State of Florida

# Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

## -M-E-M-O-R-A-N-D-U-M-



**DATE:** OCTOBER 22, 1998

**TO:** DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYÓ)

**FROM:** DIVISION OF WATER AND WASTEWATER (MANN, AUSTIN, WALDEN, MCCASKILL, SHAFER)
DIVISION OF AUDITING AND FINANCIAL ANALYSIS (VANDIVER)
DIVISION OF LEGAL SERVICES (GERVASI, VACCARO)

**RE:** DOCKET NO. 971663-WS - 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.

**AGENDA:** 11/03/98 - REGULAR AGENDA - POST HEARING DECISION - PARTICIPATION LIMITED TO COMMISSIONERS AND STAFF

**CRITICAL DATES:** NONE

**SPECIAL INSTRUCTIONS:** NONE

**FILE NAME AND LOCATION:** C:\123\SARC\FCWC\971663.RCM

### CASE BACKGROUND

Florida Cities Water Company (FCWC or utility) is a Class A water and wastewater utility which operates under the Commission's jurisdiction in Lee and Brevard Counties. FCWC also operates as a water and wastewater utility in Collier (Golden Gate), Sarasota, and Hillsborough Counties (Carrollwood), which are not subject to the jurisdiction of this Commission. The utility has eight water and six wastewater treatment plants. For the regulated systems, FCWC serves approximately 24,000 water customers and 14,000 wastewater customers. (EXH 11, MM 4, p. 1)

On December 29, 1997, the utility filed a petition for limited proceeding pursuant to Section 367.0822, Florida Statutes, seeking approval to recover certain legal expenses incurred in its defense of a legal action brought by the United States Department of

Justice (DOJ), on behalf of the United States Environmental Protection Agency (EPA) relating to violations of the Clean Water Act (CWA) (petition). Recovery is sought through a monthly customer surcharge, applicable to the utility's water and wastewater customers in South Ft. Myers, North Ft. Myers (Lee County) and Barefoot Bay (Brevard County). The action addressed alleged violations at three wastewater facilities: Waterway Estates (Lee County), Barefoot Bay (Brevard County), and Carrollwood (Hillsborough County).

On October 1, 1993, the DOJ, on behalf of the EPA, filed a complaint in the United States District Court, Middle District of Florida.[1] The complaint alleges that FCWC violated the CWA at the Waterway Estates wastewater treatment plant (Lee County). (EXH 4, GSA 2) According to FCWC attorney Baise, EPA's dissatisfaction arose over the timeliness of completing the work set forth in the action plan. (EXH 17, p. 8) Later, this complaint was amended to include alleged violations at the Barefoot Bay and Carrollwood wastewater plants. (TR p. 49) FCWC filed an answer to the complaint on November 2, 1994 denying the allegations. (EXH 4, GSA 3)

The trial in the federal court was held between March 25 and April 5, 1996 and lasted eight days. The court entered its judgment against FCWC in the amount of $309,710 in civil penalties. (TR p. 78)

Civil penalties imposed by the United States District Court of $309,310 are not sought for recovery. While the total legal expenses incurred were $3,826,810, the utility is seeking to recover $2,265,833, plus the estimated rate case costs of $182,382 in bringing this matter before the Commission. (EXH 11, MM 3, p. 1) The utility proposes to collect this rate increase over a ten year period, spreading the costs through a monthly surcharge to all customers of the utility. This proposal means that systems not involved in the enforcement action would incur a rate increase through a surcharge.

The utility states that upon approval of a surcharge as sought in this proceeding, it will seek approval by Collier, Hillsborough, and Sarasota Counties of a surcharge to be applicable to its customers in those counties, as well. On March 20, 1998, the Office of Public Counsel (OPC) filed notice of its intervention in this proceeding. Its intervention was acknowledged by the Commission by Order No. PSC-98-0430-PCO-WS, issued March 26, 1998.

[1] U.S. District Court Case No. 93-281-CIV-FTM-21

On July 10, 1998, OPC filed a motion to dismiss FCWC's petition. On July 17, 1998, FCWC filed a motion for extension of time to file a response thereto, to and including July 29, 1998. FCWC's motion for extension of time was granted at the July 20, 1998, prehearing. On July 29, 1998, FCWC filed its response to OPC's motion to dismiss. Also, on July 29, 1998 OPC filed a memorandum of law in support of its motion to dismiss. OPC's motion to dismiss was denied by Order No. PSC-98-1160-PCO-WS, issued August 25, 1998.

Service hearings were held in Barefoot Bay on July 7, 1998, and in Ft. Myers on July 8, 1998. The Commission conducted an evidentiary hearing on August 12, 1998 in Tallahassee. This is the staff's recommendation based upon the record made at those hearings.

As a preliminary matter at the August 12, 1998, hearing, the following stipulations were approved:

**APPROVED STIPULATIONS**

1. If a surcharge is approved, FCWC shall reduce its rates to remove the litigation costs when the recovery is complete.

2. If a surcharge is approved, FCWC shall file an annual statement of total revenues recovered through the surcharge at the time that it files its annual report.

3. If a surcharge is approved, it shall be listed as a separate item on the customers' bill, and shall be identified as an environmental litigation surcharge.

4. Both costs and attorneys' fees were denied by the Federal Court to FCWC.

5. The amount of litigation expenses incurred by FCWC totals $3,826,210. While OPC does not join in this proposed stipulation, it will not contest it.

6. The prefiled testimony of all the witnesses shall be inserted into the record as though read; the witnesses need not be present to testify; all prefiled exhibits shall be identified and received into the record; all testimony and exhibits shall be received in the order set forth in the prehearing order; and all discovery, including requests for production of documents and interrogatories, and any deposition transcripts from depositions which have been

taken in this docket and any late-filed deposition exhibits may be received into the record.

## ACRONYMS AND ABBREVIATIONS

| | |
|---|---|
| AWT | advanced wastewater treatment |
| BR | Brief |
| CIAC | contributions-in-aid-of-construction |
| CWA | Clean Water Act |
| DOAH | Division of Administrative Hearings |
| FAC | Florida Administrative Code |
| FDEP | Florida Department of Environmental Protection (formerly known as the FDER) |
| FDER | Florida Department of Environmental Regulation |
| DOJ | United States Department of Justice |
| EPA | United States Environmental Protection Agency |
| FCWC | Florida Cities Water Company |
| FS | Florida Statutes |
| NARUC | National Association of Regulatory Utility Commissioners |
| NPDES | National Pollution Discharge Elimination Permit |
| OPC | Office of Public Counsel |
| OPEB | Other Post Employment Benefits |
| SJRWMD | St. Johns River Water Management District |
| SSU | Southern States Utilities, Inc. (now Florida Water Services Corporation) |
| TOP | temporary operating permit |
| UWF | United Water Florida |
| USDOJ | United States Department of Justice |
| USEPA | United States Environmental Protection Agency |
| WW | wastewater |

## DISCUSSION OF ISSUES

**ISSUE 1**: Does the proposed recovery by FCWC of the litigation expenses constitute retroactive ratemaking?

**RECOMMENDATION**: Yes, the proposed recovery by FCWC of the litigation expenses constitutes retroactive ratemaking, and for this reason, it should be denied. If the Commission disagrees that the utility's request is a request for retroactive ratemaking, staff recommends that the request should still be denied on the basis that FCWC management did not act in a reasonable or prudent manner to avoid the occurrence of federal prosecution. (Gervasi, Mann)

**POSITION OF THE PARTIES**

**FCWC**: No.

**OPC**: Yes. Although the Citizens do not believe that the litigation expenses sought were incurred in the provision of water and/or wastewater service to the public, if such litigation expenses were so incurred, they were incurred for consumption delivered contemporaneously with the expenses, the last of which was booked by the utility, below the line, prior to 1997. This case is no different from any other in which a utility seeks to establish future rates designed to retroactively recover expenses or losses neglected or foregone from prior periods. The Commission has consistently ruled against retroactive ratemaking. (Larkin)

**STAFF ANALYSIS**:

FCWC

FCWC claims that recovery of the litigation expenses being requested in this limited proceeding, which were incurred between 1993 and 1997, does not constitute a request for retroactive ratemaking. Even though these amounts were incurred and expensed prior to the filing date in this case, the utility believes that recovery of these amounts does not constitute retroactive ratemaking because: 1) these amounts are not being applied to past consumption, as the utility has requested that these amounts be recovered from current and future customers and that this be based on the number of customers and not the consumption levels; and 2) the recovery of these amounts is not an attempt to recover past losses. This belief is founded on the understanding that retroactive ratemaking only occurs when new rates are applied to

prior consumption and/or when a utility attempts to recover past losses from current and future customers. (FCWC BR p. 6)

FCWC cites to City of Miami v. Florida Public Service Commission, 208 So. 2d 249 (Fla. 1968), in arguing that the Florida Supreme Court has based its rulings regarding retroactive ratemaking upon applicable statutory language. In City of Miami, the Court found that Sections 364.14 and 366.06 (2), Florida 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 259-60. The statutory language supporting this finding is that the Commission shall determine just and reasonable rates "to be thereafter observed and in force" (Section 364.14, Florida Statutes), 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, Florida Statutes). The utility argues that the majority of the Florida court cases decided after City of Miami which address the issue of retroactive ratemaking are telephone and electric utility cases which rely upon the statute-based reasoning of City of Miami. (FCWC BR p. 7)

The utility argues that "retroactive ratemaking only occurs when new rates are applied to prior consumption." Citizens v. Florida Public Service Commission, 448 So. 2d 1024, 1027 (Fla. 1984). FCWC cites to GTE Florida Inc. v. Clark, 668 SO. 2d 971, 973 (Fla. 1996) and to Southern States Utils., Inc. v. Florida Public Service Commission, 704 So. 2d 555 (Fla. 1st DCA 1997) (rejecting the Commission's reasoning that the surcharge at issue was a new rate applied to prior consumption), in arguing that its request for a surcharge to recover litigation costs is not retroactive ratemaking because the surcharge would not be applied to prior consumption. (FCWC BR p. 8; TR pp. 250-52)

Moreover, the utility argues that its request is not retroactive ratemaking because the surcharge would not result in recovery from current and future customers of losses produced by prior consumption. By Order No. PSC-95-1376-FOF-WS, issued November 6, 1995, in Docket No. 940847-WS, In Re: Application for a rate increase in Duval County by Ortega Utility Co., 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 "would apply to prior consumption, thus retroactively raising rates." However, the Commission did allow Ortega to recover certain depreciation expenses for past years on the basis that such adjustment covered depreciation expenses that were approved but were designed to be

recovered on a prospective basis, whereas the utility's proposed adjustment addressed a failure to achieve sufficient income which the utility believed could be attributed to depreciation in general. FCWC argues that in requesting recovery of its litigation expenses, it likewise is not requesting an adjustment for failure to achieve sufficient income, but is instead requesting recovery of prudently incurred, necessary, allowable expenses, unrelated to consumption and unrelated to revenue losses.

The utility argues that 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. See, e.g., In re: Application for Rate Increase in Duval, Nassau, and St. Johns Counties by United Water Florida Inc., 97 F.P.S.C. 5:641, 686; In re: Application for Rate Increase in Lee County by Lehigh Utilities, Inc., 93 F.P.S.C. 2:775, 795. (FCWC BR pp. 11-12)

Further, the utility points out that the Commission allows for recovery of appellate rate case expense. By Order No. PSC-94-0738-FOF-WU, issued June 15, 1994, in Docket No. 900386-WU, In re: Application for a rate increase in Marion County by Sunshine Utilities of Central Florida, Inc., 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. FCWC argues that the same reasoning should apply here, as the litigation expense could not be contained within a test year and is a non-recurring, extraordinary expense. The Commission has also allowed recovery of other out of test year litigation expenses on the basis that these litigation expenses are extraordinary and non-recurring. See, e.g., Order No. 6094, issued April 5, 1974, in Docket No. 74061-EU, (allowing Florida Power Corporation to recover non-recurring, extraordinary legal expenses incurred in connection with antitrust litigation); Order No. 5044, issued February 4, 1971, in Docket No. 70214-W, (allowing Southern Gulf Utilities to recover litigation expense amortized over fifteen years).

FCWC argues that courts in other jurisdictions recognize that extraordinary and non-recurring one time costs are recoverable and do not constitute retroactive ratemaking. Among other cases, the utility cites to Popowsky v. Pennsylvania Public Utility Commission, 643 A.2d 1146 (Pa. Commw. Ct. 1994) (holding that a rate increase to recover transitional expenses incurred in

switching from cash to accrual accounting was not retroactive ratemaking, but an 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).

The utility argues that during the period that the litigation expense at issue was incurred, there was no way to determine how long the process would continue nor to what extent the costs would accumulate. (FCWC BR p. 16; TR pp. 356-65) According to the utility, sufficient data was not available to seek and support rate recovery of the costs at the time incurred. (FCWC BR p. 16; TR pp. 356-57) Also according to the utility, 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. (FCWC BR p. 17)

OPC

According to OPC, retroactive ratemaking occurs when a utility seeks future recovery for past expenses. (OPC BR p. 10) OPC takes issue with the following definition of retroactive ratemaking tendered by utility witness McClellan:

> Retroactive ratemaking generally refers to the application of current rates to recover from current ratepayers (or return to current ratepayers) revenues that should have been recovered (or not recovered) in rates of prior periods to cover costs of ordinary events [sic] effects were limited to those periods. (TR pp. 353-354)

OPC believes that the utility witness has tailored his definition to suit the facts of this case by restricting the definition to ordinary events whose effects are limited to prior periods. OPC does not agree with this limited definition. OPC argues in its brief that the utility witness could only base his definition of retroactive ratemaking on "years of experience," and nothing more. (EXH 21 p. 4)

OPC counters that the restriction on retroactive ratemaking refers to the application of current rates to recover from current ratepayers (or return to current ratepayers) revenues that should have been recovered in the past. (OPC BR p. 6). All of the

litigation costs were expensed for federal tax purposes either in the year of occurrence or before the case at hand was filed. Since these amounts have already been expensed below the line, the time has come and gone for seeking recovery. Akin to the concept of "below the line," OPC draws a figurative line in the sand. On one side of the line are past expenses and on the other side are the current expenses. Past expenses should not be resurrected in the test year. (OPC BR p. 6) According to OPC, because these expenses were incurred in prior periods, the Commission does not have the authority to "resurrect" these amounts for recovery from current and future ratepayers. (OPC BR p. 6)

OPC argues that the reason the utility did not come before the Commission at the outset of the occurrence of litigation expense was because, as utility witness Allen testified, it was "highly doubtful" that the Commission would allow recovery of these amounts. This opinion by the President of the utility was based on past experiences with the Commission. (TR p. 266)

OPC cites to Gulf Power Company v. Bevis, 289 So. 2d 401 (Fla. 1974). In this case, the Commission was overturned when it created a test year that exposed Gulf Power Company to newly created corporate income taxes. The Court reversed the Commission, upon finding that "rates are fixed for the future rather than for the past and for that reason a pre-fixed earlier period cannot be arbitrarily applied." From this decision, OPC draws the conclusion that the Commission's ratemaking jurisdiction is limited to prospective remedies. (OPC BR p. 11)

According to OPC, in the Ortega case cited above, the water and wastewater utility applied for a higher authorized rate of return to recover past losses that were the result of under recovery of depreciation expenses for periods before the test year. The Commission denied this request and stated the following:

> We believe that the request for authority to reverse depreciation expense that has already been recognized is a request to recover past losses. Granting the request would be a form of retroactive ratemaking because it seeks to recover past losses, however the utility wishes to define which accounting terms might be affected. Whether that adjustment is titled a correction to accumulated depreciation or a correction to CIAC, the impact is the same, rate base is increased to eliminate a loss that has already been recorded. (OPC BR p. 12)

The Commission decided not to allow the recovery of these past losses, even though the utility could have been entitled to the expense had it been requested in the prior rate case. The Commission would not go back and correct these losses by increasing future rates. OPC argues that the prohibition against retroactive ratemaking delineated in Ortega should apply with even greater force in the case at hand since Ortega involved recognized losses, not merely unrecovered expenses that are being requested by FCWC. (OPC BR p. 13) According to OPC, Ortega wanted new rates to make up for a revenue shortfall in prior periods. FCWC is trying to make up for expenses which occurred in prior periods. Ortega failed and so should FCWC. (OPC BR p. 14)

The next case cited in OPC's brief was decided by Order No. 17304, issued March 19, 1987, in Docket No. 850062-WS, and involved Meadowbrook Utility Systems, Inc. (Meadowbrook). Meadowbrook sought recovery from a previously established inadequate rate of return. The utility requested that common equity be increased by $54,243 due to the loss of that amount of revenues during the time that the interim rates from the prior rate case were in effect. By allowing a higher weighted cost for the return on equity, the utility would have been permitted to collect past losses in future rates. The Commission denied this request. The Commission took the following quotation from a North Carolina Case, Utilities Comm. V. Edmisten, 232 S.E. 2nd 184 (S.C.S. Ct. 1977), to explain its decision:

> Technically, retroactive rate making occurs when an additional charge is made for past use of utility service, or the utility is required to refund revenues collected, pursuant to then lawfully established rates, for such past use. A rate is fixed or allowed when it becomes effective . . . and rates must be fixed prospectively from their effective date. G. S. 62-136 (a) provides that the Commission shall determine rates 'to be thereafter observed and in force'. The Commission may not fix rates retroactively so as to make them collectible for past services . . .In re Application of Meadowbrook Utility Systems, Inc 87 F.P.S.C. 3:209 (1987) at 216 (OPC BR p. 14)

According to OPC, the surcharge sought here is brought about solely because of the conditions which prevailed before the case was filed. In Meadowbrook, the past condition which could not be remedied arose from allegedly inadequate interim rates. In the instant case, the past condition which cannot be remedied is inadequate recovery of litigation expenses. OPC argues that in

principle, the instant case is virtually identical to Meadowbrook and should be denied. (OPC BR p. 15)

The next case cited by OPC is GTE Florida, Inc. v. Clark, 668 So. 2d 971 (Fla. 1996). According to OPC, the court ordered the Commission to fix the effects of an erroneous order back to the point when the error effected rates. On appeal, the Commission's rate case decision for the telecommunications company was found to be in error. The court remanded the order to the Commission for further consideration and in an attempt to avoid the prohibition against retroactive ratemaking, the Commission reordered rates on remand that only made the utility partially whole. An appeal was taken from this decision and the court distinguished the surcharges from retroactive ratemaking by stating that "[w]e also reject the contention that GTE's requested surcharge constitutes retroactive ratemaking. This is not a case where a new rate is requested and then applied retroactively. The surcharge we sanction is implemented to allow GTE to recover costs already expended that should have been lawfully recoverable in the PSC's first order." Id. at 981. (OPC BR p. 16)

According to OPC, the significance of the GTE case is to show that when a court overrules a Commission order, it is not retroactive ratemaking to make the correction ordered by the court. The court is ordering the Commission to cure its previous mistake, as if the mistake were never made, and to allow the utility "to recover the contested expense just as if the Commission had correctly resolved the matter in the first place." (OPC BR p. 17) OPC argues that the instant case presents no such factual or legal scenario. There is no Commission order, no challenge, no reversal, and no remand. There is only a reach back for expenses previously and allegedly incurred. (OPC BR p. 18)

OPC cites to City of Miami v. Florida Public Service Commission, cited above, as another example of a "past conditions" type of case. The City of Miami tried to get the Commission to order a refund to customers based upon past overearnings, but the Commission declined, and ordered only a prospective reduction of rates to avoid future overearnings. The Florida Supreme Court approved the Commission's action, finding that retroactive ratemaking is prohibited.

OPC also cites to Southern Bell Telephone and Telegraph Co. v. Florida Public Service Commission, 453 So. 2d 780 (Fla. 1984) Gentel petitioned the Commission to change the way Southern Bell and Gentel shared toll revenues. The Commission came up with a new sharing model and ordered that it be applied retroactively to prior

periods in which a different approved model had been applied. The Court rejected the Commission's effort to remedy the past methodology. The Florida Supreme Court noted the following:

> We believe that the statutory authority to adjudicate such disputes is properly related to the Commission's essential function as regulator of the rates and service of utilities. However, we believe that any such adjudication must be given prospective effect only. To hold otherwise would violate the principle against retroactive ratemaking. See City of Miami v. Florida Public Service Commission, 208 So.2d 249 (Fla. 1968) 453 So.2d at 784

Id. at 784. (OPC BR p. 21)

The next case cited is United Telephone Company of Florida v. Mann, 403 So. 2d 962 (Fla. 1981). This case involved a reverse make-whole proceeding in which the Commission found overearnings by United Telephone and ordered a refund retroactively back to the day that the Commission had ordered certain revenues subject to bond. The Court found that the interim statute which permitted the Commission to establish interim rates contingent upon the outcome of the full hearing, permitted it to do so irrespective of whether the comprehensive proceeding resulted in an increased revenue or decreased revenue requirement for the applicant. The court implicitly recognized the prohibition against retroactive ratemaking in holding that "the commission has the discretion to determine [the] amount of revenues collected during the interim period which are excessive so long as that amount does not exceed the amount ordered subject to refund at the interim hearing."

Id. at 968 (OPC BR pp. 22-23)

OPC also cites to In Re: Application of Century Utilities, Inc., 82 F.P.S.C. 3:54 (1982). In this case, the utility attempted to convince a DOAH hearing examiner that it should be permitted to establish new rates which would allow recovery for incorrect depreciation rates that were in effect before the rate case filing. The hearing examiner rejected the attempt and the Commission adopted the DOAH order. The Commission order provides:

> The petitioner contends that the 2.5% annual depreciation rate should be retroactively applied because the change is the result of a "correction of an error" rather than a "change in accounting estimate."
>
> * * *

> The examples given in APB Opinion No. 20, paragraphs .10 and .13, to distinguish an error from a change in estimate lead the undersigned to conclude that a change in the projected life span of an asset, for depreciation purposes, is a change in estimate requiring prospective application only.
>
> * * *
>
> It is concluded that the 6% deprecation rate should apply from 1969 through the 1979 test year and that the 2.5% rate should apply from that date forward.

The hearing officer's conclusions were adopted by the Commission. Id. at 59 (OPC BR p. 26)

OPC contends that these "past conditions" cases support the premise that "no utility, no consumer, and not even one telephone company having been short changed by another telephone company, has ever been permitted to collect new rates which reach back in time to some perceived shortfall, whether the shortfall be perceived as low earnings, over earnings, or just expenses." (OPC BR p. 26) OPC argues that this is simply because the Commission has jurisdiction to engage only in prospective ratemaking, past conditions notwithstanding. According to OPC, while this may appear to be a harsh doctrine at first blush, in each of the above-cited cases, a party could have acted sooner to lessen its detriment. Ortega could have filed for new rates during the time of its alleged depreciation shortfall; Meadowbrook could have addressed its allegedly inadequate interim rates in the docket in which they arose; the City of Miami could have filed its petition sooner, or persuaded the Commission to hold some revenue subject to refund during the pendency of the case in order to have captured the overearnings achieved by FP&L and Bell in 1963 and thereafter; Gentel might have filed its petition earlier against Bell alleging a problem with separations and settlements; Century might have filed earlier to set its depreciation schedules right, and lastly, FCWC, in the instant case, might have filed its petition back when it began to incur these litigation expenses. If there be any harshness, OPC argues that it is harshness which could have been avoided by earlier action on the part of FCWC. (OPC BR pp. 26-27)

OPC concludes that a stake was driven in the ground when the utility filed its petition for relief on December 29, 1997. (OPC BR p. 30) When this filing was made, the expenses of the past became frozen in time, not to be resurrected for payment by current and future ratepayers. OPC argues that FCWC should have come forward and filed a petition requesting a prospective remedy such as an administrative order, in order to preserve its right to

collect these expenses. This was not done and therefore the time to recover these amounts has come and gone.

Analysis

The parties agree to substantially all the facts in this case. The facts relevant to this issue are as follow:

- On October 1, 1993, the civil lawsuit U.S. v. FCWC was filed against FCWC, alleging violations of the CWA. (TR p. 95)
- Between 1991 and 1997, FCWC incurred litigation costs of $3,905,664 and between 1994 and 1997 all of these expenses were written off below the line. (EXH 16, p. 5)
- On August 20, 1996, a judgement was rendered in the civil suit brought by the DOJ, and FCWC was found guilty of 1,536[2] violations of the CWA and fined $309,710[3], broken down as follows: (TR p. 78)

| FCWC System | Violations | Fines |
|---|---|---|
| Waterway | 1,038 | $289,425 |
| Carrollwood | 234 | 14,675 |
| Barefoot Bay | 264 | 5,610 |
| Total | 1,536 | $309,710 |

(EXH 4, GSA 24)

- On February 3, 1997, a judgement was rendered by the Federal Court denying FCWC's request for recovery of legal fees. (TR p. 169)
- On December 29, 1997, FCWC filed the limited proceeding petition at issue before the Commission to recover $2,265,000 in litigation costs from its regulated customers.

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[2] OPC, in Issues 3 and 12, claims that there were 2,300 violations of the CWA by FCWC. (EXH 6, GHB 97, p. 10) Staff believes the number is actually 1,536, as reported in the federal court order. (EXH 6, GHB 97, p. 22)

[3] See Attachment A for additional detail.

While there is agreement among the parties as to the underlying facts of this case, there is disagreement on the issue of whether these litigation costs can be recovered from the ratepayers, or whether approval of the utility's request is barred by the prohibition against retroactive ratemaking.

According to the utility (EXH 11, MM 2, pp. 5-7), the following table represents when the litigation costs occurred:

| Year | Litigation Expense |
|---|---|
| 1991-92 | $ 7,569 |
| 1993 | 91,628 |
| 1994 | 992,768 |
| 1995 | 1,327,999 |
| 1996 | 1,411,817 |
| 1997 | 73,982 |
| Total | $3,905,763 |

All of these amounts were expensed below the line in the year of occurrence. (EXH 12, p. 26) OPC argues that since all of these amounts were expensed prior to the filing date of this limited proceeding, December 29, 1997, the utility cannot recover these amounts. According to FCWC witness Murphy, all of the litigation "expenses were expensed below [the] line in the years incurred, '91 through '96/'97. So they need to be reestablished onto the books..." (EXH 12, p. 26) While it could be argued that the amount spent in 1997, less than 2% of the total, could be captured in the test year of this petition (this petition was filed in 1997), staff does not believe that the record supports this amount being treated any differently than the other amounts reported in previous years.

For the reasons set forth below, staff agrees with OPC that the utility's request for recovery of the litigation expenses at issue should be denied in its entirety because it constitutes a request for retroactive ratemaking, which is prohibited by law. Our review of the facts in this case and the cases cited by both OPC and the utility lead us to conclude that FCWC is seeking to bring forward past expenses and recover these amounts in future rates, which request violates the prohibition against retroactive ratemaking.

By Order No. PSC-98-1243-FOF-WS, issued September 21, 1998, in Docket No. 971596-WS, In re: Petition for limited proceeding regarding other postretirement employee benefits and petition for variance from or waiver of Rule 25-14.012, F.A.C., by United Water Florida Inc., at page 13, the Commission recently observed that:

> This Commission has consistently recognized that ratemaking is prospective and that retroactive ratemaking is prohibited. See City of Miami; Gulf Power Co. v. Cresse, 410 So. 2d 492 (Fla. 1982); Meadowbrook Utility Systems, Inc. v. Florida Public Service Commission, 518 So. 2d, 326 (Fla. 1987); Citizens of the State of Florida v. Florida Public Service Commission, 448 So. 2d 1024 (Fla. 1982); and GTE Florida Inc. v. Clark. See also Ortega Utility Company 95 Florida Public Service Commission 11:247 (1995). The general principle of retroactive ratemaking is that new rates are not to be applied to past consumption. The Courts have interpreted retroactive ratemaking to occur when an attempt is made to recover either past losses (underearnings) or overearnings in prospective rates. Past losses are interpreted to be prior period costs that a utility did not recover through its rates, causing the utility to earn less than a fair rate of return. An example of this was addressed in the Ortega case, when the utility requested to reduce accumulated depreciation in a rate case for prior losses where the utility argued that it had not earned a fair rate of return. In City of Miami, the petitioner argued that rates should have been reduced for prior period overearnings and that the excess earnings should be refunded. Both of these attempts were deemed to be retroactive ratemaking and thus were prohibited.

Staff disagrees with the utility's implicit argument that City of Miami V. Florida Public Service Commission is inapplicable because it is based on statutory language not contained in Chapter 367, Florida Statutes, but in Chapters 364 and 366. We note that also by Order No. PSC-98-1243-FOF-WS, at page 14, the Commission observed that "[e]ven though Section 367 does not contain the same specific language as Chapters 364 and 366, the Courts have consistently applied the same prospective requirement for ratemaking. It would not be fair, just, or reasonable to the customers to set rates based on prior consumption." This same "fair, just, and reasonable" standard is contained in Chapter 367, Florida Statutes.

Staff agrees with OPC that the utility's argument that GTE Florida Inc. v. Clark should be interpreted to mean that the proposed surcharge is not a new rate applied to prior consumption fails to take into consideration that GTE concerned a surcharge which the Court sanctioned to allow the utility to recover costs already expended which the Commission should have previously allowed in an order which was reversed by the Court. The facts of the present case are clearly distinguishable from those in GTE. As noted by the Commission in Order No. PSC-98-1243-FOF-WS, at page 16, the GTE case "should be read narrowly to apply in situations in which a surcharge was permitted to recover costs which should have been allowed in a timely filed case. UWF did not request recovery or deferral of the OPEB costs in question prior to incurring the costs." Likewise, FCWC did not request recovery or deferral of the litigation costs in question prior to incurring the costs, and there is no erroneous order in existence which must be corrected to allow the utility to recover costs which should have been previously allowed.

The utility also argues that its request is similar to the recovery which the Commission allowed by the Ortega order cited above, of "certain depreciation expenses for past years on the basis that such adjustment covered depreciation expenses that were approved but were designed to be recovered on a prospective basis." This argument fails. The expenses which FCWC requests to recover here have not been previously approved for recovery on a prospective basis. The expenses have not been approved at all.

The utility further argues that the proposed litigation costs are extraordinary and non-recurring, and should therefore fall within an exception to the prohibition against retroactive ratemaking. However, the NARUC Uniform System of Accounts 1996 requires that Commission approval must be obtained to treat an item as extraordinary:

> General-Extraordinary Items--Those items related to the effects of events and transactions which have occurred during the period and which are not typical or customary business activities of the company shall be considered extraordinary items. Commission approval must be obtained to treat an item as extraordinary. Such request must be accompanied by complete detailed information.[4]

[4] Note that the language in the 1984 NARUC Uniform System of Accounts, the last revision prior to 1996, is the same as stated above. (1984 NARUC System of Accounts, p. 16)

Rule 25-30.115, Florida Administrative Code, requires utilities to maintain their accounts and records in conformance with the 1996 NARUC Uniform System of Accounts. Because FCWC has not obtained prior Commission approval to treat this expense as extraordinary, the cases which the utility cites for the proposition that there is an exception to the prohibition against retroactive ratemaking for non-recurring extraordinary costs are inapplicable.

Utility witness McClellan testified that the reason the utility did not come before the Commission at the outset of the litigation and request some type of administrative treatment for these costs was because the utility did not know how long the civil case would take to resolve, nor how much it would eventually cost. (TR pp. 356-357) The utility did not seek recovery of these costs until the end of 1997, some four years after the initiation of the court case in 1993 and some six years after the first payment of legal fees related to the case. (EXH 12, p. 26) Arguing that the utility did not need absolute knowledge of the extent of the expense to come before the Commission, OPC witness Larkin testified:

> If the Company had a basis to recover these expenses, it was to file a rate case at the time the expenses were being incurred and ask for the recovery as part of a rate case, or to come before the Commission and ask for an Accounting Order allowing for the deferral of the legal fees to be considered in a single issue rate case. The Company has not done so, and has merely decided to retroactively attempt to recover these expenses from ratepayers. (TR p. 263)

As OPC points out in its brief, this situation could have been avoided. During the course of the litigation with the EPA/DOJ, FCWC filed several rate cases. In any of these proceedings, the utility could have filed a request with the Commission regarding the status of the mounting legal expenses. FCWC came before the Commission in Docket No. 950387-SU, a North Ft. Myers rate case, and according to staff witness Moniz, "the Commission accepted a stipulation to remove the legal fees from rate base. The record did not reflect why these fees were capitalized for more than two years and then expensed below the line." (TR p. 316) The utility could have, at this time, contested the staff's adjustment, but for unknown reasons they chose not to.

The utility argues that the Commission has allowed recovery of other out of test year litigation expenses on the basis that these expenses are extraordinary and non-recurring. As noted above, FCWC

cites to Order No. 6094, issued April 5, 1974, in Docket No. 74061-EU, and Order No. 5044, issued February 4, 1971, in Docket No. 70214-W, as support for its position. However, staff notes that the expenses approved in those dockets were requested in rate cases, and not for costs incurred prior to the date the application was filed, as is the case here. As courts have made clear, there is no reasonable claim for costs incurred prior to the date the application was filed or for cost categories discovered after the rate case is approved. The prohibition against retroactive ratemaking protects the public by ensuring that present consumers will not be required to pay for past deficits of the company in their future payments. This practice is fair to the public utility, for it can act as speedily as it sees fit to move for a correction of inadequate rates. It is also fair to the consumers, as they are safeguarded from surprise surcharges related to past accounting periods.

The prohibition against retroactive ratemaking also prevents the company from employing future rates as a means of insuring the investments of its stockholders. If a utility's income were guaranteed, the company would lose all incentive to operate in an efficient, cost-effective manner, thereby leading to higher operating costs and eventual rate increases.

Allowance of these litigation expenses would violate the principle against retroactive ratemaking because it denies customers their right to be free from surprise surcharges after the service has been provided. Staff believes the utility had ample opportunity to bring these costs before the Commission when they were first being incurred, but chose not to. By choosing this course, the utility created generational inequity that the staff believes cannot be corrected without violating the prohibition against retroactive ratemaking.

For the foregoing reasons, staff recommends that the utility's petition for limited proceeding to recover litigation costs should be denied. Recovery of these past expenses would be neither fair, just, nor reasonable.

Policy Considerations

While staff believes that granting FCWC's petition in this case constitutes retroactive ratemaking, we also believe the petition should be denied on its merits as discussed below.

FCWC management had complete control over whether to come before the Commission to request recognition of litigation costs as

they were first being incurred. The utility chose not to request Commission recognition of these amounts, as required by the NARUC system of accounts. Similar to the way the utility handled the initial denial of the NPDES permit for Waterway in 1986 (EXH 5, p. 14 and EXH 10, p. 55) or the way the utility failed to file for an NPDES permit for Barefoot Bay before discharging to open waters (EXH 4, GSA 14, p. 2), FCWC has shown on numerous occasions a propensity to put off compliance with administrative edicts.

The following select chronology[5] of events highlights the enforcement actions taken by the EPA, DEP and other parties and the untimely response to these activities by FCWC:

**Carrollwood**

9/01/77 Hillsborough County Pollution Control Commission issues citation to FCWC for failure to comply with FDEP TOP[6] and illegal discharge to Sweetwater Creek (TR p. 64)

10/01/79 FDEP sends notice to FCWC that no discharges are to be made to Sweetwater Creek (TR p. 65)

4/19/91 EPA Admin. Order **FCWC fined $15,000** for illegal discharge between 6/87 and 7/90 to Sweetwater Creek (TR pp. 68-69)

6/05/91 Interconnection agreement with Hillsborough County (EXH 4, GSA 12, p. 1) **Completion of an interconnection agreement with the County took almost 12 years**, from 1979 to 1991 (TR p. 69)

**Barefoot Bay**

11/13/85 FDER discovers illegal discharge of effluent to Sebastian River (EXH 4, GSA 14, pp. 2-3)

2/28/90 FCWC applies for initial NPDES permit for system, some **four years after the first discovery of illegal discharge of effluent into open waters** in 1985(EXH 4, GSA 19, p. 2)

9/25/91 EPA Consent Agreement and Order-**Fine of $6,000** for illegal discharge of effluent (EXH 4, GSA 23, p. 4)

12/16/94 FCWC files application with EPA for NPDES permit following conversion to AWT. (TR pp. 71-72) **Conversion took more than six years to complete.**

**Waterway**

12/08/86 NPDES permit denied based on a zero wasteload allocation (EXH 10, p. 55)

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[5] See Attachment C for additional events.

[6] Temporary Operating Permit

07/15/88 FDER Consent Order **Fined $15,000** (EXH 10, p. 57)
9/01/92 AWT completed (TR pp. 54-55)
6/01/93 Outfall line changed-from the first notice in 1987, **it took almost 6 years for the utility to comply with regulatory mandates** of AWT and moving the outfall line. (TR p. 55)

All three of the systems named in the federal suit were fined and experienced prolonged delays in adhering to consent orders and the requirements of the CWA. According to FDEP witness Ahmadi, construction delays by FCWC were unjustified. (EXH 15, p. 19) As an example, it took almost six years, from 1986 until 1992, for the Waterway treatment plant to be upgraded to AWT status and for the outfall line to be moved. (TR pp. 54-55; EXH 3, p. 11) Be it delays in compliance with administrative orders, consent agreements, construction schedules, and/or accounting instructions, the utility has repeatedly delayed timely response to regulatory mandates. In resolving the problems at Waterway, FDEP witness Ahmadi contends that the utility had difficulty dealing with Source, Inc. (engineers picked by the utility), FDER review, compliance with the antidegraduation rule, and interaction with both North Ft. Myers Utility and Lee County. (EXH 15, pp. 35-36) These difficulties caused a 594 day delay in compliance with the consent agreement that the utility had with the EPA. (EXH 15, p. 37) According to FDEP witness Ahmadi, FCWC was "dragging their feet and not going to go ahead with the AWT process unless they were forced to." (EXH 15, p. 27) Having reviewed the history of events for this utility, staff concludes that the delays in adhering to regulatory orders from the EPA and DEP were neither reasonable nor prudent.

The Federal Court ruled that Waterway had violated the CWA by discharging effluent to the Caloosahatchee River without a permit between October 1, 1988 and October 31, 1989, some 369 days. (EXH 6, p. 7) For over a year, the utility ignored the requirement that it have an active NPDES permit. Near the end of 1985, the FDER noted illegal discharges coming from the Barefoot Bay wastewater plant. (EXH 4, GSA 14, pp. 2-3) Apparently the EPA was not aware that this system was in operation, or that it was discharging effluent to the Sebastian River. FCWC did not make an initial application for an NPDES permit for this facility until February 28, 1990. (EXH 4, GSA 19, p. 2) So while it was dumping effluent illegally for over a year at the Waterway plant, it took almost four years for the utility to come forward and make application for the Barefoot Bay system. Utility witness Allen made the statement that he "never believed that the company didn't think that it was necessary to have an NPDES permit." (EXH 5, p. 44) However, it

would be another six years at the Barefoot Bay system before the effluent discharge problem would be corrected through the construction of an advanced wastewater treatment facility. (TR p. 72)

The utility has taken every opportunity to blame other parties for the circumstance FCWC found itself in the early 1990's, including that the EPA wrongly denied the issuance of an NPDES permit (EXH 5, p. 14); the County of Hillsborough would not work with the utility toward interconnection (TR pp. 64-65); Lee County caused delays in providing zoning changes (EXH 10, p. 55); the Army Corp. of Engineers caused delays in the relocation of the outfall line at Waterway (EXH 10, p. 61); the EPA reporting requirements were unfair (TR p. 77); and the DOJ would not negotiate in good faith to settle this matter. (TR pp. 74-75) Nevertheless, despite these problems, the management of the utility had complete control over coming before the Commission to request recognition of these litigation expenses when they were first being incurred.

Even if the Commission were to disagree that the utility's request for recovery of the litigation expenses at issue is a request for retroactive ratemaking, staff would recommend that the request should still be denied based on the unreasonable delays by FCWC management to adhere to environmental mandates. We are cognizant that two cases cited by FCWC involved Commission approval for the non-retroactive recovery of legal expenses incurred for defending fines from DEP and EPA. The Commission, in those cases, concluded that the legal expenses were 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. In re: Application for Rate Increase in Duval, Nassau, and St. Johns Counties by United Water Florida Inc., 97 F.P.S.C. 5:641, 686; In re: Application for Rate Increase in Lee County by Lehigh Utilities, Inc., 93 F.P.S.C. 2:775, 795. Staff believes these two cases can be differentiated from the case at hand since there was no elimination of large capital improvements to the regulated systems of FCWC, nor did the management act in a reasonable manner to avoid or reduce the amount of fines imposed. To the contrary, the utility showed on numerous occasions that it was willing to accept the imposition of fines in furtherance of delaying the construction of mandated plant improvements.

Two Florida Water Services Corporation (Florida Water) cases not cited by the parties involved recovery of legal costs incurred to litigate fines from the DEP and EPA. Although the litigation costs were allowed, the costs were also immaterial to the total revenue requirement. Moreover, they could be viewed as legal

expense that would be recurring and normal in day-to-day operations of the utility. By Order No. PSC-93-0423-FOF-WS, issued March 22, 1993, in Docket No. 920199-WS, the Commission acknowledged that if a utility defends itself against DER action, the customers would benefit if rate base were lower because the utility did not have to make improvements. When rate base is not lowered, the defense efforts accrue directly to the benefit of the stockholders, just as the utility's avoidance of a fine would. In the case at hand, FCWC President Allen testified that there was no reduction in the amount of rate base that was eventually placed in service for the regulated systems of Barefoot Bay and Waterway Estates. (EXH 18, pp. 8-9, 11)

In the case at hand, the record does not reflect that the legal expenses were incurred to avoid capital improvements or to limit costly legal proceedings. For these reasons and from a policy standpoint, staff does not believe that the disputed legal costs should be allowed. There is no showing in the record that the test year provision for litigation costs is usual, as was the finding in the Florida Water cases cited above. Quite to the contrary, FCWC's litigation costs represent what can happen if all efforts at compliance and compromise fail. Staff does not agree that legal costs should be disallowed out of hand because they were incurred to defend the utility against alleged violations or that the utility should acquiesce in all cases, but we do believe that the utility should abide by its own promises (consent agreements). Should it risk the wrath of the federal government through unnecessary delays in compliance, it should do so at the peril of the stockholders. Staff does not believe that there should be an absolute prohibition against recovery of legal fees in any proceeding where a fine is imposed, but the Commission should decide on a case by case basis if the utility has acted in a reasonable and prudent manner. Staff does not believe that FCWC has done either in this case.

The litigation expense at issue here cannot be described as a legitimately incurred cost of operation. This case did not just involve the utility and the FDEP or EPA, but the matter was turned over to the DOJ for prosecution. The administrative route had failed and a civil trial was pursued in an attempt to get the utility to abide by the consent orders it had already agreed to. Staff does not believe that the evidence supports the contention that ratepayers benefited from the utility's defending itself in this federal lawsuit. The utility was not successful in its efforts to thwart a fine and there is no evidence in the record that the ratepayers benefitted from decreased amounts of rate base at any of the PSC regulated systems.

Based on the above, staff cannot recommend that the litigation costs in this case be passed through to the customers. Staff believes that recovery of these amounts today would constitute retroactive ratemaking, and while there have been exceptions to this policy, the case at hand does not comport with the facts supporting those exceptions. Staff does not agree with the utility that it is "requesting recovery of prudently incurred, necessary, [and] allowable expenses." (FCWC BR p. 10) Staff is of the opinion that the utility did not avoid the construction of capital improvements, did not avoid environmental fines and prosecution, did not follow prescribed accounting instructions, did not comply with mandated environmental improvements in a timely manner, and finally, did not act in a prudent or reasonable manner in dealing with administrative mandates and agreements. Based on the conclusion that granting relief in this docket would violate the prohibition against retroactive ratemaking and that FCWC management did not act in a reasonable or prudent manner to avoid the occurrence of federal prosecution, staff recommends that FCWC's petition for limited proceeding to recover litigation costs should be denied.

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

**RECOMMENDATION:** No. (Mann)

**POSITION OF THE PARTIES**

**FCWC:** No.

**OPC:** Yes. (Larkin)

**STAFF ANALYSIS:** It is the opinion of the utility that there is no statute, rule, or policy that requires that a utility first obtain an accounting order prior to filing a petition for a limited proceeding to recover litigation expenses. (FCWC BR p. 18)

OPC argues that when OPC witness Larkin was asked to refer to a rule that specifically required an accounting order, he admitted that he was unaware if such a policy or rule requirement existed. (EXH 16, p. 12) Mr. Larkin also stated that by coming before the Commission in pursuit of an accounting order, the utility may have had an opportunity to avoid the prohibition against retroactive ratemaking. (TR p. 263) It is his opinion that the utility should have sought recognition of the deferral by the Commission. (EXH 16, p. 14) OPC witness Larkin, quoting from FAS 71, cited the following:

> a regulated company can capitalize an item which would be normally expensed in an accounting period **based on an understanding or authority from the Commission** that they can do that and that there will be revenues provided in rates equal at least to the capitalized cost. (EXH 16, pp. 51-52)(emphasis added)

The fact that the utility claims that these expenses were "extraordinary" leads the staff to believe that the following NARUC accounting instruction may have been helpful in determining whether or not to come before the Commission for an accounting order:

> Extraordinary Items-Those items related to the effects of events and transactions which have occurred during the period and which are not typical or customary business activities of the company shall be considered extraordinary items. **Commission approval must be obtained** to treat an item as extraordinary. Such request must be

> accompanied by complete detailed information. (1996 NARUC System of Accounts, p. 17)(emphasis added)

Adherence to these accounting instructions is mandated by the following rule[7]:

> 25-30.115 Uniform System of Accounts for Water and Wastewater Utilities.
> Water and wastewater utilities shall, effective January 1, 1998, maintain their accounts and records in conformity with the 1996 NARUC Uniform Systems of Accounts adopted by the National Association of Regulatory Utility Commissioners. All inquiries related to the interpretation of these uniform systems of accounts shall be submitted to the Commission's Division of Water and Wastewater in writing.

While staff agrees with the utility that there is no specific requirement that a utility first obtain an accounting order prior to filing a petition for a limited proceeding, we do believe, that based on the NARUC accounting instructions, that it would have been advisable to obtain such an accounting order in this case.

[7] Note that the language in the 1984 NARUC Uniform System of Accounts, the last revision prior to 1996, is the same as stated above. (1984 NARUC System of Accounts, p. 16) The rule that was in effect in 1985 mandated compliance with the NARUC System of Accounts.

**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?

**RECOMMENDATION**: Yes, however in staff's opinion prior effort to comply with EPA and FDEP mandates may have forestalled action by the DOJ. (Walden, Mann)

**POSITION OF THE PARTIES**

**FCWC**: Yes.

**OPC**: The Citizens have no position as to whether FCWC defended itself in a reasonable and prudent manner from the charges levied by the Federal environmental authorities. However, the Citizens urge that FCWC acted unreasonably and imprudently by violating the Clean Water Act more than 2300 times and acted unreasonably and imprudently by incurring the enforcement action of the federal authorities. (Larkin)

**STAFF ANALYSIS**:

FCWC

FCWC believes that it acted reasonably and prudently in defending itself against charges of violating the CWA. The utility believes the case was an example of an overzealous prosecution by a DOJ attorney. (TR p. 322; EXH 5, p. 29) The major issues were severity of violations and the ability of FCWC to pay penalties. The DOJ was demanding $53 million in penalties at the onset of the trial. (EXH 5, pp. 40-43)

Witness Allen testified that the outcome of the enforcement case was a successful defense of legal action brought against the utility. (TR p. 48) He further testified that FCWC kept the EPA informed of upgrades occurring to the wastewater plant, including the relocation of the outfall to the Caloosahatchee River. (TR p. 57) He went on to describe how settlement offers were made, how outside counsel was retained to assist in these settlement discussions, and then, how other counsel was retained when settlement became unlikely. (TR pp. 59-60, 78-82) Allen claims that the utility controlled expenses and acted prudently in the defense of this case. (TR pp. 84-90)

Witness Baise stated that his team reviewed documents in EPA's files, and inquired at four EPA offices for records of NPDES permit

denials. Substantial time was spent reviewing documents of the EPA and the DEP. Mr. Baise testified that this review showed that denial of a permit under the Clean Water Act program was rare. (EXH 19, pp. 7-10)

Mr. Baise testified that Ms. Connie Kagey, of the EPA, made an egregious error and violated the EPA's own regulations in denying the NPDES permit for Waterway Estates. EPA had been notified one month before Ms. Kagey acted to deny this permit, that this facility had a wasteload allocation. Dr. Ahmadi, with the FDEP, stated that Waterway Estates had a wasteload allocation every year from the time it was first authorized to operate. (EXH 19, pp. 11, 13, 49)

In 1993, prior to the federal trial, Mr. Baise brought the matter of improper denial of the permit to the attention of the EPA and the DOJ, showing this case was unusual and did not need to be pursued vigorously. EPA would not change its mind. (EXH 19, pp. 27-28)

Mr. Baise stated that he thought the complaint filed by the DOJ was wrong. It was impossible to get EPA and DOJ to deal with facts and stop the legal action. FCWC was forced into a position of defending itself. At the trial, witness Baise stated that this federal action was based on a mistake by an EPA employee. He made the same assertion in the Motion for Summary Judgment. The mistake made was improper denial of Waterway Estates' 1986 NPDES permit renewal. (EXH 19, pp. 17, 28-29)

OPC

OPC has taken a position that the Commission should not have to judge the quality and motives of the Court's case, or the zeal of the government's prosecution. Mr. Larkin testified that the federal court had adequate opportunity to do this, and in fact responded to FCWC's request for attorneys' fees and costs from the federal government by stating that the company

> [had] not adduced sufficient proof of the bad conduct or ill motive of [the Government] in litigating these claims so as to support a finding of bad faith. [The] Government's actions and conduct herein are simply not of the character that merits awards under the bad faith exception. (TR p. 275)

Mr. Larkin added that even if the government's case were determined to be extremely aggressive, the ratepayer is not the payer of these costs; ratepayers were not in charge of the utility's system, its

operation, or its violation of the Clean Water Act and responsibility for legal fees should rest with the stockholders. (TR pp. 275-276)

Witness Larkin did not believe the government acted maliciously toward FCWC. He suggested not allowing the company to recover litigation costs because it was management's responsibility to operate the plants, and the ratepayer should not be held responsible for any proposed violation. Mr. Larkin believes that violation of the Clean Water Act is clearly something management has control over. The thrust of his comments was toward the expenses that flow through rates to the customers, and not a reevaluation of what the court did. (EXH 16, pp. 18-22)

Analysis

Staff believes that at the point in time at which FCWC finally took action, the utility acted prudently and reasonably in defending the interests of the shareholders. The record contains no evidence that FCWC did not act prudently and reasonably in defending the legal action brought by the DOJ on behalf of the EPA. Staff has reviewed the invoices for legal services and read the testimony by Mr. Geddie, a consultant for the utility who reviewed the reasonableness of the legal expenses. (TR pp. 176-193) With the record being devoid of quantitative analysis of the legal defense, staff is not in a position to recommend any specific adjustments.

Nevertheless, for informational purposes, staff notes that there are certain areas in the legal defense that appear to have provided little or no value for the ratepayers. The record contains evidence that significant amounts of legal time were spent researching terms such as "outfall location" and "receiving waters." (TR p. 100) Ratepayers could certainly expect that the utility should be aware of the meanings of these terms. Legal research was done regarding "claim splitting" (TR p. 137) and the effect this would have on Avatar and FCWC. Avatars' involvement is irrelevant to the ratepayers in this case. Several unsuccessful attempts were made to "disqualify the DOJ attorney." (TR p. 113) Staff believes this has little or no value to the ratepayers. Quoting from the legal invoices, in [the]"spring and summer our research included a substantial legal and factual inquiry into the inferences to be drawn from invoking the 5th Amendment at depositions" (TR pp. 75-76) Staff does not believe that these expenditures benefitted the ratepayers and that they had direct benefit instead for the utility management.

The legal invoices contained reference to research regarding a Biven's action.[8] (TR p. 136) Since this action was never pursued, staff is at a loss to determine from the record what constitutional protections were being violated by the DOJ, EPA, or the judiciary. Once again, there appears to be no benefit to the utility customers.

Ratepayers could fairly ask why they should have to pay the legal costs related to the unsuccessful request for costs and attorneys' fees under Federal Rules 54 and 68. The utility counsel, for a second time, could not prove to the judge that FCWC was a prevailing party, nor could they prove that the government had acted in a wanton, vexatious, egregious, and/or oppressive way. (EXH 5, p. 77) Adding to these costs, the utility filed a cross appeal of the federal judges' denial of the FCWC motion for costs and attorneys' fees, which was subsequently withdrawn. (TR pp. 170-171)

According to utility attorney Baise, the CWA is a strict liability statute, meaning that every exceedance of an NPDES permit is a violation. (EXH 18, p. 11) Accepting this as correct, staff wonders why the utility did not accept the punishment for the undisputed violations. No one has perfect foresight and everyone has perfect hindsight, but looking back at the occurrence of $3.9 million in legal fees for a $309,710 fine, it appears, at least on the face of it, to be an imprudent expenditure. Since this litigation did not save the regulated ratepayers from the expense of mandated improvements in plant, then does the fine become $4.2 million when you add the legal fees to the actual penalty? (EXH 18, pp. 9-11)

In summary, staff believes that FCWC acted prudently and reasonably in defending the legal action brought by the DOJ on behalf of the EPA. However, as noted in Issue 4, the utility did not act prudently in failing to challenge the EPA's 1986 NPDES permit denial. This action on the part of the utility may have forestalled the legal action by the USDOJ.

[8]From Black's Law Dictionary, 6th ed.:Biven's Action-name for type of action for damages to vindicate constitutional right when federal government official has violated such right.

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

**RECOMMENDATION:** No. (Walden)

**POSITION OF THE PARTIES**

**FCWC:** Yes. There is no way to determine the amount of FCWC's litigation expenses if the EPA action had been challenged.

**OPC:** No. In 1986, FCWC had substantial evidence in its possession that refuted the EPA's basis for its decision to deny the permit. FCWC should have challenged the EPA's 1986 tentative denial of Waterway Estates' (Waterway) NPDES permit renewal, pursuant to Title 40, Section 124.13, Code of Federal Regulations. FCWC should also have challenged the EPA's 1986 final denial of Waterway's NPDES permit renewal, pursuant to Title 40, Section 124.74, Code of Federal Regulations.

**STAFF ANALYSIS:**

FCWC

FCWC was notified by the EPA by letter dated July 22, 1986 of its intent to tentatively deny the renewal of the NPDES permit. The letter stated that denial was being considered due to no wasteload allocation being assigned to the facility by the Florida DER on January 19, 1981, and further stated that there should be no permitted discharge from the wastewater treatment plant to the Caloosahatchee River via a canal. (TR p. 201; EXH 9, MA-2, p. 4; EXH 5, p. 13)

A wasteload allocation had been in existence for this facility as far back as 1975, and no change had been made in the allocation between 1981 and 1986. (TR pp. 202-203) In fact, the DEP had notified the EPA of the wasteload allocation assigned to Waterway Estates by letter dated May 7, 1986, stating the allocation of this wastewater plant, five other plants, and a reserve allocation that was not assigned. (TR pp. 206; EXH 9, MA-4, p. 1) Meanwhile, the DEP had issued an operating permit to Waterway Estates dated August 2, 1983, with an expiration date of August 2, 1988. (TR p. 205; EXH 9, MA-3)

It appears that the EPA was not aware that the Waterway plant had a valid operating permit and a wasteload allocation from the Florida DEP. After receiving the letter stating tentative denial,

and being in possession of evidence showing a valid wasteload allocation, FCWC failed to notify the EPA that the reason for tentative denial was erroneous, or at least subject to question. Witness Allen did not know whether the company had responded in writing or not. (EXH 5, pp. 19-20) Witness McClellan clarified that the utility did not respond. FCWC did not carry out any procedures to challenge either the tentative denial in July, or the final denial in December of 1986. (EXH 13, response to Staff Interrogatory 32)

Instead, FCWC met with the Florida DEP on July 29, 1986 to discuss the tentative denial of the NPDES permit. The DEP stated it would honor the current permit it had issued which was valid for two more years. (TR p. 206; EXH 9, MA-5; EXH 19, p. 31) FCWC believed it was satisfying the lead permitting agency, the Florida DEP, since DEP had established the wasteload allocation. (TR p. 52, 207, 209) The State of Florida has more stringent wastewater effluent limitations than the EPA. EPA requires 85% removal; Florida is 90 or 95%. Most NPDES permits do not have limitations for phosphorus and nitrogen at the levels Florida has. (EXH 19, pp. 42-43)

Witness Allen stated that while EPA had the jurisdiction to issue NPDES permits, with his experience in permitting issues with respect to the Clean Water Act, the DER was clearly the lead agency although the DER did not have authority to issue NPDES permits until May of 1995. The utility's view was if the DEP were satisfied due to a more comprehensive permitting system, then the EPA would go along with whatever those requirements were, due to EPA's reliance on DEP and local issues. The DEP was not asked to contact the EPA to explain that there was a wasteload allocation for the Waterway system. (TR p. 52; EXH 5, pp. 44-46, 15-19)

Another letter was sent to FCWC from the EPA dated December 8, 1986, notifying the utility of denial of the NPDES permit application for Waterway Estates. This letter stated that this was the EPA's final permit decision, which would become effective thirty days from the receipt of the letter by the utility, although it could be contested by submitting a request for hearing. (TR p. 206; EXH nine, MA-6) No response was made by FCWC to EPA.

This permit denial was an issue in the DOJ trial. (EXH 18, pp. 11-12) Witness Allen stated that he did not know how it could be concluded that a challenge of the permit denial would have been successful. If the utility had filed a protest, he did not think the outcome would have been any different, and thought the EPA would have done basically the same things that occurred, i.e.,

acquiescing to the DER and moving the outfall out of the canal, and upgrading the wastewater treatment plant to AWT. One change that might have been different is the first administrative order from the EPA instead of saying to cease the discharge, might have included two other alternatives, such as relocating the outfall and upgrading the plant. (EXH 5, pp. 28, 101-103)

Concerning a challenge of the permit denial, witness Baise stated that when he had challenged permits after issuance, EPA had vigorously fought the challenge. He believed that EPA did not want to admit any mistake, and would rather have the court tell them they were wrong in denying a permit. Mr. Baise did not have confidence that anything different would have occurred if the matter had been brought to the EPA's attention in January 1987. (EXH 19, pp. 22-23, 28) Witness Allen did not believe that legal expenses of defending FCWC could have been avoided if the permit denial had been challenged. (EXH 5, p. 17)

There was no doubt that Ms. Kagey, an employee of the EPA, did not follow EPA regulations, and in fact, broke those regulations in denying the permit. (EXH 19, p. 26) Her supervisor said he could find no reason the denial occurred. Ms. Kagey relied on a regional study from 1980 or 1981, which proposed a huge regional facility, to which other facilities would connect. All facilities that connected would then have a zero wasteload allocation. (EXH 19, pp. 26, 48)

FCWC alleges that compliance was important, and the company's goal was to achieve that. Compliance was always a top priority, according to witness Allen, and he consistently promoted strict compliance as being in the best interest of his employer and the utility customers. Avatar and its subsidiaries support this too. Reasons include good stewardship, avoidance of economic sanctions, and maintaining productive a relationship with the regulatory agencies. (TR pp. 324-325)

FCWC worked with the DEP and the EPA to make sure Carrollwood, Barefoot Bay, and Waterway Estates were in compliance, and to take action necessary to achieve compliance. Barefoot Bay and Carrollwood were resolved with the EPA and the DEP. Waterway Estates was resolved with the DEP [but not the EPA] prior to the DOJ's allegations. No appreciable legal work was necessary until the EPA wanted to pursue the Waterway Estates issue. (TR pp. 340-341) The initial investigation and complaint by the DOJ were only directed toward the North Ft. Myers wastewater system, Waterway Estates. (TR pp. 226-227)

Meanwhile, the Waterway Estates plant continued to discharge effluent to a canal, which flowed into the Caloosahatchee River. EPA notified FCWC by letter dated May 7, 1987, that Waterway Estates was in violation of the Clean Water Act, and issued a "Section 309" order, which ordered FCWC to cease discharging pollutants to the waters of the United States as early as practicable, but not later than September 30, 1988. (TR p. 210)

The order specifically states that the NPDES permit for this treatment plant was denied December 8, 1986. The order further states:

> Discharges of pollutants into waters of the United States are unlawful unless permitted by and NPDES permit, or specifically exempted from NPDES requirements. The final effluent limits for this facility to a canal of the Caloosahatchee River are "no discharge." An NPDES permit cannot be issued to a facility that is discharging to a no discharge area. (EXH 9, MA-8, pp. 1-3)

An NPDES permit was issued September 29, 1989 by the EPA. (TR pp. 210-211; EXH 9, MA-9) Two administrative orders were issued by the EPA, which contained a schedule for compliance and plant improvements. The schedule was amended twice, and FCWC met the parameters of that schedule except with respect to consistently meeting nitrogen and toxicity limits set forth in the NPDES permit. (TR pp. 53-54)

OPC

OPC witness Larkin stated that had the permit denial been challenged, there would have been an administrative process with the EPA, but he did not know what the level of litigation expenses might have been. (EXH 16, p. 54)

Analysis

Staff notes that witness Baise's testimony about the fruitless pursuit of a challenge refers to a period after the permit denial had been issued. Nothing in his testimony suggests what the outcome might have been if the utility had questioned the tentative denial in July 1986. More than four months elapsed (July 22 until December 8, 1986) between the letter of tentative denial and actual denial of the NPDES permit.

Staff tends to agree with witness Allen that it could not be concluded that a challenge of the permit denial would have been successful. That having been said, staff is still perplexed by the fact that FCWC failed to challenge the permit denial (either the tentative denial or the final denial); did not notify the EPA that it had a wasteload allocation and that the NPDES permit was being denied in error; did not share with the EPA the DEP's opinions that the Waterway Estates plant was meeting the DEP's requirements, and had a valid operating permit; that it thought DEP was the lead agency for permitting; that the utility viewed compliance with regulations as a top priority. Obviously the company was willing to devote substantial resources and spend significant dollars to defend the permit denial once the lawsuit had been filed in its belated challenge of the permit denial as shown in Exhibit 11, MM 2.

Whether or not a challenge of the permit denial would have been upheld and what the outcome would have been is speculative and not especially relevant to this issue. The issue is whether the failure to respond to the denial was prudent. Certainly a challenge of the permit denial might have avoided the lawsuit and resulting trial, as well as the significant legal expenses.

Staff concludes, based upon the evidence, that it was not prudent for the utility to fail to challenge the permit denial.

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

**RECOMMENDATION:** Staff is unable to quantify, from the information contained in the record, the amount of litigation expenses which may not have been fairly or reasonably incurred. Therefore, if the Commission disagrees with staff's recommendation in Issue 1 that recovery of these expenses should be denied, staff recommends that the record should be reopened in order to take evidence on the fairness and reasonableness of these expenses. (Mann, Gervasi)

**POSITION OF THE PARTIES**

**FCWC:** Yes.

**OPC:** No position.

**STAFF ANALYSIS:** No witness testified as to the fairness and/or the reasonableness of the amount of litigation expenses incurred by FCWC in defending the DOJ complaint. The record contains no audit of these expenses. From the record, staff is unable to quantify an amount of these expenses that may not have been fairly or reasonably incurred. Nevertheless, staff notes that there appear to be certain areas of litigation costs that may have provided little or no value to the ratepayers, as discussed below.

One cannot refute the right of any party to have the best legal team possible when a company's corporate life is at stake (TR p. 80), but staff does not believe that the ratepayers should have to pay for a "Cadillac" when a "Chevrolet" would do the job. The utility hired several people for the defense of the civil action by DOJ, such as the former Secretary of the FDEP, a former USDOJ official and the former General Counsel of the EPA. (TR pp. 79-81) It appears in this case that no expense was spared in defending the company of violating the CWA. Based on the fact that they were found to have violated the CWA, staff believes that some of the legal expense may have been excessive.

While the utility makes the assertion that it has not included any FCWC employee costs in this petition for recovery of litigation costs (TR p. 83), staff is left wondering just how much employee time, time that has already been compensated by ratepayers, was

spent on this case.[9] Witness Allen, in response to questions about the time spent by FCWC employees on this case, and the related salaries, could not determine an amount. (TR p. 83) Staff believes that the utility customers could make an argument that through compensation of employee wages, the ratepayers have already paid for a portion of the litigation cost.

The record details that litigation expense was used in connection with a 5th Amendment claim by FCWC President Allen. (TR p. 75) Staff, as stated in Issue 3, cannot reconcile the recovery of costs related to a criminal defense from ratepayers who, through their utility, were involved in a civil lawsuit. Staff also doubts the reasonableness of making the ratepayers pay for the "spring and summer" of research on the "inferences" to be drawn from invoking the 5th Amendment at depositions. (TR pp. 75-76) Staff does not believe that these legal efforts provided any benefit to the ratepayers.

One of the named systems in the federal case was the Carrollwood wastewater facility. From the record, staff could not determine the amount of legal expense that was spent defending the Carrollwood system. This utility system is in Hillsborough County, a county not regulated by the Florida Public Service Commission. Staff has concerns that this petition for recovery of litigation costs could involve regulated ratepayers being forced to pay a portion of the legal fees incurred to defend a system that is not regulated by the FPSC.

FCWC witness Allen claims that the federal prosecution was conducted by an "overzealous trial attorney [at] the DOJ." (EXH 5, p. 29) It was his belief that this was a "no-case" (EXH 5, p. 47) and that the litigation costs in this case were the responsibility of the DOJ "who did everything they could [do] to drive up the legal expense-everything." (EXH 5, p. 48) The DOJ's activities included interviewing past employees, requesting documents by the thousands, and threatening the company with huge fines, to the extent that Mr. Allen claimed that the DOJ attorney was "violating the law." (EXH 5, p. 72) In the end, in a ruling against the appeal by the utility for attorney's fees, the judge did not agree with FCWC's arguments and denied FCWC's appeal for attorney's fees. Once the judge made his decision, staff believes that expense for

[9] According to the record, FCWC employees put together over 1 million documents and millions of bytes of information. (TR p. 84)

the second appeal, an appeal that was subsequently withdrawn, had no value for the ratepayers. (TR pp. 169-171)

Staff believes another factor in this issue is the amount of related party legal activity and cost that was incurred. FCWC admitted that some of the litigation costs were "intermingled" between the two defendants, FCWC and Avatar[10]. (EXH 5, p. 79) Since the record is silent to the amounts associated with these efforts, staff believes the Commission should be aware of this uncertainty and that any amount of related party expense should not be collected from the ratepayers.

As outlined in Issue 3, legal research regarding the specificity of defining an "outfall location," the research to determine the definition of "receiving waters" (TR p. 100), legal research regarding "claim splitting" (TR p. 137), and the unsuccessful attempts to "disqualify the DOJ attorney" (TR p. 113) all appear to involve legal expense that the ratepayers should not be held responsible for.

No one has perfect foresight and everyone has perfect hindsight. Looking back at the settlement process, the lowest offer by the USDOJ to settle this case was $2,200,000. (TR p. 142) Considering that the utility spent almost twice this amount in litigation costs and fines, staff is left to wonder whether it is fair or reasonable to ask the ratepayers to pay more than the amount of the lowest settlement offer (the petition before the Commission seeks $2,265,833 from PSC regulated customers and $3,589,368 from all FCWC customers). (EXH 11, MM 1, p. 1)

Staff does not believe that the legal costs related to the unsuccessful request for attorneys' fees and costs under Federal Rules 54 and 68, which is only available for a prevailing party upon proof of wanton, vexatious, egregious, and/or oppressive reasons, are reasonable based on the judge's decision. This unsuccessful attempt for attorney fees was denied as the federal judge did not find that the prosecution was wanton or that FCWC was a prevailing party. (TR. p. 169) Staff does not believe that it would be fair or reasonable for the ratepayers to have to pay the legal costs related to the cross appeal of the federal judge's denial of the FCWC motion for costs and attorney's fees, an appeal that was subsequently withdrawn by the company. (TR pp. 170-171)

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[10] Avatar is the parent company of FCWC and was named as a codefendant in the federal suit. (EXH 4, GSA 7, p. 1)

In conclusion, it is questionable whether the entire amount of litigation expenses incurred by FCWC is fair and reasonable. However, staff is unable to quantify, from the information contained in the record, an amount of the litigation expenses which may not have been fairly or reasonably incurred. Therefore, if the Commission disagrees with staff's recommendation in Issue 1 that recovery of these expenses should be denied, staff recommends that the record should be reopened in order to take evidence on the fairness and reasonableness of these expenses.

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

**RECOMMENDATION**: Yes. (Mann)

**POSITION OF THE PARTIES**

**FCWC**: No.

**OPC**: Yes.

**STAFF ANALYSIS**:

FCWC

The utility, in its brief, claims that it is the potential penalty for violating the CWA, $25,000 per day per violation, that provides an incentive for the utility to comply with the Act, not the recovery of litigation costs. (FCWC BR p. 26) Utility President Allen testified that "environmental regulatory compliance has been and remains a top priority FCWC goal." (TR p. 86) He went on further to say that "compliance has always been a top priority personally and I have consistently promoted strict compliance as always being in the best interests of my employer and its utility customers." (TR p. 324) When asked by OPC counsel if the potential recovery of litigation costs by FCWC would provide a disincentive to comply with the Clean Water Act, Allen disagreed that recovery of these litigation costs would insulate the utility management from compliance with the CWA, and that any suggestion along this line of reasoning "borders on insult." (TR pp. 323-325)

OPC

OPC witness Larkin made the argument that if a utility can pass on litigation expenses related to a violation of the CWA, that this utility would be less likely to voluntarily comply with the CWA. (TR p. 265) The concern voiced by the witness for OPC is that the Florida Public Service Commission should not allow these litigation expenses if doing so would "frustrate federal authorities' enforcement of the CWA." (OPC BR p. 39)

Analysis

Staff agrees with the OPC that potential recovery of litigation costs in this case could set a precedent that other utilities could view as a disincentive to comply with the Clean

Water Act. FCWC was fined multiple times, by both the EPA and the FDEP, and it still did not complete required alterations to its plants in a timely fashion. The utility can claim that the potential fine of $25,000 per day provides effective incentive to insure compliance, but staff believes the record indicates otherwise. All three of the systems in this case were fined, some more than once, and in the case of Barefoot Bay, the utility completely ignored the requirement to have an NPDES permit. (EXH 4, p. 14) While the Commission has heretofore allowed minor amounts of legal expense related to environmental fines and administrative actions, there is nothing minor about the case at hand. The following list of governmental agencies, at one time or another, were involved in attempts to get FCWC to obey the CWA and correct their effluent disposal problems: EPA, FDEP, Hillsborough County Pollution Control Commission (TR p. 64), Brevard County Office of Natural Management (EXH 4, GSA 14, p. 3), Hillsborough County, Army Corp. of Engineers (EXH 10, p. 58), and the St. John's River Water Management District (EXH 4, GSA 13, p. 8), and finally, the DOJ. These agencies undoubtedly spent considerable amounts of time and money in an attempt to get FCWC to timely adhere to consent orders and administrative agreements. By allowing the recovery of these litigation costs, staff believes the Commission would be sending a signal that the utility is to be held harmless in this action, except for the fine imposed and six percent of the legal costs.

At its disposal in pursuit of compliance with the Clean Water Act, the EPA, the DEP and the DOJ have administrative orders, consent agreements, fines and the threat of litigation in their arsenal. Staff does not believe that the Commission should diminish one of these mechanisms, the threat of litigation, as an enforcement vehicle by holding the utility harmless in this action. Staff agrees with OPC that allowance in this case would frustrate the efforts of other agencies to mandate compliance with the CWA. In cases such as this, where the utility has gone beyond the normal day to day environmental compliance issues, the utility should be held accountable for its misdeeds and prolonged delays. The Commission is not a bonding agency for the water and wastewater industry, and should a utility invite prosecution from the DOJ for CWA violations, they should be made aware that they do so at their own peril. With this forewarning, staff believes that the Commission would provide additional incentive to comply with the Clean Water Act and set a precedent regarding the consequences for delaying the construction of mandated plant improvements.

In this case, approximately 18,842 hours-over 9 full work years were billed by Baise and associates.[11] (EXH 6, GHB 108, p. 3) The end result of all of this legal work was a $309,710 fine and the completion of some much overdue utility construction. Staff believes that the proposed inclusion of litigation expenses would allow the utility to circumvent a portion of their obligation to abide by rules and regulations of the EPA and DEP in a timely manner.

[11] At an average $165 per hour, each full work year (2,080 hours billed) cost $343,200. (EXH 6, GHB 108, p. 3)

**ISSUE 7**: Stricken.

**ISSUE 8**: Stricken.

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

**RECOMMENDATION**: The degree to which bankruptcy would have affected the quality of service provided to FCWC's customers is unknown. (Walden)

**POSITION OF THE PARTIES**

**FCWC**: Yes.

**OPC**: No. While bankruptcy is normally not a desirable course for any entity to take, the provision of water services and of wastewater disposal is an industry pervasively regulated by a host of governmental authorities. Even criminal exposure may be had for those who might illegally pollute, or provide unhealthy water. While FCWC urges calamitous failure of service in the event of a large fine, it is far more reasonable to assume that service would continue, much as before, under government stewardship, likely under the auspices of a federal bankruptcy court. A receiver or trustee in bankruptcy would be as accountable to regulatory authorities as FCWC is now.

As FCWC sees disaster in the bankruptcy scenario, it justifiably sees elimination of its shareholders' equity interest in the firm and a probable transfer to government or, eventually, other private interests. While a forced, wholesale change in ownership of this utility may be calamitous to FCWC and its developer parent, it may well be of no consequence to ratepayers. In fact, given the elimination of the obligation to service equity capital and the discharge or elimination of debt, the customers may have emerged with lower rates, in lieu of lesser services. (Larkin)

**STAFF ANALYSIS**:

FCWC

Utility witness McClellan testified that he did not know if FCWC had been forced into bankruptcy if the requested DOJ fines would have been paid. At a level of $30 million, probably so, and if the fine were $100 million, bankruptcy would probably have occurred. Regardless of bankruptcy, the financial pressures would have been extreme. (EXH 13, pp. 15, 47)

The penalties sought by the DOJ were of such a financial magnitude that FCWC would not have been able to pay such amounts, and would place the financial integrity of the company in jeopardy. The utility would have probably been forced into bankruptcy. (TR p. 225)

Witness Allen stated that if FCWC had been fined $53 million, the utility would have gone out of business. Bankruptcy would probably have followed. (EXH 18, pp. 54-55) Continuity of service would likely have occurred, but the company's assets would have been liquidated. Both FCWC and the customers receiving service would have been at risk. Capital improvements would have ceased. (EXH 18, pp. 58-59, 61-62) Witness Murphy essentially agreed with Mr. Allen, adding that whether bankruptcy occurred or not, the penalties faced by FCWC would have probably precluded the company from conducting its normal business operations. (EXH 12, p. 10)

Utility witness McClellan testified that if the company had gone into bankruptcy, it is reasonable to conclude that creditors would demand that the utility be maintained as a going concern, and chances are a receiver would be appointed. The receiver's only source of revenue would be rates from customers, since the capital market would not be very interested in lending money at competitive interest rates. As a result, deterioration or even curtailment of service might result. Level of service would be affected, as would the quality of service. (EXH 13, pp. 50-53) Witness McClellan did not agree with OPC witness Larkin whose testimony tends to infer that bankruptcy would have been in the best interest of the ratepayers. Mr. McClellan did not believe that a company that went through bankruptcy would be able to maintain the same quality of service at a lower rate level, but instead was convinced that undesirable consequences to the ratepayers would result. (TR pp. 366-367)

Utility witness McClellan testified that quality of service would suffer due to the crippled financial situation. Even though the stockholders' equity would be wiped out, the new entity running the bankrupt company would still need access to financial funds. Acquiring capital would be difficult due to the history of the utility, i.e., bankruptcy. It would be hard to predict what might happen after bankruptcy. (EXH 13, pp. 61-65) Generally, if the company were to go out of business, customers would experience a deprivation in service. (EXH 12, p. 42)

OPC

OPC witness Larkin was aware of a railroad that went into Chapter 11 bankruptcy, and was able to raise funds for capital improvements. Mr. Larkin did not believe that a water or wastewater company would fare differently. He did not know of a water or wastewater company that had raised capital while in bankruptcy. For the FCWC situation, Mr. Larkin thought that while the stockholders and debt holders would have been harmed by bankruptcy, it would have neither harmed nor benefitted the ratepayers. (TR p. 280; EXH 16, pp. 46-47)

Mr. Larkin did not believe that Chapter 11 bankruptcy would affect the service provided to the ratepayers, since the liabilities of the bankrupt company are held in abeyance and FCWC would continue to operate the business. He contends that the court would decide which debts would be discharged, or if the entity should be sold or reorganized with a restructuring of outstanding obligations. Due to the public's health, safety, and welfare, he expected the court would be vigilant to ensure the public was not affected by the bankruptcy. Moreover, he believes that if there were to be a bankruptcy sale, it is probable that other water and wastewater companies in the area would take over these facilities. He noted that the primary group to be affected by a bankruptcy would be the company's debtholders and stockholders. (TR p. 277)

Staff

Witness Merchant stated that the threat of bankruptcy could be serious to a utility, depending upon how imminent it was. (EXH 17, p. 49)

Analysis

While bankruptcy might not be a selection of choice, had the fines and penalties been of severe proportions to place the utility in this situation, service to the customers would most likely have continued, albeit not at the levels that the customers have previously experienced. The plants and collection systems would continue to have to meet the standards prescribed by the regulatory agencies. Any impact on the quality of service as a result of a potential bankruptcy is purely speculative. While quality of service and the ability of the utility to continue to meet standards may be, to some degree, diminished, service would most likely continue unabated. The real impact of bankruptcy would be felt by the shareholders and their equity interest in FCWC. The

degree to which bankruptcy would have affected the quality of service provided to FCWC's customers is unknown.

**ISSUE 10**: Should recovery of litigation expenses from the ratepayers depend on whether the utility or the ratepayers benefitted from the litigation?

**RECOMMENDATION**: No. The recovery of litigation expenses from the ratepayers should depend on whether the litigation costs were reasonable and prudently incurred. (Mann)

**POSITION OF THE PARTIES**

**FCWC**: No.

**OPC**: Yes.

**STAFF ANALYSIS**:

FCWC

The utility does not believe that recovery of litigation expenses from the ratepayers should depend on whether the utility or the ratepayers benefitted from the litigation. Utility witness McClellan testified that under the cost of service standard, the utility should be able to recover all expenses that it prudently and legitimately incurred in providing efficient and reliable service. (TR pp. 361-362) If the utility had not defended itself against the claims of the EPA/DOJ, the financial consequences for the utility would have been extremely serious, a healthy financial system would not have emerged, and rates and services could have been negatively impacted. (TR p. 362) For these reasons, the utility belief is that what benefits the utility also benefits the ratepayers. (FCWC BR p. 30) Recovery of litigation expenses from the ratepayers should not depend on whether the utility or the ratepayers benefitted from the litigation, but rather whether or not the expenditures were prudent and legitimate.

OPC

In its brief, OPC merely indicated that the recovery of litigation expenses from the ratepayers should depend on whether the utility or the ratepayers benefitted from the litigation. (OPC BR p. 40) OPC witness Larkin testified that the "ratepayers receive no benefit from violations of the CWA." (EXH 16, p. 22)

Analysis

Staff agrees with the utility that recovery of litigation expenses from the ratepayers should not depend on whether the utility or the ratepayers benefitted from the litigation, but rather on whether or not the expenditures were prudent and legitimate. Staff concludes, as outlined in Issue 1, that FCWC management did not act in a reasonable and prudent manner in complying with environmental mandates of the EPA and the FDEP. If the litigation costs in this case could be viewed as recurring, normal day-to-day interaction between regulatory agencies and the utility, then staff could support the recovery of a reasonable amount of the costs, but the case at hand does not involve normal costs. If the utility could have proved that by defending itself against FDER action that the customers would benefit through lower rate base as the result of not having to make unnecessary improvements (SSU case, Docket No. 920199-WS, Order No. PSC-93-0423-FOF-WS issued March 22, 1993), then the staff would be able to conclude that the ratepayers had benefitted from the litigation and therefore recovery of the costs would be reasonable and prudent. This did not happen in this case. FCWC President Allen testified that there was no reduction in the amount of rate base that was eventually placed in service for the regulated systems of Barefoot Bay and Waterway Estates. (EXH 18, pp. 8-11) Since the rate base requirements were not reduced for the regulated systems, the defense efforts accrued directly to the benefit of the stockholders in the form of protecting their equity interests.

Nevertheless, for informational purposes, staff notes that with the exception of speculation that bankruptcy would have had a deleterious effect on utility service, the record contains no support that the ratepayers benefitted from this litigation. To the contrary, OPC witness Larkin testified that while the stockholders and debt holders would have been harmed by bankruptcy, it would have neither harmed nor benefitted the ratepayers. (TR p. 280; EXH 16, pp. 46-47) While staff does not completely agree that the ratepayers would have experienced no effect from an FCWC bankruptcy, staff does not believe that the avoidance of bankruptcy by FCWC creates a benefit for the ratepayers. Staff believes that freedom from bankruptcy, as a result of compensatory rates and charges based upon fair and reasonable expenses and a return on used and useful plant in service, is an expectation of the ratepayers, not a benefit. The risk of bankruptcy, while potentially a burden and source of frustration for the customers, is more correctly a liability for the shareholders and a responsibility of the management.

Staff believes that the Commission should follow the precedent established in the Southern Bell case (Docket No. 880069-TL, Order No. 20162 issued October 13, 1988)(See Issue 1) in which the Commission denied legal fees based on a lack of showing that the action was reasonable. The recovery of litigation expenses from the ratepayers should depend on whether the litigation costs were reasonable and prudently incurred.

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

**RECOMMENDATION**: No. (Mann)

**POSITION OF THE PARTIES**

**FCWC**: 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.

**OPC**: No. The expenses in question occasioned a limited proceeding addressing millions of dollars. That matter alone suggests something atypical is going on. An occasional brush with the USEPA, (although certainly not the USDOJ) may well be routine, but this case is a far cry from the inevitable disagreement which crops up between a regulated entity and its regulator. This case, according to FCWC itself, placed the current ownership of the utility at risk. The notion that it represents an episode of business as usual is quite fortunately false. (Larkin)

**STAFF ANALYSIS**:

FCWC

As stated above, the utility does not believe this issue is relevant to this proceeding. (FCWC BR p. 31) The utility relies on the fact that these litigation costs were legitimate and prudently incurred and need not be normal and recurring to be considered for recovery. Utility witness McClellan testified that these expenses were prudently incurred and under the circumstances the amount is reasonable. (TR pp. 361-362) While not arguing that the litigation costs were normal or recurring, utility witness Allen testified that "such expenses are not unlike any other expense incurred in the course of fulfilling its obligations with respect to the provision of service to its customers." (TR p. 89) While he believes these expenses are just like any other utility expense, Allen testified that "FCWC faced almost insurmountable challenges requiring extraordinary measures in meeting the directives of the FDEP and the EPA." (TR p. 87) Utility attorney Baise testified how extremely rare it was for an NPDES permit to be rescinded. (TR p. 100) Supporting this conclusion, former EPA employee Marlar stated in deposition that he agreed that denial of a permit renewal was a rare event. (TR p. 111) Through a Freedom of Information Request of other EPA offices, counsel for the utility was able to determine

that it was in fact very rare for an active NPDES permit to be rescinded. (TR p. 113)

OPC

OPC witness Larkin testified that he did not think it was likely that a utility would incur $3.9 million of legal expenses in a "run-of-the-mill" environmental compliance case. (EXH 16, p. 44) According to EPA officials, there are more than 13,000 active NPDES permits in Region IV. (TR p. 134) When asked if any other permit had been denied, an EPA official answered that he was unaware of any utility with an active NPDES permit having the renewal denied. (TR pp. 119-120)

Analysis

Staff agrees with the parties that this case involves subject matter that cannot be considered normal, and for the sake of the utility and all parties concerned, we hope this matter will not be recurring. FCWC, in its brief, agrees by saying that "the record clearly supports that the litigation expense incurred by FCWC for which recovery is sought was an extraordinary, nonrecurring event." (FCWC BR p. 17) Since everyone is in agreement that this litigation was an extraordinary event, staff believes that the utility should have treated the litigation as an extraordinary expense. To do this, they should have followed the aforementioned accounting instruction from the NARUC uniform system of accounts:

> Extraordinary Items-Those items related to the effects of events and transactions which have occurred during the period and which are not typical or customary business activities of the company shall be considered extraordinary items. **Commission approval must be obtained** to treat an item as extraordinary. Such request must be accompanied by complete detailed information. (NARUC System of Accounts p. 17)(emphasis added)

Since the utility failed to do this in rate case proceedings between 1992 and 1996, staff believes the time to request extraordinary status for these expenses, some of which are six years old, has come and gone. Staff does not believe that the litigation expenses sought in this case can be reasonably characterized as normal, recurring costs of doing business.

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

**RECOMMENDATION**: No. (Mann)

**POSITION OF THE PARTIES**

**FCWC**: Yes. $2,265,833 through a surcharge as set forth in FCWC's petition.

**OPC**: None. The petition is a plain attempt to gain a surcharge by means of retroactive ratemaking. Moreover, the Commission has consistently held that fines and penalties are not recoverable from ratepayers. Upon identical rationale, the expenses associated with resisting fines and penalties should similarly be disallowed. The customers of this utility have absolutely no control over the management policies of the utility. When management runs afoul of enforcement authority, is found to have violated statutes such as the Clean Water Act on more than 2300 instances, the stockholders of the company, not its captive customers, should be held responsible for all of the consequences thereof. (Larkin)

**STAFF ANALYSIS**: FCWC argues that these litigation costs were reasonably and prudently incurred and they should be entitled to recover $3,589,368 from all of its customers (TR p. 85), $2,265,833 from those customers under the regulation of the Florida Public Service Commission. (TR p. 86)

OPC argues that no recovery should be made of these litigation costs, as recovery of the legal fees and costs would violate the prohibition against retroactive ratemaking. (See Issue 1)

Staff agrees with OPC that the utility has petitioned to recover litigation costs from a prior period and that recovery of these amounts would violate the prohibition against retroactive ratemaking. Therefore, in accordance with the staff recommendation in Issue 1, staff recommends that the petition for recovery of the litigation costs in this docket be denied.

Should the Commission decide that recovery of these litigation is not barred by the convention against retroactive ratemaking and that some of the expenses are to be considered reasonable and prudent, staff has developed some alternative methodologies for determining the amount of the surcharge that might be collected from the ratepayers. The first chart details the calculation done

by the utility in its petition for determining the recovery of $2,265,833 in litigation costs[12]:

Utility method:

| | |
|---|---|
| Total Legal Fees | $3,826,210 |
| Less Amount Absorbed by Utility (6%)[13] | 236,842 |
| Net Legal Fees | 3,589,368 |
| Weighted PSC Regulated Customers | 63.13% |
| Surcharge to be collected from regulated customers | 2,265,833 |
| Annual surcharge: all PSC customers | $4.58 |
| Monthly surcharge: all PSC customers | $.38 |
| Annual surcharge: just WW PSC customers | $10.97 |
| Monthly surcharge: just WW PSC customers | $.91 |
| Annual surcharge: just fined WW systems | $25.62 |
| Monthly surcharge: just fined WW systems | $2.14 |

The above chart details FCWC's request for recovery of a surcharge and includes the allocation to all customers, just the wastewater customers, and lastly, just the wastewater customers at the plants that were named in the federal suit and fined. The following calculations represent suggestions for other ways to allocate the legal fees between the utility and the ratepayers.

Instead of using the formula that the utility proposes, wherein the amount allocated to FCWC is based on the fine of

[12] Note: all calculations assume a ten year amortization period (See Issue 18), no carrying charges have been applied and the amounts do not include provision for regulatory assessment fees of 4.5% (See Issue 16). See Attachment B for additional detail.

[13] The utility is not seeking to recover the judgement against the utility for $309,710 and has calculated the 6% portion that the shareholders are forgoing recovery on by dividing the fine amount of $309,710 into the last written settlement offer by DOJ of $5,000,000. (TR p. 85)

$309,700 divided by the last written offer for settlement from the DOJ of $5,000,000 (TR p. 85), staff suggests that another way to calculate the allocation among the utility, shareholders and ratepayers would be to take the fine amount of $309,700 and divide it by the oral settlement offer from the DOJ of $2,200,000. (TR p. 142) Instead of the 6% allocation of litigation costs to the utility, this method results in the utility share becoming 14%. The following chart details the effect of this calculation:

$309,700 fine/$2,200,000 DOJ settlement offer method:

| | |
|---|---|
| Total Legal Fees | $3,826,210 |
| Less Amount Absorbed By Utility (14%) | 538,730 |
| Net Legal Fees | 3,287,480 |
| Weighted PSC Regulated Customers | 63.13% |
| Surcharge to be collected from regulated customers | 2,075,262 |
| Annual surcharge: all PSC customers | $4.20 |
| Monthly surcharge: all PSC customers | $.35 |
| Annual surcharge: just WW PSC customers | $10.05 |
| Monthly surcharge: just WW PSC customers | $.84 |
| Annual surcharge: just fined WW systems | $23.47 |
| Monthly surcharge: just fined WW systems | $1.96 |

The next method involves taking the proposed oral settlement offer from the DOJ of $2,200,000 (TR p. 142), subtracting the fine amount of $309,700, to arrive at a figure of $1,890,300. This amount is approximately one half of the total reported litigation expense of $3.9 million. Therefore staff has calculated the amount of the surcharge based on a 50/50 split between the ratepayers and the utility. The results are as follows:

50/50 split method:

| | |
|---|---|
| Total Legal Fees | $3,826,210 |
| Less Amount Absorbed By Utility (50%) | 1,193,105 |
| Net Legal Fees | 1,193,105 |

| | |
|---|---|
| Weighted PSC Regulated Customers | 63.13% |
| Surcharge to be collected from regulated customers | 1,207,671 |
| Annual surcharge: all PSC customers | $2.44 |
| Monthly surcharge: all PSC customers | $.20 |
| Annual surcharge: just WW PSC customers | $5.85 |
| Monthly surcharge: just WW PSC customers | $.49 |
| Annual surcharge: just fined WW systems | $13.66 |
| Monthly surcharge: just fined WW systems | $1.14 |

Lastly, according to Mr. Baise, the lead attorney for FCWC during the Federal trial, "one third of the violations at issue in the DOJ action would not have occurred but for the EPA's own mistakes or omissions." (TR p. 165) Accepting this to be true, then the following details a one third allocation of the legal costs to the ratepayers, one third to the utility management, and a one third allocation to the shareholders of FCWC.

1/3 allocation method

| | |
|---|---|
| Total Legal Fees | $3,826,210 |
| Less Amount Absorbed By Utility and shareholders (66%) | 2,550,552 |
| Net Legal Fees | 1,275,658 |
| Weighted PSC Regulated Customers | 63.13% |
| Surcharge to be collected from regulated customers | 805,275 |
| Annual surcharge: all PSC customers | $1.63 |
| Monthly surcharge: all PSC customers | $.14 |
| Annual surcharge: just WW PSC customers | $3.90 |
| Monthly surcharge: just WW PSC customers | $.32 |
| Annual surcharge: just fined WW systems | $9.11 |
| Monthly surcharge: just fined WW systems | $.76 |

While it is the utility's proposal to recover these litigation expenses from every customer company-wide, at 42 cents per month, there are many ways that these amounts could be allocated. For example, if the surcharge where to be only allocated to Barefoot Bay, Carrollwood, and North Ft. Myers, the surcharge increases to $3.44 per month. Should the Commission decide instead to allocate these expenses by the ratio of the amount of the penalty incurred by division, the North Ft. Myers customers would be charged $9.11 per month; Carrollwood customers would be charged $2.49 per month; and, Barefoot Bay customers would be charged $.57 per month. (TR pp. 373-374)

To reiterate the staff recommendation, staff recommends that any allowance of these litigation costs would violate the prohibition against retroactive ratemaking and therefore no amount of litigation cost should be recovered through a surcharge.

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

**RECOMMENDATION**: No. It involved only three wastewater systems: Barefoot Bay, Carrollwood, and Waterway Estates. (Walden)

**POSITION OF THE PARTIES**

**FCWC**: Yes.

**OPC**: No position.

**STAFF ANALYSIS**:

FCWC

The amended complaint filed by the EPA involved three wastewater systems: Carrollwood, Barefoot Bay, and Waterway Estates and were the only plants subject to Florida Cities' litigation costs. (TR pp. 226-227; EXH 13, p. 13) Carrollwood is in Hillsborough County, a county not regulated by the Commission, and the other two systems are in Brevard and Lee Counties, respectively. Brevard and Lee Counties are regulated by the Commission with respect to Chapter 367, Florida Statutes.

Carrollwood was denied an NPDES permit in September 1984 because its disposal to Sweetwater Creek had a wasteload allocation of no discharge. This denial was followed by an Administrative Order in November 1984, requiring the cessation of discharge to the creek by June 1987, while continuing to comply with the earlier NPDES permit. FCWC decided to connect to the Hillsborough county wastewater treatment plant, and in January 1987 contracted with an engineering firm to design the pumping station and force main to transmit wastewater to the county's system. (TR pp. 65-69) A consent agreement with EPA followed, and penalties were assessed upon the utility. Carrollwood continued to discharge, operating under an administrative order. Carrollwood was assessed a penalty of $15,000 for discharging effluent to open waters without an NPDES permit between June 1987 and July 1990. (TR p. 244; EXH 5, pp. 5-8, 35-36, 39-40; EXH 4, GSA 24, pp. 6-7)

Barefoot Bay in Brevard County was cited by the EPA for discharging pollutants without an NPDES permit into a drainage canal that led to the Sebastian River. A penalty of $6,000 was assessed. (TR p. 74; EXH 4, GSA 23) Barefoot Bay was also involved in the trial, and the Court ruled in summary judgment that the

allegations occurred prior to the consent orders, which settled all the issues related to this system, and were not going to be considered by the court. (EXH 5, p. 37) The final order of the Court found Barefoot Bay had exceeded the permitted allowances for total residual chlorine, failed chronic toxicity tests, and, failed to report BOD on a weekly basis for a specified period of time. (EXH 4, GSA 24, p. 3) Barefoot Bay was assessed a penalty of $5,610. (TR p. 244)

Waterway Estates in Lee County was denied an NPDES permit in December 1986, again due to having no wasteload allocation. Waterway Estates continued to discharge to the Caloosahatchee River without an NPDES permit from October 1, 1988 through October 31, 1989. The final order of the Court found that Waterway Estates discharged to the river without a permit for this 13-month period, discharged into a canal instead of the river between November 1989 and July 1991, had some violations of total nitrogen loading and concentration, and, three toxicity test violations. (EXH 5, pp. 9-10, 31-33; EXH 4, GSA 24, p. 7) Waterway Estates was assessed a penalty of $289,425 by the Court. (TR p. 244)

A major portion of the DOJ trial involved the severity of the alleged violations and the ability of FCWC to pay penalties. The maximum demand by the government was $53 million, but when the trial began, through summary judgment, many allegations had been eliminated. (EXH 5, p. 40-43) Witness Allen had stated in deposition that there were discharges at all three sites, and the Court did assess a penalty against FCWC for those discharges. (EXH 5, p. 39) Mr. Allen stated that the discovery, the pretrial motions, briefs and other proceedings were so intermingled that any attempt to account for legal expenses on a specific plant or system basis was not possible. (TR p. 83)

Witness Baise stated that the DOJ expanded the focus of the case, and conducted substantial discovery involving not only the wastewater plants listed above, but also Fiesta Village, Golden Gate, South Gate and so on. (EXH 19, p. 18) He stated that the DOJ investigated all FCWC's wastewater systems in Collier, Lee, Brevard, Sarasota, and Hillsborough counties, beginning in early 1994 until the amended case was filed on March 30, 1995. (TR pp. 345-346)

Witness Allen stated that the Court trial was viewed as a company-wide situation that really potentially would impact all customers uniformly. He stated that it was impossible to go through and allocate these expenses to individual systems such as Carrollwood and Waterway Estates. He added that fundamentally it

is difficult to separate water and wastewater. He stated that the company's proposal is to bill half as much of a surcharge to those customers who only receive one service, which makes the proposal equitable. (EXH 5, pp. 55-57) The proposal is to collect litigation and rate case expenses from PSC regulated systems as well as the PSC non-regulated systems of Carrollwood in Hillsborough County, Golden Gate in Collier County, and the Sarasota County systems. (TR pp. 48-49; EXH 18, pp. 39-40) Further, Mr. Allen testified that it is appropriate for all water and wastewater customers to pay these litigation costs because the expenditure of these funds avoided calamitous results to the entire system of Florida Cities customers. (EXH 13, p. 14; TR pp. 226-228; 232, 248)

Staff

Witness Merchant stated that the litigation costs were incurred because of violations at the Barefoot Bay, Carrollwood, and Waterway Estates wastewater systems. Ms. Merchant further testified that any assumption that the legal fees incurred for these three wastewater systems should be the shared burden of all the water and non-involved wastewater customers would be inappropriate. (TR pp. 306-307)

Analysis

The evidence cited above shows that only the Barefoot Bay, Carrollwood, and Waterway Estates wastewater systems were involved when the amended complaint was filed. As noted by utility counsel Baise, other systems were reviewed by the DOJ, but were not named in the amended complaint.

Staff concludes it is unfair to include all systems in this proceeding when violations at all systems did not occur. Service areas that should be included are Barefoot Bay, Carrollwood, and Waterway Estates.

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

**RECOMMENDATION**: No. The costs associated with the litigation, if allowed by the Commission, should only be allocated to the specific systems involved, consistent with the existing Commission methodology. (Mann)

**POSITION OF THE PARTIES**

**FCWC**: Yes.

**OPC**: No position as to any allocation issue. No recovery of the expenses which were incurred several years ago, and for purposes which don't serve the ratepayers should be permitted.

**STAFF ANALYSIS**:

FCWC

According to the utility, these litigation costs were related to a company wide situation that would impact all customers uniformly. (EXH 5, p. 56) Even though witness Allen admitted that only the wastewater systems were involved in the federal case (EXH 18, p. 12), he believes that the case was central to the ongoing operations of the entire company. (EXH 5, p. 81) When asked if there was a way to allocate these amounts among different systems, the response was that it would be "impossible to allocate." (EXH 5, p. 56)

OPC

As with the other issues dealing with allocation of these litigation costs, OPC takes no position. As stated above, OPC believes that no recovery of litigation costs should be permitted.

Staff

According to staff witness Merchant, FCWC rates for all but two of the systems have been set on a system specific basis and are not uniform.[14] (TR p. 307) Staff witness Merchant believes that these "litigation fees are not a cost of providing water service, nor are they a cost of wastewater service to any of the other FCWC

[14] North and South Ft. Myers water systems have uniform rates.

wastewater facilities not penalized." (TR p. 307) She believes that should the Commission decide to allow some or all of these litigation costs, they should be allocated only to the North Ft. Myers, Barefoot Bay and Carrollwood wastewater customers. (TR p. 311)

Staff witness Moniz testified that the utility has one consolidated capital structure and working capital for the utility is allocated to each facility. The Commission has determined a separate rate of return for each facility and general plant is allocated. (TR p. 317)

Analysis

Staff concludes that because individual rates are established for each FCWC system, that each system has its own rate of return (TR p. 317), and because not all of the FCWC systems were named in the federal lawsuit, that any costs allowed by the Commission should only be allocated to the three systems that were fined for violations of the CWA(North Ft. Myers, Barefoot Bay, and Carrollwood wastewater customers). Staff believes this is consistent with the existing ratesetting methodology used to determine rates for FCWC. However, the litigation costs should only be allocated to the customers at these three systems if the evidence in the record shows that the costs were reasonable and prudently incurred. As outlined in Issue 1, staff does not believe that these costs were reasonable nor prudently incurred and therefore no allocation should be made. Should the Commission decide to deny staff's recommendation in Issue 1 and allow some of the litigation costs, staff recommends that the permitted costs be allocated among the North Ft. Myers, Barefoot Bay, and Carrollwood wastewater customers only.

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

**RECOMMENDATION**: None is appropriate. (Mann)

**POSITION OF THE PARTIES**

**FCWC**: $228,000.

**OPC**: No recovery of rate case expense is appropriate irrespective of whether FCWC recovers anything on its petition. Recovery of rate case expense (like the litigation expense) has not been shown to yield earnings outside the range of the last authorized rate of return, and for all the Commission knows, may cause the utility to overearn.

**STAFF ANALYSIS**:

FCWC

FCWC argues in its brief that recovery of rate case expense should not be dependent upon recovery of the litigation costs. (FCWC BR p. 35) Should the Commission decide not to allow the litigation costs, it should nonetheless allow the rate case expense because it was reasonably and prudently incurred. (Id.) According to a late filed exhibit filed by counsel for the utility, the current projection for rate case expense is $182,382 and not $228,000 as listed in the prehearing statement. (EXH 11, MM 3, p. 1)

OPC

OPC argues in its brief that no recovery of rate expense is appropriate based on the idea that the utility has not made a showing that its earnings are outside the last established authorized range for the rate of return. (OPC BR p. 41) Beyond this argument, OPC claims that the rate case expense in this case was imprudently incurred. (OPC BR p. 43) OPC once again cites the testimony by FCWC witness Allen that recovery of the litigation costs was "highly doubtful" based on his "past experience with the Commission," therefore it was imprudent to bring this matter before the Commission and incur additional rate case expense. (TR p. 266) Since the utility did not make a showing that it is earning outside its authorized rate of return and the utility had foreknowledge that recovery was doubtful, OPC recommends that no recovery of rate case expense be allowed.

Analysis

While not agreeing with OPC that FCWC must 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, staff does agree that the utility should not be allowed to recover rate case expense in this docket if the Commission decides against the recovery of litigation costs. FCWC witness Allen, who has extensive experience with the FPSC, stated that recovery of the litigation costs was "highly doubtful" based on his "past experience with the Commission." (TR p. 266) With this understanding, staff agrees with OPC that it was imprudent to bring this matter before the Commission and incur additional rate case expense.

Staff concludes that if the Commission disallows recovery of litigation costs, as staff recommends in Issues 1 and 12, that no rate case expense should be allowed. However, if the Commission allows recovery of some amount of litigation costs, a like percentage of the rate case expense should be allowed.

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

**RECOMMENDATION**: Yes. (Mann)

**POSITION OF THE PARTIES**

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

**OPC**: No position.

**STAFF ANALYSIS**: According to staff witness Merchant, regulatory assessment fees should be collected on any surcharge that is approved by the Commission. (TR p. 311) The utility is in agreement with this position. (FCWC BR p. 37)

OPC has taken no position on this issue, as they believe that no allowance should be made for the litigation costs because such a surcharge would violate the prohibition against retroactive ratemaking.

Staff believes that any amounts collected from the customers to reimburse the utility for litigation costs incurred should be considered utility operating revenues and as such regulatory assessment fees are required to be collected on those amounts. This is in accordance with Rule 25-30.120 (1), Florida Administrative Code, which states:

> As applicable and as provided in S. 350.113, F.S., each utility shall remit a fee based upon its gross operating revenue. This fee shall be referred to as a regulatory assessment fee. Each utility shall pay a regulatory assessment fee in the amount of 0.045 of its gross revenues derived from intrastate business.

While staff does not believe that the Commission should allow any recovery of the litigation costs contained in this docket, should the Commission decide that recovery is appropriate, then regulatory assessment fees should be collected on these amounts as they would represent a component of gross operating revenue. The utility, in the position statement above, has agreed to pay regulatory assessment fees related to litigation costs allowed by the Commission.

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

**RECOMMENDATION**: None. (Mann)

**POSITION OF THE PARTIES**

**FCWC**: $2,265,833 plus rate case expenses.

**OPC**: No surcharge should be approved.

**STAFF ANALYSIS**: According to the brief filed by the utility, the appropriate amount of revenue to be collected through the surcharge is $2,493,833. (FCWC BR p. 37) This amount is composed of $2,265,833 in litigation costs and $228,000 in rate case expense.[15]

OPC argues that no recovery should be made of the litigation costs (See Issues 1 and 12), nor should there be an allowance for rate case expense (See Issue 15). OPC believes that any recovery in this case would violate the prohibition against retroactive ratemaking.

Staff believes this issue is redundant of Issues 12 and 15. As stated in those issues, the record contains no evidence that any party to this docket contested a specific amount of litigation cost. Staff agrees with OPC that no recovery should be allowed in this case. Therefore the appropriate amount of revenue to be collected through a surcharge in this case is $0. Should the Commission decide that some of the litigation costs should be recovered, Issue 12 details differing options that the Commission could consider. Should the Commission decide to make an allowance in this case, this issue would become a fallout number based on that decision.

[15] According to a late filed exhibit filed by counsel for the utility, the current projection for rate case expense is $182,382 and not $228,000 as listed in the prehearing statement. (EXH 11, MM 3, p. 1)

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

**RECOMMENDATION**: Yes. Should the Commission decide to allow the recovery of some or all of the litigation costs in this docket, staff recommends that FCWC's requested recovery period of ten years for litigation costs should be approved. (Mann)

**POSITION OF THE PARTIES**

**FCWC**: Yes.

**OPC**: The Citizens oppose any surcharge. However, if a surcharge is approved, it should be sized so as to be recovered over a period of ten years.

**STAFF ANALYSIS**: FCWC requested a ten-year recovery period for litigation costs in its petition. While staff is in agreement with OPC that no surcharge is appropriate in this case because any allowance would violate the prohibition against retroactive ratemaking, if the Commission finds that some amount of recovery for litigation costs should be allowed, then a ten-year recovery period is reasonable.

While the parties are not in agreement over whether the litigation costs should be granted, they are in agreement that if the Commission decides to allow the expense, that the amounts should be amortized over a ten-year period. (TR pp. 22-23) Therefore, should the Commission decide to allow the recovery of some or all of the litigation costs in this docket, staff recommends that FCWC's requested recovery period of ten years for litigation costs should be approved.

**ISSUE 19**: What are the appropriate surcharges?

**RECOMMENDATION**: None. (Mann)

**POSITION OF THE PARTIES**

**FCWC**:

| 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 |

**OPC**: Zero.

**STAFF ANALYSIS**: The schedule above details the requested recovery from the utility. These amounts were calculated as follows:

| | Litigation Costs | Rate Case Expense[16] | Total |
|---|---|---|---|
| Allocated legal expense | $3,589,368 | | |
| % to FPSC customers | 63.13% | | |
| Revenue requested | 2,265,833 | $228,000 | $2,493,833 |
| Amortization period-years | 10 | 10 | 10 |
| Amortization period-months | 120 | 120 | 120 |
| Revenue per year | 226,583 | 22,800 | 249,383 |
| Revenue per month | 18,882 | 1,900 | 20,782 |
| Total weighted PSC customers | 49,443 | 49,443 | 49,443 |
| Monthly surcharge rate-5/8" | $0.382 | $0.038 | $0.42 |

[16] For this table, staff has used the rate case expense amount that was reported in the prehearing statement to show how the utility has calculated the above rates. According to a late filed exhibit filed by counsel for the utility, the current projection for rate case expense is $182,382. (EXH 11, MM 3, p. 1)

The Citizens oppose any surcharge. Staff agrees with OPC, based on the prohibition against retroactive ratemaking. The utility has an obligation to file rate schedules that are, on their face, legal. Illegal rate schedules, including those schedules that violate the rule against retroactive ratemaking are, by definition, not just and reasonable. Therefore, staff recommends that the appropriate surcharges should be $0. Should the Commission decide to allow a portion of these litigation costs, then the final amounts will be subject to the resolution of other issues.

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

**RECOMMENDATION**: Any allowance for litigation costs and rate case expense in this case should not be included as a rate base item and should be amortized, on a straight line basis, over a ten-year period. (Mann)

**POSITION OF THE PARTIES**

**FCWC**: FCWC should be able to currently record those costs incurred in prior years.

**OPC**: No position.

**STAFF ANALYSIS**:

FCWC

Utility witness McClellan believes that FCWC should be able to currently record those costs incurred in prior years for litigation costs, some $2,265,833, along with the rate case expense from this docket, some $228,000, as a regulatory asset. These amounts would be amortized over a ten-year period and the unamortized portion would remain in rate base. (EXH 13, pp. 20-21)

Utility witness McClellan argues that any amount allowed by the Commission in this docket should be treated like any other regulatory asset and placed in rate base. (EXH 13, pp. 20-21) He believes that these amounts should be considered to be "just like any piece of plant for ratemaking purposes," which would mean if there is a future rate case and the Commission were to allow an increase in the authorized rate of return, the utility would be entitled to increase this regulatory asset in accordance with the increase in the rate of return. (EXH 13, pp. 21-25)

OPC

OPC has taken no position on this issue, as they believe that no allowance should be made for the litigation costs because such a surcharge would violate the prohibition against retroactive ratemaking.

Analysis

Staff is in agreement with OPC that no surcharge should be allowed in this docket, and therefore no recommendation on an accounting treatment would be necessary. Should the Commission decide to allow all or a portion of the litigation costs and rate case expense, staff believes this amount should not be included as a rate base item and should merely be amortized, on a straight line basis, for a ten-year period. Staff believes these amounts should not be treated like any other piece of equipment or plant in service. Staff does not believe that any allowed amount could be considered used and useful, nor does staff believe that these amounts should potentially be increased through an adjustment to the authorized rate of return. Staff understands that this would preclude the utility from earning a carrying charge on these amounts, but believes the Commission should be able to make a decision in this docket regarding a fixed and known amount. The utility argues that it would lose the time value of money if these charges could not be adjusted for increases in the authorized rate of return. (EXH 13, p. 26) Staff agrees that this is true, just like extending the recovery period of the asset from four years to ten years. In order for a piece of real equipment to be placed into rate base, it must be "owned and used by the utility in its utility operations, and [shall] have an expected life in service of more than one year from the date of installation." (NARUC System of Accounts p. 56) While these amounts may be around for ten years, staff does not believe that they will be used in "utility operations" or provide any "service."

Staff recommends that any allowance for litigation costs and rate case expense in this case should not be included as a rate base item and should be amortized, on a straight line basis, over a ten-year period.

**ISSUE 21**: Should FCWC be allowed to include any unrecovered litigation expenses being amortized in its next rate case in order to earn a rate of return on the unrecovered balance?

**RECOMMENDATION**: No. (Mann)

**POSITION OF THE PARTIES**

**FCWC**: Yes. The allowed rate of return on rate base is not an issue in this case. The allowed rate of return will be determined in a rate case. The legal expenses incurred by FCWC were expensed "below the line" meaning that the expenses were not included in operating income. Therefore, no matter what accounting treatment is allowed by the Commission, the recovery of the legal expense through the surcharge should not affect net operating income. It is 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 and would allow for a rate of return in future rate case proceedings.

**OPC**: No. Since the Citizens oppose the recovery of any of the litigation expense as a legitimate expense chargeable to ratepayers, any return should also be denied. Additionally, should the Commission find some amount is recoverable from ratepayers only that amount should be recovered without return. (Larkin)

**STAFF ANALYSIS**:

FCWC

Utility witness McClellan testified that while the shareholders have absorbed the carrying costs related to this federal suit to date, the Commission should permit a rate of return on the unamortized portion of the costs at the time of the next rate case. (EXH 12, p. 34) He further testified that additional carrying costs will be incurred during the recovery period, therefore the utility should be able to recover these amounts at the time of the next rate case on the unamortized balance. (TR p. 253) McClellan also testified that if FCWC does not have a rate case in the next ten years, that no carrying charges would be applied. (EXH 12, p. 29)

OPC

As stated above, the Citizens oppose the recovery of any of the litigation expense because any such allowance is disallowed by the prohibition against retroactive ratemaking. OPC witness Larkin testified that recovery of these legal fees provides no benefit to the ratepayers and merely protects the stockholders' interests (TR p. 283) Should any allowance be approved by the Commission, Larkin believes the amount allowed should be the full extent of the recovery, nothing more. (Id.)

Analysis

Staff agrees with OPC that no recovery should be made, and if the Commission were to make an allowance, no rate of return allowance should be granted in the future (See Issue 20). Had the utility wanted to recover a return on these litigation costs in this or in any future proceeding, it should have been requested in this case, and it was not. Before the Commission makes its decision in this docket, it should be aware of the total revenue impact associated with the recovery of the litigation costs. To make an informed decision, the amounts before the Commission should be sufficiently known and measurable. Since they are not, staff recommends that if the Commission decides to allow some or all of the requested litigation costs, in opposition to the staff's recommendation in Issue 1, FCWC should not be allowed to include any unrecovered litigation expenses in its next rate case in order to earn a rate of return on the unrecovered balance.

**ISSUE 22**: Should FCWC's request to amortize rate case expense over ten years be approved?

**RECOMMENDATION**: Yes, if the Commission approves rate case expense in Issue 15 of this recommendation, FCWC's request to amortize such expense over ten years should be approved. (Gervasi, Mann)

**POSITION OF THE PARTIES**

**FCWC**: Stipulated.

**OPC**: Proposed stipulation.

**STAFF ANALYSIS**: By its petition, FCWC requests that rate case expense be amortized over a period of ten years. The position of both FCWC and OPC is that if rate case expense is approved in this docket, the utility's request to amortize it over ten years should be approved. This issue was proposed for stipulation by the parties and, as a preliminary matter, was brought before the Commission for a ruling at the hearing. After some discussion, the Commission took no action on this proposed stipulation at the hearing. (TR p. 16-25) Therefore, staff includes it as an issue here. No action will be necessary unless the Commission approves an amount of rate case expense in Issue 15.

Section 367.0816, Florida Statutes, requires that "[t]he amount of rate case expense determined by the [C]ommission pursuant to the provisions of this chapter to be recovered through a public utilities [sic] rate shall be apportioned for recovery over a period of 4 years. At the conclusion of the recovery period, the rate of the public utility shall be reduced immediately by the amount of rate case expense previously included in rates." Nevertheless, staff recommends approval of a ten-year period of amortization for rate case expense because both parties agree that a ten-year amortization period would be in their best interests.

In so recommending, staff is cognizant that the language of Section 367.0816, Florida Statutes, mandates a four-year amortization period for rate case expense. However, the parties agree that it is in the best interests of both the utility and the customers for the Commission to approve a ten-year amortization period. The utility requests recovery of the litigation expenses over a ten-year period of time. As counsel for the utility explained at the hearing, if the Commission approves such recovery, and also approves rate case expense, it would make sense for recovery of the rate case expense to be spread over the same period

of time as the litigation expenses. It would also mean that there would be a lower amount collected from the customers over a longer period of time. (TR p. 21-22)

Moreover, staff notes that the Commission typically allows utilities to waive mandatory statutory deadlines for case processing because those deadlines are included in the law for the protection of the utilities. For example, Section 367.081 (6), Florida Statutes, requires the Commission to take final action on a rate case and enter its final order within twelve months of the official date of filing. However, because this deadline is included in the law for the protection of the utility, the Commission allows utilities to request waiver of this statutory deadline. Approving a ten-year amortization period for rate case expense is analogous to approving a utility's request to waive a statutorily mandated deadline for case processing.

For the foregoing reasons, staff recommends that if the Commission approves an amount of rate case expense in Issue 15, FCWC's request for amortization of such expense over a ten-year period should be approved.

**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?

**RECOMMENDATION**: No, under Section 367.0822, Florida Statutes, FCWC is not required to 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. (Gervasi)

**POSITION OF THE PARTIES**

**FCWC**: No.

**OPC**: Yes.

**STAFF ANALYSIS**:

FCWC

FCWC points out that the Commission has already determined, by Order No. PSC-98-1160-PCO-WS, denying OPC's Motion to Dismiss, issued August 25, 1998, in this docket, that the utility was not required to allege as a prerequisite to the relief it seeks that present rates cause it to earn below its last authorized rate of return. By that Order, the Commission observed that "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." The utility argues that it follows that if the allegation is not required, certainly proof is not required. (FCWC BR p. 39)

FCWC states that OPC contends that Section 367.0822, Florida Statutes, prohibits an adjustment in rates if the effect would be to change the last rate of return. The utility argues that it is not proposing a change in rates that will affect its rate of return. It is proposing a separate distinct temporary surcharge to recover extraordinary non-recurring costs.

FCWC further argues that the acceptance of OPC's position by the Commission would place an impossible burden on the utility. It would require that during every year from 1992 through 1998 FCWC should have filed an underearning rate case to recover the DOJ related litigation expenses. According to the utility, this would be an absurd result and the Commission would have undoubtedly required the utility to defer the expenses until the court's

decision on the merits was rendered and the actual amount of litigation expenses was known. FCWC cites to Dorsey v. State, 402 So. 2d 1178 (Fla. 1981), in arguing that it is a basic tenet of statutory construction that statutes will not be interpreted so as to yield an absurd result.

OPC

OPC argues that the utility does not allege that the payment of the proposed costs ever rendered the earnings of the utility to be other than fair and reasonable, and that the petition contains absolutely no allegation that the expenditures, if made, ever placed the utility outside the range of its last authorized rate of return. According to OPC, the Commission can provide no relief to any utility which omits such an issue from its pleading and proof, with certain exceptions not applicable here. (OPC BR p. 45)

To support its position, OPC cites to Gulf Power Co. v. Florida Public Service Commission, 453 So. 2d 799 (Fla. 1984) (finding that under the Commission's rate setting authority, a utility seeking a change must demonstrate that the present rates are unreasonable, citing Section 366.06 (1), F.S., as well as show that the rates fail to compensate the utility and fail to produce a reasonable return on its investment). OPC argues that the utility did not even allege these things, let alone show them, as the Florida Supreme Court requires. (OPC BR p. 46)

According to OPC, the limited proceedings statute merely relieves the utility from having to allege and prove a presently fair rate of return, as it permits the utility to rely on the last established one. OPC cites to Order No. PSC-98-0892-PCO-WS, issued July 6, 1998, in Docket No. 980670-WS, initiating an investigation into the rates and charges of Sanlando Utilities Corporation, for the proposition that the prerequisite to Commission action is whether the utility is earning outside its last authorized rate of return.

OPC argues that the principal ratemaking statute by which the Commission is bound in water and wastewater cases is Section 367.081, Florida Statutes, which provides that the Commission shall establish rates which provide for a fair return on the investment of the utility in its property used and useful in the provision of utility service to the public. And there is no allegation before the Commission in this case that the existing rates approved for FCWC do not provide for that fair return.

Moreover, OPC argues that Sections 367.081 (4) (b) and (c), Florida Statutes, providing for a yearly indexing and pass through by utilities which qualify under those sections, require that a utility must by affidavit certify that neither the index nor the pass through increase will cause the utility to earn outside its previously authorized rate of return. Thus, according to OPC, even in the sections establishing automatic pass through and indexing, strict attention is paid to the earnings posture of the utility.

Finally, OPC argues that although the limited proceeding statute was designed to enable an interested party to bring a single issue to the Commission, it does not excuse the petitioner from alleging and proving that the single issue has done it injury or harm which necessitates Commission action. To the contrary, Section 367.0822, Florida Statutes, requires that "unless the issue of rate of return is specifically addressed in the limited proceeding, the commission shall not adjust rates if the effect of the adjustment would be to change the last rate of return." According to OPC, no party in this proceeding can provide any assurance that the rates sought by FCWC would not have the effect of increasing its last rate of return. If the Commission were to permit the utility to recover money now that it failed to collect in the years 1992 through 1997, the utility's profits will increase, which will have the effect of raising the last authorized rate of return. And it does not matter how the money sought by this petition is booked. If the utility gets it, return on investment goes up. The utility's Lee County Division (South Ft. Myers Wastewater System) is currently before the Commission based upon the Commission's finding by Order No. PSC-97-1125-PCO-SU, issued September 25, 1997, in Docket No. 970991-SU, that this system is almost certainly overearning. If FCWC's petition is granted, that overearnings condition will be exacerbated.

Analysis

Staff agrees with FCWC that Section 367.0822, Florida Statutes, the limited proceeding statute under which the utility filed its petition, 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. Staff also agrees that it necessarily follows that if the allegation is not required, certainly proof is not required.

OPC points out that Section 367.0822, Florida Statutes, prohibits an adjustment in rates if the effect would be to change the last rate of return. However, the utility does not propose a

change in rates that will affect its rate of return. It is proposing a separate distinct temporary surcharge to recover costs which the utility has already expensed.

With respect to the authorities cited by OPC to argue its position on this issue, staff notes that none of these cases were filed under Section 367.0822, Florida Statutes, and are therefore inapplicable.

For the foregoing reasons, staff recommends that under Section 367.0822, Florida Statutes, FCWC is not required to 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.

DOCKET NO. 971663-WS
DATE: October 22, 1998

Attachment A

**BREAKDOWN OF FCWC PENALTY**

**FCWC's was assessed a $309,710 penalty which was over three its wastewater facilities, as follows:**

| | |
|---|---|
| Barefoot Bay | $ 5,610 |
| Carrollwood | $ 14,675 |
| Waterway Estates | $289,425 |
| Total | **$309,710** |

**The following is a more detailed breakdown of each facility's assessed penalty:**

**Barefoot Bay** [Before suit was filed had already been assessed $6,000 (EPA)

| | |
|---|---|
| • 79 days[1] of BOD[2] violations * $10 per day | $ 790 |
| • 182 days[3] of Total Residual Chlorine violations * $10 per day | 1,820 |
| • 3 days[4] of Chronic Toxicity Test violations * $1,000 per day | 3,000 |
| | **$ 5,610** |

**Carrollwood** [Before suit was filed had already been assessed $15,000 (EPA)]

| | |
|---|---|
| • 153 days[5] of Phosphorus violations * $25 per day | $ 3,825 |
| • 31 days[6] of CBOD[7] violations * $25 per day | 775 |
| • 122 days[8] of Nitrogen violations * $25 per day | 3,050 |
| • 184 days[9] of Total Residual Chlorine violations * $25 per day | 4,600 |
| • 92 days[10] of Total Suspended Solids violations * $25 per day | 2,300 |
| • 5 days[11] of Fecal Coliform violations * $25 per day | 125 |
| | **$ 14,675** |

**Waterway Estates** [Before suit was filed had already been assessed $15,000 (DER)]

| | |
|---|---|
| • 396 days[12] of unpermitted discharges * $25 per day | $ 9,900 |
| • 621 days[13] of discharges to an unpermitted location * $25 per day | 15,525 |
| • 261 days[14] of Nitrogen violations * $1,000 per day | 261,000 |
| • 3 days[15] of Chronic Toxicity Test violations * $1,000 per day | 3,000 |
| | **$289,425** |

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1 Occurred on a weekly basis between Nov. '91 & June '93 and twice in Nov. '93.

2 BOD stands for Biological Oxygen Demand.

3 Occurred between Sept. '92 & March '93.

4 Occurred in Sept. - Oct. '92, May '93, and Feb. '94.

5 Occurred between July '91 to Nov. '91.

6 Occurred the Month of Oct. '91.

7 CBOD stands for Carbonaceous Biological Oxygen Demand.

8 Occurred in July '91 and Sept.-Nov. '91.

9 Occurred between July '91 and Jan. '92.

10 Occurred between Oct. '91 to Dec. '91.

11 Occurred between July '91 and Jan. '92.

12 Occurred between Oct. 1, 1988 to Oct. 31, 1989 (EPA's 5/11/87 Administrative Order set a 9/30/88 deadline to meet all final requirements).

13 Occurred between 11/1/89 to 7/14/91 (11/1/89 - effective date of Waterway's NPDES permit and 7/14/91 - effective certification date of Waterway's outfall).

14 Occurred between July '91 to March '92.

DOCKET NO. 971663-WS
DATE: October 22, 1998

Attachment B

# Allocation Methods

| All Customers | Utility Method 6% | Fine/Offer 14% $309,710/ $2,200,000 | 1/2 to customers | 1/3 to customers |
|---|---|---|---|---|
| Total Legal Fees | $3,826,210 | $3,826,210 | $3,826,210 | $3,826,210 |
| Allocated to FCWC | 236,842 | 538,643 | 1,913,105 | 2,550,807 |
| Net legal expense | 3,589,368 | 3,287,567 | 1,913,105 | 1,275,403 |
| % to FPSC customers | 63.13% | 63.13% | 63.13% | 63.13% |
| $ to FPSC customers | 2,265,833 | 2,075,317 | 1,207,671 | 805,114 |
| Annual amount (10) years | 226,583 | 207,532 | 120,767 | 80,511 |
| Monthly | 18,882 | 17,294 | 10,064 | 6,709 |
| Weighted customers | 49,443 | 49,443 | 49,443 | 49,443 |
| Annual amount | **$4.58** | **$4.20** | **$2.44** | **$1.63** |
| Monthly amount | **$0.38** | **$0.35** | **$0.20** | **$0.14** |
| Total per customer over 10 yr. | **$46** | **$42** | **$24** | **$16** |

| Just Wastewater Customers | Utility Method 6% | Fine/Offer 14% $309,710/ $2,200,000 | 1/2 to customers | 1/3 to customers |
|---|---|---|---|---|
| Total Legal Fees | $3,826,210 | $3,826,210 | $3,826,210 | $3,826,210 |
| Allocated to FCWC | 236,842 | 538,730 | 1,913,105 | 2,550,552 |
| Net legal expense | 3,589,368 | 3,287,480 | 1,913,105 | 1,275,658 |
| % to FPSC customers | 52.68% | 52.68% | 52.68% | 52.68% |
| $ to FPSC customers | 1,890,752 | 1,731,728 | 1,007,756 | 671,972 |
| Annual amount (10) years | 189,075 | 173,173 | 100,776 | 67,197 |
| Monthly | 15,756 | 14,431 | 8,398 | 5,600 |
| Weighted customers | 17,231 | 17,231 | 17,231 | 17,231 |
| Annual amount | **$10.97** | **$10.05** | **$5.85** | **$3.90** |
| Monthly amount | **$0.91** | **$0.84** | **$0.49** | **$0.32** |
| Total per customer over 10 yr. | **$110** | **$101** | **$58** | **$39** |

| Just Fined Systems | Utility Method 6% | Fine/Offer 14% $309,710/ $2,200,000 | 1/2 to customers | 1/3 to customers |
|---|---|---|---|---|
| Total Legal Fees | $3,826,210 | $3,826,210 | $3,826,210 | $3,826,210 |
| Allocated to FCWC | 236,842 | 538,730 | 1,913,105 | 2,550,552 |
| Net legal expense | 3,589,368 | 3,287,480 | 1,913,105 | 1,275,658 |
| % to FPSC customers | 89.94% | 89.94% | 89.94% | 89.94% |
| $ to FPSC customers | 3,228,381 | 2,956,854 | 1,720,702 | 1,147,364 |
| Annual amount (10) years | 322,838 | 295,685 | 172,070 | 114,736 |
| Monthly | 26,903 | 24,640 | 14,339 | 9,561 |
| Weighted customers | 12,601 | 12,601 | 12,601 | 12,601 |
| Annual amount | **$25.62** | **$23.47** | **$13.66** | **$9.11** |
| Monthly amount | **$2.14** | **$1.96** | **$1.14** | **$0.76** |
| Total per customer over 10 yr. | **$256** | **$235** | **$137** | **$91** |

DATE: October 22, 1998 **Timeline**

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| Date | System | Event |
|---|---|---|
| 11/13/85 | Barefoot Bay | FDER notes illegal discharge without NPDES permit(Exh.4,GSA14,P.2) |
| 12/27/85 | Barefoot Bay | FDER notes illegal discharge without NPDES permit(Exh.4,GSA14,P.2) |
| 01/22/86 | Barefoot Bay | FDER notes illegal discharge without NPDES permit(Exh.4,GSA14,P.2) |
| 01/29/86 | Barefoot Bay | FDER warning notice to FCWC re: discharge (Exh.4,GSA21,P.2) |
| 10/14/86 | Barefoot Bay | Brevard Co. Off. of Nat. Mgmt. determine perk pond failure and ill. discharge(Exh.4,GSA14,P.3) |
| 03/04/87 | Barefoot Bay | FDER Notice of Violation/Illegal discharge(Exh.4,GSA14,P.4) |
| 10/18/88 | Barefoot Bay | **Consent decree between FDER and FCWC Fine of $5,980 and required improvements-inject. well(TR,P.71,L.22)** |
| 09/14/89 | Barefoot Bay | FDER notes illegal discharge without NPDES permit(TR,P.73,L.4-5) |
| 02/28/90 | Barefoot Bay | FCWC applies for NPDES permit(Exh.4,GSA19,P.2) |
| 03/23/90 | Barefoot Bay | EPA receives NPDES application(Exh.4,GSA19,P.2) |
| 09/26/90 | Barefoot Bay | USEPA Order-CWA Violations(testing and info. required)(Exh.4,GSA19,P.2) |
| 10/09/90 | Barefoot Bay | SJRWMD issues order for FCWC to buy land for effluent disposal(Exh.4,GSA13,P.8) |
| 09/16/91 | Barefoot Bay | NPDES Permit(Cease discharge by June 1995)(TR,P.74,L.1-2,GSA) |
| 09/25/91 | Barefoot Bay | **Consent agreement and Order from EPA $6,000 fine for Sept. 14, 1989 discharge-no tax deductibility(TR,P.74,L.3-9)** |
| 09/12/96 | Barefoot Bay | PSC rate case order 951258-WS, PSC-96-1147-FOF-WS $4,866,338 for AWT(GSA 13) |
| 09/05/97 | Barefoot Bay | FDEP WW treatment permit(TR,P.72-73,L.23-25,1-3,GSA) |
| | | |
| 03/15/91 | Cape Coral | **DOJ/EPA bring suit for illegal discharge-$750,000 fine (TR,P.55,L.25,GSA)** |
| | | |
| 06/01/75 | Carrollwood | USEPA issues NPDES permit-expires 8/15/80(TR,P.64,L.15-19,GSA) |
| 09/01/77 | Carrollwood | Hills. Co. Pollution Control Comm. notices FCWC as not being in compliance with FDEP TOP(TR,P.64,L.21-24,GSA) |
| 10/01/79 | Carrollwood | FDEP notices FCWC of no discharge to Sweetwater Creek(TR,P.65,L.10-12,GSA) |
| 09/15/84 | Carrollwood | NPDES Permit Denied(Exh.5, P.5, L.16-20,GSA) |
| 11/27/84 | Carrollwood | EPA Administrative Order, cease discharge no later than June 1987(Exh.5,P.7,GSA) |
| 06/01/87 | Carrollwood | EPA Order to cease discharge by 6/1/87(Exh.5,P.7,L.16,GSA) |
| 03/01/88 | Carrollwood | Hillsborough County states they have available capacity for $5,538,000(TR,P.65,L.21-25,GSA) |
| 04/11/89 | Carrollwood | Engineering agreement with Dyer et al for AWT plant at Carrollwood (GSA 9) |
| 09/27/90 | Carrollwood | EPA Admin. Order for Carrollwood (TR,P.68,L.16-17,GSA) |
| 04/19/91 | Carrollwood | **EPA Admin. Order assessing penalties for Carrollwood $15,000 No valid NPDES June 1897-July 1990(TR,P.68,L.22,GSA)** |
| 05/28/91 | Carrollwood | NPDES permit FL0029319 AAWT by 2/1/93(TR,P.69,L.1-7,GSA) |
| 06/05/91 | Carrollwood | Interconnection agreement with Hillsborough County(GSA 12) |

Attachment C 2/3

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## Timeline

| Date | System | Event |
|---|---|---|
| 04/01/91 | FCWC | Retains Parsons & Landers; Jay Landers former secretary of FDEP(TR,P.78,L.22-25,GSA) |
| 09/01/91 | FCWC | Retains Alston & Bird; Lee Deltihns former USEPA Region IV General Counsel(TR,P.79,L.7,GSA) |
| 12/09/92 | FCWC | Settlement offer by DOJ/EPA for $5,024,074 (TR,P.58,L.13,GSA) |
| 12/12/92 | FCWC | $5,000,000 settlement offer by EPA/DOJ(TR,P.85,L.21-24,GSA) |
| 12/16/92 | FCWC | Meeting with EPA, DOJ and FCWC to settle claims(TR,P.58,L.22-23,GSA) |
| 05/01/93 | FCWC | Consults with Weil, Getshal & Manges-Avatar Law Firm(TR,P.80,L.14,GSA) |
| 06/01/93 | FCWC | Retains Jenner & Block; Gary Baise lead attorney(TR,P.88,L.8,GSA) |
| 08/01/93 | FCWC | Retains Henderson, Franklin, Starnes & Holt(TR,P.81,L.10-11,GSA) |
| 10/01/93 | FCWC | US vs. FCWC (TR,P.95,L.12-13,GHB) |
| 11/22/94 | FCWC | US vs. FCWC Answer filed by FCWC(TR,P.51,L.4-5,GSA) |
| 03/14/95 | FCWC | $500,000 offer settlement rejected by EPA/DOJ(TR,P.75,L.2-5,GSA) |
| 03/27/95 | FCWC | Allen deposed and pleads 5th Amendent(TR,P.75,L.12-16,GSA) |
| 03/30/95 | FCWC | US vs. FCWC Amended complaint including Avatar, Barefoot Bay and Carrollwood (TR,P.127,L.15,GHB) |
| 09/01/95 | FCWC | Retains Richard Leon former USDOJ official(TR,P.81,L.19-21,GSA) |
| 11/13/95 | FCWC | Allen changes mind and decides to testify(TR,P.76,L.9-12,GSA) |
| 03/25/96 | FCWC | EPA/DOJ trial begins and lasts 8 days(TR,P.76,L.14-15,GSA) |
| 08/20/96 | FCWC | **US vs. FCWC Judgement Fine of $309,710(TR,P.167,L.19,GHB)** |
| 10/18/96 | FCWC | US vs. FCWC DOJ/EPA appeals(TR,P.169,L.16,GHB) |
| 11/01/96 | FCWC | US vs. FCWC FCWC appeals decision on legal fees(TR,P.170,L.8-10,GHB) |
| 02/03/97 | FCWC | US vs. FCWC Legal costs and attorney fees denied(TR,P.169,L.1-2,GHB) |
| 08/06/97 | FCWC | US vs. FCWC Joint appeals abandoned(TR,P.171,L.16-17,GHB) |
| | | |
| 05/01/95 | FDEP | FDEP obtains NPDES authority from EPA (TR,P.52,L.8-10,GSA) |
| | | |
| 09/24/81 | Waterway | NPDES Permit Reissued-1.08 m gal. effluent into Cal. River(Exh. 5, P.12, L.14-16, GSA) |
| 04/07/86 | Waterway | USEPA letter detailing expiration of NPDES permit(Exh.10,P.55,MA) |
| 05/09/86 | Waterway | Renewal application for NPDES permit submitted(Exh.10,P.55,MA) |
| 07/22/86 | Waterway | Tentative denial of NPDES permit by EPA(Exh.5,P.14,L.22,GSA) |
| 12/08/86 | Waterway | NPDES Permit Denied by EPA-No wasteload allocation (Exh.10,P.55,MA) |
| 05/11/87 | Waterway | EPA Admin. Order cease discharge by 9/30/88(Exh.10,P.56,MA) |
| 07/15/88 | Waterway | FDEP Consent Order(Exh.10,P.57,MA) |
| 08/02/88 | Waterway | Expiration date of FDEP permit(TR,P.54,L.16-17,GSA) |
| 08/31/88 | Waterway | Amend. to EPA Admin. Order-cease by 11/1/90(Exh.10,P.58,MA) |
| 09/23/88 | Waterway | FDEP TOP permit granted(Exh.10,P.58,MA) |
| 09/30/88 | Waterway | NPDES permit expires(TR,P.49,L.23-24,GSA) |
| 03/29/89 | Waterway | App. to Army Corp. of Eng. for outfall(Exh.10,P.59,MA) |
| 03/30/89 | Waterway | USEPA notice of noncompliance(Exh.10,P.59,MA) |
| 04/19/89 | Waterway | FCWC notice to FDEP of "circumstances beyond our control"(Exh.10,P.59,MA) |
| 05/16/89 | Waterway | EPA notice of violation of NPDES permit(Exh.10,P.59,MA) |
| 06/12/89 | Waterway | App. to Army Corp. of Eng. for outfall complete(Exh.10,P.60,MA) |
| 06/19/89 | Waterway | Letter to FDER requesting wasteload allocation for Waterway(TR,P.67,L.18-19,GSA) |
| 09/26/89 | Waterway | EPA notice of violation of CWA, Admin. Order(Exh.10,P.59,MA) |
| 09/29/89 | Waterway | NPDES Permit Reissued(TR,P.99,L.19-20,GHB) |
| 09/29/89 | Waterway | EPA issues final NPDES permit(Exh.10,P.61,MA) |
| 05/01/90 | Waterway | EPA deadline for plant upgrade(Exh.10,P.65,MA) |
| 05/17/90 | Waterway | FCWC submits request for extension to EPA(Exh.10,P.64,MA) |
| 05/17/90 | Waterway | FCWC submits request for extension to DEP and TOP(Exh.10,P.64,MA) |
| 08/01/90 | Waterway | Amended EPA deadline for plant construction to begin(Exh.10,P.65,MA) |
| 10/01/90 | Waterway | FDEP doesn't accept "circumstances beyond our control"(Exh.10,P.66,MA) |
| 10/25/90 | Waterway | FCWC submits request for extension to DEP(Exh.10,P.67,MA) |
| 11/01/90 | Waterway | FDEP deadline for construction to begin(Exh.10,P.66,MA) |
| 12/11/90 | Waterway | FCWC submits request for extension to EPA for 9/1/92 deadline(Exh.10,P.67,MA) |
| 04/04/91 | Waterway | Meeting with EPA re: Waterway(TR,P.56,L.17-18,GSA) |
| 04/10/91 | Waterway | EPA call claiming FCWC out of compliance since 1987(Exh.10,P.68,MA) |
| 06/12/91 | Waterway | Show Cause Meeting with EPA re: Waterway(TR,P.56,L.17-18,GSA) |
| 07/11/91 | Waterway | Outfall line completed(Exh.10,P.71,MA) |
| 08/01/91 | Waterway | Rev. EPA sch. mandated relocation by 8/1/91 and water quality by 11/1/91(TR,P.53,L.19,GSA) |
| 10/01/91 | Waterway | Revised EPA schedule mandated compliance with water quality by 10/1/91(Exh.10,P.61,MA) |
| 06/05/92 | Waterway | Plant upgrade completed(TR,P.54,L.25,GSA) |
| 06/09/92 | Waterway | Meeting with EPA re: Waterway(TR,P.56,L.17-18,GSA) |
| 09/01/92 | Waterway | FDEP deadline for construction to begin(Exh.10,P.66,MA) |
| 09/01/92 | Waterway | GHB claims DOJ has begun threatening a law suit(TR,P.101,L.23,GHB) |
| 12/09/92 | Waterway | USEPA requests DOJ to bring suit(Exh.10,P.74,MA) |
| 12/23/92 | Waterway | FCWC $250,000 settlement offer to DOJ for Waterway(TR,P.59,L.11-14,GSA) |
| 01/05/93 | Waterway | FCWC $500,000 settlement offer to DOJ for Waterway(TR,P.59,L.22-23,GSA) |
| 07/21/93 | Waterway | Meet with DOJ in Atlanta(TR,P.100,L.12-13,GHB) |
| 09/01/93 | Waterway | **GHB meets with DOJ and claims no more than $200,000 in fines(TR,P.101,L.9-10,GHB)** |
| 10/01/93 | Waterway | US vs. FCWC 93-281-CIV-FTM-21-CWA Violations(TR,P.49,L.10-11,GSA) |

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## Timeline

| Date | System | Event |
|---|---|---|
| 09/24/81 | Waterway | NPDES Permit Reissued-1.08 m gal. effluent into Cal. River(Exh. 5, P.12, L.14-16, GSA) |
| 04/07/86 | Waterway | USEPA letter detailing expiration of NPDES permit(Exh.10,P.55,MA) |
| 05/09/86 | Waterway | Renewal application for NPDES permit submitted(Exh.10,P.55,MA) |
| 07/22/86 | Waterway | Tentative denial of NPDES permit by EPA(Exh.5,P.14,L.22,GSA) |
| 12/08/86 | Waterway | NPDES Permit Denied by EPA-No wasteload allocation (Exh.10,P.55,MA) |
| 05/11/87 | Waterway | EPA Admin. Order cease discharge by 9/30/88(Exh.10,P.56,MA) |
| 07/15/88 | Waterway | FDEP Consent Order(Exh.10,P.57,MA) |
| 08/02/88 | Waterway | Expiration date of FDEP permit(TR,P.54,L.16-17,GSA) |
| 08/31/88 | Waterway | Amend. to EPA Admin. Order-cease by 11/1/90(Exh.10,P.58,MA) |
| 09/23/88 | Waterway | FDEP TOP permit granted(Exh.10,P.58,MA) |
| 09/30/88 | Waterway | NPDES permit expires(TR,P.49,L.23-24,GSA) |
| 03/29/89 | Waterway | App. to Army Corp. of Eng. for outfall(Exh.10,P.59,MA) |
| 03/30/89 | Waterway | USEPA notice of noncompliance(Exh.10,P.59,MA) |
| 04/19/89 | Waterway | FCWC notice to FDEP of "circumstances beyond our control"(Exh.10,P.59,MA) |
| 05/16/89 | Waterway | EPA notice of violation of NPDES permit(Exh.10,P.59,MA) |
| 06/12/89 | Waterway | App. to Army Corp. of Eng. for outfall complete(Exh.10,P.60,MA) |
| 06/19/89 | Waterway | Letter to FDER requesting wasteload allocation for Waterway(TR,P.67,L.18-19,GSA) |
| 09/26/89 | Waterway | EPA notice of violation of CWA, Admin. Order(Exh.10,P.59,MA) |
| 09/29/89 | Waterway | NPDES Permit Reissued(TR,P.99,L.19-20,GHB) |
| 09/29/89 | Waterway | EPA issues final NPDES permit(Exh.10,P.61,MA) |
| 05/01/90 | Waterway | EPA deadline for plant upgrade(Exh.10,P.65,MA) |
| 05/17/90 | Waterway | FCWC submits request for extension to EPA(Exh.10,P.64,MA) |
| 05/17/90 | Waterway | FCWC submits request for extension to DEP and TOP(Exh.10,P.64,MA) |
| 08/01/90 | Waterway | Amended EPA deadline for plant construction to begin(Exh.10,P.65,MA) |
| 10/01/90 | Waterway | FDEP doesn't accept "circumstances beyond our control"(Exh.10,P.66,MA) |
| 10/25/90 | Waterway | FCWC submits request for extension to DEP(Exh.10,P.67,MA) |
| 11/01/90 | Waterway | FDEP deadline for construction to begin(Exh.10,P.66,MA) |
| 12/11/90 | Waterway | FCWC submits request for extension to EPA for 9/1/92 deadline(Exh.10,P.67,MA) |
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## ISSUE AND RECOMMENDATION SUMMARY

**ISSUE 1**: Does the proposed recovery by FCWC of the litigation expenses constitute retroactive ratemaking?
**RECOMMENDATION**: Yes, the proposed recovery by FCWC of the litigation expenses constitutes retroactive ratemaking, and for this reason, it should be denied. If the Commission disagrees that the utility's request is a request for retroactive ratemaking, staff recommends that the request should still be denied on the basis that FCWC management did not act in a reasonable or prudent manner to avoid the occurrence of federal prosecution. (Gervasi, Mann)

**ISSUE 2**: Is there any requirement that this utility should have obtained an accounting order prior to filing this petition?
**RECOMMENDATION**: No. (Mann)

**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?
**RECOMMENDATION**: Yes, however in staff's opinion prior effort to comply with EPA and FDEP mandates may have forestalled action by the DOJ. (Walden, Mann)

**ISSUE 4**: Was FCWC's failure to challenge the EPA's 1986 NPDES permit denial a prudent decision?
**RECOMMENDATION**: No. (Walden)

**ISSUE 5**: Is the amount of litigation expenses incurred by FCWC in defending the complaint of DOJ fair and reasonable?
**RECOMMENDATION**: Staff is unable to quantify, from the information contained in the record, the amount of litigation expenses which may not have been fairly or reasonably incurred. Therefore, if the Commission disagrees with staff's recommendation in issue 1 that recovery of these expenses should be denied, staff recommends that the record should be reopened in order to take evidence on the fairness and reasonableness of these expenses. (Mann, Gervasi)

**ISSUE 6**: Does the potential recovery of litigation costs by FCWC provide a disincentive to comply with the Clean Water Act?
**RECOMMENDATION**: Yes. (Mann)

**ISSUE 7**: Stricken.
**ISSUE 8**: Stricken.

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

**RECOMMENDATION**: The degree to which bankruptcy would have affected the quality of service provided to FCWC's customers is unknown. (Walden)

**ISSUE 10**: Should recovery of litigation expenses from the ratepayers depend on whether the utility or the ratepayers benefitted from the litigation?
**RECOMMENDATION**: No. The recovery of litigation expenses from the ratepayers should depend on whether the litigation costs were reasonable and prudently incurred. (Mann)

**ISSUE 11**: Are the litigation expenses sought in this case reasonably characterized as normal, recurring costs of doing business?
**RECOMMENDATION**: No. (Mann)

**ISSUE 12**: Should any portion of FCWC's litigation costs be recovered through a surcharge, and if so, how much?
**RECOMMENDATION**: No. (Mann)

**ISSUE 13**: Did the DOJ litigation involve all of FCWC's wastewater systems?
**RECOMMENDATION**: No. It involved only three wastewater systems: Barefoot Bay, Carrollwood, and Waterway Estates. (Walden)

**ISSUE 14**: Should FCWC's request to allocate the costs among all of its customers be approved?
**RECOMMENDATION**: No. The costs associated with the litigation, if allowed by the Commission, should only be allocated to the specific systems involved, consistent with the existing Commission methodology. (Mann)

**ISSUE 15**: What is the appropriate amount of rate case expense?
**RECOMMENDATION**: None is appropriate. (Mann)

**ISSUE 16**: Should FCWC be required to pay regulatory assessment fees on any revenues that may be approved in this docket?
**RECOMMENDATION**: Yes. (Mann)

**ISSUE 17**: What is the appropriate amount of revenue, if any, to be collected through the surcharge?
**RECOMMENDATION**: None. (Mann)

**ISSUE 18**: Should FCWC's requested recovery period for litigation costs be approved?
**RECOMMENDATION**: Yes. Should the Commission decide to allow the recovery of some or all of the litigation costs in this docket,

staff recommends that FCWC's requested recovery period of ten years for litigation costs should be approved. (Mann)

**ISSUE 19**: What are the appropriate surcharges?
**RECOMMENDATION**: None. (Mann)

**ISSUE 20**: If the Commission issues an order that provides for the recovery of litigation costs, what is the appropriate accounting treatment?
**RECOMMENDATION**: Any allowance for litigation costs and rate case expense in this case should not be included as a rate base item and should be amortized, on a straight line basis, over a ten-year period. (Mann)

**ISSUE 21**: Should FCWC be allowed to include any unrecovered litigation expenses being amortized in its next rate case in order to earn a rate of return on the unrecovered balance?
**RECOMMENDATION**: No. (Mann)

**ISSUE 22**: Should FCWC's request to amortize rate case expense over ten years be approved?
**RECOMMENDATION**: Yes, if the Commission approves rate case expense in Issue 15 of this recommendation, FCWC's request to amortize such expense over ten years should be approved. (Gervasi, Mann)

**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?
**RECOMMENDATION**: No, under Section 367.0822, Florida Statutes, FCWC is not required to 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. (Gervasi)