

SETTLEMENT AGREEMENT

This Settlement Agreement is entered into this 9th day of March, 2006, by and among Aloha Utilities, Inc. (Aloha), the Office of Public Counsel on behalf of the citizens of the State of Florida (OPC), and Wayne T. Forehand, John H. Gaul, and Sandy Mitchell, Jr., Intervenor in Docket No. 050018-WU (Intervenors). Aloha, OPC and Intervenor are collectively referred to as the "Parties".

WHEREAS, the Florida Public Service Commission ("Commission") has initiated proceedings in Docket No. 050018-WU (Show Cause Docket) relating to the potential deletion of a portion of the territory to which Aloha is currently authorized to provide water service, as more fully set forth in Order No. PSC-05-0204-SC-WU, and Aloha is vigorously defending this case; and

WHEREAS, the Commission has opened an investigation in Docket No. 050183-WU (Investigation Docket) into whether there is probable cause to initiate additional deletion proceedings with respect to other portions of Aloha's water service territory; and

WHEREAS, Aloha has filed a notice of appeal of the order initiating the Investigation Docket in the First District Court of Appeal (Investigation Appeal); and

WHEREAS, the underlying issues in the Show Cause Docket and the Investigation Docket arise out of the presence of hydrogen sulfide in the water in the homes of some Aloha customers and various taste, odor and color issues that result from such presence (the "hydrogen sulfide issues"); and

WHEREAS, Aloha has filed an action against the Commission in Leon County Circuit Court Case No. 05-CA-01142 seeking declaratory and injunctive relief (Declaratory Judgment Action); and

WHEREAS, Aloha has appealed to the First District Court of Appeal in Case No. 04-5242 (Refund Appeal) a Commission order that requires Aloha to refund certain amounts previously collected from its customers; and

WHEREAS, the Commission has issued Order No. PSC-05-0709-FOF-WU (Water Quality Order) in Docket No. 010503-WU (Water Quality Proceeding) granting Aloha's request to replace the requirement in Order No. PSC-02-0593-FOF-WU that Aloha remove 98% of the hydrogen sulfide from its finished water with a goal that the level of hydrogen sulfide in its water should not exceed 0.1 mg/L, and has specified the locations and frequency of required testing; and

WHEREAS, Aloha has appealed the Water Quality Order to the First District Court of Appeal in Case No. 05-3662 (Water Quality Appeal); and

WHEREAS, on July 20, 2005, Aloha submitted to the Commission an Offer of Settlement that was intended to resolve the Show Cause Docket, the Investigation Docket, the Investigation Appeal, the Declaratory Judgment Action, the Refund Appeal, the Water Quality Proceeding, and the Water Quality Appeal; and

WHEREAS, after hearing public comments on August 15, 2005 on the Offer of Settlement, the Commission on August 17, 2005 deferred taking action on the Commission staff recommendation to accept the Offer of Settlement and instead directed the Commission staff to conduct further negotiations involving Aloha, appropriate customer representatives, the Office of Public Counsel, and other interested persons; and

WHEREAS, the pending Commission dockets and appeals were placed in abeyance to provide the parties an opportunity to negotiate; and

WHEREAS, Aloha's existing method of treatment converts hydrogen sulfide into other forms of sulfur; and

WHEREAS, prior to the first negotiation session, in order to facilitate a resolution of these issues, Aloha funded and produced a study by the University of South Florida (the "USF Study") that recommended anion exchange as the preferred treatment option to address the hydrogen sulfide issues; and

WHEREAS, anion exchange removes all forms of ionic sulfur; and

WHEREAS, after review of the USF Study and further consideration of various alternatives, an independent consultant retained by the Commission agrees that anion exchange is the water treatment option that has the best likelihood of eliminating or minimizing the hydrogen sulfide issues on a cost-effective basis; and

WHEREAS, in order to facilitate a settlement, Aloha has produced and submitted to the other Parties a non-binding, conceptual capital cost estimate ("Conceptual Cost Estimate") for implementing anion exchange at Plants 2, 6, 8, 9 and Mitchell (treating Wells 3 and 4), which estimate is based on the cost of facilities sized to treat the full current pumping capacity of the wells at those sites (i.e. 500 GPM for each well), and an independent consultant retained by the Commission has reviewed and verified the reasonableness of that estimate for its intended purpose; and

WHEREAS, Aloha is ready and willing to implement anion exchange as more fully set forth below upon approval by the Commission of such treatment method; and

WHEREAS, Aloha believes that due to the risk of future disallowance for cost recovery purposes, it will not have the ability to finance the anion exchange facilities in the absence of either (1) formal regulatory approval by the Commission of implementation of anion exchange, or (2) the existence of a legally enforceable water treatment standard that requires the implementation of anion exchange; and

WHEREAS, Aloha further believes it will not have the ability to finance the construction of anion exchange facilities while the Show Cause Docket is pending, due to the risk to lenders that a portion of Aloha's revenue-generating territory may be deleted; and

WHEREAS, in the event the Show Cause Docket and/or Investigation Docket were to result in an order deleting any portion of Aloha's territory, Aloha will exercise every legal right at its disposal to resist such deletion and to preserve or recover the full value of its assets; and

WHEREAS, the Parties agree that the public interest is better served by the prompt implementation of anion exchange than by prolonged administrative, judicial and appellate litigation.

NOW, THEREFORE, the Parties agree as follows:

1. The "Effective Date" is the date that a Commission order accepting and approving this Settlement Agreement becomes final and non-appealable.
2. (a) The Parties agree, and the Commission order approving this Settlement Agreement shall find, that (i) it is prudent for Aloha to implement anion exchange at Plants 2, 6, 8, 9, and Mitchell (treating Wells 3 and 4) as if there were a legally enforceable water treatment standard that requires the implementation of such option and the cost of such treatment shall be considered an environmental compliance cost under Section 367.081(2), Florida Statutes, and (ii) the reasonable costs of anion exchange facilities sized to treat the full current pumping capacity of the wells at those sites (i.e. 500 GPM for each well) shall be recoverable through rates, and the anion exchange facilities will be considered 100% used and useful. The Parties further agree, and the Commission order approving this Settlement Agreement shall find, that no additional treatment facilities for hydrogen sulfide shall be required at this time at Plants 1 and 7.
- (b) The Parties agree, and the Commission order approving this Settlement Agreement shall find, that this agreement will not preclude any substantially affected party from challenging, the Commission staff from auditing, or the Commission from reviewing, the reasonableness of the specific costs incurred in implementing anion exchange at the time Aloha seeks recovery of the related costs; however, the Commission's review shall not revisit for ratemaking purposes the fundamental agreement that anion exchange is a prudent option that should have been implemented. The Parties further agree that the Conceptual Cost Estimate provided by Aloha shall be admissible in such cost recovery proceeding only for the purpose of considering if the estimate was a reasonable, good faith estimate at the time it was performed. The estimate has been produced by Aloha only after qualification and explanation of the limited circumstances under which such estimate could be produced and the limited basis upon which such estimate could be relied upon.

- (c) The Parties agree, and the Commission order approving this Settlement Agreement shall find, that Aloha may seek cost recovery for such anion exchange facilities through a three-phase limited proceeding, subject to true-up. The Parties agree that the Commission will process such application as a limited proceeding, will not expand the scope of the proceeding beyond issues related to the installation, operation and maintenance of the anion exchange facilities, and will issue its Phase I order within 90 days after receipt of the petition.
- (1) Phase I shall provide a temporary rate increase (subject to true-up) designed to recover the projected carrying cost (interest during construction) on the average of the projected monthly balances, over the projected Phase I period, of construction work in progress for the anion exchange facilities based on pre-construction detailed engineering cost estimates. Such rate increase shall take effect as soon as possible after the date that on-site construction for anion exchange facilities commences.
 - (2) Phase II shall provide a temporary rate increase (subject to true-up) designed to recover (A) the capital cost of the anion exchange facilities based on actual and/or contracted expenditures, and (B) the projected incremental operating cost of the anion exchange facilities. Such rate increase shall take effect as soon as possible after all of the anion exchange facilities contained herein have been constructed and have been placed in operation.
 - (3) Phase III rates shall provide a final rate increase based on actual audited costs of the anion exchange facilities and one year of actual incremental operating expense experience. Aloha shall file its application for Phase III rates no later than 120 days after it has one year of actual operating expense experience. To the extent that Phase I and Phase II rates have either over- or under-collected the actual costs of the anion exchange facilities, based on the average of the actual monthly costs during the Phase I and Phase II periods, those rates shall be trueed-up via a credit or surcharge during the first twelve months the final Phase III rates are in effect.
 - (4) Because the Phase I and Phase II rates are subject to true-up, no opportunity for hearing will be provided at the time those rates are established and the Commission and its staff shall not hold customer meetings.
 - (5) The Phase I rates are designed to recover the carrying cost of the anion exchange facilities during construction. Under subsection (3) above, any over- or under-recovery of such Phase I carrying cost will be refunded through a credit or collected through a surcharge during the first twelve months the final Phase III rates are in effect. Therefore Aloha shall not be entitled to capitalize or recover any Allowance for Funds Used During Construction for these facilities.

- (6) The Phase I and Phase II rates are temporary rates subject to true-up as necessary to correct for any over- or under-collection. Therefore the incremental revenues produced by such rates are not required to be held in escrow and are fully and immediately available to Aloha to fund the related debt service, capital costs, or operating expenses associated with the installation and operation of the anion exchange facilities.

The Parties agree that the Phase I and II proceedings shall not address “repression” in gallons of usage. Such issue shall be addressed, if appropriate, only in the setting of Phase III rates.

- (7) Phase III rates shall be established by a PAA order issued within 6 months after Aloha’s submission of actual capital cost data and one year of actual incremental operating expense data for the in-service anion exchange facilities. In the event the Phase III PAA Order is protested, the Commission will issue its Final Order within 8 months of the date of such protest.
- (8) Aloha intends to finance the construction of the anion exchange facilities through debt. Accordingly, the Phase I, II and III rate increases will contain no allowance for a return on equity and no corresponding gross-up for federal income tax expense.

3. On or immediately after the Effective Date:

- (a) The Commission will voluntarily dismiss both the Show Cause Docket and the Investigative Docket.
- (b) No further enforcement action will be requested by the Parties or taken by the Commission against Aloha, nor any further disallowances or penalties of any kind will be assessed against Aloha by the Commission in any future proceeding, based on action or inaction relating to water quality or customer service issues which have been raised in Docket Nos. 950615-SU, 960545-WS, 010503-WU, 020896-WS, 050018-WU or 050183-WU, which action or inaction occurred prior to the Effective Date.
- (c) Aloha will voluntarily dismiss the Declaratory Judgment Action, with prejudice, and will voluntarily dismiss the Investigation Appeal and the Water Quality Appeal.
- (d) Aloha will voluntarily dismiss the Refund Appeal. The amount to be refunded as required by Order No. PSC-04-1050-FOF-WU is currently approximately \$290,000. This amount (“Gross Refund”) shall be updated to the Effective Date and shall include interest calculated in accordance with Rule 25-30.360(4), F.A.C. through that date. In order to determine the Net Refund, the Gross Refund shall be reduced by the documented costs of Aloha (up to \$45,000) to prepare the Conceptual Cost Estimate, and the amount of such documented costs shall

immediately be released from escrow. This reduction reflects the prior letter agreement between Aloha and OPC which has been approved by the Commission, that the cost (up to \$45,000) of preparing the Conceptual Cost Estimate for anion exchange shall be recovered from customers in this manner. After reimbursing Aloha for this documented cost, the Net Refund shall remain in the escrow account, accruing interest at the rate actually earned on that account. The Net Refund, plus interest earned thereon, shall be used to help pay for the anion exchange project. Aloha shall record an amount equal to the Net Refund, plus the interest earned thereon, as a contribution-in-aid-of-construction (CIAC) of the anion exchange facilities at the time the order establishing Phase III rates under Section 2(c) has become final and non-appealable. At that time, the balance in the escrow account shall be released to Aloha. Aloha acknowledges that it shall not be entitled to recover through rates, a return on, or return of, such portion of its investment either in the limited proceeding conducted under Section 2(c), or in any future rate proceeding.

- (e) Aloha will proceed in good faith to implement anion exchange at Plants 2, 6, 8, 9 and Mitchell (treating Wells 3 and 4) as set forth in Section 4. No later than 30 days following the Effective Date, Aloha shall seek recognition by Pasco County that the implementation of anion exchange, as outlined herein, complies with the requirements of Pasco County Ordinance No. 05-2444 (the "Ordinance") or Aloha shall pursue such other course of action as Aloha deems necessary to allow the installation of anion exchange facilities in lieu of forced draft aeration facilities. The Parties agree that anion exchange constitutes an alternative technology that meets or exceeds the sulfide removal capacity of forced draft aeration and is economically, technologically and environmentally feasible within the meaning of the Ordinance. The Parties agree to support Aloha's efforts to gain County approval for the implementation of anion exchange in lieu of forced draft aeration. The time requirements outlined in Paragraph 4 below for various aspects of the implementation of anion exchange treatment shall be tolled from the Effective Date until such time as there is no impediment or prohibition to the implementation of anion exchange, as outlined herein, as a result of the Ordinance.
4. (a) Aloha will install anion exchange at Plants 2, 6, 8, 9 and Mitchell (treating Wells 3 and 4) in accordance with the following schedule. To the extent that staging of construction is necessary, facilities shall be installed first at Plants 8 and 9. The Parties agree that, based on current knowledge, an estimate of 24 months from the Effective Date is a reasonable timetable for completion of the project and that the following are reasonable estimates of the various activities required:
- (i) design, including preliminary design and final engineering design: 6 months;
 - (ii) permitting: 4 months;

(iii) bidding, contract award, fabrication and construction: 14 months.

- (b) Aloha shall file with the Commission, with copies to the Parties, quarterly reports on the progress of implementation. The first such report shall be due 90 days after the Effective Date. Such reports shall detail the work completed during the preceding quarter and provide a timetable for future activities. After each quarterly filing, the Commission staff will arrange a meeting with Aloha and the Parties to review the progress report. In the event that staff concludes after such meeting that Aloha is not proceeding in good faith to attempt to complete the project within 24 months, the staff may, depending on the circumstances, recommend that the Commission take enforcement action for violation of the Commission order approving this settlement. Aloha and the other Parties shall have the right to participate in any such extension or enforcement proceeding. Such enforcement action shall be initiated in a manner that provides Aloha with the right to a hearing and complies with any other applicable requirements of Chapter 120. If the Commission initiates such enforcement action, nothing herein shall limit in any way Aloha's right to seek relief in Circuit Court from any procedural or substantive due process violation of Aloha's property rights by the Commission which is alleged to have occurred after the Effective Date. Nothing in this subsection precludes any Party from taking any action otherwise legally available to it.
- (c) In the event that compliance with the 24 month timetable is delayed by any cause beyond the control of Aloha, including but not limited to natural disasters or other events due to natural causes with or without the intervention of man, strikes, material or supply shortages, delays in the financing, fabrication or delivery of materials or supplies, or actions or inactions by any governmental authority, the Commission shall take no enforcement action against Aloha based on such delay, and the timetable for completion of the project shall be appropriately tolled and extended.
- (d) Within 30 days after the Department of Environmental Protection's approval of an operation and maintenance plan for the anion exchange facilities at a treatment site, Aloha shall provide an informational copy of the approved plan to the Commission and the Office of Public Counsel.

5. The Parties agree to implementation of the following testing for total sulfides in lieu of the testing for total sulfides required by Order No. PSC-05-0709-FOF-WU:

- (a) Beginning 30 days after the installation of anion exchange at a particular treatment site, Aloha shall begin testing for total sulfides at three locations for such site: (i) the raw water influent into the anion exchange facilities (ii) the treated water effluent from the anion exchange facilities, after the treated water effluent from the separate anion exchange reactors at the site has been combined, and (iii) the finished water after disinfection. The testing of raw water influent is for informational purposes only. Based on projected effectiveness of the anion

exchange treatment process, the goal is for the level of total sulfides in the combined treated water effluent to be at or below 0.3 mg/L, and in the finished water to be at or below 0.1 mg/L (compliance tests).

- (b) Beginning 30 days after the Effective Date, Aloha shall begin compliance testing for total sulfides in the finished water from Plants 1 and 7. The goal is for the level of total sulfides to be at or below 0.1 mg/L.
- (c) Beginning 30 days after Aloha starts to purchase water from Pasco County, Aloha shall begin testing for total sulfides in the purchased water at a point prior to the point at which the Pasco County water enters Aloha's distribution system. The testing of Pasco County water is for informational purposes only.
- (d) The compliance testing at each treatment site shall be performed on a monthly basis until the applicable goal for such site has been met for six consecutive months. Compliance testing at that site shall then be performed on a quarterly basis. If a quarterly test shows that the applicable goal has been exceeded, then monthly compliance testing at that site shall resume until the site achieves the goal for three consecutive months. A test of the purchased water shall be required in each month in which a compliance test is required at any of the treatment sites. Results of the tests outlined herein shall be submitted to the Commission within 30 days after the end of the month in which the test was performed.
- (e) In the event that the goal at any single treatment site is exceeded on any two compliance tests in a twelve month period, the Commission staff shall arrange a meeting with Aloha and the Parties to attempt to identify the root cause of the exceedance and to discuss what further action, if any, is appropriate.
- (f) All such testing shall end three years from initiation of such testing, unless any specific site has failed to achieve the goal for sulfide levels outlined herein on any compliance test during the third year of that three year period. In such case, testing shall continue at that site until there has been a twelve month period with no exceedances.

6. Aloha agrees to treat \$250,000 of the cost incurred in construction of the anion exchange facilities as a contribution-in-aid-of-construction. Aloha acknowledges that it shall not be entitled to recover through rates a return on, or return of, such portion of its investment either in the limited proceeding conducted under Section 2(c) or in any future rate proceeding. Aloha shall record this contribution at the time the order establishing the Phase III rates under Section 2(c) has become final and non-appealable.

7. Neither Aloha nor the Commission will seek recovery from the other of attorneys fees, costs, damages, or other compensation related to any action taken by the other on or prior to the Effective Date. Further, Aloha will not seek recovery from its ratepayers of any litigation costs, legal fees, consultant fees, and costs arising directly from or resulting from any judicial or quasi-judicial litigation in the Show Cause Docket, the Investigation Docket, the Declaratory Judgment

Action, the Refund Appeal, the Investigation Appeal, the Water Quality Proceeding, and the Water Quality Appeal. The Parties agree that Aloha may recover the portion of the cost of the USF Study that did not relate solely to the use of hydrogen peroxide. The recovery of the portion of the cost that did relate solely to the use of hydrogen peroxide may be litigated in Phase III of the limited proceeding described in Section 2(c). The provisions of this section will take effect on the Effective Date.

8. The Parties acknowledge that Aloha intends to finance the installation of anion exchange treatment facilities through the issuance of debt. The Parties agree to cooperate in good faith to explore the potential availability of governmental grant monies and/or low cost loans to finance or refinance such facilities.

9. In the event the Commission finds probable cause that Aloha has violated its obligations under Section 3(c), 3(d), 3(e), 4(a), 4(b), 4(d) or 5, as such obligations are incorporated without change in a Commission order approving the Settlement Agreement, nothing in this Settlement Agreement, or the Commission's acceptance thereof, shall limit in any way the Commission's authority to take enforcement action against Aloha for such alleged violation pursuant to Section 367.161, Florida Statutes. Such enforcement action shall be initiated in a manner that provides Aloha with the right to a hearing and complies with any other applicable requirements of Chapter 120. If the Commission initiates such enforcement action, nothing herein shall limit in any way Aloha's right to seek relief in Circuit Court from any procedural or substantive due process violation of Aloha's property rights by the Commission which is alleged to have occurred after the Effective Date.

10. This Settlement Agreement shall bind the Parties only if it is approved by the Commission, without change, and is incorporated by reference in a final Commission order.

11. If this Settlement Agreement is not approved by the Commission, without change, then neither the Settlement Agreement nor the staff recommendation that the Commission approve the Settlement Agreement will be admissible in any present or future judicial or administrative proceeding.

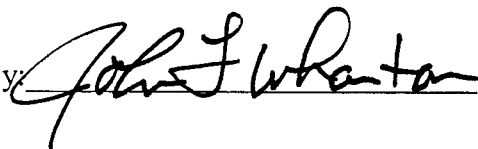
12. By entering into this Settlement Agreement, Aloha does not admit to any violation of any statute, rule or order, nor does such agreement constitute an admission of fault or liability on water quality or customer service issues which have been raised by the Commission or some of Aloha's customers. Conversely, by entering into this Settlement Agreement, OPC and the Intervenors do not concede that no such violations have occurred. In the event this Settlement Agreement is not accepted by the Commission, without change, neither Aloha nor any other party to any of the proceedings referenced herein (including the Commission) waives any legal, factual, policy or other position, or any legally available rights and remedies, otherwise available to it.

13. Nothing in this Settlement Agreement shall be read or interpreted to establish or imply any waiver by any Party of any right, privilege, or protection afforded said Party under Florida law, unless such waiver is set forth specifically herein.

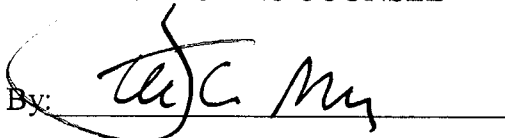
14. Each Intervenor executing this Settlement Agreement, and each customer ratifying this Settlement Agreement, is doing so only on behalf of himself or herself, individually, and in no way is agreeing to the terms and conditions of this Settlement Agreement on behalf of any other customer or group of customers. No such Intervenor or customer shall be sued by Aloha, or any of its assigns, because of such person's execution or ratification of this Settlement Agreement. No such Intervenor or customer shall sue Aloha, or any of its assigns, because of Aloha's execution of this Settlement Agreement.

EXECUTED this 9th day of March, 2006.

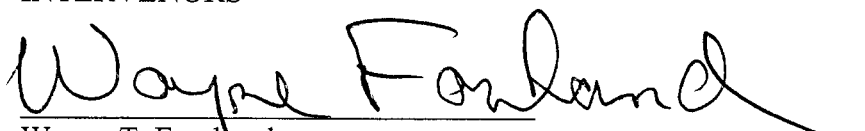
ALOHA UTILITIES, INC.

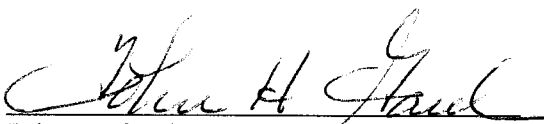
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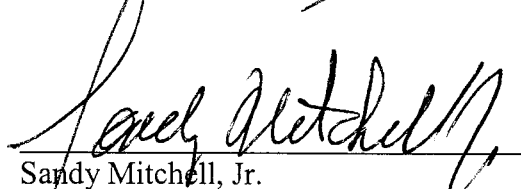
OFFICE OF PUBLIC COUNSEL

By: 

INTERVENORS


Wayne T. Forehand


John H. Gaul


Sandy Mitchell, Jr.

RATIFICATION BY CUSTOMERS

The undersigned customers of Aloha hereby ratify and support the foregoing Settlement Agreement between Aloha and the Office of Public Counsel.

Richard L. Levin
Thomas B. Vaurio
Joel A. Kurtz

Richard E. Wittay
John P. Andrews

STATEMENT BY COMMISSION STAFF

The Commission staff have participated in settlement negotiations with the Parties and have reviewed the foregoing Settlement Agreement. Based on that participation and review, staff will recommend to the Commission that it issue a final order approving the Settlement Agreement, without change, and that the Commission undertake such actions and issue such orders as necessary or appropriate to facilitate implementation of this Settlement Agreement.

Dated: 3/9/06

Paul D. Ma
General Counsel

Joseph D. Juel
For Director of Economic Regulation