calculated the amount of water which would be returned to the system as wastewater. Mr. Biddy estimated I/I for all systems as the difference between treated wastewater flows and what he identified as 80% of water sold to wastewater connections (Tr. 823). As Mr. Seidman testified, the general assumption that only 80% of water used is returned to the wastewater system is typically applied only to residential service and is based on the assumption that irrigation water is included in residential use (Tr. 823). Mr. Biddy in his calculations ignored the fact that some of these systems have irrigation which is separately metered (and therefore already

excluded from residential use) and that the Commission typically assumes that 96% of general service water is returned to the wastewater system (Tr. 823). Mr. Biddy admitted in cross examination that he did not do a breakdown between general service and residential customers because he did not go into "that fine a detail"(Tr. 284). Mr. Biddy also acknowledged that even though he understood that a number of purely irrigation meters exist in the Summertree system, he used the same 80% assumption when he was making his calculations for Summertree (Tr. 285). He acknowledged that in a service area in which there is a separate irrigation system that the appropriate figure is likely to be much greater than 80% that is returned to the water system (Tr. 285). Mr. Biddy said he "went ahead and used the 80% figure" because of "restraints of time and budget"(Tr. 286).

Mr. Biddy also agreed with the testimony of Mr. Redemann that the Commission typically assumes that 96% of the water purchased by general service customers is returned as wastewater (Tr. 284).

ISSUE 13: What methodology should be employed to calculate the used and useful percentages, and what are the appropriate used and useful percentages for the Utility's water distribution and wastewater collection systems?

POSITION

There is no rule that sets out a methodology to determine used and useful for distribution and collection systems. Typically, the Commission evaluates the relationship of lots on which customers exist or have existed to lots to which service is available with due regard to growth and the system configuration.

ARGUMENT:

In this case, for those systems already determined to be built out, and for which the water distribution and wastewater collection system were previously determined to be 100% used and useful, there are no significant changes that would

warrant a change in the previously determined used and useful factors and therefore there is no need to determine the appropriate methodology which should be employed to calculate such used and useful percentages (Tr. 143, Ex. 7). Mr. Seidman did evaluate the distribution and collection portion of the Golden Hills/Crownwood and Summertree systems because they had not previously been determined to be 100% used and useful (Tr. 834).

With regard to the Golden Hills/Crownwood water distribution system, Mr. Seidman made a calculation that based on the ERC capacity previously determined by the Commission, used and useful was approximately 97% and that therefore 100% should be used (Tr. 834). In an abundance of caution, after receiving a discovery request from OPC, Mr. Seidman also made an actual lot count from system maps and determined that approximately 586 units could be served (Tr. 834). He therefore estimated that used and useful would calculate to approximately 90% for the Golden Hills/Crownwood water distribution system. Based on the layout of the system and the location of available lots were located, it was his recommendation that the distribution system be considered 100% used and useful.

With regard to the collection system, which serves only the Crownwood area, Mr. Seidman determined that it was 100% used and useful based on the configuration of the system. Noting that the wastewater system only serves an area developed as quadraplexes, Mr. Seidman reviewed plats of the development and determined the potential number of quadraplex buildings which could be constructed (Tr. 835). On that basis, the area served could be anywhere from 52% to 70% developed (Tr. 835). However, noting that there had been no development activity in the last five years, and that there did not seem to be any potential interest in further development, it was Mr. Seidman's opinion that the wastewater collection system would probably not be any less, even if the existing buildings were all that

were initially planned, and that on that basis the collection system serving this grouping of buildings should be considered 100% used and useful (Tr. 835).

With regard to Summertree, Mr. Seidman did not make a determination of used and useful for the distribution and collection systems because they are fully contributed (Tr. 835).

It was also Mr. Redemann's opinion that all of the UIF water service territories in Seminole, Pinellas, and Orange Counties, and all other water systems in Pasco County except Summertree, are built-out and therefore should be considered 100% used and useful (Tr. 647). He noted the Commission had previously determined used and useful percentages for those water systems (Tr. 647). In conclusion, Mr. Redemann testified that he agreed with not only the Utility's used and useful calculations for its water distribution system (Tr. 663), but that he also agreed with the Utility's used and useful calculations for the wastewater collection system (Tr. 663).

Not surprisingly, Mr. Biddy's opinion varied from that of Mr. Seidman and Mr. Redmann. Mr. Biddy did not consider the size of the distribution and collection lines installed when he calculated used and useful (Tr. 308).

ISSUE 14: What is the appropriate rate base?

POSITION

The appropriate rate base is a fall-out issue subject to the resolution of other issues.

COST OF CAPITAL

ISSUE 15: What is the appropriate cost rate for short-term debt?

The parties stipulated that appropriate rate is 5.18%. (Tr. 911)

ISSUE 16: What is the appropriate return on equity (ROE) for UIF?

POSITION

Return on equity should be established in accordance with the leverage formula, which Public Counsel has stipulated to in prior Class A utility rate cases.

ARGUMENT:

Section 367.081 (4) (f), Florida Statutes, provides that a utility may, in lieu of presenting evidence on its rate of return on common equity, ask the Commission to adopt the range of rates of return on common equity under the applicable leverage formula established by the Commission. The Statute does not give that option to any other party to a proceeding. It was the OPC who raised this issue in this case. The current applicable leverage formula was established on June 13, 2003, in Order No. PSC-03-0707-PAA-WS. The current leverage formula provides for adjustment by three methods: (a) a bond yield differential of 44 basis points; (b) a private placement premium of 50 basis points; and (c) a small utility risk premium of 50 basis points. The Order does not say that such adjustments may be made; it expressly states that the resulting estimate is adjusted by means of the three methods. Further, the application of the three adjustments is not discretionary. All three adjustments must be made, subject to the cap of 11.96% set out in the Order.

OPC Witness Cicchetti asserts that the 50 basis point premium for small size should not be applied to UIF because of UIF's size relative to other water and wastewater utilities in Florida (Tr. 514). However, the evidence shows that in Order No. PSC-02-0898-PAA-WS, the Order establishing the leverage formula for 2002, the Commission mandated that this small utility premium be applied to all water and wastewater utilities in Florida (Tr. 206). Order No. PSC-03-0707-PAA-WS merely updated the leverage formula for 2003. It became final on July 8, 2003, in Order No. PSC-03-0799-CO-WS.

Regardless of UIF's size relative to other Florida water and wastewater utilities, the proper comparison to make is the size of the utility relative to the nine natural gas utilities which comprise the leverage formula's natural gas index, not other water and wastewater

utilities in Florida (Tr. 206). The smaller size of water and wastewater utilities present a greater business risk, a significant factor which this Commission recognized in the leverage formula. The Commission expressly adopted the small utility premium adjustment to compensate for the impact of the size differential (Tr. 209, 210).

OPC Witness Cicchetti asserts that the 40 basis point adjustment for bond yield differential is to compensate for the small size of Florida water and wastewater utilities relative to the companies used in the indexes to calculate the cost of equity (Tr. 500). This is incorrect. This Commission stated in Order No. PSC-02-0898-PAA-WS that its purpose is to compensate "for the difference between the credit quality of "A" rated debt and the credit quality of the minimum investment grade rating" (Tr. 211). Furthermore, as UIF Witness Ahern pointed out (Tr. 211), Order No. PSC-01-2514-FOF-WS clearly distinguishes the three methods as separate adjustments:

> "Moreover, we find that an adjustment for a bond yield differential and a private placement premium is appropriate. This would be in agreement with all the witnesses' testimonies. As for the small size premium, we find that an adjustment is justified in light of the new information presented in Witness Lester's testimony concerning the small size of Florida's WAW utilities."

OPC Witness Cicchetti was a witness in that proceeding and would have been included in the Commission's reference to the bond yield differential being in agreement with "all the witnesses' testimonies" (Tr. 211, 525). Further, in that docket, OPC Witness Cicchetti sought to have this Commission eliminate the application of the 50 basis point small utility premium, but the Commission rejected his position (Tr. 525).

It is noteworthy that OPC Witness Cicchetti admitted that he had not reviewed any prior Commission orders for Class A utilities to determine how the Commission had previously addressed the return on equity issue (Tr. 518). In fact, he did not feel that this Commission's prior applications of the leverage formula in connection with Class A utilities was relevant (Tr. 519).

Clearly, the three methods of adjustment are separate and distinct, and all three should be applied in calculating the cost of common equity when using the leverage

formula for all water and wastewater utilities. In particular, the 50 basis point premium is "very conservative reasonable and should not be disallowed in setting the rate of return for UIF" (Tr. 214).

ISSUE 17: Should UIF's ROE be lowered as a penalty to reflect the quality of its books and records?

POSITION

No, this issue had been addressed in the recent Cypress Lakes Utility rate case.

ARGUMENT:

OPC witnesses have recommended that this Commission penalize UIF by reducing its return on equity to a point at the lower end of the return on equity range (Tr. 372, 385). The purported objective of this penalty is to induce UIF to make corrections to errors and inconsistencies in its books and records (Tr. 372). However, UIF, and its parent company, Utilities, Inc., have addressed these same issues in Docket No. 020407, the rate case of a company affiliated with UIF, Cypress Lakes Utilities, Inc. Utilities, Inc. and UIF have met with the Commission Staff to discuss the Commission Staff's concerns and have devised a schedule for compliance (Tr. 875) (Ex. 28). Both UIF and Utilities, Inc., have manifested their intent to comply with the terms of Order No. PSC-03-0647-PAA-WS, and have taken steps to show their good faith efforts to complete the reforms. The issues raised in that Order are identical to the issues raised by the Commission Staff and OPC in this docket.

OPC Witness DeRonne recommended that this penalty rate of return should revert to the mid-point of the return on equity range when UIF's books and records reach some unspecified goal (Tr. 388). This recommendation obviously contemplates a point in time when the errors and inconsistencies in UIF's books and records have been corrected to some unspecified standard.

Ms. DeRonne fails to specify what standard UIF is to meet or who should determine that it has met the standard. Obviously, the Commission Staff would be required to

undertake another audit of its books and records to determine compliance. OPC has not volunteered to undertake this task.

Ms. DeRonne also fails to indicate how UIF is to achieve the readjustment to the correct return on equity, whether in a future rate case or in another proceeding, and who should bear the cost of the audit and the resulting proceeding.

More importantly, although she acknowledges that the same issues were raised in the Cypress Lakes docket, she also fails to address the impact of a penalty assessed in both this docket and the Cypress Lakes docket, to correct identical concerns of Commission Staff.

Where is the incentive to UIF? It is evident that imposing a penalty as an incentive is an unworkable solution and unfairly penalizes UIF and others. At some point in the near future, UIF's books and records will be in a satisfactory condition to the Commission Staff. UIF is now taking steps to remedy whatever issues the Commission Staff has. It would not be economically feasible or fair to Florida taxpayers, UIF, its shareholder or its rate payers to incur the cost of instituting proceedings to restore UIF's rate of return on equity to what that rate should be when the correct rate can be determined in this proceeding. UIF should not be penalized once, much less twice, for issues which it is taking action on now.

ISSUE 18: What is the appropriate cost of overall rate of return for water and wastewater for each county?

POSITION

This is a fallout issue which is subject to the determination of the appropriate rate of return on equity.

ISSUE 19: What is the appropriate amount of test year revenues?

POSITION

The appropriate amount of test year revenues is subject to the resolution of other issues.

ISSUE 20: What adjustment, if any, should be made to operation and maintenance expense to normalize purchase water expense for the Oakland Shores system in Seminole County?

The Commission granted OPC's oral Motion for Directed Verdict on this issue (Tr. 908).

ISSUE 21: What adjustment, if any, should be made to uncollectible expense to reflect a normalized level for the Weathersfield water system in Seminole County?

The Commission granted OPC's oral Motion for Directed Verdict on this issue (Tr. 908).

ISSUE 22: What adjustments, if any, should be made to the Utility's operation and maintenance expense with respect to amounts allocated from WSC?

POSITION

UIF accepts the Commission Staff's adjustments.

ARGUMENT:

UIF did not contest the exceptions set out in Staff Audit, Staff Audit Control No. 02-249-3-1 (Ex. 28) (Tr. 880). Therefore, the following adjustments should be made:

Operation and Maintenance Expense

County	Water	Wastewater
Marion	(7,304)	(1,037)
Orange	(2,753)	0
Pasco	(14,066)	2,535
Pinellas	(9,310)	0
Seminole	(36,824)	(19,800)

ISSUE 23: Should adjustments be made to the amount of salaries, pensions and benefit expense and payroll taxes included in the Company's MFR filing?

POSITION

Yes. UIF agrees with the Commission Staff's position on this issue.

ARGUMENT:

UIF agrees with the Commission Staff's adjustments for salaries, pension and benefit expenses, and payroll tax expense. Accordingly, the following adjustments should be made:

System	Salary Expense	Pension & Benefit Expense
Marion - Water	($3,206)	($814)
Marion - WW	($465)	($118)
Orange - Water	($2,945)	($748)
Pasco - Water	($15,153)	$3,576
Pasco - WW	$6,476	$1,560
Pinellas - Water	($23,315)	($5,920)
Seminole - Water	$8,666	$2,199
Seminole - WW	$4,698	$1,191

UIF's payroll tax expense should be adjusted as follows:

County	Water	Wastewater
Marion	($477)	($69)
Orange	($438)	$0
Pasco	$1,994	$883
Pinellas	($3,472)	$0
Seminole	($1,289)	$698

ISSUE 24: What adjustments, if any, should be made to the Utility's O & M expense in Seminole County with respect to the wastewater interconnection with the City of Sanford?

POSITION

UIF accepts the Commission Staff's adjustments.

ARGUMENT:

UIF agrees that a reduction in O&M expense of $80,751 to reflect the interconnection of the Lincoln Heights/Ravenna Park wastewater system, and the commencement of the purchase of wastewater treatment from the City of Sanford is appropriate (Tr. 122).

ISSUE 25: What is the appropriate amount of rate case expense?

POSITION

$515,720.01

ARGUMENT:

UIF has incurred considerable expense in this case. Expenses actually incurred and estimated expenses to complete are shown in Exhibit Nos. 28 and 29 (Tr. 854, 894-903). UIF Witness Lubertozzi testified that one of the primary factors driving rate case expense has been the amount of time required to respond to the overwhelming number of discovery requests propounded by OPC (Tr. 872). In addition, UIF incurred further costs in challenging the testimonies of OPC Witnesses Cicchetti and Dismukes in addressing the gain on sale, cost of capital and return on equity issues (Tr. 871). All of its rate case expense has been documented and supported (Tr. 873). Mr. Lubertozzi testified that none of the OPC witnesses provided any credible evidence of the methodology or statutory grounds for disallowing three-fourths of actual rate case expense incurred by UIF (Tr. 870). OPC failed to cross-examine Mr. Lubertozzi on the issue of rate case expense, thus such issues as hourly rates and amount of time incurred is uncontradicted and must be accepted

by the Commission (Tr. 882-890). The Commission Staff requested certain revisions to the schedules of actual rate case expense and an updated estimate to complete for rate case expenses (Ex. 29) (Tr. 892-903), but did not adduce any evidence that these expenses were excessive or unjustified. The entire $515,720.01 should be included as rate case expense in this proceeding (Tr. 872).

ISSUE 26: Does UIF have excessive unaccounted for water and if so, what adjustments should be made?

POSITION

Only the Pasco-Orangewood, Pasco-Summertree, Pinellas-Lake Tarpon, and Marion-Golden Hills/Crownwood systems have excessive unaccounted for water. The excess percentages are 5.0%, 3.7%, 8.1%, and 9.7%, respectively. The electric, chemical and purchased water expense of the respective counties should be adjusted to reflect the relative impact of the related systems.

ARGUMENT:

The expert witnesses for OPC and UIF essentially agreed on the issue of unaccounted for water (Tr. 819). It is notable that the Commission has not always used 10% as the limit for an acceptable level of unaccounted for water (Tr. 820) (see, for example, Order No. PSC-94-1383-FOF-WU, Order No. PSC-96-0910-FOF-WS and Order No. PSC-96-1338-FOF-WS) and that, in fact, the Commission has in the past determined that a fair average of unaccounted for water might be between 10% and 20% with good meter maintenance programs and average conditions of service (Tr. 820). The Southwest Florida Water Management District has indicated there is no need to address reduction of unaccounted for water levels of less than 15% and even in water use caution areas have determined that remedial action is not required for levels of less than 12% (Tr. 821).

The Commission Staff's Engineering Expert opined that while it has been a longstanding Commission practice to consider unaccounted for water amounts over 10% to be excessive, the percentage of unaccounted for water can vary widely from system to system (Tr. 659). It was Mr. Redmann's opinion that for those systems that have over 10%

unaccounted for water, if the utility has performed a water audit and is in the process of reducing the amount of water lost, no adjustment is needed (Tr. 660). It was also his opinion that in this case, UIF has addressed the unaccounted for water for those systems with more than 10% (Tr. 661). Mr. Redemann noted that he had listened to UIF's testimony during the case about the efforts they were making to address losses of unaccounted for water and that he was satisfied that the Utility was making efforts to address the problem (Tr. 723).

The adjustments for unaccounted for water should be based on a 12.5% allowance as testified to by UIF's expert, Mr. Seidman (Tr. 821).

ISSUE 27: Does UIF have excessive infiltration/inflow in any of its wastewater systems, and if so, what adjustments should be made?

POSITION

The only inflow and infiltration problem is in the Ravenna Park/Lincoln Heights wastewater system in Seminole County. Any adjustments should be offset by the cost of the inflow and infiltration investigation of $25,000, amortized over 3 years.

ARGUMENT:

It was Mr. Seidman's opinion that based upon his calculations, utilizing the 500 gallons per day per inch - diameter per mile criterion, that there was no excessive I/I at Summertree (Tr. 825). In that regard, he disagreed with the testimony of Mr. Biddy which not only utilized the wrong percentages of water returned to the wastewater system, as discussed elsewhere in this Post Hearing Statement (Issue 12), but who again applied his DEP design standard, as also discussed elsewhere in this Post Hearing Statement (Issue 12), in his formula.

With regard to Seminole County - Weathersfield, it was Mr. Seidman's opinion that Mr. Biddy's calculations were wrong because there was no valid basis for his determination of wastewater treated (Tr. 825). There is no metering device to measure the flow sent to the City of Altamonte Springs for treatment under the way the City bills the Utility, so there

is no measurement of treated flows against which to compare water consumed (Tr. 825). Since the agreement with the City is to bill the Utility on the basis of only 70% of water consumed, it can be reasonably concluded that the cost associated with any I/I that may exist is not being passed on to the customer through the treatment and disposal costs and therefore a determination of I/I is not necessary for this system (Tr. 826).

UIF does not have excessive infiltration/inflow in any system other than the Revenna Park Lincoln Heights Wastewater System in Seminole County. That particular system is one for which there is general agreement between OPC, the Commission Staff and the Utility (Tr. 826).

ISSUE 28: Is there a gain on sale with respect to the sale of the Druid Isle water system and of a portion of the Oakland Shores water system to the City of Maitland and/or with respect to the sale of the Green Acres Campground water and wastewater facilities to the City of Altamonte Springs, and if so, in what amounts?

POSITION

Yes. The prior Order of this Commission set forth those amounts.

ARGUMENT:

In 1999, UIF transferred its Druid Isle water system and a part of its Oakland Shores water system and their customers to the City of Maitland, and as a result had a net gain of $61,669 (Tr. 30; Ex. 28). In 1999, UIF also transferred its Green Acres Campground water and wastewater facilities and customer to the City of Altamonte Springs, and as a result had a net gain of $269,661 (Tr. 30; Ex. 28).

ISSUE 29: Should gains or losses on the sale of utility assets be included in cost of service for rate setting purposes?

POSITION

No.

ARGUMENT:

The gain or loss on the sale of the utility assets is not a cost of service for rate setting purposes. The United States Supreme Court has ruled relative to the rights of customers in utility property.

> "Customers pay for service, not the property used to render it. Their payments are not contributions to depreciation or other operating expenses, or to capital of the company. By paying bills they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company. Property paid for out of moneys received for service belongs to the company, just as does that purchased out of proceeds of its bonds and stock." *New York Telephone Company, 271 U.S. 23, 31-32 (1926).*

That ruling has been followed by the Commission:

> ". . . customers of utilities do not have any proprietary claim to utility assets. Although customers pay a return on utility investment through rates for service, they do not have ownership rights to the assets, whether contributed or paid for by utility investment. *North Fort Myers Utility, Inc., Order No. PSC-93-1821-FOF-WS*

Also in 1993, the Commission reached a similar conclusion in a Lehigh Utilities, Inc., rate case, Order No. PSC-93-0301-FOF-WS, in which the Commission concluded that "it is the shareholders who bear the risk of loss in their investments."

Almost universally, utility regulators with responsibility for setting rates do so as the basis of the utility's actual cost of providing service to customers (Tr. 31).

Fair and reasonable prices include all and only the costs of the activities undertaken by the utility to provide service. Costs are limited to those reasonably and prudently incurred for the provision of service. In addition to labor, supplies, taxes, depreciation and other operating expenses, utilities are entitled to include in their prices a reasonable return on the capital their owners and lenders have invested for the provision of utility service. These costs are usually measured for a year's period of time (a "test year") and are

matched against the quantity and quality of service expected to be provided during that period. "Cost of service" thus includes the cost of resources used or consumed during that period rather than the total amount the utility may be committed to spend or may have already spent for such resources, or the total return on capital the utility will need for all the years investors' capital is expected to be devoted to utility service. Further, expenses of activities unrelated to the provision of utility service are excluded from the price of utility services as are returns on capital not devoted to utility service (Tr. 31-32).

Cost-based rate regulation practices yield prices for utility service based on historic original costs rather than current values of the resources devoted to utility service. Thus, even though the utility asset may appreciate and be valued at above book value the rate base of the utility does not increase. It defies logic to give customers the benefit of appreciation upon the sale of a system, particularly one with a customer base. Courts have held that, however calculated, a reasonable return is one which is sufficient for the utility to maintain its credit standing and financial integrity, sufficient to attract new capital at reasonable costs and commensurate with returns being earned on investments attended by corresponding risks (Tr. 35).

For those assets which provide service to customers until retirement from service, neither depreciation nor return allowances included in utility service prices reflect the higher costs which investors will face upon replacing such assets. This risk rests squarely on the investors (Tr. 36).

Utility investments are not risk free. Although the rate of return allowed on utility investors' capital is generally lower than might be earned in some other types of businesses, this does not signify the absence of risk. As with any business, utility investors carry the risk of the success or failure of the enterprise. In particular, this includes weather, customer usage, management's ability to control costs, competition from other providers, inflation and regulatory lag, market risks and, particularly for the water industry, product risks. Depending on factors both related and unrelated to the specific utility, some investors have suffered substantial capital losses, while others who were more

fortunate realized capital gains on their investments. Clearly, investors are exposed to capital losses on the utility securities they hold (Tr. 37-38).

Regulators can limit the returns to be earned from providing utility services to customers, but not on capital transactions such as the sale of securities held by investors. Nor do regulators protect investors who are unfortunate and lose money on the sale of their utility investments. Transactions of this kind – whether complete or partial liquidations of an investor's holdings – are capital transactions and investors should bear the risk of any losses and should be entitled to any gains (Tr. 38).

The fact that customers pay rates which include depreciation and a return on investment does not suggest that gains on sale should be given to customers. Any depreciation and return which may be included in the price customers pay for service cover only that part of those resources consumed during the period when that service was provided. Thus, customers' payments cover nothing more than the cost of the safe, reliable, adequate service which they received. The obligations of both utility and customer have each been discharged and neither owes the other anything further. It is important to keep in mind that it is the investors who supply the capital which finances the utility plant which serves the customers' needs. Payment of prices which include something for return of and return on the capital investors have provided does not change the fact that it is still the investors' capital and it is the investors who own the properties which that capital financed. It is the investors whose capital is exposed to the risks of ownership and to whom gains or losses – including those from property sales – should accrue (Tr. 38-39).

Capital transactions, such as gains or losses on the sale of utility facilities, are distinguished from ordinary operating transactions which should be included in the cost of service for rate setting purposes. Capital transactions can be either "investments" or "disinvestments". In simple terms, construction or purchase of utility facilities would be an "investment" (of investors' capital), while the sale of utility facilities would be a "disinvestment" (of investors" capital). Sales such as UIF's sales of facilities to Maitland and Altamonte Springs can be either a complete or partial withdrawal of investors' capital from the utility business. Transactions of that type are not related to utility operations, but

rather, are capital transactions. That is the reason that the USOA directs accounting which distinguishes them from utility operations (Tr. 39-40).

OPC Witness Dismukes cites Proposed Agency Action ("PAA") Order No. 17168 issued February 10, 1987 relating to Florida Water Services' (then Southern States Utilities') loss of $5,643 on the sale of its Skyline Hills water system to the Town of Lady Lake in asserting that customers have consistently borne the risk of loss on the sale of utility assets (Tr. 402). Under cross-examination, Ms. Dismukes admitted that this was the only Commission decision which formed the basis of her opinion as to how the Commission had consistently treated this issue (Tr. 464). This case has previously been urged by OPC as the basis for assigning gains on sales to customers, and has previously been rejected by the Commission as a basis for doing so. In its order on rehearing of Southern States' Docket No. 920199, the Commission stated in Order No. PSC-93-1598-FOF-WS dated November 2, 1993:

> "We have reviewed the 1987 rate case Order No. 17168 cited by OPC. We find that it is the fact that SAS customers never contributed to the recovery of any return on investment which distinguishes this case from Order No. 17168. Because the facts of Order No. 17168 were not fully explored at the hearing in Docket No. 920199, we find that it is impossible to determine whether the facts in that case were the same as presented in this docket. Even if the circumstances were the same, we find that the order in that case was a proposed agency action, which was not based on evidence adduced through the hearing process."

Thus, Ms. Dismukes' reliance on the referenced decision was taken in spite of the fact that the Commission had previously rejected it as having any probative value.

Similarly, OPC Witness Dismukes reliance upon the Commission's decision in Order No. PSC-96-1320-FOF-WS (Southern States Utilities, Inc., rate case) is misplaced. In that case, the Commission did amortize the gain on sale of two facilities (and refused to do so for two others); however, the gain on sale issue was not addressed in any appeal of that decision. Ms. Dismukes admitted that the amount of money involved in that issue was

insignificant (Tr. 470). In fact, the amount involved was only one-tenth of one percent of the revenue requirement for the water system.

The three sales in question were all made under threat of condemnation (Tr. 865; Ex. 28). Thus, the shareholders of UIF did not have a choice in whether or not to sell these systems and their customers. The fact that these were not voluntary transfers was ignored by OPC Witness Dismukes (Tr. 471).

OPC also relies upon the Commission decision relating to plant abandonments and prudent retirements in asserting that gains on sale of utility systems should benefit customers (Tr. 402-403). Plant abandonments and prudent retirements result from events unforseen when the plant in question was originally purchased or constructed and placed into service, and result in the need to replace or retire the plant long before it has provided service for the estimated service life on which its depreciation (capital recovery) schedule directed by the Commission pursuant to rule was based. Such unforseen events might include the availability of more technologically advanced equipment which can provide better service or lower cost service or, more frequently, new environmental requirements with which the existing plant cannot comply (Tr. 45). When such circumstances occur, economic and engineering analyses indicate the course of action which provides the best service option at the lowest long-run cost, considering not only the cost of new facilities and/or additional operating expenses, but also the unrecovered cost of the property being evaluated for replacement (Tr. 45-46). This situation is recognized in the Commission's Rules which state:

> "The amortization period for forced abandonment or the prudent retirement, in accordance with the National Association of Regulatory Utility Commissioners Uniform System of Accounts, of plant assets prior to the end of their depreciable life shall be calculated ... ." Rule 25-30.433(9), Florida Administrative Code (emphasis added)

Clearly, this Rule demonstrates that (1) "prudence" is a prerequisite to recovery of

a plant abandonment, and (2) the value of guidance provided by the Uniform System of Accounts, belittled by both Ms. Dismukes and Mr. Cicchetti, is, at the very least, acknowledged by the Commission's own Rules. With respect to the issue of prudence, in its order on rehearing in Docket No. 911188-WS, the Commission emphasized that "prudence" is a key issue to the allowance of the recovery of a forced abandonment. The Commission stated at Page 5 of its Order:

> "We also agree with the utility's argument that the Mad Hatter case was based on evidence that reflected the utility's actions were prudent. That finding was critical to the Commission's determination that the loss should be borne by the ratepayers. In the alternative, had the Commission found the utility's decision to be imprudent, the shareholders would have borne the loss. Consequently, we find OPC's argument that the Commission routinely allows the recovery of losses on utility plant to be in error." Order No. PSC-93-1023-FOF-WS, issued July 12, 1993 (emphasis added).

In each of the plant abandonment cases cited by OPC Witness Dismukes, the Commission's allowance of recovery was based on a finding of prudence, which she ignores along with the benefits of service improvements resulting from the new facilities or service arrangements. This is not the first time that OPC has sought to analogize an abandonment loss with a gain on sale (Tr. 472). In Order No. PSC-93–1023-FOF-WS (Lehigh Utilities, Inc.), OPC argued that the Commission's decision in Order No. PSC-93-0295-FOF-WS allowing Mad Hatter Utility, Inc., to recover the loss arising from the abandonment of its wastewater treatment plants compelled the Commission to allow customers the benefit of a gain on sale. The Commission rejected that argument then, and should do so again.

OPC Witness Dismukes cites several cases, most of which occurred in the 1980s in which the Commission did direct that gains on sale of electric utility plant be assigned to customers. This is not the first case in which OPC has sought to have the Commission apply prior Commission electric utility decisions to the water and wastewater utility industry

(Tr. 474). In Order No. PSC-93-1023-FOF-WS (Lehigh Utilities, Inc.), the Commission rejected such an argument and it should do so again in this case. It is important to note that although on the surface the Commission's disposition of gains in these electric company cases appears at odds with its disposition of gains on sales in a number of water and wastewater cases, the electric company cases involved gains on disposition of specific assets in the course of operating their ongoing business. By contrast, the water and wastewater cases involved sales of utility facilities, service territories and the associated customers. The water and wastewater utilities ceased serving those territories and experienced reductions in their future revenue and earnings streams as a consequence of those sales. By contrast, sales of specific electric utility plant assets did not result in loss of customers or future revenue streams (Tr. 48).

The 1997 case involving Florida Public Utilities Company cited by OPC Witness Dismukes was, like the more recent 2002 case involving the same company (Order No. PSC-02-1159-PAA-GU, issued August 23, 2002), a Commission ruling on the company's request to amortize gains on sales of specific plant items over a period of years, not the sale of systems with the resultant permanent loss of the revenue stream.

OPC Witness Dismukes' conclusion that customers be given the gain on sales since they pay for the assets through depreciation and CIAC is inconsistent with economic reality. First, it would appear that Ms. Dismukes confuses the balance sheet credit represented by accumulated depreciation on assets sold (or not sold, for that matter) as being a cause of a "gain" on the sale of such assets. This would only be logical if the depreciation booked by the utility were in excess of the amount needed to reflect the expiration of the assets' useful lives. In Florida, depreciable lives are specified by Rule 25-30.140, Florida Administrative Code, so utilities have no flexibility in this regard. More importantly, it suggests that Ms. Dismukes does nott understand what accumulated depreciation represents (Tr. 52).

Rule 25-30.140(1)(i), Florida Administrative Code states:

> "Depreciation - As applied to depreciable utility plant, the loss in service value not restored by current maintenance incurred

> in connection with the consumption or prospective retirement of utility plant in the course of service from causes that are known to be in current operation and against which the utility is not protected by insurance. Among the causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities. The intent of depreciation per this rule is to provide for recovery of invested capital and to match this recovery as nearly as possible to the useful life of the depreciable investment."

Amounts recorded in the accumulated depreciation accounts represent that portion of the original cost of the plant sold which has been "consumed" in the course of providing service. Such amounts don't have values which may, in the ordinary course of business, be sold since such amounts equal the amount by which the original cost has "lost service value". Contrary to Ms. Dismukes' reasoning, potential purchasers don't pay for values already consumed or expired. What buyers of utility assets or systems pay for is the physical or economic usefulness which remains; in other words, any value paid for by a purchaser is the assets' remaining useful life for which no accumulated depreciation has yet been recorded, no customer has yet been "charged" and no amount of investors' capital yet recovered (Tr. 53).

It is usually true that at least some customers are required to pay contributions-in-aid of construction ("CIAC"), or service availability fees, pursuant to approved tariffs. It is also usually true that a large portion of the CIAC reflected on utilities' books represent amounts contributed by property developers. Regardless of the source, customers benefit from CIAC because of the lower rates for service which result from CIAC being a negative item in rate base and depreciation. More importantly, when customers pay CIAC, it does not result in any proprietary rights with respect to the utility's property (Tr. 53). This question was decided quite emphatically by the Supreme Court of Florida in its 1972 decision in *Dade County v. General Waterworks Corporation, 267 So. 2d 633 (Fla. 1972)*, wherein the Florida Supreme Court concluded that:

> "The manner in which defendants came to own this property does not operate to exclude it from the otherwise applicable constitutional requirements.
>
> . . .
>
> " 'Constitutional protection against confiscation does not depend on the source of the money used to purchase the property. It is enough that it is used to render service.' *Board of Public Utility Commissioners v. New York Telephone Company, 271 U.S. 23, 46; S. Ct. 363, 70 L. Ed. 808, 267 So. 2d at 640.*"

OPC's position that assigning gains on sale to customers is not confiscatory ignores the clear legal decisions to the contrary as well as economic and financial reality. It is bad enough from a financial and economic point of view when utilities are unable, for whatever reason, to earn a reasonable return. Most rate of return analysts refer to the *Bluefield Water Works, (262 U.S. 679 [1923])* and the *Hope Natural Gas, (320 U.S. 591-660[1944])* cases as the legal standards for setting appropriate rates of return. Both cases indicate that rates which fail to include adequate returns are confiscatory. By comparison, an outright taking of investors' property which results from assigning gains on sales to customers, is blatant confiscation from a financial and economic point of view, not to mention the legal implications (Tr. 60-61). The Commission, in fact, expressed the same conclusion in Order No. PSC-93-1821-FOF-WS, dated December 22, 1993, deciding the North Fort Myers Utility case:

> "We find that a refund to the customers or off-set of connection fees is not appropriate because customers of utilities do not have any proprietary claim to utility assets. Although customers pay a return on utility investments through rates for service, they do not have any ownership rights to the assets, whether contributed or paid for by utility investment."

And further,

> "The property rights that rest in the ownership of the utility land and facilities are constitutionally protected. To deny this

> property interest would constitute an unconstitutional taking by this Commission. Any contribution to the system by the customers would have no value without the risk and investment of the utility owner(s) in the land and facilities that are now being removed from utility service."

OPC Witness Cicchetti opines that unless gains on sale are attributable to customers the utility will recover more than the cost of service is absurd. What Mr. Cicchetti overlooks is that "all other things" are not equal because the sale of the property is outside the scope of providing rate regulated service. It is, in fact, at least a partial withdrawal of that much of the investors' capital from the business of providing utility service. The purchase price paid by the buyers of the utility property is not regulated as are the rates customers pay for the service they receive. More importantly, it is not the customers who pay the purchase price to the seller of the utility property, but rather an independent third party. The gain (or loss) realized by the utility on the sale of its utility plant is no more relevant to whether the utility earns above its authorized rate of return than earnings it might realize from mowing lawns for customers in its service territory because neither is a rate regulated utility service (Tr. 62-63). Dr. Charles F. Phillips, Jr. wrote:

> "The commissions can permit a company to earn neither more than a fair rate of return to make up for other unprofitable undertakings nor less when a company has additional sources of income that are profitable. The Economics of Regulation (page 147) (emphasis added.)

If the gain on sale was assigned to utility customers, they would receive a windfall and their rates would be set at less than the actual cost of providing utility service (Tr. 63).

OPC Witness Cicchetti erroneously claims that allowance of recover of standard costs incurred by utilities as a result of deregulation supports his assertion that customers are required to absorb the loss on rate of utility assets under cost of service (Tr. 526). Mr. Cicchetti admitted that the sales in question were not made as the result of deregulation (Tr. 526). "Deregulation" is the abandonment of cost-of-service regulation for at least a part of utility's business, and insofar as it is applied, represents the termination of the

"social contract" implicit in cost based rate regulation. When this occurs, the allowance of recovery of "stranded costs" is deemed to be a "transition cost" to the new (at least partial) free market system and is made in anticipation of net savings to be realized by customers even after absorbing the transition cost of "stranded assets". Since deregulation is the polar opposite of cost-of-service regulation, Mr. Cicchetti's claim is invalid and inappropriate (Tr. 63-64).

The returns on equity capital allowed by regulators, including the Commission, are intended to be compensation for the risks equity investors face. These would include general business risks (customer growth, customer usage and demand, weather, service area economics, etc.), but, under cost based ratemaking, not the risk of loss of capital. Mr. Cicchetti himself recommends 10.41% equity return in this case, or only 126 basis points more than the cost of debt. This level of risk premium would be woefully inadequate to attract capital to investments whose risks included loss of capital (Tr. 64-65).

OPC Witness Dismukes prepared an exhibit (Ex. 14), which was a compilation of information the Commission Staff had obtained from other states regarding their treatment of gains on sale. Based upon this Exhibit, Ms. Dismukes opined that there is a "clear trend" to allocate a gain to customers (Tr. 408). On cross-examination, she admitted that was a poor choice of words (Tr. 476). In fact, if any trend can be found, it is the opposite of that espoused by Ms. Dismukes. Only two states had addressed the gain on sale issue in an order relating to a water or wastewater utility. OPC Witness Cicchetti admitted that water and wastewater utilities around the country are generally treated differently from other utility industries (Tr. 529-530). North Carolina considered the issue three times. The oldest decision gave the entire gain to the customers, the next decision split the gain, and the most recent decision allowed the shareholders to keep the gain. Illinois appears to be the only state where the gain on sale issue has been addressed by an appellate court regarding a water and wastewater utility. There, the Commission's decision to give the gain on sale to the customers was reversed by the appellate court.

With regard to the three systems involved in this case, the shareholder was forced by threat of condemnation to give up forever the revenue stream from the customers of

those systems. The money from the sale of the systems compensates the shareholders for their permanent loss of revenue stream.

ISSUE 30: What is the test year operating income before any revenue increase?

POSITION

The appropriate operating income before revenue increase is subject to the resolution of other issues.

ISSUE 31: What is the appropriate revenue requirement?

POSITION

The appropriate revenue requirement is subject to the resolution of other issues.

RATES AND RATE STRUCTURE

ISSUE 32: What are the appropriate bills, ERCs and gallons to be used to set water and wastewater rates for the 2001 test year?

POSITION

The appropriate bills, ERCs and gallons to be used to set water and wastewater rates for the 2001 test year should be as set out in the E-2 and E-14 Schedules comprising Composite Exhibit No. 6 for Pasco and Seminole Counties and as set out in the MFRs in Composite Exhibit No. 5 for Marion, Orange and Pinellas Counties.

ARGUMENT:

The E-2 and E-14 Schedules comprising the MFRs, as amended and updated to reflect the comments and requests of the Commission Staff, correctly reflect the appropriate bills, ERCs and gallons to be used to set water and wastewater rates for the 2001 test year (Tr. 106, 131).

ISSUE 33: Is the Utility's proposed rate consolidation for Pasco and Seminole Counties appropriate, and if not, what if any rate consolidation is appropriate for those counties?

POSITION

Yes.

ARGUMENT:

Commission Staff Witness Lingo indicated that UIF may have submitted sufficient information to calculate rates for Pasco and Seminole Counties either on a stand-alone or consolidated basis (Tr. 789). Ms. Lingo has recommended also that UIF convert to a monthly billing structure in Seminole and Pasco Counties (Tr. 774). Whether the Commission determines that stand-alone or consolidated rates are appropriate, UIF is willing to implement a monthly billing structure for purposes of consistency throughout all systems included in this proceeding provided the costs it will incur to convert to monthly billing are included. These costs are $34,490, as set out in Exhibit No. 5, including the extra salary and related expenses described in the rebuttal testimony of Steven M. Lubertozzi (Tr. 879, 880).

ISSUE 34: What are the appropriate rates for water service for this Utility?

POSITION

The appropriate water rates are subject to the resolution of other issues.

ISSUE 35: What are the appropriate rates for wastewater service for this utility?

POSITION

The appropriate water rates are subject to the resolution of other issues.

ISSUE 36: What is the appropriate amount by which rates should be reduced four years after the established effective date to reflect the removal of amortized rate case expense, as required by Section 367.0816, Florida Statutes?

POSITION

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

ISSUE 37: Should the Utility be required to show cause, in writing within 21 days, why it should not be fined for its apparent violation of Rule 25-30.115, Florida Administrative Code, and Order No. PSC-97-0531-FOF-WU, issued May 9, 1995, in Docket No. 960444-WU, for its failure to maintain its books and records in conformance with the National Association of Regulatory Utility Commissioners (NARUC) Uniform System of Accounts?

POSITION

No, this issue had been addressed in the recent Cypress Lakes Utility rate case.

ARGUMENT:

OPC witnesses have recommended that this Commission penalize UIF by reducing its return on equity to a point at the lower end of the return on equity range (Tr. 372, 385). The purported objective of this penalty is to induce UIF to make corrections to errors and inconsistencies in its books and records (Tr. 372). However, UIF, and its parent company, Utilities, Inc., have addressed these same issues in Docket No. 020407, the rate case of a company affiliated with UIF, Cypress Lakes Utilities, Inc. Utilities, Inc. and UIF have met with the Commission Staff to discuss the Commission Staff's concerns and have devised a schedule for compliance (Tr. 875) (Composite Exhibit No. 28). Both UIF and Utilities, Inc. have manifested their intent to comply with the terms of Order No. PSC-03-0647-PAA-WS, and have taken steps to show their good faith efforts to complete the reforms. The issues raised in that Order are identical to the issues raised by the Commission Staff and OPC in this docket.

OPC Witness DeRonne recommended that this penalty rate of return should revert to the mid-point of the return on equity range when UIF's books and records reach some unspecified goal (Tr. 388). This recommendation obviously contemplates a point in time when the errors and inconsistencies in UIF's books and records have been corrected to some unspecified standard.

Ms. DeRonne fails to specify what standard UIF is to meet or who should determine that it has met the standard. Obviously, the Commission Staff would be required to undertake another audit of its books and records to determine compliance. OPC has not volunteered to undertake this task.

Ms. DeRonne also fails to indicate how UIF is to achieve the readjustment to the correct return on equity, whether in a future rate case or in another proceeding, and who should bear the cost of the audit and the resulting proceeding.

More importantly, although she acknowledges that the same issues were raised in the Cypress Lakes docket, she also fails to address the impact of a penalty assessed in both this docket and the Cypress Lakes docket, to correct identical concerns of the Commission Staff.

Where is the incentive to UIF? It is evident that imposing a penalty as an incentive is an unworkable solution and unfairly penalizes UIF and others. At some point in the near future, UIF's books and records will be in a satisfactory condition to the Commission Staff. UIF is now taking steps to remedy whatever issues the Commission has. It would not be economically feasible or fair to Florida taxpayers, UIF, its shareholder or its rate payers to incur the cost of instituting proceedings to restore UIF's rate of return on equity to what that rate should be when the correct rate can be determined in this proceeding. UIF should not be penalized once, much less twice, for issues which it is taking action on now.

ISSUE 38: Should the docket be closed?

POSITION

If the Commission's final order is not appealed, this docket should be closed upon the expiration of the time for filing an appeal.

CONCLUSION

For all of the reasons set forth in the testimony, evidence, stipulations, and exhibits placed into the record at hearing, UIF respectfully requests the Commission grant to UIF the rates, fees, and charges and other pertinent determinations requested by UIF herein.

Respectfully submitted this 22nd day of September, 2003, by:

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By: 
JOHN L. WHARTON

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by U.S. Mail (* Hand Delivery) this 22nd day of September, 2003, to:

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