

State of Florida



Public Service Commission

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COMMISSION
CLERK

DATE: July 21, 2005

TO: Director, Division of the Commission Clerk & Administrative Services (Bayó)

FROM: Office of the General Counsel (Melson) *RM*
Division of Economic Regulation (Devlin, Willis) *198*

RE: Docket No. 050018-WU – Initiation of deletion proceedings against Aloha Utilities, Inc. for failure to provide sufficient water service consistent with the reasonable and proper operation of the utility system in the public interest, in violation of Section 367.111(2), Florida Statutes.

Docket No. 050183-WU – Request by homeowners for the Commission to initiate deletion proceedings against Aloha Utilities, Inc. for failure to provide sufficient water service consistent with the reasonable and proper operation of the utility system in the public interest, in violation of Section 367.111(2), Florida Statutes.

Docket No. 010503-WU – Application for increase in water rates for Seven Springs System in Pasco County by Aloha Utilities, Inc.

AGENDA: 08/02/05 – Regular Agenda – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICERS: Deason (050018), Bradley (010503), Edgar (050183)

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\GCL\WP\050018.RCM.DOC

DOCUMENT NUMBER-DATE

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Case Background

Aloha Utilities, Inc. (Aloha or utility) is a Class A water and wastewater utility located in Pasco County. The utility consists of two distinct service areas: Aloha Gardens and Seven Springs. There are a number of active dockets, appeals, or other cases involving Aloha's Seven Springs service area and the Commission.

In September, 1996, testimony was first taken by this Commission from Aloha's customers in the Seven Springs area concerning poor quality of service provided by Aloha, due, in large part, to a "black water" problem. This black water issue was addressed in a number of proceedings from 1996 to 2005.

Active Dockets or Cases

On February 22, 2005, the Commission issued an order in Docket No. 050018-WU (Show Cause Docket) proposing to delete certain identified portions of Aloha's Seven Springs service territory from its certificate for failure by Aloha to provide service that meets the requirements of Section 367.111(2), F.S.¹ Aloha requested a hearing, and the Show Cause Docket is currently set for hearing in January, 2006. Aloha has challenged certain aspects of the Commission's action in this docket via a declaratory judgment action in Leon County Circuit Court (Declaratory Judgment Action).

On June 6, 2005, the Commission issued an order in Docket No. 050183-WU (Investigation Docket) opening an investigation into the quality of service provided to customers in the balance of Aloha's Seven Springs service area.² Aloha has filed a notice of appeal of this order in the First District Court of Appeal (Investigation Appeal).

On October 26, 2004, the Commission issued an order in Docket No. 010503-WU requiring Aloha to refund to customers an additional \$276,000 collected as interim rates during the pendency of Aloha's appeal of the final order in its last rate case.³ Aloha's appeal of the interim refund order is pending in the First District Court of Appeal (Refund Appeal).

On June 29, 2005, the Commission issued an order in Docket No. 010503-WU that replaced a requirement that Aloha remove 98% of the hydrogen sulfide from its water with a goal that the concentration of total sulfides in its finished water should not exceed 0.1 mg/L (Water Quality Order)⁴. That order also directed where and how the levels of hydrogen sulfide are to be measured and monitored. The time for appeal of that order has not yet expired.

¹ Order No. PSC-05-0204-SC-WU; see also Order No. PSC-05-0549-PCO-WU.

² Order No. PSC-05-0618-PCO-WU.

³ Order No. PSC-04-1050-FOF-WU.

⁴ Order No. PSC-05-0709-FOF-WU.

Study of Water Treatment Options

Aloha has contracted with the University of South Florida to identify and analyze the water treatment options that are available to address the hydrogen sulfide issue. That study is expected to be complete on or before August 15, 2005. Within 60 days following receipt of the final study, Aloha intends to analyze the respective costs and rate impacts of the options, and file with the Commission a request for approval of its preferred option.

Water Supply Issue

For a number of years, Aloha has withdrawn more water from its wells than is permitted under its consumptive use permits (CUPs) issued by the Southwest Florida Water Management District (SWFMWD). In its last rate case, Aloha sought to recover through rates the cost of projected purchases of approximately 1.2 MGD of water from Pasco County. The final order in that rate case determined that Aloha had not met its burden of proving that the purchase of water from Pasco County was a cost-effective alternative.⁵ The order required Aloha to perform a cost benefit analysis of all water supply alternatives.

Aloha has recently completed that study, and filed it with the Commission. In addition, Aloha has entered into a contract with Pasco County to begin purchasing 1.5 MGD of water to serve its Seven Springs service area beginning January 1, 2006. Aloha intends to file a petition for a limited proceeding to recover through rates the costs of this water purchase from Pasco County.

Settlement Negotiations

In December, 2004, Aloha and the Office of Public Counsel engaged the services of a mediator and engaged in mediation in an effort to resolve then-pending requests by some of Aloha's Seven Springs customers for deletion from Aloha's service territory.⁶ That mediation, which took place during late 2004 and early 2005, ultimately resulted in an impasse.

On April 29, 2005, Aloha wrote the Commission's General Counsel to suggest that Aloha and the Commission should undertake mediation, or less formal settlement discussions, to resolve the Show Cause Docket.

Beginning in June, 2005, a small number of the Commission staff (Msrs. Devlin, Willis and Melson) participated in settlement discussions with Aloha. Those negotiations addressed both the Show Cause Docket and all of the other pending matters involving Aloha and the Commission.

Throughout the negotiations, the parties' common goal was to shift the focus away from continued litigation and legal maneuvering and instead to establish a framework for identifying

⁵ Order No. PSC-02-0593-FOF-WU.

⁶ The requests were ultimately dismissed on procedural grounds, whereupon the Commission initiated the Show Cause Docket to address the same underlying water quality and customer service issues.

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and implementing a scientifically and technically sound water treatment option that would address the hydrogen sulfide issue in a cost-effective manner.

During the negotiations, Aloha identified several key concerns that would have to be addressed in any settlement:

1) The Commission has previously held that Aloha's water meets all DEP-mandated water quality standards. Thus, a change in water treatment methodology is not required to meet any legally enforceable water treatment standard. In the absence of such a DEP requirement, Aloha faces the risk of disallowance if it proceeds with a particular water treatment option without prior approval by the Commission. In order to successfully finance a new option, Aloha and its lenders therefore need an up-front determination that the reasonable costs of implementing the selected option will qualify for recovery through rates. In other words, they require an advance determination that it is prudent to proceed with implementation of the option selected. This is similar to the type of assurance that electric utilities receive when they obtain a need determination for a power plant, or the advance approval of a fuel supply or power purchase contract.

2) Aloha's ability to finance any major water treatment improvements is impaired by the existence of the Show Cause Docket and Investigation Docket. The threat that a portion of Aloha's service territory may be deleted casts a cloud over Aloha's future revenue stream. Thus any settlement must involve termination of these proceedings.

During the discussions, staff likewise identified several key concerns:

A) Aloha must make a show of good faith by agreeing to drop its interim rate refund appeal and promptly refunding the \$276,000 plus interest previously ordered by the Commission.

B) Aloha must remove the threat that it will seek to recover from customers the legal fees and other costs it has incurred in the Show Cause Docket and other proceedings.

C) Aloha must implement a program to provide reasonable financial assistance to customers who want to replace copper pipes with CPVC.

The settlement negotiations were fruitful, and resulted in the Offer of Settlement that is attached to this recommendation as Exhibit A. Since everything cannot be accomplished at once, the Offer of Settlement contains staggered effective dates.

- The First Effective Date is the day that the Commission votes to accept the Offer of Settlement.
- The Second Effective Date is the day that an order accepting the Offer of Settlement becomes final and non-appealable.

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- The Third Effective Date is the day that an order approving a specific water treatment option becomes final and non-appealable.

The table on the following two pages summarizes the actions that will occur on each of the effective dates, and between the Second and Third Effective Date.

Summary of Key Actions Under Offer of Settlement

	Show Cause Docket (Certificate Revocation)	Investigation Docket (Additional Territory)	Refund Appeal & Investigation Appeal	Circuit Court Lawsuit	Water Quality Case (0.1 mg/L goal / measurement points)
1st Effective Date (§1) (Vote Accepting Offer of Settlement)	Placed in abeyance. 1/06 hearing cancelled. (§5a)	Placed in abeyance. (§5b)	*Joint motion to hold in abeyance. (§5d)	*Joint motion to hold in abeyance. (§5c)	--
2nd Effective Date (§1) (Order Accepting Offer of Settlement Becomes Non- Appealable)	--	--	*Aloha voluntarily dismisses refund appeal and makes refund. (§6b)	--	*Aloha dismisses or withdraws any pending reconsideration or appeal. (§6a)
3rd Effective Date (§1) (Order Approving Treatment Method Becomes Final and Non-Appealable)	Case dismissed. (§7a) No further enforcement, penalties or disallowances for actions/inactions prior to this date related to water quality or customer service issues addressed in the above- listed dockets. (§7b)	Case dismissed. (§7a)	Aloha voluntarily dismisses investigation appeal. (§7c)	Aloha voluntarily dismisses with prejudice. (§7c)	--

* If Aloha defaults on any of these items, PSC can take show cause and investigation docket out of abeyance. (§11)

	Other
After 1st Effective Date (Vote Accepting Offer of Settlement)	--
After 2nd Effective Date (Order Accepting Offer of Settlement Becomes Non-Appealable)	<p>*As soon as final USF report is received, Aloha will provide copy to staff, OPC, and parties to show cause docket. (§13)</p> <p>*Within 60 days after receipt of report from USF, Aloha will file a petition seeking approval of its preferred water treatment option and cost estimates for all options identified in USF study. (§4a)</p> <p>PSC will dispose of petition (via PAA or hearing, as required) and will approve an option, which may be different than Aloha's preferred option. That order will approve prudence of option but will leave PSC free to review reasonableness of specific implementation costs. (§4a,c)</p> <p>*Aloha will not challenge the Commission's selected option via either protest or appeal on the grounds that the Commission selected something other than Aloha's preferred option. (§4b)</p> <p>Aloha will file a limited proceeding to recover cost of 1.5 MGD water purchase from Pasco County. PSC will process as a limited proceeding via PAA process and will not add issues. Staff will recommend at PAA stage that Aloha has adequately explored water supply alternatives. If PAA is protested, final order will be issued within 6 months after protest. (§10)</p>
After 3rd Effective Date (Order Approving Treatment Method Becomes Final and Non-Appealable)	<p>**Aloha proceeds as quickly as possible and in good faith to implement the Commission-approved treatment option. (§7d)</p> <p>**Aloha implements 18-month repiping program with \$1,000 grants and up to \$2,500 interest-free 36-month loans for up to 200 homes. Costs will be borne by Aloha and will not be recovered from ratepayers. (§8)</p> <p>Aloha will not seek to recover from ratepayers any litigation costs, legal fees, consultant fees or other costs resulting from judicial or quasi-judicial proceedings in the above-listed dockets. (§9)</p> <p>Aloha and PSC give up any claims for attorneys fees or other compensation for prior actions. (§9)</p>

* If Aloha defaults on any of these items, PSC can take show cause and investigation docket out of abeyance. If so, Aloha can seek to proceed in circuit court. (§11)

** If Aloha defaults on any of these items, PSC can initiate an enforcement action based on that default. If so, Aloha can challenge in circuit court any PSC actions that occurred after the 3rd effective date. (§12)

Discussion of Issues

Issue 1: Should the Commission issue a final order accepting Aloha's Offer of Settlement?

Recommendation: Yes. The Commission should issue a final order accepting Aloha's Offer of Settlement.

Staff Analysis: Staff believes that the acceptance of Aloha's Offer of Settlement is in the public interest. Acceptance of the Offer of Settlement will avoid protracted administrative, judicial and appellate litigation. It will allow Aloha, the Commission, and other interested persons instead to focus their resources on identifying and implementing a scientifically and technically sound, cost-effective approach to addressing the hydrogen sulfide issues.

The following three pages present, in tabular form, a summary of the key provisions of the agreement and a short statement of the effects (pros and cons) of those provisions. The table is followed by a more traditional narrative discussion of the agreement, including identification of some boilerplate provisions that are not summarized in the table.

ALOHA AGREEMENTS	COMMISSION AGREEMENTS	EFFECTS (PROS AND CONS)
Water Quality		
Aloha will submit USF study of water treatment options, submit cost and rate impact report, and request approval of preferred option.	PSC will conduct a proceeding (PAA or hearing) to review available options, including any options from the Commission's independent consultant, and will approve what it determines to be the best option.	Should result in selection of best scientific and technical solution to address the water quality problem. Shifts focus from litigation to solving problem.
Aloha will not protest or appeal a PSC decision on the grounds that it selects an option that is different than Aloha's preferred option. Aloha will proceed to implement approved option as quickly as possible.	PSC approval will establish Aloha's fundamental right to recover the prudent costs of implementation through rates. The reasonableness of specific costs will be subject to review when Aloha requests rate relief.	Aloha's agreement not to protest/appeal avoids delay in implementing the approved option. Assurance of cost recovery (coupled with termination of deletion proceeding) enables Aloha to obtain financing to implement the approved option.
Aloha will withdraw any motion for reconsideration or appeal of the order that established the 0.1 mg/L goal and specified the measurement points and requirements.		Avoids further delay in implementing the water quality monitoring program.

ALOHA AGREEMENTS	COMMISSION AGREEMENTS	EFFECTS (PROS AND CONS)
Repricing Program		
<p>Aloha will make grants of \$1,000 and 36-month interest free loans of up to \$2,500 to customers for replacement of copper piping. The program will be open for 18 months following PSC approval of a water treatment option and will be available to up to 200 homes.</p> <p>Certain procedures for the program are included as an attachment to the Offer of Settlement.</p>		<p>Eases the financial burden faced by customers who must replace copper pipes to correct pinhole leaks or to avoid recurrence of black water problems.</p> <p>Repricing program represents up to \$253,000 commitment by Aloha. This cost will not be recovered from customers. Because it relates to pipes on the customer side of the meter, this commitment is above and beyond anything the PSC could require.</p>
Interim Rate Refund		
<p>Aloha will voluntarily dismiss its appeal of the order requiring further interim rate refunds and will promptly refund the amounts ordered by the PSC.</p>		<p>Avoids risk to customers of an adverse appellate decision overturning their right to refund.</p> <p>Gets \$276,000 refund to customers quickly.</p>
Attorney Fees and Litigation Costs		
<p>Aloha will not seek to recover from ratepayers its litigation costs associated with defense of the show cause proceedings and other specified PSC and court litigation.</p>		<p>Protects customers from potentially having to pay through rates \$577,000 or more in attorneys fees and other litigation costs.</p>
<p>Aloha will not seek to recover attorneys fees or other damages from the PSC related to actions before the final effective date.</p>	<p>PSC will not seek to recover attorneys fees or damages from Aloha related to actions before the final effective date.</p>	<p>Allows both PSC and Aloha to avoid expense and risks of litigation under various theories of liability.</p>

ALOHA AGREEMENTS	COMMISSION AGREEMENTS	EFFECTS (PROS AND CONS)
Certificate Revocation Docket / Investigation Docket		
	<p>PSC will cancel January 2006 deletion hearings and hold dockets in abeyance in anticipation of reaching the final effective date. On the final effective date, PSC will dismiss both dockets.</p> <p>PSC will not take future enforcement action against Aloha (or impose any future penalties or disallowances) based on action or inactions, prior to final effective date, relating to water quality or customer service issues that have been raised in previous dockets.</p>	<p>Avoids what is likely to be 5 or more years of expensive litigation before a final decision on deletion could become effective.</p> <p>Dismissal of the deletion proceeding that has created a cloud over Aloha's future revenue stream (coupled with PSC approval of a particular treatment option) will allow Aloha to obtain financing to implement the best scientific and technical solution.</p> <p>Implementing the best scientific and technical solution lets Aloha start over with a clean slate.</p> <p>Eliminates risk that Aloha will implement a treatment solution for all of Seven Springs but that the cost ultimately could be recovered only from customers who remain in a reduced territory.</p> <p>Will not satisfy customers who believe that deletion from Aloha's territory and substituting service from Pasco County is the only acceptable option.</p>
Other Litigation		
<p>Aloha will hold its investigation appeal and its circuit court declaratory judgment action against the PSC in abeyance until the final effective date, when it will be dismissed.</p>		<p>Allows PSC and Aloha to avoid expense and risks of litigation.</p>

ALOHA AGREEMENTS	COMMISSION AGREEMENTS	EFFECTS (PROS AND CONS)
Other Future Proceedings		
<p>Aloha intends to file a limited proceeding to recover incremental cost of purchase of 1.5 MGD/day from Pasco County which is required to comply with SWFWMD requirements.</p>	<p>PSC will handle case as a limited proceeding, will not expand issues, and will issue PAA order within 90 days. If PAA is protested, PSC will issue final order within additional 6 months.</p> <p>At the PAA stage, staff will recommend that Aloha has sufficiently explored alternative sources of water.</p>	<p>Allows Aloha to use a limited proceeding to seek recovery of the costs of purchasing water from Pasco County and establishes reasonable time limits for the processing of that case.</p> <p>Allows Aloha to move forward with the purchase of needed water.</p>
<p>Although not specifically covered by the Offer of Settlement, Aloha and staff anticipate that Aloha will need to file one or more general rate cases to recover, among other things, the cost of whatever water treatment option the PSC approves.</p>		

Monetary Benefits to Customers

In addition to allowing the parties to address the root cause of the black water problem, the Offer of Settlement provides several benefits for customers.

- First, it ensures that customers will receive the \$276,000 in interim rate refunds previously ordered by the Commission promptly after the Second Effective Date. It eliminates the risk that the court of appeal might overturn the PSC decision ordering the refund. (§§5d and 6b)
- Second, it eliminates the risk that Aloha's customers may have to pay, through rates, a substantial amount of attorneys fees and other litigation costs that Aloha has spent in defending the Show Cause Docket and in other proceedings. (§9) As of June 30, 2005, Aloha had recorded approximately \$577,000 of deferred costs for which it would seek recovery and had spent an additional \$428,000 for which a recovery claim is possible. If the Offer of Settlement is not accepted, and litigation continues, the \$577,000 figure would continue to grow.
- Third, it provides a \$253,000 repiping program under which Aloha will make grants of \$1,000 and provide 36-month interest-free loans of up to \$2,500 to customers who replace copper piping in their homes with CPVC.⁷ This program will be available for 18 months after the Third Effective Date for up to 200 homes. Aloha will bear the full cost of this program, which will not be passed on to customers through rates. (§8) Certain procedures associated with the repiping program are included in an attachment to the Offer of Settlement.

Staff believes that these substantial concessions by Aloha demonstrate its good faith and its sincere desire to reach a negotiated resolution of the various pending matters.

Process for Selecting Appropriate Water Treatment Option (§3-4)

As mentioned above, the Offer of Settlement establishes a procedure for addressing the selection and implementation of a scientifically and technically sound water treatment option. First, Aloha will provide the Commission, OPC, and other parties to the Show Cause Docket a copy of USF's final report on water treatment options as soon as it is available, which is expected to be on or before August 15, 2005. Aloha will provide the data and workpapers supporting the report to the Commission, and will make representatives of USF available to consult with the Commission staff and their consultant regarding the report's data, findings and conclusions. Within 60 days after receipt of the final USF report, Aloha will file with the Commission information on the cost and rate impact of each option, and will petition the Commission to approve what Aloha believes to be the preferred option.

⁷ The \$253,000 consists of 200 grants of \$1,000 each plus the opportunity cost, at 7%, of committing up to \$500,000 to make the interest-free loans. In addition to this cost, Aloha will bear the risk of bad-debt expense associated with the loan portion of the program.

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The Commission will review Aloha's petition through a process – either PAA or hearing – in which interested parties can participate. At the conclusion of that process, the Commission will issue an order approving a specific option. Aloha will not challenge the option the Commission selects on the grounds that it differs from Aloha's preferred option.⁸ Once the order approving the option becomes final and non-appealable, Aloha will begin design, permitting and construction of the option. The Commission's approval of a specific option will establish that it is prudent for Aloha to proceed to implement the option and that Aloha will have the right, in a future rate proceeding, to recover the reasonable costs of implementation.

Staff believes that this process appropriately balances the interests of Aloha and its customers. All parties will have the opportunity to participate in the proceeding to select the water treatment option and will have information on the projected costs and rate impacts of the available alternatives. Once an option is selected, Aloha will have the assurance that the reasonable costs of implementation are recoverable, which should enable it to obtain the necessary financing. This is similar to the type of assurance that electric utilities receive when they obtain a need determination for a power plant, or the advance approval of a fuel supply or power purchase contract.

Termination of Show Cause and Investigation Dockets

If the Commission votes to accept the Offer of Settlement, the Show Cause Docket and the Investigation Docket will be placed in abeyance and the hearings scheduled for January, 2006 will be cancelled.⁹ (§5a) This will enable the parties to redirect their resources to selecting and implementing an appropriate water treatment option.

Once a Commission order approving a water treatment option has become final and non-appealable (the Third Effective Date), the Commission will dismiss the Show Cause Docket and the Investigation Docket. The slate will be wiped clean, and the Commission will not take any new enforcement action against Aloha, or impose any new penalties or disallowances, based on actions or inactions by Aloha which occurred prior to the that date and which relate to water quality or customer service issues that have been raised in earlier rate case dockets, the show cause docket, or the investigation docket. (§7a-b)

⁸ This ensures that implementation will not be delayed through legal maneuvers by Aloha. Of course, implementation of the Commission's decision could be delayed if other substantially affected parties choose to protest or appeal.

⁹ The Commission retains the right to take the cases out of abeyance if Aloha: (i) fails to provide the final USF report to the PSC and other parties immediately after its receipt, (ii) fails to file its petition for approval of its preferred water treatment option, and information on the cost and rate impact of all options, within 60 days after receipt of the final USF report, (iii) protests or appeals any order designating the Commission's selected water treatment option on the grounds that the Commission failed to select Aloha's preferred option, (iv) fails to file motions to hold the Declaratory Judgment Action, the Refund Appeal and the Investigation Appeal in abeyance immediately after the First Effective Date, (v) fails to dismiss the Refund Appeal and promptly make the required refunds immediately after the Second Effective Date, or (vi) fails to withdraw any motion for reconsideration or appeal of the Water Quality Order immediately after the Second Effective Date. If this happens, Aloha has the right to seek circuit court relief from any alleged violations of Aloha's property rights by the Commission. (§11)

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The Commission retains the right to bring an enforcement action against Aloha after the Third Effective Date if the Commission finds probable cause to believe that Aloha has violated its obligations to proceed in good faith to implement the selected water treatment option or to institute the repiping program. If that should occur, Aloha has the right to seek circuit court relief from any alleged violations of Aloha's property rights by the Commission which are alleged to have occurred after the Third Effective Date. (§12)

Staff believes that these provisions to hold the Show Cause and Investigation Dockets in abeyance, and ultimately dismiss them, are necessary parts of an overall settlement that shifts the focus from litigation to problem solving. Unless the threat of territorial deletion is removed, Aloha may have no choice but to continue to engage in aggressive litigation that diverts resources from addressing the underlying problem. Further, Aloha will likely have a problem obtaining financing for any significant water treatment improvements so long as they are operating under the treat that a portion of their customer base and revenue stream may be lost.

These provisions will not satisfy customers who believe that the only remedy for their problem is to be free of Aloha and to receive service directly from Pasco County. Staff believes, however, that there is a substantial likelihood that any such relief would be a minimum of 5 years away, and would be possible only after expensive litigation that interferes with implementing a scientific and technical solution to the hydrogen sulfide issue.

First, there is the risk that the prosecutorial staff does not prove its deletion case to the Commission's satisfaction by clear and convincing evidence. Second, there is a risk that any Commission order deleting territory gets overturned on appeal. Third, the Show Cause Order contemplates that any order of deletion would be contingent on the availability of an alternative provider. It appears almost certain that Aloha will not voluntarily sell any portion of its system to Pasco County and there is a substantial risk that Pasco County would ultimately elect not to institute condemnation proceedings or that any condemnation proceedings (and appeals therefrom) would take years to resolve. Fourth, even if Pasco County obtained the right to serve any deleted territory, there is no assurance that the rates (including any new connection charges) would be acceptable to the majority of the customers or that the quality of service would actually improve. Finally, the existence on on-going deletion proceedings creates a substantial regulatory issue regarding recovery of the cost of service improvements if a significant number of the customers they are designed to serve are eventually removed from Aloha's service territory.

In light of these factors, staff believes that the public interest is best served by approving the Offer of Settlement, including the provisions that contemplate the ultimate dismissal of the Show Cause and Investigation Dockets.

Future Rate Proceedings

The Offer of Settlement states Aloha's intention to promptly file a limited proceeding to seek to recover the cost of purchasing 1.5 MGD from Pasco County beginning January 1, 2006. A purchase of this size is needed to enable Aloha to reduce withdrawals that are currently in excess of the amounts allowed under its consumptive use permits.

If accepted, the Offer of Settlement would commit the Commission to several procedural items in regard to this case:

- The petition will be processed as a limited proceeding, and the Commission will not expand the scope of the proceeding beyond issues related to the additional water purchase. (§10a) This means that issues such as return on equity and other revenue and expense considerations would not be included. Based on staff's on-going review of annual reports, and the fairly recent rate case, staff believes that handling this water purchase issue in a limited proceeding is appropriate.
- The Commission will issue a PAA order within 90 days of receipt of the petition and, if the PAA order is protested, will issue a final order within 6 months of the date of the protest. (§10a) Limited proceedings are not normally subject to specific time frames. Staff believes that these time frames are reasonable, and will assure that Aloha receives a timely decision on its request for recovery of the cost of this water purchase.
- Based on information that staff has reviewed, and which will be filed in the limited proceeding, staff agrees at the PAA stage to recommend that Aloha has complied with the provisions of the last rate case order that required it to submit further information and analysis of water supply alternatives. (§10b) If the PAA order is protested, this does not preclude staff from making a different recommendation at the conclusion of the case if warranted by the record.

Staff believes that these procedural stipulations are appropriate, since they preserve the due process rights of any substantially affected parties to participate in the limited rate proceeding.

Although it is not specifically mentioned in the Offer of Settlement, staff anticipates that at some point – and certainly after any new water treatment option is implemented – Aloha will file a petition for a general rate increase. Under the provisions of Paragraph 4c, the Commission will not revisit the fundamental prudence of whatever water treatment option it previously approved. The Commission does retain the authority to review the reasonableness of the specific costs incurred in implementing that prudent option in a future rate case. (§4c)

Other Provisions

The Offer of Settlement contains a number of other provisions, including the following:

- On the Second Effective Date, Aloha will withdraw any motion for reconsideration or appeal of the Water Quality Order that established the 0.1 mg/L goal and specified the measurement points and requirements. (§6a) This will ensure that there is no further delay in implementing the provisions of this order.
- On the First Effective Date, Aloha and the Commission will file a joint motion to hold Aloha's Declaratory Judgment Case in abeyance. Aloha will dismiss this

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complaint on the Third Effective Date. (§§5c,7c) This will avoid the time and expense of litigating this matter.

- As of the Third Effective Date, both Aloha and the Commission give up their right to sue the other for damages or attorneys fees for any actions that occurred prior to that date. (§9) This protects both parties from the risk of litigation under various theories of liability.
- The Offer of Settlement becomes binding only if it is approved by the Commission, without change, and is incorporated by reference in a final Commission order. (§13) This is standard language in this type of agreement.
- Aloha does not admit to violation of any statute, rule or order and does not admit any fault or liability on water quality or customer service issues. (§15) This is standard language in this type of agreement.
- If the Offer of Settlement is not accepted by the Commission without change, neither it nor this staff recommendation will be admissible in any present or future judicial or administrative proceeding (§14) and neither Aloha nor any other party (including the Commission) will waive any positions, rights or remedies otherwise available to it. (§15). This is standard language in this type of agreement.

Why A Final Order

By signing the Offer of Settlement, staff agreed to recommend that the Commission enter a final order accepting the Offer of Settlement without change. In the opinion of the Commission's General Counsel, a final order, rather than a PAA order, is legally appropriate for the following reasons:

1) The only substantive action the Commission is taking is to commit to dismiss the Show Cause and Investigation Dockets once an order approving a water treatment option has become final and thereafter not to use past actions as the basis for future proceedings against Aloha. Under the applicable license revocation statute and case law, only the Commission can initiate a license revocation proceeding. Conversely, the Commission has the absolute right to voluntarily dismiss such a license revocation proceeding for any reason or no reason. In short, while other parties may be interested in the outcome of such a proceeding, they have no legal right to begin such a proceeding or to insist that such a proceeding be continued. Because the Commission has the absolute right to terminate such a proceeding, it likewise has the power to determine, without offering the opportunity for a hearing, whether the Offer of Settlement provides a sufficient basis for its discretionary decision to withdraw its prosecution.

2) Customers of Aloha may be substantially affected, in the future, by other provisions of the Offer of Settlement. This includes the provisions that require the Commission to approve some water treatment option for implementation and cost recovery, and the provisions that require the Commission to entertain and process a limited proceeding for purchased water costs. Because these matters will be resolved in Chapter 120 proceedings in which substantially

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affected persons can participate, mere approval of the Offer of Settlement does not determine any party's substantial interests.

Conclusion

The Offer of Settlement is necessarily detailed because of the number of interrelated matters at issue between Aloha and the Commission. Staff is convinced that acceptance of the Offer of Settlement, without change, is in the public interest. It offers a number of monetary benefits to Aloha's customers that could not otherwise be obtained or assured, it redirects the parties' resources away from protracted litigation toward finding and implementing a solution to the underlying problem, and it provides a much needed fresh start for Aloha, its customers, and the Commission.

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Date: July 21, 2005

Issue 2: Should the dockets affected by the Offer of Settlement be closed?

Recommendation: No. If the Offer of Settlement is accepted, then:

(1) Dockets 050018-WU and 050183-WU should be held in abeyance pending either (i) a further order consistent with paragraph 11 of the Offer of Settlement, or (ii) the occurrence of the Third Effective Date. On the Third Effective Date, these dockets should be closed administratively; and

(2) Docket 010503-WU should remain open pending the occurrence of the Second Effective Date and thereafter to monitor the interim rate refunds to be made by Aloha. After staff has verified that the refunds are complete, the docket should be closed administratively.

If the Offer of Settlement is not accepted, these dockets should remain open.

Staff Analysis: If the Offer of Settlement is accepted, the show cause docket (No. 050018-WU) and the investigation docket (No. 050183-WU) should be held in abeyance. Paragraph 11 of the Settlement Agreement allows those dockets to be taken out of abeyance if Aloha violates or fails to meet certain obligations under the Offer of Settlement. Upon occurrence of the Third Effective Date, the Commission's agreement to voluntarily dismiss these dockets will be triggered and they should be closed administratively.

The docket in which the interim rate refund is pending and the water quality monitoring has been required (No. 010503) should remain open pending the occurrence of the Second Effective Date. That date triggers Aloha's agreement to dismiss the refund appeal, to begin making refunds, and to dismiss or withdraw any request for reconsideration or appeal of the water quality order. The docket should continue to remain open until staff has verified that the refund has been completed. At that time, the docket should be closed administratively. Future monitoring of compliance with the water quality order can be continued as an undocketed matter.

If the Offer of Settlement is not accepted, these dockets should remain open.

OFFER OF SETTLEMENT

WHEREAS, the Florida Public Service Commission ("Commission") has initiated proceedings in Docket No. 050018-WU (Show Cause Docket) relating to the potential deletion of a portion of the territory to which Aloha Utilities, Inc. ("Aloha") is currently authorized to provide water service, as more fully set forth in Order No. PSC-05-0204-SC-WU, and Aloha is vigorously defending this case; and

WHEREAS, the Commission has opened an investigation in Docket No. 050183 (Investigation Docket) into whether there is probable cause to initiate additional deletion proceedings with respect to other portions of Aloha's water service territory; and

WHEREAS, Aloha has filed a notice of appeal of the order initiating the Investigation Docket in the First District Court of Appeal (Investigation Appeal); and

WHEREAS, the underlying issues in the Show Cause Docket and the Investigation Docket arise out of the presence of hydrogen sulfide in the water in the homes of some Aloha customers and various taste, odor and color issues that result from such presence (the "hydrogen sulfide issues"); and

WHEREAS, Aloha has filed an action against the Commission in Leon County Circuit Court Case No. 05-CA-01142 seeking declaratory and injunctive relief (Declaratory Judgment Action); and

WHEREAS, Aloha has appealed to the First District Court of Appeal in Case No. 04-5242 (Refund Appeal) a Commission order that requires Aloha to refund certain amounts previously collected from its customers; and

WHEREAS, the Commission has issued Order No. PSC-05-0709-FOF-WU (Water Quality Order) granting Aloha's request to replace the requirement in Order No. PSC-02-0593-FOF-WU that Aloha remove 98% of the hydrogen sulfide from its finished water with a goal that the level of hydrogen sulfide in its water should not exceed 0.1 mg/L, and has specified the locations and frequency of required testing; and

WHEREAS, Aloha has the right to seek reconsideration and/or appeal of the Water Quality Order; and

WHEREAS, the University of South Florida, under contract with Aloha, is nearing completion of a study (the "USF Study") that will identify and analyze various water treatment options to address the hydrogen sulfide issues (the "Available Options") and Aloha currently anticipates that the final USF Study will be completed on or before August 15, 2005 and such study will address tray, forced draft and packed tower aeration in addition to other water treatment options; and

WHEREAS, Aloha intends to promptly review the Available Options, analyze and estimate their respective costs and rate impact, and file with the Commission a request for

approval of Aloha's preferred water treatment option ("Aloha Option"), taking into account which option has the best likelihood of eliminating or minimizing the hydrogen sulfide issues on a cost-effective basis, within 60 days following receipt of the final USF Study; and

WHEREAS, Aloha is ready and willing to implement either the Aloha Option, or any of the other appropriate Available Options identified by the USF Study, or a technically feasible hydrogen sulfide treatment option identified by an independent consultant retained by the Commission, which shall be approved by the Commission as the preferred method to address the hydrogen sulfide issues ("Selected Option"); and

WHEREAS, Aloha believes that due to the risk of future disallowance for cost recovery purposes, it will not have the ability to finance the Selected Option in the absence of either (1) formal regulatory approval by the Commission of implementation of the Selected Option, or (2) the existence of a legally enforceable water treatment standard that requires the implementation of the Selected Option; and

WHEREAS, Aloha further believes it will not have the ability to finance the Selected Option while the Show Cause Docket is pending, due to the risk to lenders that a portion of Aloha's revenue-generating territory may be deleted; and

WHEREAS, in the event the Show Cause Docket and/or Investigation Docket were to result in an order deleting any portion of Aloha's territory, Aloha will exercise every legal right at its disposal to resist such deletion and to preserve or recover the full value of its assets; and

WHEREAS, Aloha believes that the public interest is better served by the prompt implementation of the Selected Option that has the best likelihood of eliminating or minimizing the hydrogen sulfide issues on a cost-effective basis than by prolonged administrative, judicial and appellate litigation; and

WHEREAS, Aloha believes that the purchase of water from Pasco County is the only option reasonably and feasibly available to Aloha to insure that Aloha has sufficient water to serve the potable water needs of its present and future customers.

NOW, THEREFORE, Aloha Utilities, Inc. offers to settle the Show Cause Docket, the Investigation Docket, the Investigation Appeal, the Declaratory Judgment Action, the Refund Appeal, and the Water Quality Proceeding on the following basis:

1. The "First Effective Date" is the date that the Commission votes to accept this Offer of Settlement. The "Second Effective Date" is the date that a Commission order accepting this Offer of Settlement has become final and non-appealable. The "Third Effective Date" is the date that a Commission order approving implementation of the Selected Option has become final and non-appealable.

2. The Available Options are those identified by the USF Study to address the hydrogen sulfide issues in Aloha's water service territory. The Available Options will also include any other technically feasible hydrogen sulfide treatment option recommended by an independent

consultant retained by the Commission, provided that any such option must be described by the consultant in a report with sufficient specificity and detail to enable Aloha and its engineers to evaluate the cost of such option, and, if the option is ultimately selected by the Commission, to proceed expeditiously to implement such option.

3. Aloha will provide a copy of the final USF Study to the Commission, the Office of Public Counsel, and each of the individual intervenors in the Show Cause Docket immediately upon its receipt from USF. Representatives of USF have assured Aloha that the USF Study and appendices will provide all of the relevant data and workpapers generated in the preparation of the USF Report. Aloha will provide the Commission with all of these data and workpapers. Aloha shall make the representatives of USF who worked on the study reasonably available to consult with the Commission's staff and/or consultants about their data, findings and conclusions.

4. (a) No later than 60 days following Aloha's receipt of the final USF Study, Aloha will file with the Commission and serve on all parties to the Show Cause Docket a report that analyzes and estimates the respective costs and rate impacts of the Available Options identified by the USF study. The report will be accompanied by a petition that requests Commission approval of the Aloha Option. The Commission will expeditiously conduct a proceeding to review the Available Options and to enter an order selecting one of the Available Options (the "Selected Option") and approving its implementation.

(b) Aloha agrees that it will not protest any PAA order, or appeal any final order, on the grounds that the order approves a Selected Option that is different than the Aloha Option. Provided, however, that this paragraph shall not prohibit a protest, motion for reconsideration or appeal on the grounds that the Selected Option has not been identified with sufficient specificity to enable Aloha to proceed with design and engineering.

(c) The approval of the Selected Option shall have the effect of determining that it is prudent for Aloha to proceed to implement such option as if there were a legally enforceable water treatment standard that requires the implementation of such option and that the prudent costs of implementing such option shall be recoverable through rates. Aloha acknowledges and agrees that such approval will not preclude the Commission from reviewing the reasonableness of the specific costs incurred in implementing the Selected Option at the time Aloha seeks recovery of the related costs; however, the Commission's review shall not revisit for ratemaking purposes the fundamental decision that the Selected Option should have been implemented.

5. On or immediately after the First Effective Date:

- (a) The Show Cause Docket shall be placed in abeyance, all further activity in that docket shall be suspended, and the hearings currently scheduled for January 2006 shall be cancelled.
- (b) Staff's investigation in the Investigative Docket shall be placed in abeyance and all further activity in that docket shall be suspended.

- (c) Aloha and the Commission shall file a joint motion requesting that the Circuit Court hold the Declaratory Judgment Action in abeyance. If the motion is denied, Aloha agrees not to prosecute the Declaratory Judgment Action in anticipation of the occurrence of the Third Effective Date.
 - (d) Aloha and the Commission shall file a joint motion requesting that the First District Court of Appeal hold the Refund Appeal and the Investigation Appeal in abeyance.
6. On or immediately after the Second Effective Date:
- (a) Aloha will not file, or if previously filed will withdraw or voluntarily dismiss, any request for reconsideration or any appeal of the Water Quality Order.
 - (b) Aloha will file a notice of voluntary dismissal of the Refund Appeal and shall promptly make the refunds required by Order No. PSC-04-1050-FOF-WU.
7. On or immediately after the Third Effective Date:
- (a) The Commission will voluntarily dismiss both the Show Cause Docket and the Investigative Docket.
 - (b) No further enforcement action will be taken against Aloha by the Commission, nor any further disallowances or penalties of any kind will be assessed against Aloha by the Commission in any future proceeding based on action or inaction relating to water quality or customer service issues which have been raised in Docket Nos. 950615-SU, 960545-WS, 010503-WU, 020896-WS, 050018-WU or 050183-WU, which action or inaction occurred prior to the Third Effective Date.
 - (c) Aloha will voluntarily dismiss the Declaratory Judgment Action, with prejudice, and will voluntarily dismiss the Investigation Appeal.
 - (d) Aloha will proceed as quickly as possible, and in good faith, to implement the Selected Option, including, but not limited to, design, permitting, financing, construction, testing, and operation. This obligation will be incorporated in, and imposed by, the Commission order approving implementation of the Selected Option.
8. Beginning 30 days following the Third Effective Date, and continuing for 18 months thereafter, Aloha will reimburse \$1000 of the cost incurred during said 18 month period by any of its residential customers in the Seven Springs service area for replacing copper water piping in their home with CPVC piping and will finance 100% of the remaining cost (up to an additional \$2,500) through an interest-free loan program (the "Repiping Program"). The maximum number of residential customers allowed to participate in the Repiping Program shall not exceed 200 homes. The loans will be repaid by the residential customer, without interest, in equal increments over a 36 month period. Customers must submit a written application to Aloha

within the above-noted 18 month period in order to participate in the Repiping Program. Such applications will be available at Aloha's offices. The application shall not require any credit approval. Aloha will not seek to recover the cost of the Repiping Program from its ratepayers; provided, however, this does not prevent Aloha from taking collection action against a customer to enforce Aloha's right to repayment of any loan to the customer under the Repiping Program. An outline of the procedures to be followed by Aloha in administering the Repiping Program are attached to this Offer of Settlement as Exhibit I, and are incorporated herein by reference.

9. Neither Aloha nor the Commission will seek recovery from the other of attorneys fees, costs, damages, or other compensation related to any action taken by either party on or prior to the Third Effective Date. Further, Aloha will not seek recovery from its ratepayers of any litigation costs, legal fees, consultant fees, and costs arising directly from or resulting from any judicial or quasi-judicial litigation in the Show Cause Docket, the Investigation Docket, the Declaratory Judgment Action, the Refund Appeal, the Investigation Appeal and the Water Quality Proceeding. The provisions of this paragraph will take effect on the Third Effective Date.

10. (a) Aloha intends to immediately file a limited proceeding in order to recover through water rates the cost of the additional 1.5 million gallons per day of water that Aloha has contracted to purchase from Pasco County beginning in January, 2006. The Commission will process such application as a limited proceeding, will not expand the scope of the proceeding beyond issues related to the additional water purchase, and will issue its PAA Order in such case within 90 days of the receipt of the petition. In the event the PAA Order is protested, the Commission will issue its Final Order within 6 months of the date of such protest.

(b) Aloha has provided to the Commission, and will file in the limited proceeding, a report detailing its attempts to locate alternative sources of water in order to conform to the maximum limits of its water use permit while meeting the water supply needs of its existing and future customers. Based upon that report and on the previous information provided to the Commission in Docket No. 020896-WS, the staff of the Commission will recommend at the PAA stage of the limited proceeding that Aloha has now complied with the requirements of Order No. PSC-02-0593-FOF-WU with regard to the further issues that needed to be analyzed and information that needed to be produced by Aloha to determine the most cost effective alternative for obtaining additional water resources as contained on Pages 52 and 53 of that Order.

11. In the event that Aloha violates, or fails to meet its obligations under, Section 3, 4(a), 4(b), 5(c), 5(d), 6(a) or 6(b), the Commission may take the Show Cause Docket and Investigative Docket out of abeyance. If the Commission takes those dockets out of abeyance, nothing herein shall limit in any way Aloha's right to seek relief in Circuit Court from any alleged procedural or substantive due process violation of Aloha's property rights by the Commission.

12. In the event the Commission finds probable cause that Aloha has violated its obligations under Section 7(d) or 8, or the provisions of any Commission order that incorporates those obligations, nothing in this Offer of Settlement, or the Commission's acceptance thereof, shall limit in any way the Commission's authority to take enforcement action against Aloha for

such alleged violation. Such enforcement action shall be initiated in a manner that provides Aloha with the right to a hearing and complies with any other applicable requirements of Chapter 120. If the Commission initiates such enforcement action, nothing herein shall limit in any way Aloha's right to seek relief in Circuit Court from any procedural or substantive due process violation of Aloha's property rights by the Commission which is alleged to have occurred after the Third Effective Date.

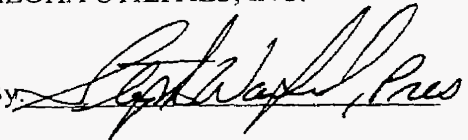
13. This Offer of Settlement shall create binding obligations on Aloha only if it is accepted by the Commission, without change, and is incorporated by reference in a final Commission order.

14. If this Offer of Settlement is not accepted by the Commission, without change, then neither the Offer of Settlement nor the staff recommendation that the Commission accept the Offer of Settlement will be admissible in any present or future judicial or administrative proceeding.

15. By making this Offer of Settlement, Aloha does not admit to any violation of any statute, rule or order, nor does such offer constitute an admission of fault or liability on water quality or customer service issues which have been raised by the Commission or some of Aloha's customers. In the event this Offer of Settlement is not accepted by the Commission, without change, neither Aloha nor any other party to any of the proceedings referenced herein (including the Commission) waives any legal, factual, policy or other position, or any legally available rights and remedies, otherwise available to it.

SUBMITTED this 20th day of July, 2005.

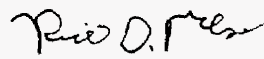
ALOHA UTILITIES, INC.


By: 

STATEMENT BY COMMISSION STAFF

The Commission's General Counsel and Director of Economic Regulation have participated in settlement negotiations with Aloha and have reviewed the foregoing Offer of Settlement. Based on that participation and review, they will recommend to the Commission that it issue a final order accepting the Offer of Settlement, without change.

Dated: 7/21/05


General Counsel


Director of Economic Regulation

ALOHA UTILITIES, INC.
Copper Pipe Replumbing Reimbursement through Loan and Grant

Procedures

1. Within 18 months of the start date for program, a customer in Aloha's Seven Springs service territory whose home has copper piping may submit an application for preapproval of a \$1,000 grant and up to a \$2,500 loan for complete repiping of the home with CPVC pipe. The application shall include:
 - a) The name and address of the customer requesting repiping within the Seven Springs service territory;
 - b) An estimate by a state licensed plumbing contractor for work to be performed to replace all existing copper piping with CVPC;
 - c) An executed Indemnification and Hold Harmless Agreement relieving Aloha from responsibility for damage to pipes, or for the work to be performed and the materials to be utilized by the licensed plumbing contractor;
 - d) The customer's authorization for Aloha to include on the customer's monthly water and sewer bill the charges for repayment of the loan portion; and
 - e) The customer's agreement to repay the loan portion along with payment for water and sewer service.
2. Aloha will notify the customer of any deficiencies in the application within 15 business days of its receipt. Aloha will approve the application within 20 business days of its receipt, or within 20 days of the correction of any deficiencies. If Aloha has previously approved 200 applications under the program, Aloha will place the customer's name on a waiting list in the event that previously approved customers do not complete their repiping projects.
3. All work related to the replacement of copper piping with CVPC shall be completed by the licensed plumbing contractor within 90 days of the approval as outlined in Paragraph 2 above. Within 30 days after completion of such work, the customer shall submit a statement from the plumbing contractor showing a specific itemization of the work performed to replace all copper pipe with CPVC, the cost of the work performed to replace all copper pipe with CPVC, and that such work has been completed in full.
4. Aloha shall schedule a closing within 30 business days after its receipt of such invoice. At closing, the customer shall be required to sign a promissory note for repayment of the loan portion. Such note shall provide for the customer to pay any attorneys' fees and costs in the event Aloha is required to institute collection action and shall provide that the obligation to repay the note will "run with the land." Upon execution and delivery of note, Aloha shall issue a check for the grant and loan proceeds payable to the customer.