

State of Florida



Public Service Commission  
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OFFICE OF THE GENERAL COUNSEL (JACOB, ESPINOZA) *JDS*  
*ONE* *wait*

RE: DOCKET NO. 010503-WU - APPLICATION FOR INCREASE IN WATER  
RATES FOR SEVEN SPRINGS SYSTEM IN PASCO COUNTY BY ALOHA  
UTILITIES, INC.  
COUNTY: PASCO

AGENDA: 04/02/02 - REGULAR AGENDA - POST HEARING DECISION -  
PARTICIPATION IS LIMITED TO COMMISSIONERS AND STAFF

CRITICAL DATES: 8-MONTH EFFECTIVE DATE: 4/10/02

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\WP\010503.RCM.WPD

DOCUMENT NUMBER-DATE

03286 MAR 21 02

FPSC-COMMISSION CLERK

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CASE BACKGROUND

Aloha Utilities, Inc. (Aloha or utility), is a Class A water and wastewater utility in Pasco County. The utility consists of two distinct service areas: Aloha Gardens and Seven Springs. The utility's service area is located within the Northern Tampa Bay Water Use Caution Area as designated by the Southwest Florida Water Management District (SWFWMD). Critical water supply concerns have been identified by SWFWMD within this area.

On August 10, 2001, Aloha filed an application for an increase in rates for its Seven Springs water system. Since the utility's application was complete as filed, the official filing date was established as August 10, 2001, pursuant to Section 367.083, Florida Statutes. In its minimum filing requirements (MFRs), the utility requests total water revenues of \$3,044,811. This represents a revenue increase of \$1,077,337 (or 54.76%). These final revenues are based on the utility's requested overall rate of return of 9.07%.

The utility's requested test year for setting final rates is the projected year ended December 31, 2001. Also, the utility requested that this application be directly set for hearing.

By Order No. PSC-01-2092-PCO-WU, issued October 22, 2001, the Commission suspended the utility's requested final rates. Also, by Order No. PSC-01-2199-FOF-WU, issued November 13, 2001, the Commission approved interim rates subject to refund with interest. Rates were increased by 15.95%.

By Order No. PSC-01-1121-PCO-WU, issued May 16, 2001, Edward O. Wood was granted intervention. Moreover, on August 24, 2001, the Office of Public Counsel filed its Notice of Intervention. By Order No. PSC-01-1750-PCO-SU, issued August 28, 2001, the Commission acknowledged OPC's intervention. In addition, on October 2, 2001, SWFWMD filed its Petition to Intervene. This petition was granted by Order No. PSC-01-1981-PCO-WU, issued October 5, 2001. Finally, on December 17, 2001, Representative Mike Fasano filed his Petition for Intervention. This Petition for Intervention was granted by Order No. PSC-01-2502-PCO-WU, issued December 21, 2001. A hearing in Pasco County was held on January 9 through 11, 2002.



**STIPULATIONS**

At the hearing, the Commission voted to approve the stipulations presented in the prehearing order and two additional stipulations regarding Issues 6 and 12. The stipulations are as follows:

Category One Stipulations

Those stipulations where the utility, SWFWMD, OPC and Staff agreed are set forth below:

1. For items erroneously expensed by the utility during the test year ended December 31, 2000, both plant and retained earnings should be increased by \$11,522 for the projected test year. Further, corresponding adjustments to operation and maintenance expense (\$12,396), accumulated depreciation (\$920), and depreciation expense (\$613), should be made to the 2001 projected test year.

2. To reflect the appropriate depreciation rate for computer equipment, accumulated depreciation should be increased by \$2,262, and retained earnings should be decreased by \$2,262.

3. CIAC should be increased by \$27,236 to correct the amount of contributed property received from April through December 2001. Corresponding adjustments should be made to increase accumulated amortization of CIAC (\$64) and test year amortization of CIAC (\$837).

4. To correct the historic starting point, the projected test year rate base should be reduced by \$10,877 to reflect the 13-month average balance of Accumulated Amortization of Contributed Taxes.

5. All deferred rate case expense related to Docket No. 991643-SU should be excluded from working capital because those costs were specifically allocated to the Seven Springs wastewater system. Total company working capital that is allocated should be reduced by \$61,702.

6. Total company working capital that is allocated should be reduced by \$32,868 to reflect the amortization of regulatory

commission expense associated with Docket No. 960545-WS. A corresponding reduction to retained earnings should also be made.

7. The annual amortization of issuing expense for the Bank of America loan should be reduced by \$1,760.

8. The total projected 13-month average balance of long-term debt should be \$9,267,979, as shown on minimum filing requirement Schedule D-5(A). The respective cost rates are those shown on that same schedule and subject to the resolution of other issues.

9. Historical December 31, 2000 test year revenues should be increased by \$7,154 to properly allocate interest income. The interest income adjustment should be escalated by the customer growth factor for a total increase of \$7,490. In addition, projected test year revenues should be increased by \$4,176 to reflect the appropriate amount of revenues for residential vacation bills.

10. Bad debt expense should be increased by \$1,237 to account for an allocation error.

11. The cost per 1,000 gallons of water to be purchased from Pasco County should be \$2.35.

12. To properly allocate the utility's recent purchase of a new office building, land and plant should be reduced by \$5,776 and \$5,935, respectively.

13. Two employees were included in salaries and wages for officers as well as the annualization of employees' salaries. Salaries and wages should be reduced by \$8,769.

14. The testimony and exhibit of staff witness Vincent C. Aldridge, the staff auditor, may be admitted into evidence, and he may be excused from attending the hearing.

15. The testimony of Staff DEP witnesses Van Hoofnagle and Gerald Foster should be taken up no later than the second day of the hearing.

16. All SWFWMD witnesses may be excused from attending the first day of the hearing. Moreover, Jay Yingling may be excused

from attending the second day, and his testimony will be taken on the third day.

17. Paul Stallcup has been substituted for Staff witness Lingo and has adopted her testimony and exhibits except for Ms. Lingo's testimony on her background and experience on pages two through line 15 of page 4 (where he has substituted his own), and her testimony on page 22, lines 5 through 14 (which has been deleted).

18. The appropriate number of ERCs for the projected 2001 test year is 10,560.

#### Category Two Stipulations

Those stipulations where the utility, SWFWMD, and Staff agreed, but where OPC took no position in the stipulations are set forth below:

19. The used and useful percentages for the water treatment plant and the water distribution system are both 100%.

20. The return on equity should be calculated using the current leverage formula in effect at the time the Commission makes its final decision in this case.

21. The utility's 44.83% allocation of pension expense to the Seven Springs water system is appropriate.

#### Issues Stipulated at Hearing

Issue 6. The cost rate for variable cost, related party debt should be the prime rate less two percent as of December 31, 2001.

Issue 12. Salary expense should be reduced by \$21,268 to correctly allocate the annualized salary of the utility operation supervisor.

#### BACKGROUND CONCLUSION

This recommendation addresses staff's recommended revenue requirement and the appropriate rate structure and rates for Aloha's Seven Springs water system. The Commission has jurisdiction pursuant to Section 367.081 and 367.111, Florida Statutes.

**DISCUSSION OF ISSUES**

**ISSUE 1:** Is the quality of service satisfactory?

**RECOMMENDATION:** No. The utility's overall quality of service is unsatisfactory. Due to Aloha's long-term problems with black water and other water quality complaints, long-term violation of its consumptive use permit, its lack of a proactive approach to finding acceptable solutions to these problems, and the customer complaints about the attitude of the utility, the overall quality of service of Aloha should be considered unsatisfactory. (WETHERINGTON)

**POSITION OF THE PARTIES**

**ALOHA:** Yes. All of the expert witnesses testifying in this proceeding agreed here and in prior extensive investigations that the Utility was providing service in accordance with all water quality standards. The Utility has demonstrated in this proceeding that it is also providing good customer service.

**SWFWMD:** No position.

**OPC:** No. The entirety of the customer testimony demonstrated that the product and the service provided by Aloha is totally unacceptable.

**WOOD:** No. The quality of service and product supplied by Aloha Utilities, Inc. is of the poorest magnitude that one could conceive. The product is smelly, corrosive, and unfit for household use. This is a State of Florida created monopoly. The State must protect the customers from this unscrupulous monopoly.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** Section 367.081(2)(a)1., Florida Statutes, and Rule 25-30.433(1), Florida Administrative Code (FAC), specify that the Commission in every rate case shall make a determination of the value and quality of service provided by the utility. This shall be derived from an evaluation of three separate components of water and wastewater utility operations: quality of the utility's product (water and wastewater); operational conditions of the utility's plant and facilities; and the utility's attempt to address customer satisfaction. Sanitary surveys, outstanding citations, violations and consent orders on file with the Department of Environmental

Protection (DEP) and the county health departments (DOH) or lack thereof over the preceding 3-year period shall also be considered. In addition, DEP and DOH officials' comments or testimony concerning quality of service as well as the complaints or testimony of utility's customers shall be considered. Staff's analysis below addresses each of these three components that must be addressed pursuant to Rule 25-30.433(1), FAC.

### Quality of Utility's Product

In this facet of the quality of service determination, staff considers the quality of the utility's product and whether the water delivered to the customers' meters meets state and federal standards.

Representative Fasano testified that Aloha delivers to its customers smelly, foul, dirty black water. He also cited the newspaper photograph which showed an Aloha fire hydrant spewing discolored water. He made reference to the fact that the black water problem had been on-going for years. It was occurring in 1996 and before. The complaints to his office still continue. The amount of complaints received amounts to reams and reams of paper. (TR 11-25)

Twenty-nine customers testified at the hearing and complained of black or discolored water; odor/taste problems; low pressure; and/or, sediment/sludge. Many customers brought containers of discolored or black water to the hearing for viewing. (TR 52-194 & 261-347)

Customer witness Oberg testified that the water in his house was dirty, occasionally turned gray and smelled like rotten eggs. He also testified that the water in his toilet tank was black and some water he drained from his hot water heater was black. (TR 79-84)

Customer witness Hawcroft testified that the water he receives is foul smelling and discolored and causes stained laundry. His household uses bottled water. It is two years since he testified before the Commission about the very same water quality problems. (TR 91-97)

Customer witness Kurien testified that he receives black water. (TR 100)

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Customer witness Corelli testified that the water he receives is not drinkable, is an inferior product and that he receives black water. (TR 126-127)

Customer witness Chestnutt testified that Aloha had never provided him with decent water. (TR 132)

Customer witness Hartinger testified that the water he receives is filthy, the water in a filter housing was black, and the filter itself was full of black grit. He further described the water as disgusting, vile, and had a foul smell. (TR 138-141)

Customer witness Wood, also an intervenor to this proceeding, spoke about the corrosive nature of Aloha's water. He stated that copper pipe does not react to water in the plumbing system unless there is an acid contaminant in the water. He testified that the hydrogen sulfide is the culprit and the water Aloha supplies is corrosive and is the cause of the black water. He also stated that the water was revolting. (TR 163-193)

Customer witness Bradbury testified that the water was black and smelly. He also referred to his soft water unit that failed after three years due to sludge buildup. (TR 263-264)

Customer witness Bulmer testified that the water quality was poor. (TR 279)

Customer witness Wickett testified that he had received dirty water and it had a pretty strong smell. He is forced to buy bottled water whenever he has company over to their house. (TR 282-288)

Customer witness Logan testified that he found a black greasy substance on the inside of his copper pipes. Also, when he filled his garden tub there was black stuff floating in the water. He stated that he was sickened by the water and that it smelled like sulphur. (TR 289-294)

Customer witness Nowack testified that the water that came out of her kitchen faucet was black, greasy sludge. She said the quality of the water is the worst she ever experienced in her whole life. (TR 295-297)

Customer witness Depergola testified that he received stinky, lousy, miserable water. When he took a shower his body smelled worse than before. The water causes stained laundry and is not drinkable. It smells and it is dirty. His pipes are filthy inside. (TR 312-315)

Customer witness Karas testified that the water was lousy and smelly. The water has really been nasty. It seems like it has rust and most of the time you see a lot of black too. (TR 316-320)

Customer witness Skipper testified that she did not drink the water nor bathe in it. It has a bad taste and a bad smell. The water turns her ice cubes yellow. She has a refrigerator with door water and ice, which she will not use. (TR 320-324)

Customer witness Legg testified that the water was black, very dirty. The water left an oily residue and was always cloudy. If he does not use the water for a week and then turns it on, it will be brown and oily, but not to the extent of the first time that it happened. (TR 324-333)

Customer witness Whitener testified that she was unable to drink her water. (TR 334)

Customer witness Rifkin testified that he received black, dirty, stinking water. (TR 336)

Customer witness Lewandowski testified that the water quality was poor. (TR 340)

Aloha, through a late-filed exhibit, has submitted a summary of its attempt to contact all of the customers who complained about the quality of the water. These attempts resulted in fifteen customers allowing the Aloha engineer to come into their home. At each home the engineer took samples of the water coming into the home and inquired of the customers where they had the most trouble inside their homes. These locations were used for the interior samples. Nowhere during any of the visits did Aloha's engineer see anything other than clean, clear water. (EXH 37)

Utility witness Watford testified that the hydrogen sulfide in Aloha's source water is converted to sulfates by chlorination. There is no sulfide coming through the customer's meter. Once the water enters the customer's home a multitude of things can cause

the formation of sulfide. (TR 498-502) Utility witness Porter testified that the black water problem occurs in the customer's home water piping. The water delivered to Aloha's customers is pure, clean, color-free, odorless and meets all State and Federal laws, rules and regulations. The problem is not unique to the customers of Aloha and does occur in other areas of Florida. The black water problem is but one manifestation of a larger problem, that of copper piping corrosion that is prevalent in many parts of Florida. The copper sulfide problem occurs when elemental sulfur and/or sulfate in the water is converted biochemically in the customer's home from harmless sulfate and elemental sulfur to hydrogen sulfide which can attack the home copper water piping and create copper sulfide which is the black substance reported by some of Aloha's customers. Aloha's water contains very small quantities of sulfate as it is delivered to the customer, varying from single digit values to the 20 to 25 mg/L level. The national drinking water standards allow 250 mg/L sulfate levels so you can see that Aloha's water contains at most only one tenth of the national limit. (TR 1280-1281)

OPC witness Biddy testified that there is a varying concentration of hydrogen sulfide in the raw water. He stated that periodically you get much higher concentrations coming through and essentially you use up all the chlorine and you pump hydrogen sulfide directly in the system and into the homes. (TR 763-861)

Staff witness Hoofnagle of the DEP testified that the black substance in the black water is copper sulfide. Factors necessary for the formation of copper sulfide include an energy source, time, temperature, sulfur reducing bacteria and either sulfates or elemental sulfur. He stated that the conditions above are found in both the customer's hot water heater and the elemental sulfur or sulfates are introduced from the distribution system. DEP believes that the black water is being formed in the customer's pipes after the meter and that this formation of black water after the meter does not constitute a violation of drinking water standards. (TR 201-244)

Witness Hoofnagle further testified that there were other occurrences of black water in Florida. These include Volusia County, the Ft. Myers area and Polk, Hillsborough, Pasco, and Pinellas Counties. According to Mr. Hoofnagle, it appears that most of these events are episodic or have been resolved. (TR 201-244)



Witness Hoofnagle testified that there are a number of things the utility might study and implement to reduce or eliminate over time the black water problems now being experienced. There is no panacea or guarantees due to the complex nature of the water and corrosion chemistry and relatively unique specific conditions that are found in the customers' water. However, aeration with pre- and post-pH adjustment added with alkalinity control has proven the most effective in other parts of Florida. Additionally there are emerging technologies that lend themselves to addressing the future Disinfection Byproducts Rule 62-550.821, FAC, as well, such as the MIEX system. This is a relatively cost effective solution. Since the black water problems do not appear in all of Aloha's service subareas, it is the DEP's belief at this time that a centralized treatment system would not be cost effective. Future and on-going engineering and cost studies need to identify technical solutions and their associated costs. (TR 201-244)

In late-file Exhibit 3, staff witness Foster of the DEP presented a description of the tri-level water treatment process used by Pasco County to remove hydrogen sulfide and reduce the corrosiveness of the water. This process begins with cascade aeration to remove sulfides. After aeration, the water is sent to storage tanks containing a naturally-occurring bacteria. These bacteria convert hydrogen sulfide into elemental sulfur. The water is then chlorinated to remove bacteria and oxidize the remaining sulfide. (TR 389-390)

Mr. Foster also testified that the finished water produced by Aloha meets all the State and Federal maximum contaminant levels for primary and secondary water quality standards including the lead and copper rule. Also, Aloha's compliance with the lead and copper rule has led to a lessening of the monitoring requirements. He further testified that the black water appears to be occurring after the water flows through the meter and that the black water after the meter does not constitute a violation of Federal and State drinking water standards. (TR 357-392)

When asked what steps Aloha had taken to alleviate the black water problem, witness Foster testified that the utility was permitted on December 12, 1995, to use a polyphosphate corrosion inhibitor. However, some home treatment units can cause the corrosion inhibitor to be less effective. The units tend to remove mineral calcium, iron and magnesium, causing the water to become corrosive. The pH is lowered. (TR 357-392)

Although some customers are dissatisfied with the taste, odor, and color of the water, witnesses Hoofnagle and Foster testified that Aloha meets the drinking water standards set forth by the DEP for water quality, and that the black water is created beyond the meter. Staff therefore recommends that the quality of Aloha's product is satisfactory.

It is apparent from the DEP testimony that Aloha has complied with all DEP rules regarding the quality of the water it produces for its customers. The method it has chosen, however, to meet this responsibility, i.e., the chemical conversion of sulfides to sulfates, has been shown to be reversible in customers service piping and is one of the factors leading to the formation of black water. Staff believes that even though Aloha has apparently met its legal obligation regarding water quality, it should take a more proactive approach to dealing with the black water problem and other customer complaints about water quality. In light of this, staff is recommending in Issue 2 that Aloha provide a plan that shows how it will have a water treatment system installed starting with wells 8 and 9 and then continuing with all wells by December 31, 2003.

Regarding a potential solution to the black water problem, witness Hoofnagle stated that if all the homes had chlorinated polyvinyl chloride (CPVC) piping there would not be a black water issue. When asked if there was anything else that would eliminate the black water problem witness Hoofnagle stated that some form of water treatment to included aeration could greatly reduce the problem. (TR 230-231) Staff witness Foster, when asked if there was a mechanism, short of replacing the copper pipe, that would eliminate the black water problem, responded by calling the plastic pipe replacement a quick fix and outside of that he did not see an easy way of doing it. (TR 382) Utility witness Watford testified that a customer named Vento had his copper pipe replaced with CPVC and had never seen discolored water again. (TR 509-510)

Both witnesses from DEP were asked to state what they believed to be the solution to the black water problem and neither cited anything as a final solution except for the replacement of the customers' copper pipe with CPVC. Witness Hoofnagle testified that forms of water treatment would only reduce the problem and stopped short of saying that additional treatment of the water would eliminate the problem. Staff believes it is reasonable to conclude that at least a very large part of the solution to the black water

problem in the Aloha service area is the replacement of the customers' copper service pipes with non-copper pipe.

Operational Conditions of the Plant

In this facet of the quality of service determination, staff considers the operational conditions of the utility's plant facilities. Staff considers whether the plant facilities meet DEP standards and are functioning properly.

Utility witness Watford testified that Aloha utilizes chlorination to convert the hydrogen sulfide in the raw water to the sulfate form. (TR 498) Utility witness Porter testified that Aloha also uses an orthopolyphosphate corrosion inhibitor. (TR 1302) Aloha's use of a corrosion inhibitor has resulted in a lessening of the monitoring requirements under the lead and copper rule. (TR 361)

Four of the customers who testified complained about low pressure. One of these customers stated that his pressure was low constantly. It was not adequate compared to other places he has lived. (TR 11-195 & 257-348)

Staff witness Foster testified that the Aloha water system meets all current DEP standards for a drinking water system including the maintenance of the required minimum pressure, quality of the finished water, monitoring, required chlorine residual, certified operators and auxiliary power. The system is generally in compliance with all applicable DEP rules. Also, Aloha's corrosion inhibitor program was approved by DEP on December 12, 1995. Witness Foster further testified that the chemical analyses of Aloha's finished water indicates no need for further treatment. (TR 360-392)

Staff witness Hoofnagle testified about fire hydrant flushing. He stated that how often a hydrant should be flushed varies tremendously. He further testified that DEP encourages utilities to flush lines through the hydrants and that it is a standard practice. (TR 229-230)

Staff believes that the record shows that the utility is meeting standards set forth by the DEP for operating conditions of its plants, as shown by the testimony of DEP witness Foster as well as by utility witnesses Watford and Porter. Therefore, staff

recommends that the operational condition of the plant is satisfactory.

### Customer Satisfaction

Customers testified for the most part about discolored or black water. There were some complaints of undesirable taste and odor, and insufficient pressure. A few customers testified about the attitude of the utility. In addition to the customer testimony previously stated the following customers testified about the level of customer service they received from the utility.

Representative Fasano testified about Aloha's defensive attitude and lack of helpfulness. He characterized the service as poor and pointed out what he believed to be an effort by Aloha to intimidate its customers into not participating in the legal process. This effort was a newsletter in which Aloha stated that if an appeal of a Public Service Commission order was pursued, it would cost the utility hundreds of thousands of dollars. This cost would be passed on to the customers. Representative Fasano reported this newsletter to the Commission and was told that Aloha's claims of potential legal costs were not so exaggerated as to be deceptive. He also characterized Aloha as a company who does not care about its customers. (TR 13-25)

Customer witness Stingo testified about the expense of installing an irrigation meter. He believed that the water distribution system as it was installed should not have been allowed and caused the installation of an irrigation system to cost more money than it should have. (TR 60-61)

Customer witness Marden testified about a damaged fire hydrant that exists today and his concerns about fire protection and safety. (TR 70-78) In late-filed Exhibit 37, Aloha stated that it repaired the hydrant on January 10, 2002.

Customer witness Kurien testified that the Commission should not be bullied by Aloha's claims of meeting DEP standards. (TR 105)

Customer witness Shepherd testified that he believed that Aloha was engaged in foot dragging as a response to water problems. (TR 146)

Customer witness Lane testified that he was in agreement about the intimidating newsletter and that Aloha is not responsive to customer complaints. He stated that when he called to complain about weak pressure, the utility comes out and measures it and says that the existing pressure meets the standard and that is all they can do. Mr. Lane believes that this is not responsive. (TR 157-159)

Customer witness Wood testified that Aloha's service is substandard and totally unsatisfactory. (TR 173-174)

Customer witness Nowack testified that Aloha is very rude to her and to its customers. She also stated that Aloha hangs up on her. (TR 294-300)

Customer witness Skipper testified that she had written Aloha a letter in the summer and had not gotten any response from them at all. (TR 321)

Customer witness Rifkin testified that he wrote on his bill a note to Mr. Watford that the water is dirty, black and stinking. Mr. Rifkin never received a response to the note. (TR 336)

Customer witness Lewandowski testified that every time he has called Aloha they have been nothing more than arrogant, egotistical prima donnas. (TR 340)

Customer witness Brown had questions about how the sewer rate was calculated on his bill and also expressed concerns over Aloha's brand new vehicles. He also had concerns about Aloha's threatening newsletter concerning legal costs being passed on to the ratepayers. (TR 147-150)

OPC witness Larkin testified that Aloha's water quality does not meet a competitive standard and in a competitive environment would be rejected by customers. It was only because Aloha was a monopoly that it could get away with this level of service and the Commission must act as a true substitute for competition. He stated that in a previous docket there was overwhelming evidence that a vast number of the Seven Springs water customers found Aloha's overall product and service to be completely unacceptable. Further, based on the customer testimony that has been presented in the two recent Aloha dockets, vast numbers of customers would go elsewhere if they had a choice. He has never encountered a higher

level of customer dissatisfaction. He stated that Aloha's Seven Springs Water Division has failed to meet a competitive standard for service, which would allow a rate increase. In other words, in a competitive environment, Aloha would not be able to raise prices because the quality of its water is below comparable service from other water companies. (TR 663-669)

Staff witness Durbin testified that during the period between January 1, 1999, and October 31, 2001, the Commission logged 193 complaints against Aloha Utilities. This number of complaints constituted the highest number of complaints per 1,000 customers of any of the similarly sized water and wastewater utility companies reviewed. The similarly sized companies included other Class A and B water and wastewater companies in Pasco County plus other selected Class A companies outside of Pasco County. The review indicated that Aloha had 15.16 complaints per 1,000 customers for the period January 1, 1999, through November 13, 2001. Other companies ranged from a low of .024 complaints per 1,000 customers by Florida Cities Water Company - Lee County Division, to a high of 13.45 complaints per 1,000 customers by Jasmine Lakes Utility Corporation. (TR 912-934)

Mr. Durbin testified that two of the complaints involved an apparent violation of the FAC or the company tariff. Of these two, one was a complaint in which it appeared that the company had sent the customer an improper bill. The other apparent violation concerned a delay in connection of service in a timely manner. (TR 912-934)

Mr. Durbin testified that the two most common complaints involved high water bills and water quality concerns, including black water complaints. Witness Durbin further testified that Aloha provided a timely response in 92% of the cases that were filed in 1999, 2000 and year to date 2001. (TR 912-934)

Utility witness Watford testified as to customer satisfaction and stated that the two cases where the utility was found to have done anything wrong averaged out to less than one complaint per year. He believes this to be a very good record. Mr. Watford also testified about the late responses. He stated that in five of the eleven cases Aloha contends that it was not late in providing a response. In one particular case he stated that Aloha has a facsimile confirmation that it did in fact file a response on the due date. Aloha then sent a confirmation the next day. This

second submission was apparently and incorrectly logged in as Aloha's response. (TR 1349-1360)

In four other cases Mr. Watford contends that the complaint was sent to Aloha's old fax number after it had moved to its new offices. After finding out about the complaints Aloha asked that the complaints be resent to the new number. In each of these cases Aloha contends they filed a response in less than the normal 15 days. In at least three of the alleged late response cases, Aloha contends that the Commission's facsimile machine failed to accept a faxed response so it was sent by mail on the due date. Based on these explanations, Mr. Watford testified that he believed there were zero late responses that were not justified. (TR 1349-1360)

Witness Watford testified that because witness Durbin did not review the other utilities cited as comparable to Aloha to determine if they were involved in rate proceedings during the time analyzed, that Mr. Durbin's testimony was flawed. Also, no attempt was made to segregate water complaints from sewer complaints and the period of time chosen for analysis was questionable. For these reasons he believed that Mr. Durbin's analysis was not a fair representation of Aloha's customer complaint level. Witness Watford also cited the Commission's management audit which stated that Aloha's customers are generally satisfied with Aloha's customer service. (TR 1349-1360)

The question of how much water the customers were using to flush the black water out of their lines was addressed in OPC witness Bidy's testimony concerning the water use projections. Mr. Bidy stated that the use of water to flush the black water out of the lines tends to skew the water use upward. (TR 772-773) Utility witness Porter testified that a worse case scenario for water use for home-line flushing would be 8.5 gallons per day. He stated this was very small relative to the 500 gallons per day consumption rate used. Also, since the number of customers reporting black water is small relative to all of the customers in the subdivisions used in the water use projections, the effect of the home-flushing becomes negligible. (Tr 1273-1274)

Staff agrees with the customers that the black water problem is a real problem, and that something needs to be done to correct it. While the water quality provided meets the DEP standards at the meter, the presence of hydrogen sulfide in the raw water being converted to sulfates, and back into sulfides, is not acceptable in

that this conversion is one of the factors leading to the creation of copper sulfide in the customers water. It is this copper sulfide that is the black substance in the black water. Also, regardless of Aloha's compliance with DEP's Lead and Copper Rule, it is apparent that a significant number of Aloha customers are experiencing corrosion in their service piping which leads to copper, in the form of copper sulfide, being in the water they receive in their home.

Staff notes that a number of customers complained about Aloha's attitude in dealing with customers. The complaints included statements that identified the utility as arrogant, egotistical, prima donnas, very rude and unresponsive.

Based on the customer testimony, a significant portion of the customers are clearly dissatisfied with Aloha's overall quality of service and have been for some time. Therefore, staff recommends that Aloha's customer satisfaction be considered unsatisfactory.

Aloha's black water complaints and its violation of the consumptive use permit have been long-term, on-going problems. (TR 15 & 557) In the issue of black water, staff believes that Aloha should have been more proactive in their pursuit of a solution. Any actions that Aloha has taken have come only at the requirement of government agencies.

Staff does not believe that Aloha has demonstrated that it is providing good customer service. While staff does not agree with the position of OPC and Intervener Wood that the quality of product is unsatisfactory, staff agrees that customer service is unsatisfactory.

Staff recommends that due to Aloha's long-term problems with black water and other water quality complaints, long-term violation of its consumptive use permit, its lack of a proactive approach to finding acceptable solutions to these problems, and the customer complaints about the attitude of the utility, the overall quality of service of Aloha Utilities be considered unsatisfactory. Possible remedies to this unsatisfactory quality of service are discussed in Issue 2.



**ISSUE 2:** Should the utility's rate increase request be denied due to poor quality of service?

**RECOMMENDATION:** No. The utility's rates should be set so as to give it the opportunity to earn within the minimum of its authorized rate of return in accordance with the holding in Gulf Power v. Wilson, 597 So. 2d 270 (Fla. 1992). However, because of the dissatisfaction of the customers with the poor quality of the water service and the treatment that they receive from the utility in response to customer complaints, the rates should be set using the minimum of the range of return on equity. Also, to reflect the poor management of this utility, the salaries of both the President and Vice-President should be reduced by 50% as set forth in the staff analysis below. The utility should also be ordered to make improvements beginning with Wells 8 and 9 and then to all of its wells to implement a treatment process designed to remove at least 98% of the hydrogen sulfide in the raw water. Such improvements to all of Aloha's wells should be placed into service by no later than December 31, 2003. Moreover, Aloha should submit a plan within 90 days of the date of the Final Order in this docket showing how it intends to comply with the above-noted requirements for the removal of hydrogen sulfide. Finally, Aloha should implement the 5 customer service measures addressed below in the staff analysis within 120 days from the date of the Final Order. (JAEGER, WETHERINGTON, DEMELLO, P. JOHNSON, MERCHANT)

**POSITION OF THE PARTIES**

**ALOHA:** No. There is no factual basis in the record to support a finding of poor quality of service, much less a legal basis for denying rate relief due to poor quality of service.

**SWFWMD:** No, even if the Commission finds that the utility is providing poor quality of service to its customers, a rate increase would support the District's ongoing efforts regarding water supply planning and resource protection. Interagency cooperation of this sort should be encouraged.

**OPC:** Yes. Regulation should simulate the results of competition. If Aloha were forced to compete for business, it would not be able to raise prices for the quality of service it provides.

**WOOD:** Yes. The Utility should be denied this increase and all subsequent increases until they can deliver a product that is

considered satisfactory to the customer. It should be a product that the customer would buy in the open market.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** Both Mr. Wood and OPC argue that the utility's entire rate request should be denied due to poor quality of service. OPC specifically argues that, similar to Dr. Kurien's recommended adoption of a community standard or a common sense standard, the Commission should adopt a competitive standard for service. (TR 665) Mr. Larkin believes that Aloha's water quality and service would fail this standard, and states:

The competitive principle requiring that regulation be a substitute for competition would view both price and service from a competitive standpoint. If the provision of water services were a competitive product, and the customers of the Seven Springs Water Division of the Aloha Utility had a choice, they would clearly reject to deal with Aloha because of the poor quality of the water service provided. Aloha's water quality would not meet a competitive standard, and in a competitive environment would be rejected by customers. (TR 666)

OPC argues further that in exchange for taking away the customers' right to choose or have this freedom of the market, Florida laws impose a regulatory framework that acts as a surrogate for the open market. Mr. Larkin testifies that "since the customer choice is removed, a strong regulatory process is the only thing that remains to keep the supplier 'honest.'" (TR 667)

OPC claims that, based on this high level of customer dissatisfaction: "If Aloha faced any competition, it would lose customers in droves - even at the current rates. At this level of disapproval with its product, if a competitive enterprise were to actually be brazen enough to increase prices, it would assure a mass exodus of its customers." (TR 668)

Under this competitive standard, OPC states that the expenditures that Aloha is seeking to recover would not be considered to be just or reasonable. OPC states that Aloha has turned "competitive reality on its head," and that Aloha first wants an increase in rates, and only then will it improve its product to a level acceptable to its customers. Mr. Larkin

testifies that, as in a competitive market, ". . . Aloha should first be required to demonstrate a product acceptable to customers, and then be considered for increased rates." (TR 668)

In his testimony, OPC witness Larkin cites the text of James C. Bonbright's *Principles of Public Utility Rates*, as follows:

Regulation, it is said, is a substitute for competition. Hence its objective should be to compel a regulated enterprise, despite its possession of complete or partial monopoly, to charge rates approximating those which it would charge if free from regulation but subject to the market forces of competition. In short, regulation should be not only a substitute for competition, but a closely imitative substitute.<sup>1</sup>

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<sup>1</sup>Public Utility Rates, Columbia University Press, Copyright 1961, p. 93.

OPC concludes its argument against granting any increase in rates by stating:

Aloha's customers should not be required to pay higher prices for Aloha's inferior product. The protections of the regulatory process should not be a one-way street. The regulatory process protects Aloha from facing any competition; the regulatory process should also protect Aloha's customers from paying higher prices for an inferior product.

Mr. Wood echoes this argument and argues that:

The utility should be denied this increase and all subsequent increases until they can deliver a product that is considered satisfactory to the customer. It should be a product that the customer would buy in the open market.

In responding to this "competitive service standard" for the provision of water service, Aloha cites Section 367.081, Florida Statutes, and states that it is "the Commission's responsibility to set just and reasonable rates . . . ." Moreover, Aloha asserts that "Mr. Larkin could not, or would not, provide any quantitative or other defined basis upon which the Commission could apply his

standard for judging a Utility's level of service." (TR 683, 688). Aloha argues that Mr. Larkin admitted that he had done no analysis to determine the level of customer satisfaction for the customer base as a whole (TR 676); that he had done no analysis of the quality of water provided by the utility (TR 676); and that he based his contention that the utility provided service below a 'competitive standard' solely on the basis of the customer complaints of less than 1/10th of 1% of the utility's customers, which he witnessed testify at hearings in this and the prior wastewater rate case (TR 677) . . . that there was no statute or rule that authorized the Commission to deny a rate increase based upon this undefined standard and that he knew of no cases where such a standard had previously been applied. (TR 675)

Based upon the above, Aloha argues in its Post-Hearing Brief that:

Mr. Larkin's proposal must be rejected, not only because it is wholly undefined and unclear and based upon only anecdotal and very limited evidence, but also because it is clearly contrary to law and the Commission's responsibility to set just and reasonable rates under the provisions of Section 367.081, Florida Statutes and the underlining [sic] rules of the Commission.

In its Post-Hearing Statement, SWFWMD took the position that:

Even if the Commission finds the utility is providing poor quality of service to its customers, a rate increase would support the District's ongoing effort regarding water supply planning and resource protection. Interagency cooperation of this sort should be encouraged. (TR 566-567, 1081-1083, 1127-1128)

In reviewing the testimony and briefs submitted by the parties, staff notes that none of the parties cite any case law whatsoever. Pursuant to Section 367.111(2), Florida Statutes, a public utility must provide:

such safe, efficient, and sufficient service as is prescribed by part VI of Chapter 403 and parts I and II of chapter 373, or rules adopted pursuant thereto; but such service shall not be less safe, less efficient, or less sufficient than is consistent with the approved

engineering design of the system and the reasonable and proper operation of the utility in the public interest. If the Commission finds that a utility has failed to provide its customers with water or wastewater service that meets the standards promulgated by the Department of Environmental Protection or the water management districts, the commission may reduce the utility's return on equity until the standards are met.

While staff believes that the service provided by Aloha meets the standards, there is some question as to whether the way that Aloha operates its system is in the public interest. In addition, Section 367.081(2)(a)1., Florida Statutes, provides that the Commission shall "fix rates which are just, reasonable, compensatory, and not unfairly discriminatory," and in every such proceeding, the Commission "shall consider the value and quality of the service and the cost of providing the service." (Emphasis supplied)

Although OPC witness Larkin proposes that the Commission adopt what he calls a "competitive standard," staff believes that this is the same question that the Commission has faced many times before, i.e., may the Commission deny what would otherwise be a warranted increase in rates due to either inadequate or inefficient service. The starting point is the principle set forth in the case of Bluefield Co. v. Public Service Commission, 262 U.S. 679 (1923). In that case, the United States Supreme Court held:

The just compensation safeguarded to the utility by the Fourteenth Amendment is a reasonable return on the property used at the time that it is being used for the public service. And rates not sufficient to yield that return are confiscatory.

Bluefield at 692.

However, there are limitations and caveats associated with this principle, and the Commission has on several occasions reduced a utility's return on equity or denied a rate increase for mismanagement or inefficient service. For instance, in Gulf Power v. Wilson, 597 So. 2d 270 (Fla. 1992), the Commission reduced Gulf Power's return on equity by 50 basis points from the midpoint of the approved range because of a finding of utility mismanagement. However, even with the reduction, the return was still well within

the authorized range. The utility had argued that this reduction was an unauthorized penalty and was in contravention of the holdings in Florida Tel. Corp. v. Carter, 70 So. 2d 508 (Fla. 1954), and Deltona Corp. v. Mayo, 342 So. 2d 510 (Fla. 1977). The Supreme Court disagreed and noted that this reduction was neither a penalty nor confiscatory, but was merely a recognition of management inefficiency. The Court noted that in both Carter and Mayo the Commission had improperly attempted to deny rates such that the rate of return was "well below the range found by the Commission as being fair and reasonable," and that this was not the case in Gulf Power. Gulf Power at 273.

According to the Florida Supreme Court, "it is well established that all a regulated public utility is entitled to is 'an opportunity to earn a fair or reasonable rate of return on its invested capital.'" Gulf Power at 273, citing United Tel. Co. v. Mann, 403 So. 2d 962, 966 (Fla. 1981)."

Under Florida law, however, "the public should not be compelled to pay increased rates because of an inefficient system." North Florida Water Company v. Bevis, 302 So. 2d 129, 130 (Fla. 1974). In the North Florida case, the Commission had found that the system contained leaks, that 34.4% of the water pumped was unaccounted for, and that a significant number of meters were stalled and not recording, which led the Commission to deny the requested rate increase. The Florida Supreme Court upheld the Commission's decision to deny a rate increase and concluded:

The fixing of public utility rates necessarily involves a balancing of the public's interest in withholding rate relief because of inadequate service and the utility's interest in obtaining rate increases to finance its necessary service improvement program. The Commission in the instant case found the former interest to be predominant. From our examination of the record, we find the Commission order to be supported by competent substantial evidence.

North Florida at 130.

In making this decision, the Court relied on United Telephone Company of Florida v. Mayo, 215 So. 2d 609 (Fla. 1968), which held that while Section 366.041, Florida Statutes, provides that no public utility shall be denied a reasonable rate of return, it in

no manner compels the Commission to grant a rate increase where the applicant's existing service is shown to be inefficient.

In United Telephone, the utility sought review of a Commission order that withheld approval of a rate increase until the utility completed its plans for improvements. The Court held that Section 366.041, Florida Statutes, plainly authorized the Commission to withhold approval of a rate increase. At the time, Section 366.041, Florida Statutes (1967), provided:

In fixing the just, reasonable, and compensatory rates, charges, fares, tolls, or rentals to be observed and charged for service within the state of Florida by any and all public utilities under its jurisdiction, the Florida Public Service Commission is authorized to give consideration, among other things, to the efficiency, sufficiency, and adequacy of the facilities provided and the services rendered, the value of such service to the public, and the ability of the utility to improve such service and facilities; provided that no public utility shall be denied a reasonable rate of return upon its rate base in any order entered pursuant to such proceedings

. . . .

United Telephone at 609. The current ratemaking statute for water and wastewater utilities, Section 367.081(2)(a)1., Florida Statutes, is very similar to the statute quoted above.

The utility had also challenged Section 366.041, Florida Statutes, on constitutional grounds, asserting that the statute deprived the utility of property, namely the rate increase, without due process of law. Disagreeing with the utility, the Court held "that the Commission's order is authorized by statute, and the statute was not shown beyond a reasonable doubt to be invalid." United Telephone at 610.

The petitioners in United Telephone had also argued that the law was settled in Carter, whereby the Commission had determined that an 18.359 percent increase was warranted, but that a penalty reduction of approximately twenty-five percent was fair and reasonable in view of inadequate and inefficient service being rendered by the utility. In Carter, the Florida Supreme Court held that the Commission could not authorize an increase in rates and at the same time assess a penalty for inadequate service. In United

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Telephone, the Florida Supreme Court noted that Section 366.041, Florida Statutes, was enacted subsequent to the Carter decision, and "for ought we know, was intended to overcome the decision." United Telephone at 610.

Subsequent to the holdings in North Florida and United Telephone, finding problems with record keeping, operations and unsatisfactory service (which required correction), for systems owned by General Development Utilities, Inc. (GDU), the Commission denied GDU's request for rate relief by Order No. 7407, issued August 27, 1976, in Docket No. 750769-WS. Relying on the decisions in United Telephone and North Florida, the Commission denied a request for reconsideration by GDU. See Order No. 7737, issued April 5, 1977, in Docket No. 750769-WS.

In Order No. 6750, issued June 26, 1975, in Docket No. R-74736-S, the Commission also denied Central Brevard Utilities Corporation's request for a rate increase stating that:

The utility has not acted in good faith with this Commission or the public they serve, by ignoring the requirements of sewage treatment imposed by Florida law. In view of the inefficiency of their system, the application for a rate increase to Central Brevard Utilities Corporation is hereby denied. (Emphasis added)

In Order No. 6750, the Commission specifically found that Central Brevard Utilities was:

not complying with the requirements of Chapter 17-4, Florida Administrative Code, for sewer systems and that the customers should not be required to pay an increase in rates to a utility that is not providing service as required by Florida law. Central Brevard Utilities Corporation has not met the sewage treatment standards as required by Florida Statutes for a period of eight (8) years. The utility has not made reasonable efforts to upgrade its operation to meet state standards for sewage treatment.

Notwithstanding the above noted case, staff believes that the holding of the Florida Supreme Court in Gulf Power is controlling. In that case, the Florida Supreme Court stated:



Accordingly, we find that the Commission's adjustment of Gulf Power's rate of return within the fair rate of return range falls within those powers expressly granted by statute or by necessary implication. City of Cape Coral v. GAC Utilities, 281 So. 2d 493 (Fla. 1973). This Court has previously recognized that this authority includes the discretion to reward, within the reasonable rate of return range, for management efficiency. In fact, Gulf Power has in the past received a ten basis point reward for efficient management through its energy conservation efforts. Gulf Power Company v. Cresse, 410 So. 2d 492 (Fla. 1982). We find that, inherent in the authority to adjust for management efficiency is the authority to reduce the rate of return for mismanagement, as long as the resulting rate of return falls within the reasonable range set by the Commission.

Gulf Power at 273.

In this case, the evidence shows that Aloha treats its customers poorly and has made slow progress towards finding a solution for the "black water" problem. Moreover, the evidence does not show that the utility has aggressively sought alternate sources of water. Its efforts appear to have been limited to seeking an increase in its water use permits (or attempting to have other WUPs transferred to them), use of reuse, some conservation measures, and interconnecting with the county. (TR 564, 1369) Aloha should have begun seeking alternate sources of water prior to its consistently exceeding the limits of its water use in 1996. (TR 557, 1253) Moreover, the utility specifically met with SWFWMD to address the noncompliance in May of 1997, and other than interconnecting with the county, has secured no alternate source of water which might have proved to be more cost effective. (TR 563)

It is undisputed that Aloha did initially begin the anti-corrosion program as required by DEP and that it is now again below the action levels for DEP's Lead and Copper Rule. Also, Aloha has complied with the requirement of this Commission to immediately implement a pilot project using the best available treatment alternative to remove the hydrogen sulfide, thereby enhancing the water quality and diminishing the tendency of the water to produce copper sulfide in the customers' homes. See Order No. PSC-00-1628-FOF-WS, issued September 12, 2000, in Docket No. 960545-WS. However, the evidence shows that for a significant number of

customers, the "black water" problem has continued to persist since at least 1996, if not before. (TR 11-194, 261-347)

For those customers experiencing "black water," the only absolute "fix" appears to be repiping with CPVC. (TR 218-219) However, another possible solution is the removal of almost all hydrogen sulfide which appears to be an expensive proposition. (TR 17, 796-799)

While the utility has proceeded with the pilot project as ordered by the Commission and has provided monthly reports as required, the pilot project has lasted for over 18 months, and the record shows that there has been little progression since July 2001. (TR 790) Moreover, the utility states that it is just now ready to begin the final stage of the pilot project, and that the final stage is projected to last anywhere from six to twelve months. (TR 1317) The need for alternate sources to increase the utility's water supply and the possibility that Pasco County may adopt a chloramine process have complicated the utility's search for a process that will correct the "black water" problem and remove hydrogen sulfide from the water. Regardless, staff believes that it is past time for Aloha to take decisive action.

Based on all the above, and considering the value and quality of the service, staff recommends that the utility's rates be set so as to give it the opportunity to earn the minimum of its authorized rate of return in accordance with the holding in Gulf Power. However, because of the dissatisfaction of the customers both because of the poor quality of the water service and the treatment that they receive from the utility in regards to their complaints and inquiries, the rates should be set using the minimum of the range of return on equity. This recommendation is also consistent with past Commission decisions in this regard. See Order No. 14931, issued September 11, 1985, in Docket No. 840267-WS, Order No. 17760, issued June 28, 1987, in Docket No. 850646-SU, Order No. 24643, issued June 10, 1991, in Docket No. 910276-WS, and Order No. PSC-96-1320-FOF-WS, issued October 30, 1996, in Docket No. 950495-WS.

Also, staff believes the continuing problems with "black water" over at least the last six years, the customers dissatisfaction with the way they are being treated and the service they receive from the utility, and the failure of the utility to aggressively and timely seek alternate sources of water supply

reflect poor management of this utility. Based on this poor management and mismanagement, staff recommends that the salaries and benefits of both the President and Vice-President should be reduced by 50%. Based on this adjustment, and noting Stipulation No. 13 (double counting of one employee's salary), the adjustment to officers' salaries is a reduction of \$28,969, and the total reduction to benefits is \$6,402. This is consistent with Commission actions taken in: Order No. 23573, issued October 3, 1990, in Docket No. 891345-EI; Order No. PSC-93-0295-FOF-WS, issued February 24, 1993, in Docket No. 910637-WS, Order No. PSC-01-1162-PAA-WU, issued May 22, 2001, in Docket No. 001118-WU; and Order No. PSC-01-1988-PAA-WU, issued October 8, 2001, in Docket No. 001682-WU. In Order No. PSC-01-1162-PAA-WU, the Commission specifically stated:

In past cases, we have found it appropriate to reduce the president's salary based on poor quality of service and the performance by management. Specifically, in Order No. PSC-93-0295-FOF-WS, issued February 24, 1993, in Docket No. 910637-WS, we found that it was appropriate to reduce the salary of Mad Hatter Utility Inc.'s (MHU) president because of the concerns with MHU's overall quality of service and the performance of its management. We found in Order No. PSC-93-0295-FOF-WS that reducing the salary of the utility's president would have a direct and immediate impact equal to or greater than a reduction to the return on equity. We further found that it sends the proper signal to management to make improvements, and that it is management, specifically the president, who is ultimately responsible for the conduct of the corporate entity, and who should be held accountable.

Staff further notes that DEP witness Foster testified that Pasco County had a hydrogen sulfide problem in its water and installed a treatment system to deal with it. According to witness Foster, he has never seen a problem with black water in the county. (TR 382) Staff believes that if Aloha had committed themselves to a more proactive approach to this problem, it possibly could have prevented this black water situation from becoming as bad as it is or possibly eliminating it entirely.

As an initial step to combat the "black water" problem, staff notes that shortly after Wells Nos. 8 and 9 were placed into service in late 1995, the complaints on "black water" sky-rocketed.

OPC witness Bidy suspects that Wells Nos. 8 and 9 have hydrogen sulfide spikes. (TR 805-808) Also, those wells are the closest to the subdivisions experiencing the worst "black water" problems. (TR 168, EX. 4) Although Aloha's Seven Springs water system is totally interconnected, staff believes that any solution to the "black water" problem must begin with Wells Nos. 8 and 9.

By Order No. PSC-00-1285-FOF-WS, the Commission required Aloha to immediately implement a pilot project using the best available treatment alternative to enhance the water quality and to diminish the tendency of the water to produce copper sulfide in the customers' homes.

Based on all the above, staff recommends that the utility be ordered to make improvements starting with Wells Nos. 8 and 9 and then to all of its wells to implement a treatment process designed to remove at least 98% of the hydrogen sulfide in the raw water. Such improvements to all of the utility's wells should be placed into service by no later than December 31, 2003. Moreover, Aloha should be required to submit a plan within 90 days of the date of the Final Order in this docket showing how it intends to comply with the above-noted requirements for the removal of hydrogen sulfide.

To address the other concerns regarding Aloha's relationship with its customers, staff recommends that the company should be required to implement additional customer service measures. The foundation for any effective business to customer relationship is communication. As a preponderance of evidence suggests, Aloha needs to improve its customer relations. Staff believes the following 5 measures will allow the utility to accomplish this directive and establish better communications with its customers.

#### 1) The Transfer Connect Program

The Public Service Commission strives to resolve disputes between regulated companies and their customers in an efficient and effective manner. Staff recommends that Aloha participate in the Transfer Connect Program, a low-cost optional program that allows each participating company to provide a toll-free telephone number by which the PSC may directly transfer a consumer for assistance. When the transfer is complete, any further charges for the call are the responsibility of the company, and not the PSC or the consumers. Each company subscribing to the Transfer Connect

Program must provide consumer assistance personnel to handle transferred calls during the company's normal business hours (i.e., a "live" customer service representative). At a minimum, Aloha would have to have personnel available from Monday through Friday, 9 a.m. to 4 p.m., Eastern Standard Time, excluding holidays observed by the company.

There are 18 companies currently participating in the Transfer Connect Program. The participants are: Florida Power & Light, BellSouth, Florida Power Corporation, Florida Water Services, Sprint-Florida, Sprint-Long Distance, Verizon, Tampa Electric Company, Excel Communications, NOS Communications, Intermedia Communications, MCI WorldCom, USA Telecorp., Billing Concepts, AT&T (Residential and Slamming), Supra Telecommunications, Gulf Power Company, and OLS. According to PSC statistics, the Commission is transferring about 1,000 calls per month to participating companies.

During the 2000-2001 fiscal year, 14 percent of the more than 67,000 total calls answered via the Commission's 800 toll-free answer line were transferred directly to the utilities. There were 1,423 cases resolved in this manner by the Telecommunications Industry, 578 cases by the Electric Industry, and 20 by the Water and Wastewater Industry. Staff maintains that Aloha would better serve its customers by using this service because customers would have the opportunity to have their problems quickly addressed by the company.

According to companies who have recently signed up to be on the Commission's Call Transfer program, Aloha may incur the following costs, which appear to be immaterial for a company such as Aloha:

Installation - \$0.00  
Monthly Rate - \$20.00  
Per Minute Charge - \$.216

## 2) Customer Service Improvements

Aloha's customers perceive that Aloha is not committed to quality customer service. OPC Witness Nowack states, "[t]his kind of consumer relationship is not what you would call good. Florida Power, there's no problem. Verizon, there's no problem. Anybody else, there's never a problem, but Aloha Utilities hates their

customers." (TR 299) Further, OPC Witness Stingo states, "Aloha does not care about the customer." (TR 62) To improve Aloha's customer relations, staff recommends that Aloha focus on providing good customer service. OPC Witness Depergola states, "I'm a businessman. I treat my customers with white gloves. I go the extra mile for my customers. I am a tailor by trade. I make sure that my customers are served properly, honestly, and on top of that, I stayed in business with recommendations. All I hear tonight, disappointment from Aloha customers, nothing but sad stories from decent people." (TR 314-315)

In response to general customer concerns, staff recommends that Aloha offer service guarantees to its customers. In addition, staff recommends that the utility improve its customer service procedures and make it easy for customers to gain access to the utility's complaint-handling system. Some examples for consideration are listed below:

A. Aloha should supervise and train its employees to be courteous, considerate and efficient at all times in their contact and dealings with its subscribers and the public in general and should make checks from time to time to insure that courteous service is actually being rendered. The utility should also implement cross training and internal customer service programs, as well as essential customer skills training, such as "telephone courtesy," "listening skills," and "how to communicate caring." In addition, Aloha should prepare a manual for customer service, which should be used regularly in order to ensure consistency in Aloha employees' dealings with customers.

B. Aloha should implement a program which places automatic credits on a customer's bill if the company fails to meet established timeliness standards for making repairs or installing service. These expenses should be accounted on Aloha's books below the line so that the general body of ratepayers will not have to reimburse Aloha for its failure to provide timely service. Aloha should file revised tariff sheets to include the following credit possibilities:

Require the company to put a \$15 credit on the bill every time an appointment is missed.

Require the company to issue a credit of \$15 to a consumer if an out of service repair exceeds 24 hours.

Require the company to issue a \$15 credit if service is not reconnected within 12 hours of receipt of customer payment.

C. Aloha should implement a multitude of standards covering its customer service and operational activities and maintain an effective system for measuring performance against those standards. The standard should be discrete, that is, relatively narrow in scope and confined to measurable service features, particularly through the company's automated (Interactive Voice Response) telephone system.

Some examples of standards should include but not be limited to:

- \* Process and handle all customer complaints within 5 days of receipt.
- \* Keep busy signals below 5 percent of incoming calls.
- \* Maintain hold or wait time at less than 1 minute.
- \* Voicemail: Return all internal and external calls within 8 working hours.

### 3) Customer Billing Improvements

Commission staff has taken complaints from Aloha customers who could not decipher their monthly bills. For example, OPC Witness Nowack states, "[b]ut my big beef with Aloha is, they can't consistently bill me for any particular time. I've been fighting with them for three or four years now, and they will read a meter, and it will have the same amount at the beginning and at the end." (TR 295-296). In order to reduce customer confusion on Aloha's monthly bills, staff recommends that Aloha be required to develop a more clear billing format for its customers.

Rule 25-30.335 (1), Florida Administrative Code, Customer Billing, states:

Except as provided in this rule, a utility shall render bills to customers at regular intervals, and each bill shall indicate: the billing period covered; the applicable rate schedule; beginning and ending meter reading; the amount of the bill; the delinquent date or the date after which the bill becomes past due; and any authorized late payment charge.

Based on staff's evaluation, Aloha's bill could be interpreted to be in compliance with the above rule. However, the current billing format does not include the applicable rates for water and wastewater charges, nor does it clearly break out the difference between the prior balance and any amounts past due. Staff recommends that Aloha redesign its current bill to include water, wastewater, and miscellaneous charges when applicable. Florida Water Services, Inc. currently provides this billing detail on its water and wastewater monthly bills. Also, staff recommends that Aloha redesign its current bill to reflect an accurate previous balance and any payments received (and the date received). For example:

Previous Balance	\$ XX.XX
Payment Received on DATE	XX.XXCR
Outstanding Balance	.00
Water Base Facility Charge	\$ X.XX
Gallonge Charge (XXXX Gallons @ .XXXXXX)	\$ XX.XX
Total Water	\$ XX.XX
Wastewater Base Facility Charge	\$ X.XX
Gallonge Charge (XXXX Gallons @ .XXXXXX)	\$ XX.XX
Total Wastewater	\$ XX.XX
Non-jurisdictional Charges	
Garbage	\$ XX.XX
Street Lighting	\$ XX.XX
Total Current Charges Due by Date	\$ XX.XX

Staff notes that Aloha's tariff does not contain a copy of the current bill. The example bill shown in the tariff was last revised in 1978. Aloha should be required to file a revised tariff that reflects the current bill within 30 days of the issuance of the Final Order in this docket. Also, Aloha should have its billing format changed along with revised tariff sheets reflecting this change within 120 days of the issuance of the Final Order in this docket.

In addition, staff recommends that Aloha provide payment options for its customers, which may include: 1) preauthorized direct debit; and 2) payment connectivity over the Internet between online customers and the utility. Preauthorized direct debit involves a customer having the payment taken directly from a checking or savings account each month. Aloha Witness Watford



mentioned this option during his testimony. (TR 551, 552). For payments via the Internet, Aloha could choose a payment processing network that allows its Web site to support multiple payment types. Many software programs today can be customized to integrate with a company's existing Web site.

#### 4) Citizens' Advisory Committee (CAC)

Staff recommends that Aloha be required to form a Citizens' Advisory Committee (CAC), a concept that was discussed during the customer testimony at the January 9, 2002 hearing. Many organizations form advisory committees to generate recommendations and provide ideas about issues facing the organization. Advisory Committees also provide opportunities for an agency to ensure that the many diverse interests of its customer base are represented on an ongoing basis. The primary purpose of the Aloha CAC would be to serve as a special communication link between Aloha customers and the utility. In addition, the CAC would allow Aloha to receive constructive input from customer representatives about any issues deemed relevant by any party, thus enabling Aloha to better understand the desires of its customers and to work toward more compatible solutions.

The committee would be comprised of 15-20 citizens representing a cross section of individual customers and various homeowners' associations in Aloha's territory who have interests and concerns about the utility's ongoing customer service. Members would probably serve two-year terms. The CAC would be formed to assist Aloha in making critical decisions that impact the level of service provided to the community. The group would research, study, and discuss specific issues with both short and long-term implications, forwarding their recommendations to Aloha. The president of Aloha and/or his designee would attend all meetings.

CAC meetings would be open to the public, and any Aloha customer could attend or contact a member to pass along any concerns, questions, comments, etc. In addition, notification of the advisory committee meetings would be made in Aloha's existing newsletter and/or other publications. The CAC would meet, at a minimum, once a month, and the meetings would be scheduled at the convenience of the committee. The CAC would provide a mechanism for citizen involvement, and its activities would be promoted through the publication of reports published in Aloha's current newsletter and on Aloha's Web site. The CAC would also conduct

citizen meetings in each of the target areas, meet with representatives of neighborhood organizations, disseminate information throughout Aloha's community, and go door-to-door to ensure that citizens are aware of the CAC activities.

Meeting summaries would be prepared after each meeting. Summaries would be available for citizen inspection. Key issues addressed during the advisory committee process would also be highlighted in the meeting notes. A CAC mailing list would be developed by members of the CAC and Aloha, and it would continue to evolve as new citizens and interested persons call to get on the mailing list.

In its initial meeting, the CAC would need to elect, at the very least, a chairman and a vice chairman. Both a chairman and a vice chair would be elected by a majority vote of the CAC members with a quorum present. The Executive Secretary of the CAC would be a designated Aloha staff person. The Executive Secretary would be responsible for recording the minutes of all CAC meetings, transmitting notices and agendas to the membership, and would transmit a copy of the minutes of each CAC meeting to each member prior to the next regular meeting. The Executive Secretary would also insure that consensus, majority, and dissenting views on all matters and issues were recorded, and, upon request, reported. He or she would also assist the subcommittees and task forces, as needed. *Robert's Rules of Order Newly Revised* would be the parliamentary authority for the conduct of meetings, except in cases where it might conflict with the bylaws to be adopted by the CAC. In addition, the CAC would adopt some guiding "principles" for conduct and actions at all future meetings. At the initial meeting, the CAC could begin formulating its mission statement, as well as its goals and objectives. At this meeting, the CAC and Aloha could place on the record items that each party considers appropriate for an Advisory Committee to discuss. The CAC could designate subcommittees to study issues of concern and present recommendations to the full CAC. Task forces could also be appointed to study or deal with issues that generally are of short duration and very specific in responsibility.

#### **5) Develop a Consumer-Friendly Web Site**

Internet Web sites are increasingly becoming accepted and used as a communications vehicle for businesses and organizations. The Internet provides a vehicle for reaching an information-oriented

segment of the residential market. During the customer hearing, Aloha's Witness Watford referenced the utility's proposed Web site in his testimony. (TR 530) The company's Web site would be a good source of information for Aloha customers. The site should be designed to offer customers an easy to follow format and the ability to file a complaint, comment on a company policy, or ask a question. Customers should also have access to all of Aloha's customer education materials and links to related Internet sites.

When designing and updating its Web activities, Aloha should consider the following factors which help to foster a customer's perception of a positive experience and promote a repeat visit and positive word-of-mouth publicity:

- \* Simplify online activities so that they are clear and easy to do with concise directions. As an example, if Aloha wants customers to e-mail the company, they need to be sure that they can do it from the Web site, as opposed to having to leave the site and then send an e-mail message.
- \* Organize the information presented within Aloha's Web site, so customers can easily find topics. A consumer interested in information about a company's conservation programs should not have to first wade through extraneous materials.
- \* Update information frequently. Nothing deters online visitors quicker than the perception that a Web site's primary contents are yesterday's news. At a minimum, Aloha needs to update its Web site and check for accuracy at least once a week.
- \* Include a feature that would offer customers a way to respond to special utility programs or services and also a way to suggest how to improve Aloha's customer service.
- \* Highlight items related to conservation issues, including links back to the water management districts' conservation information.
- \* Include a section of "frequently-asked customer questions" and a section offering water usage calculations.

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- \* Include a line item explanation of a sample customer bill.
- \* Include a link to the PSC's Web site, so customers would have the opportunity to file an online complaint with the Commission.

Aloha should be required to implement these 5 customer service measures within 120 days from the date of the Final Order.

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**ISSUE 3:** What is the appropriate cost of the Commission ordered pilot project to include in working capital for the Seven Springs water system?

**RECOMMENDATION:** The appropriate amount to include is \$54,270, which is the average cumulative balance of expenditures projected for the test year. This results in a \$135,730 decrease to the utility's requested amount of \$190,000. (MERCHANT, S. JONES)

**POSITION OF THE PARTIES**

**ALOHA:** Consistent with the Commission's actions in Order No. PSC-01-1347-PAA-WS, issued June 27, 2001, and Order No. PSC-01-2199-FOF-WS, issued November 13, 2001, and sound regulatory principals the Commission should recognize 50% of the estimated cost of the Commission ordered pilot project in rate setting.

**SWFWMD:** No position.

**OPC:** This project has essentially been suspended and the company has spent much less than projected. The average cumulative balance of expenditures projected for the test year of \$54,270 should be used instead of \$190,000. Therefore, working capital should be reduced by \$135,730.

**WOOD:** Nothing. The pilot project has never gotten off the ground. With one year of stumbling the project has attained the usual Aloha results, no progress toward solving the problem.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** In its MFRs, Aloha included a \$190,000 increase to working capital for the average estimated cost of pilot plant project recognized in Order No. PSC-01-1374-PAA-WS. (EXH 4, Volume I, page 3) This order, issued June 27, 2001, in Dockets Nos. 000737-WS and 010518-WS, finalized the overearnings investigation for the Aloha Gardens water and wastewater systems and the Seven Springs water system, and was based on the projected test year ended December 31, 2000.

By Order No. PSC-00-1285-FOF-WS, issued July 14, 2000, in Docket No. 960545-WS, the Commission had ordered Aloha to implement the pilot project to enhance water quality. In Order No. PSC-01-1374-PAA-WS, subsequent to the water quality docket, the

Commission stated that Aloha had submitted a cost estimate for the pilot project of \$380,000 in December 2000. The Commission found the estimate to be reasonable and allowed the average balance of \$190,000 to be included in working capital only. Because the pilot project was not yet completed, the Commission stated that the appropriate final treatment for these costs could be addressed in the upcoming rate case for this system (i.e., this docket).

OPC witness DeRonne testified that the pilot project, as discussed by OPC witness Bidy, has essentially been suspended and a final report has not yet been prepared by Aloha's engineer. According to Ms. DeRonne and Mr. Bidy the utility is apparently waiting until water supply issues are resolved prior to completing the pilot project. Ms. DeRonne states that based on Aloha's response to discovery, the actual balance Aloha spent and recorded on its general ledger as of August 2001 was \$74,746. In Exhibit 9 (DD-1), Schedule C-1, Ms. DeRonne provides the month-end balances in the pilot project account, along with the monthly increases in the balance. (TR 729-730)

Ms. DeRonne testified that since the actual amount spent to date is considerably lower than the projected cost of \$380,000, the balance included in working capital should be revised. She asserted that working capital should be based on the actual projected 13-month average balance for the 2001 test year, not 50% of the total projected amount to be spent. According to Ms. DeRonne, it is highly unlikely that the 13-month average test year balance would be \$190,000, particularly since Aloha essentially put the project on hold. (TR 730)

In calculating her projected test year average balance, Ms. DeRonne used the actual balances for December 2000 through August 2001. She then estimated the monthly additions for the remainder of the test year based on the average monthly expenditures for the first eight months of the year. Ms. DeRonne testified that this would probably overstate the actual amount spent given that the delay in the program might result in lower amounts being spent than projected during the last few months of the year. Her calculation of the 13-month average is also reflected on Schedule C-1 of Exhibit 9. Ms. DeRonne concludes that working capital should be reduced by \$135,730 to reflect a projected test year thirteen-month average balance of \$54,270. (TR 730-731)

On cross examination, Ms. DeRonne testified that the utility most likely will incur additional costs and she does not dispute the total projected costs. Her testimony is that in calculating its projected year working capital requirement, Aloha based its adjustment on the total estimated cost divided in two. What she has recommended is that the amount in the working capital calculation be based on the amounts that were actually incurred and reasonably projected in that 12-month period. Ms. DeRonne testified that she did not dispute how the utility recorded the asset on its books. Further, she did not believe that the Commission specifically prescribed the accounting treatment in the last overearnings investigation. The Commission just made that adjustment to calculate the rate base impact in that particular case. She was not saying that Aloha should never recover the costs of this pilot project. Her testimony was that the calculation of working capital in this case should be based on the actual amounts expended. (TR 759-762)

In his direct testimony, Mr. Bidy testified that in reviewing the progress of the pilot project, he obtained and studied copies of the monthly reports from Aloha. Exhibit 10, TLB-4, contains the reports for the months January through October 2001. Through these reports and other discovery Mr. Bidy stated he was able to analyze Aloha's actions in response to the Commission's order requiring the pilot project. Based on Aloha's reports concerning the pilot testing and the MIEX results, Mr. Bidy expected to see Mr. Porter's final report within a short time, including a design for the Aloha system and cost estimates for installation. However, Mr. Bidy testified that in the August 2001 report, Mr. Porter informed the Commission that "water supply issues have come up" and that "he has been looking into alternative water sources for the long term supply for Aloha." The August report also stated that Mr. Porter will complete a draft of the MIEX pilot trials report and review it with DEP prior to preparing the final report. Mr. Bidy stated that the September and October 2001 reports reiterate similar comments regarding the progress of the pilot project.

Mr. Bidy believed that in reading the pilot project reports in the beginning of 2001, he was encouraged that an economical solution for hydrogen sulfide removal may have been found. But when the July 2001 report suddenly reflected that "water supply issues have come up," Mr. Bidy was left with the impression that the water supply issue was of higher concern than finding a solution to the hydrogen sulfide or black water problem in Aloha's

wells. In summary, Mr. Bidy testified that he believed that Aloha's pilot testing reflected progress in solving the black water problem but that Aloha was delaying completion of the project until they solved the water supply problem. Thus, Aloha may have complied with the letter but not the spirit of the Commission's order, according to Mr. Bidy. As such, Aloha simply was stalling on this issue, as well as the issue of over pumping beyond their permit limit. (TR 783-790)

Aloha witness Nixon, in his rebuttal, testified that because the project was ordered by the Commission, and Aloha was allowed pro forma recovery of the carrying costs in the recent overearnings investigation, the Commission should be consistent with this regulatory treatment. He argues that Ms. DeRonne's suggestion that Aloha would receive a windfall if this amount were included in rate base is false. The inclusion of \$190,000 in working capital yields approximately \$16,500 in annual revenue compared to Aloha's actual out of pocket costs through August 2001 of approximately \$75,000. Thus, he states that it would take 4 1/2 years to recover the costs incurred through August 2001, which is hardly a windfall for the utility.

Mr. Nixon stated that Ms. DeRonne does not provide any explanation or justification for her elimination of this pro forma adjustment. He suggested that she was just influenced by the testimony of OPC witness Bidy, who believed that the project is substantially complete, or she believed that the total project cost of \$380,000 should have been substantially incurred by now. However, staff notes that Mr. Nixon does not address Ms. DeRonne's projection methodology. (TR 1176-1177)

Aloha witness Porter disagreed with Ms. DeRonne's testimony that an adjustment to working capital is necessary because the pilot project has been "put on hold and delayed by the Company." In his rebuttal, he stated that she has incorrectly characterized the status of the pilot project. Mr. Porter stated that the pilot project is moving ahead and has not been but on hold in any way. He testified that he is still working with the MIEX representatives in developing the next stage in the pilot process, the demonstration scale facility. Shortly before Mr. Porter filed his rebuttal testimony, he received and reviewed a proposal from the MIEX representatives related to the next phase. He also had discussions with MIEX representatives and Aloha to move ahead with the demonstration facility in early 2002 if everything could be



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arranged by that time. Mr. Porter concluded that no working capital adjustment is justified. (TR 1287-1288)

Upon cross examination by staff, Mr. Porter testified that the demonstration facility for the MIEX process may cost between \$200,000 and \$300,000, but he could not be exact. Further, these costs would be a combination of plant and operating costs. (TR 1314-1324) Exhibit 27 contains Aloha's responses to staff's interrogatories 7 and 8 regarding the pilot project. This exhibit shows that Aloha believed that its original projection of \$380,000 is considerably understated because of the impact of purchased water from Pasco County regarding the cost and water chemistry and SWFWMD's requirement to perform a reverse osmosis (R/O) feasibility study. Exhibit 10 (TLB-4), contains copies of Aloha's pilot project reports submitted to the Commission for January 2001 to October 2001 and Exhibit 28 contains the November and December 2001 status reports. Based on staff's review of Exhibits 10 (TLB-4), 27 and 28, the record reflects that substantial incremental costs have not been incurred for the pilot project above those projected by Ms. DeRonne for the last several months of the test year.

Mr. Watford testified that Aloha has spent substantial amounts of money on this pilot testing of the MIEX treatment process in order to remove hydrogen sulfide. He added that it is now known that changes will occur in the coming years, both from the chemical makeup of water being provided by Pasco County and by the increased reliance on some other long-term water source. Mr. Watford stated that it would be imprudent to proceed with the next major phase of the pilot project without knowing more about possible impacts of the changes; however, the utility is still moving forward by accumulating data collected from the first phase of the pilot project. (TR 1362)

According to Mr. Watford, the suggestion by OPC that the pilot project is on hold or will cost less than the figure estimated and required to be recognized as working capital in the last proceeding is absurd. He added that Aloha expects to spend substantially more in the future than originally estimated especially including the cost of the R/O feasibility study. Further, Mr. Watford noted that Aloha accounted for the pilot project by including it in working capital exactly as ordered by the Commission in the recent overearnings investigation. Regardless, Mr. Watford contended that Aloha had no specific deadlines, pursued the pilot project with

due diligence and kept the Commission staff informed of its progress. (TR 1362-1364)

The main dispute regarding this issue is the timing of the estimated and actual costs incurred for the pilot project. OPC's witnesses contend that the MIEX project has slowed substantially, possibly to a halt, pending a solution for the water supply problems. Whereas, Aloha's witnesses testify that upcoming changes have caused the utility to modify its project to the point that the costs will increase higher than those originally estimated. While both arguments are supported by evidence in the record, staff believes that the issue itself is much simpler. The overriding issue is what is the projected 13-month balance of the pilot project costs that should be included in the working capital allowance. To be consistent with Aloha's projection methodology for all of its balance sheet accounts, this account should be based on the test year projected balance.

Aloha has relied upon the treatment and amount included in Order No. PSC-01-1374-PAA-WS for the amount to include in working capital for the pilot project. That amount was based on an estimate made during the overearnings investigation. At that point in time, December 2000, Aloha had not submitted its first report on the MIEX project. Further, Aloha's witnesses presume that the Commission's Order in the overearnings investigation mandated that Aloha account for the estimated costs in a certain way. However, the order clearly states: "because the results of the pilot project are not yet completed . . . the appropriate final treatment for these costs can be addressed in the upcoming rate case for this system." (Order at p. 8)

Staff believes that Aloha has misconstrued Ms. DeRonne's testimony as to why she made the adjustment. The record reflects that she made the adjustment to comply with the regulatory concept of a test year. She estimated what Aloha spent during the test year and Aloha did not dispute this testimony. Aloha wants the Commission to allow recovery for more money than a reasonable projection reflects that it spent as of the end of the test year. Staff agrees with Ms. DeRonne that to allow an additional amount just in case Aloha might spend more on the overall project cost does not represent what has actually happened during the test year or any reasonable time frame thereafter. Aloha had the opportunity to submit additional evidence to support its actual costs incurred through the end of the projected test year, but did not do so.

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Based on the above, staff recommends that Ms. DeRonne's estimate of \$54,270 for working capital for the Seven Springs water system is reasonable and should be allowed. This results in a decrease to the utility's requested amount of \$135,730.

**ISSUE 4:** What is the appropriate working capital allowance?

**RECOMMENDATION:** This issue is a fall-out of Issue 3 and the recommended amount of rate case expense. The appropriate working capital allowance for the utility's Seven Springs water system is \$446,284. (S. JONES)

**POSITION OF THE PARTIES**

**ALOHA:** The balance sheet approach to working capital. This is a fallout number which results from the conclusions reached on other issues.

**SWFWMD:** No position.

**OPC:** The working capital should be adjusted to reflect either the OPC position or the Staff position on Issue 3. The ultimate working capital amount depends on which position the Commission adopts on Issue 3.

**WOOD:** Adopts OPC's position.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** The utility used the balance sheet approach to calculate working capital. (EXH 4, Vol. I, Schedules Nos. A-17(A) and G-1, pages 21-22 and 108) The utility calculated total company working capital and allocated it to each of the utility's systems based on operation and maintenance (O&M) expenses. Aloha made specific adjustments to the working capital allowance for the Seven Springs water system for deferred pilot project costs of \$190,000 (addressed in Issue 3) and unamortized deferred rate case expense of \$223,250 (addressed in Issue 16). The utility's adjusted working capital for the Seven Springs water system for the projected test year is \$843,970.

As discussed in the case background, the Commission has approved two adjustments to Aloha's calculation of total company working capital that were stipulated by the parties. The first stipulation removed deferred rate case expense related to the prior Seven Springs wastewater rate case, Docket No. 991643-SU, as this was fully allocated to the wastewater system. The second adjustment reduced working capital by \$32,868 to reflect additional

amortization of the regulatory commission expense associated with Docket No. 960545-WS.

The remaining adjustments to working capital depend upon the Commission's decision in Issues 3 and 16 regarding the pilot project costs and current rate case expense, respectively. Based on staff's recommendation in Issue 3, the projected balance of the test year pilot project costs is \$54,270, resulting in a decrease of \$135,730. In Issue 16, staff recommends total rate case expense of \$205,208. Consistent with the methodology used by the utility, the average unamortized balance of total rate case expense should be added as a specific adjustment to the working capital for the Seven Springs water system. Thus, 50% or \$102,604, is the appropriate balance to include for the Seven Springs water system.

Below is staff's calculation of working capital for the total company and the Seven Springs allocated portion.

Working Capital - Balance Sheet Approach  
Projected 12/31/01 - 13 Month Average

<b>Total Company Working Capital Calculation</b>	Balance	Stipulated	Adjusted
<b>Current Assets:</b>	<u>Per Utility</u>	<u>Adjustments</u>	<u>Balance</u>
Cash	\$594,691	\$0	\$594,691
Petty Cash	400	0	400
Accounts Receivable -Trade	788,297	0	788,297
Allowance for Bad Debts	(6,900)	0	(6,900)
Prepayments	133,805	0	133,805
Loss on Plant Retirement	4,830	0	4,830
Deferred Rate Case Expense	5,309	(61,702)	(56,393)
Other Misc. Deferred Debits	<u>428,574</u>	<u>(32,868)</u>	<u>395,706</u>
<b>Total Current Assets &amp; Deferred Debits</b>	<u>\$1,949,006</u>	<u>(\$94,570)</u>	<u>\$1,854,436</u>
<b>Current Liabilities:</b>			
Accounts Payable	\$569,491	\$0	\$569,491
Accrued Taxes	384,160	0	384,160
Deferred Rate Case Expense	<u>0</u>	<u>0</u>	<u>0</u>
<b>Total Liabilities &amp; Deferred Credits</b>	<u>953,651</u>	<u>0</u>	<u>953,651</u>
<b>Total Company Working Capital</b>	<u>\$995,355</u>	<u>(\$94,570)</u>	<u>\$900,785</u>
<b><u>Allocation Methodology</u></b>	Adj. O&M	% to	Allocated
	Expenses	Total	Working Capital
Aloha Gardens Water	444,837	9.399%	84,666
Aloha Gardens Wastewater	862,062	18.215%	164,077
Seven Springs Water	1,520,561	32.129%	289,409
Seven Springs Wastewater	<u>1,905,275</u>	<u>40.257%</u>	<u>362,632</u>
<b>Total</b>	<u>\$4,732,735</u>	<u>100.000%</u>	<u>\$900,785</u>

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<b>Adjustments to Seven Springs Water</b>	<u>Amount Per Utility</u>	<u>Amount Per Staff</u>	<u>Staff Adjustment</u>
Seven Springs Allocated Portion	\$430,720	\$289,409	(\$141,311)
Specific Adjustments			
Pilot Project	190,000	54,270	(135,730)
Deferred Rate Case Expense (Avg Unamortized)	<u>223,250</u>	<u>102,604</u>	<u>(120,646)</u>
Total Adjustments	<u>413,250</u>	<u>156,874</u>	<u>(256,376)</u>
<b>Total Working Capital</b>	<u>\$843,970</u>	<u>\$446,284</u>	<u>(\$397,686)</u>

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**ISSUE 5:** What is the appropriate projected rate base?

**RECOMMENDATION:** The projected 13-month average rate base is \$1,382,168. (S. JONES)

**POSITION OF THE PARTIES**

**ALOHA:** This is a fallout number based upon the resolution of other issues.

**SWFWMD:** No position.

**OPC:** The appropriate amount is subject to the resolution of other issues. The final result will depend on the Commission's decisions on each of the specified rate base related issues.

**WOOD:** Adopts OPC's position.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** Based upon the utility's adjusted 13-month average test year balances, the approved stipulations and staff's recommended adjustments, the appropriate projected rate base for Aloha is \$1,382,168. Schedule 1-A reflects staff's recommended rate base calculation. Staff's proposed adjustments to rate base are depicted on Schedule 1-B.

**ISSUE 6:** Stipulated at hearing.

**ISSUE 7:** What is the appropriate projected weighted average cost of capital for the projected test year ending December 31, 2001?

**RECOMMENDATION:** The weighted average cost of capital should be 8.61%. This is based on a return on equity of 10.88%, which is the minimum of the newly established range of 10.88% to 12.88%. The cost of capital calculation also is based on Stipulations 7, 8, and 20, and stipulated Issue 6. (S. JONES)

**POSITION OF THE PARTIES**

**ALOHA:** This is a fallout number based upon resolution of other issues.

**SWFWMD:** No position.

**OPC:** This issue depends on the Commission's resolution to other issues that affect the weighted cost.

**WOOD:** Adopts OPC's position.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** The weighted average cost of capital should be 8.61%, with a range of 8.61% to 8.87%. This is based on a return on equity of 10.88%, which is the minimum of the newly established range of 10.88% to 12.88%. The reduction in the return on equity to the minimum of the range is addressed in Issue 2. This issue is also a fall-out of Stipulation 7 (annual amortization of issuing expense for the Bank of America loan), Stipulation 8 (the appropriate projected 13-month average balance of long-term debt); Stipulation 20 (use of current leverage formula); and Stipulated Issue 6 (cost rate for related party variable cost debt). Schedule 2 depicts staff's cost of capital calculation.



**ISSUE 8:** What are the appropriate number of gallons sold for the projected 2001 test year?

**RECOMMENDATION:** The appropriate number of gallons sold for the projected test year 2001 are 905,635,244 for residential service and 110,486,540 for general service, as shown in Exhibit 21. (KUMMER)

**POSITION OF THE PARTIES**

**ALOHA:** 1,105,068,967 gallons, as projected by Mr. Porter utilizing 500 GPD for each new ERC which equates to an average for all customers of 287 GPD/ERC.

**SWFWMD:** No position.

**OPC:** In 2000, rainfall was the lowest in Pasco County for the 85 years that SWFWMD has kept rainfall records. Staff and OPC have normalized for weather-related variables. In 2001 the weather pattern was very close to the historic norms, and actual usage validates the OPC and Staff projections.

**WOOD:** Adopts OPC's position.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** Staff recommends the Commission adopt the methodology and results based on the regression model proposed by staff witness Stallcup. His model incorporates variables which control for weather and which capture trends in usage on a weather adjusted basis. Comparison of Mr. Stallcup's projections with actual usage produces a smaller deviation than either the method presented by the Utility or by OPC.

Actual data annual usage	Staff forecast 1/2001-6/2001	OPC forecast 1/2001-6/2001	Aloha forecast 1/2001-6/2001
1,001,718,992 <sup>1</sup>	1,016,121,784 <sup>2</sup>	1,021,416,846 <sup>2</sup>	1,105,069,500 <sup>2</sup>
Percent Difference	1.4%	2.0%	10.30%

<sup>1</sup> EXH 10, 34

<sup>2</sup> EXH 22

Mr. Stallcup's original forecast of 1,001,021,846 gallons (EXH 22, FJL-9) was within less than 1/1000th of a percentage point from the actual gallons sold. However, in Exhibit 21, witness Stallcup revised his forecast based on further review to recognize the utility's concerns about changes in usage if the water management districts lifted or lessened water restrictions. This adjustment is necessary and correct to better reflect the time period rates will actually be in effect.

Utility forecast. Utility witness Porter supported a model based on the average consumption for calendar year 2000 of 261 gallons per day, plus the number of projected new ERCs times 500 gal/day. (TR 398) The rationale for this formulation was that new customers coming on line would all use significantly greater amounts of water than the current average Aloha customer. (TR 394, 404) To support the higher average usage of the new ERCs, utility witness Watford attached to his rebuttal testimony examples of sales brochures indicating that the homes now being marketed in the Seven Springs area were larger, family oriented units as opposed to the utility's original base of small retirement homes. (EXH 29, SGW-8; TR 405,411) Staff believes Mr. Porter's model has several flaws.

First, the utility's methodology consistently confuses marginal usage with average usage. While it may be true that new customers will use more than the average, it is also true that many of the existing customers use less than the average. The only way the additional customers would significantly affect average system usage is if the number of new customers is significantly larger than the number of existing customers. The projected additional 473 ERCs represent less than 4% of the utility's total customers. Using information provided by Mr. Watford in Exhibit 29 (SGW-6) attached to his rebuttal testimony, Attachment A shows that adding 473 customers using 500 gallons/day to the total system only increases the weighted system average one gallon per day (262 gal/day compared to the 261 gal/day shown on Page 1 of 2 on that Attachment). Page 2 of 2 on that Attachment shows that even if every subdivision which uses more than the average of 261 but less than 500 gallons per day were to use the utility's projected 500 gallons per day, the weighted system average usage would only increase to 290 gallons per day. While Mr. Porter's assertion that, as the higher use customers come to dominate the lower use customers, the system average usage will increase (TR 412) is correct in a mathematical sense, this will be a long term result which need not be addressed here. To simply

take a system average, and add 500 gal/day per additional ERC per day, significantly overstates the projected usage.

Second, Mr. Porter's forecasting methodology was inconsistent with the method he used to forecast the ERCs. Mr. Porter uses a simple time trend model over the previous five years to project the increase in new ERCs, as required by the Commission's MFRs. (TR 1168) A "sanity check" performed by staff witness Stallcup using the Commission preferred linear regression forecasting approach resulted in an ERC forecast nearly identical to the forecast that the utility's method produced. (EXH 22, FJL-3) Neither staff nor OPC objected to the results of Mr. Porter's ERC analysis. However, Mr. Porter used an average analysis to forecast the gallons used. Unlike the time trend over five years used for the ERC forecast, Mr. Porter relied on the total system usage over all subdivisions for a twelve-month period from July 2000 to June 2001, then added average usage for newer subdivisions times the projected additional ERCs. (EXH 4, MFR Vol. 1, Sch. G-9, p. 134)

Staff believes that simple time trending may yield reasonable results for projecting growth in ERCs only because changes in the number of ERCs is relatively slow and easily predictable. Such stability does not apply to gallons used which can fluctuate with changes in weather or watering restrictions. Therefore, neither the 12 months data nor the averaging approach used by Mr. Porter to project ERCs is sufficient for forecasting usage.

Third, he assumes that all of the new ERCs are residential ERCs and that all will come on line on January 1 of the test year. (TR 432,435) Witness Stewart states that the assumption that all new ERCs are residential, and thus subject to the 500 gallon assumption, is in error. (TR 880) Witness Stallcup also disputes Mr. Porter's assumption that all of the new ERCs will be connected to the system on January 1. He maintains that the connections will take place over the entire year, and to include the total expected usage for the entire year overstates the total gallons used. (TR 1095)

Fourth, the utility stated that the water usage restrictions imposed by the SWFWMD should be considered in determining the appropriate forecast. (TR 1187) Witness Porter stated that expected water usage could increase if watering restriction were to be lifted, resulting in even higher usage per customer than proposed by the utility's forecast. (TR 1251) However, this approach ignores the fact that the reason the watering restrictions would be lifted

is that rainfall approached a normal year. So while **able** to use more water, the customers may actually use less water than they currently use to achieve the same results because of the increased rainfall. (TR 777) OPC witness Bidy also noted that the newer homes had high irrigation needs due to new lawns and landscaping, which may necessitate frequent watering, which would likely decline as the lawns became established. (TR 772) However, in an effort to be as accurate as possible, witness Stallcup presented a revised forecast (EXH 21) which attempts to capture changes in water management restrictions. (TR 1099) This revised forecast is what resulted in the greater deviation from the actual 2001 data in his revised forecast.

OPC forecast. OPC Witness Stewart computed an historical average gallons per day for the period 1995 through 2000, and multiplied this number by the projected ERCs to arrive at total gallons/day. This number times 365 days resulted in an annual consumption number. (TR 873) Although he did not incorporate a separate variable for weather in his projection, Mr. Stewart stated that his results did take into account rainfall in that the recorded usage would have been affected by the amount of rain. (TR 889) Mr. Stewart also recommended that the base year 2000 data be adjusted for what he termed "abnormally dry conditions" which he contends resulted in inflated usage numbers going forward. (TR 874) In Exhibit 22 (FJL-6), witness Stallcup uses data from the U.S. Drought Monitor to show that, using National Drought Mitigation Center tools, there was not a significant difference in the drought index between the two years. Therefore, he rejected OPC's adjustment to Year 2000 base data. (TR 1097) Aloha also took issue with the simple average of the last five years as an adequate predictor for future periods, in that it does not take into account the higher usage of new customers coming onto the system. (TR 1180)

Staff's forecast. Witness Stallcup constructed separate econometric models that are superior to OPC's model in that they explicitly incorporate discrete variables to account for conditions that affect the number of gallons customers use. (TR 1069) Each of Mr. Stallcup's multiple linear regression models begin with the assumption that a portion of water usage, especially irrigation use, is related to the amount of natural moisture available. (TR 1075) While OPC's model implicitly includes the effect of rainfall, Mr. Stallcup's model goes a step further and incorporates a Moisture Deficit Variable (MDV), which is a composite variable that takes into account both temperature and rainfall. This is an important

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combination because as temperature rises, the impact of a given amount of rainfall decreases due to evaporation. He states that the Commission has recognized the validity of using the MDV in prior rate cases. (TR 1075)

In addition, the model adds a variable for lagged consumption to detect trends in usage per customer. This approach addresses the utility's concerns that new customers are predicted to use significantly more water than the current system average. By adding consideration of the usage one year prior, a pattern of usage is established to include the effects of increases in average usage. (TR 1076) Since variations in weather can affect usage, Mr. Stallcup also included three binary variables to adjust out any unexplained weather deviation in both the current and lagged usage variable. This prevents abnormally wet weather from artificially depressing the forecast or artificially dry weather from inflating the forecast. (TR 1076) As noted above, Mr. Stallcup also revised his original forecast to take into account the possibility that water usage restrictions may be lifted in the near future.

Staff believes the more comprehensive multiple linear regression models more accurately capture variables affecting customer usage, and are consistent with Commission practice (See, PSC-97-0618-FOF-WS in Docket No. 960451-WS, PSC-99-0513-FOF-WS in Docket No. 980214-WS, and PSC-00-0248-PAA-WU in Docket No. 990535-WU.) Therefore, staff recommends that the multiple linear regression models be used to determine the number of gallons sold for the 2001 test year.

Change in System Average Usage after adding 473 ERCs at 500 gal/day

SUBDIVISION	GALLONS	BILLS	GALS/MTH	GALS/DAY	WGT GALS	WGT AVE USAGE
RANCHSIDE APARTMENTS	1,913,340	913	2,096	70	63,910	
ASHLEY PLACE APARTMENT	4,214,505	1,877	2,245	75	140,775	
SPRING HAVEN CONDOS	1,135,090	477	2,380	79	37,683	
HERITAGE SPRINGS	2,259,960	935	2,417	81	75,735	
RIVER OAKS CONDOS	1,235,350	480	2,574	86	41,280	
RIVERSIDE VILLAS	8,904,350	3,101	2,871	96	297,696	
OAKCREEK APARTMENTS	6,715,931	1,825	3,680	123	224,475	
COUNTRY PLACE VILLAGE	23,058,397	5,742	4,016	134	769,428	
VICEROY CONDOS	492,750	119	4,141	138	16,422	
VETERANS VILLAGE	142,284,232	27,470	5,180	173	4,752,310	
HERITAGE LAKES	58,539,830	11,210	5,222	174	1,950,540	
MILLPOND	56,028,470	8,927	6,276	209	1,865,743	
WOODTRAIL VILLAGE	23,115,080	3,375	6,849	228	769,500	
FOXHOLLOW TOWN HOMES	1,660,790	239	6,949	232	55,448	
PARK LAKE ESTATES	77,859,838	9,820	7,929	264	2,592,480	
WOODBEND	5,295,410	627	8,446	282	176,814	
WOODGATE	9,239,277	1,060	8,716	291	308,460	
RIVERSIDE VILLAGE	28,604,155	3,110	9,197	307	954,770	
WYNDTREE	59,413,671	6,158	9,648	322	1,982,876	
NATURES HIDEAWAY	41,849,469	4,311	9,707	324	1,396,764	
HILLS OF SAN JOSE	6,803,980	588	11,571	386	226,968	
NATURA	7,905,830	659	11,997	400	263,600	
CYPRESS LAKES	21,660,150	1,730	12,520	417	721,410	
PLANTATION	7,231,230	536	13,491	450	241,200	
THOUSAND OAKS	1,217,484	73	16,678	556	40,588	
FOXWOOD	63,502,203	3,758	16,898	563	2,115,754	
CHELSEA PLACE	28,599,910	1,674	17,085	569	952,506	
TRINITY OAKS	93,690,628	5,470	17,128	571	3,123,370	
FOX HOLLOW	66,965,870	3,562	18,800	627	2,233,374	
RIVIERA	<u>12,577,695</u>	<u>382</u>	<u>32,929</u>	<u>1,098</u>	<u>419,436</u>	
TOTAL	863,974,875	110,208	279,636	9,325	28,811,315	261
PROJECTED ERCS		<u>473</u>	<u>15000</u>	<u>500</u>	<u>236500</u>	
TOTAL INCLUDING NEW ERCs		110,681			29,047,815	262

Source: EXH 29 (SGW-6)

System Average Usage Assuming All Subdivisions  
 With Usage Between 261 and 500 Gals/Day  
 Use 500 Gals/day

SUBDIVISION	GALLONS	BILLS	GALS/ MTH	GALS/ DAY	WGT GALS	WGT AVE USAGE
RANCHSIDE APARTMENTS	1,913,340	913	2,096	70	63,910	
ASHLEY PLACE APARTMENT	4,214,505	1,877	2,245	75	140,775	
SPRING HAVEN CONDOS	1,135,090	477	2,380	79	37,683	
HERITAGE SPRINGS	2,259,960	935	2,417	81	75,735	
RIVER OAKS CONDOS	1,235,350	480	2,574	86	41,280	
RIVERSIDE VILLAS	8,904,350	3,101	2,871	96	297,696	
OAKCREEK APARTMENTS	6,715,931	1,825	3,680	123	224,475	
COUNTRY PLACE VILLAGE	23,058,397	5,742	4,016	134	769,428	
VICEROY CONDOS	492,750	119	4,141	138	16,422	
VETERANS VILLAGE	142,284,232	27,470	5,180	173	4,752,310	
HERITAGE LAKES	58,539,830	11,210	5,222	174	1,950,540	
MILLPOND	56,028,470	8,927	6,276	209	1,865,743	
WOODTRAIL VILLAGE	23,115,080	3,375	6,849	228	769,500	
FOXHOLLOW TOWN HOMES	1,660,790	239	6,949	232	55,448	
PARK LAKE ESTATES	77,859,838	9,820	7,929	264	2,592,480	
WOODBEND	5,295,410	627	8,446	500	313,500	
WOODGATE	9,239,277	1,060	8,716	500	530,000	
RIVERSIDE VILLAGE	28,604,155	3,110	9,197	500	1,555,000	
WYNDTREE	59,413,671	6,158	9,648	500	3,079,000	
NATURES HIDEAWAY	41,849,469	4,311	9,707	500	2,155,500	
HILLS OF SAN JOSE	6,803,980	588	11,571	500	294,000	
NATURA	7,905,830	659	11,997	500	329,500	
CYPRESS LAKES	21,660,150	1,730	12,520	500	865,000	
PLANTATION	7,231,230	536	13,491	500	268,000	
THOUSAND OAKS	1,217,484	73	16,678	556	40,588	
FOXWOOD	63,502,203	3,758	16,898	563	2,115,754	
CHELSEA PLACE	28,599,910	1,674	17,085	569	952,506	
TRINITY OAKS	93,690,628	5,470	17,128	571	3,123,370	
FOX HOLLOW	66,965,870	3,562	18,800	627	2,233,374	
RIVIERA	<u>12,577,695</u>	<u>382</u>	<u>32,929</u>	<u>1,098</u>	<u>419,436</u>	
TOTAL	863,974,875	110,208	279,636	10,646	31,927,953	

**System Weighted Average**

**290**

Source: EXH 29 (SGW-6)

**ISSUE 9(a)**: What is the appropriate projected number of purchased water gallons from Pasco County, and what is the resulting expense?

**RECOMMENDATION**: The appropriate projected number of purchased water gallons from Pasco County at this time is zero with a resulting expense of \$0. Staff also recommends that Aloha be required to perform a cost benefit analysis of an appropriate alternative water supply that allows it to fit permanently into the long-term alternative water supply plan in a manner that is not deleterious to the environment, or to Aloha's ratepayers. This analysis should include negotiating with Pasco County for a better bulk rate, which might include paying an impact fee up-front. (WETHERINGTON)

**POSITION OF THE PARTIES**

**ALOHA**: The appropriate projected number of purchased water gallons from Pasco County is the total amount of water sold, minus 5% conservation program repression, plus unaccounted for, plus flushing, minus the water use permit limits.

**SWFWMD**: Aloha must comply with the Permit. The only alternative source currently available is the purchase of needed quantities in excess of the Permit's quantities from Pasco County. Continued violation of the Permit could result in substantial fines for Aloha, and affect the renewal of the Permit in 2004.

**OPC**: For purposes of setting rates for the test year, 324,062,114 gallons should be used as a projection of water to be purchased from Pasco County. At \$2.35 per thousand gallons, the resulting expense would be \$761,546.

**WOOD**: Aloha should not be compensated for water purchased from Pasco County. If Aloha cannot meet customer demand or expansion with the current pumping permits, then their allocated district should be reduced in size, restrict the building permits issued, or transfer pumping rights from Pasco county and Tampa Bay Water.

**FASANO**: Adopts OPC's position.

**STAFF ANALYSIS**: In its MFRs, Aloha has stated that the projected amount of purchased water from Pasco County is 421,860,000 gallons annually with a pro forma adjustment of \$739,013. (EXH 4, MFR Vol. 1, Sch. G-9)



In his direct testimony, utility witness Watford testified that the primary reason for this rate case being filed was because Aloha must obtain all water above its SWFWMD permit levels from Pasco County. He states that in the past, the regulatory authorities have not been strict in requiring Aloha to conform completely to the water use permit (WUP) limitations. Mr. Watford stated that in the last year and a half that has changed. SWFWMD is now strictly requiring that Aloha limit its withdrawals for raw water to the levels authorized in its permit. He further testified that SWFWMD has also refused to allow an increase in the permit withdrawal levels leaving Aloha with no choice but to purchase additional water from Pasco County for the foreseeable future. (TR 492-493)

Witness Watford testified that the Pasco County bulk water rate is higher than it should be. He testified that Pasco County sets its rates annually. He stated that there is no new thing that has been negotiated because there is not anything new. That is Pasco County's rate. However, he stated that he had no problem seeking a lower rate from Pasco County however they could get that. (TR 526-528)

Utility witnesses Watford and Porter both testified that it was necessary for Aloha to come into compliance with its SWFWMD WUP and that there was no alternative in the short-term to meet the permit except by purchasing water from Pasco County. Witness Watford also testified that no other alternatives were presented. (TR 546 & 420) SWFWMD witness Parker testified that in 1998, Aloha submitted a permit application to renew its WUP. During the renewal process, potential alternative water sources other than new groundwater were discussed, including additional water conservation measures, desalination, aquifer storage and recovery, and interconnection to other water suppliers. At the time, Aloha rejected as infeasible all alternative water source options except additional water conservation measures, reuse supply opportunities, and interconnection to Pasco County. (TR 564)

SWFWMD witness Parker testified that Aloha began to consistently exceed the permitted annual average day withdrawal in 1996 as early as 1994. During the 1998 permit renewal process, SWFWMD's understanding was that Aloha would begin to utilize the interconnect with Pasco County and bring its existing withdrawals into compliance. The over pumping continued and compliance notices were issued by the SWFWMD in 1999 and 2000. A Notice of Violation was issued on November 21, 2000, and a consent order was proposed

on January 5, 2001. (TR 557-559) The final consent order contains a compliance plan. (TR 589)

Witness Parker testified as to the current WUP held by Aloha Utilities. The permit is number 203182.004 and was issued on April 27, 1999. It authorizes the withdrawal of 2,040,000 gallons per day on an annual average daily basis and a peak month day withdrawal quantity of 2,470,000 gallons per day. Aloha pumps groundwater from the Florida aquifer, using eight production wells distributed throughout the service area. Compliance is measured by using a 12-month running average. Aloha is not currently in compliance with its SWFWMD WUP. Witness Parker stated that Aloha must find a source of water to replace the groundwater quantities it is currently withdrawing in excess of the quantities authorized by the WUP. Aloha may do this by purchasing the excess quantity from Pasco County through the interconnect or by developing an alternative water source such as a reverse osmosis facility or other source of water that is both economically and technically feasible and permittable. (TR 562-568)

In answer to a question, witness Parker stated that the wells that Pasco County is currently using are stressed, so those well fields are subject to a reduction plan, and will eventually be reduced by as much as 40 percent in their withdrawals by 2008 or 2010. Mr. Parker further stated that the first increment in the reduction will begin in 2003 when the first alternative water sources comes on-line. (TR 602-603)

Witness Parker, under questioning as to the impact of utilizing Pasco County wells instead of Aloha's wells stated, "[w]hether or not the redistribution of that withdrawal from where it's taking place at Aloha to one of those wellfields would be a net benefit, I couldn't really say right now." (TR 604) Witness Parker stated further, "[s]o in the immediate term, I couldn't tell you whether it's a net improvement or not to shift it." (TR 604)

In late-filed exhibit 18, which is a response letter to a question from a Commissioner, SWFWMD witness Parker states that the District contends that there are benefits from requiring Aloha to immediately begin purchasing water and gives a description of how the regional water system is laid out. He states that the regional water supply authority offers the greatest potential to meet the increasing demands for water from multiple regional sources which can be managed with acceptable environmental impacts. Mr. Parker

concluded that there is an environmental benefit to requiring Aloha to purchase water from Pasco County instead of continuing to overpump its WUP. (EXH 18) Because of the late-filed nature of this exhibit, it was not subject to cross examination or rebuttal by the parties.

Exhibit 36 contains the final consent order between Aloha and SWFWMD, which was supplied to all parties as a late-filed exhibit. Although the consent order had not been formally executed by Aloha and the SWFWMD at the time of the hearing, the most recent draft of the consent order was made available by Aloha as a late-filed exhibit to utility witness Watford's January 3, 2002, deposition. Party witnesses were questioned about the draft consent order at the hearing, and this version was very similar to the final version executed by SWFWMD. The final consent order is an official agency action of SWFWMD as it has been signed by the District's governing board. The consent order states in Section III, part A.:

Until such time as Tampa Bay Water in general, in Pasco County in particular, have developed alternative water supply sources pursuant to the requirements of the Consolidated Permit, the customers of Aloha Utilities are simply replacing water drawn from Aloha Utilities with water drawn from a County well field a few miles away, both within the North Tampa Bay WUCA. Arguably, the additional demand placed on the Pasco County well fields as a result of the sale of water to Aloha will have a more deleterious effect on the environment than continued pumping by Aloha from its eight smaller, scattered wells. It short, purchasing water has not been demonstrated to benefit the environment, and may in fact be doing more harm. Therefore, until such time as alternative water sources are in place, it is questionable whether a compliance plan should require purchased water from Pasco County. (EXH 36)

Mr. Parker's letter, late-filed Exhibit 18, compared to Exhibit 36, the final executed consent order, presents the Commission with a novel situation. Exhibit 36 is the unambiguous issued order of a sister agency, whereas Exhibit 18 is a letter authored by an employee of that sister agency purporting to explain the order, Exhibit 36. The explanation tendered in Exhibit 18, however, is in notable contrast to Exhibit 36, and, in some

respects, directly contrary thereto, and contrary to Mr. Parker's hearing testimony as well.

Given the choice between the order of the agency on the one hand, and an explanatory letter of the agency employee on the other, staff recommends that the Commission should assign the greater weight to the official order of the agency, in this case, the SWFWMD.

The consent order makes several statements that indicate that it is assumed the utility's requested rate increase will be approved. No evidence was presented to indicate whether or not the purchase of water from Pasco County was a cost effective alternative. In addition, no evidence was presented to indicate that Aloha did any kind of a cost benefit analysis of any other proposed alternative water supply. There is also no record evidence to indicate that Aloha took any steps to attempt to negotiate a lower water rate with Pasco County.

While staff understands SWFWMD's authority and purpose in trying to get Aloha to adhere to its WUP, staff believes that the plan to purchase water from Pasco County is at best a short-term fix supported by contradictory testimony and a consent order that questions the potential benefits of the plan. Further, the plan to purchase water does nothing to address the long-term black water problem.

In Issue 2, staff is proposing that Aloha provide a report showing how it will have water treatment facilities installed and operational by the end of 2003. Staff believes that this construction will in all probability require Aloha to file a rate case. At that time, because of the material additions to rate base, staff anticipates that Aloha will be able to implement an aggressive conservation rate structure.

Staff believes that a rate increase should be granted only if the reasons for it are clear and well justified. As illustrated by the above testimony and excerpt from the consent order, the only justification for the plan for Aloha to purchase water from Pasco County is that it would be in compliance with its SWFWMD permit, and could possibly implement a conservation rate structure.

Regarding this issue, staff believes that there are two alternatives. The first is for Aloha to adhere to the SWFWMD

permit. This would require a significant rate increase and create a situation that, according to the consent order, may be doing more harm to the environment. The second alternative is to maintain the status quo, with Aloha not purchasing water from Pasco County, but instead require Aloha to perform a cost benefit analysis of all alternatives to determine the most cost effective alternative. Staff believes that maintaining the status quo is the best alternative for Aloha's customers at this time. Because the purchase of water from Pasco County has not been adequately studied, it is premature to judge that it is the only alternative.

Staff therefore recommends that the appropriate projected number of purchased water gallons from Pasco County at this time is zero with a resulting expense of \$0. Staff also recommends that Aloha be required to perform a cost benefit analysis of an appropriate alternative water supply that allows it to fit permanently into the long-term alternative water supply plan in a manner that is not deleterious to the environment or Aloha's ratepayers. This analysis should include negotiating with Pasco County for a better bulk rate, which might include paying an impact fee up front.

**ISSUE 9(b):** Should a provision be made to monitor whether the gallons pumped from Aloha's wells differs from the maximum permitted quantity on an annual average basis under the Water Use Permit (WUP)?

**RECOMMENDATION:** Based on staff's recommendation in Issue 9(a), no additional monitoring requirements for earnings purposes are necessary. However, if the Commission denies or changes staff's recommendation regarding the purchase of water from Pasco County, the Commission should implement quarterly monitoring of statistics of water purchased and water pumped. This should be an immaterial cost to the utility and thus no additional costs should be included in this proceeding. (MERCHANT)

**POSITION OF THE PARTIES**

**ALOHA:** No. Monitoring of this cost of operation is not necessary and is no more appropriate than monitoring of any other costs within the utility's control. In any case, the utility cannot possibly pump precisely at its "permit limits," as per SWFWMD's position stated in the Prehearing Order.

**SWFWMD:** Aloha must pump no more water from its wells than the quantity authorized by its WUP. Continued violation of the Permit after resolution of this rate case and approval by the Commission of Aloha's purchase of water would result in enforcement action by the District, which could include substantial fines.

**OPC:** Yes. The final order should include a provision that if the WUP is exceeded by more than a reasonable percentage, corresponding refunds will be required by Aloha.

**WOOD:** Adopts OPC's position.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** According to OPC witness DeRonne, if Aloha continues to withdraw more water from its wells than allowed under the WUP, even though its base rates are set to comply with the WUP, the utility will receive a windfall at the cost of ratepayers. This is because the cost of purchased water from Pasco County at \$2.35 per thousand gallons is materially greater than the amount paid in royalty fees of \$0.10 to \$0.32 per thousand. The windfall could

range from \$2.03 to \$2.35 per thousand gallons on the amount of water pumped by Aloha in excess of its WUP allowances. (TR 722)

Witness DeRonne recommended that quarterly reporting requirements be put into place in the Final Order as a safety measure to ensure that ratepayers do not pay excessive amounts for water purchases that are not ultimately made by Aloha. The reports should contain the amounts withdrawn from each of Aloha's wells and the amounts purchased from Pasco County for each quarter. When Aloha exceeds its WUP allowances and purchases less water from Pasco County, thus incurring a lower cost, Aloha should be required to defer the price differential. The amount in the deferral account should then be flowed back to ratepayers in a future proceeding. Ms. DeRonne testified that this would protect both the utility (allowing it to collect rates based on the higher-priced Pasco County purchases) and the ratepayers. In her testimony, she gives an example of how the deferral would be calculated. (TR 723)

On rebuttal, Aloha witness Nixon testified that the possibility of windfall profits, by continued over-pumping after this case is completed, is not grounded in reality. SWFWMD has proposed a substantial penalty for Aloha's past and present over-pumping. Mr. Nixon testified that the utility would not want to be subject to continued penalties and fines for over pumping. Aloha furnishes monthly reports to DEP and SWFWMD, who closely monitor Aloha's pumping. In addition, the utility files an annual report with the Commission which is used to monitor the earnings of the Company. (TR 1174)

According to Mr. Nixon, any excessive return would attract attention based on the earnings reported in Aloha's annual report filed with the Commission. Mr. Nixon concluded that it was not realistic to believe that a windfall of earnings would occur if the Commission grants rates to cover the cost of purchased water from Pasco County. Regardless, Mr. Nixon stated that Ms. DeRonne did not propose any recovery in this proceeding for the estimated costs of additional reporting requirements that may be approved. (TR 1174-1175)

Aloha witness Watford testified that Ms. DeRonne's concern that the utility will continue to exceed its WUP and thus overearn in the future has little basis. His testimony is consistent with Mr. Nixon's testimony that it is very unlikely that this will occur because SWFWMD has made it clear that substantial penalties will

result if Aloha exceeds its permit levels. Mr. Watford testified that it is more likely that the utility will not be able to pump water at a level exactly equal to its maximum permit levels and will fall under that amount. As a result, he contended, the cost of purchased water could very well increase above the levels recognized in rate setting in this proceeding under the current proposals. (TR 1381-1385)

In addition, Mr. Watford stated that the potential for shortfall from under-pumping can harm the utility more than the customers. This is because of the high marginal cost of purchased water from the County compared to Aloha's cost of pumping and treating that water. Mr. Watford did not believe that additional monitoring was appropriate as the purchased water issue was no different than other expense changes that could affect earnings. Further, he testified that the amount of purchased water for a given period will be outside of Aloha's control. If the Commission proposes to monitor earnings and purchased versus pumped water, Mr. Watford believed that recognition of both under and over earnings by the utility should be trued-up on a going forward basis. It must work both ways for all potential problems, including erroneous projections, resulting from deviations of water purchased versus water pumped. (TR 1382-1384)

Mr. Watford further testified that for any jurisdiction that the Commission retains, the Commission should recognize a need to increase rates or allow for surcharges for past under sales. In conclusion, Mr. Watford added that if additional monitoring was required, additional administrative costs must be recognized in rate setting in this proceeding. He suggested an increase of \$10,000 in annual expenses for basic monitoring requirements. This was an estimate of the additional cost for preparation, filing and answering any questions for quarterly reports filed on purchased and pumped water. (TR 1384-1385)

Based on staff's recommendation in Issue 9(a), we do not believe that any additional monitoring requirements for earnings purposes are necessary. However, if the Commission denies or changes staff's recommendation regarding the purchase of water from Pasco County, the Commission should implement quarterly monitoring of statistics of water purchased and water pumped. This should be an immaterial cost to the utility and thus no additional costs should be included in this proceeding.



**ISSUE 9(c):** What provision should the Commission make within rate setting for the potential shortfall or excess if usage by customers differs from that included in the rate setting?

**RECOMMENDATION:** No provision should be made in addition to those already provided for in Section 367.081 and 367.0814, Florida Statutes. (MERCHANT, JAEGER)

**POSITION OF THE PARTIES**

**ALOHA:** If the Commission proposes to retain jurisdiction to monitor water purchased versus pumped, then it also must retain jurisdiction to make up any shortfall resulting from usage outside the levels projected by the repression models, which are much more likely to result than over pumping, given SWFWMD's threatened fines.

**SWFWMD:** No position.

**OPC:** No special provision should be made. Aloha is seeking an unprecedented guarantee that is not contemplated in the regulatory process.

**WOOD:** Adopts OPC's position.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** In its brief, OPC argued that no special rate setting provision should be made for any potential shortfall or excess if usage by customers differs from that included in this rate case. As in every rate case, the Commission should project customer usage as accurately as possible to give Aloha the opportunity to earn a reasonable rate of return on its investment. In rate setting, projected expenses will vary from the actual amounts incurred. OPC argues that the difference could be either to Aloha's advantage or disadvantage. This is the risk that a utility absorbs in the regulatory process. OPC concludes that the Commission should not depart from these fundamental rate setting principles in this case.

In Aloha's brief, it argued that the utility has not proposed that the Commission implement a program to monitor the impacts of any potential excess earnings related to the purchase of water from Pasco County. However, if the Commission implements such a program, Aloha argues that it should also provide the utility a mechanism to

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recoup any losses that may result from incorrect projection methodologies.

Gulf Power requires the Commission to set rates to give the utility the opportunity to earn a fair rate of return on its investment. The Commission is not required to guarantee recovery of losses. If the utility perceives that its future earnings will generate less than a fair rate of return, it is within its management's purview to seek relief.

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**ISSUE 10:** Should projected chemicals and purchased power be adjusted?

**RECOMMENDATION:** Yes. Chemical expense should be decreased by \$2,234 to remove the impact of inflation for the test year. No adjustment is needed for purchased power expense. (S. JONES)

**POSITION OF THE PARTIES**

**ALOHA:** The amounts projected by Mr. Porter and Mr. Nixon should be used. Chemical expense will actually increase over test year levels because of differences in County water chemistry and re-pumping and re-chlorination expenses

**SWFWMD:** No position.

**OPC:** Yes. Two basic adjustments must be made. First, the numbers of gallons treated must be reduced to reflect the outcome of Issue 8. Second, the inflation factor should be removed because it is inconsistent with the actual test year data.

**WOOD:** Adopts OPC's position.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** On MFR Schedule B-7(B) (EXH 4, Volume 1, page 40), the utility reported historical December 31, 2000, chemicals and purchased power expenses of \$89,344 and \$80,713, respectively. These historic figures were then multiplied by Aloha's projection factors to arrive at the 2001 test year totals. The projection factors used by Aloha are detailed on MFR Schedule G-5, Page 1 of 2, Items 4 and 5. (EXH 4, Volume 1, page 113) Chemical expense was projected by applying the 2000 GNP Price Deflator Index of 2.5% and the customer-growth factor of 4.688%. The utility projected purchased power using only the customer-growth factor because of the stability of electric prices. On MFR Schedule B-7(A) (EXH 4, Volume 1, page 40), the utility reflected projected December 31, 2001, chemicals and purchased power expenses of \$95,870 and \$84,497, respectively.

In OPC witness DeRonne's direct testimony, she agreed with the general statement that any recommended reductions to the projected test year amount of gallons sold to customers would in turn have an

impact on the utility's projected level of chemical expense and purchased power. (TR 725-726)

Ms. DeRonne testified that she did not agree with the utility's application of the inflation factor to its historic test year chemical expense. She stated that her recommendation was based on the review of historical information filed in work papers submitted in the MFRs and the response to OPC's Interrogatory 5. Ms. DeRonne stated that a breakdown of chemicals the utility purchased through June 2001 in both quantity and unit cost was listed in the utility's response to OPC's Interrogatory 5. From this information, Ms. DeRonne testified that the two largest components of the utility's chemical expense were chlorine gas and Aquadene Liquid. Also, based on a review of the information provided, the unit cost per pound for chlorine gas was \$0.47 for all of 2000 and through at least June 2001. The unit cost per gallon of Aquadene Liquid was \$10.10 for all purchases in 2000 and for the first 6 months of 2001. (TR 726-727)

She concluded in her testimony that the two largest components of chemical expense had not changed and had not increased by the 2.5% inflation factor. Therefore, she recommended that the inflation factor not be applied to the historic test year level of chemical expense. In fact, the total chemical expense for the first seven months of 2001 was \$8,141 lower than the chemical expense for the same seven month period in 2000. (TR 727)

Ms. DeRonne stated she prepared schedules showing the impact of her recommendations on projected chemical expense and purchase power. She testified that the projected test year chemical expense was calculated on her Schedule B-7 (EXH 9, page 9) and resulted in a \$8,303 reduction to the Aloha's requested level. The projected test year purchased power expense was calculated on her Schedule B-8 (EXH 9, page 10) and resulted in a \$5,389 reduction to purchased power expense. (TR 727)

On cross examination by Aloha, Ms. DeRonne agreed that her recommendation for not adjusting chemical expense for inflation was based on the fact that there was no increase in the price paid for chemicals for the last 18 months. (TR 757) When asked if she had looked to see if those chemical expenses had increased in the last six months of the test period, Ms. DeRonne said she had not since she only had data through the end of June 2001. (TR 757)

Ms. DeRonne further testified that for the first six months of 2001, which is the projected test year, the company's chemical expense had actually decreased significantly. She stated that she had not made an adjustment to reflect that anomaly, but left chemical expense at the test year level without inflation. She noted no other adjustments were made except for the adjustment for changes in the amount of water that would need to be treated based on projected gallons sold for 2001. (TR 757)

Ms. DeRonne was asked whether her conclusion that since chemical expense had not changed for 18 months, chemical expenses therefore were not subject to any inflation. She responded that based on her review, the chemical expense from the historic test year to the projected test year in this case did not increase as much as the level of inflation. (TR 757)

Ms. DeRonne was asked if she had made an attempt to test other expenses of the utility to determine whether or not they were impacted more or less than the 2.5% inflation factor. She responded that she had looked through various expense accounts but that she had not done a specific analysis on an item-by-item basis. Ms. DeRonne stated that she knew the company had not applied the inflation factor to at least three accounts: legal, accounting and engineering expenses. Ms. DeRonne testified that she reviewed the utility's expense accounts and the amounts expended for each expense account by month. She stated that she did not specifically go in to determine how inflation impacted each of those accounts. Ms. DeRonne testified that her attention was drawn to the chemical expense account because for the first six months of 2001 there was a significant decline in the chemical expense over what had been booked in the historic test year for the same six-month period. (TR 757-758)

Aloha witness Nixon testified that an inflation factor was an appropriate tool for projecting chemical costs. Because rates are set on a going-forward basis, Mr. Nixon believed that an inflation factor was appropriate, despite the fact there had been no recent increases. Sooner or later, Aloha will experience a price increase for the chemicals it purchases. Mr. Nixon testified that he believed that it was reasonable to provide for that eventuality in setting rates for the future. Further, the use of an inflation factor was similar to the Commission's indexed rate increase procedures. For the Commission's index, Mr. Nixon stated that all eligible operation and maintenance expenses were increased by the

current GNP Price Deflator Index, without a showing on a line-by-line basis whether an actual increase has occurred. (TR 1176)

Aloha witness Porter disagreed with Ms. DeRonne's characterization of the fact that she thought the power and chemical costs were going to change and be lowered because of the repression in water consumption due to the new rates that are to be put into effect for conservation. Mr. Porter continued by stating that there was going to be other costs that would offset those costs and would probably raise costs more because of buying the water from Pasco County. (TR 1234)

Mr. Porter stated that Ms. DeRonne incorrectly based her testimony on the assumption that Mr. Stewart's projections are correct. Mr. Porter testified that he had shown in great detail that OPC witness Stewart's model was seriously flawed and produces inaccurate projections. Further, Mr. Porter thought the chemical and power cost projections provided by Aloha were potentially understated due to two factors. First, once Pasco County changes its water disinfection treatment system, Aloha's chemical costs will rise significantly when the utility makes similar changes in its treatment systems to make its water compatible with the county water. Second, power costs will increase when Aloha begins using more Pasco County water. Mr. Porter stated that this is because the utility will need to add and operate pressure boosting pumping equipment to enable the county supply to meet the peak flow water demands of Aloha's customers. Mr. Porter concluded that the water use and chemical cost projections of Aloha are correct, and, therefore, no adjustment is necessary. (TR 1286-1287)

On cross examination by staff, Mr. Porter agreed that chemical expense would increase in the future to enable Aloha's water to be compatible with Pasco County's new chloramine disinfection process. Mr. Porter added that he did not have an answer as to when Pasco County was going to change over to the new process, but the county had not changed over as of the hearing date. Mr. Porter stated that the utility had not started incurring increased costs for chemical expense and that he did not know how much chemical expense would increase. The utility would not know the change in chemicals or purchased power expenses until Aloha was informed of the quality and characteristics of the county's water. (TR 1313-1314)

Late-filed Exhibit 35 details Aloha's purchased power and chemicals for the last half of 2001. The exhibit shows a net

increase in expenses of \$17,973. This amount resulted from a combination of an increase to purchased power of \$23,919 and a decrease to chemical expense of \$6,326.

Staff believes that it is valid to look at a material expense to see if any trends occur that might render a projection methodology inaccurate. Since the unit costs of the two largest components of Aloha's chemical expense did not change from January 2000 through June 2001, we agree with Ms. DeRonne that those costs have not been affected by inflation. If these costs do increase in the future, then the Commission's price index adjustment can be used to offset those increases on a perspective basis. In order to remove the inflation factor applied to the historical test year, chemical expense should be reduced by \$2,234.

Based on staff's recommendation in Issue 9(a), no further adjustments are necessary to the test year amounts of chemicals and purchased power. Since both of these expenses were projected based on 2000 amounts escalated for customer growth and Aloha purchased only a small amount of water from Pasco County during that year, the test year chemical and purchased power expense included appear to be reasonable.

**ISSUE 11:** Should an adjustment be made to employee salaries and wages for open positions?

**RECOMMENDATION:** Yes. Salaries and wage expense should be decreased by \$19,835 to remove the projected salary for a new utility director position. This position was not filled at the time of the hearing in January 2002. A corresponding adjustment should also be made to decrease pensions and benefits expense by \$4,384, for a total decrease of \$24,219. This represents the allocated portion for the new position for the Seven Springs water system. (S. JONES)

**POSITION OF THE PARTIES**

**ALOHA:** No. All positions, other than the Utility Director, have been filled as of the date of hearing, and are necessary for the continued provision of quality water service and operation of the system. The Utility Director position will be filled by the time of the Commission's final vote.

**SWFWMD:** No position.

**OPC:** Shortly before the hearing, Aloha filled a large number of formerly vacant positions. Aloha should recover for those positions, but the Commission should continue to monitor Aloha's personnel vacancy ratio. The Commission should also remove a portion of the pension expense to recognize the number of ineligible employees.

**WOOD:** Adopts OPC's position.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** On MFR Schedule B-7(B) (EXH 4, Volume 1, page 39), Aloha projected 2001 salaries for existing employees of \$346,223. According to MFR Schedule G-8, page 1 of 3, (EXH 4, Volume 1, page 131), Aloha has annualized projected salaries to reflect a raise given on July 9, 2001. This resulted in an increase to salaries of \$16,445, for total annualized salaries for the 2001 test year of \$362,668. The utility also made an adjustment to increase salaries to reflect ten open positions with projected salaries of \$107,850. Aloha's total salary request for the 2001 test year was \$470,518.

Aloha witness Nixon testified that Aloha has historically had salary scales that have led to continuing high employee turnover. Mr. Nixon stated that because Aloha and Pasco County competed for



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the same qualified employees, Aloha obtained a copy of the study done by Pasco County on utility employee compensation. Aloha implemented a new wage and salary scale effective July 9, 2001, based on this study. Mr. Nixon stated the salaries and wages implemented on that date were then used to project salary expenses and benefits for the utility's projection of salary expense for July through December 2001. (TR 452) These salaries were annualized as shown on Schedule B-3(A). (EXH 4, Volume 1, page 31)

Mr. Nixon stated that Aloha believed the new salary and wage scales would make them competitive with Pasco County and reduce the high turnover rate. Mr. Nixon further testified that the utility included in its filing pro forma recognition of salaries for ten open positions, which the utility was in the process of filling. He stated the new employees would provide the staff necessary to provide quality service to the customer base. Mr. Nixon testified that Schedule G-8 of the MFR's (EXH 4, Volume 1, pages 131-133) provided a detailed listing of each employee and position, description of duties, and salary before and after implementation of the new wage scale. (TR 450-452)

Aloha witness Watford testified that the salary issue was addressed by the utility at the beginning of 2001 because of the very high turnover rate Aloha had been experiencing. Aloha used Pasco County's salary structure as a template for realigning and revising Aloha's own salary structure. He also stated that Aloha's new office building was larger and allowed the utility to add a few new employees to handle the staffing shortfalls and deficiencies. (TR 482, 488-489)

Mr. Watford described the new positions that were added after the move to the utility's new office. In early 2001, the utility hired a front office receptionist. By May 2001, a data entry operator and a customer service specialist were added to address existing problems Aloha had with serving its customers. These three new positions added \$12,371 in allocated costs to the Seven Springs water system for the test year. (TR 488)

In her direct testimony, OPC witness Ms. DeRonne testified that Aloha's filing included ten additional employee positions beyond the staff level employed as of June 30, 2001. Ms. DeRonne stated that the adjustment for these ten additional employees would increase salary and wage expense by 30% beyond the actual as of June 30, 2001. Ms. DeRonne further stated that of the ten additional staff

positions, five were for newly created positions and five were for existing positions which were vacated by former employees. She listed the newly created positions as a clerk, a fleet maintenance employee, an electronic technician, an additional utility worker, and a utility director. (TR 713)

At the time her direct testimony was filed, Ms. DeRonne stated Aloha's response to OPC's Interrogatory 25 and 27 indicated that these ten positions were not filled and Aloha had reported three additional vacancies. She concluded that the utility's filing included payroll costs associated with thirteen more employees than it actually had on-hand. (TR 713)

Accordingly, Ms. DeRonne recommended that the entire \$107,850 for the ten additional employees be removed from the utility's filing. She stated the following reasons for her recommendation. First, Aloha historically had a high employee turnover rate and problems retaining employees. Aloha had also reported that an additional three employees had left the utility. Secondly, Ms. DeRonne stated the utility would need to increase its staff who were directly charged or allocated to Seven Springs water by 37% above the current level. She stated it was unlikely Aloha would be able to fill and retain thirteen additional employees in the near future. Therefore, she concluded ratepayers should not be asked to pay costs associated with employees that do not exist. (TR 714)

During her cross examination by Aloha, Ms. DeRonne was asked if she would include the costs for the open positions if the new positions had been filled in the test period and none of them had become vacant. Ms. DeRonne stated she would not disagree if those positions had been filled at the salary levels that were proposed and no other positions had become vacant, and that she "would want to see the whole employee complement." (TR 747)

In Mr. Nixon's rebuttal testimony, he expressed the unreasonableness of Ms. DeRonne's recommendation to disallow in total, the salaries and employee benefits of the 5 new positions and 5 current open positions caused by employee turnover. Mr. Nixon testified that utility rates are set on a going-forward basis necessary to provide safe and efficient service. Mr. Nixon stated that Aloha's low salaries had consistently contributed to the utilities high turnover rate. Because of a salary increase effective July 9, 2001, Mr. Nixon stated that this high turnover rate should be greatly reduced. Mr. Nixon concluded that it was

unreasonable to deny a provision for salaries of those existing positions which may be open from time to time. He stated that Mr. Watford would testify on how he has actively been recruiting and filling the open positions. (TR 1170)

Mr. Nixon noted that the addition of a utility director would enable the utility to improve its long and short range planning. At the present time, Mr. Watford and Ms. Kurish work long hours on various matters better delegated to this new position. The current workload structure leaves little time to adequately address the recommendations contained in the PSC Staff Management Audit. (EXH 24, RCN-9) (TR 1170-1171)

Mr. Nixon further testified that to the extent that some or all of the new and open positions are approved, an adjustment would be required to employee benefits for these positions. The stipulated adjustments to pension expense increased the employee benefits percentage applicable to these positions. As part of his prefiled rebuttal testimony, Mr. Nixon stated he had attached Exhibit RCN-10 (EXH 24, RCN-10) which showed that the benefits percentage should be changed from 12.29% to 22.10%. He further stated that the 22.10% resulted in an additional increase in pension and benefits for requested pro forma salaries of \$10,580. (TR 1171)

Mr. Watford explained in his rebuttal testimony that the new employees had been added in the first half of the 2001 test year period for several reasons. First, Mr. Watford explained that the utility's old office location was too small for any additional employees at that location. Even though the utility was in desperate need of additional employees to improve customer service and keep up with the growing customer base, Mr. Watford stated it could not be accomplished until the move to its larger facility. He testified that it was only natural that now and then management would have to add additional employees to the staff. (TR 1370)

Mr. Watford also countered Ms. DeRonne's proposal of eliminating salary expense for the open positions. He stated the utility would never be able to hire and keep the needed employees to continue to provide high quality of service and hopefully to improve customer service, if the Commission did not approve these pro forma salary additions. Mr. Watford went on to state that the new employee positions and all of the vacant positions had now been filled as of the date of his pre-filing his testimony in mid-

December. He also testified that the utility expected to keep these positions filled for the long run. (TR 1370-1371)

Mr. Watford testified that the only position that remained unfilled was that of the Utility Director. He explained that the utility had offered the position to a candidate who accepted the position after several months of negotiation. Then the candidate chose to take another position to avoid having to relocate his family. Mr. Watford stated that they have re-advertised the position and have several good candidates that they are presently considering. Mr. Watford affirmed that this position was as much needed as the others to perform additional budgeting and management functions. Mr. Watford stated that the present utility management staff is unable to perform these functions because of other demands and the growth over the last several years. (TR 1371)

Mr. Watford concluded that all of the costs of the new employees and the vacant positions must be considered in final rates due to the reasons he outlined above. Also, Mr. Watford argued Ms. DeRonne's new position derived from her cross examination now points to this same conclusion. (TR 1371-1372)

On cross examination, Mr. Watford testified that the Utility Director's position was still open and that he had not had time to get it filled because of his involvement in this rate case. He stated that Aloha has since advertised this position again in industry journals, Web sites, and the local newspapers and has received plenty of applications to start the selection process for a new candidate. When asked if all positions as of the hearing date, except the Utility Director position, were still filled, Mr. Watford replied that they were. (TR 1408-1409)

In its brief, OPC argued that Aloha had supplied discovery information indicating that all of its positions had been filled, except for the Utility Director. OPC commended Aloha's effort in filling these positions. OPC further stated that Ms. DeRonne agreed in her cross examination that if the positions are filled at the proposed salary levels, then Aloha should recover the expense.

Staff believes that all positions except for the Utility Director position should be included in operating and maintenance expenses for this rate proceeding. The utility has filled these positions as of December during the test year. Aloha has also addressed the utility's salary issues, under-staffing, and their

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prior limited office space, which the utility stated contributed to the high turnover rate. Staff believes all these changes will contribute to retaining the current staff and should work towards providing better customer service for their customers.

In its brief, OPC did express a concern regarding Aloha's history of high turnover and a significant number of vacant positions. Because of these same concerns and the fact that the Utility Director's position had not been filled in the 2001 test year, staff does not recommend the inclusion of Utility Director's salary expense. Given the high turnover rate and Aloha's inability thus far to fill this position, staff does not believe that it is reasonable to include the Director's salary expense at this time. Therefore, staff is recommending a decrease of \$19,835 from salary and wage expense and \$4,384 from benefit expense for a total of \$24,219. This represents the Seven Springs water allocated portion of the Utility Director's projected salary.

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ISSUE 12: Stipulated at hearing.

ISSUE 13: What adjustments should be made to pension expense?

RECOMMENDATION: The parties agreed that pension expense should be increased by \$40,509 to correct a recording error and the benefits percentage of 22.10%. Pension expense should also be increased by \$10,580 to reflect the benefits for the pro forma salaries at the 22.10% level. (S. JONES)

POSITION OF THE PARTIES

ALOHA: An adjustment to correct a recording error and to reflect additional liability obligations is necessary. This is an increase of \$40,509 with new and open employee benefits applied at 22.10% of salary, for an additional cost of \$10,580.

SWFWMD: No position.

OPC: The Citizens have agreed with the pension expense adjustment of \$40,509. The benefits percentage of 22.10%, however, should not be applied to the entirety of the pro forma salaries as explained in Issue 11.

WOOD: Adopts OPC's position.

FASANO: Adopts OPC's position.

STAFF ANALYSIS: On MFR Schedule B-3(A) (EXH 4, Volume 1, page 31), the utility projected employee pensions and benefits expense of \$66,025 for the projected December 31, 2001, test year. This expense was calculated by taking the total annualized salary expense for the current employees of \$429,375 plus the salary for the ten new positions of \$107,850 times a benefit factor of 12.29%. The benefit percentage was calculated by taking the accrued employee benefits for the first six months of the test year and dividing that amount by the actual salaries incurred for the same time frame. This calculation is illustrated on MFR Schedule G-7, page 2 of 6. (EXH 4, Volume 1, page 126)

In OPC witness DeRonne's direct testimony, she testified that during the first six months of 2001, Aloha recorded pension expense for the Seven Springs water system that should have been allocated to the Aloha Gardens wastewater system, and vice-versa. This

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resulted in a understatement of pension expense in the MFRs. She also testified that the amount in the filing was based on an estimated pension expense amount for 2001. (TR 711-712)

Ms. DeRonne stated Aloha had now received the 2001 updated pension expense amounts from its pension plan administrator. According to the utility's response to OPC Interrogatory 12, pension expense for the Seven Springs water should have been allocated at 44.83%. (Stipulation 21) Further, based on the 2001 updated pension liability obligations furnished by the utility's pension plan administrator, pension expense should be increased by \$40,509 to correct the allocation to the Seven Springs water system and to reflect the updated liability obligations. (TR 711-712)

Utility witness Nixon, in his rebuttal testimony, agreed with Ms. DeRonne that employee pension and benefits should be increased by \$40,509 to correct the allocation of expense to the Seven Springs water system and to recognize the 2001 pension expense as calculated by the plan administrator. (TR 1169-1170)

After the stipulated adjustments to pension expense, Mr. Nixon testified that the benefit percentage for employees would also change from 12.29% to 22.10%. He stated that this change in the benefit percentage was presented in his Exhibit RCN-10. (EXH 24) Mr. Nixon further testified that the new benefit percentage of 22.10% times the pro forma salary adjustment for the ten open positions yields an additional increase of \$10,580 to benefit expense. (TR 1171)

In her direct testimony, Ms. DeRonne did not make the above adjustment of \$10,580 since she had recommended that the entire salary amount be eliminated for the ten open positions which at that time had not been filled. Therefore, she had no corresponding adjustment to pension expense. (TR 714)

During her cross examination, Ms. DeRonne was asked if she would include the costs for the open positions if the new positions had been filled in the test period and none of them had become vacant. Ms. DeRonne stated she would not disagree if those positions had been filled at the salary levels that were proposed and if there were no other positions that have become vacant. Ms. DeRonne stated that her adjustment to employee benefits would become dependent on her adjustment to employee salaries. (TR 747)

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Staff believes the pension expense should be based on the 2001 updated pension expense figure established by the utility's pension plan administrator. Therefore, staff agrees that an adjustment is needed to increase pension expense by \$40,509. This adjustment reflects the additional liability obligation and corrects the recording error initially made by the utility. Staff has reviewed Mr. Nixon's Schedule RCN-10 in Exhibit 24 and agrees that the benefit percentage to be applied to all employee salaries should be 22.10%. Staff believes the revised 22.10% also has to apply to the ten new positions. This results in an additional increase in benefit expense of \$10,580 for these open positions. Any adjustments to reduce salaries in other issues should also include a corresponding 22.10% reduction to benefit expense.



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**ISSUE 14:** Does the utility have excessive unaccounted for water, and if so, what adjustments should be made?

**RECOMMENDATION:** No. Aloha does not have excessive unaccounted for water and an allowance of 10% has been used for the projected test year. (Wetherington)

**POSITION OF THE PARTIES**

**ALOHA:** No adjustment is appropriate. The staff proposed adjustment is immaterial and contrary to allowances of over 15% in unaccounted for water recognized by the Commission in several previous cases.

**SWFWMD:** Aloha's unaccounted for water does not violate any District standards.

**OPC:** Aloha reported 9.20% unaccounted for water in 2000. That 9.20% should be used to determine the demand for water purchased from Pasco County. Alternatively if the 10.2% reported for 2001 is used, then purchased power, chemical and Pasco County purchased water expense should be reduced by 0.2%.

**WOOD:** Yes. A business in a competitive marketplace couldn't survive with a 10% unaccounted for loss. This utility and others like it should be held to more rigorous standard and not be allowed to pass everything onto the customer.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** In its MFRs, the utility provided documentation that unaccounted for water for the year 2000 was 9.2%. (EXH 4, Vol. 1 pg. 100) The utility used a 10% unaccounted for water figure for the applicable projected test year expenses. (EXH 4, Vol. 1 pg. 126) The actual water use data for the first nine months of the test year 2001 indicates that the unaccounted for water is 10.2%. (EXH 10, TLB-10)

Commission practice is to allow 10% of the total water treated as an acceptable amount of unaccounted for water in order to allow for a reasonable amount of non-revenue producing water caused by stuck meters, line flushing, etc. (See Orders Nos. PSC-00-0248-PAA-WU, issued February 7, 2000, in Docket No. 990535-WU, and PSC-00-2005-PAA-WU, issued June 7, 2000, in Docket No. 000331-WU).

OPC witness DeRonne testified that she made an adjustment for purchased water expense based on the 9.2% year 2000 figure instead of Aloha's assumed 10%. She further stated that, in response to OPC Interrogatory 50, the actual unaccounted for water percentage for the first seven months of 2001 was 8%. The utility would have to realize a considerably higher unaccounted for rate for the last five months of 2001 to bring the average 2001 rate up to 10%. (TR 719-720)

OPC witness Bidy testified that based on the first nine months of water usage the unaccounted for water should be 14%. He calculated this by dividing the total water sold by the total water pumped through September. This yielded a percentage of 86% and therefore unaccounted for water of 14%. (TR 781)

Utility witness Porter testified that Mr. Bidy did not take into account the water used in operating the system and that the unaccounted for water based on actual water usage figures for the first nine months of 2001 was 10.2%. (TR 1277)

Staff agrees with witness Porter that witness Bidy failed to take into account the non-revenue producing but accounted for water in his unaccounted for water calculation.

Utility witness Nixon testified he utilized a 10% unaccounted for water factor for an adjustment to purchased water expense for two reasons. First, it is the Commission's acceptable limit. Second, there were two months indicated in the MFR's where the company sold more water than it had pumped and purchased. He testified that the use of a 10% unaccounted for water percentage is reasonable since he was attempting to normalize the test year for going forward expenses. (TR 1172-1173)

Intervener Wood's position that a business in a competitive marketplace could not survive with a 10% unaccounted for loss is not applicable in that the amount of acceptable loss of inventory in any business will be unique to that business. It is generally accepted in the water industry that a water system will have some unaccounted for water loss. The only question is how much is acceptable.

Staff has reviewed the record and notes the utility reported that 851,020,000 gallons of water were pumped from wells or purchased during the first nine months of the test year and 764,121,000 gallons were sold or otherwise accounted for, leaving

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86,899,000 gallons as unaccounted for water (EXH 10, TLB-10). This results in 10.2% unaccounted for water for the first nine months of the test year. Staff recommends that, since chemicals and purchased power were based on 2000 expenses projected forward to 2001 by customer growth, the unaccounted for water for 2000 was 9.2% and the unaccounted for water for the first nine months of 2001 was 10.2% it is reasonable to use a 10% figure for unaccounted for water for the test year.

**ISSUE 15:** Should an adjustment be made for related-party purchased water transactions?

**RECOMMENDATION:** The royalty fee charged by the related parties should be reduced to \$0.10 per thousand gallons. (MERCHANT, JAEGER)

**POSITION OF THE PARTIES**

**ALOHA:** No. This is not only a method previously approved by the Commission as an appropriate method for acquiring water, but is also the cheapest alternative available to the utility for needed water. The alternative is purchase of 100% of Aloha's water from Pasco County at a rate substantially higher than the cost from related parties.

**SWFWMD:** No position.

**OPC:** Yes. OPC agrees with staff that the royalty fee charged by the related parties should, at a minimum, be reduced to \$0.10 per thousand gallons. This would result in a minimum reduction of purchased water expenses of \$88,330.

**WOOD:** Adopts OPC's position.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** Staff witness Fletcher testified that Aloha currently purchases water from four different entities: Tahitian, Interphase, Mitchell, and Pasco County. Both Tahitian and Interphase are related parties, whereas Mitchell and Pasco County are non-related parties. Aloha pays royalties for water purchased from its related parties at \$0.32 per thousand gallons and only pays Mitchell \$0.10 per thousand gallons. The purchased raw water expense from both Tahitian and Interphase was \$128,480 for the test year. The current price that Pasco County charges for treated water is \$2.35 per thousand. (TR 956-957, EXH 16)

Mr. Fletcher outlined the history of the contracts with Tahitian, Interphase, and Mitchell. Each of the three parties installed and incurred the original costs of the wells. Aloha has paid for repairs and maintenance and some improvements to the wells since their initial installation. The raw water agreements originated in 1972 for Mitchell, 1977 for Tahitian, and 1978 for Interphase. The original Mitchell agreement in 1972 provided for

a charge of \$0.05 per thousand gallons of water extracted, but this rate was increased to \$0.10 in October 1975. The Mitchell rate has not changed since 1975. (TR 956-957, EXH 16)

The 1977 Tahitian agreement provided for a charge of \$0.10 per thousand gallons of water extracted, but this was increased in 1988 to \$0.25 and in 1992 to \$0.32. The 1978 Interphase agreement started at \$0.10 per thousand gallons of water extracted and was also increased to \$0.32 subsequently, but Mr. Fletcher did not know when the amendments were executed for that increase. (TR 956-957, EXH 16)

Utility witness Watford testified that the royalty agreements are the best course available to Aloha for many reasons. One is that this method of payment has been previously approved by the Commission in prior cases for Aloha and other utilities. The royalty agreements allow Aloha the right to relocate wells at any point in time in the future, without buying land, if an initial location becomes unacceptable. Mr. Watford stated that he believed the royalty arrangements are better than owning parcels of land and extracting water from only those parcels. (TR 490)

Mr. Watford testified that the Commission approved the unrelated Mitchell property royalty rate in Aloha's 1976 rate case. In that case, Mr. Watford contended, the Commission staff recognized a 100% increase of the rate and that increase was included in the rate calculation approved by the Commission. Although Aloha's related party royalty rates charged by Tahitian and Interphase have increased more than that charged by rate for the Mitchell property, that basis alone is inappropriate to deny the cost. Mr. Watford added that a better indicator for determining the reasonableness of the related party charge would be to measure the effects of inflation on the amount approved in the 1979 Order. (TR 490-491)

In addition, Mr. Watford testified that it is unreasonable for the Commission to have approved this methodology for acquiring raw water in the past, and then to suggest now that Aloha should have done something different over the intervening years. Regardless, the Commission should view the current related-party arrangement in light of the alternative sources of water Aloha has available. According to Mr. Watford, the only available alternative to Aloha paying a royalty to its related parties is the purchase of bulk treated water from Pasco County. Not only is this alternative much more expensive than acquiring water through payment of a royalty and

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Aloha treating the water itself, Mr. Watford questions whether Pasco County would be willing to guarantee the quantities that Aloha needs. He testified that this would also make Aloha a captive customer of Pasco County, which Mr. Watford believed was unreasonable, unstable and risky, in addition to a substantial increase in the cost of water. (TR 491-492)

Since Mr. Watford believed that there were no other viable alternatives available to the utility, he concluded that the cost of purchasing treated water from the County is the only accurate measure of current market value. As such, he testified that the Commission should recognize the related-party royalty charge as a reasonable cost for providing service, which he believed was at or below the charge that would be imposed by an unrelated entity. Mr. Watford also added that if the Commission denied recognition of the cost of the royalty paid on raw water, Aloha would be forced to use an alternative water source for all of its water needs, which will drive rates even higher. (TR 490-493)

Mr. Fletcher agreed with Mr. Watford that the Commission included the \$0.10 Mitchell charge in the rates determined in Order No. 8450, issued August 29, 1978, in Docket No. 770720-WS. Mr. Fletcher noted, however, that neither the Tahitian nor Interphase royalty transactions were issues addressed in that case. (TR 957-958, EXH 31)

Mr. Fletcher stated that in the Florida Cities Water Company (FCWC) case, the Commission reviewed the reasonableness of a related-party royalty agreement for the purchase of raw water. In Order No. PSC-96-0859-FOF-WU, issued July 2, 1996, in Docket No. 951029-WU, the Commission approved operating expenses for a royalty fee of \$0.03 per thousand gallons in perpetuity for raw water extracted. To test the reasonableness of the royalty fee, the Commission compared the original cost of the land when first devoted to public service with the cost of the royalty. In doing this, the Commission found that a third party appraisal at the time the land was sold to a non-related party was an appropriate measure of the original cost of the land necessary for the wells, including required easements. The Commission then took an assumed rate of return and added income, property, and other tax effects to generate an approximate annual expense if the land had been owned by the FCWC. Using this calculation, the Commission found that the royalty fee transaction was less than the original cost estimate and thus approved the \$0.03 per thousand gallons royalty fee. (TR 958-959)

Mr. Fletcher testified that the Commission specifically addressed Aloha's royalty fees for the purchase of raw water in Docket No. 000737-WS. That docket was an overearnings investigation of the Aloha Gardens water and wastewater systems and the Seven Springs water system. By Order No. PSC-01-1374-PAA-WS, issued June 27, 2001, the Commission attempted to use the same test used in the FCWC's case to evaluate Aloha's royalty fees. However, Aloha maintained that its related parties did not have documentation of the original cost of the well and land when first devoted to the service of Aloha ratepayers. The Commission found that the utility should have taken the appropriate steps to determine the original cost of the land and wells as of the date the utility began extracting water from these wells in order to test whether the transaction was prudent. (TR 959-960)

Further, the Commission found that Aloha could have had these lands appraised by an independent appraiser and retained the services of a professional engineer to conduct an original cost study on the wells initially installed. Without this information, the Commission found that it could not evaluate the reasonableness of Aloha's related-party royalty fees at that time. In its order, the Commission found that it was the utility's burden to prove that its costs were reasonable. The Commission stated that, by their very nature, related-party transactions require closer scrutiny. Although a transaction between related parties is not per se unreasonable, it is the utility's burden to prove that its costs are reasonable. Florida Power Corp. v. Cresse, 413 So. 2d 1187, 1191 (Fla. 1982). This burden is even greater when the transaction is between related parties. In GTE Florida, Inc. v. Deason, 642 So. 2d 545 (Fla. 1994), the Florida Supreme Court established that the standard to use in evaluating affiliate transactions is whether those transactions exceed the going market rate or are otherwise inherently unfair. (TR 960-961)

The Commission further ordered that the issue regarding the reasonableness of the rates charged by Mitchell, Tahitian, and Interphase be addressed in the instant rate case for the Seven Springs water system. The Commission concluded that it was not precluded from finding in the instant case that the \$0.10 per thousand gallons charge for purchased raw water is appropriate for the calculation of final rates if Aloha fails to meet its burden of proof. (TR 961)

Mr. Fletcher conducted an analysis of Aloha's royalty agreements with Mitchell, Tahitian, and Interphase. (EXH 16, SBF-3) The Mitchell property contained 6,700 acres on which Aloha can locate its wells as well as a 10-acre water plant, with only a few restrictions. The Tahitian and Interphase agreements relate to 30 and 638 acres, respectively. Mr. Fletcher testified that with the related parties, the agreements can be cancelled by Tahitian and Interphase with 30 days written notice. The related-party agreements also contain escalation provisions. Mr. Fletcher noted that the Mitchell and FCWC royalty provisions were analogous in that they were both perpetual and contained a fixed rate. Since the Mitchell agreement was an arm's-length transaction, and, without any additional evidence to the contrary, Mr. Fletcher concluded that the Mitchell charge of \$0.10 was reasonable, and was of greater value to Aloha than the related-party purchased water agreements. He added that given the greater value of the Mitchell agreement, the royalty fees charged by the related parties should have been less than that charged by Mitchell. (TR 961-962)

Mr. Fletcher further concluded that he did not believe that Aloha had met its burden of proof that the royalty fee paid to its related parties for raw water was reasonable. The utility failed to provide the original cost of the land and wells as of the date Aloha began purchasing water from its related parties which would enable the Commission to perform a comparative analysis as was done in the FCWC case. As such, he could not determine the appropriate royalty fee to allow for the Tahitian and Interphase agreements. Mr. Fletcher testified that, at a minimum, the royalty fee charged by the related parties should be reduced to \$0.10 per thousand gallons. Based on the test year calculation included in the MFRs, the Seven Springs water system's operation and maintenance (O&M) expenses should be reduced by \$88,330. (TR 962-964)

On cross examination by OPC, Mr. Fletcher testified that staff had tried to obtain information to support the original cost of the land and wells when Aloha first began extracting the water, but was unable to get that information from the company. He added that had he obtained the information, he would have attempted to perform the same analysis that was done in the FCWC case to test the reasonableness of the charges. (TR 966-967)

On cross examination by Aloha, Mr. Fletcher agreed that Aloha had told staff that it could not get the information because the related party did not have the information. Mr. Fletcher also



agreed that Aloha had reported the related-party purchased water costs in its annual reports to the Commission for many years and that the Commission had never taken issue with this until the overearnings investigation in Docket No. 000737-WS. In addition, in 1998, after a Commission audit report and other discovery dealt with the issue, the Commission staff did not to make it an issue in that limited proceeding case. (TR 967, 972-973)

Mr. Fletcher testified that the market rate for raw water purchased up to the level of the WUP was the Mitchell rate, but later added that there were distinct differences between the Mitchell and the related party agreements. For any water purchased above the WUP, the short-term market for treated water would be the Pasco County rate, since the County is the utility's only option in the short-term. But Mr. Fletcher did not agree that the market rate for raw water is equal to the Pasco County rate below the WUP. (TR 975)

Regarding whether Tahitian or Interphase had ever suggested that they would discontinue service to Aloha on a whim, Mr. Fletcher noted that Mr. Watford testified that the related parties would cease the agreement if they were not paid or if Aloha broke the contract. (TR 981) Further, to the extent that SWFWMD allowed, Aloha could explore transferring the withdrawal allocation limits of those wells to other areas within the Seven Springs water system if the related parties ceased the agreements. This was based on the response staff received from SWFWMD, but Mr. Fletcher could not speak to whether SWFWMD would approve it. (TR 984-986)

Mr. Fletcher also agreed that given Aloha's circumstances in its territory and that SWFWMD is requiring Aloha to purchase water from Pasco County, which is the only provider, a true free market for treated water does not exist. As such, a market price cannot be calculated. (TR 991)

Mr. Fletcher testified, however, that there is a market price for the raw water for Aloha because Aloha has the option to purchase from Mitchell, Tahitian, and Interphase up to Aloha's WUP capacity. Above the WUP, Pasco County is the only vendor or option available for treated water and the price is \$2.35 per thousand gallons of water extracted. (TR 992-994)

Mr. Fletcher testified that it is prudent for a utility to use the most cost-effective method for expenses that it incurs. Mr.

Fletcher also testified that it would be more prudent to have a source of water which was not interruptible. He stated that it is important to weigh the costs and benefits. (TR 996) It is not just an issue of whether one source is cheaper in the short run. The short-term cost may be lower initially, but higher in the long run. If an interruptible source is disconnected, the utility would have to incur higher costs to find another source, so in the long run the cost could be higher than the non-interruptible source. Mr. Fletcher stated that you have to look at the circumstances of both the long and short run sources. (TR 997)

Mr. Fletcher testified that even if many wells in that area were going bad in 1977, it would have been prudent for Aloha to perform a cost benefit analysis to consider whether to purchase land and construct wells or enter into long-term royalty agreements with related parties. He thought that a utility should look at the conditions at the time and any expense that they are going to incur. When asked if he knew whether Aloha did that at the time the royalty agreements were signed, Mr. Fletcher stated that he did not know what the management did or what analyses they performed when they executed the agreements. (TR 1001-1002)

On redirect examination (TR 1005), Mr. Fletcher expressed staff's concern with the related-parties' provision to interrupt the contract with 30-days notice. He agreed that staff asked Aloha if it could get the contracts modified to delete the 30-day provision and the utility said no.

Aloha witness Nixon testified on rebuttal that Aloha's purchases have been disclosed in the annual reports filed with the Commission since at least 1978 and the Commission never objected to the costs until 2000. Even though a Commission audit report disclosed the related party purchases, the issue was not raised in Order No. PSC-99-1917-PAA-WS, which was issued in two limited proceedings. As such, Mr. Nixon stated that one could presume that the related party costs for purchased water were deemed reasonable by the Commission. (TR 1181-1182)

Mr. Nixon contended that the principle of regulatory finality should be exercised in this case. In his opinion, going back 24 years to second guess the prudence and cost effectiveness of Aloha's decisions, when the Commission has not objected to those decisions, was unreasonable and certainly unfair. (TR 1182)

Mr. Nixon stated that Mr. Fletcher overlooked the concept of present value and the time value of money from the raw water suppliers' perspective. The time value of money is the reason why the related party agreements contained an escalation clause. Mr. Nixon testified that the related party holders of the water rights wanted some mechanism to insure that the original \$0.10 per thousand gallon price originally agreed to retained its value over time. (TR 1182) If the current price of \$0.32 was discounted back to 1977 and 1978 dollars, the price would have been \$0.03 and \$0.04, respectively, using a discount rate of 10%. (EXH 24, RCN-13) He used this rate since that was the overall rate of return established in Aloha's 1976 rate case when the 1975 agreement with Mitchell was recognized by the Commission. Mr. Nixon's exhibit also calculates a price in today's dollars of \$0.98 and \$0.90 respectively for Tahitian and Interphase, based on what he believed was the original \$0.10 amount trended forward. (TR 1183)

Mr. Nixon testified that if you accept the notion that a dollar today is not worth as much as a dollar was 23 or 24 years ago and discount the present value of the cost per thousand gallons, the current prices of Aloha's related party agreements are very reasonable. This is particularly true given the costs of the current alternatives. (TR 1202)

On cross examination by staff, Mr. Nixon stated that other than the right to extract the water, Interphase has no investment in the land on which Wells 6 and 7 are located. This is because it no longer owns the land and does not pay property taxes on those parcels. Mr. Nixon also agreed hypothetically that had Aloha purchased land and installed its own wells, it would earn a return on the original cost of the land and wells and recognition of depreciation and property tax expenses on the wells. (TR 1210-1211)

Mr. Nixon also responded that 20 years ago, there was an emergency water situation in Pasco County requiring many utilities to shut down wells. As Aloha was a very small company then, Mr. Nixon did not think it had the money to buy the land and put in wells in 1977 and 1978. (TR 1211-1212)

On rebuttal, Utility witness Watford testified that the related party property has never been devoted to public service, only leased under a royalty arrangement. To be able to determine the original property value, the cost of condemnation of that property, which he thinks would be high, would have to be considered. While the

Commission did not specifically endorse the arrangements with Mitchell, the related cost was included in rates. Mr. Watford testified that the utility relied upon this tacit approval when Aloha made similar arrangements with a related party. He argued that it is not reasonable to say now that the utility should not have entered into the royalty arrangements, after the Commission specifically recognized such an arrangement for an unrelated third party. (TR 1365-1366)

Mr. Watford believed that the Commission must review the related party royalty agreements based on current conditions. He added that the related party has now agreed to sell treated water to Aloha at the same price charged by the County, which Mr. Watford stated is the current market value. Mr. Watford admitted, however, that he did not know how much it would cost Tahitian or Interphase to provide Aloha treated water. (TR 1413) Given the alternatives, Aloha is better off paying the royalty to its related parties than paying the County price for treated water or seeking some other unknown alternative source. Mr. Watford contended that the related party price is the best alternative that Aloha has to provide water to its customers at the cheapest possible price. Mr. Watford testified that if the Commission denies recognition of the related party royalty, then an increase should be granted to cover purchasing all water from Pasco County, or to purchase treated water from the related party at a cost similar to that charged by the County. (TR 1366-1369)

Finally, Mr. Watford addressed Mr. Fletcher's suggestion and responses from SWFWMD that the utility move to new well locations on property that it purchased. Based on Mr. Watford's discussions with SWFWMD staff, a proposal to move existing or purchase new wells to increase Aloha's capacity has the same requirements as a new permit submittal. Mr. Watford testified that new permits are denied in almost every case and that the likelihood of Aloha getting a new permit was very small. (TR 1369)

In Exhibit 31, the utility's interrogatory response stated that prior to 1992, the PSC annual report did not delineate out the amount of royalties paid for purchased water by each entity. When questioned by staff, Mr. Watford admitted that the information was not provided to the Commission prior to 1992 and the utility cannot specifically determine the amount of royalties it paid Tahitian from 1977 to 1991. Aloha only provided the information from 1992 through 2000. While the utility did not have that earlier information

available to provide, he stated that he was not aware of any requirements to keep records back that far. Regardless, Mr. Watford agreed that the total royalties paid to Tahitian and Interphase from 1992 to 2000 were in excess of \$1 million. (TR 1414-1415)

On redirect, Mr. Watford testified that the purchase price for those related party properties sold would be depressed because of Aloha's right to withdraw water. He also testified that the Mitchell agreement does not say that Mitchell will allow the location of a ten-acre plant site without payment for the land. Aloha has interpreted that to be an option agreement indicating a willingness that he would enter into negotiations to, to sell us a site. Mr. Watford also testified that the agreement specifically limits the location of a plant to an area that was not advantageous to the utility as the service area developed. In addition, he stated that Aloha could negotiate an agreement with the related parties to obtain a plant site, if needed. (TR 1435)

Mr. Watford also testified about a provision in each of the three agreements that states that the owner of the property has first use of the water for agricultural purposes and that the owner will cooperate in every manner with the utility in the SWFWMD. Mr. Watford interpreted this clause to mean that Aloha's right to withdraw water is inferior to that of the owner of the property. According to Mr. Watford, this is an important distinction between the related party contracts and that with Mitchell. The Mitchell Ranch is a large agricultural facility with water needs of its own. Through its relationship with the related parties, which are not agriculture operations, Aloha has the ability to determine who has access to that water. Whereas, under the Mitchell agreement, if Mr. Mitchell decided that he needed all of the water, Aloha would have no water under that agreement. (TR 1436-1438)

#### Staff Analysis

Staff recommends that the Commission find that the utility has failed to meet its burden to show that the related parties royalty fee is reasonable. Mr. Fletcher testified that the Interphase and Tahitian agreements are more expensive, can escalate in price even higher than the current charge, have less land available to use for well and plant sites, and have cancellation clauses with 30 days written notice. Mr. Watford's argument that the Mitchell agreement was less favorable because of Mitchell's agricultural business and first rights to the water use is conflicting. On one hand, Aloha

argues that it has control over its related parties for the water rights, but on the other, it states that Aloha has no control over the cancellation clause of the contract.

Staff believes that the utility has failed to show that its decision to enter into a royalty agreement instead of purchase land in the 1970's was prudent. During start-up years, all utilities have large initial investments that owners are required to make. Prudent decisions should be made based on a thorough analysis of the expected long-term costs and benefits that a utility will recover over the life of the plant.

Aloha did not have an appraisal of the land performed. Aloha argued that the original cost information did not exist nor was it relevant, and as such, the Commission does not need this in order to determine the reasonableness of the contracted price. Further, Aloha argued that because it is a contract between parties, the Commission should recognize this cost and not discount the contract because it was between related parties. Regardless of its arguments, staff does not believe that Aloha has shown that its related party royalties met the FCWC's test of reasonableness.

Aloha also argues that these agreements have existed for over 20 years, were entered into based on the Commission's approval of the Mitchell agreement, and the transactions have been reported to the Commission each year since inception. Staff does not believe that the Commission ever specifically addressed the Mitchell agreement until Order No. PSC-01-1374-PAA-WS. Also, Mr. Watford admitted that, not only was the information not available to Aloha, its annual reports did not specifically identify these amounts until 1992. Thus, the Commission has only seen the information reported for 10 total years. After an indication of overearnings, the Commission began reviewing the transactions in 1997 or five years after the transactions were reflected in the annual reports. Staff further notes that the original royalty fees from the related parties were initially the same as the Mitchell fees and did not reach \$0.32 per thousand gallons until apparently around 1992.

Further, Aloha wants the Commission to accept the related party cost as reasonable because it is cheaper than buying purchased water from Pasco County. Aloha relies on GTE Florida, which provides that the standard must be whether transactions exceeds the going market rate or are inherently unfair.

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For purchases of raw water below the limits in Aloha's WUP, staff believes the market price is set by the Mitchell agreement which was an arms-length transaction, i.e., \$0.10 per thousand gallons. Staff believes that it was imprudent to enter into an interruptible agreement with an escalation clause (the agreements with the related parties), when Aloha had an agreement in perpetuity with no escalation clause (the Mitchell agreement). Moreover, the Mitchell agreement has many more acres to choose from.

Further, staff agrees with Mr. Fletcher that Pasco County's rate for treated water is not a comparative market price for the related parties' raw water price. Aloha is comparing a finished product with a raw product, of which the cost to produce for each is very dissimilar.

Based on the above, staff recommends that the utility has not met its burden to prove that the cost of the related party purchased water is reasonable. Further, staff believes that the 30-day cancellation component in the related party agreements is risky, if not imprudent.

Finally, regarding the administrative finality argument, staff believes that the Commission only addressed this question for the first time in Docket No. 000737-WS, the overearnings docket. By Order No. PSC-01-1374-PAA-WS, issued June 27, 2001, in that docket, the Commission used the \$0.10 per one thousand gallons cost for both the related parties and Mitchell to determine the appropriate amount of overearnings and the Commission declined to address the reasonableness of the contracts at that time. Because the Commission left it up to the utility to come in at a later time to prove the reasonableness of the contracts, staff does not believe that the doctrine of administrative finality applies in this case.

Based on all the above, the royalty fee charged by the related parties should be reduced for regulatory purposes to \$0.10 per one thousand gallons. This reduces purchased water expenses by \$88,330.

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**ISSUE 16:** What is the appropriate amount of rate case expense?

**RECOMMENDATION:** The appropriate rate case expense for this docket is \$205,209. Pursuant to Section 367.0816, F.S., rate case expense shall be amortized over 4 years. This results in annual rate case expense of \$51,302. An adjustment should be made to O&M expenses of \$60,323 to adjust the amount requested by the utility in its MFRs. (S. JONES, MERCHANT)

**POSITION OF THE PARTIES**

**ALOHA:** The total as per the rebuttal update provided at hearing, and as provided in the testimonies of Nixon, Watford, Porter and Deterding.

**SWFWMD:** No position.

**OPC:** The company should have consolidated this current water rate case with its most recently filed wastewater case. Amortization expense of \$11,625 should be removed from O&M expenses and \$223,250 representing the average unamortized balance should be removed from the utility's working capital allowance.

**WOOD:** Zero. With the expense projected in this case, and the two (2) previous cases the customers will be burdened with 1.5 million dollars of rate case expense. What have they gotten for this expense? Nothing but excuses, and the same water, unfit for human consumption or any other use.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** The utility included a \$446,500 estimate in the MFRs for current rate case expense. (EXH 4, MFRs Vol. I, Schedule B-10, p. 42) The utility submitted a revised estimated rate case expense through completion of the file and suspend process of \$500,013. (EXH 24, RCN-14, EXH 29, SGW-1) The components of the estimated rate case expense (actual expenses and estimates to complete) are as follows:



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	<u>REVISED ESTIMATE PER EXH 24</u>			
	<u>MFR</u>	<u>ACTUAL</u>	<u>ADDITIONAL</u>	<u>TOTAL</u>
	<u>ESTIMATED</u>	<u>TO DATE</u>	<u>ESTIMATE</u>	<u>TOTAL</u>
Legal	\$250,000	\$110,136	\$166,000	\$276,136
Accounting	150,000	138,237	31,725	169,962
Engineering	40,000	15,755	16,160	31,915
Company Expense	<u>6,500</u>	<u>12,800</u>	<u>9,200</u>	<u>22,000</u>
Total	<u>\$446,500</u>	<u>\$276,928</u>	<u>\$223,085</u>	<u>\$500,013</u>
Annual Amortization	<u>\$111,625</u>			<u>\$125,003</u>

Utility witness Nixon testified that in the MFRs (EXH 4, Vol. I, B-10, p. 42), the estimated total cost of this rate case was \$446,500, with amortization of \$111,625 over a 4-year period. He stated that the rate case costs included in the MFRs were estimated based on information provided by Aloha's attorneys and consultants and their experience in the many Aloha proceedings before the Commission since 1995. Mr. Nixon stated that Aloha would provide updated actual and estimated rate case expense close to the hearing, in accordance with normal Commission practices. (TR 454)

On rebuttal, utility witness Watford testified that the amount of in-house costs related to this rate proceeding are included on Exhibit SGW-1. (EXH 29, SGW-1). This exhibit shows the total cost for this rate case to date, including notices and filing fees, incidentals, and travel estimates to complete the case. The utility relied upon its experience from the last couple of notices issued to estimate the costs for the two expected additional notices in this rate case. (TR 1342-1343)

Mr. Deterding testified that Aloha's actual and estimated rate case expenses were reasonable in light of the requirements imposed within this rate case. He stated that Aloha and its consultants have been as efficient as possible and tried to keep rate case costs to a minimum where they could. Mr. Deterding believed that the time and costs incurred have been prudent and appropriate. (TR 1441-1143)

Staff has examined the requested actual expenses, supporting documentation, and estimated expenses for the current rate case. Section 367.081(7), Florida Statutes, states that:

The Commission shall determine the reasonableness of rate case expenses and shall disallow all rate case expenses determined to be unreasonable. No rate case expense

determined to be unreasonable shall be paid by a consumer.

Based on our review of the record, staff believes that several adjustments are needed to rate case expense.

Duplicate Interim Rate Requests

During cross examination by staff, Mr. Nixon agreed that the Commission determined in Order No. PSC-01-1374-PAA-WS, issued June 27, 2001, in Docket No. 000737-WS, that the Seven Springs water system had excess earnings for the historical test year ending December 31, 2000. (TR 1208) He also agreed that staff's recommendation on overearnings for that decision was filed on May 31, 2001, and shortly afterwards it would have been available to counsel for Aloha and the utility. (TR 1209)

Mr. Nixon testified that on August 10, 2000, the utility filed for its rate case. Along with its application, the utility also filed an interim rate request and used the historical 2000 test year. The company subsequently withdrew its first interim request and filed a revised request based on the test year ended June 30, 2001. Mr. Nixon agreed that the Commission approved interim rates based on this revised test year. Mr. Nixon stated that he had prepared an exhibit, filed a few days before the hearing, that detailed the rate case expense associated with the utility's revised interim filing. Exhibit 25 listed \$1,900 for legal and \$3,556 for accounting costs associated with the duplicate filing. (TR 1209-1210)

Upon cross examination by staff, Mr. Larkin testified that he did not think a utility should recover rate case expense for two interim requests due to an error and subsequent change in test year. (TR 672-673)

Staff recommends disallowing the rate case expense related to the duplicate filings for interim rate relief by Aloha. Aloha was aware, prior to its filing, that the original interim test year would not reflect earnings below the minimum of the range on its return on equity, as required by the interim statute, Section 367.082, Florida Statutes. Staff believes that the record reflects that these costs were duplicative, and therefore, unreasonable. As such, total rate case expense should be reduced by \$5,456.

Estimated Costs to Complete the Case

Exhibit 24 breaks legal services into actual costs incurred through November 30, 2001, and estimated rate case expense through post-hearing. The legal costs to complete this case were estimated at \$166,000, which included 790 billable hours and \$8,000 in expenses. The hours were broken down into 4 sections: review and preparation of testimony pre-hearing (250 hours); hearing preparation and late-filed exhibits (250 hours); review of transcripts through final order (200 hours); and reconsideration (90 hours).

The utility's breakdown for each of these sections included a description of items to be performed but no specific amount of time associated with each item. It only provided a total number of hours, as well as costs, for each section. While the descriptions of items appeared reasonable, staff had no basis to determine whether the individual hours estimated were reasonable.

It is fully the utility's burden to justify its requested costs, with no exceptions made for rate case expense. Florida Power Corp. v. Cresse, 413 So. 2d 1187, 1191 (Fla. 1982). It has long been the Commission's policy to require detailed estimates to complete. In reviewing these estimates, staff has the opportunity to determine what types of items for which the utility is requesting recovery of and the prudence of any items and time spent.

The Commission enjoys a broad discretion with respect to allowance of rate case expense. Florida Crown Util. Servs., Inc. v. Utility Regulatory Bd. of Jacksonville, 274 So. 2d 597, 598 (Fla. 1st DCA 1973). Nevertheless, it would constitute an abuse of discretion for the Commission to automatically award rate case expense without reference to the prudence of the costs incurred in the rate case proceedings. Meadowbrook Util. Sys., Inc. v. FPSC, 518 So. 2d 326, 327 (Fla. 1st DCA 1987), rehearing denied, 529 So. 2d 694 (Fla. 1988).

The record shows that a substantial amount of work was performed by Aloha's attorneys, as evidenced by attendance at the formal proceedings, exhibits filed, and brief preparation. Based on this record evidence and on past experience in determining allowable rate case expense, we believe it is reasonable and appropriate to allow the utility 400 hours for estimated legal costs at \$200 per hour and \$5,000 in expenses. Staff believes that a

reasonable breakdown of this would be 240 for prehearing preparation and attendance at the hearing and 160 for post-hearing work through the final order. This results in a reduction to legal rate case expense of \$63,000. Staff notes that each of the other consultants for Aloha prepared detailed estimates broken down by hour for each item described whereas Aloha's attorneys did not. (EXH 24, RCN-14, pgs. 27 and 59)

Aloha estimated 90 hours, or \$18,000, plus \$500 in expenses for reconsideration costs. Staff believes that the utility's request for these costs is premature. If in fact any motions for reconsideration are filed, any increased costs can be addressed by the Commission at that time.

In reviewing the accounting estimate to complete, Aloha requested \$2,600 for costs labeled "Miscellaneous for Discovery and Additional Exhibits," which is listed after the review of the Final Order. Staff is not aware of any additional accounting exhibits or discovery that was not specifically identified in the estimate to complete or that will be required after the Final Order is issued. As such, we recommend that these amounts be removed from rate case expense.

A summary of rate case expense adjustments discussed above follows:

<u>Legal Adjustments</u>		<u>Accounting Adjustments</u>	
Duplicate Interim Filing	\$1,900	Duplicate Interim Filing	\$3,556
Undocumented & Excessive Hours Estimate	63,000	Undocumented & Excessive Hours Estimate	2,640
Reconsideration	<u>18,500</u>		<u>1,237</u>
Total	<u>\$83,400</u>	Total	<u>\$6,196</u>

#### Water Rate Case Filing

OPC witness Larkin testified that he did not believe the rate case expense projected by Aloha was reasonable. Aloha filed two rate cases essentially one right after the other. The two cases were for the same service area: the first for Seven Springs wastewater and the second for Seven Springs water. Had Aloha consolidated its recently completed wastewater rate case, which was filed in February 2000, with this current water case, Aloha would have avoided virtually the entire amount of rate case expense

associated with this case. He stated that the utility could have filed simultaneously, with a little planning on its part, as is typical in most water and wastewater rate cases. Instead, Mr. Larkin stated Aloha had chosen to be extravagant with the customers' money. Mr. Larkin requested that the Commission deny any rate case expense in this water rate case even if his recommendation on Issue 2, that Aloha had failed to meet a competitive standard for service, is not adopted. (TR 664-669, 671-672)

OPC witness DeRonne also proposed that rate case expense associated with Aloha's current case should be denied. She stated that her recommendation was based on OPC witness Larkin's direct testimony. To remain consistent with his recommendation, Ms. DeRonne stated that in her exhibits she removed the proposed average unamortized balance for rate expense of \$223,250 from working capital on her Schedule C. (EXH 9, DD-1, Schedule C, p. 12) She also removed the utility's proposed amortization of rate case expense for the current case of \$111,625 on her Schedule B. (EXH 9, DD-1, Schedule B, p. 2) (TR 728)

In his rebuttal testimony, Mr. Nixon stated that Mr. Larkin's theory and recommendation regarding rate case expense were incorrect. When Docket No. 991643-SU was filed in February 2000, Mr. Nixon stated that Aloha had no basis for requesting an increase in water rates at that time. Mr. Nixon affirmed that from 1998 through 2000, a rate increase for the Seven Springs water division would not have been supported, except for the request for recognition of purchased water costs. During this time, Aloha had two limited proceedings and one overearnings investigation on-going. The overearnings investigation was in Docket No. 000737-WS and was opened on July 18, 2000. That docket was based on the test year ended December 31, 2000. Mr. Nixon stated the utility learned that it faced large purchased water increases from Pasco County sometime around November 2000. (TR 1165-1167)

Mr. Nixon testified that on February 5, 2001, Aloha filed a limited proceeding (Docket No. 010168-WU) to recover additional purchased water costs that would be incurred from Pasco County. Aloha filed a limited proceeding instead of a rate case to minimize the regulatory costs. However, at the time the limited proceeding was filed, SWFWMD had not issued its emergency order requiring the utilities in the Tampa Bay Water Use Caution Area to implement water conservation inclining block rate structures. Mr. Nixon stated that the SWFWMD order came out on March 20, 2001, which was two days

before the staff recommendation was issued that recommended denial of the limited proceeding. By Order No. PSC-01-0997-PAA-WU, issued April 23, 2001, the Commission denied the utility's request for a limited proceeding and instead stated that a full review of the Seven Springs water earnings was required to determine whether a rate increase was warranted and to determine an appropriate rate structure. Mr. Nixon testified that another full review of the water system's earnings was required despite the fact that there was an on-going investigation in Docket No. 000737-WS. (TR 1167)

Mr. Nixon testified that Aloha customers would not have benefitted in 1999 had the utility filed a water rate request with its wastewater case. In fact, assuming that a rate increase similar in magnitude to the one requested in this case had been combined and granted with the wastewater case, the customers would have been paying much higher interim and final rates from May 2000 to the present. Mr. Nixon concluded that the rates that would have been paid by the customers, including additional rate case expense for the water portion, would have been much greater than the cost of this case, amortized over four years. (TR 1168)

Mr. Nixon stated it is not clear whether the issue of a conservation oriented inclining-block rate structure would have been addressed at the time the wastewater rate case was filed. He agreed that Aloha was put on notice that a rate restructuring would be necessary in Order No. PSC-97-0280-FOF-WS, issued March 12, 1997. Mr. Nixon stated that in this order, it was not clear if such a restructuring would simply be a base facility charge and a single block gallonage charge. He believed that if rates had been so restructured, Aloha would still be back before the Commission seeking an inclining-block rate structure in a full rate case. Mr. Nixon pointed out that since the issue date of Order No. PSC-97-0280-FOF-WS, staff has conducted two separate overearnings investigations and audits and has not addressed the rate restructuring issue at all. Based on the above, Mr. Nixon stated that Aloha's customers had actually benefitted by Aloha not combining a water rate case with the wastewater case. (TR 1168)

On rebuttal, Mr. Watford testified that Mr. Larkin had provided no evidence that showed rate case expense should be disallowed because the utility could have filed this water case at the same time as its wastewater case. (TR 1372) Mr. Watford added that the wastewater case was originally filed in April, 2000 and since then, there have been two full rate investigations by the Commission.

Even though the last case ended recently in August, 2001, both investigations resulted in no increase in water rates for the utility. Mr. Watford pointed out that the last case suggested that the utility was slightly overearning. (TR 1373)

Mr. Watford added that the only way that Aloha could have justified a rate increase was if it had proposed to begin purchasing water from Pasco County several years ago. If Aloha had done that, the long-run cost to the customers would have been higher because that additional purchased water cost would have far outweighed any savings by combining two rate cases. Mr. Watford stated that Aloha prudently investigated other alternatives for purchasing water from another source other than the County and Aloha's customers have benefitted from this approach. (TR 1373) In conclusion, Mr. Watford stated that Mr. Larkin's proposal to disallow the rate case was contrary to reason and law and that he had never heard of a case in Florida or any other jurisdiction where such a proposal has been made, much less accepted. (TR 1373-1374)

Staff believes that Mr. Larkin's argument has merit. Aloha could have easily filed a combined rate case for its water and wastewater systems. Staff disagrees with Mr. Watford that the only way it could have received rate relief in prior years was for Aloha to purchase water from Pasco County. As previously addressed in Issues 1, 2 and 9(a), Aloha had many improvements it could have made to its plant to improve its water quality or to find a new source of water. Instead, as has been pointed out numerous times in this record, Aloha continually fails to act unless it is specifically ordered to do so by a regulatory agency.

As Mr. Nixon admitted, Aloha was put on notice that a rate restructuring would be necessary in Order No. PSC-97-0280-FOF-WS, issued March 12, 1997. Water quality issues began surfacing in 1995. See Order No. PSC-00-1285-FOF-WS, issued July 14, 2000. According to SWFWMD witness Parker, Aloha began to consistently exceed the permitted annual average day withdrawal in 1996 with some excesses as early as 1994. (TR 557-559)

Messrs. Watford and Nixon both stated that costs would have been greater in the long run if Aloha had filed an earlier rate case that included the increased cost for purchased water from Pasco County. Staff disagrees with both of these witnesses. Had Aloha taken a proactive approach to address its quality of water and supply issues years ago, any plant necessary could have been in

service for several years. In addition, Aloha could have easily increased its service availability charge during that time frame to defray its investment in the plant improvements and expansion costs. This is especially true in light of the substantial growth that occurred in this system as identified in this record.

Further, Mr. Watford testified that Aloha prudently investigated other alternatives for purchasing water from another source other than the County and Aloha's customers have benefitted from this approach. If Aloha did in fact perform any such cost benefit analyses, it has not provided any support in the record of this case. Absent such evidence, the Commission cannot determine if Aloha's choice of purchasing water from Pasco County was indeed the most cost effective alternative that was available. The Commission could also have determined that what Aloha chose to do was not the most cost effective and as a result, the long-term cost for Aloha customers may have been less. Without this supporting information, the Commission cannot make a determination of which alternative was the most cost effective.

Mr. Watford also stated that he knows of no case in Florida or any other jurisdiction where a proposal has been made to eliminate rate case expense, much less where the proposal has been accepted. The Commission has addressed numerous cases where imprudent expense has been alleged as well as denied.

In Order No. PSC-98-1583-FOF-WS, issued November 25, 1998, in Docket No. 971663-WS, where Florida Cities Water Company was seeking recovery of court costs (and the rate case expense associated with the docket filing), the Commission found that the incurrence of rate case expense was imprudent and denied the utility's request for recovery. Also, in Order No. PSC-96-1320-FOF-WS, issued October 30, 1996, in Docket No. 950495-WS, the Commission denied legal rate case expense of \$25,000 incurred for what the Commission deemed an imprudent appeal of the Commission's oral decision on interim rates.

Finally, in Order No. 18960, issued March 7, 1988, in Docket No. 861338-WS, the Commission determined that expenditures for misspent time were imprudent and reduced the requested rate case expense by \$32,500. Several cases can also be found in three of Aloha's own requests for limited proceedings. In each of the three prior requests for limited proceeding, all rate case expense requested was denied as the case either showed the utility was



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earning a fair rate of return or the case was dismissed as an improper filing.

As discussed previously in this issue, it is the utility's burden to prove that its requested costs are reasonable including costs associated with rate case expense. While staff recognizes that filing combined water and wastewater rate cases would have resulted in material cost savings, there would have been incremental costs. Although staff has no method to determine those incremental costs, we believe that the total time for hearings, depositions, and preparation of testimony could have been reduced significantly. Also, notices and travel requirements would not have to have been duplicated. Staff estimates as much as 50% of the costs of this rate case could have been avoided if it had been filed in conjunction with the wastewater case. Therefore, staff recommends that only 50% of the adjusted rate case expense be allowed.

Staff recommends that the appropriate total rate case expense is \$205,209. A breakdown of the allowance of rate case expenses is as follows:

	<u>UTILITY</u> <u>REVISED</u> <u>ACTUAL &amp;</u> <u>ESTIMATE</u>	<u>LESS</u> <u>STAFF</u> <u>ADJUST-</u> <u>MENTS</u>	<u>STAFF</u> <u>ADJUSTED</u> <u>BALANCE</u>
Legal	\$276,136	\$83,400	192,736
Accounting	169,9621	6,196	163,766
Engineering	31,915	0	31,915
Company Expense	<u>22,000</u>	<u>0</u>	<u>22,000</u>
Total	<u>\$500,013</u>	<u>\$89,596</u>	<u>410,417</u>
50% Allowance			<u>205,209</u>

Based on the record and the staff recommended adjustments discussed above, total current rate case expense of \$205,209 should be allowed. Pursuant to Section 367.0816, Florida Statutes, rate case expense should be amortized over 4 years. This results in annual rate case expense of \$51,302. An adjustment should be made to O&M expenses of \$60,323 to decrease the amount requested by the utility in its MFRs.

DOCKET NO. 010503-WU

DATE: March 21, 2002

**ISSUE 17:** What conservation programs, and associated expenses, are appropriate for this utility at this time?

**RECOMMENDATION:** The utility should be allowed to recover \$120,000 in its rates for monthly service for the implementation of conservation programs as described below. (KUMMER)

**POSITION OF THE PARTIES**

**ALOHA:** All of the conservation programs agreed to between the utility and SWFWMD should be recognized and included in rates. The utility cannot implement those conservation programs unless the estimated annual cost of \$155,000 is recognized. Expenditure of these costs are required by the SWFWMD.

**SWFWMD:** Given Aloha's location and violation of the Permit, water conservation measures are necessary and appropriate. Such programs can reduce water use, benefitting the public and the environment. Customer education, implementation of operational and incentive water conservation measures applicable to its customers, and pursuit of partnerships with Pasco County are encouraged.

**OPC:** At this point, there is no agreement between Aloha and SWFWMD. Aloha's customers should not be burdened with rates to pay for non-existent programs.

**WOOD:** None. Let Aloha get its house in order. Determine where the 10% unaccounted loss is taking place and correct the situation. This is just good management practice. When Aloha starts supplying good water there will be less flushing, and the customers will be able to conserve water.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** In its initial filing, the Utility requested a rate structure consisting of a base facility charge (BFC) and a two-tier inclining block rate. (TR 453) Under its proposal, the base facilities charges and the first tier gallonage charges would be set to recover all of the approved revenue requirements, while the revenue from the second tier gallonage charges would be used to fund conservation programs. (TR 453) A similar concept was presented in SWFWMD's witness Sorenson's testimony. She advocated adopting inclining block rates to encourage conservation and allowing the utility to set rates so as to create a water conservation fund to

help pay for programs. (TR 617) The utility insisted that programs must be funded up front because benefits may only appear months or even years following program implementation, causing the utility financial harm until such cost savings are realized. (TR 495)

OPC witness DeRonne objected to the over collection of revenue requirements proposed by the utility because it would give the utility a "blank check" at ratepayers expense. (TR 737) She stated that the utility should, instead, justify any proposed conservation expenditures and allow the Commission to determine if such costs should be included in the utility's revenue requirement. (TR 737) Staff witness Stallcup also indicated that if the costs of conservation programs are included in the approved revenue requirement for rate setting purposes, then those costs should be balanced against cost savings associated with a reduction in usage. (TR 1124)

The record reflects that all parties are in agreement that conservation programs are desirable to mitigate the impact on the potable water supply in the area and that the programs need to be funded. On February 20, 2002, Aloha filed the executed signature page of the Consent Order entered into by the utility and the SWFWMD which incorporates several recommended conservation initiatives that the utility agrees to implement. (EXH 36) Staff is recommending that all but one of the proposals be funded at this time.

As part of the Consent Order with the SWFWMD, Aloha committed to the projects and the estimated costs as shown below:

Program	Estimated Incremental Cost
1. Customer Direct Mail Billing Inserts to educate customers on water usage and conservation programs and techniques	No incremental cost as Aloha currently provides informational bill stuffers
2. Free Customer Retrofit kits such as low flow showerheads, faucet aerators, leak detection tablets, replacement flapper valves and educational information	\$25,000
3. Water conservation Pilot Program - provide credits or rebates for installation of high efficiency water heaters, and low flow toilets and monitor the effectiveness of the installations	\$30,000

4. Mixed Media Conservation Messages - print and broadcast media advertising to promote conservation	\$15,000
5. Water Auditor - new staff member to implement and promote consumer conservation projects	\$38,000
6. Additional staffing to assist in administering and monitoring conservation efforts	\$30,000
7. Web site to promote utility specific conservation programs and provide links to other conservation oriented information	\$12,000

The record reflects that all parties agree that Aloha needs to aggressively pursue conservation to reduce demand on the state's limited potable water supply. (TR 452, 493, 559, 566, 612, 618, 1096,1345) SWFWMD witness Sorenson advocates the use of pilot programs which can then be used to design and target more effective future conservation programs. (TR 621) While the exact savings of the programs can not be quantified at this time (TR 623), staff agrees that the proposed expenditures shown above appear reasonable to allow Aloha to explore the options presented and recommends that \$120,000 be included in the utility's revenue requirement to fund the proposed conservation programs. However, staff recommends that the Commission disallow the utility's requested expense for the new position to assist in administering conservation efforts in the amount of \$30,000, shown in Item 6 above. As noted by staff witness Sorensen, it will take some time to get programs in place so that any measurable savings can be realized. (TR 1148, 1150) Adding a Water Auditor to develop the programs should be adequate to get the programs off the ground. If the programs prove successful and have a high penetration rate, the Commission may reconsider approving the expense for a second position at a later date in another proceeding.

DOCKET NO. 010503-WU

DATE: March 21, 2002

**ISSUE 18:** What is the test year operating income before any revenue increase?

**RECOMMENDATION:** Based on the adjustments discussed in previous issues, staff recommends that the test year operating income before any provision for increased revenues should be \$115,045. (S. JONES)

**POSITION OF THE PARTIES**

**ALOHA:** The appropriate amount is subject to the resolution of other issues in this case.

**SWFWMD:** No position.

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

**WOOD:** Adopts OPC's position. I question why any estimates were projected in the test year? If there are any projected items supported by facts they should be added to the test year numbers. The numbers and theories that have no sound basis in fact, shouldn't be considered.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** As shown on attached Schedule No. 3-A, after applying staff's adjustments, net operating income for the test year is \$115,045. Staff's adjustments to operating income are listed on attached Schedule No. 3-B.

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**ISSUE 19:** What is the appropriate revenue requirement?

**RECOMMENDATION:** The following revenue requirement should be approved. (S. JONES)

	<u>Test Year</u> <u>Revenues</u>	<u>\$</u> <u>Increase</u>	<u>Revenue</u> <u>Requirement</u>	<u>%</u> <u>Increase</u>
Water	\$1,979,140	\$6,648	\$1,985,788	0.34%

**POSITION OF THE PARTIES**

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

**SWFWMD:** No position.

**OPC:** As discussed in Issue 2, the Citizens do not believe Aloha is entitled to rate relief at this time. The calculation of a revenue requirement is subject to the Commission's resolution of a number of other issues.

**WOOD:** Adopts OPC's position.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** Aloha requested final rates designed to generate annual water revenues of \$3,044,811. This represents a revenue increase of \$1,077,337 (or 54.76%). These final revenues are based on the utility's requested overall rate of return of 9.07%

Based upon staff's recommendations concerning the underlying rate base, cost of capital, and operating income issues, staff recommends approval of rates that are designed to generate a revenue requirement of \$1,985,788. These revenues exceed staff's adjusted test year revenues by \$6,648 (0.34%) as shown on attached Schedule 3-A. This increase will allow the utility the opportunity to recover its expenses and earn a 8.61% return on its investment in rate base.

**ISSUE 20:** What is the appropriate rate structure for this utility?

**RECOMMENDATION:** The recommended rate structure for residential customers is a BFC and two-tier inclining-block rate structure. The usage blocks should be for monthly usage of: 1) 0-10,000 gallons; and 2) in excess of 10,000 gallons. The rate in the second usage block should be 1.25 times greater than the rate in the first block, with a BFC cost recovery allocation of 28%. The traditional BFC and uniform gallonage charge rate structure should be implemented for the General Service class. All gallonage allotments included in the BFC should be eliminated. (KUMMER)

**POSITION OF THE PARTIES**

**ALOHA:** A two-tiered inclining block rate structure per the SWFWMD requirements and as stated in the MFRs.

**SWFWMD:** Given the location of this utility within an area where the water resource is severely stressed, and the utility's failure to comply with the Permit, the District strongly advocates the implementation of a water-conservation oriented inclining block rate structure for Aloha.

**OPC:** OPC is not recommending a specific rate design. However, OPC believes the Commission should not approve the company's rate design as proposed because the resulting effect would be the collection of revenue in excess of the company's revenue requirement.

**WOOD:** Because of the substandard quality of service, no change should be made to the current rate structure should be made.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** The utility's current residential rate structure utilizes a BFC of \$7.32, which includes a 3 Kgal minimum allowance, and a uniform gallonage charge of \$1.32/Kgal for usage in excess of 3 Kgal. The utility proposed to remove the 3 Kgal allowance from the BFC and implement a two-tier inclining block rate structure to encourage conservation, in compliance with the wishes of the SWFWMD. (TR 453) Staff concurs with the proposal to implement an inclining-block rate structure and the removal of the initial usage from the BFC. The utility, however, proposed to recover all of its revenue requirements through the BFC and first tier, with the revenue from the second tier going towards conservation programs. Since staff

is recommending that the cost of conservation programs be included in the total revenue requirement, there is no longer any basis for setting rates to recover more than the approved revenue requirement.

Given Aloha's current low rates, and the desire to remove the 3 Kgal allowance from the BFC, the first decision in designing rates is to determine how much of the revenue requirement should be recovered in the BFC. As a general rule, the more costs that are recovered through fixed charges, the more stable the utility's earnings are. (TR 1115) However, if the BFC collects too much revenue, the resulting usage charges are too low, or the tier breakpoints too small, resulting in a failure to send meaningful conservation signals. (TR 1128) An important guideline established by the SWFWMD is to recover no more than 40% of the overall revenue requirement through the BFC. The utility proposed a 32%/68% split, with the first block recovering the full revenue requirements. This ratio is consistent with the water management district guidelines commonly used by the Commission. However, SWFWMD witness Yingling also indicated that the fixed charge portion of the bill should be kept to the minimum commensurate with the need for revenue stability. (TR 1016)

Based on the revenue requirement proposed in Issue 19, staff analysis shows that recovering 30% or more of recommended revenues through the BFC would result in gallonage rates below acceptable levels. In order to keep gallonage charges at or above current levels, staff recommends that the percentage recovered through the BFC be set at 28%. This is only slightly lower than the 32% offered by the utility and above the level of 25% recommended by staff witness Stallcup. This allows for the design of meaningful inverted block rates.



**Comparison of Conservation Adjustment Between BFC and Usage Charge**

Current BFC<sup>1</sup> \$7.32  
 Current Gal. Chg above 3 gallons \$1.32

% Revenue requirement recovered through BFC	25%	28%	30%	32%
BFC w/o 3Kgal	\$3.97	\$4.43	\$4.80	\$5.09
Gallonge charge Block 1	\$1.39	\$1.34	\$1.29	\$1.26
BFC greater than current? <sup>2</sup>	Yes	Yes	Yes	Yes
Block 1 charge greater than current?	Yes	Yes	No	No

<sup>1</sup> Current BFC includes a 3 Kgal allotment

<sup>2</sup> Current BFC after removal of 3 Kgal allotment =  $\$7.32 - (3 \times \$1.32) = \$3.36$

Recovery of 72% of the revenue requirement through usage sensitive charges results in a BFC (without any gallon allowance) of \$4.43. Witness Watford questioned setting the new BFC at a level less than the current BFC as contradictory to Commission practice. (TR 1387) However, since the current BFC includes 3 Kgal of usage, a more appropriate comparison is to subtract the cost of the 3 Kgal at the current gallonage charge, to determine whether the level of the proposed BFC is justified. Removing the cost the 3 Kgal from the BFC at current rates [ $7.32 - (3 \times \$1.32)$ ] equals a BFC without a gallonage allotment of \$3.36 compared with the recommended BFC of \$4.43. Therefore, the proposed BFC is greater than the adjusted current BFC.

Witness Stallcup initially proposed a three tier rate structure with blocks of 0-8, 8-15, and over 15 Kgal/month. (TR 1085) However, given the revenue requirements recommended in Issue 19, and recovering 28% of the revenue requirement through the BFC and 72% through the gallonage charge, a three-tier structure would have required the initial tier to fall below the current level of \$1.32. The lower first block combined with the lower BFC would have raised

the possibility of revenue instability to an unacceptable level. Therefore, staff is recommending a two-tier structure with blocks of 0-10 Kgal and above 10 Kgal/month. This increases the first tier rates slightly from \$1.32 to \$1.34 for usage up to 10 Kgal/month and sets the second tier at \$1.67 for usage in excess of 10Kgal/month. Staff is sensitive to the utility's need for some measure of revenue stability. (TR 1087). The recommended breakpoint for the tiers leaves 68% of the total gallons sold in the first tier, which mitigates the concerns about revenue stability.

In addition, Exhibit 29 (SGW-6) shows that 10 of the 30 subdivisions have average usage in excess of 10 Kgal/month. These two conditions further mitigate concerns about revenue stability resulting from the lower BFC. The differential between tiers will provide a small but meaningful first step in sending a conservation signal to high end users. In a previous case, the Commission has also determined that setting breakpoints below 10,000 gallons may adversely impact non-discretionary usage for larger families. (See Order PSC-00-0807-PAA-WU, Docket No. 991290-WU) Since the utility maintains its service territory is becoming more family oriented, staff believes this 10 Kgal tier breakpoint is appropriate at this time.

One of the Commission's concerns in designing rates is to minimize the impact on low users who may be at or near non-discretionary usage levels. Even with the decrease in the BFC, customers who currently use 3 Kgal or more will see an increase in their bills, primarily due to the removal of the 3 Kgal allowance. With the slightly higher first tier rate, customers using 3 Kgal/month will see an increase of 15%, or \$1.13, in their monthly bills. The percentage increase declines to a low of 6% for usage at 15 Kgal/month. On the other end of the usage spectrum, however, significant increases of 20% or greater affect customers using over 50 Kgal/month. The following chart shows representative increases for selected levels of usage:

## Impact of Proposed Rates on Usage Levels

Thousand gallons	Current Price	Recommended Price	Amount	% Change
0	7.32	4.43	-2.89	-39%
1	7.32	5.77	-1.55	-21%
2	7.32	7.11	-.21	-3%
3	7.32	8.45	1.13	15%
4	8.64	9.79	1.15	13%
5	9.96	11.13	1.17	12%
6	11.28	12.47	1.19	11%
7	12.60	13.81	1.21	10%
8	13.92	15.15	1.23	9%
9	15.24	16.49	1.25	8%
10	16.56	17.83	1.27	8%
15	23.16	24.53	1.37	6%
20	29.76	32.88	3.12	10%
50	69.36	82.98	13.62	20%
75	102.36	124.73	22.37	22%
150	201.36	249.98	48.62	24%
200	267.36	333.48	66.12	25%

SWFWMD advocates an aggressive inclining block rate structure (TR 1015), and staff believes, given the recommended revenue requirement, the proposed structure will put customers on notice that increased usage comes with a higher price tag. Should the utility justify higher revenue requirements in the future, the blocks and rates could be adjusted to increase the pricing signals to high users.

**ISSUE 21:** Is repression of consumption likely to occur, and, if so, what is the appropriate adjustment and the resulting consumption to be used to calculate consumption charges?

**RECOMMENDATION:** No repression adjustment due to a change in rates is appropriate. However, a 2.5% reduction in residential consumption should be made to recognize the impact of conservation programs recommended in Issue 17. The resulting consumption to be used to calculate consumption charges is 993,482 Kgal. (KUMMER)

**POSITION OF THE PARTIES**

**ALOHA:** Repression is likely to occur and is best predicted by the Water Rate Model developed by Dr. Whitcomb. However, because repression forecasts are subject to many variables and uncertain at best, consumption charges must be based exclusively on variable costs or revenue stability risk may increase substantially.

**SWFWMD:** If there is a significant increase in marginal water and sewer prices as a result of this rate case, the District would anticipate a repression of consumption. The Waterate 2001 Model price elasticity algorithm appropriately calculates repression. It may also be appropriate to apportion repression in the short term as described in the Waterate manual.

**OPC:** The Citizens accepted the 5% requested by Aloha in its MFRs, and therefore did not pursue a study to develop this issue.

**WOOD:** I believe that consumption will not be reduced based on a rate increase. I further believe that a rate increase is inflationary. The price of water will go up, but it will be the same "crappy" water. There isn't any value added to off set the price increase.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** Due to the nominal recommended increase in revenue requirement, and the minimal increase in the second tier rates, staff did not include a repression adjustment in determining consumption for setting rates. Past Commission decisions indicate minimal repression (0-4%) in several cases even where multiple tier inclining block rates were implemented along with a rate increase. (See Dockets 970164-WU, 980445-WU, 990535-WU, 010403-WU) In this case, the rate structure is essentially revenue neutral in that no

significant overall rate increase is recommended. In addition, the utility maintained throughout the hearing that its expected usage was higher than either staff or OPC projected, and that new customers would use more than current customers. (TR 1263, 1295, 1379) If the utility's projections prove more accurate than the forecast recommended here, setting rates on the forecast recommended in Issue 8 results in rates higher than those that would have been generated using the utility's forecast.

With the recommended inclining-block rates, the additional revenues in the higher block should offset any reduction in revenue due to decreases in usage. Residential consumption was, however, adjusted downward by 2.5% to account for the reduction in usage resulting from implementation of conservation programs. The projected annual savings cited in the Consent Order were 5% per year. (EXH 36) SWFWMD witness Sorensen also stated that many of the programs will likely take years to reap results. (TR 1148, 1150) Therefore, staff believes adjusting consumption to reflect the full effect of conservation would overstate the benefits of the programs' initial implementation.

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**ISSUE 22:** What are the appropriate monthly rates for service?

**RECOMMENDATION:** The appropriate monthly rates are listed below.

**Residential Service Water Rates**

Meter size	Current	Staff Recommended
<u>BFC</u>		
5/8" x 3/4"	\$7.32 (includes 3Kgal)	\$4.43
3/4"	\$0.00	\$6.65
1"	\$0.00	\$11.08
1 1/2"	\$0.00	\$22.15
<u>Usage charges</u>		
Per 1,000 gals		
0 - 3,000 gals	\$0.00	\$1.34
3,000-10,000	\$1.32	\$1.34
Over 10,000 gals	\$1.32	\$1.67

**General Service Rates**

Meter Size	Current	Staff Recommended
<u>BFC</u>		
5/8" x 3/4"	\$7.32*	\$4.43
1"	\$19.46*	\$11.08
1 1/2"	\$36.49*	\$22.15
2"	\$58.80*	\$35.44
3"	\$116.83*	\$70.88
4"	\$182.85*	\$110.75
6"	\$282.76*	\$221.50
8"	\$577.67*	\$354.00
10"	\$841.62*	\$509.45

\*Current General Service BFC include minimum gallonage allowances.

Usage Charges

All usage Per 1,000 gals	\$1.32	\$1.44
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In addition, tariffs should reflect that the Vacation Rate should be set at the new BFC of \$4.43.

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These rates, also shown on Schedule No. 4, are designed to produce revenues of \$1,985,788, excluding miscellaneous service charge revenues. The utility should file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-30.475(1), Florida Administrative Code. The rates should not be implemented until staff has approved the proposed customer notice, and the notice has been received by the customers. The utility should provide proof of the date notice was given no less than 10 days after the date of the notice. (KUMMER, S. JONES)

**POSITION OF THE PARTIES**

**ALOHA:** The appropriate monthly rates for service are subject to resolution of other issues. However, the Commission must not shift fixed costs to the gallonage charge anymore than proposed by the utility in its original filing. Such shifts are unprecedented and will create substantial additional risk on the utility.

**SWFWMD:** No position.

**OPC:** The appropriate monthly rates for service are subject to the resolution of other issues.

**WOOD:** The current monthly rate is in excess of what should be needed to keep the "Black Water" flowing. Don't talk increase until you improve the final product. I think it is questionable whether the water supplied today is properly treated.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** The above recommended rates generate the revenue requirement recommended in Issue 19 using the rate design recommended in Issue 20. If the final Commission vote on either of those issues results in a material change in the total revenue requirement or the proposed rate structure, the final rates should be recalculated to reflect the changes.

The utility should file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to

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Rule 25-40.475(1), Florida Administrative Code. The rates should not be implemented until staff has approved the proposed customer notice, and the notice has been received by the customers. The utility should provide proof of the date notice was given no less than 10 days after the date of the notice.

A comparison of the utility's original and requested rates, Commission approved interim rates and staff's recommended rates is shown on Schedule No. 4.



**ISSUE 23:** What are the appropriate service availability charges for the Seven Springs water system?

**RECOMMENDATION:** An interim plant capacity charge of \$1,000 should be approved to offset future plant requirements. The utility shall deposit the difference between \$1,000 and the current charge of \$163.80 in its current interest bearing escrow account to guarantee the interim funds collected subject to refund. The escrowed funds shall not be released until the Commission has verified that Aloha has sufficiently invested in the required plant improvements. All other escrow requirements as established by the Commission in Order No. PSC-00-1285-FOF-WS, issued on July 14, 2000, shall continue to apply. Revised tariff sheets and a proposed customer notice shall be filed by April 30, 2002, to reflect the \$1,000 interim plant capacity charge. The proposed notice shall include the date the notice will be issued, a statement that the utility is increasing its water plant capacity charge for new connections to the Seven Springs system from an interim charge of \$500 per ERC to \$1,000 per ERC, on a temporary basis, subject to refund; the utility's address, telephone number and business hours; and a statement that any comments concerning the charge should be addressed to the Director of the Division of the Commission Clerk and Administrative Services at 2540 Shumard Oak Boulevard, Tallahassee, FL 32399-0870. The approved charge shall be effective for connections made on or after the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(2), Florida Administrative Code, providing the appropriate notice has been made. The notice shall be mailed or hand delivered to all persons in the service area who have filed a written request for service within the past 12 calendar months or who have been provided service within the past 12 calendar months. In addition, the utility shall publish a copy of the approved notice in a newspaper of general circulation in its service area within 10 days of staff's approval of the notice. The utility shall provide proof of the date the notice was given within 10 days after the date of the notice. This increase is recommended in order to fund future plant requirements necessary to address solutions to the black water and long-term water supply issues. (S. JONES, MERCHANT)

**POSITION OF THE PARTIES**

**ALOHA:** No change in these charges is appropriate in this case. Those are being considered in a separate proceeding currently pending before the PSC and awaiting clarification of the intended changes to treatment process expected in the future.

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SWFWMD: No position.

OPC: The proper service availability charges are being determined in another proceeding. If the Commission decides to effect any changes, their impact will affect future revenue proceedings.

WOOD: Adopts OPC's position.

FASANO: Adopts OPC's position.

STAFF ANALYSIS: The utility currently has a temporary interim plant capacity charge of \$500 in effect for the Seven Springs water system. This temporary plant capacity charge was approved in Order No. PSC-00-1285-FOF-WS, issued July 14, 2000, in Docket No. 960545-WS. This temporary charge is subject to refund, and by that order, Aloha was required to file an immediate application for an increase in service availability charges. The establishment of a final charge would result after the conclusion of the service availability docket. Aloha's original plant capacity charge for its Seven Spring's water system is \$163.80, and the difference of \$336.20 per connection is being held subject to refund.

The utility filed its application on February 1, 2001, to increase its plant capacity charge for its Seven Springs water system to \$650 per equivalent residential connection (ERC). Docket No. 010156-WU was opened to address Aloha's application for an increase in service availability charges.

Representative Fasano testified that during his time in office, finding a solution to the on-going problems facing Aloha's customers, who are also his constituents, has become one of his top priorities. Mr. Fasano testified that since 1996, his suggestion for resolution has been that Aloha increase its impact fees to make them competitive with those of Pasco County. He stated that if those costs had been ordered years ago, given the phenomenal growth in the Aloha service area times the higher impact fees, revenue would have been generated that is needed today for Aloha's improvements. He stated this choice would not have burdened the existing customer. While this revenue has been lost over the past three years, Mr. Fasano stated he still believed it would be in the best interest of the existing customers to place the burden of the future customers on those future customers. (TR 16-22)

Mr. Fasano further testified that if Aloha's impact fees would be raised to a level competitive with those charged by the surrounding Pasco County utilities, then the need for this rate increase application here today and those in the future would probably diminish. (TR 23)

Aloha witnesses Porter and Watford provided testimony on future plant additions that Aloha projected in the near-term. They stated that, at this time, the potential chemistry of Pasco County's modified water is yet to be defined. Until this information was known, it would be imprudent to move ahead, from a technical standpoint, and construct any of the pilot project facilities until a full and complete engineering analysis of the combined effects of all the chosen alternatives can be completed. To do otherwise may result in substantial costs that could be found to be unusable or unneeded when the final analysis is completed. (TR 1260-1261; 1362-1363)

On cross examination by staff, Mr. Watford testified that the utility is not proposing any increase to its plant capacity charge in this rate case. He stated that the utility has another docket open right now to specifically address that issue; however, he stated that the utility was certainly not averse to increasing the charge. (TR 1410-1411)

Pursuant to Section 367.101, Florida Statutes, the Commission shall set just and reasonable charges for service availability. As addressed in Issues 1, 2, 9(a), and 16, Aloha has been ordered by this Commission to address numerous components of its quality of service as well as critical water supply concerns. Staff agrees with Representative Fasano that a higher plant capacity charge can defray the cost of these looming, yet unknown, plant improvements or expansion costs, and allow the future growth to pay for the future customer's own burdens instead of placing them on existing customers. Since Aloha is in such a high growth area and the new customers being added to the system are high-end users (as testified by Mr. Porter and Watford), the plant capacity charge should be more reflective of the Pasco County charge in effect.

The current Seven Springs wastewater plant capacity charge is \$1,650. Staff believes that it is reasonable to increase the water plant capacity charge to \$1,000 on an interim basis to offset future plant requirements necessary to address solutions to the black water and long-term waster supply issues. In establishing a capacity

charge, we normally include reliable estimates of plant additions and customer growth projections, by year, to make sure the proposed charge will allow the utility to be in compliance with the contribution levels required by Rule 25-30.580, FAC. While staff does not have all of the necessary information at this time, staff still believes that an interim charge is appropriate to continue offsetting the future cost of major plant requirements.

The utility shall deposit the difference between \$1,000 and the current charge of \$163.80 in its current interest bearing escrow account to guarantee the interim funds collected subject to refund. The escrowed funds shall not be released until the Commission has verified that Aloha has sufficiently invested in the required plant improvements. All other escrow requirements as established by the Commission in Order No. PSC-00-1285-FOF-WS, issued on July 14, 2000, should continue to apply.

Revised tariff sheets and a proposed customer notice should be filed by April 30, 2002, to reflect the \$1,000 interim plant capacity charge. The proposed notice should include the date the notice will be issued; a statement that the utility is increasing its water plant capacity charge for new connections to the Seven Springs system from an interim charge of \$500 per ERC to \$1,000 per ERC, on a temporary basis, subject to refund; the utility's address, telephone number, and business hours; and a statement that any comments concerning the charge should be addressed to the Director of the Division of the Commission Clerk and Administrative Services at 2540 Shumard Oak Boulevard, Tallahassee, FL 32399-0870. The approved charge should be effective for connections made on or after the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(2), Florida Administrative Code, providing the appropriate notice has been made.

The notice should be mailed or hand delivered to all persons in the service area who have filed a written request for service within the past 12 calendar months or who have been provided service within the past 12 calendar months. In addition, the utility should publish a copy of the approved notice in a newspaper of general circulation in its service area within 10 days of staff's approval of the notice. The utility should provide proof of the date the notice was given within 10 days after the date of the notice.

**ISSUE 24:** Is an interim refund appropriate and if so in what amount? (Issue not in Prehearing Order)

**RECOMMENDATION:** The proper refund amount should be calculated by using the same data used to establish final rates, excluding rate case expense. This revised revenue requirement for the interim collection period should be compared to the amount of interim revenues granted. Based on this calculation, the utility should be required to refund 4.01% of water revenues collected under interim rates. The refund should be made with interest in accordance with Rule 25-30.360(4), Florida Administrative Code. The utility should treat any unclaimed refunds as CIAC pursuant to Rule 25-30.360(8), Florida Administrative Code. (MERCHANT, S. JONES)

**STAFF ANALYSIS:** In Order No. PSC-01-2199-FOF-WU, issued November 13, 2001, the Commission approved interim rates subject to refund with interest. Rates were increased by 15.95%, pursuant to Section 367.082, Florida Statutes. The approved interim revenue from rates is shown below:

	<u>Test Year</u>	<u>\$</u>	<u>Revenue</u>	<u>%</u>
	<u>Revenues</u>	<u>Increase</u>	<u>Requirement</u>	<u>Increase</u>
Water	\$1,737,086	\$272,206	\$2,009,292	15.67%

According to Section 367.082, Florida Statutes, any refund should be calculated to reduce the rate of return of the utility during the pendency of the proceeding to the same level within the range of the newly authorized rate of return. Adjustments made in the rate case test period that do not relate to the period interim rates are in effect should be removed. Examples of these adjustments would be an attrition allowance or rate case expense, which are recovered only after final rates are established.

In this proceeding, the test period for establishment of interim rates was the twelve months ended June 30, 2001. The test year for final purposes was the projected year ended December 31, 2001. The approved interim rates did not include any provisions or consideration of pro forma adjustments in operating expenses or plant. The interim increase was designed to allow recovery of actual interest costs, and the floor of the last authorized range for equity earnings. Included in the interim test year were three months of expenses for purchased water from Pasco County.

To establish the proper refund amount, staff has calculated a revised interim revenue requirement utilizing the same data used to establish final rates. Rate case expense was excluded, because it was not an actual expense during the interim collection period. Aloha did not purchased water from Pasco County during the interim collection period. The interim collection period was from November 13, 2001 to present.

Using the principles discussed above, staff has calculated the interim revenue requirement from rates for the interim collection period to be \$1,931,381. This revenue level is less than the interim revenue of \$2,009,292, which was granted in Order No. PSC-01-2199-FOF-WU. This results in 4.01% refund of interim rates, after miscellaneous revenues have been removed.

The utility should be required to refund 4.01% of water revenues collected under interim rates. The refund should be made with interest in accordance with Rule 25-30.360(4), Florida Administrative Code. The utility should be required to submit proper refund reports pursuant to Rule 25-30.360(7). The utility should treat any unclaimed refunds as CIAC pursuant to Rule 25-30.360(8), Florida Administrative Code.

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**ISSUE 25:** What is the appropriate amount by which rates should be reduced four years after the established effective date to reflect the removal of the amortized rate case expense as required by Section 367.0816, Florida Statutes? (Issue not in Prehearing Order)

**RECOMMENDATION:** The water should be reduced as shown on Schedule 5, to remove rate case expense grossed-up for regulatory assessment fees and amortized over a four-year period. The decrease in rates should become effective immediately following the expiration of the four-year recovery period, pursuant to Section 367.0816, Florida Statutes. The utility should be required to file revised tariff sheets and a proposed customer notice setting forth the lower rates and the reason for the reduction not later than one month prior to the actual date of the required rate reduction. (S. JONES)

**STAFF ANALYSIS:** Section 367.0816, Florida Statutes requires that the rates be reduced immediately following the expiration of the four-year period by the amount of the rate case expense previously included in the rates. The reduction will reflect the removal of \$53,720 of revenues associated with the amortization of rate case expense and the gross-up for regulatory assessment fees. The reduction in revenues will result in the rates recommended by staff on Schedules 5.

The utility should be required to file revised tariff sheets no later than one month prior to the actual date of the required rate reduction. The utility also should be required to file a proposed customer notice setting forth the lower rates and the reason for the reduction.

If the utility files this reduction in conjunction with a price index or pass-through rate adjustment, separate data shall be filed for the price index and/or pass-through increase or decrease and the reduction in the rates due to the amortized rate case expense.

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**ISSUE 26:** Should this docket be closed?

**RECOMMENDATION:** The docket should be closed after the time for filing an appeal has run. (ESPINOZA)

**POSITION OF THE PARTIES**

**ALOHA:** After granting the request proposed in the MFRs, this docket should be closed.

**SWFWMD:** No position.

**OPC:** In response to Issue 9(b), the Citizens recommended the PSC retain jurisdiction for a single limited purpose. With the exception of that purpose, this docket should be closed after the expiration of any appellate activity.

**WOOD:** After denying any increase to the utility this docket should be closed. A restriction should be initiated on how many rate cases any utility can file over a given period of time.

**FASANO:** Adopts OPC's position.

**STAFF ANALYSIS:** The docket should be closed 32 days after issuance of the order, to allow the time for filing an appeal to run.



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ALOHA UTILITIES, INC. - SEVEN SPRINGS WATER SYSTEM				SCHEDULE NO. 1-A	
SCHEDULE OF WATER RATE BASE				DOCKET NO. 010503-WU	
13-MONTH AVERAGE TEST YEAR ENDED 12/31/01					
DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUST- MENTS	ADJUSTED TEST YEAR PER UTILITY	STAFF ADJUST- MENTS	STAFF ADJUSTED TEST YEAR
1 UTILITY PLANT IN SERVICE	\$9,937,171	\$0	\$9,937,171	\$5,776	\$9,942,947
2 LAND & LAND RIGHTS	42,898	0	42,898	(5,935)	36,963
3 NON-USED & USEFUL COMPONENTS	0	0	0	0	0
4 ACCUMULATED DEPRECIATION	(2,328,109)	0	(2,328,109)	(3,182)	(2,331,291)
5 CIAC	(8,479,418)	0	(8,479,418)	(27,236)	(8,506,654)
6 AMORTIZATION OF CIAC	1,923,349	0	1,923,349	64	1,923,413
7 CONTRIBUTED TAXES	(1,175,890)	0	(1,175,890)	0	(1,175,890)
8 ACCUM. AMORT-CONTRIBUTED TAXES	222,201	0	222,201	(10,877)	211,324
9 DEFERRED INCOME TAXES	835,318	0	835,318	0	835,318
10 WORKING CAPITAL ALLOWANCE	<u>430,720</u>	<u>413,250</u>	<u>843,970</u>	<u>(397,932)</u>	<u>446,038</u>
RATE BASE	<u>\$1,408,240</u>	<u>\$413,250</u>	<u>\$1,821,490</u>	<u>(\$439,322)</u>	<u>\$1,382,168</u>

ALOHA UTILITIES, INC. - SEVEN SPRINGS WATER SYSTEM ADJUSTMENTS TO RATE BASE 13-MONTH AVERAGE TEST YEAR ENDED 12/31/01		SCHED. NO. 1-B DOCKET 010503-WU
EXPLANATION	WATER	
<b><u>PLANT IN SERVICE</u></b>		
1 To capitalize items erroneously expensed during 2000. (Stip. 1)	\$11,552	
2 Properly allocate utility's new office building. (Stip. 12)	<u>(5,776)</u>	
Total	<u>\$5,776</u>	
<b><u>LAND</u></b>		
Properly allocate the utility's new office building. (Stip 12)	<u>(\$5,935)</u>	
<b><u>ACCUMULATED DEPRECIATION</u></b>		
1 Accumulated depreciation for capitalize items erroneously expensed (Stip. 1)	(\$920)	
2 To reflect the appropriate depreciation rate for computer equipment. (Stip. 2)	<u>(2,262)</u>	
Total	<u>(\$3,182)</u>	
<b><u>CIAC</u></b>		
To correct the total amount of contributed property received. (Stip. 3)	<u>(\$27,236)</u>	
<b><u>ACCUM. AMORT. OF CIAC</u></b>		
To reflect accumulated amortization for contributed property adjustment (Stip. 3)	<u>\$64</u>	
<b><u>ACCUM. AMORT. OF CONTRIBUTED TAXES</u></b>		
To correct historical starting point of amortization of contributed taxes (Stip. 4)	<u>(\$10,877)</u>	
<b><u>WORKING CAPITAL</u></b>		
To reflect adjustments and reallocation.	<u>(\$397,932)</u>	

ALOHA UTILITIES, INC. - SEVEN SPRINGS WATER SYSTEM CAPITAL STRUCTURE 13-MONTH AVERAGE TEST YEAR ENDED 12/31/01						SCHEDULE NO. 2 DOCKET NO. 010503-WU		
DESCRIPTION	TOTAL CAPITAL	SPECIFIC ADJUSTMENTS (EXPLAIN)	ADJUSTED TOTAL	PRO RATA ADJUSTMENTS	CAPITAL RECONCILED TO RATE BASE	RATIO	COST RATE	WEIGHTED COST
<b>Per Utility</b>								
1 LONG TERM DEBT	\$3,525,036	\$0	\$3,525,036	(\$2,501,723)	\$1,023,313	56.18%	9.03%	5.07%
2 SHORT-TERM DEBT	0	0	0	0	0	0.00%	0.00%	0.00%
3 PREFERRED STOCK	600,000	0	600,000	(425,866)	174,134	9.56%	9.93%	0.95%
4 COMMON EQUITY	1,587,440	0	1,587,440	(1,126,603)	460,837	25.30%	9.93%	2.51%
5 CUSTOMER DEPOSITS	<u>562,205</u>	<u>0</u>	<u>562,205</u>	<u>(398,999)</u>	<u>163,206</u>	8.96%	6.00%	<u>0.54%</u>
6 <b>TOTAL CAPITAL</b>	<u>\$6,274,681</u>	<u>\$0</u>	<u>\$6,274,681</u>	<u>(\$4,453,191)</u>	<u>\$1,821,490</u>	<u>100.00%</u>		<u>9.07%</u>
<b>Per Staff</b>								
7 LONG TERM DEBT	\$3,525,036	\$5,742,943	\$9,267,979	(\$8,199,956)	\$1,068,023	77.27%	8.25%	6.37%
8 SHORT-TERM DEBT	0	0	0	0	0	0.00%	0.00%	0.00%
9 PREFERRED STOCK	600,000	0	600,000	(530,857)	69,143	5.00%	10.88%	0.54%
10 COMMON EQUITY	1,587,440	(23,578)	1,563,862	(1,383,646)	180,216	13.04%	10.88%	1.42%
11 CUSTOMER DEPOSITS	<u>562,205</u>	<u>0</u>	<u>562,205</u>	<u>(497,418)</u>	<u>64,787</u>	4.69%	6.00%	<u>0.28%</u>
12 <b>TOTAL CAPITAL</b>	<u>\$6,274,681</u>	<u>\$5,719,365</u>	<u>\$11,994,046</u>	<u>(\$10,611,877)</u>	<u>\$1,382,169</u>	<u>100.00%</u>		<u>8.61%</u>
						<b>LOW</b>	<b>HIGH</b>	
RETURN ON EQUITY						<u>10.88%</u>	<u>12.88%</u>	
OVERALL RATE OF RETURN						<u>8.61%</u>	<u>8.87%</u>	

ALOHA UTILITIES, INC. - SEVEN SPRINGS WATER SYSTEM						SCHEDULE NO. 3-A	
STATEMENT OF WATER OPERATIONS						DOCKET NO. 010503-WU	
13-MONTH AVERAGE TEST YEAR ENDED 12/31/01							
DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUST- MENTS	ADJUSTED TEST YEAR PER UTILITY	STAFF ADJUST- MENTS	STAFF ADJUSTED TEST YEAR	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	<u>\$1,967,474</u>	<u>\$1,077,337</u>	<u>\$3,044,811</u>	<u>(\$1,065,671)</u>	<u>\$1,979,140</u>	<u>\$6,648</u> 0.34%	<u>\$1,985,788</u>
<b>OPERATING EXPENSES:</b>							
2 OPERATION & MAINTENANCE	\$1,394,460	\$1,055,944	\$2,450,404	(\$931,719)	\$1,518,685		\$1,518,685
3 DEPRECIATION	75,736	0	75,736	(224)	75,512		75,512
4 AMORTIZATION	(30,691)	0	(30,691)	0	(30,691)		(30,691)
5 TAXES OTHER THAN INCOME	278,781	55,808	334,589	(47,955)	286,634	299	286,933
6 INCOME TAXES	<u>49,564</u>	<u>0</u>	<u>49,564</u>	<u>(35,608)</u>	<u>13,956</u>	<u>2,389</u>	<u>16,345</u>
7 TOTAL OPERATING EXPENSES	<u>\$1,767,850</u>	<u>\$1,111,752</u>	<u>\$2,879,602</u>	<u>(\$1,015,507)</u>	<u>\$1,864,095</u>	<u>\$2,688</u>	<u>\$1,866,783</u>
8 OPERATING INCOME	<u>\$199,624</u>	<u>(\$34,415)</u>	<u>\$165,209</u>	<u>(\$50,164)</u>	<u>\$115,045</u>	<u>\$3,960</u>	<u>\$119,005</u>
9 RATE BASE	<u>\$1,408,240</u>		<u>\$1,821,490</u>		<u>\$1,382,168</u>		<u>\$1,382,168</u>
10 RATE OF RETURN	<u>14.18%</u>		<u>9.07%</u>		<u>8.32%</u>		<u>8.61%</u>

ALOHA UTILITIES, INC. - SEVEN SPRINGS WATER SYSTEM ADJUSTMENTS TO OPERATING INCOME 13-MONTH AVERAGE TEST YEAR ENDED 12/31/01		SCHED. NO. 3-B DOCKET NO. 010503-WU
EXPLANATION	WATER	
<b><u>OPERATING REVENUES</u></b>		
1 Remove requested revenue increase		(\$1,077,337)
2 To correct the Interest income allocation (Stip. 9)		7,490
3 To include vacation bills in projected revenues for 2001. (Stip. 9)		4,176
Total		<u>(\$1,065,671)</u>
<b><u>OPERATION &amp; MAINTENANCE EXPENSE</u></b>		
1 Remove projections for plant items erroneously expensed in 2000 (Stip 1)		(\$12,396)
2 Reallocated bad debt expense (Stip 10)		1,237
3 To remove double counted officers salary and wages. (Stip 13)		(8,769)
4 To reflect adjusted purchased water expense (Issue 9a & 15)		(987,903)
5 To remove inflation projection from chemicals expense (Issue 10)		(2,234)
6 Remove salaries & benefits for vacant utility manager position (Issue 11)		24,219
7 Correct annualized salary for operations supervisor (Issue 12-Stip)		(21,268)
8 Adjustment to pensions expense (Issue 13)		51,089
9 Remove President's & Vice President's Salary & Benefits		(35,371)
10 Rate case expense (Issue 16)		(60,323)
11 Conservation Expenses (Issue 17)		120,000
Total		<u>(\$931,719)</u>
<b><u>DEPRECIATION EXPENSE-NET</u></b>		
1 To reflect the 2001 depreciation expense for plants assets recorded in error as expense items. (Stip.1)		\$613
2 To reflect accumulated amortization for the correction of total contributed property received. (Stip. 3)		(837)
Total		<u>(\$224)</u>
<b><u>TAXES OTHER THAN INCOME</u></b>		
RAFs on revenue adjustments above		<u>(\$47,955)</u>
<b><u>INCOME TAXES</u></b>		
To adjust to test year income tax expense		<u>(\$35,608)</u>

**ALOHA UTILITIES, INC. - SEVEN SPRINGS WATER SYSTEM  
 WATER MONTHLY SERVICE RATES  
 13-MONTH AVERAGE TEST YEAR ENDED 12/31/01**

**SCHEDULE NO. 4  
 DOCKET NO. 010503-WU**

	<u>Rates Prior to Filing</u>	<u>Commission Approved Interim</u>	<u>Utility Requested Final</u>	<u>Staff Recomm. Final</u>
<b>Residential Service</b>				
Base Facility Charge:				
Meter Size:				
5/8" x 3/4"	\$7.32	\$8.31	\$9.23	\$4.43
3/4"	\$0.00	\$0.00	\$0.00	\$4.43
1"	\$0.00	\$0.00	\$0.00	\$11.08
1-1/2"	\$0.00	\$0.00	\$0.00	\$22.15
Usage Charges:				
Per 1,000 Gallons				
0 - 3,000 Gallons	\$0.00	\$0.00	\$2.24	\$1.34
3,000 - 10,000 Gallons	\$1.32	\$1.48	\$2.24	\$1.34
Over 10,000 Gallons	\$1.32	\$1.48	\$2.81	\$1.67
<b>General Service</b>				
Base Facility Charge:				
Meter Size:				
5/8" x 3/4"	\$7.32*	\$8.31*	\$9.23	\$4.43
1"	\$19.46*	\$22.10*	\$23.08	\$11.08
1-1/2"	\$36.49*	\$41.45*	\$46.15	\$22.15
2"	\$58.80*	\$66.80*	\$73.84	\$35.44
3"	\$116.83*	\$132.72*	\$147.68	\$70.88
4"	\$182.85*	\$207.72*	\$230.75	\$110.75
6"	\$282.76*	\$321.23*	\$461.50	\$221.50
8"	\$577.67*	\$656.25*	\$738.40	\$354.00
10"	\$841.62*	\$956.09*	\$1,338.35	\$509.45
Usage Charges:				
All Usage Per 1,000 Gallons	\$1.32	\$1.48	\$2.24	\$1.44
<b>Typical Residential Bills</b>				
5/8" x 3/4" Meter Size				
3,000 Gallons	\$7.32	\$8.31	\$15.95	\$8.75
5,000 Gallons	\$9.96	\$11.27	\$20.43	\$11.63
10,000 Gallons	\$16.56	\$18.67	\$31.63	\$18.83

\* Current and Commission Approved Interim General Service BFC includes minimum gallonage allowances.

DOCKET NO. 010503-WU

DATE: March 21, 2002

RECOMMENDED 4 YEAR REDUCTION SCHEDULE		
ALOHA UTILITIES, INC. - SEVEN SPRINGS WATER SYSTEM	Schedule No. 5	
PROJECTED TEST YEAR - 12/31/01		
DOCKET NO. 010503-WU		
<u>Monthly Water Rates</u>		
<u>Residential Service</u>	Monthly Recommended Rates	Monthly Rate Reduction
Base Facility Charge:		
Meter size		
5/8" x 3/4"	\$4.43	\$0.12
3/4"	\$6.65	\$0.18
1"	\$11.08	\$0.30
1 1/2"	\$22.15	\$0.60
Gallonage Charge:		
Per 1,000 gals		
0 - 3,000 gals	\$1.34	\$0.04
3,000-10,000	\$1.34	\$0.04
Over 10,000 gals	\$1.67	\$0.05
<u>General Service Rates</u>		
Meter Size		
BFC		
5/8" x 3/4"	\$4.43	\$0.12
1"	\$11.08	\$0.30
1 1/2"	\$22.15	\$0.60
2"	\$35.44	\$0.96
3"	\$70.88	\$1.92
4"	\$110.75	\$3.00
6"	\$221.50	\$5.99
8"	\$354.00	\$9.58
10"	\$509.45	\$13.78
Gallonage Charge:		
All usage Per 1,000 gals	\$1.44	\$0.04