

State of Florida



Public Service Commission

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

DATE: December 23, 2008

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Roberts, Bulecza-Banks, Fletcher, Rieger)
Office of the General Counsel (Jaeger)

RE: Docket No. 070293-SU – Application for increase in wastewater rates in Monroe County by K W Resort Utilities Corp.

AGENDA: 1/06/09 – Regular Agenda – Post Hearing Decision – Participation is limited to Commissioners and staff

COMMISSIONERS ASSIGNED: Carter, Argenziano, Skop

PREHEARING OFFICER: Argenziano

CRITICAL DATES: Utility has waived all dates through January 6, 2009.

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\070293.RCM.DOC

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Case Background

K W Resort Utilities Corp. (KWRU or Utility) is a Class A utility providing wastewater service to approximately 1,556 customers in Monroe County. Water service is provided by the Florida Keys Aqueduct Authority (FKAA). Wastewater rates were last established for this Utility in its 1983 rate proceeding.¹

On August 3, 2007, KWRU filed an application for the rate increase at issue in the instant docket. The Utility had a few deficiencies in the Minimum Filing Requirements (MFRs). KWRU requested that the application proceed directly to hearing for the establishment of rates as provided under Section 367.081(6), Florida Statutes (F.S.).

By Order No. PSC-07-0672-PCO-SU, issued August 21, 2007, the Commission acknowledged the Office of Public Counsel (OPC) intervention in this case.

KWRU also requested interim rates. Interim rates were granted by Order No. PSC-07-0812-PCO-SU, issued October 10, 2007. The Utility requested final rates designed to generate annual revenues of \$1,647,998. This represents a revenue increase of \$601,684 (or 57.51 %).

Hearing dates were originally set for February 6 and 7, 2008. However, on January 7, 2008, KWRU filed its Emergency Stipulated Motion for Continuance (Motion). As the basis for its Motion, the Utility stated that there were on-going discussions concerning the sale of KWRU and that the sale of the Utility would render this rate case moot. By Order No. PSC-08-0032-PCO-SU, issued January 8, 2008, the Commission granted KWRU's request for a continuance of at least 60 days. By Order No. PSC-08-0129-PCO-SU, issued February 28, 2008, the Commission granted the Utility a further continuance until April 7, 2008.

On April, 7, 2008, KWRU requested that the Commission re-establish the hearing dates and other controlling dates so as to allow sufficient time for the parties to complete the discovery and appropriate rebuttal testimony. As justification for this request, the Utility stated that negotiations were not far enough along and resolution sufficiently imminent to warrant a request for further continuance. OPC agreed with this request. By Order No. PSC-08-0241-PCO-SU, issued April 15, 2008, the Commission re-established the hearing dates and other controlling dates for this case. A hearing was held on October 1 and 2, 2008.

On November 25, 2008, KWRU granted staff's request that the Commission have up to and including January 6, 2009, to take its final vote on the Utility's requested rate increase.

This recommendation addresses KWRU's request for final rates. The Commission has jurisdiction pursuant to Sections 367.081 and 367.082, F.S.

Approved Stipulations

The Commission found that the stipulations reached by the parties and supported by staff were reasonable, and accepted the stipulated matters set forth below at the hearing.

¹ See Orders Nos. 14620 and 13862, issued July 23, 1985 and November 19, 1984, respectively, in Docket No. 830388-S, In re: Petition of Stock Island Utility Company, Inc. for increased sewer rates in Monroe County, Florida.

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

Discussion of Issues

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

Recommendation: The overall quality of service provided by the Utility should be considered satisfactory. However, KWRU should provide monthly reports concerning the connection status of the remaining 350 equivalent dwelling units left to be connected until the conditions of the Utility's 2002 contract with Monroe County have been fully satisfied. (Rieger)

Position of the Parties

KWRU: Yes. The quality of service provided by KWRU is satisfactory.

OPC: No. KWRU has shown a pattern of abuse in its treatment of customers that would not be tolerated in a competitive market. If the Commission grants a return, it should be set at the bottom of the authorized range.

Staff Analysis: Pursuant to Rule 25-30.433(1), Florida Administrative Code (F.A.C.), the Commission determines the overall quality of service provided by the Utility by evaluating the quality of the Utility's product, the operating condition of the Utility's plant and facilities, and the Utility's attempt to address customer satisfaction. The Utility's compliance history with the Department of Environmental Protection (DEP) and comments or complaints received from customers are also considered.

Quality of Utility's Product and Operating Conditions of the Utility's Plant and Facilities

Staff witness Johnson, from the DEP, testified that the Utility is upgrading the wastewater treatment plant to meet advanced wastewater treatment (AWT) standards and address maintenance-related repairs. Included with his testimony is a copy of a November 26, 2007 DEP warning letter to the Utility (Exhibit (EXH) 26) regarding disinfection reporting violations, total suspended solids exceedances for effluent discharged to the reuse system, and three separate wastewater spills over a three-month period. The letter noted that heavy rains and restrictions caused by the AWT upgrade may have caused the spills. Witness Johnson testified that the Utility has been cooperative and has taken action to correct the problem that caused the spill by undergoing repairs and upgrades, although there is one outstanding issue dealing with an injection well that is being corrected. (Service Hearing (SH)-Transcript (TR), 83-84, 86-87)

Customer Satisfaction

Approximately 40 customers attended the morning and evening service hearings and seventeen provided testimony, three of whom were not customers of the Utility. (SH-TR 27-152) Although most customers appeared to favor interconnecting small wastewater systems or septic tanks to a higher quality central wastewater system in order to preserve the environment of the Keys, the majority of the comments addressed the Utility's handling of the mandatory connection to the KWRU wastewater treatment plant resulting from a 2002 agreement with Monroe County.

The Florida Legislature enacted Chapter 99-395, Laws of Florida, which required existing wastewater treatment plants and onsite disposal systems, such as septic tanks, in Monroe County to cease discharge or comply with AWT standards by July 1, 2010. The Law further authorized the County to enact an ordinance that requires connection to a central sewerage system within 30 days of notice of availability of service. Monroe County subsequently passed Ordinance No. 04-2000 requiring the interconnections within 30 days of notice. The Ordinance further required the Utility to provide the required notices.

In July 2002, Monroe County and KWRU entered into a Capacity Reservation and Infrastructure Contract (Contract) which contained provisions for the County to purchase capacity from KWRU to provide service to the remaining 1,500 equivalent dwelling units (EDUs) on Stock Island that were on individual septic tanks or small package plants that could not be upgraded to AWT standards. KWRU agreed to convert its wastewater plant to AWT standards by January 1, 2007, in order to comply with Chapter 99-395. Further, the County agreed to advance funds to KWRU for the construction of the wastewater collection system on South Stock Island (SSI) in an amount not to exceed \$4,606,000, and the Utility agreed to complete the system in 16 months from the commencement of the contract. The agreement further provided that KWRU would collect its authorized plant capacity charge of \$2,700 per EDU from new connections and remit \$2,100 per EDU back to the County in repayment of the construction advances. The \$600 per EDU retained by the Utility was designed to offset the cost associated with upgrading the wastewater treatment plant to AWT standards. (EXH 37)

Pursuant to Rule 25-30.550, F.A.C., the Utility provided the Commission with a proposed developer agreement for the Harbor Shores Condominium Unit Owners Association, Inc., one of the areas that would be affected by the required interconnection. The agreement was acknowledged by Commission staff by letter dated March 21, 2003, and staff further recommended that the Utility use the agreement for all current and future connections. (EXH 44, Attachment 9)

In the summer of 2003, the Florida State Attorney's Office began receiving complaints from Monroe County citizens residing in the Stock Island area as well as two of the County Commissioners concerning the costs associated with the construction of the sewer system on Stock Island. In late 2003, the State Attorney ordered an investigation of the project and the complaints. The concerns were subsequently presented to the Grand Jury which completed its investigation in the fall of 2004. The Grand Jury concluded that Monroe County had provided little oversight for the connection of customers to the KWRU wastewater system and failed to effectively communicate with the citizens of Stock Island as to their potential financial burdens. (EXH 44, Attachment 5)

At the service hearing, customers expressed their frustration with the Utility regarding the cost of the interconnection, the impact on low income families, Utility mismanagement, and customer intimidation. With regard to the cost of the interconnection, customers testified that it had not been clear originally that, in addition to the \$2,700 connection charge, customers would also be required to bear the cost of extending onsite lines needed to connect their property to the Utility's collection system. Some customers paid \$10,000 to \$100,000 for design, permitting, and construction of onsite lines. In some instances, property owners were unable to connect to

the collection system, even though they paid the Utility's fees and installed the required infrastructure on their property. (SH-TR 71-73) Some commercial and multifamily property owners did not understand that the \$2,700 connection charge was for each EDU and not for each connection. There were allegations that unnecessary or excessive amounts were paid for construction, testing, and legal fees. Allegations were also made regarding money paid to Utility family members. Several customers testified that the Utility used less than professional actions and inappropriate behavior in requiring property owners to connect to the KWRU system. People were leery about speaking out against the Utility due to intimidation and retaliation of both a political and financial nature. (SH-TR 28, 69-70, 87, 104-107, 150-151)

One of the Monroe County Commissioners, who had contacted the Florida State Attorney's Office during their investigation, but who is not a customer of KWRU, testified. He stated that the process with the Commission and OPC works to make sure that the residents get a fair shake. Regardless of the cost, a level of service should be expected by the residents from the standpoint of quality of service. In reference to some residents not being able to hookup to the Utility's system, he testified that it was an undue burden for the customer and that it was the obligation of the Utility to provide the service. (SH-TR 83-90)

Another customer testified that the work the Utility has done is eco-friendly and supportive of the Legislature's laws to that effect. He also noted that such a project is a very expensive process, in light of the burden that the Utility is under and the decisions it has to make, it is very easy to sit back and pick on the Utility. He also thought that the infrastructure needs to be in place and the choice of the system installed was probably the smartest choice instead of wasting money on something inferior. (SH-TR 40-44)

During the technical portion of the hearing, KWRU witness Smith acknowledged the customers' frustration over the way they were treated in connecting to the system. In response to questions about the use of deputies to deliver 21 connection notices, he testified that deputies were used to hand deliver notices requiring connection to the system when notices sent out by certified mail were returned unsigned or not returned. He said that the Utility went to the County Code Enforcement Office and was told that unless the Utility served every single trailer with notice, the County would not take enforcement action. Also, some people may have signed for service for one of their trailers, but may not have signed for the second trailer, and that is the reason some got served the second time. (TH-TR 183-188)

Witness Smith went on to say that there are 350 EDUs that are left to be connected, including residential, multifamily, and commercial customers. There is also one or two who have paid the connection fee but have not yet connected because of access problems to the Utility collection system. For example, witness Smith testified that the owner of the Elmar Mobile Home Park is unwilling to install a lift-station that is needed to connect the park to the collection system. However, he also indicated that the Utility is waiting on a purchase order from the County to complete projects to connect those remaining that have access problems. Also, in response to customer questions about access to Utility board meetings, witness Smith resolved that from now on he will have an annual board meeting in Key West and open it to the public. (TH-TR 109-110, 122, 183-188)

In addition to comments received at the customer service hearing, a review was also made of complaints received by the Commission during the test year to the present. There are no active complaints against the Utility on file with the Commission at this time. During the test year, two complaints were received concerning the mandatory connection process and the use of sheriff deputies to intimidate homeowners into signing up for service. The Utility responded to these complaints with a report that referred to the Florida Statutes, the Monroe County Ordinances, and the 30-day connection notice letter with the application for service. Resolution letters were sent out to the customers; however, the complaints were closed due to a lack of customer response.

OPC Response

OPC's position is that the Utility's quality of service is unsatisfactory. Customer relations are an integral component of virtually every business enterprise. In a competitive market, customers who are mistreated will find another supplier of the service. For a protected monopoly like KWRU, however, the Commission is the only entity with the direct authority to assure appropriate treatment of Utility customers. When a Utility mistreats its customers, the Commission historically has penalized the Utility, just as the marketplace would have penalized such behavior if competition were present. In its post hearing statement, OPC indicates that the record contains many examples of customers who testified about the Utility's abusive and intimidating tactics. The Commission should acknowledge the Utility's deficiencies in how it treats its customers and set any allowed return at the bottom of the authorized range. (OPC Brief (BR), pp. 6-7)

Utility Response

The Utility believes that the quality of service it provides to its customers is satisfactory. In its post hearing statement, KWRU stressed that staff witness Johnson's testimony indicated that the Utility has been attentive and cooperative in its responses to DEP and that the DEP has not required the Utility to take any action based upon concerns or problems resulting from odors, noise, aerosol drift, or lighting. Further, there was no customer testimony regarding the typical issues that customers address in a wastewater case, such as odor, plant shutdowns or interruptions in service during storm events, or billing issues. Neither were there overwhelming comments concerning expensive service, nor the prospect of paying higher rates. Instead, the Utility points out that the overwhelming concern brought out at the customer meeting was related to mandatory connection, the Utility's utilization of personnel not employed by the Utility to operate the company, related parties or contractors, and the related expenses charged to the Utility. The Utility acknowledged that the local governmental mandatory connection directives presented difficulties and controversy, but attempted to implement the mandatory connection directives of local government in the smoothest, most expedient, and most efficient manner possible. Also, the Utility points out that the presumption that the use of related or contractual parties is inherently adverse to the interest of customers might be a presumption that could be fairly applied to the Utility if they had advance notice of the same. While the concerns of the customers are absolutely legitimate, the Utility urges that the Commission keep its eye on the ball and allow the Utility an opportunity to earn a return on its costs and investments reasonably incurred, whether or not the same went to related or contractual parties or entities. The Utility

believes that there is no genuine evidence upon which a finding that the quality of service is unsatisfactory could be made. (KWRU BR, pp. 5-7; TH-TR 82-86)

KWRU responded in even more detail to the concerns expressed by the customers in late filed EXH 44. In reference to the customer comments made about the Utility's agreement with Monroe County, the Utility indicated that the Monroe County Board of Commissioners looked at this project with a fine-tooth comb. In 2004, the Monroe County Board of Commissioners authorized a study and spent \$150,000 on an engineering report to evaluate all possible connection scenarios for the property owners. The County accepted the findings of the study which concluded that the most cost effective way for private properties to connect to central sewers was to install a vacuum system rather than a gravity system. Section 381.00655, F.S., requires that if there is an available publicly owned or investor-owned sewerage system, residential consumers are required to connect. (EXH 44, pp. 4-5) Monroe County, by ordinance, requires residential connection to the wastewater system within 30 days of connection notification. It has been determined that out of the 1,500 EDUs that the newly constructed vacuum system was intended to serve, there are four properties, which make up ten EDUs for which that service is not available. The Utility is still waiting for assistance from the County before any installation for the four properties without service can occur. (EXH 44, pp. 5, 16, 31) Concerning comments and complaints regarding the findings of the 2004 Grand Jury Report over the construction of the Utility's sewer system, the Utility points out that it was found not guilty of any wrong doing in the Grand Jury Report. However, the Utility notes that the County Engineer was found to be incompetent in performing his duties and the County Administrator and the County Commission were found negligent in their respective duties. (EXH 44, pp. 6-7) EXH 44 also provided explanations justifying the costs saving using subcontractors, and the appropriate mark-up allowance for overhead and profit margin. There was also concern about special deals for the golf course, which is a family related business. The Utility claims that this was an unsubstantiated claim and that the golf course paid for sewer service and effluent water rates in accordance with the approved Commission tariff. (EXH 44, pp. 8-9) As far as excessive fees and charges, the Utility points out that all fees paid are a result of a Commission-approved developer agreement. (EXH 44, pp. 15, 24, 25) The Utility indicated that there was Community Development/Block Ship Grants available to assist low-income customers in the connection process. (EXH 44, pp. 17, 32, 33-34)

The Utility provided additional explanations in EXH 44 in response to other customer claims made about the connection noticing process and the possible loss of homes (EXH 44, pp. 20, 23, 24, 28, 40), additional infrastructure costs, (EXH 44, pp. 22-23, 25-26) and lift-station backup problems which the Utility claims as non-existent. (EXH 44, p.38)

Analysis and Conclusion

Based on DEP witness Johnson's testimony, it appears that the quality of the Utility's treated wastewater and the operational condition of the plant are satisfactory. Although the Utility has an outstanding DEP warning letter, it is working with DEP to correct the problems. Further, it appears that some customers were clearly intimidated by the Utility as a result of tactics used to notify them of the requirement to interconnect to the Utility's wastewater treatment plant, although the County also failed to properly communicate with customers

regarding the need and cost to connect to KWRU. It is obvious that there is a certain level of animosity that exists between some customers and the Utility. This is unfortunate since it appears, in part, that the animosity is the result of activities supporting an agreement that relates to laws and ordinances designed to preserve the environment of the area in which the Utility and the customers it serves are located. Staff recognizes that for some, there have been financial and emotional hardships related to the connection process. However, it appears that the Utility has generally been responsive to customer concerns, and has applied the Commission's rules and regulations in reference to approved rates and charges, and developer agreements. Staff does not believe it is the Commission's place or responsibility to judge the legitimacy of the Utility's agreement to provide service to 1,500 EDUs as the result of its 2002 contract with Monroe County. Entities such as the Grand Jury have already reviewed and judged the merits of the contract. Staff does not see reason to intervene because there appears to be no Commission compliance issues, and staff does not believe the Commission needs to take any action in regards to the procedures used by the Utility.

However, staff does have concerns over the remaining 350 EDUs that have not connected. Possibly ten of these do not have service available, with one or two having paid the appropriate connection charges for service. Staff realizes that connection enforcement is a problem for the majority of these EDUs, and that the Utility appears to be looking at Monroe County for support in that area. For the ten EDUs, which make up four customers, staff believes that the Utility has an additional responsibility in proving to the Commission that it has made a good faith effort in making sure that service is available. Since the record is not clear concerning the status of all the 350 unconnected EDUs, staff recommends that the Utility provide a monthly report to the Commission addressing the status of the remaining 350 EDUs with particular attention given to the four potential customers that do not have service available. The report should include a description of Monroe County's enforcement activities towards those who refuse to connect to the Utility, status of what is remaining to be done to connect the four customers who do not have service available, and a complete accounting of paid connection charges for those who are not connected. These reports should continue until such time all of the 350 EDUs are connected and the conditions of the KWRU's 2002 contract with Monroe County have been fully satisfied.

Based on all of the above, the overall quality of service provided by the Utility should be considered satisfactory. However, KWRU should be required to provide monthly reports concerning the connection status of the remaining 350 EDUs left to be connected until such time the conditions of the Utility's 2002 contract with Monroe County have been fully satisfied.

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

Recommendation: Yes. Plant should be reduced by \$252,690 to remove an apparent duplication of contractual operation service fees. In addition, corresponding adjustments should be made to reduce accumulated depreciation and depreciation expense by \$10,983 and \$3,021, respectively. (Roberts, Fletcher)

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

OPC: Yes. KWRU pays its affiliate, KEI, a monthly fee under a management contract that requires KEI to perform the inspections as part of its contractual obligation. Since the monthly fee is paid by customers through their rates, the additional hook-up inspection fee constitutes a double charge for the same task.

Staff Analysis: According to Audit Finding No. 3, staff witness Welch stated that KWRU has a contract with KEI that requires two full-time operators and an operations manager, which provide for, among other things, customer relations, periodic inspections, minor maintenance, daily pumping stations inspections, preventative maintenance programs, and monitoring collection systems, reclaimed water lines, meters, pumps, and blowers. (Technical Hearing (TH)-TR 25-26) In addition, witness Welch stated that the contract includes sampling, testing, supervision, and inspection of new customer tie-ins; however, she stated that the description of KEI's work performed on customer connections appears to be more extensive. (TH-TR 26) Witness Welch asserts that the Commission should consider if the work being done by KEI exceeds what is in the contract. (TH-TR 26)

Utility witnesses Smith and DeChario asserted that KEI has a coordinator and inspector for all new connections for SSI residents, and he stated that the hook-up inspection involves an initial customer contact, review of plans and drawings, at least five field visits, as well as testing and coordination with the Utility's administrative staff. (TH-TR 113, 117-119; EXH 33, p. 4) Utility witness Smith further asserts that the contract does not cover the hook-up fees. In its brief, KWRU contends that the extensive inspection and oversight of the customer connections to its vacuum system could not have been envisioned at the time KEI and KWRU executed its agreement in December 2004. (KWRU BR, p. 9)

OPC witness Dismukes testified that the Commission should treat the functions of inspecting and hooking up customers as part of the contract for which KEI is paid a significant management fee. (TH-TR 242) In its brief, OPC argues that the contract language clearly obligates KEI to inspect customer connections as part of its overall obligation to manage, maintain, and operate the system for which the general body of ratepayers pay the monthly management fees in exchange for the service to be rendered under the contract. (OPC BR, p. 10) Witness Dismukes asserted that plant should be reduced by \$252,690 to remove an apparent duplication of contractual operation service fees. (TH-TR 242) Moreover, witness Dismukes stated that corresponding adjustments should be made to reduce accumulated depreciation and depreciation expense by \$10,983 and \$3,021, respectively. (TH-TR 242)

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Staff agrees with OPC witness Dismukes that the contract includes the work related to hook-up fees. First, in accordance with the contract between KWRU and KEI, Article II – Responsibilities of Agent (which refers to KEI) states, among other things, that KEI is responsible for supervising and inspecting new customer tie-ins. (EXH 25, p. 18) Based on the above, staff recommends that plant be reduced by \$252,690 to remove an apparent duplication of contractual operation service fees. In addition, corresponding adjustments should be made to reduce accumulated depreciation and depreciation expense by \$10,983 and \$3,021, respectively.

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

Recommendation: To remove non-utility investment, plant should be reduced by \$10,000. Accordingly, accumulated depreciation and depreciation expense should be decreased by \$1,259 and \$315, respectively. (Roberts, Fletcher)

Position of the Parties

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

OPC: Yes. KWRU presented no evidence on this issue. The customers should not be required to pay for the financial obligations of the County.

Staff Analysis: OPC witness Dismukes testified that the funds spent by KWRU to decommission Monroe County's wastewater treatment plant at its detention center should be removed because the Utility did not own the plant. (TH-TR 264) In its brief, OPC argued that KWRU did not provide any rebuttal testimony to refute witness Dismukes' recommended adjustment. (OPC BR, pp. 10-11; TH-TR 275-276) In addition, witness Dismukes discussed how KWRU was under no obligation to use customer money to dismantle the County's treatment facilities. (OPC BR, p. 11)

Utility witness Smith emphasized that the decommissioning of the existing sewage treatment plant at the Monroe County Detention Center (MCDC) was part of the agreement between the parties in order to obtain the detention center as a customer of KWRU. (KWRU BR, pp. 10-11) In its brief, KWRU asserted that the costs incurred are reasonable and appropriate in order to obtain a new customer to benefit KWRU and the general body of ratepayers. (KWRU BR, p. 11)

Staff notes that the Utility agreed to pay \$10,000 to assist the detention center in decommissioning its treatment plant, as KWRU previously provided service to the detention center. (EXH 2, Bates Stamp Nos. 00004105-00004116) Staff agrees with OPC witness Dismukes that the ratepayers should not have to bear this apparent non-utility expenditure. Based on the above, staff recommends that plant should be reduced by \$10,000 to remove costs associated with decommissioning the jail facilities. Accordingly, corresponding adjustments should be made to reduce accumulated depreciation and depreciation expense by \$1,259 and \$315, respectively.

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

Recommendation: Staff recommends that plant be reduced by \$32,198. Accordingly, accumulated depreciation and depreciation expense should be decreased by \$2,823. (Roberts, Fletcher)

Position of the Parties

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

OPC: Yes, KWRU's test year rate base should be adjusted to remove the \$32,198 management fee that KWRU paid to Green Fairways for the Monroe County Detention Center project.

Staff Analysis: OPC witness Dismukes asserted that KWRU paid Weiler Engineering a management fee to oversee the project. (TH-TR 265) In addition, witness Dismukes stated that KWRU also paid Green Fairways, an affiliate, a management fee of \$32,198. (TH-TR 265) When Monroe County auditors asked for Green Fairways' completion logs, they noted that the logs "were completed by the engineering firm and consisted of daily work reports of approximately one page per day." (TH-TR 265) Witness Dismukes contended that it appears that Weiler Engineering oversaw the project and KWRU has shown no documentation to justify paying its affiliate, Green Fairways, the \$32,198. (TH-TR 265) OPC believes that this amount should not be passed on to the ratepayers as they receive no benefit. (TH-TR 265)

Utility witness DeChario testified that, "It would be imprudent for the Utility . . . to simply turn a project over to a contractor and wait for its completion . . . in this case, Mr. Smith, through Green Fairways, has the right and responsibility of oversight and supervision of all parties working on the project." (TH-TR 455) In its brief, the Utility also asserted that there is little to nothing to support the proposed elimination of these contract fees, yet there is evidence in the record that they are not only the same fees charged to other clients of Green Fairways but that this the norm for the area for large construction contracts. (KWRU BR, p. 13) Based upon these facts, the Utility asserts that no adjustment is appropriate to these costs actually incurred by the Utility for oversight of construction projects undertaken by Green Fairways above and beyond the day-to-day administrative duties related to operation and maintenance and the costs must be recognized. (KWRU BR, p. 13)

It is the Utility's burden to prove that its costs are reasonable. See Florida Power Corp v. Cresse, 413 So. 2d 1187, 1191 (Fla. 1982). Additionally, the Commission has previously disallowed undocumented capitalized salaries.² The Utility has failed to provide adequate documentation of the oversight provided by Green Fairways for the Jail Project; therefore, staff

² See Order No. PSC-07-0505-SC-WS, p. 15, issued June 13, 2007, in Docket No. 060253-WS, In re: Application for increase in water and wastewater rates in Marion, Orange, Pasco, Pinellas, and Seminole Counties by Utilities, Inc. of Florida.

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recommends that plant be reduced by \$32,198. Accordingly, accumulated depreciation and depreciation expense should be decreased by \$2,823.

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

Recommendation: Staff recommends that plant be reduced by \$301,180. Accordingly, accumulated depreciation and depreciation expense should be decreased by \$26,406. (Roberts, Fletcher)

Position of the Parties

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

OPC: Yes, KWRU's test year rate base should be adjusted to remove the \$301,180 fee that KWRU paid Green Fairways to administer the South Stock Island project.

Staff Analysis: As in Issue 4, OPC witness Dismukes asserts that KWRU paid Weiler engineering a management fee to oversee the SSI project. (TH-TR 265) KWRU also paid Green Fairways, an affiliate, a management fee of \$301,180. (TH-TR 265) When Monroe County auditors asked for Green Fairways completion logs, they noted that the logs "were completed by the engineering firm and consisted of daily work reports of approximately one page per day." (TH-TR 265) Witness Dismukes contended that it appears that Weiler Engineering oversaw the project and KWRU has shown no documentation to justify paying its affiliate, Green Fairways, the \$301,180. (TH-TR 265) OPC believes that this amount should not be passed on to the ratepayers as they receive no benefit. (TH-TR 265)

As stated in Issue 4, Utility witness DeChario responded that: "It would be imprudent for the Utility . . . to simply turn a project over to a contractor and wait for its completion . . . in this case Mr. Smith, through Green Fairways, has the right and responsibility of oversight and supervision of all parties working on the project." (TH-TR 455) In its brief, the Utility also asserted that there is little to nothing to support the proposed elimination of these contract fees, yet there is evidence in the record that they are not only the same fees charged to other clients of Green Fairways but that this the norm for the area for large construction contracts. (KWRU BR, p. 13) Based upon these facts, the Utility asserts that no adjustment is appropriate to these costs actually incurred by the Utility for oversight of construction projects undertaken by Green Fairways above and beyond the day-to-day administrative duties related to operation and maintenance and the costs must be recognized. (KWRU BR, p. 13)

It is the Utility's burden to prove that its costs are reasonable. See Florida Power Corp v. Cresse. Additionally, the Commission has previously disallowed undocumented capitalized salaries.³ The Utility has failed to provide adequate documentation of the oversight provided by Green Fairways for the SSI Project. Staff recommends that plant be reduced by \$301,180.

³ See Order No. PSC-07-0505-SC-WS, p. 15, issued June 13, 2007, in Docket No. 060253-WS, In re: Application for increase in water and wastewater rates in Marion, Orange, Pasco, Pinellas, and Seminole Counties by Utilities, Inc. of Florida.

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Accordingly, accumulated depreciation and depreciation expense should be decreased by \$26,406.

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

Recommendation: Staff recommends that plant should be reduced by \$25,000 to remove unsupported legal fees. Accordingly, accumulated depreciation and depreciation expense should be decreased by \$2,192. (Roberts, Fletcher)

Position of the Parties

KWRU: No, these fees were for legitimate legal work in securing contracts for the benefit of the Utility and its customers.

OPC: Yes. KWRU's test year rate base should be adjusted to remove the \$25,000 legal fee paid by KWRU to the law firm Smith, Hemmesch, and Burke.

Staff Analysis: OPC witness Dismukes contended that Monroe County auditors found that KWRU could not provide any supporting documentation for the charge. (TH-TR 265) As a result, Monroe County refused to reimburse KWRU, notwithstanding its contract to reimburse KWRU's reasonable expenditures from the SSI contracts. (TH-TR 265) Even though Monroe County refused to pay this affiliated transaction because of lack of supporting documentation, KWRU is now asking the Commission to force its customers to pay it. (TH-TR 265) Ms. Dismukes believes that The Commission should refuse to allow KWRU to charge its customers for a completely undocumented payment to its affiliate. (TH-TR 265)

In its brief, the Utility stated that since the legal fees were part of a flat fee arrangement agreed to by Monroe County in writing, the contract itself is documentation of the charge. (KWRU BR, p. 14) The fact that Monroe County has failed to pay for these services does not affect the fact that KWRU incurred these legitimate cost in complying with the terms of the contract with Monroe County by negotiating agreements related to the SSI project, and that KWRU incurred an obligation to pay the \$25,000 legal bill originally agreed to by Monroe County. (KWRU BR, p. 14)

It is the Utility's burden to prove that its costs are reasonable. See Florida Power Corp v. Cresse. As discussed earlier in Issues 4 and 5, the Commission has previously disallowed undocumented capitalized salaries. The Utility has failed to provide adequate documentation for its legal fees. Staff recommends that plant be reduced by \$25,000 to remove unsupported legal fees. Accordingly, accumulated depreciation and depreciation expense should be decreased by \$2,192.

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

Recommendation: Yes. An adjustment of \$8,602 should be made to remove Mr. Johnson's capitalized moving expenses. Corresponding adjustments should be made to reduce accumulated depreciation and depreciation expense of \$1,075 and \$269, respectively. (Roberts, Fletcher, Bulecza-Banks)

Position of the Parties

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

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

Staff Analysis: KWRU capitalized in its SSI project costs, \$8,602 of relocation costs for Chris Johnson and his family. Mr. Johnson is the son-in-law of KWRU's President. According to the Utility, KWRU would stand to benefit from Mr. Johnson's participation in the SSI project and as a result, agreed to pay his moving expenses to Florida. (KWRU BR, p. 15)

OPC witness Dismukes raised Mr. Johnson's moving expenses as an issue in her direct testimony. In her testimony, witness Dismukes asserted that it would be inappropriate to capitalize Mr. Johnson's moving expenses to the SSI plant. (TH-TR 266)

Other than the information provided in its brief, KWRU did not provide sufficient evidence in the record to support the capitalization of Mr. Johnson's moving expenses. (TH-TR 476) The record is clear that KWRU did pay \$8,602 to reimburse Mr. Johnson for his relocation expenses. However, the appropriateness of capitalizing the moving expenses was not addressed.

When a utility seeks to increase its rates and charges, it has the burden to prove its requested increase is appropriate. In this case, KWRU failed to prove that Mr. Johnson's moving expenses should be capitalized. Staff, however, has additional reasons not to capitalize the relocation expenses.

Mr. Johnson is the President of KEI. Mr. Johnson owns 100 percent of KEI. Mr. Johnson is not an employee of KWRU. Mr. Johnson's employment at KEI is not required for KWRU to provide utility service. (TH-TR 233)

KWRU argues that Mr. Johnson's participation in the SSI project benefited KWRU as Mr. Johnson had KWRU's best interest at heart. Staff believes that when a utility hires a firm to conduct work on its behalf, the hired firm has a responsibility to provide the best possible service. There is no evidence in the record that indicates KEI was the only firm capable of providing the services necessary to oversee the SSI project. Further, the capitalization of engineering costs is not the issue being addressed. The issue is the capitalization of the relocation costs of the engineering firm's president.

Staff sees no reason to allow KWRU to reimburse the relocation costs of an employee of another company, much less, to capitalize those costs as part of the SSI project. The prudence of this expense is questionable considering the relocation costs are those of the son-in-law of KWRU's owner. Further, the moving expenses allowed Mr. Johnson to move to Florida to operate KEI, the company he owns.

Based on the above, staff believes that Mr. Johnson's capitalized moving costs should be removed from the SSI project costs. An adjustment of \$8,602 should be made to remove Mr. Johnson's capitalized moving costs. Corresponding adjustments should be made to reduce accumulated depreciation and depreciation expense of \$1,075 and \$269, respectively.

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

Recommendation: Yes. KWRU's test year rate base should be reduced by \$34,650. Corresponding adjustments should be made to decrease accumulated depreciation and depreciation expense both by \$1,925. (Roberts, Fletcher, Bulecza-Banks)

Position of the Parties

KWRU: No, these were legitimate charges for construction supervision of a project undertaken for the Utility.

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

Staff Analysis: This issue was raised by the OPC in witness Dismukes prefiled testimony. (TH-TR 272) KWRU did not address the issue in its rebuttal testimony. In its brief, KWRU touched on the issue of the \$4,650 for Jim Johnson's management fee and travel costs. (KWRU BR, p. 15) However, KWRU's only support for the costs is a statement that the costs were appropriate. To rebut witness Dismukes' assertion that the costs are duplicative, KWRU points out that witness Dismukes lacks experience in utility construction projects. (TH-TR 359) The \$30,000 in unsupported fees was not addressed by KWRU in its testimony or brief. (TH-TR 359; KWRU BR, p. 16)

The OPC argues that both the \$30,000 in fees billed to Johnson Constructors and the \$4,560 for travel and management services for Jim Johnson should be removed. (TH-TR 272) In witness Dismukes prefiled testimony, EXH 13, shows an invoice from Johnson Constructor to KWRU for the AWT project. On EXH 13, a charge is shown for \$30,000 but there is no information presented as to the services provided. Without supporting documentation as to the purpose of the charge, OPC believes the amount should be removed from rate base. (OPC BR, pp. 14-15) With respect to the \$4,650 for Jim Johnson's management fee and travel, witness Dismukes believes the charges to be duplicative. (OPC BR, pp. 14-15) Witness Dismukes asserts that a management service fee was paid to Johnson Constructors and to JAS for services related to the same AWT project. (OPC BR, pp. 14-15) Witness Dismukes believes that KWRU's ratepayers should not be forced to pay for two supervisors working on the same project. (TH-TR 271; OPC BR, pp. 15)

As in all utility cases, the Utility has the burden of proof. KWRU is required to support all dollars for which it seeks recovery. EXH 13, attached to witness Dismukes testimony, shows a \$30,000 charge, assessed on December 4, 2006. Under the heading, "Description" the line is blank. Although cryptic, the other entries on this invoice do include a description. KWRU was fully aware of the issue raised by witness Dismukes in her prefiled testimony. As a result,

KWRU needed to provide support for this amount. KWRU did not provide any documentation to support its case. As staff does not know the nature of the \$30,000 assessment, it cannot recommend recovery of this amount from KWRU's ratepayers.

KWRU enlisted the services of Johnson Constructors to complete its AWT upgrade project. Johnson Constructors, whose principal is Chris Johnson, enlisted the services of JAS Corporation. JAS Corporation is owned by Chris Johnson's father, Jim Johnson. In her direct testimony, witness Dismukes states that she does not believe the ratepayers should have to pay for two supervisors. KWRU did not supply testimony about the necessity of paying management fees to two companies, nor did it attempt to differentiate between the services provided by each company. (OPC BR, pp. 14-15)

KWRU focused its efforts on discrediting witness Dismukes testimony that the fees paid to Johnson Constructors and JAS Corporation were duplicative. KWRU's support for these fees is based on its statement in its brief that the costs were appropriate. KWRU argues that witness Dismukes has no experience in utility construction projects. (TH-TR 359) While witness Dismukes admitted that she has no experience in utility construction projects, such experience is not required to identify duplicative costs.

In witness Dismukes testimony, a chart is included that shows \$4,650 in charges were assessed by JAS Corp. (TH-TR 272) On the first line of the chart, a management fee of \$2,000 was assessed on October 2, 2006. However, KWRU has not provided any documentation to substantiate the appropriateness of the management fee. No documentation was provided to indicate what service was provided under the term "management service" fee.

As for Jim Johnson's travel, again, no document has been provided that indicated the appropriateness of his travel. Perhaps Chris Johnson was providing the oversight necessary and there was no need for Jim Johnson to physically be on sight. Without documentation to prove that Chris Johnson and Jim Johnson had different responsibilities related to the AWT project, staff does not believe it would be appropriate for KWRU to recoup management service fees and the associated travel for Mr. Jim Johnson. Based on the above, staff recommends that KWRU's test year rate base be reduced by \$34,650. Corresponding adjustments should be made to decrease accumulated depreciation and depreciation expense both by \$1,925.

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

Recommendation: Yes. KWRU's test year rate base should be reduced by \$32,500 to remove unsupported consultant fees paid to Mr. London. Corresponding adjustments should be made to accumulated depreciation and depreciation expense of \$6,145 and \$855, respectively. (Roberts, Fletcher, Bulecza-Banks)

Position of the Parties

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

OPC: Yes. KWRU capitalized to rate base \$32,500 of payments that were made to John London, a former Monroe County Commissioner. KWRU stated the payments were for Mr. London to serve "as liaison between Monroe County and the Utility in its efforts to expand operations to South Stock Island." These payments were made pursuant to an oral contract and no invoices exist. Customers should not be forced to pay for expenditures for which there exists no documentation as to the specific tasks that were performed.

Staff Analysis: KWRU capitalized consulting fees paid to former Monroe County Commissioner, Jack London. (TH-TR 263) KWRU asserted that while it did not issue separate invoices for the costs, that should not affect the fact that the services were provided. KWRU contended that Mr. London's services ultimately benefitted all customers as his services related to the SSI project. KWRU entered into an oral contractual agreement with Mr. London whereby Mr. London would serve as a liaison between KWRU and Monroe County. (KWRU BR, pp. 16-17)

OPC believes that the consultant fees paid by KWRU should be removed from rate base because: 1) KWRU has no written documentation indicating the services performed; 2) KWRU has not demonstrated that the customers benefitted from Mr. London's services; and 3) KWRU has not demonstrated that it was appropriate to capitalize the consulting fees. (TH-TR 262-263)

KWRU argued that the only basis for the adjustment proposed by OPC is that there are no invoices to be reviewed. Staff believes the lack of documentation alone warrants removal from rate base. A company the size of KWRU should be fully aware that documentation must be provided to justify the recovery of costs. Reliance on oral contracts alone subjects utilities to potential disagreements regarding terms of the agreement. In this case, KWRU has no written contract with Mr. London and received no invoices detailing the services provided by Mr. London. Further, KWRU contended that all ratepayers benefitted from Mr. London's services, but KWRU provided no documentation to support its claim. (OPC BR, pp. 16-17)

Staff believes that KWRU has not provided documentation necessary to support inclusion of Mr. London's consulting fees in rate base. As a result, staff recommends that \$32,500 be removed from KWRU's test year rate base. Corresponding adjustments should be made to accumulated depreciation and depreciation expense of \$6,145 and \$855, respectively.

Issue 10: Should KWRU's test year rate base be adjusted for White and Case legal charges related to Monroe County Audit Report?

Recommendation: Yes. KWRU's test year rate base should be reduced by \$27,230 to remove legal fees associated with the response to the Monroe County Audit Report. Corresponding adjustments should also be made to decrease accumulated depreciation and depreciation expense by \$1,814 and \$907, respectively. (Roberts, Fletcher)

Position of the Parties

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

OPC: Yes. Rate base should be reduced by the \$27,230 (EXH 2) paid to the law firm of White and Case.

Staff Analysis: OPC witness Dismukes testified that she does not believe that the legal fees associated with the response to the Monroe County audit by the law firm of White and Case should be capitalized and included in rate base. (TH-TR 264) Witness Dismukes stated that the legal fees associated with the response to the Monroe County audit should be removed citing correspondence that the law firm attended a meeting with KWRU that was at the request of KWRU to discuss the funds that the County refused to reimburse the Utility. (TH-TR 353-354) Dismukes stated that the appropriate reduction for the Case and White legal fees is \$27,230 and the depreciation expense is \$907 and accumulated depreciation is \$1,814. (TH-TR 366-367)

Utility witness DeChario testified that Monroe County commissioned this audit as part of its requirements for the use of municipal funds. (TH-TR 450-451) As with any audit, Mr. DeChario also stated the Utility being audited may be called upon to correct or clarify assumptions of the independent auditor and that occasionally a response is required. (TH-TR 450) DeChario also stated that it was proper for the Utility to capitalize these expenditures in accordance with NARUC Accounting Instruction 19. (TH-TR 450-451)

Utility Plant-Components of Construction Costs (15) "Legal Expenditures" includes the general legal expenditures incurred in connection with construction and the court and legal costs directly related thereto . . . NARUC USOA for Wastewater Utilities, 1996, Page 24 (TH-TR 451)

Staff agrees with witness Dismukes that the \$27,230 in legal expenses related to the KWRU response to the Monroe County Audit Report should not be included in the test year rate base. The burden of proof in ratemaking cases in which a utility seeks an increase in rates rests on the utility. See South Fla. Natural Gas Co. v. Florida Pub. Serv. Commission (534 So. 2d 695 (Fla. 1988)); Florida Power Corp. v. Cresse; Sunshine Utilities. v. Florida Pub. Serv. Commission (577 So. 2d 663, 666 (Fla. 1st DCA 1991)). Staff does not believe the Utility has met its burden of proof that these legal fees were directly related to the construction associated with the SSI construction project. As such, staff recommends KWRU's test year rate base be reduced by

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\$27,230 to remove legal fees associated with the response to the Monroe County Audit Report. Corresponding adjustments should also be made to decrease accumulated depreciation and depreciation expense by \$1,814 and \$907, respectively.

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

Recommendation: Yes. KWRU's test year rate base should be reduced by \$422 to remove costs associated with a media advertisement. Accordingly, corresponding adjustments should be made to decrease accumulated depreciation and depreciation expense by \$117 and \$23, respectively. (Roberts, Fletcher)

Position of the Parties

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

OPC: Yes. The \$422 that KWRU spent for a newspaper advertisement should be removed from rate base. KWRU did not attempt to rebut this issue.

Staff Analysis: OPC witness Dismukes stated that prior to the test year; KWRU spent \$422 for a newspaper advertisement. (TH-TR 266) KWRU capitalized the cost and included it in rate base rather than expense the cost in the period in which it was incurred. (TH-TR 266) OPC asserts that the balance should be removed from rate base. (TH-TR 71, 266)

KWRU stated that the advertisement was an action undertaken at the County's request to assist customers in understanding of the required system expansion and required interconnection to the system on SSI, thereby benefiting all of the Utility's customers through a larger rate base. (KWRU BR, p. 18) KWRU also stated that an adjustment of this nature actually discourages good customer relations and a Utility's attempts to keep its customers informed. (TH-TR 88; KWRU BR, p. 18)

It is the Utility's burden to prove that its costs are reasonable. See Florida Power Corp v. Cresse. Staff agrees with witness Dismukes that the \$422 associated with the newspaper advertising expense should be removed from the test year rate base. Staff believes that this expense should have been expensed in the period in which it was incurred. Accordingly, corresponding adjustments should be made to decrease accumulated depreciation and depreciation expense by \$117 and \$23, respectively.

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

Recommendation: Yes. To remove administration fees paid to Green Fairways and to remove cost incurred for not obtaining the necessary permits in a timely manner, pro forma plant should be reduced by \$124,921. Accordingly, corresponding adjustments should also be made to decrease accumulated depreciation and depreciation expense both by \$6,940. In addition, a corresponding adjustment should be made to decrease property taxes by \$1,027. (Roberts, Fletcher)

Position of the Parties

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

OPC: Yes, two adjustments: (1) the redundant \$111,374 administration fee paid to Green Fairways should be removed; and (2) the \$13,547 of costs incurred because of an unnecessary delay should be removed.

Staff Analysis: In its filing, the Utility reflected \$1,139,707 in pro forma plant. (EXH 3, Vol. 1, p. 3) In its brief, KWRU indicated the pro forma plant additions were related to the upgrade project undertaken by the Utility for the AWT conversion. (KWRU BR, p. 18) In its brief, OPC asserted that two adjustments from the pro forma plant additions should be removed from rate base. (KWRU BR, pp.17 -18)

Administration fees paid to Green Fairways:

According to Audit Finding No. 2, staff witness Welch stated that Mr. Smith manages many companies and there are no time records to support the allocation of his time spent on the Utility. (TH-TR 25) Mr. Smith also charges 10 percent of large construction projects to plant for the management of the construction project. (TH-TR 25) Green Fairways charged the Utility \$107,198 in 2002 and \$194,377 in 2003 for the project of lining the collection system with a fiberglass liner in order to keep from having to replace the crumbling clay system. (TH-TR 25) In 2006, \$124,984 was charged for the work on the AWT plant expansion project. (TH-TR 25) Through cross examination by the Utility, witness Welch acknowledged that she has not compared these figures to Key Haven which is mentioned as the only utility that is similarly situated to KWRU. (TH-TR 49-50)

Utility witness Smith emphasized that Green Fairways charged the Utility an oversight administrative fee related to construction projects. (KWRU BR, p. 18; TH-TR 160) Witness Smith testified that a project manager must obtain financing for these projects, and generally has to personally guarantee these projects and sign the contracts in order to obtain the financing. (TH-TR 158) He contended that this type of agreement is not unusual and typically a management fee for projects, property, and management is normal. (TH-TR 151) Witness Smith asserted “. . . there isn't a manager who will do the management of a project which is completely different than, . . ., a capital intensive project.” He stated that a management company manages those big projects, but they charge additional amounts, typically 10 percent of the overall cost of a project. (TH-TR 151) However, he stated there is a huge difference between acting as a project administrator versus acting as just a manager of the Utility Company. (TH-TR 158) Witness

Smith admitted that he does not keep track of his time that he spends on various projects, but he feels that one-third of his time is devoted to Utility matters. (TH-TR 142, 145) He asserted that as project administrator you have to plan, engage in construction oversight, conduct quality assurance, manage the payment of contractors, and arrange financing. (TH-TR 160)

OPC witness Dismukes testified that, according to the agreement for construction of the AWT project, Green Fairways, Inc. and Johnson Constructors, LLC together are the "Contractor" for this project. (TH-TR 269) Both companies are affiliates of KWRU. Johnson Constructors and JAS Corp. are owned by Jim Johnson (Chris Johnson's father) and several of the charges relate to travel charges of Mr. Jim Johnson. (TH-TR 271) In addition, according to the contract for this project, the engineering firm Weiler Engineering, is responsible for providing administration. (TH-TR 271) Witness Dismukes testified that KWRU has not demonstrated the need for the excessive oversight responsibility and nor adequately documented the actual services provided by Green Fairways. (OPC BR, p. 17, TH-TR 271) She does not believe ratepayers should pay for two supervisors. (TH-TR 271) Therefore, Ms. Dismukes recommends removing the \$111,374 for Green Fairways fees from rate base. (TH-TR 271)

Utility witness DeChario emphasized it would be imprudent for the Utility, or anyone for that matter, to simply turn a project over to a contractor and wait for its completion. (TH-TR 455) The chain of supervision is necessary whether building a home or expanding a wastewater treatment plant. (TH-TR 455) Subcontractors supervise their employees, contractors supervise the subcontractors, engineers supervise the contractors, and ultimately the property owner, in this case Mr. Smith, through Green Fairways, has the right and responsibility of oversight and supervision of all parties working on the project. (TH-TR 455)

It is the Utility's burden to show that its requested expenses are reasonable. See Florida Power Corporation v. Cresse. Staff agrees with OPC witness Dismukes that the administrative fees paid to Green Fairways for the oversight of the construction projects should be removed from rate base. Staff believes that KWRU has not met its burden of proof. Specifically Mr. Smith acknowledged that he does not keep track of time spent on various projects. (TH-TR 142) Therefore, staff recommends that \$111,374 be removed from KWRU's pro forma plant additions. Accordingly, corresponding adjustments should be made to decrease accumulated depreciation and depreciation expense both by \$6,187.

Subcontractors, US Filter Davco

OPC witness Dismukes testified that the added costs associated with the change orders from Davco were due to KWRU's failure to have the permits in place to start the job as scheduled. (TH-TR 270) The change orders reflect additional housing costs associated with Davco and the delay of the project. Davco was to originally start the job on November 8, 2006, so a house was rented for \$3,300 a month. (TH-TR 270) However, KWRU was red tagged and Davco could not pour the slab until the permits were pulled. (TH-TR 270) Through cross examination, Utility witness DeChario testified that he has no rebuttal testimony regarding these change orders. (TH-TR 477) Witness Dismukes does not believe customers should have to pay for KWRU's failure to properly secure the permits for the project. (TH-TR 271) Therefore, she recommends removing \$13,547 from the pro forma adjustment and the corresponding adjustments for accumulated depreciation and depreciation expense. (TH-TR 271)

Utility witness Castle emphasized that the Capacity Reservation Agreement between Monroe County and KWRU specifically stated that the agreement constituted all required permits and that no further permits were required from the County. (TH-TR 423) Mr. Castle testified that KWRU had assumed no building permit was needed based on the agreement. (TH-TR 423) He further asserted, when the County red-tagged the AWT construction project, work was stopped until the permit could be obtained. (TH-TR 423) Witness Castle contended that the delay was caused by the position taken from the Building Department that the permitting condition in the Agreement was not valid and that a building permit was required. (TH-TR 423)

Staff agrees with OPC witness Dismukes that the added costs of \$13,547 associated with the change-orders from Davco should be removed. Staff believes the change orders were due to KWRU not having permits in place for the scheduled work and believes that customers should not have to pay for KWRU's failure to properly secure permits for the project. Thus, staff recommends that pro forma plant be reduced by \$13,547. Accordingly, corresponding adjustments should be made to decrease accumulated depreciation and depreciation expense both by \$753.

In conclusion, to remove administration fees paid to Green Fairways and to remove cost incurred for not obtaining the necessary permits in a timely manner, staff recommends that pro forma plant be reduced by \$124,921. Accordingly, corresponding adjustments should also be made to decrease accumulated depreciation and depreciation expense both by \$6,940. In addition, a corresponding adjustment should be made to decrease property taxes by \$1,027.

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

Recommendation: The Utility's wastewater treatment plant and collection and reuse systems should all be considered 100 percent used and useful. (Rieger)

Position of the Parties

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

OPC: The wastewater treatment plant is 72.14% used and useful, rather than the 100% that the utility is seeking. Rate base should be reduced by \$1,324,595 to reflect the used and useful adjustment.

Staff Analysis:

KWRU

The Utility considers its treatment plant and wastewater collection system to be 100 percent used and useful because of its contractual obligations to Monroe County to provide wastewater treatment to a developed area for environmental reasons. However, in its MFRs, the Utility calculated a 61.35 percent used and useful for its wastewater treatment plant, although no growth was included in the calculation. The Utility expanded the capacity of its wastewater treatment plant in 1997 and subsequently upgraded the treatment plant to AWT standards and expanded its collection system to accommodate an additional 1,500 EDUs pursuant to a contract between the Utility and Monroe County. (EXH 3; KWRU BR, pp. 19-30)

Although not all of the potential customers located within the environmentally sensitive area have connected, the Utility has included Monroe County's advance payments as a reduction to rate base for rate making purposes. This, according to the Utility, eliminates the need for a non-used and useful adjustment. In addition, to further bolster its claims that this facility should be 100 percent used and useful, the Utility maintains that the plant is designed and built to provide reuse and will be an AWT plant, as mandated by Monroe County. (EXH 3; KWRU BR, pp. 19-30)

OPC

OPC agrees that the Utility's collection system is 100 percent used and useful; however, OPC believes that the Utility's wastewater treatment plant is 72.14 percent used and useful based on the annual average test year flow of 288,000 gallons per day (gpd), a growth allowance of 72,000 gpd (capped at 5 percent per year for 5 years pursuant to Section 367.081(2)(a)2, F.S.), and the permitted capacity of the plant of 499,000 gpd. OPC witness Woodcock testified that his disagreement with the Utility's used and useful analysis lies in both the calculated used and useful and the rationale for 100 percent used and useful. (OPC BR, pp.18-19)

Witness Woodcock points out that the Utility's used and useful calculation incorrectly relies on the maximum three-month average daily flow rather than the lower annual average flow (consistent with the permitted capacity), pursuant to Rule 25-30.432, F.A.C. In reference to growth, witness Woodcock admitted that he did not take into account a mandatory connection ordinance, any particular agreement commitment the Utility made to Monroe County, or any other commitments or reservations of capacity. He explained that if he was looking at how he would prudently plan for growth, he would consider the mandatory connections, agreements, and commitments. However, for the purposes of used and useful, he did not see them as relevant issues. (TH-TR 389-391, 403-405)

When questioned as to why engineers would prudently design a plant without the constraints of the Commission's wastewater used and useful rule, witness Woodcock pointed out that used and useful is not an engineering principle. He agreed that a utility could design a plant that an engineer would think was prudently sized, yet not warrant inclusion in rate base at 100 percent used and useful. He indicated that KWRU's plant is appropriately sized and that the expansion and the installation of the AWT facilities represent environmental compliance costs. Witness Woodcock asserted that there is an opportunity for those costs not included in rate base to be collected as the Utility's service area grows and the used and useful approaches 100 percent. (TH-TR 394, 399-401, 409-410)

Witness Woodcock explained that the collection system consists of two parts, the original gravity collection system and the newer vacuum system. His review showed that the gravity part of the collection system was essentially built out and therefore 100 percent used and useful. The newer vacuum system, although not yet at the design capacity of serving 1,500 EDUs, was funded by Monroe county and is considered a fully contributed system; therefore, the vacuum system should be excluded from the used and useful analysis. (TH-TR 392)

Witness Woodcock points out that the MFRs seem to indicate that expansion of the wastewater treatment plant was required by Monroe County in 2001. However, the expansion was actually made in 1997, which was prior to the agreement with Monroe County for expansion of the system. His review of the Utility's Capacity Reservation Contract with Monroe County found that the Utility is allowed to keep \$600 of the \$2,700 capacity reservation fee for the purpose of upgrading the wastewater treatment plant to AWT standards. The agreement made no mention of expanded treatment capacity. Therefore, the traditional used and useful calculation should be applied. (TH-TR 391)

KWRU Response

In response to OPC's used and useful analysis, KWRU's witness Castle agrees with OPC that the permitted capacity is based on annual average daily flow rather than the three-month average daily flow reflected in the MFRs. He also agrees with witness Woodcock that the 1997 plant expansion was not required by agreement with Monroe County, but was required by DEP in order to provide capacity for the Key West Golf Club (KWGC) Development housing. However, the conversion to AWT was required by the agreement with Monroe County. (TH-TR 422)

Witness Castle points out that Rule 25-30.432 F.A.C., provides that the extent to which the area served is built out should be considered. He indicates that the rule implies that projected

growth based on factors other than a strict percentage should be reasonably allowed. He stated that the utility's service area is experiencing significant redevelopment of properties into higher density uses as indicated by capacity reservation agreements with KWRU. He believes that the known developments proposed to connect to the utility should be considered in future capacity calculations as well as a standard percentage growth rate. (TH-TR 422, 432) All customers were supposed to be connected to the system within two years; however, considerable balking by the customers and lax enforcement by Monroe County has delayed these connections. (EXH 3, Vo. 1 p. 85)

Monroe County provided funding for the expansion by paying the capacity fees of all the Stock Island residents under a repayment agreement with the Utility. The Utility has included these advances as a reduction to rate base for ratemaking purposes, thus eliminating the need for a non-used and useful adjustment. In addition, the plant is designed and built to provide reuse and will be an AWT plant as mandated by Monroe County. (EXH 3, Vo. 1 p. 85)

In its post hearing statement, the Utility states that the factors clearly exist which the Commission should consider, pursuant to Rule 24-30.432 F.A.C., to find that the existing wastewater treatment plant and the expansion, refurbishment, and upgrade of KWRU's facilities are 100 percent used and useful. In this regard, the Commission should consider the growth of the system, the mandate of the legislature and Monroe County which directly resulted in the upgrade and expansion; and the nature and reality of the service area and the mandatory connection ordinance and the reservations of capacity related to each, which essentially render the service area as "built out." Rule 24-30.432, F.A.C., expressly provides that the enumerated factors are only some of the factors that the Commission will consider in determining the used and useful amount, and is not by any means an exhaustive list. The rule also expressly provides that it does not apply to reuse projects, pursuant to Section 367.0817(3), F.S., nor investment for environmental compliance pursuant to Section 367.081(2)(a)2.c, F.S. The Utility's post hearing statement goes on to refer to Chapter 99-395, in which the Legislature enacted certain sewage requirements for Monroe County which, in section 6 of that law, required sewage facilities to go to AWT by July 1, 2010. In furtherance of that mandate, the Utility points out that Monroe County secured an agreement from the Utility to convert its wastewater treatment system to AWT by January 1, 2007, providing that the Utility is allowed to recapture the costs of its conversion to AWT and increased operating costs by a resolution of the County Commission. (KWRU BR, pp. 19-30)

Analysis and Conclusion

Staff believes that OPC's calculated used and useful adjustment is somewhat shortsighted in lieu of KWRU's rationale for a 100 percent used and useful determination. Staff agrees with the Utility that the factors clearly exist, pursuant to Rule 24-30.432 F.A.C., to find that the Utility's wastewater treatment plant and collection and reuse systems are all 100 percent used and useful. The record shows that the remaining capacity of the treatment facility and lines have been committed and contributed towards the provision of service of the 1,500 EDUs that the Utility agreed to serve pursuant to a contract with Monroe County. Although not all of the potential customers located within the environmentally sensitive area have connected, it appears that Monroe County's advance payment for these customers clearly reserves that remaining

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capacity. In addition, the record shows that the facility should be 100 percent used and useful, because the plant is designed and built to provide reuse and will be an AWT plant, as mandated by Monroe County. Given the above, staff recommends that KWRU's wastewater treatment plant, entire collection system, and reuse systems are all 100 percent used and useful in providing service to the customers of the Utility.

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

Recommendation: Consistent with staff's previously recommended plant adjustments, the appropriate test year balance of accumulated depreciation is \$2,674,088. (Roberts, Fletcher)

Position of the Parties

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

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

Staff Analysis: In its filing, KWRU reflected \$2,803,410 of test year accumulated depreciation. (EXH 3, Vol. 1, p. 1) Consistent with staff's previously recommended plant adjustments, staff recommends that the appropriate test year balance of accumulated depreciation is \$2,674,088.

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

Recommendation: The appropriate test year balances of CIAC and accumulated amortization of CIAC are \$5,563,429 and \$726,153, respectively. (Roberts, Fletcher)

Position of the Parties

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

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

Staff Analysis: In its filing, KWRU reflected historical test year balances of \$4,856,429, \$686,844, and \$2,777,630 for CIAC, advances for construction, and accumulated amortization of CIAC, respectively. (EXH 3, Vol. 1, p. 1) Staff witness Welch testified that \$707,000 of advances for construction should be transferred to CIAC as a result of the KWRU's reimbursement of funds received by Monroe County through the collection of cash CIAC from customers. (TH-TR 30-32)

OPC witness Dismukes agrees with Ms. Welch's recommended \$707,000 transfer from advances for construction to CIAC. (TH-TR 31-32) Utility Witness DeChario agrees with Ms. Welch's adjustment, as well. (EXH 33, p. 9) Ms. Welch, Ms. Dismukes, and Mr. DeChario all agreed that this adjustment does not affect rate base. (TH-TR 32; EXH 33, p. 9)

Based on the above, staff recommends that the appropriate test year balances of CIAC and accumulated amortization of CIAC are \$5,563,429 and \$726,153, respectively.

Issue 16: What is the appropriate working capital allowance?

Recommendation: The appropriate working capital allowance is \$464,578. Accordingly, working capital should be decreased by \$32,269. (Roberts, Fletcher)

Position of the Parties

KWRU: The Working Capital Allowance, as outlined in the Utility's original filing, adjusted for the effect of the stipulations on that balance.

OPC: The Utility's filed Working Capital Allowance should be reduced by the \$168,265 in temporary cash investments that were improperly included and by the unamortized balance of rate case expense.

Staff Analysis: In its filing, the Utility reflected a Working Capital Allowance of \$496,846. (EXH 3, Vol. 1, p. 1) Pursuant to Order No. PSC-08-0607-PHO-SU, p. 24, it has been stipulated that temporary cash investments of \$168,265 be removed from working capital allowance, and working capital would be increased by \$2,689 for prepaid expenses.

OPC witness Dismukes recommended a rate decrease and that KWRU had no need to file for a rate increase for wastewater operations and that the associated rate case expense should be disallowed. (TH-TR 313, 318) Ms. Dismukes asserted that working capital allowance should be reduced by the unamortized balance of rate case expense. (TH-TR 345-346)

KWRU Witness DeChario stated that a rate increase is fair and reasonable for the economic climate in which it operates. (TH-TR 462) Also, KWRU stated that \$133,341 of the actual rate case expenditures of this case are directly related to responding to the discovery propounded by OPC, as well as the preparation of rebuttal testimony in response to unreasonable adjustments and allegations put forth in OPC testimony. (TH-TR 462-463) In its brief, KWRU stated that it believes that the working capital allowance originally outlined in the Utility's application, adjusted for the effect of the stipulations, is the appropriate balance. (KWRU BR, p. 31)

The Utility included \$100,000 of average deferred rate case expense in its working capital allowance of \$496,846. (EXH 3, Vol. 1, p. 1) It is Commission practice to include the average approved amount of rate case expense in the working capital calculation for Class A water and wastewater utilities.⁴ Consistent with Commission practice and staff's total recommended rate case expense of \$466,615 in Issue 31, staff recommends that the appropriate working capital is \$464,578 [\$496,846 less \$168,265 plus \$2,689 plus ((\$466,615/2) less \$100,000)]. Accordingly, working capital should be decreased by \$32,269.

⁴ See Order Nos. PSC-08-0327-FOF-EI, issued May 19, 2008, in Docket No. 070304-EI, In re: Review of 2007 Electric Infrastructure Storm Hardening Plan filed pursuant to Rule 25-6.0342, F.A.C., submitted by Florida Public Utilities Company.; PSC-01-0326-FOF-SU, issued February 6, 2001, in Docket No. 991643-SU, In re: Application for increase in wastewater rates in Seven Springs System in Pasco County by Aloha Utilities, Inc.; and PSC-97-1225-FOF-WU, issued October 10, 1997, in Docket No. 970164-WU, In re: Application for increase in rates in Martin County by Hobe Sound Water Company.

Issue 17: What is the appropriate rate base?

Recommendation: Consistent with other recommended adjustments, the appropriate 13-month average rate base is \$127,795. (Roberts, Fletcher)

Position of the Parties

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

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

Staff Analysis: Based on staff's recommended adjustments, the appropriate 13-month average rate base is \$127,795. Schedule No. 1-A depicts staff's rate base calculation. Staff's proposed adjustments to rate base are depicted on Schedule No. 1-B.

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

Recommendation: The appropriate return on common equity is 12.67 percent based on the Commission's leverage formula approved at the December 16, 2008 agenda conference and an equity ratio of 27.34 percent. Staff recommends an allowed range of plus or minus 100 basis points be recognized for ratemaking purposes. (Roberts, Fletcher, Bulecza-Banks)

Position of the Parties

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

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

Staff Analysis: The return on equity (ROE) requested in the Utility's filing is 12.01 percent. This return is based on the application of the Commission's leverage formula approved in Order No. PSC-07-0472-PAA-WS and an equity ratio of 26.22 percent.⁵

On May 10, 2008, the Commission staff filed its annual recommendation to update the water and wastewater leverage formula based on current financial data. On May 20, 2008, in Docket No. 080006-WS, the Commission voted to deny staff's recommended application of the water and wastewater leverage formula and set the matter for hearing. A hearing was held on October 23, 2008. Based on the evidence in the record, staff filed its recommended water and wastewater methodology on December 4, 2008. The Commission approved staff's recommended methodology at the December 16, 2008 agenda conference which reflected the leverage graph methodology and calculations proposed in staff's May 10, 2008, recommendation.

Staff believes the Company's proposed return on equity of 12.01 percent should be updated to reflect the cost rate yielded by the Commission's leverage formula approved at the December 16, 2008 agenda conference. Based on the approved methodology and an equity ratio of 27.34 percent, staff recommends a ROE of 12.67 percent. Staff recommends an allowed range of plus or minus 100 basis points be recognized for ratemaking purposes.

⁵ See Order No. PSC-07-0472-PAA-WS, issued June 1, 2007, in Docket No. 070006-WS, In Re: Water and Wastewater Industry Annual Reestablishment of Authorized Range of Return on Common Equity for Water and Wastewater Utilities Pursuant to Section 367.081(4)(f), Florida Statutes.

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

Recommendation: Based on the resolution of the previous issues, the appropriate weighted average cost of capital, including the proper components, amounts, and cost rates associated with the capital structure, is 8.62 percent. (Roberts, Fletcher, Bulecza-Banks)

Position of the Parties

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

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

Staff Analysis: As shown on MFR Schedule D-1, KWRU originally proposed an overall cost of capital of 8.39 for the test year ending December 31, 2006. (EXH 3, Vol. 1, p. 57) KWRU acknowledges that its proposed weighted average cost of capital should be updated for the effects, if any, of the stipulations agreed to by the parties. (KWRU BR, p. 32)

OPC has not recommended any specific adjustments to KWRU's proposed capital structure but acknowledges that the weighted average cost of capital should be adjusted for the outcome of the Commission's decisions involving rate base. (OPC BR, p. 21)

Based on the resolution of the preceding issues, staff's recommended capital structure yields an overall cost of capital of 8.62 percent. Schedule No. 2 contains staff's recommended capital structure.

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

Recommendation: Yes. To reflect the appropriate annualized revenue adjustment, revenues should be increased by \$6,264. Second, revenues should be increased by \$14,600 to reflect the appropriate rental fee. Finally, test year revenues should be increased by \$19,575 to include income related to the County lift stations. (Roberts, Fletcher)

Position of the Parties

KWRU: Test year revenues should be those outlined in KWRU's original application, adjusted for the effects (if any) of the stipulations outlined herein. KWRU benefitted by allowing contract personnel to utilize the trailer while charging them rent. Costs not recovered are appropriate expenses and the use of the trailer benefitted customers. MCDC revenue is merchandise/jobbing income. Related expenses should be removed to below-the-line merchandise/jobbing expenses equal to the revenue amount.

OPC: Yes. Test year revenues should be adjusted: (1) to avoid a mismatch, revenues should incorporate the same FKAA billing data that KWRU is using in its proposed rate design; (2) to reflect the historical level of rental income; and (3) to reflect revenue collected from Monroe County.

Staff Analysis: In its filing, KWRU reflected adjusted test year revenues of \$1,046,314. (EXH 3, Vol. 1, p. 39) OPC believes there are three adjustments necessary to test year revenues that address: annualized revenues, rental income, and revenue collected from Monroe County. (OPC BR, p. 21)

Annualized Revenues

Utility witness Smith testified that the Utility has always operated with a flat rate for sewer service because it was difficult to obtain water usage information from the FKAA. (TH-TR 96) He further stated that because FKAA has been the provider of water service to all of KWRU's wastewater customers, obtaining that information was necessary in order to move to a base facility type charge, including a base charge and usage charge. (TH-TR 96) He asserted that it is appropriate for the Utility to move to a base and gallonage charge because it is a better indicator of the cost of providing service to each customer and helps to promote conservation. (TH-TR 96)

OPC witness Dismukes testified that the number of bills, according to the FKAA usage information, is different from the number of bills KWRU has reported. According to witness Dismukes, the Utility provided an explanation of this difference in its response to OPC Interrogatory 60:

The Utility has historically billed flat rates for all but commercial customers. With the FKAA information, certain customers which were flat rate billed, such as multifamily apartment units, have individually metered units as billed by FKAA. As a result, the number of residential customers, including individually metered apartment units, increased. Additionally, based on the FKAA data, meter

sizes were updated to agree to what was being billed for commercial and multi-family bulk meters by FKAA. Also, some commercial establishments are being served by multiple meters which were being flat rate billed as a single meter.

Witness Dismukes further testified that in order to ensure consistency between test year revenue and the proposed rate design which contains different billing units, test year revenue should be adjusted, where possible, using the FKAA billing data provided by the Utility. As shown in EXH 14, witness Dismukes asserted that test year revenue should be increased by \$158,151 to reflect the appropriate annualized revenue adjustment.

Utility witness DeChario testified that Ms. Dismukes' annualized revenue adjustment is a matching principal violation because the billing unit information from FKAA includes customers beyond the test year number of customers. (TH-TR 443)

Staff agrees with Utility witness DeChario that the inclusion of pro forma billing units to project revenues would be a matching principal violation if the expenses are not projected as well. However, when comparing the Utility's MFR Schedules E-2(a) and E-3, staff believes that the Utility has failed to include six general service bills, and KWRU also used the incorrect rate for its 4-inch general service customers. (EXH 3, Vol. 1, pp. 69-70) Staff has calculated test year revenues of \$1,052,578. Based on the above, staff recommends that the appropriate annualized revenue adjustment should be \$6,264.

Rental Income

According to Audit Finding No. 3, staff witness Welch testified that KEI has its office in a Utility-owned trailer. KEI pays KWRU \$24,000 annually for the use of this trailer; it also uses the Utility owned trucks, but only pay for the gasoline and vehicle maintenance. (TH-TR 25, 35)

OPC witness Dismukes agreed with staff witness Welch. (TH-TR 233) Even though KEI rents the Utility trailer that is located at the sewer site, no employees of either the Utility or Key KWGC occupy the trailer. (TH-TR 235) In addition, Weiler Engineering Corporation and KEI paid \$37,400 in rent to KWRU. (TH-TR 274) Witness Dismukes examined the billing summary the Company provided in response to Citizens' Interrogatory 4. The rent charged to KEI has always remained constant at \$2,000/month. In contrast, since 2002, the rent charged to Weiler Engineering Corporation changed four times in five years during the test year and the monthly rent went from \$1,750 to \$800 without an explanation for the change. Witness Dismukes recommends that the Commission adjust test year revenues to reflect the monthly rent of \$1,750 paid by Weiler Engineering Corporation for the entire year. Accordingly, she recommends that the test year revenue be increased by \$14,600. In addition, the staff notes that Johnson Constructors, another affiliate of KWRU, uses the same address as the Utility trailer, but there is no type of rent that has been paid by this entity. (TH-TR 274)

The Utility did not file testimony on this issue. Utility witness DeChario testified that he did not address the issue specifically as part of the revenue requirement. He felt that the billing data in response to something Ms. Dismukes did and the MFRs stood on their own. (TH-TR 477-478; EXH 33, Vol. 1, pp. 69-70)

Staff agrees with OPC witness Dismukes that during the test year, Weiler Engineering's rental fee went from \$1,750 a month down to \$800 without explanation. Again the Utility has the burden to show that its requested expenses are reasonable. See Florida Power Corporation v. Cresse. Staff recommends that KWRU should increase test year revenue by \$14,600 to reflect a \$1,750 monthly rental fee.

Revenue Collected from Monroe County

According to Audit Finding No. 10, staff witness Piedra testified that the Utility recorded \$19,575 in general ledger account number 80271 - MCDC Income, for income received from the MCDC. This relates to income for cleaning the County lift stations. (EXH 23) This was not included in the operating revenues in its MFRs. Witness Piedra recommends that the test year revenues be increased by \$19,575. (TH-TR 69)

OPC witness Dismukes testified that since the Utility has no employees, this service is most likely provided by KEI. The person that performed this service on behalf of the County would appear to be the same person that maintains the Utility lift stations. She has not seen documents which indicate that KEI keeps a record of the time spent on servicing Monroe County lift stations versus the Utility lift stations. Consequently, in the absence of showing that the cost of cleaning these lift stations has been excluded from the costs charged to the Company, the associated revenue income should be recorded above the line for ratemaking purposes. (TH-TR 275) Therefore, test year revenue should be increased by \$19,575. (TH-TR 215, 275; EXH 23, 27)

Utility witness DeChario testified that the full responses to the audit report are contained in Exhibit PED 8. (TH-TR 469, EXH 33) He believes that the income is properly stated below the line. Witness DeChario asserted that it would be better if it were included in NARUC Account 415 - Revenues from Merchandise, Jobbing, and Contract Work, which states, in part "These accounts shall include all revenues derived from . . . contract work." (EXH 33, p. 9) The nature of the agreement with Monroe County, who owns the lift-stations, falls into this category. (EXH 33, p. 9) The Utility acknowledges that a similar amount of expenses should also be reclassified below the line to NARUC Account 416 - Expenses of Merchandise, Jobbing, and Contract Work. (EXH 33, p. 9)

Staff agrees with both OPC witness Dismukes and staff witness Piedra that this income relates to cleaning the County lift stations. The income was not included in the operating revenues of the MFRs and should be recorded above the line for ratemaking purposes. Because the Utility has not provided any documentation showing the cost charged to KWRU for the cleaning of the lift stations and has not provided any support showing that these costs have been excluded from the Utility's test year expenses, staff recommends that test year revenues be increased by \$19,575.

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

Recommendation: Yes. To reflect the amortization of non-recurring amounts incurred during the test year, sludge removal expense should be reduced by \$9,129. (Roberts, Fletcher)

Position of the Parties

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

OPC: Yes. KWRU's test year sludge hauling expenses were abnormally high. The expense should be reduced by \$9,129 to reflect the amortization of non-recurring amounts incurred during the test year.

Staff Analysis: In its filing, KWRU reflected test year sludge removal expense of \$38,196. (EXH 3, Vol. 1, p. 47) Pursuant to Prehearing Order No. PSC-08-0607-PHO-SU, p. 24, it has been stipulated that \$9,129 be removed from sludge removal expense to reflect the amortization of non-recurring amounts incurred during the test year. As such, staff recommends that sludge removal expense should be reduced by \$9,129 as shown in Stipulation No. 5.

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

Recommendation: Yes. Based on the Utility's three-year average of indexed costs, test year chemical expense should be reduced by \$16,117. (Roberts, Fletcher)

Position of the Parties

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

OPC: Yes. Chemical expenses were abnormally high during the test year and should be reduced by \$16,480. [T. 285]

Staff Analysis: OPC asserts that the chemicals purchased for use by the Utility are supplied by KEI, a supplier owned by the son-in-law of the owner of KWRU, Mr. Smith. (TH-TR 12) OPC also asserts that the relationship between KWRU and KEI has resulted in costs that are up to 30 percent higher than "in a more conventional situation," and that this results in higher costs for purchased chemicals. (TH-TR 11-16) OPC witness Dismukes cites that along with sludge hauling, chemical expenses were abnormally high. (TH-TR 279) The expense should be reduced by \$16,480 to reflect a normalized level based on a three-year average. (TH-TR 285)

KWRU stated that witness Dismukes admitted that customer growth had occurred in the past three-year period, but failed to account for inflation, customer growth, and an overall increase in costs. (TH-TR 350-353) In its brief, the Utility stated that the three-year average is not reasonable, based on increased customers, higher treatment requirements, and increased costs. (KWRU BR, p. 34) KWRU went on to state that witness Dismukes has done no analysis whatsoever to determine the reasonableness of these increases in costs. (TH-TR 350) KWRU also cites that witness Dismukes had made no attempt to compare the costs with any similarly situated utilities at the time she had made her adjustments. (TH-TR 353) Witness Smith stated that the Utility is going to an AWT treatment process as a result of county and state mandates, and as a result, they will be required to bring down a lot more chemicals and haul a lot more sludge. (TH-TR 98-99)

Staff agrees with KWRU that chemicals would likely increase as a result of its transition to an advanced wastewater treatment facility. However, the Utility has failed to meet its burden to support any quantifiable amount. It is the Utility's burden to prove that its costs are reasonable. See Florida Power Corp v. Cresse.

Staff agrees with OPC in part; chemicals expense increased from \$27,490 in 2005 to \$50,763 in 2006. Staff believes that the increase in test year chemicals expense was substantially higher than in preceding years. Staff also agrees with KWRU that witness Dismukes failed to consider increases in the cost of chemicals. Based on the substantial increase in chemical expense in the test year, staff believes that chemicals expense should be reduced by \$16,117 to normalize the indexed chemical expense. This is consistent with prior Commission decisions to

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index operations and maintenance (O&M) expenses.⁶ Recognizing the customer growth, staff believes that a three-year period, versus a four or five-year period, is reasonable in normalizing the increase in chemical expense.

⁶ See Order No. PSC-05-0624-PAA-WS, p. 23, issued June 7, 2005, in Docket No. 040450-WS, In Re: Application for rate increase in Martin County by Indiantown Company, Inc.

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

Recommendation: No. (Roberts, Fletcher)

Position of the Parties

KWRU: No, I&I was not excessive before this work. Any effect of the re-sleeving on infiltration and inflow is minor/immaterial.

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

OPC: Yes. Test year expenses should be reduced for the reduction in flow associated with re-sleeving the collection systems.

Staff Analysis: OPC witness Dismukes testified that chemicals and purchase power expenses should be decreased as a result of the Utility's re-sleeving line project. (TH-TR 300-304) It is Commission practice to reduce chemicals and purchase power expenses when a Utility has excessive infiltration and inflow (I&I). (TH-TR 303)

Utility witness DeChario testified that the Commission did not make an O&M expense reduction resulting from excessive I&I for KWRU's neighboring utility, Key Haven Utility Corporation, (TH-TR 457) Specifically, witness DeChario pointed out that the Commission found the following in its Order No. PSC-03-0351-PAA-SU:

Adjustments to plant used and useful percentage and operating expenses such as power and chemicals could be recommended because of the excessive infiltration determination. However, in this case consideration should be given to the age of the system, the severe conditions the facilities are exposed to with the saltwater and high ground water environment, and the recent improvements done to the collection system to help reduce the problem. Staff sees no benefit to penalizing the utility by further reducing used and useful or expenses based on excessive infiltration when the problem is being addressed satisfactorily.

(TH-TR 457) As a result, witness DeChario asserted that no adjustments are necessary. (TH-TR 457)

Staff agrees with Utility witness DeChario. Further, staff notes that neither OPC witnesses Dismukes nor Woodcock testified that the Utility had any excessive I&I. Staff believes it is unfair to reduce expenses for the Utility's re-sleeving line project because the Commission would not reduce expenses if a Utility had I&I flows of 10 percent or less. Moreover, in accordance with the Commissions decision in the above-cited order, staff recommends no adjustments are necessary.

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

Recommendation: To remove expenses associated with an unsupported mark-up by a related party, chemicals, sludge hauling, and materials and supplies should be reduced by \$7,913, \$2,690, and \$23,224, respectively. (Roberts, Fletcher)

Position of the Parties

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

OPC: Yes. KWRU pays KEI to perform its routine utility functions. KEI, an affiliate, charges KWRU a 30% markup on the actual costs of chemicals and sludge hauling services. It is unconscionable to force KWRU's customers to pay 30% more for an integral part of the service merely to enrich an affiliate company.

Staff Analysis: Staff witness Welch testified that KEI purchases supplies, chemicals, and sludge hauling and then bills the Utility for these services. (TH-TR 25) Witness Welch stated that related party charges to a Utility require additional review to determine whether the related party bills the Utility at actual cost and does not use the affiliate company to increase prices to the Utility. (TH-TR 25) She attempted to determine if KEI increases the costs for these items and to compare a sample of the costs to prices on the internet. (TH-TR 25-26, 37, 44-45)

OPC witness Dismukes testified that Chris Johnson, owner of KEI, stated in the confidential portion of his deposition and in response to Citizens POD 28, that the Company provided an invoice from KEI with notation that certain charges are marked up over cost. (TH-TR 236) Witness Dismukes asserted that if KWRU purchased the chemicals and moved the sludge, the Commission would not permit it to expense more than the actual costs. (TH-TR 237) Witness Dismukes stated that the removal of the 30 percent mark-ups would reduce chemicals, sludge hauling, materials & supplies expense by \$7,913, \$2,690, and \$23,224, respectively.

Utility witnesses Smith and DeChario testified that EXH 25 justifies the 30 percent mark-up imposed upon the Utility by KEI and stated that such a mark-up is in keeping with the standard practice for providing such services by third party contractors. (TH-TR 108, 445; EXH 25, p. 41) Specifically, EXH 25 includes an operating cost proposal by U.S. Water Service Corporation, which was not accepted by KWRU. (EXH 25) Among other things, this cost proposal states that "[t]he costs for chemicals and residuals management are to be billed to KWRU on a per occurrence basis with an appropriate allowance for overhead and margin." (EXH 25, p. 41) Further, witness DeChario asserted that, in GTE Florida, Inc. v. Deason, 642 So. 2nd 545 (Fla. 1994), the Court's standard to review affiliate transactions is whether the transaction exceeds the going market rate or is otherwise inherently unfair. (TH-TR 447)

Through cross examination, witness Welch testified that KEI did not appear to make a large profit based on its financial statements, but she did not know whether it was because KEI was making a lot of money in contractual labor. (TH-TR 38) She still contended that KEI is marking up certain items. (TH-TR 38) Witness Welch testified that subsequent to the GTE case

cited by witness DeChario, that it was her understanding that the Federal Communications Commission came out with a lower of cost or market rule in number 32.27C. (TH-TR 51) She asserted that the Commission has traditionally used the lower of cost or market to determine the cost of affiliate transactions.

It is the Utility's burden to show that its requested expenses are reasonable. See Florida Power Corporation v. Cresse. Staff agrees with witnesses Welch and Dismukes that the 30 percent mark-ups of chemicals, sludge hauling, and materials and supplies should be disallowed. Regardless of whether you apply the going market rate or inherently unfair standard cited in the GTE case, or the lower of cost or market standard, staff believes that the Utility has not met its burden of proof that 30 percent is reasonable. In so recommending, staff notes that "it is the [Commission's] prerogative to evaluate the testimony of competing experts and accord whatever weight to the conflicting opinions it deems necessary." See Gulf Power Co. v. FPSC, 453 So. 2d 799, 805 (Fla. 1984). Therefore, staff recommends that chemicals, sludge hauling, and materials and & supplies be reduced by \$7,913, \$2,690, and \$23,224, respectively.

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

Recommendation: No. KWRU’s decision to spread the payments over a 12-month period appears to be reasonable based on the amount of the premiums and the associated finance charges. (Roberts, Fletcher)

Position of the Parties

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

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

Staff Analysis: KWRU included \$701 in finance charges related to payment of its insurance policies over time. (TH-TR 72) According to the insurance documents, finance charges accrue if payment is not made in full. (TH-TR 72) KWRU asserts that its insurance premiums are charged to a prepaid expense account and amortized over the term of the policy, which covers the twelve-month period beginning in August and ending in July. (TH-TR 72) KWRU believes the payment of finance charges should not be deemed a “late” payment, but should be recognized as a prepaid insurance amount. KWRU further argues that the \$701 is a minor amount and should be treated as the cost of insurance. (KWRU BR, p. 37; EXH 33, p. 9)

OPC believes that interest accrued on late payments should be denied on the grounds that the interest charges are avoidable if paid timely. (TH-TR 316-317) As such, OPC believes general liability insurance should be reduced by \$701.

Staff has reviewed the insurance financing documents and notes that the premiums are in excess of \$20,000. While it has been prior Commission practice to deny the recovery of foregone property tax discounts since the utility had control of the timing of its payments, staff views this situation differently. Although KWRU does have control over whether payment would be made as a lump sum or paid over time, the decision to spread the payments over a 12-month period appears to be reasonable based on the amount of the premiums and the associated finance charges. As a result, staff recommends that no adjustment be made to KWRU’s general liability insurance.

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

Recommendation: Yes. Advertising expenses should be reduced by \$26,653 to remove cost related to public relation functions. (Roberts, Fletcher)

Position of the Parties

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

OPC: Yes, KWRU's test year expenses should be adjusted to remove \$26,653 that was charged to advertising and related to public relations.

Staff Analysis: In its filing, KWRU reflected \$25,315 of test year contractual services – public relations in Schedule B-9. (EXH 3, Vol. 1, p. 48) Staff Witness Piedra stated that the Utility recorded \$25,000 in Account 760 – Advertising Expenses, for charges to William Barry for public relations. (EXH 23, p. 32)

OPC witness Dismukes recommended that the Commission disallow all of the expenses charged to advertising expenses because, as the Utility admitted, they are related to public relations functions. Therefore, the adjustment for advertising expenses related to public relations is \$26,653. (TH-TR 299)

In its brief, the Utility stated that the items produced by Mr. Barry were not a public relations campaign, but, instead, were an attempt to educate and keep the customers of the Utility informed about the requirement that they hook into their system and the costs and benefits of that requirement. (KWRU BR, p. 38) The Utility asserted that the cost is not for public relations but for customer service and should be considered an appropriate function of the Utility. (KWRU BR, p. 38)

Staff has reviewed the sample items produced by Mr. Barry for KWRU. (EXH 17, p. 32) The items include newspaper articles regarding KWRU, letters written on behalf of KWRU, and public statements/press releases. (EXH 17, p. 32) Staff believes that the items produced by Mr. Barry were for public relation purposes. The Commission has previously disallowed expenses associated with public relations and promotional purposes.⁷ Therefore, staff recommends that advertising expenses should be reduced by \$26,653 to remove costs related to public relation functions.

⁷ See Order Nos. PSC-93-0301-FOF-WS, issued February 25, 1993, in Docket No. 911188-WS, In Re: Application for a Rate Increase in Lee County by Lehigh Utilities, Inc.; PSC-96-1320-FOF-WS, issued October 30, 1996, in Docket No. 950495-WS, In Re: Application for rate increase and increase in service availability charges by Southern States Utilities, Inc. for Orange-Osceola Utilities, Inc. in Osceola County, and in Bradford, Brevard, Charlotte, Citrus, Clay, Collier, Duval, Highlands, Lake, Lee, Marion, Martin, Nassau, Orange, Osceola, Pasco, Putnam, Seminole, St. Johns, St. Lucie, Volusia, and Washington Counties.; and PSC-97-0618-FOF-WS, Docket No. , issued May 30, 1997, in Docket No. 960451-WS, In re: Application for rate increase in Duval, Nassau, and St. Johns Counties by United Water Florida Inc.

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

Recommendation: Yes, KWRU's expenses should be reduced by \$30,000. (Roberts, Fletcher)

Position of the Parties

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

OPC: Yes, KWRU's test year expenses should be adjusted to remove 50% of the \$60,000 management fee that Mr. Smith charges the Utility through Green Fairways.

Staff Analysis: According to staff's audit report, Mr. Smith manages several other businesses through Green Fairways in addition to KWRU, including KWGC, Venetian Partners - office Building in San Francisco, 900 Commerce - offices in Oakbrook Illinois, Portland Court - office building in Addison, Rail Golf Course - in Springfield, Illinois, and Deer Creek Golf Course in University Park, Illinois. (EXH 23, p. 10)

The staff audit further stated that Mr. Smith performs the following duties for KWRU including: review of all bids, hire of key employees, review and approve budgets, coordinate financing, provide advance funds, monitor contract employees, coordinate public relations, engage accountants and lawyers, coordinate with FCAA, engage engineers, coordinate county contracts, negotiate customer contracts, supervise expansion and coordinates rate cases. (EXH 23, p. 10)

The staff audit also stated that Mr. Smith indicated that 1/3 of his time is spent on the Utility. According to a letter provided by his accountant, one third of his actual salary far exceeds the amount included in KWRU's expense. But, Mr. Smith manages many companies as indicated above and there are no time records to support the allocation of his time spent on the Utility. Staff's audit also notes that most of Mr. Smith's salary is not provided in a W-2 since his businesses are limited partnerships. Less than 10 percent of Mr. Smith's salary comes from Green Fairways, because he is paid the excess of Green Fairways revenues less expenses. Because the actual hours spent on KWRU by Mr. Smith cannot be determined, it is difficult to determine the reasonableness of the charges in relation to Mr. Smith's other companies. (EXH 23, pp. 10-11)

The staff audit report also included the following breakdown based on Mr. Smith's W-2 from Green Fairways, and the management fees and project administrative fees. (EXH 23, p. 11)

<u>Year</u>	<u>Mr. Smith's W-2 Green Fairways Salary</u>	<u>Management Fees to KWRU</u>	<u>Project Administrative fees in Plant</u>	<u>Total Charged to KWRU</u>
2001	\$55,000	\$60,000	\$0	\$60,000
2002	190,000	60,000	107,198	167,198
2003	70,000	100,000	194,377	294,377
2004	70,000	80,000	0	80,000
2005	35,000	81,667	0	81,667
2006	40,000	60,000	124,984	184,984

OPC witness Dismukes stated that the Utility failed to provide adequate documentation supporting the management fee paid to Green Fairways. (TH-TR 244) Mr. Smith could not produce any timesheets in support of the amount of time that he spends managing the Utility versus the numerous other companies that he owns or operates through Green Fairways. (TH-TR 244) Even assuming that Mr. Smith spends 50 percent of his time managing the Utility, his salary equates to an annualized salary of \$120,000, which appears excessive given the amount of time that Mr. Smith spends at the Utility's headquarters in Key West. Even while in Key West, Mr. Smith spends time managing the KWGC. (TH-TR 244) While Mr. Smith undoubtedly spends time on the phone with utility-related employees when he is not in town (which is approximately once a month), witness Dismukes finds it difficult to believe that he spends 50 percent of his time on utility business given the fact that he is a managing partner of a law firm and owns numerous other businesses. (TH-TR 244) Furthermore, Mr. Smith has most likely been spending more time recently on utility matters due to the rate case and other issues that should subside now that most customers have hooked up to the system. (TH-TR 244) If Mr. Smith maintained time records it would be easier to determine how much time he typically spends on utility business. (TH-TR 244) In the absence of documentation supporting the ongoing time spent by Mr. Smith on utility matters, witness Dismukes recommended that the Commission remove 50 percent of Mr. Smith's management fee, or \$30,000, under the assumption that on a going forward basis, Mr. Smith will spend less time on utility matters and there has been no demonstration that the \$60,000 is reasonable. (TH-TR 244)

Utility witness DeChario stated that the amounts charged for Mr. Smith for a management fee are in lieu of a direct salary, since the Utility has no employees; these amounts are recorded as a management fee. (EXH 33) The amount charged by Green Fairways for management fees are for Mr. Smith's day-to-day oversight of the Utility operations in-lieu of any direct salary. (EXH 33) Since the Utility has no employees and does not report wages to the Internal Revenue Service, the amounts charged by Green Fairways for the benefit of Mr. Smith are in lieu of salaries and are recorded as management fees. (EXH 33) Mr. Smith, as reported in the audit, devotes a substantial portion of his time dealing with the day-to-day operation and maintenance of utility matters and utility oversight. (EXH 33) The Utility argues that another

clear example of the reasonableness of Mr. Smith's charge is the fact that the Commission recently completed a limited rate proceeding for Key Haven Utilities, the only other regulated sewer utility near Key West. (EXH 33) In that proceeding for Key Haven Utilities, the Commission allowed a management fee for the services of Mr. Luhan in lieu of salary which was approximately three times the amount per ERC that Green Fairways charges the Utility in lieu of a salary for Mr. Smith. (EXH 33)

According to Staff's audit report, Mr. Smith indicated that 1/3 of his time is spent on the Utility. (EXH 23, p. 10) Based on Mr. Smith's representation, staff has determined that Mr. Smith's effective annualized salary from 2001 through 2006 is as follows:

<u>Year</u>	<u>Annualized Salary</u>
2001	\$180,000
2002	501,594
2003	883,131
2004	240,000
2005	245,001
2006	554,953

Utility witness DeChario included the following comparison between KWRU and Key Haven Utilities in his rebuttal testimony. (EXH 29)

Company	Class	Salary	Customers	Gallons	Meter Equivalent	Salary/1,000 gallons	Salary/meter equivalent
Key Haven	B	\$26,000	442	27,209,000	444	\$0.96	\$58.56
KWRU	B	\$60,000	1,503	95,991,000	1,708	\$0.63	\$35.13

Staff acknowledges the comparison of Key Haven and KWRU provided by the Utility. However, staff believes the total annualized compensation for Mr. Smith including management fees as well as project administrative fees should be taken into account. If the total annualized compensation for Mr. Smith in 2006 charged to KWRU were included in the above comparison chart, the following would result:

Company	Class	Annualized Salary	Customers	Gallons	Meter Equivalents	Salary/1,000 gallons	Salary/meter equivalent
KWRU	B	\$554,953	1,503	95,991,000	1,708	\$5.78	\$324.91

Based on Mr. Smith's total annualized compensation charged to KWRU in 2006, Mr. Smith's salary per 1,000 gallons sold and salary per meter equivalent is considerably higher than Key Haven Utilities. It is the Utility's burden to prove that its costs are reasonable. See Florida Power Corp v. Cresse. The Utility has failed to provide any support documentation relating to the actual amount of time Mr. Smith spends managing KWRU; therefore, staff cannot determine if the management fee of \$60,000 is a prudent amount. Based on all the above, staff agrees with OPC and recommends that the \$60,000 management fee be reduced by \$30,000.

Issue 28: Should test year expenses be adjusted for certain transactions between Keys Environmental (KEI) and KWRU?

Recommendation: Yes, test year expenses should be reduced by \$71,053 (\$1,313+\$15,000+\$51,663+\$3,077) for certain transactions between KEI and KWRU. Additionally, plant in service should be increased by \$66,663 (\$15,000+51,663). Accordingly, accumulated depreciation and depreciation expense should be increased by \$3,086. (Roberts, Fletcher)

Position of the Parties

KWRU: No, KEI charges must be based upon market values. KEI lab testing is not part of the services agreed to contractual services. Hookup fees paid to KEI by KWRU should be capitalized. When contractors broke sewer lines those were repaired by KEI. The cost of broken lines is a responsibility of KWRU and not collectible from contractors.

OPC: Yes. Expenses should be reduced by: (1) \$1,313 charged for lab testing expenses; (2) \$15,000 in hook-up fees that should have been capitalized; (3) \$51,663 of misclassified expenditures identified by Staff audit; and (4) \$3,077 that should be recovered from third parties.

Staff Analysis: According to Audit Finding No. 3, KEI was started by Mr. Smith's son-in-law to service KWRU. (EXH 23, p. 12) KEI purchases supplies, chemicals, and sludge hauling, then bills KWRU for these services. (EXH 23, p. 12) KEI has its office in a trailer owned by KWRU and pays \$24,000 for its use. (EXH 23, p. 12) KEI also uses trucks owned by KWRU, but pays for its own gas and maintenance. (EXH 23, p. 12)

According to staff's audit, the contract with KEI requires two full time operators, and a manager to work a minimum of eight hours a day on weekdays and two hours a day on the weekends. (EXH 23, p. 12) The contract includes customer relations, periodic inspections, minor maintenance, daily pumping stations inspections, preventative maintenance programs, collection systems monitoring, reclaimed water lines monitoring, and meters, pumps, and blowers monitoring. KEI reads the meters and maintains an answering service and dispatch. (EXH 23, p. 12) The contract also says they will do the sampling, testing, and supervise and inspect new customer tie-ins. (EXH 23, p. 12)

In 2006, KWRU recorded \$450,776 of invoices from KEI. (EXH 23, pp. 12-13) This amount is broken down in the following chart:

Expense Description	Amount
Monthly operations fee at \$23,206 per month	\$278,472
Monthly fees for Air Vac service at \$3,333 per month	<u>40,000</u>
Total contractual fees	<u>\$318,472</u>

Fees received from developers for review and inspections were used to reduce the monthly operating fee amount	(81,233)
Net contractual fees	<u>\$237,239</u>
Hook-up fees that should be capitalized	\$15,000
Chemicals and supplies	43,203
Trailer repairs	982
Plant repairs	59,283
Vacuum repairs	24,004
Sludge hauling	19,472
Filter beds work	2,393
Generator work	6,652
Equipment and supplies	631
Lift station cleaning	2,854
Lift station repair	37,405
Pump repair	1,637
Sewer line cleaning	1,376
Sewer line repair	10,181
Vacuum collection system	24,895
Effluent repairs	14,536
Miscellaneous	1,530
Transferred to plant	<u>(52,497)</u>
Total	<u>\$450,776</u>

Included in the chemicals and supplies charges is \$1,313 for lab testing. (EXH 23, p. 13) Sampling and testing were supposed to be part of the contract. (EXH 23, p. 13) In its brief, the Utility stated that lab testing, while included as a function of KEI under the agreement to provide

services, was not intended to be a function covered by the regular monthly payment, but instead was intended to be a function for which KEI would separately bill the Utility. (KWRU BR, p. 40) Staff disagrees with the Utility and believes that sampling and testing is supposed to be covered in the contract between KWRU and KEI and therefore these charges should be removed. Staff recommends that expenses be reduced by \$1,313.

The \$15,000 of hook-up fees charged to the operations account should be transferred to plant account 363. (EXH 23, p. 13) In its response to staff's audit report and in its brief, the Utility agreed with this adjustment. (TH-TR 33; KWRU BR, p. 39) Therefore, staff recommends that those expenses be reduced by \$15,000 and plant in service be increased by \$15,000. Accordingly, accumulated depreciation and depreciation expense should be increased by \$179.

Pursuant to Order No. PSC-08-0607-PHO-SU, pp. 24-25, a stipulation was approved regarding the capitalization of \$51,663 of items that were expensed in the test year. As such, staff recommends that expenses be reduced by \$51,663 and plant be increased by \$51,663. Accordingly, accumulated depreciation and depreciation expense should be increased by \$2,907.

Staff's audit report also noted that included in the expense accounts was a bill for \$2,083 for damage to a pit vacuum that was caused by Waste Management and an invoice from the Oceanside Marina for \$995. (EXH 23, p. 14) The Utility asserted in its brief that it has not been reimbursed and these costs were incurred by the Utility in maintenance of its system. (KWRU BR, p. 40) However, the Utility stated that if in some future time period, it is able to recover some costs, those costs will be offset against any repairs in the years in which those receipts are obtained. (KWRU BR, p. 40) Staff believes these items should be recovered from the cost causer and not from the rate payers; therefore, staff recommends that expenses be reduced by \$3,077 (\$2,083+\$995).

In summary, staff recommends test year expenses should be reduced by \$71,053 ($\$1,313 + \$15,000 + \$51,663 + \$3,077$)⁸ for certain transactions between KEI and KWRU. Additionally, plant in service should be increased by \$66,663 ($\$15,000 + \$51,663$). Accordingly, accumulated depreciation and depreciation expense should be increased by \$3,086.

⁸ As recommended by OPC.

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

Recommendation: Yes. The test year balance for contractual services – other should be reduced by \$12,038 to remove bonuses paid to non-utility employees. (Roberts, Fletcher)

Position of the Parties

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

OPC: Yes. Test year expenses should be reduced by \$12,038 for bonuses paid to Key West Golf Course employees.

Staff Analysis: In its filing, KWRU reflected contractual services-other expense of \$1,302. By Order No. PSC-08-0607-PHO-SU, p 24, the Commission approved a stipulation to reduce contractual services-other by \$1,302 to reflect the amortization of non-recurring amounts incurred during the test year.

OPC witness Dismukes stated that KWRU pays KWGC, an affiliate, an \$8,000 monthly fee for KWGC to provide ongoing services. (TH-TR 233) In the test year, KWGC paid its employees bonuses totaling \$12,038 and charged them to KWRU. (TH-TR 233) The \$8,000 monthly fee should cover the services that KWRU receives, and any bonus that the golf course wants to give its own employees should not be paid by utility customers. (TH-TR 233)

KWRU witness DeChario testified that these “bonuses” were in fact, not bonuses, but rather compensation for work that was performed “above and beyond normal recurring operation and maintenance and management of the Utility.” (KWRU BR, p. 40) Witness DeChario went on to state that the EDU bonuses paid were for additional administrative work performed to process customer requests for service, as a result of the large influx of new customers from the SSI project. Witness DeChario also stated that the bonuses paid to Mr. Carter “encourages him to achieve results and thereby put downward pressure on rates by increasing its customer base.” (TH-TR 452) Mr. DeChario then asserted that not charging these expenses to the entity that incurred them would violate the Generally Accepted Accounting Principle of matching revenues and expenses. (TH-TR 451-452)

It is the Utility’s burden to prove that its costs are reasonable. See Florida Power Corp v. Cresse. After analyzing the charges made to contractual services – other, staff believes that the bonuses paid to the employees of KWGC should be removed from the contractual services – other. Staff believes that the “compensation” paid for work performed “above and beyond normal recurring operation and maintenance” should reasonably be assumed as part of the \$8,000 monthly fee for services. In particular, the compensation paid for processing EDUs is designed for acquiring additional new customers, and is primarily for the benefit of the Utility and its stockholders and should not be borne by the ratepayers. Staff believes that contractual services – other should be reduced by \$12,038.

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

Recommendation: Yes. Miscellaneous expense should be reduced by \$22,132. (Roberts, Fletcher)

Position of the Parties

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

OPC: Yes. Three adjustments: (1) \$19,106 in travel and local lodging for Mr. Smith; (2) \$2,525 in expenses to transport a car purchased in Illinois and to pay a Key West hotel bill for Mr. Johnson; (3) \$420 in fees paid to Monroe County Sheriff's Office; (4) \$161 paid to Rotary Club and Blossoms Flowers.

Staff Analysis: KWRU has included in the test year, miscellaneous expenses related to Mr. Smith's travel and lodging, moving expenses to transport a car from Illinois to Key West, delivery of hook-up notices by the Monroe County Sheriff's department, a donation, and floral costs. (TH-TR pp.50-51, 57, 69-70, 269, 300)

With respect to Mr. Smith's travel and lodging expenses, KWRU argues that travel costs are part of Mr. Smith's compensation package. (EXH 33, p. 9; KWRU BR, p. 41) KWRU asserts that Mr. Smith spends one third of his time on the Utility's business regardless of whether he is in Illinois or in Key West. (TH-TR 145) OPC argues that the highest ranking utility officers are expected to work full-time for the utility and live in proximity to the utility. As a result, no travel expenses would be necessary. (OPC BR, p. 33)

Staff believes that it is the owner's choice of where he wishes to reside. However, the customers should not be required to pay the cost of travel because Mr. Smith chooses to live a considerable distance from KWRU. Staff believes that this issue is related to a utility's choice to maintain its books and records outside the state of Florida. Rule 25-30.110(1)(a)2.(c), F.A.C., requires a utility to reimburse the Commission for the reasonable travel expense incurred by each Commission representative during any review of the out-of-state records of the utility or its affiliates if it chooses to keep its records outside the state. Based on this rule, a utility is permitted to keep its records outside the state, but must reimburse the Commission for any travel that must be incurred to view the records. Similarly, the Commission has denied Federal Express costs incurred by a utility to ship its records to Florida.⁹

Staff believes Mr. Smith certainly has the choice as to where to live, but that choice should not impose additional costs to KWRU and its customers. As Mr. Smith's choice to live outside Florida also imposes additional lodging costs, those costs should also be removed from

⁹ See Order No. PSC-07-0205-PAA-WS, p. 28, issued March 6, 2007, in Docket No. 060258-WS, In re: Application for increase in water and wastewater rates in Seminole County by Sanlando Utilities Corp.

the test year expenses. Based on the above, staff believes the \$19,106 amount should be removed from test year expenses.

Other costs included in miscellaneous expenses relate to transporting a vehicle purchased in Illinois to Key West. KWRU argues that it purchased the truck in Illinois because it was a good price and matched the Utility's needs. (KWRU BR 42) Included in the transportation costs is lodging expenses for Chris Johnson.

OPC argues that there are automobile dealerships in the Keys and Miami and that it was unnecessary for KWRU to purchase a vehicle in Illinois and transport it to Florida. OPC also argues that KWRU did not provide any evidence to support the costs.

There is no evidence in the record to indicate that KWRU paid less for the vehicle in Illinois than it would have had to pay in Florida, thus warranting the recovery of transportation costs. When a utility seeks to increase its rates, it must support its request and be prepared to provide documentation necessary to prove the costs incurred are reasonable. KWRU has not provided any documentation to allow staff to determine whether purchasing the vehicle in Illinois and transporting it to Florida was less than or equal to the cost of purchasing the vehicle in Florida. As a result, staff recommends the \$2,525 in transportation costs and lodging be removed from the test year expenses.

Another item included in miscellaneous expenses is the cost to deliver hook-up notices to the citizens of SSI. Monroe County imposed a requirement that all KW customers be notified, by certified letter, of their obligation to connect to KWRU's new system. If the customer refused to sign the letter or failed to send it back to KWRU, the Utility would be required to hand-deliver notices to these customers. (TH-TR 183-184) KW argued that it engaged Monroe County's Sheriff's Department to deliver the notification, rather than a private company, as it was the least cost alternative. (TH-TR 184)

OPC argues that the use of deputies to issue hook-up notices was intimidating to the customers. OPC also disputes KWRU's claim that the deputies were only used as a last resort. (SH-TR 50, 51, 62; OPC BR, p. 33)

Under the circumstances, staff believes that engaging deputies to hand-deliver notices to customers who refused the certified letter was appropriate. The cost of noticing these customers was \$420. Customer witness Wigington testified that she had signed the original registered letter but still was hand-delivered a notice by a deputy. (TH-TR 57) KWRU argues that there may have been instances where customers signed the original registered letter and still received a hand-delivery from a deputy. In these cases, the customer may have only signed one letter yet owned two properties. As KWRU had to have a letter on file for each property, they would have needed the deputy to hand deliver a notice for the property for which no letter had been received. (TH-TR 186) Staff believes that KWRU was responsible for ensuring that it received letters for every property. As the record indicates that Ms. Wigington was served a notice by a deputy even though she had signed the original registered letter, staff believes the \$20 fee for that delivery should be removed, resulting in a total notification expenses of \$400.

While staff believes the notification expenses were reasonable, it is a non-recurring expense. In accordance with Rule 25-30.433(8), F.A.C., non-recurring expenses are to be amortized over a 5-year period, unless a shorter period of time can be justified. In this case, staff recommends that the \$400 of expense be amortized over five years, resulting in a yearly expense of \$80 ($\$400/5$). As \$420 was included in test year expenses, staff recommends a reduction to test year expenses of \$340.

OPC witness Dismukes testified that KWRU made a donation of \$100 to the Rotary Club of Key West and paid \$61 to Blossoms in Paradise. (TH-TR 300) Utility witness DeChario testified that the Utility did not present any rebuttal testimony on these items. (TH-TR 482) In its brief, KWRU stated it was in agreement with Ms. Dismukes' adjustment to reduced \$161 for the above items. (KWRU BR, p. 41) As such, staff recommends that miscellaneous expenses be reduced by \$161 for these two items.

Based on staff's adjustments discussed above, miscellaneous expense should be reduced by \$22,132 ($\$19,106 + \$2,525 + \$340 + 161$).

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

Recommendation: The appropriate amount of rate case expense is \$466,615. The four-year amortization results in test year rate case expense of \$116,654, which increases the MFR amortization amount by \$66,654. (Roberts, Fletcher)

Position of the Parties

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

OPC: No rate case expense should be allowed because the rate case was not warranted. Even if some rate case expense is allowed it should be adjusted to remove the excess costs that were incurred to uncover and correct all the errors in the initial submission.

Staff Analysis:

KWRU's Argument

KWRU initially submitted in their MFRs \$200,000 in rate case expense, for an annual amortization expense of \$50,000. After the hearing, KWRU updated their actual and estimated rate case expense and submitted it in Late-Filed EXHs 41 through 43. In its update, KWRU requested a total rate case expense of \$609,778. (EXHs 41-43) This results in a increase of \$409,778 to the initial amount in the MFRs. Based on the Utility's requested rate case increase, the four-year amortization test year rate case expense would be \$152,444, (EXHs 41-43) which increased the MFRs amortization amount by \$102,444.

KWRU believes that the increase in rate case expense was primarily due to preparing responses to OPC's unprecedented and repetitious discovery. (KWRU BR, p. 42; TH-TR 462) The Utility and its consultants have spent considerable time and effort in attempting to respond to OPC's voluminous data requests and have demonstrated that the request for a rate increase is fair and reasonable for the economic climate in which it operates, and the extraordinary amount of rate case expense it has incurred as a direct result of OPC's involvement in this case. (TH-TR 462) KWRU asserts that twenty one of the PODs or interrogatories submitted requested information duplicating what staff had requested. (TH-TR 461)

In its brief, KWRU also states that it filed this rate proceeding as a result of governmental imposed requirements that KWRU move to AWT and other costs it incurred to keep in environmental compliance. (KWRU BR, p. 43)

OPC's Argument

OPC alleges that KWRU's request for additional rate case expense is not acceptable. (OPC BR, p. 34; TH-TR 313) OPC believes that after all adjustments are made to correct the errors in the filing, the revenue requirement shows that rates were adequate before the rate case was filed. (TH-TR 313) OPC asserts that this case never should have been filed and customers should not be forced to pay for a Utility's imprudent decision to file for a rate increase when

none is warranted. (TH-TR 313) OPC argues that they had no impact in causing the rate case expense to increase. (OPC BR, p. 34; TH-TR 313)

Furthermore, OPC stated the number and the magnitude of the Utility's own errors and dealings have justified OPC's challenge of the rate filing. (OPC BR, p. 34) By conceding thirty-one separate errors, KWRU has effectively demonstrated the justification for OPC's involvement. (OPC BR, p. 34) Rather than fault OPC, the Utility should acknowledge its own actions caused the additional expense. (TH-TR 313) Moreover, because of KWRU's affiliate relationships, OPC had to examine more than one set of books and ask for the financial information concerning each of the affiliates that provides services to the Utility. (OPC BR, pp. 34-35)

Finally, KWRU's failure to provide adequate and timely response to OPC's discovery forced OPC to file three motions to compel. (TH-TR 308) These motions to compel resulted in the modifications to the procedural schedule in this proceeding, either requiring KWRU for the most part to properly respond to OPC's discovery, or to modify the procedural schedule to give OPC additional time to file testimony due to KWRU's failure to provide timely and responsive answers. (TH-TR 308-313) In addition, because of KWRU's failure to provide adequate responses, OPC was forced to ask follow-up discovery questions to try and obtain the information originally requested. (TH-TR 308) Any suggestion that OPC caused the excessive rate case expense in this proceeding should be rejected by the Commission. (TH-TR 313) OPC recommends that the Commission disallow all rate case expense as a rate decrease should be authorized by the Commission, not an increase. (OPC BR, p. 35; TH-TR 313)

Staff Analysis

KWRU included in its MFRs an estimate of \$200,000 for current rate case expense. (EXH 3) Staff requested an update of the actual rate case expense incurred, with supporting documentation, as well as the estimated amount to complete the case. On October 13, 2008, the Utility submitted a revised estimated rate case expense through completion of Late-Filed EXHs 41 through 43 in the amount of \$609,778. The components of the estimated rate case expense are as follows:

	<u>MFR Estimated</u>	<u>Actual</u>	<u>Additional Estimated</u>	<u>Revised Total</u>
Legal - Rose, Sundstrom & Bentley	\$100,000	\$131,143	83,340	\$314,483
Accounting - Carlstedt, Jackson, Nixon & Wilson CPA's	90,000	89,775	12,110	191,885
Engineering - Weiler Engineering	0	12,960	0	12,960
Company Time	0	74,050	6,400	80,450
Company Expense - (filing fees, mailings, copying, notices, phone, Fed Ex, etc.)	<u>10,000</u>	<u>0</u>	<u>0</u>	<u>10,000</u>
Total Rate Case Expense	<u>\$200,000</u>	<u>\$307,928</u>	<u>\$101,850</u>	<u>\$609,778</u>

Pursuant to Section 367.081(7), F.S., the Commission shall determine the reasonableness of rate case expenses and shall disallow all rate case expenses determined to be unreasonable. Also, it is the Utility's burden to justify its requested costs. See Florida Power Corp. v. Cresse. Further, the Commission has broad discretion with respect to allowance of rate case expense; however, it would constitute an abuse of discretion to automatically award rate case expense without reference to the prudence of the costs incurred in the rate case proceedings. See Meadowbrook Util. Sys., Inc. v. FPSC, 518 So. 2d 326, 327 (Fla. 1st DCA 1987), 529 So. 2d 694 (Fla. 1988). As such, staff has examined the requested actual expenses, supporting documentation, and estimated expenses as listed above for the current rate case. Based on our review, staff believes several adjustments are necessary to the revised rate case expense estimate.

First, Rose, Sundstrom & Bentley, LLP (RS&B), the law firm representing KWRU originally filed in their MFRs \$100,000 in rate case expense. (EXH 3, p. 49) On October 13, 2008, the Utility submitted an update of actual and estimated rate case expense of \$314,483 in Late-Filed EXHs 41 through 43. Based on its review of invoices, staff believes several adjustments should be made to RS&B's actual costs. RS&B spent 6.40 hours on the submission of the Utility's test year approval letter. Staff believes that these hours are excessive, in light of the Utility's accounting consultant's time related to the test year request. As such, staff recommends that only three hours be allowed for the test year request which would result in a \$935 reduction. In addition, staff also identified 15.2 hours and \$298 of costs related to staff's revisions to the Utility's synopsis, the Commission's approval in part to OPC's motions to compel, the MFR deficiencies, and the time related to the Utility's approved abatement period. Staff believes the ratepayers should not have to bear these costs. Thus, staff recommends that legal costs should be reduced by \$4,478.

Second, staff believes that the Utility's estimated legal costs of \$83,340 are excessive. RS&B estimated 145 hours for reviewing hearing transcripts, filing late-filed hearing exhibits, and preparing the Utility's brief. Staff believes 85 hours should be more than sufficient to accomplish those tasks, which results in a reduction of \$16,500. RS&B also included a request for \$1,250 of costs which had no detail breakdown or support documentation. Moreover, RS&B included \$23,200 for time related to a motion for reconsideration. Because it is not known whether the utility will request reconsideration of the Commission's decision, staff believes that it would be premature to include this cost in rate case expense. It has been Commission practice not to include the allowance of cost estimates for reconsideration or appeals in rate case expense.¹⁰ Because reconsideration is considered a possibility, not a certainty, rate case expense should be reduced by \$23,200. If a motion for reconsideration is filed, a determination will be made at a later time, upon request, as to the reasonableness of the amounts requested and whether inclusion of those amounts are appropriate.

Third, Carlstedt, Jackson, Nixon & Wilson CPA's (CJNW) had originally filed in their MFRs \$90,000 for accounting fees. (EXH 3, p. 49) In Late-Filed EXHs 41 through 43, the Utility submitted an update of actual and estimated rate case expense of \$191,885. Based on staff's review of invoices, staff has identified 4.5 hours related to the Commission's approval in part to OPC's motions to compel and the MFR deficiencies. Staff believes the ratepayers should

¹⁰ See Order No. PSC-01-0326-FOF-SU, issued February 6, 2001, in Docket No. 991643-SU, In re: Application for increase in wastewater rates in Seven Springs System in Pasco County by Aloha Utilities, Inc.

not have to bear these costs. Thus, staff recommends that these costs be reduced by \$720. Further, staff believes that the Utility's estimated accounting costs of \$12,110 are excessive. CJNW estimated 32 hours and 16 hours for Utility witness DeChario and CJNW's Senior Partner, respectively, related to reviewing the Utility's brief and staff's recommendation. Staff believes that the 32 hours for DeChario is more than sufficient to accomplish those tasks. Thus, staff recommends that rate case expense be reduced by \$3,520.

Fourth, KWRU originally did not include an estimate of engineering fees in its MFRs. (EXH 3) However, in the Utility's Late-Filed EXHs 41 through 43, Weiler Engineering submitted \$12,960 in invoices. Staff reviewed these expenses and recommends the full \$12,960 be included in rate case expense.

Fifth, KWRU did not file Company time in their MFRs. (EXH 3, p. 49) Then, in Late-Filed EXHs 41 through 43, the Utility submitted an up-to-date actual and estimated rate case expense of \$80,450 - an actual amount of \$74,050 and an estimate for remaining costs of \$6,400. Staff believes that the Utility has not met its burden of proof by failing to provide timesheets of hours worked. The Commission has consistently relied on time records to support Utility time spent on rate case matters.¹¹ As such, staff recommends that the entire amount of \$80,450 should be disallowed.

In summary, staff recommends that rate case expense be decreased by \$143,163 for MFR deficiencies, and for unsupported and unreasonable rate case expense. The appropriate total rate case expense is \$466,615. A breakdown of rate case expense is as follows:

	<u>MFR Estimated</u>	<u>Utility Revised Actual & Estimated</u>	<u>Staff Adjustment</u>	<u>Allowed Total</u>
Legal - Rose, Sundstrom & Bentley	\$100,000	\$314,483	(\$46,363)	\$268,120
Accounting - Carlstedt, Jackson, Nixon & Wilson CPA's	90,000	191,885	(16,350)	175,535
Engineering - Weiler Engineering	0	12,960	0	12,960
Company Time	0	80,450	(80,450)	0
Company Expense - (filing fees, mailings, copying, notices, phone, Fed Ex, etc.)	<u>10,000</u>	<u>10,000</u>	<u>0</u>	<u>10,000</u>
Total Rate Case Expense	<u>\$200,000</u>	<u>\$609,778</u>	<u>(\$143,163)</u>	<u>\$466,615</u>

¹¹ See Order Nos. PSC-07-0130-SC-SU, p. 31, issued February 15, 2007, in Docket No. 060256-SU, In re: Application for increase in wastewater rates in Seminole County by Alafaya Utilities, Inc.; and PSC-07-0205-PAA-WS, p. 27, issued March 6, 2007, in Docket No. 060258-WS, In re: Application for increase in water and wastewater rates in Seminole County by Sanlando Utilities Corp.

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Annual Amortization Amounts	<u>\$50,000</u>	<u>\$152,445</u>	<u>(\$35,791)</u>	<u>\$116,586</u>
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Therefore, rate case expense should be increased by \$66,654 over the MFR requested amount of \$50,000, for a total annual rate case expense of \$116,654.

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

Recommendation: Yes. Based on the resolution on previous recommended plant adjustments, the depreciation expense should be reduced by \$48,759. (Roberts, Fletcher)

Position of the Parties

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

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

Staff Analysis: In its filing, KWRU reflected net depreciation expense of \$205,903. (EXH 3, Vol. 1, p. 39) Based on the approved stipulations and previous recommended plant adjustments, staff recommends that depreciation expense should be reduced by \$48,759.

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

Recommendation: The test year operating loss is \$132,988 for wastewater before any revenue increase. (Roberts, Fletcher)

Position of the Parties

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

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

Staff Analysis: The issue is subject to resolution of other issues related to revenues and operating expenses and rate base, and is primarily a "fall-out" number. Based on the adjustments discussed in previous issues, staff recommends that the test year operating income before any provision for increased revenues should be a loss of \$132,988 for wastewater. The schedule for wastewater operating loss is attached as Schedule No. 3-A and the adjustments are shown on Schedule No. 3-B.

Issue 34: What is the appropriate revenue requirement?

Recommendation: The following revenue requirement should be approved: (Roberts, Fletcher)

	<u>TOTAL</u>	<u>\$ INCREASE</u>	<u>% INCREASE</u>
Wastewater	\$1,328,524	\$241,771	22.25%

Position of the Parties

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

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

Staff Analysis: The issue is a summary computation that is subject to the resolution of other issues related to rate base, and cost of capital, and is primarily a “fall-out” number. The computation of the revenue requirement is shown on Schedule No. 3-A and is \$1,328,524 which represents an increase of \$241,771 or 22.25 percent.

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

Recommendation: The Utility's rate structure should be changed from the current flat rate structure, to the base facility and gallonage charge rate structure. In addition, the residential monthly wastewater gallonage cap should set at 10,000 gallons. (Roberts, Fletcher)

Position of the Parties

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

OPC: No position.

Staff Analysis: KWRU wastewater customers receive their water service from the FKAA. The Utility's current rate structure is a flat rate charged to all residential service customers. (TH-TR 96) The rate structures for general service and multi-family classes consists of a base facility charge and gallonage charge. The Utility's current rate structure for wastewater service was approved by this Commission in the last rate case, primarily because water use information from the FKAA was not available at that time.

The Utility, pursuant to Rule 25-30.437(6), F.A.C., requested that it be allowed to implement a base facility/gallonage charge rate structure in this filing. The Utility has submitted a billing analysis using potable water data obtained from the FKAA, and has provided documentation stating that this data will be available from the FKAA on a going-forward basis.

In changing from a flat rate structure to measured consumption, a residential wastewater gallonage cap should be established. This cap recognizes that any water used by residential customers over the cap is for purposes such as lawn sprinkling and washing automobiles and is not collected by the wastewater system. In determining the appropriate wastewater gallonage charge, the Commission commonly recognize that only 80 percent of the residential water used is collected and treated by the wastewater system; the other 20 percent of the residential water is used for other purposes and is not returned to the wastewater system. There is no cap on usage for general service wastewater bills and it is assumed that 100 percent of general service use will be returned to the collection system. Therefore, for the general service class, the gallonage charge should be 20 percent greater than the residential gallonage charge.

Generally, the residential wastewater gallonage caps are set at 6,000, 8,000, or 10,000 gallons per month. Considering the above factors, the residential wastewater gallonage cap for KWRU should be set at 10,000 gallons per month. This is the gallonage cap the Utility requested in the MFRs.

Based on the foregoing, staff recommends that the appropriate rate structure for the wastewater system is the base facility charge (BFC)/uniform gallonage charge rate structure with the residential monthly wastewater gallonage cap of 10,000 gallons.

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

Recommendation: The appropriate wastewater monthly rates are shown on Schedule No. 4. Excluding miscellaneous service charge, reuse, and other revenues, the recommended wastewater rates are designed to produce revenues of \$1,222,064. The Utility should file revised wastewater tariff sheets and a proposed customer notice to reflect the Commission-approved rates for the wastewater system. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-30.475(1), F.A.C. In addition, the approved rates should not be implemented until staff has approved the proposed customer notice. The Utility should provide proof of the date notice was given no less than 10 days after the date of the notice. (Roberts, Fletcher)

Position of the Parties

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

OPC: No position.

Staff Analysis: The recommended rates are designed to produce revenue of \$1,222,064 for wastewater, excluding miscellaneous service charge, reuse, and other revenues. Staff calculated rates using test-year number of bills and consumption and using rate structure recommended in Issue 35.

The Utility should file revised wastewater tariff sheets and a proposed customer notice to reflect the Commission-approved wastewater rates. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-30.475(1), F.A.C. The approved wastewater rates should not be implemented until staff has approved the proposed customer notice. The Utility should provide proof of the date notice was given no less than ten days after the date of the notice.

If the effective date of the new rates falls within a regular billing cycle, the initial bills at the new rate may be prorated. The old charge should be prorated based on the number of days in the billing cycle before the effective date of the new rates. The new charge should be prorated based on the number of days in the billing cycle on and after the effective date of the new rates. In no event should the rates be effective for service rendered prior to the stamped approval date.

A comparison of the Utility's original rates and staff's recommended wastewater rates is shown on Schedule No. 4, respectively.

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

Recommendation: The appropriate wastewater monthly rates are shown on Schedule No. 4. The Utility should file revised wastewater tariff sheets and a proposed customer notice to reflect the Commission-approved rates for the wastewater system. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-30.475(1), F.A.C. In addition, the approved rates should not be implemented until staff has approved the proposed customer notice. The Utility should provide proof of the date notice was given no less than 10 days after the date of the notice. (Roberts, Fletcher)

Position of the Parties

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

OPC: No position.

Staff Analysis: The Utility's proposed reuse gallonage rate of \$0.69 per thousand gallons is appropriate. (EXH 3, Volume 1, p. 67) Staff recommends that KWRU's proposed reuse rate is reasonable given the Utility is basically limited with any cost effective effluent disposal alternatives. In its filing, KWRU proposed a continuation of a flat bulk rate for two marinas. (EXH 3, Volume 1, p. 68) By Order No. PSC-02-1165-PAA-SU,¹² the Commission approved the methodology for calculating bulk wastewater rates which was set at 78.37 percent of the residential flat rate. This bulk rate was less than the residential rate because the bulk water customers own and maintain the lift-stations that connect to the Utility's collection system. Consistent with the methodology approved by Order No. PSC-02-1165-PAA-SU, staff agrees with KWRU's proposed continuation of a flat bulk rate for two marinas.

The Utility should file revised wastewater tariff sheets and a proposed customer notice to reflect the Commission-approved rates for the wastewater system. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-30.475(1), F.A.C. In addition, the approved rates should not be implemented until staff has approved the proposed customer notice. The Utility should provide proof of the date notice was given no less than 10 days after the date of the notice.

A comparison of the Utility's original rates and staff's recommended water and wastewater rates are shown on Schedule No. 4.

¹² Issued August 26, 2002, in Docket No. 020520-SU, In re: Complaint by Safe Harbor Marina against K W Resort Utilities Corp. and request for new class of service for bulk wastewater rate in Monroe County.

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

Recommendation: The proper refund amount should be calculated by using the same data used to establish final rates, excluding rate case expense and other items not in effect during the interim period. This revised revenue requirement for the interim collection period should be compared to the amount of interim revenue requirement granted. Based on this calculation the Utility should be required to refund 2.14 percent of wastewater revenues collected under interim rates. The refund should be made with interest in accordance with Rule 25-30.360(4), F.A.C. The Utility should be required to submit proper refund reports pursuant to Rule 25-30.360(7), F.A.C. The Utility should treat any unclaimed refunds as CIAC pursuant to Rule 25-30.360(8), F.A.C. Further, the corporate undertaking should be released upon staff's verification that the required refunds have been made. (Roberts, Fletcher)

Position of the Parties

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

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

Staff Analysis: By Order No. PSC-07-0812-PCO-SU, issued October 10, 2007, the Commission authorized the collection of interim wastewater rates, subject to refund, pursuant to Section 367.082, F.S. The approved interim revenue requirement was \$1,227,722, which represents an increase of \$204,008, or 19.93 percent.

According to Section 367.082, F.S., any refund should be calculated to reduce the rate of return of the Utility during the pendency of the proceeding to the same level within the range of the newly authorized rate of return. Adjustments made in the rate case test period that do not relate to the period interim rates are in effect should be removed. Rate case expense is an example of an adjustment which is recovered only after final rates are established.

In this proceeding, the test period for establishment of interim and final rates is the historical period ending December 31, 2006. KWRU's approved interim rates did not include any provisions for pro forma or projected operating expenses or plant. The interim increase was designed to allow recovery of actual interest costs and the floor of the last authorized range for equity earnings.

To establish the proper refund amount, staff has calculated a revised interim revenue requirement utilizing the same data used to establish final rates. Rate case expense was excluded because this item is prospective in nature and did not occur during the interim collection period.

Using the principles discussed above, staff calculates that the \$1,227,722 wastewater revenue requirement granted in Order No. PSC-07-0812-PCO-SU for the interim test year is greater than the revenue requirement for the interim collection period of \$1,202,989. This results

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in a 2.14 percent refund of interim rates. The Utility should be required to refund 2.14 percent of wastewater revenues collected under interim rates. The refund should be made with interest in accordance with Rule 25-30.360(4), F.A.C. The Utility should be required to submit proper refund reports pursuant to Rule 25-30.360(7), F.A.C. The Utility should treat any unclaimed refunds as CIAC pursuant to Rule 25-30.360(8), F.A.C. Further, the corporate undertaking should be released upon staff's verification that the required refunds have been made.

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

Recommendation: The wastewater rate should be reduced as shown on Schedule No. 4 to remove \$122,151 of wastewater rate case expense, grossed-up for regulatory assessment fees, which is being amortized over a four-year period. The decrease in rates should become effective immediately following the expiration of the four-year rate case expense recovery period, pursuant to Section 367.0816, F.S. The Utility should be required to file revised tariffs and a proposed customer notice setting forth the lower rates and the reason for the reduction no later than 30 days prior to the actual date of the required rate reduction. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-40.475(1), F.A.C. The rates should not be implemented until staff has approved the proposed customer notice. KWRU should provide proof of the date notice was given no less than 10 days after the date of the notice. (Roberts, Fletcher)

Position of the Parties

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

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

Staff Analysis: Section 367.0816, F.S., requires rates to be reduced immediately following the expiration of the four-year amortization period by the amount of the rate case expense previously included in the rates. The reduction will reflect the removal of revenues associated with the amortization of rate case expense and the gross-up for regulatory assessment fees which is \$122,151 for wastewater. The decreased revenue will result in the rate reduction recommended by staff on Schedule No. 4.

The Utility should be required to file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-40.475(1), F.A.C. The rates should not be implemented until staff has approved the proposed customer notice. KWRU should provide proof of the date notice was given no less than 10 days after the date of the notice.

If the Utility files this reduction in conjunction with a price index or pass-through rate adjustment, separate data should be filed for the price index and/or pass-through increase or decrease, and for the reduction in the rates due to the amortized rate case expense.

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

Recommendation: Yes. To ensure that the Utility adjusts its books in accordance with the Commission's decision, KWRU should provide proof, within 90 days of the final order issued in this docket, that the adjustments for all the applicable NARUC USOA primary accounts have been made. (Roberts, Fletcher)

Position of the Parties

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

OPC: Yes.

Staff Analysis: To ensure that the Utility adjusts its books in accordance with the Commission's decision, staff recommends that KWRU provide proof within 90 days of the final order issued in this docket that the adjustments for all the applicable NARUC USOA primary accounts have been made.

Issue 41: Should this docket be closed?

Recommendation: If the Commission's final order is not appealed, this docket should be closed upon staff's approval of the tariffs, verification of the required refunds, and the expiration of the time for filing an appeal. (Jaeger)

Position of the Parties

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

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

Staff Analysis: If the Commission's final order is not appealed, this docket should be closed upon staff's approval of the tariffs, verification of the required refunds, and the expiration of the time for filing an appeal.

K W Resort Utilities Corp. Schedule of Wastewater Rate Base Test Year Ended 12/31/06			Schedule No. 1-A Docket No. 070293-SU		
Description	Test Year Per Utility	Utility Adjust- ments	Adjusted Test Year Per Utility	Staff Adjust- ments	Staff Adjusted Test Year
1 Plant in Service	\$9,371,002	\$1,139,707	\$10,510,709	(\$933,498)	\$9,577,211
2 Land and Land Rights	222,745	152,255	375,000	0	375,000
3 Non-used and Useful Components	0	0	0	0	0
4 Accumulated Depreciation	(2,740,042)	(63,368)	(2,803,410)	129,322	(2,674,088)
5 CIAC	(4,856,429)	(707,000)	(5,563,429)	0	(5,563,429)
6 Amortization of CIAC	686,844	39,309	726,153	0	726,153
7 CWIP	265,413	(265,413)	0	0	0
8 Advances for Construction	(2,777,630)	0	(2,777,630)	0	(2,777,630)
9 Working Capital Allowance	0	496,846	496,846	(32,269)	464,578
10 Other	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
11 Rate Base	<u>\$171,903</u>	<u>\$792,336</u>	<u>\$964,239</u>	<u>(\$836,445)</u>	<u>\$127,795</u>

K W Resort Utilities Corp.		Schedule No. 1-B
Adjustments to Rate Base		Docket No. 070293-SU
Test Year Ended 12/31/06		
Explanation	Wastewater	
<u>Plant In Service</u>		
1	To correct a misclassification of purchased land (Stip. 1)	(\$152,255)
2	To correct for a misclassification. (Stip. 2)	577
3	To capitalized a beachcleaner which was expensed. (Stip. 3)	910
4	To remove duplication of contractual operation service fees. (I-2)	(252,690)
5	To remove non-utility investment. (I-3)	(10,000)
6	To remove management fee associated with Green Fairways. (I-4)	(32,198)
7	To remove SSI project management fee. (I-5)	(301,180)
8	To remove unsupported legal fees. (I-6)	(25,000)
9	To remove Mr. Johnsons moving expense. (I-7)	(8,602)
10	To remove Johnson's contractors costs. (I-8)	(34,650)
11	To remove Mr. London's consultant fees. (I-9)	(32,500)
12	To remove White & Case legal charges. (I-10)	(27,230)
13	To remove Key West Citizen PR Advertisement. (I-11)	(422)
14	To reflect the appropriate pro forma plant. (I-12)	(124,921)
15	To capitalized certain items expensed in the test year. (I-28)	<u>66,663</u>
	Total	<u>(\$933,498)</u>
<u>Accumulated Depreciation</u>		
1	To correct a misclassification of purchased land (Stip. 1)	\$71,274
2	To correct for a misclassification. (Stip. 2)	(52)
3	To capitalized a beachcleaner which was expensed. (Stip. 3)	(493)
4	Depr. Exp.associated w/ removal of operation service fees. (I-2)	10,983
5	Depreciation associated with non utility investment. (I-3)	1,259
6	Depreciation associated with management fee. (I-4)	2,823
7	Depreciation associated with SSI management fee. (I-5)	26,406
8	Depreciation associated with legal fees. (I-6)	2,192
9	Depreciation associated with Johnson moving expense. (I-7)	1,075
10	Depreciation associated with Johnson contractors. (I-8)	1,925
11	Depreciation associated with London's consulting fees. (I-9)	6,145
12	Depreciation associated with White & Case legal charges. (I-10)	1,814
13	Depreciation associated with Key West Citizen PR Advertisement. (I-11)	117
14	To reflect the appropriate pro forma depreciation expense. (I-12)	6,940
15	To capitalized certain items expensed in the test year. (I-28)	<u>(3,086)</u>
	Total	<u>\$129,322</u>
<u>Working Capital</u>		
1	To remove temporary cash investments. (Stip. 4)(I-16)	(\$168,265)
2	To reflect prepaid expenses. (Stip. 9)(I-16)	2,689
3	To reflect the appropriate deferred rate case expense. (I-16)	<u>133,308</u>
	Total	<u>(\$32,269)</u>

K W Resort Utilities Corp.						Schedule No. 2				
Capital Structure-Simple Average						Docket No. 070293-SU				
Test Year Ended 12/31/06										
		Specific	Subtotal	Prorata	Capital		Cost	Weighted		
	Total	Adjust-	Adjusted	Adjust-	Reconciled		Rate	Cost		
Description	Capital	ments	Capital	ments	to Rate Base	Ratio		Cost		
Per Utility										
1	Long-term Debt	\$1,475,869	\$0	\$1,475,869	(\$804,132)	\$671,737	69.66%	7.17%	4.99%	
2	Short-term Debt	0	0	0	0	0	0.00%	0.00%	0.00%	
3	Preferred Stock	0	0	0	0	0	0.00%	0.00%	0.00%	
4	Common Equity	555,435	0	555,435	(302,679)	252,756	26.21%	12.01%	3.15%	
5	Customer Deposits	39,746	0	39,746	0	39,746	4.12%	6.00%	0.25%	
6	Deferred Income Taxes	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0.00%</u>	0.00%	<u>0.00%</u>	
7	Total Capital	<u>\$2,071,050</u>	<u>\$0</u>	<u>\$2,071,050</u>	<u>(\$1,106,811)</u>	<u>\$964,239</u>	<u>100.00%</u>		<u>8.39%</u>	
Per Staff										
8	Long-term Debt	\$1,475,869	\$0	\$1,475,869	(\$1,384,800)	\$91,069	71.26%	7.17%	5.11%	
9	Short-term Debt	0	0	0	0	0	0.00%	0.00%	0.00%	
10	Preferred Stock	0	0	0	0	0	0.00%	0.00%	0.00%	
11	Common Equity	555,435	0	555,435	(521,162)	34,273	26.82%	12.67%	3.40%	
12	Customer Deposits	39,746	0	39,746	(37,293)	2,453	1.92%	6.00%	0.12%	
13	Deferred Income Taxes	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0.00%</u>	0.00%	<u>0.00%</u>	
14	Total Capital	<u>\$2,071,050</u>	<u>\$0</u>	<u>\$2,071,050</u>	<u>(\$1,943,256)</u>	<u>\$127,795</u>	<u>100.00%</u>		<u>8.62%</u>	
						LOW	HIGH			
						RETURN ON EQUITY	<u>11.67%</u>	<u>13.67%</u>		
						OVERALL RATE OF RETURN	<u>8.35%</u>	<u>8.89%</u>		

K W Resort Utilities Corp. Statement of Wastewater Operations Test Year Ended 12/31/06						Schedule No. 3-A Docket No. 070293-SU	
Description	Test Year Per Utility	Utility Adjust- ments	Adjusted Test Year Per Utility	Staff Adjust- ments	Staff Adjusted Test Year	Revenue Increase	Revenue Requirement
1 Operating Revenues:	<u>\$1,012,695</u>	<u>\$635,303</u>	<u>\$1,647,998</u>	<u>(\$561,245)</u>	<u>\$1,086,753</u>	<u>\$241,771</u> 22.25%	<u>\$1,328,524</u>
Operating Expenses							
2 Operation & Maintenance	\$1,017,156	\$222,154	\$1,239,310	(\$180,099)	\$1,059,211		\$1,059,211
3 Depreciation	181,844	24,059	205,903	(48,759)	157,144		157,144
4 Amortization	5,297	(968)	4,329	0	4,329		4,329
5 Taxes Other Than Income	79,594	37,962	117,556	(34,233)	83,323	10,880	94,202
6 Income Taxes	<u>0</u>	<u>0</u>	<u>0</u>	<u>(84,265)</u>	<u>(84,265)</u>	<u>86,884</u>	<u>2,619</u>
7 Total Operating Expense	<u>1,283,891</u>	<u>283,207</u>	<u>1,567,098</u>	<u>(347,357)</u>	<u>1,219,741</u>	<u>97,764</u>	<u>1,317,505</u>
8 Operating Income	<u>(\$271,196)</u>	<u>\$352,096</u>	<u>\$80,900</u>	<u>(\$213,888)</u>	<u>(\$132,988)</u>	<u>\$144,007</u>	<u>\$11,018</u>
9 Rate Base	<u>\$171,903</u>		<u>\$964,239</u>		<u>\$127,795</u>		<u>\$127,795</u>
10 Rate of Return	<u>-157.76%</u>		<u>8.39%</u>		<u>-104.06%</u>		<u>8.62%</u>

K W Resort Utilities Corp. : Adjustment to Operating Income Test Year Ended 12/31/06		Schedule 3-B Docket No. 070293-SU
Explanation	Wastewater	
<u>Operating Revenues</u>		
1	Remove Utilities requested final revenue increase.	(\$601,684)
2	To reflect the appropriate annualized test year revenues. (I-20)	6,264
3	To reflect the appropriate test rental fee. (I-20)	14,600
4	To include income related to County lift stations. (I-20)	<u>19,575</u>
	Total	<u>(\$561,245)</u>
<u>Operation and Maintenance Expense</u>		
1	To capitalized a beachcleaner which was expensed. (Stip. 3)	(\$11,825)
2	To reflect the appropriate sludge removal expense. (Stip. 5) (I-21)	(9,129)
3	To remove on-utility telephone expenses. (Stip. 6)	(7,508)
4	To remove political contributions. (Stip. 7)	(1,203)
5	To reflect the amortization of non-recurring amounts (Stip. 8)	(1,032)
6	To remove out-of-period expenses. (Stip. 9)	(2,689)
7	To reduce golf cart related expenses. (Stip. 10)	(1,548)
8	To reflect the appropriate chemicals expense. (I-22)	(16,117)
9	To remove mark-up of pro forma expenses. (I-24)	(33,826)
10	To reduce advertising expense for public relation functions. (I-26)	(26,653)
11	To reflect the appropriate management fees. (I-27)	(30,000)
12	To remove mark-up and reclassify historical test year expenses. (I-28)	(71,053)
13	To reflect the appropriate contractual services- other expenses. (I-29)	(12,038)
14	To reflect the appropriate miscellaneous expenses. (I-30)	(22,132)
15	To reflect the appropriate rate case expense. (I-31)	<u>66,654</u>
	Total	<u>(\$180,099)</u>
<u>Depreciation Expense - Net</u>		
1	To correct a misclassification of purchased land (Stip. 1)	(\$6,766)
2	To correct for a misclassification. (Stip. 2)	104
3	To capitalized a beachcleaner which was expensed. (Stip. 3)	493
4	Depr. Exp. associated w/ removal of operation service fees. (I-2)	(3,021)
3	Depreciation expense associated with non utility investment. (I-3)	(315)
4	Depreciation expense associated with management fee. (I-4)	(2,823)
5	Depreciation expense associated with SSI management fee. (I-5)	(26,406)
6	Depreciation expense associated with legal fees. (I-6)	(2,192)
7	Depreciation expense associated with Johnson moving. (I-7)	(269)
8	Depreciation expense associated with Johnson constructors. (I-8)	(1,925)
9	Depreciation expense with London's consulting fees. (I-9)	(855)
10	Depreciation expense with White & Case legal charges. (I-10)	(907)
11	Depreciation expense with Key West Citizen PR Advertisement. (I-11)	(23)
12	To reflect the appropriate pro forma depreciation expense. (I-12)	(6,940)
13	To capitalize certain items expensed in the test year. (I-28)	<u>3,086</u>
	Total (Aggregate Adjustment in Issue 32)	<u>(\$48,759)</u>
<u>Taxes Other Than Income</u>		
1	Remove RAFs on above revenue adjustments.	(\$25,256)
2	To correct for a misclassification. (Stip. 2)	(7,950)
3	To reflect the appropriate pro forma property taxes. (I-12)	<u>(1,027)</u>
	Total	<u>(\$34,233)</u>

K W Resort Utilities Corp.					Schedule No. 4
Wastewater Monthly Service Rates					Page 1 of 2
Test Year Ended 12/31/06					
	Rates Prior to Filing	Commission Approved Interim	Utility Requested Final	Staff Recomm. Final	Four Year Rate Reduction
<u>Residential</u>					
Flat Rates	\$40.39	\$47.61			
Base Facility Charge All Meter Sizes:			\$35.08	\$18.39	\$1.69
Gallonage Charge - Per 1,000 gallons (10,000 gallon cap)			\$4.49	\$3.57	\$0.33
<u>General Service</u>					
Base Facility Charge by Meter Size:					
5/8" x 3/4"	\$30.73	\$36.21	\$35.08	\$18.39	\$1.69
1"	\$74.72	\$88.06	\$87.70	\$45.98	\$4.23
1-1/2"			\$175.40	\$91.95	\$8.45
2"	\$229.52	\$270.50	\$280.64	\$147.12	\$13.53
3"	\$454.63	\$535.80	\$526.20	\$294.24	\$27.05
4"	\$707.94	\$834.35	\$877.00	\$459.75	\$42.27
6"			\$1,754.00	\$919.50	\$84.54
8"			\$2,806.40	\$1,655.10	\$152.18
8" Turbo			\$3,157.20	\$2,114.85	\$194.45
Gallonage Charge, per 1,000 Gallons	\$3.40	\$4.01	\$5.27	\$4.29	\$0.39
<u>Multi-Residential and Commercial</u>					
Flat Rate	\$40.39	\$47.61			
Base Facility Charge by Meter Size:					
5/8" x 3/4"			\$35.08	\$18.39	\$1.69
1"			\$87.70	\$45.98	\$4.23
1-1/2"			\$175.40	\$91.95	\$8.45
2"			\$280.64	\$147.12	\$13.53
3"			\$526.20	\$294.24	\$27.05
4"			\$877.00	\$459.75	\$42.27
Gallonage Charge, per 1,000 Gallons			\$5.27	\$4.29	\$0.39
<u>Reclaimed Water</u>					
Gallonage Charge, per 1,000 Gallons	\$0.45	\$0.53	\$0.69	\$0.69	\$0.06

K W Resort Utilities Corp.					Schedule No. 4
Wastewater Monthly Service Rates					Page 2 of 2
Test Year Ended 12/31/06					
	Rates Prior to Filing	Commission Approved Interim	Utility Requested Final	Staff Recomm. Final	Four Year Rate Reduction
<u>Private Lift Station Owners</u>					
5/8" x 3/4"	\$32.55	\$38.32	\$35.08	\$18.39	\$1.69
1"	\$74.72	\$88.06	\$87.70	\$45.98	\$4.23
2"	\$229.52	\$270.50	\$280.64	\$147.12	\$13.53
Gallage Charge, per 1,000 Gallons	\$2.74	\$3.23	\$5.27	\$4.29	\$0.39
<u>Bulk Wastewater Rates</u>					
<u>Safe Harbor Marina</u>					
13 Residential Units @ 1 ERC each	\$525.11	\$618.87	\$456.04	\$337.37	\$31.02
18 Live Aboard Boats @ .6 ERC each	\$436.20	\$514.09	\$378.86	\$281.14	\$25.85
27 Non-Live Aboard Boats @ .2 ERC each	\$218.10	\$257.04	\$189.43	\$140.57	\$12.92
6 Vacant Slips @ .2 ERC each	\$48.46	\$57.11	\$42.10	\$21.46	\$1.97
2 Bathhouses @ 1 ERC each	\$80.79	\$95.21	\$70.16	\$51.90	\$4.77
2 Commercial Businesses @ .5 ERC each	\$40.39	\$47.61	\$35.08	\$25.95	\$2.39
1 Commercial Bar	<u>\$51.53</u>	<u>\$60.73</u>	<u>\$44.90</u>	<u>\$33.11</u>	<u>\$3.04</u>
Total	<u>\$1,400.58</u>	<u>\$1,650.67</u>	<u>\$1,216.57</u>	<u>\$891.51</u>	<u>\$81.97</u>
<u>South Stock Island Marinas (Peninsular Marina)</u>					
13 Residential Units @ 1 ERC each	\$525.11	\$618.87	\$456.04	\$337.37	\$31.02
16 Live Aboard Boats @ .6 ERC each	\$387.73	\$456.96	\$336.77	\$248.70	\$22.87
26 Non-Live Aboard Boats @ .2 ERC each	\$210.04	\$247.55	\$182.42	\$134.08	\$12.33
Bathhouse @ 1 ERC	\$40.39	\$47.61	\$35.08	\$25.95	\$2.39
3 Commercial Businesses @ .5 ERC each	<u>\$60.59</u>	<u>\$71.41</u>	<u>\$52.62</u>	<u>\$38.93</u>	<u>\$3.58</u>
Total	<u>\$1,223.86</u>	<u>\$1,442.39</u>	<u>\$1,062.93</u>	<u>\$785.04</u>	<u>\$72.18</u>
<u>General Service Multiple Agreement</u>					
Large Swimming Pool (4 ERCs)	\$161.57	\$190.42	\$140.32	\$25.95	\$2.39
Small Swimming Pool (1.18 ERCs)	\$47.67	\$56.18	\$41.39	\$25.95	\$2.39
<u>Temporary Service Agreement</u>					
Sweetwater Environmental, Inc.					
Minimum Charge on 127,100 gallons	\$728.28	\$858.21	\$669.82	\$545.17	\$50.13
Gallage Charge, per 1,000 Gallons	\$5.73	\$6.75	\$5.27	\$4.29	\$0.39
<u>Typical Residential Bills 5/8" x 3/4" Meter</u>					
3,000 Gallons	\$40.39	\$47.61	\$48.55	\$29.10	
5,000 Gallons	\$40.39	\$47.61	\$57.53	\$36.24	
10,000 Gallons	\$40.39	\$47.61	\$79.98	\$54.09	
(Wastewater Gallage Cap - 10,000 Gallons)					