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State of Florida



# Public Service Commission

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COMMISSION  
CLERK

## -M-E-M-O-R-A-N-D-U-M-

**DATE:** March 13, 2006

**TO:** Director, Division of the Commission Clerk & Administrative Services (Bayó)

**FROM:** Office of the General Counsel (Melson) *RDW* *MMW* *Q* *JDJ*  
Division of Economic Regulation (Devlin, Wilms, Rendell)

**RE:** Docket No. 050018-WU – Initiation of deletion proceedings against Aloha Utilities, Inc. for failure to provide sufficient water service consistent with the reasonable and proper operation of the utility system in the public interest, in violation of Section 367.111(2), Florida Statutes.

Docket No. 050183-WU – Request by homeowners for the Commission to initiate deletion proceedings against Aloha Utilities, Inc. for failure to provide sufficient water service consistent with the reasonable and proper operation of the utility system in the public interest, in violation of Section 367.111(2), Florida Statutes.

Docket No. 010503-WU – Application for increase in water rates for Seven Springs System in Pasco County by Aloha Utilities, Inc.

**AGENDA:** 04/04/06 – Regular Agenda – Interested Persons May Participate

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICERS:** Edgar (Docket Nos. 010503-WU and 050183-WU)  
Deason (Docket No. 050018-WU)

**CRITICAL DATES:** None

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\GCL\WP\0500182.RCM.DOC

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### Case Background

Aloha Utilities, Inc. (Aloha or utility) is a Class A water and wastewater utility located in Pasco County. The utility consists of two distinct service areas: Aloha Gardens and Seven Springs. There are currently three active dockets,<sup>1</sup> three appeals in the First District Court of Appeal,<sup>2</sup> and one Circuit Court case in Leon County,<sup>3</sup> involving Aloha's Seven Springs service area and the Commission.

In February 2005, the Commission initiated deletion proceedings in Docket No. 050018-WU for a portion of the Seven Springs service area based on a number of problems that ultimately stem from the presence of hydrogen sulfide in the water.

On August 17, 2005, the Commission deferred consideration of staff's recommendation to accept a comprehensive Offer of Settlement negotiated by staff and submitted by Aloha in an effort to resolve Docket Number 050018-WU and all other outstanding matters. At that time, the Commission decided to hold the deletion proceeding in abeyance and directed staff to undertake negotiations with Aloha, the Office of Public Counsel (OPC), customer representatives, and other interested parties in an attempt to reach a resolution that is satisfactory to all parties.

On March 9, 2006, after several months of extensive negotiations in which staff participated, a Settlement Agreement ("Settlement") was executed by Aloha, OPC, and individual intervenors Wayne T. Forehand, John H. Gaul, and Sandy Mitchell, Jr. (Intervenors). Aloha, OPC and Intervenors are collectively referred to as the "Parties." The Settlement was also ratified by Richard Letvin, Donna B. Vaurio, Joel A. Kurtz, Richard E. Wiltsey, and John P. Andrews, non-intervenor customers of Aloha who are active members of the Committee For Better Water Now. Mr. Edward O. Wood, another individual intervenor in the deletion docket, has not signed the Settlement.

The Settlement, a copy of which is attached to this recommendation as Attachment A, is a comprehensive agreement that resolves all outstanding dockets and court proceedings between Aloha and the Commission. The terms of the Settlement are summarized in Issue 1. That issue contains staff's recommendation that approval of the Settlement in its entirety, without change, is in the best interests of Aloha and its customers.

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<sup>1</sup> Docket No. 050018-WU (Show Cause Docket) is a proceeding to delete certain portions of Aloha's water service territory. Docket No. 050183-WU (Investigation Docket) is an investigation into whether the Commission should initiate deletion proceedings for additional portions of Aloha's water service territory. Docket No. 010503-WU (Water Quality Proceeding) is a continuation of Aloha's last rate case in which an interim rate refund is pending and in which the Commission entered an order establishing a water quality goal of 0.1 mg/L of total sulfides and specified testing locations and frequencies.

<sup>2</sup> Case No. 04-5242 (Refund Appeal) is Aloha's appeal of the Commission order requiring a refund of previously collected interim rates. Case No. 05-3247 (Investigation Appeal) is Aloha's appeal of the Commission order initiating the Investigation Docket. Case No. 05-3662 is Aloha's appeal of the Commission order establishing the 0.1 mg/L water quality goal and specifying the testing locations and frequencies.

<sup>3</sup> Case No. 05-CA-01142 (Declaratory Judgment Action) is a complaint that seeks declaratory and injunctive relief related to the Commission's prosecution of the Show Cause Docket.

Docket Nos. 050018-WU, 050183-WU, 010503-WU

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In a related matter, by Order No. PSC-06-0015-FOF-WU, issued January 4, 2006, the Commission approved a letter agreement between Aloha and OPC that formalized their agreement regarding recovery of the cost of preparing a conceptual cost estimate for the proposed treatment facilities. On January 12, 2006, Mr. Edward O. Wood, a customer intervenor, timely filed a letter requesting reconsideration of the Order. Oral argument was not requested. On January 23, 2006, Aloha filed a response in opposition to Mr. Wood's request. Issue 2 of this recommendation addresses the request for reconsideration.

The Commission has jurisdiction pursuant to Chapters 120 and 367, Florida Statutes.

### **Discussion of Issues**

**Issue 1:** Should the Commission issue a final order approving the Settlement?

**Recommendation:** Yes. The Commission should issue a final order approving the Settlement in its entirety and without change. The Settlement offers a number of monetary benefits to Aloha's customers that could not otherwise be obtained or assured, it redirects the Parties' resources away from protracted litigation toward implementing an agreed solution to the underlying water quality problem, and it provides a much needed fresh start for Aloha, its customers, and the Commission. (MELSON, DEVLIN, WILLIS, RENDELL)

**Staff Analysis:** Staff believes that approval of the negotiated Settlement is in the public interest and that the Settlement fairly balances the interests of Aloha and its customers. Approval of the Settlement will avoid protracted administrative, judicial and appellate litigation. It will allow Aloha to focus its resources on implementing a new treatment method – anion exchange – that the Parties have agreed represents a prudent approach to removing hydrogen sulfide from the water, thereby addressing the related taste, odor and color problems. It will also provide a fresh start for Aloha, its customers and the Commission.

Anion exchange was identified as the preferred water treatment option in a study performed for Aloha by the University of South Florida. Unlike the current treatment method that converts hydrogen sulfide into other forms of sulfur, anion exchange removes all forms of ionic sulfur from the water. After review of the USF study, and further consideration of various alternatives, Dr. James Taylor of the University of Central Florida, who was retained by the Commission as an independent consultant, agreed 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.

In order to facilitate the settlement negotiations, Aloha provided a non-binding, conceptual capital cost estimate ("Conceptual Cost Estimate") for installing anion exchange facilities. That estimate showed an installed capital cost of \$6.13 million, plus or minus 30%. Dr. Taylor reviewed the Conceptual Cost Estimate and concluded that it is a reasonable estimate based on good faith assumptions at the time it was prepared.

The following is a summary of the Settlement.

#### **Key Elements of Settlement**

- **Water Treatment Method (§2a).** The Parties agree that it is prudent for Aloha to implement anion exchange at five of its seven water treatment sites and that no additional treatment is required at this time at the remaining two sites where the level of hydrogen sulfide in the raw water is lower. This means that the reasonable cost of anion exchange facilities at the five sites will be recoverable through rates, and that anion exchange facilities sized to treat the full current pumping capacity at those sites will be 100% used and useful for ratemaking purposes. These agreements will become Commission findings if the Settlement is approved.

- Reasonable Costs (§2b). The Parties agree that the Commission can review and audit, and any substantially affected party can challenge, the reasonableness of the specific costs incurred in implementing anion exchange. However, any rate review will not revisit the fundamental agreement and finding that anion exchange is a prudent option that should have been implemented. Further, the Conceptual Cost Estimate will be admissible in cost recovery proceedings only for the purpose of considering if it was a reasonable, good faith estimate at the time it was performed. These agreements will become Commission findings if the Settlement is approved.
- Aloha Recording of CIAC (§6). Aloha agrees to record \$250,000 of the construction cost for the anion exchange facilities as a contribution-in-aid-of-construction. This provision was negotiated in lieu of a provision in Aloha's earlier Offer of Settlement which would have established a repiping program with an estimated cost of approximately \$250,000. This financial contribution by Aloha could not be achieved outside of a Settlement.
- Construction Schedule (§4). Aloha will install the anion exchange facilities in accordance with the schedule set forth below. A current County ordinance (under challenge by Aloha) requires Aloha to install forced draft aeration facilities. The Parties agree to support Aloha's efforts to gain County approval for implementation of anion exchange in lieu of forced draft aeration. The 24-month construction schedule does not begin to run until any impediment to anion exchange created by the County ordinance has been removed. The construction schedule is also subject to tolling in the event of a force majeure.
  - Design: 4 months
  - Permitting: 4 months
  - Bidding, contract award, fabrication and construction: 14 months

If construction staging is required, anion exchange facilities will be installed first at Wells 8 and 9, which have the highest concentration of hydrogen sulfide in the raw water. Aloha will file quarterly progress reports during construction, and staff will arrange a meeting to review each progress report with the Parties. If staff concludes that Aloha is not proceeding in good faith to meet the schedule, it may recommend enforcement action. Aloha remains free to request any necessary extension of time, and the other Parties remain free to seek other relief in the event the schedule is not being met.

- Testing for Sulfides (§5). The Parties agree to a protocol of testing for sulfides to replace the testing requirements imposed by Order No. PSC-05-0709-FOF-WU. Under the agreed protocol, water at the plants equipped with anion exchange will be tested at three points on either a monthly or quarterly basis: raw water, water after anion exchange and before disinfection, water after disinfection. The raw water testing is for informational purposes. The compliance goal for water after anion exchange is for total sulfides to be at or below 0.3 mg/L, and after disinfection for

total sulfides to be at or below 0.1 mg/L. Testing at each plant continues for a minimum of 3 years, or longer if necessary to demonstrate a 12-month period with no exceedances of the compliance goals. If any site fails two compliance tests in a 12-month period, staff will meet with Aloha and the parties to attempt to identify the root cause of the exceedance and discuss what further action, if any, is appropriate.

- Limited Proceeding for Cost Recovery (§2c). The Parties agree that Aloha may seek cost recovery for the anion exchange facilities in a three-phase limited proceeding. (This structure was suggested by staff and is modeled after a procedure used recently for Water Management Services, Inc. on St. George Island). Because the Phase I and Phase II rates will be temporary rates subject to true-up: no opportunity for hearing is necessary; no customer meetings will be required; the incremental revenues will not have to be held in escrow; and repression will not be taken into account. Because Aloha intends to finance the construction through debt, the Phase I, II and III rate increases will contain no allowance for return on equity and no gross-up for federal income tax expense. The three phases are as follows:
  - Phase I: Temporary rates during construction designed to recover the carrying cost (interest during construction) on the projected average balance of construction work in progress. These temporary rates are subject to true-up in Phase III and are in lieu of Aloha accruing an Allowance for Funds Used During Construction (AFUDC).
  - Phase II: Temporary rates during the first twenty months (more or less) the anion exchange facilities are in operation. These temporary rates are subject to true-up in Phase III and will be designed to recover the actual or contracted cost of the anion exchange facilities and the projected incremental operating costs.
  - Phase III: Final rates based on actual construction costs and one year of actual operating expense history, both of which are subject to audit and to review for reasonableness. If there is any over- or under- collection in Phases I or II, there will be an offsetting credit or surcharge during the first 12 months the Phase III rates are in effect. Phase III rates will be set via a PAA order within 6 months after Aloha's submission of actual cost data. In the event of a protest, the Commission will enter its final order within 8 months of the date of the protest. Any necessary repression adjustment will be considered in Phase III.
- Dismissal of Litigation (§3). On or immediately after the Effective Date (i.e., the date a Commission order approving the Settlement becomes final and non-appealable), Aloha and the Commission will terminate the pending proceedings as follows:
  - The Commission will dismiss the Show Cause Docket (Docket No. 050018-WU) and the Investigation Docket (Docket No. 050183-WU).

- Aloha will dismiss the Declaratory Judgment Action in Circuit Court, the Investigation Appeal, the Water Quality Appeal, and the Refund Appeal. The amount that would ordinarily be refunded (approximately \$290,000) will be reduced by the documented cost (up to \$45,000) of preparing the Conceptual Cost Estimate. The balance will remain in escrow, earning interest, until the Phase III rates take effect. At that time, the funds in escrow, including accrued interest, will be released to Aloha and Aloha will record a corresponding amount as a contribution-in-aid-of-construction. This provision uses the dollars that would otherwise be refunded in the manner requested during negotiations by the individual intervenors. It also eliminates the risk that Aloha might prevail on appeal, in which case none of these funds would benefit customers.
- Fresh Start and Future Enforcement (§3b and 9). After the Effective Date, no further enforcement action against Aloha will be requested by the Parties or taken by the Commission (and no further disallowances or penalties will be assessed), based on Aloha's actions or inactions prior to the Effective Date relating to water quality or customer service issues which have been raised in prior dockets. The Commission may initiate a new enforcement action based on actions or inactions after the Effective Date in the event it finds probable cause that Aloha has violated its obligations under the Settlement.
- Prior Litigation Costs (§7). Aloha agrees not to seek recovery from its ratepayers of any litigation costs, legal fees, consultant fees, and costs arising from 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. At the time of the earlier Offer of Settlement, staff estimated that these costs were in the vicinity of \$1,000,000. These costs will grow substantially if the Show Cause Docket proceeds to hearing and the other litigation and appeals continue. A ban on recovery of these costs could not be achieved outside of a Settlement.

#### Other Provisions

The Settlement contains a number of other provisions, including the following:

- The Parties agree to cooperate in exploring the potential availability of governmental grant monies and/or low cost loans to finance or refinance the anion exchange facilities. (§8) This offers the possibility of reducing the ultimate rate impact to Aloha's customers.
- Both Aloha and the Commission give up their right to sue the other for damages or attorneys fees for any actions that occurred prior to the Effective Date. (§7) This protects both parties from the risk of litigation under various theories of liability.

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- The Settlement becomes binding only if it is approved by the Commission, without change, and is incorporated by reference in a final Commission order. (¶10) This is standard language in this type of agreement.
- Aloha does not admit to violation of any statute, rule or order and does not admit any fault or liability on water quality or customer service issues. (¶12) Conversely, OPC and Intervenors do not concede that no such violations have occurred. This is standard language in this type of agreement.
- If the Settlement is not accepted by the Commission without change, neither it nor this staff recommendation will be admissible in any present or future judicial or administrative proceeding (¶11) and neither Aloha nor any other party (including the Commission) will waive any positions, rights or remedies otherwise available to it. (¶12) This is standard language in this type of agreement.
- Nothing in the Settlement shall establish or imply a waiver of any rights unless the waiver is explicitly set forth in the Settlement. (¶13)
- Each Intervenor who executes the Settlement, and each customer who ratifies it, is doing so only on his or her own behalf. No Party will sue another Party because of the other Party's execution of the Settlement. (¶14)

#### Absence of Agreement by Intervenor Wood

Staff believes that the absence of agreement to the Settlement by Mr. Edward O. Wood, an individual intervenor in Docket No. 050018-WU, does not affect the Commission's ability to approve the Settlement. Staff understands that Mr. Wood's position is that the Commission should continue with the proceeding to delete a portion of Aloha's territory so that he can ultimately obtain service from Pasco County.

Under the applicable license revocation statute and case law, however, only the Commission can initiate and maintain a license revocation proceeding. Conversely, the Commission has the absolute right to voluntarily dismiss such a license revocation proceeding for any reason or no reason. In short, while Mr. Wood may be interested in the outcome of Docket No. 050018-WU, he has no legal right to insist that the proceeding be continued. Because the Commission has the absolute right to terminate such a proceeding, it likewise has the power to determine, without offering the opportunity for a hearing, whether the Settlement reached by Aloha, OPC and the other individual intervenors provides a sufficient basis for what amounts to a discretionary decision to withdraw its prosecution.

Further, the Florida Supreme Court recognized in South Florida Hospital and Healthcare Association v. Jaber, 887 So.2d 1210 (Fla. 2004) that the Commission has the power to approve settlements among less than all the parties to a proceeding, particularly where, as here, the objecting party is provided with an opportunity to address the Commission at the time it considers whether to approve or reject the settlement.



Conclusion

The Settlement is necessarily detailed because of the number of interrelated matters at issue between Aloha, the other Parties, and the Commission.

Staff is convinced that approval of the Settlement, without change, is in the public interest. It offers a number of monetary benefits to Aloha's customers that could not otherwise be obtained or assured, it redirects the parties' resources away from protracted litigation toward implementing an agreed water treatment solution to address the underlying problem, and it provides a much needed fresh start for Aloha, its customers, and the Commission.

**Issue 2:** Should Mr. Edward O. Wood's request for reconsideration of Order No. PSC-06-0015-FOF-WU be granted?

**Recommendation:** If the Commission approves the Settlement in Issue 1, Mr. Wood's motion for reconsideration is moot and no ruling is required. If the Commission does not approve the Settlement, Mr. Wood's request should be denied because it does not raise an issue of fact or law that the Commission overlooked or failed to consider. (MELSON)

**Staff Analysis:** By Order No. PSC-06-0015-FOF-WU, the Commission approved a letter agreement between Aloha and the Office of Public Counsel regarding recovery of costs for a non-binding capital cost estimate for installation of anion exchange facilities.

By letter, Mr. Wood requests reconsideration of the Order, stating that he believes that the Order was issued with very little consideration for the rights of the customers involved. Mr. Wood further states that any competitive company would not accept such a charge from any of its vendors required to make changes to have an acceptable product. Mr. Wood questions how a conceptual analysis could have an error possibility of plus or minus 30%, and states that there should have been no possible variance to the final cost.

In its response, Aloha points out that the Commission has often had occasion to restate its standard in reviewing motions for reconsideration. Aloha states that Mr. Wood's request should be denied because it does nothing more than reargue issues which were necessarily considered by the Commission prior to its issuance of the Order. Aloha further states that Mr. Wood makes no argument that the Commission overlooked or failed to consider anything.

The standard of review for a motion for reconsideration is whether the motion identifies a point of fact or law that the Commission overlooked or failed to consider in rendering its Order.<sup>4</sup> Moreover, in a motion for reconsideration, it is not appropriate to reargue matters that have already been considered.<sup>5</sup> A motion for reconsideration should not be granted "based upon an arbitrary feeling that a mistake may have been made, but should be based upon specific factual matters set forth in the record and susceptible to review."<sup>6</sup>

The overall Settlement discussed in Issue 1 contains a provision for recovery of the costs of preparing the conceptual cost estimate that is consistent with letter agreement approved by the Order. If the Commission approves the Settlement in Issue 1, the order approving the Settlement will effectively supersede Order No. PSC-06-0015-FOF-WU and thereby render Mr. Wood's request for reconsideration moot.

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<sup>4</sup> See Diamond Cab Co. v. King, 146 So. 2d 889 (Fla. 1962); and Pingree v. Quaintance, 394 So. 2d 161 (Fla. 1st DCA 1981).

<sup>5</sup> Sherwood v. State, 111 So. 2d 96 (Fla. 3rd DCA 1959) (citing State ex. rel. Jaytex Realty Co. v. Green, 105 So. 2d 817 (Fla. 1st DCA 1958)).

<sup>6</sup> Stewart Bonded Warehouse, Inc. v. Bevis, 294 So. 2d 315, 317 (Fla. 1974).

If the Commission does not approve the Settlement in Issue 1, staff recommends that the request for reconsideration should be denied. Mr. Wood's request for reconsideration fails to identify a point of fact or law that the Commission overlooked or failed to consider in rendering its Order. In approving the letter agreement, the Commission considered the method of recovery as specified therein, including, among other things, the error possibility of plus or minus 30%. The Commission expressly found it to be an appropriate method for allowing Aloha to recover the cost of the estimate. See Order No. PSC-06-0015-FOF-WU at page 2.

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**Issue 3:** Should the dockets affected by the Offer of Settlement be closed?

**Recommendation:** If the Settlement is approved, Docket No. 050018-WU (Show Cause Docket), and Docket No. 050183-WU (Investigation Docket) should be closed after the Order Approving Settlement has become final and non-appealable. Docket No. 010503-WU, in which interim rate monies are being held in escrow, should remain open until those monies are released to Aloha, and recorded as CIAC, at which time the docket should be closed.

If the Settlement is not approved, these dockets should remain open. (MELSON)

**Staff Analysis:** If the Settlement is approved, it calls for the Commission to voluntarily dismiss (i.e. close), the Show Cause Docket (Docket No. 050018-WU) and the Investigation Docket (Docket No. 050183-WU) on or immediately after the Effective Date.

The interim rate escrow account established in Docket No. 010503-WU will remain in existence until the effective date of Phase III rates, at which time the remaining funds will be released to Aloha and Aloha will record an equivalent amount as CIAC. Therefore Docket No. 010503-WU should remain open until the escrow account is closed, at which time the docket should be closed administratively.

If the Settlement is not approved, these dockets should remain open.

SETTLEMENT AGREEMENT

This Settlement Agreement is entered into this 9<sup>th</sup> 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

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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 true-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 Intervenor 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 9<sup>th</sup> day of March, 2006.

ALOHA UTILITIES, INC.

By: John J. Whelan

OFFICE OF PUBLIC COUNSEL

By: W.C. My

INTERVENORS

Wayne Forehand  
Wayne T. Forehand

John H. Gaul  
John H. Gaul

Sandy Mitchell, Jr.  
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 Letwin  
Thomas B. Vaurio  
Joel A. Kutz

Richard E. Wittay  
John P. Andrews  
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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

Paige D. Ma  
General Counsel

Joseph D. Juel  
For Director of Economic Regulation