M E M O R A N D U M

October 8, 1998

TO: DIVISION OF RECORDS AND REPORTING

FROM: DIVISION OF LEGAL SERVICES (JAEGER)

RE: DOCKET NO. 950495-WS - APPLICATION FOR RATE INCREASE AND INCREASE IN SERVICE AVAILABILITY CHARGES BY SOUTHERN STATES UTILITIES, INC. FOR ORANGE-OSCEOLA UTILITIES, INC. IN OSCEOLA COUNTY, AND IN BRADFORD, BREVARD, CHARLOTTE, CITRUS, CLAY, COLLIER, DUVAL, HIGHLANDS, LAKE, LEE, MARION, MARTIN, NASSAU, ORANGE, OSCOLA, PASCO, PUTNAM, SEMINOLE, ST. JOHNS, ST. LUCIE, VOLUSIA, AND WASHINGTON COUNTIES.

Please place the attached letter dated September 29, 1998 in the docket file.

RRJ/lw

Attachment

cc: Division of Water and Wastewater (Hill, Crouch, Willis, Chase, Rendell, Merchant)
Division of Auditing and Financial Analysis (Lester)

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September 29, 1998

All Parties of Record

Re: Counter-offer to Proposed Settlement

Ladies and Gentlemen:

As you are aware, the Sugarmill Woods Civic Association, Inc. is not happy with the provisions of the settlement proposed by the utility. For reasons that I will restate below, Sugarmill Woods believes that the proposed settlement (1) unwisely abandons the opportunity offered by the First District Court of Appeal to address the continuing problem of how to calculate used and useful percentages for systems with mixed usages and, in the process, (2) saddles Sugarmill Woods and many other systems' customers with rate increases greatly disproportionate to their real revenue and rate responsibility. While Sugarmill Woods understands the utility's, staff's and Commission's desire to have this matter closed as quickly and as amiably as possible, these consumers are not inclined to willingly pay even greater subsidies than they are already forced to remit by the capband rate structure to see this goal met. However, in a gesture at compromise and in a recognition that existing methods for determining used and useful may alternatively either short-change the utility or its customers, Sugarmill Woods has devised an alternative used and useful methodology which it believes treats both the utility and its customers fairly. Accordingly, Sugarmill Woods would agree to the settlement of this docket on the conditions that will be described below.

Status on Remand

It is clear that the First District Court of Appeal's June 10, 1998 opinion was final and conclusive on a number of issues, while clearly giving the Commission the opportunity to reopen the record to more adequately support certain decisions reached in the final order. Some of the conclusively decided issues impact all utility customers' rates, but in a relatively minimal way. For example, the downward equity adjustment (assuming the First District doesn't reconsider and reverse itself on the requirement of the utility paying for the customer refunds) appears to affect all systems' customers. Presumably the resulting "equity" adjustments would be made to each system and incorporated in prospective rate increases through the use of the currently approved "capband" rate structure. Likewise, if it were determined that the utility were entitled to the recovery of "equity adjustment" losses from entry of the final order to date, it would appear all systems' customers would be subject to surcharges, again through application of the capband rate structure. It should be noted that the percentage increase resulting from this adjustment is substantially less than a 4.7 percent increase.

As opposed to the equity related adjustment, there are a number of other conclusive First District rulings that would entitle the utility to additional prospective rate increases, and perhaps additional surcharges, but which would be the revenue responsibility of, and collectable only from, distinct operating systems. For example, the Commission's used and useful calculations on "reuse facilities" were reversed and the Commission was directed to increase the used and useful percentages to 100 percent. There is a clear and unambiguous requirement that the utility be given an increase in prospective rates (and presumably surcharge amounts as well) as a result. The resulting increases, however, are directly assignable to the systems benefitting from the reuse service. At best, both the prospective increases and retroactive surcharges would be assigned to all the systems in the reuse systems' respective capbands. There is no credible logic for assigning any of these reuse revenue responsibilities (either prospective or surcharge) to Sugarmill Woods or, for that matter, to the bulk of the systems in the case. Sugarmill Woods' capband rates already force it to pay subsidies of approximately 7 percent over its true stand-alone/cost of service based on actual usage and meter size and not the hypothetical 10,000 gallon per month for a 5/8 x 3/4 inch meter. Sugarmill Woods is not interested in seeing those subsidies increased on remand in the name of customer unity or convenience or as the result of implicit coercion.

There are other system specific adjustments resulting from the Court's conclusive rulings and/or the Commission's confessions of error that cannot be attributed to Sugarmill Woods or a majority of the other systems. The future and past revenue responsibilities for these adjustments should be also be flowed through to the specific systems involved, or, at most, to those systems in their existing capbands.

On two major issues the First District reversed the Commission for its failure to support a policy shift by reasonable explanation and by adequate supporting evidence. While it reversed the Commission's decisions, the Court clearly gave the agency the opportunity to reopen the record for the purpose of reimplementing those decisions. The Court said:

> For this policy shift, too, the PSC must give a reasonable explanation on remand and adduce supporting evidence, if it can, to justify a change in policy required by no rule or statute. That failing, the PSC should adhere to its prior practices in calculating used and useful percentages for water transmission and distribution systems and wastewater collection systems serving mixed use areas.

One remand/rehearing issue involves what flow levels to use to determine peak demand and concerns only 8 wastewater systems. This issue does not impact Sugarmill Woods either directly or through increases imposed through application of the capbands. It should be noted, however, that the Staff has aggressively asserted to the Commissioners that it could win on this issue on a reopening of the record, which the Staff also vigorously recommended. If such support is not attempted or is not successfully obtained, then the Commission would have to revert to its prior policy.

The primary issue that would affect Sugarmill Woods on the remand is the used and useful calculation for Transmission, Distribution, and Collection Systems. The Court has said that the Commission's use of what I will call the "straight lot count" method in mixed use areas

was an insufficiently explained departure from past Commission policy that could not stand absent adequate explanation and additional supporting evidence. Such additional evidence, unless already in the record, but not cited to, presumably has to be taken in a reopened record. Absent such an explanation, the Court has made clear that the Commission must revert to what the Court has been led to believe is the Commission's sole representation of prior policy. That policy of using just unconverted ERCs was illustrated by the Court's citation to the Commission's earlier order concerning the utility's operations at Marco Island, which operations Sugarmill Woods believes conclusively demonstrate the failings of the ERC methodology in certain circumstances and formed, to a very large degree, the record basis for the Commission reverting to the straight lot count method in mixed use areas.

Without going into exhaustive detail on the Marco Island example, it is clear that the Commission's prior determinations of 100 percent used and useful for water lines was in error where over 50 percent of all residential lots to be served by those lines were not built on. Irrespective of whether the straight lot count method treats the utility fairly or not, fair and clearheaded individuals understand that something less than 100 percent is required where more than one-half of the residential lots to be eventually served are clearly not being presently served, but must be served by the existing lines at some point in the future. So, while the straight lot count might not be completely fair to the utility, we all know that the unconverted ERC is not fair to customers in some mixed use areas, but particularly where there are a high percentage of residential meters larger than 5/8 x 3/4, as is the case at Marco Island, Sugarmill Woods and Pine Ridge, just to name a few. At Sugarmill Woods the high percentage of 1 inch residential meters would result in the water system being considered 100 percent used and useful when only 3900 of a total of 8,252 lots available were in fact connected.[1]

The Commission abandoned the unconverted ERC methodology in mixed use areas because the Commissioners knew that the result was patently unfair as demonstrated by Marco Island. It would be unconscionable for these same Commissioners to revert to what they know is clearly wrong and anti-customer without taking advantage of the Court-offered opportunity of reviving the more equitable decision made in the final order. Furthermore, no customer group should be forced to accept rate increases that reflect a return to the ERC methodology without an opportunity for meaningfully protesting its failures in an evidentiary hearing.

The Court has offered the Commission an opportunity to supplement its support for its used and useful decision. It would be irresponsible for the Commission not to take advantage of the opportunity or to allow customers to be compelled to accept a settlement by suggestions that

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[1] Using an unmodified ERC equivalency, a system with all 1 inch residential meter would be considered 100 percent used and useful after only 40 percent (2.5 ERCs x 40 = 100 percent) of the total lots were connected. This is obviously irrational and unfair. Logically, one should argue that a building or hookup moratorium is appropriate in situations in which either the water distribution or sewer collection system is found to be 100 percent used and useful. How could it logically be otherwise?

they will fare dramatically worse if they do not.[2] It would be irresponsible for Staff not to press ahead with its responsibility for defending the Commission's most recent decision where it knows the alternative is wrong and inequitable.

Sugarmill Woods Treated Unfairly By Proposed Settlement

As noted above, Sugarmill Woods believes it is only equitably and legally obliged to pay its required system specific equity adjustment through prospective increases and potential surcharges. The other system specific adjustments are not Sugarmill Woods' responsibility. The unfairness of the unconverted ERC calculation at Sugarmill Woods and the fallacy that this method is the Commission's only prior policy are revealed in prior SSU final orders.

At Sugarmill Woods' request, the Commission individually examined the distribution and collection used and useful calculations in the 1992 rate case and got the correct result there. In hindsight, it is a methodology the Commission should have specifically reinstituted for Sugarmill Woods and imposed for Pine Ridge, Marco Island and similar systems with large percentages of 1 inch residential meters and/or mixed use areas with significant commercial service. What the Commission did in the 1992 case is described beginning at page 29, Order No. PSC-93-0423-FOF-WS, entered in Docket No. 920199-WS:

> **ERC Calculation**
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> In the MFRs, SSU calculated distribution and collection facilities used and useful, before adding margin reserve, to be 47 %, which equals the ratio of 4,291 to 9,054 "ERCs/Lots." According to utility witness Hartman, 4,291 represents the number of active ERCs during the test year. He stated he arrived at this figure by using AWWA meter equivalency standards, under which certain meter sizes equate to a set number of ERCs. For instance, 1" meters are the equivalent of 2.5 ERCs. Mr. Hartman indicated that SSU used 9,054 as the denominator for its comparison because it was the number which SSU and COVA stipulated using the last rate case.
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> COVA witness Jones testified that the 9,054 ERCs figure used in the last case was based on the premise that each lot was served by a 1" meter. In the case of Sugar Mill Woods, ERCs should be based on lots instead of meter equivalents, Mr. Jones stated. Therefore, he asserted, SSU improperly used strict meter equivalents for test year ERCs in the numerator of the used and useful equation

[2] The Staff's calculations, although presumably "worse case", ignore prior decisions of the Commission, especially as to Sugarmill Woods, assume the maximum unconverted ERC used and useful calculation and juggle the capband rates to further maximize the revenue and rate effect. The elimination of Amelia Island from the shared capband with Sugarmill Woods and Pine Ridge results in the latter two systems receiving maximum potential water rate increases of 32.07 percent! The 4.7 percent settlement increase, whether deserved or not, begins to look reasonable by comparison.

and 9,054 in the denominator. In order to make the comparison consistent, Mr. Jones contended, SSU should have multiplied 9,054 by the 2.5 AWWA meter equivalent.

* * *

In consideration of the above, we reject SSU's calculation of used and useful for the Sugar Mill Woods water distribution and wastewater collection facilities. Each of the lots with service available should be counted as one ERC, as each residential lot will have one meter to serve the dwelling, regardless of meter size. This comparison will encompass 98% of the billings for the test period. When each lot with an active customer is treated as one ERC, the systems will be 100% used and useful at buildout. However, since commercially zoned lots may have a higher density and have individually metered units, we believe using meter equivalents for such customers is a better measurement than counting each lot as one ERC.

We used the billing data in the MFRs to calculate the appropriate number of ERCs below. For water, we relied on Schedule No. E-2A and calculated each residential customer with a 1" or smaller meter as one ERC. Counting all other meter sizes using meter equivalents, we find 1,800 residential ERCs and 135 general service ERCs. For wastewater, we counted all residential customers as one ERC and used meter equivalents for all general service customers. We calculated 1,717 residential ERCs and 95 general service ERCs.

(Emphasis supplied.)

From the above, it is clear that using strict unconverted ERC meter equivalencies to calculate used and useful was not the Commission's sole prior policy as the Court was unfortunately led to believe. More importantly, it is clear that the Commission's 1992 treatment at Sugarmill Woods rationally addressed the used and useful percentage calculation for systems with high percentage 1 inch residential meters, while fairly recognizing the increased demand imposed by commercial meters of 1 inch or greater. It is a methodology that more equitably addresses the concerns of the customers and the utility than the straight lot count method used in the final order or reversion to the AWWA ERC meter equivalencies.[3]

[3] Use of the AWWA meter equivalencies is clearly an attempt to find the "lowest common denominator" and compare "apples to apples" when assessing relative potential demand. It makes sense to assign 1 inch meters a relative value of 2.5 and 5/8 x 3/4 inch meters as 1.0 where the latter is the predominant meter size (the lowest common denominator). However, where 1 inch meters are the predominant meter size (the lowest common denominator), they should be assigned the value of 1 ERC as the Commission did for Sugarmill Woods in the1992 case.

The Commission's "correct" treatment of Sugarmill Woods in the 1992 was due to the consumers there pressing their case on the inequities of the general policy and the Commission recognized their situation, but did not make a comparable adjustment to all similar systems. The inherent failings of the meter equivalency method adopted for all other systems in the 1992 case is discussed in the final order at hand, even though the exception for Sugarmill Woods is not. In Order No. PSC-96-1320-FOF-WS, at Page 65, the Commission stated:

> In Docket No. 920199-WS, we approved a methodology proposed by SSU that compared unconverted ERCs with lots available. In many instances, that methodology resulted in the "number of lots" connected for SSU's facilities in excess of the actual number of lots available, thereby achieving a used and useful percentage greater than 100 percent. The potential mismatching effect of the unconverted ERCs methodology is graphic if one considers that a three inch meter is equivalent to 15 ERCs, giving a result, under that methodology, of 1,500 percent used and useful. SSU acknowledged that the methodology it proposed in this proceeding is a better one than that applied in Docket No. 920199-WS.
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> Using SSU's proposed lots connected to lots available methodology would result in many cases in a significantly lower used and useful percentage than that allowed in the utility's last rate case. For example, the used and useful percentage for mains at Druid Hills was 100 percent in Docket No. 920199-WS, but is 73.33 percent applying the proposed methodology.
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> Another problem encountered in determining the appropriate methodology for determining used and useful percentages on mains becomes apparent when considering Marco Island's transmission and distribution facilities. That facility's transmission and distribution mains have been considered 100 percent used and useful at least since May 26, 1987. See Order No. PSC-93-1070-FOF-WS. Yet, the utility even then projected water growth of 200 ERCs per year. With the lot count methodology we approve in this case, the used and useful percentage for mains is calculated as 44.1 percent.
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> In OPC's view, the lot count method allocates the water main costs fairly to all customers. Further, OPC witness Biddy stated that the lot count method does not fail to recognize the costs to accommodate fire flow and looped lines, because it allocates the total costs through used and useful percentages. We do not through the lot count methodology "penalize" the utility for installing larger diameter mains to meet fire flows. Thus, we find that the appropriate methodology to use for determining used and useful percentages for transmission, distribution and collection lines is to compare lots connected to lots available. To

continue to allow the comparison of ERCs connected to lots available methodology would invite skewed used and useful percentages.

(Emphasis supplied.)

Sugarmill Woods continues to believe that the used and useful methodology it argued for and obtained from the Commission in the 1992 case remains the fairest methodology for not only it, but all the systems operated by the utility. Using straight ERC meter equivalencies is demonstrably unfair in systems with high percentages of 1 inch residential meters because it very rapidly overstates the percentage used and useful prior to buildout. The straight lot count method adopted by the Commission in the 1995 case, on the other hand, has the very real potential for shortchanging the utility by failing to fully recognize the demand placed on the system by commercial customers with 1 inch and greater meters.

Sugarmill Woods believes that the Staff should continue to press its claim that it can support the Commission's final order upon a reopening of the record, but with a recognition - out of fairness to the utility - that the goal of a new hearing would be to support the methodology used for Sugarmill Woods in the 1992 case and not an unthinking readoption of the straight lot count methodology.

Counter-Offer

Sugarmill Woods believes the arguments for accepting the 4.7 percent settlement deal are specious all around. It doesn't owe that much money under any legitimate ratemaking concept and believes suggestions that "customer solidarity" and sharing of the revenue responsibility legitimately owed the utility are patently ridiculous given the past inter-system customer rate structure battles engendered by the utility and Staff. On the other hand, the Staff's retreat from its forceful recommendation to the Commissioners on the necessity of a reopened record and support of the final order, coupled with a proposed utility settlement that once again pits customer against customer by offering some groups a "free ride" at the expense of others, forces Sugarmill Woods to reexamine its chances of success at hearing. Not only must it address the Staff's fading resolve on supporting its final order position, Sugarmill Woods must also confront the implicit threat that it will face up to 32 percent water rate increases by Staff abandoning the 1992 rate treatment and reverting to straight unconverted ERC equivalencies.

In the spirit of compromise and in an effort to affirmatively address the unresolved, but recognized problems with calculating used and useful for lines and mains, Sugarmill Woods will agree to settle this case on acceptance of the following:

1. A recalculation of the base facility charge for all systems in proportion to the gallonage ERCs in excess of the rated meter ERCs on a prospective basis. Sugarmill Woods' calculation would be based on the 500 gallons per day ERC figure approved by earlier Commission order. These increases would be imposed on all systems without regard to existing caps. See the explanation below.

2. A prospective 4.7 percent increase on base facility charges, but no prospective increases on gallonage charges. These increases would also be imposed on all systems without regard to the existing rate caps.

3. Hold the line on any recalculation of used and useful percentages until the next rate case for any system involved here. The methodology approved in Docket No. 950495-WS will not be disturbed. None of the parties to the settlement will either initiate nor participate in any intervening rulemaking proceeding or other proceeding whose purpose is to establish a procedure or methodology for determining used and useful percentages for any of the utility systems involved in this case.

4. Per the utility's proposed settlement offer:

   A. There will be no surcharges;

   B. There will be no additional rate case expense;

   C. The utility will not file a motion for attorneys fees; and

   D. The Commission will close the gain on sale docket, Docket No. 980744-WS and utility shareholders will retain the gain on sale, and the issue will not be reconsidered.

Items 2-4 above should be reasonably self-explanatory, while Item 1 will require some further explanation.

While trying to resolve the apparent inequities of both the straight lot count and unconverted ERC equivalency used and useful methodologies, it occurred to Sugarmill Woods that the real problem, which wasn't being either recognized or addressed, was that certain customers were placing actual demands on the utility's systems which were not fully reflected in rates. For example, take the case of a commercial customer whose 2 inch meter is AWWA rated at 8 ERCs. Based on 350 g.p.d../ERC, the assumed equivalent daily usage would be 2,800 (8 x 350) g.p.d. The problem, however, is that while this customer would only be paying a base facility charge established on 8 ERCs, the utility's billing records reveal many examples of such customers routinely placing substantially greater daily average demands on the system, which excesses are not currently reflected in rates. For example, assume the hypothetical 2 inch water customer's bill showed that it had an average daily usage of 5,000 g.p.d. during the number of days in the meter reading period. This would then indicate that the 2,800 g.p.d. assumed by the 2 inch ERC would have been exceeded by 2,200 g.p.d. (5,000 - 2,800), which is an additional demand that must be met by the utility's physical plant. The excess of 2,200 g.p.d. equates to an additional 6.29 ERCs (2,200/350 g.p.d.) which are essentially being obtained for "free" by the customer. The unrecognized benefit's cost can be a substantial loss to the utility. If we assume, for this example, that the base facility cost for the system in question is $16.33 per ERC, the

unrecognized revenue would be $102.72 (6.29 x $16.33) for the billing period.[4] Under the concept being proposed for settlement by Sugarmill Woods, the utility would be allowed to charge this customer for the additional demand the customer has placed on the system in terms of capital and other fixed costs, which in this case would be an additional $102.72 base facility charge which would be collected in the respective monthly billing. This methodology would more reasonably allow the utility to recover the costs of additional demand each month in their billings directly from those customers imposing the demand.

This concept need not be confined to commercial customers. For example, take the case of a residential customer at Sugarmill Woods with a 5/8 x 3/4 inch meter, whose assumed average daily gallonage would be 500 g.p.d. (per Commission order) for the standard one ERC and whose current base facility charge for that meter size is $4.89 per month. Under the current concept, that customer would incur no additional facility usage charge if, because of a dry month and increased irrigation usage or whatever the reason, he or she used double or even triple the 500 g.p.d. envisioned by the single ERC. Is this fair to the utility? The method that Sugarmill Woods is willing to stipulate to for purposes of settlement would compensate the utility for the greater than expected demand being imposed, while not unreasonably increasing the rates of those customers using 500 g.p.d. or less. For example, assume a Sugarmill Woods customer with a 5/8 x 3/4 inch meter who uses 1,218 g.p.d. on average during the meter reading period. This is 718 g.p.d. in excess of the prior order establishing 500 g.p.d. per ERC for Sugarmill Woods. He would effectively be placing an additional demand on the system of 1.436 ERCs (718/500). Under Sugarmill Wood' proposal, this customer, and the many others like him, would be charged for the full ERCs imposed during the billing period. In this case, the utility would be due an additional base facility charge of $7.02 (1.436 x $4.89) rather than just the single ERC base facility charge of $4.89. Again, the utility would be due rather substantial increases in its revenues, but most importantly, it would collect those revenues from the specific and identifiable customers imposing the additional demand (used and useful) on the various systems.

Sugarmill Woods believes that this proposal of "sliding BFCs" would go a long way toward curing any inequity to the utility by use of the straight lot count method in systems with appreciable mixed use. Additionally, it would protect customers from the obvious and previously recognized failures of the unconverted ERC equivalency method in systems with high percentages of 1 inch residential meters. Application of this method would allow all other provisions of the used and useful calculations arrived at during the current case to remain unchanged until the next rate case. When the next case is considered, the Commission and the utility would have documented operating experience with which to judge the effectiveness and fairness of this methodology. Depending upon the results, this methodology could be adopted on

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[4] 350 g.p.d. is the typical daily gallonage per ERC as provided by rule. However, the Commission should use higher amounts were specifically approved by Commission order. In the case of Sugarmill Woods, 500 g.p.d. was first approved by Commissioners Marks, Cresse, Gunter and Nichols in Order No. 14380, issued May 17, 1985, in Docket No. 840206-WS. The same 500 g.p.d. for water and 255 g.p.d. for sewer were again approved by the Commission in Order No. 21836, issued in Docket 881339-WS on September 5, 1989.

a going forward basis or the Commission could take evidence on which to establish a new methodology that would cure the problems of the two methods generally (not including the 1992 Sugarmill Woods treatment) utilized to date. Lastly, this method would have an enhanced conservation benefit since it would give all customers the incentive to control the amount of their monthly base facility charge by correspondingly reducing their consumption.

Sugarmill Woods believes this methodology would treat all parties to this proceeding fairly, while allowing the Commission to close the docket without additional hearings. To the extent the provisions of this methodology are not completely clear or that the other provisions require additional explanation, the undersigned and representatives of Sugarmill Woods will be happy to discuss the counter offer either individually or collectively with the parties.

Sincerely,

Michael B. Twomey
Attorney for Sugarmill Woods
Civic Association, Inc.