State of Florida

Public Service Commission

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DATE: AUGUST 11, 1999

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

FROM: DIVISION OF LEGAL SERVICES (JAEGER, CIBULA, GERVASI)
DIVISION OF WATER AND WASTEWATER (LOWE, WILLIS, CHASE, MERCHANT, RENDELL)

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

AGENDA: AUGUST 23, 1999 - SPECIAL AGENDA - DECISION ON REMAND - PARTICIPATION IS DEPENDENT UPON VOTE IN ISSUE NO. 1

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\LEG\WP\950495S3.RCM

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CASE BACKGROUND

On June 28, 1995, Southern States Utilities, Inc., now Florida Water Services Corporation (hereinafter Florida Water or utility), a Class A utility, filed an application for approval of uniform interim and final water and wastewater rate increases for 141 service areas in 22 counties, pursuant to Sections 367.081 and 367.082, Florida Statutes, respectively. The utility also requested a uniform increase in service availability charges, approval of an allowance for funds used during construction (AFUDC) and an allowance for funds prudently invested (AFPI).

On October 30, 1996, the Commission issued Order No. PSC-96-1320-FOF-WS (Final Order) granting, among other things, a rate increase using the capband rate structure, and approving Allowance for Funds Prudently Invested (AFPI) charges in this rate proceeding. Notices of Appeal were subsequently filed with the First District Court of Appeal (First District or Court). On December 2, 1996, and December 31, 1996, the Court issued orders abating the appeal pending our disposition of all motions or cross-motions for reconsideration. On December 3, 1996, Florida Water filed a Motion to Stay Refund of Interim Rates and Reduction to AFPI Charges Pending Appeal and Motion to Release/Modify Bond Securing Refund of Interim Rates (Motion). In that Motion, Florida Water requested a stay of the provisions of the Final Order relating to the refund of a portion of the interim rates and the imposition of new charges for AFPI. The Office of Public Counsel (OPC) filed a response in opposition to Florida Water's Motion.

By Order No. PSC-97-0099-FOF-WS (Stay Order), issued January 27, 1997, the Commission acknowledged that, pursuant to Rule 25-22.061(1)(a), Florida Administrative Code, there was a mandatory stay as to the refund of interim rates relating to Lehigh and Marco Island. However, by that same Order, the Commission denied Florida Water's request to stay the reduction to AFPI charges. On February 11, 1997, Florida Water filed a motion for reconsideration of the Stay Order related to the partial stay of AFPI charges.

By Order No. PSC-97-0374-FOF-WS, issued April 7, 1997, the Commission ruled on the November 14, 1996, motion for reconsideration filed by Citrus County Board of County Commissioners, Sugarmill Woods Civic Association, Inc., Marco Island Fair Water Defense Fund Committee, Concerned Citizens of Lehigh Acres, East County Water Control District, Springhill Civic Association, Inc., Hidden Hills Country Club Association, Inc., Citrus Park Homeowners Association, and the Harbour Woods Civic Association (Marco, et al.); the November 26, 1996, cross-motion

for reconsideration filed by Florida Water; and the January 15, 1997, motion for reconsideration filed by OPC. Also, on its own motion, the Commission reconsidered and corrected certain errors in regard to AFPI charges, private fire protection charges, and plant capacity charges/main extension charges.

By Order No. PSC-97-0613-FOF-WS, issued May 29, 1997, the Commission ruled on Florida Water's February 11, 1997 motion for reconsideration of the Stay Order and OPC's March 3, 1997 motion requesting the full Commission to reconsider the Prehearing Officer's denial of its request for the Prehearing Officer to establish a schedule for filing motions for reconsideration. In that Order, the Commission reconsidered its previous decisions on stays of AFPI charges and allowed Florida Water to implement its alternate stay proposal, to continue charging, subject to refund, the higher of any AFPI charges. Through this mechanism, the Commission recognized that AFPI charges were severable and the potential for backbilling was minimized.

With the issuance of that Order, the Commission disposed of all motions for reconsideration and any requests for stays, and briefs were filed with the First District. Subsequently, on June 10, 1998, the First District issued its opinion on review of the Final Order in Southern States Utils., Inc. v. FPSC, 714 So. 2d 1046 (Fla. 1st DCA 1998)[Southern States II]. Sugarmill Woods Civic Association, Inc. (Sugarmill Woods), timely filed a motion for rehearing, clarification, and certification of this opinion. By opinion dated August 5, 1998, the Court denied this motion, and, on August 21, 1998, issued its mandate. A summary of the June 10, 1998, Court opinion follows.

First District's Opinion

In issuing its mandate, the Court, acting *en banc*, affirmed and approved the capband rate structure and the Commission's decision declining to make a downward adjustment in rate base to reflect the price the utility paid for Lehigh Acres. In approving the capband rate structure, the Court held that "whenever the PSC has jurisdiction to set water and sewer rates for multiple systems, inter-system functional relatedness is no prerequisite to the PSC's setting rates that are uniform across a group of systems." Southern States II, at 1051. In so holding, the Court expressly overruled Citrus County v. Southern States Utils., Inc., 656 So. 2d 1307 (Fla. 1st DCA 1995).

The Court reversed the Commission's decision to use annual average daily flows (AADF) in the numerator of the used and useful

equation for eight wastewater treatment plants and to use the lot count method in determining used and useful percentages for the water distribution and wastewater collection systems serving mixed use areas. The Court remanded these issues to the Commission for the taking of additional evidence, if it exists. The Court also reversed the Commission's decision to exclude a portion of the prudently incurred construction costs for reuse facilities from rate base.

Moreover, the Court acknowledged that the Commission had confessed error in canceling the previously allowed AFPI charges, and in using AADF in the numerator of the used and useful equation for three wastewater treatment plants when the Department of Environmental Protection (DEP) permit was not based on AADF. Further, because a refund on the rate structure question was no longer being required in Docket No. 920199-WS, the Court concluded that the Commission should revisit its decision to reduce (by $4.8 million) the utility's investment in equity in light of the status of ongoing litigation on that issue. Southern States II at 1058-59. Regarding the interim rate refund issue, the Court stated that "[b]ecause issues pertaining to refunds may well be moot, once the PSC sets new permanent rates on remand, addressing these issues at this juncture would be premature." Id. at 1049.

Actions Following Mandate

After the Court's issuance of its mandate, the Commission considered whether to reopen the record to take further evidence on the AADF and lot count methodology issues at its September 1, 1998 agenda conference. After much discussion and questions about the dollar amounts associated with each issue on remand, the Commission voted to defer action and directed staff to file a recommendation addressing the entire matter for a special agenda conference. Moreover, the Commission directed staff to analyze the costs and benefits of reopening the record and to meet with the parties to explore the possibility of settlement.

Although settlement meetings were held, no agreement could be reached among the parties. Nevertheless, on October 2, 1998, Florida Water and the Marco Island Fair Water Rate Defense Committee filed a joint offer of settlement (first offer) and proposal for disposition of mandate. On November 12, 1998, Florida Water filed a modification to the joint offer of settlement (modified offer).

On September 22, 1998, the City of Marco Island filed a petition to intervene, and at the November 13, 1998 special agenda

conference, The Moorings and the Moorings Homeowners Association made an oral request for intervention.

Order No. PSC-99-0093-FOF-WS, issued January 15, 1999, (First Order on Remand) memorializes the Commission's decisions made at the November 13, 1998 special agenda conference and the December 15, 1998 agenda conference. By that Order, the Commission granted intervention status to the City of Marco Island and The Moorings and Moorings Homeowners Association; rejected the first offer and modified offer of settlement; authorized Florida Water to implement increased rates for the used and useful adjustment for reuse facilities, the equity adjustment, and admitted errors (non-discretionary or Category I issues); ordered that the record in this proceeding be reopened to take additional evidence on the use of the lot count methodology in mixed use areas and the use of AADF in the numerator of the used and useful equation (discretionary or Category II issues); and proposed to authorize Florida Water to implement a surcharge for the nondiscretionary issues and ordered that if protested, the issue of what action should be taken with regard to the collection of surcharges shall be made an issue in the scheduled remand hearing.

By Order No. PSC-99-0664-PCO-WS, issued April 5, 1999, the Commission denied the utility's motion to transfer the remand proceeding to the Division of Administrative Hearings, granted Sugarmill Woods' petition for formal hearing concerning the proposed surcharges, and approved a list of issues for consideration on remand. Based on a disagreement with that Order, and with an order on discovery (Order No. PSC-99-0612-PCO-WS, issued April 2, 1999), Florida Water filed a Motion for Abatement and Continuance and Request for Expedited Ruling (Motion for Abatement) on April 12, 1999. Moreover, Florida Water disagreed with a second order on discovery, Order No. PSC-99-0708-PCO-WS, issued April 13, 1999, and filed a Motion to Enforce Mandate in the First District on May 3, 1999, in which it argued that all three of the above-noted orders were in error. On May 6, 1999, Florida Water filed a Motion to Toll Time for Service of Responses to OPC's Second Set of Interrogatories and Third and Fourth Requests for Production of Documents on Remand (Motion to Toll Time).

By Order No. PSC-99-0800-PCO-WS, issued April 21, 1999, the Prehearing Officer granted Florida Water's Motion for Abatement, abating the remand proceeding pending disposition of the appellate action on the utility's Motion to Enforce Mandate, and the Chairman's Office canceled the prehearing and hearing dates. Moreover, by Order No. PSC-99-1199-PCO-WS, issued June 14, 1999,

the Prehearing Officer granted in part and denied in part the utility's Motion to Toll Time.

On that same date, June 14, 1999, the utility filed its Motion for Approval of New Offer of Settlement and Proposal for Disposition of Mandate on Remand (New Offer of Settlement). In the New Offer of Settlement, Florida Water states that the offer is supported by the City Of Marco Island and the Amelia Island Community Association, Inc., et al. (Amelia Island).

On June 24, 1999, the utility filed a Motion for Reconsideration of Order No. PSC-99-1199-PCO-WS (Motion for Reconsideration), whereby it requests the Commission to reconsider its decision to require the utility to respond to OPC's discovery propounded before the abatement of the remand proceeding and to which the utility had no objection. However, one week prior to the filing of this Motion for Reconsideration, by Opinion dated June 17, 1999, the First District denied Florida Water's Motion to Enforce Mandate, disposing of the appellate action.

On June 28, 1999, OPC and Sugarmill Woods filed responses to the New Offer of Settlement. On July 2, 1999, OPC filed a response to the utility's Motion for Reconsideration and on July 12, 1999, Florida Water filed its Response to OPC's Motion to Consolidate.

The Commission has received numerous letters from individuals from the Zephyr Shores Estate Property Owners in opposition to the 1.7 percent rate increase proposed in the New Offer of Settlement. The Commission also received one letter dated July 8, 1999, signed by eight individuals purporting to be members of the Board of Directors of Citrus Springs (Citrus County, Florida) Civic Association, in support of the New Offer of Settlement.[1] In addition, by letter dated June 28, 1999, the utility forwarded a letter from Frederick Kramer, representing the Marco Island Fair Water Defense Fund Committee, stating that it was in support of the utility's New Offer of Settlement. Also, by cover letter dated July 21, 1999, Kenneth W. Bolster forwarded a petition signed by eight customers of Florida Water's Deltona plant. In their petition, the customers request the Commission to accept the settlement offer, and specifically state, among other things, that

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[1]On July 27, 1999, Citrus County passed a resolution to rescind the Commission's jurisdiction over that county. However, this has no effect on the Commission's processing of this rate case.

"surcharges create a severe hardship for our customers, and further litigation expenses are only included in future customer rates."

This recommendation addresses the utility's New Offer of Settlement, OPC and Sugarmill Woods' responses thereto, the utility's Motion for Reconsideration and OPC's response, and OPC's Motion to Consolidate and the utility's response.

DISCUSSION OF ISSUES

ISSUE 1: Should parties be allowed to participate?

RECOMMENDATION: Yes. Participation should be limited to ten minutes for each party. (JAEGER)

STAFF ANALYSIS: Typically, post-remand recommendations are noticed as "Parties May Not Participate," with participation limited to Commissioners and staff. Rule 25-22.0021, Florida Administrative Code, provides that:

> [w]hen a recommendation is presented and considered in a proceeding where a hearing has been held, no person other than staff who did not testify at the hearing and the Commissioners may participate at the agenda conference. Oral or written presentation by any other person . . . is not permitted, unless the Commission is considering new matters related to but not addressed at the hearing.

Staff believes that the Commission will be considering matters contained in the New Offer of Settlement, such as the utility's entitlement to collect surcharges, which are related to, but were not addressed at, the hearing. In addition, given the complex nature of the issues which have been raised, staff believes that participation by the parties would be helpful to the Commission's understanding of the issues. Therefore, staff recommends that participation at the agenda conference should be allowed, but limited to ten minutes for each party.

ISSUE 2: Should the Commission accept Florida Water Services Corporation's New Offer of Settlement and Proposal for Disposition of Mandate on Remand?

PRIMARY STAFF RECOMMENDATION: No, the New Offer of Settlement should be rejected as filed. However, primary staff would recommend acceptance if Florida Water would agree to withdraw the following provisions contained in C. and D. of paragraph 20 thereof:

1. [For a period running to June 28, 2002,] Florida Water would not be subject to an earnings investigation by the Commission or a petition or complaint to decrease Florida Water's water or wastewater rates or charges;

2. If Florida Water experiences earnings in excess of the top of the range of its authorized return on equity for the calendar years 1999, 2000, 2001 or 2002 such excess earnings would be shared between Florida Water and its customers on a one-third/two-thirds basis, one-third to be retained by Florida Water and two-thirds to be refunded to Florida Water's customers; and

3. Florida Water's shareholders would retain in full the gain on sale of Florida Water's Orange County land and facilities. In sufficient time prior to Commission consideration of this settlement proposal, the Commission would provide notice in the Florida Administrative Weekly of its intent to close Docket No. 980744-WS in recognition of this settlement. Any and all issues concerning Florida Water's gain on sale of its Orange County land and facilities shall not be revisited or reconsidered by the Commission.

Further, the Commission should recede from its finding in Order No. PSC-99-0093-FOF-WS that to do other than strictly adhere to the capband methodology in calculating rates based on the new revenue requirement would be a change in rate structure. If a revised offer of settlement is proposed which removes the provisions identified above, the Category II rates should be calculated as an across the board increase. Also, Sugarmill Woods' pending protest to the proposed agency action portion of Order No. PSC-99-0093-FOF-WS, issued January 15, 1999, would be mooted by the Commission's decision to approve the New Offer of Settlement, as there would be no assessment of a surcharge and therefore no surcharge methodology in dispute. (LOWE, WILLIS, RENDELL, MERCHANT, CHASE)

ALTERNATE STAFF RECOMMENDATION: The legal staff agrees with the primary staff that the utility's New Offer of Settlement should be rejected. However, legal staff would only recommend that the Commission accept a revised settlement offer if, in addition to the removal of the provisions identified in the primary staff recommendation, instead of the creation of a regulatory asset for the Category I and II surcharges, which we recommend is inconsistent with GTE v. Clark, the utility were to agree to charge surcharges only to those customers who were customers during the time the incorrect rates were in effect in the amount of the proposed regulatory asset over an appropriate period. The utility should be advised that the provision for the creation of a regulatory asset is unacceptable, and that this portion of the settlement offer, contained in paragraph 20 B., must be modified so as to conform with the requirements of GTE. Pending these revisions, legal staff would recommend that the Commission reject the offer as filed, and proceed to hearing. (JAEGER, CIBULA, GERVASI)

STAFF ANALYSIS: This staff analysis represents both the primary and alternate staff analyses except where otherwise indicated herein.

As mentioned in the Case Background, on June 14, 1999, Florida Water filed a Motion for Approval of New Offer of Settlement and Proposal for Disposition of Mandate on Remand. The purpose of the New Offer of Settlement is to resolve the outstanding issues on remand in the instant case and to take other actions to resolve and close Docket No. 980744-WS (the docket opened to address the issue of the gain on sale of Florida Water's Orange County land and facilities).

In analyzing previous offers of settlement, staff initially took the position that it was the prerogative of the Commission to reopen the record on the two discretionary issues, and conduct further hearings. Although the Commission has voted to reopen the record, staff believes that the Commission could still, if it found it to be in the public interest, reconsider on its own motion this decision.

In considering this New Offer of Settlement, staff has attempted to analyze whether it would now be in the public interest for the Commission to accept this offer. As in the past analysis, staff has examined possible outcomes on the two discretionary issues and what the utility is willing to accept in its offer.

The premise is that the Commission could decline to conduct further proceedings, and the utility would be entitled to the revenues associated with the two discretionary issues. The additional revenues required for these two issues can be calculated from the evidence in the record. Where the utility has agreed to accept less than the maximum amount of revenues, the Commission may decide that, at some point, the public interest would not be served by conducting further hearings. Also, where the utility is willing to take less than what it is entitled to under the court's remand decision, then due process has been met, and the Commission's decision could be issued as final agency action.

In addition to determining whether the new offer is in the public interest, staff believes that the Commission must also determine whether any of the provisions of the new settlement offer are in contravention of the law, due process, or the law of the case as set forth in the First District's opinion. Staff's analysis is based on all the above-noted conditions.

As the Commission is aware, and as also discussed in the Case Background, Florida Water previously filed an offer of settlement, which, after several modifications, was ultimately rejected by the Commission. <u>See</u> Order No. PSC-99-0093-PCO-WS. Staff believes that it might be helpful at this point in the analysis to recap the earlier offers of settlement so that the Commission can better understand how this offer varies.

<u>PAST SETTLEMENT OFFERS</u>

The first settlement offer was filed on October 2, 1998, on behalf of Florida Water and its Marco Island customers. That settlement offer provided for an across the board rate increase of 4.8 percent (approximately a $2.8 million annual revenue increase); creation of a regulatory asset in the amount of $4.4 million for recovery of the Category I (also known as the non-discretionary issues and consisting of correcting for the used and useful adjustment for reuse facilities, the equity adjustment, and admitted errors), and Category II (also known as discretionary issues and involving the discretion of the Commission to reopen the record to take additional evidence on the use of the lot count methodology in mixed use areas and the use of AADF in the numerator of the used and useful equation) surcharges to be recovered in rates by no later than October 13, 2001; and closing of the gain-on-sale docket, Docket No. 980744-WS, with the issue not to be reconsidered.

In response to concerns raised by staff, the first settlement offer was modified by the utility by letter dated November 12, 1998. In its modified offer, the utility agreed that the $2.8 million annual revenue increase could be allocated among the service areas pursuant to the capband rate structure. Also, while disagreeing that creation of a regulatory asset would be improper, Florida Water proposed that it be allowed to bill surcharges (over a period of two years) at the level of $5.6 million which, when adjusted for Florida Water's annual attrition level of approximately 7 percent, would allow collection of approximately $4,728,000 in surcharges. Further, the modified offer of settlement provided that any difference from the projected $4,728,000 to be collected from the surcharge would be applied as a credit or debit to contributions-in-aid-of-construction (CIAC).

Upon considering this modified offer of settlement, the Commission expressed serious concern about the propriety of closing the gain-on-sale docket, and, at the November 13, 1998, special agenda conference, Florida Water agreed that the provision could be dropped.

Despite these modifications, the Commission voted to reject the offer of settlement at the November 13, 1998, special agenda conference. By Order No. PSC-99-0093-FOF-WS at page 10, the Commission stated that:

> [i]n considering whether we should accept either of the offers of settlement as our decision on remand, we note that the customers we have heard from have indicated that they prefer that we exercise our discretion to have a hearing on the AADF and lot count issues. Furthermore, OPC, representing all of the customers on these issues, has taken a position that we should conduct a hearing. We decline to substitute our judgment on these issues for those of the parties that have indicated that they wish to go to hearing. For these reasons, we reject the offers of settlement.

With these rejections of the offers of settlement, a hearing was scheduled for June 16-18, 1999. However, this hearing was canceled pending further appellate action of Florida Water. With the issuance of its opinion dated June 17, 1999, the First District denied Florida Water's Motion to Enforce Mandate, which apparently disposed of all of Florida Water's appellate action. Therefore, the hearing has now been rescheduled for February 2-4, 2000.

NEW OFFER OF SETTLEMENT

In paragraph 20 of its New Offer of Settlement filed on June 14, 1999, Florida Water proposes the following:

> A. Reduction in prospective Category II rate increase - Florida Water proposes to settle the Category II prospective rate increase for $966,167, or approximately one-half of the amount remaining at issue. This results in approximately a 1.7% average increase in rates. The increase in rates would be implemented within sixty days after the Commission vote approving this Settlement Offer.
>
> B. No Surcharges - Florida Water proposes that both Category I and II surcharges be booked as a regulatory asset in the amount of $8.5 million (including interest) as of August 1, 1999 and the Commission shall authorize recovery of such regulatory asset (to be amortized over 30 years or a shorter period if the Commission deems appropriate) in the Company's next rate case based on the same surcharge methodology previously ordered for Category I surcharges in Order No. PSC-99-0093-FOF-WS. No amortization of the asset would occur until it is included in rates.[2]
>
> C. Three Year Stayout - Florida Water proposes a 3 year stayout for both rate filings by the Company and earnings investigations by the Commission for all service areas involved in this docket. Indexing and pass-throughs would be allowed. Under this proposal, Florida Water would forego the filing of an application for increased rates, either pursuant to Section 367.081(6) or 367.0822, Florida Statutes, for a period running to Friday, June 28, 2002. For the same period, Florida Water would not be subject to an earnings investigation by the Commission or a petition or complaint to decrease Florida Water's

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[2]The total estimated surcharge through August 1, 1999 assuming approval of this settlement offer is $8.5 million (including interest). The regulatory asset to be booked will be calculated based upon the effective date of the Category II rate increase. If remand hearings go forward and an appeal is filed, a virtual certainty, the surcharge is estimated to grow to $13.5 million through August 1, 2001. (Footnote contained in Florida Water Motion)

water or wastewater rates or charges. If Florida Water experiences earnings in excess of the top of the range of its authorized return on equity for the calendar years 1999, 2000, 2001 or 2002[3] such excess earnings would be shared between Florida Water and its customers on a one-third/two-thirds basis, one-third to be retained by Florida Water and two-thirds to be refunded to Florida Water's customers.[4]

D. Close Orange County Docket No. 980744-WS - Florida Water's shareholders would retain in full the gain on sale of Florida Water's Orange County land and facilities. In sufficient time prior to Commission consideration of this settlement proposal, the Commission would provide notice in the Florida Administrative Weekly of its intent to close Docket No. 980744-WS in recognition of this settlement. Any and all issues concerning Florida Water's gain on sale of its Orange County land and facilities shall not be revisited or reconsidered by the Commission.

E. Rate Case Expense - Accrued rate case expense relating to reconsideration, appeals and the remand would be deferred and considered in Florida Water's next rate case. The total actual appeal and remand expense to date is approximately $450,000 and the total estimated through hearings and appeals is $1.1 million.

F. Interim Rate Refunds - There would be no interim rate refunds. This issue applied only to Lehigh and Marco Island wastewater customers. While Florida Water continues to believe the refund requirement was unlawful, these refunds are eliminated as a result of the Category I rate increase and surcharges approved by the Commission

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[3]The prospect of Florida Water earning in excess of its authorized return on equity is extremely unlikely given the fact that Florida Water earned approximately a 5% return on water and wastewater operations per its 1998 annual report. (Footnote contained in Florida Water Motion)

[4]A similar sharing proposal was recently approved by the Commission for Florida Power & Light Company pursuant to Order No. PSC-99-0519-AS-EI issued March 17,1999 in Docket No. 990067-EI. (Footnote contained in Florida Water Motion)

and the Category II rates and surcharges reflected in this Settlement Offer.

G. No Change in AFPI Rates - The Company proposes no change in Allowance for Funds Prudently Invested (AFPI) rates and termination of the existing escrow.

H. The resolution of the revenue requirements and rate issues as proposed herein shall not be construed to reflect Commission precedent or policy and shall not be revisited or reconsidered by the Commission.

I. This Settlement Offer is not severable, divisible or subject to modification and shall be deemed withdrawn in the event the Commission does not vote to approve this Offer of Settlement and Proposal for Disposition of Mandate on Remand in its entirety.

According to Florida Water's Motion, the additional benefits of this latest offer when compared with prior settlement offers include:

1) The overall water and wastewater revenue requirement increase (Categories I and II combined) would be reduced from $2.8 million to $2.0 million.

2) Out-of-pocket, cash payments of surcharges are eliminated. Category I surcharges currently total approximately $2.4 million to date, with interest continuing to accrue. Total potential Category I and II surcharges, assuming an appellate process through August 1, 2001 (a conservative estimate), with interest, are estimated to be $13.5 million. Cash payments of approximately $13.5 million of surcharges are eliminated, replaced by approximately $8.5 million of surcharges (as of August 1, 1999) booked as a regulatory asset as described above.

3) The Company stays out of rate cases affecting the service areas in this docket until at least June 28, 2002.

4) This Settlement Offer has a net present value benefit of approximately $1.9 million to Florida Water's customers compared to Florida Water's prior offers.

5) Rate case expense of approximately $650,000 is eliminated and all rate case expense related to reconsideration of the final order, the appeals and the remand process is deferred until Florida Water's next rate case.

6) The potential for higher rates and additional rate case expense of approximately $1.7 million associated with another rate case is deferred until at least June 28, 2002 due to the 3 year stayout.

7) While Florida Water maintains that application of Commission precedent to the Orange County gain on sale would not result in any sharing of the gain, if one assumes *arguendo* that the full gain is factored into Florida Water's earnings, amortization of the pre-tax $7 million gain over five years would not cause Florida Water to earn in excess of its authorized rate of return and, therefore, no rate reduction could be imposed. The 1998 return on equity of approximately 5% would increase less than 1.5% to approximately 6.5%.

Staff has analyzed each provision of the New Offer of Settlement as set forth below.

ANALYSIS OF EACH PROVISION OF THE NEW OFFER

A. Category II Rate Increase

In its new offer, Florida Water proposes to settle for an increase of $966,167 in its annual water and wastewater revenue for the Category II issues, or approximately one-half of the amount remaining at issue. This represents an increase of approximately 1.7 percent. In its response to Florida Water's offer, OPC states that instead of accepting the utility's revenue requirement proposals, the Commission should decide the amount Florida Water is entitled to receive in the remand proceeding. According to its Response, Sugarmill Woods opposes the offer and believes that the hearing process must be completed. Sugarmill Woods further states that the proposed reduction in the prospective Category II rate increase is overstated.

In evaluating this New Offer of Settlement, staff attempted to quantify the possible outcome on the AADF and lot count methodology issues which are the only issues on remand for which the Commission has been allowed a choice as to how to proceed. One reasonable outcome could be that the lot count methodology is approved but the

AADF issue is not. If this were the case, the utility would be entitled to approximately $466,971 in additional annual revenue. Another reasonable outcome could be that the AADF issue is approved but the lot count is not. If this were the case, the utility would be entitled to additional annual revenue of approximately $1,464,644. On the other hand, if the Commission does not support both the AADF and the lot count methodologies, the utility could be entitled to the total amount of approximately $1,931,615 in additional annual revenue.

Further, these amounts do not include any allowance for additional rate case expense. Therefore, another factor staff considered in evaluating the proposed settlement offer was the time and cost of continuing litigation. Florida Water has estimated that additional rate case expense to date is approximately $400,000, with an estimated $1.1 million in estimated rate case expense through the hearing and appeal process. This will be addressed later in staff's analysis.

Another factor not present when the Commission considered the first settlement offer is the decision by the First District in Palm Coast Utility Corp. v. FPSC, Case No. 97-1720 (Fla. 1st DCA May 10, 1999)[Palm Coast -- Docket No. 951056-WS]. In the Palm Coast case, the same Category II issues of Florida Water (AADF and lot count) were in dispute and considered by the Court. However, in Palm Coast, the Commission sponsored a staff witness specifically to present evidence in the record to support the methods used. Notwithstanding this evidence, the Court overturned the Commission again on both issues, finding that the record lacked an adequate basis for the change in methodology. As a result, staff's confidence is diminished that a favorable decision by the First District on appeal of the remand decision will be obtained should the Commission rule on remand that the lot count and AADF methodologies should be used.

Based on the above, staff believes that if Florida Water were to agree to settle for the amount stated in its offer, which is approximately one-half of the amount to which it is entitled on remand, and modifies the provisions of the offer which staff does not support for the reasons discussed below, such an offer would constitute a fair, just, and reasonable resolution to this case.

Discussion of Rate Structure

While the rate increase proposed by Florida Water in the New Offer of Settlement represents an increase of approximately 1.7 percent, the utility did not indicate how the rates should be

calculated. In its first Offer of Settlement, Florida Water proposed that the prospective rate increase be implemented pursuant to either percentage increases or equal rate increases, by meter sizes, to existing rates.[5]

In staff's recommendation dated October 21, 1998, on the first settlement offer, staff originally had concerns with allocating the increase across the board, stating that: "Staff believes that an across the board increase, while maintaining the current rate relationships, would be considered a change in the approved capband rate structure since it changes the subsidization among the service areas and the methodology used in determining the rate bands." Further, staff indicated that calculating rates using the capband rate structure would "ensure that there is no change from the capband rate structure, which was upheld by the court."

However, after further extensive analysis of the capband rate structure, staff believes that its previous statements were inaccurate in light of calculating rates based on a settlement offer. To understand why, one must remember the premise behind the calculation of the capband rate structure, which is that it starts with system stand alone rates, modifies the stand alone rates based on a cap of customers' bills at 10,000 gallons, and then groups the remaining systems below the cap based on similar cost as determined by an average bill. In other words, the basis of the capband rate structure, and the starting point for calculating rates using this rate structure, is the system specific revenue requirement.

Under Florida Water's settlement offer there is no system specific revenue requirement. The amount of the increase contained in the New Offer of Settlement is simply a revenue amount offered by the utility that it is willing to accept. Nowhere is there any calculation of how this amount is spread among the issues on remand or even between the water and wastewater systems. Therefore, there is no means of spreading this increase between the water and wastewater services and then among the various systems based on any accurate measure of cost.

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[5]Staff notes that on September 29, 1998, Sugarmill Woods filed a counter offer to Florida Water's first offer of settlement in which it proposed a prospective increase of 4.7 percent applied to base facility charges (BFCs), but no increases to gallonage charges. These proposed increases would have been made without regard to existing caps. The Commission took no action on this counter offer.

Since there is no cost-based method of allocating the revenue increase by system under the settlement offer, staff would basically have to allocate the increase in the same proportion as the non-discretionary revenue requirement in order to estimate system specific revenue increases. In other words, the method we would use would be to spread the total settlement offer revenue increase between the water and wastewater services in the same proportion as the non-discretionary revenue requirement. Then these amounts would be spread to the various service areas in the same manner. This method would result in, at best, a rough estimate of the revenue requirement by system since each system is not equally affected by the issues on remand and neither issue affects all systems.

In staff's opinion, given the uncertainty with regard to an accurate system specific revenue requirement, it makes no sense to fine tune the rate calculations by insisting on a strict adherence to the capband rate structure. Without accurate system stand alone rates, there would be no way of ensuring that the systems contained in the resulting bands are truly grouped according to similar costs.

For the above noted reasons, staff believes that it would be appropriate to allocate the proposed settlement amount across the board, without regard to the existing cap. The caps were originally established well over six years ago in Docket No. 920199-WS, on the basis of an affordability determination. The caps have been raised at least twice since the final rates went into effect as a result of the instant docket. Thus, the affordability concern has not been addressed for several years. Staff believes that it would be fair, just, and reasonable to increase all water and wastewater rates by 1.7 percent across the board. This increase would maintain the current level of subsidizations in the capband rates calculated as a result of the non-discretionary items. This across the board increase would also minimize any inequities which may occur if the increase were calculated through the capband rate structure by artificially banding service areas. Thus, this across the board methodology would not lead to unfairly discriminatory rates.

Staff further notes that the Commission has long held that spreading rate increases across the board for interim purposes does not change rate structure. (See Order Nos. PSC-96-1388-FOF-WS & PSC-96-0170-FOF-WS.) Thus, if the proposed settlement amount is applied across the board to the existing rates, it should not be interpreted as a change in rate structure. For these reasons, staff recommends that the Commission recede from its finding in

Order No. PSC-99-0093-FOF-WS that to do other than strictly adhere to the capband methodology in calculating rates based on the new revenue requirement would be a change in rate structure.

B. No Surcharges But Creation of Regulatory Asset

Florida Water proposes that both Category I and Category II surcharges be booked as a regulatory asset in the amount of $8.5 million (including interest) as of August 1, 1999, and the Commission authorize recovery of such regulatory asset (to be amortized over 30 years or a shorter period if the Commission deems appropriate) in the Company's next rate case based on the same surcharge methodology previously ordered for Category I surcharges in Order No. PSC-99-0093-FOF-WS. The amount of the actual regulatory asset to be booked would be calculated based upon the effective date of the Category II rate increase. Also, Florida Water is not requesting recovery through its rates at this time; therefore, the company would be foregoing any return on this regulatory asset for at least the next three years. This return could amount to approximately $2.59 million of additional revenue over these three years. Further, no amortization of the asset would occur until it is included in rates.

In its response to this portion of the settlement offer, OPC agreed that the Commission should use a regulatory asset in lieu of surcharges. However, OPC stated that the proposal was far too heavily weighed in Florida Water's favor on both the two discretionary issues and the gain-on-sale docket. OPC proposed that the Commission determine the amount of surcharges Florida Water was entitled to receive in this remand proceeding and book this amount as a regulatory asset.

In its response, Sugarmill Woods objects to the creation of a regulatory asset saying that the booking of "Category I and II surcharges as a regulatory asset would ultimately charge the wrong customers for the surcharges." Sugarmill Woods further states that not only would the proposal shift the expense to future customers, rather than the current customers from whom the surcharges are due, but that "the methodology suggested would create a 'uniform' surcharge, rather than correlate the liability for the surcharges to particular systems and allocate them on a stand alone or capband basis." Sugarmill Woods argues that such allocation "on a uniform basis would be a departure from the Commission's policy favoring capband rates." However, staff believes that it is important to note that the allocation of this regulatory asset has not been addressed. Thus, the allocation among service areas will be at issue in Florida Water's next rate case.

There is a primary and alternative staff analysis with regard to the creation of a regulatory asset to recover the surcharge amount. In the Primary Staff Analysis, staff discusses why it believes the creation of a regulatory asset is a reasonable and fair method to recover the surcharge amount. In the Alternative Staff Analysis, staff discusses why it believes the use of a regulatory asset to recover this amount is inconsistent with GTE Florida Inc. v. Clark , 668 So. 2d 971 (Fla. 1996)[GTE].

Primary Staff Analysis: When analyzing this portion of the offer, staff notes that there exists some inconsistency in the wording in the settlement offer. First, the offer indicates "No Surcharges" and continues with recovery through a regulatory asset to be amortized over 30 years. However, later the offer provides that the recovery of the asset would be based on the same "surcharge" methodology contained in Order No. PSC-99-0093-FOF-WS.[6] Staff contacted the utility concerning this inconsistency and received verbal confirmation that this wording was incorrect. The utility intends to book the full regulatory asset, amortize it over 30 years, and seek recovery of the asset from all customers in its next rate case.

Regulatory assets are created from rate actions taken by regulatory agencies. Regulatory assets arise from specific expenses or losses that would have been included in determining operating income in one period under the general requirements of the Uniform System of Accounts, but for it being probable that such items will be included in a different period or periods for purposes of developing the rates the utility is authorized to charge. Regulatory assets can also be created in reconciling differences between the requirements of generally accepted accounting principles, regulatory practice and tax laws. A

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[6]In Order No. PSC-99-0093-FOF-WS, issued January 15, 1999, the Commission approved a surcharge methodology for Florida Water based upon a base facility surcharge (BFS) to be applied across the board to all systems. This BFS would have been applied, by meter size, to all affected customers for the period of time they were utility customers. For water-only customers who were customers during this time, the utility was to collect these surcharges as a one-time charge. For the wastewater-only customers and the water and wastewater customers, the utility was to collect the surcharges over a six month time frame. For any remaining uncollectible amount, the utility had the opportunity to petition for a mechanism to recover this uncollectible amount.

regulatory asset can be used to recover both historic and future costs.

Regulatory assets are commonly used in all of the regulated industries. Rate case expense is an example of a regulatory asset that is created for water and wastewater utilities in every rate case. Rate case expense is a historic cost that is amortized or recovered over a four year period on a prospective basis. The Commission in this current Florida Water rate case, created regulatory assets to recover historic costs from current and future customers. Order No. PSC-96-1320-FOF, issued October 30, 1996, in Docket No. 950495-WS, created a regulatory asset to recover the utility's costs associated with Docket No. 930880-WS (the rate structure investigation). This asset was required to be recovered over a five year period from all customers during the five year period, regardless of whether they were customers during the time those costs were incurred. Another regulatory asset was created to recover the historic costs for three Marco Island Water Supply projects that were abandoned. These costs were amortized over ten years and recovered from both current and future customers.

The regulatory asset that would be created if the settlement offer is accepted is a means of avoiding surcharging customers for past usage. As mentioned above, the amount of the asset as of August 1, 1999 would be $8.5 million, including interest. However, the actual amount of the asset would be calculated based upon the effective date of the rate increase for Category II issues. Florida Water estimates that if remand hearings go forward and a subsequent appeal is filed, the surcharge is estimated to grow to approximately $13.5 million through August 1, 2001.

The Commission has previously been faced with this extremely complicated and difficult decision regarding the imposition of surcharges to customers of this utility. In Docket No. 920199-WS, the Commission was faced with the task of determining whether surcharges and refunds should be required as a result of a change in rate structure, and if so, how should they be recovered. Ultimately, in Order No. PSC-98-0143-FOF-WS, issued January 26, 1998, the Commission determined that no refunds and no surcharges should be made.

In making the determination that no refunds or surcharges were appropriate in that case, the Commission struggled with reconciling several court decisions. First, in GTE, the Florida Supreme Court mandated that GTE be allowed to recover its erroneously disallowed expenses from the date the erroneous order was issued through a surcharge that could be applied only to customers that received GTE

services during the disputed period of time. In so holding, the Court viewed "utility ratemaking as a matter of fairness. Equity required that both ratepayers and utilities be treated in a similar manner." GTE, at 972. Subsequently, the First District issued Southern States Utility, Inc. v. FPSC, 704 So. 2d 555 (Fla. 1st DCA 1997)[Southern States]. In Southern States, the Court stated that the Commission violated the directive of treating the ratepayers and the utility in a similar manner when it ordered a refund to customers that paid more under a uniform rate structure but did not allow a surcharge to customers that paid less under the uniform rate structure. Thus, consistent with the GTE and Southern States decisions, the Commission must establish a method of collecting the surcharge amount that meets the following objectives: ensures that neither the utility nor ratepayers receive a windfall as a result of an erroneous Commission order; treats the utility and ratepayers in a similar manner; and, allows the utility the opportunity to earn a fair rate of return. In Order No. PSC-98-0143-FOF-WS, the Commission recognized that these objectives are extremely difficult to reconcile in a fashion that is entirely equitable for all involved.

In attempting to fulfill these objectives, staff considered the principles of fairness and equity espoused by the courts in both GTE and Southern States. There are several problems that exist when determining an equitable solution to surcharges. The first is that the affected customers were never given notice of the possibility of retroactive surcharges, and these customers are unable to go back over the past three years and adjust their consumption in order to lower their bill. This is the main policy reason why ratemaking has historically been prospective in nature and retroactive ratemaking has been prohibited. It was also an overriding concern of the Commission in Docket No. 920199-WS when faced with having to require surcharges to customers that paid too little under the uniform rate if a refund to those that paid too much was to be allowed. In Order No. PSC-98-0143-FOF-WS in Docket No. 920199-WS at page 24, the Commission determined that, in that instance, it was more inequitable to surcharge customers who had no ability to change consumption or choose to remain a utility customer.

Second, the ability of the utility to collect from former customers must be considered. Nearly three years have passed since the final rates were first placed into effect. Florida Water had indicated that it experiences customer attrition of up to 7 percent per year. This could result in up to 21 percent of the affected customers having moved from the utility's service area. One must consider the ability of the utility to collect surcharges from

these customers given the reality that customers that have left the system have little incentive to pay the surcharges. In the likely event these customers do not pay, Florida Water's only recourse would be through the court system, which may be impractical and certainly costly. The Commission recognized this concern in Order No. PSC-99-0093-FOF-WS, at page 26 issued in this docket. In order to be completely consistent with the GTE decision and keep the utility whole, the remaining customers that were on line during the surcharge period would be responsible for the surcharge amounts that the utility was unable to collect from the customers that have left the system.

Further, the ability of the remaining customers to pay the surcharge amounts must be considered, especially if they will be responsible for the uncollectible amount related to those customers that left the system. If the surcharges are too high and customers are not able to pay, the utility may be faced with the decision of disconnecting service. However, this may not be a practical or effective means of collection, especially if there is a large number of customers that do not pay. *Pursuant to GTE and Southern States*, these uncollectible amounts would also have to be addressed.

Staff has had extreme difficulty trying to reconcile the First District's various decisions, the Supreme Court's decision, and the various interpretations of those decisions, with the practical aspects of implementation. The Commission determined in Order No. PSC-98-0143-FOF-WS in Docket No. 920199-WS at page 13, that if the utility cannot, from a practical standpoint, collect the entire surcharge amount, the fairness and equity principles espoused in Southern States and GTE decisions have not been fulfilled. Staff further notes that the Commission, in Order No. PSC-99-0093-FOF-WS, determined that the Commission must approve a surcharge method which is as fair as is practicable and permitted by the facts and complexity of this case. Further, at page 22 of that Order, the Commission found that it had the flexibility in the case to administer surcharges in any equitable manner that the facts will permit.

Considering all of the arguments above, technical staff believes that Florida Water's offer to book the surcharges as a regulatory asset is fair, just, and not unduly discriminatory and should be approved. However, as stated previously, the allocation to the various systems should be decided in Florida Water's next rate proceeding.

Alternate Staff Analysis: When staff considered the utility's first offers of settlement (in its October 21, 1998 recommendation and at the November 13, 1998 special agenda conference), staff expressed the concern that creation of a regulatory asset in lieu of a surcharge would apparently be inconsistent with the GTE and Southern States court decisions. By creating a regulatory asset to be amortized over thirty years, a portion of the amount attributable to the surcharge would be recovered from current and future customers who were not customers during the period that the incorrect rates were in effect.

In the GTE decision, at 972, the Florida Supreme Court held that "no customer should be subjected to a surcharge unless that customer received GTE services during the disputed period of time." Also, in the GTE decision, at 973, the Court concluded that "no new customers should be required to pay a surcharge." Although the creation of a regulatory asset is a different methodology than a surcharge, and alternate staff is sympathetic to the concerns raised in the primary analysis, a regulatory asset does have the effect of requiring future customers to pay increased rates based on the utility not having collected a surcharge to which it was entitled as a result of the Commission's erroneous decision. This would be inconsistent with the holdings in GTE.

According to GTE, it is improper to have new customers pay increased rates attributable to a Commission error that was made before such customers became customers of the utility. Therefore, in order for the New Offer of Settlement to be in accord with GTE the utility would need to agree to charge surcharges only to those customers who were customers during the time the incorrect rates were in effect, instead of the creation of a regulatory asset, for the Category I and II surcharges. The surcharges could be in the amount of the proposed regulatory asset, charged over an appropriate period. The utility should be advised that the provision for the creation of a regulatory asset is unacceptable, and that this portion of the settlement offer, contained in paragraph 20 B., must be modified so as to conform with the requirements of GTE.

C. Three Year Stay-Out Provision for Both the Utility and the Commission

Under this provision of the settlement offer, Florida Water, in return for pledging not to file a rate case within three years, either pursuant to Section 367.081(6) or 367.0822, *Florida Statutes*, requests that the utility not be subject to an earnings investigation by the Commission or a petition or complaint to

decrease its water or wastewater rates or charges for the same period. Further, Florida Water requests that if it "experiences earnings in excess of the top of the range of its authorized return on equity for the calendar years 1999, 2000, 2001 or 2002 such excess earnings would be shared between Florida Water and its customers on a one-third/two-thirds basis, one-third to be retained by Florida Water and two-thirds to be refunded to Florida Water's customers."

Staff believes that this provision is very similar to the provision offered by the parties in Docket No. 960444-WU, the application for rate increase and for increase in service availability charges in Lake County by Lake Utility Services, Inc. (LUSI). In that case, as a part of the stipulation, the parties proposed the following:

> Neither LUSI, Citizens nor the Commission will institute any proceeding to change the rates or charges set forth in the settlement agreement, or to place any rates or charges subject to refund, based on information related to any period earlier than an historical 1999 test year; and that if LUSI makes at least $525,000 in capital investments during the calendar year 1999, proceedings to change rates or charges shall not be initiated based on information earlier than an historical 2000 test year.

In addressing the above proposal of the parties in Order No. PSC-99-0635-FOF-WU, issued April 5, 1999, the Commission found that:

> LUSI has agreed to lower rates and service availability charges below those that were in effect prior to the rate case. LUSI has also agreed to refund all interim rates collected since 1996. However, both of these reductions were agreed to by the utility, with the provision that rates and charges would not be changed again before a 1999 test year, with an additional year added on if the utility invests in a substantial amount of plant in 1999.
>
> This is not the first time that we have ruled on a settlement agreement which includes language purporting to restrict our actions. By Order No. PSC-94-0172-FOF-TL, issued February 11, 1994 in Dockets Nos. 920260-TL, 910163-TL, 910727-TL, 900960-TL and 911034-TL, we approved a settlement agreement between OPC and Southern Bell, which resolved issues regarding Southern Bell's earnings and revenue requirement. In that Order, we noted that certain provisions of the settlement purported

to require us to act, to refrain from acting or to otherwise restrict our actions in some manner. However, at page five of that Order, we stated that such provisions generally must fail as a matter of law. "See, e.g., United Telephone Company v. Public Service Commission, 496 So. 2d 116, 118 (Fla. 1986), (parties to a contract cannot confer jurisdiction). Similarly, parties cannot by contract or agreement . . . limit our jurisdiction."

Further at page five, we cited our ongoing responsibility under Chapter 364, Florida Statutes, to ensure that Southern Bell's rates charges and practices were fair, just and reasonable, and stated:

> When we approve a stipulation between parties, the provisions of the stipulation become part of our order. However, we cannot by our own order, require or preclude a future Commission from carrying out its mandate. This is analogous to the principle that in adopting legislation, the legislature is not bound by actions of prior legislatures nor can it bind future legislatures.

Likewise, this Commission has an ongoing responsibility under Section 367.081, Florida Statutes, to ensure that LUSI's rates are fair, just and reasonable. Therefore, the parties cannot limit our jurisdiction by way of a settlement agreement.

Citing to a previous order, we also indicated at page six of our Order that, even if we so desired, we cannot be bound to a specific course of action by stipulation, stating:

> [W]e do not possess the legal capacity of a private party to enter into contracts covering our statutory duties. Indeed, we cannot abrogate -- by contract or otherwise -- our authority to assure that our mandate from the Legislature is carried out. As a result, we may not bind the Commission to take or forego action in derogation of our statutory obligations.

> See Order No. 22352, issued December 29, 1989 in Docket No. 890216-TL.
>
> Nevertheless, we determined that the specific provisions in OPC's and Southern Bell's settlement agreement were "not fatal flaws; they are simply unenforceable against the Commission and are void ab initio. The parties cannot give away or obtain that for which they have no authority." Order No. PSC-94-0172-FOF-TL at page six. Therefore, we accepted the parties' settlement agreement but indicated that if we were required to alter any of its provisions, such changes could be the basis for a party to the settlement to abrogate the prospective portions of the agreement. Likewise, we find it appropriate to accept OPC's and LUSI's settlement in this same manner.

In the case at hand, Florida Water has offered to compromise on the amounts that it would be due if the Commission declined to reopen the record or if the utility prevailed on the AADF and lot count issues. However, Florida Water specifically states under subparagraph I. of its offer that, "This Settlement Offer is not severable, divisible or subject to modification and shall be deemed withdrawn in the event the Commission does not vote to approve this Offer of Settlement and Proposal for Disposition of Mandate on Remand in its entirety."

Although the Commission has accepted stipulations with a similar provision before (albeit stating that the provision was void ab initio), staff believes that this unilateral offer of compromise by the utility is slightly different from the prior stipulations. In this case, the utility and other parties have not entered into a settlement agreement -- rather, the utility is requesting the Commission to agree to certain conditions. When the Commission declines to agree to those conditions and the conditions are part of a whole, then staff believes that pursuant to the terms of the offer, the offer is withdrawn.

Based on the foregoing, staff recommends that the utility should be advised that the provision that it not be subject to an earnings investigation by the Commission or a petition or complaint to decrease Florida Water's water or wastewater rates or charges for three years is unacceptable.

Also under this subparagraph of its offer, the utility points to Order No. PSC-99-0519-AS-EI, issued March 17, 1999 in Docket No. 990067-EI, as precedent for the utility to retain one-third of any

overearnings, and only refund two-thirds of any overearnings to the customers. The utility overlooks the fact that this was a total stipulation agreed to by all parties involved. Based on the same reasoning set forth above, staff believes that this portion of the settlement offer should also be rejected. The utility can advise the Commission of whether its offer is indeed withdrawn as a result of the Commission's decision on these, or on any other provision of the New Offer of Settlement.

D. Closing of Gain-on-Sale Docket -- Docket No. 980744-WS

This same provision appeared in the utility's original offer of settlement, and it was discussed extensively at the November 13, 1998 special agenda conference. The utility argued that the Commission had the discretion to open the docket, and, therefore, had the discretion to close the docket. The Commission seemed to reject this argument, and the utility ultimately agreed to delete this provision from the original settlement offer.

One commissioner specifically expressed concern that closing of the gain-on-sale docket would preclude due process rights for the other parties (Transcript of November 13, 1998 special agenda conference at page 79). That commissioner stated that the closing of the gain-on-sale docket would involve a concession by parties who were not represented, and that the Commission did not have the authority to do this. (Transcript at page 105) Another commissioner stated that the closing of the gain-on-sale docket would affect others rights, later clarified to mean procedural due process rights, and that by excluding that provision, the settlement offer could be accepted. (Transcript at pages 281 and 294)

In review of all the above, staff does believe that the Commission has the option of closing the gain-on-sale docket (but would retain the option of bringing it up in a subsequent rate case or proceeding). However, Florida Water is requesting that the docket not only be closed, but that the question of the gain on sale of its Orange County land and facilities not be revisited or reconsidered by the Commission. Based on the reasoning set forth in the LUSI Order discussed in subparagraph C. above and the principles of due process, staff does not believe that the Commission should accept this provision. Staff believe that to accept this provision would effectively deny the due process rights of the parties to be heard. Staff does not believe that providing notice in the Florida Administrative Weekly of the Commission's intent to close the gain-on-sale docket, as suggested by the utility in its offer, would be an appropriate procedure. The denial of a person's right to be heard on a matter is not cured by

way of a notice informing the person of such denial of that right.

Based on the above, staff believes that the utility should be advised that the provision to close the gain-on-sale docket, and that the issue not be revisited or reconsidered, is unacceptable. Pending the removal of this provision, the Commission should reject Florida Water's offer of settlement.

E. Treatment of Rate Case Expense for Reconsideration, Appeals and Remand

In paragraph E. of the settlement offer, Florida Water requested that accrued rate case expense incurred for reconsideration, appeals and remand be deferred and considered in its next rate case. The utility estimates that this amount to date is approximately $450,000. If the case continues to hearing, Florida Water projects that rate case expense will escalate to $1.1 million.

Staff believes that this portion of the settlement offer is reasonable and should be accepted. This settlement does not address prudence of any amounts incurred -- only that they will be considered in the next rate proceeding. Any issues regarding prudence of rate case expense incurred for reconsideration, appeals and remand will be litigated along with the projected rate case expense of the next rate case.

F. Interim Rate Refunds

In Order No. PSC-96-1320-FOF-WS, the Commission found that Florida Water should refund 5.69 percent of wastewater service revenues collected under interim rates for Lehigh, and refund 27.53 percent of wastewater revenues collected for Marco Island. However, the Commission admitted error, to the Court, that it ordered a higher interim refund to Marco Island than the amount of interim revenues held subject to refund. This was due to the fact that in Order No. PSC-96-0125-FOF-WS, the Commission ordered Florida Water to hold 18.19 percent of interim revenues subject to refund. Further, Florida Water appealed the Commission's decision on interim refunds arguing that such refunds should have been set on a company-wide basis. OPC cross-appealed, and took the opposite view that interim refunds should have been ordered on a system-specific basis. The Court did not find it necessary to address either side's argument "[b]ecause issues pertaining to refunds may well be moot, once the PSC sets new permanent rates on remand . . ." Southern States II, at 1049. In the Florida Water New Offer of Settlement, the utility proposes no interim refunds. The offer

states, "While Florida Water continues to believe the refund requirement was unlawful, these refunds are eliminated as a result of the Category I rate increases and surcharges approved by the Commission and the Category II rate and surcharges reflected in this Settlement Offer."

In order to evaluate this aspect of the offer, staff has analyzed whether or not interim refunds would be required if the issues of lot count methodology and AADF were decided in Florida Water's favor. Based on our analysis, there would be no wastewater interim refunds to Lehigh, but there would still be an insignificant wastewater interim refund of .01 percent to Marco Island. The approximate amount is $422 annually. Given the insignificant amount of interim wastewater refund to Marco Island wastewater customers, this refund would be extremely difficult to calculate, and may only total a few cents to customers. Furthermore, Florida Water has indicated that both the City of Marco Island and the Marco Island Fair Water Defense Fund Committee, Inc. support the offer of settlement. Therefore, if the affected parties agree to forgo their right to any interim rate refund, staff agrees with Florida Water's offer relating to no interim rate refunds. In its response, in opposition to Florida Water offer, Sugarmill Woods indicate that there may be interim rate refunds due to Sugarmill Woods. Staff disagrees with this statement. It has been previously determined by the Commission that there are no interim rate refunds due to Sugarmill Woods. The only affected parties would be Lehigh and Marco Island.

G. No Change in AFPI Rates

In paragraph G. of the settlement offer, Florida Water requests that the Commission not make any changes to AFPI charges and that the escrow requirement be terminated. Most of the issues on remand relate to increases in used and useful plant and, as such, most likely would have a corresponding decrease to the AFPI charges approved for some systems in the Final Order.

Staff points out several items regarding any possible change to AFPI charges. First, since staff is recommending accepting the settlement regarding the revenue increase, that amount is not based on any specific system and revenue requirements by system have not been determined. Accordingly, the appropriate amount of AFPI per system cannot be determined.

Next, as admitted by the Commission in its appellate brief, some AFPI charges were erroneously decreased in the Final Order. Those AFPI charges should have been capped at the amount approved

in previous cases. The escrow requirement relates to those systems where the Commission admitted error and the escrowed amount relates to the difference between the AFPI charges approved in the Final Order and the previously approved capped amounts. Since the Commission has admitted error on those amounts, it is appropriate to release the funds in the escrow account and cancel the escrow requirement. Staff points out that for those systems where AFPI charges were capped, no changes would result even if a revenue requirement per system was identified.

Third, the recent statutory change to lengthen the margin reserve period will increase the prospective amounts of used and useful plant allowed in future rate proceedings. Out of necessity, staff believes that the role of AFPI will need to be revisited in future rate proceedings, particularly Florida Water's next rate case. To dispose of this remand and ultimately reduce rate case expense charged to the ratepayers, staff believes that Florida Water's request to not change AFPI charges should be approved. Further, staff recommends that the escrow requirement should be discontinued and the escrowed funds released to the utility.

H. Acceptance of Settlement Offer Not to Reflect Commission Precedent or Policy and Not Subject to be Revisited or Reconsidered

The first half of this provision is a fairly standard provision for settlements, and staff agrees that it should be in any offer of settlement. However, staff notes that this is not a stipulation, and all parties would be entitled to file a motion for reconsideration pursuant to the provisions of Rule 25-22.060, Florida Administrative Code. Therefore, any final order approving this settlement offer or a modified settlement offer would be subject to a motion for reconsideration. Regarding the provision concerning whether the settlement would be revisited, staff notes that if a settlement is approved as final agency action, then the principles of administrative finality would be applicable. With these understandings, staff believes that this portion of the settlement offer is acceptable.

I. Settlement Offer Not Divisible or Subject to Modification

The utility has merely indicated that this is an all or nothing settlement offer. Staff believes that if the Commission rejects or modifies any portion of the offer, then the utility has the right to withdraw the offer. In fact, by the terms of the offer itself, the offer is deemed to be withdrawn if the Commission rejects or modifies any portion. Therefore, if the Commission

wishes to modify or reject any portion of the settlement offer, and accept only a portion, staff believes that the utility should confirm whether such modification renders the offer withdrawn.

CONCLUSION

Based on the above, primary staff believes that the noted portions of the provisions set forth in subparagraphs C. and D. of the utility's settlement offer are unacceptable. The three unacceptable provisions are:

1. The utility shall not be subject to an earnings investigation by the Commission or a petition or complaint to decrease Florida Water's water or wastewater rates or charges to the period ending June 28,2002;

2. That if Florida Water experiences earnings in excess of the top of the range of its authorized return on equity for the calendar years 1999, 2000, 2001 or 2002 such excess earnings would be shared between Florida Water and its customers on a one-third/two-thirds basis, one-third to be retained by Florida Water and two-thirds to be refunded to Florida Water's customers; and

3. That the Commission would provide notice in the Florida Administrative Weekly of its intent to close Docket No. 980744-WS in recognition of this settlement, and that any and all issues concerning Florida Water's gain on sale of its Orange County land and facilities shall not be revisited or reconsidered by the Commission.

Further, the Commission should recede from its finding in Order No. PSC-99-0093-FOF-WS that to do other than strictly adhere to the capband methodology in calculating rates based on the new revenue requirement would be a change in rate structure, and, if a revised offer of settlement is proposed which removes the provisions identified above, the Category II rates should be calculated as an across the board increase.

In addition to the above, alternate staff believes that the provision for creation of a regulatory asset would have to be modified as set forth in alternate staff's analysis to comply with the requirements of GTE.

Therefore, dependent on the Commission's vote on the acceptability of subparagraph B. of the settlement offer (regulatory asset portion), the utility must either accept that

those provisions are unacceptable and acknowledge that the settlement offer is not withdrawn, or the utility may delete or modify the objectionable portions or withdraw its offer in its entirety. Staff believes if the utility agreed to these modifications to its offer of settlement (alternate staff would also require modification of the regulatory asset portion), then the remainder of the offer would be acceptable.

Further, if the Commission were to approve the offer, staff believes this decision could be issued as a final agency action because it is based on existing evidence in the record and consistent with the Court's remand. Sugarmill Woods' pending protest to the proposed agency action portion of Order No. PSC-99-0093-FOF-WS would be mooted by the Commission's decision to approve the New Offer of Settlement, as there would be no assessment of a surcharge and therefore no surcharge methodology in dispute.

Based on the above, if the utility were to modify its offer to incorporate the changes discussed herein, staff would recommend that the Commission accept the offer of settlement. However, for the foregoing reasons, staff recommends that the Commission reject the settlement offer as it now stands, and go to hearing as scheduled.

ISSUE 3: Should the Office of Public Counsel's Motion for Consolidation be granted?

RECOMMENDATION: No, the Office of Public Counsel's Motion for Consolidation should be denied. (JAEGER)

STAFF ANALYSIS: Along with its Response to Florida Water's Motion for Approval of New Offer of Settlement, OPC also moved to consolidate this docket, Docket No. 950495-WS, with the gain-on-sale docket, Docket No. 980744-WS. In paragraph 6. of its response, OPC states that if the gain on the sale of Florida Water's systems in Orange County and the gain on the sale of a laboratory in Volusia County are decided in favor of the citizens, the amount of the gain on sale could be used to offset the surcharge (regulatory asset) decided upon in Docket No. 950495-WS, and perhaps even eliminate the need for any surcharge (regulatory asset). OPC goes on to say that netting the impact of these two proceedings would provide greater regulatory predictability to customers and provide a more even-handed approach to all parties.

Florida Water timely filed its Response in Opposition to Office of Public Counsel's Motion to Consolidate on Jule 12, 1999. In its argument, Florida Water cites Rule 28-106.108, Florida Administrative Code, which states:

> If there are separate matters which involve similar issues of law or fact, or identical parties, the matters may be consolidated if it appears that consolidation would promote the just, speedy and inexpensive resolution of the proceedings, and would not unduly prejudice the rights of a party.

Based on this rule, Florida Water argues that the two used-and-useful issues left open by the First District are in no way similar to the gain-on-sale issues in Docket No. 980744-WS. Moreover, Florida Water argues that OPC wishes to consolidate post-test year revenue items into this rate case remand proceeding while ignoring Florida Water's post-test year increased investments and expenses. Florida Water states that such an approach would violate the basic tenets of ratemaking (would skew the ratemaking equation) and clearly prejudice the rights of Florida Water.

Also, Florida Water argues that consolidation would violate the mandate of the First District in this case. In making this argument, Florida Water cites both Basic Energy Corp. v. Hamilton County, 667 So. 2d 249, 250 (Fla. 1st DCA 1995)[Basic Energy

Corp.], and Doctors' Osteopathic Medical Center v. Department of Health & Rehabilitative Services, 459 So. 2d 1063 (Fla. 1st DCA 1984). In Basic Energy Corp., the First District stated:

> [a] trial court's role upon the issuance of a mandate from an appellate court becomes purely ministerial and its function is limited to obeying the appellate court's order or decree. . . . A trial court does not have discretionary power to alter or modify the mandate of an appellate court in any way, shape or form. . . .

Florida Water argues that the mandate issued by the First District in this case was a specific mandate, as opposed to a general mandate. Florida Water states that a specific mandate limits the lower tribunal to proceedings on remand which conform to the specific language used by the court in reversing the lower tribunal. In Basic Energy Corp., at 250, the First District specifically stated: "A remand phrased in language which limits the issues for determination will preclude consideration of new matters affecting the cause." Florida Water argues that the First District only gave the Commission discretion on two issues (lot count and AADF) and that to open up other issues would be in violation of the mandate.

In reviewing the two cases for which OPC seeks consolidation, Staff does not believe that consolidation would promote the just, speedy and inexpensive resolution of the remand proceedings. If anything, staff believes that consolidation would slow down the remand proceedings, and make them more complicated and more expensive. Moreover, staff does not believe there would be significant savings in the gain-on-sale docket by virtue of consolidation. Staff believes that the Commission should proceed with all due speed to resolve this remand proceeding, and notes that over 13 months have elapsed since the issuance of the First District's order. Staff further believes that the results obtained in the remand proceeding are in no way dependent upon the results that may be obtained in the gain-on-sale docket. Therefore, staff recommends that OPC's Motion to Consolidate should be denied.

ISSUE 4: Should Florida Water Services Corporation's Motion for Reconsideration of Order No. PSC-99-1199-PCO-WS be granted?

RECOMMENDATION: No. The Commission should deny Florida Water's Motion for Reconsideration of Order No. PSC-99-1199-PCO-WS, acknowledge that the Order on Abatement is no longer in effect, and confirm that as of the date of this vote, the tolling of the time for discovery responses has ended. If the Commission agrees that the New Settlement Offer of Florida Water should not be accepted, the utility should be required to respond to the Office of Public Counsel's Second Set of Interrogatories and Third Request for Production of Documents to which the utility had raised no objection within 23 days of the date of this Order. Also, the utility should be required to respond to all other discovery within the normal timeframes. (JAEGER)

STAFF ANALYSIS: As noted in the background, the utility filed a Motion for Reconsideration of Order No. PSC-99-1199-PCO-WS. By that Order issued on June 14, 1999, the Commission, through the Prehearing Officer, ordered the utility to respond to those portions of the Office of Public Counsel's Second Set of Interrogatories and Third Request for Production of Documents to which the utility had raised no objection within 23 days of the effective date of the Order. These discovery requests had been served on the utility on April 9, 1999.

Prior to the issuance of that Order, the Prehearing Officer had issued Order No. PSC-99-0800-PCO-WS (Order on Abatement) on April 21, 1999, which granted the utility's Motion for Abatement and Continuance and Request for Expedited Ruling (Motion for Abatement). In its Motion for Abatement, filed on April 12, 1999, the utility stated that it planned to file an appellate action on Order No. PSC-99-0612-PCO-WS -- Order Denying Motion for Protective Order On Staff's Interrogatory No. 5, and Order No. PSC 99-0664-PCO-WS -- Order Denying Motion To Transfer Remand Proceeding, Granting Petition For Formal Hearing Concerning Surcharges, And Approving List of Issues For Consideration On Remand. The utility stated that the appeal would be in the form of a Motion to Enforce the Mandate issued by the First District in this case.

Also, Florida Water stated that it would in all probability file appellate action on the discovery order regarding the discovery requests of OPC. Further, the utility stated that judicial economy would be enhanced by resolving pending issues affecting the scope of discovery and issues for hearing prior to

engaging in further discovery, preparation and submission of testimony, and participation in the final hearing on remand.

In the Motion for Abatement, Florida Water specifically requested that the remand proceeding be abated, and dates for the prehearing conference, the hearing, the filing of prehearing statements, and the filing of testimony and exhibits be canceled and reset upon disposition of its appellate action. The utility also stated that it had contacted the parties, and that all parties either agreed with the motion or did not object to the motion being granted.

Based on these representations, the Prehearing Officer granted the Motion for Abatement. However, a dispute arose over the discovery requests filed prior to the Order on Abatement and whether this would constitute "further discovery." Therefore, on May 6, 1999, Florida Water filed its Motion to Toll Time for Service of Responses of Office of Public Counsel's Second Set of Interrogatories and Third and Fourth Requests for Production of Documents on Remand. The Prehearing Officer determined that judicial economy would not be promoted by delaying a response to those portions of OPC's discovery which were filed prior to the Order on Abatement and to which the utility had filed no objection. Therefore, by Order No. PSC-99-1199-PCO-WS, the utility was ordered to respond to those portions of the Office of Public Counsel's Second Set of Interrogatories and Third Request for Production of Documents to which the utility had raised no objection within 23 days of the effective date of the Order.

In its motion for reconsideration, Florida Water contends that the Prehearing Officer failed to consider or overlooked two points. First, Florida Water argues that the Prehearing Officer chose form over substance in determining that OPC's April 9 discovery requests did not constitute "further discovery", and that the response to be drafted after the Order on Abatement would be further discovery and would require significant manpower and resources. Second, Florida Water points to its New Offer of Settlement filed on June 14, 1999, and that this lends further support to the proposition that judicial economy would be served by tolling all pending discovery responses.

OPC filed its timely response to the Motion for Reconsideration on July 2, 1999. By a subsequent letter dated July 12, 1999, OPC admitted that its first paragraph as to the timeliness of the Motion for Reconsideration was in error, and withdrew that allegation. However, it reaffirmed the rest of its response. OPC argues that Florida Water raises no point which the

Prehearing Officer overlooked or failed to consider, and, therefore, the Motion for Reconsideration must be denied. For the utility's first point, OPC states that the Prehearing Officer rightfully determined that tolling the time to provide these discovery request would not enhance judicial economy.

With respect to the utility's second point, OPC notes that the New Offer of Settlement was not even submitted until after the Prehearing Officer reached his decision. OPC argues as follows:

> How can Florida Water seriously argue that the Prehearing Officer failed to consider a matter that was in no way a basis for Florida Water's motion to toll nor a matter brought to his attention by any of the parties, nor even a matter that existed at the time his decision was rendered? Does Florida Water contend that its motion for reconsideration should be sustained because the Prehearing Officer failed to consider or anticipate that Florida Water was going to later file a motion for approval of new offer of settlement? Florida Water's motion for a new offer of settlement was not filed until the day that the subject Prehearing Officer's Order No. PSC-99--1199-PCO-WS was actually published and filed. While the motion for approval of a new offer of settlement might have been the basis for a new motion to toll the time of discovery, it certainly is not a basis for a motion for reconsideration under the standard provided by the Diamond Cab Company of Miami v. King and Pingree v. Quaintence cases previously cited.

Rule 25-22.0376(1), Florida Administrative Code, permits a party who is adversely affected by a non-final order of the Commission to file a motion for reconsideration of that order. It is well-established in the law that the purpose of reconsideration is to bring to the Commission's attention some point that the Commission overlooked or failed to consider or a mistake of fact or law. The standard for determining whether reconsideration is appropriate is set forth in Diamond Cab Co. of Miami v. King, 146 So. 2d 889, 891 (Fla. 1962). In Diamond Cab, the Florida Supreme Court declared that the purpose of a petition for reconsideration is to bring to an agency's attention a point of law or fact which it overlooked or failed to consider when it rendered its order. It is not intended as a procedure for rearguing the whole case merely because the losing party disagrees with the judgment or order. Staff has applied this standard in its review of Florida Water's motion.

Concerning the utility's first ground for the filing of its motion, pursuant to the utility's request, Order No. PSC-99-0800-PCO-WS only granted abatement pending the completion of the utility's appellate action. However, by Order dated June 17, 1999, one week prior to the utility filing its Motion for Reconsideration, the First District denied Florida Water's Motion to Enforce Mandate. Because the appellate action of Florida Water is complete, pursuant to the terms of the abatement order, this case should no longer be held in abeyance. Therefore, the Commission need not determine whether responding to discovery propounded prior to the issuance of the Order on Abatement constitutes further discovery.

However, Florida Water now appears to argue that the Order On Abatement should be continued pending the Commission's ruling on its New Offer of Settlement. If the Commission rules on the New Offer of Settlement in Issue 2 above, there is no longer a need to continue the abatement. If the Commission accepts the offer, then the case will be complete and no further discovery will be required. If it rejects the offer, then there will no longer be a need to hold the case in abatement, and discovery should be allowed to proceed.

In consideration of all the above, the utility has failed to show how the Commission erred or overlooked any point of law or fact by rendering the Order for which the utility seeks reconsideration. At most, the utility has merely raised new grounds for a second order on abatement. Based on the foregoing, staff recommends that the utility's motion for reconsideration be denied. Further, the Commission should acknowledge that the Order on Abatement is no longer in effect, and that the tolling of the time for discovery responses has ended. If the Commission agrees that the New Settlement Offer of Florida Water should not be accepted, the utility should be required to respond to the Office of Public Counsel's Second Set of Interrogatories and Third Request for Production of Documents to which the utility had raised no objection within 23 days of the date of this Order. Also, the utility should be required to respond to all other discovery within the normal timeframes.

ISSUE 5: Should this docket be closed?

RECOMMENDATION: No, the docket should remain open in order to conduct the hearing now scheduled for February 2-4, 2000. (JAEGER)

STAFF ANALYSIS: If the Commission agrees that the New Settlement Offer of Florida Water should not be accepted, then this docket should remain open in order to conduct the hearing now scheduled for February 2-4, 2000.