BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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| In re: Application of PALM COAST UTILITY CORPORATION for an increase in water and sewer rates in Flagler County, Florida | DOCKET NO. 890277-WS<br>ORDER NO. 22843<br>ISSUED: 4-23-90 |

The following Commissioners participated in the disposition of this matter:

THOMAS M. BEARD
JOHN T. HERNDON

APPEARANCES:

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ORDER ESTABLISHING INCREASED RATES
FOR WATER AND WASTEWATER SERVICE

BY THE COMMISSION:

## I. CASE BACKGROUND

By Order No. 18785, issued February 2, 1988, this Commission initiated an investigation into, among other matters, the level of investment of Palm Coast Utility Corporation (PCUC) in utility plant assets. Docket No. 871395-WS was opened in order to process the investigation. By Order No. 18713, issued January 21, 1988, the Commission acknowledged the intervention of the Office of Public Counsel (OPC) in the investigation docket.

On May 19, 1989, during the pendency of the investigation docket, PCUC completed the minimum filing requirements for a general rate increase and that date was established as the official filing date. Docket No. 890277-WS was opened in order to process PCUC's rate application. By Order No. 21666, issued August 2, 1989, this Commission acknowledged OPC's intervention in the rate case docket.

By Order No. 21794, issued August 28, 1989, the Commission subsumed Docket No. 871395-WS, the investigation docket, into Docket No. 890277-WS, the rate case docket.

By separate petitions dated July 17, 1989, James Martin and Patrick Ferrante, two customers of PCUC, requested to intervene in this docket. By Orders Nos. 21664 and 21665, issued August 2, 1989, their petitions were granted.

A hearing was held on the rate case and investigation matters on December 6 through 8, 1989, in Palm Coast, and continued on January 6, 1990, in Tallahassee.

## II. FINDINGS OF FACT, LAW AND POLICY

Having considered the evidence presented at hearing, the briefs of the parties and the recommendation of the Staff of this Commission (Staff), we hereby enter our findings of fact, law and policy.

## STIPULATIONS

The parties and Staff have agreed to the stipulation that, since miscellaneous revenues are generated from both water and wastewater service, 60 percent of these revenues should be allocated to water and 40 percent should be allocated to wastewater. Having heard no evidence to convince us otherwise, we find that this stipulation is reasonable. It is, therefore, approved.

## QUALITY OF SERVICE

Staff, PCUC, and OPC agree that the quality of service is satisfactory. According to the testimony of Department of Environmental Regulation (DER) witnesses Rodriguez and Houriet, PCUC is in compliance with the standards set forth by DER and has adequate capacity to serve the customers. In addition, PCUC has won awards for the operation of its plants for several of the past years.

Several customers reported that the water quality was good; however, one customer testified that the customers in the Seminole Woods area do not receive the same quality of service as other PCUC customers and should not pay the same rate.

One customer presented a section of an aluminum hand-held lawn sprinkling device, identified as Exhibit No. 1, that has a considerable amount of external corrosion. Less corrosion is visible on the internal side of the pipe. There is a split in the pipe where the aluminum tubing joins the brass hose bib coupling. There is no visible corrosion at the split and it is difficult to determine what caused the split or whether some of the corrosion is due to electrolysis between the two dissimilar metals. The customer concluded that the water caused the corrosion of the aluminum pipe. He also testified that he does not drink the water. This same customer provided Composite Exhibit 2, which is a group of photographs. One of these photographs shows water flowing out of a fire hydrant. The customer alleges that the hydrant has run every day for three and a half years.

Another customer testified that he has lived in Palm Coast for eight years and that he has never seen a fire hydrant checked to see if it is operable. He testified that he operated a significant number of hydrants in New York City

prior to his move to Palm Coast. In its response to customer testimony, Exhibit No. 35, PCUC did not respond to the allegation that hydrants had not been checked.

Another customer testified regarding an accumulation of water on the golf course at the fourteenth tee. He believes that the water originated at the pump station on the golf course. He also stated that he has contacted two persons connected with the golf course concerning this matter but that there has been no action taken. He was told, however, that the flooded area is due to surface water. Again, PCUC did not address this customer's concern in Exhibit No. 35.

One customer testified about what he believed to be excessive chlorine in the drinking water. He explained that the recommended maximum contaminant level is .5 parts per million yet, with his test kit, he has occasionally found the chlorine to be in excess of that amount. PCUC did not respond to this complaint in Exhibit No. 35, either.

Another customer testified about a fire hydrant running eight to ten hours per day for the last five months. According to this customer, the hydrant was flowing at 10:00 a.m. on December 6, 1989, and was still flowing that evening. He testified that the hydrant flowed that way six or seven days a week. Again, PCUC offered no explanation in Exhibit No. 35.

Another customer testified regarding the provision of water and wastewater service to a new school, apparently outside of PCUC's service territory. She also had a number of questions regarding the utility's service area, the expenses that would be incurred in enlarging the boundaries to include the school, and whether it is normal to include a refundable main extension fee clause in a service availability contract. This customer was concerned that an area adjacent to the school is currently being developed on land that was apparently owned by PCUC's parent, ITT, and that the development may be served from lines paid for by the School Board, with no provision for a refund to the School Board. PCUC did not respond to this customer's concerns because she was not directly involved in this contract.

Another customer went to PCUC's offices and spent some time reviewing its rate filing. He expressed some concern about the amount of unaccounted-for water and for the lack of documentation or a study supporting the amount of the cost

allocable to utility operations as opposed to cable operations. He believes that the cost of the cable operation should have been deducted from the utility's rate filing. In fact, he even offered to perform a study, free of charge, to assist PCUC in making this allocation. This customer also stated that he would have liked to see a maintenance report or some documentation in support of the $100 annual fire hydrant fee charged by PCUC.

This customer also addressed the quality of the water, specifically in regard to the erosion of plumbing seals in his home. He testified that, in spite of the fact that his home is only two years old, he has had to replace the seals in two toilets and one sink. He further stated that he has discussed the problem with plumbers and that he was told that the seal erosion was caused by a chemical in the water. While he did not know if this problem exists exclusively in Palm Coast, he testified that it was not a problem in Atlanta, Georgia, where he used to live. Again, PCUC did not respond to this customer's concerns in Exhibit No. 35.

Based upon the customers' testimony and PCUC's responses thereto, it appears that PCUC is sometimes disregardful of its customers' concerns. This inattentiveness is highlighted by a portion of the testimony of Patrick Ferrante, an intervenor in this case, in his capacities as a customer of the utility and president of the homeowners' association. Mr. Ferrante testified as follows:

> I would just like to kind of reinforce a problem that was brought forth by [intervenor Martin] by just giving you one brief example.
>
> I sent in a set of interrogatories containing 21 questions. I am going to relate my response to just one. No. 11. Question No. 11 requests to submit on a per hydrant basis a detailed breakdown of annual maintenance and related costs.
>
> Response to that question: "This interrogatory is vague and unclear requiring clarification as to the period of time or the year for which the information is requested. Furthermore, to provide the information on a per hydrant basis [is] not readily available [and] would be unduly burdensome and oppressive."

> This was a request for clarification on some of the questions. I attempted to clarify the question, and the second response to it was basically the same, that it would be cumbersome and burdensome for them to kind of gather that information.
>
> I bring that before you because Mr. Martin produced for you a basis for fire hydrant charges on a per hydrant basis, readily available; you already have it in your files. But, yet, they refuse to make it available. The point I'm making is this type of cooperation, or lack of it, is what we have been running into over the past several years with PCUC. I think if there were a more cooperative effort on their part these hearings wouldn't be half as long or half as cumbersome as they are now.

At the hearing, PCUC agreed to provide late-filed Exhibit 12, which was to detail the test year maintenance and related costs for the fire hydrants, divided by the total number of hydrants, for an average test year cost per hydrant. Although PCUC claimed that to produce such a breakdown for Mr. Ferrante would have been burdensome and oppressive, the exhibit is only one page long.

Based upon the foregoing discussion, we find that the quality of water and wastewater service provided by PCUC is satisfactory. However, we also find that customer relations are somewhat lacking. Accordingly, we hereby direct PCUC to devote more efforts toward improving customer relations.

## RATE BASE

Our calculations of rate base are attached to this Order as Schedule No. 1A for water and Schedule No. 1B for wastewater, with our adjustments detailed on Schedule No. 1C. Those adjustments which are self-explanatory, or which are essentially mechanical in nature, are depicted on those schedules without further discussion in the body of this Order. The remaining adjustments are discussed below.

Unaccounted-for Water

PCUC argues that the 13.5 percent reported level of unaccounted-for water is reasonable. PCUC witness Guastella Mr. Guastella quoted from Order No. 18625, the final order from PCUC's last rate case, issued January 4, 1988, in which we stated that, "Commission policy is to analyze unaccounted for water on an individual utility basis. We concur with Mr. Guastella that a 13.5% level is reasonable based on his testimony regarding the causes of unaccounted-for water."

OPC argues that PCUC has understated unaccounted-for water by classifying plant use water as accounted-for, unsold water, and deducting it from unaccounted-for water. OPC believes that the utility's unaccounted-for water is actually 176,479,000 gallons, or 21.9 percent

OPC witness Parrish apparently believes that most of the 89,048,000 gallons classified as accounted-for/not sold on Schedule F-1 is for plant use water. Witness Guastella testified, however, that the plant use water, which totals some 600,000 gallons per day (gpd), is not included on Schedule F-1. He also stated that it is not included as treated water delivered to the system.

Witness Parrish also testified that water losses in the distribution system might include flushing and fire flows. He believes that a "gracious" allowance for such purposes would be 60,000 gpd, or 21,900,000 gallons per year. The testimony of witness Guastella, however, indicates that PCUC's losses also include construction work, repairs, recirculation, other clearances for construction, chlorination of systems, and sewer cleaning.

We are not persuaded that OPC's position is supported by the record. Accordingly, we reject its suggestion that the utility's unaccounted for water is 21.9 percent.

In his unaccounted-for water analysis, Schedule F-1, witness Guastella totalled water treated and delivered to the system, and subtracted from that water sold, meter loss at 3 percent and accounted-for/not sold water. The remainder, presumably, is the amount of unaccounted-for water. In his analysis, Mr. Guastella relied upon manuals, his knowledge, and American Water Works Association (AWWA) articles. He explained that an acceptable level of unaccounted-for water can vary from 10 to 20 percent.

Witness Guastella also addressed treated water necessary to operate the water treatment plant. This water was not included as accounted-for/not sold. Witness Guastella suggests that this water should be taken into account so that the losses that are unaccounted-for are addressed. We reject this suggestion, however, since this "other water treated" is not delivered to the system and is not part of the category upon which unaccounted-for water is based.

We also find that the water used for plant flushing that recirculates back to the raw water has been counted both in the 600,000 gpd allocated to plant use and in accounted-for/not sold. Since this recirculated flushing is 20 percent of the total amount of accounted-for/not sold, we have disallowed this portion, which is 17,810,000 gallons (48,793 gpd) for the test year.

As for meter loss, the utility provided a late-filed exhibit which is a copy of an article that addresses, among other sources of loss, loss due to under-registration of meters. The article discusses a range of under-registration, and suggests that an overall allowance of 3 percent for under-registration is economically feasible. We are not able to conclude for whom it would be economically feasible.

Witness Guastella testified regarding accuracy curves of meters. He stated that meters cannot be designed to operate at 100 percent accuracy at all rates of flow. With flows above 2 to 3 gpm or below 1 gpm, Mr. Guastella testified that the meter will record more water than is actually passing through it. He specifically stated that the meter would never record less than what is actually passing through it.

We find that Mr. Guastella's testimony regarding the accuracy curves of meters is in direct conflict with a practice of allowing for meter loss at 3 percent. If the meter would always register more water than was passing through it, and never less, it makes no sense to allow for a loss of 3 percent.

In addition, we do not find the late-filed article regarding under-registration of meters persuasive. The article was presented on May 13, 1957, at the Annual Conference (presumably of the AWWA) in Atlantic City, N. J. The references in the article are dated 1940, 1954, and 1956. The data are, therefore, quite outdated.

Based upon the discussion above, we are not persuaded that the inclusion of a meter loss factor is appropriate. We find, therefore, that the meter loss factor should be excluded and that this amount should be considered unaccounted-for water.

Based upon the evidence of record, we find that PCUC's level of unaccounted-for water is 18 percent. Since the record indicates that a reasonable level of unaccounted-for water for this utility is 13.5 percent, we also find that PCUC has an excessive unaccounted-for water amount of 4.5 percent.

Margin Reserve

PCUC's position is that margin reserve represents an allowance for capacity which must be available to meet short-term growth, while continuing to provide safe and adequate service to all customers. To calculate margin reserve for this proceeding, witness Guastella multiplied the average annual percentage of growth by 1.5 in order to allow for a reasonable construction and lag period. PCUC believes that it should be allowed margin reserves of 25.2 percent for water and 23.3 percent for wastewater.

OPC does not believe that any amount of margin reserve should be allowed in the used and useful calculations. OPC witness Parrish argued that the cost of facilities for future use should be shifted to future customers and developers. According to witness Parrish, the concept of margin reserve for developer-owned utilities has become a regulatory anachronism in Florida.

In its brief, OPC suggests that PCUC will be allowed a double recovery if it is allowed a margin reserve because it also collects guaranteed revenues. However, OPC makes no cite to the record to support this allegation.

We believe that PCUC must have sufficient capacity to serve new customers at the time those customers connect. Section 367.111(1), Florida Statutes, requires each utility to provide service to the area described in its certificate within a reasonable time. The concept of margin reserve recognizes costs which the utility has incurred to provide service to customers in the near future.

Notwithstanding the above, we find that the utility has overstated the appropriate margin reserves by averaging the percentages of ERCs added per year. Instead, we find that it is more appropriate to calculate margin reserve by taking an average of the actual number of ERCs added per year. Accordingly, we find it appropriate to include a margin reserve of 16.1 percent for water and 15.3 percent for wastewater in our calculations of rate base.

Imputation of CIAC on Margin Reserve

PCUC imputed CIAC related to the margin reserve in its rate base calculations. As discussed above, OPC believes that any margin of reserve is inappropriate.

Since we have reduced the utility's margin reserve calculations, we must also reduce the CIAC imputed on the margin reserve. Using a margin reserve of 16.1 percent for water and 15.3 percent for wastewater, the reduction to CIAC would be $550,747 and $811,578 for water and wastewater, respectively. However, the imputed CIAC is partially offset by accumulated amortization of CIAC. Accordingly, based upon the evidence of record and our discussion above, we find it appropriate to reduce CIAC by net amounts of $472,765 for water and $696,700 for wastewater.

Fire Demand

In its calculations of used and useful plant, PCUC included an allowance for fire demand. PCUC states that the fire demand allowed in its last rate case was 1500 gpm for four hours. PCUC is requesting a higher demand in this case to provide for fire demands in commercial areas as well as residential areas. Witness Guastella explains that he used an estimated fire demand which is significantly lower than the demands actually experienced in the 1985 forest fires.

OPC argues that the inclusion of an allowance for fire demand overstates the used and useful portions of source of supply and treatment facilities. OPC witness Parrish accepts the utility's fire demand of 600,000 gpd; however, he believes that fire demand should be met from storage, and not from source of supply or treatment facilities. He argues that it is unlikely that a fire will occur on a day of maximum demand, or that fire demand storage would need to be replenished on the maximum day of plant demand.

Witness Guastella testified that fire demands for this utility are met by all components of the system. He explained that storage and treatment are designed to meet fire demands and that both are necessary to maintain demands throughout the system. He also reported that the water provided to the system is all lime softened and that, before it can be used to fill the storage tanks, the water must be produced from the wells and pass through the treatment cycle. Therefore, according to PCUC, this production and treatment capacity must be included in fire demand for the purpose of calculating used and useful plant.

Because we are uncomfortable speculating about the likelihood of a fire occurring on the day of maximum demand, we find that the inclusion of fire demand of 2,000 gpm, for five hours, does not overstate the used and useful calculations for source of supply and treatment plant facilities.

Capacity of Storage Facilities

OPC believes that PCUC has overstated the used and useful percentage for storage plant facilities due to misstatement of the capacity of the storage facilities and of the equalization demand. OPC witness Parrish argues that PCUC's clearwell should be included in total storage, which raises total storage to 2,391,500 gallons, as compared to PCUC's calculation of 2,150,000 gallons of total storage. Mr. Parrish also did not include a margin reserve allowance in his calculations.

PCUC witness Guastella stated that the clearwell is part of the operating function of the plant and should not, therefore, be relied upon for storage. He also noted that this is the conclusion reached by this Commission in PCUC's last rate case. According to PCUC, the treated water is filtered, collects in the clearwell, is pumped to storage, and then by high service pumps to the system. Water in the clearwell is not available to the system until it enters the storage tanks.

Based upon the evidence of record and the discussion above, we find that the clearwell capacity should not be included in the total storage capacity.

Used and Useful Water Plant

The following table represents PCUC's and OPC's positions regarding the percentages of water plant that are used and useful, and the percentages that we find appropriate for the purpose of this proceeding.

Water Plant

| | PCUC(1) | OPC | COMMISSION APPROVED |
|---|---|---|---|
| Intangible Plant | 100 % | 100 % | 100 % |
| Source of Supply | 100 | 77.8 | 100 |
| Water Treatment Plant | 100 | 67.2 | 89 |
| Storage (Accts. 303, 304, 330) | 70.2 | 55.4 | 67 |
| Mains (Acct. 331) | 23.7 | 18.9 | 22.1 (2) |
| Mains, refunded (Acct. 331) | 100 | 100 | 100 |
| Services (Acct. 333) | 92.6 | 74.0 | 86 |
| Meters & Install. (Acct. 334) | 100 | 100 | 100 |
| Miscellaneous (Acct. 339) | 100 | 100 | 100 |
| Hydrants (Acct. 335) | 59.9 | 59.9 | 59.9 |
| General Plant (Accts. 304, 340) | 66.1 | 66.1 | 66.1 |
| All other accounts | 100 | 100 | 100 |

(1) Includes margin reserve of 25.2%
(2) Composite

PCUC performed an extensive used and useful analysis for its water plant accounts. For the most part, the utility employed the same methodologies used in its last rate case. The differences this time are a greater in-plant use allowance for the water treatment plant, a greater allowance for fire demand, and a margin reserve calculation based upon the last five years instead of the last three years. As previously discussed, we have adjusted PCUC's margin reserve to reflect an average of the raw number of ERCs added per year rather than an average of the percentages of growth for each year.

OPC's calculations of used and useful water plant exclude any margin reserve or any allowance for fire demand for the wells and treatment plant. As discussed more fully above, we have rejected OPC's positions regarding both fire demand and margin reserve.

In its calculations of used and useful water treatment plant, PCUC adjusted the rated capacity of the plant by 10 percent (600,000 gpd) to allow for in-plant uses. Witness Guastella stated that, for used and useful purposes, using 90 percent of the plant capacity, thereby allowing 10 percent for in-plant use, is conservative and provides ample cushion for any instantaneous need to operate the plant in excess of its rated capacity. In support of this position, Mr. Guastella cited Docket No. 850600-WS, the application of St. Augustine Shores Utilities, a Division of United Florida Utilities Corporation, for an increase in water and sewer rates in St. Johns County, and Docket No. 850151-WS, the application of Marco Island Utilities, a Division of Deltona Utilities, Inc, for an increase in water and sewer rates in Collier County, as two instances in which this Commission applied a 90 percent factor to rated capacity. In its brief, PCUC also cited the St. Augustine Shores Utilities case as support for the 90 percent factor.

We have reviewed the above-referenced orders, and have found no reference to any plant factor in either of the orders. In the St. Augustine Shores Utilities case, we did recognize that some water was required for in-plant use, however, we made no specific reference to any numerical factor. In the Marco Island Utilities case, we find no mention of any allowance for in-plant use, much less any reference to a plant factor. Nevertheless, we agree with witness Guastella that using 90 percent of the rated capacity as usable capacity provides ample cushion.

Based upon the evidence of record and our discussion above, we find that the appropriate percentages of used and useful water plant are as set forth in the table above. Notwithstanding our acceptance of the 90 percent factor, however, we have some lingering concerns regarding the in-plant use and its allocation to specific uses. We believe, therefore, that before PCUC files for another rate increase, it should have at least twelve months of accurate data, metered where possible, regarding:

1. in-plant use that enters the sewer system, such as laboratory and restroom use;
2. water used for chemical feed, such as lime slaking or chlorination;
3. plant filter backwashing;

4. recirculated water, such as the decant from the sludge blowoffs and filter backwashing;
5. in-plant use using treated water that is not recirculated and does not enter the sewer system, such as irrigating the grounds surrounding the plant;
6. any other plant use not mentioned above, and;
7. hydrant flow records showing the quantity of water flushed, identified by hydrant number or address, including whether the hydrant is located on a used and useful main.

Used and Useful Wastewater Plant

The following table represents PCUC's and OPC's positions regarding the percentages of wastewater plant that are used and useful, and the percentages that we find appropriate for the purpose of this proceeding.

Wastewater Plant

| | PCUC(1) | OPC | COMMISSION APPROVED |
|---|---|---|---|
| Intangible Plant | 100 % | 100 % | 100 % |
| Pumping Plant | 27.0 | 27.0 | 25 |
| Treatment Plant | 100 | 76.9 | 87 |
| Collection & Interceptors | | | |
| Structures, Acct. 354 | 100 | 100 | 100 |
| Coll. Main, Acct. 361 | 29.6 | 25.0 | 27.9 (2) |
| Services, Acct. 363 | 29.9 | 24.2 | 29 |
| General Plant, Accts. 304, 340 | 62.1 | 62.1 | 62.1 |
| All other accounts | 100 | 100 | 100 |

(1) Includes margin reserve of 23.3%
(2) Composite

PCUC performed an extensive used and useful analysis for the wastewater plant accounts. For the most part, the utility employed the same methodologies used in its last rate case. In preparing its wastewater analysis, PCUC made every attempt to remain consistent with our decision in its last rate case.

OPC made an adjustment to the utility's calculations to disallow margin reserve. Other than this, OPC suggested no further adjustments. As addressed under our discussion of that issue, we believe that a margin reserve is appropriate and have, therefore, rejected OPC adjustment.

As also addressed under our discussion of that issue, we have adjusted PCUC's proposed margin reserve to reflect an average of the raw number of ERCs added per year rather than an average of the percentages of growth for each year.

Based upon the evidence of record and the adjustments discussed above, we find that the appropriate percentages of used and useful wastewater plant are as set forth in the table above.

Capitalization of Repairs

OPC witness DeWard suggested that the plant in service account may be significantly overstated because "[t]he Utility appears to have followed a practice of capitalizing items which normally would be expensed." Mr. DeWard was evidently referring to various schedules and workorders attached to his prefiled testimony that suggest that certain repairs may have been capitalized. In order to "adequately analyze plant additions," witness DeWard indicated that he would need to review all of PCUC's Continuing Property Records (CPRs) and obtain original copies of supporting documentation. In its brief, OPC contends that "[w]ithout adequate time to review the records, it is impossible to quantify the dollar amount of repair items improperly capitalized."

In his rebuttal testimony, witness Guastella explained that some of the records used by witness DeWard as evidence of capitalized repair costs is CPR detail concerning the $2.5 million repair program of the mid-1970's, which matter is discussed more fully hereunder. PCUC contends that the Commission was fully informed about and accepted the accounting treatment afforded this repair work, and that this does not represent a routine pattern of capitalizing repair expenditures. Mr. Guastella further responded to Mr. DeWard's apparent reliance on two contracts as evidence of improper accounting. The first contract concerns expenditures related to the retirement of a sewer line, regarding which Mr. Guastella testified that the utility followed proper accounting treatments. The second contract was part of the $2.5 million repair program.

PCUC's books and records have been audited by this Commission in each of PCUC's four prior rate proceedings. Mr. Guastella argued that these prior audits did not "reflect any overstatement of original plant construction costs." In

addition, a review of our prior PCUC orders confirms that there were no disallowances of "improperly" capitalized repair costs in those prior proceedings. Mr. Guastella further reported that audits by PCUC's accounting firm, Arthur Andersen & Co., did not reflect any overstatement of plant construction costs.

Under cross examination, Mr. DeWard admitted that his examination did not include a review of PCUC's published and audited financial reports. Mr. DeWard indicated that he had no reason to doubt that PCUC's outside auditors were qualified to render an opinion on the utility's financial statements. Mr. DeWard reported that, if he were performing a follow-up audit, he would typically rely on a prior audit opinion. With respect to audit work, Mr. DeWard also agreed that it is not necessary to examine every invoice and every check for assurance that supporting documentation is available. However, Mr. DeWard disagreed that an outside audit would support PCUC's contention that its reported plant investments were adequately documented. By way of explanation, Mr. DeWard stated that,

> Yes, perhaps the numbers are there, perhaps amounts were paid. We are looking at a rate case setting where we are determining whether things are prudently incurred, whether they are capitalizing items they shouldn't be. We are looking at an entirely different situation than here in the audited financial statements.

Mr. DeWard also indicated that, while the "numbers might be fine," he was concerned with used and useful matters, issues of prudence, and an overall policy of capitalization. He also indicated that his interest could involve matters which might not be considered material in terms of the overall financial report.

We do not believe that OPC's contention that PCUC has routinely capitalized repair items is supported by the record. Mr. DeWard appears to have misunderstood the character of the records which he contends show an improper capitalization of repair costs. PCUC's books and records have been reviewed by both this Commission and Arthur Anderson & Co., and no inappropriate capitalization of repair costs has ever been detected. Accordingly, based upon the evidence of record and the discussion above, we find that rate base is not overstated due to improper capitalization of repair costs.

AFUDC and Overhead Charges

In its brief, OPC argues that PCUC failed to provide any meaningful documentation to support its capitalized allowance for funds used during construction (AFUDC) and overhead charges. OPC contends that return on equity should be reduced by 100 basis points as a penalty for PCUC's failure to provide meaningful information.

Utility witness Guastella testified that Mr. DeWard and other representatives of OPC visited PCUC's offices during the week of May 22, 1989, and while there, asked for and received documentation of 131 items, including overhead, from PCUC's CPR system. Mr. Guastella further testified that OPC never informed PCUC that its supporting documentation for the selected items was inadequate. He further refers to prior Commission and independent auditor review of PCUC's records as evidence that construction costs were properly recorded.

Based upon the evidence of record, we cannot find that plant-in-service is overstated due to any inappropriate capitalization of AFUDC and overhead charges.

Original Source Documentation

OPC contends that PCUC has failed to support its reported plant balance by providing original source documentation. OPC recommends reducing PCUC's return on equity by 100 basis points as a corresponding penalty.

In his prefiled testimony, witness DeWard indicated that, unless he was able to review all of PCUC's original cost documents, it would be impossible for him to adequately analyze plant additions. Mr. DeWard also testified that he would want to examine original contracts and invoices on "everything."

This Commission has audited the utility's books and records in each of PCUC's previous rate proceedings. Its books and records are also audited by Arthur Andersen & Co. for the purpose of rendering an audit opinion. No errors of any material nature have ever been reported or detected. In fact, under cross examination, Mr. DeWard seemed to agree, although reluctantly, that documentation to support plant balances had been reviewed by PCUC's outside auditors.

Based upon the discussion above and the evidence of record, we find that adequate source documentation has been provided both to this Commission and the utility's outside auditors to support reported plant investments.

Capitalized Repair/Replacement Costs

During the 1970s, a significant amount of defective plant was allegedly constructed. As a result, PCUC apparently had to repair and/or complete a substantial portion of this plant. Some of the costs incurred in this repair program were capitalized on PCUC's books. The remainder of the costs were treated as an extraordinary property loss, which loss has been amortized for approximately ten years.

"Reconsideration" of Previous Decisions

PCUC argues that we thoroughly examined the repair program and approved PCUC's treatment of the costs therefrom in the utility's first rate proceeding before this Commission. PCUC argues that no new information regarding the repair program has been brought to light during this proceeding, and that we should not, therefore, make any adjustments to its plant or expense accounts.

OPC contends that we were never truly informed as to the nature or the extent of the problem. OPC believes that it has brought new information to our attention during this proceeding which shows that the construction of the original defective plant was either caused by or facilitated by PCUC and/or its affiliates. Accordingly, OPC argues that all costs to repair and/or complete the defective plant should be borne by the utility and not the ratepayers.

In its first rate case, by letter dated October 30, 1980, PCUC specifically requested that we approve a $980,000 extraordinary loss account, the "expense" portion of the repair program. The utility's letter did not, however, indicate that approximately $1.5 million had also been added to the plant accounts for "completion" work performed during the same period. PCUC witness Guastella nevertheless testified that this letter brought the matter to this Commission's attention.

Mr. Guastella also referred to the testimony of Mr. F. Marshall Deterding, a former Commission employee who was assigned to PCUC's first rate proceeding before the Commission,

in PCUC's last rate case. In that proceeding, Mr. Deterding testified that "I looked at documents to assure myself that the loss they were requesting to amortize was a reasonable thing to pass on to customers." (Emphasis added) He also testified that "I recall the company requested, I reviewed it, I analyzed it, I asked for information on it and made a decision that was appropriate." (Emphasis added) He further testified that "I had certainly come to the conclusion that the Utility was not at fault and it acted prudently." (Emphasis added) After hearing Mr. Deterding's testimony in PCUC's last rate case, we found that, while he did establish that amortization of the extraordinary loss was allowed in PCUC's first rate case, Mr. Deterding was uninformed about many of the underlying facts concerning the subject.

PCUC's first rate proceeding before this Commission was initially assigned to a Division of Administrative Hearings hearing officer. Mr. Deterding was a witness in that case. Although an accounting schedule was attached to Mr. Deterding's testimony, the amounts identified as test year amortization of the extraordinary loss were only $954 for water and $769 for wastewater. Since this was an immaterial amount, and since Mr. Deterding had already assured himself that PCUC had not acted imprudently and that its proposed treatment was appropriate, it does not appear that that the $2.5 million in repairs to defective plant was ever brought to the attention of either the hearing officer or this Commission. In fact, this is borne out by the final order in that case, Order No. 10463, issued December 18, 1981, which makes no mention of either the extraordinary property loss or any provision relating to the $1.5 million amount added to plant.

Based upon the evidence and our discussion above, we find that this Commission was never fully informed about the nature or the extent of the defective plant and the subsequent repair program.

Cause of Defective Plant

In its brief, OPC argues that defective work may have occurred because of a Federal Trade Commission (FTC) review of ITT Community Development Corporation's (ICDC's) sales practices and because ICDC had to place permanent reference markers by July 1, 1973, in order to avoid certain unspecified requirements of Chapters 177 and 380, Florida Statutes. OPC

admits, however, that it is not aware of any action taken by any governmental body against ICDC due to any alleged violations of these statutes.

Next, OPC contends that ITT, the parent company of both ICDC and PCUC, imprudently caused the defective construction work "in order to keep up with the promises of its aggressive and successful marketing campaign to sell lots, to attempt to avoid possible FTC sanctions and to avoid costly and time consuming governmental land development and environmental regulation." In support of its arguments, OPC relies almost exclusively on "Citizens' Recommendation Concerning Nine Remaining Issues" (Citizens' Recommendation), which was filed by OPC in the investigation docket, and the myriad of attachments to that document.

At the hearing, PCUC objected to Citizens' Recommendation as being legal argument rather than testimony. We agreed and, on that basis, we excluded the narrative portion of that document from the record. PCUC also objected to virtually all of the attachments to that document, with the exception of Attachment D, which was already included in the record. After hearing the arguments of PCUC and OPC regarding the admissibility of the various attachments, we declined to admit Attachments F and U, and excluded Attachment S, subject to the submission of further information regarding its relevance. Such information was not subsequently presented. We admitted Attachments G, H, and I, which are documents filed by ICDC and PCUC in a number of consolidated civil proceedings arising out of the alleged faulty construction work. Further, although we expressed a certain amount of skepticism regarding the value to be afforded these documents, we also admitted Attachment O, a brief filed by a one of the parties, a defendant in at least one of the civil actions, and Attachment P, certain deposition pages reportedly culled from those proceedings. Finally, we took notice of Attachments Q and R, which documents appear to reflect an agreement and a decision rendered by the FTC regarding certain land sales practices of ICDC.

For its arguments, OPC places great reliance upon Attachments O and P to Exhibit 30. We do not believe that Attachment O, the defendant's brief, is an objective analysis of the disputed facts since it appears to be intended to render the defendant's case in the most favorable light. Besides being disorganized and often unreadable, Attachment P, the deposition pages, were evidently chosen out of a much larger

pool. It is often impossible to determine who the deponent is, whose attorney is asking the questions, or the subject matter being discussed. Accordingly, we place no reliance on the brief or the deposition pages.

In its brief, PCUC again argues the inadmissibility of the attachments to Citizens' Recommendation. Among its other arguments, PCUC contends that Attachments G, H and I to Exhibit 30 are inadmissible as admissions, citing Sea Cabin, Inc. v. Scott, Burk, Rozie & Harris, 496 So. 2d 163 (Fla. 4th DCA 1986). Upon consideration, we believe that Sea Cabin stands for the proposition that a statement of an individual who is not a party to the present proceeding is inadmissible as an admission in that proceeding.

PCUC also argues that, under Yates v. Bass Randy, Inc., 379 So. 2d 710 (Fla. 4th DCA 1980), and DeLong v. Williams, 232 So. 2d 246 (Fla. 4th DCA 1970), the documents must be preliminarily authenticated before being admissible. A reading of Yates and DeLong, however, indicate that documents may be authenticated by either direct or circumstantial evidence. Further, the authenticity of Attachments G, H and I to Exhibit 30 was never called into question during the hearing. In fact, PCUC admitted that these documents were its own. Since the authenticity of these documents was never raised, PCUC should not be heard to argue it now; nevertheless, its own admission that these documents were its own is at least circumstantial evidence of their authenticity.

PCUC further argues that the documents are inadmissible under Juste v. Dept. of Health & Rehab. Services, 520 So. 2d 60 (Fla. 1st DCA 1988), University of North Florida v. Unemployment Appeals Commission, 445 So. 2d 1062 (Fla. 1st DCA 1984), and Quick v. State, 450 So.2d 880 (Fla 4th DCA 1984), because OPC failed to have a records custodian lay a proper predicate. However, we do not believe that these cases are persuasive since Juste and Quick concern business records and University of North Florida concerns public records. As already mentioned, PCUC did not deny that these documents were, in fact, its own. Accordingly, we find that a proper predicate has been laid.

Under Section 90.803(18), Florida Statutes, admissions of a party or a representative, agent or servant of the party are admissible against the party. Contrary to the position espoused by PCUC, this includes admissions made by the party's

attorney(s). Payton Health Care Facilities, Inc. v. Estate of Campbell, 497 So. 2d. 1233, 1238 (Fla. 2d DCA 1986), review denied 500 So. 2d 545 (1986) (complaint filed in separate action), and United States v. McKeon, 738 F. 2d 26, 30-33 (2d Cir. 1984) (attorney's opening statement).

The following statements have been drawn from Attachments G and I to Exhibit 30.

> Plaintiffs, ITT COMMUNITY CORPORATION and PALM COAST UTILITIES CORPORATION (hereafter referred to as ICDC and PSU respectively) have suffered compensatory damages . . . as a result of a pattern of fraud and dishonesty on the part of John Barton, Daniel Cooper, . . . and C. D. Lowery of Lowery Brothers . . .
> (Exhibit 30, Attachment G, Page 1)

> While serving as ICDC's chief engineer and ICDC's project director, Mr. Barton and Mr. Cooper, respectively, were responsible for negotiating construction contracts with the various contractors, and were charged with the duty of properly overseeing the inspection, supervision and approval of the quality and quantity of the work done on the project. They also had the responsibility for approving the contractors' payment or draw requests.
>
> Instead of carrying out their duties properly, both men knowingly permitted the contractors to violate and ignore contract specifications, to provide substandard materials and otherwise to perform in such a way as to obtain substantial benefit for themselves and to inflict heavy damages upon plaintiffs.
>
> Not only did Barton and Cooper cover-up such fraudulent and illegal activities, but in fact, they facilitated the fraud by firing employees who tried to complain of such activities and, as noted, actually participated in the scheme by taking kickbacks and other payments from the contractors.
> (Exhibit 30, Attachment "G", Page 2)

> Preliminary studies prepared by engineers indicated that there were significant defects and deficiencies in the work which had been done by Lowery Brothers, Inc. . . . Accordingly, the engineers made detailed and comprehensive investigations into such work. These investigations have shown that there were in fact serious deficiencies in the Palm Coast . . . sewer and water systems . . . caused by breaches of contract on the part of these contractors. In addition, these contractors, in certain instances, were paid for work that was never performed.
>
> Plaintiffs are asserting that the fraud and dishonesty of John Barton and Dan Cooper caused the construction defects and deficiencies which have been found.
> (Exhibit 30, Attachment "I")

Based upon the above admissions by ICDC and PCUC, we find that water and wastewater plant was defectively constructed due to contractors' breaches of contracts and that these breaches were caused or made possible by the fraud and dishonesty of employees of ICDC and that, as a result, it was necessary for PCUC to perform extensive repairs to the facilities. We do not find that the repair program was imprudent; however, we find that the repair program was necessitated by the imprudent construction of the original plant. Further, we do not believe that PCUC's ratepayers should have to pay a return on both the original cost of the plant as well as the costs incurred to repair it. Accordingly, we find that all of the costs related to the repair of the defective water and wastewater plant should be removed from PCUC's plant and expense accounts.

Cost of Repairs

In its brief, OPC also attempted to quantify the total costs incurred to repair the defective plant. OPC argues that Attachments G, H and I to Exhibit 30 suggest that the total cost of the repairs was $2,571,000. However, OPC also contends that the extent of the problem may be much greater as evidenced by excessive unaccounted-for water and infiltration. OPC also believes that 37.93 percent of certain engineering costs, in-house costs, legal expenses and alleged kickbacks should be added to the actual damages claimed.

Witness Guastella disagreed with OPC's allegation that there were obvious problems in PCUC's water and wastewater systems due to "excessive" unaccounted for water and infiltration. Mr. Guastella testified that the levels of unaccounted for water and infiltration are reasonable. Mr. Guastella also testified that the amount booked by PCUC did not include any provisions for kickbacks, legal fees, or other overhead charges. In addition, Mr. Guastella testified that many of the costs of the repair program were actually completion costs and that they are, therefore, properly included in plant in service.

As for Mr. Guastella's distinction between repair and completion costs, OPC argues that the allocation was arbitrarily made, based upon whether the water and wastewater systems had been activated in the particular section and without regard to the character of the work actually performed. OPC's argument appears persuasive. In Attachment I to Exhibit 30, PCUC and ICDC attempted to describe and quantify the defects in the water and wastewater systems. Attachment I does not appear to identify any new construction other than the completion of plant paid for but not performed by the original contractors. In addition, according to the record reveals, there was apparently no attempt to distinguish between repair expenditures and new construction costs while the work was actually being performed. Most of the work, in fact, appears to be related to repairs. Accordingly, we find Mr. Guastella's distinction between repair and completion costs to be of limited service.

Based upon the evidence of record, we find that the total cost of the repair program was $2,519,030. The amount charged to the extraordinary loss account was $983,230. The amount charged to plant is subject to used and useful adjustments. Therefore, a division of the capitalized portion among primary plant accounts is necessary to make the appropriate corrections. A calculation of the amount of accumulated depreciation for the capitalized portion of the repair program is also needed for this adjustment. We have used 1979 to establish the accumulated depreciation account. After allocating the plant portion between the water and wastewater divisions and among the various primary accounts, the net reduction to plant in service is $329,340 for water and $847,266 for wastewater. After applying the appropriate used and useful percentages, we find that the appropriate net reductions to rate base are $87,941 for water and $235,624 for wastewater.

Offset of Insurance Settlement

Finally, OPC argues that a portion of the costs incurred to repair and/or replace the defective plant should be offset by a $2,000,000 settlement from ICDC's insurance carrier. The record indicates that ICDC's insurer paid ICDC $2,000,000 for payment of legal fees. Since it appears that this settlement was only for legal costs, we find that the record does not support OPC's proposed offsetting adjustment.

Used and Useful Provision for CIAC

On December 4, 1989, PCUC served a response to a Staff request for admission concerning different used and useful ratios applied to an $85,000 contribution of land (beachfront tank site) and its offsetting contributions-in-aid-of-construction (CIAC) account. PCUC agreed that, applying its requested 70.2 percent used and useful ratio to the beachfront tank site would result in a $30,404 increase to CIAC and that such an adjustment was appropriate. OPC agrees that the used and useful CIAC provision should be increased. We also agree. Accordingly, we find it appropriate to increase CIAC by $30,404.

Imputation of CIAC

Cost of Water Plant Included in Lot Price

OPC argues that we should impute CIAC equal to the entire cost of PCUC's water system because "ICDC has held out to lot purchasers that the price of the lot included the provision of water service." Mr. DeWard testified that "the Utility established the initial "prepaid connection fee" relating to the provision of water service at $50.00." According to Mr. DeWard, ICDC admitted claiming more than $10.8 million in expenses for costs associated with the "Water Distribution System" for tax purposes. Mr. DeWard also argues that different terms regarding the time for payment of water and wastewater "prepaid connection fees" in different offering statements further support his position.

Witness Guastella testified that PCUC has "accurate detailed records supporting all amounts of CIAC that have been paid by its customers" and that Mr. DeWard's proposed imputation of CIAC would violate Rule 25-30.570, Florida Administrative Code, which states:

> (1) If the amount of CIAC has not been recorded on the utility's books and the utility does not submit competent substantial evidence as to the amount of CIAC, the amount of CIAC shall be imputed to be the amount of plant costs charged to the cost of land sales for tax purposes if available, or the proportion of the cost of the facilities and plant attributable to the water transmission and distribution and the sewage collection system. (Emphasis supplied)

With regard to the offering statements, Mr. Guastella testified that "the early offering statements clearly state that the connection fee was an estimate based upon current construction costs. Therefore, purchasers were on notice that the water connection fee was subject to increases."

In its brief, OPC refers to two additional documents to support its position that CIAC should be imputed. The first document appears to be one page from an early offering statement, which states: "The estimated cost of providing a central water system to the property is $504,947. The Company has guaranteed the cost." Mr. Guastella testified that that statement was probably the developer's way of assuring the lot purchaser that utility services would be available and that arrangements would be made to assure that utility service would be available.

The second document referenced by OPC is a portion of a report prepared by Russell & Axon. That report states that "[t]he Utility had chosen not to collect a main extension fee from purchasers of property prior to March 1, 1978." Mr. Guastella reported that the term "main extension fee" could be construed in many ways, including payment for an extension beyond the utility's existing system.

During cross-examination about ICDC's claimed tax deduction for the water distribution system, Mr. Guastella reported that he reviewed documents which indicated that the deduction was for some kind of reserve for which a tax deduction was not permitted, and that there was a corresponding reversal. He further reported that correspondence indicated that the reserve may have been for future operating costs, rather than a charge for water transmission and distribution costs. He testified that the record was unclear about what this

deduction was intended to represent, but that he was certain that the plant was capitalized on PCUC's books and had not been expensed for tax purposes.

Based upon the record, we do not find that the cost of the water system was included in the price of a lot. Accordingly, we reject OPC's proposal that we impute additional CIAC to offset the cost of the water transmission and distribution system.

"Receivable" Prepaid CIAC

Pursuant to the terms of many of ICDC's offering statements and land sales contracts, ICDC collects prepaid connection fees from many of the lot purchasers. In addition, ICDC has allowed some of these lot purchasers to pay the prepaid connection fee "on time." OPC suggests that PCUC should record receivables for all connection fees currently payable to ICDC and credit its CIAC accordingly. Although Mr. DeWard recommended this accounting treatment, he did not propose any adjustment that would affect the utility's revenue requirement calculation.

PCUC contends that it is not a party to these offering statements, that this Commission has no jurisdiction to regulate offering statements, and that the offsetting receivable and CIAC accounts, if recorded, would not affect the ratesetting equation.

Under cross-examination, Mr. DeWard reported that he did not know of any precedent for his proposed entry relating to unpaid prepaid connection fees. Mr. DeWard testified that accounting principles support the recordation of this "valid receivable." Mr. DeWard admitted, however, that lot purchasers are not utility customers. He also admitted that this Commission does not exercise any direct control over ICDC.

Witness Guastella testified that Mr. DeWard's proposal is contrary to the prescribed accounting instructions for PCUC, since those instructions indicate that CIAC should be recorded when received. Mr. Guastella also testified that the amount to be collected cannot be ascertained with certainty. For instance, he pointed out that contracts can be cancelled or one housing unit might occupy two lots. He also testified that OPC's proposed accounting treatment would be an unworkable

proposition for financial reporting purposes. He further testified that OPC's proposed adjustment has no practical value for this proceeding.

We agree with Mr. Guastella that the prescribed accounting instructions for PCUC provide for the recordation of CIAC when received. Future lot owners are not customers of PCUC, and recording the amounts that they have not paid to ICDC as a receivable on PCUC's books seems far removed from the ratesetting concern before this Commission. In any respect, it does not appear that Mr. DeWard's proposed adjustment has any practical value in this proceeding. Accordingly, we reject OPC's proposed treatment of recording unpaid prepaid CIAC as receivables on the utility's books.

Misclassification of Prepaid CIAC

OPC contends that prepaid CIAC for the water division is wrongly included in the prepaid account for the wastewater division, and that an adjustment is necessary. PCUC contends that the apparent misclassification is an immaterial amount, and that used and useful CIAC provisions are not understated in any case.

PCUC has acknowledged that, subsequent to filing its MFRs, it identified $93,593 worth of non-used water CIAC that is reflected in the MFRs as nonused wastewater CIAC. The misclassification appears to be an inadvertent error. In any event, the correcting adjustment would not affect the used and useful CIAC amount for this proceeding. Therefore, we find that it is unnecessary to make any correcting adjustment for the purpose of this proceeding.

Due and Payable Prepaid CIAC

OPC argues that CIAC is understated because PCUC has not demanded payment in full from ICDC of all outstanding prepaid CIAC due and payable pursuant to the terms of ICDC's offering statements. PCUC's arguments are that it is not a party to these offering statements, that it cannot "demand payment" from ICDC, and that this matter is not a consideration in setting rates for current customers.

Witness Guastella testified that ICDC collects connection fees from lot purchasers and transfers that money to PCUC, but that there are no Commission requirements relating to such

collections. Mr. Guastella testified that PCUC had an arrangement with ICDC whereby PCUC is to receive prepaid connection fees from ICDC as a means of funding plant construction.

Based upon the evidence of record, we do not find that the amount of used and useful CIAC is understated because PCUC has not demanded payment in full of all connection fees that have not been paid to ICDC by lot purchasers. PCUC does not appear to be a party to land sales contracts, none of which are included in the record, since it is neither the buyer or the seller. Further, we do not believe that the land sales practices of ICDC are proper matters for this Commission's consideration. Accordingly, we reject OPC's proposed treatment.

Interest and/or Finance Charges

OPC believes that PCUC's wastewater CIAC balance is understated because PCUC has allowed ICDC to retain finance charges or similar amounts paid by individuals who have been allowed to pay their connection fees under extended payment terms. PCUC contends that any interest paid to ICDC by individuals who received extended terms for payment of connection fees should be retained by ICDC. PCUC further contends that there is no precedent for treating interest as additional CIAC, and that it would be unused CIAC in any respect.

Witness Guastella testified that homesite purchasers are not required to pay interest for future CIAC obligations pursuant to the terms of their purchase agreements. He reported that the "only interest related to CIAC that ICDC receives from homesite purchasers occurs after the purchase as a result of purchasers requesting to defer the previously agreed upon payment of CIAC." Mr. Guastella testified that it was appropriate for ICDC to retain these interest charges since ICDC pays PCUC guaranteed revenues for non-used plant, which amount is made larger due to the extended payment arrangements. He also indicated that he knew of no precedent for treating interest income as additional CIAC, much less as CIAC in the capital structure. During the hearing, Mr. Guastella stated that extended payment terms for connection charges were, to his understanding, infrequent.

Under cross-examination, Witness DeWard admitted that he was not aware of any other regulatory agency that had considered CIAC as part of the capital structure. He also stated that he knew of no other situation where interest was classified as CIAC, although he recommended such treatment in this case.

Based upon the evidence adduced at the hearing, we do not believe that OPC's proposal to include added CIAC in the capital structure for interest charges relating to extended payment of connection fees by lot purchasers is supportable. The contention that interest income should be considered CIAC is apparently without precedent. Further, ICDC's retention of interest charges for extending payment conditions does not appear unreasonable since PCUC receives greater guaranteed revenues from ICDC when connection charges are delayed. We, therefore, reject OPC's proposed treatment of interest charges.

Interest Earned on CIAC Trust Account

OPC contends that the interest earned on a prepaid connection fee trust account should be considered additional CIAC. PCUC contends that interest earned on the trust account should not be considered CIAC and that the trust account relates to unused CIAC in this proceeding.

An account titled "Sewer CIAC in Trust" appears on an MFR schedule titled "Contributions in Aid of Construction, Advances and Accumulated Amortization". This account is apparently part of PCUC's CIAC balance. PCUC's balance sheet also shows a cash account of $4,415,659 and a liability account of $4,416,138 as of December 31, 1988, which accounts refer to a trust balance. Witness DeWard includes the trust account in the schedule which shows his proposed CIAC provision for inclusion in the capital structure. Therefore, there is no apparent dispute concerning whether the trust account is part of PCUC's CIAC balance.

During the hearing, witness DeWard testified that he could not cite any precedent wherein interest income had been classified as CIAC. Witness Guastella also testified that he knew of no precedent for treating interest income as CIAC.

Based upon the record, we do not find that interest income on the CIAC trust account should be treated as additional CIAC. Accordingly, we reject OPC's proposed adjustment.

Allocation of Accumulated Amortization of CIAC

In a response to a request for admission by Staff, PCUC agreed that the approach used to allocate accumulated amortization of CIAC between water and wastewater in its MFRs is different than the approach used in its 1988 annual report, due to the amortization of specific water and wastewater CIAC balances in 1987 and 1988. The MFR allocation is based upon relative water and wastewater CIAC amounts without regard to timing of CIAC receipts. PCUC also stated that the allocation of CIAC amortization that is shown in its 1988 Annual Report is a reasonable approximation of the allocation that would have occurred had the method of allocation used for 1987 and 1988 been used consistently since inception." Under cross-examination, Witness Guastella also stated, "I have no problem using the allocation in the annual report."

OPC believes that all accumulated amortization related to CIAC imputed on the margin reserve should be excluded since OPC does not believe that any margin reserve is appropriate. OPC offered no evidence, however, to support this contention.

Based upon the evidence of record, we find that the appropriate method of allocation is that used in PCUC's 1988 annual report. Using this method rather than the method used in the MFRs results in a transfer of $296,199 worth of CIAC from water to wastewater. However, since more water CIAC is used and useful (80.43 percent) than wastewater CIAC (19.59 percent), the net resulting impact is a $238,193 reduction for water and a $57,765 increase for wastewater. The accumulated amortization accounts for imputed CIAC are also changed, for a further reduction of $42,062 for water and an increase of $11,086 for wastewater. The net adjustment resulting from the adjustments above is a reduction of $280,255 to water rate base and an increase of $68,851 to wastewater rate base.

Land

Valuation of Land

OPC believes that the use of appraisals for valuation of land based upon its "highest and best" use is inappropriate if it conflicts with the intended use of that property as a utility site. OPC also argues that at least one of the appraisals is an improper basis for valuation since it refers to land purchases in the Daytona Beach area for uses other than

utility purposes. OPC refers to the accounting instruction for regulated utilities requiring plant to be recorded "at the cost incurred by the person who first devoted the property to utility service" and then contends that the Commission should adopt the treatment used for the valuation of land used in Docket No. 850941-WS, the application of Rolling Oaks Utilities, Inc. for increased rates and charges in Citrus County, and Docket No. 850151-WS, the application of Marco Island Utilities, a division of Deltona Utilities, Inc., for an increase in water and sewer rates in Collier County. OPC argues that the existence of the utility gives rise to greater property values to surrounding properties, and that the appropriate valuation when the transaction is not an arms-length transfer is the cost to the developer plus inflation .

In its brief, PCUC argues that land was recorded on the utility's books when dedicated to utility service by PCUC, that the recorded values were all reviewed by Staff, and that those amounts were accepted by the Commission in each of PCUC's prior rate proceedings. PCUC further contends that the land values were booked in accordance with prescribed accounting instructions, and that there has been no showing that the booked land costs are unreasonable.

The appraisal which OPC argues is an unreasonable basis for land valuation is an appraisal that was reviewed by Staff in Docket No. 810485-WS, PCUC's second rate case before this Commission. In that docket, we approved a Staff recommendation to reduce the booked amounts for four land parcels which had been valued based upon comparable sales of commercial properties in communities near Palm Coast. We also used deflation factors to reduce the market valuation amounts to approximate original cost when first dedicated to utility service. As a result of Staff's recommendation, we issued proposed agency action Order No. 12174, on June 27, 1983. That order was subsequently protested by both PCUC and the Palm Coast Civic Association. OPC was also an intervenor in that proceeding. After a formal hearing in that case, by Order No. 12957, issued February 6, 1984, we disposed of the issue concerning land as follows:

> Four land parcels purchased by the Utility from an affiliated party were included in the plant in service account based on the appraised market value in 1981. Actual dedication to utility

> service occurred in prior periods and Order No. 12174 shows reduced amounts based on estimated market values at date of dedication. The Utility agreed to those land valuation adjustments. Although the value of land was raised as a point of issue at the prehearing conference, neither Public Counsel nor the Association pursued this issue during testimony, cross-examination, or upon submission of legal briefs. The Commission will, therefore, reaffirm its conclusions in Order No. 12174 with respect to use of the dedication rather than the transfer date as the basis for cost determination.

The subject of proper land values was not addressed in PCUC's next two rate cases, which were processed under Docket No. 840092-WS and Docket No. 870166-WS.

The utility has provided copies of the subject land appraisals as an exhibit in this case. The first appraisal, dated May 1, 1981, describes four utility parcels. This appraisal indicates that the property was valued as though vacant and available for its highest and best use.

The second appraisal, dated December 1, 1983, describes 23 well sites, 55 pumping station sites, one elevated water tank site, and one sewage treatment plant site. That report indicates that the "purpose of the appraisal was to estimate the market value of the unencumbered fee simple interest of the 'land' only, excluding all improvements, as of the requested dates of valuation." In the section titled "Discussion of Value", the appraiser reported that the parcels varied in size from .02 to 4.13 acres, and that the valuation dates varied from October 1972 to December 1981. With regard to use of those properties for utility purposes, the appraiser reported that "[w]e take the position that those parcels being utilized for well and pump station sites could have been incorporated for use similar to the surrounding properties." With regard to the methodology used to establish various time frame values, the appraiser reported that, based upon relative increases in market values, "we have applied an appreciation rate of 7% to the sales used in each particular section to each individual parcel appraised. This time adjustment, either positive or

negative, correlated each sale to the subject parcels to indicate a final land value estimate as of the date of valuation in question."

The third appraisal, dated December 11, 1985, concerns an 18.11 acre site for a future water plant, which property was appraised as having a market value of $136,000, assuming that the subject property could be developed residentially.

The last appraisal, dated December 12, 1985, concerns a 2.28 acre site adjacent to the water treatment plant, which was appraised at $150,800 based upon its highest and best use.

These appraisal reports, particularly the second report, indicate that the properties were appraised based upon their date of dedication to utility service by PCUC. There is nothing in the record to indicate that the reports were prepared by anyone other than a qualified, independent appraiser.

The recorded land values differ from the appraisal values in some respects. The land values approved in Docket No. 810485-WS were adopted on the utility's books. The properties considered in the second appraisal report were booked at 60.2 percent of the appraisal values. PCUC reports it negotiated that the 60.2 percent factor with ICDC. The recorded purchase price for the 2.28 acre site was $86,025 rather than the $150,800 appraisal amount. The 18.11 acre plant site was recorded at $136,609, including an apparent appraisal fee, which plant is considered future use property for this proceeding.

As noted above, both PCUC and OPC refer to our prior orders in support of their positions. In Docket No. 850151-WS, the application of Marco Island Utilities, a division of Deltona Utilities, Inc., for an increase in water and sewer rates in Collier County, we considered certain appraisals. By Order No. 17600, issued May 26, 1987, we determined that improvements added after land was dedicated to utility service should be excluded for valuation purposes. We indicated that improvements added before dedication of land to utility service could be included, but information to show the cost of those improvements was not provided. Because appraisals in that docket were deemed insufficient evidence of value, we used some earlier determination of original cost plus allowances for inflation.

In Docket No. 850941-WS, the application by Rolling Oaks Utilities, Inc. for increased rates and charges in Citrus County, we considered an appraisal of land based upon its alleged market value. By Order No. 17532, issued May 8, 1987, we determined that the property should not be valued based upon its "highest and best" use, but rather, upon its intended use as a utility site. Accordingly, we valued the land as the original cost to the developer plus some factor for inflation.

In Docket No. 881503-WS, the application of Poinciana Utilities, Inc. for a rate increase in Osceola County, we considered four parcels that were apparently purchased by the utility for a price in excess of appraised values. A market value approach was used to appraise each property unit. The planned use as a utility site was considered for two parcels, with the third and fourth parcels appraised as commercial and agricultural property, respectively, as the highest and best use. By Order No. 22166, issued November 9, 1989, we determined that the valuation of those properties based upon the original cost of the land to the developer plus inflation provisions resulted in per acre costs which were "much lower than the values established by the independent appraisals, which could be used as an indication of what the cost would be in an arms-length transaction." We also determined that "the per acre costs, adjusted for the percentage increase in the [consumer price index], appear to be unreasonably low and unrealistic for the per acre costs during the time period that Poinciana purchased the land." Finally, we stated that, "[a]lthough the appraisal methodologies are somewhat questionable, they are independent. Our preference has been to use independent appraisals when they exist."

A review of the prior orders indicates a preference to use independent appraisals when those reports provide reasonable land values. If the valuation includes improvements added after the property is placed in service, adjustments would be appropriate, as in the Marco Island Utilities case. Consideration of the intended use of land for utility purposes is also appropriate, as in the Rolling Oaks Utilities, Inc. and Poinciana Utilities, Inc. cases. Use of the original cost to the developer plus allowances for inflation may result in unreasonable and unrealistic valuations and should only be used when reasonable appraisals are not available.

Based upon the discussion above, it appears that it was PCUC, not ICDC, that actually devoted the land to public service. The recorded costs were based upon appraised values, or lesser sums, when the land was placed into service. There is nothing in the record to indicate that the appraiser was not independent or qualified to perform an appraisal. The record does not indicate that the property was valued based on improvements added after the property was placed in utility service. The rate base determinations in prior proceedings for PCUC have included portions of the recorded land values, and there was no submission of new information in this docket to indicate that we should reconsider these prior orders. There is no direct testimony in the case to indicate that recorded land values are unreasonable. Further, the record does not reveal the original cost basis to ICDC for land, nor what improvements should be considered prior to dedication of land to utility service. Accordingly, we find that the record does not support OPC's proposal that we reduce the booked value of land to the original cost to ICDC, adjusted for inflation.

Removal of Double Entry

PCUC's land account includes two provisions for the same elevated storage tank site (South Zone). The original recorded value of this land was $11,118. The second provision for the land is $20,770. PCUC agrees that its land account should be reduced by $20,770. Accordingly, we find that land should be reduced by $20,770.

Land Held for Future Use

The utility's land account also includes certain well sites which are not presently used for utility purposes. Witness Guastella agreed that those sites should be considered property held for future use. Accordingly, we find that well sites SW #28, SW #31, LW #14 and LW #49 should be removed, which further reduces the land account by $28,041.

Buffer Zone

There was also considerable discussion at the hearing concerning the utility's purchase of a 2.28 acre buffer zone for its present water treatment plant, the recorded $86,025 purchase price for that property, and why the property was not deemed dedicated to utility service in an earlier period.

Witness Guastella testified that the property was not acquired until 1985, because it was not until then that PCUC discovered that a commercial strip was potentially planned for that area. He reported that PCUC acquired this buffer area to avoid problems which might later arise with commercial development on that property due to PCUC's use of lime for water treatment and traffic at the water plant.

PCUC provided a late-filed exhibit to further explain this land purchase and other land-related concerns. PCUC explained that traffic conditions near the water plant changed dramatically between 1972, when the water treatment plant site was first dedicated to utility service, and 1985, when the buffer zone was purchased. The road abutting the plant has grown from a two-lane highway to a four-lane divided highway leading to a major I-95 interchange. In addition, there has been continuing commercial and industrial growth in the area.

A plat map prepared in 1971 indicates that the buffer zone was immediately adjacent to a highway, and that it was located in an area described as a reserved parcel. PCUC indicates that the recorded plats in this exhibit show no reservation of property for utility purposes, except for reservation of easements for "water and sewer mains". PCUC also reports that the term "reserved parcel" was a generic term meaning reservation for purposes other than single family dwellings.

Upon consideration of the above, we do not find that any adjustments are necessary for the buffer zone property.

Prepaid Income Taxes for Post-1986 Collections of CIAC

In its calculations of rate base, PCUC included prepaid income taxes of $293,019 for water and $294,605 for wastewater, for post-1986 collections of CIAC.

OPC believes the that debit deferred income taxes associated with post-1986 CIAC collections should be excluded from rate base for three reasons. First, the Commission did not specifically allow the inclusion of the prepaid taxes when it approved PCUC's gross-up formula. Second, OPC is not sure whether state income taxes have been paid on CIAC since 1986. Finally, OPC believes that PCUC has adequate working capital relief, because the gross-up is collected before the tax payments are actually due.

PCUC believes that the prepaid taxes associated with post-1986 CIAC are appropriately added to rate base. PCUC Witness Guastella testified that the prepaid income taxes were reduced by the gross-up PCUC was allowed to collect. He further explained that PCUC's gross-up is calculated using a present value method whereby the gross-up amount is reduced by the tax effect of the future tax depreciation. The utility supports its position by reference to Order No. 21265, issued May 22, 1989, by which we approved a similar method of accounting for Jacksonville Suburban Utilities Corporation. Part of the Staff recommendation upon which Order No. 21265 was based stated that "debit deferred taxes or prepaid taxes [should] be a line item in rate base, so that it will not be affected by any working capital consideration." Witness Guastella further testified that state income taxes have been paid on the CIAC amounts.

By Order No. 17598, issued May 26, 1987, we approved PCUC's proposed present value formula for grossing up for the tax effect of CIAC. The approved formula recognizes the tax effect of depreciation that will be received in the future. This partial gross-up has the effect of offsetting part of the current tax associated with CIAC, but requires the utility to prepay taxes associated with the CIAC amounts that will be recovered through tax depreciation. Schedule C-13 of the MFRs demonstrates that the gross-up amounts were used as an offset when calculating the associated debit deferred taxes. The recognition of these prepaid taxes is consistent with the full normalization of income taxes and our prior decisions dealing with similar issues.

Based upon the evidence of record and our discussion above, we find that the debit deferred taxes of $293,019 for water and $294,605 for wastewater are appropriately included in rate base.

Working Capital

PCUC's requested working capital amount is based upon the formula approach, or one-eighth of test year operation and maintenance expenses. The utility did not specifically request a waiver of the balance sheet method of calculating working capital. Because it is requesting a separate rate base provision for investigation costs, that charge was not considered in computing the formula amount.

PCUC witness Guastella testified that the one-eighth fraction is based upon the "FPC Formula" for a monthly billing cycle. He also testified that PCUC's use of the formula approach was based upon this Commission's decision in Docket No. 880883-WS, in which we considered various measures relating to ratesetting procedures for water and wastewater utilities. By Order No. 21202, issued May 8, 1989, we found that the formula method is appropriate for water and wastewater utilities and directed Staff to initiate rulemaking to adopt the formula method. Mr. Guastella indicated that the formula approach is appropriate in this instance because it eliminates the need to devote any time to a balance sheet calculation of working capital.

Under cross-examination, Mr. Guastella testified that PCUC did not attempt a balance sheet calculation of working capital because the costs incurred in such a process would likely have been disallowed. He further indicated that a balance sheet calculation would have been difficult because of used and useful measurements and other considerations.

OPC witness DeWard testified that the utility's requested working capital amount should be wholly removed because information to permit a balance sheet calculation was not provided, because working capital was not included in the utility's last rate proceeding, and because the formula approach always results in a working capital allowance rather than a required amount.

In PCUC's last rate case, we did not approve a working capital allowance because PCUC did not request such an allowance, because the record did not include adequate used and useful information to yield a balance sheet measurement of working capital, and because we could not rely on an apparently flawed balance sheet calculation presented by one of the witnesses.

In Order No. 21202, we expressed our continued confidence in the balance sheet approach for measurement of working capital, but acknowledged that this approach is not cost justified for the water and wastewater industries. We found that the formula approach for measurement of working capital was appropriate for the water and sewer industry and that it would likely result in reduced rate case costs. However, we also decided that, as an offsetting consideration, no separate

provision for deferred charges would be permitted in the rate base calculation. The exclusion of deferred charges concerns deferred rate case costs as well as other deferred items.

Although PCUC did not request a formal waiver of the balance sheet method, we believe that it has sustained its burden to show that the formula approach is a valid means of measuring working capital. Accordingly, we find that $119,235 is the appropriate working capital provision for water and $92,810 is the appropriate working capital provision for wastewater.

Deferred Investigation Charges

The utility's requested rate base amount includes a separate provision for deferred investigation costs related to Docket No. 871395-WS. The requested amount, or $112,500, is divided equally between the water and wastewater divisions, and represents a projected $150,000 cost reduced to reflect the average unamortized balance for the test year.

The investigation and this rate proceeding were combined pursuant to Order No. 21794, issued August 28, 1989. Prior to that date, PCUC incurred actual investigation costs of $71,389. Thus, separate rate base consideration of investigation costs, if allowed, should be reduced to reflect a lesser expenditure than the projected amount prior to the combining of proceedings. Further, since the provision for investigation costs includes amounts incurred in 1989, it does not represent the average outstanding balance for the 1988 test year. Finally, as reflected by Order No. 21794, we found that many of the issues in the investigation were intrinsic to this rate proceeding. Thus, it appears that much of the work in the investigation was made part of this rate proceeding.

Based upon the evidence and our discussion above, we do not find it appropriate to allow a separate provision for the cost of the investigation. Accordingly, we have removed these amounts from PCUC's proposed rate base calculations.

Rate Base

Based upon PCUC's application, the evidence of record and the adjustments made above, we find that the appropriate levels of rate base for this proceeding are $10,546,502 for water and $4,103,273 for wastewater.

## COST OF CAPITAL

Our calculation of the appropriate cost of capital for this proceeding is attached to this Order as Schedule No. 2A, with our adjustments detailed on Schedule No. 2B. Those adjustments which are self-explanatory, or which are essentially mechanical in nature, are depicted on those schedules without any further discussion herein. The major adjustments are discussed below.

### Taxes Paid on Pre-1987 Collections of CIAC

The thrust of this issue is whether PCUC could have avoided paying income taxes associated with pre-1987 collections of CIAC. Utility witness Scheibel and Staff witness Causseaux agreed that three requirements had to be met in order for CIAC to be nontaxable. First, the CIAC received had to be true contributions-in-aid-of-construction. Second, any cash CIAC had to expended within two taxable years after the year of receipt and accurate records had to be maintained. This is also referred to as the "look forward" rule. Third, the CIAC could not be included in the utility's rate base for ratemaking purposes.

The IRS released proposed regulations relating to the taxation of CIAC on May 31, 1978. Although these regulations were never finalized, they did provide some guidance regarding the appropriate interpretation of the tax law. The regulations stated that the CIAC must be for the expansion, improvement, or replacement of the utility's water or sewage facilities. This has been referred to as the purpose requirement.

The regulations then gave examples of the expenditure rule. The regulations stated that the expenditures should be on the cash basis and not the accrual basis.

The regulations also discussed what is commonly referred to as the "look back" rule. The look back rule provided guidance on plant that was placed in service before the CIAC was received. The regulations specified that the purpose requirement is not met unless there is an agreement, binding under local law, between the prospective contributor and the utility. The agreement must be in place when the plant is placed in service and must specify that the utility was to receive CIAC as reimbursement for the cost of the facility.

PCUC used the look forward rule to determine the taxability of CIAC. PCUC argues that, because it was not able to expend all the cash CIAC within two taxable years after it was received, PCUC paid income taxes on CIAC for the years 1983-1986. According to Mr. Scheibel,

> Simply stated, PCUC used the CIAC it received in a given year for expansion, improvement or replacement of utility plant in that year and carried over any excess CIAC to the subsequent two years. If the CIAC it received in a given year were not spent within the following two years on expansion, improvement, or replacement of utility plant, PCUC included such excess nonexpended CIAC in its taxable income.

Witness Causseaux believes that some of the taxes on CIAC would have been avoidable if the look back rule had been used. She believes that the "binding agreement" requirement would have been satisfied by the Commission's tariffs. According to Ms. Causseaux,

> Utilities under the jurisdiction of this Commission must charge their tariffed rates and charges. Those rates and charges must be paid by the customers. Those rates and charges are enforceable under state laws. As such they should satisfy the requirements of the Service.

Witness Scheibel argues that the utility's tariffs are not adequate to meet the requirements of the IRS. He bases his conclusion on a legal opinion rendered by an attorney that a tariff is not a contract or agreement. We note, however, that the opinion only addresses contract law.

In its brief, PCUC argues that, under Kislak v. Kreedian, 95 So. 2d 510, 515 (Fla. 1957) an agreement binding under local law is, by definition, a contract. However, we believe that Kislak merely stands for the proposition that a contract is an agreement enforceable at law, not that all agreements are necessarily contracts.

PCUC also relies upon Black's Law Dictionary to support its position that "agreement" and "contract" are synonymous. Black's defines "agreement" as:

> A coming or knitting together of minds; a coming together in opinion or determination; the coming together in accord of two minds on a given proposition; in law a concord of understanding and intention between two or more parties with respect to the effect upon their relative rights and duties of certain past or future facts or performances; the consent of two or more persons concurring respecting the transmission of some property, right, or benefits, with the view of contracting an obligation, a mutual obligation . . . The act of two or more persons, who unite in expressing a mutual and common purpose, with the view of altering their rights and obligations. The union of two or more minds in a thing done or to be done; a mutual assent to do a thing . . . A compact between parties who are thereby subjected to the obligation or to whom the contemplated right is thereby secured.

In its discussion of agreement, Black's also states that:

> Although [an agreement is] often used as synonymous with "contract" . . . it is a wider term than "contract" . . . An agreement might not be a contract, because not fulfilling some requirement . . . Black's Law Dictionary 89 (4th ed. 1968)

After arguing that agreement and contract are synonymous, PCUC goes on to argue and to cite a number of authorities for the proposition that a tariff is not a contract. We do not believe that these authorities are persuasive, since it does not appear that Staff ever claimed that PCUC's tariff qualified as a contract. However, we do believe that PCUC's tariff would have qualified, under the proposed regulations, as an agreement binding under local law. Notwithstanding that ICDC interposes itself between PCUC and the future customers for the purposes of pre-collections of CIAC charges, at the time a customer wishes to connect, that customer must agree to pay the prevailing, tariffed CIAC charge and PCUC must agree to hook the customer up. This agreement is binding under local law; the customer must pay the charge, and PCUC must collect the charge and hook the customer up. Even if the contributor is

not a customer, for instance if it is a developer, it is still required to pay the existing charge. If there are special circumstances involved, which circumstances might justify a charge other than the tariffed charge, PCUC and the developer must have an approved special service availability contract.

If PCUC is correct that an actual contract was required for the look back rule, we believe that a prudent utility would have made provisions to enter into such contracts to ensure the least tax liability possible. Mr. Scheibel testified that a utility would have become aware of the need for contracts when the proposed regulations were issued in May, 1978. For the period of time between when the applicable sections of the Internal Revenue Code were enacted in February, 1976, and the regulations were released, in May, 1978, witness Scheibel testified that guidance was offered by the law itself and the committee report language. Use of the look back rule was not lost for this period of time. With guidance from the law itself, as well as the case law, committee reports, and the Proposed Regulations, PCUC still did not attempt to structure its affairs in order to avoid taxes on the CIAC. According to Mr. Scheibel,

> Income taxes have to obviously take a back seat to economic and other business decisions. But if it were possible for a utility to organize its affairs in a way that would meet with the approval from a business and a regulatory climate and in the process, save income taxes, I believe that's what they should do.

Basically, PCUC's argument is that it did not qualify to use the look back rule. We do not necessarily agree. The crux of the matter is that it never tried. Even if PCUC is correct that its tariffs would not have satisfied the "binding agreement" requirement, we are unaware of any economic or business decisions that would have prohibited PCUC from entering into CIAC contracts that would have satisfied the IRS.

Based upon the record and our discussion above, we find it appropriate to disallow $3,078,522 worth of debit deferred taxes associated with pre-1987 collections of CIAC.

Failure to Take Investment Tax Credits (ITCs)

PCUC failed to claim any ITCs on certain additions that were transferred from CWIP to plant in service. This error was noted on a 1978 workpaper. Although the schedule indicates that the ITC amount would be picked up on IRS audit, the ITCs were never realized or booked.

If the ITCs had been realized by the utility or its parent, they would have been included in the utility's capital structure at zero cost and amortized below-the-line. This would have had the effect of reducing the utility's overall rate of return.

OPC believes that $264,356 of ITCs should be imputed to reflect those that PCUC failed to claim on its tax returns. PCUC argues that the benefits of the ITCs were not realized by the utility or its parent, so an adjustment to recognize them should not be made. Further, PCUC states that OPC failed to take into consideration the accumulated ITC amortization that would have occurred if the ITCs had been recognized.

Since it was through its own error that the utility did not realize the benefits of the ITCs, we do not believe that the ratepayers should bear additional costs. We find, therefore, that the ITCs should be imputed to PCUC's capital structure. However, we also agree with PCUC that the accumulated amortization of the ITCs should be taken into consideration as well. At the hearing, Staff requested a late-filed exhibit calculating what the accumulated ITC amortization would have been. Late-filed Exhibit 40 appears to provide a listing of ITC amortization by year for all utility ITCs, so it is not usable for the purpose of this adjustment. Accordingly, we have calculated the accumulated balance of ITC amortization using a reasonable approach. The ITC amortization balance was calculated using a rate of 3 percent. This was calculated by dividing the 1988 ITC amortization by the thirteen month average balance of ITCs for 1988. Using a 3 percent amortization rate and the half-year convention, the accumulated ITC amortization balance would be $83,272 at the end of 1988.

Based upon the evidence and the discussion above, we find that a net accumulated ITC balance of $185,050 on a thirteen month average basis should be imputed to PCUC's capital structure.

Deferred Income Taxes Understated
Due To AFUDC Considerations

Witness DeWard testified that he increased deferred taxes associated with AFUDC for two reasons. The first reason is that PCUC did not record any deferred taxes related to AFUDC in 1978 and 1979. The second reason is that for the years 1980, 1981, 1982, and 1985, PCUC recorded deferred taxes as if a portion of the AFUDC related to equity. Mr. DeWard believes that the entire amount of AFUDC related to debt. He stated that PCUC's books did not reflect any equity AFUDC.

Witness Guastella testified that PCUC capitalizes both debt and equity for AFUDC purposes. Mr. Guastella testified that during 1978 and 1979, all funding was supplied by ICDC and was, therefore, equity-related. As a result, no deferred taxes would have been recorded since no book-tax timing difference existed. For the years 1980, 1981, 1982, and 1985, Mr. Guastella believes that the deferred taxes have been recorded correctly. He refers to Exhibit 29, Schedule 29-75, to demonstrate that the deferred taxes have been recorded related to the debt portion of AFUDC and a permanent difference recognized for the equity portion of AFUDC.

Generally, the debt portion of AFUDC creates a book-tax timing difference that is recognized through deferred income taxes. The equity portion creates a book-book difference, but not deferred income taxes. The equity book-tax timing difference is recognized through current taxes as a permanent difference. If, as Mr. Guastella testified, all funding during 1978 through 1979 was equity related, PCUC would not have recorded deferred income taxes. In addition, Schedules 29-74 and 29-75 of Exhibit 29 appear to support PCUC's argument that deferred taxes associated with AFUDC were calculated correctly.

Based upon the record, we find that no adjustment should be made for deferred income taxes associated with AFUDC.

Deferred Income Taxes Understated
Due to Property Loss Considerations

PCUC has a $291,702 thirteen month average debit deferred tax balance recorded on its books associated with the extraordinary property loss. These deferred taxes were recorded in conjunction with a book write off of the extraordinary property loss in order to be in compliance with

Statement of Financial Accounting Standard No. 90, "Regulated Enterprises - Accounting for Abandonments and Disallowances of Plant Costs." This financial standard has not been recognized for ratemaking purposes. The book write down is being recognized for financial statement purposes only.

OPC argues that all costs associated with the extraordinary property loss should be the responsibility of the utility. As a cost associated with the loss, there should not be an impact on the ratepayer.

Witness Guastella argued that "selective reconciling of capital structure . . . is not based on sound ratemaking principles." He stated that other rate base adjustments could also be reconciled to their capital structure components but that they generally are not.

We believe that an adjustment should be made to the debit deferred taxes associated with the extraordinary property loss. The debit deferred taxes were the result of an entry made for financial statement purposes only. Since we have decided to completely exclude the extraordinary loss for ratemaking purposes, the associated debit deferred taxes should also be removed. Accordingly, we find that $291,702 of debit deferred taxes should be removed from PCUC's capital structure.

Failure to Use Accelerated Depreciation

OPC takes the position that deferred income taxes should be imputed to PCUC's capital structure because the utility did not take accelerated depreciation on its tax return due to purposes that serve the parent company. OPC believes that this is at odds with the interests of the the utility's customers and increases the costs which the ratepayers must bear. Imputing the deferred taxes would negate the detrimental effects on the ratepayers.

PCUC argues that the deferred income taxes cannot be directly imputed, and that an adjustment that would indirectly achieve the same result cannot be made because a normalization violation would occur. The violation could result in lower deferred income taxes resulting in a higher cost of service. Witness Scheibel testified "that a normalization violation would occur even where this artificial increase or imputation were made to correct perceived inequities between the customer and the utility."

PCUC did not offer any evidence to dispute the allegation that accelerated depreciation was not taken due to consolidated tax considerations. In fact, witness Scheibel testified that PCUC did not use accelerated depreciation for all years in which PCUC had taxable income. The allegation is further supported by a letter, dated June 26, 1981, from ITT to all U.S. affiliates. The letter instructed the companies to use a certain method of depreciation in order to receive ITC benefits on the consolidated return.

We agree with PCUC that a violation could occur if deferred income taxes are imputed or an indirect adjustment is made to accomplish the same result. Accordingly, we do not believe that such an imputation should be made, but only because a normalization violation might hurt the ratepayers in the long-run.

Notwithstanding the above, we believe that a prudent utility should attempt to provide the best possible service at the lowest possible cost. This includes paying the least amount of tax legally possible. Based upon this as well as other issues, we find that there has been a pattern, on PCUC's part, of not taking the cost of service into consideration when determining its tax policies. We believe that it is appropriate to send a signal to PCUC. Accordingly, we find it appropriate to assess an equity penalty of 50 basis points against PCUC for its failure to take the interests of its ratepayers into consideration when determining its tax policies.

Interest as Cost-free Capital

As discussed more fully above, OPC argues that we should include interest, installment or other incremental amounts in excess of principal amounts for prepaid wastewater connection charges in PCUC's capital structure as cost-free capital. Since we have already determined that such adjustments are inappropriate, no further discussion of this matter is necessary.

Prepaid CIAC as Cost-free Capital

Witness DeWard testified that PCUC has significantly over-collected wastewater "prepaid connection fees" in relation to actual plant balances. Comparing gross plant balances to the gross CIAC balances, including the sewer CIAC trust, Mr. DeWard determined that CIAC in excess of 75 percent of the plant

amount should be treated as cost-free capital. However, Mr. DeWard was unable to cite to any precedent for his proposed treatment of the prepaid CIAC.

Under cross examination, Mr. DeWard stated that he did not know how service availability charges are established or whether a "milestone year" was a consideration in setting service availability charges. Mr. DeWard seemed to suggest that larger charges would be required for the water division. Mr. DeWard admitted that PCUC would need to make significant additional investments to provide service to future customers, including as much as $33.5 million for the installation of PEP installations. Mr. DeWard testified that he included the CIAC trust account in his CIAC total (but, significantly he did not consider its offsetting cash trust account), because ICDC's payment of guaranteed revenues is reduced by interest on the trust account, and because he believed that the trust account offers no real protection that funds would be available for future construction. He testified that it was improper to consider the overall nonused CIAC and nonused plant amounts for the combined water and wastewater systems.

In its brief, PCUC argues that prepaid CIAC should not be included in the capital structure. PCUC refers to Mr. DeWard's inability to cite to any other jurisdiction where CIAC was considered part of the capital structure.

We do not believe that nonused CIAC should be considered in the capital structure. Mr. DeWard could cite no precedent for such treatment. The combined water and wastewater rate base totals requested by PCUC, which are $16,103,845 per MFR Schedules A-1 and A-2, are less than PCUC's reported capital structure, which is $28,383,746 per MFR Schedule D-1. We believe that this shows that PCUC still has a significant investment in nonused plant facilities.

Mr. DeWard's proposed adjustment to include CIAC in the capital structure, based upon CIAC exceeding 75 percent of plant for the sewer system, involves consideration of total plant and total CIAC numbers, not just the portions which are considered used and useful.

Rule 25-30.580, Florida Administrative Code, provides guidelines for establishing service availability charges. That rule indicates that the maximum level of CIAC, net of amortization, should not exceed 75 percent of a utility's

original cost of plant, net of accumulated depreciation, when "the facilities and plant are at their designed capacity." In this case, PCUC's collection plant is obviously known to have capacity beyond the current customer demand. Mr. DeWard's use of the 75 percent factor to compare gross plant and CIAC amounts, rather than net account balances, evidently gives no consideration to design capacity measurements.

Upon consideration, we do not find OPC's proposal to treat all CIAC in excess of 75 percent of plant as cost-free capital to be appropriate.

Prudency of Proposed Equity Level

Witness Guastella testified that PCUC's actual equity ratio is 74.23 percent. Mr. Guastella believes that this equity level is fair and reasonable for PCUC and that the resultant capital structure is beneficial to both PCUC and its ratepayers. He stated that the large amount of equity will benefit the utility by lowering its perceived level of risk within the capital markets and that this is important for a utility which will be expanding and need to attract capital. He also stated that the perceived lower level of risk will also benefit the ratepayer because, over the long-run, it will produce a lower overall cost of capital to the utility. Finally, Mr. Guastella points out that the leverage formula is designed to take the relatively higher percentage of equity capital into account when it is used to determine the appropriate rate of return on equity.

Witness DeWard argued that PCUC's equity ratio is not prudent and that, absent a decision by this Commission which would include the additional sources of capital proposed by OPC, the equity ratio should be reduced to no more than 40 percent.

This Commission's practice has been to use the actual capital structure and embedded cost rates associated with utility operations when the component balances are reasonable. We have followed this practice because we believe that decisions regarding capital structure are the prerogative of management. Management faces the complex and intricate issues of corporate finance on a day to day basis and is responsible for maintaining a utility's credit rating and ability to attract capital. However, our practice does allow for certain types of adjustments when necessary due to management error or for regulatory purposes.

While we do not believe that PCUC's equity level is imprudent, we do recognize OPC's concern that the ratio is high relative to the average equity ratio for a typical water and wastewater utility. However, it should be noted that the leverage formula serves to balance the impact of the equity to debt ratio trade-off. As the more costly equity balance increases relative to the debt balance, the return on equity decreases. In this case, the leverage formula produces an equity cost rate of 12.13 percent. This results in only a 334 basis point spread between the cost of equity and the long-term debt cost rate of 8.79 percent.

Based upon the discussion above, we do not find that the record supports OPC's position that the utility's equity level is imprudent. Neither does the record support OPC's position that, absent a decision by this Commission to include the additional sources of capital proposed by OPC, the equity level should be reduced to no more than 40 percent of PCUC's capital structure. Accordingly, we find that the actual equity ratio of 74.23 percent is appropriate for this utility for the purpose of this proceeding.

Return on Equity

According to PCUC witness Guastella, the appropriate return on equity should be determined by applying the leverage formula established by this Commission by Order No. 19718 issued July 26, 1988. OPC witness Mr. DeWard argued that the appropriate return on equity should be determined using the leverage formula in effect at the time of our vote on this issue. Neither witness took a position for the use of any method other than the leverage formula to calculate return on equity. We, therefore, find that the leverage formula is the appropriate method to determine return on equity.

While this Commission does analyze historic test year data in rate cases, it uses this analysis to set rates on a prospective basis. The appropriate return on equity is likewise determined on a going-forward basis. Since we revised the leverage formula when we issued Order No. 21775 on August 23, 1989, the leverage formula established in Order No. 19718 is no longer in effect. We agree with witness DeWard that the appropriate return on equity should be determined by applying the current leverage formula. We note further that PCUC did not protest Order No. 21775.

Based upon the current leverage formula and PCUC's capital structure, we find that the appropriate return on equity is 12.13 percent.

## Overall Cost of Capital

In establishing PCUC's appropriate overall cost of capital, we have used its adjusted capital structure, with each account reconciled on a pro rata basis. In order to establish a reasonable range for the overall rate of return, we have also added a factor of plus or minus 1 percent to the return on equity. Based upon the evidence of record and the adjustments discussed above, we find that the appropriate overall cost of capital is 9.21 percent, with a range of 8.88 percent to 10.20 percent.

## NET OPERATING INCOME (NOI)

Our calculations of the appropriate levels of NOI for this proceeding are attached as Schedule No. 3A for water and Schedule No. 3B for wastewater, with our adjustments detailed on Schedule No. 3C. Those adjustments which are self-explanatory, or which are essentially mechanical in nature, are depicted on those schedules without any further discussion in the body of this Order. The remaining adjustments are discussed below.

## Annualization of Miscellaneous Revenues

Effective June 1, 1988, PCUC was authorized to increase its miscellaneous service charges for initial, normal, and violation reconnection charges by 50 percent. OPC proposed, and PCUC agrees, that the utility's 1988 miscellaneous revenues should be annualized. The parties agree that the adjustment should be based on a 50 percent increase for miscellaneous revenues collected from January through May, 1988.

Based upon the evidence and our discussion above, we find that miscellaneous revenues should be increased by $6,578. This amount should be allocated to water and wastewater based upon the number of bills.

Reduction to Operating Expenses for Unaccounted-for Water

Since we have already found PCUC's level of unaccounted-for water to be excessive, we also find that purchased power for the raw water supply and water treatment plant, and chemicals for the water treatment plant should be reduced by 4.5 percent.

Used and Useful Adjustments to Operation and Maintenance (O&M) Expenses

Pursuant to Section 367.081, Florida Statutes, PCUC adjusted its O & M labor expenses to account for used and useful adjustments. PCUC reviewed its total costs as reflected in its records and made a determination what portions were incurred in the operation of the used and useful property. PCUC's adjustments were based upon its proposed used and useful percentages. The accounts adjusted by the utility included wastewater collection, water distribution, and some of the administrative and general accounts.

PCUC also employed a weighting factor to approximate the work activity in different areas. A factor of two was used for the active water lots in water, and a factor of three was used for the active wastewater lots, as compared to the inactive lots. The utility believes that these factors are conservative estimates. The weighting factor calculation was made after gathering information from the supervisors in each of the departments who said that, by and large, most of the activity and most of the maintenance work is in areas that are built up and have customers. For the administrative area, adjustments were based on interviews with department personnel.

The used and useful percentages used in PCUC's calculations include a margin reserve. PCUC included a margin reserve in these calculations because the portion of plant which represents margin reserve has already been constructed. It must, therefore, be maintained.

OPC's position is that the used and useful portions of plant are overstated due to the inclusion of margin reserve in all plant accounts and the inclusion of fire flow in the water treatment plant accounts. As discussed previously, we believe that the inclusions of margin reserve and fire flow are appropriate. Accordingly, we reject OPC's suggestion that any further reductions are necessary.

Upon consideration of the evidence and our discussion above, we find that, although there is some room for doubt regarding PCUC's weighting factors, it did attempt to separate charges incurred for nonused and useful plant. Accordingly, with our adjustments for margin reserve, we find that the used and useful provisions for the water distribution system should be reduced by $14,293, the used and useful provision for the wastewater collection system should be reduced by $4,079, and the used and useful provision for the administrative and general department should be reduced by $7,628.

Tank Painting

In his testimony, OPC witness DeWard proposed reducing expenses by $9,875 to eliminate an amortization provision for tank painting, under the assumption that such amortization ended during the test year.

Witness Pennacchio testified that the amortization of tank painting was not completed during the test year. He further testified that the amortization treatment is used to reflect the incurrence of a periodic cost, and that elimination of the expense would suggest that tanks were not painted in the past and will not be painted in the future.

OPC no longer proposes the removal of the tank painting amortization charge. In any respect, the record does not support finding that tank painting expenses should be removed. We, therefore, find that no adjustment is necessary.

Depreciation Rates

Both PCUC and OPC take the position that PCUC's current depreciation rates should be retained. PCUC argues that its current rates take the specific plant into consideration and that they are the same rates allowed by this Commission in PCUC's last rate case. Since PCUC's 1983 depreciation study, it has not made any significant retirements of plant.

Under Rule 25-30.140(3), Florida Administrative Code, utilities involved in rate proceedings before this Commission are required to employ average service life depreciation rates based upon guideline lives and salvages (guideline rates). PCUC does not currently use guideline rates but rather, depreciation rates allowed by this Commission in its last rate case.

In support of its use of the nonguideline rates, PCUC submitted the following:

> We believe that the depreciable lives presently in use fairly reflect the expected useful lives of the PCUC property. We therefore propose to continue using depreciable lives currently in effect as opposed to using the shorter depreciable lives currently embodied in the FPSC's recent guidelines as delineated in Rule 25-30.140. (MFR Filing in this proceeding, Schedule B-14, p. 3)

Under Rule 25-30.140(5), Florida Administrative Code, a utility may request to use average service lives other than those shown in the rule. However, it must specifically request to use nonguideline rates and must justify its use of the rates by supporting data. PCUC did not specifically request to use nonguideline rates. Neither did it submit any supporting data to justify its use of nonguideline rates. The only justification given by PCUC was a statement at the hearing that its current depreciation rates had been approved in prior rate cases.

In its brief, PCUC argues that no evidence has been presented that its present depreciation rates are unreasonable. We reject this argument, however, since the burden rests with PCUC to justify any departure from the requirements of Rule 25-30.140, Florida Administrative Code.

Based upon the evidence and the discussion above, we find that PCUC should use the guideline depreciation rates embodied in Rule 25-30.140, Florida Administrative Code.

Depreciation Expense

PCUC has calculated depreciation expense based upon its proposed used and useful percentages and its current depreciation rates. OPC proposes a depreciation expense based upon its proposed used and useful percentages and PCUC's current depreciation rates.

Since we have already determined that PCUC should employ the guideline depreciation rates, we find that the appropriate test year depreciation expense provisions are $681,731 for water and $529,364 for wastewater.

Amortization of Extraordinary Property Loss

As addressed more fully under our discussion of rate base, we do not believe that any of the $2,519,030 in expenditures related to the repair of defective plant should be borne by PCUC's ratepayers. This includes any provision related to the utility's extraordinary property loss. Accordingly, we find it appropriate to remove $5,047 for water and $7,250 for wastewater, which represent the amortization expense for the extraordinary property loss.

Rate Case Expense

In its application, PCUC estimated $490,380 in total rate case expense. This amount consisted of $110,380 in prior unamortized expenses, an estimate of $150,000 for the investigation proceeding and an estimate of $230,000 for this rate case. The estimated current rate case amount was based upon projected legal costs of $50,000, projected accounting costs of $70,000, projected engineering costs of $60,000 and $50,000 in projected direct costs to PCUC. PCUC subsequently revised its request for rate case expense for the current case to $429,892.53, which includes actual investigation charges of $71,388.79 and actual and projected rate case costs of $358,503.74.

Unamortized Prior Rate Case Expense

As noted above, PCUC requested that we allow $110,380 in unamortized prior rate case expense. This amount was based upon its use of a 1988 test year. Since the rates approved herein will go into effect in March of 1990, a substantial portion of the requested amount has already been collected through PCUC's existing rates. PCUC witness Pennacchio testified that, in 1988, PCUC recovered $66,674 in rate case expense through its existing rates. He also testified that he had no reason to believe that the same amount was not collected through rates during 1989. Accordingly, at the time that the new rates go into effect, unamortized prior rate case expense has actually been reduced by $83,333 ($110,380 less $66,674 recovered in 1989 less $16,669 recovered during the first quarter of 1990).

In addition to the above, in PCUC's last rate case, we made a used and useful adjustment to the rate case expense allowed in that proceeding. Consistent with our decision in that case,

we have made the same used and useful adjustment to the remaining portion of unamortized prior rate case expense, for a further reduction of .

Based upon the record and our discussion above, we find that the appropriate amount of unamortized prior rate case expense for the purpose of this proceeding is .

Current Rate Case Expense

Rate case expense, like any other expense, is recoverable only if it is reasonably and prudently incurred. Moreover, it is the Commission's responsibility to evaluate rate case expense to determine whether the costs incurred were reasonable and prudent. Meadowbrook Utility Systems, Inc. v. Florida Public Service Commission, 518 So.2d 326 (Fla. 1st DCA 1987), review denied, 529 So.2d 694 (Fla. 1988). In this case, PCUC has requested $429,892.53 in current rate case expense. We find, however, that PCUC has not met its burden of proving the amount requested was both reasonable and prudent.

OPC, through its witness, Mr. DeWard, questioned the prudence of several costs incurred by the utility in the course of the investigation and rate case. Specifically, Mr. DeWard testified that all accounting consultant fees should be removed because PCUC's controller, Mr. Kelly, and his assistant, Mr. Bilinski, could have prepared the MFRs and testified in this proceeding. Mr. DeWard also recommended that engineering fees be reduced by $27,000 to agree with his understanding concerning reasonable engineering costs for the hearing. However, in its brief, OPC suggested that it would be appropriate to allow $50,000 for engineering fees, since such services were necessary in order to prepare PCUC's MFRs.

With regard to legal fees, OPC recommended that legal fees for both the investigation and the rate case proceedings be reduced by 50 percent. OPC argues that, because PCUC objected to virtually every discovery request propounded to it, many more hours were devoted to motions, answers, cross-motions, etc., than were necessary to arrive at the final product. While OPC recognizes that PCUC was within its rights to approach this case with whatever strategy it chose, it argues that the ratepayers should not be required to pay the costs of PCUC's particular strategy, when a less costly approach would have served it as well. In other words, only prudently incurred costs can be recovered from ratepayers.

OPC also recommended that we reduce the total investigation costs by 50 percent because of PCUC's counterproductive tactics. Witness DeWard testified that this adjustment is reasonable because all of the motions generated by PCUC impeded rather than advanced the investigation, and the costs incurred as a result of PCUC's strategy could, therefore, be disallowed in their entirety.

In its brief, OPC further proposed that we reduce PCUC's requested amount for tax consulting fees to $15,000, since the utility's tax consultant only addressed one issue.

The adjustments discussed above, absent anything further, would reduce PCUC's requested current rate case expense to $183,583. However, OPC also contends that we should make a used and useful reduction of 35.65 percent to this amount. Accordingly, OPC recommends that we only allow $118,309 in current rate case expense.

PCUC countered the adjustments proposed by OPC through the testimony of Mr. Pennacchio and Mr. Guastella. With respect to accounting consulting fees, Mr. Pennacchio testified that Mr. Kelly did not believe that he and Mr. Bilinski could satisfy the requirements for a rate application and that they were also encumbered by their involvement in the investigation docket. Utility witness Guastella also testified that, to the extent possible, his firm relied upon PCUC to compile information and prepare schedules. In addition, Mr. Guastella also reported that PCUC attempted to minimize the investigation costs by using outside consultants as little as possible.

As for OPC's recommended used and useful adjustment, Mr. Pennacchio testified that such an adjustment was inappropriate since this rate proceeding concerned charges to existing customers. He believed that the costs should, therefore, be borne by the utility's existing customers and that no used and useful adjustment should be made.

Determining the appropriate amount of rate case expense is not an easy task. On the one hand, the utility is certainly entitled to some rate case expense, as it cannot change its rates absent our approval. On the other hand, ratepayers should not be burdened with an expense that is unreasonable or was imprudently incurred.

In this case, the evidence and testimony, as well as our own observations of the conduct of the case, leads us to conclude that rate case expense requested is grossly excessive. We believe that PCUC's management of this case was not conducive to a prompt adjudication of the issues and an efficient and effective resolution of the investigation and rate case. Even taking into account the complexity of the issues and the adversarial nature of the proceedings, it is our opinion that the proceedings were unduly complicated and contentious and that PCUC bears some responsibility for this fact.

We note that a great deal of time in this case was spent on discovery and other procedural matters, and issues of relatively little substance. There was a constant barrage of incredibly tedious motions, cross-motions, responses to motions, and objections to discovery requests. While we recognize that such tactics may sometimes be necessary in order to provide effective representation, we believe that the adversarial tactics in this case were taken well beyond what is reasonable. Further, in spite of the fact that the ultimate burden rests upon it to demonstrate that rate case expense is prudent, it appears that PCUC chose to fuel rather than to defuse the adversarial nature of these proceedings.

We also believe PCUC's use of outside consultants, selection of witnesses, and preparation of testimony reflects poor management of the rate case and rate case expense. Specifically, we found one of PCUC's witnesses to be both uninformed and uninformative. He added little to the proceeding and in some instances, we believe that he hindered our understanding of the issues and facts. He deferred a number of questions to another witness, and did not understand or have answers to a number of other questions.

PCUC's choice of witnesses and use of outside consultants is also perplexing since PCUC is a relatively sophisticated company and has a very competent in-house staff. There also appears to be a conflict between the testimony it presented as to work performed and expenses incurred in connection with the investigation and rate case. As noted above, Mr. Pennacchio stated that Mr. Kelly and Bilinski were working on matters relating to the investigation and had minimized the use of outside consultant services in the investigation. Yet, PCUC reported no in-house costs for the investigation proceeding, but significant in-house costs for the rate proceeding. This

conflict cannot help but cast doubt on the reliability of the evidence presented by PCUC to justify rate case expense.

In addition, when the hourly rates of Messrs. Guastella and Pennacchio are compared to the utility's estimate of the costs of their services through the completion of this case, it appears that, on the eve of the hearing, PCUC expected these consultants to put in a total of seven more forty-hour weeks. This also stretches the bounds of credibility.

Based upon the foregoing, we cannot find that the requested level of rate case expense was reasonably and prudently incurred. If we were to approve such a level of expense, we believe that it would not only be an abuse of discretion but it would also encourage the type of excessively contentious behavior that occurred in this proceeding. PCUC and other utilities must assume the risk for unnecessarily incurring rate case expense, as there must be some incentive to continuously strive to minimize all costs, including those in a rate case. It is, however, difficult if not impossible, to precisely quantify the amount of rate case expense that should not be borne by the ratepayers. Nevertheless, having heard all of the evidence in this case and considered the voluminous number of procedural disputes that had to be referred by the Prehearing Officer, it is inescapable that some reduction in rate case is both necessary and appropriate. However, we cannot accept the rate case expense amount recommended by Public Counsel. The evidence does not leads to the conclusion that the amount recommended is an accurate assessment of what costs were reasonably and prudently incurred.

We are left with choosing a reasonable alternative between the two amounts advocated. Initially, we find it is appropriate to allow PCUC to recover the expense associated with the investigation, since the Commission initiated that investigation. We will, therefore, allow $71,389 in expenses attributable to the investigation. However, of the remaining amount of $358,504, we will allow PCUC to recover only 60 percent of that figure, or $215,102. We believe this to be a reasonable amount because the utility's management of the case contributed significantly to increasing the costs. It could have made better use of its in-house staff in procedural matters and in the rate case especially, since its in-house

staff prepared the information and would have been better able to answer questions. Additionally, the witnesses who did testify should have been more informed with respect to the subject of their testimony. Finally, the utility could have been less contentious on discovery and other procedural matters which had little to do with the substantive issues in the case.

At the same time, we recognize that embedded in the $469,892.53 expense requested by the utility, are some reasonable and prudent costs. We believe that allowing PCUC to recover $286,102 in current rate expense will adequately compensate it for those legitimate costs.

Used and Useful Adjustment

As for OPC's suggestion that we reduce the allowable amount of rate case expense by a used and useful adjustment, although we made such an adjustment in PCUC's last rate case, upon further reflection, we do not believe that such an adjustment is appropriate in this case. The purpose of this proceeding is to set rates for PCUC's existing customers. Accordingly, we believe that the existing customers should bear the allowed costs of this proceeding. We, therefore, reject OPC's proposed used and useful adjustment.

Amortization of Rate Case Expense

Utility witness Pennacchio proposed a two-year amortization period for rate case charges based on the historical frequency of prior rate applications and anticipated subsequent applications. He reported that a longer period only serves to compound the unamortized amounts to be recovered in each succeeding case.

OPC witness DeWard recommended that rate case expense be amortized over three years. He testified that he thought that PCUC was seeking recovery of returns that it was not entitled to. He stated that he believes that a four-year amortization period was appropriate, but because of consistent growth in the service territory, he believes that a three-year amortization period is appropriate for this proceeding only.

Under cross-examination, Mr. Pennacchio reported that PCUC does not have an exact schedule for filing rate applications. However, given the construction currently underway, Mr.

Pennacchio indicated that a rate application within two years was conceivable. He testified that PCUC has not routinely applied for index and pass-through rate increases; however, he believes that these measures would not have delayed any of the past rate applications, nor would they delay subsequent filings.

Consistent with current Commission practice, a four-year amortization period is routinely employed. In addition, under Section 367.0816, Florida Statutes, the amortization period is now required to be four years. PCUC, however, filed its application before that section became effective. Accordingly, we are allowed more latitude in determining a reasonable amortization period. Although the utility has historically filed for rate increases approximately every two years, our calculation of the revenue requirement indicates that compensatory rates will result from this proceeding. Additional plant construction may influence how soon the next application is filed, but customer growth will also be a factor.

Based upon the evidence of record and our discussion above, we find that OPC's recommended three-year amortization period is reasonable under the circumstances of this case.

Depreciation For Transportation Equipment

In his testimony, OPC witness DeWard proposed reducing test year expenses by $29,312 for water and $30,348 for wastewater to reflect the assignment of a portion of depreciation charges for transportation equipment to plant accounts.

Utility witness Pennacchio testified that PCUC's capitalized labor rate already includes depreciation related to transportation equipment.

OPC no longer proposes an adjustment to reduce depreciation expense for transportation equipment. In any respect, the record does not support a finding that such an adjustment is appropriate.

Parent-Debt Adjustment

OPC argues that a parent debt adjustment must be made in accordance with Rule 25-14.004, Florida Administrative Code. PCUC does not agree. PCUC states that its income tax calculation was made on a stand alone basis consistent with the usage of the leverage graph for a stand alone capital

structure. Utility witness Pennacchio testified that the result of the leverage formula "becomes questionable when you impose debt interest from another outside source of capital." He further argued that it is inconsistent to use both the leverage formula and the parent-debt rule

> . . . because the leverage formula determines a cost rate for equity based on the stand-alone capital structure of the utility, Palm Coast Utility. And if an imputation is made of interest from the parent, which thereby reduces the equity, the tax rate, and removes . . . the tax buffer and adds to the risk of the utility's capital stock, it's inconsistent with the . . . purpose of the leverage graph."

Under Rule 25-14.004, Florida Administrative Code,

> In Commission proceedings to establish revenue requirements . . . the income tax expense of a regulated company shall be adjusted to reflect the income tax expense of the parent debt that may be invested in the equity of the subsidiary where a parent-subsidiary relationship exists and the parties to the relationship join in the filing of a consolidated income tax return . . . It shall be a rebuttable presumption that a parent's investment in any subsidiary or in its own operations shall be considered to have been made in the same ratios as exist in parent's overall capital structure. (Emphasis added)

The rule states that the adjustment shall be made. This is a generic rule that applies to all utilities that file a consolidated tax return and use their own capital structure for ratemaking purposes. PCUC did not present any evidence that ITT's investment in the utility has been made in any ratio other than that which exists in ITT's overall capital structure.

A reading of the rule, in fact, indicates that the parent debt rule is designed to achieve the "inconsistent" results to which Mr. Pennacchio objects. The rule is designed to adjust income tax expense in a manner that reflects all debt that may be related to the utility operations and deducted on the

consolidated tax return. This can have the effect of reducing the utility's return on equity. We note further that, even where utilities use the leverage formula, we have nevertheless consistently applied the parent debt rule.

The utility submitted a late-filed exhibit which indicates that the appropriate parent debt adjustment is $91,751 for water and $37,220 for wastewater. Adjusting for our modifications to PCUC's used-and-useful percentages, we find that the appropriate provision for interest expense due to the parent debt adjustment $76,440 for water and $29,756 for wastewater.

Excess Deferred Income Taxes

PCUC and OPC agree that an adjustment should be made using the requirements of Section 203E of the Tax Reform Act of 1986.

PCUC submitted a late-filed exhibit to detail what it believes to be the appropriate adjustments. At the hearing, it was agreed that OPC would be allowed the opportunity to verify the amounts shown in the exhibit. Although the parties discussed among themselves, off the record, the information required to verify the amounts, OPC's witness was to formally describe it when he took the stand. We are not aware of any formal request for information to verify the amounts. In its brief, OPC argues that "adequate information has not been provided by the company to determine the appropriate level of flow back related to deferred taxes associated with accelerated depreciation (protected items)" and suggests a method supported by OPC Witness DeWard in his testimony. His method is based upon the book provision for capitalized interest, adjusted for used-and-useful percentages.

We do not believe that Mr. DeWard's method is appropriate. We do not believe that using capitalized interest is a valid surrogate for the excess deferred tax balances. We, therefore, find that income tax expense should be adjusted by $1,208 for water and $1,208 for wastewater.

Hydrant Revenues

The utility's test year water revenues include $73,000 for fire hydrant charges. Witness Pennacchio testified that those revenues are based on an annual charge of $100 each for 730 hydrants. The utility bills for hydrants based on a contract with Flagler County which provides that any hydrant with less

than three customers within 500 feet, other than a commercial situation, would be prorated to the number of customers. If there is only one customer within 500 feet, then that hydrant is counted as one-third of a hydrant. If there are two customers within 500 feet of the hydrant, then it counts as two-thirds of a hydrant for billing purposes.

The County was billed $73,000 on February 1, 1988, based upon an April, 1987, count of hydrants. OPC argues that hydrant revenues are understated because the amount included in the test year revenues is for a 1987 hydrant count. OPC's position is that the correct hydrant revenues should be based upon the utility's used and useful hydrant analysis. That schedule shows 1,185 used and useful hydrants. OPC's position is that the appropriate revenues should be $118,500.

Witness Pennacchio testified that the 1,185 hydrants in the utility's used and useful analysis was based upon the number of hydrants serving at least one customer. In that analysis, any hydrant serving at least one customer was considered 100 percent used and useful.

We are persuaded by the utility's argument that the hydrant revenue for the test year should not be based on its used and useful hydrant analysis. The utility is authorized to bill the County for hydrants based upon the number of houses within 500 feet of a hydrant. We agree that the April, 1987, count of hydrants appears to produce a mismatch for the 1988 test year. However, because sufficient information is not available in the record to correct the mismatch, we find that that no adjustment should be made.

Used and Useful Property Taxes

Based upon our previous adjustments to used and useful plant, we also find it appropriate to reduce property taxes to correspond to the reduced used and useful plant provisions. Accordingly, we have compared the property appraiser's valuation shown on Schedule B-16 of the MFRs to PCUC's proposed net used and useful plant amounts. We then applied this factor to our used and useful plant adjustments using the applicable property tax rate. This results in an adjustment of $7,511 for water and $6,849 for wastewater.

## REVENUE REQUIREMENT

Based upon PCUC's application and our determination of other issues herein, we find that the appropriate revenue requirements are $3,127,930 for water and $1,687,559 for wastewater on an annual basis. These revenue requirements represent annual increases of $639,103 (25.68 percent) for water and $227,125 (15.55 percent) for wastewater.

## RATES AND CHARGES

### Bills and Gallons

PCUC believes that the appropriate bills and gallons for the purpose of this proceeding are as shown in MFR Exhibit 3, Schedule E. OPC took no position regarding this issue.

We agree that final rates should be set using the bills and gallons shown on Schedule E of MFR Exhibit 3. However, that schedule does not identify the number of bills related to private fire protection charges. That information was obtained from the utility in response to an interrogatory and confirmed by witness Pennacchio under cross examination. The $83,260 revenues from private fire protection were generated through 428 bills.

Based upon the evidence of record, we find that the appropriate bills and gallons to use for ratesetting purposes are 97,729 bills and 589,001,000 gallons for water and 655,202 bills and 323,306,000 gallons for wastewater.

### Rates

We find that the appropriate rates for this utility are those set forth on Schedule No. 4A for water and Schedule No. 4B for wastewater. These rates have been designed to produce annual revenues of $3,127,930 for water and $1,687,559 for wastewater, using the base facility charge rate design. It is our practice to use the base facility charge structure for setting rates because of its ability to track costs and to give the customers some control over their water and wastewater bills. Each customer pays his pro rata share of the related costs necessary to provide service through the base facility charge and only the actual usage is paid for through the gallonage charge.

The rates approved for water service are uniform for residential and general service customers. The rates approved for wastewater service include a base charge for all residential customers, regardless of meter size, with a cap of 8,000 gallons of usage per month for the gallonage charge. There is no cap on the gallonage charge for general service wastewater bills. The differential in the gallonage charge for residential and general service wastewater customers is designed to recognize that a portion of a residential customer's water usage will not be returned to the wastewater system.

The approved rates will be effective for meter readings on or after thirty days from the stamped approval date on the revised tariff sheets. The revised tariff sheets will be approved upon Staff's verification that the tariffs are consistent with this Commission's decision and that the proposed customer notice is adequate.

PCUC's current rates, its interim water rates, its requested final rates, and the rates approved herein are set forth on Schedule No. 4A for water and Schedule No. 4B for wastewater. The difference in the approved revenue increase and the approved rate increase is due to the reallocation of miscellaneous revenues.

Temporary-on Charges

During the test year, PCUC collected $2,138 in temporary-on charges. These charges are collected for service provided for short durations, typically under ten days, where establishing customer credit, initiating a new account, producing a bill and refunding the customer's deposit is too burdensome. PCUC usually collects these charges from rental agents and cleaning services, to clean rental properties. It is not the same as an initial connection charge.

Under cross examination, witness Pennacchio admitted that PCUC has no tariff authority to collect a temporary on charge. He also agreed that the utility charges $14 per request for temporary service regardless of the amount of water usage. PCUC has provided no cost justification for the $14 charge.

We do not agree that it is burdensome for PCUC to use its approved tariff charges. Using the temporary-on charge does not eliminate the need for the utility to render a bill or to

keep accurate records of the transaction. We, therefore, believe that PCUC should use its approved miscellaneous service charges and base facility charge rates. Further, we find that the $14 charge is discriminatory. The temporary customer has unlimited use of water and wastewater service and pays nothing for the utility's cost of turning the meter on and off while service is being provided. PCUC's normal reconnection charge alone is $15.

Based upon the record and our discussion above, we find that PCUC should discontinue its collection of temporary-on charges. However, even though PCUC has collected these charges without authority, we do not believe that it should be required to refund the amounts collected because the amount per customer would be so small, the cost of the administration of the refund would be excessive and the customers did receive a valuable service, notwithstanding the PCUC billed for it inappropriately.

Refund of Interim Rates

By Order No. 21570, issued July 18, 1989, we suspended PCUC's proposed rates. Also by Order No. 21570, we approved an 8.88 percent interim increase for water, subject to refund, and placed 7.01 percent of PCUC's existing wastewater rates subject to refund. PCUC filed a corporate undertaking as security to guarantee any potential refund.

Since the approved final revenues exceed the interim revenues, we find that no refund is required. We further find that PCUC's corporate undertaking may be cancelled.

Regulatory Assessment Fees on Guaranteed Revenues

PCUC collects guaranteed revenues from both ICDC and Admiral Corporation pursuant to guaranteed revenue agreements. These agreements have been previously approved by the Commission. During the investigation, one of the issues identified by Staff was whether these guaranteed revenues should be subject to regulatory assessment fees. PCUC argues that neither statutory law, administrative rules nor the utility's approved tariffs support the subjection of guaranteed revenues to regulatory assessment fees. Other than its stated position, OPC made no further discussion of this issue.

Tariffs

PCUC first argues that its tariffs neither mention regulatory assessment fees nor how they should be recovered. PCUC also argues that it has two Commission approved water tariffs and one Commission approved wastewater tariff, each of which was approved subsequent to the Commission's adoption of Rule 25-30.515(9), Florida Administrative Code, concerning guaranteed revenues.

Initially, while PCUC argues that there are no provisions for guaranteed revenues in its guaranteed revenue contracts, it should be noted that neither are there any provisions for the recovery of property taxes. Nevertheless, PCUC does recover these taxes under the contracts.

In addition, we do not believe that the current lack of a provision for regulatory assessment fees in the contracts or the utility's tariffs is controlling in this instance. Simply because regulatory assessment fees are not currently being collected does not make such collection inappropriate. If such an argument were accepted, the same logic would lead to the conclusion that the Commission could never approve increased rates as a result of changing circumstances or new rates or charges in the wake of a changing regulatory climate.

Rules

Next, PCUC argues that the definition of "guaranteed revenue agreement" included in Rule 25-30.515(9), Florida Administrative Code, does not include guaranteed revenues as part of gross revenues, much less gross operating revenues. PCUC argues that guaranteed revenues cannot, therefore, be considered as operating revenues. We do not agree. Under Rule 25-30.515(9), Florida Administrative Code,

> (9) Guaranteed Revenue Agreement means a written agreement by which an applicant agrees to pay a charge designed to cover the utility's costs <u>including, but not limited to the cost of operation, maintenance, depreciation, and any taxes, and to provide a reasonable return to the utility,</u> for facilities that are subject to the agreement, a portion of which may not be used and useful to the utility or its existing customers. (Emphasis added)

The expenses underlined above are all operating expenses. Accordingly, it would seem to follow that any revenues collected to cover such expenses and provide a reasonable return to a utility would be operating revenues. We are, therefore, not persuaded by this argument.

Case Law

PCUC also cites a case decided by the Supreme Court of Washington, King County Water District No. 68 v. Tax Commission, 362 P. 2d 244 (Wash. 1961). In that case, the Tax Commission had claimed a tax due on " . . . money received as reimbursement for the cost of constructing, installing, and inspecting facilities for the purpose of operating a water distribution system . . ." According to the Court,

> Constructing, installing, and inspecting facilities for the purpose of operating a plant do not constitute operations of such facilities as expressly provided for under this statutory definition. Thus it follows that money received as reimbursement for the cost of constructing, installing, and inspecting facilities for the purpose of operating a water distribution system would not be within the operation of the Water District's distribution business. King County, at 245-246.

First, it should be pointed out that a Washington State decision is not controlling. However, even if this was a decision of the Florida Supreme Court, it is not on point. Monies received as reimbursement for the costs of constructing, installing and inspecting facilities are more in the nature of CIAC than guaranteed revenues. We are, therefore, not persuaded by this argument, either.

Uniform Systems of Accounts

PCUC also argues that "[t]here is nothing anywhere within the Uniform System of Accounts to support an assertion that guaranteed revenues are required to be accounted for as operating revenues."

The record appears, however, to indicate otherwise. Under Rule 25-30.115(2), Florida Administrative Code, guaranteed revenues are to be accounted for in Accounts 469 and 530.

According to the NARUC system, Account 400, Operating Revenues, is a revenue control account which totals those water revenues in Accounts 460 through 474. Account 400 is also the control account which totals those sewer revenues in Accounts 521 through 536. Since guaranteed revenues are accounted for and totalled under operating revenue accounts, it would seem to follow that they are operating revenues.

PCUC further argues that a policy change, such as making guaranteed revenues subject to regulatory assessment fees, should not be made without giving all affected persons an opportunity to be heard on the matter. We agree. However, we believe that PCUC had its opportunity to be heard when we amended Rule 25-30.115(2), Florida Administrative Code, to specifically include guaranteed revenues in the operating revenue accounts.

Finally, PCUC argues that, if we find that guaranteed revenues are subject to regulatory assessment fees, they should only be so subjected on a prospective basis.

Based upon the record and our discussion above, we find that PCUC's collection of guaranteed revenues should be subject to regulatory assessment fees, on a prospective basis, effective for guaranteed revenues collected on or after March 20, 1990.

## III. CONCLUSIONS OF LAW

1. This Commission has jurisdiction to establish PCUC's rates and charges pursuant to Section 367.081, Florida Statutes.

2. As the applicant in this case, PCUC has the burden of proof that its proposed rates are justified.

3. The rates approved herein are just, fair, reasonable, compensatory, not unfairly discriminatory and in accordance with the requirements of Section 367.081, Florida Statutes, and other governing law.

It is, therefore,

ORDERED by the Florida Public Service Commission that the application by Palm Coast Utility Corporation for increased rates for water and wastewater service is hereby approved, to the extent set forth in the body of this Order. It is further

ORDERED that the stipulation contained in the body of this Order is hereby approved in all respects. 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 in the form of discourse in the body of this Order or schedules attached hereto are, by reference, expressly incorporated herein. It is further

ORDERED that Palm Coast Utility Corporation shall improve its relations with its customers, as set forth in the body of this Order. It is further

ORDERED that Palm Coast Utility Corporation is hereby assessed a penalty of 50 basis points for its failure to take the interests of its customers into consideration when determining its tax policies. It is further

ORDERED that Palm Coast Utility Corporation shall discontinue its collection of temporary-on charges. It is further

ORDERED that, prior to its implementation of the rates approved herein, PCUC shall submit a proposed customer notice explaining the increased rates and the reasons therefor. It is further

ORDERED that, prior to its implementation of the rates approved herein, the utility shall submit and have approved revised tariff pages. The revised tariff pages will be approved upon Staff's verification that they accurately reflect this Commission's decision and upon Staff's approval of the proposed customer notice. It is further

ORDERED that the increased rates approved herein shall be effective for meter readings taken on or after the stamped approval date on the revised tariff pages. It is further

ORDERED that Palm Coast Utility Corporation's corporate undertaking be and is hereby released.

By ORDER of the Florida Public Service Commission this 23rd day of APRIL, 1990.

STEVE TRIBBLE, Director
Division of Records and Reporting

( S E A L )

RJP

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), 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 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 Records and Reporting 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 or sewer utility by filing a notice of appeal with the Director, Division of Records and Reporting 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.

ORDER NO. 22843
DOCKET NO. 890277-WS
PAGE 74

PALM COAST UTILITY CORPORATION
SCHEDULE OF WATER RATE BASE
TEST YEAR ENDED 12/31/88

SCHEDULE 1-A
DOCKET NO. 890277-WS

| DESCRIPTION | TEST YEAR PER UTILITY | UTILITY ADJUSTMENTS | UTILITY ADJUSTED BALANCE | ADJUSTMENTS PER COMMISSION | COMMISSION ADJUSTED BALANCE |
|---|---|---|---|---|---|
| PLANT IN SERVICE | 41,842,358 | (20,560,142) | 21,282,216 | (1,189,355) | 20,092,861 |
| LAND AND LAND RIGHTS | 369,528 | 0 | 369,528 | (48,811) | 320,717 |
| ACCUM DEPRECIATION | (8,758,747) | 4,133,059 | (4,625,688) | 230,099 | (4,395,589) |
| CIAC | (6,862,072) | (181,024) | (7,043,096) | 520,343 | (6,522,753) |
| ACCUM AMORTIZATION | 971,453 | 25,796 | 997,249 | (358,237) | 639,012 |
| PREPAID TAXES | 1,265,576 | (972,557) | 293,019 | 0 | 293,019 |
| INVESTIGATION COSTS | 56,250 | 0 | 56,250 | (56,250) | 0 |
| WORKING CAPITAL | 126,939 | 0 | 126,939 | (7,704) | 119,235 |
| RATE BASE TOTAL | 29,011,285 | (17,554,868) | 11,456,417 | (909,915) | 10,546,502 |

PALM COAST UTILITY CORPORATION
SCHEDULE OF WASTEWATER RATE BASE
TEST YEAR ENDED 12/31/88

SCHEDULE 1-B
DOCKET NO. 890277-WS

| DESCRIPTION | TEST YEAR PER UTILITY | UTILITY ADJUSTMENTS | UTILITY ADJUSTED BALANCE | ADJUSTMENTS PER COMMISSION | COMMISSION ADJUSTED BALANCE |
|---|---|---|---|---|---|
| PLANT IN SERVICE | 42,709,868 | (26,452,536) | 16,257,332 | (1,568,266) | 14,689,066 |
| LAND AND LAND RIGHTS | 588,895 | | 588,895 | 0 | 588,895 |
| ACCUM DEPRECIATION | (9,115,027) | 5,439,288 | (3,675,739) | 319,992 | (3,355,747) |
| CIAC | (45,451,133) | 34,999,854 | (10,451,279) | 811,578 | (9,639,701) |
| ACCUM AMORTIZATION | 5,842,412 | (4,363,040) | 1,479,372 | (46,027) | 1,433,345 |
| PREPAID TAXES | 2,164,702 | (1,870,097) | 294,605 | 0 | 294,605 |
| INVESTIGATION COSTS | 56,250 | | 56,250 | (56,250) | 0 |
| WORKING CAPITAL | 97,992 | | 97,992 | (5,182) | 92,810 |
| RATE BASE TOTAL | (3,106,041) | 7,753,469 | 4,647,428 | (544,155) | 4,103,273 |

ORDER NO. 22843
DOCKET NO. 890277-WS
PAGE 76

PALM COAST UTILITY CORPORATION
ADJUSTMENTS TO RATE BASE
TEST YEAR ENDED 12/31/88

SCHEDULE NO. 1-C
DOCKET NO. 890277-WS
PAGE 1 OF 2

| | WATER | WASTEWATER |
|---|---|---|
| 1) UTILITY PLANT IN SERVICE | | |
| A. Used and useful adjustment for treatment plant | (587,760) | (645,451) |
| B. Used and useful adjustment for mains | (396,835) | (521,169) |
| C. Used and useful adjustment for services | (36,687) | (27,772) |
| D. Used and useful adjustment for storage plant | (55,497) | |
| E. Used and useful adjustment for pumping plant | | (67,050) |
| F. Used and useful provision relating to removal of "Repair Program" costs | (114,576) | (306,824) |
| | ($1,189,355) | ($1,568,266) |
| 2) LAND AND LAND RIGHTS | | |
| A. Removal of second provision for tank site | (20,770) | |
| B. Additional well sites to be considered PAFU | (28,041) | |
| | ($48,811) | |
| 3) ACCUMULATED DEPRECIATION | | |
| A. Used and useful adjustment for treatment plant | 102,218 | 122,954 |
| B. Used and useful adjustment for mains | 80,060 | 104,614 |
| C. Used and useful adjustment for services | 8,443 | 6,622 |
| D. Used and useful adjustment for storage plant | 12,763 | |
| E. Used and useful adjustment for pumping plant | | 14,622 |
| F. Used and useful provision relating to removal of "Repair Program" costs | 26,635 | 71,200 |
| | $230,099 | $319,992 |
| 4) CONTRIBUTIONS IN AID OF CONSTRUCTION | | |
| A. Matching provision for used and useful well sites | (30,404) | |
| B. Adjustment for reduced margin of reserve provision | 550,747 | 811,578 |
| | $520,343 | $811,578 |
| 5) ACCUMULATED AMORTIZATION OF CIAC | | |
| A. Adjustment for reduced margin of reserve porvision | (77,982) | (114,878) |
| B. Reallocation of reserve account - actual CIAC | (238,193) | 57,765 |
| C. Reallocation of reserve account - imputed CIAC | (42,062) | 11,086 |
| | ($358,237) | ($46,027) |

PALM COAST UTILITY CORPORATION
ADJUSTMENTS TO RATE BASE
TEST YEAR ENDED 12/31/88

SCHEDULE NO. 1-C
DOCKET NO. 890277-WS
PAGE 2 OF 2

| | WATER | WASTEWATER |
|---|---|---|
| 6) INVESTIGATION COSTS | | |
| Remove provision for investigation costs | ($56,250) | ($56,250) |
| 7) WORKING CAPITAL ALLOWANCE | | |
| Adjustment for reduction to operating expenses | ($7,704) | ($5,182) |

ORDER NO. 22843
DOCKET NO. 890277-WS
PAGE 78

PALM COAST UTILITY CORPORATION
SCHEDULE OF CAPITAL STRUCTURE
TEST YEAR ENDED 12/31/88

SCHEDULE NO. 2-A
DOCKET NO. 890277-WS

| COMPONENT | BALANCE PER MFRS | COMMISSION TEST YEAR ADJUSTMENTS | ADJUSTED TEST YEAR | COMMISSION PRO RATA ADJUSTMENTS | COMMISSION ADJUSTED BALANCE | WEIGHT | COST | WEIGHTED COST |
|---|---|---|---|---|---|---|---|---|
| STOCKHOLDER EQUITY | 21,068,245 | 0 | 21,068,245 | (11,409,244) | 9,659,001 | 65.93% | 11.63% | 7.67% |
| LONG TERM DEBT | 5,269,231 | 0 | 5,269,231 | (2,853,176) | 2,416,055 | 16.49% | 8.79% | 1.45% |
| SHORT TERM DEBT | 107,683 | 0 | 107,683 | (58,828) | 48,855 | 0.33% | 9.00% | 0.03% |
| CUSTOMER DEPOSITS | 254,104 | 0 | 254,104 | (136,690) | 117,414 | 0.80% | 8.00% | 0.06% |
| DEFERRED ITC | 3,010,162 | 198,267 | 3,208,429 | (1,737,167) | 1,471,262 | 10.04% | 0.00% | 0.00% |
| DEFERRED FED. TAXES | 2,412,871 | 0 | 2,412,871 | (1,306,336) | 1,106,535 | 7.55% | 0.00% | 0.00% |
| PREPAID FED. TAXES | (3,738,550) | 3,370,224 | (368,326) | 198,979 | (169,347) | -1.16% | 0.00% | 0.00% |
| TOTAL | 28,383,746 | 3,568,491 | 31,952,237 | (17,302,462) | 14,649,775 | 100.00% | | 9.21% |
| | | | | RANGE OF REASONABLENESS | | | LOW | HIGH |
| | | | | EQUITY | | | 11.13% | 13.13% |
| | | | | OVERALL RATE OF RETURN | | | 8.88% | 10.20% |

ORDER NO. 22843
DOCKET NO. 890277-WS
PAGE 79

PALM COAST UTILITY CORPORATION
ADJUSTMENTS TO CAPITAL STRUCTURE
TEST YEAR ENDED 12/31/88

SCHEDULE NO. 2-B
DOCKET NO. 890277-WS
PAGE 1 OF 1

| | |
|---|---|
| ADJUSTMENTS TO ACTUAL ACCOUNTS | |
| A. Provision for additional Investment Tax Credits | 198,267 |
| B. Adjustment relating to Extraordinary Loss Account | 291,702 |
| C. Adjustment relating to taxes on pre-1987 CIAC amounts | 3,078,522 |
| | $3,568,491 |
| PRO RATA ADJUSTMENTS | |
| A. Stockholder Equity | (11,409,244) |
| B. Long Term Debt | (2,853,176) |
| C. Short Term Debt | (58,828) |
| D. Customer Deposits | (136,690) |
| E. Deferred Investment Tax Credits | (1,737,167) |
| F. Deferred Federal Taxes | (1,306,336) |
| G. Prepaid Federal Taxes | 198,979 |
| | ($17,302,462) |

ORDER NO. 22843
DOCKET NO. 890277-WS
PAGE 80

PALM COAST UTILITY CORPORATION
STATEMENT OF WATER OPERATIONS
TEST YEAR ENDED 12/31/88

SCHEDULE 3-A
DOCKET NO. 890277-WS

| DESCRIPTION | AVERAGE TEST YEAR PER UTILITY | ADJUSTMENTS TO THE TEST YEAR | UTILITY ADJUSTED TEST YEAR | ADJUSTMENTS PER COMMISSION | ADJUSTED TEST YEAR | ADJUSTMENT FOR REVENUE INCREASE | ADJUSTED BALANCE |
|---|---|---|---|---|---|---|---|
| OPERATING REVENUES | 2,445,264 | 863,610 | 3,308,874 | (820,047) | 2,488,827 | 639,103 | 3,127,930 |
| OPERATING EXPENSES | | | | | | | |
| OPERATION AND MAINTENANCE | 1,204,808 | (151,798) | 1,053,010 | (99,134) | 953,876 | | 953,876 |
| DEPRECIATION | 1,184,233 | (538,377) | 645,856 | 35,875 | 681,731 | | 681,731 |
| AMORTIZATION - CIAC | (180,493) | (571) | (181,064) | (9,603) | (190,667) | | (190,667) |
| TAXES OTHER THAN INCOME | 314,721 | (30,736) | 283,985 | (28,013) | 255,972 | 15,978 | 271,950 |
| INCOME TAXES | (93,097) | 585,451 | 492,354 | (293,315) | 199,039 | 240,870 | 439,909 |
| TOTAL OPERATING EXPENSES | 2,430,172 | (136,031) | 2,294,141 | (394,190) | 1,899,951 | 256,848 | 2,156,799 |
| OPERATING INCOME | 15,092 | 999,641 | 1,014,733 | (425,857) | 588,876 | 382,255 | 971,131 |
| RATE OF RETURN | 0.13% | | 8.86% | | 5.58% | | 9.21% |

ORDER NO. 22843
DOCKET NO. 890277-WS
PAGE 81

PALM COAST UTILITY CORPORATION
STATEMENT OF WASTEWATER OPERATIONS
TEST YEAR ENDED 12/31/88

SCHEDULE NO. 3-B
DOCKET NO. 890277-WS

| DESCRIPTION | AVERAGE TEST YEAR PER UTILITY | ADJUSTMENTS TO THE TEST YEAR | UTILITY ADJUSTED TEST YEAR | ADJUSTMENTS PER COMMISSION | ADJUSTED TEST YEAR | ADJUSTMENT FOR REVENUE INCREASE | ADJUSTED BALANCE |
|---|---|---|---|---|---|---|---|
| OPERATING REVENUES | 1,448,863 | 371,102 | 1,819,965 | (359,531) | 1,460,434 | 227,125 | 1,687,559 |
| OPERATING EXPENSES | | | | | | | |
| OPERATION AND MAINTENANCE | 978,112 | (156,674) | 821,438 | (78,958) | 742,480 | | 742,480 |
| DEPRECIATION | 1,135,285 | (656,558) | 478,727 | 50,637 | 529,364 | | 529,364 |
| AMORTIZATION - CIAC | (1,026,387) | 761,496 | (264,891) | (30,319) | (295,210) | | (295,210) |
| TAXES OTHER THAN INCOME | 222,521 | (49,215) | 173,306 | (15,837) | 157,469 | 5,678 | 163,147 |
| INCOME TAXES | (11,313) | 210,940 | 199,627 | (120,888) | 78,739 | 91,014 | 169,753 |
| TOTAL OPERATING EXPENSES | 1,298,218 | 109,989 | 1,408,207 | (195,365) | 1,212,842 | 96,692 | 1,309,534 |
| OPERATING INCOME | 150,645 | 261,113 | 411,758 | (164,166) | 247,592 | 130,433 | 378,025 |
| RATE OF RETURN | 3.24% | | 8.86% | | 6.03% | | 9.21% |

ORDER NO. 22843
DOCKET NO. 890277-WS
PAGE 82

PALM COAST UTILITY CORPORATION
ADJUSTMENTS TO OPERATING STATEMENTS
TEST YEAR ENDED 12/31/88

SCHEDULE NO. 3-C
DOCKET NO. 890277-WS
PAGE 1 OF 2

| | WATER | WASTEWATER |
|---|---|---|
| 1) OPERATING REVENUES | | |
| A. Adjustment to reverse requested revenue amount | (826,625) | (359,531) |
| B. Adjustment to annualize miscellaneous charges | 6,578 | |
| | ($820,047) | ($359,531) |
| 2) OPERATION AND MAINTENANCE EXPENSES | | |
| A. Adjustment for unaccounted for level of water | (8,726) | |
| B. Used and useful - water distribution | (14,293) | |
| C. Used and useful - wastewater collection | | (4,079) |
| D. Used and useful - admin. and general | (4,531) | (3,295) |
| E. Adjustment for rate case expense | (71,584) | (71,584) |
| | ($99,134) | ($78,958) |
| 3) DEPRECIATION EXPENSE | | |
| A. Remove amortization of extraordinary loss account | (5,047) | (7,250) |
| B. Used and useful adjustment per Utility depr. rates | (27,415) | (31,850) |
| C. Adjustment to reflect use of guideline rates | 68,337 | 89,737 |
| | $35,875 | $50,637 |
| 4) AMORTIZATION EXPENSE - CIAC | | |
| A. Effect of reduced provision for margin of reserve | 13,769 | 20,289 |
| B. Adjustment to reflect use of guideline rates | (23,372) | (50,608) |
| | ($9,603) | ($30,319) |
| 5) TAXES OTHER THAN INCOME | | |
| A. Regulatory assessment tax relating to requested revenues | (20,666) | (8,988) |
| B. Regulatory assessment tax relating to miscellaneous revenues | 164 | |
| C. Used and useful reduction to property taxes | (7,511) | (6,849) |
| | ($28,013) | ($15,837) |

ORDER NO. 22843
DOCKET NO. 890277-WS
PAGE 83

PALM COAST UTILITY CORPORATION
ADJUSTMENTS TO OPERATING STATEMENTS
TEST YEAR ENDED 12/31/88

SCHEDULE NO. 3-C
DOCKET NO. 890277-WS
PAGE 2 OF 2

| | WATER | WASTEWATER |
|---|---|---|
| 6) PROVISION FOR INCOME TAXES | | |
| A. Adjustment to show deferred tax adjustment | (1,208) | (1,208) |
| B. Adjustment to yield Staff calculation of test year income taxes prior to revenue adjustment | (292,097) | (119,680) |
| | ($293,305) | ($120,888) |
| 7) OPERATING REVENUES | | |
| Adjustment to reflect recommended revenue amount | $639,103 | $227,125 |
| 8) TAXES OTHER THAN INCOME | | |
| Regulatory assessment tax relating to recommended revenues | $15,978 | $5,678 |
| 9) PROVISION FOR INCOME TAXES | | |
| Adjustment to yield Staff calculation of test year income taxes after revenue adjustment | $240,870 | $91,014 |

ORDER NO. 22843
DOCKET NO. 890277-WS
PAGE 84

Schedule No. 4A

Palm Coast Utility Corporation

Schedule of Current, Interim, Requested, and Approved Rates

| | Monthly Water Rates | | | |
|---|---|---|---|---|
| | Current | Interim | Utility Requested | Commission Approved |
| **Residential and General Service** | | | | |
| Base Facility Charge: | | | | |
| Meter Size: | | | | |
| 5/8"x3/4" | $7.74 | $8.44 | $10.45 | $9.91 |
| 1" | $19.35 | $21.10 | $26.12 | $24.76 |
| 1-1/2" | $38.70 | $42.20 | $0.00 | $49.53 |
| 2" | $61.92 | $67.53 | $83.59 | $79.25 |
| 3" | $123.84 | $135.06 | $167.18 | $158.49 |
| 4" | $193.50 | $211.03 | $261.23 | $247.64 |
| 6" | $387.00 | $422.06 | $522.45 | $495.28 |
| Charge per 1,000 Gallons | $2.64 | $2.88 | $3.56 | $3.38 |
| **Private Fire Protection** | | | | |
| Line Size: | | | | |
| 4" | $64.49 | $70.33 | $87.06 | $82.53 |
| 6" | $128.99 | $140.68 | $174.14 | $165.08 |
| 8" | $206.38 | $225.08 | $278.61 | $264.13 |
| 10" | $296.65 | $323.52 | $400.48 | $379.65 |
| 12" | $554.58 | $604.82 | $748.68 | $709.75 |
| **Irrigation Service** | | | | |
| Base Facility Charge: | | | | |
| Meter Size: | | | | |
| 5/8"x3/4" | $3.87 | $4.22 | $5.22 | $4.95 |
| 1" | $19.35 | $21.10 | $26.12 | $24.76 |
| 1-1/2" | $38.70 | $42.20 | $0.00 | $49.53 |
| 2" | $61.92 | $67.53 | $83.59 | $79.25 |
| 3" | $123.84 | $135.06 | $167.18 | $158.49 |
| 4" | $193.50 | $211.03 | $261.23 | $247.64 |
| 6" | $387.00 | $422.06 | $522.45 | $495.28 |
| Charge per 1,000 Gallons | $2.64 | $2.88 | $3.56 | $3.38 |

Schedule No. 4B

Palm Coast Utility Corporation

Schedule of Current, Requested and Approved Rates

| | Monthly Wastewater Rates | | |
|---|---|---|---|
| | Current | Utility Requested | Commission Approved |
| **Residential** | | | |
| Base Facility Charge: | | | |
| Meter Size: | | | |
| All Meter Sizes | $9.07 | $11.34 | $10.33 |
| Charge per 1,000 Gallons (Maximum 8,000 Gallons) | $2.39 | $2.99 | $2.72 |
| **General Service** | | | |
| Base Facility Charge: | | | |
| Meter Size: | | | |
| 5/8"x3/4" | $9.07 | $11.34 | $10.33 |
| 1" | $22.68 | $28.34 | $25.82 |
| 1-1/2" | $45.35 | $0.00 | $51.63 |
| 2" | $72.56 | $90.70 | $82.60 |
| 3" | $145.12 | $181.40 | $165.20 |
| 4" | $226.75 | $283.44 | $258.13 |
| 6" | $453.50 | $566.88 | $516.26 |
| Charge per 1,000 Gallons | $2.87 | $3.59 | $3.27 |