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**Subject:** Electronic Filing: Docket No. 100330-WS - OPC's Preliminary Areas of Concern  
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Electronic Filing

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**b. Docket No. 100330-WS**

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

c. Document being filed on behalf of Office of Public Counsel

d. There are a total of **23 pages**.

e. The document attached for electronic filing is **Citizens Preliminary Areas of Concern in the Aqua Utilities Florida, Inc., Rate**.

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DOCUMENT NUMBER-DATE

01964 MAR 24 =

FPSC-COMMISSION CLERK

3/24/2011

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Application for increase in water/ )  
wastewater rates in Alachua, Brevard, DeSoto, ) DOCKET NO. 100330-WS  
Hardee, Highlands, Lake, Lee, Marion, Orange, )  
Palm Beach, Pasco, Polk, Putnam, ) March 24, 2011  
Seminole, Sumter, Volusia, and Washington )  
Counties by Aqua Utilities Florida, Inc. )  
\_\_\_\_\_ )

CITIZENS' PRELIMINARY AREAS OF CONCERN IN THE  
AQUA UTILITIES FLORIDA, INC. RATE CASE  
DOCKET NO. 100330-WS

The Office of Public Counsel (OPC) files this document to provide the staff of the Florida Public Service Commission (PSC) with our preliminary areas of concern in the Aqua Utilities Florida, Inc. rate case. These are not meant to be a complete list that we would pursue if this case were to go to hearing. This list encompasses many of our issues based on a current review of the responses to discovery and staff data requests. More issues may be added as we continue our review and some issues may be deleted as additional responses are received.

**I. QUALITY OF SERVICE**

The quality of service is unsatisfactory. The Commission should reduce the utility's return on equity for its failure to provide satisfactory customer service, accurate bills, and satisfactory water quality to its customers. The testimony at the customer meetings overwhelmingly demonstrated the extreme customer dissatisfaction with Aqua's water quality, customer service, billing and affordable rates. The utility has made assertions at the customer meetings and in its quality of service reports that it has added significant plant and made significant changes to its customer service. Despite these assertions, the customers are still extremely dissatisfied with the quality of their water and their interactions with the utility's customer service.

**II. RATE BASE**

**Pro Forma Plant Additions**

Aqua Utilities Florida, Inc.'s (AUF) filing includes an historic test year ending April 30, 2010. The utility has proposed pro forma plant additions of \$3,879,469 for plant to be constructed after the test year. The plant additions are offset by \$369,045 of projected retirement values, resulting in net additions of \$3,510,425 included in the

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filing. The filing contends that these are all plant additions that are projected to be complete within a year from the filing.

In allowing pro forma plant additions, the Commission considers whether the item is known and measurable. It has typically required substantial support for the additions, such as design documents, contracts and project quotes. Based on our review of the support provided by AUF in response to Citizens PODs and interrogatories, as well as information provided in response to Staff interrogatories, AUF has not supported many of the proposed additions. For several of the projections, the Utility has provided minimal to no support, particularly for the projects for which construction has not begun. Additionally, several projects have been completed for less than the projected cost included in the filing, and several of the projects have been canceled or delayed.

We recommend that for the pro forma plant additions contained in the filing, several should be reduced to reflect actual costs and several should be removed in their entirety. We further recommend that the projects that have been delayed so long that they are not projected to be completed by 4/30/11 – or 12 months after the test period in the case, be removed. For each of those projects, the Utility also has not provided a reasonable level of support for the costs.

Our recommended revisions to the proposed pro forma plant additions, by rate band, are presented in the tables below, along with brief explanations for why various projects should be removed. These tables provide the recommended reductions to plant in service (PIS), by rate band, to remove the pro forma additions. These will also impact depreciation expense and accumulated depreciation, which will be fall-out numbers, and are not included in the tables below. The tables below do not include the impact of any non-used and useful factors.

A. Water Rate Band 1

<u>AUF-W1</u>	<u>Date In Service</u>	<u>Plant Add in MFRs</u>	<u>Actual Cost</u>	<u>Reduction to PIS</u>
Ocala Oaks - Hydropneumatic Tank Replacement	1/26/11	40,000	32,658	(7,342)
Rosealie Oaks - Hydropneumatic Tank Replacement	2/8/11	40,000	39,439	(561)
Tangerine Looping Project	9/29/10	90,000	127,564	37,564
Jasmine Lake Disinfection Contact Time	Est 4/11	180,000	-	(180,000)
Tangerine Hardness sequestering	2010	9,500	9,500	-
Reduction to Pro forma Plant Additions				<u>(150,339)</u>

The Jasmine Lake Disinfection Contract Time project should be removed as the Utility has provided no support for the project costs and the project has not yet started. The Utility has not addressed this project in several responses to interrogatories that seek support for project costs and project status for the various plant additions.

B. Water Rate Band 2

<u>AUF-W2</u>	<u>Date In Service</u>	<u>Plant Add in MFRs</u>	<u>Actual Cost</u>	<u>Reduction to PIS</u>
Lake Gibson Estate - Hydropneumatic Tank Replacement	11/2/2010	80,000	78,877	(1,123)
Piney Woods - Hydropneumatic Tank Replacement	4/29/10	35,000	29,928	(5,072)
Sunny Hills - connect Well 4 to Plant 1 Storage Fac	Est. 4/14/11	50,000	-	(50,000)
Sunny Hills - Additional Storage Facility	Est. 6/14/11	120,000	-	(120,000)
Reduction to Pro forma Plant Additions				<u>(176,195)</u>

The Sunny Hills - Connect Well 4 to Plant 1 Storage Facility project should be removed because: (1) the project has not yet begun; (2) bids have just recently been received for some of the project which do not support the cost in the filing; (3) the project is still being designed; (4) projected costs not supported; and (5) it does not appear likely that the project will be complete within twelve months after the end of the test year. While they did indicate an April 14, 2011 completion date in response to an interrogatory, the design is not yet even complete and no contracts have been entered.

The Sunny Hills – Additional Storage Facility project should be removed because: (1) the design and permitting of the project are not complete; (2) the project has not even been started; (3) the projected costs in the filing have not been supported; and (4) it will not be completed within one year after the test year.

C. Water Rate Band 3

<u>AUF-W3</u>	<u>Date In Service</u>	<u>Plant Add in MFRs</u>	<u>Actual Cost</u>	<u>Revision to PIS</u>
48 Estates - Hydropneumatic Tank Replacement	5/27/10	23,345	21,253	(2,092)
Ravenswood - Hydropneumatic Tank Replacement	5/25/10	10,000	23,173	13,173
Increase to Pro forma plant additions				<u>11,081</u>

For Water Rate Band 3, the actual cost of one of the projects that was included was higher than the original projection contained in the filing. Thus, the net impact is an increase in the pro forma plant additions of \$11,081.

#### D. Water Rate Band 4

AUF-W4	Date In Service	Plant Add in MFRs	Actual Cost	Reduction to PIS
Arredondo Estates - Hydropneumatic Tank Replacement	Est 2/28/11	60,000	59,862	(138)
The Woods - Hydropneumatic Tank Replacement	4/29/10	30,000	26,581	(3,419)
Tomoka View and Twin Rivers Storage Liners (a)	Est 3/30/11	70,000	70,000	-
Lake Suzy - Fire Flow	Est 5/30/11	65,000	-	(65,000)
Lake Josephine/Sebring - Secondary Water quality	Est 5/30/11	300,000	-	(300,000)
Leisure Lakes - Secondary Water Quality	Est 5/30/11	150,000	-	(150,000)
Summit Chase - Water Sand Strainer Project	11 & 12/10	20,000	14,255	(5,745)
Zephyr Shores Water quality project	2010	36,217	36,217	-
Reduction to Pro forma plant additions				<u>(524,302)</u>

The Lake Suzy Fire Flow project is still in the design phase. The projected has been delayed to more than twelve months after the end of the test year and the AUF has provided no quotes or support for the projected costs.

For the Lake Josephine/Sebring – Secondary Water Quality project, the projected has been delayed to more than a year after the end of the test year and no bids have been received on the project.

The Leisure Lakes – Secondary Water Quality project should be removed because: (1) the design and DEP permit package is not yet complete, (2) the projected completion is more than twelve months after the end of the test year; and (3) bidding has not yet started on the project. AUF has not supported the projected costs.

The Tomoka View and Twin Rivers Storage Liners pro forma addition of \$70,000 should also be removed. It is still in the list above as an addition; however, we have been unable to find support or any information on this project in the information provided to date.

#### E. Wastewater Rate Band 2

AUF-S2	Date In Service	Plant Add in MFRs	Actual Cost	Reduction to PIS
Park Manor I & I	Deferred	40,000	-	(40,000)
Arredondo Farms - WWTF Upgrades	9/10	240,000	291,870	51,870
Jasmine Lakes - Generator (a)	Est. 3/31/11	50,000	50,000	-
Jasmine Lakes - weir and walkway replacement	Deferred	65,000	-	(65,000)
Lake Suzy - Air headers and Surge Tank	12/10?	80,000	141,695	61,695
South Seas - Reject and Surge Tank Replacement	Est. 3/1/11	400,000	400,000	-
South Seas - Wet Weather Storage	Canceled	350,000	-	<u>(350,000)</u>
Reduction to Pro forma plant additions				<u>(341,435)</u>

For the Park Manor I & I Project, the Jasmine Lakes Weir and Walkway Replacement project, and the South Seas Wet Weather Storage project, AUF indicated in response to discovery that it has decided to either defer or cancel the project and is no longer requesting recovery in this case.

The Jasmine Lakes Generator project (\$50,000) is still included, at this point, in the above listing. However, we have been unable to find any support for the cost in the information reviewed to date and the Utility did not provide the current status in response to discovery.

F. Wastewater Rate Band 3

AUF-S3	Plant Add in MFRs	Actual Cost	Reduction to PIS
Jungle Den – Sewer I & I	60,000	-	(60,000)
Rosalie Oaks – Relocate to plant site	80,000	-	(80,000)
Reduction to Pro forma plant additions			<u>(140,000)</u>

AUF included \$60,000 in its pro forma plant additions in Wastewater Rate Band 3 for a Jungle Den Sewer I&I study /project. However, the Utility ended up doing the project in-house with internal staff for a much lower cost. Thus, the full addition of \$60,000 should be removed from the pro forma plant additions. The costs associated with in-house staff are covered elsewhere in the Utility's filing.

AUF included \$80,000 in its pro forma plant additions in Wastewater Rate Band 3 to relocate a lift station in the Rosalie Oaks system. We do not believe the utility has justified the prudence and need for this investment.

G. Wastewater Rate Band 4

AUF-S4	Date In Service	Plant Add in MFRs	Actual Cost	Reduction to PIS
Village Water - Effluent Disposal	Est 5/30/11	75,000	-	(75,000)
Village Water - Effluent Reuse Solution		175,000	-	(175,000)
Reduction to Pro forma plant additions				<u>(250,000)</u>

For these projects, AUF indicated that the project has changed and that it has not yet been determined what will ultimately be done and what the project will entail. AUF indicated it is in negotiations with a property owner to potentially acquire land to dispose of the effluent and that analysis and design are being performed to see if that is a viable option. The originally projected option was determined to not be a viable option and the ultimate project may end up being significantly more costly than the amount included in the filing. Given the status, it appears unlikely that it will be completed in the near future.

#### H. Other Rate Bands

<u>Other Rate Bands:</u>	<u>Date In Service</u>	<u>Plant Add in MFRs</u>	<u>Actual Cost</u>	<u>Reduction to PIS</u>
Breeze Hill - Sewer I & I	Est 3/31/11	100,000	-	<u>(100,000)</u>
Peace River - Gross Alpha Treatment	Est. 12/11	50,000	-	<u>(50,000)</u>

For the Breeze Hill Sewer I & I project, the project is still in the bidding process, the estimate in the filing is not support by any documentation, contracts or quotes, and it has not yet begun.

For the Peace River – Gross Alpha Treatment project, the project has been significantly delayed. The project is very preliminary in nature and the Utility does not yet know what it will do with the project. Cleary the cost projections are unsupported and will occur well beyond the test period.

#### III. Used and Useful

Generally, OPC believes that the used and useful methodologies supported by the OPC witness in the last rate case should be used in this rate case. Because the *used and useful percentages are overstated*, the utility's revenues are overstated which leads to unaffordable rates for the customers. Following are specific concerns with changes in this rate case.

##### A. Palm Port

The Palm Port wastewater treatment plant was stipulated in the last rate case to be 58% used and useful. The current case indicates 100% used and useful. In its response to OPC Interrogatory No. 142, the utility provided its calculation for used and useful and indicates that the capacity is based on 15,000 gpd rather than the 40,000 gpd used in the last case. We believe that the Commission should be consistent and used the 40,000 gpd used in the last rate case.

##### B. Breeze Hill

The Commission found that the Breeze Hill wastewater plant was 56.63% used and useful. The system has not added more than a few customers since the last rate case in Docket No. 011481-WS. Schedule F-6 in the current rate case shows an excessive amount of infiltration and inflow which appears to be what the utility is relying on to raise its used and useful percentage from 56.63% to 95.86% used and useful. We believe that the excessive infiltration and inflow should be removed before the used and useful calculation is made. We recognize that the net plant is not material; however, it is important to set the correct percentage for future cases when plant additions may be material.

C. Zephyr Shores

The last rate case included a second well for this system. This well does not appear to have been added to the used and useful calculation on Schedule F-5.

D. Peace River

The Commission has not previously set a used and useful amount for this system. Schedule F-3 Appendix shows Water Treatment Data. The Peace River water treatment plant has a capacity of 260,000 gpd and a maximum day of 141,000 gpd, which does not calculate to be 100% used and useful. However, the utility shows it as 100% used and useful. The lines are 81.7% and 80% used and useful but the utility claims that the system is built out so it should be 100%. The wastewater treatment plant has a calculated used and useful percent of 54.43% but the utility uses a 100% amount due to the utility's claim that the system is built out. The utility purchased these systems recently and should have found in a due diligence that the system capacity was larger than the current demand. We do not believe that the current customers should be required to pay for the extra demand. The utility should have made accommodations for that in the price it was willing to pay for the system and any excess should be the responsibility of the shareholders.

E. Fairways at Mount Plymouth

The Commission has not previously set a used and useful amount for this system. Schedule F-3 Appendix shows Water Treatment Data. The Fairways plant has a capacity of 360,000 gpd and a maximum day of 253,000 gpd, but the utility shows it as 100% used and useful. The utility has multiple wells but the utility uses 100% as the claims that the system is built out. The wastewater treatment plant has a calculated used and useful percent of 39.95% but the utility uses a 100% amount for the same reason. The utility purchased these systems recently and should have found in a due diligence that the system capacity was larger than the current demand. We do not believe that the current customers should be required to pay for the extra demand. The utility should have made accommodations for that in the price it was willing to pay for the system and any excess should be the responsibility of the shareholders.

**IV. Working Capital Allowance**

A. Materials and Supplies

Schedule A-18, Page 1 of 1 shows the monthly balances for Materials and Supplies. The April 30, 2009 balance is \$216,412 and the April 30, 2010 balance is \$609,054. This is an increase of 181%. The utility response to OPC Interrogatory No. 128 explains that the increase is related to the installation of the new RF Meters. However, in response to OPC Interrogatory No. 19 the utility stated that the radio frequency meter exchange program was completed in 2008. We do not believe that there should be such a large inventory maintained on a monthly basis that would be needed to replace new meters. Some level of inventory should certainly be maintained, but the utility has not justified why it should be at this level.



## B. Accrued Taxes

Included in Cash Working Capital is a negative amount for accrued taxes of (\$1,129,222), which serves to increase the working capital allowance. Typically, accrued taxes result in a reduction to working capital, not an increase.

This issue was addressed in the prior AUF case and was adjusted by the Commission in PSC-09-0385-FOF-WS. In that case, the accrued tax amount (debit) was the result of amounts owed to Aqua Utilities Florida, Inc. from the parent company Aqua America, Inc. for the tax benefit of the losses that were included in the 2006 and 2007 Federal Income Tax returns. In that case, the Commission ordered as follows:

Since the debit-balance in accrued taxes is caused by tax benefits related to losses included in prior federal income tax returns, and the Utility will be reimbursed these amounts by its parent company, the taxes owed to AUF in the amount of \$2,884,818 shall be removed from the 13-month average to normalize the balance. To normalize the accrued tax balance for purposes of setting rates, the negative amount of federal income tax included in AUF's accrued tax detail schedule shall be removed from the accrued taxes balance for the test year. The 13-month average balance for accrued taxes less the amounts included for federal income tax results in a net credit balance of \$179,622. This equates to an adjustment of \$1,334,964 to normalize the accrued taxes balance for the test year. As a result, we find that an adjustment of \$1,334,964 shall be made to accrued taxes.

Once again in this case, there is a substantial accrued tax debit balance. Based on the general ledger provided by AUF, the (\$1,129,222) included for accrued taxes in the working capital calculation includes (\$1,892,709) for the 13-month average test year balance in Account 236129 – Accrued Taxes – Federal – AQS. This (\$1,892,709) should be removed, resulting in a \$1,892,709 reduction to working capital. Staff addressed this in its Audit Finding 4, but had a slightly different balance of \$1,917,134 instead of \$1,892,709.

## V. CAPITAL STRUCTURE

### Accumulated Deferred Income Taxes – Bonus Depreciation and Plant Additions

While the Utility has included pro forma plant additions in its filing, it has not included the impact of those plant additions on the accumulated deferred income tax (ADIT) balance that is included as part of the capital structure at zero cost. The inclusion of ADIT in the capital structure serves to reduce the overall rate of return and acknowledges that the ADIT is a cost free source of capital to the Utility. It is not appropriate to include pro forma plant additions in rate base without also reflecting the increase in ADIT in the capital structure that will result from those very same projects. We recommend that the ADIT associated with the pro forma plant additions that are allowed in rate base be reflected in the capital structures on a rate band by rate band basis. In the historic test year, the ADIT is allocated amongst the various Florida rate

bands; however, the ADIT associated with the pro forma additions should be assigned to the rate bands which include the plant additions.

The Small Business Jobs Act was signed into law on September 27, 2010. This Act reinstated the 50 percent bonus tax depreciation for 2010 retroactively to January 1, 2010. Additionally, The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 was signed into law on December 17, 2010. This Act provides for 100 percent bonus tax depreciation for qualifying capital investments placed into service after September 8, 2010 through December 31, 2011. As a result of these Acts, the majority of capital additions completed by AUF between January 1, 2010 and September 7, 2010 qualify for 50 bonus depreciation, and the majority of capital additions already completed or to be completed by AUF between September 8, 2010 and December 31, 2011 will qualify for the 100% bonus depreciation. For the periods in which the 50% bonus depreciation is applicable, the Utility will also be able to depreciate, for tax purposes, the remaining 50% of the balances using the normal tax depreciation schedules. Thus, the depreciation that will be received for income tax purposes will be in excess of 50% during the periods in which the 50% bonus depreciation applies. Therefore, the utility will be able to pay significantly less income taxes, if any. In fact, in a company conference call with financial analysts on February 24, 2011, the company projected that it may not owe any income taxes for 2011.

As both of these Acts were signed into law AFTER the date AUF's filing was prepared, the filing does not include the impact of the bonus depreciation on the ADIT balances in the filing. The bonus depreciation provides significant cash flow benefits to AUF as a result of significant reductions to income taxes. These benefits should increase the accumulated deferred income taxes included in the capital structure, which will lower the overall rate of return. Therefore, several adjustments need to be made to reflect the impacts.

#### A. Historic Test Year Bonus Depreciation – ADIT Impact

The first adjustment that should be made is to reflect the increase in ADIT associated with the plant additions that were placed into service by AUF between January 1, 2010 and April 30, 2010, or the last four months of the test period in this case. In response to Citizens Interrogatory 140, the Utility provided the impact of the bonus depreciation on the ADIT balances in the capital structure resulting from the additions placed into service during the period January 1, 2010 through April 30, 2010. Based on a review of the response, it appears the Utility factored in the impact correctly in the revised capital structures presented in the response. The impact, comparing the rate of return in the original filing to the updated rate of return reflecting the impact of the historic test year bonus depreciation, is included in the tables to be provided below in the discussion of the bonus depreciation on the pro forma plant additions.

#### B. Pro Forma Plant Additions – Bonus Depreciation

The ADIT balances presented in the filing also need to be updated to reflect the impact of the bonus depreciation on the pro forma plant additions included in the case.

The majority of the additions will qualify for either 50% or 100% bonus depreciation. Whether the 50% or the 100% rate is applicable depends upon the date the project is completed. For each pro forma plant addition that is allowed, the associated ADIT impact should also be reflected in the capital structure for the respective rate bands. It would be inappropriate to allow a pro forma addition in plant in service with the resulting depreciation expense and not include the impact on accumulated deferred income taxes resulting from that same addition.

There are several interrogatories outstanding seeking the information needed to quantify the impact on ADIT in each of the respective capital structures resulting from bonus depreciation. Below are tables, by rate band, of initial estimates of the ADIT associated with each of the adjusted pro forma plant additions. These exclude the ADIT impact from the pro forma plant additions we have recommended for disallowance. As for the pro forma additions that we recommend be removed, the associated ADIT impact needs to be reflected for any that are subsequently allowed.

The estimates below assume a consolidated tax rate of 38.575% and also assume that the additions are subject to the MACRS 20 year tax tables for tax purposes. These are also consistent with the assumptions used by AUF in determining the impact of bonus depreciation on the historic test year plant additions. We need the Utility's responses to discovery for more precise estimates.

### 1. Water Rate Band 1

AUF-W1	Date In Service	Plant Add In MFRs	Actual Cost	Reduction to PIS	Qualify for Bonus Deprec.	Estimated ADIT Impact
Ocala Oaks - Hydropneumatic Tank Replacement	1/26/11	40,000	32,658	(7,342)	Yes - 100%	12,238
Rosealle Oaks - Hydropneumatic Tank Replacement	2/8/11	40,000	39,439	(561)	Yes - 100%	14,778
Tangerine Looping Project	9/29/10	90,000	127,564	37,564	Yes - 100%	48,061
Jasmine Lake Disinfection Contact Time	Est 4/11	180,000	-	(180,000)		
Tangerine Hardness sequestering	2010	9,500	9,500	-	Yes - 50%	1,757
Reduction to Pro forma plant additions				<u>(150,339)</u>		
Increase In ADIT In Capital Structure						<u>76,834</u>
Rate of Return In Initial Filing						7.55%
Rate of Return updated for bonus depreciation on TY additions						7.53%
Rate of Return adjusted for Estimated ADIT Impact - Post TY adds						7.43%
Rate of return adjusted for reduction to PIS and ADIT Impact						7.42%

## 2. Water Rate Band 2

AUF-W2	Date In Service	Plant Add in MFRs	Actual Cost	Reduction to PIS	Qualify for Bonus Deprec. ?	Estimated ADIT Impact
Lake Gibson Estate - Hydropneumatic Tank Replace.	11/2/2010	80,000	78,877	(1,123)	Yes - 100%	29,557
Piney Woods - Hydropneumatic Tank Replacement	4/29/10	35,000	29,928	(5,072)	Yes - 50%	5,731
Sunny Hills - connect Well 4 to Plant 1 Storage Fac	Est. 4/14/11	50,000	-	(50,000)		
Sunny Hills - Additional Storage Facility	Est. 6/14/11	120,000	-	(120,000)		
Reduction to Pro forma plant additions				<u>(176,195)</u>		
Increase In ADIT in Capital Structure						<u>35,287</u>
Rate of Return in Initial Filing						7.54%
Rate of Return updated for bonus depreciation on TY additions						7.51%
Rate of Return adjusted for Estimated ADIT impact - post TY adds						7.44%
Rate of return adjusted for reduction to PIS and ADIT impact						7.42%

## 3. Water Rate Band 3

AUF-W3	Date In Service	Plant Add in MFRs	Actual Cost	Reduction to PIS	Qualify for Bonus Deprec. ?	Estimated ADIT Impact
48 Estates - Hydropneumatic Tank Replacement	5/27/10	23,345	21,253	(2,092)	Yes - 50%	4,070
Ravenswood - Hydropneumatic Tank Replacement	5/25/10	10,000	23,173	13,173	Yes - 50%	4,437
Reduction to Pro forma plant additions				<u>11,081</u>		
Increase in ADIT in Capital Structure						<u>8,507</u>
Rate of Return in Initial Filing						7.58%
Rate of Return updated for bonus depreciation on TY additions						7.55%
Rate of Return adjusted for Estimated ADIT Impact - post TY adds						7.50%
Rate of return adjusted for reduction to PIS and ADIT Impact						7.50%

## 4. Water Rate Band 4

AUF-W4	Date In Service	Plant Add in MFRs	Actual Cost	Reduction to PIS	Qualify for Bonus Deprec.	Estimated ADIT Impact
Arredondo Estates - Hydropneumatic Tank Replacement	Est 2/28/11	60,000	59,862	(138)	Yes - 100%	22,431
The Woods - Hydropneumatic Tank Replacement	4/29/10	30,000	26,581	(3,419)	Yes - 50%	5,090
Tomoka View and Twin Rivers Storage Liners (a)	Est 3/30/11	70,000	70,000	-	Yes - 100%	26,230
Lake Suzy - Fire Flow	Est 5/30/11	65,000	-	(65,000)		
Lake Josephine/Sebring - Secondary Water quality	Est 5/30/11	300,000	-	(300,000)		
Leisure Lakes - Secondary Water Quality	Est 5/30/11	150,000	-	(150,000)		
Summit Chase - Water Sand Strainer Project	11 & 12/10	20,000	14,255	(5,745)	Yes - 100%	5,249
Zephyr Shores Water quality project	2010	36,217	36,217	-	Yes - 50%	6,699
Reduction to Pro forma plant additions				<u>(524,302)</u>		
Increase In ADIT in Capital Structure						<u>65,699</u>
Rate of Return in Initial Filing						7.60%
Rate of Return updated for bonus depreciation on TY additions						7.58%
Rate of Return adjusted for Estimated ADIT Impact - post TY adds						7.52%
Rate of return adjusted for reduction to PIS and ADIT Impact						7.50%

## 5. Wastewater Rate Band 1

AUF-S1	Date In Service	Plant Add in MFRs	Actual Cost	Reduction to PIS	Qualify for Bonus Deprec.	Estimated ADIT Impact
Valencia Terrace WWTF Improvements (a) ???		82,071	82,071	-	Yes - 50%	14,861
Increase In ADIT In Capital Structure						14,861
Rate of Return In Initial Filing						7.52%
Rate of Return updated for bonus depreciation on TY additions						7.50%
Rate of Return adjusted for Estimated ADIT impact - post TY adds						7.34%

## 6. Wastewater Rate Band 2

AUF-S2	Date In Service	Plant Add in MFRs	Actual Cost	Reduction to PIS	Qualify for Bonus Deprec.	Estimated ADIT Impact
Park Manor I & I	Deferred	40,000	-	(40,000)		
Arredondo Farms - WWTF Upgrades	9/10	240,000	291,870	51,870	Yes - 100%	106,329
Jasmine Lakes - Generator (a)	Est. 3/31/11	50,000	50,000	-	Yes - 100%	18,215
Jasmine Lakes - weir and walkway replacement	Deferred	65,000	-	(65,000)		
Lake Suzy - Air headers and Surge Tank	12/10?	80,000	141,695	61,695	Yes - 100%	51,620
South Seas - Reject and Surge Tank Replacement	Est. 3/1/11	400,000	400,000	-	Yes - 100%	145,721
South Seas - Wet Weather Storage	Canceled	350,000	-	(350,000)		
Reduction to Pro forma plant additions				(341,435)		
Increase In ADIT In Capital Structure						197,341
Rate of Return In Initial Filing						7.59%
Rate of Return updated for bonus depreciation on TY additions						7.57%
Rate of Return adjusted for Estimated ADIT Impact - post TY adds						7.39%
Rate of return adjusted for reduction to PIS and ADIT impact						7.37%

For the remaining pro forma projects requested by the Utility, we have either recommended that they be removed (see previous section), or they would not qualify for the bonus depreciation due to the type of project. These adjustments to the accumulated deferred income taxes will increase the balance and because it has a zero cost rate, the overall cost of capital will be lowered. The impact of bonus depreciation on the test year plant additions has the following impact on the rate of return for the remaining rate bands: (1) Wastewater Rate Band 3 ROR went from 7.49% to 7.47%; (2) Wastewater Rate Band 4 ROR went from 7.57% to 7.55%; (3) Breeze Hill remains at 7.87%; (4) Fairway at Mt. Plymouth went from 7.94% to 7.87%; and (5) Peace River went from 7.70% to 7.68%.

## VI. NET OPERATING INCOME

### A. Revenues

Test year consumption and therefore revenue is understated due to abnormally high levels of rainfall during the test year. NOAA data, company budgets, and newspaper articles indicate that rainfall during the test year was abnormally high. Therefore, test year revenue should be increased to reflect a more normal level of

consumption and rainfall. The Utility's 2010 budget also indicates that test year consumption is understated. We recommend that the following adjustment be made to increase test year revenues.

Estimated Total Company Adjustment		AUF Jurisdictional Percentages		AUF Jurisdictional Adjustments	
Water	Sewer	Water %	Sewer %	Water	Sewer
\$ 605,326	\$ 224,994	72%	43%	\$ 436,050	\$ 95,752

**B. Non-Utility Revenue**

Non-Utility Revenue should be moved above the line for ratemaking purposes. We requested information about non-utility revenue in OPC Interrogatory No. 42. However, the utility's response is different than what Aqua showed in the response to OPC Request for Production of Documents (POD) No. 8, Attachment 1. It appears that the utility has substantial non-utility revenue that has not been allocated to the Florida systems. Moreover, the Utility refused to supply non-utility income at the parent level in its response to OPC Interrogatory No. 42. In the absence of consistent and accurate data, the Commission should err in the favor of customers and the following non-utility revenue amounts should be included in test year revenues.

Estimated Total Company Adjustment		AUF Jurisdictional Percentages		AUF Jurisdictional Adjustments	
Water	Sewer	Water %	Sewer %	Water	Sewer
\$ 277,669	\$ 177,832	72%	43%	\$ 200,021	\$ 75,681

**C. Excessive "Other Use" Water**

As part of its calculation of unaccounted for water, the utility includes a certain amount of "water for other uses." The F-1 Appendix, pages 5 and 6 of 8, shows the "water for other uses" used for each system. The average amount of "other uses" appears to be about 20% of the total water sold, or less. However, the amounts shown for the following four systems equate to more water for "other uses" than the total amount of water sold. These appear to be excessive amounts of "water for other uses." Unless the utility can justify the excessive "water for other uses," the allowable amount should be reduced to 20% and corresponding adjustments should be made to operating expenses.

<u>System</u>	<u>Pump/Purch</u>	<u>Other Uses</u>	<u>Gallons Sold</u>	<u>Other as % of Sold</u>
Lake Josephine/Sebring	63,643	31,530	28,956	108.89%
Leisure Lakes	16,554	10,055	5,230	192.26%
Sunny Hills	71,023	31,248	26,470	118.05%
The Woods	7,344	3,899	2,967	131.41%

**D. Excessive Infiltration and Inflow**

For Breeze Hill, Jungle Den, Park Manor/Interlachen Lake, the utility asked for a pro forma plant adjustment for an I & I study and plant improvements. Aqua's Schedule F-6 includes Note 1 suggests that no adjustment should be made for excessive infiltration and inflow because Aqua has requested the pro forma improvement. In other words, no adjustment should be made because the utility is asking for a study for why there is a problem and the related plant improvements. We believe that the excessive infiltration and inflow should be adjusted from expenses (and used and useful). The excessive flows increase expenses that the customers should not bear as they are unreasonable in providing service to the current customers. If the utility is making the improvements, the expenses will decrease with the lower flows. The three systems and the excessive flows are:

Breeze Hill	65.43%
Jungle Den	48.99%
Park Manor/Interlachen Lake	55.42%

**E. Salaries and Wages – Wage Increases**

The utility has included in its test year and pro forma adjustments 4% wage increases for both 2010 and 2011. We believe that the Commission must set the right incentives for the utility to behave as a company would in a competitive marketplace. When the utility is requesting 4% annual wage increases in years where most competitive companies are slashing budgets, we believe that the utility is not acting as good stewards of the customers money in operating the utility. We believe that the 4% raises for 2010 and 2011 should be removed and all related payroll benefits and taxes.

**F. Salaries and Wages – Net Terminations and New Hires**

The utility has requested an adjustment to Salaries and Wages for Net Terminations and New Hires for both 2009 and 2010. We believe that the concept of a test year is to use the salaries and wages and adjust only for known changes. The fact that a utility has turnover during a year is routine therefore the related turnover expenses should not be adjusted to smooth out the turnover. In addition, we do not believe that an adjustment should be made to both 2009 and 2010.

**G. Purchased Power**

We have not completed an analysis of the Purchased Power expense; however we believe that all electric rate increases and decreases need to be accounted for in pro forma expenses.

**H. Sludge Hauling Expense – Optimization of Processes**

The utility estimated a reduction in sludge hauling expense in 2010 due to the optimization of facility processes and further monitoring of sludge concentrations. Due to improvements the field staff has made in the return lines, Aqua estimated that it will be able to reduce hauling expenses by \$34,209 annually over current and forecast. Only one fourth of this reduction is reflected in the test year. Therefore, we believe that the test year sludge hauling expense should be reduced by the remaining amount of \$25,657.

Estimated Total Company Adjustment		AUF Jurisdictional Percentages		AUF Jurisdictional Adjustments	
Water	Sewer	Water %	Sewer %	Water	Sewer
	\$ (25,657)		43%		\$ (10,919)

**I. Sludge Hauling Expenses – Budget**

Sludge hauling expenses in the test year are overstated. According to the response to OPC POD No. 8, sludge hauling expenses were budgeted to be \$154,207 less in 2010 than budgeted in 2009. Since the test year only reflects four months of 2010, the test year should be adjusted to reflect the expected lower level of sludge removal expenses. We believe that it is reasonable to estimate that a reduction in sludge hauling expenses in the amount of \$115,655 is not reflected in the test year and the following adjustment should be made to decrease expenses.

Estimated Total Company Adjustment		AUF Jurisdictional Percentages		AUF Jurisdictional Adjustments	
Water	Sewer	Water %	Sewer %	Water	Sewer
	\$ (115,655)		43%		\$ (49,220)

**J. Materials and Supplies**

Our review of the utility's 2010 forecast found that the utility reduced materials and supplies by 25%. The utility response to OPC POD No. 8 states that "supplies were reduced based on actual materials purchased excluding the unaccounted for Water meters which account for \$61,600 of the forecasted amount which will not repeat in



2010. Each area was evaluated as to their use of supplies and the budget adjusted accordingly based on current and future use." We believe that the utility's budget reduction should be applied to a full year. Therefore, the test year expense should be reduced by an additional \$10,200.

Estimated Total Company Adjustment		AUF Jurisdictional Percentages		AUF Jurisdictional Adjustments	
Water	Sewer	Water %	Sewer %	Water	Sewer
\$ (48,299)	\$ (3,717)	72%	43%	\$ (34,792)	\$ (1,582)

**K. Contractual Services Accounting**

During the test year, the utility incurred accounting charges that are non-recurring. In its response to OPC POD No. 8, the utility stated that it had internal audit investigation charges that were unbudgeted and will not repeat in 2010 related to the Meter Inventory. In addition, the utility states that in 2010 Sarbanes Oxley Section all 404 compliance fees will be budgeted on the corporate books and \$4,800 was removed from the 2010 FL budget for these charges. Therefore, we believe that the test year Contractual Services-Accounting fees should be reduced.

Estimated Total Company Adjustment		AUF Jurisdictional Percentages		AUF Jurisdictional Adjustments	
Water	Sewer	Water %	Sewer %	Water	Sewer
\$ (6,958)	\$ (3,873)	72%	43%	\$ (5,012)	\$ (1,648)

**L. Contractual Services Legal**

Our review of Legal expenses found that the utility has recorded legal expenses in the test year that should be removed.

1) During the test year, Aqua incurred legal expenses related to several consent orders, a court case (DeMint Case), and other matters that should not be passed on to customers. Aqua incurred \$76,850 in legal fees responding to consent orders proposed by the Southeast Region of the Florida Department of Environmental Protection ("DEP") concerning the operation of the Jasmine Lakes wastewater treatment facility, and the Village Water wastewater facility. The Jasmine Lakes matter has been resolved through a short form consent order. Costs related to consent orders should not be charged to ratepayers. In addition, the Utility incurred \$1,243 associated with the DeMint Litigation also related to Jasmine Lakes. These costs should be removed from the test year and deferred until the Commission can make a determination as to their reasonableness.

2) We believe that Legal expenses in the test year for general regulatory matters are overstated. Aqua requests test year expenses of \$87,366. However, our review of legal expenses in periods prior to the test year shows that these costs average \$2,631 per month. Therefore, we believe that the test year expenses should be reduced by \$55,795.

3) The test year expenses included Legal expenses in the amount of \$5,093 associated with the Lake Yale acquisition. These expenses should be removed from the test year as acquisition-related costs should not be charged to ratepayers.

4) The utility incurred expenses in a case titled American Environmental Container v Aqua Utilities Florida. AUF incurred these fees after the plaintiff claimed it was entitled to collect tap fees for a fire line that AUF's predecessor installed in the Village Water system. This matter was settled and legal fees incurred by AUF were not recoverable through the lawsuit. We believe that test year expenses should be reduced by \$7,155 as these expenses are nonrecurring. In addition, this issue is related to the acquisition of the system and these costs are not properly charged to ratepayers.

5) The utility incurred \$4,268 in legal fees associated with the six month monitoring of customer service issues related to the prior AUF rate case (Docket No. 080212-WS.) These costs would not have been incurred if the quality of service was satisfactory, therefore the expenses should be removed from the test year.

6) During the test year the Utility incurred \$1,545 allocated across multiple systems for legal advice in connection with rate cases and regulatory matters. Legal expenses associated with rate cases should be recovered during the rate cases. Accordingly, these expenses should be removed from the test year.

Estimated Total Company Adjustment		AUF Jurisdictional Percentages		AUF Jurisdictional Adjustments	
Water	Sewer	Water %	Sewer %	Water	Sewer
\$ (37,556)	\$ (24,052)	72%	43%	\$ (27,053)	\$ (10,236)
	\$ (78,093)				\$ (78,093)
				\$ (7,155)	

**M. Contractual Services – Management Fees**

Overall, OPC believes that the allocation of overhead and affiliate charges places an excessive burden on the Florida ratepayers. The Commission's mission statement says that it is committed to making sure that Florida's consumers receive some of their most essential services — electric, natural gas, telephone, water, and wastewater — in

a safe, affordable, and reliable manner. These allocations lead to unaffordable rates for the Florida ratepayers. If the Commission's role is to substitute for a normal marketplace in the case of a monopoly utility service, it should hold the utility provider to a standard of providing the services at an affordable rate.

Aqua America, Inc., the parent company of AUF, is a publicly traded holding company with both regulated and non-regulated subsidiaries operating in several states. AUF has contracted with Aqua Services Inc. for the provisioning of a variety of managerial, operations, and regulatory support. The utility claims that being part of the large organization that is supported by a service company reduces costs to customers. To support the validity for such a claim the utility should demonstrate that there are economies of scale associated with being part of a bigger organization where costs allegedly can be spread over more customers resulting in a lower cost per customer. No such showing has been made by the utility.

In the utility's last rate case, Docket No. 080121-WS, OPC compared the service company charges per customer to that of other Class A water and combination water/wastewater utilities in Florida. The Commission however found that it would be more appropriate to make this comparison using Class C companies. (Order 09-0385-FOF-WS, p. 55.)

An analysis using Class C companies shows that the layers of management associated with the provision of services by Aqua Services has not produced any cost savings for customers, but has resulted in excessive costs. In fact, when compared to other Class C companies, the services provided by Aqua Services show diseconomies of scale. Using the cost per customer of comparative Class C companies in Florida indicates that the charges from Aqua Services are excessive by \$886,702 for the water operations and by \$456,393 for the wastewater operations.

The current test year (2009) is two years later than the test year from the prior rate case (2007). According to the U.S. Department of Labor, Bureau of Labor Statistics, the Average Annual CPI increase for 2008 was 3.8% over the prior year and for 2009 it was a .4% decrease over 2008. The overall operation and maintenance expenses for the four water rate bands increased 25.18% and for the four sewer bands increased 12.16%. The most significant component of these increases is the requested management fee charged to the systems. Schedules B-7 and B-8 require the utility to explain all differences that are not explained by growth and CPI. The utility has failed to do that. The explanation provided merely states that the increase is a result of a shift between accounts and an increase in the amount. We believe the previous allocated management fee amounts were too high and a factor in the unaffordable rates established in the last rate case. To put an added burden on the customers of an additional \$1.3 million<sup>1</sup> is unreasonable and has not been justified by the utility.

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<sup>1</sup> This total is for the four water and four wastewater rate bands and excludes the three new water and wastewater systems. These systems should also be included in any adjustments made.

**N. Allocation Methodology for Newly Acquired Systems**

The allocation methodology for administrative and management costs is based on an ERC factor of all the systems in the Aqua "family." On December 22, 2009, Aqua America announced its purchase of a wastewater treatment, disposal and re-use system in Lumpkin County, Georgia. This plant will sell wastewater treatment, disposal and re-use services to the Lumpkin County Water and Sewerage Authority, which in turn provides service to the public. The utility states that this is the equivalent of 20 ERCs. We believe that this should be examined more closely as it appears that this may not be a reasonable allocation for this system in the Aqua family. It appears that this system may require more administrative and management costs than a system of 20 ERCs. We believe that more of these costs should be allocated to this system which would lower the costs allocated to Florida customers.

**O. Contractual Services – Management Fees (Computer Services)**

Computer service expenses were reduced significantly from the 2009 forecast to the 2010 budget. Therefore, we believe that test year expenses are overstated due to the 2010 budgeted changes for hardware and software maintenance.

Estimated Total Company Adjustment		AUF Jurisdictional Percentages		AUF Jurisdictional Adjustments	
Water	Sewer	Water %	Sewer %	Water	Sewer
\$ (23,564)	\$ (19,877)	72%	43%	\$ (16,974)	\$ (8,459)

**P. Contractual Services - Other**

The utility hired Floridian Partners for a total of \$22,026 to assist with regulatory matters. These costs are related to lobbying and should be disallowed for ratemaking purposes. The test year also includes \$34,799 associated with Cynergy Consulting charges associated with influencing legislation. Cynergy currently provides legislative services for AUF. This includes monitoring and advising AUF of any pending or potential legislative actions and/or issues related to the water and wastewater industry either on the state or local level. Cynergy also participates in customer relation issues when requested. The Commission has historically disallowed costs related to influencing legislation and influencing regulatory matters. Therefore, we believe that these costs should be removed from test year expenses.

Estimated Total Company Adjustment		AUF Jurisdictional Percentages		AUF Jurisdictional Adjustments	
Water	Sewer	Water %	Sewer %	Water	Sewer
\$ (34,640)	\$ (22,185)	72%	43%	\$ (24,953)	\$ (9,441)

**Q. Bad Debt Expense**

The test year bad debt expense for each rate band ranges from 0% - 12% of the operating revenues. The utility requested a pro forma increase for 1.48% of the requested revenue increases. We believe that this shows two problems with the bad debt expense. First, the test year expense should be adjusted to reflect the expected bad debt rate. Second, we do not believe that the utility has fully supported what that rate should be. As stated, the utility requested a 1.48% rate for future revenue increases. The staff audit of the affiliate transactions includes a confidential work paper "2009 board of directors minutes notes." The notes on pages 3 and 4 show a different percentage for bad debt expense, as well as project changes that impact the bad debt expense. In addition, the utility's 2009 forecast compared to the 2010 budget showed a reduction of \$57,776 for water and \$14,382 for wastewater. We believe that these documents provide evidence of that a lower bad debt expense rate is appropriate. Using the difference in the budget as a guide, we believe that the following adjustment should be made to test year expenses.

Estimated Total Company Adjustment		AUF Jurisdictional Percentages		AUF Jurisdictional Adjustments	
Water	Sewer	Water %	Sewer %	Water	Sewer
\$ (57,776)	\$ (14,382)	72%	43%	\$ (41,619)	\$ (6,121)

**R. Rate Case Expense**

The utility's requested rate case expense of \$670,269 is inflated and should be reduced. The utility was granted a rate increase a mere two years ago. It now requests that an additional \$167,567 be added to expenses on an annual basis to process another rate case. Many of the line items included in Schedule B-10 appear to be estimated on the high side.

- Legal
  - estimates includes ROE testimony and 12 service hearings
  - includes costs for a total of 1,415 hours for three attorneys
- The utility estimated its hours needed to complete the rate case. It has submitted details of how it estimated legal hours. But, it does not appear that the estimates for the consultants, in house employees, and noticing requirements have been

provided. The utility did not fully support the estimates, so these should be reduced to more comparable amounts.

**S. Miscellaneous Expenses – Public Relations**

Test year miscellaneous expenses include costs for Public Relations. The Town Hall meetings were eliminated in 2009 but some of these costs appear to be included in test year expenses. Assuming 75% of the 2010 difference between budget and forecast is included in the April 2010 test year; we believe test year expenses should be reduced by \$17,516.

Estimated Total Company Adjustment		AUF Jurisdictional Percentages		AUF Jurisdictional Adjustments	
Water	Sewer	Water %	Sewer %	Water	Sewer
\$ (17,293)	\$ (223)	72%	43%	\$ (12,457)	\$ (95)

**T. Miscellaneous Expenses – Penalties and Fines**

During the test year the utility incurred fines and penalties. The Commission has historically removed these expenses from the test year. Therefore, test year expenses should be reduced by \$21,469.

Estimated Total Company Adjustment		AUF Jurisdictional Percentages		AUF Jurisdictional Adjustments	
Water	Sewer	Water %	Sewer %	Water	Sewer
\$ (13,087)	\$ (8,382)	72%	43%	\$ (9,428)	\$ (3,567)

**U. Depreciation Expense**

Our review of the depreciation expense for each system shows that the amounts allocated to the systems for computer equipment is unreasonable for such small systems. Of the total of fourteen rate bands<sup>2</sup> two show that computer depreciation expense is more than 30% of the total depreciation expense and four show that computer depreciation expense is greater than 20% of the total depreciation expense. This may also mean that the plant allocated to the systems and included in rate base is high. But the high level of computer depreciation expense for these small systems is another factor that leads to the creation of unaffordable rates.

<sup>2</sup> Eight water and wastewater rate bands, plus Breeze Hill water and wastewater, Peace River water and wastewater and Fairways water and wastewater.

Schedule B-13 for the Breeze Hill system indicates an adjusted test year depreciation expense for the water system of \$14,334. This is approximately an 8% composite depreciation rate when applied to the test year average utility plant in service shown on Schedule A-1. The utility justifies this amount in its response to OPC Interrogatory No. 134 by stating that it is "a cumulative three year rate to record the catch up of the accumulated depreciation balance retroactive to December 31, 2006." The utility did not provide any support for why this was necessary and appropriate. Aqua bought the system and should record the balances set by the Commission and should use the prescribed depreciation rates. Even if the three year "catch-up" was reasonable, that period is over and those expenses should not be used on a going forward basis.

#### V. Income Tax Expense

##### Domestic Production Activities Deduction

The American Jobs Creation Act of 2004 provides for a Domestic Production Activities Deduction (DPAD) of 9% on qualifying production activity income. Under the 2004 Act, the production of potable water, including the acquisition, collection and storage of raw water, qualifies as production activity to which the deduction is applicable. Based on a review of the Income Tax expense calculations in the Utility's filing, it does not appear that the DPAD is included in the income tax expense calculations. We are waiting for responses to discovery to determine if an adjustment should be made. We believe that the deduction should be reflected as a reduction to income tax expense; however, a utility may not qualify due to not meeting certain taxable income thresholds. We may recommend an adjustment upon receipt of outstanding discovery.



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I **HEREBY CERTIFY** that a true and correct copy of the foregoing Citizens' Preliminary Areas of Concern to Aqua Utilities Florida, Inc., has been furnished by E-mail and by U. S. Mail to the following parties this 24<sup>th</sup> day of March, 2011:

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