

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application for increase in wastewater rates in Monroe County by K W Resort Utilities Corp. | DOCKET NO. 070293-SU
ORDER NO. PSC-08-0607-PHO-SU
ISSUED: September 19, 2008

PREHEARING ORDER

BY THE COMMISSION:

Pursuant to Notice and in accordance with Rule 28-106.209, Florida Administrative Code (F.A.C.), a Prehearing Conference was held on September 15, 2008, in Tallahassee, Florida, before Commissioner Nancy Argenziano, as Prehearing Officer.

APPEARANCES:

F. MARSHALL DETERDING, ESQUIRE, and JOHN L. WHARTON, ESQUIRE, Rose, Sundstrom & Bentley, LLP, 2548 Blairstone Pines Drive, Tallahassee, Florida 32301
On behalf of K W Resort Utilities, Corp. (KWRU).

STEPHEN C. BURGESS, ESQUIRE, Office of Public Counsel, c/o The Florida Legislature, 111 West Madison Street, room 812, Tallahassee, Florida 32399-1400
On behalf of the Citizens of the State of Florida (OPC).

RALPH R. JAEGER, ESQUIRE, Florida Public Service Commission, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850
On behalf of the Florida Public Service Commission (Staff).

MARY ANNE HELTON, ESQUIRE, Florida Public Service Commission, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850
Advisor to the Florida Public Service Commission

PREHEARING ORDER

I. CASE BACKGROUND

On August 3, 2007, K W Resort Utilities Corp. (KWRU or Utility) filed its application for an increase in its wastewater rates in Monroe County. Pursuant to the request of the Utility, this rate application was set directly for hearing on February 6 and 7, 2008. However, when it appeared that the Utility might be sold, the Utility requested a continuance, which was granted.¹

¹ Order No. PSC-08-0032-PCO-SU, issued January 8, 2008.

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However, when the negotiations for the sale of the Utility reached an impasse, the Utility requested that the hearing be rescheduled. That request was granted, and the hearing was rescheduled for October 1 and 2, 2008.²

This Order is issued pursuant to the authority granted by Rule 28-106.211, Florida Administrative Code (F.A.C.), which provides that the presiding officer before whom a case is pending may issue orders necessary to effectuate discovery, prevent delay, and promote the just, speedy, and inexpensive determination of all aspects of the case.

II. CONDUCT OF PROCEEDINGS

Pursuant to Rule 28-106.211, F.A.C., this Prehearing Order is issued to prevent delay and to promote the just, speedy, and inexpensive determination of all aspects of this case.

III. JURISDICTION

This Commission is vested with jurisdiction over the subject matter by the provisions of Chapter 367, Florida Statutes (F.S.).³ This hearing will be governed by said Chapter and Chapters 120, F.S., and Chapters 25-30, 25-22, and 28-106, F.A.C., as well as any other applicable provisions of law.

IV. PROCEDURE FOR HANDLING CONFIDENTIAL INFORMATION

Information for which proprietary confidential business information status is requested pursuant to Section 367.156, F.S., and Rule 25-22.006, F.A.C., shall be treated by the Commission as confidential. The information shall be exempt from Section 119.07(1), F.S., pending a formal ruling on such request by the Commission or pending return of the information to the person providing the information. If no determination of confidentiality has been made and the information has not been made a part of the evidentiary record in this proceeding, it shall be returned to the person providing the information. If a determination of confidentiality has been made and the information was not entered into the record of this proceeding, it shall be returned to the person providing the information within the time period set forth in Section 367.156(2), F.S. The Commission may determine that continued possession of the information is necessary for the Commission to conduct its business.

It is the policy of this Commission that all Commission hearings be open to the public at all times. The Commission also recognizes its obligation pursuant to Section 367.156, F.S., to protect proprietary confidential business information from disclosure outside the proceeding. Therefore, any party wishing to use any proprietary confidential business information, as that term is defined in Section 367.156, F.S., at the hearing shall adhere to the following:

² Order No. PSC-08-0241-PCO-SU, issued April 15, 2008.

³ Specifically, Sections 367.081, 367.0816, 367.0817, 367.082, and 367.156, F.S.

- (1) When confidential information is used in the hearing, parties must have copies for the Commissioners, necessary staff, and the court reporter, in red envelopes clearly marked with the nature of the contents and with the confidential information highlighted. Any party wishing to examine the confidential material that is not subject to an order granting confidentiality shall be provided a copy in the same fashion as provided to the Commissioners, subject to execution of any appropriate protective agreement with the owner of the material.
- (2) Counsel and witnesses are cautioned to avoid verbalizing confidential information in such a way that would compromise confidentiality. Therefore, confidential information should be presented by written exhibit when reasonably possible.

At the conclusion of that portion of the hearing that involves confidential information, all copies of confidential exhibits shall be returned to the proffering party. If a confidential exhibit has been admitted into evidence, the copy provided to the court reporter shall be retained in the Office of Commission Clerk's confidential files. If such material is admitted into the evidentiary record at hearing and is not otherwise subject to a request for confidential classification filed with the Commission, the source of the information must file a request for confidential classification of the information within 21 days of the conclusion of the hearing, as set forth in Rule 25-22.006(8)(b), F.A.C., if continued confidentiality of the information is to be maintained.

V. PREFILED TESTIMONY AND EXHIBITS; WITNESSES

Testimony of all witnesses to be sponsored by the parties and Staff has been prefiled and will be inserted into the record as though read after the witness has taken the stand and affirmed the correctness of the testimony and associated exhibits. All testimony remains subject to timely and appropriate objections. Upon insertion of a witness' testimony, exhibits appended thereto may be marked for identification. Each witness will have the opportunity to orally summarize his or her testimony at the time he or she takes the stand. Summaries of testimony shall be limited to five minutes.

Witnesses are reminded that, on cross-examination, responses to questions calling for a simple yes or no answer shall be so answered first, after which the witness may explain his or her answer. After all parties and Staff have had the opportunity to cross-examine the witness, the exhibit may be moved into the record. All other exhibits may be similarly identified and entered into the record at the appropriate time during the hearing.

The Commission frequently administers the testimonial oath to more than one witness at a time. Therefore, when a witness takes the stand to testify, the attorney calling the witness is directed to ask the witness to affirm whether he or she has been sworn.

VI. ORDER OF WITNESSES

<u>Witness</u>	<u>Proffered By</u>	<u>Issues #</u>
<u>Direct</u>		
William L. Smith, Jr.	KWRU	1-13, 20-22, 24, 26-314
Paul DeChario, C.P.A.	KWRU	2-41
Kimberly H. Dismukes	OPC	2-17, 20-34, 38
Andrew T. Woodcock, P.E., M.B.A.	OPC	13
Iliana H. Piedra	Staff	25
Kathy L. Welch	Staff	17
Steven Johnson*	Staff	1
<u>Rebuttal</u>		
William L. Smith, Jr.	KWRU	31
Edward R. Castle	KWRU	1-3, 8, 13, 20-23, 31
Paul E. DeChario	KWRU	2-40

*The parties have agreed that Staff Witness Johnson may be excused from attending the first day of the hearing, if it appears that the hearing will go two days.

VII. BASIC POSITIONS

KWRU: The Utility is entitled to a rate increase as contained within its revised and final application and MFRs presented with the initial application and the increased wastewater revenues as specified therein. All such revenue requirements should be adjusted for stipulations agreed to and the substantial increase in rate case costs incurred and outlined in Rebuttal Testimony. As with many Florida utility's, KWRU has always relied on outside contractors for many aspects of operations and maintenance. For the first two years of operation under the present ownership, KWRU used an independent 3rd party operations contractor. In 2000, the owners' son in law who has extensive training and experience in engineering, formed a wastewater operations company to perform these services for KWRU at

a lower cost than was available from unrelated contractors in the Florida Keys, and to provide various wastewater services to other entities throughout the Keys. KEI continues to provide these same services at a lower cost than its nearest competitor in the Florida Keys to this day.

OPC: Under normal circumstances, a utility hires employees who perform substantially all of the ongoing, routine utility functions, and the utility pays market-based salaries which the Commission can examine for reasonableness. In this case, however, KWRU has NO employees of its own. Instead, KWRU has various affiliates (e.g., golf course, management firm, law firm, service company) whose employees perform all utility functions. Accordingly, KWRU relies on related party transactions for even the most mundane utility functions. In addition, some of the utility functions are billed to the customers by an affiliate company and some are billed by KWRU. This business structure that was chosen by Mr. Smith, the owner of KWRU, requires a heightened scrutiny of all transactions for reasonableness, and has given rise to many areas wherein KWRU's customers are paying excessive amounts and duplicate charges for certain services. OPC and PSC Staff auditors have identified many adjustments that need to be made to KWRU's filing.

STAFF: Staff's positions are preliminary and based on materials filed by the parties and on discovery. The preliminary positions are offered to assist the parties in preparing for the hearing. Staff's final positions will be based upon all the evidence in the record and may differ from the preliminary positions.

VIII. ISSUES AND POSITIONS

ISSUE 1: Is the quality of service provided by K W Resort Utilities Corp. satisfactory?

KWRU: Yes. The quality of service provided by KWRU is satisfactory. (Smith and Castle)

OPC: No position pending customer testimony.

STAFF: No. The quality of service is not satisfactory at this time. (Johnson)

ISSUE 2: Should KWRU's test year rate base be adjusted for Keys Environmental⁴ hook-up fees?

KWRU: No, the amount charged to the Utility for the supervision of the hook-up is not part of the contract services provided by Keys Environmental and is therefore an appropriate additional rate base item and cost to capitalize on the Utility's books.

⁴ Keys Environmental is Keys Environmental, Inc., and will be referred to as either Keys Environmental or KEI.

KEI's contract specifies that all expenditures for both capital and operations costs be approved each year by the Utility Owner. KEI separately states such capital expenditures on its invoices and KWRU appropriately capitalizes such capital expenditures. It is appropriate to capitalize labor and materials to prepare an asset for use regardless of the source of such expenses. This separately stated charge is not a "double" charge. (DeChario, Smith, Castle)

OPC: Yes. When a customer connects to the system, that customer must hire and pay his own private contractor for all material and labor to actually run the lateral and make the connection to the main. Keys Environmental, Inc. (KEI) inspects that work to approve the connection. KEI is an affiliate of KWRU. In 2005, KWRU paid KEI \$350 per hookup; in 2006 KWRU increased the payments to \$450. The customer being connected is charged by KWRU the amount that KWRU pays to KEI. KWRU already has an ongoing relationship with KEI under which it pays KEI a substantial monthly service fee to manage and perform KWRU's utility functions. That contract does allow KEI to charge more if it performs tasks over and above the general functions, but the contract specifies extra tasks (e.g., jet rodding the sewer lines and sludge hauling), and connection inspection is not among the specified tasks. Accordingly, the function of inspecting new connections should be considered as part of the general service already covered under the KWRU/KEI service contract (and paid by customer rates), and customers should not be charged twice for the same task. The amount that has already been collected through this double recovery should be removed from KWRU's rate base. Plant in service should be reduced by \$252,690. (Dismukes, p. 26)

STAFF: To remove an apparent duplication of management service fees, plant should be reduced by \$252,690. In addition corresponding adjustments should be made to reduce accumulated depreciation and depreciation expense by \$10,983 and \$3,021, respectively.

ISSUE 3: Should KWRU's test year rate base be adjusted for KWRU's contribution to the decommissioning of jail facilities?

KWRU: No, the Utility's contract with the County provided that the Utility would run a line and decommission the jail's sewer facilities. The Utility was paid a capacity charge as part of this agreement, and the agreement to "decommission" was part of the requirements in order to secure that interconnect of, and new service to, the jail facilities. Since KWRU did not own the Monroe County Jail Wastewater Treatment Facilities, the cost of decommissioning as well as any other costs necessary to prepare the land for its intended use are properly capitalized in accordance with NARUC Accounting Instruction for Account 353(8). (DeChario, Smith, Castle)

OPC: Yes. When Monroe County's Detention Center connected to KWRU's system, it no longer needed its own sewer treatment plant which it had been using. KWRU expended \$10,000 toward the cost to decommission the Detention Center's treatment plant. This is not a cost that should be borne by KWRU's other customers and should be removed from rate base. (Dismukes, p. 48)

STAFF: To remove non-utility investment, plant should be reduced by \$10,000. Accordingly, accumulated depreciation and depreciation expense should be decreased pending further development of the record.

ISSUE 4: Should KWRU's test year rate base be adjusted for Green Fairways Jail Project management fee?

KWRU: No, Green Fairways charges a 10% contract administration fee on all major projects, and Green Fairways did oversee this project and charged the normal fee for those services. As such, this cost is at market value and should be capitalized. (DeChario, Smith)

OPC: Yes. KWRU paid Weiler Engineering a management fee to oversee the South Stock Island (SSI) project. KWRU also paid Green Fairways, an affiliate, a management fee of \$32,198. When Monroe County auditors asked for Green Fairways completion logs, they noted that the logs "were completed by the engineering firm and consisted of daily work reports of approximately one page per day." Obviously, Weiler Engineering oversaw the project, and KWRU has shown no documentation to justify paying its affiliate, Green Fairways, the \$32,198. The Commission should not force customers to pay for unjustified payments to a related party. (Dismukes, p. 49)

STAFF: To remove duplicative management service fees, plant should be reduced by \$32,198. Accordingly, accumulated depreciation and depreciation expense should be decreased pending further development of the record.

ISSUE 5: Should KWRU's test year rate base be adjusted for Green Fairways SSI⁵ Project management fee?

KWRU: No, the contract with the County said that Green Fairways would charge a 10% management fee, and Green Fairways did so. This was part of the negotiated contract with the County, and was not part of the normal duties that Green Fairways has performed for the Utility. As such, this cost is at market value and should be capitalized. (DeChario, Smith)

⁵ South Stock Island

OPC: Yes. As with Issue 5, KWRU paid Weiler Engineering a management to oversee the South Stock Island project. It also paid Green Fairways \$301,180 for "administration" of the SSI project. The completion logs for Green Fairways, however were completed by Weiler Engineering. There has been no documentation to demonstrate that Green Fairways actually administered the project. Customers should not be forced to pay \$301,180 to a related party without explicit proof (timesheets, etc.) that the work was performed. (Dismukes, p. 49)

STAFF: To remove duplicative management service fees, plant should be reduced by \$301,180. Accordingly, accumulated depreciation and depreciation expense should be decreased pending further development of the record.

ISSUE 6: Should KWRU's test year rate base be adjusted for Smith, Hemmesch, and Burke legal fees?

KWRU: No, these fees were for legitimate legal work in securing contracts for the benefit of the Utility and its customers. Monroe County agreed to pay \$25,000 in legal fess on a flat fee basis for legal services related to the contract. Monroe County initially paid for these services. It was only after the Audit that Monroe County reduced a subsequent payment to KWRU for these charges after learning that it was incumbent on the Country to secure additional documentation. Neither the County nor the Utility were aware of this requirement until after the Audit. (DeChario, Smith)

OPC: Yes. KWRU's filing claims a legal expense of \$25,000 paid to the law firm of Smith, Hemmesch & Burke on the claim that the law firm negotiated contracts on the SSI projects. Mr. Smith is the managing partner of the law firm. The Monroe County auditors, however, found that KWRU could not provide any supporting documentation for the charge. As a result, Monroe County refused to reimburse KWRU, notwithstanding its contract to reimburse KWRU's reasonable expenditures from the SSI contracts. Even though Monroe County refused to pay this affiliated transaction because of lack of supporting documentation, KWRU is now is asking the Commission to force its customers to pay it. The Commission should refuse to allow KWRU to charge its customers for a completely undocumented payment to its affiliate. (Dismukes, p. 49)

STAFF: To remove unsupported legal fees, plant should be reduced by \$25,000. Accordingly, accumulated depreciation and depreciation expense should be decreased pending further development of the record.

ISSUE 7: Should KWRU's test year rate base be adjusted for Mr. Johnson's moving expenses?

KWRU: No, these expenses were a part of the compensation that Mr. Johnson agreed to in order to operate KWRU through KEI. (DeChario, Smith)

OPC: Yes. KWRU paid \$8,602 to move Chris Johnson and his family, and included that cost as a capital component of the SSI project. Mr. Johnson manages KEI and is Mr. Smith's son-in-law. This is not a proper capital component of the SSI project and should be removed from KWRU's rate base. (Dismukes, p. 50)

STAFF: To remove moving expenses from the Utility's investment for its South Stock Island project, plant should be reduced to \$8,602. Accordingly, accumulated depreciation and depreciation expense should be decreased pending further development of the record.

ISSUE 8: Should KWRU's test year rate base be adjusted for Johnson Constructors charges for JAS Corp.?

KWRU: No, these were legitimate charges for construction supervision of a project undertaken for the Utility. (DeChario, Smith, Castle)

OPC: Yes. KWRU paid Johnson Constructors a fee for management services for the Advanced Waste Treatment (AWT) upgrade. KWRU also paid JAS Corp a fee for management services. Johnson Constructors is owned by Chris Johnson and JAS Corp is owned by his father, Jim Johnson. Ratepayers should not be forced to pay for two supervisors for the project. The rate base should be reduced by the fees and travel expenses that were charged by Jim Johnson. The unsupported fees of Johnson Constructors is \$30,000 and the travel amounts for Jim Johnson total \$4,650. (Dismukes, p. 55, 56)

STAFF: To remove duplicative management service fees, plant should be reduced by \$4,650. Accordingly, accumulated depreciation and depreciation expense should be decreased pending further development of the record.

ISSUE 9: Should KWRU's test year rate base be adjusted for Mr. London's consulting fees?

KWRU: No, Mr. London's services were as a consultant to assist in management of the Utility and later in securing funding and service arrangements with the County on behalf of the Utility. (DeChario, Smith)

OPC: Yes. KWRU capitalized to rate base \$32,500 of payments that were made to John London, a former Monroe County Commissioner. KWRU stated the payments were for Mr. London to serve "as liaison between Monroe County and the Utility in its efforts to expand operations to South Stock Island." These payments were

made pursuant to an oral contract and no invoices exist. Customers should not be forced to pay for expenditures for which there exists no documentation as to the specific tasks that were performed. (Dismukes, p. 46)

STAFF: To remove capitalized consulting fees, plant in service should be reduced by \$32,500. Accordingly, accumulated depreciation and depreciation expense should be decreased pending further development of the record.

ISSUE 10: Should KWRU's test year rate base be adjusted for White and Case Legal Charges Related to Monroe County Audit Report?

KWRU: No, the Utility was required to respond to the County audit, which was a part of the costs of the capitalized project. These legal services were necessary in order to prepare that response. (DeChario, Smith)

OPC: Yes. Prior to the test year, KWRU paid the law firm of White and Case \$27,230 for legal services in responding to the Monroe County Audit report. Rather than expense the cost in the period it was incurred, KWRU capitalized it and put it in rate base. This type of cost should be expensed, rather than capitalized. The balance should be removed from rate base. (Dismukes, p. 48)

STAFF: To remove non-utility costs, plant in service should be reduced by \$27,500. Accordingly, accumulated depreciation and depreciation expense should be decreased pending further development of the record.

ISSUE 11: Should KWRU's test year rate base be adjusted for the Key West Citizen PR Advertisement?

KWRU: No, this is an action undertaken at the County's request to assist customers in understanding of the required system expansion and required interconnection of customers, thereby benefitting all of the Utility's customers through a larger customer base. (DeChario, Smith)

OPC: Yes. Prior to the test year, KWRU spent \$422 for a newspaper advertisement. Rather than expense the cost in the period in which it was incurred, KWRU capitalized it and put it into rate base. This type of cost should be expensed, rather than capitalized. The balance should be removed from rate base. (Dismukes, p. 50)

STAFF: To remove the cost associated with a media advertisement, plant should be reduced by \$422. Accordingly, accumulated depreciation and depreciation expense should be decreased pending further development of the record.

ISSUE 12: Should adjustments be made to the Utility's pro forma plant additions?

KWRU: No, these are normal, legitimate fees for work done to oversee construction projects. (DeChario, Smith)

OPC: Yes. (1) KWRU had agreements with two different companies, Johnson Constructors and Green Fairways, to serve as contractor for the AWT conversion project. Both companies are affiliates to KWRU. In addition, Weiler Engineering is also being paid for the responsibility of administering the contract. KWRU has not demonstrated the need for the excessive oversight responsibility and does not adequately document the actual services being provided by Green Fairways. Accordingly, the \$111,374 of fees for Green Fairways should be removed from the rate base. (2) One of the subcontractors, US Filter Davco, charged \$13,547 of additional costs for change orders (e.g., \$3,300/mo. for house rental) that were caused by a delay when "the customer was red tagged and could not pour the slab until the permits were done." Customers should not pay for living expenses because a subcontractor was brought in too early and had to wait for the permit (particularly with three companies administering the contract). (Dismukes, pp. 53-56)

STAFF: Yes. The exact amount of the adjustment to be determined pending further development of the record.

ISSUE 13: What are the used and useful percentages of the Utility's wastewater treatment plant and collection and reuse systems?

KWRU: The Utility's wastewater treatment plant, entire collection system, and reuse systems, are all 100% used and useful in providing service to the customers of the Utility. (DeChario, Smith, Castle)

OPC: The wastewater treatment plant is 72.14% used and useful. The gravity portion of the collection system should be considered 100% used and useful. The vacuum portion of the collection system is entirely contributed, so a used and useful adjustment would not affect rates. Rate base should be reduced by \$1,324,595 to reflect the used and useful adjustment. (Woodcock, Dismukes, p. 50)

STAFF: The Utility's wastewater treatment plant and collection system should be considered 100% used and useful at this time. However pending further development of the record, this position is subject to change. In accordance with Commission practice and Section 367.0817(3), Florida Statutes, the reuse system should be considered 100% used and useful.

ISSUE 14: What is the appropriate test year balance of accumulated depreciation?

KWRU: The test year accumulated depreciation balance, as outlined in the Utility's original filing, adjusted for the effect of the stipulations on that balance. (DeChario)

OPC: This is subject to the resolution of other issues. If the Commission agrees with OPC's positions, the accumulated depreciation is \$2,216,294. (Dismukes)

STAFF: The appropriate amount is subject to the resolution to other issues.

ISSUE 15: What are the appropriate test year balances of contributions-in-aid of construction (CIAC) and accumulated amortization of CIAC?

KWRU: The test year CIAC and accumulated amortization of CIAC, as outlined in the Utility's original filing, as adjusted for the effect of the stipulations on that balance. (DeChario)

OPC: This is subject to the resolution of other issues. If the Commission agrees with OPC's positions, the balance of CIAC is \$4,695,791 and accumulated amortization of CIAC is \$793,415. (Dismukes)

STAFF: No position pending further development of the record.

ISSUE 16: What is the appropriate working capital allowance?

KWRU: The working capital allowance, as outlined in the Utility's original filing, adjusted for the effect of the stipulations on that balance. (DeChario)

OPC: Yes. Working capital should be reduced by the unamortized balance of rate case expense. (Dismukes, p. 97)

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

ISSUE 17: What is the appropriate rate base?

KWRU: The appropriate rate base is that outlined in the Utility's original application, adjusted for the effect of the stipulations on that balance. (DeChario)

OPC: This is subject to the resolution of other issues. If the Commission agrees with OPC's positions, the rate base is (\$2,779,630). (Dismukes)

STAFF: The appropriate amount is subject to the resolution of other issues. (Welch)

ISSUE 18: What is the appropriate return on common equity?

KWRU: The appropriate return on common equity is that yielded from use of the Commission's leverage formula in effect at the time the Final Order is issued in this proceeding. (DeChario)

OPC: OPC has not adjusted KWRU's requested ROE.

STAFF: The return on equity should be updated to reflect the cost rate yielded by the current leverage formula in effect at the time the Commission renders its final decision in this case.

ISSUE 19: What is the appropriate weighted average cost of capital including the proper components, amounts, and cost rates associated with the capital structure?

KWRU: The appropriate weighted average cost of capital is that contained in the Utility's filing, adjusted for any effects of the stipulations outlined herein and the updated cost of common equity, based upon the leverage formula in existence at the time of the Commission's Final Order in this proceeding. (DeChario)

OPC: OPC is not recommending specific adjustments to the costs or ratios in the capital structure. The amount of each component will depend on the aggregate outcome of all decisions involving rate base.

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

ISSUE 20: Should any adjustments be made to test year revenues?

KWRU: Test year revenues should be those outlined in the Utility's original application, adjusted for the effects (if any) of the stipulations outlined herein. (DeChario, Smith, Castle)

Incorporating FKAA data is an inappropriate matching and the proposed method for recognition of FKAA data by OPC is nonsensical.

The Utility benefitted by allowing the contract personnel to utilize the construction trailer as needed, while charging them rent. Costs not recovered through rent are appropriate Utility expenses and in fact, the use of the trailer in this method benefitted all Utility customers by lower costs for outside contractors.

Monroe County Detention Center revenue is merchandise and jobbing income that is passed through to a third party contractor. It should be classified as such and since the amount of related expenses for KEI provided to the Utility cannot be determined, an equal amount of expenses should be removed to below-the-line merchandising and jobbing expenses in an amount equal to the revenue amount.

OPC: Yes. (1) KWRU historically billed on a flat rate because it did not have individual water usage information. KWRU now has access to Florida Keys Aqueduct Authority (FKAA) information and is proposing to use the information to change its billing structure. The FKAA information, however, shows a greater number of separate residential customers than KWRU had been using. To assure consistency between test year revenue and the proposed rate design, test year revenues should be increased to reflect the actual billing data that KWRU will use. (Dismukes, p 57). (2) A trailer owned by KWRU is occupied by KEI and by Weiler Engineering. During the test year, Weiler's monthly rental fee went from \$1,750 down to \$800, without any explanation. To reflect the historic rate, revenue should be increased by \$14,600. (Dismukes, p 58). During the test year, KWRU charged Monroe County \$19,575 for maintenance of some of the county's lift stations and wastewater system. KWRU recorded this income below the line. Without documentation that the KWRU costs of performing this service has been removed from test year expenses, the income should be recorded above the line for ratemaking purposes. (Dismukes, p. 59)

STAFF: No position pending further development of the record.

ISSUE 21: Should any adjustments be made to sludge removal expenses?

KWRU: No, the OPC proposed three year average is not reasonable, based on increased customers, higher treatment requirements, and increased costs. The actual costs for the test year and for future years must be recognized. (DeChario, Smith, Castle)

OPC: Yes. KWRU's test year sludge hauling expenses were abnormally high. The expense should be reduced by \$7,819 to reflect a normalized level. (Dismukes, p. 65)

STAFF: No position pending further development of the record.

ISSUE 22: Should any adjustments be made to chemicals expense?

KWRU: No, the OPC proposed three year average is not reasonable, based on increased customers, higher treatment requirements, and increased costs. The actual costs

for the test year and for future years must be recognized. (DeChario, Smith, Castle)

OPC: Yes. As with sludge hauling, chemical expenses were abnormally high. The expense should be reduced by \$16,480. (Dismukes, p. 69)

STAFF: Yes. Based on the Utility's three-year average, test year chemical expenses should be reduced by \$16,480.

ISSUE 23: Should KWRU's test year expenses be adjusted for the reduction of infiltration and inflow related to the re-sleeving of its lines?

KWRU: No, I & I was not excessive before this work was done. Any effect of the re-sleeving on infiltration and inflow is extremely minor, to the point of being immaterial. (DeChario, Castle)

There is no material reduction in costs and the proposed AWT expenses should be judged based upon what constitutes fair market value for those services, in related party transactions.

OPC: Yes. Beyond debate, the re-sleeving, of itself, will result in a decrease in electrical and chemical expenses, and the move to AWT, of itself, will increase those same expenses. Unfortunately, KWRU did not make a separate adjustment for re-sleeving, but rather estimated expectations for the two considerations combined, and claims a net increase of \$177,583. In making its estimate, however, KWRU assumed a flow rate of 400,000 GPD. Two adjustments: (1) Test year revenues are based on a flow rate of 287,000 GPD, which is a huge mismatch to the 400,000 that KWRU is seeking for these expenses. To match these expenses to the revenue that KWRU has used requires a decrease of \$109,704. (2) The projected expenses contemplate purchasing the chemicals from KEI, an affiliate. KEI charges KWRU a markup of 30% over cost. There is nothing that prevents KWRU from purchasing supplies directly from KEI's source, other than the business arrangement chosen by KWRU's owner. Customers should not pay 30% above cost just to enrich KWRU's affiliate, and these expenses should be reduced by another \$33,344. (Dismukes, pp. 86-91)

STAFF: No position pending further development of the record.

ISSUE 24: Should KWRU's test year expenses be adjusted to remove any markup in pro forma expenses?

KWRU: No, the fair market value of these services is the appropriate test based upon case law. These charges were reasonable for the services provided. (DeChario, Smith)

OPC: Yes. KWRU has no employees and therefore performs none of its own functions. Rather, KWRU pays KEI to perform its routine utility functions. KEI, an affiliate, charges KWRU a 30% markup on the actual costs of chemicals and sludge hauling services used in performing the utility functions. In a typical arrangement, KWRU would hire its own employees to run the operations and purchase the chemicals itself (at no markup) from the same source that KEI is using. It is unconscionable to force KWRU's customers to pay 30% more for an integral part of the service merely to enrich an affiliate company. These marked up expenses should be reduced by \$33,826 to reflect their actual cost. (Dismukes, pp. 19-21)

STAFF: No position pending further development of the record.

ISSUE 25: Should any adjustments be made to insurance – general liability?

KWRU: No. This is a periodic insurance payment, not a finance charge, and is reasonable and must be recognized. (DeChario)

OPC: Yes. PSC Staff auditors recommended the removal of a late payment penalty charged to KWRU by its liability insurer. The Staff noted: "Commission policy has been to reduce operating expenses for interest incurred on late payments, on the grounds that the expense is avoidable. . . ." OPC agrees that expenses should be reduced by \$701. (Dismukes, p. 101)

STAFF: Yes. General Liability insurance should be reduced by \$701 to remove non-utility cost. (Piedra)

ISSUE 26: Should any adjustments be made to advertising expenses?

KWRU: These costs were undertaken per the County's request and benefitted all customer by providing for a substantial increase in customer base. Therefore, these costs should be recognized as beneficial to the Utility. (DeChario, Smith)

OPC: Yes. During the test year, KWRU incurred advertising expenses that the Utility agrees was for the specific purpose of public relations functions. This is not a cost that captive customers should be forced to bear. Expenses should be reduced by \$26,653. (Dismukes, p. 83)

STAFF: Yes. Advertising expenses should be reduced by \$26,653 to remove cost related to public relation functions.

ISSUE 27: Should KWRU's test year expenses be adjusted for Mr. Smith's Management Fees Charged by Green Fairways?

KWRU: No, Mr. Smith receives no salary from the Utility and this is what is charged for his services to the Utility, which charges are reasonable, based upon comparable systems. (DeChario, Smith)

OPC: KWRU pays Green Fairways, an affiliate, management fees for the services of its owner, Mr. Smith. Mr. Smith could produce no timesheets to document activity spent on KWRU. OPC recommends removing half of this charge, or \$30,000. (Dismukes, p. 28)

STAFF: No position pending further development of the record.

ISSUE 28: Should test year expenses be adjusted for certain transactions between Keys Environmental and KWRU?

KWRU: No, Keys Environmental charges must be based upon market values, not on whether there is a "mark up." Keys Environmental lab testing is not part of the services agreed to under the general Utility services provided to KWRU by KEI and are, therefore, appropriated separate charges. We agree that hookup fees paid to KEI by KWRU should be capitalized. When contractors broke sewer lines those were repaired by KEI. The cost of such repairs is a responsibility of the Utility and is not collectible for reimbursement from the contractors. (DeChario, Smith)

OPC: Yes. (1) KWRU included \$1,313 for lab testing, but KWRU's contract with KEI specifies that KEI will provide sampling and testing. (2) KWRU expensed \$15,000 in sewer hook-up fees that should have been capitalized to plant. (3) PSC Staff auditors identified \$51,663 of expenses that are more appropriately capitalized. (4) PSC Staff auditors identified two items totaling \$3,077 that are going to be or should be recovered from third parties. All of these items should be removed from expenses. (Dismukes, pp. 26, 27)

STAFF: No position pending further development of the record.

ISSUE 29: Should any other adjustments be made to contractual services – other expenses?

KWRU: Golf cart costs include maintenance and insurance and the specialized golf cart used by the Utility and as such, the allocation method is appropriate. Employee bonuses are not bonuses in fact, but are instead reimbursement to persons for extra work performed on behalf of the Utility, and are reasonable for the services performed. (DeChario, Smith)

OPC: Yes. KWRU pays Key West Golf Course (KWGC), an affiliate, an \$8,000 monthly fee for KWGC to provide ongoing services. In the test year, KWGC paid its employees bonuses totaling \$12,038 and charged them to KWRU. The \$8,000 monthly fee should cover the services that KWRU receives, and any bonus that the golf course wants to give its own employees should not be paid by utility customers. (Dismukes, p. 16)

STAFF: No position pending further development of the record.

ISSUE 30: Should any adjustments be made to miscellaneous expenses?

KWRU: No, these travel expenses were a reasonable part of the compensation package provided by the Utility for Mr. Smith. Sheriff's Office delivery notices were required by the County as part of the agreement to increase the customer base, and the Utility chose the least cost option for achieving this requirement. (DeChario, Smith)

OPC: Yes. (1) Mr. Smith is a partner in multiple business ventures in Illinois, San Francisco and Key West. Mr. Smith's wife owns a house in Key West. KWRU has included \$13,106 for Mr. Smith's travel expenses and \$6,000 for lodging in Key West for Mr. Smith. Typically, a utility owner/officer lives near the utility and does not incur travel costs to tend to other ventures. Utility customers should not pay for Mr. Smith's travel costs or his cost to stay in Key West. (2) Charges totaling \$2,525 were incurred for (i) moving expenses to drive a car that was purchased in Illinois and driven to Key West, and (ii) hotel charges in Key West for Chris Johnson. (3) \$420 in fees to Monroe County Sheriff to deliver hook-up notices to customers. (Dismukes, pp. 71-75). (4) \$100 donation to Rotary and \$61 paid to Blossoms in Paradise. (Dismukes, p. 84)

STAFF: Yes. At this time, miscellaneous expenses should be reduced by \$161 to remove charitable and non-utility expenses. However, a further adjustment may need to be made pending further development of the record.

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

KWRU: The amount outlined in the Utility's Rebuttal Testimony, including both actual and estimated expenses, through the conclusion of this case. (DeChario, Smith, Castle)

OPC: No rate case expense is warranted because the rate case is unnecessary. (Dismukes, p. 97)

STAFF: The appropriate amount is subject to further development of the record. Only prudently incurred rate case expense should be allowed and amortized over four years.

ISSUE 32: Should any adjustment be made to test year net depreciated expense?

KWRU: The net depreciation expense outlined in the Utility's filing, adjusted for any effects of the stipulations contained herein should be recognized in rate setting. (DeChario)

OPC: Yes. Depreciation expense should be adjusted to reflect changes in plant in service. (Dismukes)

STAFF: No position pending further development of the record.

ISSUE 33: What is the test year wastewater operating income or loss before any revenue increase?

KWRU: The net operating loss outlined in the Utility's original filing, adjusted for the effect of any stipulations agreed to herein. (DeChario)

OPC: The appropriate net operating income before any decrease or increase is subject to the resolution of other issues. (Dismukes)

STAFF: The appropriate operating income before revenue increase is subject to the resolution of other issues.

ISSUE 34: What is the appropriate revenue requirement?

KWRU: The revenue requirement outlined in the Utility's filing, updated for the effect of the stipulations contained therein, and updated rate case expense as outlined in the Utility's Rebuttal Testimony. (DeChario)

OPC: The appropriate revenue requirement is (\$415,540). (Dismukes)

STAFF: The appropriate revenue requirement is subject to the resolution of other issues.

ISSUE 35: What is the appropriate rate structure for this Utility?

KWRU: The rate structure outlined in the Utility's original application. (DeChario)

OPC: No position.

STAFF: At this time, the appropriate rate structure should be a base facility charge and gallage charge structure instead of the Utility's flat rate structure.

ISSUE 36: What are the appropriate monthly residential and general service rates?

KWRU: The residential and general service rates as proposed in the Utility's original application, updated for the effect of any stipulations agreed to herein and the additional rate case expense outlined in the Utility's Rebuttal Testimony. (DeChario)

OPC: No position.

STAFF: The final wastewater rates are subject to the resolution of other issues. The gallage charge for private lift stations should be 80% of the gallage charge for General Service customers.

ISSUE 37: What are the appropriate monthly bulk and reuse service rates?

KWRU: The bulk and reuse service rates as proposed in the Utility's original application, updated for the effect of any stipulations agreed to herein and the additional rate case expense outlined in the Utility's Rebuttal Testimony. (DeChario)

OPC: No position.

STAFF: The Utility's proposed reuse gallage rate of \$0.69 per thousand gallons is appropriate. However, the final bulk wastewater rates are subject to the resolution of other issues.

ISSUE 38: In determining whether a portion of the interim increase granted should be refunded, how should the refund be calculated, and what is the amount of the refund, if any?

KWRU: The amount of the refunds, if any, is subject to the resolution of other issues. However, the PSC rule which requires that refunds be made with interest based on commercial paper rates when a utility has secured the potential refunds with an escrow account, and therefore cannot earn interest at that level, is clearly confiscatory. (DeChario)

OPC: The entire amount of the interim should be refunded, along with the appropriate interest. (Dismukes)

STAFF: The amount of the refunds, if any, is subject to the resolution of other issues.

ISSUE 39: What is the appropriate amount by which rates should be reduced four years after the established effective date to reflect the removal of the amortized rate case expense as required by Section 367.0816, Florida Statutes?

KWRU: Rates should be reduced by the amount of annual effect of rate case expense authorized as delineated in the Utility's Rebuttal Testimony. (DeChario)

OPC: No rate case expense should be granted, so no subsequent decrease is necessary.

STAFF: The amount of the rate reduction is subject to the resolution of other issues.

ISSUE 40: Should the Utility be required to provide proof, within 90 days of an effective order finalizing this docket, that it has adjusted its books for all the applicable NARUC USOA primary accounts associated with the Commission approved adjustments?

KWRU: The Utility agrees to provide such proof, to the extent there is a finding that any such adjustments are warranted. (DeChario)

OPC: Yes.

STAFF: Yes. KWRU should be required to submit, within 90 days after the date of the final order in this docket, a description of all entries or adjustments to its future annual reports, books and records, and other financial reports as required by the Commission in this rate case.

ISSUE 41: Should this docket be closed?

KWRU: Yes, after granting of the rates necessary in order to allow the Utility to recover its costs and generate a fair rate of return on its investment are granted and final. (DeChario)

OPC: Yes, after the appropriate permanent rates are set and the interim rates have been refunded.

STAFF: If the Commission's final order is not appealed, this docket should be closed upon the expiration of the time for filing an appeal.

IX. EXHIBIT LIST

<u>Witness</u>	<u>Proffered By</u>		<u>Description</u>
<u>Direct</u>			
Paul E. DeChario	KWRU	EXH. A	Volumes 1-4, Minimum Filing Requirements
Paul E. DeChario	KWRU	PED-1	Resume
Kimberly H. Dismukes	OPC	KHD-1	Summary of Adjustments
Kimberly H. Dismukes	OPC	KHD-2	Organizational Chart
Kimberly H. Dismukes	OPC	KHD-3	900 Commerce Generator
Kimberly H. Dismukes	OPC	KHD-4	Keys Environmental, Inc. Charges
Kimberly H. Dismukes	OPC	KHD-5	Keys Environmental, Inc. Markup
Kimberly H. Dismukes	OPC	KHD-6	Hurricane Hole Change Order
Kimberly H. Dismukes	OPC	KHD-7	Monroe County Detention Center Project Costs
Kimberly H. Dismukes	OPC	KHD-8	Green Fairways Change Orders
Kimberly H. Dismukes	OPC	KHD-9	Johnson Constructors AWT Project Charges
Kimberly H. Dismukes	OPC	KHD-10	Adjustment to Test Year Revenue
Kimberly H. Dismukes	OPC	KHD-11	Operations and Maintenance Expense Comparisons
Kimberly H. Dismukes	OPC	KHD-12	Mr. Smith's Travel Expenses
Kimberly H. Dismukes	OPC	KHD-13	Public Relations Letters
Kimberly H. Dismukes	OPC	KHD-14	Public Relations Samples
Kimberly H. Dismukes	OPC	KHD-15	Adjustment to AWT Proforma Increase

<u>Witness</u>	<u>Proffered By</u>		<u>Description</u>
Kimberly H. Dismukes	OPC	KHD-16	Letter Addressing Discovery Matters
Andre T. Woodcock, P.E., M.B.A.	OPC	ATW-1	Resume
Andre T. Woodcock, P.E., M.B.A.	OPC	ATW-2	Used and Useful Calculations
Iliana H. Piedra	Staff	IHP-1	Staff Audit Report of K W Resort Utilities Corp.
Kathy L. Welch	Staff	KLW-1	History of Testimony Provided by Kathy Welch
Kathy L. Welch	Staff	KLW-2	Audit Finding 3 Work Papers
Steven Johnson	Staff	SJ-1	Warning Letter from FDEP to K W Resort dated November 26, 2007.

Rebuttal

Paul E. DeChario	KWRU	PED-2	Contract Operations Cost Comparison Data
Paul E. DeChario	KWRU	PED-3	Chemicals Cost Comparison Data
Paul E. DeChario	KWRU	PED-4	Comparison of Officers' Salary
Paul E. DeChario	KWRU	PED-5	Monroe County's Response to Grand Jury
Paul E. DeChario	KWRU	PED-6	Rate Case Expense by Classification
Paul E. DeChario	KWRU	PED-7	Historical Capital Projects Costs
Paul E. DeChario	KWRU	PED-8	Utility Responses to the FPSC Audit Report

Parties and Staff reserve the right to identify additional exhibits for the purpose of cross-examination.

X. PROPOSED STIPULATIONS

1. To correct a misclassification of purchased land, plant should be reduced by \$152,255. Corresponding adjustments should be made to reduce Accumulated Depreciation by \$71,274 and Depreciation Expense by \$6,766.
2. To correct the misclassification of Florida Department of Environmental Protection permit and renewal application fees, taxes other than income should be reduced by \$7,950 and plant increased by \$577. Corresponding adjustments should be made to increase accumulated depreciation by \$52 and increase depreciation expense \$104.
3. KWRU purchased a beachcleaner which it expensed during the test year. The beachcleaner should have been capitalized. To correct this error, operating expenses should be decreased by \$11,825 and average plant increased by \$910. Accumulated depreciation and depreciation expense should be increased by \$493.
4. In accordance with Commission practice, temporary cash investments of \$168,265 should be removed from working capital.
5. Sludge removal expense should be reduced by \$9,129 to reflect the amortization of non-recurring amounts incurred during the test year.
6. Miscellaneous expenses should be reduced by \$7,508 to remove non-utility telephone expenses.
7. In accordance with Rule 25-30.115(1), F.A.C., materials and supplies, advertising, and miscellaneous expenses should be reduced by \$1,203 to remove expenses related to political contributions and fundraising.
8. Contractual services – other should be reduced by \$1,032 to reflect the amortization of non-recurring amounts incurred during the test year.
9. Pursuant to Audit Finding No. 12, the correct amount for the copier fee for Account 720, Materials and Supplies, should not be \$5,378, but 50% of that amount, or \$2,689. This reduces operating expenses by \$2,689 for out of period charges, and increases prepaid expenses by \$2,689.
10. Pursuant to Audit Finding No. 17, the cost for the use of a golf cart recorded in Account 736, Contractual Services Other, should be reduced from \$2,400 annually to \$852 annually. This reduces operating expenses by \$1,548. The Utility does not agree that this properly captures all costs related to the use of the golf cart but has agreed to this adjustment because it is immaterial.
11. In order to reclassify expenses, plant should be increased by \$51,663, and O&M expenses should be reduced by \$51,663. Accordingly, accumulated depreciation and depreciation

expense should be increased pending further development of the record as to the appropriate primary accounts for these costs.

XI. PENDING MOTIONS

There are no pending motions at this time.

XII. PENDING CONFIDENTIALITY MATTERS

There are no pending confidentiality matters at this time.

XIII. POST-HEARING PROCEDURES

If no bench decision is made, each party shall file a post-hearing statement of issues and positions. A summary of each position of no more than 50 words,⁶ set off with asterisks, shall be included in that statement. If a party's position has not changed since the issuance of this Prehearing Order, the post-hearing statement may simply restate the prehearing position; however, if the prehearing position is longer than 50 words, it must be reduced to no more than 50 words. If a party fails to file a post-hearing statement, that party shall have waived all issues and may be dismissed from the proceeding.

Pursuant to Rule 28-106.215, F.A.C., a party's proposed findings of fact and conclusions of law, if any, statement of issues and positions, and brief, shall together total no more than 55 pages and shall be filed at the same time.

XIV. RULINGS

Opening statements, if any, shall not exceed ten minutes per party.

It is therefore,

ORDERED by Commissioner Nancy Argenziano, as Prehearing Officer, that this Prehearing Order shall govern the conduct of these proceedings as set forth above unless modified by the Commission.

⁶ Except for Issues 2, 20, 23, 28, and 30 which will be limited to 70 words.

By ORDER of Commissioner Nancy Argenziano, as Prehearing Officer, this 19th day of September, 2008.



NANCY ARGENZIANO
Commissioner and Prehearing Officer

(S E A L)

RRJ

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

Any party adversely affected by this order, which is preliminary, procedural or intermediate in nature, may request: (1) reconsideration within 10 days pursuant to Rule 25-22.0376, Florida Administrative Code; or (2) judicial review by the Florida Supreme Court, in the case of an electric, gas or telephone utility, or the First District Court of Appeal, in the case of a water or wastewater utility. A motion for reconsideration shall be filed with the Office of Commission Clerk, in the form prescribed by Rule 25-22.060, Florida Administrative Code. Judicial review of a preliminary, procedural or intermediate ruling or order is available if review of the final action will not provide an adequate remedy. Such review may be requested from the appropriate court, as described above, pursuant to Rule 9.100, Florida Rules of Appellate Procedure.