State of Florida

Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

-M-E-M-O-R-A-N-D-U-M-

DATE: January 17, 2008

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Fletcher, Bulecza-Banks, Walden)
Office of the General Counsel (Hartman)

RE: Docket No. 060122-WU – Joint petition for approval of stipulation on procedure with Office of Public Counsel, and application for limited proceeding increase in water rates in Pasco County, by Aloha Utilities, Inc.

AGENDA: 01/29/08 – Regular Agenda – Proposed Agency Action - Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Skop

CRITICAL DATES: 1/29/08 (Settlement Order Deadline)

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\060122.RCM.DOC

08 JAN 17 PM 1:13
COMMISSION CLERK
RECEIVED-FPSC

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. In February 2005, the Commission initiated deletion proceedings in Docket No. 050018-WU for a portion of the Seven Springs service area based on a number of problems that ultimately resulted from the presence of hydrogen sulfide in the water. On March 9, 2006, after several months of extensive negotiations in which staff participated, a Settlement Agreement was executed by Aloha, the Office of Public Counsel (OPC), and individual intervenors. The Settlement Agreement resolved all outstanding dockets and court proceedings between Aloha and the Commission, and was approved by the Commission by Order No. PSC-06-0270-AS-

WU[1]. A key element of the Settlement Agreement is the acknowledgement of the parties that it is prudent for Aloha to implement a new water treatment method – anion exchange – to address the current problems that stem from the presence of hydrogen sulfide in the water.

In addition to the hydrogen sulfide issue, Aloha has been exceeding its water use permit (WUP) limits. To address Aloha's excess withdrawals, on October 26, 2004, Aloha entered into a Bulk Water Agreement with Pasco County (County), wherein it contracted to purchase approximately 1.5 million gallons of water per day from the County in order to meet the needs of current and future customers. However, at that time, there were several issues between the County and Aloha that needed to be resolved before any water could be delivered. Based on a discussion with Aloha's counsel, the utility now projects it could begin purchasing water from the County as soon as April of 2008.

Significant costs are expected to be associated with the purchase of this water and the installation and operation of related chloramination facilities. Aloha is converting its disinfection process from chlorine to chloramines, in order to make its potable water compatible with water purchased from the County. On February 13, 2006, as part of the negotiations between the parties towards reaching the Settlement Agreement, OPC and Aloha filed a Joint Petition to Approve Stipulation on Procedure, which formalized an agreement between Aloha and OPC regarding the procedure to be followed and the issues to be addressed in the event Aloha filed a future limited proceeding to recover the costs of the purchased water and related chloramination facilities. The Commission approved the Stipulation on Procedure by Order No. PSC-06-0169-S-WU, issued March 1, 2006, in this docket.

On July 26, 2006, the Commission staff issued its audit report related to the chloramination facilities. At the time the audit was being conducted, the timing of the bulk water delivery,[2] including points of connections with the County's water system, was not resolved. In addition, Aloha had not yet paid the associated impact fees for any additional bulk water. Conversion from chlorination to chloramination could not take place until both the timing of the bulk water delivery was resolved and the impact fees paid. As a result, the staff auditors' examination consisted of a review of a schedule of plant additions related to the chloramination facilities, by primary account numbers. Specifically, the staff auditors traced all recorded plant additions associated with the chloramination facilities to vendor invoices and reviewed all journal entries and AFUDC calculations associated with the plant additions and retirements. However, the auditors did not determine whether the amounts recorded by the utility were solely for the chloramination facilities.

---

[1] Issued April 5, 2006, in Docket No. 050018-WU, In Re: 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, In Re: 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, and Docket No. 010503-WU, In Re: Application for increase in water rates for Seven Springs System in Pasco County by Aloha Utilities, Inc.

[2] See Document No. 09083 (Aloha's Quarterly Report), filed October 2, 2006, in Docket No. 060606-WS, In re: Progress reports on implementation of Anion Exchange in Pasco County, filed by Aloha Utilities, Inc. pursuant to Order PSC-06-0270-AS-WU.

Effective December 20, 2006, the County began collecting substantially higher impact fees to be charged for plant capacity, including the plant capacity that Aloha contracted to reserve by way of the Bulk Water Agreement. On November 30, 2006, Aloha and OPC entered into a Stipulation and Joint Petition to Approve Stipulation, specifying, among other things, that the impact fees paid by Aloha to the County on or before December 19, 2006, at the County's lower impact fees, for the purchase of Phases I, II, and III [total of 3.1 million gallons per day (mgd)] for bulk water service should be considered prudent and that no used and useful adjustments should be made to those impact fees. The Commission approved that Stipulation by Order No. PSC-07-0023-S-WU, issued January 8, 2007, in this docket, and Aloha paid the lower County impact fees on December 19, 2006.

Also, by the terms of the November 30, 2006 Stipulation, Aloha and OPC agreed to work toward gaining immediate approval of a stipulated increase in water service availability charges for Aloha to a minimum level of $3,000 per equivalent residential connection, by entering into an additional stipulation and request to the Commission. To that end, on February 7, 2007, Aloha and OPC entered into a Stipulation to Increase Service Availability Charges, which was filed in this docket on February 9, 2007, along with a Joint Petition to approve it. The Commission approved that Joint Petition by Order No. PSC-07-0281-S-WU, issued April 2, 2007.

On September 28, 2007, Aloha filed its application for a limited proceeding to recover the costs for the chloramination and purchased water from the County. Due to timing and the level of costs related to the interconnection with the County, impact fees, and purchased water, staff evaluated the merits of applying a phased-in rate approach. Issue 1 addresses staff's recommendation regarding a phased-in rate approach.

While not directly at issue here, as a matter of context, it is important to be aware of the progress of the anion exchange treatment project. The parties to the settlement agreed to an estimate of 24 months as being a reasonable timetable for completion of this project. Project design was estimated to take 6 months; permitting was estimated to take 4 months; and bidding, contract award, fabrication and construction was estimated to take 14 months. However, based on delays in working out the bulk water purchases with Pasco County, the project was stalled in the design phase until April 11, 2007, when the County provided Aloha all the needed bulk water engineering information.

Once the water purchase details were resolved, Aloha then needed to complete the design phase of the project. Aloha apparently had difficulty getting a crucial technical report from the University of South Florida (USF), specifically from Dr. Audrey Levine, an engineering professor. With the utility's knowledge, Dr. Levine left employment from USF in December 2006. From communication that staff has received, it appears that Aloha was aware of problems with getting the contracted reports in timely fashion by June 2007, but failed to report these difficulties in its quarterly progress report filed on July 3, 2007. By letter dated September 5, 2007, the utility notified staff that it could not be assured it would receive Dr. Levine's final design report in the near future and that, as a result, the completion schedule would be impaired. Dr. Levine finally submitted her report in two parts in October and November of 2007. The late report has further contributed to delay in the design phase. Aloha claims that the holdup in receiving the report is attributable to delay by USF.

Moreover, analysis of the final design report has identified additional permitting issues as a result of the concentration of brine generated from the anion exchange process. Since the issues were first indentified, the parties have met on numerous occasions to discuss and assess options for resolving this matter. Staff continues to closely monitor the utility's compliance with the settlement agreement and will continue to review compliance and other issues relative to the settlement agreement in Docket No. 060606-WU.

This recommendation addresses the costs associated with the tie-in facilities, the impact fees paid to the County, the utility's purchased water gallons needed in 2008 and 2009, and the operation and maintenance costs for the utility's chloramine conversion. The Commission has jurisdiction pursuant to Sections 367.081 and 367.0822, Florida Statutes.

Discussion of Issues

Issue 1: Is a phased-in approach appropriate for the limited proceeding?

Recommendation: Yes, this limited proceeding should be trifurcated into three phases as set forth in staff's analysis below. (Fletcher)

Staff Analysis: In accordance with the Stipulation Order No. PSC-07-0281-S-WU, the Commission is required to make its decision within 120 days after the receipt of the petition and will issue its PAA Order no more than 20 days thereafter. The deadline for the Commission's decision is January 29, 2008. Staff believes this limited proceeding should be addressed in three phases.

Phase one should address the costs associated with the tie-in facilities, the impact fees paid to the County, the utility's purchased water gallons needed in 2008 and 2009, and the operation and maintenance costs for the utility's chloramine conversion. Phase two should address the plant costs and property taxes associated with the chloramination facilities, a true up for the actual costs of the tie-in facilities, rate case expense, and the revenue reduction to adjust the 2009 required rate of return to staff's recommended weighted cost of capital of 7.03% discussed in Issue 3. Phase two should be scheduled for the Commission's consideration at its March 18, 2008, Agenda Conference. Phase three should address the utility's additional purchase of approximately 0.71 mgd of water, including any associated water storage facilities and impact fees paid to the County. The Commission's consideration of phase three should not be necessary until approximately two years from now. As discussed below, there are several reasons staff believes it is necessary to trifurcate this proceeding into three phases.

Phase One

As part of phase one, the tie-in facilities, the payment of impact fees, and the prospective payments of the County bulk water rates are needed in order to receive the purchased water. Further, according to its response to Staff's Fourth Data Request, the utility now plans on leasing land instead of purchasing land as originally contemplated in its application. Because the utility has not signed an agreement for the required land, staff believes it is appropriate to include the land cost as initially proposed for phase one and true up the actual cost of securing the land in phase two through the utility's submission of a cost benefit analysis for its decision to lease rather than purchase the land. The tie-in facilities, impact fees, purchased water, and the chloramine conversion costs can be easily handled in phase one.

Phase Two

The other items to be considered in the limited proceeding are the plant costs and property taxes associated with the chloramination facilities, a true up for the actual costs of the tie-in facilities, and rate case expense, as well as the revenue reduction to adjust the 2009 required rate of return to the appropriate weighted cost of capital for the utility. Staff has several reasons why these costs should be considered in phase two. First, during the staff's audit, the utility provided 572 invoices related to the hard and soft costs for the chloramination facilities. The hard costs are the actual construction and materials costs, and the soft costs are the remaining associated costs (i.e. overhead, engineering, supervision, and other costs). As discussed above, staff auditors did not determine whether all these invoices related to the chloramination facilities. Based on staff's review of these invoices from the time the audit was issued to shortly after the utility filed its application, staff continued to discover that Aloha requested some hard and soft costs that are not related to the chloramination facilities. Based on Aloha's response dated November 19, 2007, to Staff's Second Data Request, staff discovered that there were additional costs unrelated to the chloramination facilities. Also, on December 17, 2007, staff propounded its Fifth Data Request to determine whether some additional identified costs actually relate to the chloramine conversion for the utility's Seven Springs water system. The responses to Staff's Fifth Data Request are due by January 21, 2008.

Second, the members of the Committee for Better Water Now, which consists of a group of Aloha customers, have expressed several concerns regarding the utility's requested costs of its chloramination facilities. Consideration of these other items in phase two will allow for more thorough review by staff, as well as OPC.

Phase Three

The last items to be considered relate to the utility's additional purchase of approximately 0.71 mgd of water, including any associated water storage facilities and impact fees paid to the County. In a response to a staff data request, Aloha asserted that its additional purchase of approximately 0.71 mgd of water will not take place until late 2009 or 2010. As such, the Commission's consideration of phase three should not be necessary until approximately two years from now.

Summary

In accordance with the Stipulation Order No. PSC-07-0281-S-WU, the Commission is required to make its decision within 120 days after the receipt of the petition and will issue its PAA Order no more than 20 days thereafter. The deadline for the Commission's decision is January 29, 2008. Based on the reasons set forth above, staff recommends this limited proceeding should be trifurcated into three phases. Phase one should address the costs associated with the tie-in facilities, the impact fees paid to the County, the utility's purchased water gallons needed in 2008 and 2009, and the operation and maintenance costs for the utility's chloramine conversion. Phase two should address the plant costs and property taxes associated with the chloramination facilities, a true up for the actual costs of the tie-in facilities, rate case expense, and the revenue reduction to adjust the 2009 required rate of return to staff's recommended weighted cost of capital of 7.03% discussed in Issue 3. Phase three should address the utility's additional purchase of approximately 0.71 mgd of water, including any associated water storage facilities and impact fees paid to the County. According to a letter dated December 21, 2007, from the utility's counsel, Aloha does not oppose the phased-in approach recommended by staff.

Issue 2: Should phase one costs requested in Aloha's limited proceeding application be approved?

Recommendation: Yes. However, several adjustments to the utility's filing are necessary, as detailed in staff's analysis. (Fletcher, Walden)

Staff Analysis: As discussed in Issue 1, phase one incorporates the rate base additions which include the costs associated with the Pasco County tie-in facilities and the impact fees paid to the County, as well as the associated accumulated depreciation, contributions in aid of construction (CIAC), and accumulated amortization of CIAC. In addition, phase one addresses the operating expenses related to purchasing water including the utility's operation and maintenance (O&M) expenses for purchased water gallons needed in 2008 and 2009 and the expenses for the chloramine conversion, as well as the taxes other than income (TOTI). Furthermore, staff is recommending that phase one rates should initially be based on the projected 2008 costs and later adjusted for the projected 2009 costs because staff believes it would be unfair for ratepayers to pay 2009 projected costs before the utility starts to realize those costs.

Rate Base Additions

Pasco County Tie-In Facilities

The utility requested $903,593 in plant costs related to the tie-in facilities. In response to a staff data request, Aloha provided an itemized cost breakdown from its engineer to support its requested amount. The utility has not completed the permitting process to date. Because the facilities are needed in order to begin purchasing water from the County, staff believes the cost should be trued-up. Even though the actual cost of the tie-in facilities are not known at this time, staff believes it is reasonable to include these estimated costs in phase one because these costs can be trued up in phase two.

Impact Fees Paid to the Pasco County

Aloha requested $4,136,675 of plant costs for the payment of impact fees to the County in 2006. As mentioned in the case background, the utility paid the impact fees for 3.1 mgd of water before the County's fees tripled on December 20, 2006. In exchange for this advanced payment, OPC and Aloha stipulated that those impact fees should be considered prudent and that no used and useful adjustments should be made to those impact fees. The Commission later approved that stipulation between OPC and the utility. However, as discussed more fully below, staff recommends the use of 2007 actual gallons to determine the projected gallons required to be purchased from the County. Based on the required 2008 and 2009 gallons of 2.06 mgd and 2.29 mgd, respectively, staff recommends that the impact fees associated with 2008 and 2009 are $3,552,267 and $3,915,885, respectively.

Accumulated Depreciation

In its application, Aloha reflected accumulated depreciation of $39,254 and $248,201 for the tie-in facilities and impact fees to the County, respectively. As discussed above, phase one rates will initially be based on the projected 2008 costs and later adjusted for the projected 2009 costs. As such, staff recommends that the 2008 and 2009 projected year-end accumulated depreciation for the tie-in facilities and impact fees to the County should be $72,442 and $278,623, respectively.

CIAC and Accumulated Amortization of CIAC

In its application, the utility reflected $6,282,000 and $393,162 for CIAC and accumulated amortization of CIAC, respectively. By Order No. PSC-07-0023-S-WU, p. 6, the approved stipulation required that in future limited proceedings designed to recover the costs associated with chloramination for the purchase of bulk water and the anion exchange facilities, the CIAC collected from the date of the stipulation through the approved test year of each limited proceeding will be recognized in rates. Based on responses to staff data requests and discussions with the utility, it appears that phase three in this docket and the final phase of the anion exchange limited proceeding will not occur until late 2009 or 2010. Thus, staff believes it is appropriate to allocate the CIAC projected amounts through 2009 between the gross plant ratios of phase one and phase two plant.

The following table illustrates the gross plant ratios for the tie-in facilities, the impact fees paid to the County, and the chloramination facilities.

Gross Plant Additions	Gross Plant	Ratio	Phase One	Phase Two
Chloramination Facilities	$3,848,657	43.30%	N/A	43.30%
Pasco County Water Tie-In Facilities	903,593	10.16%	10.16%	N/A
Impact Fees Paid to Pasco for Purchased Water	4,136,675	46.54%	46.54%	N/A
Total Gross Plant Additions	$8,888,925	100.00%	56.70%	43.30%

To maintain consistency with the recommended use of 2007 actual gallons to project the impact fees and purchased water expense, staff believes the actual ERCs in 2007 should be used to project CIAC balances. Because the utility has two billing cycles with one in mid month, Aloha could only provide the ERCs by customer class and meter size through November 2007. Based on the gross plant ratio of 56.70% and the actual ERCs through November 2007, staff recommends that the 2008 and 2009 year-end CIAC balances for phase one are $1,496,954 and $2,270,947, respectively. Correspondingly, staff recommends that the 2008 and 2009 year-end accumulated amortization of CIAC balances for phase one are $93,104 and $108,159, respectively.

Summary of Rate Base Additions

Based on the above, staff recommends that the appropriate 2008 and 2009 rate base additions are $2,979,569 and $2,378,067, respectively. The rate base additions through 2009 decreased primarily from the increases in accumulated depreciation and CIAC in 2009. However, as addressed in Issue 5, the 2009 base facility charges will be adjusted to account for this reduction.

Operating Expenses

In its filing, the utility requested a net increase of O&M expenses, net depreciation expense, and TOTI of $3,567,866, $91,980, and $71,191, respectively. As discussed in Issue 1, phase one excludes rate case expense and the associated depreciation expense and property taxes for the chloramination facilities. With those exclusions and adjusting the CIAC amortization expense based on a 56.70% gross plant ratio for the tie-in facilities and impact fees paid to the County, Aloha's requested a net increase of O&M expenses, net depreciation expense, and TOTI are $3,524,116, $53,071, and $21,960, respectively. Based on a review of the requested costs, staff believes adjustments are necessary to O&M expenses and net depreciation expense.

O&M Expenses

Account No. 601, Salary and Wages – Employees

In its filing, the utility included incremental labor costs of $99,685 and $12,486 related to the chloramine conversion and the tie-in facilities with the County, respectively. This represents a total incremental increase of $112,171. First, Aloha determined the $99,685 amount by taking the difference between the utility's engineer's estimate of labor costs after the completion of the chloramine facilities and its 2005 actual labor cost before the chloramine facilities were completed. Aloha provided a detailed description of the incremental labor required and determined the incremental labor costs by applying the 2005 hourly rates by its engineer's estimated incremental hours. Second, the $12,486 amount was determined by applying the utility engineer's estimated incremental hours by blended 2007 hourly rates. Upon review, staff believes the requested labor costs are reasonable.

Account No. 604, Employee Pensions and Benefits

According to its application, Aloha requested $46,293 in employee pensions and benefits associated with the incremental labor costs discussed above. The utility utilized the ratio of these costs to total salary and wages in 2005 which was 41.27%. Given the constant rise in health care costs, staff believes Aloha's use of the 2005 ratio is reasonable to equate the incremental employee pensions and benefits.

Account No. 610, Purchased Water

In its filing, the utility reflected a net purchased water increase of $3,136,080. Using simple linear regression, Aloha projected total 2009 required pumped and purchased gallons of 4.44 mgd which equates to 1.620 billion gallons annually. By subtracting the total allowable water use permit (WUP) withdrawal limit of 2.04 mgd or 744,600,000 gallons, the utility reflected a total of 2.40 mgd or 876,000,000 gallons required to be purchased by 2009. By applying the County's rate of $3.68 per 1,000 gallons rate, Aloha projected a purchased water increase of $3,223,680. The utility currently purchases raw water associated with a few of its well sites at a cost of $0.10 per 1,000 gallons. Multiplying the $0.10 per 1,000 gallons rate by the utility's 2009 projected gallons of 876,000,000 yields a purchased water expense reduction of $87,600. Aloha's adjustment here reflects the utility's removal of the pumped raw water gallons above its WUP limits.

Upon review, staff believes four adjustments are necessary to Aloha's purchased water increase of $3,223,680. First, based on its annual reports, the utility used the historical gallons from 2002 to 2006 to project its 2007, 2008, and 2009 pumped and purchased gallons. Aloha's projection workpapers reflect 2006 pumped and purchased gallons of 1.408 billion gallons while the utility's annual report reflects 1.406226 billion gallons. As such, the 2006 historical gallons which Aloha used to project were overstated by 1.774 million gallons.

Second, members of the Better Water Now committee expressed concerns that the residential and commercial growth has significantly declined and, as a result, the utility projections are overstated. To respond to this concern, staff requested the utility to provide the actual 2007 gallons of water pumped. The actual 2007 gallons were 86.606 million gallons less than the utility's projected 2007 amount. As such, staff used the actual gallons from 2003 to 2007 in order to project the required gallons in 2008 and 2009. Third, based on the recommended 2008 and 2009 required gallons of 2.06 mgd and 2.29 mgd, respectively, the utility's purchased water expense reduction of $87,600 should be adjusted to $75,224 for 2008 and to $83,579 for 2009.

Finally, it is Commission practice to allow 10% unaccounted for water and to reduce purchased water, purchased power, and chemicals for excessive unaccounted for water so that ratepayers do not bear those costs.[3] Based on the utility's annual reports, Aloha's historical gallons used in its projections include excessive unaccounted for water. Attachment A illustrates staff's calculations for the excessive unaccounted for water and the resulting purchased water expense reduction of $348,514 from the utility's purchased water increase of $3,223,680. Based on the above, staff recommends that the appropriate purchased water expense for 2008 and 2009 are $2,573,292 and $2,875,166, respectively.

Account No. 615, Purchased Power

In its filing, the utility reflected a net purchased power decrease of $12,136. First, Aloha determined a purchased power decrease of $39,073 related to the chloramination facilities by subtracting the actual 2005 purchased power cost by its engineer's projected power cost. Second, based on its engineer's estimated power needs for the tie-in facilities, the utility projected a purchased power increase of $26,937. With the exception of the 5.67% excessive unaccounted for water in 2005, staff believes Aloha's net purchased power decrease is reasonable. As discussed above, it is Commission practice to allow 10% unaccounted for water. When applying the excessive unaccounted for water percentage of 5.67%, staff believes the appropriate net purchased power decrease should be $11,448.

Account No. 618, Chemicals

According to its application, the utility requested an increase of $27,626 for chemicals. First, based on Aloha's engineer estimated amount of ammonia solution needed, the utility

[3] See Order No. PSC-07-0505-SC-WS, pp.31-32, issued June 13, 2007, in Docket No. 060253-WS, In re: Application for increase in water and wastewater rates in Marion, Orange, Pasco, Pinellas, and Seminole Counties by Utilities, Inc. of Florida and Order No. PSC-99-0513-FOF-WS, pp. 8-10, issued March 12, 1999, in Docket No. 980214-WS, In re: Application for rate increase in Duval, St. Johns and Nassau Counties by United Water Florida Inc.

projected a $12,597 increase in chemicals. Second, Aloha determined the chemical increase of $1,062 by subtracting the actual 2005 corrosion inhibitor cost by its engineer's projected corrosion cost after the chloramine conversion. Third, the utility determined a chemicals increase of $13,967 by subtracting the actual 2005 gas and liquid chlorine costs by its engineer's projected liquid chlorine cost after the chloramine conversion. With the exception of the 5.67% excessive unaccounted for water in 2005, staff believes Aloha's chemicals increase is reasonable. As discussed above, it is Commission practice to allow 10% unaccounted for water. When applying the excessive unaccounted for water percentage of 5.67%, staff believes the appropriate chemicals increase should be $26,060.

Account No. 620, Materials and Supplies

In its filing, the utility reflected an increase of $24,285 to materials and supplies expense. First, Aloha's engineer estimated a $12,500 allowance for miscellaneous parts, repairs, and supplies for the chloramine facilities. This allowance represents 0.32% of its requested gross chloramine conversion plant. The historical ratios of total materials and supplies and total gross plant in 2004 and 2005 were 1.07% and 1.77%, respectively. The utility's requested gross chloramine plant would have to be reduced by approximately $2.748 million or 71.41% before the $12,500 allowance would exceed the historical 1.07% ratio in 2004. Second, Aloha's engineer estimated an $11,785 maintenance allowance for the tie-in facilities. This allowance represents 1.30% of its requested gross Pasco County tie-in plant. Because the 1.30% ratio is within the range of the 2004 and 2005 historical ratios, staff believes the requested materials and supplies expenses are reasonable.

Account No. 635, Contractual Services – Testing

According to its application, the utility requested an increase of $66,952 for contractual services – testing. Aloha provided an itemized breakdown of the additional testing needed which was prepared by the utility's engineer. Upon review, staff believes the requested testing expenses are reasonable.

Account No. 636, Contractual Services – Other

In its filing, Aloha requested an increase of $122,845 for contractual services – other. First, based on service quotes, the utility included $49,438 for instrument maintenance. Second, Aloha determined an increase of $56,287 by subtracting the actual 2005 controllers and chemical feed equipment maintenance cost by its engineer's projected contracted cost after the chloramine conversion. Third, the utility included $17,120 for pigging and disinfection of the raw water line to its Mitchell plant. Upon review, staff believes the pigging and disinfection of the raw water line is needed on occasion but is unrelated to the chloramine conversion and should be removed. Based on the above, staff recommends that the appropriate contractual services – other expense should be $105,725 ($49,438 plus $56,287).

Net Depreciation Expense

Consistent with staff's above recommendations for accumulated depreciation and accumulated amortization of CIAC, staff recommends that the appropriate corresponding net depreciation expense for 2008 and 2009 is $52,136 and $87,192, respectively.

Summary of Total Operating Expenses

Based on the above, staff recommends that the total operating expenses for 2008 and 2009 should be $2,942,201 and $3,270,777, respectively.

Issue 3: What is the appropriate cost of capital for this limited proceeding?

Recommendation: Based on the recommended return of equity of 12.01% with an allowed range of plus or minus 100 basis points to be recognized for ratemaking purposes, the appropriate weighted cost of capital is 7.03%. (Fletcher)

Staff Analysis: In its filing, Aloha requested a 7.04% weighted cost of capital. In the utility's last rate proceeding, the Commission approved a weighted cost of capital of 8.52%.[4] Using the Commission's current leverage formula to determine Aloha's return on equity and the current cost rates for the remaining capital structure components, staff calculated a 7.03% weighted cost of capital.

Section 367.0822, Florida Statutes, states:

> [U]nless the issue of rate of return is specifically addressed in the limited proceeding, the commission shall not adjust rates if the effect of the adjustment would be to change the last authorized rate of return.

Since the utility's last rate case, Aloha's long-term debt has increased by approximately $41 million which resulted in a significant change in the utility's equity ratio. As such, staff recommends the return on equity for this utility should be reestablished in this proceeding to 12.01% with an allowed range of plus or minus 100 basis points to be recognized for ratemaking purposes. Staff's calculated overall rate of return of 7.03% is 149 basis points lower than the Commission's previously authorized overall rate of return of 8.52%. Based on the above, staff recommends that the weighted cost of capital is 7.03%.

[4] See Order No. PSC-02-0593-FOF-WU, pp. 47-48, issued April 30, 2002, in Docket No. 010503-WU, In re: Application for increase in water rates for Seven Springs System in Pasco County by Aloha Utilities, Inc.

Issue 4: What are the appropriate 2008 and 2009 revenue increases for phase one?

Recommendation: The appropriate 2008 and 2009 revenue increases for phase one should be $3,300,173 and $299,780, respectively, as shown on Schedule No. 1. (Fletcher)

Staff Analysis: Based on staff's adjustments in Issues 2 and 3, staff recommends that the appropriate 2008 and 2009 revenue increases for phase one should be $3,300,173 and $299,780, respectively, as shown on Schedule No. 1.

Issue 5: What are the appropriate 2008 and 2009 rates for phase one?

Recommendation: The appropriate 2008 and 2009 rates for phase one are shown on Schedule No. 4. The 2008 rates should not be implemented until Aloha provides proof that the Florida Department of Environmental Protection (FDEP) has certified the completion of the tie-in facilities with Pasco County. The utility should be required to file revised tariff sheets and a proposed customer notice to reflect the appropriate rates approved by the Commission, pursuant to Rule 25-22.0407(10), F.A.C. to reflect the appropriate rates. The approved rates should be effective for service rendered on or after the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1), F.A.C., provided the customers have received notice. The rates should not be implemented until proper notice has been received by the customers. The utility should provide proof of the date notice was given within 10 days after the date of the notice. (Fletcher)

Staff Analysis: Staff believes that the allocation between the base facility charge (BFC) and gallonage charge should be calculated so the purchased water expense is recovered solely through the gallonage charge because of the variable nature of this expense. Schedule Nos. 2 and 3 reflect staff's 2008 and 2009 BFC and gallonage charge allocation, respectively. Staff recommends that rates should be designed to allow the utility the opportunity to generate additional 2008 and 2009 annual operating revenues recommended in Issue 4, as reflected on Schedule No. 4. However, staff recommends that the 2008 rates should not be implemented until Aloha provides proof that the Florida Department of Environmental Protection (FDEP) has certified the completion of the tie-in facilities with Pasco County.

The utility should be required to file revised tariff sheets and a proposed customer notice to reflect the appropriate rates approved by the Commission, pursuant to Rule 25-22.0407(10), F.A.C. The approved rates should be effective for service rendered on or after the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1), F.A.C., provided the customers have received notice. The rates should not be implemented until proper notice has been received by the customers. The utility should provide proof of the date notice was given within 10 days after the date of the notice.

A comparison of the utility's present rates, Aloha's requested rates, and staff's 2008 and 2009 recommended rates are shown on Schedule 4.

Issue 6: Should this docket be closed?

Recommendation: No. This docket should remain open pending the resolution of phase two and phase three requested costs. (Fletcher, Hartman)

Staff Analysis: As mentioned in the case background, the Commission's consideration of phase three will not be necessary until approximately two years from now. Thus, staff recommends this docket should remain open pending the resolution of phase two and phase three requested costs.

Unaccounted for Water Analysis **Attachment A**

Year	Total Gallons Pumped and Purchased (000)	Gallons of Water Sold (000)	Unaccounted For Water (UFW)	Allowable UFW	Excessive UFW	UFW Adjustment Gallons of P & P (000)	W/ UFW Adj. Gallons of P & P (000)
2003	1,047,747	919,302	12.26%	10.00%	2.26%	(23,670)	1,024,077
2004	1,196,048	1,011,972	15.39%	10.00%	5.39%	(64,471)	1,131,577
2005	1,220,593	1,029,346	15.67%	10.00%	5.67%	(69,188)	1,151,405
2006	1,406,226	1,222,935	13.03%	10.00%	3.03%	(42,668)	1,363,558
2007	1,360,394	1,182,201	13.10%	10.00%	3.10%	(42,153)	1,318,241
2008	1,531,691	1,294,180					1,443,864
2009	1,618,037	1,367,856					1,525,895

Purchased Water Expense	Per Utility	2008 Per Staff	2009 Per Staff	Month	2007 Gallons Actual Pumped	2007 Gallons Sold (1)
				January	103,472,400	87,919,176
Total Amount Required	1,620,600	1,443,864	1,525,895	February	91,240,300	82,423,723
Total Allowable Well Withdrawals	744,600	744,600	744,600	March	118,098,500	96,090,412
Amount Required From County	876,000	699,264	781,295	April	119,315,200	112,634,049
Cost per 1,000 gallons	$3.68	$3.68	$3.68	May	139,913,300	118,358,549
Purchased Water Expense	$3,223,680	$2,573,292	$2,875,166	June	118,162,200	109,649,854
				July	114,864,000	95,969,120
2008 and 2009 Purchased Water Adjustments		($650,388)	$301,874	August	114,612,700	97,077,616
				September	104,284,200	93,659,265
Net Reduction of 2008 and 2009 Adjustments		($348,514)		October	110,968,100	90,334,352
				November	115,772,800	99,364,084
				December	109,690,300	98,721,270
				Total	1,360,394,000	1,182,201,470

Note:

(1) Because of Aloha has two billing cycles with one in mid month, the utility was unable to provide the actual gallons sold for the month of December, 2007. However, based on the Commission's practice of 10% allowable unaccounted for water, the utility estimated the gallons of water sold by multiplying the December of 2007 pumped gallons by 90%.

Aloha Utilities, Inc. **Schedule No. 1**
Phase One Revenue Requirement Calculations **Docket No. 060122-WU**

Rate Base	2009 Utility	2008 Staff Adjustments	2008 Staff Recomm.	2009 Staff Adjustments	2009 Staff Recomm.
Plant Additions					
Pasco County Water Tie-In Facilities (Including Land)	$903,593	$0	$903,593	$0	$903,593
Capacity Charges Paid to Pasco for Purchased Water	4,136,675	(584,408)	3,552,267	363,618	3,915,885
Total Additions	$5,040,268	($584,408)	$4,455,860	$363,618	$4,819,478
Accumulated Depreciation					
Pasco County Water Tie-In Facilities	($39,254)	$26,169	($13,085)	($26,169)	($39,254)
Capacity Charges Paid to Pasco for Purchased Water	(248,201)	188,844	(59,357)	(180,013)	(239,369)
Total Accumulated Depreciation	($287,455)	$215,013	($72,442)	($206,182)	($278,623)
Contributions in Aid of Construction (CIAC)					
Gross Plant Ratio of 56.70%	($3,562,069)	$2,065,115	($1,496,954)	($773,993)	($2,270,947)
Accumulated Amortization of CIAC					
Gross Plant Ratio of 56.70%	$222,934	($129,829)	$93,104	$15,054	$108,159
Total Rate Base Additions	$1,413,678	$1,565,891	$2,979,569	($601,502)	$2,378,067
Total Increase to Rate Base	$1,413,678	$1,565,891	$2,979,569	($601,502)	$2,378,067
Rate of Return	7.03%	7.03%	7.03%	7.03%	7.03%
Increase in Rate of Return	$99,382	$110,082	$209,464	($42,286)	$167,178
Operating Expenses					
Operation and Maintenance (O&M) Expenses					
Salary & Wages - Employees	$112,171	$0	$112,171	$0	$112,171
Employee Pensions and Benefits	46,293	0	46,293	0	46,293
Purchased Water	3,223,680	(650,388)	2,573,292	301,874	2,875,166
Purchased Water Reduction from Related Party Wells	(87,600)	12,376	(75,224)	(8,355)	(83,579)
Purchased Power Reduction Due to Purchased Water	(39,073)	2,215	(36,858)	0	(36,858)
Purchased Power for Tie-in Facilities	26,937	(1,527)	25,410	0	25,410
Chemicals	27,626	(1,566)	26,060	0	26,060
Materials and Supplies	24,285	0	24,285	0	24,285
Contractual Services - Testing	66,952	0	66,952	0	66,952
Contractual Services - Other	122,845	(17,120)	105,725	0	105,725
Total O&M Expenses	$3,524,116	($656,010)	$2,868,106	$293,519	$3,161,625
Net Depreciation Expense					
Specific Depr. Exp. and 56.70% Ratio for Amort. Exp.	$53,071	($936)	$52,136	$35,057	$87,192
Taxes Other Than Income (TOTI)					
Payroll Taxes	$8,581	$0	$8,581	$0	$8,581
Property Taxes	13,379	0	13,379	0	13,379
Total TOTI	$21,960	$0	$21,960	$0	$21,960
Total Operating Expenses	$3,599,147	($656,946)	$2,942,201	$328,576	$3,270,777
Total Revenue Increase Before RAFs	$3,698,529	($546,864)	$3,151,665	$286,290	$3,437,955
RAF Expansion Factor	0.955	0.955	0.955	0.955	0.955
Additional Revenue Requirement	$3,872,805	($572,632)	$3,300,173	$299,780	$3,599,953

Aloha Utilities, Inc. **2008 Allocation of Base Facility and Gallonage Charges**		**Schedule No. 2** **Docket No. 060122-WU**
Allocation of Additional 2008 Revenue Requirement		
Total Additional Revenue Requirement Increase		$3,300,173
Total Cost of Purchased Water from Pasco County	$2,573,292	
Divide by factor for RAFs	0.955	
Total Purchased Water Cost in Recommended Revenue Increase	$2,694,547	(2,694,547)
Recommended Revenue Increase Related to Base Facility Charges		$605,626
Percentage increase in Base Facility Charges		
Total 2008 Annualized Revenues Using Existing Rates		$2,897,764
Less 2009 Annualized Gallonage Revenue Using Existing Rates		(2,123,011)
Annualized Base Facility Charge Revenue Using Existing Rates		$774,753
Total Base Facility Charge Revenue Increase		$605,626
Divide by 2009 Annualized Base Facility Charge Revenue		$774,753
Percentage Increase in Base Facility Charges		78.17%
2008 Increase in Gallonage Charges		
Recommended Revenue Increase Related to Gallonage Charges		$2,694,547
Divide by Projected 2008 Gallons Sold (000)		1,367,856
2008 Recommended Gallonage Charge Increase		$1.97

Aloha Utilities, Inc.		**Schedule No. 3**
2009 Allocation of Base Facility and Gallonage Charges		**Docket No. 060122-WU**
Allocation of Incremental Decrease of 2009 Revenue Requirement		
Total Incremental Revenue Requirement Increase		$299,780
Total Cost of Purchased Water from Pasco County	$301,874	
Divide by factor for RAFs	0.955	
Total Purchased Water Cost in Recommended Revenue Increase	$316,098	(316,098)
Recommended Revenue Decrease Related to Base Facility Charges		($16,318)
Percentage increase in Base Facility Charges		
Total 2009 Annualized Revenues Using Existing Rates		$3,041,745
Less 2009 Annualized Gallonage Revenue Using Existing Rates		(2,243,925)
Annualized Base Facility Charge Revenue Using Existing Rates		$797,820
Total Base Facility Charge Revenue Increase		($16,318)
Divide by 2009 Annualized Base Facility Charge Revenue		$797,820
Percentage Increase in Base Facility Charges		-2.05%
2009 Increase in Gallonage Charges		
Recommended Revenue Increase Related to Gallonage Charges		$316,098
Divide by Projected 2009 Gallons Sold (000)		1,367,856
2009 Recommended Gallonage Charge Increase		$0.23

Aloha Utilities, Inc. **Schedule No. 4**
Schedule of Monthly Water Rates **Docket No. 060122-WU**

	Present Rates	Utility Requested Rates	Staff Recomm. 2008 Rates	Staff Recomm. 2009 Rates
Residential				
Base Facility Charges By Meter Size				
5/8 x 3/4"	$4.47	$7.30	$7.96	$7.80
3/4"	$6.70	$10.94	$11.94	$11.69
1"	$11.18	$18.26	$19.92	$19.51
1-1/2"	$22.38	$36.56	$39.87	$39.06
Gallonage Charges per 1,000 Gallons				
Gallonage Charge - (0 - 10,000 gallons)	$1.53	$4.01	$3.50	$3.73
Gallonage Charge - (over 10,000 gallons)	$1.90	$4.38	$3.87	$4.10
General Service				
Base Facility Charges By Meter Size				
5/8/ x 3/4"	$4.47	$7.30	$7.96	$7.80
1"	$11.18	$18.26	$19.92	$19.51
1-1/2"	$22.38	$36.56	$39.87	$39.06
2"	$35.79	$58.46	$63.77	$62.46
3"	$71.60	$116.96	$127.57	$124.96
4"	$111.87	$182.74	$199.32	$195.24
6"	$223.73	$365.46	$398.62	$390.47
8"	$357.95	$584.71	$637.76	$624.72
10"	$514.56	$840.53	$916.79	$898.04
Gallonage Charge per 1,000 Gallons	$1.67	$4.15	$3.64	$3.87
	Typical Residential Bills 5/8" x 3/4" Meter			
3,000 Gallons	$9.06	$19.33	$18.46	$18.99
5,000 Gallons	$14.35	$31.00	$29.44	$30.34
10,000 Gallons	$26.48	$58.36	$54.92	$56.81