RUDEN
McCLOSKY
SMITH
SCHUSTER &
RUSSELL, P.A.
ATTORNEYS AT LAW

215 SOUTH MONROE STREET
SUITE 815
TALLAHASSEE, FLORIDA 32301

TELEPHONE: (850) 681-9027
FAX: (850) 224-2032

E-MAIL: KGC@RUDEN.COM

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September 14, 1998

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Blanca S. Bayo, Director
Division of Records & Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

HAND DELIVERY

Re: Docket No. 971663-WS
Petition of FLORIDA CITIES WATER COMPANY, seeking recovery of environmental litigation costs in a limited proceeding for its NORTH and SOUTH FT. MYERS DIVISION in Lee County and BAREFOOT BAY DIVISION in Brevard County, Florida

Dear Ms. Bayo:

Enclosed, for filing in the above docket, are an original and fifteen (15) copies of Florida Cities Water Company's Post-Hearing Statement of Issues and Positions and Brief.

Please acknowledge receipt of the foregoing by stamping the enclosed extra copy of this letter and returning same to my attention. Thank you for your assistance.

Sincerely,

Kathryn G.W. Cowdery

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APP
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FPSC-RECORDS/REPORTING

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition of FLORIDA CITIES WATER COMPANY, seeking recovery of environmental litigation costs in a limited proceeding for its NORTH and SOUTH FT. MYERS DIVISION in Lee County and BAREFOOT BAY DIVISION in Brevard County, Florida	Docket No. 971663-WS

POST-HEARING STATEMENT OF ISSUES AND POSITIONS AND BRIEF OF FLORIDA CITIES WATER COMPANY

B. Kenneth Gatlin
Kathryn G.W. Cowdery
Ruden, McClosky, Smith,
Schuster & Russell, P.A.
215 S. Monroe St., Suite 815
Tallahassee, FL 32301
(850) 681-9027

Attorneys for Florida Cities Water Company

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STATEMENT OF FACTS

Florida Cities Water Company (FCWC) is seeking approval to recover a portion of legal expenses it incurred in its successful defense of legal action brought by the United States relating to alleged violations of the Clean Water Act (CWA) plus rate case expenses. Recovery is sought through a monthly customer surcharge applicable to FCWC's water and wastewater customers in South Fort Myers, North Fort Myers (Lee County) and Barefoot Bay (Brevard County). FCWC proposes that it be allowed to collect the surcharge for a period of ten (10) years or until such time as the expenses have been fully recovered, whichever occurs first. FCWC recognizes that the Commission does not have jurisdiction over FCWC's rates in Collier, Hillsborough and Sarasota counties and upon approval of a surcharge in this proceeding, FCWC will seek approval by those counties of a surcharge to be applicable to customers in those counties.

The United States Department of Justice (DOJ), on behalf of the United States Environmental Protection Agency (EPA), filed a complaint in the United States District Court, Middle District of Florida, on October 1, 1993, alleging that FCWC had violated the CWA at its Waterway Estates Wastewater Treatment Plant (Lee County). (Exhibit 4, GSA-2) Later, an amended complaint was filed which brought the scope of the allegations pertaining to alleged

violations of the CWA to include FCWC's Barefoot Bay and Carrollwood (Hillsborough County) treatment plants. (T. 49) The original complaint alleged violations of the CWA and requested a civil penalty in the amount of $25,000 per day for each alleged violation. The total civil penalty requested was $32,375,000. (T. 50) FCWC did not have the financial resources to pay this penalty. (T. 50, 51) FCWC filed an answer to the complaint on November 2, 1994 denying the allegations. (Exhibit 4, GSA-3)

Prior to the complaint being filed, FCWC had met with EPA in an attempt to resolve the issues on April 4, and June 19, 1991 and June 9, 1992. FCWC furnished EPA the routine monthly discharge monitoring reports and additional reports and information requested by EPA. Between April 10, 1988 and October 12, 1992, FCWC furnished EPA with thirty seven (37) special reports. (T. 57, 58) However, EPA indicated in these meetings that it was limited to a maximum settlement penalty of $125,000. This clearly indicated that EPA was seeking a settlement in a much greater amount and that the only way this was possible was through EPA involving DOJ. (T. 56, 57)

FCWC had settlement discussions with DOJ prior to the filing of the original complaint on October 1, 1993. DOJ, by letter dated December 9, 1992, offered to settle the case for $5,000,000. (Exhibit 4, GSA-4) FCWC did not believe that this offer was fair

and equitable. (T. 58) FCWC proposed a counteroffer in the amount of $250,000. (T. 59) This offer was rejected and FCWC made an additional counteroffer in January of 1993 in the amount of $500,000. (T. 59) DOJ did not accept the counteroffer. The DOJ trial attorney stated, "the government could get at least a million dollars by just showing up in court in this matter." (T. 60)

DOJ filed an amended complaint on March 30, 1995. (Exhibit 4, GSA-7) This complaint alleged additional violations at Waterway Estates and added violations for Barefoot and Carrollwood. (T. 62)

The amended complaint requested a civil penalty in the amount of $104,325,000. (T. 63) FCWC did not have the financial resources to pay this penalty. (T. 63)

On November 22, 1995, the United States District Court ruled on the various summary judgment motions that each party had filed. As a result of FCWC's motion, the Court virtually eliminated DOJ's case against Barefoot and Carrollwood and eliminated over $50,000,000 in potential penalties (T. 141, Exhibit 6, GHB-61).

The trial in the federal court was held in the period of time from March 25 to April 5, 1996 and lasted eight days.

In its order (Exhibit 4, GSA-24) the Court found that any "potential risk of harm" to the environment had not been quantified by DOJ. DOJ had stipulated in its pretrial discovery responses that it had no evidence showing violations of the CWA resulted in

any environmental harm. (T. 76-77)

With respect to Barefoot, the Court found that the TRC and BOD violations were not serious and that the toxicity test violations were somewhat serious. (T. 77)

With respect to Carrollwood, the Court found that none of the violations were serious. (T. 77)

With respect to Waterway Estates, the Court found that most of the violations were not serious. Furthermore, the Court found that the discharges to an unpermitted location violations were somewhat mitigated by the fact that the canal was a previously approved discharge location. (T. 77)

The court entered its judgment against FCWC in the amount of $309,710 in civil penalties. (T. 78) This compares to the $104,000,000 in civil penalties requested by DOJ and the $5,000,000 settlement offer by DOJ. Thus, by defending itself in this litigation, FCWC was able to reduce the proposed penalties.

At the Commission hearing in this proceeding, FCWC presented Mr. Gerald S. Allen, President of Florida Cities Water Company, to explain the purpose of FCWC's application in this docket, describe the legal action brought against FCWC by DOJ and, the history of events leading to the litigation, efforts to settle the litigation and a discussion of the final outcome of the litigation.

Mr. Michael Acosta, Vice President Engineering and Operations

of FCWC, provided testimony pertaining to the permitting issues related to the Waterway Estates Wastewater Treatment Plant and the relocation of the effluent outfall line.

Mr. Gary H. Baise, who was the lead counsel for Florida Cities in the litigation, testified as to the legal issues in the proceeding, settlement discussion and offers, and the outcome of the litigation.

Mr. John D. McClellan, Regulatory Consultant, Deloitte and Touche LLP, testified as to the prudence of FCWC's defense against the complaint from a financial perspective and the regulatory principles applicable to FCWC's request for rate relief.

Mr. Michael Murphy, Vice President and Chief Financial Officer, FCWC, testified as to the litigation expenses and the surcharge proposed by FCWC to collect the expenses.

Mr. L. Gray Geddie Jr., Esquire, Ogletree, Deakins, Nash, Smoak & Stewart, P.C., testified as to the reasonableness of the defense by FCWC's attorneys and the reasonableness of the fees and charges associated with the defense.

Dr. Abdul D. Ahmadi, Program Administrator of Water Facilities for the Florida Department of Environmental Protection, testified regarding the history of permits pertaining to the FCWC Waterway Treatment Plant.

ISSUE 1: Does the proposed recovery by FCWC of the litigation

expenses constitute retroactive ratemaking?

FCWC Position: *No.*

FCWC's proposal to recover the litigation expenses through a surcharge does not constitute retroactive ratemaking.

The Florida Supreme Court, the First District Court of Appeal and the Commission agree on the following definition of retroactive ratemaking: Retroactive ratemaking only occurs when new rates are applied to prior consumption. The Commission has further explained that retroactive ratemaking results when a utility attempts to recover past losses from current and future customers.

FCWC's proposed surcharge is not based on prior consumption. Neither is a surcharge an attempt to recover past losses. Accordingly, the surcharge does not reflect retroactive ratemaking.

The Florida Supreme Court has based its rulings regarding retroactive ratemaking upon applicable statutory language.

In City of Miami v. Florida Public Service Commission, 208 So.2d 249 (Fla. 1968), the Florida Supreme Court looked to §§ 364.14 and 366.06(2), Fla. Stat., in reviewing Commission rate orders for a telephone company and an electric company, and in addressing retroactive ratemaking. The Court found that the statutes precluded "a retroactive order by the Commission which would make rate reductions effective before the dates of the PSC Orders requiring the refund." Id. at 259-260. The statutory

language supporting this determination is that the commissioners shall determine just and reasonable rates "to be thereafter observed and in force" (Section 364.14, Fla. Stat.) and that it shall determine just and reasonable rates "to be thereafter charged for such service" "in the future" (Sections 366.06(3) and 366.07, Fla. Stat.). Id. The Court cited as support for its decision, Public Utilities Commission of Ohio v. United Fuel Gas. Co., 317 U.S. 456 (1942), "presenting the same question and involving an Ohio statute having basically the same language as the Florida Statutes." Id. at 260.

The majority of the Florida court cases decided after City of Miami v. Florida Public Service Commission which address the issue of retroactive ratemaking are telephone and electric utility cases relying upon the statute-based reasoning of City of Miami.

In Citizens v. Public Service Comm'n, 448 So.2d 1024 (Fla. 1984), the Court agreed with the Commission's conclusion that application of an amended cost recovery factor rule was not retroactive ratemaking because "retroactive ratemaking only occurs when new rates are applied to prior consumption. *See Gulf Power Co. v. Cresse,* 410 So.2d 492 (Fla. 1982)." (Emphasis added). Citizens v. PSC at 1027.

Likewise, FCWC's request for a surcharge to recover litigation costs is not retroactive ratemaking because the surcharge would not

be applied to prior consumption nor to recover losses produced by prior consumption. In a rate case filed by Southern States Utilities, Inc., the PSC's final order concluded that the utility could not impose a surcharge on customers who had paid less under a prior uniform rate structure than under the new rate structure. In support fo its decision, the PSC cited the Supreme Court rulings in Gulf Power Co. v. Cresse, supra, and Citizens v. PSC, 448 So.2d 1024 (Fla. 1984), (retroactive ratemaking occurs when new rates are applied to prior consumption). In Re: Application for rate increase. . . Southern States Utilities etc., 95 F.P.S.C. 10:371, 375.

The utility appealed, and the Court reversed, holding that the surcharge requested by SSU was not retroactive ratemaking, relying upon the reasoning of the Florida Supreme Court in GTE Florida Inc. v. Clark, 668 So.2d 971, 973 (Fla. 1996). Southern States Utilities, Inc. v. FPSC, 704 So.2d 555 (Fla. 1st DCA 1997). In reversing the Commission's order, the Court rejected the Commission's reasoning that the surcharge was a new rate applied to prior consumption. Neither can FCWC's requested surcharge be considered a new rate applied to prior consumption.

The Commission has observed that retroactive ratemaking "results when a utility attempts to recover past losses from current and future customers."(Emphasis supplied). In Re:

Application for rate increase . . . by SSU etc., 96 F.P.S.C. 10:386, 456. In that same order, the Commission also stated that "we will not make an adjustment to bring the utility's earnings for any historic periods to a level that would be equivalent to its authorized rate of return. Any such adjustment would violate the prohibition against retroactive ratemaking." Id. at para. 23. Likewise, in In Re: Application for a rate increase in Duval County by Ortega Utility Company, 95 F.P.S.C. 11:246, Docket 940847, Order No. 95-1376-FOF-WS, issued Nov. 6, 1995, the Commission disallowed the utility's request to adjust rate base to recover cumulative losses traced to unrecovered depreciation. The Commission reasoned that such an adjustment to rate base for past losses would mean increased rates "would apply to prior consumption, thus retroactively raising rates." Id. at 95 F.P.S.C. 11:258. Notwithstanding the foregoing assertion, the PSC did allow Ortega recovery of certain costs for past years, on the basis that:

> These adjustments differ from the $239,377 reversal of "uncompensated" depreciation proposed by the utility. That adjustment would eliminate all wastewater depreciation charges from 1988 until June of 1994 because income was presumably deficient. Our adjustment covers a different period, from January 1987 until June 1989, when the rates approved in Docket No. 871262-WS had not yet been implemented. Our adjustment covers depreciation expenses that were approved but were designed to be recovered on a prospective basis; the utility's proposed adjustment addresses a failure to achieve sufficient income which the utility believes can be attributed to depreciation in general.

Id. at 95 F.P.S.C. 11:259. The Commission in Ortega apparently did not consider its adjustment for prior depreciation expenses to be retroactive ratemaking because it did not involve an adjustment for failure to achieve sufficient income. FCWC in requesting recovery of its litigation expense is likewise not requesting an adjustment for failure to achieve sufficient income, but is requesting recovery of prudently incurred, necessary, allowable expenses, unrelated to consumption and unrelated to revenue losses.

The surcharge to recover litigation expenses is not retroactive ratemaking

FCWC's requested surcharge is not retroactive ratemaking because the surcharge would not be applied to prior consumption, which the Courts have held is the only circumstance when retroactive ratemaking occurs. Neither is the requested surcharge designed to recover past losses, that is, it is not an adjustment to bring FCWC's earnings for an historical period to a level that would be equivalent to its authorized rate of return. The recovery of past losses or adjustments to recover past earnings relate to revenues from past consumption. The surcharge to recover litigation expenses has no relationship to revenues related to past consumption and would not result in retroactive ratemaking. (T. 250-252)

FCWC's litigation expense was a prudent and reasonable cost of

providing service. See Issue 3 herein. Because of this, the costs should be recoverable pursuant to cost of service ratemaking principles. (T. 249-252, 367-368, Exhibit 13, pp. 26, 44-45)

The Commission has cited the statutory language of Sec. 367.081(2)(a) "for further guidance" that appellate rate case expenses should be recovered by a utility. In re: Application for a rate increase in Marion County by Sunshine Utilities of Central Florida, Inc., 94 F.P.S.C. 6:227. In that case, the Commission ruled that all rate case expense by definition is an out of test year, non-recurring, extraordinary expense that is substantiated through documentation filed after the conduct of the hearing.

This same reasoning applies in the instant case, where the litigation expense could not be contained within a test year, and is a non-recurring, extraordinary expense.

The FPSC allows recovery of legal expenses incurred for defending against fines from DEP and EPA

Commission policy has consistently been that legal expenses incurred for defending fines from DEP and EPA are allowable expenses. The Commission has concluded that legal expenses of this nature are recoverable because defending fines from DEP and EPA may facilitate avoided or a reduced amount of fines, or eliminate or postpone large capital improvements to systems. E.g. In re: Application for Rate Increase in Duval, Nassau, and St. Johns

Counties by United Water of Florida, Inc., Docket No. 960451-WS, 97 F.P.S.C. 5:641, 686; In re: Application for a rate increase in Lee County by Lehigh Utilities, Inc., 93 F.P.S.C. 2:775, 795 (Commission allowed recovery of legal expenses for defense of DER and EPA fines, which included negotiations to reduce fines, or eliminate or postpone large improvements to systems). FCWC's defense of the complaint reduced DOJ's proposed civil penalty of $104,000,000 to the actual court ordered penalty of $309,700. Commission policy is to allow legal expenses for such mitigation of penalties.

Recovery of extraordinary, non-recurring litigation expenses, outside of any test-year period

Utilities are not strictly limited by the Commission to recovering litigation defense expenses falling within a one year test year as part of a full rate proceeding. The Commission has allowed recovery of out of test year litigation expenses on the basis that these litigation expenses are extraordinary, non-recurring expenses.

For example, the Commission allowed Florida Power Corporation to recover its legal expenses incurred in connection with antitrust litigation, normalized over a four-year period, where such expenses were incurred during the period 1970-1973 "and were nonrecurring extraordinary expenses." In re: Petition of Florida Power

Corporation etc., Docket No. 74061-EU, Order No. 6094. See also In re: Application for a rate increase in Marion County by Sunshine Utilities of Central Florida, Inc., 94 F.P.S.C. 6:227, supra, (where the Commission allowed a portion of appellate rate case expense, recognizing it as out of test year, nonrecurring, extraordinary expense), and In re: Application of Southern Gulf Utilities, for an increase in rates and charges etc., Order No. 5044, Docket No. 70214-W, issued February 4, 1971 ($15,000 of litigation expense was amortized over fifteen years).

The reasoning in Central Illinois Public Service Co. v. Fed. Energy Reg. Comm'n., 941 F.2d 622 (7th Cir. 1990), is applicable to the instant case. In Central Illinois, the electric utility, CIPS, was involved in litigation lasting seven years, which settled. The FERC held that CIPS' disposition of settlement proceeds was unreasonable, and that litigation expenses should not have been deducted from settlement proceeds distributed to the ratepayers. The Commission held that CIPS should have either sought recovery of its litigation expenses in its base rates or have sought Commission approval for an alternative disposition of the settlement proceeds when they were received, and denied CIPS' recovery of the litigation expenses. The Court reversed, stating that "CIPS merely sought to recoup the expenses it reasonably incurred in the prosecution of the seven-year litigation." Id. at 630.

Just as litigation expenses were approved by the Commission in the Florida Power Corporation, GTE Florida, and Sunshine Utilities cases cited above, and were not found to be retroactive ratemaking, FCWC's requested surcharge should be approved.

Recovery of other prior period expenses

Besides allowing recovery of litigation expenses incurred over a prior period of years, the Commission allows recovery of prior period expenses allocated over future periods, for other extraordinary, non-recurring expenses. Generally, the basis for such delayed recovery goes to characteristics of the costs which inhibit their recovery as incurred. E.g. In re: Application for rate increase by Central Telephone Company of Florida, Docket Nos. 910980-TL, 910027-TL, 910529-TL, 92 F.P.S.C. 7:548, 592-593. Compare Richter v. Florida Power Corporation, 366 So.2d 798 (Fla. 2nd DCA 1979), recognizing the principle of retroactive ratemaking but holding it inapplicable, stating that the PSC may alter a final decision under extraordinary circumstances; and Florida Power & Light Company v. Belcher Oil Company, 82 F.R.D. 78 (S.D. Fla. 1979), where the Court rejected the claim that the FPSC did not have jurisdiction because it has no authority to make retroactive ratemaking orders, relying on the holding in Richter "that under certain circumstances, the Public Service Commission could alter its already set rates in extraordinary circumstances." Likewise,

the Commission orders refunds regarding prior authorized collections unrelated to consumption. E. g. Gulf Power Company v. Florida Public Service Comm'n., 487 So.2d 1037 (Fla. 1986) (PSC order requiring power company to refund $2,200,000 in adjustments for 1980, 1981, and 1982 because of managerial imprudence in renewing contract in 1984 and subsequently failing to terminate its contract, resulting in high fuel expenses, was not retroactive ratemaking).

In most, if not all, of the cases in which delayed cost recovery has been allowed by the Commission, the expense of a prior period has been recovered in subsequent periods, and the Commission has not found such recovery to be retroactive ratemaking. The delayed cost recovery provides recovery that is not otherwise attainable due to a variety of reasons. Most often, the rationale supporting delayed recovery relates to a combination of events, e.g., an inability to determine on a timely basis the level of costs to be recovered, and the unacceptable impact on rates if recovered as incurred.

Courts in other jurisdictions recognize that extraordinary and non-recurring one time costs are recoverable and do not constitute retroactive ratemaking. In Popowsky v. Pennsylvania Public Utility Comm'n., 643 A.2d 1146 (Pa. Commw. Ct. 1994), the Court held that a rate increase in order to recover transitional expenses incurred

in switching from cash to accrual accounting was not retroactive ratemaking, but extraordinary, one-time event, and the water company had not had the opportunity to seek recovery of the expenses until the accrued accounting of such obligations was approved.

See also Philadelphia Electric Company v. Penn. Public Utility Comm'n., 502 A.2d 722, 728 (recognizing exception to general rule of retroactive recovery of unanticipated expenses has been recognized where the expenses are extraordinary and nonrecurring, e.g., storm damage cases); and MCI Telecommunications Corp. v. Public Service Comm'n. of Utah, 840 P.2d 765, 771-772 (Utah 1992) (recognizing as exception to rule against retroactive ratemaking for unforeseeable and extraordinary increases or decreases in expenses, and differentiating them from inaccurate estimates in the rate-making process).

As evidenced by the record in this case, the litigation expense incurred by FCWC was incurred over a number of years. During that period, there was no way to determine how long the process would continue nor to what extent the costs would accumulate. (T. 356-365) Under these conditions, sufficient data was not available to seek and support rate recovery of the costs at the time incurred. (T. 356-357) Based upon past Commission practice and policy, if such recovery had been sought, the nature

and magnitude of the costs would have likely resulted in the costs being viewed as extraordinary and the recovery spread over a number of years (and likely still be in the process of recovery).

The record clearly supports that the litigation expense incurred by FCWC for which recovery is sought was an extraordinary, nonrecurring event which did not arise from company mismanagement or "imperfect forecasts in the ratemaking process." Rather, FCWC acted in the best interests of the company and the ratepayer's in defending this litigation. See Issue 3 herein.

In summary, regulators have long practiced the spreading of costs incurred in one period over subsequent periods. Such practices have not been considered to embrace retroactive ratemaking. Generally, the spreading of costs is applied either to avoid the dramatic rate impact that would result if rates were adjusted to recover the costs currently or to recognize the longer term benefits of the costs (or both). This spreading of cost recovery is precisely what FCWC is seeking. Along with avoiding complications in anticipating and providing for costs that were being incurred each year that the litigation continued, delaying recovery and spreading the litigation costs over future periods avoids any dramatic rate impact and recognizes the fact that there are ongoing benefits to avoiding the penalties sought by the DOJ. Accordingly, the recovery of the litigation expenses as proposed by

FCWC in this proceeding does not constitute retroactive ratemaking. (T. 354-355)

ISSUE 2: Is there any requirement that this utility should have obtained an accounting order prior to filing this petition?

FCWC Position: *No.*

There is no statute, rule, or policy which would require FCWC to request any accounting order prior to filing this petition for limited proceeding to recover litigation expenses. Staff agrees that there is no such requirement. Staff Position on Issue 2, Prehearing Order No. PSC-98-1046-PHO-WS, issued Aug. 3, 1998 in this docket. Even though OPC takes the position that there is such a requirement, its witness admitted that he did not know or investigate whether such a PSC policy or rule requirement existed. (Exhibit 16, pp. 12, 15) Rather, OPC's position is that since some other states have rules requiring such an accounting, Florida must certainly have one also (OPC's witness could not, however, testify with any certainty as to what states might have such rules). (Exhibit 16, pp. 13-16) This position is, of course, incorrect, because the Florida Public Service Commission has no such policy or rule requirement.

The Commission cannot require FCWC to follow a procedure which does not exist. E.g. GTE Florida Inc. v. Clark, 668 So.2d 971 (Fla. 1996)(the PSC's argument that GTE was precluded from

recovering certain expenses because it failed to request a stay was rejected by the Court in that the rule provision allowing a request for a stay was not mandatory); and So. States Util v. FPSC, 704 So.2d at 558-559, supra.

Issue 3: Did FCWC act prudently and reasonably in defending the legal action brought by the United States Department of Justice on behalf of the Environmental Protection Agency?

FCWC Position: *Yes.*

OPC takes no position on this issue.

Staff's position is that FCWC did act prudently and reasonably.

FCWC has offered the testimony of Gerald S. Allen, President of FCWC, and Gary H. Baise, lead attorney in FCWC's defense in the EPA litigation, who gave, in detail, the history of the litigation and what legal actions were taken in response to the DOJ complaint. There has been no testimony or evidence to show that FCWC did not act prudently and reasonably in defending the litigation. All of the testimony and evidence show conclusively that FCWC did act prudently and reasonable in defending the legal action. Mr. L. Gray Geddie, Jr. stated: "The government through its Amended Complaint sought to recover statutory penalties under the Clean Water Act in an amount in excess of $104,000,000. In the ultimate opinion of the Court issued on August 20, 1996, those penalties were reduced to $309,710. In my opinion, this result was an

astonishing victory for FCWC and a tribute to the quality of the defense presented by the company and its attorneys. As noted by the Court, the mitigation evidence offered by FCWC was very persuasive and compelled the reduction in the amount of penalties. Specifically, the Court essentially adopted the company's positions on the important mitigation issues of the seriousness of the Clean Water Act violations, the history of past violations, the company's good faith efforts to comply with the requirements of the regulations, the economic impact of the proposed penalty, and the other equitable factors brought to the court's attention by the company's evidence. The scope of the remedy sought by the government, namely the $104 million, made this case a "bet the company" case in that FCWC simply could not afford to pay the penalties sought. Even the government's own economic expert noted that FCWC could only pay a penalty of $7.5 million and would have to borrow the money to pay that. As noted by Judge Nimmons, "Florida Cities does not have the ability to pay the statutory maximum penalty." With the prospect of an unfavorable outcome affecting the ability of the company to survive, it was certainly reasonable for the company to present a vigorous defense led by the finest, most experienced lawyers that the company could find. It was through the efforts of those attorneys that the extraordinary results in this case were obtained." (T. 179-180)

The Commission should find that FCWC did act prudently and reasonably in defending the legal action brought by the United States Department of Justice on behalf of Environmental Protection Agency.

Issue 4: Was FCWC's failure to challenge the EPA's 1986 NPDES permit denial a prudent decision?

FCWC Position: *Yes.*

Staff and OPC believed that the failure to challenge the permit denial was not prudent. However, there is no evidence or testimony offered on behalf of either Staff or OPC that supports their position. OPC's witness Larkin does not consider himself an expert in environmental compliance regulation and has not made himself conversant with DEP or EPA rules and regulations. (Exhibit 16, page 16.) He is familiar with the Clean Water Act only from his experience in this proceeding. (Exhibit 16, page 9.) Mr. Larkin has no idea what the level of litigation expenses would have been if FCWC had challenged the denial of the permit. (Exhibit 16, page 54.) Staff's witness Merchant did not know the amount of expenses would have been if a protest had been filed; does not know anybody that knows of any evidence that reflects the amount. Ms. Merchant did not say whether the litigation expense would be less if FCWC had protested the denial. Nor, did she know of any way to determine the difference in cost. (Exhibit 17, page 45-46.)

Mr. Baise testified that FCWC could not have avoided the

litigation by challenging the permit denial. In his professional opinion EPA would not have changed its position, even if its mistakes had been called to its attention at the time of a challenge to the permit denial. (Exhibit 7, page 10.) The facts concerning EPA's mistake, regarding the permit denial, was brought to the attention of EPA as early as 1993 and EPA would not change its mind at that time. There is no indication that bringing the facts to the attention of the EPA in January 1987 would have caused it to do anything any differently. (Exhibit 19, pages 27-28.)

Based on the testimony and the evidence of record, the Commission should find that FCWC's decision not to challenge EPA's 1986 NPDES permit denial was prudent.

Issue 5: Is the amount of litigation expenses, incurred by FCWC, in defending the complaint of DOJ fair and reasonable?

FCWC Position: *Yes.*

OPC took no position on this issue.

Staff took no position, pending further development of the record.

The only testimony and evidence, placed in the record on this issue, was by FCWC. Mr. L. Gray Geddie, Jr. was presented by FCWC to provide an expert opinion as to the reasonableness of the legal expenses incurred by FCWC in defending the enforcement action brought by the DOJ for alleged violations of the CWA. (T. 178)

Mr. Geddie's opinion is that the legal fees incurred by FCWC were necessary and reasonable in light of the number and type of violations alleged, magnitude of the civil penalties sought, the litigation strategies used by the DOJ attorneys, and the ultimate outcome of the case. (T. 178)

There has been no evidence or testimony presented in this record that contradicts Mr. Geddie's opinion.

Mr. Geddie is an attorney who has concentrated his practice on the environmental and toxic tort areas. (T. 177) A substantial portion of his practice is premised upon the Federal Clean Water Act, the Clean Air Act, the Toxic Substances Control Act, Super Fund, and the numerous State and Federal regulations, which implement these statutes. (T. 177) In addition to membership in state and federal bars, he is a member of the Defense Research Institute and the South Carolina Defense Trial Lawyers Association. He has been a frequent lecturer on environmental litigation issues before those organizations, as well as business and industry related trade associations. (T. 178)

In reaching his opinion that the legal fees incurred by FCWC were necessary and reasonable, he reviewed the decision of the United States District Judge Ralph W. Nimmons dated August 20, 1996, observing that the government, through its amended complaint, sought to recover statutory penalties under the Clean Water Act in

the amount of $104,000,000, and that the Court in its opinion reduced those penalties to $309,710, which in Mr. Geddie's opinion was ". . . an astonishing victory for FCWC and a tribute to the quality of the defense presented by the company and its attorneys." Mr. Geddie observed that the Court essentially adopted FCWC's positions on all important litigation issues of the seriousness of the CWA violations, the history of past violations, the company's good efforts to comply with the requirements of the regulations, the economic impact of the proposed penalty and the other equitable factors brought to the Court's attention by FCWC's evidence. (T. 179)

Mr. Geddie testified that the United States Supreme Court had approved the "lodestar" attorney fee method which is a calculation of multiplying attorneys hourly rate times the number of hours expended. The attorney's hourly rate is influenced by the skill and sophistication as well as the experience of the attorney and number of hours expended will depend upon the difficulty of the issues in the case. (T. 180) Mr. Geddie's opinion is that the hourly rate of the attorneys was reasonable, the scope and the extent of the legal work was reasonable and that the total legal fees sustained by FCWC were reasonable under the circumstance of the case, saying that, "there can be little doubt that the legal expenses suffered by FCWC resulted in a drastic reduction of the

potential penalties ultimately paid by the company." (T. 181)

Mr. Geddie then proceeded to describe how he interviewed each of the attorneys involved in the case, reviewed pleadings, determined that the hourly rates charged by each attorney, or law firm, were reasonable in consideration of the attorneys abilities, experience and effort. (T. 181-187)

In Mr. Geddie's opinion, the company took reasonable steps to keep the legal fees in check. It made an early offer of judgment in the amount of $500,000, and after the Court decision tried to recover the legal costs it had incurred, from the plaintiff, pursuant to the Federal Rules of Civil Procedures. In Mr. Geddie's opinion, the District Court reluctantly denied this motion because of the fact that the plaintiff was the government and had not agreed to be sued in such a manner. Had the plaintiff been a private litigant, rather than the government, Mr. Geddie believed that FCWC would have prevailed and recovered its litigation costs. Mr. Geddie concluded: ". . . in the end FCWC did what it had to do to prevail in this case - those efforts were prudent - those efforts were reasonable - and most importantly, those efforts were effective." (T. 193)

Issue 6: Does the potential recovery of litigation costs by FCWC provide a disincentive to comply with the Clean Water Act?

FCWC Position: *No.*

This issue was raised by witness Larkin, on behalf of OPC. The Clean Water Act provides for a $25,000 per day violation. This penalty presents the greatest financial peril which is placed on alleged violators, not legal expense. In this case, FCWC faced potential penalties, up to $104,000,000, which is 46 times the legal expenses it seeks to recover in this docket. FCWC is not seeking to recover the penalties in this case. (T. 325)

Gerald Allen, President of Florida Cities Water Company, testified that he had been involved in water and wastewater utility management before the enactment of the Clean Water Act and the Safe Drinking Water Act and many other laws governing water and wastewater utilities, and has first-hand experience with their evolution. He witnessed the conflicting interpretations of these laws and the evolution of a new legal specialty. Mr. Allen testified that compliance has always been a top priority personally, and that he has consistently promoted strict compliance as always being in the best interest of the utility and the utility's customers. The management of Avatar Utilities Inc. and Florida Cities Water Company have strongly supported this position. The reasons for this position include, but are not limited to, a demonstration of good environmental stewardship and corporate citizenship, avoidance of economic sanctions, maintaining productive relationships with regulatory agencies and fostering

professional pride throughout the company. Mr. Allen took a strong position that any implication that the ability to recover a part of FCWC's legal expense in connection with defending itself against grossly overstated allegations of violations of the law represents a disincentive to comply borders on insult. (T. 324-325)

Gary H. Baise is an expert on the Clean Water Act and its enforcement and testified on behalf of FCWC. Mr. Baise testified CWA does not address the issue of whether penalties or legal fees ought to be paid by shareholders or ratepayers. Therefore, under the CWA there is no basis to support Mr. Larkin's policy argument that the purpose of the CWA is frustrated by shifting legal fees to ratepayers. Mr. Baise pointed out that Mr. Larkin does not understand the framework of the CWA, nor has he studied the many court cases involving the CWA. At $25,000 a day violation and criminal sanctions of many years imprisonment, violators of the CWA are subject to some of the most severe criminal penalties imposed by the federal environmental laws. Violations of the CWA can result in the financial ruin of companies and individuals and the imprisonment of company's officers and employees. Generally, in civil cases, such as that against FCWC under the CWA, legal expenses are very small compared to the potential liability associated with the allegations. In Mr. Baise's opinion, Mr. Larkin's position is without basis and is not consistent with the

history of enforcement of the CWA. (T. 336-337)

Mr. Larkin admitted that he was not an expert on environmental compliance regulation. (Exhibit 16, page 6.) He is not an expert in the design and permitting and construction of the wastewater plant or water plant. (Exhibit 16, page 8.) His experience with the CWA is just what he's learned from this case. (Exhibit 16, page 9.) He is not familiar with the regulations under the CWA that have been adopted by EPA. (Exhibit 16, page 9.) Mr. Larkin admitted that he could cite no court case or any other authority for his position that the recovery of litigation cost by FCWC would provide a disincentive to comply with the Clean Water Act. (Exhibit 16, page 36.) Mr. Larkin's "expertise" is shown in his testimony found on page 36 of Exhibit 16.

> Q. And if they know they're going to recover them [the litigation expenses], as I understand your position, there's not the incentive to comply?
> A. [Larkin] they would be less likely to comply.
> Q. Do you have a court or commission opinion that reflects any kind of finding along that line?
> A. No.
> Q. Have you looked for one?
> A. No. I think it's just the general common sense that would tell you that if I can recover my expenses, I'm -- regardless of what they are, regardless of my actions, I'm not going to be too concerned about what my actions are.
> Q. If I agree to pay your legal expenses and fines, would you start running red lights?
> A. Oh, I might. Who knows? I mean, you know that's not my nature. I am not in the habit of doing that. But if I were in hurry going to the airport and --
> Q. Old Gatlin will pay for it, I might as well run it?

A. -- and I want to make that flight, I might run it.
Q. But if it wasn't going to be paid, you would stop for the light?
A. I would think about stopping. I might be motivated enough that I would take the chance.

Issues 7 & 8: Stricken.

Issue 9: Would bankruptcy have seriously affected the quality of service provided to FCWC's customers?

FCWC Position: *Yes*.

A utility cannot pay its debts. The utility cannot secure capital for needed plant additions. The financial condition gets so bad that the utility is forced into bankruptcy. Does anyone believe that customers' service would not be seriously affected? Probably the only two entities that have publicly said "no" are in this case: The Office of Public Counsel of the State of Florida, and more shocking, the Staff of the Commission. OPC's witness Larkin goes further, taking the position that as a result of the necessity of bankruptcy the customers would be better off. He says ". . .the utility (albeit not the shareholders) could have emerged from the bankruptcy proceedings, debts discharged and stockholder interests extinguished. With neither debt to retire, nor equity service, utility rates might have seen a significant lessening." (T. 278) In other words, get rid of equity investment and debt and rates can be reduced. Surely, Mr. Larkin knows that the bankrupt utility will need to be able to secure new debt financing and

hopefully, some equity investment. Maybe under his ratemaking theory the utility could go bankrupt again and rid itself of the new debt and equity, thus reducing rates again. Staff does not say to what extent it buys into OPC's fanciful theory about the good that results from bankrupting utilities. It is not believable that the Commission will adopt OPC's theory.

Issue 10: Should recovery of litigation expenses from the ratepayers depend on whether the utility or the ratepayers benefited from the litigation?

FCWC Position: *No.*

A utility should have the right of recovery of costs prudently incurred in operating and maintaining the system. Under the cost of service standard, a regulated utility is entitled to an opportunity to recover all its cost prudently and legitimately incurred in providing efficient and reliable service, and in maintaining a financially healthy utility. (T. 361) Actually, when this is accomplished the ratepayers benefit. There does not appear to be any reasonable challenge to the position that had FCWC not mounted a defense against the DOJ claim that (1) the financial consequences would have been extremely serious, (2) a financially healthy system would not have emerged and (3) rates and services could have been negatively impacted. (T. 362)

Issue 11: Are the litigation expenses sought in this case reasonably characterized as normal, recurring costs of doing business?

FCWC Position: *No.*

FCWC does not believe this to be an issue in this proceeding. FCWC has not alleged that this expense is recurring, although environmental litigation is normal. The expense in this case was prudently incurred and under the circumstances the amount is reasonable. The litigation expense is properly characterized as an extraordinary, nonrecurring expense. It is a legitimate cost of doing business and the Commission should allow its recovery for the reasons set forth in Issues 1, 2, 3, 4, 5, 6, 9, 10, 12, 13 and 14.

Issue 12: Should any portion of FCWC's litigation costs be recovered through a surcharge, and if so, how much?

FCWC Position: *Yes, $2,265,833.*

The total amount of litigation expenses that FCWC is seeking to collect through rates is $ 3,826,210. FCWC is seeking to recover from all of its customers without regard to rate making jurisdiction $3,589,368. (T. 85) The most rational basis for determining the amount that FCWC is justified in recovering is to compare the offer of settlement presented by the DOJ prior to the filing of the original complaint with the final judgment rendered by the Court. The offer presented by the DOJ by letter dated December 12, 1992 provided for FCWC's payment of a penalty in the amount of $ 5,000,000 (Exhibit 4, GSA-4), whereas the final judgment was $ 309,700 or 6.19% of the offer. Therefore FCWC is

not seeking recovery of the 6.19% ($ 236,842) of its legal expenses associated with its defense, but is justified in recovering the remainder of 93.81% of the total. Therefore FCWC will forego the recovery of $ 547,562 including the penalty. This compares closely with the $ 500,000 settlement offer presented to the DOJ by FCWC before the litigation was initiated and before FCWC had sustained any appreciable legal expenses. (T. 85-86) The total legal expenses FCWC is seeking to recover from the counties regulated by the Commission (Lee and Brevard) amounts to $2,265,833 over ten years. (T. 86) The Commission jurisdictional customers were allocated 63.13% of the total legal expenses based upon a ratio of weighted customers under Commission jurisdiction to the FCWC weighted customers. (T. 233)

Recovery of environmental litigation defense expense through surcharge is in the customers' best interests. To allow recovery of such costs only within the period incurred would distort rates.

Issue 13: Did the DOJ litigation involve all of FCWC's wastewater systems?

FCWC Position: *Yes.*

Beginning with the discovery following the filing of the original complaint, all of FCWC's facilities were involved. It was not until over two years after the complaint was filed that the scope of the legal work was narrowed to only Waterway Estates,

Carrollwood and Barefoot Bay. The discovery, pre-trial motions, briefs and other proceedings were so intermingled that an attempt to account for legal expenses on a specific plant or system basis was not possible. (T. 83)

Issue 14: Should FCWC's request to allocate the costs among all of its customers be approved?

FCWC Position: *Yes.*

The penalty claims by DOJ were so substantial that the financial integrity of FCWC was in jeopardy. It is recognized that there is a close relationship between the level of service provided to customers and the company's financial health. The future viability of the entire company, including its water systems, was at stake. All customers were in peril of being adversely impacted by the litigation. Because of this, FCWC has proposed that all of its customers share in the expense incurred by FCWC in defending the allegations of DOJ. (T. 225-227)

The proposed financial penalties of DOJ represented a possible financial calamity to FCWC. The financial effects would have been system wide. (T. 226) The penalties sought by DOJ would of necessity have been borne by FCWC, not just one of its systems. (T. 227) The proposed surcharge by FCWC amounts to $ .42 each per water and wastewater customer per month. Under Staff's position the monthly charge would increase to $3.44 per month for wastewater

customers in North Fort Myers, Barefoot Bay and Carrollwood divisions only. If the Commission determined that an appropriate allocation method might be a ratio of the amount of penalty incurred by division, then the North Fort Myers wastewater customers would be charged $9.11 per month, and Barefoot Bay and Carrollwood customers would be charged $ .57 and $2.49 per month respectively. (T. 224-225)

Issue 15: What is the appropriate amount of rate case expense?

FCWC Position: *$228,000.* (Exhibit 11, MM-3.)

FCWC is willing to forego the four-year amortization of rate case expense prescribed by § 367.0816, Fla.Stat. and amortize such expense over the same period of time as the Commission prescribes for the recovery of the litigation expenses.

A public utility is entitled to recover in rates those expenses reasonably necessary to provide service to its customers. Such operating expenses include prudently-incurred rate case expense. West Ohio Gas Company v. Public Utility Commission of Ohio, 294 U.S. 63 (1935); Driscoll v. Edison Light and Power Company, 307 U.S. 104 (1939).

PSC Staff has taken the position that if the PSC "disallows recovery of litigation costs, then no rate case expense should be allowed." (Prehearing Order at p. 14) While FCWC believes that the PSC will allow recovery of the litigation costs sought in the

instant proceeding, it in any event submits that rate case expense recovery should not be dependent upon recovery of the litigation costs.

FCWC steadfastly maintains that its requested recovery of litigation costs is consistent with well-established regulatory and legal principles. FCWC's analysis of such principles and prior decisional law is set forth at length under Issue 1 of this Brief. Even if the PSC were to deny recovery of the litigation costs, it should nonetheless allow recovery of FCWC's reasonably and prudently-incurred rate case expense in seeking recovery of such litigation costs. FCWC presented its case in good faith, without any fraud or illegality, and with ample support from prior PSC decisions allowing recovery of litigation costs over an extended period. Given such broad decisional precedent, it cannot be gainsaid that FCWC's case was "unfounded," nor does anything in the record suggest that the expense of the proceeding had been "swollen by untenable objections." Driscoll, 307 U.S. at 120-121; West Ohio Gas Company, 294 U.S. at 74.

Florida courts have consistently found that whether a rate increase is granted is not the sole criteria on which the rate-setting body may exercise its discretion in determining appropriate rate case expense. The automatic disallowance of rate case expense on the basis of denial of the rate increase requested constitutes

a departure from the essential requirements of law. Florida Crown Utility Services, Inc. v. Utility Regulatory Board of City of Jacksonville, 274 So.2d 597, 598-599 (Fla. 1st DCA 1973). See also Westwood Lake, Inc. v. Metropolitan Dade County Water and Sewer Board, 203 So.2d 363 (Fla. 3d DCA 1967); Driscoll, 307 U.S. 104, 120-121 (1939) (utility allowed its fair and proper litigation expense incurred to oppose reduction of rates); Meadowbrook Utility Systems, Inc. v. Florida Public Service Commission, 518 So.2d 326 (Fla. 1st DCA 1987), rev. den. 529 So.2d 694 (Fla. 1988) (court sustained PSC approval of rate case expense which resulted in higher rates although utility found to be overearning).

PSC Staff's outcome-determinative position is also inconsistent with prior PSC rate case practice. The PSC, for example, has recently denied two applications for rate increases, while nevertheless allowing a rate case expense which it found to be reasonable and prudently incurred. In re: Application of Florida Cities Water Company, 96 F.P.S.C. 9:139, 163-164 (1996); In re: Application of Palm Coast Utility Corporation, 96 F.P.S.C. 11:27, 83-88 (1996). While these two rate case decisions were challenged by the utilities on appeal, no cross-appeal was taken on the rate case expenses allowed by the PSC.

Regardless of the level of success which FCWC achieves in its recovery of litigation costs, the PSC should adhere to its

longstanding tradition of allowing the utility to recover its reasonable and prudently-incurred rate case expenses.

Issue 16: Should FCWC be required to pay regulatory assessment fees on any revenues that may be approved in this docket?

FCWC Position: *Yes, if required by the Commission.*

Issue 17: What is the appropriate amount of revenue, if any, to be collected through the surcharge?

FCWC Position: *$2,265,833 plus rate case expenses of $228,000 totaling $2,493,833.*

Issue 18: Should FCWC's requested recovery period for litigation costs be approved?

FCWC Position: *Yes.*

OPC and staff agree that if a surcharge is approved that a ten year recovery period is reasonable.

Issue 19: What are the appropriate surcharges?

FCWC Position: *FCWC proposes that the surcharges be established as follows:

Meter Size	Monthly Surcharge Rate by Meter Size
5/8"	$ 0.42
1"	1.05
1-1/2"	2.10
2"	3.36
3"	6.72
4"	10.50
6"	21.00
8"	42.00*

Then charges will be applicable to each water and each wastewater customer.

These charges would cease when the allowed revenue was collected or not more than ten years from the effective date of the charges, whichever is earlier.

Issue 20: If the Commission issues an order that provides for the recovery of litigation costs, what is the appropriate accounting treatment?

FCWC Position: *The total legal expenses to be recovered should be recorded as a regulatory asset and included in rate base, then be amortized over a ten year period.*

As the surcharge is collected it would be recorded as a revenue which would be offset by the amortization of the regulatory asset. Only the unamortized regulatory asset would remain in rate base. (T. 236)

Issue 21: Should FCWC be allowed to include any unrecovered litigation expense being amortized that was in its next rate case in order to earn a rate of return on the unrecovered balance?

FCWC Position: *Yes.*

In paragraph 9 of FCWC's Petition for Limited Proceedings, FCWC requested that the total legal expenses to be recovered be recorded as a regulatory asset and included in rate base. This regulatory asset would then be amortized over a ten year period. As the surcharge is collected, it would be recorded as revenue which would be offset by the amortization of the regulatory asset. Only the unamortized regulatory asset would remain in rate base. If there are any rate filings during that period, any unamortized

costs should be recognized as a rate base component. This unamortized component would be in rate base upon which a rate of return would be allowed as any other rate base component. (T. 253)

Issue 22: Stipulated.

Issue 23: Stricken.

Issue 24: Must FCWC allege and prove, as a prerequisite to the relief it seeks, that present rates cause it to earn below its last authorized rate of return?

FCWC Position: *No.*

OPC's position is yes. The Commission has already determined that FCWC was not required to make this allegation in Order No. PSC-98-1160-PCO-WS saying:

> Section 367.0822, Florida Statutes, does not require a utility to allege in a petition for limited proceeding that any expenses it has or is incurring places the utility's earnings outside the last authorized range of rate of return.

It follows that if the allegation is not required, certainly proof is not required.

FCWC filed its petition in this proceeding pursuant to Section 367.0822(1), Fla. Stat.

FCWC proposes in this case that it be allowed a temporary surcharge to recover extraordinary non-recurring costs. FCWC does not propose to increase its rates. OPC contends that § 367.0822, Fla. Stat., prohibits an adjustment in rates if the effect would be to change the last rate of return. FCWC is not proposing a change

in rates that will effect its rate of return. It is proposing a separate distinct temporary charge.

Furthermore, the acceptance of OPC's position by the Commission would place an impossible burden on FCWC. OPC's position would mean that during every year from 1992 through 1998 FCWC should have filed an underearning rate case to recover the DOJ related litigation expenses. This would be an absurd result and undoubtably the Commission would have required FCWC to defer the expenses until the court's decision on the merits was rendered and the actual amount of litigation expenses was known. It is a basic tenet of statutory construction that statutes will not be interpreted so as to yield an absurd result. Dorsey v. State, 402 So.2d 1178 (Fla. 1981). FCWC had no way of predicting the amount of these litigation expenses. The fact is that the expenses were non-recurring extraordinary expenses and may not have been allowed as a basis for increasing rates in 1992-1998. For these reasons, FCWC has proposed that, now that the total amount of the expense is known, the recovery should be by temporary surcharge. With recovery by surcharge the question of under or over earnings remains separate. If FCWC is over-earning in one division, the Commission might consider a reduction of rates. If a division is under-earning the FCWC might consider seeking approval to increase rates. In either event the surcharge would remain the same.

Respectfully submitted this 14th day of September, 1998.

B. Kenneth Gatlin

Kathryn G.W. Cowdery
Ruden, McClosky, Smith, Schuster
& Russell, P.A.
215 S. Monroe St., Suite 815
Tallahassee, FL 32301
(850) 681-9027

Attorneys for Florida Cities Water Company

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by hand delivery to Rosanne Gervasi, Esq., Division of Legal Services, Florida Public Service Commission, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850 and to Harold McLean, Esq., Office of Public Counsel, c/o The Florida Legislature, 111 W. Madison Street, Room 812, Tallahassee, FL 32399-1400, on this 14th day of September, 1998.

B. KENNETH GATLIN

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