Law Offices
HOLLAND & KNIGHT
A Registered Limited Liability Partnership

315 South Calhoun Street
Suite 600
P.O. Drawer 810 (ZIP 32302-0810)
Tallahassee, Florida 32301
904-224-7000
FAX 904-224-8832

Atlanta
Boca Raton
Fort Lauderdale
Jacksonville
Lakeland
Miami
Orlando
St. Petersburg
Tallahassee
Tampa
Washington, D.C.
West Palm Beach

KAREN D. WALKER
850-425-5612

Internet Address:
kwalker@hklaw.com

July 28, 1997

VIA HAND DELIVERY

Ms. Kay Flynn, Chief
Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: In re: Application for increase in rates in Martin County by Hobe Sound Water Company, Docket No. 970164-WU

Dear Ms. Flynn:

We are in receipt of your July 16, 1997 letter to Michael A. Carfine enclosing Florida Public Service Commission ("FPSC") staff's Audit Report of The Hobe Sound Water Company (the "Company") for the projected test period ending June 30, 1998. Set forth below are the Company's comments on each of the audit exceptions and audit disclosures contained in the Audit Report.

Response to Audit Exceptions

ACK

Audit Exception No. 1

The Company does not object to capitalizing the four Bishop & Associates invoices, the two Elephant Repl. Co. invoices, or the Hughes Supply, Inc. invoice for the $795 saw. However, the Company questions the need to capitalize the Hughes Supply, Inc. invoice for two pipe wrenches totaling $148 (one was $60 and the other was $80 not including sales tax). These are minimal expenses traditionally not capitalized. The Company also questions the appropriateness of capitalizing the remaining Hughes Supply, Inc. invoices which are for meter replacement parts and meter supplies.

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Audit Exception No. 2

The Company does not agree that it has understated water accumulated depreciation by $1,505 due to its alleged failure to reconcile accumulated depreciation to Order No. PSC-94-1452-FOF-WU. The Company had an adjusted accumulated depreciation balance of $1,574,140 on December 31, 1993. Order No. PSC-94-1452-FOF-WU reduced the Company's 1993 year-end balance by $28,332 for an adjusted balance of $1,545,808. The reconciliation of the year-end 1994 balance, brought forward from Docket No. 940475-WU is as follows:

Accumulated Depreciation Reconciliation

	Per Docket No. 940475-WU					
	1990	1991	1992	1993	PSC Order Adjustments	1994
A/D Beginning Balance	973,353	1,088,206	1,239,480	1,399,508	1,574,140	1,545,808
Regulatory Adjustment Items:						
Golf Course Wells (Non-Utility)	(4,426)	(385)	(385)	0	0	(770)
Reclass Car Phone Investment	38	84	84	0	0	168
Road Improvement Costs	792	73	(321)	0	0	0
AFUDC at Unauthorized Rate	(4,340)	(2,316)	(2,316)	0	0	(4,632)
Meter Installations-Labor 1980 to 1990	1,188	277	277	0	0	454
Capitalized Labor	258	520	520	0	0	1,086
Retire Pump Equipment @Well #11				(1,949)	0	0
Retire Pump Equipment @Well #6				(4,145)	0	0
Motor reclass @Well #11				105	0	168
Pipeline Project-AFUDC & labor				164	0	1,974
Meter labor & Reclass				34	0	82
Hydrant reclass				14	0	27
Tools reclass				132	0	265
Retire Storage Tank					(10,651)	0
Record of Tank Removal Costs					(4,316)	0
Correct Depreciation Rate for Mains					(12,824)	0
Duplicate Entry					(966)	966*

A/D on Intercostal Pipeline Finance Costs				0	(175)	(212)
Removal of A/D on Unsubstant. Plant	0	(49)	(49)	0	0	(196)
Meter Installations-Labor 1969 to 1980	0	633	69	0	0	0
A/D on Pipe Relocated by Parent Co.	0	(221)	(221)	0	0	(885)
Subtotal	(6,490)	(1,384)	(2,342)	(5,645)	(28,332)	(1,505)
Reconciling Item in 1994 Rate Case	(15,633)	(409)	(409)	0	0	(426)
Adjustments	(22,123)	(1,793)	(2,751)	(5,645)	(28,332)	(1,931)
Per Book Accrual	157,036	165,067	162,779	180,277	0	223,834
Per book Retirements	(20,060)	(2,000)	0	0	0	0
A/D Ending Balance	1,088,206	1,239,480	1,399,508	1,574,140	1,545,808	1,767,711

The reconciling amount of $1,505, in the 1994 column above, reflects the depreciation necessary to bring the regulatory adjustments forward to December 31, 1994, which is when the correcting entries were made on the books of the Company. The supporting documentation for this accumulated depreciation summary was provided with the Company's response to Audit Request #33. The asterisk designates the Company's omission to record the $966 entry required by Order No. PSC-94-1452-FOF-WU. Thus, the accumulated depreciation should not be increased, but instead should be decreased by $966 per the FPSC's prior Order.

Audit Exception No. 3

The Company objects to this audit exception. A portion of the $10,122 for utility plant-in-service at June 30, 1996 includes work performed for the utility by its parent company and reimbursement by the Company to its parent company for time and materials, including labor charges from the parent company for service rendered by their electrician who wired wells for the Company. The majority of the other items included in the $10,122 charge are not intercompany related. The Company has provided, subsequent to the field audit, additional information supporting these charges via Federal Express delivery to FPSC staff on July 8, 1997.

Audit Exception No. 4

The factual basis for Audit Exception No. 4 is not supported by the information that the Company provided to staff during the audit. As stated in the Company's response to Audit Request #13:

> The wells addressed in the SFWMD Consent Order are currently fully equipped and operable. These wells are temporarily not in use as supply wells, but are in use as monitoring wells. Per the Consent Agreement, these wells may return to serve as supply sources when the saltwater influence recedes. The Water Company is currently using these wells to monitor and report the movement of the saltwater influence.

This status holds true for five of the six wells located east of route US 1. The exception is Well #5. As stated in the Company's response to Audit Request #36: "Well #5 was the first well affected by saltwater intrusion. The Water Management District recorded the well abandoned as a source of supply. As such, it is anticipated that the well will remain at its current status [as a monitoring well]." These six wells have not been abandoned and are necessary facilities for the Company's current groundwater monitoring program.

Audit Exception No. 5

Although the FPSC has disallowed Janet Brown's salary in the past, her position has changed as a result of corporate restructuring. Due to the Company operating as a "stand-alone" entity following corporate restructuring, there no longer exists an opportunity for the Company to share employees with its former parent company. Thus, Ms. Brown now acts as an officer of the Company (Corporate Secretary), as well as Executive Secretary to the Company's President. As Executive Secretary, Ms. Brown provides the Company President with administrative assistance in performing his vast range of utility policy and management functions. However, she also provides the only "coverage" the Company has for secretarial and clerical duties which cannot always be handled solely by the Company's Office Manager, Cindy Foley.

Janet Brown receives 50% of her annual salary from the Company (reflected in the MFRs) as compensation for her duties as Corporate Secretary and her position as Executive Secretary under the Company's administrative function. Ms. Brown continues to share her duties. The other half of her annual compensation is received for the time devoted to the Company President's other, outside business activities.

Audit Exception No. 6

The now non-existing computer rental ($200 a month) was a cost the Company previously incurred in sharing equipment with its parent company. All computer related costs are now included in Account No. 675, Miscellaneous Equipment. However, the Company did not adjust out this $200 a month rental from Account No. 642, Rental of Equipment, in anticipation that its new office arrangement following corporate restructuring would require the Company to rent other non-computer related equipment (such as postage metering equipment) at a similar annual cost.

Audit Exception No. 7

The Company does not object to this audit exception.

Audit Exception No. 8

The Company does not object to this audit exception except that treating the cost as a non-annual expense should create a prepaid deferred debit with the unamortized amount receiving rate base consideration.

Audit Exception No. 9

The Company does not object to this audit exception and will file a Notice of Regulatory Assessment Fee Adjustment form to correct the understated revenues and regulatory assessment fees.

Audit Exception No. 10

The Company disagrees with this audit exception. The Company's working cash account is not an interest bearing account. The Company established a "rainy day" reserve account (temporary investment) in the mid 1980's which has an "untouched" balance of approximately $7,300. This is the Company's only interest earning cash account which increased by $157 in interest earned between July 1995 and June 1996 (the historical test period). This cash account is included with all other working cash accounts on the balance sheet/working capital Schedule A-17.

Response to Audit Disclosures

Audit Disclosure No. 1

The projected annual cost of operating the new catalytic filtration facility is based on the following Bishop & Associates engineering estimate:

	Estimated Annual Cost*
Operator (10 hours/week)	$13,000
Chlorine	7,000
Electric Power	2,500
Media Replacement (10 year intervals)	2,000
Filter Painting (10 year intervals)	2,000
Maintenance Materials & Labor	1,000
Iron Removal Disposal (2 year intervals)	2,500
Total Annual Costs	$30,000

*Incremental Due to Filtration Process

The Company took a conservative approach when establishing the annual proforma expense associated with the operation of the filtration facility. It omitted the cost of the operator ($13,000), thereby including (in the MFRs) only $17,000 as the normalized annual cost of operating the new facility.

Audit Disclosure No. 2

The Company believes that Audit Disclosure No. 2 should be appropriately included within Audit Exception No. 4. The Company's response to this audit disclosure is the same as its response to Audit Exception No. 4. However, should the FPSC decide to remove the wells from utility plant-in-service, the undepreciated costs should receive rate treatment in order to make the utility whole since the cost of the wells was prudently incurred at the time of well construction.

Audit Disclosure No. 3

The Company's response to Audit Request #31 which is restated in this audit disclosure explains the Company's position on the issue of the salary of the Company's Vice President and General Manager, and its Executive Secretary. As described by the Company, due to corporate restructuring, the previous subsidization or sharing of salary costs between the Company and its parent company has been eliminated. Both of these individuals are currently compensated by the Company for their dual roles as Company officers and for their duties and responsibilities as Company employees.

* * *

Pursuant to your letter, please forward this response to the appropriate staff analyst(s) for consideration in the preparation of a recommendation in this docket. Thank you for your assistance in this matter.

Sincerely,

HOLLAND & KNIGHT LLP

Karen D. Walker

Karen D. Walker

KDW/

cc: Roseanne Capeless, Esq.
Mr. Jack Shreve, Public Counsel
Mr. Michael A. Carfine
Mr. John F. Guastella
Mr. Gary C. White

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