

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application for increase  
in water rates for Seven Springs  
System in Pasco County by Aloha  
Utilities, Inc.

DOCKET NO. 010503-WU  
ORDER NO. PSC-02-0593-FOF-WU  
ISSUED: April 30, 2002

The following Commissioners participated in the disposition of  
this matter:

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BRAULIO L. BAEZ  
MICHAEL A. PALECKI

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DOCUMENT NUMBER-DATE

04725 APR 30 02

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On behalf of the Commission.

FINAL ORDER DENYING WATER RATE INCREASE,  
REQUIRING REFUNDS, APPROVING NEW RATE STRUCTURE AND CHARGES,  
INCREASING TEMPORARY SERVICE AVAILABILITY CHARGES SUBJECT TO  
REFUND, APPROVING CONSERVATION MEASURES, AND REQUIRING  
IMPLEMENTATION OF CUSTOMER SERVICE MEASURES

BY THE COMMISSION:

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I. BACKGROUND

Aloha Utilities, Inc. (Aloha or utility) is a Class A water and wastewater utility in Pasco County. The utility consists of two distinct service areas: Aloha Gardens and Seven Springs. The utility's service area is located within the Northern Tampa Bay Water Use Caution Area as designated by the Southwest Florida Water Management District (SWFWMD). Critical water supply concerns have been identified by SWFWMD within this area.

On August 10, 2001, Aloha filed an application for an increase in rates for its Seven Springs water system. Since the utility's application was complete as filed, the official filing date was established as August 10, 2001, pursuant to Section 367.083, Florida Statutes. In its minimum filing requirements (MFRs), the utility requested total water revenues of \$3,044,811. This represents a revenue increase of \$1,077,337 (or 54.76%). These final revenues are based on the utility's requested overall rate of return of 9.07%.

The utility's requested test year for setting final rates is the projected year ended December 31, 2001. Also, the utility requested that this application be directly set for hearing. By

Order No. PSC-01-2092-PCO-WU, issued October 22, 2001, we suspended the utility's requested final rates. Also, by Order No. PSC-01-2199-FOF-WU, issued November 13, 2001, we approved interim rates subject to refund with interest, which increased rates by 15.95%. A hearing in Pasco County was held on January 9 through 11, 2002.

Edward O. Wood, the Office of Public Counsel (OPC), SWFWMD, and Representative Mike Fasano intervened in this case.

This Order reviews the appropriate revenue requirement, rate structure, rates, and service availability charges for Aloha's Seven Springs water system. We have jurisdiction pursuant to Sections 367.081 and 367.111, Florida Statutes.

## II. STIPULATIONS

At the hearing, we approved the following stipulations presented in the prehearing order and two additional stipulations regarding Issues 6 and 12.

### A. Category One Stipulations

Those stipulations where the utility, SWFWMD, OPC, and our staff agreed are set forth below:

1. For items erroneously expensed by the utility during the test year ended December 31, 2000, both plant and retained earnings shall be increased by \$11,522 for the projected test year. Further, corresponding adjustments to operation and maintenance expense (\$12,396), accumulated depreciation (\$920), and depreciation expense (\$613) shall be made to the 2001 projected test year.

2. To reflect the appropriate depreciation rate for computer equipment, accumulated depreciation shall be increased by \$2,262, and retained earnings shall be decreased by \$2,262.

3. CIAC shall be increased by \$27,236 to correct the amount of contributed property received from April through December 2001. Corresponding adjustments shall be made to increase accumulated amortization of CIAC (\$64) and test year amortization of CIAC (\$837).

4. To correct the historic starting point, the projected test year rate base shall be reduced by \$10,877 to reflect the 13-month average balance of Accumulated Amortization of Contributed Taxes.

5. All deferred rate case expense related to Docket No. 991643-SU shall be excluded from working capital because those costs were specifically allocated to the Seven Springs wastewater system. Total company working capital that is allocated shall be reduced by \$61,702.

6. Total company working capital that is allocated shall be reduced by \$32,868 to reflect the amortization of regulatory commission expense associated with Docket No. 960545-WS. A corresponding reduction to retained earnings shall also be made.

7. The annual amortization of issuing expense for the Bank of America loan shall be reduced by \$1,760.

8. The total projected 13-month average balance of long-term debt shall be \$9,267,979, as shown on minimum filing requirement Schedule D-5(A). The respective cost rates are those shown on that same schedule and subject to the resolution of other issues.

9. Historical December 31, 2000, test year revenues shall be increased by \$7,154 to properly allocate interest income. The interest income adjustment shall be escalated by the customer growth factor for a total increase of \$7,490. In addition, projected test year revenues shall be increased by \$4,176 to reflect the appropriate amount of revenues for residential vacation bills.

10. Bad debt expense shall be increased by \$1,237 to account for an allocation error.

11. The cost per 1,000 gallons of water to be purchased from Pasco County shall be \$2.35.

12. To properly allocate the utility's recent purchase of a new office building, land and plant shall be reduced by \$5,776 and \$5,935, respectively.

13. Two employees were included in salaries and wages for officers as well as the annualization of employees' salaries. Salaries and wages shall be reduced by \$8,769.

14. The testimony and exhibit of staff witness Vincent C. Aldridge, the staff auditor, may be admitted into evidence, and he may be excused from attending the hearing.

15. The testimony of staff DEP witnesses Van Hoofnagle and Gerald Foster shall be taken up no later than the second day of the hearing.

16. All SWFWMD witnesses may be excused from attending the first day of the hearing. Moreover, Jay Yingling may be excused from attending the second day, and his testimony will be taken on the third day.

17. Paul Stallcup has been substituted for Staff witness Lingo and has adopted her testimony and exhibits except for Ms. Lingo's testimony on her background and experience on pages two through line 15 of page 4 (where he has substituted his own), and her testimony on page 22, lines 5 through 14 (which has been deleted).

18. The appropriate number of ERCs for the projected 2001 test year is 10,560.

#### B. Category Two Stipulations

Those stipulations where the utility, SWFWMD, and Staff agreed, but where OPC took no position in the stipulations are set forth below:

19. The used and useful percentages for the water treatment plant and the water distribution system are both 100%.

20. The return on equity shall be calculated using the current leverage formula in effect at the time the Commission makes its final decision in this case.

21. The utility's 44.83% allocation of pension expense to the Seven Springs water system is appropriate.

C. Issues Stipulated at Hearing

Issue 6. The cost rate for variable cost, related party debt shall be the prime rate plus two percent as of December 31, 2001.

Issue 12. Salary expense shall be reduced by \$21,268 to correctly allocate the annualized salary of the utility operations supervisor.

III. QUALITY OF SERVICE

Section 367.081(2)(a)1., Florida Statutes, and Rule 25-30.433(1), Florida Administrative Code, specify that in every rate case, we shall determine the value and quality of service provided by the utility. Rule 25-30.433(1), Florida Administrative Code, requires us to evaluate three separate components of water and wastewater utility operations: (1) quality of the utility's product; (2) operational conditions of the utility's plant and facilities; and (3) the utility's attempt to address customer satisfaction. Our analysis of each of the three components identified in Rule 25-30.433(1), Florida Administrative Code, is set out below.

A. Quality of Utility's Product

In this facet of the quality of service determination, we consider the quality of the utility's product and whether the water delivered to the customers' meters meets state and federal standards.

At the hearing, we heard testimony from 29 customers who were dissatisfied with the quality of service provided by Aloha. They complained of black or discolored water; odor/taste problems; low pressure; sediment/sludge; and the utility's response to customer complaints or inquiries. Many customers brought containers of discolored or black water to the hearing for viewing. Their testimony is summarized below.

Representative Fasano testified that Aloha delivers to its customers smelly, foul, dirty black water. He also alluded to the newspaper photograph which showed an Aloha fire hydrant spewing discolored water. He made reference to the fact that the black



water problem had been on-going for years, was occurring in 1996 and before, and that complaints to his office still continue. The amount of complaints received amounts to reams and reams of paper.

Customer witness Oberg testified that the water in his house was dirty, occasionally turned gray, and smelled like rotten eggs. He also testified that the water in his toilet tank was black and some water he drained from his hot water heater was black.

Customer witness Hawcroft testified that the water he receives is foul smelling and discolored and causes stained laundry. His household uses bottled water. He stated that he testified about the very same water quality problems two years ago, and the problems remain the same.

Customer witness Kurien testified that he receives black water.

Customer witness Corelli also testified that the water he receives is not drinkable, is an inferior product and that he receives black water.

Customer witness Chestnutt testified that Aloha had never provided him with decent water.

Customer witness Hartinger testified that the water he receives is filthy, the water in a filter housing was black, and the filter itself was full of black grit. He further described the water as disgusting, vile, and foul smelling.

Customer witness Wood, also an intervenor to this proceeding, spoke about the corrosive nature of Aloha's water. He stated that copper pipe does not react to water in the plumbing system unless there is an acid contaminant in the water. He testified that the hydrogen sulfide is the culprit, and the water Aloha supplies is corrosive and is the cause of the black water. He also stated that the water was revolting.

Customer witness Bradbury testified that the water was black and smelly. He also referred to his soft water unit that failed after three years due to sludge buildup.

Customer witness Bulmer testified that the water quality was poor.

Customer witness Wickett testified that he had received dirty water, and it had a pretty strong smell. He is forced to buy bottled water whenever he has company over to his house.

Customer witness Logan testified that he found a black greasy substance on the inside of his copper pipes. Also, when he filled his garden tub, there was black stuff floating in the water. He stated that he was sickened by the water and that it smelled like sulphur.

Customer witness Nowack testified that the water that came out of her kitchen faucet was black, greasy sludge. She said the quality of the water is the worst she has experienced in her whole life.

Customer witness Depergola testified that he received stinky, lousy, miserable water, and that when he took a shower his body smelled worse than before. He further stated that the water causes stained laundry, is not drinkable, smells, and is dirty. His pipes are filthy inside.

Customer witness Karas testified that the water was lousy, smelly, and nasty. It seems like it has rust, and, most of the time, you see a lot of black.

Customer witness Skipper testified that she did not drink the water nor bathe in it. It has a bad taste and a bad smell. The water turns her ice cubes yellow. She has a refrigerator with door water and ice, which she will not use.

Customer witness Legg testified that the water was black, very dirty, left an oily residue, and was always cloudy. If he does not use the water for a week and then turns it on, it will be brown and oily, but not to the extent of the first time that it happened.

Customer witness Whitener testified that she was unable to drink her water.

Customer witness Rifkin testified that he received black, dirty, stinking water.

Customer witness Lewandowski testified that the water quality was poor.

Aloha, through a late-filed exhibit, submitted a summary of its attempt to contact all of the customers who complained about the quality of the water. Fifteen of these customers allowed an Aloha engineer to come into their home. At each home the engineer took samples of the water coming into the home and inquired of the customers where they had the most trouble inside their homes. These locations were used for the interior samples. Nowhere during any of the visits did Aloha's engineer see anything other than clean, clear water.

The engineers of the utility, OPC, and DEP all appear to agree that the black particulate in the water giving the water a black or grayish color is copper sulfide. They also appear to agree that the copper sulfide is formed by the reaction of hydrogen sulfide with copper pipes. However, the reason why some homes with copper pipes have a copper sulfide problem (black water), and others do not, is not as easily explained. For Aloha, the black water problems were initially concentrated in its Chelsea, Wyndtree, and Wyndgate subdivisions, but appears to be spreading to other subdivisions.

Hydrogen sulfide naturally occurs in much of the source water for Florida's utilities. The black water problem is not unique to the customers of Aloha and does occur in other areas of Florida. It is but one manifestation of a larger problem, that of copper piping corrosion that is prevalent in many parts of Florida. Witness Hoofnagle testified that black water had been found in the Ft. Myers area, and in Polk, Hillsborough, Pasco, Volusia, and Pinellas Counties. According to Mr. Hoofnagle, it appears that most of these events are episodic or have been resolved.

Utility witness Watford testified that the hydrogen sulfide in Aloha's source water is converted to sulfates by chlorination. Sulfates or elemental sulfur will not react with copper under normal conditions, and Mr. Watford claims that there is no sulfide coming through the customer's meter. However, once the water

enters the customer's home, a multitude of things can cause the formation of sulfide. Utility witness Porter testified that the black water problem occurs in customers' home water piping. Aloha claims that the water delivered to Aloha's customers is pure, clean, color-free, odorless, and meets all State and Federal laws, rules and regulations.

The DEP witnesses agreed that copper sulfide occurs when elemental sulfur or sulfate in the water is converted biochemically in the customer's home from harmless sulfate and elemental sulfur to hydrogen sulfide, which can attack the home copper water piping and create copper sulfide which is the black substance reported by some of Aloha's customers. Factors necessary for the formation of copper sulfide include an energy source, time, temperature, sulfur reducing bacteria, and either sulfates or elemental sulfur. DEP witness Hoofnagle stated that the above conditions are found in both the customer's hot water heater, and the elemental sulfur or sulfates are introduced from Aloha's distribution system.

Aloha's water contains very small quantities of sulfate as it is delivered to the customer, varying from single digit values to the 20 to 25 mg/L level. The national drinking water standards allow 250 mg/L sulfate levels, so Aloha's water contains at most only one tenth of the national limit. DEP believes that the black water is being formed in the customer's pipes after the meter and that this formation of black water after the meter does not constitute a violation of drinking water standards.

Mr. Foster also testified that the finished water produced by Aloha meets all the state and federal maximum contaminant levels for primary and secondary water quality standards including the lead and copper rule. Also, Aloha's compliance with the lead and copper rule has led to a lessening of the monitoring requirements.

OPC witness Biddy disagrees with utility witness Watford's contention that no hydrogen sulfide is coming through the customers' meters. He believes that there is a varying concentration of hydrogen sulfide in the raw water, and that periodically you get much higher concentrations. He believes that when the high concentrations peak, all the chlorine is used up, and not all the hydrogen sulfide is converted to either harmless sulfates or elemental sulfur. Under these circumstances, he

believes hydrogen sulfide is pumped directly into the system, through the customers' meters, and into the homes.

Witness Hoofnagle testified that there are a number of things the utility might study and implement to reduce or eliminate over time the black water problems now being experienced. There is no panacea or guarantees due to the complex nature of the water and corrosion chemistry and relatively unique specific conditions that are found in the customers' water. However, aeration with pre- and post-pH adjustment added with alkalinity control has proven to be the most effective in other parts of Florida. Additionally there are emerging technologies that lend themselves to addressing the future Disinfection Byproducts Rule 62-550.821, Florida Administrative Code, as well, such as the MIEX system. This is a relatively cost effective solution. Since the black water problems do not appear in all of Aloha's service subareas, it is the DEP's belief at this time that a centralized treatment system would not be cost effective. Future and on-going engineering and cost studies need to identify technical solutions and their associated costs.

In late-filed Exhibit 3, staff witness Foster of the DEP presented a description of the tri-level water treatment process used by Pasco County to remove hydrogen sulfide and reduce the corrosiveness of the water. This process begins with cascade aeration to remove sulfides. After aeration, the water is sent to storage tanks containing a naturally-occurring bacteria. These bacteria convert hydrogen sulfide into elemental sulfur. The water is then chlorinated to remove bacteria and oxidize the remaining sulfide.

When asked what steps Aloha had taken to alleviate the black water problem, witness Foster testified that the utility was permitted on December 12, 1995, to use a polyphosphate corrosion inhibitor. However, some home treatment units can cause the corrosion inhibitor to be less effective. The units tend to remove mineral calcium, iron and magnesium, causing the water to become corrosive, and the pH is lowered.

Although some customers are dissatisfied with the taste, odor, and color of the water, witnesses Hoofnagle and Foster testified that Aloha meets the drinking water standards set forth by the DEP

for water quality, and that the black water is created beyond the meter. We therefore find that the quality of Aloha's product is satisfactory.

It is apparent from the DEP testimony that Aloha has complied with all DEP rules regarding the quality of the water it produces for its customers. The method it has chosen, however, to meet this responsibility, i.e., the chemical conversion of sulfides to sulfates, has been shown to be reversible in customers' service piping and is one of the factors leading to the formation of black water. Even though Aloha has apparently met its legal obligation regarding water quality, we believe it should be taking a more proactive approach to dealing with the black water problem and responding to its numerous customer complaints about water quality.

Regarding a potential solution to the black water problem, witness Hoofnagle stated that if all the homes had chlorinated polyvinyl chloride (CPVC) piping there would not be a black water issue. When asked if there was anything else that would eliminate the black water problem, witness Hoofnagle stated that some form of water treatment to include aeration could greatly reduce the problem. Staff witness Foster, when asked if there was a mechanism, short of replacing the copper pipe, that would eliminate the black water problem, responded by calling the plastic pipe replacement a quick fix and, outside of that, he did not see an easy way of doing it. Utility witness Watford testified that a customer named Vento had his copper pipe replaced with CPVC and had never seen discolored water again.

Both witnesses from DEP were asked to state what they believed to be the solution to the black water problem and neither cited anything as a final solution except for the replacement of the customers' copper pipe with CPVC. Witness Hoofnagle testified that forms of water treatment would only reduce the problem and stopped short of saying that additional treatment of the water would eliminate the problem. It appears that at least a very large part of the solution to the black water problem in the Aloha service area is the replacement of the customers' copper service pipes with non-copper pipe. However, notwithstanding this, we believe that Aloha's chosen treatment method of converting hydrogen sulfide to sulfate or elemental sulfur through chlorination has not proven to be an adequate remedy. Moreover, Aloha's use of ortho-

polyphosphates has not proven to be an adequate remedy. Therefore, Aloha shall be required to take additional measures to correct this "black water" problem.

#### B. Operational Conditions of the Plant

In this facet of the quality of service determination, we consider the operational conditions of the utility's plant facilities, and whether the plant facilities meet DEP standards and are functioning properly.

Utility witness Watford testified that Aloha utilizes chlorination to convert the hydrogen sulfide in the raw water to the sulfate form. Utility witness Porter testified that Aloha also uses an orthopolyphosphate corrosion inhibitor. Aloha's use of a corrosion inhibitor has resulted in a lessening of the monitoring requirements under the lead and copper rule.

Four of the customers who testified complained about low pressure. One of these customers stated that his pressure was low constantly, and was not adequate compared to other places he has lived.

Staff witness Foster testified that the Aloha water system meets all current DEP standards for a drinking water system including the maintenance of the required minimum pressure, quality of the finished water, monitoring, required chlorine residual, certified operators, and auxiliary power. The system is generally in compliance with all applicable DEP rules. Also, Aloha's corrosion inhibitor program was approved by DEP on December 12, 1995. Witness Foster further testified that the chemical analyses of Aloha's finished water indicates no need for further treatment.

Staff witness Hoofnagle testified about fire hydrant flushing. He stated that how often a hydrant should be flushed varies tremendously. He further testified that DEP encourages utilities to flush lines through the hydrants and that it is a standard practice.

The record shows that the utility is meeting standards set forth by the DEP for operating conditions of its plants, as evidenced by the testimony of DEP witness Foster as well as by

utility witnesses Watford and Porter. Therefore, we find that the operational condition of the plant is satisfactory.

### C. Customer Satisfaction

In addition to the customer testimony summarized above, we heard testimony from customers about the level of customer service received from the utility. Customers testified for the most part about discolored or black water. There were some complaints of undesirable taste and odor, and insufficient pressure. Some customers testified about the attitude of the utility. This testimony is summarized below.

Representative Fasano testified about Aloha's defensive attitude and lack of helpfulness. He characterized the service as poor and pointed out what he believed to be an effort by Aloha to intimidate its customers into not participating in the legal process. This effort was a newsletter in which Aloha stated that if an appeal of a Public Service Commission order was pursued, it would cost the utility hundreds of thousands of dollars, the cost of which would be passed on to the customers. Representative Fasano reported this newsletter to the Commission and was told that Aloha's claims of potential legal costs were not so exaggerated as to be deceptive. He also characterized Aloha as a company who does not care about its customers.

Customer witness Stingo testified about the expense of installing an irrigation meter. He believed that the water distribution system as it was installed should not have been allowed and caused the installation of an irrigation system to cost more money than it should have.

Customer witness Marden testified about a damaged fire hydrant, and his concerns about fire protection and safety. In late-filed Exhibit 37, Aloha stated that it repaired the hydrant on January 10, 2002.

Customer witness Kurien testified that we should not be bullied by Aloha's claims of meeting DEP standards.

Customer witness Shepherd testified that he believed that Aloha was engaged in foot dragging as a response to water problems.



Customer witness Lane testified that he was in agreement with Representative Fasano about the intimidating newsletter, and that Aloha is not responsive to customer complaints. He stated that when he called to complain about weak pressure, the utility came out, measured it, and said that the existing pressure meets the standard, and that is all they can do. Mr. Lane believes that this was not responsive.

Customer witness Wood testified that Aloha's service is substandard and totally unsatisfactory.

Customer witness Nowack testified that Aloha is very rude to her and to its customers. She also stated that Aloha hangs up on her.

Customer witness Skipper testified that she had written Aloha a letter in the summer and had not gotten any response from them at all.

Customer witness Rifkin testified that he wrote on his bill a note to Mr. Watford that the water is dirty, black, and stinking. Mr. Rifkin never received a response to the note.

Customer witness Lewandowski testified that every time he has called Aloha, they have been nothing more than arrogant, egotistical prima donnas.

Customer witness Brown had questions about how the sewer rate was calculated on his bill and also expressed concerns over Aloha's brand new vehicles. He also had concerns about Aloha's threatening newsletter concerning legal costs being passed on to the ratepayers.

We also heard testimony from the parties concerning customer service. OPC witness Larkin testified that Aloha's water quality does not meet a competitive standard and in a competitive environment would be rejected by customers. It was only because Aloha was a monopoly that it could get away with this level of service and that this Commission must act as a true substitute for competition. He stated that, in a previous docket, there was overwhelming evidence that a vast number of the Seven Springs water customers found Aloha's overall product and service to be

completely unacceptable. Further, based on the customer testimony that has been presented in the two recent Aloha dockets, vast numbers of customers would go elsewhere if they had a choice. He stated that he has never encountered a higher level of customer dissatisfaction, and that in a competitive environment, Aloha would not be able to raise prices because the quality of its water is below comparable service from other water companies.

Staff witness Durbin testified that during the period between January 1, 1999, and October 31, 2001, the Commission logged 193 complaints against Aloha Utilities. This number of complaints constituted the highest number of complaints per 1,000 customers of any of the similarly sized water and wastewater utility companies reviewed. The similarly sized companies included other Class A and B water and wastewater companies in Pasco County plus other selected Class A companies outside of Pasco County. The review indicated that Aloha had 15.16 complaints per 1,000 customers for the period January 1, 1999, through November 13, 2001. The other companies reviewed ranged from a low of .024 complaints per 1,000 customers by Florida Cities Water Company - Lee County Division, to a high for the other companies of 13.45 complaints per 1,000 customers by Jasmine Lakes Utility Corporation.

Mr. Durbin testified that two of the complaints involved an apparent violation of the Florida Administrative Code or the company tariff. Of these two, one was a complaint in which it appeared that the company had sent the customer an improper bill. The other apparent violation concerned a delay in connection of service in a timely manner. Mr. Durbin testified that the two most common complaints involved high water bills and water quality concerns, including black water complaints. Witness Durbin further testified that Aloha provided a timely response in 92% of the cases that were filed in 1999, 2000, and year-to-date 2001.

Utility witness Watford also testified as to customer satisfaction and stated that the two cases where the utility was found to have done anything wrong averaged out to less than one complaint per year. He believes this to be a very good record. Mr. Watford also testified about the late responses. For five of the alleged eleven late responses, Aloha contends that it was not late in providing a response. In one particular case, he stated that Aloha has a facsimile confirmation that it did in fact file a

response on the due date. Aloha then sent a confirmation the next day. This second submission was apparently incorrectly logged in as Aloha's response.

In four other cases, Mr. Watford contends that the complaint was sent to Aloha's old fax number after it had moved to its new offices. After finding out about the complaints Aloha asked that the complaints be resent to the new number. In each of these cases, Aloha contends they filed a response in less than the normal 15 days. In at least three of the alleged late response cases, Aloha contends that the Commission's facsimile machine failed to accept a faxed response so it was sent by mail on the due date. Based on these explanations, Mr. Watford testified that he believed there were zero late responses that were not justified.

In addition, witness Watford testified that because witness Durbin did not review the other utilities cited as comparable to Aloha to determine if they were involved in rate proceedings during the time analyzed, that Mr. Durbin's testimony was flawed. Also, no attempt was made to segregate water complaints from sewer complaints, and the period of time chosen for analysis was questionable. For these reasons, he believed that Mr. Durbin's analysis was not a fair representation of Aloha's customer complaint level. Witness Watford also cited this Commission's management audit of Aloha, which stated that Aloha's customers are generally satisfied with Aloha's customer service.

We have reviewed the management audit conducted by our staff, and note that it was based on a very limited number of samples over a very short period of time. As stated in the report on page 19: "The four-question survey was a snapshot of one week of service requests originated during the week of September 26 through October 2, 2000. Staff randomly contacted a judgement [sic] sample of 37 of the 209 customers having interaction with Aloha during the designated period." Even the staff who conducted the audit acknowledged that the survey sample size fell short of being statistically valid. The record shows that the conclusions of the management audit staff that Aloha's customers were generally satisfied with service, timeliness of response and overall handling of customer requests is inconsistent with the multitude of customers who testified almost in one voice about Aloha's poor

quality of service and the unresponsiveness of Aloha to consumers' complaints.

We find that a significant number of customers have been receiving "black water" from Aloha for over six years, and it is past time for Aloha to do something about it. While the water quality provided meets the DEP standards at the meter, the presence of hydrogen sulfide in the raw water that is converted to sulfates and back into sulfides is not acceptable because this conversion process is one of the factors leading to the creation of copper sulfide in the customers' water. This copper sulfide is the black substance in the water causing the water to be either black or gray in color. Even though Aloha complies with DEP's Lead and Copper Rule, a significant number of Aloha customers experience corrosion in their service piping, which leads to the formation of copper sulfide in their homes.

We also find that a large number of customers had complaints about Aloha's attitude in dealing with its customers. We heard testimony that the utility was arrogant, egotistical, very rude, unresponsive, and acted like prima donnas.

A significant portion of the customers are clearly dissatisfied with Aloha's overall quality of service, and have been for some time. Therefore, we find that the utility is not providing good customer service and the quality of customer service provided by Aloha is unsatisfactory.

Aloha has violated its water use permit with SWFWMD starting in 1994, and consistently since 1996. In addition, Aloha's customers have complained about black water since at least early 1996. Any actions that Aloha has taken to eliminate these problems have come about in response to requirements made by governmental authorities. Moreover, the actions that Aloha has taken have been slow-moving and ineffective. Because of Aloha's long-term problems with black water and other water quality complaints, long-term violation of its consumptive use permit, its lack of a proactive approach to finding acceptable solutions to these problems, and the customer complaints about the attitude of the utility, we find that the overall quality of service provided by Aloha is unsatisfactory.

IV. IMPACT OF UNSATISFACTORY QUALITY OF SERVICE

A. OPC's Competitive Standard Argument

Both Mr. Wood and OPC argue that the utility's entire rate request should be denied due to its poor quality of service. OPC specifically argues that we should adopt a competitive standard for service. OPC witness Larkin argues that Aloha's water quality and service would fail this standard, and testified:

The competitive principle requiring that regulation be a substitute for competition would view both price and service from a competitive standpoint. If the provision of water services were a competitive product, and the customers of the Seven Springs Water Division of the Aloha Utility had a choice, they would clearly reject to deal with Aloha because of the poor quality of the water service provided. Aloha's water quality would not meet a competitive standard, and in a competitive environment would be rejected by customers.

According to OPC, in exchange for taking away the customers' right to choose, Florida laws impose a regulatory framework that acts as a surrogate for the open market. Mr. Larkin testified that "since the customer choice is removed, a strong regulatory process is the only thing that remains to keep the supplier 'honest.'"

OPC argues that:

If Aloha faced any competition, it would lose customers in droves - even at the current rates. At this level of disapproval with its product, if a competitive enterprise were to actually be brazen enough to increase prices, it would assure a mass exodus of its customers.

Under this competitive standard, OPC argues that the expenditures that Aloha is seeking to recover would not be considered to be just or reasonable. According to OPC, Aloha has turned "competitive reality on its head," because Aloha first wants an increase in rates before it will improve its product to a level acceptable to its customers. Mr. Larkin testified that, as in a competitive market, ". . . Aloha should first be required to demonstrate a

product acceptable to customers, and then be considered for increased rates."

In his testimony, OPC witness Larkin relied on James C. Bonbright's *Principles of Public Utility Rates*, as follows:

Regulation, it is said, is a substitute for competition. Hence its objective should be to compel a regulated enterprise, despite its possession of complete or partial monopoly, to charge rates approximating those which it would charge if free from regulation but subject to the market forces of competition. In short, regulation should be not only a substitute for competition, but a closely imitative substitute.

In conclusion, OPC argued against granting Aloha an increase in rates, stating:

Aloha's customers should not be required to pay higher prices for Aloha's inferior product. The protections of the regulatory process should not be a one-way street. The regulatory process protects Aloha from facing any competition; the regulatory process should also protect Aloha's customers from paying higher prices for an inferior product.

Mr. Wood echoed OPC, stating:

The utility should be denied this increase and all subsequent increases until they can deliver a product that is considered satisfactory to the customer. It should be a product that the customer would buy in the open market.

In response, Aloha argues that pursuant to Section 367.081, Florida Statutes, it is the Commission's "responsibility to set just and reasonable rates . . . ." Moreover, Aloha asserted that "Mr. Larkin could not, or would not, provide any quantitative or other defined basis upon which the Commission could apply his standard for judging a Utility's level of service." Aloha argued that Mr. Larkin admitted that he had done no analysis to determine the level of customer satisfaction for the customer base as a

whole; that he had done no analysis of the quality of water provided by the utility; and that he based his contention that the utility provided service below a "competitive standard" solely on the basis of the customer complaints of less than 1/10th of 1% of the utility's customers, which he witnessed testify at hearings in this and the prior wastewater rate case, that there was no statute or rule that authorized this Commission to deny a rate increase based upon this undefined standard, and that Mr. Larkin knew of no cases where such a standard had previously been applied.

In its Post-Hearing Brief, Aloha argued:

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

SWFWMD supported a rate increase, and argued that "even if the Commission finds the utility is providing poor quality of service to its customers, a rate increase would support the District's ongoing effort regarding water supply planning and resource protection."

In considering the above arguments, we note that pursuant to Section 367.111(2), Florida Statutes, a public utility must provide:

such safe, efficient, and sufficient service as is prescribed by part VI of Chapter 403 and parts I and II of chapter 373, or rules adopted pursuant thereto; but such service shall not be less safe, less efficient, or less sufficient than is consistent with the approved engineering design of the system and the reasonable and proper operation of the utility in the public interest. If the Commission finds that a utility has failed to provide its customers with water or wastewater service that meets the standards promulgated by the Department of Environmental Protection or the water management

districts, the commission may reduce the utility's return on equity until the standards are met.

While the service provided by Aloha appears to meet DEP standards, the question here is whether Aloha operates its system in the public interest. In addition, Section 367.081(2)(a)1., Florida Statutes, provides that we shall "fix rates which are just, reasonable, compensatory, and not unfairly discriminatory," and in every such proceeding, we "shall consider the value and quality of the service and the cost of providing the service." (Emphasis supplied)

OPC witness Larkin's "competitive standard" proposal raises the same question that we have faced many times before, that is, whether we should deny an otherwise warranted rate increase based on either inadequate or inefficient service. To answer the question, we must start with the principle set forth in Bluefield Co. v. Public Service Commission, 262 U.S. 679 (1923). In that case, the United States Supreme Court held:

The just compensation safeguarded to the utility by the Fourteenth Amendment is a reasonable return on the property used at the time that it is being used for the public service. And rates not sufficient to yield that return are confiscatory.

Bluefield at 692.

There are limitations and caveats associated with this principle. We have on several occasions reduced a utility's return on equity or denied a rate increase for mismanagement or inefficient service. For instance, in Gulf Power v. Wilson, 597 So. 2d 270 (Fla. 1992), we reduced Gulf Power's return on equity by 50 basis points from the midpoint of the approved range because of a finding of utility mismanagement. With the reduction, the return was still well within the authorized range. The utility argued that this reduction was an unauthorized penalty and was in contravention of the holdings in Florida Tel. Corp. v. Carter, 70 So. 2d 508 (Fla. 1954), and Deltona Corp. v. Mayo, 342 So. 2d 510 (Fla. 1977). The Supreme Court disagreed and found that this reduction was neither a penalty nor confiscatory, but was merely a recognition of management inefficiency. The Court noted that in



both Carter and Mayo the Commission had improperly attempted to deny rates such that the rate of return was "well below the range found by the Commission as being fair and reasonable," and that this was not the case in Gulf Power. Gulf Power at 273. According to the Florida Supreme Court, "it is well established that all a regulated public utility is entitled to is 'an opportunity to earn a fair or reasonable rate of return on its invested capital.'" Gulf Power at 273, citing United Tel. Co. v. Mann, 403 So. 2d 962, 966 (Fla. 1981)."

Under Florida law, however, "the public should not be compelled to pay increased rates because of an inefficient system." North Florida Water Company v. Bevis, 302 So. 2d 129, 130 (Fla. 1974). In the North Florida case, the Commission had found that the system contained leaks, that 34.4% of the water pumped was unaccounted for, and that a significant number of meters were stalled and not recording, which led the Commission to deny the requested rate increase. The Florida Supreme Court upheld the Commission's decision to deny a rate increase and concluded:

The fixing of public utility rates necessarily involves a balancing of the public's interest in withholding rate relief because of inadequate service and the utility's interest in obtaining rate increases to finance its necessary service improvement program. The Commission in the instant case found the former interest to be predominant. From our examination of the record, we find the Commission order to be supported by competent substantial evidence.

North Florida at 130.

In making its decision, the Court relied on United Telephone Company of Florida v. Mayo, 215 So. 2d 609 (Fla. 1968), which held that while Section 366.041, Florida Statutes, provides that no public utility shall be denied a reasonable rate of return, it in no manner compels the Commission to grant a rate increase where the applicant's existing service is shown to be inefficient. In United Telephone, the utility sought review of a Commission order that withheld approval of a rate increase until the utility completed its plans for improvements. The Court held that Section 366.041, Florida Statutes, plainly authorized the Commission to withhold

approval of a rate increase. At the time, Section 366.041, Florida Statutes (1967), provided:

In fixing the just, reasonable, and compensatory rates, charges, fares, tolls, or rentals to be observed and charged for service within the state of Florida by any and all public utilities under its jurisdiction, the Florida Public Service Commission is authorized to give consideration, among other things, to the efficiency, sufficiency, and adequacy of the facilities provided and the services rendered, the value of such service to the public, and the ability of the utility to improve such service and facilities; provided that no public utility shall be denied a reasonable rate of return upon its rate base in any order entered pursuant to such proceedings

. . . .

United Telephone at 609. The current ratemaking statute for water and wastewater utilities, Section 367.081(2)(a)1., Florida Statutes, is very similar to the statute quoted above.

United Telephone had also challenged Section 366.041, Florida Statutes, on constitutional grounds, asserting that the statute deprived the utility of property, namely the rate increase, without due process of law. Disagreeing with the utility, the Court held "that the Commission's order is authorized by statute, and the statute was not shown beyond a reasonable doubt to be invalid." United Telephone at 610.

The petitioners in United Telephone had also argued that the law was settled in Carter, whereby the Commission had determined that an 18.359 percent increase was warranted, but that a penalty reduction of approximately twenty-five percent was fair and reasonable in view of inadequate and inefficient service being rendered by the utility. In Carter, the Florida Supreme Court held that the Commission could not authorize an increase in rates and at the same time assess a penalty for inadequate service. In United Telephone, the Florida Supreme Court noted that Section 366.041, Florida Statutes, was enacted subsequent to the Carter decision, and "for ought we know, was intended to overcome the decision." United Telephone at 610.

We have also denied rate increases for other utilities because of poor and inefficient service. Subsequent to the holdings in North Florida and United Telephone, finding problems with record keeping, operations, and unsatisfactory service (which required correction) for systems owned by General Development Utilities, Inc. (GDU), we denied GDU's request for rate relief by Order No. 7407, issued August 27, 1976, in Docket No. 750769-WS. Relying on the decisions in United Telephone and North Florida, we denied a request for reconsideration by GDU. See Order No. 7737, issued April 5, 1977, in Docket No. 750769-WS.

In addition, in Order No. 6750, issued June 26, 1975, in Docket No. R-74736-S, we denied Central Brevard Utilities Corporation's request for a rate increase because:

The utility has not acted in good faith with this Commission or the public they serve, by ignoring the requirements of sewage treatment imposed by Florida law. In view of the inefficiency of their system, the application for a rate increase to Central Brevard Utilities Corporation is hereby denied.

In Order No. 6750, we found that Central Brevard Utilities was:

not complying with the requirements of Chapter 17-4, Florida Administrative Code, for sewer systems and that the customers should not be required to pay an increase in rates to a utility that is not providing service as required by Florida law. Central Brevard Utilities Corporation has not met the sewage treatment standards as required by Florida Statutes for a period of eight (8) years. The utility has not made reasonable efforts to upgrade its operation to meet state standards for sewage treatment.

We believe that the holding of the Florida Supreme Court in Gulf Power is controlling. In that case, the Florida Supreme Court found:

. . . that the Commission's adjustment of Gulf Power's rate of return within the fair rate of return range falls within those powers expressly granted by statute or by

necessary implication. City of Cape Coral v. GAC Utilities, 281 So. 2d 493 (Fla. 1973). This Court has previously recognized that this authority includes the discretion to reward, within the reasonable rate of return range, for management efficiency. In fact, Gulf Power has in the past received a ten basis point reward for efficient management through its energy conservation efforts. Gulf Power Company v. Cresse, 410 So. 2d 492 (Fla. 1982). We find that, inherent in the authority to adjust for management efficiency is the authority to reduce the rate of return for mismanagement, as long as the resulting rate of return falls within the reasonable range set by the Commission.

Gulf Power at 273.

In this case, the evidence shows that Aloha treats its customers poorly and has made slow progress towards finding a solution for the "black water" problem. Moreover, the evidence does not show that the utility has aggressively sought alternate sources of water. Aloha's only efforts appear to have been limited to seeking an increase in its water use permits (WUPs) (or attempting to have other WUPs transferred to them), using reuse, implementing some conservation measures, and interconnecting with the county. Aloha should have begun aggressively seeking alternate sources of water prior to its consistently exceeding the limits of its WUP in 1996. Moreover, the utility specifically met with SWFWMD to address its noncompliance with its WUP in May of 1997, and other than interconnecting with the county, has secured no alternate source of water which might have proved to be more cost effective.

It is undisputed that Aloha did initially begin the anti-corrosion program as required by DEP and that it is now again below the action levels for DEP's Lead and Copper Rule. Also, Aloha has complied with our requirement to implement a pilot project using the best available treatment alternative to remove the hydrogen sulfide, thereby enhancing the water quality and diminishing the tendency of the water to produce copper sulfide in customers' homes. See Order No. PSC-00-1628-FOF-WS, issued September 12, 2000, in Docket No. 960545-WS. However, notwithstanding these

minimal efforts, the "black water" problem has continued to persist for a significant number of customers since 1996, if not before.

#### 1. Solution to Copper Sulfide Problem

For those customers experiencing "black water," the only absolute "fix" appears to be repiping with CPVC. However, another possible solution is the removal of almost all hydrogen sulfide. While the utility has proceeded with the pilot project as ordered by this Commission and has provided monthly reports as required, the pilot project has lasted for over 18 months, and the record shows that there has been little progression with it since July 2001. The utility states that it is just now ready to begin the final stage of the pilot project, and that the final stage is projected to last anywhere from six to twelve months. We acknowledge that the need for alternate sources to increase the utility's water supply and the possibility that Pasco County may adopt a chloramine process have complicated the utility's search for a process that will correct the "black water" problem and remove hydrogen sulfide from the water. Nevertheless, it is past time for Aloha to take decisive action.

We further note that DEP witness Foster testified that Pasco County had a hydrogen sulfide problem in its water and installed a treatment system to deal with it. According to witness Foster, he has never seen a problem with black water in the county. We believe that if Aloha had committed themselves to a more proactive approach to this problem, and this type of problem having already been addressed by the County, that Aloha had the opportunity to prevent the situation from becoming as bad as it is and possibly eliminate it entirely.

As an initial step to combat the "black water" problem, we note that shortly after Wells Nos. 8 and 9 were placed into service in late 1995, the complaints on "black water" sky-rocketed. OPC witness Biddy suspects that Wells Nos. 8 and 9 have hydrogen sulfide spikes. Also, those wells are the closest to the subdivisions experiencing the worst "black water" problems. Although Aloha's Seven Springs water system is totally interconnected, we believe that any solution to the "black water" problem must begin with Wells Nos. 8 and 9.

By Order No. PSC-00-1285-FOF-WS, we required Aloha to immediately implement a pilot project using the best available treatment alternative to enhance the water quality and to diminish the tendency of the water to produce copper sulfide in the customers' homes. Based on the above, the utility shall make improvements starting with Wells Nos. 8 and 9, and then to all of its wells, to implement a treatment process designed to remove at least 98% of the hydrogen sulfide in the raw water. Such improvements to all of the utility's wells shall be placed into service by no later than December 31, 2003. Moreover, Aloha shall submit a plan within 90 days of the date of the Final Order in this docket showing how it intends to comply with this requirement to remove hydrogen sulfide.

### 2. Return on Equity Set at Minimum

Based on the above, and after considering the value and quality of the service, we find that the utility's rates shall be set to give it the opportunity to earn the minimum of its authorized rate of return in accordance with Gulf Power. We have set the rates at the minimum of the range of return on equity because of the overwhelming dissatisfaction of Aloha's customers due to the poor quality of the water service and their treatment by the utility in regards to their complaints and inquiries. Our actions are consistent with past decisions in this regard. See Order No. 14931, issued September 11, 1985, in Docket No. 840267-WS, Order No. 17760, issued June 28, 1987, in Docket No. 850646-SU, Order No. 24643, issued June 10, 1991, in Docket No. 910276-WS, and Order No. PSC-96-1320-FOF-WS, issued October 30, 1996, in Docket No. 950495-WS.

### 3. Reduction to President's and Vice-President's Salary

Also, we find the continuing problems with "black water" over at least the last six years, the customers' dissatisfaction with the way they are treated, the poor service they receive from the utility, and the failure of the utility to aggressively and timely seek alternate sources of water supply reflect poor management of this utility. Therefore, based on this poor management and mismanagement, the amount allowed for salaries and benefits of both the President and Vice-President shall be reduced by 50%. Based on this adjustment and noting Stipulation No. 13 (double counting of

one employee's salary), the adjustment to officers' salaries is a reduction of \$28,969, and the total reduction to benefits is \$6,402. This is consistent with our actions taken in: Order No. 23573, issued October 3, 1990, in Docket No. 891345-EI; Order No. PSC-93-0295-FOF-WS, issued February 24, 1993, in Docket No. 910637-WS, Order No. PSC-01-1162-PAA-WU, issued May 22, 2001, in Docket No. 001118-WU; and Order No. PSC-01-1988-PAA-WU, issued October 8, 2001, in Docket No. 001682-WU. In Order No. PSC-01-1162-PAA-WU, we specifically stated:

In past cases, we have found it appropriate to reduce the president's salary based on poor quality of service and the performance by management. Specifically, in Order No. PSC-93-0295-FOF-WS, issued February 24, 1993, in Docket No. 910637-WS, we found that it was appropriate to reduce the salary of Mad Hatter Utility Inc.'s (MHU) president because of the concerns with MHU's overall quality of service and the performance of its management. We found in Order No. PSC-93-0295-FOF-WS that reducing the salary of the utility's president would have a direct and immediate impact equal to or greater than a reduction to the return on equity. We further found that it sends the proper signal to management to make improvements, and that it is management, specifically the president, who is ultimately responsible for the conduct of the corporate entity, and who should be held accountable.

#### B. Customer Service Improvements

As we discussed above, the customers who testified in this case were overwhelmingly dissatisfied with the customer service provided by Aloha. Thus, the evidence suggests that Aloha needs to improve its customer relations. Because the foundation for a good customer relationship is good communications, we have identified the following five measures that will greatly improve Aloha's communications with its customers, and will ultimately improve the level of customer service provided by Aloha. To that end, Aloha shall implement these five measures as further discussed below.

1. The Transfer Connect Program

We strive to resolve disputes between regulated companies and their customers in an efficient and effective manner. One of the tools that we have to accomplish that goal is the Transfer Connect Program, a low-cost optional program that allows each participating company to provide a toll-free telephone number by which the Commission may directly transfer a consumer for assistance. When the transfer is complete, any further charges for the call are the responsibility of the company, and not the Commission or the consumers. Each company subscribing to the Transfer Connect Program must provide consumer assistance personnel to handle transferred calls during the company's normal business hours (i.e., a "live" customer service representative). There are 18 companies currently participating in the Transfer Connect Program. The participants are: Florida Power & Light, BellSouth, Florida Power Corporation, Florida Water Services, Sprint-Florida, Sprint-Long Distance, Verizon, Tampa Electric Company, Excel Communications, NOS Communications, Intermedia Communications, MCI WorldCom, USA Telecorp., Billing Concepts, AT&T (Residential and Slamming), Supra Telecommunications, Gulf Power Company, and OLS. According to Commission statistics, the Commission is transferring about 1,000 calls per month to participating companies. During the 2000-2001 fiscal year, 14 percent of the more than 67,000 total calls answered via the Commission's 800 toll-free answer line were transferred directly to the utilities. There were 1,423 cases resolved in this manner by the Telecommunications Industry, 578 cases by the Electric Industry, and 20 by the Water and Wastewater Industry.

According to companies who have recently signed up to be on the Commission's Call Transfer program, Aloha may incur the following costs, which appear to be immaterial for a company such as Aloha:

Installation - \$0.00  
Monthly Rate - \$20.00  
Per Minute Charge - \$.216

We find that Aloha would better serve its customers by using this service because customers would have the opportunity to have their problems addressed quickly by the company. Therefore, Aloha shall



participate in the Transfer Connect Program, as described in Rule 25-22.032(3), Florida Administrative Code. At a minimum, Aloha needs to have personnel available from Monday through Friday, 9 a.m. to 4 p.m., Eastern Standard Time, excluding holidays observed by the company, to answer the telephone.

2. Employee Training, Customer Service Guarantees, and Implementation of Standards Covering Aloha's Customer Service and Operational Activities

At the hearing, we heard testimony that Aloha's customers perceive that Aloha is not committed to quality customer service. Customer witness Nowack states, "[t]his kind of consumer relationship is not what you would call good. Florida Power, there's no problem. Verizon, there's no problem. Anybody else, there's never a problem, but Aloha Utilities hates their customers." Customer witness Stingo stated similarly, "Aloha does not care about the customer." Customer witness Depergola states, "I'm a businessman. I treat my customers with white gloves. I go the extra mile for my customers. I am a tailor by trade. I make sure that my customers are served properly, honestly, and on top of that, I stayed in business with recommendations. All I hear tonight, disappointment from Aloha customers, nothing but sad stories from decent people."

To improve its customer relations, Aloha needs to focus on providing good customer service. We find that one method available to improve its customer relations is the offering of service guarantees. In addition, we find that customer service would be better if the utility improved its customer service procedures by doing things such as making it easier for customers to gain access to the utility's complaint-handling system. To improve its customer relations, we find that Aloha shall implement the following changes to its customer service procedures:

- a. Aloha shall supervise and train its employees to be courteous, considerate, and efficient at all times in their contact and dealings with its subscribers and the public in general and shall make checks from time to time to insure that courteous service is actually being rendered. The utility shall also implement cross training and internal customer service programs, as well

as essential customer skills training, such as "telephone courtesy," "listening skills," and "how to communicate caring." In addition, Aloha shall prepare a manual for customer service, which should be used regularly in order to ensure consistency in Aloha employees' dealings with customers.

b. Aloha shall implement a program that places automatic credits on a customer's bill if the company fails to meet established timeliness standards for making repairs or installing service. These expenses shall be accounted on Aloha's books below the line so that the general body of ratepayers will not have to reimburse Aloha for its failure to provide timely service. Aloha shall file revised tariff sheets to include the following credit possibilities:

- a \$15 credit for each missed appointment
- a \$15 credit if an out of service repair exceeds 24 hours
- a \$15 credit if service is not reconnected within 12 hours of receipt of customer payment.

c. Aloha shall implement a multitude of standards covering its customer service and operational activities and maintain an effective system for measuring performance against those standards. Each standard should be discrete, that is, relatively narrow in scope and confined to measurable service features, particularly through the company's automated (Interactive Voice Response) telephone system.

Examples of possible standards include, but are not limited to:

- Process and handle all customer complaints within 5 days of receipt.
- Keep busy signals below 5 percent of incoming calls.

- Maintain hold or wait time at less than 1 minute.
- Return all internal and external calls within 8 working hours.

### 3. Customer Billing Improvements

Aloha shall make changes to its bills to develop a clearer billing format to reduce customer confusion. Our staff has taken complaints from Aloha customers who could not decipher their monthly bills. For example, customer witness Nowack states, "[m]y big beef with Aloha is, they can't consistently bill me for any particular time. I've been fighting with them for three or four years now, and they will read a meter, and it will have the same amount at the beginning and at the end."

Rule 25-30.335(1), Florida Administrative Code, Customer Billing, states:

Except as provided in this rule, a utility shall render bills to customers at regular intervals, and each bill shall indicate: the billing period covered; the applicable rate schedule; beginning and ending meter reading; the amount of the bill; the delinquent date or the date after which the bill becomes past due; and any authorized late payment charge.

The current billing format does not include the applicable rates for water and wastewater charges, nor does it clearly break out the difference between the prior balance and any amounts past due. Aloha shall redesign its current bill to include water, wastewater, and miscellaneous charges when applicable. Also, Aloha shall redesign its current bill to reflect an accurate previous balance and any payments received (and the date received). For example:

Previous Balance	\$ XX.XX
Payment Received on DATE	XX.XXCR
Outstanding Balance	.00
Water Base Facility Charge	\$ X.XX
Gallonage Charge (XXXX Gallons @ .XXXXXX)	\$ XX.XX
Total Water	\$ XX.XX
Wastewater Base Facility Charge	\$ X.XX
Gallonage Charge (XXXX Gallons @ .XXXXXX)	\$ XX.XX
Total Wastewater	\$ XX.XX
Non-jurisdictional Charges	
Garbage	\$ XX.XX
Street Lighting	\$ XX.XX
Total Current Charges Due by Date	\$ XX.XX

Aloha's tariff does not contain a copy of the current bill, and the example bill shown in the tariff was last revised in 1978. Aloha shall file a revised tariff that reflects the current bill within 30 days of the issuance of the Final Order in this docket. Also, Aloha shall have its billing format changed along with revised tariff sheets reflecting this change within 120 days of the issuance of the Final Order in this docket.

In addition, Aloha shall provide payment options for its customers, which may include preauthorized direct debit and payment connectivity over the Internet between online customers and the utility. Preauthorized direct debit involves a customer having the payment taken directly from a checking or savings account each month. For payments via the Internet, Aloha could choose a payment processing network that allows its Web site to support multiple payment types. Many software programs today can be customized to integrate with a company's existing Web site. We find that these changes should enhance Aloha's customer relations and eliminate confusion over the billing process.

#### 4. Citizens' Advisory Committee (CAC)

Aloha shall form a Citizens' Advisory Committee (CAC). This concept was raised by the customers at the hearing as a means to improve customer relations. Many organizations form advisory committees to generate recommendations and provide ideas about issues facing the organization. Advisory Committees also provide

opportunities for an agency to ensure that the many diverse interests of its customer base are represented on an ongoing basis. The primary purpose of the Aloha CAC would be to serve as a special communication link between Aloha customers and the utility. In addition, the CAC would allow Aloha to receive constructive input from customer representatives about any issues deemed relevant by any party, thus enabling Aloha to better understand the desires of its customers and to work toward more compatible solutions.

The committee would be comprised of 15-20 citizens representing a cross-section of individual customers and various homeowners' associations in Aloha's territory who have interests and concerns about the utility's ongoing customer service. Members would probably serve two-year terms. The CAC would be formed to assist Aloha in making critical decisions that impact the level of service provided to the community. The group would research, study, and discuss specific issues with both short and long-term implications, forwarding their recommendations to Aloha. The president of Aloha or his designee would attend all meetings.

CAC meetings would be open to the public, and any Aloha customer could attend or contact a member to pass along any concerns, questions, comments, etc. In addition, notification of the advisory committee meetings would be made in Aloha's existing newsletter and other publications. The CAC would meet, at a minimum, once a month, and the meetings would be scheduled at the convenience of the committee. The CAC would provide a mechanism for citizen involvement, and its activities would be promoted through the publication of reports published in Aloha's current newsletter and on Aloha's Web site. The CAC would also conduct citizen meetings in each of the target areas, meet with representatives of neighborhood organizations, disseminate information throughout Aloha's community, and go door-to-door to ensure that citizens are aware of the CAC activities.

Meeting summaries would be prepared after each meeting. Summaries would be available for citizen inspection. Key issues addressed during the advisory committee process would also be highlighted in the meeting notes. A CAC mailing list would be developed by members of the CAC and Aloha, and it would continue to evolve as new citizens and interested persons call to get on the mailing list.

In its initial meeting, the CAC would need to elect, at the very least, a chairman and a vice chairman. Both a chairman and a vice chair would be elected by a majority vote of the CAC members with a quorum present. The Executive Secretary of the CAC would be a designated Aloha staff person. The Executive Secretary would be responsible for recording the minutes of all CAC meetings, transmitting notices and agendas to the membership, and would transmit a copy of the minutes of each CAC meeting to each member prior to the next regular meeting. The Executive Secretary would also insure that consensus, majority, and dissenting views on all matters and issues were recorded, and, upon request, reported. He or she would also assist the subcommittees and task forces, as needed. *Robert's Rules of Order Newly Revised* would be the parliamentary authority for the conduct of meetings, except in cases where it might conflict with the bylaws to be adopted by the CAC. In addition, the CAC would adopt some guiding "principles" for conduct and actions at all future meetings. At the initial meeting, the CAC could begin formulating its mission statement, as well as its goals and objectives. At this first meeting, the CAC and Aloha could place on the record items that each party considers appropriate for an Advisory Committee to discuss. The CAC could designate subcommittees to study issues of concern and present recommendations to the full CAC. Task forces could also be appointed to study or deal with issues that generally are of short duration and very specific in responsibility.

We find that the formation of the CAC will improve communications between the utility and its customers, and thus improve customer service.

#### 5. Develop a Consumer-Friendly Web Site

Internet Web sites are increasingly becoming accepted and used as a communications vehicle for businesses and organizations. The Internet provides a vehicle for reaching an information-oriented segment of the residential market. During the customer hearing, Aloha's witness Watford testified that the utility was developing a Web site. We find that the company's Web site would be a good source of information for Aloha customers. The site should be designed to offer customers an easy-to-follow format and the ability to file a complaint, comment on a company policy, or ask a

question. The web site should link Aloha's customers to education materials and other related Internet sites.

When designing and updating its Web activities, Aloha should consider the following factors to help foster a customer's perception of a positive experience and promote a repeat visit and positive word-of-mouth publicity:

- Simplify online activities so that they are clear and have concise directions that are easy to follow. As an example, if Aloha wants customers to be able to e-mail the company, Aloha needs to be sure that the customers can e-mail from the Web site, as opposed to having to leave the site and then send an e-mail message.
- Organize the information presented within Aloha's Web site, so customers can easily find topics. A consumer interested in information about a company's conservation programs should not have to first wade through extraneous materials.
- Update information frequently. Nothing deters online visitors quicker than the perception that a Web site's primary contents are yesterday's news. At a minimum, Aloha needs to update its Web site and check for accuracy at least once a week.
- Include a feature that would offer customers a way to respond to special utility programs or services, and also a way to suggest how to improve Aloha's customer service.
- Highlight items related to conservation issues, including links back to the water management districts' conservation information.
- Include a section of "frequently-asked customer questions" and a section offering water usage calculations.

- Include a line item explanation of a sample customer bill.
- Include a link to the Commission's Web site, so customers would have the opportunity to file an online complaint with the Commission.

Aloha shall implement these five customer service measures within 120 days from the date of the Final Order. An additional operation and maintenance (O&M) expense of \$44,136 shall be allowed for Aloha to implement these customer service measures.

#### V. RATE BASE

##### A. Amount of Pilot Project to Include in Working Capital

In its MFRs, Aloha included a \$190,000 increase to working capital for the average estimated cost of the pilot project recognized in Order No. PSC-01-1374-PAA-WS, issued June 27, 2001, in Dockets Nos. 000737-WS and 010518-WS. That Order finalized the overearnings investigation for the Aloha Gardens water and wastewater systems and the Seven Springs water system, and was based on the projected test year ended December 31, 2000.

By Order No. PSC-00-1285-FOF-WS, issued July 14, 2000, in Docket No. 960545-WS (the water quality docket), we ordered Aloha to implement the pilot project to enhance water quality. In Order No. PSC-01-1374-PAA-WS, subsequent to the water quality docket, we noted that Aloha had submitted a cost estimate for the pilot project of \$380,000 in December 2000. We found the estimate to be reasonable and allowed the average balance of \$190,000 to be included in working capital only. Because the pilot project was not yet completed, we stated that the appropriate final treatment for these costs could be addressed in the upcoming rate case for this system (i.e., this docket).

OPC witness DeRonne testified that the pilot project has essentially been suspended and a final report has not yet been prepared by Aloha's engineer. According to Ms. DeRonne and OPC witness Bidy, the utility is apparently waiting until water supply issues are resolved prior to completing the pilot project. Ms. DeRonne stated that based on Aloha's response to discovery, the actual balance Aloha spent and recorded on its general ledger for



the pilot project as of August 2001 was \$74,746. In Exhibit 9 (DD-1), Schedule C-1, Ms. DeRonne provided the month-end balances in the pilot project account, along with the monthly increases in the balance.

Ms. DeRonne testified that since the actual amount spent to date is considerably lower than the projected cost of \$380,000, the balance included in working capital should be revised. She asserted that working capital should be based on the actual projected 13-month average balance for the 2001 test year, not 50% of the total projected amount to be spent. According to Ms. DeRonne, it is highly unlikely that the 13-month average test year balance would be \$190,000, particularly since Aloha essentially put the project on hold.

In calculating her projected test year average balance, Ms. DeRonne used the actual balances for December 2000 through August 2001. She then estimated the monthly additions for the remainder of the test year based on the average monthly expenditures for the first eight months of the year. Ms. DeRonne testified that this would probably overstate the actual amount spent given that the delay in the program might result in lower amounts being spent than projected during the last few months of the year. Her calculation of the 13-month average is also reflected on Schedule C-1 of Exhibit 9. Ms. DeRonne concludes that working capital should be reduced by \$135,730 to reflect a projected test year thirteen-month average balance of \$54,270.

Ms. DeRonne notes that Aloha based its adjustment on the total estimated cost divided by two. She believes that the amount in the working capital calculation should be based on the amounts that were actually incurred and reasonably projected in that 12-month period. Further, she did not believe that we specifically prescribed the accounting treatment in the last overearnings investigation. We just made that adjustment to calculate the rate base impact in that particular case. She was not saying that Aloha should never recover the costs of this pilot project. Her testimony was that the calculation of working capital in this case should be based on the actual amounts expended.

Through review of monthly reports and other discovery, Mr. Bidy stated he was able to analyze Aloha's actions in response to

our order requiring the pilot project. Mr. Bidy noted that in the August 2001 report, Mr. Porter informed the Commission that "water supply issues have come up" and that "he has been looking into alternative water sources for the long term supply for Aloha." The August report also stated that Mr. Porter will complete a draft of the MIEX pilot trials report and review it with DEP prior to preparing the final report. Mr. Bidy stated that the September and October 2001 reports reiterate similar comments regarding the progress of the pilot project.

Based on the pilot project reports in the beginning of 2001, Mr. Bidy stated that he thought that an economical solution for hydrogen sulfide removal may have been found. But when the July 2001 report suddenly reflected that "water supply issues have come up," Mr. Bidy was left with the impression that the water supply issue was of higher concern than finding a solution to the hydrogen sulfide or black water problem in Aloha's wells. In summary, Mr. Bidy testified that he believed that Aloha's pilot testing reflected progress in solving the black water problem, but that Aloha was delaying completion of the project until they solved the water supply problem. Thus, Mr. Bidy concludes that Aloha may have complied with the letter, but not the spirit of our order regarding the pilot project, and that Aloha simply was stalling on this issue, as well as the issue of overpumping their permit.

Aloha witness Nixon, in his rebuttal, testified that because the project was ordered by this Commission, and Aloha was allowed pro forma recovery of the carrying costs in the recent overearnings investigation, that we should be consistent with this regulatory treatment. He argued that Ms. DeRonne's suggestion that Aloha would receive a windfall if this amount were included in rate base is false. The inclusion of \$190,000 in working capital yields approximately \$16,500 in annual revenue compared to Aloha's actual out-of-pocket costs through August 2001 of approximately \$75,000. Thus, he stated that it would take 4 1/2 years to recover the costs incurred through August 2001, which is hardly a windfall for the utility.

Mr. Nixon testified that Ms. DeRonne does not provide any explanation or justification for her elimination of this pro forma adjustment. He suggested that she was just influenced by the testimony of OPC witness Bidy, who believed that the project is

substantially complete, or she believed that the total project cost of \$380,000 should have been substantially incurred by now. However, Mr. Nixon does not address Ms. DeRonne's projection methodology.

Aloha witness Porter disagreed with Ms. DeRonne's testimony that an adjustment to working capital is necessary because the pilot project has been "put on hold and delayed by the Company." In his rebuttal, he testified that she incorrectly characterized the status of the pilot project. Mr. Porter stated that the pilot project is moving ahead and has not been but on hold in any way. He testified that he is still working with the MIEX representatives in developing the next stage in the pilot process, which is the demonstration scale facility. Shortly before Mr. Porter filed his rebuttal testimony, he received and reviewed a proposal from the MIEX representatives related to the next phase. He also had discussions with MIEX representatives and Aloha to move ahead with the demonstration facility in early 2002 if everything could be arranged by that time. Mr. Porter concluded that he thought no working capital adjustment was justified.

Upon cross examination, Mr. Porter testified that the demonstration facility for the MIEX process may cost between \$200,000 and \$300,000, but he could not be exact. Further, these costs would be a combination of plant and operating costs. Exhibit 27 shows that Aloha believed that its original projection of \$380,000 is considerably understated because of the impact of purchased water from Pasco County regarding the cost and water chemistry, and SWFWMD's requirement to perform a reverse osmosis (R/O) feasibility study. Aloha's pilot project reports submitted to the Commission for January 2001 through December 2001 reflect that substantial incremental costs have not been incurred for the pilot project above those projected by Ms. DeRonne for the last several months of the test year.

Mr. Watford testified that Aloha has spent substantial amounts of money on this pilot testing of the MIEX treatment process in order to remove hydrogen sulfide. He added that it is now known that changes will occur in the coming years, both from the chemical makeup of water being provided by Pasco County and by the increased reliance on some other long-term water source. Mr. Watford stated that it would be imprudent to proceed with the next major phase of

the pilot project without knowing more about possible impacts of the changes; however, the utility is still moving forward by accumulating data collected from the first phase of the pilot project.

According to Mr. Watford, the suggestion by OPC that the pilot project is on hold or will cost less than the figure estimated and required to be recognized as working capital in the last proceeding is absurd. He added that Aloha expects to spend substantially more in the future than originally estimated especially including the cost of the R/O feasibility study. Further, Mr. Watford noted that Aloha accounted for the pilot project by including it in working capital exactly as ordered by the Commission in the recent overearnings investigation.

Aloha has relied upon the treatment and amount included in Order No. PSC-01-1374-PAA-WS (the overearnings investigation Order) for the amount to include in working capital for the pilot project. At the time of that Order, the amount was based on an estimate, and Aloha had not submitted its first report on the MIEX project. Further, Aloha's witnesses presumed that our Order in the overearnings investigation mandated that Aloha account for the estimated costs in a certain way. However, our order clearly states: "because the results of the pilot project are not yet completed . . . the appropriate final treatment for these costs can be addressed in the upcoming rate case for this system." (Order at p. 8)

The main dispute regarding this issue is the timing of the estimated and actual costs incurred for the pilot project. OPC's witnesses contend that the MIEX project has slowed substantially, possibly to a halt, pending a solution for the water supply problems. Whereas, Aloha's witnesses testify that upcoming changes have caused the utility to modify its project to the point that the costs will increase higher than those originally estimated.

We believe the overriding issue is what is the projected 13-month balance of the pilot project costs that should be included in the working capital allowance. To be consistent with Aloha's projection methodology for all of its balance sheet accounts, we find that this account should be based on the test-year projected balance.

Ms. DeRonne testified that she made the adjustment to comply with the regulatory concept of a test year. Her estimates of what Aloha spent during the test year were undisputed. Aloha seeks to recover more money than a reasonable projection would reflect that the utility spent at the end of the test year. To allow an additional amount simply because Aloha may spend more on the overall project cost does not represent what actually happened during the test year or any reasonable time thereafter. Aloha had the opportunity to submit additional evidence to support its actual costs incurred through the end of the projected test year, but did not do so. Based on the above, we find Ms. DeRonne's estimate of \$54,270 for working capital for the Seven Springs water system is reasonable and shall be allowed. This results in a decrease of \$135,730 to the amount of working capital for the pilot project requested by the utility.

#### B. Total Working Capital

The utility used the balance sheet approach to calculate working capital. The utility calculated total company working capital and allocated it to each of the utility's systems based on O&M expenses. Aloha made specific adjustments to the working capital allowance for the Seven Springs water system for deferred pilot project costs of \$190,000 and unamortized deferred rate case expense of \$223,250. The utility's adjusted working capital for the Seven Springs water system for the projected test year was \$843,970.

As discussed above, we have approved two adjustments to Aloha's calculation of total company working capital that were stipulated to by the parties. The first stipulation removed deferred rate case expense related to the prior Seven Springs wastewater rate case, Docket No. 991643-SU, as this was fully allocated to the wastewater system. The second adjustment reduced working capital by \$32,868 to reflect additional amortization of the regulatory Commission expense associated with Docket No. 960545-WS.

Because we found the test-year-pilot-project costs to be \$54,270, we reduced working capital by an additional \$135,730, as discussed in the previous section. Also, as discussed below, the total rate case expense approved by us is \$205,208. Consistent

with the methodology used by the utility, the average unamortized balance of total rate case expense should be added as a specific adjustment to the working capital for the Seven Springs water system. Thus, 50% of the rate case expense of \$205,208, or \$102,604, is the appropriate balance to include for the Seven Springs water system.

Below is our calculation of working capital for the total company and the Seven Springs allocated portion. The appropriate allocation percentage of the total company working capital of \$900,785 was 32.040%, and resulted in \$288,607 being allocated to the Seven Springs water division. We then added specific adjustments to the Seven Springs water division for the pilot project (increase of only \$54,270 and not the \$190,000 requested by the utility), and deferred rate case expense (increase of only \$102,604, and not the \$223,250 requested by the utility), for a total increase of \$156,874, resulting in a total working capital of \$445,482.

Working Capital - Balance Sheet Approach  
Projected 12/31/01 - 13 Month Average

Total Company Working Capital Calculation	Balance	Stipulated	Adjusted
<b>Current Assets:</b>	<u>Per Utility</u>	<u>Adjustments</u>	<u>Balance</u>
Cash	\$594,691	\$0	\$594,691
Petty Cash	400	0	400
Accounts Receivable -Trade	788,297	0	788,297
Allowance for Bad Debts	(6,900)	0	(6,900)
Prepayments	133,805	0	133,805
Loss on Plant Retirement	4,830	0	4,830
Deferred Rate Case Expense	5,309	(61,702)	(56,393)
Other Misc. Deferred Debits	<u>428,574</u>	<u>(32,868)</u>	<u>395,706</u>
<b>Total Current Assets &amp; Deferred Debits</b>	<u>\$1,949,006</u>	<u>(\$94,570)</u>	<u>\$1,854,436</u>
<b>Current Liabilities:</b>			
Accounts Payable	\$569,491	\$0	\$569,491
Accrued Taxes	384,160	0	384,160
Deferred Rate Case Expense	<u>0</u>	<u>0</u>	<u>0</u>
<b>Total Liabilities &amp; Deferred Credits</b>	<u>953,651</u>	<u>0</u>	<u>953,651</u>
<b>Total Company Working Capital</b>	<u>\$995,355</u>	<u>(\$94,570)</u>	<u>\$900,785</u>

<u>Allocation Methodology</u>	Adj. O&M Expenses	% to Total	Allocated Working Capital
Aloha Gardens Water	444,837	9.411%	84,777
Aloha Gardens Wastewater	862,062	18.239%	164,292
Seven Springs Water	1,514,359	32.040%	288,607
Seven Springs Wastewater	<u>1,905,275</u>	<u>40.310%</u>	<u>363,108</u>
<b>Total</b>	<u>\$4,726,533</u>	<u>100.000%</u>	<u>\$900,785</u>
<b>Adjustments to Seven Springs Water</b>	Amount	Amount	Comm.
	<u>Per Utility</u>	<u>Per Comm.</u>	<u>Adjustment</u>
Seven Springs Allocated Portion Specific Adjustments	\$430,720	\$288,607	(\$142,113)
Pilot Project	190,000	54,270	(135,730)
Deferred Rate Case Expense (Avg Unamortized)	<u>223,250</u>	<u>102,604</u>	<u>(120,646)</u>
<b>Total Adjustments</b>	<u>413,250</u>	<u>156,874</u>	<u>(256,376)</u>
<b>Total Working Capital</b>	<u>\$843,970</u>	<u>\$445,482</u>	<u>(\$398,488)</u>

Therefore, for the Seven Springs water division, working capital is calculated to be \$445,482.

### C. Total Rate Base

Based upon the utility's adjusted 13-month average test year balances, the approved stipulations, and our adjustments, the appropriate projected rate base for Aloha is \$1,381,612. Schedule No. 1-A, which is attached, reflects our rate base calculation. Our adjustments to rate base are depicted on the attached Schedule No. 1-B.

### VI. COST OF CAPITAL

The weighted average cost of capital is calculated to be 8.52%, with a range of 8.52% to 8.78%. This is based on a return on equity of 10.34%, which is the minimum of the newly established range of 10.34% to 12.34%. Based on inadequate service and mismanagement, we have reduced the return on equity to the minimum of the range. This issue is also a fall-out of Stipulation 7 (annual amortization of issuing expense for the Bank of America loan), Stipulation 8 (the appropriate projected 13-month average balance of long-term debt); Stipulation 20 (use of current leverage formula); and Stipulated Issue 6 (cost rate for related party

variable cost debt should be prime rate plus two percent as of December 31, 2001). Schedule No. 2, which is attached, depicts our cost of capital calculation.

## VII. NET OPERATING INCOME

### A. Number of Gallons Sold for the Projected 2001 Test Year

#### 1. Utility Forecast

Utility witness Porter supported a model based on the average consumption for calendar year 2000 of 261 gallons per day (gpd), plus the number of projected new ERCs times 500 gpd. The rationale for this formulation was that new customers coming on line would use significantly greater amounts of water than the current average Aloha customer. To support the higher average usage of the new ERCs, utility witness Watford attached to his rebuttal testimony examples of sales brochures indicating that the homes now being marketed in the Seven Springs area were larger, family oriented units as opposed to the utility's original base of small retirement homes. For the reasons discussed below, we believe that Mr. Porter's model has several flaws.

First, the utility's methodology consistently confuses marginal usage with average usage. While it may be true that new customers will use more than the average, it is also true that many of the existing customers use less than the average. The only way the additional customers would significantly affect average system usage is if the number of new customers is significantly larger than the number of existing customers. The projected additional 473 ERCs represent less than 4% of the utility's total customers. Using information provided by Mr. Watford in Exhibit 29, Attachment A shows that adding 473 customers using 500 gallons/day to the total system only increases the weighted system average one gallon per day (262 gpd compared to the 261 gpd shown on Page 1 of 2 on that Attachment). Page 2 of 2 on that Attachment shows that even if every subdivision that uses more than the average of 261, but less than 500 gallons per day, were to use the utility's projected 500 gallons per day, the weighted system average usage would only increase to 290 gallons per day. While Mr. Porter's assertion that, as the higher use customers come to dominate the lower use customers, the system average usage will increase is correct in a



mathematical sense, this will be a long term result which need not be addressed here. To simply take a system average and add 500 gpd per additional ERC per day, significantly overstates the projected usage.

Second, Mr. Porter's forecasting methodology was inconsistent with the method he used to forecast the ERCs. Mr. Porter used a simple time trend model over the previous five years to project the increase in new ERCs, as required by the Commission's MFRs. A "sanity check" performed by staff witness Stallcup using our preferred linear regression forecasting approach resulted in an ERC forecast nearly identical to the forecast that the utility's method produced. Neither this Commission nor OPC objected to the results of Mr. Porter's ERC analysis. However, Mr. Porter used an average analysis to forecast the gallons used. Unlike the time trend over five years used for the ERC forecast, Mr. Porter relied on the total system usage over all subdivisions for a twelve-month period from July 2000 to June 2001, then added average usage for newer subdivisions times the projected additional ERCs.

We believe that simple time trending may yield reasonable results for projecting growth in ERCs only because changes in the number of ERCs is relatively slow and easily predictable. Such stability does not apply to gallons used which can fluctuate with changes in weather or watering restrictions. Therefore, neither the 12-months data nor the averaging approach used by Mr. Porter to project ERCs is sufficient for forecasting usage.

Third, he assumed that all of the new ERCs are residential ERCs and that all will come on line on January 1 of the test year. OPC Witness Stewart stated that the assumption that all new ERCs are residential, and thus subject to the 500 gallon assumption, is in error. Witness Stallcup also disputed Mr. Porter's assumption that all of the new ERCs will be connected to the system on January 1. He maintained that the connections will take place over the entire year, and to include the total expected usage for the entire year overstates the total gallons used.

Fourth, the utility stated that the water usage restrictions imposed by the SWFWMD should be considered in determining the appropriate forecast. Witness Porter stated that expected water usage could increase if watering restrictions were to be lifted,

resulting in even higher usage per customer than proposed by the utility's forecast. However, this approach ignores the fact that the reason the watering restrictions would be lifted is that rainfall approached a normal year. While able to use more water, the customers may actually use less water than they currently use to achieve the same results because of the increased rainfall. OPC witness Biddy also noted that the newer homes had high irrigation needs due to new lawns and landscaping, which may necessitate frequent watering, which would likely decline as the lawns became established. In an effort to be as accurate as possible, witness Stallcup presented a revised forecast which attempted to capture changes in water management restrictions. This revised forecast is what resulted in the greater deviation from the actual 2001 data in his revised forecast.

## 2. OPC Forecast

OPC Witness Stewart computed an historical average gallons per day for the period 1995 through 2000, and multiplied this number by the projected ERCs to arrive at total gpd. This number times 365 days resulted in an annual consumption number. Although he did not incorporate a separate variable for weather in his projection, Mr. Stewart stated that his results did take into account rainfall in that the recorded usage would have been affected by the amount of rain. Mr. Stewart also recommended that the base-year 2000 data be adjusted for what he termed "abnormally dry conditions" which he contended resulted in inflated usage numbers going forward. In Exhibit 22, witness Stallcup used data from the U.S. Drought Monitor to show that, using National Drought Mitigation Center tools, there was not a significant difference in the drought index between the two years. Therefore, he rejected OPC's adjustment to Year 2000 base data. Aloha also took issue with the simple average of the last five years as an adequate predictor for future periods, in that it does not take into account the higher usage of new customers coming onto the system.

## 3. Staff Witness Stallcup's Forecast

Staff Witness Stallcup constructed separate econometric models that we find to be superior to OPC's model because they explicitly incorporate discrete variables to account for conditions that affect the number of gallons customers use. Each of Mr. Stallcup's

multiple linear regression models begins with the assumption that a portion of water usage, especially irrigation use, is related to the amount of natural moisture available. While OPC's model implicitly includes the effect of rainfall, Mr. Stallcup's model goes a step further and incorporates a Moisture Deficit Variable (MDV), which is a composite variable that takes into account both temperature and rainfall. This is an important combination because as temperature rises, the impact of a given amount of rainfall decreases due to evaporation. Further, we have recognized the validity of using the MDV in prior rate cases.

In addition, Mr. Stallcup's model adds a variable for lagged consumption to detect trends in usage per customer. This approach addresses the utility's concerns that new customers are predicted to use significantly more water than the current system average. By adding consideration of the usage one year prior, a pattern of usage is established to include the effects of increases in average usage. Since variations in weather can affect usage, Mr. Stallcup also included three binary variables to adjust out any unexplained weather deviation in both the current and lagged usage variable. This prevents abnormally wet weather from artificially depressing the forecast, or artificially dry weather from inflating the forecast. As noted above, Mr. Stallcup also revised his original forecast to take into account the possibility that water usage restrictions may be lifted in the near future.

#### 4. Conclusion

We find that the more comprehensive multiple linear regression models more accurately capture variables affecting customer usage, and are consistent with our practice. (See, PSC-97-0618-FOF-WS in Docket No. 960451-WS, PSC-99-0513-FOF-WS in Docket No. 980214-WS, and PSC-00-0248-PAA-WU in Docket No. 990535-WU.) Therefore, we find that the multiple linear regression models shall be used to determine the number of gallons sold for the 2001 test year.

We adopt the methodology and results based on the regression model proposed by staff witness Stallcup. His model incorporates variables that control for weather and capture trends in usage on a weather-adjusted basis. Comparing Mr. Stallcup's projections with actual usage produces a smaller deviation than either the method presented by Aloha or by OPC, as shown on the table below.

Actual data annual usage	Staff forecast 1/2001-6/2001	OPC forecast 1/2001-6/2001	Aloha forecast 1/2001-6/2001
1,001,718,992	1,016,121,784	1,021,416,846	1,105,069,500
Percent Difference	1.4%	2.0%	10.30%

Mr. Stallcup's original forecast of 1,001,021,846 gallons was within less than 1/1000th of a percentage point from the actual gallons sold. However, in Exhibit 21, witness Stallcup revised his forecast based on further review to recognize the utility's concerns about changes in usage if the water management district lifted or lessened water restrictions. This adjustment is necessary and correct to better reflect the time period rates will actually be in effect.

Accordingly, the appropriate number of gallons sold for the projected test year 2001 is 905,635,244 for residential service and 110,486,540 for general service.

B. Projected Number of Gallons of Purchased Water From Pasco County

In its MFRs, Aloha projected that it would purchase 421,860,000 gallons annually from Pasco County, with a pro forma adjustment of \$739,013.

The utility argued that the primary reason for filing this rate case was because Aloha must obtain all water above its SWFWMD permit levels from Pasco County. Aloha stated that in the past, the regulatory authorities have not been strict in requiring it to conform completely to the water use permit (WUP) limitations, but that SWFWMD is now strictly requiring that Aloha limit its withdrawals for raw water to the levels authorized in its permit. Aloha argued that SWFWMD has also refused to allow an increase in the permit withdrawal levels, leaving Aloha with no choice but to purchase additional water from Pasco County.

We disagree. Aloha has not sustained its burden of proof. We believe that a rate increase should be granted only if the reasons for it are clear and well justified. No evidence was presented to indicate whether or not the purchase of water from Pasco County is a cost-effective alternative. In addition, no evidence was

presented to indicate that Aloha did any kind of a cost benefit analysis of any other proposed alternative water supply. There is also no record evidence to indicate that Aloha took any steps to attempt to negotiate a lower water rate with Pasco County.

We believe that the plan to purchase water from Pasco County is at best a short-term fix. Further, the plan to purchase water does nothing to address the long-term black water problem.

By this Order, we are requiring that Aloha provide a report showing how it will have water treatment facilities installed and operational by the end of 2003. This construction will in all probability require Aloha to file a rate case. At that time, because of the material additions to rate base, we anticipate that Aloha will be able to implement an aggressive conservation rate structure.

By this Order, we also require Aloha to perform a cost benefit analysis of all alternatives to determine the most cost-effective alternative for Aloha's customers at this time. Because the purchase of water from Pasco County has not been adequately studied, it is premature to judge that it is the only alternative.

Accordingly, we find that the appropriate projected number of purchased water gallons from Pasco County at this time is zero with a resulting expense of \$0. Further, Aloha shall be required to perform a cost benefit analysis of an appropriate alternative water supply that allows it to fit permanently into the long-term alternative water supply plan in a manner that is not deleterious to the environment or Aloha's ratepayers. This analysis shall include negotiating with Pasco County for a better bulk rate, which might include paying an impact fee up front.

We note that our denial of Aloha's request to recover expenses for purchased water from Pasco County should not be construed to mean that this Commission does not support the SWFWMD's conservation goals. We support those goals. However, we must also consider the impact on Aloha's captive ratepayers. These customers should not be held responsible for the utility's failure to properly plan for its customers' long-term water needs.

The Commission strongly encourages all parties to work toward a long-term solution to Aloha's water supply problems. We recognize that once a prudent long-term solution is identified, a rate increase and a conservation rate structure may be justified.

We continue to expect Aloha to comply with all requirements of the SWFWMD. Consistent with our Memorandum of Understanding with Florida's five water management districts, this Commission commits to work with our sister agency, the SWFWMD, to promote greater conservation of Florida's precious water resources and to continue to take all reasonable steps to implement conservation-oriented rate structures as needed.

C. Monitoring Gallons Pumped Versus Potential Shortfall Or Excess for Customer Usage

At OPC's request, we added an issue to consider whether we should monitor whether the actual gallons pumped from Aloha's wells differs from the maximum permitted quantity on an annual average basis under the WUP. In response to this, Aloha thought that if there was a specific provision for monitoring overpumping, then there should be some similar provision if the consumption of the customers proved to be greater than estimated, and Aloha experienced a shortfall in revenues.

According to OPC witness DeRonne, if Aloha continues to withdraw more water from its wells than allowed under the WUP, even though its base rates are set to comply with the WUP, the utility will receive a windfall at the cost of ratepayers. She recommended that quarterly reporting requirements be put into place in the Final Order as a safety measure to ensure that ratepayers do not pay excessive amounts for water purchases that are not ultimately made by Aloha.

On rebuttal, both Aloha witness Nixon and Watford testified that the possibility of windfall profits, by continued overpumping after this case is completed, was not likely due to SWFWMD's proposed substantial penalty for Aloha's past and present overpumping. Mr. Watford did not believe that additional monitoring was appropriate as the purchased water issue was no different than other expense changes that could affect earnings. If we did propose to monitor earnings and purchased versus pumped water, Mr.

Watford believes that recognition of both under and overearnings by the utility should be trued-up on a going forward basis. He thought that it must work both ways for all potential problems, including erroneous projections, resulting from deviations of water purchased versus water pumped.

As to the utility's concern about a shortfall in earnings due to an underestimation of customer consumption, OPC argued that no special rate setting provision should be made for any potential shortfall or excess if usage by customers differs from that included in this rate case.

We believe Gulf Power requires us to set rates to give the utility the opportunity to earn a fair rate of return on its investment. We are not required to guarantee recovery of losses. If the utility perceives that its future earnings will generate less than a fair rate of return, it is within its management's purview to seek relief. Also, we note that we are projecting the number of purchased water gallons from Pasco County to be zero. Therefore, we find that there is neither a need to monitor the gallons purchased nor a need for additional monitoring requirements for earnings purposes.

#### D. Projected Chemicals and Purchased Power

On MFR Schedule B-7(B), the utility reported historical December 31, 2000, chemicals and purchased power expenses of \$89,344 and \$80,713, respectively. These historic figures were then multiplied by Aloha's projection factors to arrive at the 2001 test year totals. Chemical expense was projected by applying the 2000 GNP Price Deflator Index of 2.5% and the customer-growth factor of 4.688%. The utility projected purchased power using only the customer-growth factor because of the stability of electric prices. On MFR Schedule B-7(A), the utility reflected projected December 31, 2001, chemicals and purchased power expenses of \$95,870 and \$84,497, respectively.

In OPC witness DeRonne's direct testimony, she agreed with the general statement that any recommended reductions to the projected test year amount of gallons sold to customers would in turn have an impact on the utility's projected level of chemical expense and purchased power. However, she did not agree with the utility's

application of the inflation factor to its historic test year chemical expense. Ms. DeRonne argued that the two largest components of the utility's chemical expense were chlorine gas and Aquadene Liquid. The unit cost per pound for chlorine gas was \$0.47 for all of 2000 and through at least June 2001. The unit cost per gallon of Aquadene Liquid was \$10.10 for all purchases in 2000 and for the first 6 months of 2001. Based on this lack of change, she concluded that the inflation factor of 2.5% was not warranted and should not be applied to the historic test year level of chemical expense. In fact, the total chemical expense for the first seven months of 2001 was \$8,141 lower than the chemical expense for the same seven-month period in 2000. She testified that the projected test year chemical expense resulted in an \$8,303 reduction to the Aloha's requested level. The projected test year purchased power expense resulted in a \$5,389 reduction to purchased power expense. Ms. DeRonne further testified that for the first six months of 2001, which is the first half of the projected test year, the company's chemical expense had actually decreased significantly. She stated that she had not made an adjustment to reflect that anomaly, but left chemical expense at the test year level without inflation.

Aloha witness Nixon testified that an inflation factor was an appropriate tool for projecting chemical costs. Because rates are set on a going-forward basis, Mr. Nixon believed that an inflation factor was appropriate, despite the fact there had been no recent increases. Further, Mr. Nixon thought the use of an inflation factor was similar to our own price-index rate increase procedures.

Aloha witness Porter disagreed with Ms. DeRonne's characterization that power and chemical costs were going to decrease because of the repression in water consumption due to the new rates. Mr. Porter argued there would be other off-setting costs that would potentially increase because of buying the water from Pasco County.

Mr. Porter argued that Ms. DeRonne incorrectly based her testimony on the assumption that Mr. Stewart's projections were correct. Further, Mr. Porter testified that Aloha's chemical and power cost projections provided were potentially understated due to two factors. Mr. Porter concluded that Aloha's water use and



chemical cost projections were correct, and, therefore, no adjustment was necessary.

We find that it is valid to look at a material expense to see if any trends occur that might render a projection methodology inaccurate. Since the unit costs of the two largest components of Aloha's chemical expense did not change from January 2000 through June 2001, we agree with Ms. DeRonne that those costs have not been affected by inflation. If these costs do increase in the future, then our price index mechanism can be used to offset those increases on a prospective basis. In order to remove the inflation factor applied to the historical test year, chemical expense shall be reduced by \$2,234.

Based on our decision concerning the purchase of water from the County, no further adjustments are necessary to the test year amounts of chemicals and purchased power. Since both of these expenses were projected based on 2000 amounts escalated for customer growth and Aloha purchased only a small amount of water from Pasco County during that year, we find that the test year chemical and purchased power expense are reasonable.

#### E. Salaries and Wages for Open Positions

On MFR Schedule B-7(B), Aloha projected 2001 salaries for existing employees of \$346,223. According to MFR Schedule G-8, Aloha annualized projected salaries to reflect a raise given on July 9, 2001. This resulted in an increase to salaries of \$16,445, for total annualized salaries of \$362,668 for the 2001 test year. The utility also made an adjustment to increase salaries to reflect ten open positions with projected salaries of \$107,850. Aloha's total salary request for the 2001 test year was \$470,518.

Aloha testified that Aloha has historically had salary scales that have led to continuing high employee turnover. Because Aloha and Pasco County competed for the same qualified employees, Aloha obtained a copy of the study done by Pasco County on utility employee compensation. Aloha implemented a new wage and salary scale effective July 9, 2001, based on this study. The revised salaries and wages implemented were used to project salary expenses and benefits for July through December 2001. The utility testified that the new salary and wage scales would make them

competitive with Pasco County and reduce the high turnover rate. The utility included in its filing pro forma recognition of salaries for ten open positions, which the utility was in the process of filling.

OPC testified that the adjustment for the ten additional employees would increase salary and wage expense by 30% beyond the actual as of June 30, 2001. According to OPC, of the ten additional staff positions, five were for newly created positions and five were for existing positions which were vacated by former employees.

At the time intervenor direct testimony was filed, these ten positions were not filled, and Aloha had reported three additional vacancies. OPC argued that it was unlikely Aloha would be able to fill and retain thirteen additional employees in the near future. Therefore, OPC concluded that the entire \$107,850 for the ten additional employees should be removed from the utility's filing.

On rebuttal, the utility testified that its rates should be set to provide safe and efficient service, and that with the salary increase effective July 9, 2001, the high turnover rate should be greatly reduced. Also, the addition of a utility director would enable the utility to improve its long and short range planning. The utility further testified that to the extent that some or all of the new and open positions are approved, an adjustment would be required to employee benefits for these positions.

The utility argued it would never be able to hire and keep the needed employees to continue to provide high quality of service and hopefully to improve customer service, if the Commission did not approve these pro forma salary additions. According to the utility, the new employee positions and all of the vacant positions, except for that of the Utility Director, had been filled by mid-December, 2001. In addition, the utility stated it has been actively pursuing an employee to fill the Utility Director position.

Based on the utility's testimony that it has addressed its salary, under-staffing, and limited office space problems, and because the vacant positions are filled, except Utility Director, we find that all the positions, except that of Utility Director,

shall be included in operating and maintenance expenses. These changes should contribute to retaining the current staff and should work towards providing better customer service for their customers. Based on this finding, salary and wages expenses shall be reduced by \$19,835, and a corresponding reduction to the benefit expense of \$4,384 shall be made, for a total reduction of \$24,219. This represents the Seven Springs water allocated portion of the Utility Director's projected salary.

F. Pension Expense

On MFR Schedule B-3(A), the utility projected employee pensions and benefits expense of \$66,025 for the projected December 31, 2001 test year. OPC argued that Aloha had misallocated expenses between the Seven Springs water system and the Aloha Gardens wastewater system, and the utility agreed. In addition, OPC argued that the pension expense should be based on the updated 2001 pension expense amounts provided by Aloha's pension plan administrator, instead of the estimated amounts set out in the utility's MFRs.

We find that the pension expense should be based on the 2001 updated pension expense figure established by the utility's pension plan administrator, and increase pension expense by \$40,509, accordingly. This adjustment reflects the additional liability obligation and corrects the recording error initially made by the utility. Moreover, the evidence shows that the benefit percentage for employees shall be changed from 12.29% to 22.10%, and this percentage applies to the ten new positions. This results in an additional increase in benefit expense of \$10,580 for these open positions.

G. Excessive Unaccounted For Water

In its MFRs, the utility provided documentation that unaccounted for water for the year 2000 was 9.2%. The utility used a 10% unaccounted for water figure for the applicable projected test year expenses. The actual water use data for the first nine months of the test year 2001 indicates that the unaccounted for water was 10.2%.

As a starting point, it is our practice to allow 10% of the total water treated as an acceptable amount of unaccounted for water in order to allow for a reasonable amount of non-revenue producing water caused by stuck meters, line flushing, etc. (See Orders Nos. PSC-00-0248-PAA-WU, issued February 7, 2000, in Docket No. 990535-WU, and PSC-00-2005-PAA-WU, issued June 7, 2000, in Docket No. 000331-WU).

OPC presented conflicting testimony concerning the correct percentage to use for unaccounted for water. OPC witness DeRonne argued that the number was less than 10%, and that it should be based on the actual numbers.

OPC witness Bidy testified that, based on the first nine months of water usage, the unaccounted for water should be 14%. He calculated this by dividing the total water sold by the total water pumped through September.

Utility witness Porter testified that Mr. Bidy did not take into account the water used in operating the system and that the unaccounted for water based on actual water usage figures for the first nine months of 2001 was 10.2%. We agree that witness Bidy failed to take into account the non-revenue producing but accounted for water in his unaccounted for water calculation.

Utility witness Nixon testified that he utilized a 10% unaccounted for water factor for an adjustment to purchased water expense for two reasons. First, he noted that it was our accepted practice to use this limit. Second, there were two months indicated in the MFR's where the company sold more water than it had pumped and purchased. He testified that the use of a 10% unaccounted for water percentage is reasonable since he was attempting to normalize the test year for going forward expenses.

We find that Intervener Wood's position that a business in a competitive marketplace could not survive with a 10% unaccounted for loss is not applicable in that the amount of acceptable loss of inventory in any business will be unique to that business. It is generally accepted in the water industry that a water system will have some unaccounted for water loss. The only question is how much is acceptable.

The utility reported that 851,020,000 gallons of water were pumped from wells or purchased during the first nine months of the test year, and 764,121,000 gallons were sold or otherwise accounted for, leaving 86,899,000 gallons as unaccounted for water. This results in 10.2% unaccounted for water for the first nine months of the test year. Because the unaccounted for water for 2000 was 9.2% and the unaccounted for water for the first nine months of 2001 was 10.2%, we find it reasonable to use a 10% figure for unaccounted for water for the test year. This is not excessive, and no adjustments for excessive unaccounted for water are necessary.

#### H. Related-Party Purchased Water Transactions

Aloha currently purchases water from four different entities: Tahitian, Interphase, Mitchell, and Pasco County. Both Tahitian and Interphase are related parties to Aloha, whereas Mitchell and Pasco County are non-related parties. Aloha pays royalties for water purchased from its related parties at \$0.32 per thousand gallons and pays Mitchell only \$0.10 per thousand gallons. The purchased raw water expense from both Tahitian and Interphase was \$128,480 for the test year. The current price that Pasco County charges for treated water is \$2.35 per thousand gallons.

Each of the three private parties installed and incurred the original costs of the wells. Aloha has paid for repairs and maintenance and some improvements to the wells since their initial installation. The raw water agreements originated in 1972 for Mitchell, 1977 for Tahitian, and 1978 for Interphase. The original Mitchell agreement in 1972 provided for a charge of \$0.05 per thousand gallons of water extracted, but this rate was increased to \$0.10 in October 1975. The Mitchell rate has not changed since 1975.

The 1977 Tahitian agreement provided for a charge of \$0.10 per thousand gallons of water extracted, but this was increased in 1988 to \$0.25 and in 1992 to \$0.32. The 1978 Interphase agreement started at \$0.10 per thousand gallons of water extracted and was also increased to \$0.32 subsequently.

Utility witness Watford thought that the royalty agreements were the best course available to Aloha for many reasons, and stated that this method of payment has been previously approved by

the Commission in prior cases for Aloha and other utilities. He further argued that the royalty agreements allow Aloha the right to relocate wells at any point in time in the future, without buying land, if an initial location becomes unacceptable, and so it was better than owning the land.

Mr. Watford noted that the Commission approved the unrelated Mitchell property royalty rate in Aloha's 1976 rate case, which contained a 100% increase of the royalty rate (from \$.05 to \$.10). Mr. Watford argues that just because the related party royalty rates charged by Tahitian and Interphase have increased more than that charged for the Mitchell property, that this basis alone is inappropriate to deny the cost. He believes that a better indicator for determining the reasonableness of the related party charge would be to measure the effects of inflation on the amount approved in the 1979 Order.

In addition, Mr. Watford testified that it is unreasonable for the Commission to have approved this methodology for acquiring raw water in the past, and then to suggest now that Aloha should have done something different over the intervening years. Regardless, Mr. Watford argued that we should view the current related-party arrangement in light of the alternative sources of water Aloha has available, which he states is the purchase of bulk treated water from Pasco County. He questioned whether the County would be willing to guarantee the quantities that Aloha needs, and thought that this would also make Aloha a captive customer of the County, and would be unreasonable, unstable and risky, and much more expensive.

Mr. Watford testified that we should recognize the related-party royalty charge as a reasonable cost for providing service, which he believed was at or below the charge that would be imposed by an unrelated entity. Mr. Watford also added that if we deny recognition of the cost of the royalty paid on raw water, Aloha would be forced to use an alternative water source for all of its water needs, which will drive rates even higher.

Mr. Fletcher agreed with Mr. Watford that we included the \$.10 Mitchell charge in the rates determined in Order No. 8450, issued August 29, 1978, in Docket No. 770720-WS. Mr. Fletcher

noted, however, that neither the Tahitian nor Interphase royalty transactions were issues addressed in that case.

Mr. Fletcher stated that in the Florida Cities Water Company (FCWC) case, we reviewed the reasonableness of a related-party royalty agreement for the purchase of raw water. In Order No. PSC-96-0859-FOF-WU, issued July 2, 1996, in Docket No. 951029-WU, we approved operating expenses for a royalty fee of \$0.03 per thousand gallons in perpetuity for raw water extracted. To test the reasonableness of the royalty fee, we compared the original cost of the land when first devoted to public service with the cost of the royalty. In doing this, we found that a third party appraisal at the time the land was sold to a non-related party was an appropriate measure of the original cost of the land necessary for the wells, including required easements. We then took an assumed rate of return and added income, property, and other tax effects to generate an approximate annual expense if the land had been owned by the FCWC. Using this calculation, we found that the royalty fee transaction was less than the original cost estimate and thus approved the \$0.03 per thousand gallons royalty fee.

Mr. Fletcher testified that we specifically addressed Aloha's royalty fees for the purchase of raw water in Docket No. 000737-WS. That docket was an overearnings investigation of the Aloha Gardens water and wastewater systems and the Seven Springs water system. By Order No. PSC-01-1374-PAA-WS, issued June 27, 2001, we attempted to use the same test used in the FCWC case to evaluate Aloha's royalty fees. However, Aloha maintained that its related parties did not have documentation of the original cost of the well and land when first devoted to the service of Aloha ratepayers. In that Order, we found that the utility should have taken the appropriate steps to determine the original cost of the land and wells as of the date the utility began extracting water from these wells in order to test whether the transaction was prudent.

Further, we found that Aloha could have had these lands appraised by an independent appraiser and retained the services of a professional engineer to conduct an original cost study on the wells initially installed. Without this information, we found that we could not evaluate the reasonableness of Aloha's related-party royalty fees at that time. In our Order, we found that it was the utility's burden to prove that its costs were reasonable.

By their very nature, related-party transactions require closer scrutiny. Although a transaction between related parties is not per se unreasonable, it is the utility's burden to prove that its costs are reasonable. Florida Power Corp. v. Cresse, 413 So. 2d 1187, 1191 (Fla. 1982). This burden is even greater when the transaction is between related parties. In GTE Florida, Inc. v. Deason, 642 So. 2d 545 (Fla. 1994), the Florida Supreme Court established that the standard to use in evaluating affiliate transactions is whether those transactions exceed the going market rate or are otherwise inherently unfair. In the Order in the overearnings docket, we directed that the issue regarding the reasonableness of the rates charged by Mitchell, Tahitian, and Interphase be addressed in the instant rate case for the Seven Springs water system.

Mr. Fletcher conducted an analysis of Aloha's royalty agreements with Mitchell, Tahitian, and Interphase. That analysis shows that the Mitchell property contains 6,700 acres on which Aloha can locate its wells as well as a 10-acre water plant, with only a few restrictions. The Tahitian and Interphase agreements relate to only 30 and 638 acres, respectively. Mr. Fletcher expressed concern that the related parties' agreements can be cancelled by Tahitian and Interphase with 30-days written notice. When asked if this provision could be deleted, Aloha responded that it could not. The related-party agreements also contain escalation provisions. Mr. Fletcher noted that the Mitchell and FCWC royalty provisions were analogous in that they were both perpetual and contained a fixed rate. Since the Mitchell agreement was an arm's-length transaction, and having reviewed the other related party agreements, Mr. Fletcher concluded that the Mitchell charge of \$0.10 was reasonable, and was of greater value to Aloha than the related-party purchased water agreements. He added that given the greater value of the Mitchell agreement, the royalty fees charged by the related parties should have been less than that charged by Mitchell.

Mr. Fletcher further concluded that he did not believe that Aloha had met its burden of proof that the royalty fee paid to its related parties for raw water was reasonable. The utility failed to provide the original cost of the land and wells as of the date Aloha began purchasing water from its related parties which would enable us to perform a comparative analysis as we did in the FCWC



case. As such, he could not determine the appropriate royalty fee to allow for the Tahitian and Interphase agreements. Mr. Fletcher testified that, at a minimum, the royalty fee charged by the related parties should be reduced to \$0.10 per thousand gallons. If this adjustment is made, the Seven Springs water system's O&M expenses would be reduced by \$88,330.

Mr. Fletcher further testified that our staff had tried to obtain information to support the original cost of the land and wells when Aloha first began extracting the water, but was unable to obtain that information. He added that had he obtained the information, he would have attempted to perform the same analysis that was done in the FCWC case to test the reasonableness of the charges.

Mr. Fletcher testified that the market rate for raw water purchased up to the level of the WUP was the Mitchell rate. For any water purchased above the WUP, the only available short-term source for treated water would be Pasco County, which currently charges \$2.35 per thousand gallons to its bulk customers. Mr. Fletcher did not agree that the market rate for raw water is equal to the Pasco County rate above the WUP, based, in part, on the fact that the County is the only provider and that a true free market for treated water does not exist.

Mr. Fletcher noted that Mr. Watford testified that the related parties would cease the agreement if they were not paid or if Aloha broke the contract. Mr. Fletcher also noted that Aloha had control of the WUPs, and to the extent that SWFWMD allowed, Aloha could explore transferring the withdrawal allocation limits of the related party wells to either the Mitchell property or other areas within the Seven Springs water system if the related parties canceled the agreements. This was based on the response staff received from SWFWMD, but Mr. Fletcher could not speak to whether SWFWMD would approve it.

Mr. Fletcher testified, however, that there is a market price for the raw water for Aloha because Aloha has the option to purchase from Mitchell, Tahitian, and Interphase up to Aloha's WUP capacity. Above the WUP, Pasco County is the only vendor or option available for treated water.

Mr. Fletcher testified that it is prudent for a utility to use the most cost-effective method and to weigh all costs and benefits to reduce expenses that it incurs. Mr. Fletcher also testified that it would be more prudent to have a source of water which was not interruptible. A cheaper source in the short run may actually not be the best choice if it will ultimately cost you more over the long run. If an interruptible source is disconnected, the utility would have to incur higher costs to find another source, so in the long run the cost could be higher than the non-interruptible source. Mr. Fletcher stated that you have to look at the circumstances of both the long and short-run sources.

Mr. Fletcher testified that even if many wells in that area were going bad in 1977, it would have been prudent for Aloha to perform a cost benefit analysis to consider whether to purchase land and construct wells or enter into long-term royalty agreements with related parties, or use its agreement with Mitchell. He thought that a utility should look at the conditions at the time and any expense that they are going to incur. When asked if he knew whether Aloha did that at the time the royalty agreements were signed, Mr. Fletcher stated that he did not know what the management did or what analyses they performed when they executed the agreements.

Aloha witness Nixon testified that Aloha's purchases have been disclosed in the annual reports filed with this Commission since at least 1978 and that we never objected to the costs until 2000. Even though a Commission audit report disclosed the related party purchases, the issue was not raised in Order No. PSC-99-1917-PAA-WS, which was issued in two limited proceedings. As such, Mr. Nixon stated that one could presume that the related party costs for purchased water were deemed reasonable by the Commission.

Mr. Nixon contended that the principle of regulatory finality should be exercised in this case. In his opinion, going back 24 years to second guess the prudence and cost-effectiveness of Aloha's decisions, when the Commission has not objected to those decisions, was unreasonable and certainly unfair.

Mr. Nixon admitted that Interphase no longer owns the land and does not pay property taxes on those parcels. Mr. Nixon also

agreed hypothetically that had Aloha purchased land and installed its own wells, it would earn a return on the original cost of the land and wells and recognition of depreciation and property tax expenses on the wells.

Mr. Watford testified that the related party property has never been devoted to public service, only leased under a royalty arrangement. To be able to determine the original property value, the cost of condemnation of that property, which he thinks would be high, would have to be considered. While he notes that we did not specifically endorse the arrangements with Mitchell, the related cost was included in rates. Mr. Watford testified that the utility relied upon this tacit approval when Aloha made similar arrangements with a related party. He argues that it is now unreasonable to say that the utility should not have entered into the royalty arrangements, after the Commission specifically recognized such an arrangement for an unrelated third party.

Mr. Watford believes that we must review the related party royalty agreements based on current conditions and that the related party has now agreed to sell treated water to Aloha at the same price charged by the County, which Mr. Watford stated is the current market value. Mr. Watford admitted, however, that he did not know how much it would cost Tahitian or Interphase to provide Aloha treated water. Given the alternatives, Mr. Watford argues that Aloha is better off paying the royalty to its related parties than paying the County price for treated water or seeking some other unknown alternative source. Mr. Watford testified that if we deny recognition of the related party royalty, then an increase should be granted to cover purchasing all water from Pasco County, or to purchase treated water from the related party at a cost similar to that charged by the County.

Finally, Mr. Watford addressed Mr. Fletcher's suggestion and responses from SWFWMD that the utility move to new well locations on property that it purchased. Based on Mr. Watford's discussions with SWFWMD staff, a proposal to move existing or purchase new wells to increase Aloha's capacity has the same requirements as a new permit submittal. Mr. Watford testified that new permits are denied in almost every case and that the likelihood of Aloha getting a new permit was very small.

In Exhibit 31, the utility's interrogatory response stated that prior to 1992, the Commission annual report did not delineate the amount of royalties paid for purchased water by each entity. When questioned by staff, Mr. Watford admitted that the information was not provided to the Commission prior to 1992 and the utility cannot specifically determine the amount of royalties it paid Tahitian from 1977 to 1991. Aloha only provided the information from 1992 through 2000. While the utility did not have that earlier information available to provide, he stated that he was not aware of any requirements to keep records back that far. Regardless, Mr. Watford agreed that the total royalties paid to Tahitian and Interphase from 1992 to 2000 were in excess of \$1 million.

Mr. Watford also testified about a provision in each of the three agreements that states that the owner of the property has first use of the water for agricultural purposes and that the owner will cooperate in every manner with the utility in the SWFWMD. Mr. Watford interpreted this clause to mean that Aloha's right to withdraw water is inferior to that of the owner of the property. According to Mr. Watford, this is an important distinction between the related party contracts and that with Mitchell. The Mitchell Ranch is a large agricultural facility with water needs of its own. Through its relationship with the related parties, which are not agriculture operations, Aloha has the ability to determine who has access to that water. Whereas, under the Mitchell agreement, if Mr. Mitchell decided that he needed all of the water, Aloha would have no water under that agreement.

We find that the related party agreements have significant differences with the Mitchell agreement. Moreover, we find that the utility has failed to meet its burden to show that the related parties royalty fee is reasonable. The Interphase and Tahitian agreements are more expensive, can escalate in price even higher than the current charge, have less land available to use for well and plant sites, and have cancellation clauses with 30 days written notice. Mr. Watford's argument that the Mitchell agreement was less favorable because of Mitchell's agricultural business and first rights to the water use is not convincing. On one hand, Aloha argues that it has control over its related parties for the water rights, but on the other, it states that Aloha has no control over the cancellation clause of the contract.

The utility has failed to show that its decision to enter into a royalty agreement with related parties, rather than use its agreement with Mitchell or purchase land in the 1970's was prudent. During start-up years, all utilities have large initial investments that owners are required to make. Prudent decisions should be made based on a thorough analysis of the expected long-term costs and benefits that a utility will recover over the life of the plant.

Aloha did not have an appraisal of the land performed. Aloha argued that the original cost information did not exist nor was it relevant, that we did not need this in order to determine the reasonableness of the contracted price. Further, Aloha argued that because it is a contract between parties, we should recognize this cost and not discount the contract because it was between related parties. Regardless of its arguments, we do not believe that Aloha has shown that its related party royalties met the test we delineated in the FCWC case for reasonableness.

Aloha also argues that these agreements have existed for over 20 years, were entered into based on our approval of the Mitchell agreement, and the transactions have been reported to the Commission each year since inception. We have never specifically addressed the Mitchell agreement until Order No. PSC-01-1374-PAA-WS. Also, Mr. Watford admitted that the amount paid to the related parties prior to 1992 was not available to Aloha, and the annual reports did not specifically identify these amounts until 1992. Thus, the information has only been available in the annual reports since that time. After an indication of overearnings, we began reviewing the transactions in 1997 or five years after the transactions were reflected in the annual reports. The original royalty fees from the related parties were initially the same as the Mitchell fees and did not reach \$0.32 per thousand gallons until apparently around 1992.

Further, Aloha wants us to accept the related party cost as reasonable because it is cheaper than buying purchased water from Pasco County. Aloha relies on GTE Florida, which provides that the standard must be whether transactions exceeds the going market rate or are inherently unfair.

For purchases of raw water below the limits in Aloha's WUP, we find the market price is set by the Mitchell agreement which was an

arms-length transaction, i.e., \$0.10 per thousand gallons. Moreover, we find that it was imprudent to enter into an interruptible agreement with an escalation clause (the agreements with the related parties), when Aloha had an agreement in perpetuity with no escalation clause (the Mitchell agreement), especially when the Mitchell agreement has many more acres to choose from.

Further, we agree with Mr. Fletcher that Pasco County's rate for treated water is not a comparative market price for the related parties' raw water price. Aloha is comparing a finished product with a raw product, of which the cost to produce for each is very dissimilar.

Based on the above, we find that the utility has not met its burden to prove that the cost of the related party purchased water is reasonable. Further, the 30-day cancellation component in the related party agreements is risky, if not imprudent.

Finally, regarding the administrative finality argument, we note that we only addressed this question for the first time in Docket No. 000737-WS, the overearnings docket. By Order No. PSC-01-1374-PAA-WS, issued June 27, 2001, in that docket, we used the \$0.10 per one thousand gallons cost for both the related parties and Mitchell to determine the appropriate amount of overearnings, and we declined to address the reasonableness of the contracts at that time. Because we left it up to the utility to come in at a later time to prove the reasonableness of the contracts, we do not believe that the doctrine of administrative finality applies in this case.

Based on the above, the royalty fee charged by the related parties should be reduced for regulatory purposes to \$0.10 per one thousand gallons. This reduces purchased water expenses by \$88,330.

#### I. Rate Case Expense

The utility included a \$446,500 estimate in its MFRs for current rate case expense, which the utility revised to \$500,013 at the end of the file and suspend process. The components of the

estimated rate case expense (actual expenses and estimates to complete) are as follows:

	<u>REVISED ESTIMATE PER EXH 24</u>			
	<u>MFR</u>	<u>ACTUAL</u>	<u>ADDITIONAL</u>	
	<u>ESTIMATED</u>	<u>TO DATE</u>	<u>ESTIMATE</u>	<u>TOTAL</u>
Legal	\$250,000	\$110,136	\$166,000	\$276,136
Accounting	150,000	138,237	31,725	169,962
Engineering	40,000	15,755	16,160	31,915
Company Expense	<u>6,500</u>	<u>12,800</u>	<u>9,200</u>	<u>22,000</u>
Total	<u>\$446,500</u>	<u>\$276,928</u>	<u>\$223,085</u>	<u>\$500,013</u>
Annual Amortization	<u>\$111,625</u>			<u>\$125,003</u>

The utility argued that its rate case expense is based on actual numbers where possible, and estimates based on the utility's prior experience in proceedings before the Commission.

Mr. Deterding testified that Aloha's actual and estimated rate case expenses were reasonable in light of the requirements imposed within this rate case. He stated that Aloha and its consultants have been as efficient as possible and tried to keep rate case costs to a minimum where they could. Mr. Deterding believed that the time and costs incurred have been prudent and appropriate.

Section 367.081(7), Florida Statutes, provides:

The commission shall determine the reasonableness of rate case expenses and shall disallow all rate case expenses determined to be unreasonable. No rate case expense determined to be unreasonable shall be paid by a consumer.

We have examined the requested actual expenses, supporting documentation, and estimated expenses for the current rate case. Based on our review of the record, we find that several adjustments are necessary.

1. Duplicate Interim Rate Requests

During cross examination by our staff, Mr. Nixon agreed that the Commission determined in Order No. PSC-01-1374-PAA-WS, issued

June 27, 2001, in Docket No. 000737-WS, that the Seven Springs water system had excess earnings for the historical test year ending December 31, 2000. He also agreed that our staff's recommendation on overearnings for that decision was filed on May 31, 2001, and shortly afterwards it would have been available to counsel for Aloha and the utility.

Notwithstanding that, Mr. Nixon testified that on August 10, 2001, the utility filed an interim rate request and used the historical 2000 test year, the same year in which we had already determined overearnings to exist. The company subsequently withdrew its first interim request and filed a revised request based on the test year ended June 30, 2001. Mr. Nixon agreed that we approved interim rates based on this revised test year. Mr. Nixon stated that he had prepared an exhibit, filed a few days before the hearing, that detailed the rate case expense associated with the utility's revised interim filing. Exhibit 25 listed \$1,900 for legal and \$3,556 for accounting costs associated with the duplicate filing.

OPC witness Larkin testified that he did not think a utility should recover rate case expense for two interim requests due to an error and subsequent change in test year. Aloha was aware, prior to its filing, that the original interim test year would not reflect earnings below the minimum of the range on its return on equity, as required by the interim statute, Section 367.082, Florida Statutes. The record reflects that these costs were duplicative, and, therefore, unreasonable. As such, we find that total rate case expense shall be reduced by \$5,456, to reflect these duplicative expenses.

## 2. Estimated Costs to Complete the Case

Exhibit 24 breaks legal services into actual costs incurred through November 30, 2001, and estimated rate case expense through post-hearing. The legal costs to complete this case were estimated at \$166,000, which included 790 billable hours and \$8,000 in expenses. The hours were broken down into 4 sections: review and preparation of testimony pre-hearing (250 hours); hearing preparation and late-filed exhibits (250 hours); review of transcripts through final order (200 hours); and reconsideration (90 hours). The utility's breakdown for each of these sections



included a description of items to be performed but no specific amount of time associated with each item. It only provided a total number of hours, as well as costs, for each section. While the descriptions of items appeared reasonable, we have no basis to determine whether the individual hours estimated were reasonable. On the other hand, Aloha's other consultants prepared detailed estimates broken down by hour for each item listed for them.

It is the utility's burden to justify its requested costs, with no exceptions made for rate case expense. Florida Power Corp. v. Cresse, 413 So. 2d 1187, 1191 (Fla. 1982). It has long been our policy to require detailed estimates to complete the case. In reviewing these estimates, we have the opportunity to determine the types of items for which the utility is requesting recovery of and the prudence of any items and time spent.

We enjoy a broad discretion with respect to allowance of rate case expense. Florida Crown Util. Servs., Inc. v. Utility Regulatory Bd. of Jacksonville, 274 So. 2d 597, 598 (Fla. 1st DCA 1973). Nevertheless, it would constitute an abuse of discretion for us to automatically award rate case expense without reference to the prudence of the costs incurred in the rate case proceedings. Meadowbrook Util. Sys., Inc. v. FPSC, 518 So. 2d 326, 327 (Fla. 1st DCA 1987), rehearing denied, 529 So. 2d 694 (Fla. 1988).

The record shows that a substantial amount of work was performed by Aloha's attorneys, as evidenced by attendance at the formal proceedings, exhibits filed, and brief preparation. Based on this record evidence and on past experience in determining allowable rate case expense, we find that it is reasonable to allow the utility 400 hours for estimated legal costs at \$200 per hour and \$5,000 in expenses. We find that a reasonable breakdown of this would be 240 hours for prehearing preparation and attendance at the hearing and 160 hours for post-hearing work through the final order. This adjustment results in a reduction to legal rate case expense of \$63,000.

Aloha estimated 90 hours, or \$18,000, plus \$500 in expenses for reconsideration costs. The utility's request for these costs is premature. If in fact any motions for reconsideration are filed, any increased costs can be addressed by us at that time.

In reviewing the accounting estimate to complete, Aloha requested \$2,600 for costs labeled "Miscellaneous for Discovery and Additional Exhibits," which is listed after the review of the Final Order. There were no additional accounting exhibits or discovery that was not specifically identified in the estimate to complete or that will be required after the Final Order is issued. As such, we have removed these amounts from rate case expense.

Our summary of rate case expense adjustments discussed above follows:

<u>Legal Adjustments</u>		<u>Accounting Adjustments</u>	
Duplicate Interim Filing	\$ 1,900	Duplicate Interim Filing	\$3,556
Undocumented & Excessive Hours Estimate	63,000	Undocumented & Excessive Hours Estimate	2,640
Reconsideration	<u>18,500</u>		<u>1,237</u>
Total	<u>\$83,400</u>	Total	<u>\$6,196</u>

### 3. Water Rate Case Filing

OPC witness Larkin testified that he did not believe the rate case expense projected by Aloha was reasonable. Aloha filed two rate cases essentially one right after the other. The two cases were for the same service area: the first for Seven Springs wastewater and the second for Seven Springs water. Had Aloha consolidated its recently completed wastewater rate case, which was filed in February 2000, with this current water case, he asserts that Aloha would have avoided virtually the entire amount of rate case expense associated with this case. He stated that the utility could have filed simultaneously, with a little planning on its part, as is typical in most water and wastewater rate cases. Based on Mr. Larkin's testimony, OPC witness DeRonne suggested adjustments to remove the proposed average unamortized balance for rate expense of \$223,250 from working capital, and to remove the utility's proposed amortization of rate case expense for the current case of \$111,625.

The utility disagreed that it could have filed the rate increase at issue here with its last wastewater rate case. The utility testified that its customers would not have benefitted in

1999 had the utility filed a water rate request with its wastewater case.

The utility also argued that it was not clear whether the issue of a conservation oriented inclining-block rate structure would have been addressed at the time the wastewater rate case was filed. According to the utility, its customers had actually benefitted by not combining a water rate case with the wastewater case.

The utility argued that the only way that Aloha could have justified a rate increase was if it had proposed to begin purchasing water from Pasco County several years ago. If Aloha had done that, the long-run cost to the customers would have been higher because that additional purchased water cost would have far outweighed any savings by combining two rate cases.

We find that Mr. Larkin's argument has merit. Aloha could have easily filed a combined rate case for its water and wastewater systems. We disagree with Mr. Watford that the only way it could have received rate relief in prior years was for Aloha to purchase water from Pasco County. As addressed above, Aloha had many improvements it could have made to its plant to improve its water quality or to find a new source of water. Instead, Aloha continually failed to act unless it is specifically ordered to do so by a regulatory agency.

As Mr. Nixon admitted, by Order No. PSC-97-0280-FOF-WS, issued March 12, 1997, Aloha was put on notice that a rate restructuring would be necessary. Water quality issues began surfacing in 1995. See Order No. PSC-00-1285-FOF-WS, issued July 14, 2000. According to SWFWMD witness Parker, Aloha began to consistently exceed the permitted annual average day withdrawal in 1996 with some exceedings as early as 1994.

Messrs. Watford and Nixon both stated that costs would have been greater in the long run if Aloha had filed an earlier rate case that included the increased cost for purchased water from Pasco County. Had Aloha taken a proactive approach to address its quality of water and supply issues years ago, any necessary plant could have been in service for several years. In addition, Aloha could have easily increased its service availability charge during

that time frame to defray its investment in the plant improvements and expansion costs. This is especially true in light of the substantial growth that occurred in this system.

Further, Mr. Watford testified that Aloha prudently investigated other alternatives for purchasing water from another source other than the County and Aloha's customers have benefitted from this approach. If Aloha did in fact perform any such cost benefit analyses, it has not provided any support in the record of this case. Absent such evidence, we cannot determine if Aloha's choice of purchasing water from Pasco County was indeed the most cost effective alternative that was available. We could also have determined that what Aloha chose to do was not the most cost effective and as a result, the long-term cost for Aloha customers may have been less. Without this supporting information, we cannot make a determination of which alternative was the most cost effective.

Mr. Watford also stated that he knows of no case in Florida or any other jurisdiction where a proposal has been made to eliminate rate case expense, much less where the proposal has been accepted. We disagree. We have addressed numerous cases where imprudent expense has been alleged as well as denied.

In Order No. PSC-98-1583-FOF-WS, issued November 25, 1998, in Docket No. 971663-WS, where Florida Cities Water Company was seeking recovery of court costs (and the rate case expense associated with the docket filing), we found that the incurrence of rate case expense was imprudent and denied the utility's request for recovery. Also, in Order No. PSC-96-1320-FOF-WS, issued October 30, 1996, in Docket No. 950495-WS, we denied legal rate case expense of \$25,000 incurred for what we deemed an imprudent appeal of our oral decision on interim rates. In addition, in Order No. 18960, issued March 7, 1988, in Docket No. 861338-WS, we determined that expenditures for misspent time were imprudent and reduced the requested rate case expense by \$32,500. Finally, in each of its three prior requests for limited proceeding, all rate case expense requested by Aloha was denied because we determined that the utility was earning a fair rate of return or the case was dismissed as an improper filing.

As discussed above, it is the utility's burden to prove that its requested costs are reasonable. We find that filing combined water and wastewater rate cases would have resulted in material cost savings, and the customers should not be made to pay because Aloha incurred imprudent rate case expense. While a combined filing would have greatly reduced costs, we acknowledge that there would have been incremental costs. Although we have no method to determine those incremental costs, we believe that the total time for hearings, depositions, and preparation of testimony would have been reduced significantly. Also, notices and travel requirements would not have to have been duplicated. We believe it is reasonable that as much as 50% of the costs of this rate case could have been avoided if it had been filed in conjunction with the wastewater case. Therefore, we shall only allow 50% of the adjusted rate case expense.

Our breakdown of the allowance of rate case expenses is as follows:

	<u>UTILITY REVISED ACTUAL &amp; ESTIMATE</u>	<u>LESS COMM. ADJUST- MENTS</u>	<u>COMM. ADJUSTED BALANCE</u>
Legal	\$276,136	\$83,400	192,736
Accounting	169,9621	6,196	163,766
Engineering	31,915	0	31,915
Company Expense	<u>22,000</u>	<u>0</u>	<u>22,000</u>
Total	<u>\$500,013</u>	<u>\$89,596</u>	<u>410,417</u>
50% Allowance			<u>205,209</u>

Based on the record and our adjustments discussed above, total current rate case expense of \$205,209 shall be allowed. Pursuant to Section 367.0816, Florida Statutes, rate case expense shall be amortized over 4 years. This results in an annual rate case expense of \$51,302. Based on this allowance, an adjustment shall be made to O&M expenses of \$60,323 to decrease the amount requested by the utility in its MFRs.

J. Conservation Programs

With respect to conservation programs, Aloha shall be allowed to recover \$120,000 in its rates for monthly service for the implementation of conservation programs as described below.

In its initial filing, the utility requested a rate structure consisting of a base facility charge (BFC) and a two-tier inclining block rate. Under its proposal, the base facilities charges and the first tier gallonage charges would be set to recover all of the approved revenue requirements, while the revenue from the second tier gallonage charges would be used to fund conservation programs. A similar concept was presented in SWFWMD's witness Sorenson's testimony. She advocated adopting inclining block rates to encourage conservation and allowing the utility to set rates to create a water conservation fund to help pay for programs. The utility insisted that programs must be funded up front because benefits may only appear months or even years following program implementation, causing the utility financial harm until such cost savings are realized.

OPC witness DeRonne objected to the over collection of revenue requirements proposed by the utility because it would give the utility a "blank check" at ratepayers expense. She stated that the utility should, instead, justify any proposed conservation expenditures and allow us to determine if such costs should be included in the utility's revenue requirement. Staff witness Stallcup also indicated that if the costs of conservation programs are included in the approved revenue requirement for rate setting purposes, then those costs should be balanced against cost savings associated with a reduction in usage.

All parties are in agreement that conservation programs are desirable to mitigate the impact on the potable water supply in the area, and that the programs need to be funded. On February 20, 2002, Aloha filed the executed signature page of the Consent Order entered into by the utility and the SWFWMD which incorporates several recommended conservation initiatives that the utility agreed to implement. We find it appropriate that all but one of the proposals be funded at this time.

As part of the Consent Order with the SWFWMD, Aloha committed to the projects and the estimated costs as shown below:

Program	Estimated Incremental Cost
1. Customer Direct Mail Billing Inserts to educate customers on water usage and conservation programs and techniques	No incremental cost as Aloha currently provides informational bill stuffers
2. Free Customer Retrofit kits such as low flow showerheads, faucet aerators, leak detection tablets, replacement flapper valves, and educational information	\$25,000
3. Water conservation Pilot Program - provide credits or rebates for installation of high efficiency water heaters, and low flow toilets and monitor the effectiveness of the installations	\$30,000
4. Mixed Media Conservation Messages - print and broadcast media advertising to promote conservation	\$15,000
5. Water Auditor - new staff member to implement and promote consumer conservation projects	\$38,000
6. Additional staffing to assist in administering and monitoring conservation efforts	\$30,000
7. Web site to promote utility specific conservation programs and provide links to other conservation oriented information	\$12,000

All parties agree that Aloha needs to aggressively pursue conservation to reduce demand on the state's limited potable water supply. SWFWMD witness Sorenson advocated the use of pilot programs which can then be used to design and target more effective future conservation programs. While the exact savings of the programs can not be quantified at this time, we agree that the proposed expenditures shown above appear reasonable to allow Aloha to explore the options presented and thus find that \$120,000 be included in the utility's revenue requirement to fund the proposed conservation programs.

However, we shall disallow the utility's requested expense for the new position to assist in administering conservation efforts, in the amount of \$30,000, as shown in Item 6 above. As noted by SWFWMD witness Sorensen, it will take some time to get programs in place so that any measurable savings can be realized. Adding a Water Auditor to develop the programs should be adequate to get the programs off the ground. If the programs prove successful and have a high penetration rate, we can reconsider approving the expense for a second position at a later date in another proceeding.

#### K. Test Year Operating Income

Based on the adjustments discussed above, we find that the test year operating income before any provision for increased revenues is \$117,714. The schedule for operating income is attached as Schedule No. 3-A, and the adjustments to operating income are listed on attached Schedule No. 3-B.

### VIII. REVENUE REQUIREMENT

The computation of the revenue requirement is shown on Scheduled No. 3-A and is \$1,979,140, which represents neither an increase nor a decrease.

### IX. RATES AND CHARGES

The utility requested final rates designed to produce revenues of \$3,044,811. The requested revenues would have represented an increase of \$1,077,337 or 54.76%, and would have been based on the utility's requested overall rate of return of 9.07%.

Consistent with our findings above, the final rates approved for the utility's Seven Springs water system shall be designed to produce annual revenues of \$1,979,140. This will allow the utility the opportunity to recover its expenses and earn an 8.52% return on its investment in rate base.

#### A. Rate Structure

We further find that the appropriate rate structure for residential customers is a BFC and two-tier inclining-block rate structure. The usage blocks shall be for monthly usage of: 1) 0-



10,000 gallons; and 2) in excess of 10,000 gallons. The rate in the second usage block shall be 1.25 times greater than the rate in the first block, with a BFC cost recovery allocation of 25.3%. The traditional BFC and uniform gallonage charge rate structure shall be implemented for the General Service class. All gallonage allotments included in the BFC shall be eliminated.

The utility's current residential rate structure utilizes a BFC of \$7.32, which includes a 3 Kgal minimum allowance, and a uniform gallonage charge of \$1.32/Kgal for usage in excess of 3 Kgal. The utility proposed to remove the 3 Kgal allowance from the BFC and implement a two-tier inclining block rate structure to encourage conservation, in compliance with the wishes of the SWFWMD. We concur with the proposal to implement an inclining-block rate structure and the removal of the initial usage from the BFC. The utility, however, proposed to recover all of its revenue requirements through the BFC and first tier, with the revenue from the second tier going towards conservation programs. Since we have allowed the cost of conservation programs to be included in the total revenue requirement, there is no longer any basis for setting rates to recover more than the approved revenue requirement.

Given Aloha's current low rates, and the desire to remove the 3 Kgal allowance from the BFC, our first decision in designing rates is to determine how much of the revenue requirement should be recovered in the BFC. As a general rule, the more costs that are recovered through fixed charges, the more stable the utility's earnings. However, if the BFC collects too much revenue, the resulting usage charges are too low, or the tier breakpoints too small, resulting in a failure to send meaningful conservation signals. An important guideline established by the SWFWMD is to recover no more than 40% of the overall revenue requirement through the BFC. The utility proposed a 32%/68% split, with the first block recovering the full revenue requirements. This ratio is consistent with the water management district guidelines that we commonly use. However, SWFWMD witness Yingling also indicated that the fixed charge portion of the bill should be kept to the minimum commensurate with the need for revenue stability.

Based on the revenue requirement approved above, analysis shows that recovering 30% or more of recommended revenues through the BFC would result in gallonage rates below acceptable levels.

In order to keep gallonage charges at or above current levels, we find it appropriate to set the percentage recovered through the BFC at 25.3%. This is only lower than the 32% offered by the utility and slightly above the level of 25% recommended by staff witness Stallcup. We find that our decision allows for the design of meaningful inverted block rates.

**Comparison of Conservation Adjustment  
 Between BFC and Usage Charge**

Current BFC<sup>1</sup> \$7.32  
 Current Gal. Chg above 3 gallons \$1.32

% Revenue requirement recovered through BFC	25%	28%	30%	32%
BFC w/o 3Kgal	\$4.02	\$4.44	\$4.75	\$5.08
Gallonage charge Block <sup>1</sup>	\$1.38	\$1.33	\$1.29	\$1.25
BFC greater than current? <sup>2</sup>	Yes	Yes	Yes	Yes
Block 1 charge greater than current?	Yes	Yes	No	No

<sup>1</sup> Current BFC includes a 3 Kgal allotment

<sup>2</sup> Current BFC after removal of 3 Kgal allotment =  $\$7.32 - (3 \times \$1.32) = \$3.36$

Recovery of 74.7% of the revenue requirement through usage sensitive charges results in a BFC (without any gallon allowance) of \$4.02. Witness Watford questioned setting the new BFC at a level less than the current BFC as contradictory to Commission practice. However, since the current BFC includes 3 Kgal of usage, a more appropriate comparison is to subtract the cost of the 3 Kgal at the current gallonage charge, to determine whether the level of the proposed BFC is justified. Removing the cost of the 3 Kgal from the BFC at current rates [ $7.32 - (3 \times \$1.32)$ ] equals a BFC without a gallonage allotment of \$3.36 compared with our approved

BFC of \$4.02. Therefore, the proposed BFC is greater than the adjusted current BFC.

Witness Stallcup initially proposed a three tier rate structure with blocks of 0-8, 8-15, and over 15 Kgal/month. However, given the revenue requirements recommended above, and recovering 25.3% of the revenue requirement through the BFC and 74.7% through the gallonage charge, a three-tier structure would have required the initial tier to fall below the current level of \$1.32. The lower first block combined with the lower BFC would have raised the possibility of revenue instability to an unacceptable level. Therefore, we find it appropriate to approve a two-tier structure with blocks of 0-10 Kgal and above 10 Kgal/month. This increases the first tier rates slightly from \$1.32 to \$1.38 for usage up to 10 Kgal/month and sets the second tier at \$1.72 for usage in excess of 10Kgal/month. We are sensitive to the utility's need for some measure of revenue stability. The approved breakpoint for the tiers leaves 68% of the total gallons sold in the first tier, which mitigates the concerns about revenue stability.

In addition, Exhibit 29 shows that 10 of the 30 subdivisions have average usage in excess of 10 Kgal/month. These two conditions further mitigate concerns about revenue stability resulting from the lower BFC. We find that the differential between tiers will provide a small but meaningful first step in sending a conservation signal to high-end users. In a previous case, we determined that setting breakpoints below 10,000 gallons may adversely impact non-discretionary usage for larger families. (See Order PSC-00-0807-PAA-WU, Docket No. 991290-WU) Since the utility maintains its service territory is becoming more family oriented, we find that this 10 Kgal tier breakpoint is appropriate at this time.

One of our concerns in designing rates is to minimize the impact on low users who may be at or near non-discretionary usage levels. Even with the decrease in the BFC, customers who currently use 3 Kgal or more will see an increase in their bills, primarily due to the removal of the 3 Kgal allowance. With the slightly higher first tier rate, customers using 3 Kgal/month will see an increase of 11%, or \$0.84, in their monthly bills. The percentage increase declines to a low of 7% for usage at 15

Kgal/month. On the other end of the usage spectrum, however, significant increases of 20% or greater affect customers using over 50 Kgal/month. The following chart shows representative increases for selected levels of usage:

**Impact of Proposed Rates on Usage Levels**

Thousand gallons	Current Price	Approved Price	Amount	% Change
0	7.32	4.02	-3.30	-45%
1	7.32	5.40	-1.92	-26%
2	7.32	6.78	-.54	-7%
3	7.32	8.16	0.84	11%
4	8.64	9.54	0.90	10%
5	9.96	10.92	0.96	10%
6	11.28	12.30	1.02	9%
7	12.60	13.68	1.08	9%
8	13.92	15.06	1.14	8%
9	15.24	16.44	1.20	8%
10	16.56	17.82	1.26	8%
15	23.16	24.72	1.56	7%
20	29.76	33.32	3.56	12%
50	69.36	84.92	15.56	22%
75	102.36	127.92	25.56	25%
150	201.36	256.92	55.56	28%
200	267.36	342.92	75.56	28%

SWFWMD advocates an aggressive inclining block rate structure, and we believe, given the approved revenue requirement, the proposed structure will put customers on notice that increased

usage comes with a higher price tag. Should the utility justify higher revenue requirements in the future, the blocks and rates can be adjusted to increase the pricing signals to high users.

#### B. Repression of Consumption

Due to the revenue requirement not increasing and the minimal increase in the second tier rates, we do not find it appropriate to include a repression adjustment in determining consumption for setting rates. Past Commission decisions indicate minimal repression (0-4%) in several cases, even where multiple tier inclining block rates were implemented along with a rate increase. (See Dockets 970164-WU, 980445-WU, 990535-WU, 010403-WU) In this case, the rate structure is revenue neutral because there is no increased revenue requirement. In addition, the utility maintained throughout the hearing that its expected usage was higher than either our staff or OPC projected, and that new customers would use more than current customers. If the utility's projections prove more accurate than the forecast approved here, setting rates on the forecast approved above results in rates higher than those that would have been generated using the utility's forecast.

With the approved inclining-block rates, the additional revenues from the higher block should offset any reduction in revenue due to decreases in usage. We do, however, find it appropriate to adjust residential consumption downward by 2.5% to account for the reduction in usage resulting from implementation of conservation programs. The projected annual savings cited in the Consent Order were 5% per year. SWFWMD witness Sorensen also testified that many of the programs will likely take years to reap results. Therefore, we find that adjusting consumption to reflect the full effect of conservation would overstate the benefits of the programs' initial implementation.

#### C. Monthly Service Rates

The appropriate monthly rates are as follows:

**Residential Service Water Rates**

Meter size	Current	Commission Approved
<b><u>BFC</u></b>		
5/8" x 3/4"	\$7.32 (includes 3Kgal)	\$4.02
3/4"	\$0.00	\$6.03
1"	\$0.00	\$10.05
1 1/2"	\$0.00	\$20.10
<b><u>Usage charges</u></b>		
Per 1,000 gals		
0 - 3,000 gals	\$0.00	\$1.38
3,000-10,000	\$1.32	\$1.38
Over 10,000 gals	\$1.32	\$1.72

**General Service Rates**

Meter Size	Current	Commission Approved
<b><u>BFC</u></b>		
5/8" x 3/4"	\$7.32*	\$4.02
1"	\$19.46*	\$10.05
1 1/2"	\$36.49*	\$20.10
2"	\$58.80*	\$32.16
3"	\$116.83*	\$64.32
4"	\$182.85*	\$100.50
6"	\$282.76*	\$201.00
8"	\$577.67*	\$321.60
10"	\$841.62*	\$462.30

\*Current General Service BFC include minimum gallonage allowances.

**Usage Charges**

All usage Per 1,000 gals	\$1.32	\$1.49
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In addition, tariffs shall reflect that the Vacation Rate shall be set at the new BFC of \$4.02.

These rates, also shown on the attached Schedule No. 4, are designed to produce revenues of \$1,979,140, excluding miscellaneous service charge revenues. The utility shall file revised tariff sheets and a proposed customer notice to reflect our approved rates. The approved rates shall be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-30.475(1), Florida Administrative Code. The rates shall not be implemented until our staff has approved the proposed customer notice, and the notice has been received by the customers. The utility shall provide proof of the date notice was given no less than 10 days after the date of the notice.

A comparison of the utility's original and requested rates, the approved interim rates, and the approved final rates is shown on attached Schedule No. 4.

#### D. Service Availability Charges

The utility currently has a temporary interim plant capacity charge of \$500 in effect for the Seven Springs water system. This temporary plant capacity charge was approved in Order No. PSC-00-1285-FOF-WS, issued July 14, 2000, in Docket No. 960545-WS. This temporary charge is subject to refund, and pursuant to that Order, on February 1, 2001, Aloha filed an application for an increase in service availability charges, which was assigned Docket No. 010156-WU. The establishment of a final charge should occur at the conclusion of that service availability docket. Aloha's original plant capacity charge for its Seven Spring's water system is \$163.80, and the difference of \$336.20 per connection is being held subject to refund.

Representative Fasano testified that during his time in office, finding a solution to the on-going problems facing Aloha's customers, who are also his constituents, has become one of his top priorities. Mr. Fasano testified that since 1996, his suggestion for resolution has been that Aloha increase its impact fees to make them competitive with those of Pasco County. He stated that if those costs had been ordered years ago, given the phenomenal growth in the Aloha service area times the higher impact fees, revenue would have been generated that is needed today for Aloha's improvements. He stated this choice would not have burdened the existing customer. While this revenue has been lost over the past

three years, Mr. Fasano stated he still believed it would be in the best interest of the existing customers to place the burden of the future customers on those future customers. Mr. Fasano further testified that if Aloha's impact fees would be raised to a level competitive with those charged by the surrounding Pasco County utilities, then the need for this rate increase application and those in the future would probably diminish.

Aloha witnesses Porter and Watford provided testimony on future plant additions that Aloha projected in the near-term. They stated that, at this time, the potential chemistry of Pasco County's modified water is yet to be defined. Until this information was known, it would be imprudent to move ahead, from a technical standpoint, and construct any of the pilot project facilities until a full and complete engineering analysis of the combined effects of all the chosen alternatives can be completed. To do otherwise may result in substantial costs that could be found to be unusable or unneeded when the final analysis is completed.

On cross examination by staff, Mr. Watford testified that the utility is not proposing any increase to its plant capacity charge in this rate case and referred to Docket No. 010156-WU, the open service availability docket. However, Mr. Watford stated that the utility was certainly not averse to increasing the charge.

Pursuant to Section 367.101, Florida Statutes, we must set just and reasonable charges for service availability. As addressed above, we have ordered Aloha to address numerous components of its quality of service as well as critical water supply concerns. We agree with Representative Fasano that a higher plant capacity charge can defray the cost of these looming, yet unknown, plant improvements or expansion costs, and allow the future growth to pay for the future customers' own burdens instead of placing them on existing customers. Since Aloha is in such a high growth area and the new customers being added to the system are high-end users, the plant capacity charge should be more reflective of the Pasco County charge in effect.

The current Seven Springs wastewater plant capacity charge is \$1,650. We find that it is reasonable to increase the water plant capacity charge to \$1,000 on an interim basis to offset future plant requirements necessary to address solutions to the black



water and long-term waster supply issues. In establishing a capacity charge, we normally include reliable estimates of plant additions and customer growth projections, by year, to make sure the proposed charge will allow the utility to be in compliance with the contribution levels required by Rule 25-30.580, Florida Administrative Code. While we do not have all of the necessary information at this time, we still believe that an interim charge is appropriate to continue offsetting the future cost of major plant requirements.

Therefore, the new interim service availability charge for water shall be \$1,000, with the difference between \$163.80 and \$1,000 being subject to refund. Aloha shall deposit this difference in its current interest bearing escrow account to guarantee the interim funds collected subject to refund. The escrowed funds shall not be released until we have verified that Aloha has sufficiently invested in the required plant improvements. All other escrow requirements as established by this Commission in Order No. PSC-00-1285-FOF-WS, issued July 14, 2000, shall continue to apply.

Revised tariff sheets and a proposed customer notice shall be filed by April 30, 2002, to reflect the \$1,000 interim plant capacity charge. The proposed notice shall include the date the notice will be issued; a statement that the utility is increasing its water plant capacity charge for new connections to the Seven Springs water system from an interim charge of \$500 per ERC to \$1,000 per ERC, on a temporary basis, subject to refund; the utility's address, telephone number, and business hours; and a statement that any comments concerning the charge should be addressed to the Director of the Division of the Commission Clerk and Administrative Services at 2540 Shumard Oak Boulevard, Tallahassee, FL 32399-0870. The approved charge shall be effective for connections made on or after the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(2), Florida Administrative Code, providing the appropriate notice has been made.

The notice shall be mailed or hand delivered to all persons in the service area who have filed a written request for service within the past 12 calendar months or who have been provided service within the past 12 calendar months. In addition, the utility shall publish a copy of the approved notice in a newspaper

of general circulation in its service area within 10 days of our staff's approval of the notice. The utility shall provide proof of the date the notice was given within 10 days after the date of the notice.

X. INTERIM REFUNDS

By Order No. PSC-01-2199-FOF-WU, issued November 13, 2001, we approved interim rates subject to refund with interest. Rates were increased by 15.95%, pursuant to Section 367.082, Florida Statutes. The approved interim revenue from these rates is shown below:

	Test Year	\$	Revenue	%
	<u>Revenues</u>	<u>Increase</u>	<u>Requirement</u>	<u>Increase</u>
Water	\$1,737,086	\$272,206	\$2,009,292	15.67%

According to Section 367.082(4), Florida Statutes, any refund must be calculated to reduce the rate of return of the utility during the pendency of the proceeding to the same level within the range of the newly authorized rate of return. Adjustments made in the rate case test period that do not relate to the period interim rates are in effect should be removed.

In this proceeding, the test period for establishment of interim rates was the twelve months ended June 30, 2001. The test year for final rates purposes was the projected year ended December 31, 2001. The approved interim rates did not include any provisions or consideration of pro forma adjustments in operating expenses or plant. The interim increase was designed to allow recovery of actual interest costs, and the floor of the last authorized range for equity earnings. Included in the interim test year were three months of expenses for purchased water from Pasco County.

To establish the proper refund amount, we calculated a revised interim revenue requirement utilizing the same data used to establish final rates. Rate case expense was excluded, because it was not an actual expense during the interim collection period. Aloha did not purchase water from Pasco County during the interim collection period. The interim collection period is from

November 13, 2001 to the date that Aloha implements the final rates approved.

Using the principles discussed above, we calculated the interim revenue requirement from rates for the interim collection period to be \$1,914,375. This revenue level is less than the interim revenue of \$2,009,292, which was granted in Order No. PSC-01-2199-FOF-WU. This results in a 4.87% refund of interim rates, after miscellaneous revenues have been removed.

Accordingly, we find that the utility shall refund 4.87% of water revenues collected under interim rates. The refund shall be made with interest in accordance with Rule 25-30.360(4), Florida Administrative Code. The utility shall submit proper refund reports pursuant to Rule 25-30.360(7), Florida Administrative Code. The utility shall treat any unclaimed refunds as CIAC pursuant to Rule 25-30.360(8), Florida Administrative Code.

#### XI. FOUR-YEAR RATE REDUCTION

Section 367.0816, Florida Statutes, requires that rates be reduced by the amount of the rate case expense previously included in the rates immediately following the expiration of the four-year period. The reduction will reflect the removal of \$53,720 of revenues associated with the amortization of rate case expense and the gross-up for regulatory assessment fees. The reduction in revenues will result in the monthly rate reduction shown on Schedule No. 5.

The utility shall file revised tariff sheets no later than one month prior to the actual date of the required rate reduction. The utility shall also file a proposed customer notice setting forth the lower rates and the reason for the reduction.

If the utility files this reduction in conjunction with a price index or pass-through rate adjustment, separate data shall be filed for the price index and/or pass-through increase or decrease and the reduction in the rates due to the amortized rate case expense.

Based on the foregoing, it is

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ORDERED by the Florida Public Service Commission that the application by Aloha Utilities, Inc., for increased rates and charges for water service for the Seven Springs water system is hereby denied in part and granted in part as set forth in the body of this Order. It is further

ORDERED that each of the findings contained in the body of this Order is hereby approved in every respect. It is further

ORDERED that all matters contained herein, whether set forth in the body of this Order or in the schedules attached hereto are, by reference, expressly incorporated herein. It is further

ORDERED that Aloha Utilities, Inc. shall make improvements to Wells Nos. 8 and 9, and then to all its wells, to implement a treatment process designed to remove at least 98 percent of the hydrogen sulfide in its raw water. Such improvements to all of Aloha's Seven Springs water system shall be placed into service by no later than December 31, 2003. It is further

ORDERED that Aloha Utilities, Inc. shall submit a plan within 90 days of the date of this Final Order showing how it intends to comply with our requirement to remove hydrogen sulfide. It is further

ORDERED that Aloha shall file a revised tariff that reflects the current bill within 30 days of the date of this Final Order. It is further

ORDERED that Aloha shall have its billing format changed along with revised tariff sheets reflecting this change within 120 days of the date of this Final Order. It is further

ORDERED that Aloha Utilities, Inc. shall implement the five customer service measures described in the body of this Order, within 120 days of the date of this Final Order. It is further

ORDERED that Aloha Utilities, Inc., shall implement the conservation programs as described in this Order. It is further

ORDERED that, prior to the implementation of the rates and charges approved herein, Aloha Utilities, Inc., shall submit, and

have approved, revised tariff sheets. The revised tariff sheets shall be approved upon staff's verification that they are consistent with this decision and that the proposed customer notice is adequate. It is further

ORDERED that the rates approved herein shall be effective for service rendered on or after the stamped approval date of the revised tariff sheets in accordance with Rule 25-30.475, Florida Administrative Code, provided the customers have received notice. It is further

ORDERED that, prior to the implementation of the rates and charges approved herein, Aloha Utilities, Inc., shall submit a proposed customer notice pursuant to Rule 25-22.0407(10), Florida Administrative Code, reflecting the appropriate rates and charges, and explaining the rates and charges and the reasons therefor. It is further

ORDERED that Aloha Utilities, Inc., shall provide proof of the date notice was given within 10 days after the date of the notice. It is further

ORDERED that Aloha Utilities, Inc., shall make refunds with interest pursuant to Rule 25-30.360, Florida Administrative Code, as set forth in the body of this Order. It is further

ORDERED that Aloha Utilities, Inc., shall submit proper refund reports in accordance with Rule 25-30.360(7), Florida Administrative Code. It is further

ORDERED that Aloha Utilities, Inc., shall treat any unclaimed refunds as contributions-in-aid-of-construction pursuant to Rule 25-30.360(8), Florida Administrative Code. It is further

ORDERED that the temporary water service availability charges shall be increased from \$500 to \$1,000, with the difference between the \$1,000 and \$163.80 being held subject to refund. It is further

ORDERED that Aloha Utilities, Inc. shall deposit the difference between \$1,000 and the current charge of \$163.80 for its temporary water service availability charges in its current interest bearing escrow account to guarantee the interim funds

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collected subject to refund. The escrowed funds shall not be released until the Commission has verified that Aloha has sufficiently invested in the required plant improvements. All other escrow requirements as established by us in Order No. PSC-00-1285-FOF-WS, issued July 14, 2000, shall continue to apply. It is further

ORDERED that Aloha Utilities, Inc. shall file revised tariff sheets and a proposed customer notice by April 30, 2002, to reflect the \$1,000 interim plant capacity charge. The proposed notice shall include the date the notice will be issued; a statement that the utility is increasing its water plant capacity charge for new connections to the Seven Springs system from an interim charge of \$500 per ERC to \$1,000 per ERC, on a temporary basis, subject to refund; the utility's address, telephone number, and business hours; and a statement that any comments concerning the charge should be addressed to the Director of the Division of the Commission Clerk and Administrative Services at 2540 Shumard Oak Boulevard, Tallahassee, FL 32399-0870. It is further

ORDERED that the approved charge shall be effective for connections made on or after the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(2), Florida Administrative Code, providing the appropriate notice has been made. It is further

ORDERED that the notice shall be mailed or hand delivered to all persons in the service area who have filed a written request for service within the past 12 calendar months or who have been provided service within the past 12 calendar months. In addition, Aloha Utilities, Inc. shall publish a copy of the approved notice in a newspaper of general circulation in its service area within 10 days of staff's approval of the notice. The utility shall provide proof of the date the notice was given within 10 days after the date of the notice. It is further

ORDERED that Aloha Utilities, Inc. shall reduce its rates for amortization of rate case expense as set forth in the body of this Order. It is further

ORDERED that Aloha Utilities, Inc. shall file revised tariff sheets and a proposed customer notice setting forth the lower rates

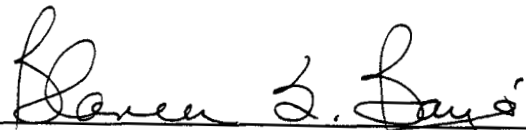
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and the reason for the reduction no later than one month prior to the actual date of the required rate reduction. It is further

ORDERED that if Aloha Utilities, Inc. files this reduction in conjunction with a price index or pass-through rate adjustment, separate data shall be filed for the price index and/or pass-through increase or decrease and the reduction in the rates due to the amortized rate case expense. It is further

ORDERED that this docket shall be closed after the time for filing an appeal has run.

By ORDER of the Florida Public Service Commission this 30th day of April, 2002.



BLANCA S. BAYÓ, Director  
Division of the Commission Clerk  
and Administrative Services

( S E A L )

RRJ/LAE

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative

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hearing or judicial review will be granted or result in the relief sought.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of the Commission Clerk and Administrative Services, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water and/or wastewater utility by filing a notice of appeal with the Director, Division of the Commission Clerk and Administrative Services and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.



**Attachment A**

Page 1 of 2

**Change in System Average Usage after adding 473 ERCs at 500 gal/day**

SUBDIVISION	GALLONS	BILLS	GALS/MTH	GALS/DAY	WGT GALS	WGT AVE USAGE
RANCHSIDE APARTMENTS	1,913,340	913	2,096	70	63,910	
ASHLEY PLACE APARTMENT	4,214,505	1,877	2,245	75	140,775	
SPRING HAVEN CONDOS	1,135,090	477	2,380	79	37,683	
HERITAGE SPRINGS	2,259,960	935	2,417	81	75,735	
RIVER OAKS CONDOS	1,235,350	480	2,574	86	41,280	
RIVERSIDE VILLAS	8,904,350	3,101	2,871	96	297,696	
OAKCREEK APARTMENTS	6,715,931	1,825	3,680	123	224,475	
COUNTRY PLACE VILLAGE	23,058,397	5,742	4,016	134	769,428	
VICEROY CONDOS	492,750	119	4,141	138	16,422	
VETERANS VILLAGE	142,284,232	27,470	5,180	173	4,752,310	
HERITAGE LAKES	58,539,830	11,210	5,222	174	1,950,540	
MILLPOND	56,028,470	8,927	6,276	209	1,865,743	
WOODTRAIL VILLAGE	23,115,080	3,375	6,849	228	769,500	
FOXHOLLOW TOWN HOMES	1,660,790	239	6,949	232	55,448	
PARK LAKE ESTATES	77,859,838	9,820	7,929	264	2,592,480	
WOODBEND	5,295,410	627	8,446	282	176,814	
WOODGATE	9,239,277	1,060	8,716	291	308,460	
RIVERSIDE VILLAGE	28,604,155	3,110	9,197	307	954,770	
WYNDTREE	59,413,671	6,158	9,648	322	1,982,876	
NATURES HIDEAWAY	41,849,469	4,311	9,707	324	1,396,764	
HILLS OF SAN JOSE	6,803,980	588	11,571	386	226,968	
NATURA	7,905,830	659	11,997	400	263,600	
CYPRESS LAKES	21,660,150	1,730	12,520	417	721,410	
PLANTATION	7,231,230	536	13,491	450	241,200	
THOUSAND OAKS	1,217,484	73	16,678	556	40,588	
FOXWOOD	63,502,203	3,758	16,898	563	2,115,754	
CHELSEA PLACE	28,599,910	1,674	17,085	569	952,506	
TRINITY OAKS	93,690,628	5,470	17,128	571	3,123,370	
FOX HOLLOW	66,965,870	3,562	18,800	627	2,233,374	
RIVIERA	<u>12,577,695</u>	<u>382</u>	<u>32,929</u>	<u>1,098</u>	<u>419,436</u>	
TOTAL	863,974,875	110,208	279,636	9,325	28,811,315	261
PROJECTED ERCS		<u>473</u>	<u>15000</u>	<u>500</u>	<u>236500</u>	
TOTAL INCLUDING NEW ERCs		110,681			29,047,815	262

Source: EXH 29 (SGW-6)

System Average Usage Assuming All Subdivisions  
 With Usage Between 261 and 500 Gals/Day  
 Use 500 Gals/day

SUBDIVISION	GALLONS	BILLS	GALS/ MTH	GALS/ DAY	WGT GALS	WGT AVE USAGE
RANCHSIDE APARTMENTS	1,913,340	913	2,096	70	63,910	
ASHLEY PLACE APARTMENT	4,214,505	1,877	2,245	75	140,775	
SPRING HAVEN CONDOS	1,135,090	477	2,380	79	37,683	
HERITAGE SPRINGS	2,259,960	935	2,417	81	75,735	
RIVER OAKS CONDOS	1,235,350	480	2,574	86	41,280	
RIVERSIDE VILLAS	8,904,350	3,101	2,871	96	297,696	
OAKCREEK APARTMENTS	6,715,931	1,825	3,680	123	224,475	
COUNTRY PLACE VILLAGE	23,058,397	5,742	4,016	134	769,428	
VICEROY CONDOS	492,750	119	4,141	138	16,422	
VETERANS VILLAGE	142,284,232	27,470	5,180	173	4,752,310	
HERITAGE LAKES	58,539,830	11,210	5,222	174	1,950,540	
MILLPOND	56,028,470	8,927	6,276	209	1,865,743	
WOODTRAIL VILLAGE	23,115,080	3,375	6,849	228	769,500	
FOXHOLLOW TOWN HOMES	1,660,790	239	6,949	232	55,448	
PARK LAKE ESTATES	77,859,838	9,820	7,929	264	2,592,480	
WOODBEND	5,295,410	627	8,446	500	313,500	
WOODGATE	9,239,277	1,060	8,716	500	530,000	
RIVERSIDE VILLAGE	28,604,155	3,110	9,197	500	1,555,000	
WYNDTREE	59,413,671	6,158	9,648	500	3,079,000	
NATURES HIDEAWAY	41,849,469	4,311	9,707	500	2,155,500	
HILLS OF SAN JOSE	6,803,980	588	11,571	500	294,000	
NATURA	7,905,830	659	11,997	500	329,500	
CYPRESS LAKES	21,660,150	1,730	12,520	500	865,000	
PLANTATION	7,231,230	536	13,491	500	268,000	
THOUSAND OAKS	1,217,484	73	16,678	556	40,588	
FOXWOOD	63,502,203	3,758	16,898	563	2,115,754	
CHELSEA PLACE	28,599,910	1,674	17,085	569	952,506	
TRINITY OAKS	93,690,628	5,470	17,128	571	3,123,370	
FOX HOLLOW	66,965,870	3,562	18,800	627	2,233,374	
RIVIERA	<u>12,577,695</u>	<u>382</u>	<u>32,929</u>	<u>1,098</u>	<u>419,436</u>	
TOTAL	863,974,875	110,208	279,636	10,646	31,927,953	

**System Weighted Average**

**290**

Source: EXH 29 (SGW-6)

ALOHA UTILITIES, INC. - SEVEN SPRINGS WATER SYSTEM				SCHEDULE NO. 1-A		
SCHEDULE OF WATER RATE BASE				DOCKET NO. 010503-WU		
13-MONTH AVERAGE TEST YEAR ENDED 12/31/01						
DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUST- MENTS	ADJUSTED TEST YEAR PER UTILITY	COMM. ADJUST- MENTS	COMM. ADJUSTED TEST YEAR	
1 UTILITY PLANT IN SERVICE	\$9,937,171	\$0	\$9,937,171	\$5,776	\$9,942,947	
2 LAND & LAND RIGHTS	\$42,898	\$0	\$42,898	(\$5,935)	\$36,963	
3 NON-USED & USEFUL COMPONENTS	\$0	\$0	\$0	\$0	\$0	
4 ACCUMULATED DEPRECIATION	(\$2,328,109)	\$0	(\$2,328,109)	(\$3,182)	(\$2,331,291)	
5 CIAC	(\$8,479,418)	\$0	(\$8,479,418)	(\$27,236)	(\$8,506,654)	
6 AMORTIZATION OF CIAC	\$1,923,349	\$0	\$1,923,349	\$64	\$1,923,413	
7 CONTRIBUTED TAXES	(\$1,175,890)	\$0	(\$1,175,890)	\$0	(\$1,175,890)	
8 ACC AMORT-CONTRIBUTED. TAXES	\$222,201	\$0	\$222,201	(\$10,877)	\$211,324	
9 DEFERRED INCOME TAXES	\$835,318	\$0	\$835,318	\$0	\$835,318	
10 WORKING CAPITAL ALLOWANCE	<u>\$430,720</u>	<u>\$413,250</u>	<u>\$843,970</u>	<u>(\$398,488)</u>	<u>\$445,482</u>	
<b>RATE BASE</b>	<b><u>\$1,408,240</u></b>	<b><u>\$413,250</u></b>	<b><u>\$1,821,490</u></b>	<b><u>(\$439,878)</u></b>	<b><u>\$1,381,612</u></b>	

ALOHA UTILITIES, INC. - SEVEN SPRINGS WATER SYSTEM ADJUSTMENTS TO RATE BASE 13-MONTH AVERAGE TEST YEAR ENDED 12/31/01		SCHEDULE NO. 1-B DOCKET NO. 010503-WU
EXPLANATION	WATER	
<b><u>PLANT IN SERVICE</u></b>		
1 To capitalize items erroneously expensed during 2000. (Stip. 1)	\$11,552	
2 Properly allocate utility's new office building. (Stip. 12)	<u>(5,776)</u>	
Total		<u>\$5,776</u>
<b><u>LAND</u></b>		
Properly allocate the utility's new office building. (Stip 12)		<u>(\$5,935)</u>
<b><u>ACCUMULATED DEPRECIATION</u></b>		
1 Accumulated depreciation for capitalize items erroneously expensed (Stip. 1)	(\$920)	
2 To reflect the appropriate depreciation rate for computer equipment. (Stip. 2)	<u>(2,262)</u>	
Total		<u>(\$3,182)</u>
<b><u>CIAC</u></b>		
To correct the total amount of contributed property received. (Stip. 3)		<u>(\$27,236)</u>
<b><u>ACCUM. AMORT. OF CIAC</u></b>		
To reflect accumulated amortization for contributed property adjustment (Stip. 3)		<u>\$64</u>
<b><u>ACCUM. AMORT. OF CONTRIBUTED TAXES</u></b>		
To correct historical starting point of amortization of contributed taxes (Stip. 4)		<u>(\$10,877)</u>
<b><u>WORKING CAPITAL</u></b>		
To reflect adjustments and reallocations.		<u>(\$398,488)</u>

**ALOHA UTILITIES, INC. - SEVEN SPRINGS WATER SYSTEM**  
**CAPITAL STRUCTURE - 13 Month Average**  
**13-MONTH AVERAGE TEST YEAR ENDED 12/31/1**

**SCHEDULE NO. 2**  
**DOCKET NO. 010503-WU**

DESCRIPTION	TOTAL CAPITAL	SPECIFIC ADJUSTMENTS (EXPLAIN)	ADJUSTED TOTAL	PRO RATA ADJUSTMENTS	CAPITAL RECONCILED TO RATE BASE	RATIO	COST RATE	WEIGHTED COST	
<b>Per Utility</b>									
1 LONG TERM DEBT	\$3,525,036	\$0	\$3,525,036	(\$2,501,723)	\$1,023,313	56.18%	9.03%	5.07%	
2 SHORT-TERM DEBT	0	0	0	0	0	0.00%	0.00%	0.00%	
3 PREFERRED STOCK	600,000	0	600,000	(425,866)	174,134	9.56%	9.93%	0.95%	
4 COMMON EQUITY	1,587,440	0	1,587,440	(1,126,603)	460,837	25.30%	9.93%	2.51%	
5 CUSTOMER DEPOSITS	562,205	0	562,205	(398,999)	163,206	8.96%	6.00%	0.54%	
6 <b>TOTAL CAPITAL</b>	<u>\$6,274,681</u>	<u>\$0</u>	<u>\$6,274,681</u>	<u>(\$4,453,191)</u>	<u>\$1,821,490</u>	<u>100.00%</u>		<u>9.07%</u>	
<b>Per Commission</b>									
7 LONG TERM DEBT	\$3,525,036	\$5,742,943	\$9,267,979	(\$8,200,386)	\$1,067,593	77.27%	8.25%	6.37%	
8 SHORT-TERM DEBT	0	0	0	0	0	0.00%	0.00%	0.00%	
9 PREFERRED STOCK	600,000	0	600,000	(530,885)	69,115	5.00%	10.34%	0.52%	
10 COMMON EQUITY	1,587,440	(23,578)	1,563,862	(1,383,718)	180,144	13.04%	10.34%	1.35%	
11 CUSTOMER DEPOSITS	562,205	0	562,205	(497,444)	64,761	4.69%	6.00%	0.28%	
12 <b>TOTAL CAPITAL</b>	<u>\$6,274,681</u>	<u>\$5,719,365</u>	<u>\$11,994,046</u>	<u>(\$10,612,433)</u>	<u>\$1,381,613</u>	<u>100.00%</u>		<u>8.52%</u>	
						<b>LOW</b>	<b>HIGH</b>		
						<u>10.34%</u>	<u>12.34%</u>		
RETURN ON EQUITY						<u>8.52%</u>	<u>8.78%</u>		
OVERALL RATE OF RETURN									

ALOHA UTILITIES, INC. - SEVEN SPRINGS WATER SYSTEM						SCHEDULE NO. 3-A	
STATEMENT OF WATER OPERATIONS						DOCKET NO. 010503-WU	
13-MONTH AVERAGE TEST YEAR ENDED 12/31/1							
DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUST- MENTS	ADJUSTED TEST YEAR PER UTILITY	COMM. ADJUST- MENTS	COMM. ADJUSTED TEST YEAR	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	<u>\$1,967,474</u>	<u>\$1,077,337</u>	<u>\$3,044,811</u>	<u>(\$1,065,671)</u>	<u>\$1,979,140</u>	<u>(\$0)</u> -0.00%	<u>\$1,979,140</u>
<b>OPERATING EXPENSES:</b>							
2 OPERATION & MAINTENANCE	<u>\$1,394,460</u>	<u>\$1,055,944</u>	<u>\$2,450,404</u>	<u>(\$936,021)</u>	<u>\$1,514,383</u>		<u>\$1,514,383</u>
3 DEPRECIATION	<u>75,736</u>	<u>0</u>	<u>75,736</u>	<u>(224)</u>	<u>75,512</u>		<u>75,512</u>
4 AMORTIZATION	<u>(30,691)</u>	<u>0</u>	<u>(30,691)</u>	<u>0</u>	<u>(30,691)</u>		<u>(30,691)</u>
5 TAXES OTHER THAN INCOME	<u>278,781</u>	<u>55,808</u>	<u>334,589</u>	<u>(47,955)</u>	<u>286,634</u>	<u>(0)</u>	<u>286,634</u>
6 INCOME TAXES	<u>49,564</u>	<u>0</u>	<u>49,564</u>	<u>(33,976)</u>	<u>15,588</u>	<u>(0)</u>	<u>15,588</u>
7 TOTAL OPERATING EXPENSES	<u>\$1,767,850</u>	<u>\$1,111,752</u>	<u>\$2,879,602</u>	<u>(\$1,018,176)</u>	<u>\$1,861,426</u>	<u>(\$0)</u>	<u>\$1,861,426</u>
8 OPERATING INCOME	<u>\$199,624</u>	<u>(\$34,415)</u>	<u>\$165,209</u>	<u>(\$47,495)</u>	<u>\$117,714</u>	<u>(\$0)</u>	<u>\$117,714</u>
9 RATE BASE	<u>\$1,408,240</u>		<u>\$1,821,490</u>		<u>\$1,381,612</u>		<u>\$1,381,612</u>
10 RATE OF RETURN	<u>14.18%</u>		<u>9.07%</u>		<u>8.52%</u>		<u>8.52%</u>

ALOHA UTILITIES, INC. - SEVEN SPRINGS WATER SYSTEM ADJUSTMENTS TO OPERATING INCOME 13-MONTH AVERAGE TEST YEAR ENDED 12/31/1		SCHEDULE NO. 3-B DOCKET NO. 010503-WU
EXPLANATION	WATER	
<b>OPERATING REVENUES</b>		
1 Remove requested revenue increase		(\$1,077,337)
2 To correct the interest income allocation (Stip. 9)		7,490
3 To include vacation bills in projected revenues for 2001. (Stip. 9)		4,176
Total		<u>(\$1,065,671)</u>
<b>OPERATION &amp; MAINTENANCE EXPENSE</b>		
1 Remove projections for plant items erroneously expensed in 2000 (Stip 1)		(\$12,396)
2 Reallocated bad debt expense (Stip 10)		1,237
3 To remove double counted officers salary and wages. (Stip 13)		(8,769)
4 To reflect adjusted purchased water expense (Issue 9a & 15)		(987,903)
5 To remove inflation projection from chemicals expense (Issue 10)		(2,234)
6 Remove salaries & benefits for vacant utility manager position (Issue 11)		(24,219)
7 Correct annualized salary for operations supervisor (Issue 12-Stip)		(21,268)
8 Adjustment to pensions expense (Issue 13)		51,089
9 Remove President's & Vice President's Salary & Benefits		(35,371)
10 Rate case expense (Issue 16)		(60,323)
11 Conservation Expenses (Issue 17)		120,000
12 To reflect costs for customer improvement initiatives		44,136
Total		<u>(\$936,021)</u>
<b>DEPRECIATION EXPENSE-NET</b>		
1 To reflect the 2001 depreciation expense for plants assets recorded in error as expense items. (Stip.1)		\$613
2 To reflect accumulated amortization for the correction of total contributed property received. (Stip. 3)		(837)
Total		<u>(\$224)</u>
<b>TAXES OTHER THAN INCOME</b>		
RAFs on revenue adjustments above		<u>(\$47,955)</u>
<b>INCOME TAXES</b>		
To adjust to test year income tax expense		<u>(\$33,976)</u>

<b>ALOHA UTILITIES, INC. - SEVEN SPRINGS WATER SYSTEM</b>		<b>SCHEDULE NO. 4</b>		
<b>WATER MONTHLY SERVICE RATES</b>		<b>DOCKET NO. 010503-WU</b>		
<b>FINAL 13-MONTH AVERAGE TEST YEAR ENDED 12/31/01</b>				
	<b>Rates Prior to Filing</b>	<b>Commission Approved Interim</b>	<b>Utility Requested Final</b>	<b>Commission Approved Final</b>
<b>Residential Service</b>				
Base Facility Charge:				
Meter Size:				
5/8" x 3/4"	\$7.32	\$8.31	\$9.23	\$4.02
3/4"	\$0.00	\$0.00	\$0.00	\$6.03
1"	\$0.00	\$0.00	\$0.00	\$10.05
1-1/2"	\$0.00	\$0.00	\$0.00	\$20.10
Usage Charges:				
Per 1,000 Gallons				
0 - 3,000 Gallons	\$0.00	\$0.00	\$2.24	\$1.38
3,000 - 10,000 Gallons	\$1.32	\$1.48	\$2.24	\$1.38
Over 10,000 Gallons	\$1.32	\$1.48	\$2.81	\$1.72
<b>General Service</b>				
Base Facility Charge:				
Meter Size:				
5/8" x 3/4"	\$7.32*	\$8.31*	\$9.23	\$4.02
1"	\$19.46*	\$22.10*	\$23.08	\$10.05
1-1/2"	\$36.49*	\$41.45*	\$46.15	\$20.10
2"	\$58.80*	\$66.80*	\$73.84	\$32.16
3"	\$116.83*	\$132.72*	\$147.68	\$64.32
4"	\$182.85*	\$207.72*	\$230.75	\$100.50
6"	\$282.76*	\$321.23*	\$461.50	\$201.00
8"	\$577.67*	\$656.25*	\$738.40	\$321.60
10"	\$841.62*	\$956.09*	\$1,338.35	\$462.30
Usage Charges:				
All Usage Per 1,000 Gallons				
	\$1.32	\$1.48	\$2.24	\$1.49
<b>Typical Residential Bills</b>				
5/8" x 3/4" Meter Size				
3,000 Gallons	\$7.32	\$8.31	\$15.95	\$8.49
5,000 Gallons	\$9.96	\$11.27	\$20.43	\$11.47
10,000 Gallons	\$16.56	\$18.67	\$31.63	\$18.92
* Current and Commission Approved Interim General Service BFC includes minimum gallonage allowances.				



<b>ALOHA UTILITIES, INC. - SEVEN SPRINGS WATER SYSTEM</b>		<b>SCHEDULE NO. 5</b>	
<b>4 YEAR REDUCTION SCHEDULE</b>			
<b>DOCKET NO. 010503-WU</b>			
<u>Monthly Water Rates</u>		<u>Commission</u>	<u>4-Year</u>
		<u>Approved</u>	<u>Reduction</u>
		<u>Monthly</u>	<u>to Monthly</u>
		<u>Rates</u>	<u>Rates</u>
<b>Residential Service</b>			
Base Facility Charge:			
'Meter size			
5/8" x 3/4"		\$4.02	\$0.11
3/4"		\$6.03	\$0.16
1"		\$10.05	\$0.27
1 1/2"		\$20.10	\$0.55
Gallonage Charge:			
Per 1,000 gals			
0 - 3,000 gals		\$1.38	\$0.04
3,000-10,000		\$1.38	\$0.04
Over 10,000 gals		\$1.72	\$0.05
<b>General Service Rates</b>			
Base Facility Charge:			
'Meter size			
5/8" x 3/4"		\$4.02	\$0.11
1"		\$10.05	\$0.27
1 1/2"		\$20.10	\$0.55
2"		\$32.16	\$0.87
3"		\$64.32	\$1.75
4"		\$100.50	\$2.73
6"		\$201.00	\$5.46
8"		\$321.60	\$8.73
10"		\$462.30	\$12.55
Gallonage Charge:			
All usage Per 1,000 gals		\$1.49	\$0.04