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November 29, 2000

Ms. Blanca S. Bayó, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0870

RE: Docket No. 991643-SU

Dear Ms. Bayó:

Enclosed are an original and fifteen copies of a Post-Hearing Statement of the Citizens of the State of Florida for filing in the above-referenced docket.

Also Enclosed is a 3.5 inch diskette containing the Post-Hearing Statement of the Citizens of the State of Florida in WordPerfect for Windows 6.1 format. Please indicate receipt of filing by date-stamping the attached copy of this letter and returning it to this office. Thank you for your assistance in this matter.

Sincerely,

Stephen C. Burgess
Deputy Public Counsel

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Application for increase in wastewater rates in Seven Springs System in Pasco County by Aloha Utilities, Inc.	Docket No. 991643-SU Filed: November 29, 2000

POST-HEARING STATEMENT OF THE CITIZENS OF THE STATE OF FLORIDA

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The Citizens of the State of Florida, through the Office of Public Counsel, submit this Brief.

ISSUE 1: Is the quality of service satisfactory?

No. Aloha's authorized ROE should be reduced by 100 basis points to reflect substandard customer treatment.

Doris Boyce testified that she went to the Aloha offices to lodge a complaint and to discuss the matter with Stephen Watford. When she attempted to speak with Mr. Watford, the utility had Ms. Boyce physically removed by the police [T-349].

Such heavy-handed treatment of a captive customer (literally, in this case) is altogether inappropriate. Aloha is a statutorily protected monopoly. Water and wastewater service are necessities of life, and Ms. Boyce is prevented by law from obtaining the services from any other source (whether it be from her own well and septic tank, or from a competitor of Aloha). The customers' hands are tied by law -- they must do business with Aloha.

This one-sided relationship should obligate Aloha to treat its customers with courtesy and respect. When a customer takes the time to come to Aloha's office for an inquiry or complaint, that customer's concern should be investigated thoroughly. To call the police to have the customer removed is the pinnacle of customer mistreatment. It is no wonder that Ms. Boyce voiced this strongly worded reaction:

> I'm really - - I hate them. I hate them with a passion, because everybody I know, all they do is complain and gripe and, I really, I just hate them. That's all I have to say.
> [T-349]

Ms. Boyce lives in Aloha Gardens, but she voiced the sentiment expressed by virtually every Aloha customer who testified at the hearing. It is clear that Aloha does not put forth sufficient effort to treat its customers' concerns properly. Aloha's authorized ROE should be reduced to reflect this improper treatment.

ISSUE 2: Are the proposed modifications and expansion of the Aloha wastewater treatment plant prudent and justified?

The Citizens do not take issue with Aloha's construction decisions. The Citizens believe, however, that Aloha's modification and expansion projects are sized to serve substantial future growth. Accordingly, used and useful adjustments must be made to properly allocate the cost of these projects.

Issue 7 addresses the question of used and useful. In the discussion of that issue, the Citizens demonstrate that significant portions of plant modifications and expansion are sized to service the ultimate built-out population. As such, these items exceed the capacity necessary to serve the current customer base. Accordingly, while these plant items may be prudent, they are not 100% used and useful in serving current customers.

ISSUE 3: Are the costs of the utility's infiltration and inflow reduction program prudent?

Because the entire costs (including future costs) of the I/I reduction program are included in the test year, fairness dictates that the entire effect of the I/I reduction also be recognized. If further I/I reductions are not recognized, neither should the expenditures that are incurred for the purpose of reducing I/I.

The utility has undertaken an infiltration and inflow (I/I) reduction program pursuant to its agreement with DEP. The I/I reduction program was planned to extend over a several year period, and is expected to cost $15,000 per month. At the time that Aloha filed its testimony, the program had been in effect for only a few months and had already resulted in an I/I reduction of 140,000 gallons per day (GPD). In its filings, Aloha reflected the 140,000 GPD reduction of I/I.

The I/I reduction program, however, did not end when the 140,000 GPD reduction was achieved. Instead, it is to continue for some indeterminate period. This means that the program expenditures of approximately $15,000/month have continued unabated since the 140,000 GPD reduction was achieved, and will continue unabated until the program is completed.

The utility's filing, then, seeks to saddle the customers with the entire program expenditures throughout the projected test year, but recognizes the positive effects from only the first few months of the program. This treatment is the height of unfairness. If the customers are required to pay the monthly expenditures, they should receive the entire benefits that will flow from the program during that period. If, on the other hand, the customers receive the benefits from only the first few months of the program, their rates should reflect only the expenditures from those months of the program. Paying the expenditure without reflecting the benefit is patently unfair.

Mr. Porter, testifying for Aloha, has stated that the program will result in no further I/I reductions beyond 140,000 GPD already achieved. While the Citizens dispute Mr. Porter's claim, his assertion makes little difference to the fairness equation. If Mr. Porter is indeed correct, then why is the utility continuing to spend $15,000 per month for a continuing I/I reduction program that it knows will not reduce I/I? This is the pinnacle of imprudent spending: to spend $15,000 per month on a program to reduce I/I that will not reduce I/I. Under the utility's own claims, these expenditures are imprudent and should not be included in rates pursuant to §367.081, F.S.

If Aloha's claim is that it is required by the agreement with DEP, then the utility should never have entered such an agreement or it should have immediately petitioned for an amendment to the

CFJ. To blithely go on spending $15,000/month of ratepayers' money on a program that will not produce any results is nonsense.

If Aloha was convinced that there would be no further I/I reductions resulting from the I/I reduction program, it should have ceased the $15,000 monthly expenditures immediately. The customers should not bear such wasteful expenditures. If, however, the Commission includes this expenditure in rates, then it should impute further I/I reduction. Mr. Biddy has testified that another 140,000 GPD would be a conservative estimate for further reduction [T-408]. The Commission should adjust the U&U, the electric expense and the chemical expense to reflect the reduced I/I, or it should remove the program expenditures.

ISSUE 4: Should the utility be allowed to capitalize invoices previously expensed?

No. The capitalization of these previously expensed items would constitute double recovery and should be disallowed. The Seven Springs wastewater system's plant should be reduced by $127,232 and accumulated depreciation should be reduced by $76,548. Depreciation expense should also be reduced by $6,675.

This issue involves a number of capital expenditures that Aloha erroneously expensed in previous years. In its filing, the utility is now seeking to make retroactive adjustments. Aloha's proposed treatment is improper. To restate these previously expensed items would be allowing a double recovery for the same expenditure. Mr. Stambaugh explained the concept as follows:

> The effect of expensing these items in previous years was to reduce the utility's NOI in those years. If the utility is permitted to recover the depreciation expense related to this capitalization of previous years expenses, it will in a sense be recovering these costs twice, using

> depreciation expense as the recovery vehicle this time, as compared to O&M expense used in previous years.
> [T-574]

Mr. Larkin also provided testimony supporting Mr. Stambaugh's reasoning on this issue [T-370].

Mr. Nixon tried to counter with the argument that Aloha did not recover the previously expensed items because its average return during all the years in question did not exceed the top of its authorized range. Mr. Nixon's argument is invalid because the historical earnings used by Mr. Nixon did not reflect any adjustments that the Commission would make in a rate case. Under questioning from Mr. Jaeger, Mr. Larkin explained this deficiency in Mr. Nixon's argument:

> Q. Now, if the accountant for the utility show that they did not overearn in those years, has that been audited or is that - - I mean, is there any way to tell if he'd made any errors?
>
> A. Well, there's no way to tell if those calculations are on a Commission regulatory basis, whether the - - for instance, the working capital was calculated in the same manner we would do it now.
>
> [T-370, 371]

Mr. Stambaugh also pointed out that an additional danger of allowing Aloha's proposed treatment is the potential encouragement of improprieties. Mr. Stambaugh pointed out the following:

> Allowing this utility to increase its rate base for items previously expensed would be giving a "green light" for any utility to manipulate its earnings reports in years that it is over earning and then capitalizing these items to increase rate base in another year when this is more beneficial.
> [T-574]

Based on the sound arguments posed by Mr. Stambaugh and Mr. Larkin, the Commission should reject Aloha's effort to capitalize previously expensed items.

ISSUE 5: Should the Commission consider the new office building cost for the utility in this rate proceeding?

The Commission should not allow Aloha to recover the cost of the new office building because the utility has not justified the costs. The Commission gave the utility more than ample opportunity but Aloha failed to carry its burden of proof.

In its initial filing, Aloha included no information about costs related to an office relocation. The initial filing asked the Commission to grant the rental fees that were being paid under the former lease. Information about the relocation later began being submitted by Aloha throughout the case [T-680]. Through Order No. PSC-00-1747-PHO-SU, the Commission granted Aloha a unique opportunity to present evidence in September, 2000, or seven months after the initial MFR's were submitted with costs under the old lease. At that time, Aloha was entitled to submit all evidence that it deemed necessary to change from the lease costs submitted in the initial filing, and to demonstrate the veracity and prudence of the relocation costs. It was Aloha's burden to demonstrate the reasonableness and prudence of the costs. As Ms. Merchant pointed out:

> But a utility is required to justify its requested costs, whether it is an office building, or whether it is a utility plant, or whether it is a reuse facility or any item. It has to be a prudent expense. And that's what we do is we analyze the prudence of expenses and costs that the utilities request. It is a common tool that we use.
> [p. 736, l. 14-20]

Aloha presented the testimony of Mr. Watford, purporting to support the prudence of the relocation expenditures. Aloha's evidence, however, suffered from several deficiencies, and the utility failed to meet its burden of proof.

First, the utility failed to show that the costs were reasonable in comparison to the benefits received. Aloha presented no testimony establishing the performance of a cost benefit analysis of the different options that were available to the utility [T-682]. Thus, the Commission is left without "a reasonable basis on which to determine whether the utility made a prudent and cost effective choice in deciding to buy [the] building." [T-683].

Aloha's testimony gives no assurance to the Commission that all reasonable lease alternatives were explored by the utility or presented to the Commission [T-683]. As Ms. Merchant points out, a prudent business owner operating in the competitive market would have performed an in-depth cost/benefit analysis when making such a significant purchase [T-683]. Aloha's customers should not suffer under less astute business practices because they are served by a franchised monopoly. Aloha's failure to come forward has left this purported expenditure unsupported.

Midway through this rate proceeding, Aloha sought to change a significant aspect of its initial filing. The Commission gave Aloha a generous opportunity to present any evidence that it believed necessary to support the reasonableness and prudence of the building. Aloha was clearly on notice that in order to depart from its initial filing, the utility was expected to come forward with the necessary proof. Aloha failed to provide the Commission with the necessary proof and thereby squandered the procedural opportunity offered by the Commission. Consequently, the Commission should disallow the proposed expenditures for the relocation.

ISSUE 6: Does Aloha have excessive infiltration and inflow (I&I)?

Yes, Aloha does have excessive infiltration and inflow (I/I), and is currently undertaking a project to reduce its I/I. The entire costs (including projected future costs) have been included in the projected test year. Accordingly, the results of the I/I reduction should also be considered in the flows for calculating U&U.

Florida DEP has adopted the "Ten State Standard" for determining an allowable level of inflow and infiltration [T-428]. These standards are applied by DEP to both new and rehabilitated sewer systems [T-429]. Once Aloha's sewer system has been fully rehabilitated (which it should be after the rehabilitation program for which it is paying $15,000/month), the Ten State Standards should be applied. Florida DEP has already recently applied this standard to another older system which had undergone a rehabilitation program [T-429]. There is no reason, then, that the same standard should not be applied to Aloha.

The Ten State Standard allows for an I/I of "200 GPD per inch of pipe diameter per mile of sewer line." [T-406]. The application of this standard to Aloha would allow 56,000 GPD of I/I. Any I/I that exceeds that standard should be considered excessive by the PSC [T-431,432].

The most important point, however, is that Aloha continues to undertake an I/I reduction program and pass on the cost to its customers. As long as the customers are required to pay for a program that reduces excess I/I, the customers should receive any potential benefit from the program's completion.

ISSUE 7: What is the used and useful percentage of the wastewater treatment plant and the wastewater collection system?

The WWTP should be considered 72.97% used and useful, with the exception of the equalization tank and the new headworks, which should be considered 48.65%. The wastewater collection system should be considered 78.7% used and useful.

The equalization tanks and the new headworks are two new plant components that were designed for the ultimate capacity of 2.4 MGD [T-409]. This is more than twice the capacity that will be needed even five years after the projected test year.

When a utility sizes major components at more than double the capacity necessary to serve the customer base even after five years of growth, it is obviously installing plant to serve a future customer base. It is patently unfair for current customers to bear the entire burden of carrying costs for plant items that are designed to serve the future customers at ultimate build-out. That burden should be shared fairly between the current customers and the future home purchasers for whom the excess capacity is being held.

The proper sharing mechanism is AFPI. The cost of holding unused plant capacity to be available to hook up a future customer should be paid by that future customer for whom the currently unused capacity is being held. It certainly should not be paid by the current customer who has absolutely no use for that unused capacity.

An appropriate AFPI should be calculated, and a used and useful percentage of 48.65% should be applied to the equalization tank and the new headworks [T-410].

The same principle of fair cost sharing should be applied to the rest of the treatment plant. The ratio, however, is different because the components are sized to a lower capacity. The proper used and useful percentage for the rest of the sewage treatment plant should be 72.97% [T-409].

This percentage will require current customers to pay for plant necessary to serve new customer hook-ups through the year 2006. While this is also unfairly burdensome to current customers, the five-year growth is required by statute. Beyond the statutory requirement, however, new hookups should pay their own way. The Commission should not require current customers to subsidize new growth beyond the year 2006, so the balance of the treatment plant should be limited to 72.97% used and useful.

Finally, the collection system also must be adjusted to prevent current customers from supporting lines necessary to serve future customers. In order to properly balance the collection system costs between current customers and future customers, the Commission should apply the ratio of "currently connected" lots to total available lots that can be served by existing lines [T-405]. Again because of the statutory requirement, the Citizens have adjusted the currently connected lots to reflect the lots that will be connected through the year 2006. This results in a used and useful percentage of 78.7%. The Commission should not require current customers to pay for more than five years of growth and should consider the collection system to be 78.7% used and useful.

ISSUE 8: Should a used and useful adjustment be applied to the reuse facilities?

Although the Citizens are philosophically opposed to requiring current customers to subsidize Aloha's anticipated growth, OPC is no longer seeking a used and useful adjustment for the reuse facilities.

In this case Aloha has sized its reuse components to serve its ultimate build out size, reflecting about 20 years of growth. The Citizens are philosophically opposed to requiring current customers to subsidize that much growth. Nevertheless, the Citizens are aware of sections 367.0817(3) and 403.064(10), F.S., as well as the current judicial interpretation of those sections. Accordingly, the Citizens are no longer seeking the Commission to make a used and useful adjustment on the reuse facilities.

ISSUE 9: Are any adjustments necessary to test year CIAC and accumulated amortization of CIAC for changes in projection methodology?

The Citizens take no position on this issue.

ISSUE 10: What is the appropriate regulatory treatment of contributed taxes and accumulated deferred income taxes?

The Citizens agree with the testimony of Mr. McPherson that the contributed taxes should be reflected as CIAC and fully included for the calculation of rate base.

ISSUE 11: Should the cash operating account balance be removed from the working capital calculation?

Yes, the balance is excessive and has not been adequately explained.

As Mr. Larkin pointed out in his testimony, Aloha had failed to bring forward any proof of the need or prudence of maintaining such a high level of cash on hand. Mr. Larkin states:

> The Company has not shown that the maintaining of a half million-dollar cash balance in the Company's bank is a requirement of providing service to ratepayers. Unless and until the Company can demonstrate providing services to ratepayers requires the maintenance

of a bank account with a $500,000 balance it should not be included
as working capital.
[T-230]

Even though the account generates a nominal return and even if that return is added to earnings, the fact remains that an excessive balance unnecessarily raises rates. The working capital is included in rate base and is given the overall rate of return. Since this is significantly higher than the nominal earnings on the cash account, it is important to the customers that the cash account be maintained at a level no higher than necessary.

As Mr. Larkin pointed out, Aloha has not demonstrated the need to keep the cash account at a level in excess of $500,000.

ISSUE 12: Are any adjustments necessary to the working capital allowance for rate case expense?

This should be a fall-out issue, depending on the adjustments that are made to rate case expense.

Generally the Commission allows the average unamortized balance of rate case expense to be in rate base as a working capital component. Accordingly, any disallowances of the total allowable rate case expense should automatically reduce the unamortized balance to be included in working capital.

ISSUE 13: What is the appropriate working capital allowance?

The appropriate amount is subject to the resolution of other issues.

ISSUE 14: What is the appropriate projected rate base?

The appropriate amount is subject to the resolution of other issues.

ISSUE 15: Should any adjustments be made to retained earnings and customer deposits to determine the overall cost of capital?

Yes. The Citizens agree with PSC Staff witnesses that several adjustments must be made to Aloha's filed capital structure to reflect a proper cost of capital. Aloha's filed retained earnings were overstated by $172,806, and the filed customer deposits were understated by $345,117.

Aloha's filing contained two very large errors which overstated the overall cost of capital. First, the utility significantly overstated its retained by recording large expense items at the end of the year rather than evenly throughout. Mr. McPherson explains:

> The utility's thirteen-month average balance of retained earnings of $1,878,373 was computed based on actual monthly general ledger activity. Many of the utility's largest journal entries are made only at the end of the year. Some of these adjustments are made to record depreciation, CIAC amortization, income tax expense, and amortization of rate case expenses. All of these expenses actually occur during the course of the entire year.
> [T-505]

As Mr. McPherson then points out, the appropriate treatment is to assume the income and expenses take place evenly throughout the year. Using this appropriate method, Mr. McPherson recalculated the September 30, 1998, retained earnings as the proper beginning point. To that starting point the historic test year earnings should be added to the monthly balance. Here again, however, the utility recorded income such as to overstate its effect on the average monthly balance of retained earnings. Mr. McPherson states:

> Likewise, for the nine months ended September 30, 1999, the utility reports a loss of $62,533 or $6,948 per month. However, in its MFR Schedule A-19(c) the utility shows income of $266,622 for the first eight months and then a large loss of $329,155 in the last month. This

method overstates the monthly retained earnings balance every month except at the year end.
[T-505]

So again, Mr. McPherson had to adjust the year's earnings to prevent a skewed effect on the monthly average retained earnings. The effect was to reduce Aloha's historic test year average retained earnings by $172,806 [T-506].

The second major adjustment to the utility's retained earnings is necessitated by Aloha's understatement of its customer deposits. By making several erroneous projections and estimates, Aloha substantially understated its customer deposits [T-663, 664]. To arrive at the level of customer deposits, Aloha now agrees with Ms. Merchant that the projected level should be increased by $345,117 [T-666]. This amount should be removed from the retained earnings to derive a proper capital structure.

The Commission should adopt both Mr. McPherson's and Ms. Merchant's proposed adjustments to Aloha's retained earnings.

ISSUE 16: What is the appropriate weighted average cost of capital for the projected test year ending September 30, 2001?

The weighted average cost of capital will be a fall-out issue based on adjustments made by the Commission on various other issues.

ISSUE 17: What is the appropriate prospective Allowance for Funds Used During Construction rate for Aloha?

It is the Citizens' understanding that this is a stipulated issue.

<u>ISSUE 18</u>: What is the appropriate method of projecting customers and consumption for the projected year ending September 30, 2001, and what changes, if any, are appropriate to the utility's projection factors?

The Citizens do not take a position on this issue.

<u>ISSUE 19</u>: What adjustments, if any, are necessary to the 2001 projected test year revenues and expenses to reflect the appropriate number of wastewater customers, bills, and consumption?

Any such adjustment should be consistent with the Commission's decision on the customer growth rate (Issue 18).

<u>ISSUE 20</u>: What is the appropriate amount of reuse revenue to include in the test year?

The Citizens do not dispute Ms. Merchant's position that the appropriate reuse rate should be $.32 per thousand gallons. The Citizens believe that because Aloha extended the Mitchell property contract without approval - - in violation of Commission order - - the $.32 should be imputed to the Mitchell property reuse.

The proper determination of the appropriate amount of reuse revenue calls for the resolution of two different components. First, the Commission should decide the proper rate to establish for the reuse product. In Docket No. 950615-SU, the Commission established a reuse rate of $.25 per thousand gallons. At the time that charge was established, Pasco County was charging a reuse rate of $.28/thousand gallons. In its Order No. PSC-97-0280-FOF-WS, the Commission determined that Aloha's $.25/thousand gallon charge was market based because of the rate and the proximity of the Pasco County facilities [T-668].

The most recent information in the record indicates that Pasco's rate had gone up to $.32/thousand gallons as of 1999 [T-668]. It is possible that by the 2000-2001 projected test year, Pasco's rate may be even higher, but there is no evidence on that point. As a result of Pasco County's $.04 increase, Ms. Merchant recommended an increase in Aloha's rate. Ms. Merchant stated that she believed that an appropriate market-based rate for Aloha would be $.32 [T-669]. The Citizens do not dispute Ms. Merchant's position.

The second component to determine the total projected reuse revenue is the number of gallons of reuse that Aloha should be anticipated to sell. In Aloha's previous reuse case (Docket No. 950615-SU), the Commission allowed Aloha to charge a zero rate to the Mitchell property, pursuant to a contract that existed at that time. The Commission ordered a reevaluation of the rate at the expiration of the contract, and required Commission approval for any extension of the contract.

Aloha, however, violated the Commission's directive and extended its Mitchell property contract without Commission approval. Accordingly, the Citizens believe it is proper to impute the gallonage rate to the reuse distributed to the Mitchell property. The gallons used at the Mitchell property should be added into the calculation of reuse revenue to incorporate in the projected test year.

ISSUE 21: What is the appropriate salary for Aloha's vice-president?

The Citizens agree with the Staff that because the vice-president spends only 20% of her time with utility operations, her salary should be no higher than 20% of the president's salary.

Mr. Stambaugh explained the facts succinctly, as follows:

> The payroll expense for the test year for the utility president was $122,595 and for the vice-president was $68,250. The percentage of time spent as an officer of Aloha Utility was 100% for the president and 20% for the vice-president. Expanding the vice-president's salary to 100% equates to an annual rate of pay of $341,250.
> [T-579]

Mr. Stambaugh then pointed out that in Order No. PSC-99-1917-PAA-WS, the Commission ordered that the vice-president's annualized salary should not exceed the president's annualized salary. Accordingly, the Commission set the vice-president's salary at 20% of the president's.

In fact, the Commission's allowance is generous to Aloha. The obvious intuitive conclusion is that a vice-president's salary should be significantly below the president's. How many corporations pay the vice-president equal to the president? Conventionally, the president is paid substantially more than the vice-president. By allowing Aloha's vice-president's annualized salary to equal its president's annualized salary, the Commission has already given Aloha the benefit of any doubt.

In addition to Mr. Stambaugh, Mr. Larkin testified at length on the issue, supporting Mr. Stambaugh's conclusion and rationale [T-218, 219; 235-244; 372-377]. Based on the time spent on utility operations, the vice-president's salary should be no higher than 20% of the president's salary.

ISSUE 22: Should an adjustment be made to remove expenses associated with an administrative employee?

Yes. The utility stated that the justification for adding this particular position was that it was required by the CFJ. While the CFJ specifically identifies two other positions, which have been filled, it says nothing about the position in question.

As Mr. Larkin points out in his testimony, it is the utility's burden to justify that all of its expenditures are reasonable and prudent. For the particular employee identified by Mr. Larkin for this issue, Aloha's justification was that the Consent Final Judgment required that hiring. Mr. Larkin stated:

> Included within that projection is the salary for an individual which the Company claims they were required to hire as a result of the Consent Final Judgment. The Consent Final Judgment states that "the Company does not require any additional administrative employees be added to the Company's employment rolls. I am removing from the projected salaries the administrative person that the Company has added under the purported justification that it was a requirement of the DEP.
> [T-221].

As Mr. Larkin pointed out, Aloha's claim is not supported by the document which was offered as the justification. The Commission should disallow the salary of this administrative employee.

ISSUE 23: Should the cost of the annual financial audit be allocated to all of the utility's systems?

Yes. The bank loan benefits all Aloha divisions with this low cost source of capital. The audit is, in effect, simply a cost of the debt. Since other divisions share the benefits of this low-cost capital, they should also share the cost.

The capital structure used in this rate case is the company-wide capital structure. This means that the Seven Springs Wastewater's allocated capital structure receives only an allocated share of this particular loan. In the Commissions eyes, then, only a small portion of this loan is being used to support Seven Springs Wastewater capital assets. The balance of this loan -- in the Commission's eyes -- is being used to support assets of Aloha's other divisions. This is the traditional treatment for allocating aggregate capital structure to a specific division.

It must be recognized, however, that for this specific loan, this allocated capital structure benefits all of Aloha's other operations. It benefits them because it spreads this low-cost source of capital into the other divisions. If instead, the entire amount of this loan were viewed as supporting only Seven Springs wastewater assets, that would significantly lower the overall cost of capital charged to these ratepayers. The rates in this case would be significantly lower.

Not only is the nominal loan rate below the average cost of capital in the aggregate capital structure, it is a source that is not grossed up for taxes. Therefore, the loan is well below the aggregate overall cost of capital.

Since the entire Aloha company is receiving the benefit of this loan, the entire company should share in the cost of obtaining it. In this sense, the audit cost is effectively just part of the cost of the debt. If the debt is to be diffused into an aggregate capital structure, its true cost must be recognized in that diffusion. The $24,000 should be recognized as part of the cost of this loan. As such, the $24,000 cost of the audit should be allocated to Seven Springs wastewater in the same proportion that the total loan has been allocated into the reconciled capital structure.

ISSUE 24: Should any additional adjustments be made to Contractual Services - Accounting, for non-recurring costs?

The Citizens agree with Mr. McPherson that accounting expenses should be reduced by $1,113 to remove non-recurring fees associated with the implementation of the new accounting software system.

This adjustment should be made because the amount in question reflects a non-recurring expense. As Mr. McPherson stated:

> The utility replaced its general ledger and billing software systems in July of 1999 with a new accounting software system. The utility's accounting firm, Cronin, Jackson, Nixon & Wilson, assisted the utility with the implementation of the new system by reviewing system output, balancing accounts, and testing accuracy. The replacement of billing and accounting systems is an infrequent event and expenses related to this event are non-recurring.
> [T-506, 507]

Mr. McPherson pointed out that because this item is of a non-recurring nature, it falls under Rule 25-30.433(8), F.A.C. As such, the expenditure should be amortized over a five year period,, rather than expensed in the test year. The Citizens agree with this treatment.

ISSUE 25: Should an adjustment be made to Contractual Services -- Accounting, as a result of the Company hiring a new comptroller?

Yes. As a result of the Comptroller's accounting expertise, Aloha has less need to rely on outside accounting services to maintain the company's books and records. Contractual Services should be reduced by $7,449 to reflect the savings as a result of hiring this new employee.

If a personnel change can reasonably be expected to result in reducing the need for outside services, then the anticipated cost savings should be reflected in rates. In this particular instance, Aloha has hired a new comptroller. Mr. Larkin described the productivity gains that he anticipated, as follows:

> The Company has hired a new comptroller who has an accounting background. The addition of the new comptroller should result in productivity gains related to keeping the Company's books and records. In other words, they will not have to rely as extensively as

> they have in the past on outside accounting services to maintain the books and records and file reports with the Public Service Commission and other entities.
> [T-222]

In recognition of the productivity gains that he anticipated, Mr. Larkin reduced the charge for outside accounting services by an amount reflecting 50% of that portion of the comptroller's salary that is allocated to Seven Springs [T-223]. The Commission should adopt this adjustment and reduce expenses by $7,449.

ISSUE 26: Should any adjustments be made to remove expenses associated with the settlement of the DEP enforcement action?

Yes. Aloha's stockholders should bear this expense. Aloha paid a penalty for violations cited by DEP. Customers should not pay either the penalty or the legal expense Aloha incurred to fight it.

The subject of this issue began as action taken against Aloha for violations cited by DEP. As final disposition of DEP's action, Aloha accepted a Consent Final Judgment (CFJ) that placed numerous requirements on Aloha. One of the requirements was that Aloha pay a $18,400 penalty to dispose of the issues raised by DEP. In response to cross-examination, Mr. Larkin read these words directly from the CFJ:

Q. [by Mr. Deterding] And where are the penalties that you're referring to addressed?

A. "The following compliance with all the terms of this judgment, including the payment of any stipulated penalties due to the requirements of this judgment shall be deemed satisfied." That's on page 7.

[T-246]

The explicit language leaves no room for reasonable argument. The phrase "terms of this judgment" is followed by the modifier "including." This construction always means that whatever term follows the modifier "including" is a subset of the term that precedes the modifier "including." Accordingly, we can conclude that "stipulated penalties due to the requirements of this judgment" are part of the "terms of this judgment," for which "compliance" is required.

Then, on page 10, the CFJ specifies that one of "the requirements of [the] judgment" to be satisfied is a payment of $18,400. Mr. Larkin testified:

> [I]t says, "Within 10 days of the execution of this judgment Aloha shall pay the department $18,400 in settlement of alleged violations." I think, that's pretty clear. I think, all that language is pretty clear. [T-246, 247]

The DEP and Aloha agreed upon ("stipulated") a payment of $18,400 to settle the dispute.

Aloha claims this language is merely coincidental, but the utility seeks a contrived interpretation of the CFJ language. One need only ask two questions: (1) If there is no "stipulated penalty" in this agreement, then why would that term be included in the CFJ at all? (Surely, DEP is not simply trying to confuse its readers by throwing in a completely superfluous term). (2) What is the purpose of the $18,400 payment to DEP, if it is not a penalty.

Aloha, of course, relies heavily on the language that it "has admitted no . . . wrongdoing." This language, however, is the type normally found in virtually any settlement. As an administrative agency, the Commission has encountered similar situations.

Consider a hypothetical. Suppose the PSC perceives a violation by a regulated utility and starts action against that utility. Then the utility comes to the agency and says, "We'll pay for all remedial action you propose, and we'll pay whatever fines you would have tried to impose -- just don't make us admit guilt or wrongdoing." Under those circumstances, the PSC may well agree to exculpatory language in a settlement to avoid the cost and uncertainty of litigation. Such pragmatism, however, should not mean the customers should pay the penalty imposed.

The current case is akin to the hypothetical. Simply because Aloha "has admitted no wrongdoing" does not mean the customers should pay the penalty. The Commission should disallow the $18,400 payment to DEP and all legal costs that Aloha incurred to fight the DEP action taken as a result of Aloha's violations.

ISSUE 27: Is an adjustment necessary to chemicals and purchased power expenses as a result of the utility's infiltration and inflow reduction program?

Yes, Aloha has included future costs for an I/I reduction program that is ongoing. If future costs are recognized, fairness dictates that the corresponding I/I reduction also be recognized. Chemicals and purchased power should be reduced by 23.37% to reflect the lower I/I resulting from the program.

It is axiomatic that if I/I is reduced, then the amount of flow that Aloha is required to collect and treat will likewise be reduced. A reduction in the flow will result in a reduction to two primary operating expenses: purchased power and chemicals.

The Citizens do not know precisely how much further I/I will be reduced by Aloha's continuing I/I reduction program. The Citizens do know that the customers are being asked to continue to pay for the program that costs $15,000 per month. As long as they pay for the reduction program,, they should receive the cost benefits that the I/I reduction program will produce.

Mr. Biddy has conservatively estimated an additional I/I reduction of 140,000 GPD [T-407]. In accordance with that reduction, the customers should receive the benefit of lower expenses for chemicals and for electricity. Those expenses should be reduced by 23% [T-408].

ISSUE 28: Should any adjustments be made to the utility's base year ended 9/30/99 balance for Account 720 - Materials & Supplies?

Yes. The utility has incurred a drastic increase which has not been adequately explained. This account should be reduced by $17,179 to reflect indexing of this account for customer growth and inflation from the 1998 level.

As Mr. Larkin testifies, this account has increased drastically without any justification being offered. Mr. Larkin stated:

> The materials and supplies account have increased drastically from 1998 to the test year ended September 30, 1999. It has increased approximately 62%. The Staff's audit and disclosures' adjustments remove $12,703 from this balance. However, the balance still increased by approximately 36%, even with those adjustments. The Company has not accounted for this dramatic increase.
> [T-222]

Aloha has tried to justify this increase, but has only managed to accentuate the lack of justification. The utility has offered Exhibit 23 to explain the increase. An examination of that exhibit, however, shows the problem. As an example, consider the following increases that are excerpted from the exhibit:

VENDOR	1/1/99 - 9/30/99	1/1/98 - 9/30/98
Elec & Mech	5847.06	464.05
Grainger	9,686.87 (1,118 Cap.)	4,078.21
Grayarc	134.88	65.95

GrayBar	2,120.37	-0-
Guardian Eq.	12,368.08 (6,837 Cap.)	871.24

Aloha shows the increases, but nowhere does the utility even attempt to show that the 1999 amount is the new norm of what can be expected on a year-to-year basis. With Exhibit 23 as a purported justification, Aloha has totally missed the point: the Citizens do not doubt that the money was spent in 1999. The concern is whether that amount reflects the norm. That is precisely the problem. OPC is concerned that the 1999 amount reflects a spike - an anomaly - that will not be continued on a going-forward basis. Aloha simply shows that it was spent.

Returning to Exhibit 23, the Citizens ask: Will the Elec. & Mech. invoices continue at the $5,847 level, or return to the $464 norm demonstrated in the prior year? Will the Grainger continue at the $8,568 level or return to the $4,078 norm demonstrated in the prior year? Will the Graybar continue at the $2,120 or return to the zero norm of the prior year? Will the Guardian continue at the $5,531 or return to the $871 norm? Is this spike a result from all the 1999 capital asset activity, which will revert to a lower norm in the future?

Unless Aloha can answer those questions, it has not even begun to justify the drastic jump in 1999 expenses. Since 1999 is being used to project two more years into the future, it must be justified as normal before future rates can be based on it. A utility could encounter unusual expenses in a given year (maybe because of significant capital asset upgrades), but unless those expenses continue at the higher level, rates should not be established on anomalous transactions.

Aloha has not shown its 1999 materials and supplies expenses are normal. The future projected years should not be based on an abnormally high level of expense. The 1998 amount should be brought forward for inflation and customer growth. The excess should be removed.

ISSUE 29: Should an adjustment be made to Contractual Services - Other, to remove the projected maintenance expense for the new plant?

Yes. Aloha has made no adjustment to reflect the manufacturer's guarantee on new equipment. Unless this is addressed, Account 736 - Contractual Services - Other, should be reduced by $175,000 (the 5% expense factor), since this is new plant that is guaranteed by the manufacturer.

When asked whether Aloha would encounter $175,000 of preventive maintenance for the new plant, Mr. Biddy responded:

> No, it wouldn't be nowhere close to 175,000 simply because it's brand new equipment. The only maintenance you will be doing will be preventive maintenance that the operator will do as he goes about his normal duties, and most of those are lubrication-type things. If there is a breakdown, it's covered by the warranties, so it would be a very small percentage of that 175
> [T-489]

The $175,000 is based on 5% of the cost of the plant which even Mr. Porter conceded is merely a rule of thumb which has origins in EPA publications [T-211, 212].

The Citizens are not taking exception with this rule of thumb. Over the life of the plant, the average O&M costs may end up being approximately 5% each year. The problem, however, is that we are not dealing with the total life of the plant. These rates are being set for a period when the plant is brand new. Major repair and replacement costs (all of which contribute to the 5% average) which will be incurred over the life of the plant will not be encountered during the first few years for which these rates will be set. Consequently, the 5% rule of thumb average has no application.

The Citizens are not arguing that there will be no maintenance expense; the Citizens merely argue that it will not be near 5% or $175,000. The Citizens believe that it is Aloha's burden to bring forward an accurate figure that is applicable to the first few years of the plant life. Since Aloha has failed to show what a reasonable amount would be, the 5% should be removed.

<u>ISSUE 30</u>: Should any adjustments be made to the base year ended September 30, 1999 balance for miscellaneous expenses?

Yes. Aloha incurred a significant increase in Miscellaneous Expenses, which has not been adequately explained. Accordingly, the account should be reduced by $16,155, and would then reflect the historical average indexed for infiltration and customer growth.

The argument here is similar to that urged by the Citizens in Issue 28. Our concern is that anomalous (or spiked) expense levels are being worked into the projection basis. These spiked expenses will improperly skew the projections by incorporating temporary anomalies as though they are the norm.

Mr. Larkin demonstrated this problem by stating:

> Historically, the Company has incurred approximately $24,000 in account 775 - Miscellaneous Expense. The average for the years 1996, 1997, and 1998 was $23,666. The balance in this account jumped to $62,041 for the year ended December 31, 1999, and was $57,861 for the 12 months ended September 30, 1999, which was used as a base for projecting the test year ended September 30, 2001. Part of this increase has been removed in the Staff audit when the Staff discovered that the Company had charged the DEP fine of $18,400 to this account. After removing this amount the account balance is still approximately 67% higher than the average for the prior three years ended December 31, 1996, 1997, and 1998. [T-224]

Because Aloha has not even attempted to show that the 1999 amount is now the norm, that level cannot be used to base the projections on. Rather, it should be the previous norm, adjusted for inflation and customer growth.

ISSUE 31: What is the appropriate amount of current rate case expense?

Only prudently incurred rate case expense should be allowed and amortized over four years.

ISSUE 32: What is the appropriate amortization period and amount of contributed taxes associated with the Seven Springs wastewater system?

The composite life of 26.9 years for the CIAC assets should be used. This results in an increase in amortization of the tax by $18,808.

Aloha's filing sought an amortization period of 40 years. This is inappropriate as Mr. Larkin pointed out:

> The Company has amortized this balance over a 40-year period. CIAC assets have a composite life of approximately 26.9 years for years prior to 1998 as disclosed in the work papers to the Staff audit. A more appropriate life for the amortization of this tax would be the life over which the CIAC assets are amortized. I have changed the amortization to coincide with life used to amortize the CIAC. [T-226]

The Commission should adopt the 26.9 year amortization as recommended by Mr. Larkin.

ISSUE 33: What is the appropriate millage rate to project tangible personal property taxes?

Taxes other than income should be reduced by $23,819 to reflect the minimum amount of tax that should have been paid had the company taken advantage of the discount period. This adjustment is consistent with Staff Audit Disclosure No. 10.

This issue arose from a disclosure in the Staff audit. The utility included its personal property taxes at the rate that was paid after the early discount payment period had expired [T-581, 582]. The customers should not be forced to pay for the utility's failure to take advantage of the discount. Pursuant to Commission precedent, the rate should be based on an anticipated payment during the discount period.

ISSUE 34: What is the test year operating income before any revenue increase?

The appropriate amount is subject to the resolution of other issues.

ISSUE 35: What is the appropriate revenue requirement?

The appropriate amount is subject to the resolution of other issues.

ISSUE 36: What are the appropriate final wastewater rates?

The final wastewater rates are subject to the resolution of other issues.

ISSUE 37: Should the Commission determine a reuse rate in this proceeding, and if so, what is the appropriate rate?

The Citizens do not take a position on this issue.

ISSUE 38: Who should bear the risk that the company will not find buyers for its reclaimed water?

The Citizens agree with Staff that the utility should bear the risk that it will not find buyers for its reclaimed water.

ISSUE 39: Should the three-step rate reduction required by Order No. PSC-97-0280-FOF-WS be implemented, modified, or canceled?

The Citizens do not take a position on this issue.

ISSUE 40: Should Aloha's Seven Springs wastewater plant capacity charge be revised?

The Citizens do not take a position on this issue.

ISSUE 41: Should Aloha be fined in the amount of $250 for its apparent violation of Order No. PSC-97-0280-FOF-WS by its failure to timely file the extension of the Mitchell agreement with the Commission for approval?

The Citizens agree with Staff on this issue.

Respectfully submitted,

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CERTIFICATE OF SERVICE
DOCKET NO. 991643-SU

I HEREBY CERTIFY that a copy of the foregoing CITIZENS' POSTHEARING STATEMENT has been furnished by U.S. Mail or *hand-delivery to the following parties this 29th day of November, 2000.

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