

BEFORE THE  
FLORIDA PUBLIC SERVICE COMMISSION

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<p>In the Matter of</p> <p>Petition of Florida Cities Water Company for limited proceeding to recover environmental litigation costs for North and South Ft. Myers Divisions in Lee County and Barefoot Bay Division in Brevard County.</p>	<p>:</p> <p>:</p> <p>:</p> <p>:</p> <p>:</p> <p>:</p> <p>:</p> <p>:</p> <p>:</p>	<p>DOCKET NO. 971663-WS</p>
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VOLUME 2

Pages 195 through 377

PROCEEDINGS: HEARING

BEFORE: CHAIRMAN JULIA L. JOHNSON  
COMMISSIONER J. TERRY DEASON  
COMMISSIONER SUSAN F. CLARK  
COMMISSIONER JOE GARCIA  
COMMISSIONER E. LEON JACOBS, JR.

DATE: Wednesday, August 12, 1998

TIME: Commenced at 9:30 a.m.  
Concluded at 11:00 a.m.

PLACE: Betty Easley Conference Center  
Room 148  
4075 Esplanade Way  
Tallahassee, Florida

REPORTED BY: H. RUTHE POTAMI, CSR, RPR  
Official Commission Reporter

APPEARANCES:  
  
(As heretofore noted.)

DOCUMENT NUMBER - DATE

08701 AUG 17 98

FREE ELECTRONIC REPORTING

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## P R O C E E D I N G S

1  
2 (Transcript follows in sequence from  
3 Volume 1.)

4 MR. GATLIN: The next is Mr. Acosta's  
5 testimony.

6 CHAIRMAN JOHNSON: It will be inserted into  
7 the record as though read.

8 MR. GATLIN: May I offer his exhibits,  
9 Exhibits MA-1 through MA-9 as a composite exhibit?

10 CHAIRMAN JOHNSON: MA-1 through 9 will be  
11 identified as Composite Exhibit 9.

12 (Exhibit 9 marked for identification.)

13 MR. GATLIN: I'd like to point out that  
14 there were a couple of missing pages to his exhibits,  
15 which we recognized about two weeks ago and we filed  
16 with the Commission and served on parties, and I want  
17 to make sure that those are included in those  
18 exhibits.

19 CHAIRMAN JOHNSON: Let the record reflect  
20 that MA-1 through 9 will include the insertion of the  
21 pages that had previously been missing but that have  
22 been provided to all parties.

23 MS. GERVASI: And Staff would identify as  
24 Exhibit No. 10 a composite exhibit consisting of a  
25 transcript of Mr. Acosta's deposition taken on

1 May 6th, as well as the utility's responses to certain  
2 Staff requests for production of documents and an  
3 interrogatory as well.

4 MR. GATLIN: I would like to offer the  
5 testimony of Mr. --

6 CHAIRMAN JOHNSON: For some reason, I don't  
7 have that one.

8 MS. GERVASI: We have extra copies here,  
9 Commissioner.

10 CHAIRMAN JOHNSON: What was the short title  
11 on that one?

12 MS. GERVASI: "Transcript of deposition,  
13 PODs and interrogatory."

14 CHAIRMAN JOHNSON: PODs and interrogs, and I  
15 think we were on 10.

16 MS. GERVASI: Yes, ma'am.

17 CHAIRMAN JOHNSON: Show it marked as 10.  
18 (Exhibit 10 marked for identification.)

19 CHAIRMAN JOHNSON: Mr. Gatlin?

20 MR. GATLIN: What was the last number?

21 CHAIRMAN JOHNSON: It was Composite  
22 Exhibit 10. It was Mr. Acosta's deposition  
23 transcript, PODs and interrogatories.

24 MR. GATLIN: Thank you.

25

1 **FLORIDA CITIES WATER COMPANY**

2 **RATE APPLICATION FOR RECOVERY OF LEGAL EXPENSES**

3 **TESTIMONY OF MICHAEL ACOSTA**

4

5 Q. Please state your name and business address.

6 A. Michael Acosta, 4837 Swift Road, Suite 100, Sarasota,  
7 Florida 34231.

8 Q. By whom are you employed and in what capacity?

9 A. I am employed by Florida Cities Water Company (FCWC)  
10 as Vice President, Engineering & Operations.

11 Q. Is a summary of your educational and professional  
12 background attached as Appendix A?

13 A. Yes, it is.

14 Q. What is the purpose of your testimony?

15 A. The purpose of my testimony is to explain significant  
16 events, especially permitting, and progress pertaining  
17 to meeting the requirements set forth in the United  
18 States Environmental Protection Agency (EPA)  
19 Administrative Orders and the Florida Department of  
20 Environmental Protection (FDEP), formerly known as the  
21 Florida Department of Environmental Regulation,  
22 Consent Orders for the upgrade of Waterway Estates  
23 Advanced Wastewater Treatment Plant (Waterway) in Lee  
24 County.

25 Q. Were you directly involved in the process, in

- 1           1986, of renewing the National Pollution  
2           Discharge Elimination System (NPDES) permit for  
3           Waterway?
- 4   A.   No, my testimony in this regard is based on my  
5           review of Company records.
- 6   Q.   When you began employment at FCWC in October  
7           1985, was there a valid NPDES permit?
- 8   A.   Yes, the permit had been issued on September 24,  
9           1981 and expired on September 24, 1986.
- 10  Q.   Based on your review, was FCWC in compliance with  
11           this permit?
- 12  A.   Yes.
- 13  Q.   When did FCWC apply for renewal of the NPDES  
14           permit?
- 15  A.   May 9, 1986 (Exhibit 9 MA-1).
- 16  Q.   Did EPA notify FCWC that renewal of the permit  
17           might be denied?
- 18  A.   Yes, the EPA notified FCWC on July 22, 1986 that  
19           it had tentatively concluded that the renewal  
20           application should be denied (Exhibit 9 MA-2).
- 21  Q.   What was the reason the EPA gave for considering  
22           denial of renewal of the NPDES permit?
- 23  A.   The EPA stated that denial was being considered  
24           because FCWC did not have a wasteload allocation  
25           for discharging from the plant in the

1 Caloosahatchee River.

2 Q. What is a wasteload allocation?

3 A. A wasteload allocation is the allocation granted  
4 a particular facility for discharging pollutants  
5 into waters of the United States. The  
6 allocations take into account the maximum  
7 pollutant loading a water body can assimilate  
8 without degradation.

9 Q. What is the significance of a wasteload  
10 allocation?

11 A. A wasteload allocation is necessary, in a water  
12 quality limited stream, for the issuance of an  
13 NPDES permit.

14 Q. Was a wasteload allocation established for the  
15 Caloosahatchee River?

16 A. Yes.

17 Q. When was the wasteload allocation established?

18 A. 1975.

19 Q. Who established the wasteload allocation to the  
20 Caloosahatchee River where the effluent from the  
21 Waterway was discharged?

22 A. The FDEP established the wasteload allocation for  
23 the Caloosahatchee River.

24 Q. As part of the wasteload allocation established  
25 by FDEP for the Caloosahatchee River was part of



1 that allocation allotted to Waterway?

2 A. Yes.

3 Q. What was the wasteload allocation for the WWE  
4 plant in 1981?

5 A. The wasteload allocation in 1981 for the WWE  
6 plant was 1.5 million gallons per day (mgd),  
7 however this was limited by the capacity of the  
8 plant which was 1.08 mgd.

9 Q. Had FDEP changed Waterway's wasteload allocation  
10 between 1981 and 1986?

11 A. No.

12 Q. What changed from the time of the NPDES permit  
13 issuance in 1981 to when FCWC applied for permit  
14 renewal in 1986 that would have caused EPA to say  
15 that no wasteload allocation existed for  
16 Waterway?

17 A. Nothing had changed officially during this period  
18 with respect to the wasteload allocation.  
19 However, the FDEP's wasteload allocation  
20 documentation report, a planning document, issued  
21 in January of 1981 states in one part "The  
22 Waterway Estates Treatment Plant was eliminated  
23 from further modeling due to the assumed tie-in  
24 to the Cape Coral facility and the assumed  
25 impracticality of upgrading to AWT and relocating

1 the outfall."

2 Q. Why did the FDEP make the assumption that the  
3 Waterway would be eliminated?

4 A. A 201 facilities plan had been developed by Lee  
5 County in 1977. This plan would have established  
6 a regional wastewater treatment plant north of  
7 the Caloosahatchee River to treat wastewater from  
8 Waterway Estates, Cape Coral, North Fort Myers  
9 Utilities, Lee County Utilities, and other  
10 service areas north of the River.

11 Q. What is a 201 facilities plan?

12 A. A 201 facilities plan is a document, generally  
13 done by a municipal agency that provides "for the  
14 application of the best practicable waste  
15 treatment technology before any discharge into  
16 receiving waters, including reclaiming and  
17 recycling of water, and confined disposal of  
18 pollutants so they will not migrate to cause  
19 water or other environmental pollution and shall  
20 provide for consideration of advanced waste  
21 treatment techniques".

22 Q. Did this 201 facilities plan provide for a  
23 wasteload allocation for Waterway?

24 A. No. In addition, under the plan Waterway would  
25 have been phased out.

- 1 Q. Was this plan officially adopted or implemented?
- 2 A. No.
- 3 Q. Was FCWC ever notified by FDEP that its wasteload  
4 allocation had been eliminated or otherwise  
5 changed?
- 6 A. No.
- 7 Q. Did the FDEP also require a permit for Waterway?
- 8 A. Yes, the FDEP required an operating permit.
- 9 Q. Was FCWC operating under an existing operating  
10 permit issued by FDEP for the WWE plant?
- 11 A. Yes.
- 12 Q. When was the permit issued by FDEP?
- 13 A. August 2, 1983.
- 14 Q. Did this permit cover the discharge from Waterway  
15 to the Caloosahatchee River?
- 16 A. Yes.
- 17 Q. Was the FDEP permit in effect at the time the EPA  
18 denied renewal of the NPDES permit?
- 19 A. Yes, the permit had an expiration date of August  
20 2, 1988. (Exhibit 9 MA-3).
- 21 Q. To FCWC's knowledge did the EPA check with the  
22 FDEP regarding the existence of a wasteload  
23 allocation for Waterway prior to issuing the  
24 denial of the renewal of the NPDES permit on  
25 December 8, 1986?

- 1 A. No, to the contrary, in discovery it was  
2 determined that by letter dated May 7, 1986, the  
3 FDEP notified the EPA that the wasteload  
4 allocation for Waterway was 1.08 million gallons  
5 per day (Exhibit 9 MA-4).
- 6 Q. Did the EPA give FCWC any advance warning that it  
7 was considering denial of the renewal of the  
8 NPDES permit?
- 9 A. Yes.
- 10 Q. Did FCWC bring the July 22, 1986 notice from EPA  
11 that it was considering denying the permit  
12 renewal to the attention of the FDEP?
- 13 A. Yes, FCWC met with the Southwest District of the  
14 FDEP staff on July 29, 1986 to discuss the EPA's  
15 conclusion that the permit should be denied  
16 (Exhibit 9 MA-5).
- 17 Q. Was FCWC notified that the permit renewal had  
18 been denied?
- 19 A. Yes, by letter dated December 8, 1986 (Exhibit  
20 9 MA-6).
- 21 Q. Was there a means of challenging the denial of  
22 the permit renewal?
- 23 A. Yes.
- 24 Q. Did FCWC challenge the denial?
- 25 A. No.

- 1 Q. Based on your review of the records why did FCWC  
2 not pursue the opportunity to challenge the  
3 permit denial.
- 4 A. FCWC immediately began the process of complying  
5 with upgrading the plant to advanced wastewater  
6 treatment standards and relocating the outfall to  
7 the six foot contour of the Caloosahatchee River.  
8 In addition, FCWC believed it was satisfying the  
9 lead permitting agency in the matter, the FDEP.  
10 FDEP had developed the wasteload allocation and  
11 was working with FCWC to establish a schedule to  
12 upgrade Waterway and relocate the outfall.
- 13 Q. Did the EPA consult with the FDEP prior to denial  
14 of the permit renewal?
- 15 A. Yes.
- 16 Q. Was such consultation routine in these types of  
17 permitting matters?
- 18 A. Yes. Generally the EPA would consult with the  
19 FDEP in a process known as certification.
- 20 Q. Please describe the certification process?
- 21 A. In the certification process one agency sends a  
22 permit application to another agency for the  
23 second agency's review. This review is for  
24 general conformance with the rules, regulations  
25 and policies\_of the second agency.

1 Q. Did the FDEP "certify" the renewal of the NPDES  
2 permit?

3 A. Yes. However, the FDEP, by July 29, 1986,  
4 recommended that, upon expiration of the current  
5 operating permit, the plant be upgraded to meet  
6 advanced wastewater treatment standards and the  
7 discharge be redirected from the canal leading to  
8 the Caloosahatchee River directly to the River  
9 itself or be eliminated. This recommendation is  
10 reflected in the NPDES worksheet prepared by  
11 FDEP. (Exhibit 9 MA-7).

12 Q. What other action did FCWC initiate in response  
13 to the EPA's notice that renewal of the NPDES  
14 permit would most likely be denied and the FDEP's  
15 position that the discharge should be relocated  
16 or eliminated?

17 A. On November 10, 1986 FCWC solicited engineering  
18 proposals for "the preparation of an engineering  
19 report to evaluate and recommend effluent  
20 discharge and wastewater treatment process design  
21 alternatives and recommend the most cost-  
22 effective and permissible alternative" and  
23 entered into an agreement with Environmental  
24 Science and Engineering, Inc. On March 27, 1987  
25 to perform these services.

1 Q. Based on your experience and a review of the  
2 record which agency, FDEP or EPA did FCWC believe  
3 was the controlling agency in regards to the  
4 permitting issues associated with Waterway?

5 A. It has been my experience that the FDEP is the  
6 lead agency in matters associated with permitting  
7 wastewater treatment and disposal facilities.  
8 The FDEP does routine inspections of the plant,  
9 permits all new connections to the collection  
10 system(s) leading to the plant, issues operating  
11 permits for the plant and received monthly plant  
12 operating statistics which are used to monitor  
13 the performance of the plant. EPA's only  
14 involvement is receiving monthly discharge  
15 reports and periodic inspections, usually during  
16 permit renewal cycles. Based on my review of the  
17 record, FCWC was working with FDEP in regards to  
18 the permitting of Waterway and believed that it  
19 was satisfying all requirements necessary for the  
20 continued operation of Waterway.

21 Q. Was FDEP satisfied with the strides made by FCWC  
22 in the permitting process and with the operation  
23 of the facility in general?

24 A. It is my opinion that FDEP was satisfied with the  
25 operation of the facility and with the progress

- 1 being made in the permitting process by FCWC.
- 2 Q. Was the plant performance satisfactory during  
3 this period of time?
- 4 A. Yes, the plant was meeting all the water quality  
5 parameters contained in both the NPDES permit  
6 issued in 1981 by EPA and the operating permit  
7 issued by FDEP in 1983.
- 8 Q. What action did the EPA take after denial of the  
9 renewal of the NPDES permit?
- 10 A. By letter dated May 11, 1987, the EPA notified  
11 FCWC that Waterway was in violation of the Clean  
12 Water Act and issued a "Section 309" Order  
13 (Exhibit 9 MA-8).
- 14 Q. What was FCWC ordered to do?
- 15 A. FCWC was ordered to cease discharging pollutants  
16 to the water of the United States at the earliest  
17 date practical but not later than September 30,  
18 1988.
- 19 Q. In your opinion, was meeting this deadline  
20 possible?
- 21 A. No, considering all the design, permitting and  
22 construction that would be necessary this  
23 deadline was not practical nor could it have been  
24 met.
- 25 Q. Was a new NPDES permit ever issued by EPA?



- 1 A. Yes on September 29, 1989. (Exhibit 9 MA-9)
- 2 Q. When and how did you become personally involved  
3 in the upgrade of the Waterway?
- 4 A. I first became involved in the Waterway upgrade  
5 in the late fall of 1987 when I was asked to  
6 provide site visits of the Waterway Estates  
7 facility to prospective engineering firms. The  
8 prospective firms were in the process of  
9 preparing proposals to be submitted for design  
10 services associated with the upgrade of the plant  
11 and outfall to meet FDEP and EPA requirements.
- 12 Q. Was an engineering firm retained as a result of  
13 the proposals?
- 14 A. Yes, Source, Inc. was retained in February, 1988.
- 15 Q. What were Source's responsibilities in regards to  
16 the upgrade of the Waterway?
- 17 A. Source was to design the necessary facilities in  
18 order to upgrade the plant to meet advanced  
19 treatment standards and design an outfall to the  
20 six-foot contour of the Caloosahatchee River as  
21 required by FDEP and EPA and the preparation and  
22 submission of all permit and zoning applications  
23 necessary to construct the upgrade.
- 24 Q. What permits, variances and exemptions were  
25 necessary for this upgrade?

1 A. A building permit, a zoning variance and a  
2 development order or exemption therefrom were  
3 required from Lee County. A FDEP construction  
4 permit for the plant, an Army Corps of Engineers  
5 permit and an exemption from South Florida Water  
6 Management District were required.

7 Q. Why was a zoning variance required when a  
8 wastewater treatment plant already existed on the  
9 site?

10 A. A zoning variance was required because the  
11 upgrade required the use of the entire site to  
12 accommodate all the proposed treatment processes,  
13 therefore setbacks could not be maintained and a  
14 variance was required to build without setbacks.

15 Q. What is a setback?

16 A. A setback is an area of land that needs to be  
17 left between the property line to the nearest  
18 building or structure. In order to construct the  
19 plant on this site a zero setback was required.

20 Q. When did Source file the zoning variance request?

21 A. The request was filed in June 1988.

22 Q. What was Lee County's response to the request?

23 A. The request was denied in August 1988.

24 Q. Why was the request denied?

25 A. At hearing, questions were raised by members of

1 the Board of Adjustments and the general public.

2 Q. What did FCWC do in response to the denial?

3 A. FCWC appealed the denial and the zoning variance  
4 and provided additional information in response  
5 to the questions raised at the hearing. The  
6 variance\_was ultimately granted in October 1988  
7 without the need to pursue the appeal.

8 Q. What is a development order?

9 A. A development order is a document required by  
10 ordinance in Lee County that allows the  
11 development of a site and places the conditions  
12 on the development of the site.

13 Q. When was the application for a development order  
14 exemption submitted to Lee County?

15 A. The application for a development order exemption  
16 was submitted concurrently with the zoning  
17 variance request.

18 Q. What was the outcome of the application for a  
19 development order exemption?

20 A. The exemption to the development order was denied  
21 initially because Lee County stated that "there  
22 is over 2500 square feet of additional impervious  
23 area and the impervious calculations are not  
24 complete. Ultimately the exemption was approved  
25 in April, 1989.

1 Q. What is an FDEP construction permit?

2 A. An FDEP construction permit is a document  
3 necessary to construct the processes that would  
4 treat the wastewater to meet advanced wastewater  
5 treatment standards. Reasonable assurance must  
6 be given to FDEP that the design would meet these  
7 standards.

8 Q. When was the application for an FDEP construction  
9 permit submitted?

10 A. The application was submitted in May, 1989.

11 Q. Why was this FDEP permit application not  
12 submitted concurrently with the zoning and  
13 development order application?

14 A. The construction permit application could not be  
15 completed until the plans were finalized and the  
16 plans could not be finalized until the zoning  
17 variance and development order exemption were in  
18 place.

19 Q. Why was that the case?

20 A. If the FDEP construction permit were filed  
21 without the zoning variance and development order  
22 exemption in place then the site plan as  
23 submitted to FDEP could change if some portion of  
24 the zoning variance or development order  
25 exemption were altered during the approval

1 process. If that occurred a site plan change  
2 would be necessary and the entire permit  
3 application would have to be resubmitted to FDEP  
4 for approval.

5 Q. When was the FDEP permit issued?

6 A. March 1990.

7 Q. What is an Army Corps of Engineers dredge and  
8 fill permit and why was it required for this  
9 project?

10 A. An Army Corps of Engineers permit is required  
11 anytime excavation in waters of the United States  
12 is undertaken. In this case, excavation was  
13 required in order to install an outfall pipeline  
14 to the six-foot contour of the Caloosahatchee  
15 River.

16 Q. When was the Army Corps of Engineers dredge and  
17 fill permit application submitted?

18 A. April 1989.

19 Q. Why was this permit application not filed sooner?

20 A. For the same reasons that the FDEP permit  
21 application could not be filed sooner. In  
22 addition, this pipeline emanates from the  
23 ultraviolet disinfection chamber and a movement  
24 of that structure by only a few feet would have  
25 caused a complete resubmission.

- 1 Q. When was this permit received?
- 2 A. April 1990.
- 3 Q. Why was a South Florida Water Management District  
4 permit required for this project?
- 5 A. An exemption under the District's stormwater  
6 permitting was necessary for this project.
- 7 Q. When was the exemption application submitted?
- 8 A. January 1989.
- 9 Q. When was the exemption received?
- 10 A. February 1989.
- 11 Q. What is a building permit and why was it  
12 necessary for this project?
- 13 A. A building permit is the document that actually  
14 allows the construction of, in this case, the  
15 treatment structures and control building. It is  
16 necessary in order to obtain inspections of the  
17 progress of construction by local government.
- 18 Q. Who applies for a building permit?
- 19 A. A State of Florida licensed contractor is the  
20 only entity that can apply for a building permit.
- 21 Q. When was a contractor employed by FCWC?
- 22 A. The contract for the plant upgrade was signed by  
23 FCWC and Cardinal Contractors in August 1990 and  
24 a Notice to Proceed was issued in August 1990 for  
25 the construction of the Waterway Estates Advanced

- 1 Wastewater Treatment Plant.
- 2 Q. Why was a Notice to Proceed not issued earlier  
3 than August 1990.
- 4 A. While all the permits were in place, with the  
5 exception of the building permit, in April 1990  
6 and bids were received that same month FCWC  
7 undertook a value engineering study to ensure the  
8 best possible product was being built at the best  
9 value for FCWC's ratepayers. FCWC routinely  
10 performs value engineering studies on projects as  
11 complex and intricate as this one.
- 12 Q. Did the contractor begin construction in August  
13 1990?
- 14 A. No, the contractor applied to Lee County for a  
15 building permit in September 1990, however, the  
16 permit was not issued until December 1990.
- 17 Q. Why did the permit take so long to issue?
- 18 A. That is not entirely clear, however, a new  
19 requirement imposed by Lee County involved  
20 concurrency. A letter of concurrency had to be  
21 issued by the County in order to issue the  
22 building permit. A letter of concurrency was  
23 issued in October 1990. The building permit in  
24 December 1990.
- 25 Q. What is a concurrency requirement?

1 A. The concurrency requirement was implemented by  
2 ~~the~~ Lee County in order to ensure that basic  
3 services such as roads, water and wastewater  
4 were in place and meeting current standards prior  
5 to the development of a parcel of land.

6 Q. Why was the concurrency requirement not obtained  
7 sooner?

8 A. The concurrency requirement had been implemented  
9 after the development order exemption was issued  
10 and prior to the submission of the building  
11 permit application. The concurrency requirement  
12 is normally part of the development order  
13 process. In this case the development order  
14 exemption was already in place so Lee County  
15 required concurrency prior to the issuance of the  
16 building permit.

17 Q. When did the contractor begin actual  
18 construction?

19 A. The contractor performed some preliminary work  
20 during the time the building permit application  
21 was being processed by Lee County, however only  
22 very limited work could be done during this  
23 period. Construction began in earnest in January  
24 1991.

25 Q. When was the upgrade to the Waterway completed?



- 1 A. The plant construction was completed in April  
2 1992. The outfall main was completed in June  
3 1991.
- 4 Q. Is that a normal construction period for this  
5 type of work?
- 6 A. Considering that the existing plant had to remain  
7 in operation during the entire construction  
8 period along with the extremely tight building  
9 site, less than one acre, the time frame for  
10 building this plant was extremely timely.
- 11 Q. Does this conclude your testimony?
- 12 A. Yes.

1           **MR. GATLIN:** I'd like to offer the testimony  
2 of Mr. Michael E. Murphy to be inserted into the  
3 record as though read.

4           **CHAIRMAN JOHNSON:** It will be so inserted.

5           **MR. GATLIN:** Mr. Murphy has Exhibits 1  
6 through 12 identified -- I mean 4, identified MM-1  
7 through 4. There's an updated exhibit that we filed a  
8 couple of weeks ago, which is the rate case expense  
9 which we identified as Exhibit 3A, and I would like  
10 that included in the exhibits that are being received.  
11 I guess it needs to be identified, Madam Chairman.

12           **CHAIRMAN JOHNSON:** That would be -- I'm  
13 sorry. His original file was MM-1 through 4?

14           **MR. GATLIN:** Yes.

15           **CHAIRMAN JOHNSON:** And there's one  
16 additional one?

17           **MR. GATLIN:** That's identified as 3A, and I  
18 assume that we could identify the whole group as a  
19 composite.

20           **CHAIRMAN JOHNSON:** Okay. Show that  
21 additional document added, and we will mark the  
22 exhibits as a composite, and that will be Exhibit 11.  
23 All of the parties have the -- you said 3A?

24           **MR. GATLIN:** 3A, yes, ma'am.

25           **CHAIRMAN JOHNSON:** All of the parties have

1 that document?

2 MS. GERVASI: Yes, ma'am.

3 (Exhibit 11 marked for identification.)

4 MS. GERVASI: And Staff would identify as  
5 the next exhibit, I believe 12, a composite exhibit  
6 consisting of a deposition of Mr. Murphy as well as  
7 responses to discovery.

8 MR. GATLIN: I would offer Mr. McClellan,  
9 John D. McClellan's testimony to be inserted in the  
10 record.

11 CHAIRMAN JOHNSON: One second. Mine were a  
12 little out of order. I'm back to Staff. Michael  
13 Murphy, this was the transcript and the Staff's first  
14 set of interrogatories?

15 MS. GERVASI: Yes, ma'am.

16 CHAIRMAN JOHNSON: Okay. I'll mark that  
17 as 12.

18 MS. GERVASI: Thank you.

19 (Exhibit 12 marked for identification.)  
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FLORIDA CITIES WATER COMPANY  
WATER & WASTEWATER OPERATIONS

Docket No. 97\_\_\_\_-WS

TESTIMONY OF MICHAEL MURPHY

Q. Please state your name and business address.

A. Michael E. Murphy, 4837 Swift Road, P.O. Box 21597,  
Suite 100, Sarasota, Florida 34231.

Q. By whom are you employed and in what capacity?

A. I am employed by Florida Cities Water Company (FCWC or  
the Company) as Vice President and Chief Financial  
Officer.

Q. How long have you served in that capacity?

A. Since May, 1994.

Q. Would you describe your education and business  
background?

A. My resume is attached as Exhibit 11 (MM-1).

Q. Have you previously testified before the Commission?

A. Yes. In Barefoot Bay Docket 951258-WS.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to present certain of  
the legal expenses incurred by FCWC related to the  
charges brought by the U. S. Environmental Protection  
Agency (EPA) (the charges) and the litigation filed by  
the U.S. Department of Justice (DOJ) (the litigation)  
against FCWC, the method of recovery of those legal

1 expenses that FCWC proposes to use, the rate case  
2 expenses associated with this proceeding and the  
3 surcharges FCWC proposes to collect from its  
4 customers. Also, I will sponsor the following  
5 exhibits filed in this proceeding on behalf of FCWC:  
6 FLORIDA CITIES WATER COMPANY, LEGAL EXPENSES, Exhibit  
7 11 (MM-2) "Legal Expenses Schedule",  
8 FLORIDA CITIES WATER COMPANY, RECOVERY OF LEGAL  
9 EXPENSES, RATE CASE EXPENSE RECOVERY SCHEDULE, Exhibit  
10 11 (MM-3) "Rate Case Expense Schedule" and  
11 FLORIDA CITIES WATER COMPANY, RECOVERY OF LEGAL  
12 EXPENSES & RATE CASE EXPENSES, PROPOSED SURCHARGE  
13 RATES & REVENUES SCHEDULE, Exhibit 11 (MM-4) "Rate  
14 Schedule".

15 **LEGAL EXPENSES**

16 Q. Why has FCWC filed this application for recovery of  
17 legal expenses and proposed water and wastewater  
18 surcharge rates?

19 A. The necessity for filing this application for recovery  
20 of legal expenses and proposed surcharge rates arises  
21 from the fact that FCWC incurred \$3,826,210 of legal  
22 expenses related to the charges and the litigation  
23 filed against FCWC. The chronology and details of  
24 the charges and litigation are presented by Mr. Gerald  
25 Allen and Mr. Gary Baise.

- 1 Q. What is the purpose of the Legal Expenses Schedule,  
2 Exhibit 11 (MM-2)?
- 3 A. The Legal Expenses Schedule summarizes and categorizes  
4 the legal expenses related to the above referenced  
5 charges and litigation.
- 6 Q. What time periods are presented on the Legal Expenses  
7 Schedule?
- 8 A. The Legal Expenses Schedule reflects costs incurred  
9 from 1991 through the conclusion of the litigation.
- 10 Q. Did FCWC pay these legal expenses?
- 11 A. Yes.
- 12 Q. How were these legal expenses recorded on the books of  
13 FCWC during the period 1991 through 1997?
- 14 A. The legal expenses incurred have been expensed "below  
15 the line".
- 16 Q. Of the total legal expenses of \$3,826,210 how much is  
17 FCWC seeking to recover through a surcharge from all  
18 its customers regardless of rate jurisdiction?
- 19 A. As covered by Mr. Allen in his testimony, FCWC is  
20 seeking to recover \$3,589,368 from all rate  
21 jurisdictions.
- 22 Q. Of the net legal expenses of \$3,589,368 how much is  
23 FCWC seeking to recover from its customers in the  
24 Florida Public Service Commission (PSC) rate  
25 jurisdictions, North Ft. Myers Wastewater, South Ft.

1 Myers Wastewater, Ft. Myers Water and Barefoot Bay  
2 Water and Wastewater?

3 A. FCWC is seeking to recover \$2,265,833 from the PSC  
4 jurisdiction, namely those customers in Lee and  
5 Brevard Counties.

6 **Financial Effect of Requested Penalties on FCWC**

7 Q. Were the financial penalties requested by DOJ  
8 financially significant to FCWC?

9 A. Yes. In fact the penalty amounts claimed by the DOJ  
10 were of such a financial magnitude that FCWC clearly  
11 would not have been able to pay such amounts if the  
12 court had found FCWC liable, therefore, the financial  
13 integrity of the Company was in jeopardy.

14 Q. Why do you feel the financial integrity of the  
15 Company was in jeopardy?

16 A. The financial penalties requested by the DOJ were so  
17 substantial that FCWC would not have been able to fund  
18 the claims and would have probably been forced into  
19 bankruptcy.

20 Q. Isn't it presumptuous to think that the DOJ would have  
21 wanted to put the Company out of business?

22 A. Not necessarily, the DOJ's financial witness testified  
23 that the Company was financially capable of paying a  
24 fine of \$7,500,000. The only way for the Company to  
25 fund a penalty of that magnitude would be to borrow

- 1 funds. However, based on my experience, I do not  
2 believe the Company's lenders, banks and insurance  
3 companies, are interested in financing non-cash flow  
4 activities. They require that debt investment  
5 generate cash flow for repayment. They do not lend  
6 upon expenses which do not generate revenues.  
7 Likewise equity capital (like the Company's  
8 shareholders) are not inclined to invest for the  
9 payment of expenses with no potential repayment.
- 10 Q. Since the Complaint, as amended, and penalty as sought  
11 therein were ultimately directed towards only three of  
12 FCWC's systems, why does FCWC propose that the legal  
13 expenses be allocated to all FCWC customers?
- 14 A. As indicated above, the penalties requested by the DOJ  
15 were of such magnitude that payment of the penalties  
16 would have been extremely difficult, if not impossible  
17 and all FCWC systems, water and wastewater, would have  
18 been adversely and materially effected.
- 19 Q. Please clarify how all FCWC systems would have been  
20 adversely affected?
- 21 A. These DOJ proposed financial penalties represented a  
22 possible financial calamity to FCWC. Although the  
23 allegations in the Complaint were local in nature, the  
24 financial effects would have been system wide. The  
25 initial investigation and Complaint was only directed



1           towards the North Ft. Myers Wastewater system.  
2           However, the penalty sought of \$34 million would of  
3           necessity had to be borne by FCWC not just that one  
4           system. At the time of the original Complaint the  
5           North Ft. Myers Wastewater system had annual operating  
6           revenues of \$1,464,917 and operating income of  
7           \$313,430. This system could not financially support  
8           a significant penalty. Although the charges might  
9           have been localized, the financial impacts to FCWC  
10          were not.

11   Q.    Is FCWC seeking recovery of the legal expenses from  
12          all its customers, both water and wastewater,  
13          regardless of the FCWC system providing service.

14   A.    Yes.

15   Q.    Why is FCWC seeking recovery from all its customers?

16   A.    At one time or another all of FCWC's wastewater  
17          systems were under investigation by the DOJ and  
18          consequently legal expenses were sustained by all.  
19          Ultimately only three wastewater systems were targeted  
20          in the amended Complaint and penalties sought.  
21          However the claims made by the DOJ were so substantial  
22          as compared to the size of the systems that the  
23          financial integrity of FCWC was in jeopardy. At the  
24          time of the amended Complaint the annual operating  
25          revenues and operating incomes of those systems

1 totaled \$3,284,921 and \$596,408, respectively. It is  
2 recognized that there is a close relationship between  
3 the level of service provided to customers and a  
4 company's financial health. The future viability of  
5 the entire Company, including its water systems, was  
6 at stake. All customers were in peril of being  
7 adversely impacted by the litigation. Because of  
8 this, FCWC proposes that all FCWC customers, water and  
9 wastewater, share in the expenses incurred by FCWC in  
10 defending the allegations of the DOJ and litigation,  
11 using some rational method that is simply applied.

12 **RATE CASE EXPENSES**

13 Q. What is the purpose of the Rate Case Expense Schedule,  
14 Exhibit 11 (MM-3)?

15 A. The Rate Case Expense Schedule shows an estimated  
16 amount for certain expenses that will be incurred  
17 during this proceeding (rate case expenses).

18 Q. Is FCWC seeking the recovery of rate case expenses  
19 incurred in this proceeding?

20 A. Yes. However, the actual amount of rate case expense  
21 will not be known until the conclusion of this  
22 proceeding. FCWC requests that it be allowed to file  
23 a schedule of the actual appropriate expenses incurred  
24 plus an estimate to complete this rate proceeding  
25 immediately prior to hearing.

1           **SURCHARGE RATES**

2           Q.    What is the purpose of the Rate Schedule, Exhibit  
3           11 (MM-4)?

4           A.    The Rate Schedule develops the proposed surcharge  
5           rates that would generate the revenue required to  
6           recover the legal expenses discussed earlier (the  
7           Surcharge).

8           Q.    What time period was used in the preparation of the  
9           Rate Schedule?

10          A.    The Rate Schedule is based upon active customers as of  
11          September 30, 1997

12          **Allocation Method**

13          Q.    Please describe the allocation method utilized on the  
14          Rate Schedule.

15          A.    While the number of customers provides the general  
16          basis for allocation, FCWC believes that meter size  
17          needs to be considered in the allocation. Using meter  
18          size as a factor reflects the fact that a customer  
19          receiving service from a 1 inch meter places a  
20          greater demand on the system than a customer receiving  
21          service from a 5/8 inch meter. FCWC's current rate  
22          structure for water and wastewater service recovers  
23          fixed costs through a fixed monthly base facility  
24          charge for each meter size weighted by an AWWA 5/8  
25          inch meter equivalent factors. It is logical to

1 recover the fixed costs in this proceeding in a  
2 similar method. Therefore, FCWC applied the AWWA  
3 meter weighting factors to the number of customers in  
4 each class and in each meter size category. This  
5 resulted in the number of weighted customers, which  
6 becomes the denominator in the surcharge calculation  
7 that will be discussed later in this testimony. We  
8 have attempted to arrive at the lowest common  
9 denominator for cost allocation. A 5/8 inch meter is  
10 that lowest common denominator. From there we can  
11 equate single family residential customers with multi-  
12 family or commercial customers. For example using the  
13 AWWA meter weighting factors, a customer that has a 1  
14 inch meter is equivalent to 2 and 1/2 customers that  
15 have a 5/8 inch meter. This logic is easily seen in  
16 the fact that a multifamily unit typically has a  
17 larger service meter which is required to serve more  
18 than one residential dwelling.

19 Q. How does an allocation method based upon a water meter  
20 size relate to a wastewater customer?

21 A. A standard wastewater rate making practice is to  
22 equate a wastewater customer to a water meter size  
23 and/or water consumption. Since wastewater flows are  
24 not typically metered at the collection site (ie. the  
25 customer's home or business) it is reasonable to

1 allocate to wastewater customers based upon the water  
2 meter size. Like a water customer, a wastewater  
3 customer with a larger water meter will typically  
4 generate larger wastewater flows. Therefore using the  
5 AWWA factors are appropriate.

6 Recovery Period

7 Q. What cost recovery period was chosen for this  
8 proposal?

9 A. The recovery period that was chosen and used in the  
10 Rate Schedule is ten years.

11 Q. Why was a period of ten years chosen?

12 A. The ten year cost recovery period was selected because  
13 it is not overly burdensome to the ratepayers and  
14 also allows the utility to recover the costs over a  
15 reasonable period. The ten year cost recovery period  
16 is also discussed by Mr. John McClellan in his  
17 testimony.

18 Q. Over what period of time should the rate case expenses  
19 be recovered?

20 A. In order to be consistent with the ten year  
21 amortization period of the surcharge rate, a ten year  
22 amortization period for the recovery of rate case  
23 expenses would be reasonable and less confusing for  
24 all parties; FCWC, the PSC, and most importantly  
25 FCWC's customers.

1 Q. Do you have any other comments regarding the ten year  
2 recovery period?

3 A. Yes. Based on the current number of customers, the  
4 costs of including rate case expenses, will be  
5 recovered in ten years as presented on the Rate  
6 Schedule. However, since customer growth will be a  
7 factor, although not currently known, the Surcharge  
8 would be accumulated and then discontinued by FCWC  
9 once the costs have been recovered.

10 Rate Schedule

11 Q. Please describe the Rate Schedule, Exhibit \_\_\_ (MM-4).

12 A. Page 1, rows 1-8, summarizes the additional revenue  
13 requested by category: Legal Expenses, Rate Case  
14 Expenses, and Total; and calculates the respective  
15 surcharge rates. In addition, page 1 of the Rate  
16 Schedule summarizes the number of customers and  
17 weighted customers (as previously discussed based on  
18 AWWA 5/8 inch meter equivalent weighting factors) from  
19 each of FCWC's PSC and non PSC jurisdictional  
20 divisions and operations. While this proceeding  
21 pertains to the PSC jurisdictions and related  
22 requested revenues, legal expenses will be allocated  
23 to all FCWC customers in the same consistent manner.  
24 It is necessary to segregate total FCWC customers  
25 into customers under PSC and Non-PSC jurisdictions

- 1 Q. How were the remaining Surcharge rates, based on total  
2 costs, determined for the other meter sizes?
- 3 A. The remaining Surcharge rates were determined by  
4 applying the AWWA meter weighting factors as shown on  
5 page 2 . These are the same meter equivalent factors  
6 used in the PSC annual report and represent the demand  
7 flows that can pass through a given meter size  
8 compared to a 5/8 inch meter. For example, the 1 inch  
9 meter surcharge rate was determined by multiplying the  
10 5/8 inch meter surcharge rate times 2.5 ( $\$0.42 \times 2.5$   
11  $= \$1.05$ . FCWC has utilized these AWWA factors in all  
12 of its recent rate case applications and the PSC has  
13 utilized these same factors in all of their Final Rate  
14 Orders to FCWC.

15 **Typical Surcharge Rates**

- 16 Q. What would the monthly Surcharge be for a typical  
17 residential water or wastewater customer under the  
18 proposed Surcharge rate structure?
- 19 A. Given the fixed amount to be recovered over a ten year  
20 period, a typical residential customer would be  
21 charged \$0.42 monthly for each water or wastewater  
22 service. In other words, if a customer has water and  
23 wastewater service, they would be charged a total of  
24 \$0.84 per month for up to ten years.
- 25 Q. How does this compare to a current typical residential

1 bill (5/8 inch meter) in Barefoot Bay and Ft. Myers?

2 A. As follows:

3		Barefoot	South	North
4		<u>Bay</u>	<u>Ft Myers</u>	<u>Ft Myers</u>
5	Typical Water and			
6	Wastewater Bill:	\$51.69	\$48.48	\$74.55
7	Proposed Surcharge			
8	Water and Wastewater:	\$ <u>0.84</u>	\$ <u>0.84</u>	\$ <u>0.84</u>
9	Proposed Water and			
10	Wastewater Bill			
11	with Surcharge:	\$ <u>52.53</u>	\$ <u>49.32</u>	\$ <u>75.39</u>

12 **Regulatory Assessment Fees**

13 Q. Has the Company considered the Florida Public Service  
14 Commission (the Commission) regulatory assessment fee  
15 in the calculation of the Surcharge?

16 A. No. The Surcharge does not include a gross-up for the  
17 Commission's 4.5% regulatory assessment fee.

18 Q. Why?

19 A. The Company does not know if the Commission will  
20 consider the Surcharge subject to its fee. If the  
21 Commission does consider the surcharge subject to its  
22 fee, then the Surcharge as calculated must be  
23 increased by the 4.5% regulatory assessment fee.

24 **Accounting Treatment**

25 Q. What accounting treatment is FCWC requesting from the



- 1 Commission regarding the recovery of legal expenses?
- 2 A. The legal expenses were expensed "below the line",  
3 meaning that the expenses were not included in  
4 operating income, so it is important that no matter  
5 what accounting treatment is allowed by the Commission  
6 that the recovery of the Surcharge relating to the  
7 legal expenses not affect net operating income.
- 8 Q. Do you have a recommended accounting treatment ?
- 9 A. Yes. We recommend that the total legal expenses to be  
10 recovered be recorded as a regulatory asset and  
11 included in Rate Base. This regulatory asset would  
12 then be amortized over a ten year period. As the  
13 Surcharge is collected it would be recorded as a  
14 revenue which would be off-set by the amortization of  
15 the regulatory asset. Only the unamortized regulatory  
16 asset would remain in rate base.
- 17 Q. Do you have anything further to add regarding your  
18 testimony?
- 19 A. Yes. This testimony supports Exhibit 11 (MM-2),  
20 Exhibit 11 (MM-3), and Exhibit 11 (MM-4) as filed  
21 in this case. However, my testimony may be modified  
22 at the hearing so as to address or be consistent with  
23 any stipulations, testimony, or other changed  
24 circumstances occurring prior to the hearing.
- 25 Q. Does that conclude your testimony?

1 A. Yes, it does.

1                   **MR. GATLIN:** Offer the testimony of  
2 Mr. John D. McClellan to be inserted into the record  
3 as though read.

4                   **CHAIRMAN JOHNSON:** It will be so inserted.

5                   **MR. GATLIN:** And he has no exhibits.

6                   **MS. GERVASI:** And we would offer another  
7 composite exhibit of Mr. Allen's deposition transcript  
8 and -- excuse me. Mr. McClellan's deposition  
9 transcript and responses to discovery.

10                   **CHAIRMAN JOHNSON:** We'll mark that as  
11 Composite 13.

12                   **MR. McLEAN:** Pardon me just for a moment.  
13 Ms. Gervasi, you're talking all the discovery for  
14 which that gentleman is responsible, or just the ones  
15 we have here?

16                   **MS. GERVASI:** Just the ones as identified on  
17 the cover sheet for the exhibit.

18                   **MR. McLEAN:** Okay. I have it. Fine.

19                   **CHAIRMAN JOHNSON:** Okay.

20                   (Exhibit 13 marked for identification.)  
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Litigation Expense Recovery

Testimony of John D. McClellan

1  
2  
3  
4 Q. Please state your name and business address.

5 A. My name is John D. McClellan, and my business address  
6 is 555 12<sup>th</sup> Street, N.W., Suite 500, Washington, D.C.  
7 20004.

8 Q. What is your current professional position?

9 A. I am a self employed regulatory consultant engaged in  
10 assisting clients of the firm of Deloitte & Touche LLP  
11 (D&T) in utility accounting and regulatory issues.

12 Q. Were you an active partner of D&T?

13 A. Yes. Up until June of 1992, I was a partner of the  
14 firm. I retired as a partner at that time, but have  
15 continued to serve the firm and its clients as a  
16 consultant on utility accounting and regulatory  
17 issues.

18 Q. What was your responsibility as a partner of the firm?

19 A. My primary responsibility was that of a regulated  
20 utility industry specialist. In conjunction with that  
21 position, I served as the firm's National Regulatory  
22 Practices Partner, having primary responsibility for  
23 the regulatory activities of the firm. I continue to  
24 function as a regulatory specialist on behalf of the  
25 firm, but in the capacity of an individual contractor.

- 1 Q. How long were you with Deloitte & Touche?
- 2 A. I joined the predecessor firm of Haskins & Sells in  
3 1969.
- 4 Q. With whom were you affiliated prior to 1969?
- 5 A. I was on the staff of the Florida Public Service  
6 Commission from 1957 to 1969, and was Director of the  
7 Accounting Department at the time I left the  
8 Commission to join D&T.
- 9 Q. Are you licensed as a certified public accountant?
- 10 A. Yes. I currently hold an active license in Florida,  
11 and have been licensed in a number of numerous other  
12 states.
- 13 Q. Have you previously testified as an expert witness in  
14 Florida?
- 15 A. Yes, on numerous occasions.
- 16 Q. Have you prepared an outline of your background and  
17 experience?
- 18 A. Yes. The outline is attached as Appendix A.
- 19 Q. What is the purpose of your testimony in this  
20 proceeding?
- 21 A. Florida Cities Water Company ("FCWC" or the "Company")  
22 requested that I submit testimony in this proceeding  
23 addressing (1) the Company's requested recovery of  
24 a portion of approximately \$3.8 million of litigation  
25 expenses incurred in defending against the charges by

1 the United States Environmental Protection Agency  
2 (EPA) claiming that provisions of the Clean Water Act  
3 (the "CWA") had been violated; (2) the propriety of  
4 such recovery under regulatory principles; (3) whether  
5 the recovery of the litigation expense is appropriate  
6 by a per customer surcharge; (4) the financial  
7 prudence of the Company's pursuit of a defense against  
8 the EPA charges; and (5) the propriety of recovery of  
9 certain rate case expenses that are now being incurred  
10 in seeking recovery of the litigation expenses.

11 **BACKGROUND**

12 Q. Are you familiar with the events leading to that  
13 litigation, the development of the proceedings and the  
14 decisions rendered in the process?

15 A. Yes.

16 Q. How did you become familiar with these events?

17 A. I reviewed various documents, had a number of  
18 discussions of the events with Company officials, and  
19 reviewed the testimony of the Company witnesses who  
20 have submitted testimony in this proceeding.

21 Q. Would you briefly describe these events and the nature  
22 of the charges brought by the EPA?

23 A. Yes. The particular conditions leading to the  
24 litigation process, the resulting developments and the  
25 ultimate decision rendered by the court system will be

1 described in more detail by other witnesses. As a  
2 brief summary, however, the problem began in 1986  
3 when the EPA denied FCWC's application for renewal of  
4 its National Pollution Discharge Elimination System  
5 (NPDES) permit for the Waterway Estates Wastewater  
6 Plant. The conditions that caused FCWC to start  
7 incurring the costs sought to be recovered in this  
8 proceeding began to develop in 1991 when the EPA  
9 concluded that the Company had failed to meet  
10 scheduled responses to an administrative order  
11 resulting from a show cause hearing held in Atlanta in  
12 1991. The problem began to accelerate in October of  
13 1993 when the U.S. Department of Justice (DOJ) filed  
14 on behalf of the EPA a complaint in Federal District  
15 Court against FCWC alleging violations of the CWA at  
16 the Waterway Estates Wastewater Treatment Plant. In  
17 March, 1995 DOJ filed an amended complaint which  
18 added alleged violations of the CWA at the Barefoot  
19 Bay and Carrollwood Wastewater Treatment plants.

20 Q. Did the complaints seek assessment of a civil penalty  
21 against FCWC?

22 A. Yes. The legal proceedings initiated by the DOJ  
23 attempted to impose very large penalties on the FCWC  
24 system. The original complaint sought a civil penalty  
25 in the total amount of \$32,375,000. The amended

1 complaint increased the amount of the requested  
2 penalties to \$104,325,000.

3 Q. Were efforts made to settle this controversy?

4 A. Yes. The attempt to settle this controversy is  
5 described by Mr. Gerald Allen and Mr. Gary H. Baise,  
6 FCWC witnesses in this case. However, it is my  
7 understanding that in an attempt to reach a reasonable  
8 settlement, FCWC discussed and negotiated with DOJ and  
9 EPA on several occasions both before and after the  
10 litigation was started. In December of 1992, before  
11 the initial complaint was filed, DOJ offered a  
12 settlement proposal that would have required a payment  
13 by FCWC of a penalty of \$5 million. FCWC did not  
14 accept this settlement, but, as explained by Mr.  
15 Allen, did respond with a counter offer to settle with  
16 a payment of \$250,000 in December 1992. That offer  
17 was increased to \$500,000 in January 1993. These FCWC  
18 offers were rejected by EPA and DOJ. On October 1,  
19 1993, the DOJ filed the complaint in federal court.  
20 Thereafter, it is my understanding that the attorneys  
21 for DOJ and FCWC had further settlement discussions.

22 Q. What was the amount of the penalty ultimately  
23 assessed against FCWC by the Court?

24 A. After lengthy legal proceedings, the assessments were  
25 set at a total of \$309,710. These amounts were



1 based upon assessments of \$5,610 at Barefoot Bay,  
2 \$14,675 at Carrollwood and \$289,425 at Waterway  
3 Estates. Mr. Allen and Mr. Baise further explain the  
4 court's ruling.

5 **THE COMPANY'S REQUESTED RECOVERY**

6 Q. Is the Company requesting recovery of the \$309,710  
7 penalty assessment made by the federal court?

8 A. No. The recovery request of the costs incurred in the  
9 litigation process is limited to a portion of amounts  
10 expended in defending against the attempted \$104  
11 million penalty assessment and recovery of the  
12 estimated \$250,000 of rate case expenses to be  
13 incurred in this proceeding undertaken to obtain  
14 litigation expense recovery approval.

15 Q. What were the total litigation expenses incurred in  
16 opposing the DOJ Amended Complaint seeking \$104  
17 million of penalties.

18 A. The costs incurred in the legal defense undertaken to  
19 avoid the \$104 million of penalties sought by the  
20 EPA/DOJ amounted to approximately \$3.8 million.

21 Q. Is the Company seeking recovery of a substantial  
22 portion of these costs?

23 A. Yes. As explained by Mr. Allen, FCWC is seeking to  
24 recover \$3,589,368 of the \$3,826,210 of the litigation  
25 expenses.

1 Q. What is your opinion of the method used by Mr. Allen  
2 in arriving at the \$3,589,368.

3 A. Mr. Allen's approach recognizes that some costs would  
4 have been absorbed by FCWC had an early settlement  
5 been successful and the litigation process avoided.  
6 In assessing FCWC's responsibility for a portion of  
7 these costs, he correlated the DOJ's original offer of  
8 settlement in the amount of \$5,000,000 with the  
9 Court's final determination of a civil penalty of  
10 \$309,710. In this process, he applied the  
11 penalty/settlement offer ratio to the expenses  
12 incurred in pursuing the litigation defense. The  
13 resulting ratio of 6.19% as applied to the \$3.8  
14 million of costs produced an unrecoverable amount of  
15 \$236,842 which was deducted from the total litigation  
16 expenses of \$3,826,210 resulting in \$3,589,368 of  
17 recoverable litigation expenses.

18 Q. Was that the only measure applied by Mr. Allen in  
19 evaluating a cost responsibility to be absorbed by  
20 FCWC?

21 A. No. He also established a second recovery amount  
22 using a different measure. In this measure, the  
23 litigation expenses of \$3.8 million were reduced by  
24 the difference between the \$500,000 settlement offer  
25 that presumably would have settled the issue and the

1 final judgement of \$309,710 imposed by the court. The  
2 \$309,710 penalty is being absorbed by the Company.  
3 If the \$190,290 difference (\$500,000 - \$309,710) is  
4 also absorbed by subtraction from the litigation  
5 expenses incurred, the Company would be entitled to a  
6 recovery of slightly more than the \$3.6 million  
7 requested using the penalty/settlement ratio measure  
8 that has been applied. Recovery of the lesser of the  
9 two amounts is requested.

10 Q. Of the total \$3.6 million of recoverable litigation  
11 expenses, how much is being requested from customers  
12 subject to this Commission's jurisdiction?

13 A. The request in this filing is that the Commission  
14 approve the recovery of \$2,265,833 from customers  
15 being served in counties subject to the Commission's  
16 jurisdiction. As explained by Mr. Murphy, FCWC will  
17 seek approval to recover the balance of the expenses  
18 from rate regulatory authorities in the counties not  
19 subject to the Commission's jurisdiction. The manner  
20 in which this portion of the recoverable litigation  
21 expenses has been determined is presented in the  
22 testimony of Mr. Murphy.

23 Q. Did the Company incur carrying charges on the funds  
24 required to pay the litigation expenses over the last  
25 five years?

1 A. Yes.

2 Q. Have the related carrying costs been recorded?

3 A. No.

4 Q. What is the approximate level of such costs?

5 A. Assuming a capital cost of 10%, the funding of the  
6 litigation efforts for which cost recovery is being  
7 requested would have resulted in costs accumulating  
8 to over \$4.5 million by the end of this year. This  
9 accumulated cost measure reflects the current revenue  
10 recovery that would be necessary to make FCWC whole  
11 for the costs of the litigation incurred since this  
12 struggle began.

13 Q. Is FCWC requesting recovery of these total accumulated  
14 costs that have actually been incurred?

15 A. No. Recovery of the prior period costs is being  
16 requested for only the direct portion of the costs.  
17 No request is being made for recovery of the related  
18 prior years' carrying costs.

19 **PROPRIETY OF RECOVERY**

20 Q. Have you reviewed the Company's rationale for the  
21 recovery of these costs and the proposed methods of  
22 establishing tariff provisions that will achieve this  
23 objective?

24 A Yes. As is discussed in Mr. Murphy's testimony and  
25 reflected in his exhibits, the litigation expenses

1           were incurred to protect the system from severe  
2           financial damages. The Company was convinced that  
3           a direct challenge to the claimed damages was  
4           necessary to preserve the system and to maintain the  
5           services to which the customers are entitled.

6    Q.    Would serious financial penalties have been assumed if  
7           the suit filed by the DOJ had no been challenged?

8    A.    Yes. Although there is no way to identify the  
9           specific amount of penalty that may have been  
10          assessed, given the penalty levels sought the amount  
11          would have been substantial. It is very clear that  
12          any attempt to satisfy financial obligations at the  
13          levels sought by the DOJ in the litigatory process  
14          would have left the Company with monetary demands that  
15          would have to be diverted from the normal conduct of  
16          operations of both the water services and the  
17          wastewater services provided to the system levels,  
18          assuming that such service could have been maintained  
19          at all. Accordingly, the incurrance of litigation  
20          expenses was unavoidable in the defense of the systems  
21          against the penalties sought by the DOJ. These  
22          actions preserved the system from calamitous financial  
23          burdens and clearly benefitted all customers on the  
24          system, whether water, wastewater or both.  
25          Consequently, all customers should share in the cost

1 reimbursement.

2 Q. Do observations made by the court support your  
3 conclusion that the penalties sought would have been  
4 financially calamitous?

5 A. Yes. There are observations contained in the  
6 judgement that clearly recognize the inability of the  
7 Company to pay the judgements sought, and that  
8 adequate funds were not available or accessible. As  
9 observed at page 20 of the Court's judgement, it is  
10 found that FCWC did "...not have the ability to pay  
11 the statutory maximum penalty. . . ." and that  
12 planned capital expenditures would "...exhaust the  
13 available lines of credit."

14 **PROPRIETY OF SURCHARGE**

15 Q. Is the proposed use of a surcharge to recover the  
16 litigation expenses an appropriate vehicle to achieve  
17 the targeted cost recovery?

18 A. Yes. Although there are alternative ways in which the  
19 costs may be assessed, the use of a surcharge has the  
20 clear advantage of providing for the recovery of a  
21 specific level of costs since the recovery process  
22 will terminate when the identified costs have been  
23 recovered.

24 Q. Is the application of a surcharge per customer an  
25 appropriate method of recovering the litigation

1 costs?

2 A. Yes. The recovery of the litigation expenses on a  
3 customer surcharge basis appears to be the most  
4 appropriate of the available methods. All of the  
5 system's water and wastewater customers benefited from  
6 the Company's battle to avoid the crippling penalties  
7 sought in the Complaint, and all customers should  
8 share in the costs of the battle. While not directly  
9 proportional to consumption, the benefits from the  
10 litigation efforts do vary with customer size. For  
11 example, large customers, both water and wastewater,  
12 received a greater relative benefit simply because  
13 they depend on higher levels of service being  
14 maintained. Accordingly, a customer based charge is  
15 proposed, but it is weighted by meter size to  
16 recognize the relative levels of benefits between  
17 customer classes. As is discussed by Mr. Murphy,  
18 levels of wastewater services correlate with levels of  
19 water usage and the application of a surcharge level  
20 that relates to meter size recognizes this condition.  
21 As applied, the monthly charges will be equal for all  
22 customers with similar sized meters. The monthly  
23 charges are scheduled over a 10 year period, but will  
24 continue only until the identified costs are  
25 recovered. At that point the charges will be

1 terminated. If customer growth occurs as expected,  
2 the recovery period will be somewhat shorter than 10  
3 years.

4 Q. Is it appropriate to spread the recovery over future  
5 periods?

6 A. Most certainly. The spreading of the cost burden is  
7 not only appropriate, but it is the only practical way  
8 to assess the costs. It has been a long and  
9 frequently used regulatory procedure, both here in  
10 Florida and elsewhere, to spread significant short  
11 period costs over longer periods to achieve a  
12 balancing of customer and utility interests. The  
13 targeted balance of interests (1) minimizes the rate  
14 impact on customers while (2) providing cost recovery  
15 without undue delay. In this instance, the recovery  
16 period of 10 years introduces such a balance. There  
17 is no specific period that is "right" or "wrong".  
18 While a different period could be used, 10 years is a  
19 long period and any change should be toward a shorter  
20 period.

21 Q. Is it appropriate to recover from the system as a  
22 whole those costs incurred from defending against  
23 charges directed at specific parts of the system?

24 A. I do not believe that there is any doubt as to this  
25 approach. It is the most appropriate manner in which



1 the costs incurred may be correlated with the benefits  
2 received in the Company's successful efforts in  
3 defending the financial viability of the water and  
4 wastewater systems. Even though the charges were  
5 directed to individual facilities, the assessed  
6 penalties would have become the burden of the entire  
7 system. As observed earlier, the attempt to pay the  
8 assessments would have financially crippled the system  
9 and would have seriously disrupted the service across  
10 the full customer base. The legal defense taken was  
11 necessary to preserve the total system and the service  
12 to all customers. The litigation expenses were truly  
13 beneficial to the entire system and it is appropriate  
14 to spread and recover the costs accordingly.

15 Q. How is the cost recovery being applied under the  
16 Company's filing?

17 A. The costs are being assigned on a weighted customer  
18 basis. It is recognized that the cost benefits have  
19 no direct relationship to customer consumption levels  
20 and that usage volumes is not an appropriate basis for  
21 recovery. Accordingly, the recovery approach assigns  
22 a fixed monthly charge per customer, but with a  
23 customer meter size weighting to recognize customer  
24 size.

25 Q. Have you addressed the propriety of weighting the

1 customer by meter size in assessing the monthly charge  
2 per customer?

3 A. Yes. As previously stated, customers provide the  
4 general allocation base. However, the size of a  
5 customer also reflects the degree of benefit realized  
6 by pursuing the litigation. Accordingly, meter size  
7 is factored into the recovery provision to reflect the  
8 level of benefits received. In addition, this  
9 approach is consistent with existing tariff structures  
10 that provide for recovery of fixed costs through a  
11 monthly charge weighted by meter size.

12 Q. Does the requested surcharge include provisions for  
13 future delays in cost recovery?

14 A. No. The request is that the \$3.6 million of costs  
15 directly incurred in the litigation process be  
16 recovered in equal annual amounts per customer over  
17 the next 10 years. Additional carrying costs will be  
18 incurred during this recovery period, and if there are  
19 any rate filings during that period, any unamortized  
20 costs should be recognized as a rate base component.

21 **RECOVERY OF RATE CASE EXPENSE**

22 Q. In your opinion, should FCWC recover its expenses for  
23 this proceeding?

24 A. Yes. This rate case process is a necessary adjunct  
25 to the recovery of the litigation expenses, a role

1           that justifies recovery of the costs incurred in  
2           processing this case, and which endorses the  
3           spreading of the costs to customers in a manner  
4           consistent with the assignment of the related  
5           litigation expenses.

6 Q.    Are the litigation expenses and the rate case  
7           expenses to be recovered over the same period?

8 A.    Yes, the intent is to recover both over the next 10  
9           years.

10 Q.   Does that complete your testimony?

11 A.   Yes.

**Resume of**                    **JOHN D. MCCLELLAN**

**Position**                    **Consultant (Retired Partner)**  
**Deloitte & Touche LLP**  
**Washington, D.C.**

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**Utility Experience**      Mr. McClellan is a former partner of Deloitte & Touche LLP. Since his retirement from D&T in 1992, he has functioned under a contractual arrangement in which he provides utility accounting and ratemaking services to the firm's public utility industry clientele. Prior to retirement, he functioned as the National Regulatory Practices Partner with primary responsibility for the firm's public utility regulatory services.

As a public utility industry specialist, he has been continuously involved in public utility accounting and regulatory policies and proceedings, problem analyses, special studies, and training programs. In assisting clients in various aspects of the ratemaking process, he has served as an expert witness in a wide variety of issues. He has addressed numerous state regulatory commissions, legislative committees, special agencies, city councils, state and federal courts, the Federal Energy Regulatory Commission, the Canadian National Energy Board and the Ontario Energy Board.

Prior to joining D&T, Mr. McClellan served as the Chief Accountant of the Florida Public Service Commission. As a Commission staff member from 1957 to 1969, he participated in the areas of development of accounting procedures, audits, rate base, test period operating results, rate of return and capital cost evaluations, cost allocations, rate design criteria, automatic adjustment clauses, and a variety of special study projects.

**Utility Clients Served**      Mr. McClellan has served clients throughout the industry. These include operating utilities, regulators and parties being served by utilities. Some of these clients, grouped according to the client role in the engagement, are identified in the following lists.

*Operating Utilities:*

Florida Power & Light Co.  
Tampa Electric Company  
Southern Bell Telephone Co.  
(in Fla. Ga., S.C., N.C. and La.)  
Atlanta Gas Light Co.  
Duke Power Company  
Virginia Power Company

Florida Progress  
Gulf Power Company  
General Telephone  
Peoples Gas  
Carolina P&L.  
South Carolina Electric & Gas Co  
American Electric Power

Texas Utilities Company  
 Southern Union Gas Co.  
 Tucson Electric Power Co.  
 Nevada Power Co.  
 Entergy Corporation  
 Kansas City Power & Light Co.  
 Delmarva Power & Light Co.

Houston Lighting & Power Co.  
 Lone Star Gas Co.  
 Arizona Public Service Co.  
 San Diego Gas & Electric  
 Transcanada Pipelines  
 Citizens Utilities  
 Alltel, Inc.

*Regulators:*

Canadian National Energy Board  
 Ontario Energy Board  
 Texas Public Utility Commission  
 Illinois Commerce Commission

Canadian Transport Comm  
 New York PSC  
 Missouri PSC  
 Vermont PSC

*Consumers:*

Delaware Industrial Group  
 Virginia Committee for Fair Rates  
 City of Martinsville, Va.  
 Group of Texas Electric Cooperatives  
 Attorney General of Virginia  
 Ghanaian Aluminum Smelter

Virginia Industrial Group  
 Connecticut Industrial User  
 Southern Union Gas  
 Group of Texas Municipal  
 Public Counsel of Vermont  
 Canadian Industrial Gas User

**Publications  
 and Speaking**

Mr. McClellan has lectured at numerous public utility seminars, including presentations to the FERC staff and to the Florida, New York, Missouri, Texas, Arkansas and Illinois State Commission staffs, various professional and educational groups, and a Pan American seminar for the Servicio Nacional de Electricidad in San Jose, Costa Rica. He has conducted various training courses, including the D&T sponsored *Tax Aspects of Regulation* and is a co-author of the D&T Public Utility Manual. He is also a contributing author to *Accounting For Public Utilities*.

**Education**

Mr. McClellan graduated from Florida State University in 1957 with a B.S degree in Business Administration, and a major in accounting. He has attended numerous industry training courses since beginning his career as a public utility regulatory specialist.

**Professional**

Mr. McClellan is a Certified Public Accountant and is a member of the American Institute of Certified Public Accountants. In his role as a specialist in the public utility industry, he has served on various AICPA, NARUC, and industry committees addressing public utility accounting and ratemaking principles.

1           **MR. GATLIN:** I would offer the testimony of  
2 Dr. Abdul Ahmadi, DEP program administrator of water  
3 facilities, for insertion into the record as though  
4 read.

5           **CHAIRMAN JOHNSON:** It will be so inserted.

6           **MR. GATLIN:** Mr. Ahmadi has two exhibits,  
7 ABA-1 and ABA-2. I would like to have those  
8 identified.

9           **CHAIRMAN JOHNSON:** They will be identified  
10 as Composite Exhibit 14.

11                   (Exhibit 14 marked for identification.)

12           **MS. GERVASI:** And Staff would like to have  
13 identified Mr. Ahmadi's deposition transcript as well  
14 as the discovery items as specified on the cover sheet  
15 of our composite exhibit.

16           **CHAIRMAN JOHNSON:** That will be identified  
17 as Composite 15.

18           **MS. GERVASI:** Thank you.

19                   (Exhibit 15 marked for identification.)

20

21

22

23

24

25



1 A. Yes.

2

3 Q. Did you give a deposition and testify at trial in that  
4 case?

5 A. Yes.

6 Q. Are Exhibits \_\_\_\_ (ABA-1) and \_\_\_\_ (ABA-2) a copy of the  
7 transcript of your deposition and testimony at trial  
8 respectively, in that litigation?

9 A. Yes.

10 Q. Have you reviewed the transcripts of your testimony of  
11 your deposition (Exhibit \_\_\_ (ABA-1) and trial (Exhibit  
12 \_\_\_\_ (ABA-2)?

13 A. Yes.

14 Q. Are there any changes or corrections you wish to make  
15 to these transcripts?

16 A. No. Except the middle initial as noted.



1           **MR. McLEAN:** The Citizens move the testimony  
2 of Hugh Larkin, Jr. into the record as though read,  
3 and that would include his appendix. Mr. Larkin has  
4 no exhibits.

5           **CHAIRMAN JOHNSON:** Okay. The testimony will  
6 be inserted as though read. Staff?

7           **MS. GERVASI:** Staff would like to identify  
8 as an exhibit the transcript of Mr. Larkin's  
9 deposition as well as late-filed Deposition Exhibit 1.

10           **CHAIRMAN JOHNSON:** It will be identified as  
11 Composite 16.

12           **MS. GERVASI:** Thank you.

13                   (Exhibit 16 marked for identification.)  
14  
15  
16  
17  
18  
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23  
24  
25

1 DIRECT TESTIMONY  
2 OF  
3 HUGH LARKIN, JR.  
4 ON BEHALF OF THE CITIZENS OF FLORIDA  
5 BEFORE THE  
6 FLORIDA PUBLIC SERVICE COMMISSION  
7 REGARDING THE RECOVERY OF LITIGATION COSTS  
8

9 INTRODUCTION

10 Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

11 A. My name is Hugh Larkin, Jr. I am a Certified Public Accountant licensed in the states  
12 of Florida and Michigan and the senior partner in the firm of Larkin & Associates,  
13 Certified Public Accountants, with offices at 15728 Farmington Road, Livonia,  
14 Michigan 48154.

15  
16 Q. HAVE YOU PREPARED AN APPENDIX WHICH DESCRIBES YOUR  
17 QUALIFICATIONS AND EXPERIENCE?

18 A. Yes. I have attached Appendix I which is a summary of my experience and  
19 qualifications.

20  
21 Q. ON WHOSE BEHALF ARE YOU APPEARING?

22 A. Larkin & Associates was employed by The Florida Office of Public Counsel ("OPC")  
23 to provide testimony regarding the recovery of litigation costs from certain water and  
24 wastewater customers of the Florida Cities Water Company (FCWC) who are subject  
25 to the jurisdiction of the Florida Public Service Commission.

1

2 Summary of Recommendations and Conclusions

3

Q. WOULD YOU PLEASE SUMMARIZE THE RECOMMENDATIONS AND  
4 CONCLUSIONS YOU HAVE REACHED REGARDING THE RECOVERY OF  
5 LITIGATION COST FROM FLORIDA CITIES WATER COMPANY'S (FCWC)  
6 RATEPAYERS SUBJECT TO THE JURISDICTION OF THE FLORIDA PUBLIC  
7 SERVICE COMMISSION?

8

A. I am recommending that the Florida Public Service Commission not authorize the  
9 recovery of litigation costs from those ratepayers subject to its jurisdiction. I have  
10 reached this recommendation based on my conclusion that if the Commission were to  
11 authorize the recovery of these legal fees it would be retroactive ratemaking.  
12 Additionally, the litigation costs incurred primarily benefitted the stockholders and  
13 debtholders of FCWC. Also, to establish a precedent of this nature in the State of  
14 Florida would place ratepayers in a position of guaranteeing or being the payer of last  
15 resort for any and all litigation undertaken by regulated public utilities in the State of  
16 Florida.

17

18 Q. HOW WILL YOUR TESTIMONY BE ORGANIZED?

19 A. My testimony will be organized in the following headings:

20

a. Company's Proposal is Retroactive Ratemaking

21

b. Ratepayers Not Responsible for Fines, Penalties and Related Costs

22

c. Financial Integrity

23

d. Legal Expenses in this Instance are Atypical

24

e. Criminal Legal Fees

25

f. Inclusion of Unrecovered Legal Fees in Rate Base

1 g. Alternative Allocation of Legal Fees

2  
3 Company's Proposal is Retroactive Ratemaking

4 Q. IS THERE ANY RATEMAKING BASIS FOR THE COMPANY TO REQUEST  
5 THE LEGAL FEES UNDER CONSIDERATION IN THIS CASE?

6 A. No, there is not. Clearly, what the Company is requesting is retroactive ratemaking.  
7 The Company did not and does not have an accounting order authorizing them to  
8 defer any of the expenses associated with the legal fees in question. In fact, the  
9 Company did not defer any of the legal expenses requested in this case. In each  
10 accounting year 1991 - 1997 the Company booked, "below the line" the legal fees  
11 according to Mr. Murphy's testimony. Thus, each year the Company recorded as  
12 expense the legal fees incurred. Since the Company has no accounting order allowing  
13 it to defer the expense and the expenses were incurred throughout the period 1991 -  
14 1997, the Company cannot accumulate those expenses and then ask the ratepayers to  
15 compensate the Company at some future point. This is clearly retroactive ratemaking  
16 and is not authorized, either by the Florida Public Service Commission or generally  
17 accepted ratemaking principles. The Company has expensed the incurrence of the  
18 legal fees in each of the years 1991 - 1997. If the Company had a basis to recover  
19 these expenses, it was to file a rate case at the time the expenses were being incurred  
20 and ask for the recovery as part of a rate case, or to come before the Commission and  
21 ask for an Accounting Order allowing for the deferral of the legal fees to be  
22 considered in a single issue rate case. The Company has not done so, and has merely  
23 decided to retroactively attempt to recover these expenses from ratepayers. Thus, it  
24 appears to me that the Company should not prevail on this issue based on the fact  
25 that it had no authority to defer the expense and no authority to retroactively collect it

1 from ratepayers.

2  
3 Ratepayers Not Responsible for Fines, Penalties and Related Costs

4 Q. UNDER RATE MAKING PRINCIPLES ARE RATEPAYERS HELD  
5 RESPONSIBLE FOR FINES, PENALTIES AND RELATED COSTS?

6 A. As a general rule, ratepayers are not responsible for fines and penalties or any related  
7 costs. Generally, rate making principles have concluded that fines and penalties are  
8 violations by management of laws that they knew or should have known existed, and  
9 that any violation of law is the responsibility of management, who work directly for  
10 stockholders. Thus, ratepayers in utility rate making cases are generally not held  
11 responsible for the payment of fines and penalties. Since the underlying principle of  
12 utility rate making is that the fines and penalties are the responsibility of management,  
13 who work directly for the stockholders, then any related expense, such as legal fees,  
14 should be treated in the same manner as the fine or penalty. Clearly, the Florida  
15 Public Service Commission has recognized that the fines and penalties incurred by  
16 utilities in their operations, regardless of whether those fines and penalties are  
17 assessed by a local jurisdiction, the state or a federal agency, should not be collected  
18 in rates from ratepayers. It is also reasonable that any associated expense, such as  
19 legal fees, interest or cost associated with correcting violations, should not be  
20 collected from ratepayers if these costs would not have been incurred absent the fine  
21 or penalty.

22 The reasoning underlying this basic principle is that management must be held  
23 responsible for its actions. It must be aware of the requirements of the law, and it  
24 must follow those laws regardless of their conclusion as to the fairness or economic  
25 reasonableness of the requirements of the law. If regulation allowed the recovery of

1 fines and penalties and/or any related costs from ratepayers, clearly, management and  
2 stockholders would be shielded from the affects of their actions. They could operate  
3 with impunity knowing that as a general principle they could recover any penalty or  
4 fine and related costs from ratepayers. Clearly, in a competitive environment they  
5 would not recover such costs. To the extent that the Commission shifts the costs of  
6 the violations - whether penalty or legal fees incurred in litigation over penalties -  
7 from the Company to the ratepayers, it holds the Company harmless from such  
8 violations and frustrates the purpose of the Clean Water Act.

9  
10 Q. SHOULD THE FLORIDA PUBLIC SERVICE COMMISSION ENSURE THAT  
11 ITS ACTIONS ARE CONSISTENT WITH THE INTENT OF FEDERAL AND  
12 STATE REGULATORY AGENCIES?

13 A. Yes. This case provides an excellent example of how passing to the customers the  
14 expenses associated with a utility's violation of federal law would insulate the utility  
15 management from compliance with the CWA. It is worthy of note that neither the  
16 EPA, DOJ, nor the federal Judge was ever aware that the Company might shift the  
17 expenses of litigation its customers.

18  
19 In fact, the contrary was indicated. In FCWC President Mr. Allen's November 13,  
20 1995 Deposition, taken by the DOJ, he testified as follows:

21 Q. (By DOJ Attorney Jacobs) Mr. Allen, are you involved in rate making  
22 proceedings for Florida Cities Water Company?

23 A. Yes.

24 Q. You mentioned that approximately \$2 million had been set aside for  
25 purposes of this litigation. Do you know whether any of that money has been

1 included in the rate base?

2 A. No, it has not.

3 Q. And do you have plans to include any of that money in the rate base?

4 A. Highly doubtful.

5 Q. Why?

6 A. Well, I probably do not have the expertise from an accounting  
7 perspective to really address this, but -- and maybe I was presumptuous when  
8 I said probably not. The answer is, frankly, I don't know.

9 Q. Actually, you said highly doubtful, not probably not.

10 A. Well --

11 Q. On what did you base that answer? What made you think it was highly  
12 doubtful?

13 A. We., it depends on -- depends on a number of factors. Quite frankly,  
14 the reason I said highly doubtful is I think the commission will look at this  
15 expense with -- when I say commission, I'm talking about the public service  
16 commission -- without a lot of inclination to include it in a rate base.

17 Q. Why do you say that?

18 A. Just based on my past experience with the commission.

19 Q. As we sit here today, is it your intention, as the president of Florida  
20 Cities Water Company, to include in any submission to the public service  
21 commission any of these funds that have been set aside for use in this  
22 litigation; that is to say, for purposes of rate-base calculations?

23 A. I don't know.

24 Q. Well, who will make that decision?

25 A. Well, I think the -- first, the decision will not be made until --even to

1 consider whether or not to seek rate base or any other treatment of these  
2 expenses until the outcome of the case is resolved.

3  
4 Thus, Mr. Allen indicated that FCWC's seeking to include expenses associated with  
5 this litigation was "highly unlikely." While Mr. Allen hastened to add that he was no  
6 expert regarding whether the expenses could be recovered through the rate making  
7 process, the matter was apparently not raised again. It is reasonable to conclude that  
8 the DOJ and the Federal Judge were under the reasonable impression that the violator  
9 - FCWC - like any other violator - would be liable for whatever penalty and expenses  
10 arose from this litigation. It is also reasonable to assume that the Court and the DOJ  
11 were aware that the Company was incurring substantial litigation expenses, and that  
12 its ability to pay any penalty would be lessened to that extent

13  
14 Q. HAS THE FLORIDA PUBLIC SERVICE COMMISSION ALLOWED THE  
15 RECOVERY OF FINES AND PENALTIES IN THE RATE MAKING PROCESS?

16 A. To my knowledge, they have not.

17  
18 Q. HAS THE FLORIDA PUBLIC SERVICE COMMISSION ALLOWED THE  
19 RECOVERY OF LEGAL FEES AND RELATED COSTS ASSOCIATED WITH  
20 FINES AND PENALTIES?

21 A. I am aware of two cases in which the Commission dealt with a utility's legal expenses  
22 incurred in dealing with the Department of Environmental Regulation (DER) and the  
23 Environmental Protection Agency (EPA). The first of these cases involved Lehigh  
24 Utilities, Inc., in Docket No. 911188-WS, Order No. PSC-93-0301-FOF-WS, issued  
25 February 25, 1993.



1  
2 In that Order, at page 21, the Commission stated the following:

3 Test Year Legal Expenses

4 In the MFRs, a portion of the allocated A&G expenses included non-rate case  
5 related legal expenses. OPC offered no testimony in support of its position  
6 that this amount should be reduced by the amount allocated for defense of  
7 DER and Environmental Protection Agency (EPA) fines.

8  
9 Utility witness Ludsen testified that Lehigh should pay its allocated share of  
10 legal expenses incurred in defending SSU systems from the various  
11 governmental entities that levy fines. Witness Ludsen further testified that  
12 negotiations which may avoid or reduce fines, or eliminate or postpone large  
13 improvements to systems, are included in this expense. He also testified that  
14 allocation of legal expenses maintains stable cost assignments to systems on a  
15 year-to-year basis.

16  
17 Based on the foregoing, we find it appropriate to allow the utility to recover  
18 its legal expenses relating to permitting and compliance. Accordingly, no  
19 adjustment to legal expenses has been made.

20  
21 It is not clear from the above quoted Order what the extent of the legal fees were, or  
22 whether they related directly to fines and penalties imposed by the Environmental  
23 Protection Agency. The last paragraph in the quoted Order which discuss this issue  
24 states, in part, that the Commission is allowing "...legal expenses relating to  
25 permitting and compliance." This description does not appear to be the same as

1 defending the utility in an action where the Company has been fined for violation of a  
2 requirement of the law. Obtaining permits and complying with regulations would be a  
3 normal event in the course of operations and would not be the same as legal fees  
4 incurred to defend the Company's management and stockholders against violations of  
5 statutes or regulations. Additionally, it would appear that whatever legal fees were  
6 involved in the Lehigh Utilities case were probably de minimus, since the fine involved  
7 was only \$7,500. The \$7,500 fine was removed as part of a stipulation as shown on  
8 page 4, Item 4 of the Order.

9  
10 Q. PLEASE DISCUSS THE SECOND CASE YOU ARE AWARE OF.

11 A. The second case is Docket No. 960451-WS, Order No. PSC-97-0618-FOF-WS,  
12 issued May 30, 1997. I was a witness in that docket, and I recommended that the  
13 Commission remove legal fees incurred to defend EPA and DEP violations. The  
14 amount of legal fees associated with my recommendation was \$453. Needless to say,  
15 there was not extensive litigation of this issue. The Commission accepted the  
16 conclusion that "...the legal expenses incurred for defending fines from DEP and EPA  
17 could facilitate avoided or a reduced amount of fines." The full discussion of the  
18 issue in the Order is as follows:

19 Legal Costs for Defense of EPA or DEP Violations

20 OPC witness Larkin identified expenses included in the base year related to  
21 legal fees incurred to defend EPA and DEP violations. He testified that the  
22 utility's ratepayers should not be required to finance such violations, as these  
23 expenses are unrelated to the provision of water and wastewater service. As  
24 such, Mr. Larkin proposed adjustments to remove these expenses from the  
25 test year. By applying the 1996 and 1997 inflation factors to the base year

1 amount of \$431, he proposed to reduce water operations by \$163 and  
2 wastewater operations by \$290.

3 In its brief, UWF argued that the utility has a good record of compliance with  
4 environmental rules and regulations. In support of this statement, the utility  
5 referred to the testimony of an employee of the Department of Health and  
6 Rehabilitative Services (HRS) and two employees of DEP, who appeared on  
7 behalf of staff in this proceeding. In further support of UWF's position that  
8 these legal expenses should be allowed, in its brief, the utility referenced Order  
9 No. PSC-93-0301-FOF-WS. By that Order, the Commission determined that  
10 it was appropriate to allow legal expenses incurred for defense of DER (now  
11 DEP) and EPA fines, as these costs could serve to avoid or reduce fines, or  
12 eliminate or postpone large system improvements.

13  
14 Although we find that fines associated with violations of DEP and EPA should  
15 be borne by the shareholders of the utility, we believe it is reasonable for UWF  
16 to recover the costs of defending such fines. As the commission previously  
17 concluded, the legal expenses incurred for defending fines from DEP and EPA  
18 could facilitate avoided or a reduced amount of fines. Therefore, we find that  
19 no such adjustments are necessary to test year expenses.

20  
21 As I previously indicated, the amount of legal fees were small, only \$453. I do not  
22 believe that the Order in Docket No. 960451-WS represents a precedent by the  
23 Commission, nor does it focus on the relationship between the fines and penalties and  
24 legal fees. Moreover, it is doubtful that the commission should or did there intend to  
25 establish precedent in a \$453 issue which would control a multi-million dollar issue in

1 a later case.

2  
3 It is also worthy of note that in each of the cases, the expenses were test year  
4 expenses, unlike the instant case.

5  
6 It is fair to say that at least in terms of materiality, this is a case of first impression  
7 before the Florida Public Service Commission.

8  
9 Q. WHAT DO YOU MEAN BY FOCUS ON THE RELATIONSHIP BETWEEN THE  
10 FINES AND PENALTIES AND LEGAL FEES?

11 A. If an expense, whether it be a fine or a penalty, is not recoverable in rates because it  
12 does not meet the standard of a necessary and prudent expense incurred in the  
13 provision of water and wastewater service, then any related expense, such as legal  
14 fees, should not be included in rates. The associated legal expense must take on the  
15 same character as the fines and penalties. To do otherwise would cause the  
16 ratepayers to be responsible for an expense associated with the primary expense  
17 which the Commission has already found ratepayers not to be responsible.

18  
19 Q. IS IT NOT TRUE THAT THE LEGAL FEES MAY SERVE TO REDUCE THE  
20 FINES AND PENALTIES?

21 A. That may be true. However, since the fines and penalties are the responsibility of the  
22 stockholder, only the stockholder would benefit from the reductions of the fine or  
23 penalty. Consequently, the stockholders should bear the cost related to the fine or  
24 penalty. As an example, if the Commission were to find that a particular item of plant  
25 constructed by a utility should not be added to rate base because it is not used or

1 useful or was not prudently incurred, the Commission would not add depreciation  
2 expense to rates in order to allow the Company to recover the costs of such plant. If  
3 stockholders were not entitled to earn a rate of return on the plant, they also would  
4 not be entitled to recover their investment through depreciation expense. The  
5 depreciation expense would follow the treatment of the plant. If the plant was  
6 eliminated from the cost of service, the depreciation expense would also be removed  
7 because the two are inter-related. The same is true with EPA fines and penalties. If  
8 the fines and penalties are eliminated from the cost of service, then legal fees  
9 associated with those fines and penalties should also be eliminated from the cost of  
10 service.

11  
12 Q. I NOTE IN THE ORDER YOU QUOTED FROM DOCKET NO. 960451-WS, AN  
13 ARGUMENT WAS ADVANCED BY THE COMPANY IN ITS BRIEF THAT  
14 THE LEGAL FEES COULD ELIMINATE OR POSTPONE LARGE SYSTEM  
15 IMPROVEMENTS. ALTHOUGH THE COMMISSION DID NOT ADOPT THAT  
16 PORTION OF THE COMPANY'S ARGUMENT IN APPROVING THE \$453 IN  
17 LEGAL FEES, WOULD YOU PLEASE COMMENT ON THAT PROPOSITION?

18 A. It is my understanding that neither the DEP nor the EPA orders companies to add  
19 large system improvements. It is my understanding that these two regulatory  
20 agencies find that companies are in violation of the law and that the company itself  
21 must determine how to eliminate the violation and comply with the law. The  
22 elimination of the violation may require the addition of system improvements, it may  
23 require repair, or it may require the connection of the wastewater system to another  
24 plant. The environmental agencies either find the utility is or is not in compliance  
25 with the requirements of the law. If these agencies are mistaken as to whether a

1 particular utility's wastewater treatment facilities comply with the law, then normally  
2 the company's own engineers can prove the company's compliance with the  
3 requirements of the law. No legal expense would be incurred, since it would be a  
4 matter of testing to determine whether the utility complies or does not comply with  
5 the environmental requirements. Consequently, I do not see how the incurrence of  
6 legal expenses could change the requirements of the law so that a utility would not  
7 have to comply with the environmental requirements. If there are alternatives that are  
8 less costly, clearly, that is within the prerogative of the utility to make those least cost  
9 plant additions, as long as they meet the standard required by the law.

10  
11 A very similar argument was advanced by the Company in its litigation. In fact, it  
12 appears that the Company scheduled the testimony of Charles Hill, of the Commission  
13 staff to make the point. Essentially, the company argued that there could be no  
14 economic advantage to the company by deferring investment. As the argument goes,  
15 the ratemaking process permits the company a return only upon investment actually  
16 made, thus investment deferred or avoided can provide no economic benefit to the  
17 company. Implicit in this argument is the notion that deferring investment inures to  
18 the benefit of the customers rather than the utility.

19  
20 Q. DID THE FEDERAL COURT ADDRESS THIS ARGUMENT.

21 A. Indeed it did. The Court rejected the argument finding that "...the Court disagrees  
22 with Florida Cities' contention that it can only realize an economic benefit from  
23 investing, not deferring investment. [Exhibit 6 (GHB-97, p16) memorandum order  
24 dated August 20, 1996] Thus while the company may champion the customer's  
25 interest in low rates, it is clear that the company also serves its own economic

1 interests by deferring construction which is sometimes later found to bring about  
2 violations of laws such as the CWA.

3  
4 Q. IS IT YOUR UNDERSTANDING THAT FLORIDA CITIES WATER COMPANY  
5 WAS FOUND TO BE IN VIOLATION OF THE CLEAN WATER ACT?

6 A. It is my understanding, based on my review of the judgement issued by the United  
7 States District Court, that Florida Cities Water Company was found to violate the  
8 National Pollutant Discharge System (NPDES), violations were at Barefoot Bay and  
9 Carrolwood, and there were claims for unpermitted discharges, discharges to an  
10 unpermitted location and NPDES violations at Waterway Estates. The Court's Order  
11 indicates that there were 269 Clean Water Act violations at Barefoot Bay, 234 Clean  
12 Water Act violations at Carrolwood, and 1,038 Clean Water Act violations at  
13 Waterway Estates. None of the Court's findings appear to deal with how Florida  
14 Cities Water Company should or might have complied with the Clean Water Act, and  
15 it does not appear to me to have been part of the litigation before the court.

16  
17 In fact, it is clear that the court was faced with two issues during the trial: 1) The  
18 amount of the penalty to be assessed against FCWC, and 2) the liability of Avatar, if  
19 any. FCWC's violations of the CWA were established by summary judgement.

20  
21 Q. THROUGHOUT THE COMPANY'S FILING IN THIS CASE, THE COMPANY  
22 APPEARED TO BE ARGUING THAT THE JUSTICE DEPARTMENT  
23 REPRESENTING THE ENVIRONMENTAL PROTECTION AGENCY WAS  
24 UNREASONABLE AND COULD HAVE, AND SHOULD HAVE, SETTLED  
25 THIS SUIT EARLY ON WHEN LESS LITIGATION COST WOULD HAVE

1 BEEN INCURRED. WOULD YOU PLEASE COMMENT?

2 A. The Company's filing clearly indicates that they feel that the Justice Department was  
3 unreasonable and that significant legal fees were incurred as a result of the actions of  
4 the Justice Department. Neither I, nor the Commission, has any conclusive basis as to  
5 whether the Company is right or wrong in this contention. The Federal court had  
6 adequate opportunity to agree with the Company on this point. When the company  
7 sought to recover its attorney's and costs from the federal governments, the court  
8 found that the Company "[had] not adduced sufficient proof of the bad conduct or ill  
9 motive of [the Government] in litigating these claims so as to support a finding of bad  
10 faith. [The] Government's actions and conduct herein are simply not of the character  
11 that merits awards under the bad faith exception." [Exhibit 6 (GHB-101, p9)]

12  
13 To react to the Company's allegations regarding the zeal of the government's  
14 prosecution of this case is to cast the Commission in the position of judging the  
15 quality and motives of the Government's case. This is neither a legally sanctioned nor  
16 desirable role of the Florida Commission.

17  
18 Even if assuming for the sake of argument that the Company is correct and that the  
19 Justice Department's pursuit of this case was extremely aggressive, there would be no  
20 basis to ask ratepayers to pay the legal cost. Clearly, the ratepayer is not and should  
21 not be the payer of last resort. The ratepayer should not be held to pay each and  
22 every cost that the Company feels it incurs as a result of over-zealous litigation on the  
23 part of the Federal Government. Ratepayers were not in charge of the Company's  
24 system. They did not plan it, they did not operate it, and they were not responsible  
25 for the analysis, application and violation of the Clean Water Act. Therefore, the



1 ratepayers should not be held responsible for these legal fees on the basis of the  
2 Company's argument of over- zealous prosecution. The theory that over-zealous  
3 prosecution shifts the burden of responsibility for these legal fees from stockholders  
4 to ratepayers is not reasonable.  
5

6 Financial Integrity

7 Q. WHAT IS YOUR UNDERSTANDING OF FLORIDA CITIES WATER  
8 COMPANY'S ARGUMENT FOR PLACING THE RESPONSIBILITY FOR THE  
9 LEGAL FEES EXPENDED BY THE COMPANY TO DEFEND THE  
10 STOCKHOLDERS ON RATEPAYERS?

11 A. Two of the Company's witnesses, Mr. Murphy and Mr. McClellan, advance the  
12 theory that even though the Company realizes they cannot collect the penalty from  
13 ratepayers and that the penalty is the responsibility of the stockholders, any legal fees  
14 incurred in defending the stockholders from the incurrence of the penalty is the  
15 responsibility of the ratepayer. The underlying theory of both witnesses is that, had  
16 the Company not defended the stockholders from the payment of the settlement  
17 demanded by the Justice Department, the Company would have suffered financially,  
18 even to the extent that a bankruptcy filing might have been required. Had a  
19 bankruptcy filing been required, according to the Company's witnesses, the ratepayers  
20 would have suffered, and this, therefore, justifies requiring the ratepayers to reimburse  
21 the Company for defending its stockholders.  
22

23 Q. DO YOU BELIEVE THAT THE COMPANY FILING FOR CHAPTER 11  
24 BANKRUPTCY WOULD HAVE AFFECTED THE SERVICE RECEIVED BY  
25 RATEPAYERS?

1 A. No, I do not. When filing for Chapter 11 Bankruptcy, the normal procedure is that  
2 the payment of liabilities of the bankrupt company are held in abeyance and the  
3 company continues to operate in the hands of the debtor (the current owners of the  
4 company). The bankruptcy court would then decide which of the debts of the entity  
5 will be discharged and whether the entity should be sold in order to discharge debts of  
6 the bankrupt firm or reorganized with a restructuring of outstanding obligations. The  
7 bankruptcy court attempts to continue to operate businesses where feasible, since an  
8 operating entity is essentially more valuable than an entity which has discontinued  
9 operations. Additionally, in a situation where health, safety and welfare are part of  
10 the responsibility of the company in bankruptcy, the court would be vigilant to ensure  
11 that the public was not adversely affected by the bankruptcy filing. Thus, the  
12 Company's argument that a bankruptcy filing would have eliminated or affected the  
13 quality of service received by ratepayers is not realistic. The primary group which  
14 would have been affected detrimentally by a bankruptcy filing would have been the  
15 Company's investors (debtholders and stockholders). The stockholders' equity  
16 would have been in jeopardy. The satisfaction of any obligation that the court found  
17 could not be satisfied through liquid assets available in the bankrupt company would  
18 have been satisfied through sale of the Company. The court would have offered the  
19 bankrupt company for sale as an operating entity both to protect the health and safety  
20 of the public and to receive the highest value from the assets. Common sense would  
21 dictate that buried pipe, which does not provide service, is of no value even if the  
22 health and safety issues related to the operation of a water and wastewater utility  
23 could be set aside. It is probable that other water and wastewater companies in the  
24 area would have taken over these facilities in a bankruptcy sale.

25

1 Whereas the company presents a worst case scenario, i.e., that bankruptcy would  
2 have occasioned a severance or termination of service, it is as reasonable for the  
3 Commission to consider an offsetting best case scenario: that the utility (albeit not the  
4 shareholders) could have emerged from the bankruptcy proceedings, debts  
5 discharged and stockholder interests extinguished. With neither debt to retire, nor  
6 equity to service, utility rates might have seen a significant lessening.

7  
8 The Company's dire predictions regarding a severe deterioration or cessation of  
9 service should be seen as an extreme and unlikely scenario.

10  
11 Q. COULD FCWC JUST HAVE CURTAILED SERVICE WITHOUT DECLARING  
12 BANKRUPTCY, THUS HARMING RATEPAYERS?

13 A. I would think not. The Florida Department of Environmental Protection is charged  
14 with the responsibility of ensuring that health and safety standards are maintained at  
15 water and wastewater facilities. If operators are not operating these systems to  
16 protect the public interest, this agency has the responsibility to take action to ensure  
17 that they do. I would conclude that the curtailment of service would not be an option  
18 to a pervasively regulated industry.

19  
20 In fact, one of the Company's own witnesses, Gary H. Baise, states exactly the  
21 opposite of Company witnesses Murphy and McClellan. On page 7, of his Direct  
22 Testimony, lines 12-14 he states, "FCWC officials immediately started working with  
23 the FDEP and EPA to develop a resolution of the matter because this was a public  
24 health facility and, unlike a manufacturing facility, could not shut down for repairs or  
25 cease operation." Mr. Baise recognized that the scenario set forth by Messrs.

1 Murphy and McClellan was not a realistic alternative and apparently neither did the  
2 FCWC officials whom Mr. Baise stated immediately started working on a solution.  
3 Clearly, the bankruptcy curtailment of service scenario is a strawman set up by the  
4 Company to attempt to paint the ratepayer as receiving benefits from FCWC's  
5 incurrence of legal fees.  
6

7 Q. IS IT POSSIBLE THAT THERE IS SOME LEVEL OF SERVICE THE  
8 COMPANY COULD HAVE CURTAILED WITHOUT JEOPARDIZING HEALTH  
9 AND SAFETY?

10 A. Yes. It is possible that there are repair services that could have been delayed, minor  
11 amounts that could have been saved by not responding quickly to customer  
12 complaints, etc. However, the main beneficiary of the expenses incurred to fight the  
13 fines and penalties imposed by the Environmental Protection Agency was the  
14 stockholders, not the ratepayers. Had any substantial penalty been assessed against  
15 the Company, that penalty would purportedly have required the Company to file  
16 bankruptcy, thus eliminating or placing in jeopardy the equity interest of stockholders  
17 and debtholders. A continuation of service to customers would still have gone  
18 forward, regardless of whether the current stockholders and debtholders interest  
19 would have survived. The substantial benefit of the litigation was to the stockholders.  
20

21  
22 Q. WHAT EXPERIENCE HAS LARKIN & ASSOCIATES HAD WITH  
23 BANKRUPTCY FILINGS?

24 A. Larkin & Associates have been accountants for the trustee in bankruptcy of Michigan  
25 Interstate Railway Company, d/b/a/ Ann Arbor Railroad System, which was in

1 Chapter 11 before the United States Bankruptcy Court for the Eastern District of  
2 Michigan for approximately eight years. During that time as accountants for the  
3 trustee, we issued financial statements which were filed with the bankruptcy court.  
4 At no time during the period that Michigan Interstate Railway Company was in  
5 bankruptcy did the trustee attempt to eliminate services. During the approximate  
6 eight years that the trustee was in charge of the railroad system, the process was to  
7 reorganize the operation, such that it became profitable. It was eventually sold with  
8 debtors receiving some percentage of their outstanding obligation, while stockholders  
9 received a minor return of their investment. At no time did the trustee attempt to sell-  
10 off portions of the assets, which were essential to the operation of the railroad.

11  
12 In addition to our direct involvement with the above identified bankruptcy, we have  
13 participated before public utility commissions where utilities either were in bankruptcy  
14 or were experiencing financial difficulties and contemplating bankruptcy. These  
15 utilities were the El Paso Electric Company, which did go into bankruptcy, Consumer  
16 Power Company (now Consumer Energy) and Gulf States Utilities. We are currently  
17 involved in the State of Connecticut on behalf of the Office of Consumer Counsel in  
18 cases involving Connecticut Light & Power Company, a subsidiary of Northeast  
19 Utilities. This company is currently experiencing financial difficulties as a result of the  
20 failure of its nuclear units to operate. It has been our experience that even utilities  
21 under financial stress do not attempt to curtail costs which might affect the quality of  
22 service to current ratepayers. The difficulty is always involved in maintaining bond  
23 payments to debt holders on an on-going basis. Any cash flow normally is used to  
24 maintain the level of service to current ratepayers. Thus, I do not believe that a utility  
25 experiencing financial difficulty would jeopardize its operation by curtailing service to

1 ratepayers.

2  
3 Our bankruptcy experience aside, it is a matter of general knowledge that the trustee  
4 in bankruptcy has a fiduciary duty to creditors to conserve the assets of the  
5 bankrupt's estate. It would be a serious breach of that duty to permit a utility such as  
6 Florida Cities to simply shut down to the extent that its value was reduced to salvage  
7 value. The greatest value of Florida Cities to creditors is that of a going concern; it  
8 is entirely reasonable to assume that a trustee in bankruptcy would, on behalf of  
9 creditors, ensure that Florida Cities continued to achieve a revenue stream through  
10 the routine provision of service and the continued compliance with regulatory  
11 authorities. In other words, the Company's theory concerning a decline in service, and  
12 possible cessation flies in the face

13  
14 of what we know the likely result of bankruptcy to be, and ought to be rejected for  
15 that reason.

16  
17 Legal Expenses in this Instance are Atypical

18 Q. IN MR. ALLEN'S TESTIMONY, AT PAGE 46, HE ATTEMPTS TO  
19 CHARACTERIZE THE LEGAL EXPENSES INCURRED AS NORMAL, RUN OF  
20 THE MILL, REASONABLY AND PRUDENTLY INCURRED EXPENSES. DO  
21 YOU AGREE WITH THAT CHARACTERIZATION?

22 A. No, I do not. Clearly, these expenses are atypical. The way the Company has asked  
23 to recover the costs, the length of time the Company has asked to recover them over,  
24 and the fact that this is a single issue rate case clearly shows that they are not typical  
25 expenses. The expenses incurred were not incurred fulfilling the Company's

1 obligation to provide service. They were incurred in protecting the Company's  
2 stockholders from fines and penalties, resulting from established violations of federal  
3 law, which would have affected the stockholder's equity interest.

4  
5 Q. MR. ALLEN ALSO CHARACTERIZES THESE LEGAL FEES AS THE SAME  
6 AS INCURRED BY THE COMPANY IN OTHER SETTLEMENT DEMANDS BY  
7 CLAIMANTS, INCLUDING REGULATORY AGENCIES. WOULD YOU  
8 PLEASE COMMENT?

9 A. Mr. Allen does not give specific details of what types of claimants and what  
10 regulatory agencies the Company incurs legal fees in relationship to. However, if the  
11 legal fees incurred are the result of defending management or the Company's  
12 stockholders against violations of laws which management failed to comply with, or  
13 against tort liability in which company management was expressly found to have  
14 breached a civil duty, then they would be of the same nature as those at issue in this  
15 case and should be excluded from recovery. One cannot place a broad description  
16 over legal settlements or legal fees as the Company has attempted and state that these  
17 are of the same nature, and therefore, ought to be recovered from ratepayers. In any  
18 instance where it is discovered that a violation occurred because management failed in  
19 its responsibilities, those legal fees should not be the responsibility of ratepayers.

20  
21 Criminal Legal Fees

22 Q. IS IT YOUR UNDERSTANDING THAT SOME OF THE LEGAL FEES  
23 INCURRED MAY HAVE BEEN FOR THE CRIMINAL DEFENSE OF SOME OF  
24 THE COMPANY'S EMPLOYEES?

25 A. It is not clear whether the Company has removed from the total expenses legal fees

1 incurred for the possible criminal prosecution of some of the Company's  
2 management. To the extent that the Company incurred legal fees for criminal  
3 defense, and those fees are included within the expenses incurred, clearly that has no  
4 benefit to ratepayers and should be removed prior to the consideration of the  
5 Commission of any recovery.

6  
7 Inclusion of Unrecovered Legal Fees in Rate Base

8 Q. SOME OF THE COMPANY'S WITNESSES SUGGEST THAT THE  
9 UNRECOVERED LEGAL FEES THAT ARE BEING AMORTIZED OUGHT TO  
10 BE INCLUDED IN RATE BASE IN THE COMPANY'S NEXT RATE CASE  
11 FILING. DO YOU AGREE?

12 A. No, I do not. The recovery of the legal fees, in my opinion, is not justified, it  
13 provides no benefit to the ratepayer and was incurred to protect the stockholders'  
14 interests. To allow the Company to earn a return on these illegitimate expenses  
15 would add insult to injury. If the Commission were to decide to allow the recovery of  
16 these expenses (if it can get around the retroactive recovery issue), that is all that the  
17 Company should recover. Anything above that amount is not justified.

18  
19 Q. DOES THAT CONCLUDE YOUR TESTIMONY?

20 A. Yes, it does.  
21  
22  
23  
24  
25



QUALIFICATIONS OF HUGH LARKIN, JR.

Q. WHAT IS YOUR OCCUPATION?

A. I am a certified public accountant and a partner in the firm of Larkin & Associates, Certified Public Accountants, with offices at 15728 Farmington Road, Livonia, Michigan.

Q. PLEASE DESCRIBE YOUR EDUCATION AND EXPERIENCE.

A. I graduated from Michigan State University in 1960. During 1961 and 1962, I fulfilled my military obligations as an officer in the United States Army.

In 1963 I was employed by the certified public accounting firm of Peat, Marwick, Mitchell & Co., as a junior accountant. I became a certified public accountant in 1966.

In 1968 I was promoted to the supervisory level at Peat, Marwick, Mitchell & Co. As such, my duties included the direction and review of audits of various types of business organizations, including manufacturing, service, sales and regulated companies.

Through my education and auditing experience of manufacturing operations, I obtained an extensive background of theoretical and practical cost accounting.

I have audited companies having job cost systems and those having process cost systems, utilizing both historical and standard costs.

I have a working knowledge of cost control, budgets and reports, the accumulation of overheads and the application of same to products on the various recognized methods.

Additionally, I designed and installed a job cost system for an automotive parts manufacturer.

I gained experience in the audit of regulated companies as the supervisor in charge of all railroad audits for the Detroit office of Peat, Marwick, including audits of the Detroit, Toledo and Ironton Railroad, the Ann Arbor Railroad, and portions of the Penn Central Railroad Company. In 1967, I was the supervisory senior accountant in charge of the audit of the Michigan State Highway Department, for which Peat, Marwick was employed by the State Auditor General and the Attorney General.

In October of 1969, I left Peat, Marwick to become a partner in the public accounting firm of Tischler & Lipson of Detroit. In April of 1970, I left the latter firm to form the certified public accounting firm of Larkin, Chapski & Company. In September 1982 I re-organized the firm into Larkin & Associates, a certified public accounting firm. The firm of Larkin & Associates performs a wide variety of auditing and accounting services, but concentrates in the area of utility regulation and ratemaking. I am a member of the Michigan Association of Certified Public Accountants and the American Institute of Certified Public Accountants. I testified before the Michigan Public Service Commission and in other states in the following cases:

U-3749 Consumers Power Company - Electric  
Michigan Public Service Commission

U-3910 Detroit Edison Company  
Michigan Public Service Commission

DOCUMENT NUMBER-DATE

05703 MAY 22 88

FPSC-RECORDS/REPORTING

U-4331	Consumers Power Company - Gas Michigan Public Service Commission
U-4332	Consumers Power Company - Electric Michigan Public Service Commission
U-4293	Michigan Bell Telephone Company Michigan Public Service Commission
U-4498	Michigan Consolidated Gas sale to Consumers Power Company Michigan Public Service Commission
U-4576	Consumers Power Company - Electric Michigan Public Service Commission
U-4575	Michigan Bell Telephone Company Michigan Public Service Commission
U-4331R	Consumers Power Company - Gas - Rehearing Michigan Public Service Commission
6813	Chesapeake and Potomac Telephone Company of Maryland, Public Service Commission, State of Maryland
Formal Case No. 2090	New England Telephone and Telegraph Co. State of Maine Public Utilities Commission
Dockets 574, 575, 576	Sierra Pacific Power Company, Public Service Commission, State of Nevada
U-5131	Michigan Power Company Michigan Public Service Commission
U-5125	Michigan Bell Telephone Company Michigan Public Service Commission
R-4840 & U-4621	Consumers Power Company Michigan Public Service Commission
U-4835	Hickory Telephone Company Michigan Public Service Commission
36626	Sierra Pacific Power Company v. Public Service Commission, et al, First Judicial District Court of the State of Nevada
American Arbitration Assoc.	City of Wyoming v. General Electric Cable TV
760842-TP	Southern Bell Telephone and Telegraph Company, Florida Public Service Commission

U-5331	Consumers Power Company Michigan Public Service Commission
U-5125R	Michigan Bell Telephone Company Michigan Public Service Commission
770491-TP	Winter Park Telephone Company, Florida Public Service Commission
77-554-EL-AIR	Ohio Edison Co., Public Utility Commission of Ohio
78-284-EL-AEM	Dayton Power and Light Co., Public Utility Commission of Ohio
0R78-1	Trans Alaska Pipeline, Federal Energy Regulatory Commission (FERC)
78-622-EL-FAC	Ohio Edison Co., Public Utility Commission of Ohio
U-5732	Consumers Power Company - Gas, Michigan Public Service Commission
77-1249-EL-AIR, et al	Ohio Edison Co., Public Utility Commission of Ohio
78-677-EL-AIR	Cleveland Electric Illuminating Co., Public Utility Commission of Ohio
U-5979	Consumers Power Company, Michigan Public Service Commission
790084-TP	General Telephone Company of Florida, Florida Public Service Commission
79-11-EL-AIR	Cincinnati Gas and Electric Co., Public Utilities Commission of Ohio
790316-WS	Jacksonville Suburban Utilities Corp., Florida Public Service Commission
790317-WS	Southern Utility Company, Florida Public Service Commission
U-1345	Arizona Public Service Company, Arizona Corporation Commission
79-537-EL-AIR	Cleveland Electric Illuminating Co., Public Utilities Commission of Ohio
800011-EU	Tampa Electric Company, Florida Public Service Commission

800001-EU	Gulf Power Company, Florida Public Service Commission
U-5979-R	Consumers Power Company, Michigan Public Service Commission
800119-EU	Florida Power Corporation, Florida Public Service Commission
810035-TP	Southern Bell Telephone and Telegraph Company, Florida Public Service Commission
800367-WS	General Development Utilities, Inc., Port Malabar, Florida Public Service Commission
TR-81-208**	Southwestern Bell Telephone Company, Missouri Public Service Commission
810095-TP	General Telephone Company of Florida, Florida Public Service Commission
U-6794	Michigan Consolidated Gas Company, 16 refunds Michigan Public Service Commission
U-6798	Cogeneration and Small Power Production -PURPA, Michigan Public Service Commission
810136-EU	Gulf Power Company, Florida Public Service Commission
E-002/GR-81-342	Northern State Power Company Minnesota Public Utilities Commission
820001-EU	General Investigation of Fuel Cost Recovery Clauses, Florida Public Service Commission
810210-TP	Florida Telephone Corporation, Florida Public Service Commission
810211-TP	United Telephone Co. of Florida, Florida Public Service Commission
810251-TP	Quincy Telephone Company, Florida Public Service Commission
810252-TP	Orange City Telephone Company, Florida Public Service Commission
8400	East Kentucky Power Cooperative, Inc., Kentucky Public Service Commission

U-6949	Detroit Edison Company - Partial and Immediate Rate Increase Michigan Public Service Commission
18328	Alabama Gas Corporation, Alabama Public Service Commission
U-6949	Detroit Edison Company - Final Rate Recommendation Michigan Public Service Commission
820007-EU	Tampa Electric Company, Florida Public Service Commission
820097-EU	Florida Power & Light Company, Florida Public Service Commission
820150-EU	Gulf Power Company, Florida Public Service Commission
18416	Alabama Power Company, Public Service Commission of Alabama
820100-EU	Florida Power Corporation, Florida Public Service Commission
U-7236	Detroit Edison-Burlington Northern Refund Michigan Public Service Commission
U-6633-R	Detroit Edison - MRCS Program, Michigan Public Service Commission
U-6797-R	Consumers Power Company - MRCS Program, Michigan Public Service Commission
82-267-EFC	Dayton Power & Light Company, Public Utility Commission of Ohio
U-5510-R	Consumers Power Company - Energy Conservation Finance Program, Michigan Public Service Commission
82-240-E	South Carolina Electric & Gas Company, South Carolina Public Service Commission
8624	Kentucky Utilities, Kentucky Public Service Commission
8648	East Kentucky Power Cooperative, Inc., Kentucky Public Service Commission
U-7065	The Detroit Edison Company (Fermi II), Michigan Public Service Commission
U-7350	Generic Working Capital Requirements, Michigan Public Service Commission

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820294-TP	Southern Bell Telephone Company, Florida Public Service Commission
Order RH-1-83	Westcoast Gas Transmission Company, Ltd., Canadian National Energy Board
8738	Columbia Gas of Kentucky, Inc., Kentucky Public Service Commission
82-168-EL-EFC	Cleveland Electric Illuminating Company, Public Utility Commission of Ohio
6714	Michigan Consolidated Gas Company Phase II, Michigan Public Service Commission
82-165-EL-EFC	Toledo Edison Company, Public Utility Commission of Ohio
830012-EU	Tampa Electric Company, Florida Public Service Commission
ER-83-206**	Arkansas Power & Light Company, Missouri Public Service Commission
U-4758	The Detroit Edison Company - (Refunds), Michigan Public Service Commission
8836	Kentucky American Water Company, Kentucky Public Service Commission
8839	Western Kentucky Gas Company, Kentucky Public Service Commission
83-07-15	Connecticut Light & Power Company, Department of Utility Control State of Connecticut
81-0485-WS	Palm Coast Utility Corporation, Florida Public Service Commission
U-7650	Consumers Power Company - (Partial and Immediate), Michigan Public Service Commission
83-662**	Continental Telephone Company, Nevada Public Service Commission
U-7650	Consumers Power Company - Final Michigan Public Service Commission
U-6488-R	Detroit Edison Co. (FAC & PIPAC Reconciliation), Michigan Public Service Commission
Docket No. 15684	Louisiana Power & Light Company, Public Service Commission of the State of Louisiana

U-7650 Reopened	Consumers Power Company (Reopened Hearings) Michigan Public Service Commission
38-1039**	CP National Telephone Corporation Nevada Public Service Commission
83-1226	Sierra Pacific Power Company (Re application to form holding company), Nevada Public Service Commission
U-7395 & U-7397	Campaign Ballot Proposals Michigan Public Service Commission
820013-WS	Seacoast Utilities Florida Public Service Commission
U-7660	Detroit Edison Company Michigan Public Service Commission
U-7802	Michigan Gas Utilities Company Michigan Public Service Commission
830465-EI	Florida Power & Light Company Florida Public Service Commission
U-7777	Michigan Consolidated Gas Company Michigan Public Service Commission
U-7779	Consumers Power Company Michigan Public Service Commission
U-7480-R	Michigan Consolidated Gas Company Michigan Public Service Commission
U-7488-R	Consumers Power Company - Gas Michigan Public Service Commission
U-7484-R	Michigan Gas Utilities Company Michigan Public Service Commission
U-7550-R	Detroit Edison Company Michigan Public Service Commission
U-7477-R	Indiana & Michigan Electric Company Michigan Public Service Commission
U-7512-R	Consumers Power Company - Electric Michigan Public Service Commission
18978	Continental Telephone Company of the South - Alabama, Alabama Public Service Commission

9003	Columbia Gas of Kentucky, Inc. Kentucky Public Service Commission
R-842583	Duquesne Light Company Pennsylvania Public Utility Commission
9006*	Big Rivers Electric Corporation Kentucky Public Service Commission *Company withdrew filing
U-7830	Consumers Power Company - Electric (Partial and Immediate) Michigan Public Service Commission
7675	Consumers Power Company - Customer Refunds Michigan Public Service Commission
5779	Houston Lighting & Power Company Texas Public Utility Commission
U-7830	Consumers Power Company - Electric - "Financial Stabilization" Michigan Public Service Commission
U-4620	Mississippi Power & Light Company (Interim) Mississippi Public Service Commission
U-16091	Louisiana Power & Light Company Louisiana Public Service Commission
9163	Big Rivers Electric Corporation Kentucky Public Service Commission
U-7830	Consumers Power Company - Electric - (Final) Michigan Public Service Commission
U-4620	Mississippi Power & Light Company - (Final) Mississippi Public Service Commission
76-18788AA & 76-18793AA	Detroit Edison (Refund - Appeal of U-4807) Ingham County Circuit Court Michigan Public Service Commission
U-6633-R	Detroit Edison (MRCS Program Reconciliation) Michigan Public Service Commission
19297	Continental Telephone Company of the South - Alabama, Alabama Public Service Commission
9283	Kentucky American Water Company Kentucky Public Service Commission
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R-850021	Duquesne Light Company Pennsylvania Public Service Commission
TR-85-179**	United Telephone Company of Missouri Missouri Public Service Commission
6350	El Paso Electric Company The Public Utility Board of the City of El Paso
6350	El Paso Electric Company Public Utility Commission of Texas
85-53476AA & 85-534855AA	Detroit Edison-refund-Appeal of U-4758 Ingham County Circuit Court Michigan Public Service Commission
U-8091/ U-8239	Consumers Power Company-Gas Michigan Public Service Commission
9230	Leslie County Telephone Company, Inc. Kentucky Public Service Commission
85-212	Central Maine Power Company Maine Public Service Commission
850782-EI & 850783-EI	Florida Power & Light Company Florida Public Service Commission
ER-85646001 & ER-85647001	New England Power Company Federal Energy Regulatory Commission
Civil Action * No. 2:85-0652	Allegheny & Western Energy Corporation, Plaintiff, - against - The Columbia Gas System, Inc., Defendant
Docket No. 850031-WS	Orange Osceola Utilities, Inc. Before the Florida Public Service Commission
Docket No. 840419-SU	Florida Cities Water Company South Ft. Myers Sewer Operations Before the Florida Public Service Commission
R-860378	Duquesne Light Company Pennsylvania Public Service Commission
R-850267	Pennsylvania Power Company Pennsylvania Public Service Commission
R-860378	Duquesne Light Company - Surrebuttal Testimony - OCA Statement No. 2D Pennsylvania Public Service Commission

Docket No. 850151	Marco Island Utility Company Before the Florida Public Service Commission
Docket No. 7195 (Interim)	Gulf States Utilities Company Public Utility Commission of Texas
R-850267 Reopened	Pennsylvania Power Company Pennsylvania Public Service Commission
Docket No. 87-01-03	Connecticut Natural Gas Corporation Connecticut Department of Public Utility Control
Docket No. 5740	Hawaiian Electric Company Hawaii Public Utilities Commission
1345-85-367	Arizona Public Service Company Arizona Corporation Commission
Docket 011 No. 86-11-019	Tax Reform Act of 1986 - California Generic California Public Utilities Commission
Case No. 29484	Long Island Lighting Company New York Department of Public Service
Docket No. 7460	El Paso Electric Company Public Utility Commission of Texas
Docket No. 870092-WS*	Citrus Springs Utilities Before the Florida Public Service Commission
Case No. 9892	Dickerson Lumber EP Company - Complainant vs. Farmers Rural Electric Cooperative and East Kentucky Power Cooperative - Defendants Before the Kentucky Public Service Commission
Docket No. 3673-U	Georgia Power Company Before the Georgia Public Service Commission
Docket No. U-8747	Anchorage Water and Wastewater Utility Report on Management Audit
Docket No. 861564-WS	Century Utilities Before the Florida Public Service Commission
Docket No. FA86-19-001	Systems Energy Resources, Inc. Federal Energy Regulatory Commission
Docket No. 870347-TI	AT&T Communications of the Southern States, Inc. Florida Public Service Commission

Docket No. 870980-WS	St. Augustine Shores Utilities Inc. Florida Public Service Commission
Docket No. 870654-WS*	North Naples Utilities, Inc. Florida Public Service Commission
Docket No. 870853	Pennsylvania Gas & Water Company Pennsylvania Public Utility Commission
Civil Action* No. 87-0446-R	Reynolds Metals Company, Plaintiff, v. The Columbia Gas System, Inc., Commonwealth Gas Services, Inc., Commonwealth Gas Pipeline Corporation, Columbia Gas Transmission Corporation, Columbia Gulf Transmission Company, Defendants - In the United States District Court for the Eastern District of Virginia - Richmond Division
Docket No. E-2, Sub 537	Carolina Power & Light Company North Carolina Utilities Commission
Case No. U-7830	Consumers Power Company - Step 2 Reopened Michigan Public Service Commission
Docket No. 880069-TL	Southern Bell Telephone & Telegraph Florida Public Service Commission
Case No. U-7830	Consumers Power Company - Step 3B Michigan Public Service Commission
Docket No. 880355-EI	Florida Power & Light Company Florida Public Service Commission
Docket No. 880360-EI	Gulf Power Company Florida Public Service Commission
Docket No. FA86-19-002	System Energy Resources, Inc. Federal Energy Regulatory Commission
Docket Nos. 83-0537-Remand & 84-0555-Remand	Commonwealth Edison Company Illinois Commerce Commission
Docket Nos. 83-0537-Remand & 84-0555-Remand	Commonwealth Edison Company -Surrebuttal Illinois Commerce Commission
Docket No. 880537-SU	Key Haven Utility Corporation Florida Public Service Commission
Docket No. 881167-EI***	Gulf Power Company Florida Public Service Commission

Docket No. 881503-WS	Poinciana Utilities, Inc. Florida Public Service Commission
Cause No. U-89-2688-T	Puget Sound Power & Light Company Washington Utilities & Transportation Committee
Docket No. 89-68	Central Maine Power Company Maine Public Utilities Commission
Docket No. 861190-PU	Proposal to Amend Rule 25-14.003, F.A.C. Florida Public Service Commission
Docket No. 89-08-11	The United Illuminating Company State of Connecticut, Department of Public Utility Control
Docket No. R-891364	The Philadelphia Electric Company Pennsylvania Public Utility Commission
Formal Case No. 889	Potomac Electric Power Company Public Service Company of the District of Columbia
Case No. 88/546*	Niagara Mohawk Power Corporation, et al Plaintiffs, v. Gulf+Western, Inc. et al, defendants (In the Supreme Court County of Onondaga, State of New York)
Case No. 87-11628*	Duquesne Light Company, et al, plaintiffs, against Gulf + Western, Inc. et al, defendants (In the Court of the Common Pleas of Allegheny County, Pennsylvania Civil Division)
Case No. 89-640-G-42T*	Mountaineer Gas Company West Virginia Public Service Commission
Docket No. 890319-EI	Florida Power & Light Company Florida Public Service Commission
Docket No. EM-89110888	Jersey Central Power & Light Company Board of Public Utilities Commissioners
Docket No. 891345-EI	Gulf Power Company Florida Public Service Commission
BPU Docket No. ER 8811 0912J	Jersey Central Power & Light Company Board of Public Utilities Commissioners
Docket No. 6531	Hawaiian Electric Company Hawaii Public Utilities Commissioners
Docket No. 890509-WU	Florida Cities Water Company, Golden Gate Division Florida Public Service Commission

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Docket No. 880069-TL	Southern Bell Telephone Company Florida Public Service Commission
Docket Nos. F-3848, F-3849, and F-3850	Northwestern Bell Telephone Company South Dakota Public Utilities Commission
Docket Nos. ER89-* 678-000 & EL90-16-000	System Energy Resources, Inc. Federal Energy Regulatory Commission
Docket No. 5428	Green Mountain Power Corporation Vermont Department of Public Service
Docket No. 90-10	Artesian Water Company, Inc. Delaware Public Service Commission
Case No. 90-243-E-42T*	Wheeling Power Company West Virginia Public Service Commission
Docket No. 900329-WS	Southern States Utilities, Inc. Florida Public Service Commission
Docket Nos. ER89-* 678-000 & EL90-16-000	System Energy Resources, Inc. (Surrebuttal) Federal Energy Regulatory Commission
Application No. 90-12-018	Southern California Edison Company California Public Utilities Commission
Docket No. 90-0127	Central Illinois Lighting Company Illinois Commerce Commission
Docket No. FA-89-28-000	System Energy Resources, Inc. Federal Energy Regulatory Commission
Docket No. U-1551-90-322	Southwest Gas Corporation Before the Arizona Corporation Commission
Docket No. R-911966	Pennsylvania Gas & Water Company The Pennsylvania Public Utility Commission
Docket No. 176-717-U	United Cities Gas Company Kansas Corporation Commission
Docket No. 860001-EI-G	Florida Power Corporation Florida Public Service Commission
Docket No. 6720-TI-102	Wisconsin Bell, Inc. Wisconsin Citizens' Utility Board
(No Docket No.)	Southern Union Gas Company Before the Public Utility Regulation Board of the City of El Paso
Docket No. 6998	Hawaiian Electric Company, Inc.

Before the Public Utilities Commission of the State of Hawaii

Docket No. TC91-040A      In the Matter of the Investigation into the Adoption of a Uniform  
Access Methodology  
Before the Public Utilities Commission of the State of South Dakota

Docket Nos. 911030-WS  
& 911067-WS      General Development Utilities, Inc.  
Before the Florida Public Service Commission

Docket No. 910890-EI      Florida Power Corporation  
Before the Florida Public Service Commission

Docket No. 910890-EI      Florida Power Corporation, Supplemental  
Before the Florida Public Service Commission

Case No. 3L-74159      Idaho Power Company, an Idaho corporation  
In the District Court of the Fourth Judicial District of the State of  
Idaho, In and For the County of Ada - Magistrate Division

Cause No. 39353\*      Indiana Gas Company  
Before the Indiana Utility Regulatory Commission

Docket No. 90-0169  
(Remand)      Commonwealth Edison Company  
Before the Illinois Commerce Commission

Docket No. 92-06-05      The United Illuminating Company  
State of Connecticut, Department of Public Utility Control

Cause No. 39498      PSI Energy, Inc.  
Before the State of Indiana - Indiana Utility Regulatory Commission

Cause No. 39498      PSI Energy, Inc. - Surrebuttal testimony  
Before the State of Indiana - Indiana Utility  
Regulatory Commission

Docket No. 7287      Public Utilities Commission - Instituting a Proceeding to Examine the  
Gross-up of CIAC  
Before the Public Utilities Commission of the State of Hawaii

Docket No. 92-227-TC      US West Communications, Inc.  
Before the State Corporation Commission of the State of New Mexico

Docket No. 92-47      Diamond State Telephone Company  
Before the Public Service Commission of the State of Delaware

Docket Nos. 920733-WS      General Development Utilities, Inc.      &  
920734-WS  
Before the Florida Public Service Commission

Docket No. 92-11-11      Connecticut Light & Power Company  
State of Connecticut, Department of Public Utility Control

Docket Nos. EC92-21-000 Entergy Corporation

& ER92-806-000	Before the Federal Energy Regulatory Commission
Docket No. 930405-EI	Florida Power & Light Company Before the Florida Public Service Commission
Docket No. UE-92-1262	Puget Sound Power & Light Company Before the Washington Utilities & Transportation Commission
Docket No. 93-02-04	Connecticut Natural Gas Corporation State of Connecticut, Department of Public Utility Control
Docket No. 93-02-04	Connecticut Natural Gas Corporation Supplemental State of Connecticut, Department of Public Utility Control
Docket No. 93-057-01	Mountain Fuel Supply Company Before the Utah Public Service Commission
Cause No. 39353 (Phase II)	Indiana Gas Company Before the Indiana Utility Regulatory Commission
PU-314-92-1060	US West Communications, Inc. Before the North Dakota Public Service Commission
Cause No. 39713	Indianapolis Water Company Before the Indiana Utility Regulatory Commission
93-UA-0301*	Mississippi Power & Light Company Before the Mississippi Public Service Commission
Docket No. 93-08-06	SNET America, Inc. State of Connecticut, Department of Public Utility Control
Docket No. 93-057-01	Mountain Fuel Supply Company - Rehearing on Unbilled Revenues - Before the Utah Public Service Commission
Case No. 78-T119-0013-94	Guam Power Authority vs. U.S. Navy Public Works Center, Guam - Assisting the Department of Defense in the investigation of a billing dispute. Before the American Arbitration Association
Application No. 93-12-025 - Phase I	Southern California Edison Company (Before the California Public Utilities Commission)
Case No. 94-0027-E-42T	Potomac Edison Company (Before the Public Service Commission of West Virginia)
Case No. 94-0035-E-42T	Monongahela Power Company (Before the Public Service Commission of West Virginia)
Docket No. 930204-WS**	Jacksonville Suburban Utilities Corporation (Before the Florida Public Service Commission)

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Docket No. 5258-U	Southern Bell Telephone and Telegraph Company (Before the Georgia Public Service Commission)
Case No. 95-0011-G-42T*	Mountaineer Gas Company (Before the West Virginia Public Service Commission)
Case No. 95-0003-G-42T*	Hope Gas, Inc. (Before the West Virginia Public Service Commission)
Docket No. 95-02-07	Connecticut Natural Gas Corporation State of Connecticut, Department of Public Utility Control
Docket No. 95-057-02*	Mountain Fuel Supply Before the Utah Public Service Commission
Docket No. 95-03-01	Southern New England Telephone Company State of Connecticut, Department of Public Utility Control
BRC Docket No. EX93060255 OAL Docket PUC96734-94	Generic Proceeding Regarding Recovery of Capacity Costs Associated with Electric Utility Power Purchases from Cogenerators and Small Power Producers Before the New Jersey Board of Public Utilities
Docket No. U-1933-95-317	Tucson Electric Power Before the Arizona Corporation Commission
Docket No. 950495-WS	Southern States Utilities Before the Florida Public Service Commission
Docket No. 960409-EI	Prudence Review to Determine Regulatory Treatment of Tampa Electric Company's Polk Unit 1
Docket No. 960451-WS	United Water Florida Before the Florida Public Service Commission
Docket No. 96-UA-389	Generic Docket to Consider Competition in the Provision of Retail Electric Service Before the Public Service Commission of the State of Mississippi

\*Case Settled

\*\*Issues Stipulated

\*\*\*Company withdrew case

Additionally, I performed an investigation and analysis of Michigan Consolidated Gas Company and participated in the discussion which led to the settlement of Michigan Consolidated rate case which was culminated in Rate Order U-4166.

From April 28, 1975, to March 15, 1976, I was under contract to the Michigan House of Representatives as Technical Staff Director of a Special House Committee to study and evaluate the effectiveness of the Michigan Public Service Commission and the rates and service of public utilities. As Technical Staff Director, I supervised personnel loaned to the Committee from the State Auditor General's Office. The reports to that Committee prepared by myself and Allen Briggs, an attorney, to revise utility regulation, were adopted in virtually all material respects in its final report and recommendations and served as a basis of numerous bills introduced in the 1976 and 1977 sessions of the legislature. The Staff of the Committee, under my direction, investigated and reported to the Committee on numerous regulatory issues, including ratepayer participation in utility regulation, fuel cost adjustment clauses, purchased gas adjustment



clauses, comparative electric, gas and telephone rates, treatment of subsidiaries of utilities in ratemaking, research and planning capabilities of the Michigan Public Service Commission, utility advertising, regulatory oversight of utility management, deferred taxes in ratemaking and the organizational structure and functions of the Michigan Public Service Commission.

In the course of my work as a certified public accountant, I advise clients concerning the obtaining of capital funds, and have worked with banking institutions in obtaining loans. I have participated in negotiating the sale and purchase of businesses for clients, in connection with which I have valued the physical assets of various business firms, and also determined the value of present and future earnings measured by market rates of return. I have participated in acquisition audits on behalf of large national companies interested in acquiring smaller companies.

My testimony in utility rate cases has been sponsored by state Attorney Generals, groups of municipalities, a district attorney, Peoples' Counsel, Public Counsel, a ratepayers' committee, and I have also worked as a Staff Consultant to the Arizona Corporation Commission.

In November 1985, with two members of the firm, I presented a seminar on utility accounting for the Legal Services Regional Utilities Task Force in Atlanta, Georgia.

In September, 1988, with two members of the firm, I presented a seminar on utility accounting for the Office of Consumer Advocate, Attorney General's Office, State of Pennsylvania. Individuals from that division as well as Commission Staff members attended.

1           **MS. GERVASI:** Staff would like to at this  
2 time have the prefiled direct testimony of  
3 Ms. Patricia W. Merchant inserted into the record as  
4 though read.

5           **CHAIRMAN JOHNSON:** It will be so inserted.

6           **MS. GERVASI:** And she has no prefiled  
7 exhibits.

8           **CHAIRMAN JOHNSON:** Okay.

9           **MR. GATLIN:** I would like to offer for  
10 identification the deposition of Pat W. Merchant for  
11 the record.

12           **CHAIRMAN JOHNSON:** We'll mark that  
13 Exhibit 17, short titled "Deposition transcript of  
14 Merchant."

15                   (Exhibit 17 marked for identification.)

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DOCKET NO.: 971663-WS - Florida Cities Water Company  
WITNESS: **Direct Testimony of Patricia W. Merchant,**  
Appearing on Behalf of Staff  
DATE FILED: JUNE 19, 1998

DOCUMENT NUMBER-DATE

06535 JUN 19 98

FPSC-RECORDS/REPORTING

## 1 DIRECT PREFILED TESTIMONY OF PATRICIA W. MERCHANT

2 Q. Please state your name and professional address.

3 A. My name is Patricia W. Merchant and my business address is 2540 Shumard  
4 Oak Boulevard, Tallahassee, Florida 32399-0850.

5 Q. By whom are you employed and in what capacity?

6 A. I am employed by the Florida Public Service Commission as a Public  
7 Utilities Supervisor in the Division of Water and Wastewater.

8 Q. How long have you been employed by the Commission?

9 A. I started working at the Commission in September 1981.

10 Q. Would you state your educational background and experience?

11 A. I received a Bachelor of Science degree with a major in accounting from  
12 Florida State University in August 1981. Upon graduation, I was employed by  
13 the Commission as a Public Utilities Auditor in what is now the Division of  
14 Auditing and Financial Analysis. My primary responsibility in that capacity  
15 was to perform audits on the books and records of electric, gas, telephone,  
16 water and wastewater public utilities. In August 1983, I joined what is now  
17 the Division of Water and Wastewater as a Regulatory Analyst in the Bureau of  
18 Accounting. In May 1989, I became a Regulatory Analyst Supervisor in what is  
19 now the Accounting Section of the Bureau of Economic Regulation, in which  
20 capacity I am currently employed. I have attended various regulatory seminars  
21 and Commission in-house training and professional development meetings  
22 concerning regulatory matters.

23 Q. Are you a Certified Public Accountant?

24 A. Yes, I am. In September 1983, I received a certificate and a license  
25 to practice in the State of Florida by the Florida Board of Accountancy.

1 Q. Are you a member of any professional associations?

2 A. Yes. I am a member in good standing of the American Institute of  
3 Certified Public Accountants and the Florida Institute of Certified Public  
4 Accountants (FICPA). I am a former member of the Board of Governors of the  
5 FICPA and was the President of the Tallahassee Chapter of the FICPA for the  
6 year ended June 30, 1994. I currently am the Vice Chair of the Florida State  
7 University Accounting Conference Committee of the FICPA.

8 Q. Have you ever testified before the Florida Public Service Commission?

9 A. Yes, in Docket No. 840047-WS, Application of Poinciana Utilities, Inc.  
10 for increased water and wastewater rates; in Docket No. 850031-WS, Application  
11 of Orange/Osceola Utilities, Inc. for increased water and wastewater rates;  
12 in Docket No. 850151-WS, Application of Marco Island Utilities for increased  
13 water and wastewater rates; in Docket No. 881030-WU, Investigation of Sunshine  
14 Utilities rates for possible over earnings; in Docket No. 940847-WS,  
15 Application of Ortega Utility Company for increased water and wastewater  
16 rates; and in Docket No. 911082-WS, Water and Wastewater Rule Revisions to  
17 Chapter 25-30, Florida Administrative Code.

18 Q. Were you accepted as an expert in regulatory accounting?

19 A. Yes, I was.

20 Q. Have you ever testified before any other tribunals as an expert in  
21 regulatory accounting?

22 A. Yes. I testified before the Division of Administrative Hearings, Case  
23 No. 97-2485RU, Aloha Utilities, Inc., and Florida Waterworks Association,  
24 Inc., Petitioners, vs. Public Service Commission, Respondent, and Citizens of  
25 the State of Florida, Office of Public Counsel, Intervenors.

1 | Q. Would you explain what your general responsibilities are as a Public  
2 | Utilities Supervisor in the Accounting Section of the Bureau of Economic  
3 | Regulation?

4 | A. I am responsible for the supervision of five professional accountants  
5 | in the accounting section. This section is responsible for the financial,  
6 | accounting and rates review and evaluation of complex formal rate proceedings  
7 | before the Commission. This specifically includes the analysis of file and  
8 | suspend rate cases, overearnings investigations and limited proceedings of  
9 | Class A and B water and wastewater utilities under the jurisdiction of the  
10 | Florida Public Service Commission. The accounting section is also responsible  
11 | for the review of smaller filings of Class A and B utilities, such as  
12 | allowance for funds used during construction (AFUDC), allowance for funds  
13 | prudently invested (AFPI), service availability applications, and tariff  
14 | filings. This section coordinates, prepares and presents staff  
15 | recommendations before the Commission on the above type cases. This section  
16 | is also responsible for preparing testimony, testifying and writing cross-  
17 | examination questions for hearings involving complex accounting and financial  
18 | issues.

19 | Q. Can you summarize the issues to which you are providing testimony?

20 | A. I am testifying about Florida Cities Water Company's (FCWC) requested  
21 | method of allocating litigation fees incurred to all FCWC water and wastewater  
22 | customers. I am also providing opinion testimony regarding when or if  
23 | environmental legal fees should be recovered by a utility's customers.  
24 | Further, I address the accounting classification of any revenues which may be  
25 | collected from the customers.

1 Q. Please explain your testimony regarding the allocation to all FCWC  
2 customers.

3 A. FCWC has requested that all of its water and wastewater customers  
4 reimburse the company for litigation expenses incurred in FCWC's defense  
5 against the U.S. Department of Justice (DOJ) and the U.S. Environmental  
6 Protection Agency (EPA). FCWC claims that the DOJ proposed penalties were of  
7 such magnitude, that any payment of these penalties would have severely  
8 damaged the financial integrity of FCWC. According to FCWC, by litigating  
9 these actions, FCWC preserved all systems from such calamity, thus benefitting  
10 all FCWC customers.

11 Q. Was FCWC ultimately required to pay the maximum penalty sought by the  
12 DOJ?

13 A. No. FCWC was fined a total of \$309,710 for violations of the Clean  
14 Water Act (CWA). This was made up of \$289,425 for the Waterway Estates  
15 Wastewater Treatment Plant (North Ft. Myers), \$14,675 for the Carrollwood  
16 Wastewater Treatment Plant (Hillsborough County), and \$5,610 for the Barefoot  
17 Bay Wastewater Treatment Plant (Brevard County). The utility incurred a total  
18 of \$3,826,210 for legal fees in defense of its violations of the CWA.

19 Q. How did the utility account for these legal fees on its books?

20 A. During the early years the utility capitalized some portion of these  
21 costs for the expansion of the North Ft. Myers wastewater treatment plant.  
22 During 1994, FCWC began expensing these legal fees below the line for rate  
23 setting purposes. FCWC had written off all of these costs prior to 1997.

24 Q. Did the write-off of the penalties and legal fees cause any severe  
25 financial damages to FCWC?

1 | A. No, in my opinion, they did not. FCWC has not filed bankruptcy or  
2 | documented any direct financial harm caused by the write-off of these costs.

3 | Q. In your opinion, should the threat of severe financial harm to FCWC  
4 | resulting from the DOJ proposed penalties be considered the burden of all  
5 | FCWC's water and wastewater customers?

6 | A. No, it should not. These costs were incurred because of violations at  
7 | specific wastewater facilities of FCWC. As Commission witness Moniz  
8 | testifies, FCWC's rates for all but two systems have been set on a system-  
9 | specific basis and are not uniform. The only facilities that have uniform  
10 | rates are the North and South Ft. Myers water systems. To assume that the  
11 | legal fees incurred for three wastewater systems found in violation of the CWA  
12 | are the shared burden of all water and non-involved wastewater customers is  
13 | inappropriate. These legal fees are not a cost of providing water service,  
14 | nor are they a cost of wastewater service to any of the other FCWC wastewater  
15 | facilities not penalized.

16 | Q. Do you have an opinion regarding when or if environmental legal fees  
17 | should be recovered by a utility's customers?

18 | A. Yes. In general, legal costs prudently incurred by a utility for  
19 | maintaining environmental compliance or bringing a utility into compliance  
20 | with new environmental regulations should be considered a normal cost of doing  
21 | business. If a utility can show that legal fees incurred for environmental  
22 | compliance were prudent and sufficiently documented, then those costs should  
23 | be recovered from the ratepayers. In a circumstance when an environmental  
24 | agency claims that a utility is in non-compliance with environmental standards  
25 | and a utility disputes this and ultimately is found to be in compliance, then



1 | the Commission should look at the specifics in each case to decide whether the  
2 | utility prudently incurred legal fees in its defense of these claims. It is  
3 | also common for utilities to incur legal fees in conjunction with a penalty  
4 | or a consent order. I do not believe that just because penalties were  
5 | incurred that the associated legal fees should always be disallowed. If a  
6 | utility can show that the legal fees in such a case minimized or avoided  
7 | increased plant or operational costs to provide service, then such costs could  
8 | be considered beneficial to the customers and this should be considered on a  
9 | case by case basis. As long as the utility sufficiently justifies that the  
10 | legal fees incurred were prudent and not excessive, then the legal fees,  
11 | exclusive of the penalty, should be recovered through rates.

12 | Q. What are some circumstances when environmental legal fees should not be  
13 | recovered by the customers?

14 | A. First, if a utility fails to provide sufficient documentation supporting  
15 | its requested expenses or the amounts are deemed excessive or imprudent, then  
16 | those costs should be disallowed. It is the utility's burden to show that its  
17 | requested expenses are prudent and reasonable. Further, if the utility fails  
18 | to show that it acted prudently to maintain compliance with environmental  
19 | requirements, or that its defense mitigated other costs that might have  
20 | otherwise been incurred in connection with violations, then the associated  
21 | legal fees should be borne by the shareholders. The mere fact that a utility  
22 | incurs legal fees associated with a penalty does not automatically require  
23 | that those fees should be borne by the customers.

24 | Q. Has the Commission addressed some of these issues in prior cases?

25 | A. Yes. In Order No. PSC-97-1547-FOF-WS, (issued December 12, 1997, in

1 | Docket No. 970521-WS, Betmar Utilities, Inc.), the Commission denied \$1,245  
2 | in legal fees associated with contesting allegations of a Florida Department  
3 | of Environmental Protection (DEP) consent order. The utility stated that the  
4 | legal fees incurred were legitimate utility expenses in connection with a DEP  
5 | consent order and as such, should be recovered. The Commission found that  
6 | even if the legal fees were found to be prudent, the utility failed to meet  
7 | its burden by its failure to provide supporting documentation to support its  
8 | legal fees. In Order No. PSC-93-0423-FOF-WS (issued March 22, 1993, in Docket  
9 | No. 920199-WS, Southern States Utilities, Inc.), the Commission allowed legal  
10 | fees associated with environmental fines because the evidence supported that  
11 | the ratepayers benefitted from the utility's defending itself in regulatory  
12 | proceedings. If the utility succeeds, rate base or other expenses may be  
13 | lower. In Order No. PSC-93-1070-FOF-WS (issued July 23, 1993, in Docket No.  
14 | 920655-WS, Southern States Utilities, Inc. - Marco Island), the Commission  
15 | found that the suggestion that legal fees be disallowed because they were  
16 | incurred to defend the utility against alleged violations presupposes that the  
17 | utility should acquiesce in all cases, whether or not fault exists.  
18 | Litigation may be appropriate even when imposition of a fine is a possibility,  
19 | when compliance with a disputed regulation will create adverse economic  
20 | consequences. On other occasions, payment of a fine pursuant to a consent  
21 | order, even when "guilt" is not admitted, may result in avoidance of further  
22 | litigation costs that would be detrimental to a utility's financial condition.  
23 | The Commission found that an absolute prohibition against recovery of legal  
24 | fees in any proceeding where a fine may be imposed would be impractical. In  
25 | that docket, the Commission was addressing test year legal fees of \$20,738.

1 | not all of which related to contesting environmental compliance with the EPA  
2 | and DEP.

3 | Q. How was this issued addressed by the Commission for other industries?

4 | A. In Order No. PSC-97-1047-FOF-EI (issued September 5, 1997, in Docket No.  
5 | 970007-EI, Investor-Owned Electric Utilities), the Commission accepted a  
6 | stipulation that legal expenses directly associated with environmental  
7 | compliance activities approved by the Commission incurred in order to comply  
8 | with environmental laws or regulations should be recovered. However, the  
9 | Commission stated that those costs will continue to be examined on a case-by-  
10 | case basis in order to determine the prudence of its recovery. In Order No.  
11 | 20162 (issued October 13, 1988, in Docket No. 880069-TL, Southern Bell), the  
12 | Commission denied recovery of expenses incurred in the settlement of antitrust  
13 | cases. The Commission found that Southern Bell had not shown that the  
14 | expenses were reasonable or to the benefit of Florida ratepayers.

15 | Q. Are you testifying to the issue of whether or not any costs should be  
16 | recovered by the FCWC customers?

17 | A. No, I am not recommending specifically as to whether or not any costs  
18 | incurred by FCWC should be recovered through customer rates. If the  
19 | Commission finds that FCWC has shown that the legal fees were reasonable and  
20 | prudent and were incurred to maintain compliance, or to minimize or avoid  
21 | other increased plant or operational costs to provide service, then it may be  
22 | appropriate for some amount of legal fees associated with this litigation to  
23 | be recovered by FCWC's customers. I am not testifying as to whether FCWC has  
24 | met this burden in this case, or what amount, if any, should be considered  
25 | prudent or reasonable.

1 Q. If the Commission does allow some costs to be recovered by the  
2 customers, how should they be allocated?

3 A. Any allowed costs should only be recovered from the North Ft. Myers,  
4 Barefoot Bay and Carrollwood wastewater customers. The fees should be  
5 allocated between these customers based on the evidence in the record that  
6 shows what costs were incurred to maintain compliance or how FCWC minimized  
7 or avoided other increased plant or operational costs.

8 Q. Please describe the accounting treatment for any amounts collected from  
9 the customers associated with these legal fees.

10 A. Any amounts collected from the customers to reimburse the utility for  
11 litigation costs incurred would be considered utility operating revenues and  
12 as such regulatory assessment fees are required to be collected on those  
13 amounts. These revenues should be recorded in Account No. 536, Other  
14 Wastewater Revenues. According to Section 367.145, Florida Statutes,  
15 regulatory assessment fees are based on 4.5 percent of gross revenues of the  
16 utility derived from intrastate business. The only exemption in the statute  
17 is for sales for resale made to a regulated company.

18 Q. Does this conclude your testimony?

19 A. Yes, it does.

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1           **MS. GERVASI:** Staff would like to have the  
2 prefiled direct testimony of Ms. Sally H. Moniz  
3 inserted into the record as though read.

4           **CHAIRMAN JOHNSON:** It will be so inserted.

5           **MS. GERVASI:** Thank you.  
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*DOCKET NO.:* 971663-WS - Florida Cities Water Company  
*WITNESS:* **Direct Testimony of Sarah (Sally) H. Moniz,**  
Appearing on Behalf of Staff  
*DATE FILED:* JUNE 19, 1998

DOCUMENT NUMBER-DATE

06534 JUN 19 88

FPSC-RECORDS/REPORTING

## 1 DIRECT PREFILED TESTIMONY OF SARAH (SALLY) H. MONIZ

2 Q. Please state your name and professional address.

3 A. My name is Sarah (Sally) H. Moniz and my business address is 2540  
4 Shumard Oak Boulevard, Tallahassee, Florida 32399-0873.

5 Q. By whom are you employed and in what capacity?

6 A. I am employed by the Florida Public Service Commission (FPSC) as a  
7 Professional Accountant Specialist in the Division of Water and Wastewater.

8 Q. How long have you been employed by the Commission?

9 A. Since June, 1990.

10 Q. Please state your educational background.

11 A. I received a Bachelor of Business Administration degree with a Major in  
12 Accounting from Valdosta State College, which is now Valdosta State  
13 University, in August, 1981.

14 Q. Please describe your employment history and experience in the field of  
15 regulatory accounting.

16 A. In June of 1990, I began my employment with the Florida Public Service  
17 Commission, in the Division of Water and Wastewater. While employed with the  
18 Commission I have held the following positions: Regulatory Analyst II from  
19 June 1990 to November 1991; Regulatory Analyst III from November 1991 until  
20 October 1, 1994; and Regulatory Analyst IV from October 1994 until October  
21 1996. In October of 1996, I was promoted to my present position as a  
22 Professional Accountant Specialist in the Bureau of Economic Regulation.  
23 Since my employment with the FPSC, I have attended various regulatory seminars  
24 and Commission in-house training and professional development meetings  
25 concerning regulatory matters. Additionally, I have participated in numerous

1 rate proceedings on behalf of Commission staff.

2 Q. Please explain your duties as a Professional Accountant Specialist in  
3 the Accounting Section of the Bureau of Economic Regulation.

4 A. As a professional accountant, I am responsible for financial, accounting  
5 and rate reviews and evaluations of complex formal rate proceedings before the  
6 Commission. This specifically includes the analysis of file and suspend rate  
7 cases, overearnings investigations and limited proceedings of Class A and B  
8 water and wastewater utilities under the jurisdiction of the FPSC. I am also  
9 responsible for reviewing smaller filings of Class A and B utilities, such as  
10 allowance for funds used during construction (AFUDC), allowance for funds  
11 prudently invested (AFPI), service availability applications and tariff  
12 filings. I coordinate, prepare, and present staff recommendations before the  
13 Commission on the above type cases. In addition, I am responsible for  
14 preparing testimony, testifying and writing deposition and cross-examination  
15 questions for hearings involving complex accounting and financial issues.

16 Q. Please describe your employment history in other areas of accounting.

17 A. Prior to my employment with the Commission, I held the following  
18 positions: Budget Specialist in the Office of Planning and Budget with the  
19 Florida Department of General Services, from May 1989 until June 1990;  
20 Accounting Supervisor in the Comptroller's office of the Florida Department  
21 of Transportation from October 1988 until May 1989; Accountant with the  
22 Georgia Department of Family and Children Services from September 1986 through  
23 October 1988; Staff Accountant with Callahan and Company, C.P.A.'s in  
24 Donalsonville, Georgia, from April 1986 until September 1986; Staff Accountant  
25 with Burke-Burke and Company, C.P.A.'s, Donalsonville, Georgia, from January



1 | 1985 until April 1986; Accounting Instructor, Gordon Junior College,  
2 | Barnsville, Georgia, January 1984 until June 1984; Retail Cost Accountant  
3 | Gold Kist, Inc., South East Division, Moultrie, Georgia, February 1982 until  
4 | August 1983.

5 | Q. What is the purpose of your testimony?

6 | A. To discuss the regulatory treatment utilized by the Commission or  
7 | reflected in prior Commission orders relating to Florida Cities Water  
8 | Company's (FCWC or utility) defense to the Environmental Protection  
9 | Agency/Department of Justice (EPA/DOJ) litigation. I am also testifying to  
10 | the approved regulatory treatment of FCWC's facilities in past rate cases.

11 | Q. When FCWC first began incurring legal costs related to EPA/DOJ  
12 | litigation costs, how were these costs treated on the utility's books?

13 | A. In the North Ft. Myers wastewater rate case (Docket No. 950387-SU), the  
14 | Commission found that during 1992, 1993 and 1994, the utility capitalized EPA  
15 | litigation legal fees as part of an expansion project to the North Ft. Myers  
16 | wastewater treatment plant.

17 | Q. Did the utility continue to capitalize the litigation expenses?

18 | A. No. During 1994, the utility began expensing all additional legal fees  
19 | pertaining to the lawsuit and reporting them below the line.

20 | Q. How were the litigation expenses treated in the North Ft. Myers rate  
21 | case?

22 | A. By Order No. PSC-96-1133-FOF-SU, issued September 10, 1996, the  
23 | Commission accepted a stipulation to remove the legal fees from rate base.  
24 | The record did not reflect why these fees were capitalized for more than two  
25 | years and then expensed below the line. Since the legal fees were not

1 | included in the customer's rates, the Commission did not address the  
2 | appropriateness of reporting the litigation fees above the line or the  
3 | accounting treatment.

4 | Q. Did the utility continue to expense these costs below the line?

5 | A. Yes. According to Order No. PSC-96-1133-FOF-SU, all the legal costs  
6 | were "expensed below the line".

7 | Q. Concerning your other area of testimony, the approved regulatory  
8 | treatment of FCWC's facilities in past rate cases, do any of FCWC's facilities  
9 | have uniform rates?

10 | A. Yes, pursuant to Order No. 16768 (Docket No. 851007-WU), the Commission  
11 | approved uniform water rates for the North and South Ft. Myers' systems.  
12 | However, all the other systems have separate rates for each facility.

13 | Q. What cost components are shared among FCWC's water and wastewater  
14 | facilities?

15 | A. FCWC is a consolidated entity with six operating divisions, three of  
16 | which are under the jurisdiction of the FPSC. As such, it has one set of  
17 | financial statements and one consolidated balance sheet. The utility is  
18 | required to use the balance sheet method to calculate its working components,  
19 | as required by Rule 25-30.433(2), Florida Administrative Code. Therefore,  
20 | working capital is allocated to all of the utility's facilities. FCWC also  
21 | has one consolidated capital structure which is allocated based on rate base  
22 | to each water and wastewater system. However, the Commission establishes a  
23 | separate rate of return on equity for each facility. The utility's general  
24 | plant is also allocated to each system.

25 | Q. Does this conclude your testimony?

1 | A: Yes, it does.  
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1           **MR. GATLIN:** May I inquire of Staff, was the  
2 deposition of Mr. Larkin that was identified as an  
3 exhibit, was that his complete deposition and exhibit?

4           **MS. GERVASI:** Do you mean was that the  
5 entire transcript of the deposition?

6           **MR. GATLIN:** Yes, right; the complete  
7 transcript of the deposition and the exhibit that he  
8 had. It looks to me like it was, but I wanted to make  
9 sure.

10          **MS. GERVASI:** Yes, sir, it is the complete  
11 transcript.

12           I guess we're on to the rebuttal.

13          **CHAIRMAN JOHNSON:** I guess I said for  
14 Ms. Moniz for that to be inserted into the record as  
15 though read, and there were no exhibits.

16          **MS. GERVASI:** No exhibits, correct.

17          **MR. McLEAN:** And no depositions, as I  
18 recall.

19          **MS. GERVASI:** Correct.

20          **CHAIRMAN JOHNSON:** Yes. We're on rebuttal.

21          **MR. GATLIN:** What was the number of  
22 Ms. Merchant's deposition?

23          **CHAIRMAN JOHNSON:** 17.

24          **MR. GATLIN:** I would like to offer the  
25 rebuttal testimony of Mr. Gerald S. Allen to be

1 inserted as though read.

2 CHAIRMAN JOHNSON: It will be inserted.

3 MR. GATLIN: I would like to offer the  
4 rebuttal testimony of Mr. Gary --

5 MS. GERVASI: Before we go on to that, did  
6 Mr. Allen not have any prefiled exhibits, Mr. Gatlin?

7 MR. GATLIN: None.

8 MS. GERVASI: Then at this point we'd like  
9 to identify as Exhibit No. 18 the deposition  
10 transcript for Mr. Allen taken on July 30th of 1998.

11 CHAIRMAN JOHNSON: It will be marked as 18.

12 (Exhibit 18 marked for identification.)

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1 FLORIDA CITIES WATER COMPANY  
2 RATE APPLICATION FOR RECOVERY OF LEGAL EXPENSES  
3 REBUTTAL TESTIMONY OF GERALD S. ALLEN  
4 TO DIRECT TESTIMONY OF  
5 HUGH LARKIN, JR. AND PATRICIA W. MERCHANT  
6 DOCKET NO. 971663-WS

7 Q. Please state your name and business address.

8 A. Gerald S. Allen, 4837 Swift Road, Suite 100,  
9 Sarasota, Florida 34231.

10 Q. By whom are you employed and in what capacity?

11 A. I am the President of Florida Cities Water  
12 Company(FCWC).

13 Q. Did you prepare prefiled testimony in this case?

14 A. Yes.

15 Q. What is the purpose of your rebuttal testimony?

16 A. The purpose of my testimony is to rebut certain  
17 parts of the direct testimony of Hugh Larkin, Jr.  
18 prefiled on behalf of the Florida Office of Public  
19 Counsel, and Patricia W. Merchant on behalf of the  
20 Public Service Commission.

21 Q. Beginning at line 18, page 3 of his prefiled  
22 testimony, Mr. Larkin states, "[I]f the Company had  
23 a basis to recover these expenses, it was to file a  
24 rate case at the time the expenses were being  
25 incurred and as for the recovery as part of a rate

1 case, or to come before the Commission and ask for  
2 an Accounting Order allowing for the deferral of the  
3 legal fee to be considered in a single issue rate  
4 case." Why didn't FCWC take one of actions  
5 suggested by Mr. Larkin?

6 A. Until the Court issued its Judgement and Memorandum  
7 Order on August 20, 1996 ((Exhibit 4 (GSA-24)),  
8 FCWC had no solid basis for predicting the outcome  
9 of the litigation and therefore did not have a basis  
10 for seeking recovery. In fact this outcome did not  
11 become final until the U.S. Court of Appeals for the  
12 Eleventh Circuit dismissed the respective appeals of  
13 the parties at their request on August 6, 1997. See  
14 Exhibit 6 (GHB-104).

15 Q. In your opinion, would the Commission have  
16 considered multiple rate applications as the legal  
17 expenses occurred?

18 A. No. I don't believe the Commission would have  
19 considered recovery until the outcome of the  
20 litigation had been finally decided. The litigation  
21 was very dynamic and was fraught with ancillary  
22 issues primarily as a result of the overzealous  
23 prosecution by the DOJ. A snapshot at any given  
24 point would significantly differ from a snapshot a  
25 few weeks later and this situation existed for

1 almost four years. Therefore, it was not possible  
2 to accurately predict the additional legal expenses  
3 from any given point to the conclusion of the case.

4 Q. Referring to page 5 of Mr. Larkin's testimony  
5 beginning at line 10, Mr. Larkin states, "[T]hat  
6 this case provides an excellent example of how  
7 passing to the customers the expenses associated  
8 with the utility's violation of federal law would  
9 insulate the utility management from compliance with  
10 the CWA. It is worthy of note that neither the EPA,  
11 DOJ, nor the federal Judge was ever aware that the  
12 Company might shift the expenses of litigation  
13 [to]its customers." How do you interpret this  
14 question and response?

15 A. First, I believe Mr. Larkin is stating that if  
16 utilities are allowed to recover expenses associated  
17 with defending themselves against alleged violations  
18 of the Clean Water Act (CWA),it would remove  
19 incentives to comply. Second, he concludes or at  
20 least implies that the Court's final decision would  
21 have been influenced had it known that the Company  
22 might seek recovery of legal expenses sustained in  
23 defending itself. Third, Mr. Larkin concluded that  
24 the excerpt from my testimony at deposition on  
25 November 13, 1995 concealed the Company's intent to



1 later seek recovery of said expenses.

2 Q. Do you agree with Mr. Larkin that if utilities are  
3 allowed to recover expenses associated with  
4 defending themselves against alleged violations of  
5 the Clean Water Act (CWA), it would remove incentives  
6 to comply?

7 A. No. First, I became involved in water and wastewater  
8 utility management before the enactment of the Clean  
9 Water Act (CWA), the Safe Drinking Water Act and  
10 many other laws governing water and wastewater  
11 utilities and have first hand experience with their  
12 evolution. I have witnessed the conflicting  
13 interpretations of these laws and the evolution of a  
14 new legal specialty. Compliance has always been a  
15 top priority personally and I have consistently  
16 promoted strict compliance as always being in the  
17 best interests of my employer and its utility  
18 customers. Those to whom I have reported since  
19 employment by Avatar Utilities Inc. and its  
20 subsidiaries, including Florida Cities Water  
21 Company, have strongly supported this position. The  
22 reasons include, but are not limited to, a  
23 demonstration of good environmental stewardship and  
24 corporate citizenship, avoidance of economic  
25 sanctions, maintaining productive relationships with

1 regulatory agencies and fostering professional pride  
2 throughout the company. To imply that the ability  
3 to recover a part of the Company's legal expenses in  
4 connection with defending itself against grossly  
5 overstated allegations of violations of the law  
6 represents a disincentive to comply borders on  
7 insult.

8 At \$25,000 per day per violation as provided  
9 by the CWA, the greatest financial peril virtually  
10 always faced by alleged violators are penalties, not  
11 legal expenses. In the instant case, the Company  
12 faced potential penalties up to \$104 million which  
13 is forty-six times the legal expenses it seeks to  
14 recover in this docket. The Company has never  
15 attempted to recover fines or penalties nor is it  
16 seeking to do so in this case. To adopt Mr. Larkin's  
17 conclusion, one would have to also conclude that the  
18 public defender act, which provides legal defense to  
19 those who cannot afford it, removes all perils  
20 associated with criminal acts and therefore is a  
21 disincentive to comply with the law. It is nonsense  
22 to conclude that recovery of legal expenses is a  
23 disincentive to comply with the CWA or any other law  
24 or rule.

25 Q. Do you agree with Mr. Larkin's conclusion that the

1 excerpt from your testimony at deposition on  
2 November 13, 1995 concealed the Company's intent to  
3 later seek recovery of said expenses?

4 A. No. My responses at deposition were based on the  
5 facts before me at that time when the Company faced  
6 penalties up to \$104 million. The recovery of legal  
7 expenses through rates was an issue that I had given  
8 little thought to at that time. Furthermore, I did  
9 not have the benefit of knowing that the Court would  
10 dismiss almost half of the allegations in summary  
11 judgement and ten months later find penalties in the  
12 amount of \$309,710 which was but a small fraction of  
13 the legal expenses sustained by the Company. I  
14 initially stated that I doubted that the Company  
15 would expect to include the expenses in rate base  
16 but upon immediate reflection indicated that I  
17 didn't know and that a decision would not be made to  
18 seek rate base treatment or any other treatment of  
19 the legal expenses until the outcome of the case was  
20 resolved. It is important to note that the DOJ had  
21 ample opportunity to bring the issue up at trial but  
22 did not do so. The DOJ trial counsel did not  
23 examine me, Mr. Cardy, the Company's rate making  
24 expert, any other Company witness, or the DOJ's  
25 financial expert regarding rate treatment of

1 penalties or legal expenses at trial in this case.  
2 To conclude that my testimony at deposition, which  
3 was not introduced into evidence at trial and  
4 presumably was never viewed by the Court, misled  
5 both the DOJ and the Court, and influenced the  
6 Courts decision is clearly without factual basis.

7 Q. Do you agree with Mr. Larkin's conclusion that the  
8 Court's final decision would have been influenced  
9 had it known that the Company might seek recovery of  
10 legal expenses sustained in defending itself.

11 A. No. Legal expenses sustained by defendants in CWA  
12 litigation and the source of funds to pay same are  
13 not among the factors set forth in the Act for  
14 determining the validity of allegations or the  
15 amount of penalties as will be discussed by Mr.  
16 Baise in his rebuttal testimony.

17 Q. Under the same circumstances and limiting the facts  
18 to those known to you at the time, would your  
19 responses to questions by the DOJ regarding recovery  
20 of expenses through rates been different?

21 A. No.

22 Q. Beginning at line 24, page 12 of Mr. Larkin's  
23 prefiled testimony, he states, "[T]he environmental  
24 agencies either find the utility is or is not in  
25 compliance with the requirements of the law. If

1           these agencies are mistaken as to whether a  
2           particular utility's wastewater treatment facilities  
3           comply with the law, then normally the company's own  
4           engineers can prove the company's compliance with  
5           the requirements of the law. No legal expenses  
6           would be incurred, since it would be a matter of  
7           testing to determine whether the utility complies or  
8           does not comply with the environmental  
9           requirements."

10    Q.    Was this the approach that FCWC initially took in  
11           1986 after the USEPA notified FCWC that it intended  
12           to deny renewal of the NPDES permit for the Waterway  
13           Estates Wastewater Treatment Plant and for several  
14           years thereafter in dealing with the EPA and DEP?

15    A.    Yes. In fact, FCWC's engineers immediately opened  
16           communications with both agencies and started  
17           developing an action plan which FCWC believed would  
18           resolve the issues. There was never a dispute  
19           regarding the action which was necessary to satisfy  
20           the demands of the EPA and DEP. The EPA's  
21           dissatisfaction arose over the timeliness of  
22           completing the work set forth in the action plan.  
23           There was no legal counsel involvement until this  
24           dissatisfaction surfaced and little from that point  
25           in time until the DOJ entered the picture. The DOJ

1 was making demands on FCWC of a magnitude which  
2 could have placed the Company in serious jeopardy  
3 and it was prudent that the Company engage legal  
4 counsel in a more assertive manner.

5 Q. Had FCWC challenged the USEPA on its denial of  
6 renewal of the NPDES permit for the Waterway Estates  
7 Wastewater Treatment Plant in 1986, do you believe  
8 the ultimate outcome would have been different?

9 A. No, I don't believe the outcome would have been  
10 significantly different. It is my opinion that had  
11 FCWC challenged the denial and prevailed, the USEPA  
12 would have issued an administrative order mandating  
13 the upgrading of the treatment plant and relocation  
14 of the outfall initially instead of an order calling  
15 for the elimination of the discharge<sup>1</sup>. Since such  
16 initial order would not have altered FCWC's action  
17 plans, I conclude that the schedule would not have  
18 been altered. Therefore, the outcome would have not  
19 been altered.

20 Q. Beginning at line 21, page 22 of his prefilled  
21 testimony, Mr. Larking refers to "the criminal  
22 defense of some of the Company's employees." Were  
23 criminal charges brought against any past or current

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1. See prefilled direct testimony, Gerald S. Allen,  
page 10, line 6 through p. 11, line 2.

1 Company employees by the United States or the State  
2 of Florida or to the best of your knowledge were  
3 criminal investigations ever undertaken by the  
4 United States or the State of Florida with respect  
5 to any matter surrounding or arising from the  
6 litigation in this docket?

7 A. No current or former employees were charged or, to  
8 be best of my knowledge, investigated. So, there was  
9 no need for "criminal defense." I can't explain  
10 Mr. Larkin's characterization other than another  
11 example of conclusions without factual basis.

12 Q. Did the Company retain, on behalf of certain current  
13 and former employees, legal counsel to represent  
14 their personal interest?

15 A. Yes, on a limited basis in view of the case,  
16 Weitzenhoff v. United States, cited at page 32 of my  
17 prefilled direct testimony. However, this matter is  
18 not relevant in this docket since the Company is not  
19 seeking recovery through rates any of the expenses  
20 associated with such legal services.

21 Q. What is your interpretation of Ms. Merchant's  
22 prefilled direct testimony with regard to the  
23 recovery of the legal expenses sought by FCWC in  
24 this docket?

25 A. Ms. Merchant seems to be presenting her personal

1 opinion regarding the criteria which the Commission  
2 should apply in arriving at its decision regarding  
3 recovery. She presents no opinion regarding whether  
4 or not recover should be allowed or the amount  
5 thereof, if any. However, she is firm in stating  
6 that recovery, if allowed, should be through rates  
7 applicable to N. Ft. Myers, Barefoot Bay and  
8 Carrollwood wastewater customers only.

9 Q. What criteria should the Commission apply in  
10 arriving at its decision.

11 A. The fundamental foundation governing the recovery of  
12 expenses through rates is the "reasonable and  
13 prudent" criteria and it should be applied by the  
14 Commission in arriving at a decision in this case.  
15 The Commission should consider the decisions of the  
16 Company regarding its legal defense of the  
17 allegations of the DOJ and the "reasonableness and  
18 prudence" of these decisions in light of the facts  
19 available to the Company at the time they were made.  
20 Of course, important to the "reasonable and prudent"  
21 test is evaluating the ultimate results of these  
22 decisions which was the Federal Court's judgement  
23 following the trial: penalties of less than one  
24 percent of the maximum penalty claimed in the  
25 Original Complaint, less than one-half percent of



1           the maximum penalty claimed in the Amended Complaint  
2           and slightly over six percent of the settlement  
3           offer rendered by the DOJ prior to the Original  
4           Complaint.

5   Q.   Does this conclude your rebuttal testimony.

6   A.   Yes.

1           **MR. GATLIN:** I offer the testimony of  
2 Mr. Gary H. Baise to be inserted into the record.

3           **CHAIRMAN JOHNSON:** Mr. Baise's testimony  
4 will be inserted as though read.

5           **MR. GATLIN:** And he has no exhibits.

6           **CHAIRMAN JOHNSON:** Staff?

7           **MS. GERVASI:** Staff would identify the  
8 transcript of Mr. Baise's August 5th, 1998 deposition.

9           **CHAIRMAN JOHNSON:** It will be identified  
10 as 19.

11           **MS. GERVASI:** Thank you.

12           (Exhibit 19 marked for identification.)

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1                                   **FLORIDA CITIES WATER COMPANY**  
2                                   **FT. MYERS & BAREFOOT BAY DIVISIONS**  
3                                   WATER AND WASTEWATER OPERATIONS  
4                                   REBUTTAL TESTIMONY OF GARY BAISE  
5   TO  
6   DIRECT TESTIMONY  
7   OF  
8                                   Hugh Larkin, Jr. and Patricia W. Merchant  
9   DOCKET NO. 971663-WS

10       Q:   Please state your name and business address.

11       A:   Gary H. Baise, Baise, Miller & Freer, P.C., 815  
12           Connecticut Avenue, N.W., Suite 620, Washington, D.C.  
13           20006-4004.

14       Q:   By whom are you employed and in what capacity?

15       A:   I am a partner in the law firm of Baise, Miller &  
16           Freer, P.C.

17       Q:   Have you filed testimony in this case?

18       A:   Yes. I filed direct testimony in this case.

19       Q:   What is the purpose of this rebuttal testimony?

20       A:   The purpose of this testimony is to refute certain  
21           positions of OPC witness Hugh Larkin, Jr. and Patricia  
22           W. Merchant, PSC witness.

23       Q:   On page 4, line 22 of his testimony, Mr. Larkin is  
24           discussing his position that legal costs should not be  
25           recovered from rate payers, testifying as follows:

1 "The reasoning underlying this basic principle is that  
2 management must be held responsible for its actions.  
3 It must follow those laws regardless of their  
4 conclusion as to the fairness or economic  
5 reasonableness of the requirements of the law. If  
6 regulation allowed the recovery of fines and penalties  
7 and/or any related costs from ratepayers, clearly,  
8 management and stockholders would be shielded from the  
9 affects of their actions. They could operate with  
10 impunity knowing that as a general principle they  
11 could recover any penalty or fine and related costs  
12 from ratepayers. Clearly, in a competitive  
13 environment they would not recover such costs. To the  
14 extent that the Commission shifts the costs of the  
15 violations - whether penalty or legal fees incurred in  
16 litigation over penalties - from the Company to the  
17 ratepayers, it holds the Company harmless from such  
18 violations frustrates the purpose of the Clean Water  
19 Act." Is Mr. Larkin correct, please explain?

20 A. Mr. Larkin concludes that if FCWC can shift the cost  
21 of violations in terms of legal fees to the rate  
22 payers, that holds the company harmless from such  
23 violation, which frustrates the purpose of the Clean  
24 Water Act. The amount of attorneys' fees would not be  
25 admissible as evidence in a CWA enforcement action;

1           Accordingly, the Court would have no authority to  
2           consider legal costs. The CWA does not address the  
3           issue of whether penalties or legal fees are to be  
4           paid by shareholders or ratepayers. Therefore, under  
5           the CWA there is no basis to support Mr. Larkin's  
6           policy argument that the purpose of the CWA is  
7           frustrated by shifting legal fees to ratepayers. It  
8           is apparent that Mr. Larkin does not understand the  
9           framework of the Clean Water Act (CWA) nor has he  
10          studied the many court cases involving the CWA. At  
11          \$25,000 per day per violation and criminal sanctions  
12          of many years imprisonment, violators of the CWA are  
13          subject to some of the most severe civil and criminal  
14          penalties imposed by federal environmental laws.  
15          Clearly, violations of the CWA can result in the  
16          financial ruin of companies and individuals and the  
17          imprisonment of a company's officers and employees.  
18          Generally, in civil cases such as that brought against  
19          FCWC under the CWA, the legal expenses are very small  
20          compared to the potential liability associated with  
21          the allegations. To conclude, as Mr. Larkin apparently  
22          has, that the prospect of recovery of legal expenses  
23          associated with the defense of allegations of  
24          violations of the CWA represents a disincentive to  
25          comply is without basis and is not consistent with the

1 history of enforcement of the CWA. Until the Court  
2 ruled in this case there was never any consideration  
3 on my part that FCWC would be in a position to seek  
4 recovery of its legal fees in its rates.

5 Q. On page 5 of his testimony, starting with the answer  
6 on line 15 - Mr. Larkin says "... that neither the  
7 EPA, DOJ or the federal Judge was ever aware that the  
8 company might shift the expenses of litigation to its  
9 customers" Mr. Larkin then quotes from the deposition  
10 transcript of FCWC President, Mr. Allen, dated  
11 November 13, 1995. He concludes his answer on page 7,  
12 lines four through twelve are as follows: "Thus, Mr.  
13 Allen indicated that FCWC's seeking to include  
14 expenses associated with this litigation was "highly  
15 unlikely." While Mr. Allen hastened to add that he  
16 was no expert regarding whether the expenses could be  
17 recovered through the rate making process, the matter  
18 was apparently not raised again. It is reasonable to  
19 conclude that the DOJ and the federal Judge were under  
20 the reasonable impression that the violator - FCWC -  
21 like any other violator - would be liable for whatever  
22 penalty and expenses arose from this litigation. It  
23 is also reasonable to assume that the Court and the  
24 DOJ were aware that the Company was incurring  
25 substantial litigation expenses, and that its ability

1 to pay any penalty would be lessened to that extent."

2 Would you please respond to Mr. Larkin's answer?

3 A. Mr. Larkin is simply incorrect and apparently has not  
4 thoroughly reviewed the record nor does he understand  
5 the provision of the CWA which sets forth the factors  
6 courts are to consider in assessing penalties. First,  
7 at deposition, neither Mr. Gerald Allen, FCWC's  
8 President nor Mr. Bradtmiller, FCWC's Executive Vice  
9 President, ruled out the prospect of attempting to  
10 recover legal expenses through rates. Second, if the  
11 department of Justice had wanted to bring this matter  
12 to the Court's attention it could have done so through  
13 its direct examination of Mr. Gerald Allen, but it did  
14 not choose to do so or through testimony presented by  
15 any other FCWC witness. Third, the matter of how FCWC  
16 proposed to recover part or all of the legal expenses  
17 associated with its defense (even if it knew at the  
18 time) was not a matter included in the six factors  
19 which the CWA specifies for consideration by courts in  
20 assessing penalties. Therefore, the matter was not  
21 relevant to the Court's deliberations or findings in  
22 FCWC's case.

23 Q. Mr. Larkin's answer starting on line 18, page 12 and  
24 ending on line 18, page 13 sets forth his  
25 understanding of environmental law and regulation by

1 the EPA and DEP. Is his understanding correct?  
2 Please explain.

3 A. Mr. Larkin indicates that it is his "understanding"  
4 that neither the DEP nor EPA orders companies to add  
5 large system improvements. Again, Mr. Larkin is  
6 incorrect. The agencies take an active role in  
7 regulating wastewater treatment works. The CWA gives  
8 the EPA ample authority to specify remedial action and  
9 it often does so in the form of consent orders and  
10 permit conditions. It is true the company may decide  
11 what type of equipment or what brand of equipment to  
12 put into place but the fact is the requirement is such  
13 that EPA or DEP is ordering the company through the  
14 permit and the administrative order process to install  
15 the improvements. An example is EPA Administrative  
16 Order No. 89-109 and NPDES certification worksheet  
17 ((see Exhibit 9 (MA-9) and Exhibit 9 (MA-7))  
18 which directed FCWC to construct the treatment and  
19 other facilities necessary to relocate the effluent  
20 outfall and meet specific water quality standards. In  
21 addition, EPA has a tool that may order companies to  
22 construct supplemental environmental projects in order  
23 not to be subjected to additional fines. Therefore it  
24 is not accurate to suggest that all EPA does is to  
25 determine whether the company is or is not in



1 compliance with the law.

2 The CWA is a complex law subject to multiple  
3 interpretations and to conclude, as Mr. Larkin has,  
4 that it is a simple matter of the regulatory agency  
5 finding "the utility is or is not in compliance with  
6 the requirements of the law" is an oversimplification.  
7 It is indeed true that the agencies may allege that a  
8 company is in violation of the law and penalties  
9 therefor. It is up to courts to determine indeed  
10 whether there is a violation of the law. In many  
11 cases there may be a "technical" violation of the law  
12 and the courts may find penalties as low as \$1 a day  
13 or slightly more as in the case of FCWC where many of  
14 the fines were only \$10 a day compared to the agency's  
15 ability to charge or attempt to obtain \$25,000 a day.

16 Mr. Larkin implies that the company's own  
17 engineers can work out any differences regarding  
18 compliance. FCWC pursued such course. With respect  
19 to all three wastewater facilities for which the DOJ  
20 ultimately alleged violations, the first step FCWC  
21 took was to have its engineers engage the DEP and EPA  
22 in an effort to assure that these facilities were in  
23 compliance and if not in compliance, to take the  
24 action necessary to bring them into compliance. In  
25 fact, all issues pertaining to both Barefoot Bay and

1 Carrollwood were satisfactorily resolved with both the  
2 EPA and DEP and the issues pertaining to Waterway  
3 Estates were satisfactorily resolved with the DEP,  
4 prior to the DOJ's allegations. It was not until the  
5 EPA wanted to pursue the Waterway Estates issue,  
6 notwithstanding the DEP's satisfaction with FCWC's  
7 action and the outcomes, and referred the matter to  
8 the DOJ was any appreciable legal work necessary.  
9 Furthermore, the amount of legal work necessary was  
10 increased substantially when the DOJ initiated an  
11 investigation of all of FCWC's wastewater facilities  
12 and finally amended its complaint in March 1995 to  
13 include the Carrollwood and Barefoot Bay facilities.

14 Q. Beginning at line 21, page 13 and ending at line 19,  
15 page 14, Mr. Larkin purports to explain certain  
16 aspects of the litigation and the Court's findings and  
17 the penalties imposed. Are his characterizations  
18 complete and accurate?

19 A. No. First, Mr. Larkin does not discuss the Original  
20 and Amended Complaints, the numerous motions and  
21 rulings of the Court prior to trial, the factors  
22 considered by the Court, and the penalties imposed  
23 relative to the penalties claimed by the DOJ at  
24 various stages of the proceedings leading up to the  
25 trial. Through these omissions Mr. Larkin brings into

1 focus only a few small parts of the total picture,  
2 including the following:

3 (1) In its original complaint, the DOJ was claiming  
4 penalties to \$32,375,000 later amended claiming  
5 penalties to \$104,325,000. After pre-trial rulings by  
6 the Court throwing out almost half of the alleged  
7 violations, the DOJ claimed penalties during the first  
8 day of trial to \$53,450,000. These rulings were in  
9 response to motions filed by FCWC. In its post-trial  
10 memorandum, the DOJ proposed penalties in the amount  
11 of \$4,861,500 for FCWC and a similar amount for  
12 Avatar. In its final ruling, the Court found  
13 penalties in the amount of \$309,710. To put all of  
14 these claims into perspective, the penalties imposed  
15 by the Court were less than one percent of the maximum  
16 amount claimed under the Original Complaint, less than  
17 one-half percent of the maximum amount claimed under  
18 the Amended Complaint, slightly over one-half percent  
19 of the maximum amount claimed at the beginning of the  
20 trial and 6.37% of the penalty amount suggested in the  
21 DOJ's post-trial memorandum.

22 (2) It is virtually impossible to avoid a liability  
23 determination under the Clean Water Act inasmuch as it  
24 is called a strict liability statute. Therefore,  
25 every exceedance of a CWA permit is a violation. An

1           example would be any time you are running 56 mph in a  
2           55 mph speed limit zone you are in violation of the  
3           law and should therefore be technically fined. If  
4           you're running more than 20 mph over a 55 mph speed  
5           limit, you may even be charged with reckless driving.  
6           The fact is, both policy and courts exercise a great  
7           deal of discretion. The same is true with the Clean  
8           Water Act. It was clear in this case that the Court  
9           found that even though there were technical  
10          violations, the mitigating factors set forth in the  
11          Clean Water Act (including the fact that none of the  
12          violations had resulted in environmental harm) were  
13          applied fully supported the conclusion that the  
14          penalty should be minuscule.

15        Q.    Beginning on page 15 and concluding on page 16, line  
16            4, Mr. Larkin sets forth his interpretation of the  
17            nature of the DOJ prosecution and FCWC's demand of  
18            recovery of legal costs from the government. Do you  
19            agree with Mr. Larkin's interpretation? Please  
20            explain.

21        A.    No.    First, regarding the nature of the DOJ  
22            prosecution, I firmly believe that anyone who  
23            thoroughly studies the record in this case will  
24            conclude that the prosecution was without merit. This  
25            conclusion is based on my twenty-eight years

1 experience as a practicing attorney in the area of  
2 federal environmental law. In fact, I believe the  
3 case would have been settled before the trial and  
4 before significant legal costs had been sustained by  
5 FCWC had proper supervision been afforded by a person  
6 with sufficient experience in the CWA.

7 Second, notwithstanding the Court's ruling  
8 regarding recovery of legal expenses by FCWC from the  
9 DOJ, it is appropriate to review the Court's Order  
10 (Exhibit \_\_\_\_ (GHB-101)). The "bad faith" standard is  
11 extremely confining. To prevail, it must be shown  
12 that the government undertook the litigation  
13 "vexatiously, wantonly, or for oppressive reasons."  
14 The fact that the government's action was  
15 unreasonable, without merit, or unwise is not in  
16 itself adequate to demonstrate bad faith as defined by  
17 the law. It is implicit in the Court's language in its  
18 ruling against FCWC regarding FCWC's contention that  
19 it was a "prevailing party" that the Court agreed with  
20 FCWC from a fundamental perspective but was bound by  
21 case law. The Court said, "[T]he United States  
22 contends that since a judgement was returned in its  
23 favor on its claims against the Defendant Florida  
24 Cities, [that] Florida Cities is hereby precluded from  
25 being a Sec. 2412(a) 'prevailing party'. The Court

1 agrees with Plaintiff's analysis and, grudgingly  
2 (emphasis added), with its conclusion." See page 11,  
3 Exhibit \_\_\_\_ (GHB-101). Another noteworthy conclusion  
4 of the Court can be found on pages 12 and 13 of this  
5 exhibit, "[W]hile the history and purpose of Rule 68  
6 and 28 U.S.C. Sec. 2412(a) militate strongly for an  
7 award of costs to Florida Cities, the Procrustean  
8 doctrine of sovereign immunity precludes such." It is  
9 my opinion that the relationship between the penalties  
10 sought by the DOJ and those imposed by the Court  
11 (cited above) when combined with the Court's language  
12 in its order pertaining to the recovery of costs by  
13 FCWC clearly supports the proposition that many of the  
14 DOJ's actions in this case were without merit.

15 Q. Beginning at line 3, page 10, of the prefiled  
16 testimony of Patricia W. Merchant, she states that  
17 "[A]ny allowed costs should only be recovered from the  
18 North Ft. Myers, Barefoot Bay and Carrollwood  
19 customers." Were the legal efforts, and accordingly  
20 legal expenses, associated with FCWC's defense limited  
21 to these wastewater systems?

22 A. No. Following the filing of the Original Complaint,  
23 the DOJ launched an investigation of all of FCWC's  
24 wastewater systems and considerable effort was devoted  
25 during the period beginning in early 1994 and the

1 filing of the Amended Complaint on March 30,1995 to  
2 this investigation and the discovery associated  
3 therewith. FCWC's wastewater systems are located in  
4 Collier, Lee, Brevard, Sarasota and Hillsborough  
5 Counties.

6 Q. Does this conclude your testimony?

7 A. Yes.

1           **MR. GATLIN:** And I offer the testimony of  
2 Mr. Michael Acosta to be inserted into the record.

3           **CHAIRMAN JOHNSON:** It will be so inserted.

4           **MS. GERVASI:** Staff would identify Staff's  
5 Second Request for Interrogatory No. 44 to be entered  
6 into the record.

7           **CHAIRMAN JOHNSON:** It will be marked as 20,  
8 Staff Exhibit 20, Acosta's Second Request for  
9 Interrogatories -- or Staff's Second Request for  
10 Interrogatories.

11           **MS. GERVASI:** Thank you.

12                   (Exhibit 20 marked for identification.)

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**FLORIDA CITIES WATER COMPANY**  
**RATE APPLICATION FOR RECOVERY OF LEGAL EXPENSES**  
**REBUTTAL TESTIMONY OF MICHAEL ACOSTA**  
**TO DIRECT TESTIMONY OF**  
**HUGH LARKIN, JR.**  
**DOCKET NO. 971663-WS**

Q. Please state your name.

A. Michael Acosta.

Q. Have you previously provided testimony in this Docket?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my testimony is to rebut certain aspects of the direct testimony of Hugh Larkin, Jr., appearing on behalf of the Citizens of the State of Florida.

Q. Specifically which part of Witness Larkin's testimony will you rebut?

A. I will rebut Witness Larkin's testimony regarding his assertion that the Department of Environmental Protection and United States Environmental Protection Agency only "find companies are in violation of the law and that the company itself must determine how to eliminate the violation and comply with the law."

Q. Is Witness Larkin's assertion as stated above accurate?

1 A. In this case, the assertion is not accurate.

2 Q. Please explain.

3 A. In 1986, the Waterway Estates Wastewater Treatment  
4 Plant (Waterway) was a secondary plant discharging  
5 into a canal that leads to the Caloosahatchee River  
6 with all the appropriate permits to do so. FDEP had  
7 established a wasteload allocation for the  
8 Caloosahatchee River that envisioned that all surface  
9 water discharges would ultimately meet advanced  
10 wastewater treatment (AWT) standards. It is clear  
11 from the NPDES Certification worksheet Exhibit 9  
12 MA-7 that FDEP would be seeking the upgrade of  
13 Waterway to AWT and the relocation of the outfall to  
14 the six foot contour line in the Caloosahatchee River  
15 upon the expiration of the then current operating  
16 permit DO36-72569 if Waterway was going to continue  
17 discharging to surface waters. While FDEP did not  
18 design the facility it did require reasonable  
19 assurance that the facilities as designed would meet  
20 the stated water quality limits and not result in  
21 water quality violations. In this case, FDEP was not  
22 just requiring compliance but also requiring a  
23 specific upgrade to a treatment facility in order to  
24 achieve compliance with the wasteload allocation  
25 limits.

1 Q. Does this conclude your rebuttal testimony?

2 A. Yes.

1           **MR. GATLIN:** I offer the testimony of  
2 Mr. John D. McClellan, the rebuttal testimony, to be  
3 inserted into the record as though read.

4           **CHAIRMAN JOHNSON:** It will be so inserted.

5           **MR. GATLIN:** There are no exhibits.

6           **MS. GERVASI:** Staff offers the transcript of  
7 Mr. McClellan's July 30th, 1998 deposition as an  
8 exhibit.

9           **CHAIRMAN JOHNSON:** It will be marked as  
10 Exhibit 21.

11                   (Exhibit 21 marked for identification.)

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1 FLORIDA CITIES WATER COMPANY  
2 RATE APPLICATION FOR RECOVERY OF LEGAL EXPENSES  
3 REBUTTAL TESTIMONY OF JOHN D. MCCLELLAN  
4 TO DIRECT TESTIMONY OF  
5 HUGH LARKIN, JR. AND PATRICIA W. MERCHANT  
6 DOCKET NO. 971663-WS  
7 Q. PLEASE STATE YOUR NAME AND ADDRESS.  
8 A. John D. McClellan, Deloitte & Touche LLP, 555 12<sup>th</sup>  
9 Street N.W., Washington D.C., 20004.  
10 Q. ARE YOU THE SAME JOHN D. MCCLELLAN THAT FILED  
11 DIRECT TESTIMONY IN THIS CASE?  
12 A. Yes.  
13 Q. WHAT IS THE PURPOSE OF THIS REBUTTAL TESTIMONY?  
14 A. Florida Cities Water Company ("FCWC" or the  
15 "Company") requested that I review and respond to  
16 the direct testimony filed by Mr. Hugh Larkin,  
17 Jr., who is appearing as a witness for the Florida  
18 Office of Public Counsel ("OPC").  
19 Q. HAVE YOU REVIEWED MR. LARKIN'S TESTIMONY AND ARE  
20 YOU PREPARED TO RESPOND TO THE OBSERVATIONS  
21 CONTAINED THEREIN?  
22 A. Yes.  
23 Q. PLEASE PROCEED WITH YOUR RESPONSES.  
24 A. As indicated on page two of Mr. Larkin's  
25 testimony, he is recommending that the Company

1 be denied recovery of any portion of the \$3.8  
2 million of costs incurred in defending itself  
3 against the litigation resulting from claims  
4 filed and penalties sought by the Department of  
5 Justice (DOJ). He states that his  
6 recommendation is based upon the following  
7 assumptions:

- 8 • Recovery of the costs would reflect  
9 retroactive ratemaking
- 10 • The owners and creditors of the Company  
11 were the primary beneficiaries of the  
12 significant results achieved in the  
13 defense efforts and should therefore bear  
14 the costs
- 15 • The allowance by the Commission of the  
16 recovery of these costs would result in  
17 putting ratepayers in the position of  
18 "guaranteeing...[the costs of] any and all  
19 litigation undertaken by regulated public  
20 utilities..." in Florida.

21 Each of these assumptions upon which Mr. Larkin  
22 has based his recommendation is erroneous.

23 Q. WHAT IS THE BASIC CHARACTER OF RETROACTIVE  
24 RATEMAKING?

25 A. Retroactive ratemaking generally refers to the

1 application of current rates to recover from  
2 current ratepayers (or return to current  
3 ratepayers) revenues that should have been  
4 recovered (or not recovered) in rates of prior  
5 periods to cover costs of ordinary events  
6 effects were limited to those periods. For  
7 example, if it is determined that 1997 rates did  
8 not produce an adequate level of earnings (i.e.,  
9 the cost of equity capital in 1997) and 1999  
10 rates are adjusted to recover the 1997 rate  
11 shortfall (or excess), this could give rise to  
12 a legitimate claim of retroactive ratemaking.  
13 At the same time, regulators commonly allow the  
14 recovery in current or future periods of  
15 explicitly identified non recurring or  
16 extraordinary costs incurred in prior periods.

17 Q. IS RECOVERY OF NON-RECURRING OR EXTRAORDINARY  
18 COSTS OF PRIOR PERIODS CONSIDERED TO BE  
19 RETROACTIVE RATEMAKING?

20 A. No. Regulators have long practiced the  
21 spreading of costs incurred in one period over  
22 subsequent periods and do not consider the  
23 practice to embrace retroactive ratemaking.  
24 Generally, the spreading of costs is applied  
25 either to avoid the dramatic rate impact that

1 would result if rates were adjusted to recover  
2 the costs currently or to recognize the longer  
3 term benefits of the costs (or both). This  
4 spreading of cost recovery is precisely what  
5 FCWC is seeking. Along with avoiding  
6 complications in anticipating and providing for  
7 costs that were being incurred each year that  
8 the litigation continued, delaying recovery and  
9 spreading the litigation costs over future  
10 periods avoids any dramatic rate impact and  
11 gives credence to the fact that there are  
12 ongoing benefits to avoiding the penalties  
13 sought by the DOJ. The recovery of the  
14 litigation expenses as proposed by FCWC in this  
15 proceeding does not constitute retractive  
16 ratemaking.

17 Q. MR. LARKIN OBSERVES ON PAGE THREE OF HIS TESTIMONY  
18 THAT THERE IS NO ACCOUNTING ORDER THAT PROVIDED FOR  
19 DEFERRING THE EXPENSES AS INCURRED. BASED ON THIS  
20 CONDITION, HE CONCLUDES THAT RECOVERY CANNOT BE  
21 PERMITTED. WOULD YOU RESPOND?

22 A. Extraordinary cost conditions are often recognized  
23 as the costs are being incurred and cost deferral  
24 is approved as the expenditures are made. In such  
25 instances, the future regulatory treatment of the



1 cost accumulations is reserved for determination  
2 at the next rate proceeding. In other instances  
3 the extent, impact and timing of the costs are not  
4 subject to determination, and accounting cost  
5 deferral may not be or can not be obtained in  
6 advance. In these instances, the request for  
7 deferral and recovery will not arise until a rate  
8 filing occurs. In either case, cost recovery  
9 provisions will not be determined in the absence  
10 of a rate proceeding. The advance accounting  
11 approval does not assure ultimate rate recovery.  
12 Neither does the absence of such advance approval  
13 prohibit ultimate rate recovery.

14 Q. WHAT WERE THE CONDITIONS RELATING TO COST  
15 DETERMINATION AND ULTIMATE OUTCOME THAT CONFRONTED  
16 FCWC IN THE LITIGATION PROCESS?

17 A. First, costs were incurred over a number of years.  
18 During this period FCWC did not know how long the  
19 process would continue. Second, FCWC simply did  
20 not know how much cost would be incurred in the  
21 process. There was no way to estimate these costs  
22 in advance. Finally, there was no way for FCWC to  
23 accurately predict the ultimate outcome of the  
24 litigation process.

25 Q. WHY DID FCWC NOT GO BEFORE THE COMMISSION AND

1           REQUEST, IN ADVANCE, AN ACCOUNTING ORDER?

2   A.   For the reasons stated above FCWC simply did not  
3       have sufficient data and information to go before  
4       the Commission until the litigation process was  
5       completed.

6   Q.   DOES REGULATORY APPROVAL TO DEFER THE RECORDING OF  
7       AN INCURRED COST CONCURRENTLY ESTABLISH APPROVAL  
8       OF THE RATEMAKING TREATMENT OF THAT COST?

9   A.   No.   In many instances the accounting order will  
10      explicitly state that the approval is limited to  
11      accounting measures and that the ratemaking  
12      treatment of the costs will be established in  
13      subsequent rate proceedings.       Where not  
14      explicitly stated, this condition is normally  
15      implied.   Accordingly, approval of a delay in  
16      reporting costs does not establish the subsequent  
17      ratemaking treatment.

18   Q.   DO GENERALLY ACCEPTED ACCOUNTING PRINCIPLES  
19       ("GAAP") REQUIRE THAT AN ACCOUNTING  
20       ORDER EXIST FOR A REGULATED UTILITY TO  
21       DEFER A CURRENT COST ASSUMED TO BE  
22       RECOVERABLE IN FUTURE RATES?

23   A.   No.   GAAP directives for regulated systems are  
24      expressed in Financial Accounting Standards Board  
25      Statement No. 71 : Accounting for the Effects of

1 Certain Types of Regulation ("FASB 71") issued in  
2 1982. As stated at Paragraph 9 of FASB 71, for  
3 accounting purposes a regulated utility shall  
4 capitalize (i.e., defer) an incurred cost that  
5 would otherwise be charged to expenses if both of  
6 the following criteria are met:

- 7 a. It is probable that future revenue in an  
8 amount at least equal to the capitalized  
9 cost will result from inclusion of that  
10 cost in allowable costs for rate-making  
11 purposes, and
- 12 b. Based on available evidence, the future  
13 revenue will be provided to permit  
14 recovery of the previously incurred cost  
15 rather than to provide for expected  
16 levels of similar future costs. If the  
17 revenue will be provided through an  
18 automatic rate-adjustment clause, this  
19 criterion requires that the regulator's  
20 intent clearly be to permit recovery of  
21 the previously incurred cost.

22 This provision provides that costs normally  
23 expensed under GAAP standards shall be deferred if  
24 "it is probable" (i.e., can reasonably be expected  
25 or believed on the basis of available evidence or

1           logic) that future revenues will be produced  
2           through rates provided to recover the costs.  
3           Otherwise, the costs must be expensed for  
4           financial reporting purposes. The deferral  
5           conditions address recoverability issues and  
6           accounting orders are not even mentioned.

7 Q.       DOES THE ISSUANCE OF AN ACCOUNTING ORDER BY A  
8           REGULATOR SATISFY THE GAAP REQUIREMENTS FOR COST  
9           DEFERRAL?

10 A.       No.       As observed, the issue is cost  
11           recoverability. As expressed at Paragraph 4 of  
12           the Introduction to FASB 71, accounting orders may  
13           be imposed by regulators that do not conform with  
14           GAAP. Under these conditions, the issuance of the  
15           order does not provide a basis for capitalizing  
16           and amortizing the cost. This situation will  
17           arise when an accounting order is not accompanied  
18           by cost recovery probability, and in such  
19           instances the utility is not permitted to defer  
20           the costs for financial reporting purposes.  
21           Paragraph 4 of FASB 71 includes the following  
22           language:

23                   "...a regulatory authority may order an  
24                   enterprise to capitalize and amortize a cost  
25                   that would be charged to income currently by

1           an unregulated enterprise. Unless  
2           capitalization of that cost is appropriate  
3           under this Statement, generally accepted  
4           accounting principles require the regulated  
5           enterprise to charge the cost to income  
6           currently."

7 Q.   IS AN ACCOUNTING ORDER NECESSARY FOR THE  
8       SUBSEQUENT RECOVERY OF A PRUDENTLY INCURRED PRIOR  
9       PERIOD COST?

10 A.   No.    An accounting order may be useful in  
11       supporting the conclusion that rate recovery can  
12       reasonably be expected, i.e., that it is  
13       "probable".   However, as previously observed and  
14       clearly evidenced by regulatory decisions, the  
15       existence of an accounting order does not  
16       establish prospective cost recovery, and the  
17       absence of an accounting order does not prohibit  
18       prospective cost recovery.

19 Q.   IF FCWC OBTAINS A RATEMAKING ORDER THAT PROVIDES  
20       FOR THE RECOVERY OF LITIGATION COSTS, WILL FCWC BE  
21       ABLE TO CURRENTLY RECORD THOSE COSTS INCURRED IN  
22       PRIOR YEARS?

23 A.   Yes.

24 Q.   DID THE OWNERS AND/OR CREDITORS OF THE COMPANY  
25       BENEFIT FROM THE LITIGATION EFFORTS?

1 A. Yes. Had the claimed penalties of tens of  
2 millions of dollars been applied, the owners  
3 certainly would have been adversely affected. The  
4 creditors may or may not have been.

5 Q. DID THE RATEPAYERS ALSO BENEFIT FROM THOSE  
6 EFFORTS?

7 A. Yes. As has been expressed in the Company's  
8 direct testimony, the financial pressures that  
9 would have been produced by the levels of  
10 penalties sought by the DOJ would have created  
11 severe problems. The financial impact of these  
12 problems is not quantifiable, but it follows that  
13 a financially healthy company can perform more  
14 efficiently and at less costs than can a  
15 financially crippled system. Any losses in  
16 efficiency and increases in costs that result from  
17 financial crises will necessarily impact customer  
18 rates or service, or both.

19 Q. IS THE RELATIVE DEGREE TO WHICH THE COMPANY OR ITS  
20 RATEPAYERS MAY HAVE BENEFITED A LEGITIMATE ISSUE  
21 IN DETERMINING THE PROPRIETY OF COST RECOVERY?

22 A. No. The issue is the right of recovery of costs  
23 prudently incurred in operating and maintaining  
24 the system. Under the Cost of Service standard,  
25 a regulated utility is entitled to an opportunity

1 to recover all costs prudently and legitimately  
2 incurred in providing efficient and reliable  
3 service, and in maintaining a financially healthy  
4 system. There does not appear to be any  
5 reasonable challenge to the position that had the  
6 Company not mounted a defense against the DOJ  
7 claims that (1) the financial consequences would  
8 have been extremely serious, (2) a financially  
9 healthy system would not have emerged and (3)  
10 rates and/or services could have been negatively  
11 impacted. Accordingly, it is appropriate to  
12 conclude that the litigation costs were  
13 necessarily and prudently incurred. Consequently,  
14 it is appropriate that cost recovery be permitted.

15 Q. IS THERE ANY MERIT TO MR. LARKIN'S CLAIM THAT THE  
16 COMMISSION'S ALLOWING THE COMPANY TO RECOVER THESE  
17 COSTS WILL PROVIDE A "GUARANTEE" THAT FLORIDA  
18 UTILITIES WILL RECOVER "ANY AND ALL LITIGATION"  
19 COSTS IN THE FUTURE?

20 A. No. There simply is no basis for such a claim.

21 Q. AT PAGE 4, MR. LARKIN OBSERVES THAT RATEPAYERS ARE  
22 NOT GENERALLY RESPONSIBLE FOR FINES, PENALTIES OR  
23 COSTS RELATED THERETO. HAS THE COMPANY REQUEST  
24 ELIMINATED BOTH THE PENALTY AND THE RELATED  
25 LITIGATION COSTS?

1 A. Yes. As has been observed elsewhere, the Company  
2 is not requesting recovery of the penalty imposed  
3 by the decision of the court and is not requesting  
4 the full amount of litigation costs incurred. The  
5 request for recovery of litigation costs is at a  
6 level that relieves ratepayers of the portion of  
7 the costs that may be associated with the penalty.  
8 In the request, the litigation costs have been  
9 reduced by the ratio of the \$5 million penalty  
10 that would have been absorbed, had a settlement  
11 been made, to the \$309,000 penalty imposed by the  
12 court. The result is consistent with the position  
13 advocated by Mr. Larkin

14 Q. BEGINNING AT PAGE 7, LINE 18, MR. LARKIN DISCUSSES  
15 TWO CASES ADDRESSING LEGAL FEES. WOULD YOU  
16 COMMENT ON THE DECISIONS RENDERED IN THESE CASES?

17 A. Yes. In the first instance it is noted that the  
18 OPC had taken the position that legal expenses  
19 "...should be reduced by the amount allocated for  
20 defense of fines." (Larkin testimony page 8, line  
21 6) The Commission concluded that it would be  
22 appropriate to allow recovery of legal expenses  
23 relating to permitting and compliance and  
24 "Accordingly, no adjustment to legal expenses has  
25 been made." (Larkin testimony page 8, line 18)



1 This clearly shows that the OPC position relating  
2 to the disallowance of legal expenses  
3 "...allocated for defense of DER and Environmental  
4 Protection Agency (EPA) fines" was rejected.  
5 That decision fully supports the allowance of the  
6 litigation costs in this proceeding.

7 In the second case referenced (Larkin  
8 testimony page 9, line 11), the Commission again  
9 issued a decision that supports the Company  
10 request in this case. Specifically, the  
11 Commission concluded that although the fines  
12 imposed due to violations of DEP and EPA  
13 requirements should be borne by the shareholders,  
14 that it was "...reasonable for UWF to recover the  
15 costs of defending such fines." Mr. Larkin then  
16 rejects the Commission's adopted principle on the  
17 grounds that the amounts were insignificant. It  
18 is of note that the finding addressed the  
19 principle. It did not in any way condition the  
20 recognition of legal fees on the significance of  
21 the fees in question.

22 Q. IN THE ANSWER AT PAGE 15, LINE 2, MR. LARKIN  
23 OBSERVES THAT THE COMPANY PERCEIVES THE DOJ CLAIMS  
24 TO HAVE BEEN UNREASONABLE, RESULTING IN  
25 SIGNIFICANT LEGAL FEES, AND THAT THERE IS NO BASIS

1 ON WHICH THE COMMISSION MAY CONCUR WITH THIS  
2 COMPANY VIEW. WOULD YOU COMMENT?

3 A. I disagree. The DOJ was seeking damages exceeding  
4 \$100,000,000. Ultimately, the court established  
5 damages at less than \$310, 000, or about 0.3% of  
6 the penalty sought by the DOJ. Even if compared  
7 to the DOJ's early settlement offer of \$5.0  
8 million, the court imposed only about 6.0% of the  
9 DOJ amount. This appears to fully support the  
10 perception that the DOJ action was unreasonable.

11 Q. MR. LARKIN FURTHER OBSERVES AT THAT POINT THAT THE  
12 COMMISSION IS PUT IN THE POSITION OF JUDGING THE  
13 QUALITY AND MOTIVE OF THE DOJ AND THAT SUCH IS NOT  
14 THE COMMISSION'S ROLE. WOULD YOU COMMENT?

15 A. I agree that such judgement is not a  
16 responsibility of the Commission and would observe  
17 that no such judgement is needed. The court has  
18 already judged both the quality and the motive of  
19 the DOJ. It is abundantly clear that the court's  
20 decision imposing a \$300,000 fine in a case  
21 claiming \$100 million of amounts due from the  
22 Company has already judged the quality of the DOJ  
23 position as being grossly excessive. The Court  
24 clearly indicated its opinion as to DOJ's motive  
25 by saying, "[T]he United States contends that

1 since a judgement was returned in its favor on its  
2 claims against the Defendant Florida Cities,  
3 [that] Florida Cities is hereby precluded from  
4 being a Sec. 2412(a) 'prevailing party'. The  
5 Court agrees with Plaintiff's analysis and,  
6 grudgingly (emphasis added), with its conclusion."  
7 See page 11, Exhibit 6 (GHB-101).

8 Q. IN RESPONSE TO A QUESTION AT PAGE 16, LINE 23, MR.  
9 LARKIN OBSERVES THAT HE DOES NOT BELIEVE THAT  
10 BANKRUPTCY WOULD HAVE AFFECTED THE SERVICE TO  
11 RATEPAYERS. WOULD YOU COMMENT?

12 A. Mr. Larkin's view of the impact of bankruptcy is  
13 quite interesting. He argues that service would  
14 not be affected and then observes that FCWC would  
15 have emerged from the bankruptcy with debts  
16 discharged and stockholder interests extinguished.  
17 He concludes with the observation that under these  
18 conditions that "...utility rates might have seen  
19 a significant lessening." From these comments,  
20 it could be rationally concluded that the  
21 bankruptcy actually would have been the best of  
22 all worlds for the ratepayers.

23 I have a problem with this conclusion. To  
24 me, it stretches the credulity of finance and  
25 economic theory to conclude that a utility that

1 goes through a bankruptcy proceeding will be able  
2 to maintain the same quality of service, and at  
3 lower rate levels, than was maintained by the  
4 utility operating from a healthy financial  
5 position. I am convinced that such conditions  
6 would result in undesirable consequences to  
7 ratepayers.

8 Q. IS BANKRUPTCY, OR THE POTENTIAL THEREOF, THE REAL  
9 ISSUE IN THIS PROCEEDING?

10 A. No. The issue is the ability to recover  
11 reasonable costs that were prudently incurred in  
12 defending against the proposed imposition of large  
13 penalties by the DOJ; penalties that subsequently  
14 were found by the court to be inappropriate.

15 Q. EVEN IF SERVICE LEVELS AND RATES WOULD NOT HAVE  
16 BEEN ADVERSELY AFFECTED BY A LARGE PENALTY, IS  
17 THAT JUSTIFICATION FOR DENYING RECOVERY OF THE  
18 COSTS INCURRED IN AVOIDING THE PENALTY?

19 A. No. As has been observed, the Company surely has  
20 a right, if not an obligation, to defend itself  
21 against claims that appear to be unwarranted or  
22 excessive. In doing so costs will be incurred,  
23 and to the extent that such costs are reasonable  
24 and the Company actions are prudent, the costs  
25 should be recoverable in the application of cost

1 of service ratemaking principles.

2 Q. AT PAGE 23 MR. LARKIN RECOMMENDS DISALLOWANCE OF  
3 A RETURN TO MEASURE THE IMPACT OF DELAYED RECOVERY  
4 OF THE LITIGATION COSTS. WOULD YOU COMMENT?

5 A. Yes. Mr. Larkin has avidly argued against  
6 recovery of the costs in any form or manner. At  
7 this point, he appears to be building a fall-back  
8 position that will gain a partial victory in the  
9 event that cost recovery is found to be  
10 appropriate. As I have stated, both in my direct  
11 testimony and in this rebuttal testimony, I  
12 believe that accepted cost recovery principles  
13 fully support the recovery of these costs. If  
14 these costs have been legitimately incurred in  
15 maintaining the system (and no one has challenged  
16 that), cost recovery opportunity clearly should be  
17 provided. Since a part of the total cost of  
18 litigation is the cost of recovery delay, the  
19 costs associated with the delay should also be  
20 recovered.

21 To spread recovery out over a ten year period  
22 results in adding time value costs to the amounts  
23 initially expended. Accordingly, assuming that  
24 cost recovery is found to be appropriate, the rate  
25 base inclusion is unavoidable if full cost

1 recovery is to be made possible.

2 Q. DOES THAT COMPLETE YOUR REBUTTAL TESTIMONY?

3 A. Yes.

1           **MR. GATLIN:** I offer the testimony, the  
2 rebuttal testimony, of Mr. Michael E. Murphy to be  
3 inserted into the record as though read.

4           **CHAIRMAN JOHNSON:** It will be so inserted.

5           **MS. GERVASI:** And Staff would offer  
6 Responses to Staff's Second Request for Production of  
7 Documents No. 9 and Second Request for Interrogatories  
8 No. 40 and 47.

9           **CHAIRMAN JOHNSON:** It will be so marked and,  
10 it's Exhibit 22.

11                   (Exhibit 22 marked for identification.)

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1                                   **FLORIDA CITIES WATER COMPANY**  
2                                   **FT. MYERS & BAREFOOT BAY DIVISIONS**  
3                                   **WATER AND WASTEWATER OPERATIONS**  
4                                   **REBUTTAL TESTIMONY OF MICHAEL E. MURPHY**  
5   **TO**  
6   **DIRECT TESTIMONY**  
7   **OF**  
8                                   **HUGH LARKIN, JR. AND PATRICIA MERCHANT**  
9   **DOCKET NO. 971663-WS**

10       Q.    Please state your name.

11       A.    Michael E. Murphy, 4837 Swift Rd., Ste. 100, Sarasota,  
12                FL 34231.

13       Q.    What is your position with Florida Cities Water  
14                Company (FCWC)?

15       A.    I am Vice President and Chief Financial Officer.

16       Q.    Have you offered direct testimony in this proceeding  
17                on behalf of FCWC?

18       A.    Yes.

19       **TESTIMONY OF HUGH LARKIN:**

20       Q.    On page 22, line 22, of the direct testimony of Mr.  
21                Hugh Larkin Jr., he brings up a point concerning legal  
22                fees incurred for the defense of some of FCWC's  
23                employees. Did you present exhibit MM-2, Legal  
24                Expense Schedule, which is a complete listing of legal  
25                expenses and costs for which FCWC is seeking to



1 recover in this case?

2 A. Yes I did.

3 Q. Did you exclude any and all legal expenses incurred  
4 for personal legal counsel for FCWC's employees in  
5 exhibit MM-2?

6 A. Yes. To the best of my knowledge, there are no legal  
7 expenses incurred for personal legal counsel for any  
8 FCWC employee included in MM-2.

9 **TESTIMONY OF PATRICIA MERCHANT:**

10 Q. On page 5, line 24, of the direct testimony of Ms.  
11 Patricia Merchant, she brings up a point concerning  
12 whether the penalties and legal fees caused severe  
13 financial damage to FCWC, would you please respond to  
14 her point?

15 A. In my prefiled direct testimony (beginning on page 4,  
16 line 6) I pointed out that over \$100 million in  
17 penalties requested by the DOJ were of such magnitude  
18 as to constitute a possible financial calamity to  
19 FCWC. I never indicated that FCWC would be placed in  
20 financial calamity because of the legal expenses  
21 incurred by FCWC or penalty imposed by the Court.

22 Q. Has there been any financial harm to FCWC caused by  
23 the legal expenses incurred by FCWC or penalty imposed  
24 by the Court?

25 A. Financial harm is rather strong language. Certainly

1 the Company would be better off financially if it had  
2 not incurred over \$4.0 million in legal expenses and  
3 penalties in connection with this litigation.  
4 Obviously the Company has less cash to pay operating  
5 and capital outlays and the Company has reduced equity  
6 and reduced financial ratios which are important when  
7 it comes time to borrow additional funds from outside  
8 sources.

9 Q. On page 6, line 6 Ms. Merchant indicates these costs  
10 were incurred because of violations at specific  
11 wastewater divisions. Is this correct?

12 A. No. Legal expenses were incurred for all FCWC  
13 wastewater divisions. As indicated in Mr. Allen's  
14 prefiled direct testimony (beginning on page 40, line  
15 12), the DOJ was conducting discovery at all FCWC  
16 wastewater divisions until the Amended Complaint was  
17 filed in March 1995.

18 Q. On page 10, line 3 Ms. Merchant indicates that allowed  
19 costs should only be recovered from North Ft. Myers,  
20 Barefoot Bay and Carrollwood wastewater customers.  
21 How would this effect the Company's current proposal  
22 of collecting \$.42 per water and wastewater customer  
23 per month?

24 A. That amount of \$.42 per month would need to be  
25 increased to \$3.44 per month for wastewater customers

1 in the North Ft. Myers, Barefoot Bay and Carrollwood  
2 divisions only. If somehow the Commission determined  
3 that an appropriate allocation method might be a ratio  
4 of the amount of penalty incurred by division, then  
5 North Ft. Myers wastewater customers would be charged  
6 \$9.11 per month. Barefoot Bay and Carrollwood  
7 wastewater customers would be charged \$.57 and \$2.49  
8 per month, respectively. All of these options assume  
9 a recovery period of 10 years.

10 Q. Does this conclude your testimony?

11 A. Yes.

1           **MR. GATLIN:** I believe that's all we have,  
2 Madam Chairman.

3           **CHAIRMAN JOHNSON:** Is that it, Staff, for  
4 you?

5           **MS. GERVASI:** Yes, ma'am.

6           **CHAIRMAN JOHNSON:** Public Counsel?

7           **MR. McLEAN:** Nothing further, Commissioner.

8           **CHAIRMAN JOHNSON:** Show all of those  
9 exhibits admitted, then, without objection.

10          **MS. GERVASI:** Thank you.

11          **MR. GATLIN:** Thank you.

12          (Exhibits 1-22 received in evidence.)

13          **CHAIRMAN JOHNSON:** Any other matters?

14          **MS. GERVASI:** The only other thing,  
15 Commissioner, if I may, just as a reminder, announce  
16 when briefs are due. And they are due on September  
17 the 14th, with Staff recommendation going to the  
18 Commission's regular Agenda Conference on  
19 November the 3rd.

20          **CHAIRMAN JOHNSON:** Any other questions,  
21 Commissioners, or parties?

22          Seeing none, is that it?

23          **MS. GERVASI:** Yes, ma'am.

24          **CHAIRMAN JOHNSON:** Okay. This hearing is  
25 adjourned.

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**MS. GERVASI:** Thank you.

**CHAIRMAN JOHNSON:** Thank you.

**MR. McLEAN:** Thank you, Commissioners.

(Thereupon, the hearing concluded at  
11:00 a.m.)

- - - - -


1 STATE OF FLORIDA)  
2 : CERTIFICATE OF REPORTER  
3 COUNTY OF LEON )

4 I, H. RUTHE POTAMI, CSR, RPR Official  
5 Commission Reporter,

6 DO HEREBY CERTIFY that the Hearing in Docket  
7 No. 971663-WS was heard by the Florida Public Service  
8 Commission at the time and place herein stated; it is  
9 further

10 CERTIFIED that I stenographically reported  
11 the said proceedings; that the same has been  
12 transcribed under my direct supervision; and that this  
13 transcript, consisting of 376 pages, Volumes 1 and 2  
14 constitutes a true transcription of my notes of said  
15 proceedings and the insertion of the prescribed  
16 prefiled testimony of the witness.

17 DATED this 14th day of August, 1998.

18   
19 \_\_\_\_\_  
20 H. RUTHE POTAMI, CSR, RPR  
21 Official Commission Reporter  
22 (904) 413-6732  
23  
24  
25