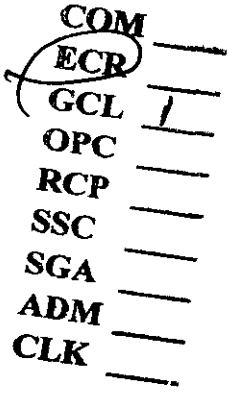
BEFORE THE FLORIDA
PUBLIC SERVICE COMMISSION
DOCKET NO. 070293-SU

POST-HEARING MEMORANDUM
FILED ON BEHALF OF
KW RESORT UTILITIES CORP.



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INTRODUCTION AND BACKGROUND

On October 1 and 2, 2008, in Key West, Florida, Commissioners Matthew M. Carter, II, Nancy Argenziano, and Nathan A. Skop heard testimony and received exhibits in the Application for Increase in Wastewater Rates in Monroe County by KW Resort Utilities, Corp. ("KWRU" or "utility"), which was filed by KWRU in Docket No. 070293-SU. This application was filed on August 3, 2007. KWRU had in the past relied on outside contractors for many aspects of operation and maintenance. The application was filed for several reasons, including the extensive capital expenditures that the utility had recently undertaken for refurbishing an aging and corroded treatment facility, conversion to Advanced Waste Treatment (AWT), and the fact that the utility had not undertaken any application for general rate relief in approximately 25 years. For the first two years of operation under the present ownership, KWRU used an independent third party operations contractor. In 2000, the owner's son-in-law, who has extensive training and experience in engineering, formed a wastewater operations company, KEI, 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 those same services at a lower cost than its nearest competitor in the Florida Keys to this day. KWRU fully appreciates and understands that the Commission will adjust any item for which KWRU has requested recovery if the Commission determines that such an adjustment is appropriate and necessary under applicable law. KWRU would expect nothing less. Unfortunately, the case has become, at least in the eyes of the Office of Public Counsel ("OPC"), something more than merely an opportunity for the Commission to determine whether such adjustments are appropriate.

KWRU has no employees. Instead, the utility receives management and office services by allocated costs from a related entity (Key West Golf Club). It has the services of its sole officer, its

president, through a management contract with another entity owned by him, in lieu of a full time salary. Its operation and maintenance functions are performed by a company (KEI) owned by the son-in-law of KWRU's president and the utility's president provides oversight for the utility's largest construction projects for a fee paid to his management company. Fees and other "related party transactions" are not uncommon with small businesses and small utilities. The issue logically is are the customers of the utility receiving services needed at a rate that is at or below what the utility could obtain from unrelated parties. This is not only logical, but is the legal requirement under the Supreme Court decision of GTE Florida, Inc. V. Deason, 642 So. 2d 545 (Fla. 1994) for reviewing such transactions.

While comparative rates in and of themselves cannot form a basis for a commission's decision on a request for rate relief, they do clearly demonstrate that the methodology utilized by this utility in its operation, construction, and management of this utility system is done in such a way that it results in a lower cost of services for the customers of the utility. Therefore, rather than being the subject of criticism and suspicion, this utility's method of operations should be applauded and fully recognized in rate setting.

OPC has long sought to demonize all related party transactions and affiliations in and of themselves, with hardly a nod to whether or not those transactions or affiliations have resulted in net savings for the customers or not. In this case, OPC has truly "swung for the fence". OPC is actually recommending a negative rate base of over $2,000,000 (Tr. 347). OPC's expert was proposing a negative return on that rate base (Tr. 348). This despite the fact that the Commission has never reduced a revenue requirement such that a negative return on a negative rate base results in a reduction of a revenue requirement (Tr. 348). This is a classic case of OPC riding into town, convincing the customers (and attempting to convince the Commission), about the "evils" of affiliated or related party transactions, suggesting that the utility be effectively "punished", and then

riding out of town leaving only the utility and the customers to deal with this aftermath. If OPC's recommendations in this case are accepted, KWRU could not continue to operate and not only the utility, but its customers, would suffer. All of this for a utility which is currently providing a cost of service which is far below the average of other wastewater providers in the Florida Keys:

Florida Keys Wastewater Rates

KW Resort Utilities: (July 2007 PSC approved rate $40.39 flat rate)
Residential Base Charge - $35.08
Wastewater flow charge - $5.27 per thousand gallons
Total Monthly bill assuming 167 gpd **($61.49)**
One time Connection Fee - $2,700 for 250 gpd = **$10.80/gal.**

FKAA Little Venice: (05/01/08)
Residential Base Charge - $34.99
Wastewater flow charge - $7.21 per thousand gallons
Total Monthly bill assuming 167 gpd **($71.22)**
One time Connection Fee - $4,500 for 167 gpd = **$26.95/gal.**

FKAA Conch Key, Hawks Cay, Duck Key: (05/01/08)
Residential Base Charge - $47.65
Wastewater flow charge - $7.43 per thousand gallons
Total Monthly bill assuming 167 gpd **($84.88)**
One time Connection Fee - $4,500 for 167 gpd = **$26.95/gal.**

FKAA Bay Point: (05/01/08)
Residential Base Charge - $47.65
Wastewater flow charge - $7.43 per thousand gallons
Total Monthly bill assuming 167 gpd **($84.88)**
One time Connection Fee - $4,500 for 167 gpd = **$26.95/gal.**

FKAA Layton: (05/01/08)
Residential Base Charge - $45.09
Wastewater flow charge - $8.95 per thousand gallons
Total Monthly bill assuming 167 gpd **($89.93)**
One time Connection Fee - $4,500 for 167 gpd = **$26.95/gal.**

City of Key West:
Residential Base Charge - $22.91
Wastewater flow charge - $4.54 per thousand gallons
Total Monthly bill assuming 167 gpd **($45.66)**
One time Connection Fee - $4,500 for 167 gpd = **$26.95/gal.**

Key Haven:
Residential Base Charge - $33.27
Wastewater flow charge - $8.76 per thousand gallons
Total Monthly bill assuming 167 gpd **($77.16)**
Proposed connection assessment if FKAA purchases **$12,000** / resident

Key Largo Wastewater Districts:
Residential Base Charge - $33.60
Wastewater flow charge - $5.27 per thousand gallons
Total Monthly bill assuming 167 gpd **($60.01)**
One time Connection Fee - $4,500 for 167 gpd = **$26.95/gal.**

Marathon (Proposed):
Residential Base Charge - $34.99
Wastewater flow charge - $7.21 per thousand gallons
Total Monthly bill assuming 167 gpd **($71.22)**
One time Connection Fee - $4,500 for 167 gpd = **$26.95/gal.**

The competitive nature of KWRU's approved rates (preliminarily approved by the PSC in July of 2007) flies in the face of the entire theme of OPC's case: that related or affiliated transactions always means harm to the customers and always justifies some form of retribution to the utility. In this case, if the evidence establishes that a particular adjustment is appropriate, then (of course) the adjustment should be made. But OPC's suggestion that the relationships, in and of themselves, should result in the taking of a butcher knife to KWRU's rate base, such that it will be left with rates which do not even allow it to cover its costs, are harmful, unfounded and ultimately in conflict with the Commission's constitutional and statutory obligations.

In accordance with Public Service Commission (the "PSC" or "Commission") practice, KW Resort Utilities, Corp. hereby submits a detailed Post-Hearing Memorandum in response to each of the enumerated issues post and Commission Order No. 08-0607-PHO-SU.

DISCUSSION OF ISSUES
ISSUE 1

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

The quality of service provided by KWRU is satisfactory. Only 17 individuals testified at the Service Hearing. Four of those customers were married couples being served at the same households. At least two of the individuals who testified were not customers. Several of the testifying customers made comments which were neutral, or which, while genuinely expressed, did not relate to any issue pertinent to KWRU's pending application. Four customers gave testimony which was, either in its entirety or on balance, favorable to KWRU.

Staff witness Johnson testified that the Florida Department of Environmental Protection had not required KWRU to take any action based upon any concerns or problems resulting from odors, noise, aerosol drift, or lightning (Tr. 83). Mr. Johnson also stated that the issues addressed in his testimony arose from a spill that occurred at KWRU's facility after hours in September while part of the construction at the facility was ongoing (Tr. 86). In his opinion, KWRU had been "very responsive" regarding that issue and it was his expectation that the issue was going to be soon resolved (Tr. 87). He testified that KWRU had been attentive and cooperative and forthcoming with regard to resolving this particular issue (Tr. 87). He gave no indication (and in fact, quite the contrary) that the Consent Order which he indicated in his prefiled testimony might need to be issued would, in fact, actually be issued. No OPC expert witness commented upon the quality of service.

Matters which the customers testifying at hearing did not address are as notable as those which were addressed. Normally, in a wastewater case, one would expect to hear customer concerns about odor (of which there were none); about plant shutdowns or interruptions in service during storm events, particularly in Key West (of which there were none); and about interactions with

utility personnel on a day to day basis regarding such routine matters as billing, service interruptions, etc. (here, the only testimony is that such concerns about routine daily service issues were resolved). Neither did any customer indicate that they thought the service was too expensive, or would be too expensive, although some did indicate they were (not surprisingly) not pleased at the prospect of paying higher rates.

Of the issues that were addressed by the various customers who testified at the Service Hearing, the overriding theme was related to mandatory connection(an issue discussed in detail under Issue 13 herein) and KWRU's utilization of personnel not employed by the utility to operate the company.

On the first issue, KWRU acknowledges that mandatory connection directives of local government present difficulties and controversy anywhere they are enacted and enforced. Monroe County Commissioner Neugent acknowledged that the County requested KWRU to send out the notices for non-compliance (Tr. 87) and KWRU also had the duty to inform customers (again, in implementation of the directive of local government) that the facilities of the utility were available for connection. KWRU has responded to the certain concerns expressed by customers about this process and how it was carried out, but suffice it to say that KWRU has attempted to implement the mandatory connection directives of local government in the smoothest, most expedient, and most efficient manner possible. KWRU obviously has no incentive to do otherwise.

Finally, as to some customer's expressed concerns about the use by KWRU of related parties or contractors, and the related expenses charged to KWRU which KWRU has requested be included in rate base, KWRU expects (and has always expected) that the Commission will fix rates for KWRU which are reasonable and compensatory and which allow KWRU to charge rates based upon KWRU's compensable investments. The presumption that the use of related or contractual parties is inherently adverse to the interest of customers (a presumption which is clearly stoked by

the Office of Public Counsel) might be a presumption that (although still incorrect) could be fairly applied to utilities if they had advance notice of the same. At least then utilities could conduct their activities accordingly. However, the application of such an adverse presumption *ex post facto* is particularly insidious. Here, while the concerns of the customers are absolutely legitimate and the Commission should consider their viewpoints appropriately, the Commission must keep its eye on the ball and allow KWRU an opportunity to earn a return on its costs and investments reasonably incurred, whether or not the same went to related or contractual parties or entities.

When one removes these "charged" issues (out of mandatory connection and the issue promoted by OPC as an inherent concern -- the use of related or affiliated persons or parties) there is no genuine evidence upon which a finding that the quality of service is unsatisfactory could be made. This utility is responsive to customer concerns and made concessions responsive to customer concerns at the time of the hearing (for instance Mr. Smith's indication that he would open his board meetings once a year so that customers could express their concerns – although he is under no requirement to do so under law or Commission practice or policy and the improvement of its facilities will all improve the quality of service even further.

ISSUE 2

Should KWRU's test year rate base be adjusted for Keys Environmental hook-up fees?

These charges, sometimes referred to throughout this proceeding as "hook up fees," are in fact inspection and oversight fees charged to the utility by KEI when they are called upon to oversee and inspect the interconnection of a customer's system with the new vacuum system operated by the utility. These inspections are critical, as noted by witness Smith (TR 113-114 and TR 117-119), in ensuring that the proper operation of the vacuum system, which is subject to substantial damage

from improper connections. The extent of the steps undertaken by KEI during the course of these inspection and oversight activities are outlined in detail in Exhibit 33, Pages 4-8.

Ms. Dismukes' basis for her position is primarily that these costs are subsumed within the contract duties of KEI. Her conclusion is based solely on the fact that the provisions of the contract, under the heading "Additional Operating Activities," specifies that KEI will wherever possible "supervise and inspect new customer tie-ins" to the utility's system, but does not have an additional dollar amount specifically associated with that function. A careful review of the agreement (Exhibit 24) shows that the language of the agreement has listed this as an additional function of KEI. However, its separation from the general duties of KEI would suggest that it is to be treated differently than those duties. For the following reasons, the position taken by OPC (and initially by the staff) to remove these capitalized costs paid to KEI by KWRU is unreasonable and unsupported by the facts in this case:

1. The failure to state the exact amount of compensation alone for these functions are not a sound basis to treat this capital cost, which is not a regular operating and maintenance cost (which are environmental in other parts of the agreement between KEI and KWRU), in the same manner as those O & M functions.

2. Not only is this a cost required to be capitalized under the NARUC System of Accounts, because it is related to the addition of new customers, it is not a regular operating cost and is subject to extreme fluctuation, depending upon the number of new customers added each year. KWRU has been in a period of adding substantial additional customers as a result of the County Ordinance mandating connection of existing septic systems to the central vacuum system of KWRU during the few years

preceding the test year (as is discussed in detail under Issue 13 herein).

3. As outlined in Mr. DeChario's testimony and in both of the staff auditors' testimonies (TR 40, 50, 54, 56 and Exhibit 23), the costs for regular operation and maintenance of the KWRU system as contracted for by KEI is at a lower cost than comparable operation and maintenance contracts by other contractors proposed to be provided to KWRU by US Water (Exhibit 24 and 25). As further illustrated by Mr. DeChario, the actual charges imposed upon KWRU previously, and on a similarly situated utility, Key Haven Utilities by a third party contractor (Synagro), are also higher than the costs imposed on KWRU by KEI (Exhibit 28). None of these comparable operation and maintenance contracts included services related to capitalized costs, and neither included recognition of the extensive additional costs related to overseeing connections to a vacuum system.

4. The contract between KWRU and KEI was entered into in December, 2004. The utility did not begin operation of the vacuum system until the end of 2005, a full year later (TR 191-192 and Exhibit 24). Therefore, the provisions in the contract between KEI and KWRU could not have envisioned the extensive inspection and oversight of customer connections to the vacuum system.

5. While the staff Audit Report recognizes this issue, that report also recognizes that the functions performed by KEI in inspecting and overseeing hookups to the vacuum system, appear to be more extensive than those that were covered by the contract (Exhibit 23, Page 11). In fact the contents of Exhibit 33, Page 4-8 outlined the

details of that oversight function and clearly demonstrate that oversight and inspection is much more extensive than a simple inspection of a new customer connection for the system prior to the implementation of the vacuum system.

6. KWRU's president, Mr. Smith, testified that if inspections had been included in the basic duties covered by the O & M contract, KEI would have had to increase their contract by that amount and that the US Water contract certainly didn't cover those functions in their proposal (TR 116).

For all of the above reasons, in order for KWRU to allow connection to its vacuum system, the services provided by KEI were a necessary expense of the utility and such services were not covered by the utility's contract between KWRU and KEI for regular operation and maintenance of the collection system. As such, denial of recovery of these costs for capitalization would be inappropriate and OPC's simplistic approach to exclude this substantial investment should be rejected.

ISSUE 3

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

The costs incurred by KWRU to assist in the decommissioning of the existing sewage treatment plant at the Monroe County detention center was a part of the agreement between the parties in order to obtain the detention center as a customer of KWRU. The position of OPC's witness is that these costs to decommission a treatment plant "that was not owned by KWRU" are "non-utility" (TR 264). This does not form a sound basis for making this adjustment. In addition, Ms. Dismukes has proposed to remove $10,000, which is the maximum that KWRU had agreed to contribute toward this decommissioning, not the actual amount capitalized. As part and parcel of

its agreement to provide service to the Monroe County Detention Center, KWRU agreed to assist the detention center in decommissioning its existing wastewater treatment plant (which had previously provided service to the detention center). It is not unusual for utilities to negotiate, through a developer agreement, concessions to assist in interconnection, especially when it enables the utility to add a substantial additional customer to its system. OPC has proposed to remove this cost simply because it was related to decommissioning a plant which was not a treatment plant owned by KWRU. OPC's approach is over-simplified and such an adjustment is unreasonable.

In addition, the adjustment as proposed by OPC is to remove $10,000 from plant in service for this adjustment. This is the maximum amount that the utility agreed to contribute toward this decommissioning. In fact, the utility capitalized less than half that amount for this function, since the demolition and removal of the treatment facility itself was ultimately undertaken by a third party at no cost to either KWRU or Monroe County. This is a typical example of Ms. Dismukes' aggressive approach toward KWRU in this case.

In conclusion, the adjustment proposed by OPC is substantially higher than the amount actually capitalized by the utility for assisting in the decommissioning of Monroe County Detention Center's old wastewater treatment plant, and costs incurred by the utility in assisting in that decommissioning was a reasonable and appropriate cost for the utility to incur in obtaining a new and substantial additional wastewater customer to the benefit of the utility and the general body of ratepayers. For this reason, no adjustments should be made.

ISSUE 4

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

AND

ISSUE 5

Should KWRU's test year rate base be adjusted for Green Fairways SSI Project management fee?

The amounts charged by Green Fairways for contract administration of major construction projects is a normal function required to be undertaken by any prudent utility management. Since the utility has no full-time staff or officers, it is charged for normal operating costs for management. Additional fees were charged to the utility for oversight and administration of two major capital projects: the jail project and the South Stock Island project (SSI project). For services above and beyond the normal operation and maintenance of the utility's facility, it is appropriate for an additional capitalized oversight and administrative fee to be assessed against the utility. The amount charged by Green Fairways is the same amount it charges for contract administration on all major construction projects which it oversees on behalf of other entities, and should be recognized.

Green Fairways, a company affiliated with the utility, charges a 10% contract administrative fee on all major projects (TR 25). This fee was charged to the utility for the administration and oversight of the construction projects related to the Monroe County Detention Center and the South Stock Island vacuum system project. The Office of Public Counsel proposed to remove these costs because they contend that Weiler Engineering provided management services for both of these projects (TR 265) (Exhibit 33, Pages 3-4). The 10% charge is a normal and accepted fee in the area for administration and construction oversight and, in fact, Monroe County accepted the 10% administrative fee as a reasonable fee for such services as part of an overall agreement for certain construction projects undertaken by the utility and reimbursed by the County (Exhibit 33, Pages 3-

4).

The Office of Public Counsel has provided no substantiation for the contention that such administrative fees are inappropriate or redundant. As she admitted, Ms. Dismukes has never worked on a utility construction project (TR 359).

Based upon the evidence of record, there is little to nothing to support the proposed elimination of these contract fees, yet there is evidence in the record that they are not only the same fees charged to other clients of Green Fairways but that this is the norm for the area for large construction contracts, both through the testimony of Mr. DeChario and through KWRU's experience in dealing with Monroe County. Based upon these facts, no adjustment is appropriate to these costs actually incurred by the utility for oversight of construction projects undertaken by Green Fairways above and beyond the day-to-day administrative duties related to operation and maintenance and the costs must be recognized.

ISSUE 6

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

OPC has proposed an adjustment to remove $25,000 in legal services related to negotiation of contracts with Monroe County on the SSI projects paid to Smith, Hemmesch and Burke. These were legitimately incurred legal costs agreed to between the utility and Monroe County as a flat fee for legal services related to the contract, and should therefore be recognized in rate setting.

As part of the contract between Monroe County and KWRU related to the SSI project, Monroe County had agreed to reimburse the utility $25,000 as a flat legal fee for the services of the law firm of Smith, Hemmesch and Burke in negotiating contracts. Monroe County initially paid these monies as agreed. However, after the audit of the County Commissioners was completed,

Monroe County decided to reduce subsequent payments to KWRU in order to effectively demand a refund of the monies previously paid for these services because of a lack of documentation. Since this was a flat fee arrangement agreed to by Monroe County in writing, the contract itself is documentation of the charge. The County's attempt to change that contract after the fact is still the subject of potential litigation. The fact that Monroe County has failed to pay for these services does not affect the fact that KWRU incurred these legitimate costs in complying with the terms of the contract with Monroe County by negotiating agreements related to the SSI project, and that KWRU incurred an obligation to pay a $25,000 legal bill originally agreed to by Monroe County.

Based upon these facts, this legitimate legal expense incurred by the utility (for which it is liable), should be recognized as a legitimate cost of the SSI project in accordance with NARUC accounting instructions, and no adjustment is appropriate. To do otherwise, as OPC suggests, is to turn the affiliated relationship of OPC so abhors on its head, and expect Mr. Smith's firm to render services to KWRU for free simply because he is the owner of the utility.

ISSUE 7

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

The utility capitalized $8,602, incurred by the utility as moving expenses, for moving Chris Johnson and his family to Florida to accept a position with Weiler Engineering and participate in the SSI project. OPC has removed this cost simply on the contention that the cost to move Mr. Johnson is an inappropriate expense to be capitalized to SSI plant. No other basis for this adjustment is proposed and the utility has provided ample explanations of the value received for this payment. Therefore, no adjustment is appropriate.

During the period of time the utility was considering start up of the SSI project Mr. Chris

Johnson, the son-in-law of KWRU's President, was considering a job offer from Weiler Engineering in Key West, Florida. In recognition of the substantial benefit that the utility could receive from Mr. Johnson going to work for Weiler Engineering and being a part of a project being undertaken on behalf of KWRU, KWRU agreed to pay Mr. Johnson's moving expenses if he would accept that position with Weiler Engineering. Mr. Johnson agreed and the utility reimbursed him for his moving expenses. The benefits to the utility of having a person looking out for the utility's interests involved in the design and oversight provided by the engineering firm was worth far more than the minor moving expense incurred by the utility. The basis for exclusion stated by OPC is broad and provides nothing more than Ms. Dismukes' predictable opinion that these costs should not be recovered. No other basis is provided for this adjustment. As noted, Ms. Dismukes admitted that she has never been involved in a utility construction project.

Therefore, based upon the great weight of evidence provided in this proceeding, the moving expenses incurred by KWRU in order to assist Mr. Johnson in relocating to the Keys in assisting the utility related to the SSI project should be recognized as an appropriate capital cost for that project.

ISSUE 8

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

The Office of Public Counsel has proposed to remove $4,650 in management services and costs provided by JAS Contractors as duplicate management fees. OPC has provided no justification that these charges in fact were duplicate, and therefore no adjustment is appropriate.

As part of the AWT upgrade project, KWRU enlisted the services of Johnson Constructors, and in turn Johnson Constructors utilized the services of JAS Corporation, owned by a relative of

KEI and Johnson Constructors principal, Chris Johnson. However, all that was paid to JAS Corporation was a minor consulting management fee for services and travel costs. These were appropriate costs incurred in relation to the AWT project. The adjustment proposed by Ms. Dismukes has no foundation and she has provided no justification other than that there is a relationship between the entities. Ms. Dismukes has admitted to having no experience in utility construction projects (TR 359).

Therefore, based upon the great weight of evidence provided on this issue, no adjustments should be made for the payments made to JAS Corporation related to travel expenses and consulting management services.

ISSUE 9

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

An adjustment has been proposed by the Office of Public Counsel to remove $32,500 capitalized to plant in service for consultant and management fees paid to Mr. Jack London between 1998 and 2003. The only basis for the adjustment proposed by OPC was that there were no invoices by which OPC could review the amounts charged or whether those were appropriately expensed or capitalized.

Mr. London was employed by the utility as a consultant for several years in assisting the utility in obtaining funding and service arrangements with the County for the SSI project and for the expansion of the utility. Mr. London's efforts were ultimately was successful and benefitted all of the customers of the utility. The fact that the utility has no separate invoices for these costs should not affect the fact that these services were provided (a fact apparently not in dispute) as a consultant to assist the utility in negotiating with Monroe County, which negotiations were ultimately successful

for the benefit of all customers.

Therefore, based upon the evidence of record, these capital costs related to the SSI project should be recognized in rate setting.

ISSUE 10

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

In order to assist the utility in responding to the Monroe County Audit Report related to the capital projects undertaken in which the County participated, KWRU enlisted the services of the White and Case law firm and incurred legal fees in the amount of $27,230 in responding to that Monroe County Audit Report. OPC has taken the position that these costs should have been expensed rather than capitalized. Ms. Dismukes only basis for this adjustment is the statement that "I do not believe that these costs should have been capitalized and therefore should not be included in rate base. The costs to the utility to defend itself against Monroe County should be borne by shareholders." This does not represent competent substantial evidence. These costs as noted by Mr. DeChario were legitimate costs of the utility responding to an Audit Report which was critical of the County's negotiations with KWRU and were incurred related to a capital project. As such, under NARUC System of Accountants, they are required to be capitalized. (TR 450-451)

Therefore, based upon the only factual evidence, and the NARUC System of Accounts, no adjustment is appropriate in these circumstances. These were legitimate costs to the utility of a capital project in obtaining funding from Monroe County related to that project.

ISSUE 11

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

The utility incurred costs to engage in a customer education program in order to inform its future customers about the central sewer service and the vacuum system and the Ordinance requiring connection to the system on South Stock Island. Monroe County specifically requested that KWRU assist customers in understanding the required system expansion and required interconnection to the sewer system (See, e.g. TR 88). This is a legitimate cost of securing the County's participation in that project and reasonably advancing customer relations. An adjustment of this nature actually discourages good customer relations and a utility's attempts to keep its customers informed of projects relevant to them. As such, no adjustment is appropriate for these costs incurred by the utility.

ISSUE 12

Should adjustments be made to the utility's pro forma plant additions?

The Office of Public Counsel has proposed two adjustments related to the AWT upgrade project undertaken by the utility. The first is to remove the fees paid to Green Fairways and Johnson Constructors for oversight of this project. The second is to remove $13,547 in additional charges from US Filter Datco related to change orders on this project. Both proposals are inappropriate and without foundation and should be rejected.

As previously discussed in Issues 4 and 5, Green Fairways charged the utility an oversight administrative fee related to construction projects equal to the amount they charged other entities for major construction projects. As noted under Issues 4 and 5 this is a normal and appropriate fee for such services in the area.

The charges from US Filter Datco incurred as the result of delays in change orders in the project were not the fault of the utility. The Capacity Reservation Agreement between Monroe County and the utility specifically stated that the agreement constituted all required permits for the project (TR 423). At a later date, the building department demanded that a permit be obtained for a portion of the project (TR 423). Therefore, this delay was caused by a position of the building department, contrary to the agreement with the County and the permitting conditions in the contract and was beyond any control of the utility. The utility had in fact done all it could to ensure itself of no delays. These costs were therefore legitimately incurred costs paid by the utility as a result of change orders outside the control of the utility and should be capitalized for the project. Therefore, based upon these facts, no adjustments should be made to the AWT project for the overheads and change order costs actually incurred by the utility and directly related to the AWT conversion project.

ISSUE 13

What are the used and useful percentages of the utility's wastewater treatment plant and collection and reuse systems?

KWRU'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. The phrase "used and useful" is nothing more than the Commission's nomenclature for the statutory (and in fact, constitutional) concept that KWRU has the lawful right to earn a return on its investment in utility property, including land acquired or facilities constructed or to be constructed within a reasonable time in the future, if:

- → Such property is needed to serve current customers;
- → Such property is needed to serve customers five years after the end of the test year at

a growth rate for equivalent residential connections not to exceed 5% per year; or

- ➔ Such property is needed to serve customers more than five full years after the end of the test year to the extent the utility presents clear and convincing evidence to justify such consideration;
- ➔ The Commission finds that the utility's investment was an environmental compliance cost in which case the Commission shall approve rates for service which shall allow the utility to recover the full amount of such costs.

See generally Section 367.081 (2)(a), Florida Statutes.

Rule 25-30.432, Florida Administrative Code, provides that for wastewater treatment plant used and useful calculations ". . . the Commission will ***also consider other factors*** such as ..." allowance for growth, I&I, "the extent to which the area served by the plant is built out", whether the permitted capacity differs from the design capacity, and other enumerated factors. The Administrative Code Rule expressly provides that the enumerated factors are only some of the factors which the Commission will consider in determining the used and useful amount, and is not by any means an exhaustive list. The Rule also expressly provides that it does not apply to reuse projects, pursuant to Section 367.0817(3), nor investment for environmental compliance pursuant to Section 367.081(2)(a)2.c Florida Statutes.

In this case, the Commission should find, and the record establishes, that under either approach (the used and useful approach set forth in the statute and the Administrative Code Rule, or the 100% recovery required to be allowed by the statute for environmental compliance) KWRU's wastewater treatment plant, collection and reuse systems, should be found to be 100% used and useful.

Background of the Project

KWRU's existing wastewater treatment facilities are located in an area subject to tidal

influences and are relatively old (Tr. 92-93). The particular location of the facilities, the types of soils on which the facilities are located, and the age of the systems have all impacted the wastewater treatment plant (Tr. 92-93). The salt in the air and in the influent, and the general environment of the Keys, is one of the harshest to steel equipment such as these treatment facilities (Tr. 93). Accordingly, the steel wastewater treatment plant was badly deteriorated and rusted out (Tr. 93). KWRU was required to undertake substantial refurbishment of the existing wastewater treatment facilities in order to continue to utilize the system for the long run (Tr. 93). Accordingly, KWRU's facilities have undergone refurbishment, due to the harsh environment in which they exist under the part and parcel of sound maintenance of the facilities and their upgrade to advance wastewater treatment standards (AWT); they have been expanded by the mandate of DEP (Tr. 430 and see generally e.g., Tr. 399-400); and the plant was then upgraded to AWT standards under the directives of state and local government.

All wastewater utilities in the Florida Keys are required to go to AWT by existing law, as discussed in detail below. Monroe County has specifically resolved that KWRU should go to AWT as quickly as possible (Tr. 94). In addition to Monroe County's resolution, KWRU realized that undertaking a change to AWT apart from the refurbishment would be duplicative and conflicting to some extent, as far as the facilities which needed to be put in place to achieve each goal separately (Tr. 94). Because Monroe County had resolved that KWRU should move forward with the AWT, in order to make the refurbishment and change to AWT as efficient and cost effective as possible, KWRU moved forward with AWT at the same time as the refurbishment (Tr. 94). This upgrade to AWT not only implemented applicable law (as discussed in more detail below) and not only was it a change that was good for the local environment, it also allowed KWRU to more

efficiently and effectively utilize the reuse that its system produces (Tr. 95). The effluent generated by the plant in the past had sometimes been unsuitable to allow its utilization as reuse water but, with the move to AWT, higher quality effluent will result and a higher quality of effluent will be produced, which will allow KWRU to dispose of all of the effluent into the reuse system (Tr. 95).

Environmental Compliance Cost

There is nothing in Section 367.081(2)(a)2.c. to indicate that the legislature intended that subsection to be narrowly construed, restrictively interpreted, or sparingly applied. The clear and entire purpose of the legislature's declaration that environmental compliance costs should be considered 100% used and useful is to encourage the state's utilities to undertake environmental compliance measures to the benefit of their customers, Florida's fragile environment, and the public as a whole. In no area of our state is this more true than in the Florida Keys. Here, the testimony and the documentation (which is either in evidence in the proceeding or of which the Commission took Official Recognition) clearly demonstrates that a directive that wastewater facilities in the Keys (such as KWRU) emanated from Tallahassee, was accepted and implemented by local government in Monroe County, and ultimately manifested itself in the upgrade to KWRU's facilities. Likewise, the expansion and refurbishment to accommodate present growth, anticipated growth, and the connection of those individuals not connected to the system, as directed by the legislature and mandated by ordinance, also fits squarely within the realm of those environmental protection projects for which the legislature deemed 100% recognition necessary and appropriate.

The evidence demonstrates that KWRU implemented and effectuated the AWT project consistent with state and local law and the directives of Monroe County. In Chapter 99-395, the legislature enacted certain sewage requirements for Monroe County (in section 6 thereof) including,

but not limited to, that

> (4) *Existing sewage facilities that discharge to other than surface waters and existing on site sewage treatment and disposal systems shall cease discharge or shall comply with the applicable treatment standards of (AWT) by July 1, 2010, and with the rule of the Department of Environmental Protection, or the Department of Health, as applicable.*

Chapter 99-395 (1999)

In furtherance of that mandate, Monroe County secured an agreement from the utility to the effect that:

> 5. *Utility further agrees to convert its wastewater treatment system to Advance Waste Water Treatment (5-5-3-1), hereafter AWT, by January 1, 2007 provided that the County so requests and that utility is allowed to recapture the costs of its conversion to AWT and increased operating costs by a resolution of the County Commission.*
>
> . . .
>
> *The utility agrees to complete the AWT upgrade at its own expense if the fees collected for the upgrade under this paragraph do not cover the total cost of the upgrade. The utility agrees to use its best efforts to require the property owners of South Stock Island to connect to the new collection infrastructure. If the owner of a property required to connect to the new collection system refuses to do so, the utility shall refer the refusal to the County which may use any available legal or equitable remedy to compel connection.*

Capacity Reservation and Infrastructure Contract (2002).

Thereafter, the county resolved as follows:

WHEREAS, the contract establishes that the County may request that KWRU upgrade its

wastewater treatment plant to meet AWT standards (5 5 3 1), and

. . .

Section 1. KWRU is requested to begin immediately to convert its wastewater treatment plant to meet AWT standards (5 5 3 1).

Resolution No. 595 (2002)

Monroe County and KWRU, in an amendment to an existing contract, noted that:

1. *. . . The parties acknowledge that the County in Resolution No. 595-2002 directed that the utility upgrade its Stock Island wastewater treatment plant to AWT by January 1, 2007 pursuant to paragraph 5 of the original contract.*

Amendment Number One to the KW Resort Utilities Corporation Capacity Reservation and Infrastructure Contract (2003)

For all the reasons explained in the testimony of Mr. Smith, KWRU agreed with the County's resolution that it proceed with AWT contemporaneous with the refurbishment project.

For this reason alone (because the upgrade tp AWT project is an environmental compliance cost) any and all costs associated with the project should be considered an environmental compliance cost and found to be 100% used and useful. OPC's used and useful expert, Mr. Woodcock, stated that the installation of the advanced wastewater treatment facilities was an environmental compliance cost (Tr. 401). No witness, expert or otherwise, testified to the contrary.

Likewise, the plant expansion and refurbishment should, in these unique circumstances, be considered an environmental compliance cost. Mandatory connection is a concept that has, under certain circumstances, ostensibly been mandated in the Florida Statutes for many years, but one that has seldom (if ever) been enforced. Because of the fragile environment of the area, the legislature

redoubled its efforts to secure and enforce the concept of mandatory connection in the Keys, including for those persons within KWRU's service area who are not connected. Local government thereafter acted accordingly to bring the legislature's mandate to fruition. In Chapter 99-395, the legislature enacted the following:

> *Section 4.* *Notwithstanding any provision of chapter 380, part I, to the contrary, a local government within the Florida Keys area of critical state concern may enact an ordinance that: (1) Requires connection to a central sewerage system within 30 days of notice of availability of services; and*
>
> **Chapter 99-395, Laws of Florida (1999)**

Monroe County responded accordingly, enacting appropriate ordinances and developing a procedure to secure a mandatory connection:

> *Section 2. (a)* *The owner of an onsite sewage treatment and disposal system must connect the system or the building's plumbing to an available publicly owned or investor-owned sewerage system within 30 days after written notification by the owner of the publicly owned or investor-owned sewerage system that the system is available for connection. The publicly owned or investor-owned sewerage system must notify the owner of the onsite sewage treatment and disposal system of the availability of the central sewerage system.*
>
> **Ordinance No. 04-2000 (2000)**
>
> *Section 4(D)* *The Florida Legislature has authorized the County to enact local legislation that: (1) requires connection to a central sewerage system within specified time periods; and (2) provides a definition of on-site sewage treatment and disposal systems that does not exclude package sewage treatment facilities even if facilities are in full compliance with all regulatory requirements and treat sewage to advanced wastewater treatment standards or utilize effluent reuse as their primary method of effluent disposal.*
>
> **Ordinance No. 017-2002 (2002)**

If KWRU did not have the expanded capacity and a fully functional facility such that the

requirements of the legislature and Monroe County could be met (upon identification, notice, and the secured compliance of persons who were not previously connected to central sewer) then neither the spirit nor the letter of those environmental mandates could be met. Simply put, if the plant capacity necessary to serve such previously unconnected persons is not existing and fully functional, then there is nothing for such prospective customers to connect to. This is why Monroe County and KWRU entered into contractual commitments reserving capacity for those persons for whom connection would be compelled, and agreed as follows:

> 1. A. *The County agrees to purchase from the utility, and the utility agrees to sell, capacity at its wastewater treatment plant sufficient to treat 1500 e.d.u.'s. The utility agrees that the capacity purchased is to serve the South Stock Island area.*
>
> **Capacity Reservation and Infrastructure Contract (July, 2002)**

It is not the position of KWRU that the mandatory connection ordinance, in and of itself, mandated expansion of the plant. However, the reality of mandatory connection takes the speculation out of whether unconnected persons in the service area would ultimately be customers of the utility. Facilities had to exist to meet that demand and this capacity could not, as the evidence demonstrates, be constructed in a vacuum. The plant expansion, refurbishment, and upgrade projects have proceeded in the most economical and timely fashion and there is no evidence to the contrary.

It was the opinion of OPC's expert that the expansion of the plant was an environmental compliance cost (Tr. 401). No witness, expert or otherwise, testified to the contrary.

The Used and Useful Methodology in the Statute and in the Rule

Should the Commission find that any facet of either the plant expansion, refurbishment, or AWT upgrade is not an environmental compliance cost under Chapter 367 (and accordingly, 100%

used and useful), the expansion and upgrade should nonetheless be deemed 100% used and useful by the Commission under the methodology contemplated by the Commission's statutes and rules.

In this case, the factors clearly exist which the Commission should consider, pursuant to Rule 25-30.432, to find that the existing wastewater treatment plant and the expansion, refurbishment, and upgrade of KWRU's facilities is 100% used and useful. In this regard, the Commission should consider the growth of the system; the mandate of the legislature and Monroe County which directly resulted in the upgrade and expansion; and the nature and reality of the service area and the mandatory connection ordinance and the reservations of capacity related to each, which essentially renders the service area as *de facto* "built out".

Growth of the System

OPC's expert acknowledged that growth of the utility has been at about 10% of its customer base per year (Tr. 403) but that he construed the Commission's Administrative Code Rule such that he only applied a 5% growth rate (Tr. 403). He did not attempt to take into account the mandatory connection ordinance; any particular commitment the utility has made to Monroe County; or any other commitments or reservations in capacity by any other persons or entities (Tr. 404-405).

OPC's expert opined that he believed the plant was expanded appropriately and that the plant was appropriately sized (Tr. 399). Yet, he also offered that under his interpretation of the rules, even prudent investment must be disallowed under the used and useful formula employed by the Commission (Tr. 398). KWRU's expert was of the opinion that the Administrative Code Rules allowed the consideration of other factors, rather than the application of the strict percentage of 5% growth rate, and that the known developments proposed to connect to the KWRU plant should be considered in future capacity calculations as well as the standard percentage growth rate (Tr. 422).

Stock Island is experiencing significant redevelopment of properties and a higher density use as indicated by capacity reservation agreements with KWRU (Tr. 422). The redevelopment of certain properties is also addressed in the wastewater report generated by URS Engineering for Monroe County (Tr. 422). It was the opinion of KWRU's expert that the expansion was required by the Florida Department of Environmental Protection in order to provide capacity and that the conversion to AWT was required by the agreement with Monroe County which implemented the legislative directive discussed elsewhere herein (Tr. 422).

The Mandates of the Legislature and Monroe County

Section 367.081(2)(a)2.c. provides the presentation of clear and unconvincing evidence to justify growth more than five full years after the end of the test year, the Commission may find property needed to serve such customers is 100% used and useful. Similarly, Rule 25-30.432, Florida Administrative Code, provides that the Commission may "consider other factors" in determining wastewater treatment plant used and useful percentages. In this case, the very existence of the mandatory connection ordinance, and the unique nature of KWRU's service area and capacity reservations, should form the basis for a finding by the Commission that KWRU's facilities are 100% used and useful. Even if the Commission decides these do not result in the categorization of these costs as "environmental compliance costs" the fact is that KWRU was compelled to undertake them by the reality of its service area and under the directives of state and local government. This is a prefect example of the type of "other factors" which the Commission should consider in determining whether KWRU's investment in its plant expansion, refurbishment, and upgrade were prudently made, to the benefit of customers, and used and useful in the public service.

The Nature of the Service Area and the Mandatory Connection Ordinance

The fact that KWRU's service area is experiencing significant redevelopment of properties and a higher density as indicated by the capacity reservation agreement (Tr. 422); the fact that redevelopment of certain properties is also addressed in the wastewater report generated by URS Engineering for Monroe County (Tr. 422); and the very fact of the mandatory connection ordinance should all be considered as "other factors" under Rule 25-30.432 to support a finding that KWRU's facilities are 100% used and useful. OPC's own expert was of the opinion that in reality what KWRU had constructed was appropriate and necessary to meet the mature and existing demand in the form of committed flows and the mandatory connection ordinance, when he opined that it was his opinion that KWRU's facilities were appropriately sized given what he knew about the service area and the customer base (Tr. 399). Rule 25-30.432 allows the Commission the flexibility to recognize the present reality of the system such as KWRU's and to avoid the injustice worked by a strict application of a formula which clearly deprives the utility of prudent investment. KWRU facilities, as expanded, refurbished, and upgraded, will clearly be utilized either to meet existing demands; to serve customers for whom capacity is already reserved or growth which is absolutely predictable and foreseeable because of the nature of the service area and/or the mandatory connection ordinance; or to meet other existing commitments. The facilities thusly necessary should be recognized under Chapter 367 and the utility allowed to earn a return on its prudent investment therein. The imprudent thing for KWRU would have been to have waited and attempted to undertake a portion of this expansion, refurbishment, or upgrade in order to meet a small, remaining percentage of its customer demand at ultimate build out. KWRU appropriately sized its facilities; it timely constructed those facilities; and it properly upgraded and refurbished

those facilities.

Other than OPC's experts' belief that his hands were tied, and that he had no choice but to find part of the facilities as non-used and useful (while at the same time he was of the opinion that they had been prudently constructed), there is no evidence or exhibits or testimony supporting anything less than a determination that all of KWRU's facilities are, in fact, 100% used and useful.

Collection and Reuse System

There is no dispute of fact with regard to KWRU's position that the collection system of the utility is 100% used and useful. Consistent with the application, the evidence, and the testimony of OPC's expert witness, the gravity system is 100% used and useful (Tr. 397) and the vacuum system is 100% used and useful. The upgrade to AWT will allow KWRU to dispose of 100% of its effluent into the reuse system (Tr. 95). In accordance with the PSC's rules and practice and the reality of KWRU's service area, the reuse system is 100% used and useful. No evidence or testimony disputed that KWRU's collection and reuse systems were 100% used and useful.

ISSUE 14

What is the appropriate test year balance of accumulated depreciation?

The test year balance of accumulated depreciation is subject to the resolution of other issues in this proceeding. However, it is the utility's position that the amount of accumulated depreciation in the utility's filings should be adjusted only for the effect of the stipulations entered into in this case.

ISSUE 15

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

The test year balances of CIAC is subject to the resolution of other issues in this proceeding. However, it is the utility's position that the amount of CIAC in the utility's filings should be adjusted only for the effect of the stipulations entered into in this case.

ISSUE 16

What is the appropriate working capital allowance?

The test year balance of working capital allowance is subject to the resolution of other issues in this proceeding. However, it is the utility's position that the amount of working capital allowance in the utility's filings should be adjusted only for the effect of the stipulations entered into in this case.

ISSUE 17

What is the appropriate rate base?

The test year balance of rate base is subject to the resolution of other issues in this proceeding. However, it is the utility's position that the amount of rate base in the utility's filings should be adjusted only for the effect of the stipulations entered into in this case.

ISSUE 18

What is the appropriate return on common equity?

The appropriate return on 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.

ISSUE 19

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

The appropriate weighted average cost of capital is that contained within the utility's filing, adjusted only for any effects of stipulations outlined herein, and the updated cost of common equity based upon the leverage formula in effect at the time the Commission's Final Order is issued in this proceeding.

ISSUE 20

Should any adjustments be made to test year revenues?

The Office of Public Counsel, through Ms. Dismukes, proposed several adjustments to the test year revenue based on three separate sets of "facts."

The first was to utilize Florida Keys Aqueduct Authority (FKAA) data to change test year revenue, despite the fact the utility is not utilizing that number of customers or those gallons for determination of test year revenue. Ms. Dismukes' proposal is therefore clearly a mismatch between the test year actual expenses and test year revenue actually achieved. Her proposal to then utilize this increased test year revenue to reduce the revenue requirement is basically nonsensical and conflicting (TR 458-459).

The second adjustment proposed by OPC is to impute revenue to the utility for rents paid by Weiler Engineering. Ms. Dismukes' proposal is based upon her contention that the amount of rent paid by Weiler has decreased during the test year. She therefore proposes to impute it at the highest level ever paid by Weiler as revenue to the utility. This utilization of the utility trailer by contract personnel was at its peak during major construction projects, thereby reducing the cost to the utility for office space for those personnel and thereby reducing cost to the utility by the rent

charge. The fact that Weiler's use of that facility decreased during the test year is indicative of the fact that the majority of the construction was nearing completion and therefore Weiler appropriately reduced their usage of that property. In the future all of it will be utilized by the utility; thereby further decreasing Weiler's utilization and paid allocation of the rents due. OPC's proposal effectively suggests that the utility should be penalized for the fact that Weiler Engineering is no longer utilizing utility facilities, to the extent they had in prior years during construction activities. Therefore, OPC's proposal in this regard is not only without foundation, it is contrary to what is anticipated to incur during the period of time rates will be in effect. Accordingly, OPC's position should be rejected.

The final adjustment proposed by the Office of Public Counsel is to impute revenues for the monies charged to Monroe County for maintenance of the Monroe County Detention Center lift station. The utility classified these costs as merchandising and jobbing and below-the-line in accordance with the NARUC System of Accounts. Instead, Ms. Dismukes proposed to include the revenue above-the-line (see Exhibit 33, Page 8 Response to Audit Finding No. 10).

Based upon the above facts, all three of these adjustments proposed by the Office of Public Counsel are unreasonable and without foundation and should be rejected.

ISSUE 21

Should any adjustments be made to sludge removal expenses?

AND

ISSUE 22

Should any adjustments be made to chemicals expense?

Ms. Dismukes has proposed on behalf of OPC that sludge hauling and chemical expenses are

abnormally high during the historic test year and should be adjusted based upon an adjustment she refers to as "normalization." This normalization adjustment (which in reality is just an averaging adjustment) is unreasonable and unprecedented and based upon an assumption of no inflation and has no recognition of the substantial customer growth experienced by the utility. In addition, it fails to recognize that costs in general have increased for these services (and Ms. Dismukes has done no analysis whatsoever to attempt to determine what a reasonable level of increase has been). Therefore, these proposed adjustments must be rejected.

Ms. Dismukes has proposed that chemical expenses and electrical expenses are "abnormally high" during the test year without any recognition or attempt to determine the reason for the increases (much less the reason for any "abnormality in the increases). Ms. Dismukes simply proposes an adjustment because there have been increases in costs. Mr. DeChario notes that this fails to include the increases resulting from the unusual customer growth that Ms. Dismukes admitted had occurred with this utility (TR 342-343 and TR 351-352); she admitted that no adjustment had been made for the effects of inflation; and, as Mr. DeChario clearly notes, she has made no consideration of the environment in which the utility exists and attempted to determine whether or not other utility costs have gone up as well (TR 353). Mr. DeChario has performed an analysis (TR 488 and Exhibit 28) showing that the costs incurred by the only similarly situated regulated sewer utility in the Keys (Key Haven Utilities), had gone up a greater percentage than those of KWRU, despite KWRU's substantially higher growth levels.

Ms. Dismukes' proposed "normalization" is a normalization in name only. Rather, it is an averaging of outdated and unrealistic costs not reflective of either current circumstances, customer growth, inflation, or the market for the provision of such services to the utility. Therefore, her adjustments are without foundation and must be rejected.

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?

An adjustment has been proposed by Office of Public Counsel to reduce chemicals, electric and sludge hauling expense, based upon two issues raised by Ms. Dismukes: (1) that the utility used out of test year flows for determination of these expenses, yet utilized test year flows for other purposes; (2) that the utility failed to take into account the reduction in chemicals in these three expenses related to the reduction in flows resulting from resleeving projects. Both of these proposals are without foundation based upon the testimony and evidence provided by Mr. DeChario and Mr. Castle and should therefore be rejected.

As to the claim by Ms. Dismukes that the flows represent a mismatch, Mr. DeChario clearly demonstrated that flows anticipated for customers who were either committed to connect or anticipated to be connected by 2007 were all utilized in determining the pro forma adjustment for 2007 flows and customers in the utility's billing analysis (TR 458). Therefore, there is no mismatch and revenues for 2007 customers are properly matched with expenses based upon 2007 flows in the pro formas.

As to Ms. Dismukes' contention that there will be a reduction in flow as a result of the resleeving, she has taken the position that the Commission frequently adjusts these operating and maintenance expenses as a result of a reduction of infiltration and inflow where infiltration inflow is excessive. Initially, it is clear from the testimony of Mr. Castle that infiltration and inflow are not excessive in this circumstance (TR 424-426), a conclusion Ms. Dismukes agreed with (TR 360). Secondly, Mr. Castle notes that any savings in chemical cost or in power used for aeration will be negligible as a result of these changes (TR 424). Finally, Mr. DeChario notes that even if there were

any significant changes, the Commission has previously taken a position in the recent Key Haven case that no adjustment to those expenses should be undertaken in order to encourage reduction in I & I and not penalize the utility (TR 457).

Therefore, based upon the evidence of record, it is clear that Ms. Dismukes proposed reductions of chemical, electric, and sludge hauling are not founded on any competent substantial evidence, and are in fact contrary to such evidence, and should be rejected.

ISSUE 24

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

The Office of Public Counsel has proposed an adjustment to remove all markups invoiced to the utility by KEI on chemicals and sludge hauling. Ms. Dismukes' sole alternative is for the utility to "hire its own employees and purchase these chemicals itself." However, she provides nothing to demonstrate her recognition of the additional costs and personnel that would be required in order to take on these functions.

In addition, Ms. Dismukes admitted she had done no comparative analysis for the services provided by KEI to KWRU to determine whether or not the services were provided at or below the market price for such services. As is also discussed under Issue 28, the proposal of US Water to provide similar services to those provided by KEI specifically noted that chemicals and residuals management would include a "appropriate allowance for overhead and margin." Staff witness Welch agreed that this is in fact a markup on those services (TR 57). The president of the utility also noted that every company provides for a markup. (TR 108).

The issue under these circumstances is not whether services are provided by an affiliate at cost, but whether the services provided by an affiliate are at or below the market value of such

services, if provided by a third party. See GTE Florida, Inc. V. Deason, 642 So. 2d 545(Fla. 1994). Ms. Dismukes offered no analysis of the market value of the services provided by the related parties. Mr. Smith, Mr. DeChario, and Exhibit 25 provide clear evidence that the 30% markup imposed upon the utility by KEI is in keeping with the standard practice for providing such services by third party contractors.

Based upon this evidence and the clear case law which governs this issue, no adjustment is appropriate.

ISSUE 25

Should any adjustments be made to insurance – general liability?

The auditor, and ultimately the Office of Public Counsel, have referred to a payment made to the general liability insurance carrier as a finance charge or a late payment. As noted in the response to the Audit Report (Exhibit 33/PED-8, Page 9 of 10), the response to Audit Finding No. 15 prepared by Mr. DeChario specifically states that this was a prepaid insurance amount and a normal expense and is mis-characterized by the auditor. The utility was never late and believes the minor amount of the finance charges properly belong with the cost of the insurance.

For this reason, the only evidence of record on this issue is that provided by Mr. DeChario in Exhibit 33 and based upon that evidence no adjustment is appropriate.

ISSUE 26

Should any adjustments be made to advertising expenses?

Ms. Dismukes has proposed to remove all costs related to advertising expense undertaken by the utility for the purposes of complying with Monroe County's request to inform the future customers of the utility of the required interconnection to the KWRU system and the reasons for the

same. OPC has incorrectly referred to this as a public relations campaign. Instead, it was an attempt to educate and keep the customers of the utility informed about the requirement that they hook into the system and the costs and benefits of that requirement. The cost is not for public relations but for customer service and should be considered an appropriate function of the utility, especially in light of the primary funding source (Monroe County) requesting that the utility undertake this method of information distribution to the future customers.

Based upon the evidence, this is a reasonable and appropriate expense of a good, well managed, and customer conscious utility and should be allowed.

ISSUE 27

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

Public Counsel proposed to eliminate one half of the amount charged by Green Fairways for management fees for the services of Mr. Smith as president of the utility. As noted by Mr. DeChario, this is the only charge imposed upon the utility for the day-to-day management services of Mr. Smith as president of the utility. Ms. Dismukes in part bases this proposal on the assumption that on a going-forward basis Mr. Smith will spend less time on utility matters. However, she provides absolutely no foundation for such a conclusion. Mr. DeChario notes that Mr. Smith's salary has been unchanged for the past nine years. Mr. DeChario provided in Exhibit 29/PED-4 an analysis of comparable sewer only systems regulated by the Commission, showing that his salary is the third lowest of those 11 comparable utilities on gallonage treated; salary per meter equivalent; and salary per equivalent residential connection and that, in fact, Mr. Smith's salary is less than one third of the average comparable officer's salaries for Class A and B utilities. Mr. Smith testified that he spends approximately one third of his time on utility matters.

Based upon the case law, Mr. Smith's salary should be judged based on the market value of the services provided. The only evidence of the market value of the services of Mr. Smith is that provided by Mr. DeChario in his analysis in his Exhibit 29. While it is nearly impossible to compare any individual officer's salaries because of the variation in the duties assigned to each officer, total officers' salaries form a good basis of comparison of utilities. Since Mr. Smith is the utility's only compensated officer, his management fee represents the only "officer's salary" for this company. A comparison with neighboring Key Haven, a similarly situated utility, also clearly demonstrates the reasonableness of Mr. Smith's compensation for his services in overseeing day-to-day operations of the utility.

Therefore, based on the only evidence of record in this proceeding related to the required basis for review, no adjustments should be made to the charges from Green Fairways for Mr. Smith's services to the utility.

ISSUE 28

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

The Office of Public Counsel has proposed four adjustments under this issue. The first is to remove $1,313 for lab testing charged to KWRU by KEI. The second proposal is that $15,000 in sewer hookup fees should have been capitalized. The third is to capitalize $51,663 of items that were originally expensed. The fourth is for two items totaling $3,077 for repairs done by KEI and charged to KWRU that Ms. Dismukes believes should be recovered from third parties. The utility is in agreement with the capitalization of the $15,000 in sewer hookup fees and with the capitalization of $51,663 as proposed by Audit Finding No. 3. However, the basis for the other adjustments are in error and neither of those remaining two adjustments are appropriate.

Lab testing, while included as a function of KEI under the agreement to provide services, was not intended to be a function covered by the regular monthly payment but instead was intended to be a function for which KEI would separately bill the utility. Therefore, no adjustment is appropriate.

Finally, as to the two repairs undertaken by KEI and charged to KWRU for which the staff and OPC contend the utility will be reimbursed, the utility has not been reimbursed and these costs were incurred by the utility in maintenance of its system. To the extent the utility is in some future time period able to recover some costs, those costs will be offset against any repairs in the years in which those receipts are obtained. However, to date, no such reimbursement has been received and the utility anticipates that these types of repairs will recur each and every year in the future. Therefore, no adjustment is appropriate.

ISSUE 29

Should any other adjustments be made to Contractual Services - Other expenses?

The Office of Public Counsel has taken the position that all the bonuses paid to Key West Golf Club (KWGC) employees should be disallowed as those bonuses, to the extent appropriate, should be covered by the $8,000 monthly management fee paid to KWGC by KWRU for the services of those employees. Mr. DeChario testified that these "bonuses" were in fact not bonuses but were in further compensation to employees of KWGC to compensate him for services above and beyond normal recurring operation and maintenance and management of the utility. These payments were compensation for assistance in obtaining additional sewer customers. It is the only method by which Mr. Carter is compensated for this additional task and encourages him to achieve the result of adding additional customers to the benefit of all of the utility's customer base (TR 451-

452). The utility had difficulty in getting customers to connect, despite a County Ordinance requiring it, and Mr. Carter was offered this bonus to assist in that regard (TR 342-345).

In conclusion, Ms. Dismukes' opposition to the bonuses is based on nothing more than her belief that "bonuses" should be subsumed within the management arrangement between KWGC and KWRU. She offers no documentation supporting her position. She has failed to consider that these are services are above and beyond the normal management duties of the personnel of KWGC and is therefore proposing to deny any compensation for these additional services provided. For these reasons, this proposed adjustment should be rejected.

ISSUE 30

Should any adjustments be made to miscellaneous expenses?

Ms. Dismukes has proposed several adjustments under this heading: (1) to remove travel costs incurred by Mr. Smith in attending to utility business in Key West; (2) for moving expenses relating to driving a truck purchased in Illinois and driven to Key West; (3) the removal of $420 paid to Monroe County to deliver hookup notices to customers; and (4) for a $100 donation to rotary and $61 paid to a florist. The utility is in agreement with the fourth item. However, the other adjustments are not well founded for the reasons outlined below.

Mr. Smith spends one third of his time on KWRU related matters (TR 145) and that time is devoted to the utility whether he is in Illinois or in Key West, Florida or in some other place (TR142-143). In addition, he spends one week per month in Key West (TR 142). The payment for Mr. Smith's travel costs is simply part of his compensation package in addition to the management fee. These costs and the total compensation package is not unreasonable for a man of Mr. Smith's expertise and experience in business management and oversight. This was clearly demonstrated by

Mr. DeChario's comparative Exhibit 29.

The cost incurred for moving a truck from Illinois to Florida is a reasonable business expense, as the utility was able to find a truck that matched its needs at that location at a good price and had to incur the cost of having that truck transported from Illinois to Key West. Therefore, this is a reasonable cost of operation.

The fees paid to the Monroe County Sheriff were discussed at length by numerous witnesses. However, both Mr. DeChario and Mr. Smith testified in detail concerning the requirement imposed by the County that the utility obtain personal service on the customers and that the utility chose the least cost alternative, use of the Monroe County Sheriff's Department, for those who refused certified letters (TR 184). Also, see Exhibit 44. As such, this is a reasonable, appropriate, and necessary business expense which should be recognized.

ISSUE 31

What is the appropriate amount of rate case expense?

The utility has incurred substantial rate case expenses as a result of this case. Mr. DeChario provided extensive testimony about why the costs for this case increased dramatically from the original estimate, in large part because of the actions of the Public Counsel and the unprecedented and often repetitious discovery undertaken by them (TR 459-463). Ms. Dismukes discusses for approximately 10 pages the reason she contends this case is complex; why OPC's massive discovery efforts were justified; and why no rate case expenses should be recognized. The primary proposal for adjustment is to recognize no rate case expense, because the Office of Public Counsel is recommending a decrease in rates and therefore the filing of the rate case was in her opinion imprudent. Mr. DeChario responds to each of the points raised by Ms. Dismukes concerning

discovery; the complexity of this case; the affiliated relationships; and the period of time since the utility's last rate proceeding and rebuts each and every one of her positions (TR 459-463).

This utility was required to file this rate proceeding as a result of governmentally imposed requirements that it move to AWT and the other costs that it incurred in environmental compliance. The utility has not had a rate increase in over 25 years and is in dire need of an increase in rates. OPC's unprecedented and nonsensical proposals for adjustment do not justify the extreme measures recommended by them, and have been counterproductive and costly to the general body of ratepayers. The utility has actually incurred substantial rate case expenses, all of which have been enumerated in great detail to the filing of Mr. DeChario's testimony, Mr. DeChario's Exhibit No. 34/PED-9, and late-filed Exhibits 41-43. Other than Ms. Dismukes' general statements, no challenge whatsoever has been posed to the rate case expenses incurred by the utility or the specific costs incurred and charged by affiliates for their additional time above and beyond normal operation and maintenance function in processing this application. Therefore, those rate case expenses must be recognized in rate setting to the full extent incurred by the utility.

ISSUE 32

Should any adjustment be made to test year net depreciation expense?

The appropriate amount of test year appreciation expense is that included in the utility's original application and any adjustments to be made to test year net depreciation expense are only those that result from recognizing the effects of any stipulations agreed to by the utility in this proceeding.

ISSUE 33

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

The amount of the test year wastewater net operating income or loss before any revenue increase will be the result of the adjustments made to that figure in the utility's filing and for the effect of any stipulations agreed to by the utility.

ISSUE 34

What is the appropriate revenue requirement?

The appropriate revenue requirement is the revenue requirement outlined in the utility's original filing, updated for the effect of stipulations agreed to by the utility and updated rate case expense as contained in the utility's rebuttal testimony, Exhibit 34, and late filed Exhibits 41-43.

ISSUE 35

What is the appropriate rate structure for this utility?

The rate structure to be utilized is that proposed in the utility's initial application. No other parties have presented any testimony or evidence related to an appropriate rate structure and therefore, the Commission must adopt the structure proposed by the utility.

ISSUE 36

What are the appropriate monthly residential and general service rates?

The residential and general service rates ultimately determined in this proceeding will be based upon the conclusions reached as to all aspects of the utility's rate base, revenue requirement, and cost of capital. However, it is the utility's position that the appropriate residential and general service rates are those proposed by the utility, updated for the effects of any stipulations, and the

additional rate case expense outlined in the utility's rebuttal testimony, Exhibit 34, and late-filed exhibits 41-43.

ISSUE 37

What are the appropriate monthly bulk and reuse service rates?

The bulk and reuse service rates ultimately determined in this proceeding will be based upon the conclusions reached as to all aspects of the utility's rate base, revenue requirement, and cost of capital. However, it is the utility's position that the appropriate bulk and reuse service rates are those proposed by the utility, updated for the effect of any stipulations, and the additional rate case expense outlined in the utility's rebuttal testimony, Exhibit 34, and late-filed exhibits 41-43.

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?

The amount of the refunds, if any, is subject to the resolution of other issues. However, the PSC requires that any refunds be made (with interest) based on commercial paper rates, even when a utility has secured potential funds with an escrow account. Therefore, to the extent that rule is applied in circumstances where an escrow account is utilized, it is clearly confiscatory.

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?

Rates should be reduced by the amount of the annual effect of rate case expense authorized to be recovered through rates which should be based on those expenses delineated in the utility's

rebuttal testimony, Exhibit 34, and late-filed exhibits 41-43.

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?

The utility agrees that it should provide proof within 90 days of the effective order in this docket that it has adjusted its books for all applicable NARUC USOA primary accounts associated within the Commission approved adjustments, to the extent there is a finding that any such adjustments are warranted.

ISSUE 41

Should this docket be closed?

This docket should be closed after appropriate rates necessary to allow the utility to recover its costs and generate a fair return on its investment, are granted and become final.

CONCLUSION

Based upon the competent and substantial evidence presented by KWRU and reflected in the record in this proceeding; the lack of credible evidence to the contrary; the often specious and conclusiory opinions of OPC's witnesses; and upon consideration of the record as a whole and applicable Florida law; KWRU's application for increase in its rates wastewater rates in Monroe County and the specific rates and other determinations requested therein should be granted by this Commission.

RESPECTFULLY SUBMITTED this 27th day of October, 2008, by:

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of both the Statement of Issues and Positions and the foregoing have been furnished via U.S. Mail or Email* to the following on this 27th day of October, 2008:

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