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COMMISSION
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December 28, 2007

VIA HAND DELIVERY

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(LICENSED IN NEW YORK ONLY)

ROBERT M. C. ROSE, (1924-2006)

Ann Cole, Director
Office of Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: K.W. Resort Utilities Corporation; PSC Docket No. 070293-SU
Application for Increase in Wastewater Rates in Monroe County
Our File No. 34000.05

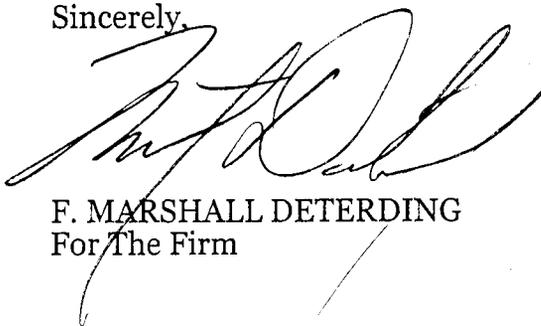
Dear Ms. Cole:

Attached are the responses to the audit report prepared by KW Resort Utilities Corp. and its consultants.

We believe after review of these certain of the conclusions reached in the audit report must be reversed or revised significantly and that these must be considered in any positions taken by the staff.

If you have any further questions in this regard, please let me know.

Sincerely,



F. MARSHALL DETERDING
For The Firm

FMD/bsr

cc: Bart Fletcher
Denise Vandiver
Cheryl Bulecza-Banks
Gerald Edwards
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Audit Finding No. 1

Plant in Service: The Utility agrees that there were \$2,137,962 of unsubstantiated plant additions for the periods ended 12/31/1984 through 12/31/1997, which were incurred by the Utility's former owner, Citicorp Real Estate, Inc. (Citicorp). Books and records were not available from Citicorp.

An Original Cost Study was performed by the Company's Engineer, Weiler Engineering, for major projects completed during the period 1984 through 1997 and is attached to this response.

Accumulated Depreciation: It appears that the Auditor removed accumulated depreciation related to the above adjustment for unsubstantiated additions only through the period ended 12/31/1997, leaving accumulated depreciation of unsubstantiated additions from 1998 through 2006 in the calculation of rate base. Also, the Auditor did not include the Ordered balance of accumulated depreciation in the analysis, overstating the adjustment by \$35,365. Additionally, the Auditor did not take into account Order No. 7522, dated November 23, 1976 (Nu-Age Utility, the previous name of the Utility), in which a composite depreciation rate of 3.46% (28.9 years) was ordered because it "justifies a higher than normal depreciation rate due to the highly corrosive air and ground environment of the Florida Keys". No adjustment was made to this ordered depreciation rate in Docket No. 830388-S. The Utility continues to use an accelerated rate based on this Order.

Based upon the Original Cost Study provided, this adjustment should not be made. However, even if the cost study was rejected and the adjustment as discussed in Plant in Service above is proposed in its unmodified form, then the full amount of depreciation related to these additions through the test year end of \$1,022,614 should also be removed from rate base, based on the actual depreciation charged by the utility.

Contributions in Aid of Construction: The auditor is removing \$867,668 of CIAC recorded during the period of the "unsubstantiated plant additions" during the period from 1984 through 1997. While the Utility agrees that if the cost study was rejected and the adjustment discussed in Plant in Service above is proposed in its unmodified form, then the full amount of CIAC recorded during this period should also be removed. The Auditor is also removing the CIAC allowed in Docket No. 830388-S of \$292 and an adjustment made in 1993 to correct a misposting in 1992 of \$17,793 which reduced CIAC. The net of these two items of \$(17,501) should be included in the adjustment to reduce the total CIAC removed

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to the amount recorded on the books of \$849,875 (\$850,167 per books less \$292 Ordered balance at 12/31/1983).

Accumulated Amortization of CIAC: The Utility agrees that if the cost study is rejected and the adjustment discussed in Plant in Service above is proposed in its unmodified form, then the full amount of CIAC amortization recorded during this period related to the reduction of CIAC discussed above should also be removed. During the period 1984 through 1997, \$32,219 of CIAC was recorded, of which \$127 of amortization ($\$292 / 30 \text{ years} \times 14 \text{ years}$) is related to amortization of CIAC included in Order No 830388-S, leaving a net reduction of \$32,092. Additionally, amortization of the \$849,875 from 1998 through the test year end should also be removed, making the total adjustment to remove amortization of unsubstantiated CIAC \$241,325.

Audit Finding No. 2

Management Fee: The amounts charged for Mr. Smith for a management fee are in lieu of a direct salary, since the utility has no employees and does not report wages to the IRS, these amounts are recorded as a management fee. 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. Since the utility has no employees and does not report wages to the IRS, these amounts charged by Green Fairways for the benefit of Mr. Smith are in lieu of sales and are recorded as management fees. 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.

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. In that proceeding, the Commission allowed a management fee for the services of Mr. Luhan in lieu of a salary which was approximately three times the amount per ERC that Green Fairways charges the utility in lieu of salary for Mr. Smith.

Administration Fees:

In addition to the management fees for day to day operations, an administrative fee of 10% of larger construction projects has also been charged by Green Fairways to KW Resort Utilities Corp. This is in order to recognize the oversight and coordination required by management for these major construction projects undertaken by the utility in recent years. This ten percent charge for administration of construction projects is an accepted and normal addition for oversight of the construction projects in the area. In fact, as a clear example of that fact Monroe County entering into a third party contract with the

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utility and in that agreement the County agreed to this same 10% administration fee as part of the overall agreement for certain construction projects undertaken by the utility and reimbursed by the County.

In addition, by administering these larger construction contracts through Green Fairways, the utility has been able to negotiate far more favorable construction agreements for construction of the utility vacuum system and for the construction of the new clarifier at substantial savings to the utility and therefore its customers which far outweigh the amount of the administrative fee. The savings were clear when compared to the bids originally received for both of these projects from outside contractors before Green Fairway's involvement.

Audit Finding No. 3

HOOK-UP COORDINATOR:

Keys Environmental, Inc. has a coordinator and inspector for all new connections undertaken on South Stock Island. Because of the unique type of system operated by the utility and its variation from the standard non-vacuum force main or gravity main system, much more is involved with each hook-up for a standard sewer system.

The hook-up coordinator who oversees through Keyes Environmental, Inc. the actual physical connection of facilities to the utility, because of the complicated arrangement between the utility and Monroe County whereby the County funds substantial portions of costs related to obtaining new customers within the South Stock Island area, the utility needed this person to also serve as a liaison between the customers and the utility and the County in ensuring all appropriate paperwork and educating the customers and area plumbers on connecting to the system. It is a position described as a connection coordinator. The duties of this person includes the following which includes (1) assist customer with the paperwork process; and

Outlined below are the details of the various aspects of the hook-up coordination undertaken by Keyes Environmental which are related to adding new customers and therefore were capitalized. An initial contract with the customer, review of plans and drawings and at least five field visits and testing and coordination with the utility's administrative staff. The detail of these duties is outlined below.

1. **Initial Contact.**

Initial contact of intention to connect. Can be in person at our office, via phone by customer, via phone by plumber, can come via KWRU billing office, by engineer or owner representative. Always be polite and accommodate the customer.

2. **Review Plans, As-Builts, site plans, etc.**

Once the customer wishes to connect review the plans, as-builts, etc. that are applicable to the connection. If engineering plans please make sure to check the approved set by Weiler Engineering Memo. This can also be found in the KEI spreadsheet Excel file Approved Projects. Consult engineering or Airvac if any questions arise.

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3. **Field Visit #1.**

Locate connection with plumber present. Point of connection is located by KEI representative. Work is discussed, vacuum specific questions are addressed, materials, submittals are provided if not provided earlier. Connection information, specifications, submittals, all discussed here. Field inspection sheet is filled out and maintained from this point until completion.

4. **Field Visit #2.**

Start of job. Notice of commencement should have alerted KEI to the start of work. HOWEVER these are contractors and some will not give notice. We will have KEI field personnel calling in excavation equipment, and when plumbers are spotted in the service area. Make sure proper materials and construction practices are being used, review work plan with contractor, communicate to contractor all required tests and inspections.

5. **Field Visit #3.**

Inspect pipe prior to backfill, inspect glue joints, slope, backfill material, compaction, etc. Test #1 can occur here. This is normally an opportunity for general inspection. Inspect materials, fill, slope on pipe, glue joints, compaction, air intake, backflow preventer, clean out assy, etc. Digital photo documentation of work and connection drawing is begun.

6. **Test #1.**

Hydrostatic Test PVC sewer lateral from building to utility point of connection (Tests are industry standards and can be indexed in the 10 State Standards or from the International Plumbing Stds). Per Monroe County.

7. **Field Visit #4.**

Test#2 Low pressure hydrostatic tests under building. To the lowest fixture point. Make sure that the plumber knows where the point of lowest fixture is. If too much pressure is put on wax seals of toilets or other fixtures problems can occur. This is the plumber's responsibility to set the test up. KEI inspections only require test verification. Ask to see the water released. This allows the inspector to see the volume of water in section under test. If this test is done in sections another test will be done at a later date.

8. **Field Visit #5.**

KEI representative will bring the sewer camera and conduct the inspection. Camera sewer lateral to insure that the pipe is free of rock or construction debris. Also the sump pit of the vacuum pit is checked with the camera. Camera all gravity and the sump. No rock is allowed period. Rock can be accelerated to 21ft/sec² by the vacuum system and sch 40 pvc fittings can shatter as a result of a rock impacting the fitting at high velocity. If the lateral has a rock it must be removed by pulling a pig or other method of the contractors choosing.

9. **Communicate with KWRU** as to fees being paid, contracts finalized, etc. Communicate with Monroe County plumbing permit open/closed. Communicate with Monroe County Public Works, Engineering, and County Administrator's office as necessary. Check if paid on C&A (consent and acknowledgement agreement). Each completed hook up must be reported at monthly meeting with Monroe County Code Enforcement. The fines cease once the septic is abandoned.

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10. **Complete Prior to Connection Check List and FAX to KWRU.** Place all pertinent documents in the file at the KWRU operations office for future reference. Put complete inspection file together and mark file as complete. File in proper cabinet.

11. **Assist customers in the paperwork process. Grants and other Loan Applications.**
To input the paperwork process - help customers get on the system and to become part of the program with Monroe County, answer basic questions and direct them to appropriate County staff, steer them to the proper resources for grants and loans, etc.

a) Application.

- Get application to customer via fax, email, standard mail, drop off, etc.
- Assist customers with application.
- Answer their questions assist them in filling out the paper work.
- Review applications that are submitted. Follow up if necessary.
- Get applications, once completed to KWRU.
- Track customers on spreadsheet of all steps toward connection.

b) Contract.

- Get contract to customer via fax, email, standard mail, drop off, etc.
- Assist customers with contract.
- Answer their questions assist them in filling out the paper work.
- Review contracts that are submitted. Follow up if necessary.
- Get contracts, once completed to KWRU.
- Track customers on spreadsheet of all steps toward connection.

12. **Attend all County Connection Task Force Meetings.**

Write a connection task force update monthly/as needed and email to all Utility staff, Monroe County officials on the task force, also copy County Commissioners, Administrators and other staff as needed.

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13. **Special Magistrate Meetings.**

Represent KWRU at all Special Magistrate Meetings (Monthly). Arrive prepared early and give accurate and honest testimony under oath. Do not judge the people at hearing, you do not know their condition, this is their right to due process and they are to be treated respectfully. Stick strictly to the facts do not offer opinions. These folks will be our future customers. Be as helpful as possible if you meet these people before or after the meeting.

14. **Code Enforcement.**

Meet with the code enforcement officer before the monthly Special Magistrate code enforcement hearings.

- Have the case docket faxed and review.
- Bring the updated connection progress list.
- Bring specific files on cases that will be called.
- Review all concerns with code enforcement officer.
- Listen to all of the concerns of code enforcement.
- Follow up on this meeting.
- Provide feedback to the Utility on the process and progress.

15. **County Attorneys and Staff.**

Interact and provide information with the Monroe County Attorney and staff. Provide developer's agreements, PSC information, hook up history, maps, and connection locations.

Meet with the KWRU staff and keep them updated on the connections happening in the field.

16. **Conduct pre construction workshop** - all licensed plumbers in lower keys invited.

- Prepare presentation.
- Prepare materials for plumbers to take home.
- Put all materials regarding connection in a packet for plumbers to take home with them.
- Provide business cards for Utility people, engineers, KEI staff, etc.
- Prepare sign in list.
- Prepare plumber list. Will be distributed to customers, put on website, etc.

17. **Meet with the County staff and their consultants, URS Griner Corp.** Give them all hookup information. Provide maps of the system showing current customers, current vacuum

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customers, future force main customers, future vacuum customers, and unknown future connection method. Explain hook up process and provide hookup documentation. Attend meetings between URS, KWRU, and Monroe County. Answer all questions and help URS and the County during their study. Took URS engineers into the field and located infrastructure in the ROW and identified them on the as-builts.

18. **Attend Monroe County Commission Meetings** as necessary. Prepare to speak to the KWRU connection process, URS review, etc. Necessary depending on what items are placed on agenda.

19. **Attend community meetings** to educate residents in the service area of the project and the steps necessary to connect. SICA meetings at the Baptist Temple etc. Other meetings one on one meetings if requested, etc.

20. **PR.**
Prepare door hangers flyers and other promotional materials.
Prepare hook up documents for the website.

Audit Finding No. 4

The Utility Agrees

Audit Finding No. 5

The Utility agrees

Audit Finding No. 6

The Utility agrees

Audit Finding No. 7

The Utility believes that this finding violates the prohibition against retroactive ratemaking as discussed in Docket No. 98-0245-WS. In Order No. 7522, 23 November 1976, the Commission authorized a depreciation rate of approximately 30 years on a composite basis. Having no further indication from the Commission in the 1983 rate case that this rate was improper, the company continued to use the accelerated rate for those accounts which were in existence in the 1983 rate case. The Company agrees that some of the depreciation rates used may need to be adjusted on a going forward basis, but not retroactively. Additionally, the Utility notes that the amounts included in NARUC Account 370 are lift stations which are properly being depreciated over 25 years, not at the rate for receiving wells of 30 years as used by the Auditor. Also, included in NARUC Account 390 but separately stated is computer equipment which is properly depreciated over 6 years, not the composite rate for office furniture and equipment of 15 year as used by the auditor. Finally, the auditor has apparently calculated a composite amortization rate for cash CIAC based on total plant. However, in accordance with Rule 25-30-

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140(9)(b), the utility has excluded general plant from its calculation of the composite rate, as well as land, which is not depreciable.

Audit Finding No. 8

The Utility agrees that there is no effect on the filing.

Audit Finding No. 9

The Utility agrees

Audit Finding No. 10

The Utility believes that this income is properly stated below the line, although it would more properly be 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”. The nature of the agreement with Monroe County, which owns the lifts stations, falls into this category. The Utility acknowledges that a similar amount of expense should also be reclassified below the line to NARUC Account 416-Expenses of Merchandise, Jobbing, and Contract Work.

Audit Finding No. 11

The Utility’s Owner does not live in or near the service area and would be negligent to not take an active role in on-site management and oversight of his interests in the Florida Keys. Mr. Smith’s travel expenses are a necessary part of the management of the Utility.

Audit Finding No. 12

The Utility agrees

Audit Finding No. 13

The Utility agrees

Audit Finding No. 14

The Utility agrees

Audit Finding No. 15

Since insurance is paid in advance, in accordance with GAAP, it is charged to a prepaid expense account and amortized over the term of the policy, which covers the calendar period beginning August and ending July. This is a normal expense and has been mischaracterized by the Auditor in both the reason for the Prepaid Account and the “avoidability” of the interest charges as being “late”. The Company was never late and the Company believes that the minor amount of finance charges properly belongs with the cost of insurance.

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Audit Finding No. 16

The Utility agrees

Audit Finding No. 17

The Utility agrees

Audit Finding No. 18

The Utility agrees

Audit Finding No. 19

The Utility agrees that the rental expenses incurred that were applied to the purchase price should be capitalized. However, the amount should be charged to NARUC Account 395-Power Operated Equipment. NARUC Account 391-Transportation Equipment is used for the moving of personnel and equipment from one point to another, Power Operated Equipment is for "...large units as are generally self-propelled or mounted on moveable equipment." The beachcleaner is not designed for transportation, but is self-propelled to perform a specific purpose. The depreciation rate for Power Operated Equipment is 8.33% (12 years). Depreciation for 2006 using ½ year convention is 492.51.