

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Application for increase in water and wastewater rates in Alachua, Brevard, DeSoto, Highlands, Lake, Lee, Marion, Orange, Palm Beach, Pasco, Polk, Putnam, Seminole, Sumter, Volusia, and Washington Counties by Aqua Utilities Florida, Inc.

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POST-HEARING BRIEF

OF

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PRELIMINARY STATEMENT

Aqua Utilities Florida, Inc. will be referred to as “AUF” or the “Utility.” Aqua America, Inc., will be referred to as “AAI” or “Aqua America.” The Florida Public Service Commission will be referred to as the “FPSC” or the “Commission.” The Office of Public Counsel will be referred to as “OPC.” The Office of the Attorney General will be referred to as the “AG.” The Florida Department of Environmental Protection will be referred to as “FDEP,” and the relevant water management districts as “WMD.”

Citations to the Final Hearing Transcript will be designated as “Tr.” followed by page number. Citations to exhibits will be designated by “Ex.” followed by the exhibit number, and page number, if applicable. The exhibit numbers refer to those assigned in Staff’s Comprehensive Exhibit List for Entry into Hearing Record.

AUF reaffirms its agreement to the stipulations to Issues 5, 8, 15, 26, 33, 35, 37, 47, and 56 as set forth in the Prehearing Order, Order No. PSC-08-0807-PHO-WS (December 4, 2008), and the stipulations to Issue 6 and to the removal of Issue 49, which agreement was reached at the Final Hearing. AUF also reaffirms its agreement to the partial stipulations agreed to at the Final Hearing regarding Issues 7, 9, 10, and 11. Accordingly, AUF’s Post-Hearing Brief does not address those issues that were stipulated and accepted at the Final Hearing.

BASIC POSITION AND CASE BACKGROUND

AUF currently operates 57 water utility systems and 25 wastewater utility systems in the following Florida counties: Alachua, Brevard, DeSoto, Highlands, Lake, Lee, Marion, Orange, Palm Beach, Pasco, Polk, Putnam, Seminole, Sumter, Volusia, and Washington. None of those systems have had a rate case or a base rate increase in over twelve years. Since rates were last established for these systems, AUF has invested significant capital to enhance its quality of service and to comply with applicable federal, state and local regulations. Furthermore, AUF has continued to experience increases in costs and operating expenses.

Despite ongoing efforts to control expenses and enhance revenues, AUF has experienced significant declining rates of return. Therefore, using the historic year 2007 as the test year, AUF has requested an increase in annual water revenues of \$4,518,358, and an increase in annual wastewater revenues of \$3,856,180. AUF's decision to seek additional revenues was not an easy one to make, but was required in order maintain the Utility's financial integrity and allow it to continue to provide reasonable, adequate and efficient service to its customers at reasonable rates. The rate relief requested is not excessive; rather, it is the minimum required to enable AUF to provide quality service and earn a fair rate of return on its investment.

To address affordability and fairness, AUF also has requested that the Commission approve a state-wide uniform rate structure, which includes uniform tariff pricing and a single cost of service, that will result in rates that are more affordable and efficient than those produced by stand-alone rates.

ISSUES AND ARGUMENT

QUALITY OF SERVICE

ISSUE 1: Is the quality of service provided by the Utility satisfactory, and if not, what action should be taken by the Commission?

AUF: *Yes. The quality of service provided by AUF is satisfactory and no further action should be taken by the Commission.*

The record shows that the quality of service provided by AUF to its customers is satisfactory as defined by the Commission. AUF is in general compliance with FDEP and applicable WMD standards, and has a clearly defined strategy to maintain compliance. AUF also has strong commitment to customer service, and is dedicated to improving customer service where needed. Accordingly, no further action by the Commission is needed to ensure quality of service.

The record demonstrates that it is AUF's top priority to ensure compliance with applicable water and wastewater standards and regulations. (Tr. 426-27, 563-64, 1092-94.) The testimony of AUF witnesses Franklin, Lihvarcik and Luitweiler detail the work that AUF has completed to ensure continual environmental compliance and describe AUF's future plans to improve the quality of the water and wastewater services that it delivers to its customers. (Tr. 426, 563-64, 1081-91, 1092-94.) AUF witness Lihvarcik provided a detailed report on environmental compliance for all of the 82 systems that are part of this rate case. (Exs. 78, 79.) The record shows that, out of all of those 82 systems, only five are currently subject to FDEP consent orders. (Tr. 1236.) The record also shows that four out of the five systems are in compliance at this time, and the fifth—Chuluota—is expected to be in full compliance in January 2009, when the next quarterly sampling is completed. (Tr. 1086, 1093, 1238-39; Exs. 206, 210.)

Undisputed evidence demonstrates that AUF has been aggressively addressing water quality issues in Chuluota. (Tr. 1092-94.) AUF witness Luitweiler explained the unique challenges to treat the natural water supply in Chuluota¹ and the actions taken by AUF to address the water quality issues. (Tr. 1093; Exs. 148, 206.) AUF changed to chloramination

¹While the natural water supply presents unique challenges in Chuluota., the record shows that Chuluota residents on average are large users of water relative to AUF's other systems. (Exs. 179, 204.)

treatment, installed new analyzers at the treatments plants, installed auto flushers and retained Dr. James Taylor, a renowned scientist and researcher in innovative water treatments. (Tr. 1081-94.) AUF witness Luitweiler testified that AUF is actively evaluating additional alternative treatments processes recommended by Dr. Taylor. (Tr. 1115-16, 1134.)

The record also demonstrates that AUF has a strong commitment to customer service. AUF has made a substantial investment in radio frequency (“RF”) meters, and has installed RF meters throughout its service area in Florida to ensure accuracy and efficiency in its metering and billing services. (Tr. 427, 441.) AUF has seen significant improvement in its meter reading performance since installing the RF meters. AUF currently has an estimated bill rate of just 1.2% per month, which is a dramatic improvement. (Tr. 507.) As a result of this decrease in the number of estimated bills, customer bills are more predictable and less subject to dispute. (Tr. 443.)

Ample record evidence demonstrates that AUF has implemented a quality improvement program to modernize its customer service management systems and improve performance at its call centers. (Tr. 475.) AUF witness Franklin testified that the quality scores of its customer service representatives has improved to 92% in November 2008. (Tr. 475-76.) This demonstrates that the quality improvement programs and intensive training implemented by AUF have been successful. In addition, the evidence shows that performance metrics in the customer call centers have improved dramatically since the third quarter of 2007 and that AUF’s performance as measured by standard industry metrics are in line with the American Waterworks Association benchmark study. (Tr. 476.) AUF also has a dedicated customer service manager for its Florida operations who has managerial authority to arbitrate and resolve customer issues. (Tr. 508.)

OPC witness Dismukes completely overlooks AUF's proactive efforts to maintain and improve the quality of utility services it provides to customers, and instead recommends that the FPSC take the unprecedented steps of (i) reducing AUF's return on common equity by 150 basis points²; and (ii) disallowing 50% of the salaries of AUF's president and its parent company's president. (Tr. 621, 662, 666.) Close review of the case law and the record shows that OPC's recommended reduction in ROE and disallowance of officers' salaries would violate Commission policy and result in confiscatory rates.

The FPSC has the authority to reduce a utility's return on equity ("ROE") if the utility has failed to provide its customers with water and wastewater service that meets the standards promulgated by the FDEP or the WMDs. *See Gulf Power Co. v. Wilson*, 597 So. 2d 270 (Fla. 1992). The FPSC also has the authority to reduce the utility's return on equity for mismanagement; however, that authority is not unlimited. *Id.* According to the Florida Supreme Court, the Commission's authority to reduce earnings is a "powerful tool" to bring about improved utility services, but it should be used "carefully" so as to avoid depressing earnings to a level that would jeopardize a utility's ability to continue service improvement programs. *See Askew v. Bevis*, 283 So. 2d 337, 340 (Fla. 1973).

Case law shows that the 150 basis point reduction in ROE that OPC recommends exceeds that authorized by law and would be confiscatory. The Florida Supreme Court has warned that a reduction in ROE by the Commission must not cause a regulated utility's authorized return to fall below the reasonable range of return. *See Gulf Power*, 597 So. 2d at 273-74. Recognizing this judicial pronouncement, the Commission's long-standing policy in the water and wastewater area has been to establish a utility's ROE with a range of reasonableness extending 100 basis

²Specifically OPC witness Dismukes recommends that the Commission reduce AUF's ROE by: 50 basis points for water quality deficiencies; 50 basis points for billing and metering deficiencies; and, 50 basis points for customer service deficiencies. (Tr. 662.)

points above and 100 basis points below that return. The Florida Supreme Court has been clear that the ROE cannot be adjusted such that the resulting rate of return falls outside this range of reasonableness. *Id.*; *City of Cape Coral v. GAC Utils.*, 281 So. 2d 493 (Fla. 1973). OPC's recommended ROE reduction of 150 basis points clearly would fall outside of the 100 basis point range which the Commission has consistently recognized in the past. *See* Order No. 17304, 1987 Fla. PUC LEXIS 1268 (rejecting OPC's request for a 200-basis-point reduction of ROE).

In implementing its authority to reduce a utility's ROE, the Commission has been careful to limit such reductions to situations where the utility has flagrantly disregarded the Commission rules and charged unauthorized rates, *see* Order No. PSC-03-0699-SU, 2003 Fla. PUC LEXIS 370; ignored Staff's request for information, *see id.*; or repeatedly violated FDEP regulations, *see* Order No. PSC-98-0763-FOF-SU, 1998 Fla. PUC LEXIS 1176 (ROE reduced by 100 basis points for poor quality of service and mismanagement, where the utility had not had a single satisfactory field inspection by either FDEP or the Health Department, had received numerous warning letters, failed to perform timely after entering into consent agreements with FDEP, and incurred fines and possible penalties in excess of the value of the utilities planned). There is no evidence in this case, and indeed no claim, that AUF has flagrantly disregarded the Commission's rules, charged unauthorized rates, ignored staff's requests for information, or repeatedly violated FDEP requirements. Indeed, AUF has shown a commitment to taking actions beyond that required by law to address the special water treatment challenges in the Chuluota area. (Tr. 1092-94.)

The Supreme Court decision in *Gulf Power* is particularly instructive in addressing whether the Commission should reduce a utility's ROE. In that case, the utility's management

admitted that a senior executive had for years been engaged in corrupt practices such as theft, misuse of utility property and inappropriate political contributions. Because of those extraordinary circumstances, the Commission reduced Gulf Power's rate of return by 50 basis points, but limited that ROE reduction for a period of two years on the basis that utility management had shown a commitment to address its prior problems. During cross-examination, witness Dismukes conceded that none of those extraordinary circumstances which gave rise to the reduction of ROE in the *Gulf Power* case are present in AUF's rate case. (Tr. 848.) Moreover, OPC witness Dismukes could not identify one case where the Commission had reduced a utility's ROE by more than 100 basis points. (Tr. 840, 847.)

Close review of the case law and of the record also show that OPC's recommended disallowance of officer salaries would violate Commission policy and result in confiscatory rates. Although the Commission has the authority to disallow the salaries of officers, it has been careful to do so only where utility management has been ineffective in its duties or has either refused or not shown a good faith effort to provide overall quality of service to its customers. See Order No. PSC-07-0077-PAA-SU, 2007 Fla. PUC LEXIS 56; Order No. PSC-01-1988-PAA-WU, 2001 Fla. PUC LEXIS 1176. In this case, there is no showing that the Utility's management has refused to address customer concerns or has failed to implement quality of service improvements. To the contrary, the evidence shows that the Utility has worked in good faith to comply with all environmental regulations and in fact has gone beyond the requirements of law and hired experts to address the hydrogen sulfide issues in the Chuluota area. (Tr. 1092-94, 1108-09.) The record also shows that AUF's management has been proactive and has aggressively sought alternative sources of water supply in areas like Chuluota where unique water treatment challenges have been issues long before Aqua acquired the systems in 2004.

(Tr. 1082.) *Compare* Order No. PSC-02-0593-FOF-WU, 2002 Fla. LEXIS 324 (disallowing 50% of the president's salary where the utility management was disengaged and extremely slow to react hydrogen sulfide problems). In fact, OPC witness Dismukes recognizes AUF's efforts to address the water treatment challenges in Chuluota and recommends that the Commission "encourage" AUF to take further appropriate actions to resolve those issues in the Chuluota area. (Tr. 813.) AUF respectfully submits that it is taking appropriate actions to resolve the issue and reducing officer salaries does not send the appropriate message to encourage such actions.

In addition to proactively seeking solutions in Chuluota, the record demonstrates that AUF has made significant capital expenditures to put in place highly efficient and accurate RF meters to address billing accuracy issues. (Tr. 427, 441, 443, 506, 699-700.) AUF has also implemented a quality improvement program to modernize its customer service management systems and improve performance at its call centers. (Tr. 475-77.) The punitive salary reductions recommended by the OPC ignores AUF's good faith efforts to provide and improve its quality of service to customers.

OPC's recommendations to reduce the Utility's ROE by 150 basis points and disallow significant portions of officer salaries are unprecedented, unwarranted and would result in confiscatory rates. Thus, those recommendations should be rejected.

RATE BASE

ISSUE 2: Should any adjustments be made to test year plant-in-service balances?

AUF: *Yes. AUF agrees to the adjustments as outlined in its response to the Staff Audit Report, as well as those set forth in the Rebuttal Testimony of Robert M. Griffin. However, established principles of res judicata, fairness and administrative finality require that the Commission honor the rate base values for the Lake Suzy system that it previously established in Order No. PSC-97-0540-FOF-WS. *

Staff auditors have recommended several adjustments to the Utility's test year Utility Plant In Service ("UPIS") balance. (Exs. 119-123.) AUF has agreed to most of those

recommended adjustments. (Tr. 1480-1501; Ex. 140.) However the record and the case law do not support staff auditor's recommended adjustments to UPIS for the Lake Suzy water and wastewater system. Specifically, the staff auditor recommended removal of \$1,617,143 (Ex. 200.) from the Lake Suzy water and wastewater rate base on the basis that AUF failed to provide record support for those plant values (\$526,322 in water plant and \$1,090,821 in wastewater plant). (Tr. 946-47; Ex. 200.) That recommendation essentially would have the Commission disavow the rate base of Lake Suzy that it previously established in Order No. PSC-97-0540-FOF-WS (the "Rate Base Order"). (Ex. 141.) The recommendation, if adopted, would violate principles of res judicata and result in confiscation of utility property. It should be rejected.

Commission practice is to honor and rely on past audits and rate base determinations in making subsequent rate base determinations. *See, e.g.*, Order No. PSC-03-1342-PAA-WS, 2003 Fla. PUC LEXIS 787. Consistent with that practice, staff auditors were given specific instructions to audit rate base for the Lake Suzy system beginning from the time that the Commission last established rate base. (Ex. 119 at 2.) It is undisputed that the rate base for the Lake Suzy system was last audited and established as of June 30, 1996 with the issuance of the Rate Base Order. (Tr. 1482-84, 951; Ex. 141.) It is also undisputed that the Rate Base Order established Lake Suzy water plant in service at \$276,374 and wastewater plant in service at \$948,939, for a total water/wastewater UPIS of \$1,225,313. (Ex. 141.) This rate base was established pursuant to a prior Commission audit, memorialized in the Rate Base Order, and relied on by AUF when it subsequently purchased the system in 2003. (Tr. 1482.) Notwithstanding these facts, when staff auditor updated the rate base for the Lake Suzy system in this case, she did not give AUF any credit for the UPIS plant balances previously established in the Rate Base Order. The record shows that the staff auditor has recommended removing

\$1,617,143 from rate base, an amount that far exceeds the total amount of the Lake Suzy UPIS established in the Rate Base Order.³

There has been no showing in this proceeding that the Commission's prior determination of rate base for Lake Suzy system was erroneous. Thus, as a successor in interest to Lake Suzy Utilities, Inc., AUF should be protected by the doctrine of res judicata from efforts to recalculate (and eviscerate) the rate base values for Lake Suzy that were previously established in the Rate Base Order. *See Metro. Dade County v. Rockmatt Corp.*, 231 So. 2d 41, 44 (Fla. 3d DCA 1970). ("[A] successor in interest to a party bound by the doctrine of res judicata is equally bound thereby as being in privity with the later.") There is no question that the doctrine res judicata applies to administrative proceedings. *See Thomson v. Dep't of Env'tl. Reg.*, 511 So. 2d 989, 911 (Fla. 1987); *Metro. Dade v. Rockmatt Corp.*, *supra*. Consequently, the Commission must honor the Lake Suzy rate base that it previously established in the Rate Base Order.

The record in this proceeding also reveals another serious problem with staff auditor's recommended adjustment to the Lake Suzy rate base. DeSoto County took back regulatory jurisdiction over the Lake Suzy system for the two-year period of 1997 and 1998. (Ex. 140, pp. 45, 47.) AUF acknowledges that the amount of plant and CIAC that was added during that two-year period is not supported with adequate records and thus could be removed from rate base. In recommending removal of plant based on lack of supporting documentation, staff auditor made a corresponding adjustment to CIAC for the Lake Suzy water. However, staff auditor *failed* to make a corresponding adjustment to CIAC for the Lake Suzy wastewater plant. (Tr. 946-47.) This failure to make a CIAC adjustment violates fundamental utility accounting principles that require corresponding adjustments to CIAC when adjustments are made to plant. *See e.g.*, Order

³ As explained *infra*, part of the \$1,617,143 that the staff auditor recommends removing includes \$504,909 which AUF added to plant during 1997-1999 when DeSoto County took back regulatory jurisdiction. When taking this amount into consideration, the record still is clear that staff auditor is recommending a substantial disallowance of the Lake Suzy UPIS established in the Rate Base Order.

No. PSC-02-1733-PAA-WU, 2002 Fla. PUC LEXIS 1099; Order No. 24050, 1991 Fla. PUC LEXIS 231; Order No. 16306, 1986 Fla. PUC LEXIS 600. The record is clear that the vast majority of Lake Suzy water and wastewater plant additions are either developer dedicated or contributed property. Indeed, it is undisputed that 80% of Lake Suzy water plant and 77% of Lake Suzy wastewater plant is contributed. (Tr. 1484.) Thus, removing wastewater plant without adjusting CIAC leaves donated property on the books with no corresponding plant item, which results in a confiscatory understatement of rate base. Accordingly, staff auditor's recommended adjustments to Lake Suzy plant without corresponding adjustments to CIAC are not appropriate.

Based on the foregoing, and as demonstrated in the record, the following adjustments to UPIS are warranted:

| System | Account | AUF Adjustment |
|-------------------|------------------|----------------|
| Water | | |
| Lake Suzy | Plant in Service | (\$190,351) |
| Lake Suzy | CIAC | (\$189,596) |
| Sebring | Plant in Service | (\$13,892) |
| Lake Josephine | Plant in Service | 203 |
| Lake Josephine | CIAC | \$1,801 |
| Wastewater | | |
| Lake Suzy | Plant in Service | (\$504,909) |
| Lake Suzy | CIAC | (\$733,536) |
| Lake Suzy | Accum Amort CIAC | (\$52,113) |

(Tr. 1481.)

ISSUE 3: Should any adjustments be made to test year land?

AUF: *Yes. To reflect the appropriate 13-month average balance, land for the Lake Suzy wastewater system should be reduced by \$171,667.*

The record shows that staff auditors have recommended a \$229,259 adjustment to the Lake Suzy wastewater land balance to reflect (i) the land value previously established by the Commission and (ii) a sale of 5.97 acres of utility that occurred on December 31, 2007. (Tr. 951.) AUF agrees in principle to the adjustment; however, testimony shows that the staff

auditors improperly calculated the 13-month average land balance assuming that the sale of the 5.97 acres occurred in December of 2006. (Tr. 1484.) The proper and most accurate way to calculate the 13-month average is to use the actual date of the land sale, which is December 31, 2007. (*Id.*) Thus, the appropriate adjustment is \$171,667, which is the 13-month average of land value based on the actual date of the land sale. (*Id.*; Ex. 180.)

ISSUE 4: Should adjustments be made to the Utility's pro-forma plant additions?

AUF: *Certain adjustments should be made to the Utility's pro-forma plant additions concerning: the customer service renovation project; the Chuluota wastewater effluent disposal project; the South Seas wastewater effluent disposal project; the Valencia Terrace SCADA project; the Village wastewater effluent disposal site project; and the newly installed Lake Josephine water treatment plant.*

Evidence adduced at the hearing shows that four projects should be adjusted out of the pro-forma plant additions because plant will not be placed into service by year-end 2008. Those projects are: the customer service renovation project which will result in a reduction of (\$8,470); the Chuluota wastewater effluent disposal project which will result in a reduction of (\$50,000); the South Seas wastewater effluent disposal project which will result in a reduction of (\$80,000); and the Valencia Terrace SCADA project which will result in a reduction of (\$25,000). (Tr. 1493-94.)

The evidence also demonstrates that two other pro-forma additions - the Village wastewater effluent disposal site project and the new Lake Josephine wastewater treatment plant - should be adjusted because the actual amounts spent on the projects differed from the amount included in the Utility's MFRs. (Tr. 1493; Ex. 180.) The Village wastewater effluent disposal site project was originally estimated to cost \$350,000, but has since been bifurcated such that only \$180,000 of the original estimated amount will be spent and closed to UPIS before December 31, 2008. The remaining \$170,000 of the effluent disposal project will be deferred at a future time and amortized over the life of the permit. The impact of this adjustment will result

in a reduction in rate base of (\$170,000). (Tr. 1495.) With respect to Lake Josephine's new wastewater treatment plant project, the cost of the project has increased from the original estimate of \$350,000 to \$694,000 (Tr. 1495; Comp. Ex. 65, Tab 19 (Staff's Request for Production No. 23).)

During the course of the hearing, AUF provided updated actual amounts spent on the pro-forma additions through October 31, 2008. (Comp. Ex. 65, Tab 33, Late-Filed Exhibit 7.) In addition, invoices for the Jasmine Lakes effluent pond in the amount of \$298,009.24 and \$45.46 were processed in November 2008. (Composite Ex. 65, Tab 33, Late-Filed Exhibit 7.) With the exception of the customer service renovation project, the Chuluota wastewater effluent disposal project, the South Seas wastewater effluent disposal project and the Valencia Terrace SCADA projects, all pro-forma additions claimed in this case will be spent and closed by year-end 2008. (Tr. 1513.)

OPC witness Dismukes claimed that the Utility's capital expenditures for 2006 and 2007 had varied significantly from budget, and therefore recommended that the Commission reduce the Utility's pro-forma plant by approximately \$1.5 million. (Tr. 795.)⁴ However, the record shows that Ms. Dismukes' budget variance claims are based on erroneous and out-dated information, and fail to take into account actual capital expenditures made by the Utility. (Tr. 795-98.) The record also shows that OPC's recommended adjustment to pro-forma plant is not based on competent substantial evidence; rather, it is based on the faulty assumption that AUF would make capital expenditures during the last 5 months of 2008 at a "constant rate", i.e., at the same rate that it made capital expenditures in the first 7 months of the year. (*Id.*) On cross-examination, witness Dismukes conceded that her "constant rate" adjustment does not take into account actual expenditures made by the Utility subsequent to July 31, 2008, which were

⁴ Ms. Dismukes orally amended her original figure to \$1,514,894 at the final hearing. (Tr. 617, 795.)

provided as record evidence in the rebuttal and deposition testimony of AUF witness Griffin. (Tr. 798, 1484, 1488-91, 1513.) Witness Dismukes also admitted that her “constant rate” adjustment does not give AUF credit for any increase in capital expenditures during the fourth quarter of 2008. (Tr. 798.)

Witness Dismukes also recommends that an averaging adjustment be made to the Utility’s pro forma plant additions. (Tr. 705.) This “averaging” adjustment ignores long-standing Commission policy to include pro forma items at full cost and not to apply an average to the requested amount.⁵ Record evidence also shows that OPC’s “averaging” adjustment would limit the Utility from recovering the prudent cost of the plant, which would likely require the Utility to come back for another rate increase sooner than would be required under current Commission practice. (Tr. 1492.)

In summary, the “constant rate” and “averaging” adjustments recommended by OPC fail to take into account evidence supporting actual expenditures, and ignore Commission precedent. Therefore, those adjustments must be rejected.

ISSUE 7: What are the appropriate used and useful percentages for the water treatment and related facilities of each water system?

AUF: *Other than the stipulations agreed to and accepted during the course of the proceeding, the appropriate used and useful ("U&U") percentages for the remaining water treatment and related facilities for each water system are identified in AUF’s MFRs and in the Direct and Rebuttal Testimony of John Guastella.*

During the course of the proceeding, OPC and AUF were able to agree to either full or partial stipulations on U&U percentages for many of the water treatment and related systems that are part of this rate case. (Tr. 314.) U&U issues on which the parties disagreed are largely

⁵ See Order No. PSC-07-0609-PAA-WS, 2007 Fla. PUC LEXIS 342; Order No. PSC-07-0082-PAA-SU, 2007 Fla. PUC LEXIS 59; Order No. PSC-07-0505-SC-WS, 2007 Fla. PUC LEXIS 310; Order No. PSC-07-0134-PAA-SU, 2007 Fla. PUC LEXIS 87; Order No. PSC-07-0130-SC-SU, 2007 Fla. PUC LEXIS 85; Order No. PSC-07-0205-PAA-WS, 2007 Fla. PUC LEXIS 130; Order No. PSC-07-0287-PAA-WS, 2007 Fla. PUC LEXIS 179; Order No. PSC-03-0699-SU, 2003 Fla. PUC LEXIS 370.

attributable to OPC witness Woodcock's deviation from Commission Rule 25-30.4325(4) (the "Single-Well Rule"), his refusal to treat built-out systems as 100% U&U, and his failure to make proper fire flow adjustments.⁶ These deficiencies are addressed below.

The Fern Terrace, Rosalie Oaks, and Twin Rivers systems each have a single well. (Tr. 317.) The Commission has repeatedly held that where, like here, the service territory is served by a single well, Rule 25-30.4325(4) requires that "a water treatment system with one well should be considered 100 percent used and useful." Order No. PSC-08-0593-PAA-WU, 2008 Fla. PUC LEXIS 414; *see also, e.g.*, Order No. PSC-96-1320-FOF-WS, 1996 Fla. PUC LEXIS 2075. Notwithstanding this clear regulatory directive, OPC witness Woodcock essentially ignores the Single-Well Rule and claims that general provisions in Rule 25-30.4325(3) authorize an alternative calculation if the well is greater than 150 gpm or if the alternative calculation produces a U&U percentage of less than 75%. Mr. Woodcock's reliance on the general language in Rule 25-30.4325(3) is misplaced. As shown above, Rule 25-30.4325(4) is specific to the instant situation, thus subsection (3) – a more general rule – must yield. *See, e.g., Palm Beach Canvassing Bd. v. Harris*, 772 So.2d 1273, 1287 (Fla. 2000) (explaining that specific provisions of law govern over those more general). Moreover, AUF respectfully submits that the exceptions to the Single-Well Rule advocated by Mr. Woodcock would generate the very same unnecessary costs and inefficiencies that the Commission sought to avoid by adopting the Single-Well Rule in the first instance. *See, e.g.*, Docket No. 070183-WS, Staff Memorandum (Mar. 27, 2008). On cross-examination, Mr. Woodcock acknowledged that the Commission "has

⁶ OPC also disagreed with AUF's approach of treating a system as 100% U&U if its calculated U&U ratio equals or exceeds 90%. Contrary to claims by OPC witness Woodcock, considering a system to be 100% U&U when the applicable formula produces a ratio of 90% is not mere arithmetic rounding. Instead, it is a proper evaluation of cost that should be recognized as necessary to provide service to existing customers taking into account prudence of investment, economies of scale and other factors specifically recognized by Commission Rule 25-30.4325(2). (Tr. 347.) *See also* Order No. PSC-03-1440-FOF-WS (Commission found that it is not unreasonable to consider distribution and collection systems that are 80% or more built-out to be 100% U&U in instances where there is no real growth potential and the existing lines are the minimum size needed to serve existing customers).

consistently found that water systems with one well are 100 percent used and useful unless it appears that the system was not prudently designed.” (Tr. 336.) Mr. Woodcock testified that he found nothing “imprudent” in his evaluation of these systems. (Tr. 337-38.) Accordingly, there is no basis for the Commission to determine that AUF systems served by one-well - including Fern Terrace, Rosalie Oaks, and Twin Rivers - are less than 100% U&U.

The record also shows that many of AUF's systems, including Arredondo Estates, Arredondo Farms, Tomoka and Twin Rivers are built out. (TR. 352.) Rule 25-30.4325(4) and Commission precedent require that those systems be considered as 100% U&U unless it appears that the system was not prudently designed. *See, e.g.,* Order No. PSC-03-1440-FOF-WS, 2003 Fla. PUC LEXIS 864. Mr. Woodcock ignores the rule and the precedent and instead uses his own unique calculation to produce a U&U percentage of less than 100% for Arredondo Estates, Arredondo Farms, Tomoka and Twin Rivers even though those systems each are built out. (Tr. 305, 336-37.) OPC witness Woodcock has made no showing that these systems were imprudently designed. (Tr. 337-38.) Thus, there is no basis for the Commission to determine that Arredondo Estates, Arredondo Farms, Tomoka and Twin Rivers are less than 100% U&U.

OPC also proposes to eliminate fire flows from U&U calculations for Chuluota, Silver Lake Estates/Western Shores, Sunny Hills and Skycrest based on his claim that “hydrants are not located throughout the service area” or “when pipes for the hydrants were less than six inches in diameter.” (Tr. 306-07.) OPC's proposal is without merit and ignores Commission precedent. Indeed, Commission practice has been to allow fire flow even in the systems that have limitations on the amount of fire flow available. *Id.; see also* Order No. PSC-96-1320-FOF-WS, 1996 Fla. PUC LEXIS 2074 (Commission found that it is appropriate to include fire flow in the U&U analysis, even if that protection is only available to a limited number of customers in the

service area). There has been no showing that the appropriate authorities have cited AUF for inadequate fire protection. *Id.* In fact, on cross-examination, OPC witness Woodcock stated that he was not alleging any of the AUF systems had been cited for improper fire protection. (Tr. 335.) Accordingly, the Commission should reject OPC's recommendation to exclude fire flow from the U&U calculations.

ISSUE 9: What are the appropriate U&U percentages for the wastewater treatment and related facilities of each wastewater system?

AUF: *Other than the stipulations agreed to and accepted during the course of the proceeding, the appropriate U&U percentages for the remaining wastewater treatment and related facilities for each wastewater system are identified in AUF's MFRs and in the Direct and Rebuttal Testimony of John Guastella.*

During the proceeding, OPC and AUF reached either full or partial stipulations on U&U percentages for many of the wastewater treatment plants ("WWTPs") and related facilities that are part of this rate case. The primary area of disagreement involved the Chuluota and the Woods WWTP. With respect to the Chuluota plant, OPC witness Woodcock ignored the FDEP permitted capacity of 100,000 gpd and instead used design capacity in the denominator of his Demand-to-Capacity ratio. (Tr. 320-21.) This is in direct contravention of Commission Rule 25-30.432, which requires that the FDEP "permitted capacity shall be used in the denominator of the [U&U] equation." (Emphasis added.) Notably, there has been no showing that the Chuluota WWTP was imprudently designed.⁷

OPC witness Woodcock also uses an improper demand-to-capacity equation for calculating the U&U percentage for The Woods WWTP. Undisputed evidence in the record shows that the FDEP permitted capacity for The Woods plant is based on the average demand for the maximum 3 consecutive months. (Tr. 288-89.) As such, the Commission requires that

⁷ To the contrary, unrebutted testimony of AUF witness Luitweiler demonstrates that the plant was well designed and the capacity was established based on reasonable growth projections at the time. (Tr. 1095-1100.) In fact, compelling evidence shows that AUF considered constructing a smaller plant, but minimal savings were projected due to required duplication of key sludge plant processes. (Tr. 1096-97.)

demand in the numerator of the U&U percentage also use the maximum 3 consecutive month flow. Rule 25-30.432, Fla. Admin. Code. Mr. Woodcock ignores the directives of Rule 25-30.432 and uses the average daily flow instead of maximum 3 consecutive month demand which is the basis for the FDEP permitted capacity. This flawed calculation causes a confiscatory understatement of the U&U percentage for The Woods WWTP.

ISSUE 10: What are the appropriate used and useful percentages for the water distribution and related facilities of each water system?

AUF: *Other than the stipulations agreed to and accepted during the proceeding, the appropriate U&U percentages for the remaining water distribution and related facilities for each water system are identified in AUF's MFRs and in the Direct and Rebuttal Testimony of John Guastella.*

During the proceeding, OPC and AUF reached partial stipulations on U&U percentages for many of the water distribution and related facilities for certain systems. Those instances where the parties were not in agreement are largely attributable to OPC witness Woodcock's refusal to accept AUF's ERCs-to-lots on lines method for calculating U&U percentages for water mains (and wastewater collection lines). The record confirms that AUF's ERCs-to-lots on lines calculation accurately recognizes that water mains (and wastewater collection lines) must be designed to cover all distances in a utility grid system as well as to meet customer demand. (Tr. 285, 355-56.)⁸ See *S. States Utils. v. Fla. Pub. Svc. Comm'n*, 714 So. 2d 1046 (Fla. 1st DCA 1998); *Palm Coast Util. Corp. v. Fla. Pub. Svc. Comm'n*, 742 So. 2d 482 (Fla. 1st DCA 1999).

ISSUE 11: What are the appropriate used and useful percentages for the collection lines and related facilities of each wastewater system?

AUF: *Other than the stipulations agreed to and accepted during the proceeding, the appropriate U&U percentages for the remaining wastewater collection lines and related facilities for each wastewater system are identified in AUF's MFRs and in the Direct and Rebuttal

⁸ By comparison, the record also shows that Mr. Woodcock recommended ratio of ERCs-to-ERCs does not provide sufficient cost recovery for mains that are designed to meet demands as well as cover distances. (Tr. 355-56.) The record shows that the Commission has consistently accepted AUF's calculations of ERCs-to-lots, and that courts have rejected attempts to change the Commission's policy of using ratios of ERCs-to-lots and convert to using ERCs-to-ERCs ratios.

Testimony of John Guastella. Further, these percentages should not be applied to force mains or lift stations.*

For the same reasons discussed in Issue 10 herein, OPC provides no legitimate basis for the Commission to require AUF to deviate from its established practice of using ERCs-to-lots on lines as the ratio to calculate U&U percentages for collection lines and related facilities for its wastewater systems. In addition, testimony shows that there are no customers connected to wastewater force mains; instead, those force mains accommodate wastewater from multiple customers as well as influent and infiltration and are designed to enable to transfer that wastewater to treatment plants independent of the number of customers. (Tr. 286, 358.) The record shows that the size and cost of these lift stations and force mains do not significantly fluctuate if more or less customers are added to the systems. Thus, there is no legitimate rationale to support OPC's recommendation to apply U&U percentages to wastewater force mains and related lift stations.

ISSUE 12: What is the appropriate method for calculating the used and useful percentages of water treatment and related facilities for water systems that are interconnected?

AUF: *The U&U percentages of water treatment and related facilities that are interconnected should be individually evaluated if each system were designed and constructed as an independent system.*

The record shows that U&U percentages of water treatment and related facilities that are interconnected should be individually evaluated if a facility was initially designed and constructed as an independent system. (Tr. 350-51.) The policy underlying this approach is that the cost to serve the customers of each system was incurred on an individual basis and thus should be recognized for rate setting purposes on that basis. (Tr. 350.) OPC's rigid protocol for treating interconnected systems as one system without taking into consideration unique factors is inappropriate in several situations. For example, OPC witness Woodcock treats the East Lake Harris Estates and the Friendly Center systems as one interconnected system, when in fact both

of those systems were developed individually and subsequently connected for purposes of achieving better reliability. (Tr. 350.) OPC witness Woodcock also treats the Sebring Lakes system and the Lake Josephine system as one system when in fact those systems were originally developed as separate systems and their interconnection is only for the purpose of emergency. In fact, the record shows that FDEP requires that interconnection to remain closed except in emergencies. (Tr. 351.) To now treat those systems as one system produces a lower U&U percentage and would improperly penalize the Utility for finding after-the-fact opportunities to improve reliability through interconnection.

ISSUE 13: What is the appropriate method for calculating the used and useful percentages of water treatment and related facilities of water systems that are actually stand-alone systems that have been combined for rate base purposes in this proceeding?

AUF: *Systems that are functionally integrated for accounting, management, administrative and operational purposes but are physically stand-alone systems should be evaluated as individual systems for calculating U&U percentages.*

Systems that are functionally integrated for accounting, management, administrative and operational purposes but are physically stand-alone systems should be evaluated as individual systems for calculating U&U percentages. This is because the cost to serve customers was incurred on an individual basis, and thus should be recognized for rate setting purposes on that basis. (Tr. 350-51.)

ISSUE 14: Should any adjustments be made to test year accumulated depreciation?

AUF: *AUF agrees with certain Staff adjustments made in this case, as outlined in the rebuttal testimony of AUF witness Robert Griffin.*

The record shows that the following adjustments to accumulated depreciation are warranted:

| Name | A/D |
|----------------------|----------|
| Lake Suzy Water | \$36,122 |
| Lake Suzy Wastewater | \$46,122 |
| Lake Josephine Water | \$17,395 |

| Name | A/D |
|---------------------|----------|
| Sebring Lakes Water | \$ 4,005 |
| Lake Osbourne Water | \$ 941 |
| Arrendondo Water | \$16,992 |
| Jasmine Lakes Water | \$35,249 |

(Tr. 1481.)

ISSUE 16: Should any adjustments be made to accounts receivable for officers and employees?

AUF: *No. This is a normal recurring business operation and should be included in the working capital calculation.*

ISSUE 17: Should any adjustments be made to other deferred debits?

AUF: *No.*

No adjustments should be made to other deferred debits. (Tr. 1505-06.) OPC, however, contends that two types of adjustments are warranted totaling \$217,890. First, OPC recommends an adjustment to correct the balance of deferred debits related to what is claimed to be the proper balance of deferred maintenance amortization. Staff appears to agree with OPC only to the extent that of an adjustment of \$11,213 to reflect amortization of deferred maintenance projects. *See* Order No. PSC-08-0807-PHO-WS at 17.

OPC also recommends a much broader adjustment based on its claim that deferred maintenance balance in overall working capital be allocated over the entire company instead of tracking the items system-by-system as AUF does now. (Tr. 925.) The record shows that AUF's system specific method is far more accurate and appropriate to that recommended by OPC witness Merchant. Indeed, AUF's direct accounting method consistently and properly identifies payments to each individual system and then records the deferred debit and offsetting expense amortization to the individual system's accounting unit. (Tr. 1504-08.) OPC fails to recognize the significant difference in the way that deferred debits, net income and debt are recorded. Deferred debits are recorded to system specific accounting units, while net income and debt are

recorded to the total company balance sheet. That difference, which is overlooked by OPC, is the underlying reason why the deferred debit component of working capital is directly assigned to individual systems. Because AUF already accurately maintains the deferred debit balances by individual system, it would be inappropriate to create another allocation to spread over the entire company. (Tr. 925.)

ISSUE 18: Should any adjustments be made to accrued taxes?

AUF: *Yes. However, the adjustment should reflect (a) the allocated portion of deferred taxes on IT equipment; (b) the average amount of accrued taxes; and (c) the calculated amount of taxes based on the revenue requirement decided by the Commission*

OPC witness Merchant recommends that an adjustment of \$1,812,682 to Accrued Taxes is appropriate to recognize that AUF will be given a fully compensatory income tax expense through its revenue requirement. (Tr. 927-31.) The record shows that Ms. Merchant's calculations contain structural flaws. As explained by AUF witness Griffin, Ms. Merchant's recommended adjustment of \$1,812,682 adjustment is for a full year affect⁹, and she applies that amount dollar-for-dollar against AUF's average accrued tax balance of (\$1,155,342), which is based on a thirteen month methodology. Had Ms. Merchant's recommended adjustment been based on a thirteen month method, approximately one half of the adjustment, or \$906,341, would be applied against AUF's average accrued tax balance. (Tr. 1510.) The record also shows that OPC witness Merchant's deferred tax recommendation will distort accrued taxes because (1) it failed to allocated only 65.85% of the deferred tax on IT equipment; (2) it failed to utilize a thirteen month average; and (3) its adjustments for Corporate IT and Corporate Capital Structures and Improvements are duplicative. (Tr. 935-36.)

ISSUE 19: Should any adjustments be made to pensions and other operating reserves?

⁹ OPC witness Merchant's recommended \$1,812,682 adjustment is based on the assumption that AUF receives the full amount of its revenue requirement proposed in the MFRs. The actual amount of the adjustment will be subject to resolution of the other issues in the proceeding.

AUF: *No. The amount of pensions and other operating reserves is already properly reflected in the MFRs. No further adjustment is appropriate.*

The pension reserves and the miscellaneous operating reserves for the test year are already reflected in the cash working capital calculation contained on MFR Schedule A-17, line 16 under "Miscellaneous Current & Accrued Liabilities," and are included on MFR Schedule A-19, line 17. (Ex. 180.) Because these balances have already been included in the cash working capital calculation, no further adjustment is required. To do otherwise would be duplicative and confiscatory.

ISSUE 20: Should any adjustments be made to deferred rate case expense?

AUF: *Yes.*

Consistent with Commission practice, AUF's average deferred rate case expense should be included in the working capital allowance. The appropriate amount of deferred rate case expense should be updated to include the revised rate case expenses set forth in Exhibit 217.

ISSUE 21: What is the appropriate working capital allowance?

AUF: *The appropriate working capital allowance is subject to the resolution of the other issues in this proceeding.*

ISSUE 22: Should a negative acquisition adjustment be included in rate base?

AUF: *No. Imposing a negative acquisition adjustment in this case would violate principles of res judicata and due process and contradict past Commission precedent.*

OPC witness Dismukes claims that AUF's rate base should be reduced because AUF purchased utility facilities from Florida Water Services Company ("FWSC") in 2004 at a price below book value. Ms. Dismukes' recommendation conveniently overlooks that the Commission expressly considered and determined that a negative acquisition adjustment was not appropriate when it approved AUF's proposed acquisition - a decision on which AUF relied in acquiring the FWSC facilities. The final order approving AUF's acquisition of the FWSC facilities makes it

clear that an "acquisition adjustment shall not be included in rate base." Order No. PSC-05-1242-PAA-WS, *reaffirmed* by Order No. PSC-05-1242A-PAA-WS ("Acquisition Order").¹⁰

There has been absolutely no showing that the Commission's Acquisition Order was based on error or mistake. Nor has there been any showing that it was unreasonable for AUF to rely on the Acquisition Order in acquiring the FWSC systems. What the record shows is that OPC and AUF both actively participated in the acquisition docket and thus should be bound by the Commission's final pronouncement in that proceeding. Established principles of res judicata, fairness and estoppel require that the Commission honor its past Acquisition Order and refrain from imposing a negative acquisition adjustment in this case. *See Thomson v. Dep't of Env'tl. Reg.*, 511 So. 2d 989, 911 (Fla. 1987)(finding that the doctrine res judicata applies to administrative proceedings); *Metro. Dade County v. Rockmatt Corp.*, 231 So. 2d 41 (Fla. 3d DCA 1970).

Equally flawed is Ms. Dismukes' claim that the *Jasmine Lakes* decision - Order No. PSC-93-1675-FOF-WS - supports her recommendation of a \$1,892,074¹¹ negative acquisition adjustment. The *Jasmine Lakes* decision is clearly distinguishable from this case. *Jasmine Lakes* was a Class "B" Utility, providing water and wastewater service with a combined rate base of \$558,092 in 1990. There, the Commission recognized a \$17,753 negative acquisition adjustment because it was undisputed that extraordinary circumstances existed at the time the utility system was acquired, namely: the prior owner was negligent and had neglected the utility for over seven years prior to the transfer; the utility was not properly functioning at the time of

¹⁰ Ms. Dismukes' claim that no party presented evidence in the earlier acquisition docket is disingenuous. The public record shows that OPC was an active participant in Docket Nos. 040951-WS and 040952-WS that culminated the issuance of the Acquisition Order. OPC is experienced in filing petitions on transfer cases, *see, e.g.*, Docket No. 971220-WS, (OPC timely filed petition to order approving transfer), but chose not to file a protest to the negative acquisition adjustment decision in this case.

¹¹ At the hearing, Ms. Dismukes stated that she had calculated the negative acquisition adjustment was wrong, and adjusted her recommendation down \$810,889 to \$1,892,074. (Tr. 617.)

the transfer; the Commission's prior order approving the transfer - Order No. 23728 –had adjusted the utility's rate base for "repairs and improvements " that were required in order for the utility to properly function; and, the purchase of the utility for less than book value was directly tied to the prior owner's negligent operation of the system.¹² As OPC argued in that case, the adjustment was necessary to “insulate the ratepayers from failures or negligence by the prior utility management.”

There are no such extraordinary circumstances present in AUF’s case. There has been no showing that the FWSC systems were abandoned or were not properly functioning utilities at the time they were acquired by AUF. AUF does not dispute that it purchased some older systems that in the ordinary course of time would require repairs and capital dollars to maintain. But the record shows that prior to acquiring the FWSC facilities AUF had “performed a reasonable investigation of the utility system and found the overall condition of the water and wastewater facilities to be in satisfactory condition[.]” Acquisition Order at 3. The Acquisition Order also makes it clear that Commission staff performed an independent evaluation and confirmed that none of the facilities being acquired were subject to FDEP enforcement actions at the time of the acquisition. *Id.* The undisputed testimony of AUF witness Luitweiler also shows that all of the FWSC systems were in environmental compliance at the time of acquisition. (Tr. 1140; 560.) Thus, unlike *Jasmine Lakes*, it cannot be said, nor does OPC assert, that a negative acquisition adjustment is necessary to “insulate the ratepayers” from any alleged FWSC “negligence.”

Furthermore, AUF purchased 58 water and wastewater systems from FWSC, not one negligently run-down system as was the case in *Jasmine Lakes*. Ms. Dismukes admits that, of these 58 systems, “Aqua America purchased [only] several of FWSC systems that were old and in poor condition and would require considerable funds to improve and operate properly.” (Tr.

¹² Furthermore, unlike here, OPC did not participate in the earlier transfer docket involving *Jasmine Lakes*.

712.) Her discussion of the 9 former FWSC systems only points to operational issues encountered in running any water and wastewater utility. (Tr. 1499.) There is no description of the condition of the assets AUF acquired for the remaining 49 FWSC systems. Her reference to 9 of 58 former FWSC systems is simply inadequate to prove extraordinary circumstances to justify a \$1,892,074 negative acquisition adjustment.

Finally, the *Jasmine Lakes* order was issued on November 18, 1993, and the Commission's acquisition adjustment rules have since changed. Commission Rule 25-30.0371 was adopted in August 2002, replacing the Commission's former case-by-case acquisition adjustment policy. Ms. Dismukes has not presented one recent case in which the Commission found a negative acquisition adjustment to be appropriate in conditions truly similar to those in this case.

There is no credible basis in the record for any negative acquisition adjustment.

ISSUE 23: What is the appropriate rate base for the December 31, 2007, test year?

AUF: *The appropriate rate base for the December 31, 2007 test year is subject to the resolution of the other issues in this proceeding.*

COST OF CAPITAL

ISSUE 24: What is the appropriate capital structure to use for rate setting purposes?

AUF: *The appropriate capital structure to be used for rate setting purposes is the capital structure of AUF.*

The appropriate capital structure to be used for rate setting purposes is the capital structure of AUF. OPC has provided no credible evidence to support any other capital structure. In fact, the evidence on which OPC relies is fundamentally flawed. In setting rates for a regulated company, Commission practice is to use the capital structure of the regulated wholly-owned subsidiary and not that of the company's parent. *See* Order No. PSC-05-0902-S-EI, 2005 Fla. PUC LEXIS 107 (the wholly-owned subsidiary's capital structure was used in establishing

rates and not that of the parent.); *compare* Order No. PSC-08-0327-FOF-EI, 2008 Fla. PUC LEXIS 203 (parent's capital structure used where the regulated entity was a division and not a wholly-owned subsidiary.) The record provides no compelling reason to deviate from that practice. Indeed, undisputed evidence shows that AUF is a separate wholly-owned subsidiary of Aqua America, Inc. (“AAI”), has its own board of directors, and operates exclusively in Florida. (Tr. 170, 183, 213-14, 231.) Moreover, AUF has its own books upon which its own capital structure is properly recorded. (Tr. 223-24.) AUF treasurer Stephen Anzaldo testified that the AUF capital structure reflects the unique risks that the Utility faces in Florida. (Tr. 214, 231.)

OPC witness Rothschild recommends that the Commission not use AUF’s capital structure to set AUF’s rates. Instead he recommends that the capital structure of AUF’s parent, AAI, be imputed for rate setting purposes. (Tr. 122, 125, 130.) On cross-examination, OPC witness Rothschild admitted that he made this recommendation solely on the basis of his review of AAI’s consolidated financial statement and not on any review of AUF’s books and records. (Tr. 179-180.) Moreover, OPC witness Rothschild did not take into account that AUF’s capital structure reflects unique risks that the Utility confronts in Florida. (Tr. 187.) His recommendation is further based on a flawed understanding of the audited AAI consolidated financial statement and there was apparently no attempt to review AUF’s MFRs in this case.

In recommending the use of AAI’s capital structure, Mr. Rothschild suggests that AUF’s capital structure understates debt. (Tr. 161.) More specifically he claims that AAI has issued approximately \$392 million of debt financing that support the regulatory operations of AUF and other AAI subsidiaries, and then claims that the \$392 million dollars are “not reflected on the books of any Aqua America, Inc.’s subsidiaries.” (Tr. 127.) This is simply incorrect. On cross-examination, OPC witness Rothschild conceded that this claim was based solely on his

interpretation of AAI's consolidated financial statement of AAI, and that he did not review any of the book or records of AUF in making this statement. (Tr. 178-180.) Witness Rothschild's claim was specifically refuted by the AUF treasurer Steven Anzaldo who, on cross-examination by OPC counsel testified that the appropriate portion of that \$392 million in debt financings in fact does appear as debt on the books of AUF. Mr. Anzaldo specifically testified that \$26,126,123 of the \$392 million is properly reflected as debt on AUF's own books, in its MFRs, and on AUF's annual report filed with the Commission. (Tr. 223-24; Ex. 180.)

Mr. Anzaldo also testified that it would be inappropriate to use AAI's capital structure to set rates for AUF because the AAI capital structure contains debt items from industrial development bonds and state revolving funds in Illinois, New Jersey, New York, Maine, Ohio and Pennsylvania which are not available for use in Florida. (Tr. 216.) Mr. Anzaldo recommended that if the Commission elects to use the AAI capital structure to set AUF's rates, the AAI capital structure should be adjusted to eliminate that short-term debt and restricted debt financing that cannot be used in Florida. Evidence shows that the adjusted AAI capital structure would be as follows: Common Equity - 58.26%; Long-term Debt - 38.67%; Customer Deposits - .78%; and, Deferred taxes - 2.29%. (Ex. 134.)

Finally, the record refutes OPC's claim that AUF's equity ratio of 62.31% is inefficient. During the proceeding it became evident that other utilities regulated by the Commission have approved equity ratios of approximately 60%,¹³ and that OPC witness Rothschild did not consider those factors in recommending the Commission impute a much lower equity ratio to AUF in this case. (Composite Ex. 65, Tab 28, pp. 37-38.) Furthermore, the Commission's recent decision in Docket No. 080006-WS makes it clear that any alleged cost impact brought about by

¹³Order No. PSC-08-0436-PAA-GU, 2008 Fla. PUC 319 (60% equity ratio approved for St. Joe Natural Gas); Order No. PSC-05-0902-S-EI, 2005 Fla. PUC LEXIS 107 (55.83% equity ratio approved for FPL).

AUF's equity ratio would be offset by operation of the Commission's leverage formula. When the Commission approved Staff's recommendation in that docket, it specifically recognized that the "ROE leverage formula specifically adjusts the cost of equity based on the financial leverage of the subject company. . . . Therefore, the issue witness Rothschild raised about the recovering the cost resulting from an inefficient capital structure from a utility's customers is unwarranted with respect to WAW utilities in Florida." Staff Recommendation at 11. Thus, as noted in Docket No. 080006, any concern raised by OPC with respect to the costs of AUF's alleged "inefficient" capital structure would be unwarranted if the Commission uses the leverage formula to establish AUF's ROE.

In summary, the record shows that AUF has an identifiable, legitimate, and properly recorded capital structure that most accurately reflects the risks and cost of service to its customers. Accordingly, AUF's capital structure should be used to set AUF's rates in this proceeding.

ISSUE 25: What is the appropriate amount of accumulated deferred taxes to include in the capital structure?

AUF: *The appropriate amount of accumulated deferred taxes to include in the capital structure is \$1,213,359.*

The record shows that accumulated deferred income taxes depicted in the Utility's MFRs should be adjusted upward to take into account taxes related to IT equipment and 2008 pro-forma plant additions. (Tr. 217-18, 935-36; Ex. 180.) However, in calculating the adjustment to accumulated deferred taxes in capital structure, OPC witness Merchant made three errors:

- She failed to account for required averaging of taxes. (Tr. 217.)
- She improperly included total Florida values for taxes related to IT equipment instead of using the appropriate portion of the total that should be allocated to the Commission-regulated systems that are part of this rate case. (Tr. 217.)
- She makes a duplicative adjustment by including an average balance of deferred taxes related to Corporate IT and Corporate Structure and Improvements when in fact that

deferred tax balance had already been allocated to capital structure of each AUF system. (Tr. 218.)

The record shows that after those errors are corrected, the appropriate adjustment would be to increase accumulated deferred taxes in the capital structure by the average amount of \$395,098. (Tr. 218.) Finally, the record shows that OPC witness Merchant fails to recognize the offsetting impact of the deferred tax adjustments on current accrued taxes. (Tr. 218.)

ISSUE 27: What is the appropriate cost rates for short-and long-term debt for the test year?

AUF: *The appropriate cost rate for long-term debt for the test year is 5.1%. AUF has no short-term debt for AUF.*

The record shows that AUF's cost of long-term debt is 5.1%. (Tr. 215.) Record evidence also demonstrates that AUF's capital structure does not have short term debt. (Tr. 216.) As explained under Issue 24, there are sound regulatory, policy and legal reasons to adhere to the AUF capital structure in setting AUF's rates. (Tr. 216-17.) If, however, the Commission decides to ignore AUF's capital structure and set rates using AAI's capital structure (which AUF respectfully submits would be improper), the evidence shows that AAI's weighted cost of long-term debt is 6.27%, when adjusted to remove subsidized tax exempt financings. (Tr. 216.)

ISSUE 28: What is the appropriate return on equity (ROE) for the test year?

AUF: *Using the Commission's leverage formula approved on December 16, 2008, the appropriate ROE for the test year is 10.77%.*

Undisputed evidence in the record shows that the leverage formula established under Section 367.081(4)(f), Florida Statutes, is a creative, innovative approach to streamline rate proceedings for Florida water and wastewater utilities like AUF. (Tr. 259; Ex. 150.) AUF has requested that its ROE be set using the Commission's leverage formula. (Tr. 104.) Consistent with Commission practice, AUF has made it clear that the leverage formula in effect at the time of the Commission's final vote in the case should be used to establish its ROE. (Tr. 108, 113-

15.) *See* Order No. 20066, 1988 Fla. PUC LEXIS 1492 (“We believe that the calculation of return on equity is appropriately based on the leverage formula in effect . . . when the Commission rendered its final decision in this case.”). The Commission’s leverage formula in effect at the time AUF filed its rate case produced an ROE of 10.25%. (Tr. 107-08.) On December 16, 2008, the Commission voted to adopt a new leverage formula pursuant to Section 367.081(4)(f), Florida Statutes in Docket No. 080006-WS (Tr. 108.) This leverage formula, which will be in effect at the Commission’s final vote in this case, produces an ROE of 10.77% for AUF. (Tr. 108.)

OPC has opposed the use of Commission’s leverage formula in this rate case, but fails to identify any credible reason why the leverage formula should not be applicable and available to AUF.¹⁴ Rather, OPC witness Rothschild simply advocates that AUF’s rates be set using a 9.47% ROE on common equity based upon a nuanced discounted cash flow (“DCF”) approach. (Tr. 122.) OPC’s opposition to the use of the leverage formula in this case forced AUF to retain an ROE expert - Paul Moul - to review and analyze OPC witness Rothschild’s ROE methodology. (Tr. 232, 259-60.) AUF witness Moul testified that, in his expert opinion, the ROE proposed by OPC is entirely inadequate to reflect current risks in common stocks, outside mainstream returns, and is incompatible with the risks present in today’s capital markets. (Tr. 233, 260.)

Moreover, on cross-examination, OPC witness Rothschild admitted he did not consider any unique risks that AUF faces as a water and wastewater operator when he proposed an ROE for AUF. (Tr. 187.) His failure to consider these risks stands in marked contrast to the

¹⁴ During the hearing, questions from OPC counsel suggested that AUF’s size could disqualify it from using the leverage formula. However, this theory overlooks the fact that the Commission has found that the leverage formula is applicable to *all* Florida water and wastewater utilities. See Staff Recommendation in Docket No. 080006-WS approved by the FPSC on December 16, 2008. Moreover, AUF is significantly smaller than the companies comprising the Natural Gas Index used to calculate the leverage formula.

Commission’s finding that its U&U policies impose “profound” and “significant” economic risks on water and wastewater utilities that are not imposed on other types of utilities. *See* Order No. PSC-01-2514-FOF, 2001 Fla. PUC LEXIS 1427. On cross-examination, OPC’s U&U expert—Andrew Woodcock—acknowledged that Florida’s U&U policies subject water and wastewater utilities like AUF to significant and unique economic risks that are not imposed on regulated electric utilities. (Tr. 332-34.) Again, however, OPC witness Rothschild had no understanding of any of these unique risks facing Florida water and wastewater utilities, and did not consider those significant risks in making his ROE proposal. (Tr. 187.) By comparison, the Commission’s leverage formula—which AUF proposes to use to establish ROE—is specifically designed to consider unique regulatory risks facing water and wastewater utilities in Florida including the “profound” regulatory risks associated with U&U adjustments. *See* Order No. PSC-01-2514-FOF, 2001 Fla. PUC LEXIS 1427.

Record evidence also shows that an ROE of 9.47%, as recommended by OPC, is far lower than the weighted average returns of Aqua America’s other subsidiaries. (Tr. 233.) AUF’s ROE expert Paul Moul testified that, if the Commission were to adopt OPC’s ROE proposal, it could discourage future investment in Florida because higher returns could be obtained in other jurisdictions. (Tr. 234.) Mr. Moul also pointed out that Rothschild misapplied traditional models to measure cost of equity in this proceeding. (Tr. 238.) Indeed, evidence adduced at hearing shows that there are fundamental flaws in Mr. Rothschild’s ROE model, including:

- A discounted cash flow (DCF) growth rate that understates investor expected growth by failing to reflect all of the factors important to investors when developing their total return requirements.
- A failure to reflect floatation costs as part of the rate of return on common equity.
- A CAPM (Capital Asset Pricing Model) approach that fails to adequately measure investor requirements of the required returns for public utilities.

(Tr. 239.) After correcting these flaws, Mr. Moul calculated an ROE of 11.46% (11.66% recognizing flotation costs) using OPC's own model. (Tr. 255.) These calculations show that the Commission's leverage formula produces an ROE for AUF that is reasonable, if not conservatively low. (Tr. 255-56.)

ISSUE 29: What is the appropriate weighted average cost of capital including the proper components, amounts, and cost rates associated with the capital structure?

AUF: * The appropriate weighted cost of capital for AUF is subject to the resolution of other issues in this proceeding.*

NET OPERATING INCOME

ISSUE 30: What are the appropriate annualized test year revenue adjustments?

AUF: * No adjustments to annualized test year revenues are appropriate.*

The validity and accuracy of AUF's billing determinants and the resulting test year revenues were attested to in the rebuttal testimony of AUF witness Gary Prettyman. (Tr. 1248-49.) That testimony stands unchallenged. Thus no adjustments to annualized test year revenues are in order.

ISSUE 31: Should a miscellaneous service revenues adjustment be made?

AUF: *No. There is nothing in the record to support any such adjustment.*

ISSUE 32: Should non-utility income be moved above-the-line for ratemaking purposes?

AUF: *No. The record shows that AUF properly recorded non-utility revenues below-the-line. If these non-utility revenues are considered above-the-line, then the respective expenses related to those revenues must also be included in the revenue requirement calculation.*

OPC initially argued that non-utility income be moved above the line in two instances: first, for non-utility revenues associated with pass-through garbage and street light services; second, for non-utility revenue associated with AAI's marketing contract with Home Services. At the hearing, OPC witness Dismukes acknowledged that garbage and street light services were

pass-through services and that expenses associated with those pass-through revenues had been appropriately charged below the line. Thus, OPC agreed that non-utility revenues associated with those pass-through services are appropriately recorded below the line. (Tr. 618.)

OPC's recommendation that non-utility revenues (i.e., commissions) associated with the Home Services contract be included above-the-line is flawed, and appears to be based on OPC's failure to understand the scope and effect of that marketing agreement. Home Services is in the business of providing service agreements for the emergency repair of domestic water and sewage systems to Pennsylvania customers only. (Tr. 1529.) Thus, contrary to claims by OPC witness Dismukes, AUF's customer list has not been given to Home Services, and AAI does not derive Home Services commissions from any Florida operations. Consequently, none of the revenues associated with those Home Services commissions should be imputed to AUF and moved "above the line." (Tr. 1529.)

ISSUE 34: Should any adjustments be made to remove non-utility expenses?

AUF: *Yes. AUF agrees with the adjustments contained in its response to the Staff Audit Report. (Ex. 170.)*

ISSUE 36: Should any adjustment be made for charges from affiliates?

AUF: *No. AUF's affiliated charges are reasonable and supported by the evidence in the record. OPC has not provided any credible evidence to support its recommended adjustments. In addition, OPC's attempts at using a comparative analysis are not only inappropriate for setting rates, its proposed analysis has serious flaws and mistakes.*

The record shows that AAI is a holding company that has a number of operating subsidiaries, including AUF. Like other utility holding companies, AAI has a service company - Aqua Services Inc. ("Service Company") - which provides AUF with necessary services including accounting, engineering, customer service, communications, corporate secretarial, human resources, information services, legal, purchasing, rates and regulatory, and water quality. (Tr. 391, 1539-41.) The services that the Service Company provides to AUF are billed to AUF

at cost. (Tr. 391.) The record in this proceeding is replete with evidence that shows the costs allocated by the Service Company to AUF are both reasonable, necessary and below market. (Tr. 1542-1549; Comp. Ex. 65, Tab 32, pp. 32-35; Ex. 161.) Furthermore, undisputed evidence in the record shows that the executive compensation structure of Aqua America and its affiliates are at or below benchmarks compared to other utilities further confirming that. In addition, the reasonableness and necessity of these affiliate charges were explained in detail to OPC through the discovery process. (Tr. 1540-42.)

OPC witness Dismukes does not take issue with the methodology whereby the Service Company's costs are allocated to AUF, nor does she address the reasonableness and the necessity of specific affiliated charges. Furthermore, Ms. Dismukes does not propose any adjustments to specific affiliated charges. (Tr. 1544-45.) Rather, she recommends that the Commission make a significant "blanket" adjustment of \$970,802 to test-year expenses for water and wastewater operations based on a general and unsupported claim that AUF's relationships with its parent and the Service Company are not efficient. (Tr. 690.) As a fall-back recommendation, Ms. Dismukes recommends that the Commission reduce test-year expenses by \$6,703 by taking into account what she claims to be services provided by Aqua America to non-regulated companies at no charge. (*Id.*) Both of these recommendations are flawed and should be rejected.

As stated, the record shows that OPC witness Dismukes does not challenge any specific affiliated charges as unreasonable. Instead, her "blanket" adjustment to affiliated charges is based on a shallow comparative analysis of the affiliate charges of other Class A Florida water utilities. The Commission expressly rejected this type of blanket adjustment by Ms. Dismukes in Order No. PSC-93-1288-FOF-SU ("We find it is appropriate to make a reduction when the record does not support an argument that any specific [affiliate] charge is unreasonable.") (Tr.

693.) In addition, Florida courts have made clear that it would be improper to rely solely on Ms. Dismukes' "comparative analysis" to test the reasonableness and the necessity of AUF's affiliated charges. In *Sunshine Utils. of Cent. Fla., Inc. v. Fla. Pub. Serv. Comm'n*, 624 So. 2d 306 (Fla. 1st DCA 1993), the First District Court of Appeal held that a comparative analysis of the salaries of other utility executives did not constitute competent, substantial evidence to support a downward adjustment to the utility president's salary in a rate case. Notably, the court in *Sunshine* addressed the weaknesses inherent in a comparative analysis like that proposed by Ms. Dismukes:

In determining whether an executive's salary is reasonable compared to salaries paid to other company executives, the comparison must, at the minimum, be based on a showing of *similar* duties, activities, and responsibilities in the person receiving the salary.

Id. at 311. OPC witness Dismukes fails to (and cannot) demonstrate that the other utilities in her comparison group have 82 separate utility systems operating throughout Florida as does AUF. Furthermore, Ms. Dismukes makes no showing that her comparison group has system costs, system designs, service territories, customer demographics, or any other operating characteristics that are similar to AUF. Uncontradicted evidence in the record shows that the operations of the utilities in Ms. Dismukes' comparison group are "very different" from AUF's operations and AUF's relationship with its parent – AAI. (Tr. 1546.) Equally flawed is Ms. Dismukes' recommended adjustment to affiliated charges based on a ratio of AUF expenses to revenues. Ms. Dismukes overlooks the fact that none of AUF's systems have received a rate increase in over 12 years. Thus, an analysis of today's cost compared to revenues established over 12 years ago is improper. (Tr. 1548.)¹⁵

¹⁵ Not only OPC witness Dismukes' comparative analysis inappropriate for setting rates in this case, the schedules that Ms. Dismukes has attached as exhibits cannot be relied upon. Ms. Dismukes' comparative analysis contains serious errors. The record shows that Ms. Dismukes' comparative analysis was pulled from different sources, had embedded inconsistencies, and contained mathematical errors. (Tr. 1546-47.)

The record also shows that AUF goes to great lengths to ensure that its costs, including affiliated charges, are just and reasonable. (Tr. 1542-44, 1549.) The record moreover shows that the Utility performed a series of analyses that specifically address and confirm the reasonableness of the costs allocated from the Service Company. (Tr. 1543-44, Ex. 162.) For example, during the test year, AUF received a total of \$823,966 in allocated charges from the Service Company for the entire state of Florida. (Ex. 180, Vol. I App. 1.) The record shows that if these services were not received from the Service Company, it would cost AUF approximately \$1,025,000 to replace them. (Tr. 1544, Ex. 162.) Thus, the record demonstrates that AUF's relationship with the Service Company produces savings of at least \$201,034 throughout Florida. This savings calculation is conservative because it does not take into account other services that the Utility receives from the Service Company such as water quality monitoring, in-house engineering, fleet services, purchasing and risk management. (Tr. 1544.) The record also shows that a number of other utilities, several of which with Florida operations, have service company charges which are significantly higher than the Service Company's charge to AUF of approximately \$25 per customer. (Comp. Ex. 65, Tab 32, p. 70; Ex. 165; Tr. 1549.) In summary, overwhelming record evidence shows that the cost allocated by the Service Company to AUF are both reasonable and necessary. OPC's recommendation to adjust AUF's affiliated charges based on the purported cost structures of other business entities, while ignoring the actual cost of the Utility, violates fundamental principles of cost-of-service regulation and must be rejected.

With respect to OPC's fall-back recommendation, Ms. Dismukes generally claims that AAI is not allocating overhead costs to its unregulated companies. (Tr. 681.) That claim has been completely refuted in the record, which clearly shows that AAI properly allocates common

costs to its unregulated affiliates. Moreover, the record shows that allocation of common costs to Aqua Wastewater Management began January 1, 2008. (Tr. 1540-41.) Ms. Dismukes ultimately recommends that the Commission reduce test-year expenses only by \$6,703. (Tr. 690.) If the Commission chooses to make an adjustment to incorporate charges for Aqua Wastewater Management going forward, that adjustment, properly allocated to AUF, would be \$4,757. (Tr. 1539.)

ISSUE 38: Should any adjustments be made to advertising expenses?

AUF: *No.*

No adjustment to advertising expenses is necessary or appropriate. OPC mischaracterizes AUF's advertising efforts as "image enhancement." The record shows that AUF's advertising is not designed to enhance its image, but rather is intended to foster communication with customers and educate AUF consumers regarding the capital it is investing in the state and the importance of protecting water as a resource. This is an important part of AUF's long-term success, and is within the range of reasonable expenses considering the limited dollar amount. (Tr. 1562-63.)

ISSUE 39: Should any adjustments be made to lobbying expenses?

AUF: *Yes. AUF agrees to the adjustment to remove charges it incurred from Cynergy.*

However, OPC's recommendation to disallow \$39,387 in lobbying expenses is miscalculated. First, it should be noted that OPC witness Dismukes' adjustment includes an amount that lobbying expenses for AUF's jurisdictional and non-jurisdictional utilities; thus, the amount cited is overstated. Second, expenses for Mr. Lane's services are not lobbying expenses but rather normal utility operation services associated with placing required regulation notices, facilitating developer agreements, assisting in the purchase of other water and wastewater systems. Mr. Lane's services are beneficial to AUF ratepayers; therefore, the associated expense is reasonable and should not be removed. (Tr. 1563.)

ISSUE 40: Should any adjustments be made for executive risk insurance?

AUF: *No. The evidence in the record shows that Aqua America's Directors & Officers Liability Insurance Policy ("D&O Policy") is a prudent risk management practice that protects the regulated assets of AUF. (Tr. 1552-53.) Thus, no adjustments should be made for executive risk insurance.*

OPC witness Dismukes argues that the D&O Policy is for the sole benefit of directors and officers. (Tr. 733, 735.) This simply is not true. The D&O Policy covers claims against the directors and officers arising from any covered wrongful act, which include errors, acts, omissions, or breach of duty by the directors and officers in their insured capacity or in any manner claimed against them solely by reason of their serving as a director or officer. Evidence at the hearing showed that it is not uncommon for lawsuits brought against a utility to also include claims against the Utility's directors and officers. (Tr. 1553.) Not having insurance coverage, whether it is general liability, auto liability, property or D&O insurance, could require AUF to pay a liability claim from its own resources, which depending on the size and nature of the claim, could economically impair the Utility's operations. (*Id.*) Thus, the coverage offered by the D&O Policy provides a fund from which to pay covered claims rather than having claims paid out of the general assets of the Utility. Without this insurance in place, there would be a potential loss of utility assets which could come at a cost to customers. (*Id.*)

Finally, the record shows that providing D&O insurance is standard among all public companies and most private companies with independent board members and non equity owning officers. (Tr. 1553.) Evidence indicates that if AUF does not provide its directors and officers with protections from the aforementioned claims, it would be difficult or impossible to get qualified people to serve in that capacity. (*Id.*)

ISSUE 41: Should any adjustments be made to contractual services – other, and contractual services - testing expenses?

AUF: * Other than the specific Audit Findings and adjustments to which AUF has agreed, no further adjustments are necessary or appropriate.*

Exhibit 170 shows that: (1) consistent with AUF's response to Audit Finding No. 17, Contractual Services-Other should be reduced by \$11,841; (2) consistent with AUF's response to Audit Finding No. 11, Contractual Services-Other should be reduced by \$4,986; (3) consistent with AUF's response to Audit Finding No. 10, Contractual Services-Other should be reduced by \$10,065; and (4) consistent with AUF's response to Audit Finding No. 16, Contractual Services-Testing should be reduced by \$310. In addition, the record shows that AUF agrees to the following adjustments recommended by OPC: (1) the amortization of Fuel for Purchased Power should be reduced by \$355 (Tr. 749.); (2) the reclassification of legal expense should reduce the test year expenses for Village Water by \$25,712; (3) a 5-year amortization of the Jasmine Lakes legal expense would add \$5,142 to Jasmine Lakes expenses. (Tr. 1564.)

OPC's other claims for additional adjustments are without merit. For example, OPC witness Dismukes recommends adjustments based on what she claims to be "abnormal" testing expenses for Fern Terrace, Grand Terrace, Jasmine Lakes, Lake Gibson, Pomona Park, River Grove and Zephyr Shores. (Tr. 746.) These claims were clearly refuted by AUF witness Szczygiel. The record shows that these testing expenses are not abnormal; instead, they are reasonable recurring costs that the Utility has incurred and will continue to incur in order to comply with FDEP requirements and respond to normally occurring weather events. (Tr. 1557-58.)

OPC witness also makes certain adjustments to expenses for Leisure Lakes, Lake Josephine, Sunny Hills, Oakwood, Imperial Mobile Terrace, and Florida Central Commerce which she claims to be "abnormal" or "non-recurring" compared to prior years. Testimony in the record however shows that these expenses are not abnormal; in fact, many are budgeted

annually by AUF at its various systems. (Tr. 1564.) Moreover, close review of the record reveals that OPC witness Dismukes has only conducted a "normalization" adjustment for those test year expenses which she deems abnormally high. She fails to make corresponding "normalization" adjustments when test year expenses are abnormally lower than those of prior years. The Commission has rejected Ms. Dismukes "heads I win, tails you lose" approach to normalization in prior rate cases. *See* Order No. PSC-93-1288-FOF-SW (the Commission specifically found that "Ms. Dismukes' adjustment should be rejected on the basis that you can't choose just one expense account to normalize and ignore the rest."). There is no valid reason for the Commission to accept that selective approach now.

OPC also proposes to remove from test year expenses deferred maintenances projects which OPC claims have been improperly amortized. (Tr. 735-38.) Such claims are not supported by the record, and are clearly refuted by AUF witness Szczygiel. Consistent with Commission practice, AUF amortizes deferral of maintenance projects to match project expense over the period of expected project benefits. (Tr. 1554-55.) For example, the record shows that permit renewals are amortized over the life of the permit based on the issuance date. Although permit renewal expenses may be incurred prior to permit issuance, those expenses are not amortized until the permit is actually issued. This is only logical because it is not until the permit is issued that the duration and full cost of the permit is realized and thus proper amortization can begin. (Tr. 1555.) In addition, the record shows that tank inspections that are required by FDEP every 5 years are amortized over 5 years. The fact that some of the inspection cost may be fully amortized in 2008 does not warrant an adjustment to expenses. Indeed, the record shows that there are numerous other tank inspections that will be required for other systems throughout the

state. (Ex. 154.) The record is clear that that AUF will incur similar expenses in subsequent years. (Tr. 1554.)

OPC witness Dismukes also recommends that the amortized costs for operations manuals be removed for Jungle Den Wastewater, Rosalie Oaks Wastewater, and Summit Chase Wastewater, because the costs of those manuals will be fully amortized in 2008. However, the record shows that OPC witness Dismukes overlooks the fact these manuals are required by FDEP and must be reviewed and updated on an annual basis. (Tr. 1555.)

OPC contends that costs associated with Severn Trent be removed from AUF's normalization adjustment based on unsupported claim that such costs are "duplicative." That claim is clearly erroneous. The record demonstrates that Severn Trent provided services to AUF's previous billing system, which was in place until October 2006. (Tr. 1551.) Because Commission Rule 25-30.335(7) requires AUF to maintain its billing records for the past 24 months, the Utility had no alternative but to continue to retain the services of Severn Trent at least through the end of 2008. (Tr. 1552.) Thus, the costs associated with Severn Trent are not duplicative. If, however, the Commission believes that an adjustment is warranted, the Severn Trent expense should be treated as non-recurring and amortized over 5 years in accordance with Commission practice. (Tr. 1552.)

ISSUE 42: Should any adjustments be made to purchased power expenses?

AUF: *No adjustment to purchased power expenses is necessary or appropriate.*

OPC recommends that test year purchased power expenses should be reduced due to what OPC witness Dismukes claims to be "abnormal flushing" activities. (Tr. 746.) The record is devoid of evidence that AUF has engaged in abnormal flushing activities. To the contrary, testimony clearly demonstrates that AUF's flushing activities are an accepted water quality

treatment protocol that is necessary in order to maintain regulatory compliance with FDEP requirements. (Tr. 1084, 1112, 1205, 1558-59.) The adjustments recommended by OPC would, in effect, penalize AUF for efforts to address regulatory compliance. (Tr. 1558-59.)

ISSUE 43: Should any adjustments be made to sludge hauling expenses?

AUF: *No adjustment is necessary or appropriate. AUF's sludge hauling expenses are properly supported in the record. (Tr. 393.) *

ISSUE 44: Should any adjustments be made to maintenance expenses?

AUF: *No adjustment is necessary or appropriate.*

AUF's maintenance expenses are properly stated in its MFRs. For the same reasons described in Issue 41, OPC has identified no legitimate basis for making adjustments to those maintenance expenses.

ISSUE 45: Should any adjustments be made to fuel for power production expenses?

AUF: *No such adjustment is necessary or appropriate.*

OPC witness Dismukes recommends that adjustments be made to several systems to amortize fuel purchases for generators. (Tr. 743-44.) The evidence shows that AUF made these additional fuel purchases to in order to comply with FDEP standby power requirements that are set forth in Rules 62-555.320(14)(a), 62-555.350(2) and 62-555.350(15)(d), F.A.C. (Tr. 1203-05.) OPC witness Dismukes' claim that the Commission's policy is to amortize these types of costs over 4 years is without merit. The 4-year amortization policy to which she refers in fact relates to the Commission's past practice of amortizing hurricane damage and repairs over a 4 year period. Those policies do not apply here where AUF is simply complying with FDEP standby power requirements. (Tr. 1550-51.)

Although not addressed in any testimony in the proceeding, review of Staff witness Stallcup's workpapers obtained through discovery indicates that he has made a repression

adjustment to the Fuel for Power account. Unrebutted testimony of AUF witness Szczygiel shows that this type of adjustment is inconsistent with past Commission practice and therefore should not be accepted. (Tr. 1550-51.) See, Order No. PSC-06-1027-PAA-WU, 2006 Fla. PUC LEXIS 649 and Order No. PSC-05-0624-PAA-WS, 2005 Fla. PUC LEXIS 443.

ISSUE 46: Should any adjustments be made for chemical expenses?

AUF: *No adjustment is necessary or appropriate.*

AUF's chemical expenses are properly supported in the record. (Tr. 393-94.) OPC claims that test year chemical expenses should be reduced by \$395 for what it deems to be "abnormal" line flushing. This claim has no merit for the reasons explained in Issue 42.¹⁶

ISSUE 48: Should any adjustment be made to salaries and wages?

AUF: *No.*

OPC's claim for adjustments to employee salaries is not convincing. First, OPC witness Dismukes contends that the Commission should disallow salaries and wages associated with acquisitions, specifically the AUF Corporate Development and Aqua Services Corporate Development positions. (Tr. 730.) Ms. Dismukes' reasoning is flawed and overlooks the customer benefits to be derived from acquisitions. As Ms. Dismukes recognizes in her testimony, acquisitions allow utility costs to be spread over a greater customer base thus making rates more affordable. (Tr. 682.) A methodology that acknowledges the benefit of acquiring new customers, but then disallows the salaries of the employees who facilitated the acquisition cannot stand. (Tr. 1537-38.) The same rationale and logic applies to the acquisition efforts at the Service Company level as well as for AUF. (*Id.*) Moreover, it is unrefuted that the AUF Corporate Development position is actively involved with other non-acquisition related dockets

¹⁶ Furthermore, FDEP and the relevant WMDs are well aware of AUF's flushing program. Staff witness Walker testified that AUF's flushing program "is a reasonable beneficial use . . . is necessary to maintain distribution water quality," and her staff has not observed "any harm associated with the flushing." (Tr. 1003, 1009.) Simply put, increased line flushing in AUF's systems is not abnormal and no adjustment to chemical expenses is warranted.

at the Commission, including working throughout the year with the Commission staff on customer complaints, territory amendments, rate cases and certifications. The AUF Corporate Development position also works with city and county officials regarding possible interconnects for water and/or wastewater supplies. (Tr. 1537-38.) Indeed Mr. Smith's timesheets for the test year show that 76% of his work hours were spent on matters other than acquisitions and corporate development. (Tr. 1538; Ex.160.)

OPC also claims that salaries for meter-reading employees should be removed from test year expenses, on the erroneous assumption that those positions would simply be eliminated due to the RF meter conversion. However, the record shows that these employees will continue to be efficiently utilized to assist with field operations, perform maintenance work, and respond to customer service and daily calls. (Tr. 1486) Thus, OPC's claim that \$55,813 should be removed from test year expenses is unfounded and unsupported. (Tr. 1485-87.)

Nor should any adjustment be made to salaries and wages for the South Seas system operator. AUF properly included a pro forma adjustment in the test year in the amount of \$102,276 for a new contract operator. (Tr. 394.) OPC has offered no credible testimony to refute this pro-forma adjustment. Uncontroverted testimony adduced at hearing showed that the South Seas operations are remote and AUF reasonably determined that a contract operator was required to oversee it. (Tr. 415.) Although the Utility had other test year expenses allocated for servicing the South Seas system, the record shows that once the new contract operator was hired, those prior expenses were not eliminated but rather reallocated to other AUF systems. Simply put, the expense of the new contract operator for South Seas did not replace prior expenses as OPC seems to suggest at the hearing. (Tr. 415-16.) Thus, there is no legitimate basis to remove the salary and wages for the South Seas operator.

Finally, OPC recommends equally inappropriate reductions to the salaries and wages of the AUF and AAI presidents. For the same reasons stated in Issue 1 herein, the Commission should reject OPC's recommended salary reductions.

ISSUE 50: Should any adjustment be made to bad debt expense?

AUF: *No. OPC has recommended an adjustment for bad debt expense, but neither the law nor the evidence presented in this case support that recommendation.*

AUF has properly stated test year bad debt expense in its MFRs. (Ex. 180.) This expense is approximately 1.5% of the Utility's revenues, which the record shows is reasonable when compared to the AUF's bad debt expense in prior years. (Tr. 1559.) It is undisputed that Commission practice is to use a three or four year average to test the reasonableness of a utility's bad debt expense for ratemaking purposes. *See e.g.*, Order No. PSC-04-1110-PAA-GU, 2004 Fla. PUC LEXIS 1054. Consistent with that practice, AUF's 4-year average bad debt expense is approximately 2.6% of revenue. Because AUF has not owned the systems for 4 years, the four-year average includes one year of bad debt expense records of prior owners - FWSC and Aqua Source. (Tr. 1559.) Using a 3-year average covering the period that AUF owned the Florida systems, bad debt is 1.8% as a percentage of revenue. (*Id.*) OPC witness Dismukes has indicated that AUF's bad debt expense in the test year was 1.5% of revenues, which is clearly below the bad debt expense averages for the past three and four year periods. (Tr. 742.) Thus the record shows that AUF's test year bad debt expense was not abnormal, and there is no legitimate basis for adjusting those expenses.

Although OPC witness Dismukes recognizes that the Commission's practice is to use a three or four year average to test the reasonableness of a utility's bad debt expense, she seems to allege that because AUF does not have four years of data, typical Commission practice is not applicable to AUF. (Tr. 741.) This is clearly erroneous. In situations like this one, where a

utility system has been fairly recently acquired by a new owner, the Commission has compared bad debt expense in the test year to bad debt expense for the years that the current owner actually owned the system. *See, e.g.*, Order No. 20066, 1988 Fla. PUC LEXIS 1492. Contrary to Ms. Dismukes' assertion, there is more than sufficient data to support AUF's bad debt expense in its MFRs. (Tr. 1559.)

Rather than following the Commission's standard practice of utilizing this actual bad debt data, Ms. Dismukes' recommendation relies entirely on a comparative analysis of the bad debt figures of other Class A Florida water utilities. (Tr. 741-42.) As more fully explained in Issue 36, it would be improper to rely solely on such a comparison to test the reasonableness of AUF's bad debt expense.¹⁷ Ms. Dismukes provides no evidence that her comparison group of other utilities have customer demographics and collections policies similar to AUF. (Tr. 742.) Furthermore, she fails to demonstrate that the utilities in the comparison group have service areas with economic conditions similar to AUF, and fails to consider the credit worthiness of AUF's customers compared to other systems. (Tr. 742-43.) Moreover, she makes no effort to show (and indeed cannot show) that the utilities in the comparison group have rate structures similar to AUF's unique cap-band structure. *Compare* Order No. PSC-96-1320-FOF-WS, 1996 Fla. PUC LEXIS 2074 (recognizing that utilities without uniform rates are likely to have higher bad debt expenses). Finally, imputing historic bad debt factors of other utilities to AUF ignores the likelihood that the current economic downturn will have a significant impact on bad debt expense. *See* Order No. PSC-92-0580-FOF-GU, 1992 Fla. PUC LEXIS 985 (expressly noting that an overall economic downturn will have a pronounced impact on bad debt expense regardless of increased collection efforts).

¹⁷*See, e.g., Sunshine Utils. of Cent. Fla., Inc. v. Fla. Pub. Serv. Comm'n*, 624 So. 2d 306, 311 (Fla. 1st DCA 1993) ("In determining whether an executive's salary is reasonable compared to salaries paid to other company executives, the comparison must, at the minimum, be based on a showing of *similar* duties, activities, and responsibilities in the person receiving the salary.")

OPC has provided no legitimate reason for the Commission to reject the actual bad debt expenses that AUF has put forward in its MFRs. Thus, no adjustment to the Utility's bad debt expenses is warranted.

ISSUE 51: Should any adjustments be made for unamortized debt issuing costs?

AUF: *No.*

The OPC argues that an adjustment to debt issuance cost of \$1,345 should be made consistent with Staff Audit Finding No. 14. OPC and the staff auditors appear to assume that AUF's letters of credit ("LOCs") are debt which the record shows they are not. (Ex. 140 at 8.) The LOCs are issued to various insurance companies as collateral for the beneficiary in the event that the claims made against various insurance policies cannot be paid by the Utility. The fees are charged to the Utility quarterly by the issuing banks, based on the outstanding amount of the issued letters of credit. The record shows that those fees should not be classified as debt issuance costs. Rather they are properly recorded by AUF as Miscellaneous Expenses under Account 675.

ISSUE 52: What is the appropriate amount of rate case expense?

AUF: *The appropriate amount of rate case expense is \$1,778,886.*

AUF has incurred considerable expense in this rate case. (Ex. 217.) The record shows that there are two primary drivers of this considerable rate case expense: (i) the 82 separate systems subject to the case, and (ii) the amount of time required to respond to the massive number of discovery requests propounded by OPC. (Tr. 815-25, 1568-72.) The record further demonstrates that proper management of discovery not only requires a utility to expend extensive internal resources, it also requires substantial time and energy by outside consultants and attorneys. More specifically, the record shows that in order to fulfill her or his professional responsibilities a Florida attorney must be personally involved in the preparation of all discovery

and responses to discovery in a rate case. *See* R. Regulating Fla. Bar 4-3.4.¹⁸ Thus, competent substantial evidence shows that rate case expense, including legal fees, is directly proportionate to the volume of discovery in the case.

In this case, OPC propounded massive volumes of discovery on AUF and that AUF made good faith effort to respond to that discovery. By conservative count, OPC propounded over 1561 interrogatories and 625 requests for production of documents on AUF. (Tr. 1572.) In order to propound this massive amount of discovery, OPC (over AUF's objections) sought and obtained the permission to expand the discovery parameters. The Prehearing Officer granted OPC's request to expand discovery but specifically warned that increasing the volumes of discovery "will almost certainly increase rate case expense." *See* Order PSC-08-0536-PCO-WS. That warning has now come to fruition. Faced with an expense that it helped create, OPC proposes that the Commission reject longstanding precedent and only allow AUF to recover 50% of the reasonable rate case expenses it incurred. (Tr. 757.) Not only is OPC's recommendation baseless, it is patently unfair. Having caused rate case expense to skyrocket with its voluminous discovery, it is preposterous for OPC to now recommend that the Commission to deny AUF its lawful right to recover all of its reasonable rate case expense in this case.

All of AUF's rate case expense has been properly documented and supported. (Exs. 195, 217.) Moreover, the amount of rate case expense is reasonable given the scope of this proceeding. In response to OPC's rate case expense schedule, AUF has included downward adjustments associated with the cost of the prior rate case and cost associated with deficiencies (Exs. 195, 217.) The record, however, shows that costs associated with AUF's substitution of counsel, protocol regarding discovery, ROE issues, witness substitution, the preparation of

¹⁸ The FPSC has found it reasonable for a utility's non-lawyer outside consultant to spend 20 hours to respond to 24 discovery requests from OPC (*i.e.*, .83 hour per request). Order No. PSC-07-0205-PAA-WS, 2007 Fla. PUC LEXIS 130. More time would be expected of an attorney given her or his ethical responsibilities for discovery under the Rules of Professional Conduct.

required billing analysis, and outside counsel hourly rates are appropriate and necessary expenses directly incurred in preparing and supporting this rate case. (Ex. 195.) Based on the foregoing, AUF should be entitled to recover in rates the entire \$1,778,586 as set forth in Exhibits 195 and 217.

ISSUE 53: Should an adjustment be made to the Utility's normalization adjustment?

AUF: *The Lake Suzy test year land lease amount should be reduced by \$4,283. AUF's normalization adjustments are fully supported by the record and no additional adjustments are necessary.*

The record shows that the normalization amount for AUF's Lake Suzy test year land lease should be reduced by \$4,283. (Tr. 1530; Exs. 153, 154.) AUF has properly supported its other normalization adjustments and no other reductions are warranted. However, OPC witness Dismukes recommends three other adjustments to normalization based on her erroneous claim that AUF failed to provide adequate support. (Tr. 715.) OPC's recommended adjustments relate to: (i) allocated payroll taxes from the administrative department; (ii) normalized Service Company headcount; and (iii) normalized Aqua Customer Operations ("ACO") costs. Contrary to Ms. Dismukes' claims, the record shows that AUF fully supported its normalization adjustment for allocated payroll taxes, and that these taxes were actually incurred and paid during the test year 2007. (Tr. 1531; Ex. 155.) In addition, the record shows that AUF provided support for its normalization adjustment to recognize an increase in Service Company headcount. (Tr. 1532; Exs. 156, 168, 169.) Moreover, AUF provided ample support for its adjustment for normalize the ACO cost for 2007. (Tr. 1532; Exs. 157, 1, 168, 169.)¹⁹ OPC also claims in its prehearing statement that AUF's 2007 4% Service Company wage increase should be removed in the amount of \$4,928. However, OPC failed to support its position with any testimony in the record. By comparison, AUF fully supported these adjustments in testimony (Tr. 1533-34), in its

¹⁹ The record shows that AUF agrees with OPC's recommended adjustment that AUF's proposed 2007 4% wage normalization increase should be reduced by \$694. (Tr. 1532.)

MFRs (Ex. 180), as well as through discovery responses (Ex. 1). In addition, the supporting workpapers were provided to both OPC and the Commission. (Exs. 1, 168, 169.)

ISSUE 54: Should an adjustment be made to the Utility's pro forma expense adjustments?

AUF: *No. No adjustments should be made.*

AUF has properly supported the pro forma expenses in its MFRs. (Tr. 393.) OPC has recommended a series of adjustments to pro forma expenses which, as demonstrated below, have no merit.

- *Market Based Adjustment.* OPC recommends the standard merit increase of 4% for AUF's operational staff instead of AUF's proposed 10% percent increase. (Tr. 720.) In so doing, OPC has essentially recommended the status quo and ignores the market based study of Saje Consulting Group, Inc. ("Saje Study"). The Saje Study shows that AUF is paying below market rates for key positions, which has undermined its ability to attract and retain well trained and effective employees. (Tr. 1533.) Evidence shows that the Utility's pro-forma salary expense is conservative. The Saje Study actually recommended an increase of \$200,000, but AUF only requested an increase of \$95,166 in its MFRs. (Tr. 1207-08, 1533.) Finally, evidence demonstrates that AUF's efforts to ensure the competitiveness of its employee compensation structure is consistent with past Commission decisions concerning market based wage increases.²⁰

- *Rates Manager.* By OPC recommending removal of the pro-forma salary for AUF's Rates Manager position, OPC essentially advocates that the position be eliminated. (Tr. 721.) The recommendation is without any merit whatsoever and, in fact, is inconsistent with the Commission's treatment of similar positions of other regulated utilities in Florida. (Comp. Ex.

²⁰ In Order No. PSC-08-0327-FOF-EI, the Commission affirmed actions virtually identical to those taken by AUF and stated: "We find that the Company has taken appropriate action to assure that its employee salaries are on the same level as other utility employees so that the Company will be competitive in hiring and retaining well trained and effective employees." See also Order No. PSC-02-0787-FOF-EI.

65, Tab 32, Late-Filed Exhibit 6.) OPC ignores the fact that the position's primary functions are to ensure regulatory compliance, serve as the primary contact for AUF with the Commission clerk, respond to customer inquiries, handle index and pass through filings, and provide assistance in rate cases and other regulatory proceedings. The regulated industry is highly specialized and it would be imprudent for AUF or any other regulated utility not to have this type of position. OPC's recommendation to remove the Rates Manager's lease expense also has no merit. The position requires that the Rates Manager be near the Commission which is located in Tallahassee. Thus, office leasing is a legitimate and integral expense associated with this position and it should not be removed from pro-forma expense. (Tr. 1537.)

- *Controller.* OPC claims that AUF failed to provide support for the controller position and thus recommends that the position be disallowed. (Tr. 722.) OPC's claim is baseless. Evidence adduced during the course of this proceeding showed that AUF hired a controller on March 31, 2008 and that the position was previously vacant. (Tr. 1534.) Evidence also showed that OPC's recommendation to eliminate the Florida controller position would hurt, not help, ratepayers. (Tr. 1535.) The Controller, like other controller positions in regulated public utilities, has many critical functions, including overseeing all utility accounting functions, providing timely financial reports to regulators and internal and external compliance controls, providing accurate and timely budget information, and assisting in the planning for future capital investment in Florida. (Tr. 1535.) The Controller position is clearly needed in order for AUF to effectively and efficiently function as a regulated utility in Florida and therefore is beneficial to ratepayers. (Tr. 1535.)

- *Aqua Connect.* OPC recommends that the Commission remove the \$60,000 adjustment for AUF's Aqua Connects program on the basis that the program appears to be designed for

image enhancement and not customer education. (Tr. 723.) The basis for OPC's adjustment is without merit. The record reflects that the purpose of Aqua Connects is not image enhancement, rather it is to foster good communications with customers by educating Florida customers on water usage, water conservation, along with customer contact information in the event of billing questions and emergencies. *See* Order No. PSC-02-0593-FOF-WU, 2002 Fla. PUC LEXIS 324 (Commission specifically determined that a "foundation for a good customer relationship is good communications.") The Aqua Connects program also provides a beneficial forum for complaint resolution by providing customers with access to employees with live billing resolution authority. (Tr. 1201-03, 1550.)²¹

ISSUE 55: Should any adjustments be made to test year depreciation expense?

AUF: *No adjustment is necessary or appropriate.*

ISSUE 57: Should any adjustments be made to property taxes?

AUF: *No adjustment is necessary or appropriate.*

AUF's property taxes are properly stated in its MFRs and are supported in the record (Tr. 1565-67.) Moreover, support for AUF's property taxes was provided to OPC and to staff in response to discovery. (Comp. Ex. 65, Tab 10, Tab 22.)

ISSUE 58: What is the test year pre-repression water and wastewater operating income or loss before any revenue increase?

²¹ OPC, in its Prehearing Statement and through Ms. Dismukes' testimony, also claims that AUF's pro forma adjustments relative to property taxes, service company headcount, 2008 service company benefits, and 2008 Aqua customer operations employee benefits are not supported by workpapers and therefore be disallowed. These allegations are baseless. The workpapers regarding the 2008 Service Company headcount were provided to both OPC and the Commission in response to discovery. (Exs. 1, 168, 169). With respect 2008 Service Company benefits, these workpapers and supporting documentation were provided to both OPC and the Commission. (Exs. 1, 168, 169). Furthermore, as the record shows that these adjustments recognize the increase to medical and dental costs for the Service Company (Tr. 1567.) With respect to the 2008 ACO employee benefits, these workpapers and supporting documents were provided to both OPC and the Commission through the discovery process. (Exs. 1, 168 and 169.) In addition, OPC's Prehearing Statement suggests that no support was offered to justify the pro forma adjustment for 2008 service company wage increase and the 2008 ACO wage increase. That is absolutely false. AUF fully supported both of these adjustments in the MFRs (Ex. 180) as well as discovery responses. (Ex. 1.)

AUF: *The appropriate test year pre-repression water and wastewater operating income or loss before any revenue increase is subject to the resolution of other issues in this proceeding.*

ISSUE 59: What is the appropriate pre-repression revenue requirement for the December 31, 2007 test year?

AUF: *The appropriate test year pre-repression revenue requirement for the December 31, 2007 test year is subject to the resolution of other issues in this proceeding.*

RATES AND CHARGES

ISSUE 60: What, if any, is the appropriate methodology to calculate a repression adjustment?

AUF: *If AUF's proposed two-tiered inclining block rate structure is approved, the appropriate repression adjustment should be -.2. If, however, a three tier inclining block rate structure is approved, the appropriate repression adjustment should be -.4.*

AUF initially proposed a -.2 repression adjustment factor as part of its proposal for a two-tiered inclined conservation rate structure. (Tr. 1362.) Staff witness Stallcup testified that the -.2 repression factor was "too low," and explained that the Commission historically evaluated customer response rates to changes in prices at a repression factor of -.4. (Tr. 1386.) Mr. Stallcup went on to recommend that the Commission adopt a three-tiered rate block with aggressive rate factors which he expects will have more of a repression effect than the two-tiered rate structure proposed by AUF and create greater volatility in water bills. (Tr. 1389.) Mr. Stallcup acknowledged that "using a price elasticity of demand of -.4 would provide a better estimate of how AUF's customers will react to an increase in rates." (Tr. 1386-87.) Staff's witness Yingling cited a repression factor range from -.23 to -.81 (Tr. 1333.) Thus, if a three-tiered inclining block rate structure is approved, a -.4 factor is more appropriate than AUF's initial proposal of -.2. (Tr. 1333.)

ISSUE 61: What, if any, limits should be imposed on subsidy and affordability values that could result if stand-alone rates are converted to a consolidated rate structure?

AUF: *Subsidy and affordability values are not hard and fact rules; instead, they are guidelines to be used by the Commission when it first considers developing a fair and reasonable consolidated rate structure.*

During the hearing it became evident that affordability and the degree to which one customer group subsidizes another are but two of many factors that the Commission considers in evaluating a proposed rate structure. (Tr. 1344-46; 1349-50.) The Commission also takes into account other factors such as ease of administration, customer acceptance and understandability, rate continuity, conservation, and revenue stability. (Tr. 1350.) *See* Order No. PSC-96-1320-FOF-WS at 215. In addressing AUF's proposed consolidated rate structure, Staff witness Stallcup used an affordability guideline of \$73.52 for water and \$91.90 for wastewater (Tr. 1399.), and a subsidy guideline of \$5.90. (Tr. 1375.) He emphasized that he was more concerned about affordability than subsidy and explained that subsidies exist in every rate structure and that "there is no right or wrong answer" when it comes to subsidies. (Tr. 1399.) Accordingly, the affordability and subsidy values used by Staff witness Stallcup are generally appropriate as guidelines that the Commission can use in developing a fair and reasonable consolidated rate structure. However, those subsidy guidelines should not be employed as hard and fast rules. Undisputed evidence shows that there is an inverse relationship between achieving affordability goals and achieving subsidy goals (Tr. 1420.) Thus, rigid application of subsidy guidelines could deprive customers of affordability benefits provided by a uniform rate structure. (Tr. 1350.)

ISSUE 62: Is it appropriate to consider subsidy limits based on stand-alone rate structure since the majority of the Utility's systems have not had stand-alone rates for over 15 years?

AUF: *No.*

The record shows that a majority of AUF's systems have not had stand-alone rates since 1993; instead, those systems currently operate under "cap band" rate structure. (Tr. 1350.) *See* Order No. PSC-96-1320-FOF-WS. In establishing that "cap-band" structure, the Commission confirmed that its ultimate goal is to move these systems to a uniform rate structure. *Id.* at 221-

226. Thus, subsidy limits based on stand-alone rates would be a step backwards from the Commission's stated goal of uniform rates. (Tr. 1458-59.)

The record also establishes that 26 of AUF's water systems and 12 of its wastewater systems have been charging rates below their true cost of service for over 12 years. (Tr. 1548.) Those 38 systems (46% of all of AUF's systems) were being subsidized by other larger systems that have since been acquired by non-regulated utilities. (Tr. 1460, 1548; Exs. 163, 164.) This loss of subsidy has left the remaining systems with rate structures that fail to produce revenues that recover their costs. (Exs. 163, 164.) Thus, it would be inappropriate to now calculate any subsidy that may or may not occur based on a hypothetical stand alone rate.

ISSUE 63: What are the appropriate rate structures for the Utility's water and wastewater systems?

AUF: *The appropriate rate structures for the Utility's water and wastewater systems is a state wide uniform consolidated rate structure.*

The appropriate rate structure for AUF's water and wastewater systems is a state wide uniform consolidated rate structure. (Tr. 1348-54, 1370.) All witnesses testifying on this subject agreed that the most important benefit to be derived from AUF's consolidated rate structure proposal is that "the cost of system upgrades can be spread over a larger number of customers thereby mitigating the dramatic increase in rates." (Tr. 1394, 1410.) Staff witness Stallcup went further and testified that "because of the extreme values of the stand-alone rates involved . . . there is a particular merit to rate consolidation." (Tr. 1410.)

The record is clear that there are no legal impediments to the Commission adopting a uniform rate structure in this case. *See S. States Utils. v. Fla. Pub. Serv. Comm'n*, 714 So. 2d 1046 (Fla. 1st DCA 1998). In fact, Florida courts have determined that the equalization of rates among different systems is not unreasonably discriminatory as a matter of law. *Id.* at 1052. Mr. Stallcup agreed that there are no legal impediments to the Commission adopting a uniform rate

structure in this case, and he further acknowledged that the Commission has previously determined that moving toward a uniform rate structure is the goal for many of the systems that are part of this particular rate case. (Tr. 1411-13; Ex. 65, Tab 26 at pp. 15-16.) *See also*, Order No. PSC-96-1320-FOF-WS at 221-226.

Mr. Stallcup testified that the consolidated rate structure initially proposed by AUF addressed the affordability guidelines of the Commission, but did not adequately address the potential for excessive subsidies. (Tr. 1415.) In response to Mr. Stallcup's concerns, AUF provided an alternative rate structure comprised of 3 water rate groupings: a main-group consisting of 48 systems with a consolidated bill of \$44.46; a mid-group consisting of 4 systems with a consolidated bill of \$40.83; and a low-group consisting of 5 systems with a consolidated bill of \$29.79. (Tr. 1416, Ex. 211.) Under this alternative, only 6 systems would exceed the subsidy guideline of \$5.90. (Tr. 1421-22.) One of the systems - Carlton Village - would have its bills actually decrease compared to current rates, and 3 systems would fall outside the subsidy guidelines by a matter of cents and not dollars.²² (Tr. 1422, Ex. 211.)

On cross-examination, Staff witness Stallcup stated that AUF's rate structure alternatives were certainly worthy of consideration by the Commission when it decides on AUF's rate structure in this case. (Tr. 1427.)

ISSUE 64: What water systems, if any, should be consolidated into a single rate structure? **(Rates Agenda Issue)**

AUF: *All water systems.*

ISSUE 65: What wastewater systems, if any, should be consolidated into a single rate structure? **(Rates Agenda Issue)**

AUF: *All wastewater systems.*

²² Another alternative discussed at the hearing, which was based on a discounted revenue requirement, included 2 water rate groupings: a main-group consisting of 51 systems with a consolidated bill of \$30.38; and a low-group consisting of 7 systems with a consolidated bill of \$26.32. Under this alternative, only 2 systems would fall outside the subsidy guidelines. (Ex. 211, p. 2.)

ISSUE 66: What, if any, are the appropriate repression adjustments to be made? (**Rates Agenda Issue**)

AUF: *As explained in Issue 45, only repression adjustments to Chemicals and Purchased Power should be made.*

ISSUE 67: What are the appropriate monthly rates for the water and wastewater systems for the Utility? (**Rates Agenda Issue**)

AUF: *The appropriate monthly rates for the water and wastewater systems for the Utility are contained in the MFRs for each respective system.*

ISSUE 68: Should the Utility be authorized to revise its miscellaneous service charges, and, if so, what are the appropriate charges?

AUF: *Yes. Consistent with Commission practice, AUF should be authorized to revise its miscellaneous service charges to the requested charges contained in the MFRs.*

ISSUE 69: In determining whether any 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?

AUF: *There should be no interim refunds.*

Interim rates collected by AUF during this proceeding were established below the revenue level to which AUF was entitled. Order No. PSC-08-0534-FOF-WS ("Interim Order"). (Tr. 386, 1354-56; Ex. 180, Schedule G.) The difference between the interim rates to be collected and the total interim revenues authorized were placed into a regulatory asset and deferred by operation of the Interim Order. Pursuant to the Interim Order, AUF's interim increase for the former FWSC systems should have been based on the aggregated revenues for all of these systems. *See* Interim Order at 10. AUF has now discovered that the Interim Order contains a computational error that deprived AUF of significant interim rate relief to which it is legally entitled. (Tr. 1573.) The Commission staff's workpapers show that it erred when it singled out 3 specific systems from the aggregated group (Silver Lakes Estates water, Skycrest water and Palm Terrace wastewater) concluded that these systems were over-earning, and denied interim rate relief. This error deprived AUF interim rate relief which is calculated at \$588,239 on an

annualized basis. (Tr. 1573.) To make AUF whole, the amount of this interim rate error should be included in the regulatory asset and recovered over a two year period. (*Id.*; Tr. 1355.)

ISSUE 70: 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, F.S.?

AUF: *This is a fall out calculation based on adjustments to revenue requirements and the appropriate rate case expense.*

OTHER ISSUES

ISSUE 71: What are the appropriate service availability charges for Aqua?

AUF: *The appropriate service availability charges are contained in the MFRs.*

ISSUE 72: Should the Utility be authorized to charge Allowance for Funds Prudently Invested (AFPI) charges, and, if so, what are the appropriate charges?

AUF: *Yes. The Utility's AFPI charges have been properly supported in the record. (Tr. 1573-74.)*

ISSUE 73: In accordance with Order No. PSC-08-0534-FOF-WS what is the amount and who would have to pay the regulatory asset (or deferred interim revenues), if it is ultimately determined by the Commission that the Utility was entitled to those revenues when it first applied for interim rates?

AUF: * Precise resolution of this issue will be based on the final revenue requirement adjusted for rate case expense.*

As explained in Issue 69, the lost interim revenues which AUF experienced as a result of the computational error in the Interim Order should also be included in the regulatory asset and recovered from customers. (Tr. 1573.) There is nothing under Florida law that would prohibit the Commission from allowing AUF to recover these lost revenues as part of a regulatory asset recovery surcharge. In fact, the Supreme Court in *GTE Florida Inc. v. Clark*, 668 So.2d 971, 975 (Fla. 1996) expressly determined that it would be inequitable to deny a utility the right to recover an increase in rates due to a "defect" in the order entered by the Commission, and that such recovery by surcharge would not be retroactive ratemaking. AUF is neutral with respect to which customers are required to pay the regulatory asset provided that it is made whole and

allowed the interim revenues to which it was entitled. Furthermore, recovery of this regulatory asset can be accomplished without violating the principles of uniform rates or single cost of service.

ISSUE 74: Should the Utility be allowed to make future index and pass through filings on a consolidated basis?

AUF: *Yes. Consistent with its single cost of service methodology, AUF should be allowed to make future index and pass through filings on a consolidated basis. This comports with Order No. PSC-96-1320-FOF-WS at 240-241.*

ISSUE 75: Should the Utility's request to consolidate its in-state FPSC-regulated accounting, filing and reporting requirements from individual system bases to one combined set of books be allowed?

AUF: *Yes.*

The record is clear that AUF's proposal for a consolidated rate structure involves two separate, but related concepts: a uniform tariff price (or a plan to achieve such over time) and a single cost of service. (Tr. 1452.) Under AUF's proposed single cost of service concept, AUF's Commission-regulated operations would be treated as one entity, instead of 82 separate systems, for purposes of establishing AUF's overall revenue requirement. Utility Plant and related accounts would continue to be tracked and reported by individual systems. (Tr. 1363-1366; 1452-53.) During the hearing, it became evident that the Commission has adopted a single cost of service concept for multi-system natural gas utilities, and by so doing expressly recognized that a single cost of service would provide real cost savings and benefits to customers by reducing or eliminating the "multiplicity of rate proceedings." *See* FPSC Order No. 5498, 1972 Fla. PUC LEXIS 123. (Tr. 1428-29.) The undisputed testimony in this case shows that AUF's single cost of service approach is expected to reduce future rate case expense by "forty-to-fifty percent," and thereby bring savings to customers. (Tr. 1365-66.) Accordingly, there being no

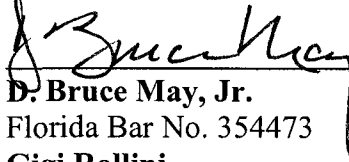
evidence in the record refuting its proposal for a single cost of service, AUF should be allowed to consolidate its in-state FPSC-regulated accounting, filing and reporting requirements.

ISSUE 76: Should this docket be closed?

AUF: *Yes.*

Respectfully submitted this 30th day of December, 2008.

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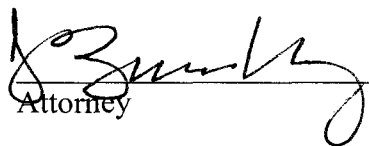
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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was furnished by electronic transmission to **Ralph Jaeger, Esq., Katherine Fleming, Esq., Caroline Klancke, Esq., Erik Saylor, Esq., Office of General Counsel, Florida Public Service Commission, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, Charles Beck, Esq., Office of Public Counsel, 111 West Madison Street, Room 812, Tallahassee, Florida 32399-1400, and to Cecilia Bradley, Esq., Office of the Attorney General, The Capitol – PL01, Tallahassee, FL 32399-1050, this 30th day of December, 2008.**



Attorney