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ROBERT M. C. ROSE
OF COUNSEL

September 1, 1999

VIA HAND DELIVERY

Ralph Jaeger, Esquire
Division of Legal Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399

Re: Aloha Utilities, Inc.; PSC Docket No. 980245-WS
Little Road Limited Proceeding
Our File No. 26038.25

DOT Line Relocation/State Road 54 - Limited Proceeding; PSC Docket No. 970536-WS
Our File No. 26038.19

Dear Ralph:

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As we discussed in the last few days, we at Aloha Utilities, Inc. have now reviewed the Staff Recommendation in the above-referenced limited proceeding dockets, which are being considered along with the results of the staff's recent audit of the calendar year 1997 (with some updates for 1998). While there are many areas of disagreement with the Staff Recommendation, given the many ongoing cases for this Utility, and its need to move forward with other matters including cases not yet before the Commission, we are willing to accept the Staff Recommendation in its entirety as long as the cost of capital is corrected (as outlined under Paragraph 3 hereof), and it is agreed that several issues can be readdressed in the Utility's next general rate proceeding. We are concerned that the Commission should specifically note that these issues can be readdressed. It is my understanding that the staff is amenable to that type of treatment and qualification on the decision. The specific

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issues which we at Aloha dispute and wish to address in the Utility's next rate proceeding are as follows:

1. Working Capital Allowance - We believe that there are numerous errors in the substantial adjustments made to the Utility's working capital allowance by the staff. These adjustments are not only incorrect, but are plainly contrary to the purpose for which a working capital allowance is recognized in rate setting for a Utility. The net result of the staff's adjustment is to reduce the Utility's working capital allowance to 10% of its test year actual figures. In addition, the staff analysis reduces the working capital allowance to less than 1/4 of what would be rendered under a 1/8th of O&M type of working capital calculation. On that basis alone, we believe the staff's calculations are patently unreasonable. I will not take this opportunity to get into all the details of our concerns with the staff's working capital calculation, but suffice it to say that on many of the major adjustments proposed we believe the staff is wrong both theoretically and factually. I believe this should be addressed in the next rate proceeding.

2. Officer Salary - The staff has made a substantial cut to the salary of the Vice President of Aloha Utilities, Inc. Each and every Utility is not the same, nor are the functions, abilities, or value of each individual's contributions to the Utility the same in every circumstance. The staff's proposal to substantially reduce the salary of one of the officers of the Utility appears to be an attempt to homogenize all Utility companies and to criticize the payroll and officer's salary of a company based solely on its deviation from the "norm" in one small area.

   Aloha Utilities has one of the most efficient, streamlined administrative operations of any water and sewer Utility in the State of Florida. We have resulting rates that are substantially lower than the majority of water and sewer Utilities in this state, and especially those in our immediate area. The Commission staff feels the need to compare selected costs incurred by Aloha to similar costs for other entities. This despite the fact that Aloha is providing overall more efficient and cheaper water and wastewater service than the Utilities to which it is being compared. Aloha has done an analysis of other companies of similar size regulated by the Commission and their total administrative salaries. The results of that analysis, which were provided to the audit staff, plainly shows that Aloha's overall administrative salaries are substantially below those of comparable companies. This adjustment appears from our perspective to be based on a very narrow view of how a Utility's administrative requirements and functions should be carried out. We believe this is another issue that the Utility should be given the opportunity to pursue in its next rate proceeding.

3. Cost of Debt - In keeping with longstanding Commission policy, the Commission staff has proposed to utilize the most recent cost of equity adopted by the Commission through its leverage formula in reviewing and establishing going-forward rates. However, by the same token, the staff has chosen to utilize a cost of debt that is more than eight months old. The prime rate of interest has increased at least two times since the end of 1998 (the point in time utilized by the staff in determining the cost of capital). We believe this is unreasonable. The prime rate as of the date of the Staff Recommendation is 8.25. As such, the cost of debt which should be recognized by the Commission in reviewing and/or setting rates at this point in time should be 10.25, and the mid-point of the overall cost of capital should be 9.35 (range of 9.01 - 9.70), rather than the 9.08% recommended by the staff.

   Based on the above, the Commission should, in this proceeding, at least recognize the corrected overall range of appropriate returns for Aloha Utilities based upon its current cost of debt, in establishing the overall range of reasonable returns for the company on a going-forward basis.

4. Capitalization and Previously Expensed Items - In keeping with a longstanding Commission practice in rate proceedings, the Utility's auditors during examination of various accounts, determined that several items which should have been capitalized had been expensed by the Utility in prior years. The staff has disallowed the capitalization of those items stating that since those costs have previously been expensed, now proposing to capitalize those items would constitute a "double recovery."

   First of all, it has been standard Commission practice for more than twenty years to capitalize those items that should have been previously capitalized, even if they had been expensed during previous years and reported as expenses on the Utility's Annual Report. Aloha is simply following what has been a longstanding Commission practice, and rightly so. Those items that should be capitalized are appropriate for capitalization, regardless of when that correction is made.

   Secondly, the Staff Recommendation implies that capitalization of these previously expensed costs was done for the sole purpose of inflating the Utility's rate base. The implication, if not accusation, is that the Utility's accountants and the Utility have conspired to artificially inflate the Utility's rate base. Such an allegation by the staff is not only derogatory, it is wholly without foundation.

Finally and most importantly, the staff has alleged that as a primary reason for the denial of recognition of these costs in rate base is that the Utility will receive "double recovery" of these costs because they were previously expensed. However, any such "double recovery" can only result if the Utility exceeded the range of its authorized returns during the year in which those items were previously expensed. The staff has provided no analysis to demonstrate that this is in fact the case, here. A detailed analysis would reveal that for the great majority, if not all of the affected years, the Utility would be below its last authorized rate-of-return. Therefore, the staff allegation that this capitalization results in a "double recovery" is not only unprecedented, but contrary to the facts.

If the members of the staff are willing to agree that the Utility should have the right to raise the above issues during the Utility's next rate proceeding, with their treatment in this case having no precedential value, and to make the one correction to the appropriate range of reasonable returns, Aloha Utilities is willing to accept the Staff Recommendation as proposed. Please let us know as quickly as possible, prior to the Commission's agenda conference, if you are amenable to such a solution, so that we can plan our participation (or lack thereof) at the agenda accordingly. Hopefully, we can resolve these two cases and the audit analysis, if these issues can be preserved, and the cost of capital corrected.

Sincerely,

ROSE, SUNDSTROM & BENTLEY, LLP

F. Marshall Deterding
For The Firm

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cc: Blanca S. Bayo
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David Porter, P.E.
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