DISTRICT COURT OF APPEAL
FIRST DISTRICT
STATE OF FLORIDA
TALLAHASSEE, FLORIDA 32399-1850

JON S. WHEELER
CLERK OF THE COURT

(904) 488-6151

January 28, 1998

Honorable Blanca Bayo, Clerk
Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

RE: FLORIDA CITIES WATER COMPANY v. STATE OF FLORIDA, FLORIDA PUBLIC SERVICE COMMISSION
Docket No.: 96-3812
Lower Tribunal Case No.: 950387-SU

Dear Ms. Bayo:

I have been directed by the Court to issue the attached mandate in the above-styled cause. It is enclosed with a certified copy of this Court's opinion.

Yours truly,

Jon S. Wheeler
Clerk of the Court

JSW/mp
Enclosures
c: (letter and mandate only)
B. Kenneth Gatlin, Esquire
Martin S. Friedman, Esquire
John L. Wharton, Esquire
F. Marshall Deterding, Esquire
Harold McLean, Esquire
Kathryn G. W. Cowdery, Esquire
Ralph R. Jaeger, Esquire
Diana W. Caldwell, Esquire
Jack Shreve, Esquire
Robert Vandiver, Esquire

ACK
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APP
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RGO
SEC 1
WAS
OTH

M A N D A T E

From

DISTRICT COURT OF APPEAL OF FLORIDA
FIRST DISTRICT

To the Honorable , Blanca Bayo, Chairman, Public Service Commission

WHEREAS, in that certain cause filed in this Court styled:

FLORIDA CITIES WATER COMPANY

Case No. 96-3812

v.

Lower Tribunal Case No. 950387-SU

STATE OF FLORIDA, FLORIDA PUBLIC SERVICE COMMISSION

The attached opinion was issued on January 12, 1998.

YOU ARE HEREBY COMMANDED that further proceedings, if required, be had in accordance with said opinion, the rules of Court, and the laws of the State of Florida.

WITNESS the Honorable Edward T. Barfield, Chief Judge

of the District Court of Appeal of Florida, First District,

and the Seal of said Court done at Tallahassee, Florida,

on this 28th day of January 1998.

DISTRICT COURT OF APPEAL
FIRST DISTRICT
STATE OF FLORIDA

Sondra Joyner, Deputy

JON S. WHEELER, Clerk
District Court of Appeal of Florida, First District

IN THE DISTRICT COURT OF APPEAL

FIRST DISTRICT, STATE OF FLORIDA

NOT FINAL UNTIL TIME EXPIRES TO FILE MOTION FOR REHEARING AND DISPOSITION THEREOF IF FILED

CASE NO. 96-3812

FLORIDA CITIES WATER COMPANY,

Appellant,

v.

STATE OF FLORIDA, FLORIDA PUBLIC SERVICE COMMISSION,

Appellee.

_____/

Opinion filed January 12, 199[illegible]

An appeal from an order of the Public Service Commission.

B. Kenneth Gatlin and Kathryn G. W. Cowdery of Gatlin, Schiefelbein & Cowdery, Tallahassee, for Appellant.

Robert D. Vandiver, General Counsel; Diana W. Caldwell, Associate General Counsel of the Florida Public Service Commission, Tallahassee, for Appellee.

Martin S. Friedman, F. Marshall Deterding, and John L. Wharton of Rose, Sundstrom & Bentley, Tallahassee, for Amicus Curiae Florida Waterworks Association, Inc.

Jack Shreve, Public Counsel; Harold A. McLean, Associate Public Counsel, Office of the Florida Public Counsel, Tallahassee, for The Citizens of the State of Florida.

BENTON, J.

Florida Cities Water Company (Florida Cities) appeals a rate order in which the Public Service Commission (PSC) disallowed approximately 2.4 million dollars that Florida Cities sought to include in its rate base. Florida Cities contends that the PSC overstated the capacity of Florida Cities's North Fort Myers

(1.0 MGD). As is customary, the PSC rated treatment capacity in terms of the average daily flow of wastewater over a year's time. Taking into account seasonal variations in demand, the PSC gauged the need for treatment capacity by calculating a peak month daily average flow. The PSC credited evidence that the average daily flow in peak months exceeded 1.0 MGD and concluded on that basis that no part of the plant represented excess capacity, i.e., that the plant was one hundred percent "used and useful."

Additional Capacity

On January 2, 1992, Florida Cities submitted a "capacity analysis report" to DER. In November of 1991, DER had informed Florida Cities that, because operating reports showed that the utility had exceeded its permitted capacity of 1.0 MGD in each of three consecutive months, Florida Administrative Code Rule 17-600.405 required Florida Cities to submit a capacity analysis report.

After reviewing Florida Cities's report, DER--to whose responsibilities the Florida Department of Environmental Protection (DEP) has since succeeded--informed Florida Cities that it needed to submit "documentation of timely planning, design and construction of needed expansions in accordance with Florida Administrative Code Rule 17-600.405(8)," now codified as Florida Administrative Code Rule 62-600.405(8).

Florida Cities furnished DEP the required documentation, and in September of 1993 applied for a construction permit to increase

reduced the rate base by almost $800,000, leaving a rate base of $5,525,915. The PSC did not question the reasonableness of the plant expansion costs or of the amounts expended for improvements but, considering the expanded and improved plant as a whole, recalculated the "used and useful" portion of the plant as only 65.9 percent. This recalculation assumed the accuracy of the PSC's finding that the expanded plant's treatment capacity was the 1.5 MGD permitted, not the 1.25 MGD treatment capacity actually designed and built.

The PSC also changed the method it used to calculate a used and useful percentage. In the 1992 rate case, the PSC made the average daily flow calculated on a peak month basis the numerator of a fraction whose denominator was the plant's treatment capacity (stated in terms of average daily flow over a year's time.) Since the fraction was greater than one, the PSC did not reach the question of a margin reserve. In the present case, the PSC changed the way it arrived at the numerator: Instead of using the average daily flow calculated on a peak month basis, it used the average daily flow calculated on an annual basis (to which it added a "reserve" of 4.58 percent), so reducing the used and useful percentage (addition of the reserve notwithstanding).

Recovery Of Expenses Incurred In Complying With Environmental Regulations

We first consider Florida Cities's contention that the PSC was required to include in the rate base all moneys Florida Cities had

"The commission shall . . . consider the investment of the utility in land acquired or facilities constructed or to be constructed in the public interest within a reasonable time in the future . . . ." § 367.081(2)(a), Fla. Stat. (1995). Capital expenditures necessary to comply with governmental regulations must be "considered" because they are "in the public interest." But utilities are entitled to a fair return only "on the investment of the utility in property used and useful in the public service." Id. Capital expenditures not "used and useful" at present are properly excluded from the rate base, even though reasonably incurred in the public interest. While such expenditures are presumably a proper basis for an allowance for funds prudently invested, no such allowance was requested in the present case.

To require the PSC to add to the rate base any and all expenditures another governmental agency's regulations require a utility to make, without regard to whether the expenditures are "used and useful" for current customers, would in effect transfer ratemaking authority from the PSC to the governmental agency requiring the expenditures. Like the North Carolina Supreme Court, we reject such an approach.

> While the opinions and criteria of the [North Carolina Department of Environmental Management (DEM)], in terms of our environment, are indeed of great importance and should be considered by the Commission and even "accorded great weight" by any utility company management in the planning and operation of its business, the determination of what is required of a utility company or

> We do not believe that the staff's proposed used and useful adjustment would be proper in this case. The expansion of the Kingsley treatment facility was required by the Department of Environmental Regulation, and we do not believe the utility should be penalized for expanding beyond current customer needs where a governmental agency has required it to do so in the public interest.

In Re: Application of Kingsley Serv. Co., 84 F.P.S.C. 3:184, 186 (1984). While "an agency's interpretation of a statute it is charged with enforcing is entitled to great deference and will be approved by this Court if it is not clearly erroneous," Florida Interexchange Carriers Ass'n ("FICA") v. Clark, 678 So.2d 1267, 1270 (Fla. 1996), the PSC has itself turned its back on its Kingsley Service Company precedent.

After handing down the Kingsley Service Company decision, the PSC adopted Florida Administrative Code Rule 25-30.434, making possible a return on funds prudently invested without including them in the rate base.[3] Promulgation of Florida Administrative Code Rule 25-30.434 was an appropriate occasion for the PSC's altering the policy it had enunciated in the Kingsley Service Company case. The new rule allows recognition of all capital

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[3]Florida Administrative Code Rule 25-30.434(1) provides:

> An Allowance For Funds Prudently Invested (AFPI) charge is a mechanism which allows a utility to earn a fair rate of return on prudently constructed plant held for future use from the future customers to be served by that plant in the form of a charge paid by those customers.

use the average maximum month, that results in a measurement that is different than the measurement of the average annual daily flow.

THE COURT: All right, so then this has been a longstanding practice that the Commission abandoned for the first time in this case?

COUNSEL: That is correct.

THE COURT: So at the very minimum then, why shouldn't this case be remanded for an explanation if nothing else?

COUNSEL: The Commission believes that it's not a policy change, it is simply a finding similar to if the Commission had been doing a miscalculation--where if the Commission had been adding 2+2=5 all along, also recognized that 2+2=4, that they should be able to undo that calculation without--that it's not a policy change, and there doesn't seem to be any requirement in the APA to ignore common sense to deal with miscalculation.

THE COURT: But now this so-called "miscalculation" recurred repeatedly in numerous cases over several years?

COUNSEL: Yes sir, that is correct . . . .

But, in an order the PSC entered on February 25, 1997, denying a motion for rehearing of an order entered on September 12, 1996--two days after the final order entered in the present case--the PSC identified the matter as an issue of "Commission policy":

> The used and useful calculation must be concerned with the maximum flows the treatment plant may experience in order to allow for that event. . . .
> . . . Therefore, consistent with Commission policy, and since this utility is subject to severe seasonal fluctuations, we calculated the used and useful percent for the treatment

Current Decisions, Division of Water and Wastewater, Rev. 2/95, p. III-45, under the heading "III Rate Base, H. Plant Held for Future Use, Used and Useful, Current Policy." No newly promulgated rule necessitated, authorized, or justified such a policy change.

The use of average daily flow in the maximum month to calculate how much treatment capacity is "used and useful" in a wastewater rate case had been repeatedly articulated as the PSC's policy. See In re Application of Indian River Utils., Inc. 96 F.P.S.C. 2:695 (1996); In re Application of Poinciana Utils., Inc., 94 F.P.S.C. 9:349, 353 (1994)(average daily flow during maximum month used to determine wastewater plant used and useful); In re Application of Gen. Dev. Utils., Inc., 93 F.P.S.C. 7:725, 742-744 (1993)(average day demand of the maximum month used to calculate used and useful); In re Application Florida Cities Water Co. (Golden Gate Division), 92 F.P.S.C. 8:270, 291 (1992)(wastewater plant 100% used and useful since it was operating above rated design capacity during maximum flow periods); In re Application of Florida Cities Water Co. (South Ft. Myers Sys.), 92 F.P.S.C. 4:547, 551-552 (1992).

Under section 120.68, Florida Statutes (Supp. 1996), remand is required in these circumstances. The statute provides:

> (7) The court shall remand a case to the agency for further proceedings consistent with the court's decision or set aside agency action, as appropriate, when it finds that:
>
> . . . .

the nature of the issue involved," Manasota-88, Inc. v. Gardinier, Inc., 481 So. 2d 948, 950 (Fla. 1st DCA 1986), the PSC must, on remand, give a reasonable explanation, if it can, supported by record evidence (which all parties must have an opportunity to address) as to why average daily flow in the peak month was ignored.

The Plant's Treatment Capacity

The other factor accounting for the discrepancy between used and useful percentages in the present proceeding and in the prior proceeding concerning Florida Cities's North Fort Myers Advanced Wastewater Treatment Plant was the PSC's determinations of the plant's treatment capacity. To the extent a determination of treatment capacity is a finding of fact,[5] the finding in the present case lacks substantial record support, the original DEP construction permit notwithstanding. In light of our decision in this regard, we need not reach Florida Cities's contention that the PSC erred in excluding its proffer of a later letter from DEP dated July 19, 1996, authorizing operation of "the modified 1.25 mgd advanced wastewater treatment plant."

As its basis for finding plant capacity to be 1.5 MGD, the PSC cited the testimony of two witnesses: Ms. Dismukes and

[5]To the extent, if any, the discrepancy is attributable to a change in policy, no explanation for such a change has been offered. No policy change has in fact been articulated in this regard. For the reasons discussed in the previous section, no such policy change could be upheld, in any event.

Testimony of Mr. Cummings, the professional engineer who oversaw construction when the plant was enlarged, explained that the capacity of the plant as actually constructed varied from what DEP originally permitted:

> Q What was the design capacity of the plant contained in the preliminary design report and FDEP permit application?
>
> A 1.30 million gallons per day (MGD) expandable to 1.5 MGD.
>
> Q On what basis was the plant capacity expansion designed and rated?
>
> A The plant expansion was originally designed to treat 1.30 MGD on an average annual daily flow basis.
>
> Q Did FCWC [Florida Cities] direct you to change the design after the preliminary design report was prepared and the FDEP permit application was filed?
>
> A Yes. FCWC directed us to change the design capacity to a maximum of 1.25 MGD based on the annual average daily flow and the design waste concentration associated with this flow.
>
> . . . .
>
> Q What is the capacity of the facility that was actually constructed by FCWC?
>
> A The plant capacity will be equal to 1.25 MGD based upon the average annual daily flow and the waste concentration associated with this flow.

As the PSC points out in its answer brief, there "is no requirement . . . that the Commission must use the permitted capacity determined by DEP when it calculates its plant flow capacity."

hydraulically[6] (even before expansion of its treatment capacity to 1.25 MGD), its ability to treat pollutants was the limiting factor and that (after it was enlarged) "[b]iologically, it can only handle 1.25 [MGD]" as an average daily flow on an annual basis.

The PSC also purported to rely on proof that no new tanks would need to be added to create a 1.5 MGD capacity and that it would be unnecessary to replace certain other existing equipment in order to equip the plant to treat larger flows. But the selfsame tanks were part of the plant when the PSC determined that the plant had a capacity of only 1.0 MGD in 1992. Logically what is important is what changes must be accomplished, not what changes could be avoided, in increasing plant capacity from 1.25 MGD to 1.5 MGD. On this question, uncontroverted testimony established that improvements costing several hundreds of thousands of dollars would

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[6]The final order confuses hydraulic capacity with biological treatment capacity in discussing Public Counsel's Exhibit No. 26. This exhibit shows that flows exceeded 1.25 MGD on twelve days (on nine of which flows also exceeded 1.5 MGD) during the test year, after construction had been ongoing for some three months. Pollutant loading did not vary directly with flows, however. The only engineer asked the significance of these data explained that, in designing a plant with the capacity to treat 1.25 MGD as an average daily flow on an annual basis, design engineers are obliged to provide capacity to treat flows that exceed the daily average, in order to accommodate peak days and months.

Television Ass'n v. Deason, 635 So. 2d 14, 15 (Fla. 1994), citing United Tel. Co. v. Public Serv. Comm'n, 496 So.2d 116, 118 (Fla. 1986) (quoting General Tel. Co. v. Carter, 115 So.2d 554, 556 (Fla. 1959). In the present case, however, Florida Cities has successfully borne "the burden of overcoming those presumptions by showing a departure from the essential requirements of law." Florida Interexchange Carriers Ass'n ("FICA") v. Clark, 678 So. 2d 1267, 1270 (Fla. 1996).

Reversed and remanded.

ERVIN and KAHN, JJ., CONCUR.