

State of Florida



Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

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

DATE: March 13, 2006

TO: Director, Division of the Commission Clerk & Administrative Services (Bayó)

FROM: Office of the General Counsel (Melson)
Division of Economic Regulation (Devlin, Willis, Rendell)

RE: Docket No. 050018-WU – Initiation of deletion proceedings against Aloha Utilities, Inc. for failure to provide sufficient water service consistent with the reasonable and proper operation of the utility system in the public interest, in violation of Section 367.111(2), Florida Statutes.

Docket No. 050183-WU – Request by homeowners for the Commission to initiate deletion proceedings against Aloha Utilities, Inc. for failure to provide sufficient water service consistent with the reasonable and proper operation of the utility system in the public interest, in violation of Section 367.111(2), Florida Statutes.

Docket No. 010503-WU – Application for increase in water rates for Seven Springs System in Pasco County by Aloha Utilities, Inc.

AGENDA: 04/04/06 – Regular Agenda – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICERS: Edgar (Docket Nos. 010503-WU and 050183-WU)
Deason (Docket No. 050018-WU)

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\GCL\WP\0500182.RCM.DOC

Case Background

Aloha Utilities, Inc. (Aloha or utility) is a Class A water and wastewater utility located in Pasco County. The utility consists of two distinct service areas: Aloha Gardens and Seven Springs. There are currently three active dockets,¹ three appeals in the First District Court of Appeal,² and one Circuit Court case in Leon County,³ involving Aloha's Seven Springs service area and the Commission.

In February 2005, the Commission initiated deletion proceedings in Docket No. 050018-WU for a portion of the Seven Springs service area based on a number of problems that ultimately stem from the presence of hydrogen sulfide in the water.

On August 17, 2005, the Commission deferred consideration of staff's recommendation to accept a comprehensive Offer of Settlement negotiated by staff and submitted by Aloha in an effort to resolve Docket Number 050018-WU and all other outstanding matters. At that time, the Commission decided to hold the deletion proceeding in abeyance and directed staff to undertake negotiations with Aloha, the Office of Public Counsel (OPC), customer representatives, and other interested parties in an attempt to reach a resolution that is satisfactory to all parties.

On March 9, 2006, after several months of extensive negotiations in which staff participated, a Settlement Agreement ("Settlement") was executed by Aloha, OPC, and individual intervenors Wayne T. Forehand, John H. Gaul, and Sandy Mitchell, Jr. (Intervenors). Aloha, OPC and Intervenors are collectively referred to as the "Parties." The Settlement was also ratified by Richard Letvin, Donna B. Vaurio, Joel A. Kurtz, Richard E. Wiltsey, and John P. Andrews, non-intervenor customers of Aloha who are active members of the Committee For Better Water Now. Mr. Edward O. Wood, another individual intervenor in the deletion docket, has not signed the Settlement.

The Settlement, a copy of which is attached to this recommendation as Attachment A, is a comprehensive agreement that resolves all outstanding dockets and court proceedings between Aloha and the Commission. The terms of the Settlement are summarized in Issue 1. That issue contains staff's recommendation that approval of the Settlement in its entirety, without change, is in the best interests of Aloha and its customers.

¹ Docket No. 050018-WU (Show Cause Docket) is a proceeding to delete certain portions of Aloha's water service territory. Docket No. 050183-WU (Investigation Docket) is an investigation into whether the Commission should initiate deletion proceedings for additional portions of Aloha's water service territory. Docket No. 010503-WU (Water Quality Proceeding) is a continuation of Aloha's last rate case in which an interim rate refund is pending and in which the Commission entered an order establishing a water quality goal of 0.1 mg/L of total sulfides and specified testing locations and frequencies.

² Case No. 04-5242 (Refund Appeal) is Aloha's appeal of the Commission order requiring a refund of previously collected interim rates. Case No. 05-3247 (Investigation Appeal) is Aloha's appeal of the Commission order initiating the Investigation Docket. Case No. 05-3662 is Aloha's appeal of the Commission order establishing the 0.1 mg/L water quality goal and specifying the testing locations and frequencies.

³ Case No. 05-CA-01142 (Declaratory Judgment Action) is a complaint that seeks declaratory and injunctive relief related to the Commission's prosecution of the Show Cause Docket.

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In a related matter, by Order No. PSC-06-0015-FOF-WU, issued January 4, 2006, the Commission approved a letter agreement between Aloha and OPC that formalized their agreement regarding recovery of the cost of preparing a conceptual cost estimate for the proposed treatment facilities. On January 12, 2006, Mr. Edward O. Wood, a customer intervenor, timely filed a letter requesting reconsideration of the Order. Oral argument was not requested. On January 23, 2006, Aloha filed a response in opposition to Mr. Wood's request. Issue 2 of this recommendation addresses the request for reconsideration.

The Commission has jurisdiction pursuant to Chapters 120 and 367, Florida Statutes.

Discussion of Issues

Issue 1: Should the Commission issue a final order approving the Settlement?

Recommendation: Yes. The Commission should issue a final order approving the Settlement in its entirety and without change. The Settlement offers a number of monetary benefits to Aloha's customers that could not otherwise be obtained or assured, it redirects the Parties' resources away from protracted litigation toward implementing an agreed solution to the underlying water quality problem, and it provides a much needed fresh start for Aloha, its customers, and the Commission. (MELSON, DEVLIN, WILLIS, RENDELL)

Staff Analysis: Staff believes that approval of the negotiated Settlement is in the public interest and that the Settlement fairly balances the interests of Aloha and its customers. Approval of the Settlement will avoid protracted administrative, judicial and appellate litigation. It will allow Aloha to focus its resources on implementing a new treatment method – anion exchange – that the Parties have agreed represents a prudent approach to removing hydrogen sulfide from the water, thereby addressing the related taste, odor and color problems. It will also provide a fresh start for Aloha, its customers and the Commission.

Anion exchange was identified as the preferred water treatment option in a study performed for Aloha by the University of South Florida. Unlike the current treatment method that converts hydrogen sulfide into other forms of sulfur, anion exchange removes all forms of ionic sulfur from the water. After review of the USF study, and further consideration of various alternatives, Dr. James Taylor of the University of Central Florida, who was retained by the Commission as an independent consultant, agreed that anion exchange is the water treatment option that has the best likelihood of eliminating or minimizing the hydrogen sulfide issues on a cost-effective basis.

In order to facilitate the settlement negotiations, Aloha provided a non-binding, conceptual capital cost estimate ("Conceptual Cost Estimate") for installing anion exchange facilities. That estimate showed an installed capital cost of \$6.13 million, plus or minus 30%. Dr. Taylor reviewed the Conceptual Cost Estimate and concluded that it is a reasonable estimate based on good faith assumptions at the time it was prepared.

The following is a summary of the Settlement.

Key Elements of Settlement

- **Water Treatment Method (¶2a).** The Parties agree that it is prudent for Aloha to implement anion exchange at five of its seven water treatment sites and that no additional treatment is required at this time at the remaining two sites where the level of hydrogen sulfide in the raw water is lower. This means that the reasonable cost of anion exchange facilities at the five sites will be recoverable through rates, and that anion exchange facilities sized to treat the full current pumping capacity at those sites will be 100% used and useful for ratemaking purposes. These agreements will become Commission findings if the Settlement is approved.

- Reasonable Costs (§2b). The Parties agree that the Commission can review and audit, and any substantially affected party can challenge, the reasonableness of the specific costs incurred in implementing anion exchange. However, any rate review will not revisit the fundamental agreement and finding that anion exchange is a prudent option that should have been implemented. Further, the Conceptual Cost Estimate will be admissible in cost recovery proceedings only for the purpose of considering if it was a reasonable, good faith estimate at the time it was performed. These agreements will become Commission findings if the Settlement is approved.
- Aloha Recording of CIAC (§6). Aloha agrees to record \$250,000 of the construction cost for the anion exchange facilities as a contribution-in-aid-of-construction. This provision was negotiated in lieu of a provision in Aloha's earlier Offer of Settlement which would have established a repiping program with an estimated cost of approximately \$250,000. This financial contribution by Aloha could not be achieved outside of a Settlement.
- Construction Schedule (§4). Aloha will install the anion exchange facilities in accordance with the schedule set forth below. A current County ordinance (under challenge by Aloha) requires Aloha to install forced draft aeration facilities. The Parties agree to support Aloha's efforts to gain County approval for implementation of anion exchange in lieu of forced draft aeration. The 24-month construction schedule does not begin to run until any impediment to anion exchange created by the County ordinance has been removed. The construction schedule is also subject to tolling in the event of a force majeure.
 - Design: 4 months
 - Permitting: 4 months
 - Bidding, contract award, fabrication and construction: 14 months

If construction staging is required, anion exchange facilities will be installed first at Wells 8 and 9, which have the highest concentration of hydrogen sulfide in the raw water. Aloha will file quarterly progress reports during construction, and staff will arrange a meeting to review each progress report with the Parties. If staff concludes that Aloha is not proceeding in good faith to meet the schedule, it may recommend enforcement action. Aloha remains free to request any necessary extension of time, and the other Parties remain free to seek other relief in the event the schedule is not being met.

- Testing for Sulfides (§5). The Parties agree to a protocol of testing for sulfides to replace the testing requirements imposed by Order No. PSC-05-0709-FOF-WU. Under the agreed protocol, water at the plants equipped with anion exchange will be tested at three points on either a monthly or quarterly basis: raw water, water after anion exchange and before disinfection, water after disinfection. The raw water testing is for informational purposes. The compliance goal for water after anion exchange is for total sulfides to be at or below 0.3 mg/L, and after disinfection for total sulfides to be at or below 0.1 mg/L. Testing at each plant continues for a

- minimum of 3 years, or longer if necessary to demonstrate a 12-month period with no exceedances of the compliance goals. If any site fails two compliance tests in a 12-month period, staff will meet with Aloha and the parties to attempt to identify the root cause of the exceedance and discuss what further action, if any, is appropriate.
- Limited Proceeding for Cost Recovery (§2c). The Parties agree that Aloha may seek cost recovery for the anion exchange facilities in a three-phase limited proceeding. (This structure was suggested by staff and is modeled after a procedure used recently for Water Management Services, Inc. on St. George Island). Because the Phase I and Phase II rates will be temporary rates subject to true-up: no opportunity for hearing is necessary; no customer meetings will be required; the incremental revenues will not have to be held in escrow; and repression will not be taken into account. Because Aloha intends to finance the construction through debt, the Phase I, II and III rate increases will contain no allowance for return on equity and no gross-up for federal income tax expense. The three phases are as follows:
 - Phase I: Temporary rates during construction designed to recover the carrying cost (interest during construction) on the projected average balance of construction work in progress. These temporary rates are subject to true-up in Phase III and are in lieu of Aloha accruing an Allowance for Funds Used During Construction (AFUDC).
 - Phase II: Temporary rates during the first twenty months (more or less) the anion exchange facilities are in operation. These temporary rates are subject to true-up in Phase III and will be designed to recover the actual or contracted cost of the anion exchange facilities and the projected incremental operating costs.
 - Phase III: Final rates based on actual construction costs and one year of actual operating expense history, both of which are subject to audit and to review for reasonableness. If there is any over- or under- collection in Phases I or II, there will be an offsetting credit or surcharge during the first 12 months the Phase III rates are in effect. Phase III rates will be set via a PAA order within 6 months after Aloha's submission of actual cost data. In the event of a protest, the Commission will enter its final order within 8 months of the date of the protest. Any necessary repression adjustment will be considered in Phase III.
 - Dismissal of Litigation (§3). On or immediately after the Effective Date (i.e., the date a Commission order approving the Settlement becomes final and non-appealable), Aloha and the Commission will terminate the pending proceedings as follows:
 - The Commission will dismiss the Show Cause Docket (Docket No. 050018-WU) and the Investigation Docket (Docket No. 050183-WU).

- Aloha will dismiss the Declaratory Judgment Action in Circuit Court, the Investigation Appeal, the Water Quality Appeal, and the Refund Appeal. The amount that would ordinarily be refunded (approximately \$290,000) will be reduced by the documented cost (up to \$45,000) of preparing the Conceptual Cost Estimate. The balance will remain in escrow, earning interest, until the Phase III rates take effect. At that time, the funds in escrow, including accrued interest, will be released to Aloha and Aloha will record a corresponding amount as a contribution-in-aid-of-construction. This provision uses the dollars that would otherwise be refunded in the manner requested during negotiations by the individual intervenors. It also eliminates the risk that Aloha might prevail on appeal, in which case none of these funds would benefit customers.
- Fresh Start and Future Enforcement (¶3b and 9). After the Effective Date, no further enforcement action against Aloha will be requested by the Parties or taken by the Commission (and no further disallowances or penalties will be assessed), based on Aloha's actions or inactions prior to the Effective Date relating to water quality or customer service issues which have been raised in prior dockets. The Commission may initiate a new enforcement action based on actions or inactions after the Effective Date in the event it finds probable cause that Aloha has violated its obligations under the Settlement.
- Prior Litigation Costs (¶7). Aloha agrees not to seek recovery from its ratepayers of any litigation costs, legal fees, consultant fees, and costs arising from litigation in the Show Cause Docket, the Investigation Docket, the Declaratory Judgment Action, the Refund Appeal, the Investigation Appeal, the Water Quality Proceeding, and the Water Quality Appeal. At the time of the earlier Offer of Settlement, staff estimated that these costs were in the vicinity of \$1,000,000. These costs will grow substantially if the Show Cause Docket proceeds to hearing and the other litigation and appeals continue. A ban on recovery of these costs could not be achieved outside of a Settlement.

Other Provisions

The Settlement contains a number of other provisions, including the following:

- The Parties agree to cooperate in exploring the potential availability of governmental grant monies and/or low cost loans to finance or refinance the anion exchange facilities. (¶8) This offers the possibility of reducing the ultimate rate impact to Aloha's customers.
- Both Aloha and the Commission give up their right to sue the other for damages or attorneys fees for any actions that occurred prior to the Effective Date. (¶7) This protects both parties from the risk of litigation under various theories of liability.

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- The Settlement becomes binding only if it is approved by the Commission, without change, and is incorporated by reference in a final Commission order. (¶10) This is standard language in this type of agreement.
- Aloha does not admit to violation of any statute, rule or order and does not admit any fault or liability on water quality or customer service issues. (¶12) Conversely, OPC and Intervenors do not concede that no such violations have occurred. This is standard language in this type of agreement.
- If the Settlement is not accepted by the Commission without change, neither it nor this staff recommendation will be admissible in any present or future judicial or administrative proceeding (¶11) and neither Aloha nor any other party (including the Commission) will waive any positions, rights or remedies otherwise available to it. (¶12) This is standard language in this type of agreement.
- Nothing in the Settlement shall establish or imply a waiver of any rights unless the waiver is explicitly set forth in the Settlement. (¶13)
- Each Intervenor who executes the Settlement, and each customer who ratifies it, is doing so only on his or her own behalf. No Party will sue another Party because of the other Party's execution of the Settlement. (¶14)

Absence of Agreement by Intervenor Wood

Staff believes that the absence of agreement to the Settlement by Mr. Edward O. Wood, an individual intervenor in Docket No. 050018-WU, does not affect the Commission's ability to approve the Settlement. Staff understands that Mr. Wood's position is that the Commission should continue with the proceeding to delete a portion of Aloha's territory so that he can ultimately obtain service from Pasco County.

Under the applicable license revocation statute and case law, however, only the Commission can initiate and maintain a license revocation proceeding. Conversely, the Commission has the absolute right to voluntarily dismiss such a license revocation proceeding for any reason or no reason. In short, while Mr. Wood may be interested in the outcome of Docket No. 050018-WU, he has no legal right to insist that the proceeding be continued. Because the Commission has the absolute right to terminate such a proceeding, it likewise has the power to determine, without offering the opportunity for a hearing, whether the Settlement reached by Aloha, OPC and the other individual intervenors provides a sufficient basis for what amounts to a discretionary decision to withdraw its prosecution.

Further, the Florida Supreme Court recognized in South Florida Hospital and Healthcare Association v. Jaber, 887 So.2d 1210 (Fla. 2004) that the Commission has the power to approve settlements among less than all the parties to a proceeding, particularly where, as here, the objecting party is provided with an opportunity to address the Commission at the time it considers whether to approve or reject the settlement.

Conclusion

The Settlement is necessarily detailed because of the number of interrelated matters at issue between Aloha, the other Parties, and the Commission.

Staff is convinced that approval of the Settlement, without change, is in the public interest. It offers a number of monetary benefits to Aloha's customers that could not otherwise be obtained or assured, it redirects the parties' resources away from protracted litigation toward implementing an agreed water treatment solution to address the underlying problem, and it provides a much needed fresh start for Aloha, its customers, and the Commission.

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Issue 2: Should Mr. Edward O. Wood's request for reconsideration of Order No. PSC-06-0015-FOF-WU be granted?

Recommendation: If the Commission approves the Settlement in Issue 1, Mr. Wood's motion for reconsideration is moot and no ruling is required. If the Commission does not approve the Settlement, Mr. Wood's request should be denied because it does not raise an issue of fact or law that the Commission overlooked or failed to consider. (MELSON)

Staff Analysis: By Order No. PSC-06-0015-FOF-WU, the Commission approved a letter agreement between Aloha and the Office of Public Counsel regarding recovery of costs for a non-binding capital cost estimate for installation of anion exchange facilities.

By letter, Mr. Wood requests reconsideration of the Order, stating that he believes that the Order was issued with very little consideration for the rights of the customers involved. Mr. Wood further states that any competitive company would not accept such a charge from any of its vendors required to make changes to have an acceptable product. Mr. Wood questions how a conceptual analysis could have an error possibility of plus or minus 30%, and states that there should have been no possible variance to the final cost.

In its response, Aloha points out that the Commission has often had occasion to restate its standard in reviewing motions for reconsideration. Aloha states that Mr. Wood's request should be denied because it does nothing more than reargue issues which were necessarily considered by the Commission prior to its issuance of the Order. Aloha further states that Mr. Wood makes no argument that the Commission overlooked or failed to consider anything.

The standard of review for a motion for reconsideration is whether the motion identifies a point of fact or law that the Commission overlooked or failed to consider in rendering its Order.⁴ Moreover, in a motion for reconsideration, it is not appropriate to reargue matters that have already been considered.⁵ A motion for reconsideration should not be granted "based upon an arbitrary feeling that a mistake may have been made, but should be based upon specific factual matters set forth in the record and susceptible to review."⁶

The overall Settlement discussed in Issue 1 contains a provision for recovery of the costs of preparing the conceptual cost estimate that is consistent with letter agreement approved by the Order. If the Commission approves the Settlement in Issue 1, the order approving the Settlement will effectively supersede Order No. PSC-06-0015-FOF-WU and thereby render Mr. Wood's request for reconsideration moot.

⁴ See Diamond Cab Co. v. King, 146 So. 2d 889 (Fla. 1962); and Pingree v. Quaintance, 394 So. 2d 161 (Fla. 1st DCA 1981).

⁵ Sherwood v. State, 111 So. 2d 96 (Fla. 3rd DCA 1959) (citing State ex. rel. Jaytex Realty Co. v. Green, 105 So. 2d 817 (Fla. 1st DCA 1958)).

⁶ Stewart Bonded Warehouse, Inc. v. Bevis, 294 So. 2d 315, 317 (Fla. 1974).

If the Commission does not approve the Settlement in Issue 1, staff recommends that the request for reconsideration should be denied. Mr. Wood's request for reconsideration fails to identify a point of fact or law that the Commission overlooked or failed to consider in rendering its Order. In approving the letter agreement, the Commission considered the method of recovery as specified therein, including, among other things, the error possibility of plus or minus 30%. The Commission expressly found it to be an appropriate method for allowing Aloha to recover the cost of the estimate. See Order No. PSC-06-0015-FOF-WU at page 2.

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Issue 3: Should the dockets affected by the Offer of Settlement be closed?

Recommendation: If the Settlement is approved, Docket No. 050018-WU (Show Cause Docket), and Docket No. 050183-WU (Investigation Docket) should be closed after the Order Approving Settlement has become final and non-appealable. Docket No. 010503-WU, in which interim rate monies are being held in escrow, should remain open until those monies are released to Aloha, and recorded as CIAC, at which time the docket should be closed.

If the Settlement is not approved, these dockets should remain open. (MELSON)

Staff Analysis: If the Settlement is approved, it calls for the Commission to voluntarily dismiss (i.e. close), the Show Cause Docket (Docket No. 050018-WU) and the Investigation Docket (Docket No. 050183-WU) on or immediately after the Effective Date.

The interim rate escrow account established in Docket No. 010503-WU will remain in existence until the effective date of Phase III rates, at which time the remaining funds will be released to Aloha and Aloha will record an equivalent amount as CIAC. Therefore Docket No. 010503-WU should remain open until the escrow account is closed, at which time the docket should be closed administratively.

If the Settlement is not approved, these dockets should remain open.