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ORIGINAL

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December 23, 1998

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

VIA HAND DELIVERY

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 Division in Lee County and Barefoot Bay Division in Brevard County.

Dear Ms. Bayo:

Enclosed for filing, on behalf of Florida Cities Water Company, are an original and one (1) copy of Directions to Clerk and original and one (1) copy of a Notice of Administrative Appeal, in reference to the above docket.

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

Thank you for your assistance.

Sincerely,

B. Kenneth Gatlin

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Enclosures

Notice
DOCUMENT NUMBER-DATE
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Directions
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14490 DEC 23 98

TAL:19412:1

IN THE FLORIDA PUBLIC SERVICE COMMISSION

ORIGINAL

Florida Cities Water Company, a Florida Corporation, Applicant/Appellant, v. State of Florida, Florida Public Service Commission, Appellee.	FPSC Case No. 971663-WS **NOTICE OF ADMINISTRATIVE APPEAL**

NOTICE IS GIVEN that Florida Cities Water Company, Appellant, appeals to the District Court of Appeal, First District, State of Florida, the final order of this commission rendered November 25, 1998. A conformed copy of the final order is attached hereto in accordance with rule 9.110(d), Fla.R.App.Procedure. The nature of the order is a final order of the Florida Public Service Commission denying Florida Cities Water Company's petition to recover environmental litigation costs for its North and South Ft. Myers Divisions in Lee County and Barefoot Bay Division in Brevard County.

TAL:19414:1

DATED this 23rd day of December, 1998.

Respectfully submitted,

Wayne L. Schiefelbein, for

B. KENNETH GATLIN
Fla. Bar No.: 0027966
KATHRYN G.W. COWDERY
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Attorneys for Florida Cities Water Company

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of Florida Cities Water Company's Notice of Administrative Appeal has been furnished by hand delivery to Rosanne Gervasi, Esq., Division of Legal Services, Florida Public Service Commission, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850 and to Harold McLean, Esq., Office of Public Counsel, c/o The Florida Legislature, 111 W. Madison Street, Room 812, Tallahassee, FL 32399-1400, on this 23rd day of December, 1998.

Wayne L. Schiefelbein, for

B. KENNETH GATLIN

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: 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.	DOCKET NO. 971663-WS ORDER NO. PSC-98-1583-FOF-WS ISSUED: November 25, 1998

The following Commissioners participated in the disposition of this matter:

JULIA L. JOHNSON, Chairman
J. TERRY DEASON
SUSAN F. CLARK
JOE GARCIA
E. LEON JACOBS, JR.

ORDER DENYING PETITION FOR LIMITED PROCEEDING AND DENYING RATE CASE EXPENSE ASSOCIATED THEREWITH

BY THE COMMISSION:

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.

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

A TRUE COPY
ATTEST Kay Flynn
Chief, Bureau of Records

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). According to FCWC witness Baise, EPA's dissatisfaction arose over the timeliness of completing the work set forth in the action plan. Later, this complaint was amended to include alleged violations at the Barefoot Bay and Carrollwood wastewater plants. FCWC filed an answer to the complaint on November 2, 1994, denying the allegations.

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. While the total legal expenses incurred were $3,826,810, the utility seeks to recover $2,265,833, plus the estimated rate case costs of $182,382. 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. We acknowledged OPC's intervention by Order No. PSC-98-0430-PCO-WS, issued March 26, 1998. 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

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

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. We conducted an evidentiary hearing on August 12, 1998, in Tallahassee.

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.

PROHIBITION AGAINST RETROACTIVE RATEMAKING

CONSIDERATIONS OF LAW

At issue is whether the proposed recovery by FCWC of the litigation expenses constitutes retroactive ratemaking. The utility's position is that it does not. OPC's position is that it does. OPC argues that although OPC does 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. According to OPC, 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. OPC points out that this Commission has consistently ruled against retroactive ratemaking.

FCWC

FCWC claims that recovery of the litigation expenses being requested in this limited proceeding, which were incurred between 1991 and 1997, does not constitute a request for retroactive ratemaking. Even though these amounts were incurred and expensed prior to the filing date of 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 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.

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.

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 under recovered depreciation. The Commission reasoned that such an adjustment "would apply to prior consumption, thus retroactively raising rates." However, the Commission allowed 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 either or 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.

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. According to the utility, sufficient data was not available to seek and support rate recovery of the costs at the time incurred. 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.

OPC

According to OPC, retroactive ratemaking occurs when a utility seeks future recovery for past expenses. 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.

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 that the utility witness could only base his definition of retroactive ratemaking on years of experience, and nothing more.

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. 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. 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 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.

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.

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 expense 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.

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. 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 also cites to Order No. 17304, issued March 19, 1987, in Docket No. 850062-WS, involving 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.

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.

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. 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 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 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).

Id. at 784.

The next case cited by OPC 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 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 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 Division of Administrative Hearings (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.

Id. at 59. The hearing officer's conclusions were adopted by the Commission.

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 plain expenses. 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; 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 in 1991. If there exists any harshness, OPC argues that it is harshness which could have been avoided by earlier action on the part of FCWC.

OPC concludes that a "stake was driven in the ground" when the utility filed its petition for relief on December 29, 1997. 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.

Our Analysis and Findings

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.
- 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.
- On August 20, 1996, a judgement was rendered in the civil suit brought by the DOJ, and FCWC was found guilty of 1,536 violations of the CWA and fined $309,710, broken down as follows:

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

- On February 3, 1997, a judgement was rendered by the Federal Court denying FCWC's request for recovery of legal fees.
- On December 29, 1997, FCWC filed the limited proceeding petition at issue before the Commission to recover $2,265,833, plus rate case expense, in litigation costs from its regulated customers.

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, 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. 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, because all of the litigation expenses were expensed below the line in the years incurred, from 1991 through 1996/1997, they need to be reestablished onto the books.

For the reasons set forth below, we agree with OPC that the utility's request for recovery of the litigation expenses at issue must 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.,[2] at page 13, we recently observed that:

> This Commission has consistently recognized that ratemaking is prospective and that retroactive ratemaking

[2]This Order is currently on appeal in the First District Court of Appeal.

> 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.

We disagree 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, we 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 standard is contained in Section 367.081(2)(a), Florida Statutes, which requires the Commission to "fix rates which are just, reasonable, compensatory, and not unfairly discriminatory."

We agree 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.

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 this 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. 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. 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.

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. The utility could have contested the staff's adjustment at that time, but for unknown reasons it chose not to do so.

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, we note 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. We find that 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 modification 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. We find that the utility had ample opportunity to bring these costs before us when they were first being incurred, but chose not to. By choosing this course, the utility created generational inequity that we find cannot be corrected without violating the prohibition against retroactive ratemaking.

For the foregoing reasons, we hereby deny FCWC's petition for limited proceeding to recover litigation costs. Recovery of these past expenses would be neither fair, just, nor reasonable.

CONSIDERATIONS OF POLICY

While we find that granting FCWC's petition in this case constitutes retroactive ratemaking, we also find it appropriate to deny the petition on its merits, as discussed below.

FCWC management had complete control over whether to come before this 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, or the way the utility failed to file for an NPDES permit for Barefoot Bay before discharging to open waters, FCWC has shown on numerous

occasions a propensity to put off compliance with administrative edicts.

The following select chronology 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[3] and illegal discharge to Sweetwater Creek.

10/01/79 FDEP sends notice to FCWC that no discharges are to be made to Sweetwater Creek.

4/19/91 EPA Admin. Order-FCWC fined $15,000 for illegal discharge between 6/87 and 7/90 to Sweetwater Creek.

6/05/91 Interconnection agreement with Hillsborough County. Completion of an interconnection agreement with the County took almost 12 years, from 1979 to 1991.

Barefoot Bay

11/13/85 FDER discovers illegal discharge of effluent to Sebastian River.

2/28/90 FCWC applies for initial NPDES permit some four years after the first discovery of illegal discharge of effluent into open waters in 1985.

9/25/91 EPA Consent Agreement and Order-Fine of $6,000 for illegal discharge of effluent.

12/16/94 FCWC files application with EPA for NPDES permit following conversion to AWT. Conversion took more than six years to complete.

[3] Temporary Operating Permit

Waterway

12/08/86 NPDES permit denied based on a zero wasteload allocation.

07/15/88 FDER Consent Order- FCWC fined $15,000.

9/01/92 AWT completed.

6/01/93 Outfall line changed. From the first notice in 1987, it took almost six years for the utility to comply with regulatory mandates of AWT and moving the outfall line.

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. As an example, it took almost six years, from 1986 until 1992, for the Waterway treatment plant to be upgraded to AWT status. 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. These difficulties caused a 594-day delay in compliance with the consent agreement that the utility had with the EPA. 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." Having reviewed the history of events for this utility, we conclude 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. For over one 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. 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. Therefore, while it was illegally discharging effluent for over one 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." 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.

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; Hillsborough County would not work with the utility toward interconnection; Lee County caused delays in providing zoning changes; the Army Corp. of Engineers caused delays in the relocation of the outfall line at Waterway; the EPA reporting requirements were unfair; and the DOJ would not negotiate in good faith to settle this matter. Nevertheless, despite these problems; the management of the utility had complete control over coming before this Commission to request recognition of these litigation expenses when they were first being incurred.

Thus, in addition to finding the utility's request for recovery of the litigation expenses at issue to be a request for retroactive ratemaking, we also find it appropriate to deny the request based on the unreasonable delays by FCWC management to adhere to environmental mandates. In so doing, 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. We differentiate these two cases from the instant case 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 instant case, however, 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.

In the instant case, 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, we find it appropriate to disallow the disputed legal costs. 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. We do 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. While we do not make the finding that there should be an absolute prohibition against recovery of legal fees in any proceeding where a fine is imposed, this Commission should decide on a case by case basis if the utility has acted in a reasonable and prudent manner. In the instant case, we find that for the reasons described above, FCWC has not acted reasonably or prudently.

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. We find that the evidence does not support the contention that ratepayers benefited from the utility's defense 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 FPSC regulated systems.

Conclusion

Based on the foregoing, we cannot approve the utility's request to pass through the requested litigation costs to the customers. We find 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. Moreover, we do not agree with the utility that it is requesting recovery of prudently incurred, necessary, and allowable expenses. We find that the utility did not avoid the construction of capital improvements, did not avoid environmental fines and prosecution, did not follow prescribed accounting instructions, and finally, did not act in a prudent or reasonable manner in its dealings concerning 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, we hereby deny FCWC's petition for limited proceeding to recover litigation costs.

RATE CASE EXPENSE

FCWC additionally requests to recover rate case expense in the amount of $182,382. OPC argues that no recovery of rate case expense is appropriate irrespective of whether FCWC recovers anything on its petition. According to OPC, 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.

FCWC argues that recovery of rate case expense should not be dependent upon recovery of the litigation costs. FCWC believes that even if we disallow the litigation costs, we should nonetheless allow the rate case expense because it was reasonably and prudently incurred.

OPC argues 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. Beyond this argument, OPC claims that the rate case expense in this case was imprudently incurred. 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, and concludes that therefore it was imprudent to bring this matter before the Commission and incur additional rate case expense. 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 argues that recovery of rate case expense should be disallowed.

Although we do not agree 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, we do agree that the utility should not be allowed to recover rate case expense in this docket on the basis that we have denied the utility's request for recovery of the litigation costs. As noted, 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. With this understanding, we agree with OPC that it was imprudent for the utility to bring this matter before this Commission and incur additional rate case expense. Therefore, we hereby deny the utility's request for recovery of rate case expense.

DOCKET CLOSURE

Upon expiration of the time for filing an appeal, no further action will be necessary and this docket shall be closed. If a party files a notice of appeal, this docket shall be closed upon resolution thereof by the appellate court.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that Florida Cities Water Company's Petition 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 is hereby denied. It is further

ORDERED that Florida Cities Water Company's request for recovery of rate case expense is denied. It is further

ORDERED that upon expiration of the time for filing an appeal, this docket shall be closed. If a party files a notice of appeal, this docket shall be closed upon resolution thereof by the appellate court.

By ORDER of the Florida Public Service Commission this 25th day of November, 1998.

Blanca S. Bayó

BLANCA S. BAYÓ, Director
Division of Records and Reporting

(S E A L)

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water and/or wastewater utility by filing a notice of appeal with the Director, Division of Records and reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.