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b. Docket No. 080121-WS

In re: Application for increase in water and wastewater rates in Alaucha, Brevard, DeSoto, Highlands, Lake, Lee, Marion, Orange, Palm Beach, Pasco Polk, Putnam, Seminole, Sumter, Volusia, and Washington Counties by Aqua Utilities Florida, Inc.

c. Document being filed on behalf of Office of Public Counsel

d. There are a total of 61 pages.

e. The document attached for electronic filing is Citizens' Post-Hearing Statement.

(See attached file: 080121 Citizens Post-Hearing Statement.sversion.doc)

Thank you for your attention and cooperation to this request.

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12/30/2008

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Application for increase in water and wastewater rates in Alachua, Brevard, DeSoto, Highlands, Lake, Lee, Marion, Orange, Palm Beach, Pasco, Polk, Putnam Seminole, Sumter, Volusia, and Washington Counties by Aqua Utilities Florida, Inc.)) Docket No. 080121-WS)) Filed: December 30, 2008)) /

CITIZENS' POST-HEARING STATEMENT

The Citizens of Florida, through the Office of Public Counsel, submit this post-hearing statement.

Issue 1: Is the quality of service provided by the Utility satisfactory, and, if not, what action should be taken by the Commission?

Position: * The company's quality of service is unsatisfactory. The Commission should reduce the company's return on equity by 1.50% for its failure to provide satisfactory customer service, accurate bills, and satisfactory water quality to its customers. In addition, the Commission should disallow a portion of executive salaries.*

Discussion: The Commission has heard an outcry from customers in this case unlike any other. Over 160 customers testified at ten service hearings held by the Commission, resulting in over 1000 pages of service hearing transcripts. Tr. 625. The additional written communications to the Commission by customers (Exh. 86, schedules 2 and 3; Exh. 193) and responses from customers received by the Office of Public Counsel (Exh. 90) overwhelmingly demonstrate the extreme customer dissatisfaction with Aqua's water quality, customer service, and billing.

Customers in Chuluota were vocal about their service problems for good reason; however, customer dissatisfaction is not limited to customers living in Chuluota by any means. Recurring issues about rude and unresponsive treatment by Aqua's customer service representatives, about bad water quality, and about billing issues were evident in virtually all service hearings, including the last hearing in New Port Richey where over 50 customers testified.

Complaints about service quality continued unabated up until the time of hearing. Ms. Janice Johnson, bookkeeper for the Scottish Highlands Condominium Association, wrote OPC on November 10, 2008, about the "countless telephone calls" she made to Aqua in an attempt to resolve severe billing problems. After four weeks she had not received any calls or correspondence from the company other than a ten day notice that the Association's water would be shut off. Exh. 189. Among the problems she faced were bills showing that their usage had jumped to twenty times their former usage. Mr. Jaeger with the PSC asked Mr. Franklin whether he would be surprised to know that customers contacting staff with service issues had never received a call from Aqua at all, much less within the 48 hour time

frame for responses agreed upon between staff and Aqua. Tr. 1183-1184; see late filed exh. 209. Despite ten service hearings where customers repeatedly complained about this type of treatment, little had changed right up until the time of the hearing. See *also* Exh. 208 (certain complaints sent to staff) and Exh.193 (consumer correspondence from Aqua customers filed through December 10, 2008).

Customer Service

Customer Service encompasses all the ways in which the company communicates with customers, the speed and courtesy of the response to customer queries, the satisfaction level of customers with the service personnel they speak with, and their satisfaction with the company's resolution of the issue that prompted the contact to the company. Tr. 694. Ms. Dismukes found that the problems reported by customers in Docket 060368-WS still plague the company. Tr. 634. A major problem is Aqua's customer service representatives who are rude, unknowledgeable and unable to provide needed information. Customers testified that they were told a supervisor would call them; however, no one ever did. Other customers testified that they were put on hold, disconnected, and never received return calls they are told they will receive. Tr. 632-633; Gainesville Tr. 33; Lakeland Tr. 27, 75, 106; Oviedo Tr. 107, 136. One customer testifying in Lakeland spoke of his ongoing dealings with Aqua's customer service to straighten out a billing issue as "six months of hell." Tr. 633. This type of treatment is unacceptable.

OPC witness Poucher emphasized that the customers who testified in the hearings were simply "the tip of the iceberg." Tr. 869. Correspondence files, complaint records and hearing testimony reflect only a small percentage of total customer dissatisfaction with the company's product and service. Mr. Poucher indicated that the PSC correspondence files had grown from the 583 pages filed in October, as part of Ms. Dismukes' direct testimony, to 1,138 pages as of the date he provided testimony in December. His analysis of the original correspondence files by Ms. Dismukes showed that 99.5% of the customers were negative concerning the company, 61% specifically opposed the rate increases, 27% cited poor water quality, and 11% cited poor service quality. Tr. 867-868. Mr. Poucher concluded that the company continues to fail to deal adequately with its customer complaints and its remedial efforts are inadequate. Tr. 892. "The best description of the current status of Aqua customer service in the minds of its customers is that service is awful." Tr. 894.

In addition, Ms. Dismukes demonstrated that the company rarely meets its targets for call center answer time performance. Tr. 629. She cited data regarding the Abandoned Call Rates that were over 9% in March 2008, as opposed to a company target of 5%. Ms. Dismukes also pointed out that the average speed of service level was better in 2006 than in 2007 and 2008 and that the target level for this measurement had been met in only two months since 2006.

Mr. Poucher emphasized that a review of the entire record of complaints, letters and hearing transcripts shows the service quality, billing, and water quality complaints are not confined to customers located in Chuluota. Aqua has a system-wide service billing and water quality problems that extend throughout its service territory in Florida. Tr. 892. When one person complains about Aqua service, the

Commissioners should be concerned. However, when hundreds of customers make the same statements, then the Commission should be alarmed and take action. Tr. 893. Aqua customer service is far below acceptable, and until a problem is brought to their attention, they appear to have no process in place to handle it. Tr. 647, 649.

When the Commission considers the totality of the company's service quality testimony, along with the abundant and passionate rebuttal by its customers and OPC witnesses, it should be clear to the Commission that the company has failed its customers by not providing an acceptable quality of service. Gainesville Tr. 23, 25; Palatka Tr. 21, 22, 25, 29, 36; Sebring Tr. 62; Exh. 14; Mt. Dora Tr. 40, 49; Oviedo evening hearing, Tr. 40, 78, 79, 81, 107, 120.

Billing

Ms. Dismukes testified that the majority of the PSC complaints addressed billing issues, including meter reading problems, improper disconnects, estimated bills, and lack of billing explanations. Tr. 626; Gainesville Tr. 67; Palatka Tr. 21, 22; Lakeland Tr. 25, 60, Exh. 14; Mt. Dora Tr. 63; Oviedo evening hearing Tr. 79, 158. Repeated billing based on estimated usage was a major problem cited by Ms. Dismukes. This was corroborated by OPC Witness Poucher, who referred to a Scottish Highlands complaint where the company sent estimated bills for 2 years prior to its replacement of the old meter in 2008. Tr. 901. Mr. Franklin's testified the failure of new meter information to be uploaded into the billing system was a source of billing errors and estimated bills. Tr. 638. When asked to provide instructions given to service representatives regarding meter replacements, the company stated that "no such documents exist." Tr. 638. A number of customers maintain that the company added a zero digit to their meter readings, resulting in excessive and inaccurate billing. In her testimony, Ms. Dismukes refers to several customers who made the complaint including an Oviedo customer who was billed over \$1000 in her initial bill for 224,000 gallons of usage and then told that she had a water leak and to call a plumber. The customer asked for a supervisor to return the call and six or seven days later no call had been received. The company, in this case, determined the problem was not an extra zero in the meter reading, but an error in the data base that showed a 2 inch meter in place, as opposed to a 5/8 inch meter. Tr. 641. Regardless of the actual causes, meter reading has been and continues to be a major customer service problem for Aqua customers. Gainesville Tr. 22, 26, 68, 82; Palatka Tr. 21, 22, 31; Lakeland Tr. 25, 69, 106; Mt. Dora Tr. 27; Oviedo evening hearing Tr. 61, 75, 85, 96, 154, 170.

Water Quality

Ms. Dismukes testified that in hearing after hearing, customers presented testimony regarding a large number of water quality problems including low water pressure, water odor, sediment and other particulate matter in the water, unpleasant taste, and DEP water quality reports showing excessive amounts of various chemicals. Gainesville Tr. 22, 50, 55, 61, 62; Palatka Tr. 19, 25, 51; Sebring Tr. 19, 22, 28, 35; Lakeland Tr. 23, 24, 38, 62, 88, 89, 99, 106; Exh. 14; Mt. Dora Tr. 62, 66, 71; Oviedo evening hearing Tr. 26, 29, 42, 46, 61, 69, 71, 80, 83, 88, 90, 94, 97, 102, 106, 114, 119, 132, 147, 160, 171. Customers testified regarding health concerns for themselves, family members, local school children, and family pets, as well as

corroded pipes and the frequent replacement of filters and appliances. Overwhelmingly, the customers said they did not drink the water and did not consider the water they purchased from Aqua to be potable. Tr. 650. At hearings in held in Lakeland, Mt. Dora and Chipley, customers complained of a variety of problems, such as cloudy water, sediment, bad taste, and chlorine and sulfur odors. The transcript of the New Port Richey hearings include the same complaints about sediment and black rings around toilets and overly-chlorinated water. Complaints in Oviedo included sediment, discoloration, foul odors, taste, to ruined appliances, faucets, and sinks, and concerns about the health risks associated with bathing in the water. Tr. 652. The quality of the water and service was so bad one customer testified that she felt like she was living in a third world country. Oviedo evening hearing Tr. 151.

Aqua Service Quality Improvements are "Too Little, Too Late"

Aqua's efforts to improve its service and water quality that it touts in the testimony of witnesses Lihvarcik and Franklin reflect recent changes that have been implemented some four and a half years after the purchase of the Florida systems, and many more that have yet to be implemented. For instance, a program to loop dead end service lines in Chuluota to eliminate the need for flushing was to have been completed "by the end of this month." Tr. 574. Witness Lihvarcik described a new monitoring system that is being implemented for manual and automatic line flushing activities that "is in draft form." Tr. 584. Four and a half years after the company took over its Florida systems, the company is now promising customer service solutions that should have been implemented long ago. The Commission should not accept promises to take action in the future without imposing meaningful penalties for what has occurred. There should also be continued monitoring on behalf of the Commission to ensure that the company's customer service and water quality issues are actually resolved.

Penalties

The evidence in this docket fully supports the imposition of a penalty by the Commission for water quality failing to meet the "minimal expectations for acceptable water quality in Florida (that) should include being able to drink the water that comes out of your faucet." Tr. 871. The rudeness of Aqua's service representatives, as well as their lack of responsiveness to customers, requires an additional penalty by the Commission. Finally, the wide range of billing problems, as well as the length of time months it took the company to address many of its billing problems, supports a penalty in this case. Aqua management is solely responsible for compliance with the customer service quality, billing quality and water quality expectations of its Florida customers, and they should be held accountable for its failures.

Aqua failed to operate its systems in a way to meet minimum standards of acceptable water quality, acceptable customer service, and acceptable billing practices. Customers are provided water that many will not drink because of its color, odor, and levels of contaminants. Water pressure is sometimes low. Communications from Aqua regarding boil notices or possible water shut off are often lacking. Meters appear sporadically read, and many readings appear erroneous. Customers are billed for water usage in amounts and for dollars that vary greatly from

month to month with no underlying reasons for this variation. Customer Service personnel are difficult to reach, and by most accounts, less than helpful. Tr. 661.

The company should be penalized 50 basis points for poor customer service quality, 50 basis points for poor billing quality and 50 basis points for poor water quality, for a total of 150 basis points. In addition, the Commission should disallow management salaries for poor service quality performance as recommended by OPC Witness Dismukes. Tr. 661-662.

Although the Commission often sets an authorized range of 100 basis points on either side of the company's authorized return on equity, there is nothing in the statutes or the Commission's rules requiring the Commission to only use this range for returns on equity. In fact, the Commission has deviated from this range on a number of occasions given particular facts and circumstances of the case.

Gulf Power Company v. Wilson, 597 So.2d 270 (Fla. 1992) stands for the proposition that the Commission can impose a return on equity penalty on a company as long as the resulting rate of return falls within the reasonable range set by the Commission. In *Gulf Power* the Commission set a range of 11.75% to 13.50%: a total range of 175 basis points. In other cases the Commission has used a much broader range. In a Southern Bell case the Commission set a floor of 11.5%, a rate setting point of 13.2%, a sharing threshold of 14.0%, and a 16% ceiling. Commission order no. 20162 issued October 13, 1988. In that case, the Commission authorized a total range of 280 basis points. In still other cases, the Commission has approved agreements where there was no authorized range of return on equity at all for the purpose of addressing earnings levels. Those settlements approved by the Commission contained revenue sharing thresholds and an earnings level below which the company would be permitted to file a case for new rates. See order no. PSC-05-0902-S-EI issued September 14, 2005, and order no. PSC-05-0945-S-EI issued September 28, 2005.

The Commission has broad discretion in setting a utility's appropriate rate of return. *Gulf Power* at 273. As discussed in issue 28, we are now experiencing record low returns on treasury yields and a flight to safety by investors to stocks such as Aqua. Given these particular facts and circumstances, the record in this case fully supports a range broader than 100 basis points below the return on equity the Commission would otherwise set.

The allowable range of returns on equity in this case should include a range of 150 basis points below the level which would be set without penalties. Penalties for failure to provide satisfactory customer service, accurate bills, and satisfactory water quality to its customers should then be applied to that level to bring Aqua to the bottom of that range until the company sufficiently addresses and corrects these problems.

Issue 2: Should any adjustments be made to test year plant-in service balances?

Position: * Yes. Citizens agree with the following adjustments proposed by Staff. *

Discussion: Citizens agree with the findings of Staff witness Ms. Dobiac on the following adjustments to plant-in-service.

System	Account	Adjustment	Reason for Adj.
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Water			
Lake Suzy	Plant in Service	(\$526,322)	Unsupported Plant
Lake Suzy	CIAC	\$137,077	Corresponding CIAC Adj.
Sebring	Plant in Service	(\$20,122)	Unsupported Plant
Lake Osborne	Plant in Service	(\$3,289)	Unsupported Plant
Mobile Terrance	Trans./Dist. Mains	\$1,247	Correct Misclassification of Expense
Wastewater			
Lake Suzy	Plant in Service	(\$1,119,520)	Unsupported Plant

Tr. 942, 946, 947, 949.

Issue 3: Should any adjustments be made to test year land?

Position: * Yes. Citizens agree with Staff Audit Finding 18. *

Discussion: Land for the Lake Suzy wastewater system should be reduced by \$229,259 to reflect a 13-month average balance. Tr. 952-53.

Issue 4: Should adjustment be made to the Utility's pro forma plant additions?

Position: * Yes. The company's pro forma plant additions should be reduced by \$1,694,013. *

Discussion: Citizens recommend that the Commission reduce Aqua's pro forma additions to plant because the company has failed to demonstrate that the projects will be completed by the end of the proforma test year consistent with the recommendations of the Citizens witness Dismukes. Her adjustments were developed by assuming the company would expend 1/12th of its budget in each month until it reached completion in December 2008. Tr. 704. This assumption was necessary to evaluate the progress the company made in meeting its capital budget, as the budget did not contain project completion dates. The methodology used by Mr. Dismukes is consistent with the approach used by the Commission in the past to test the reasonableness of projected capital expenditures. However, unlike the utility in the case below, the company failed to provide a schedule of projected completion dates for the projects in its pro forma capital additions. Ms. Dismukes explained:

"In this particular instance the company did not have a, an expenditure path, . . ., in terms of how it was projecting it was going to expend those funds. And so in order to come up with a reasonable estimate of where they were as of July 31st, I felt that it was reasonable to examine those expenditures compared to a constant rate of expenditures over the 12-month period. Tr. 796.

In the last Southern States rate case, the Commission found an approach comparable to the one used by Ms. Dismukes reasonable:

The record supports an adjustment to the projected test year capital additions. Using the updated project status report provided by Ms. Kimball, we compared the differences between the budgeted and actual in-service

dates for all projects scheduled to be completed by December 31, 1995. This analysis is similar to the evaluation performed by Mr. Larkin and Ms. DeRonne, but has been updated through year-end 1995. It appears that SSU's capital projects are still approximately two months behind schedule. There were a number of projects listed on the updated project status report that were either booked as an expense or cancelled. While these projects were not factored into the analysis of the budget-versus-actual comparison of in-service dates, this fact also supports an overall adjustment to plant-in-service.

Based on the above, with the exception of one plant addition discussed below, we find OPC's proposed project slippage adjustment to be appropriate. Consistent with OPC's analysis, we have not made adjustments based on the utility's actual plant additions. On the contrary, we are merely recognizing that the utility's projections for 1995 were not accurate. Therefore, based on the testimony provided by Mr. Larkin and Ms. DeRonne, we have reflected the over-statement of project additions as of December 31, 1995, within the 13-month average calculation for the test year ending December 31, 1996. Thus, plant-in-service shall be reduced by \$2,398,545 for water and \$464,915 for wastewater in order to account for project slippage. Order No. PSC-96-1320-FOF-WS.

As in the case above, the company has failed to demonstrate that it will complete the projects as projected. In fact, an examination of the budget-compared-to-actual as of July 2008 shows that Aqua had only completed 35% of the projects in its proposed capital budget, yet seven months of the pro forma 2008 test year had elapsed. Exh. 65, Tab 25. Similarly, as Ms. Dismukes explained, the situation had not improved by September 2008. Even though Aqua was three-quarters of the way through the year, it had spent less than half the budget. Exh. 65, Tab 29, p. 78.

Mr. Griffin agreed that the company expenditures were slow during the first 9 months of the test year:

Q Okay. So through the first nine months of 2008, the amount spent is less than you were projecting for the last three months of 2008, is that right?

A That's correct. Tr. 1515.

Not only have the company's budgeted expenditures run behind schedule, the company consistently spends less than projected. In 2006, Aqua budgeted \$13.7 million for capital projects. By the end of 2006, it spent \$10.4 million, or 24%, less than it budgeted. In 2007, Aqua spent 6% less than budgeted. Tr. 704. Mr. Griffin agreed with the figures cited by Ms. Dismukes and agreed that the analogous figures of 14.2% and 0.6% cited in his rebuttal testimony were for all AUF systems, including those systems that are not part of this rate case. Tr. 1521-1523.

Citizens recommend that the Commission make four adjustments to the company's proforma plant additions.

First, using Ms. Dismukes' methodology, as presented on Exhibit 86, Schedule 18, the company's pro forma adjustment should be reduced by \$764,894 for projects which are behind in schedule.

Second, the Commission should remove the \$350,000 pro forma adjustment for the Village Water effluent disposal and \$400,000 for the Jasmine Lakes wastewater effluent pond project. According to Ms. Dismukes, at the time of the filing of her testimony these projects were no longer being undertaken. Tr. 705.

Third, administrative projects should also be reduced by \$101,673 to reflect a slower rate of completion than assumed by the company and by \$12,862 for the Customer Service Area Renovations¹ as this project has been cancelled. Tr. 705.

Fourth, Mr. Griffin testified that the Commission should reduce the capital budget for three projects that will not be completed in 2008: the alternative effluent disposal projects for Chuluota wastewater (\$50,000) and South Seas wastewater (\$80,000) and the SCADA telemetry system for Valencia Terrace water (\$25,000). Tr. 1494-1495; Exh. 144. The incremental impact of these adjustments relative to the recommendations of Ms. Dismukes is an additional reduction to the pro forma adjustment of \$64,583. Therefore, the Commission should reduce the company's total pro forma plant adjustment by a total of \$1,694,013.

In his rebuttal testimony Mr. Griffin provided an update to Aqua's pro forma capital budget with actual expenditures through September 30, 2008. Exh. 144. If the Commission determines that this budget is more appropriate, using the same methodology proposed by Ms. Dismukes discussed above, the Commission should reduce the pro forma plant by \$1,796,720 -- more than originally proposed by the Citizens. This results because although the company has completed some projects before the end of the year, there are many other projects where they have fallen further behind.

System	Project Description	Net Adjustment to Pro Forma
System-Specific Projects		
Carlton Village Water	Meter replacements	(26,799)
Chuluota Water	Meter replacements	(156,957)
Gibsonia Estate Water	Meter replacements	(18,893)
Jasmine Lakes Water	Meter replacements	(147,821)
Lake Gibson Estates Water	Meter replacements	(92,410)
Palm Terrace Water	Meter replacements	(136,402)
Picciola Island Water	Meter replacements	(15,278)
South Seas Wastewater	Misc plant equipment replacement - Consent Order	(29,802)
Sunny Hills Water	Meter replacements	(35,333)
Sunny Hills Water	Replace water pump and motor - Well #5	(2,960)
Tomoka/Twin Rivers Water	Meter replacements	(24,730)

¹ This adjustment has been agreed to by the Company. [Tr. 1494]

Village Water	Meter replacements	(14,811)
Welaka Water	Meter replacements	(10,635)
Zephyr Shores Water	Meter replacements	(56,474)
Total System-Specific Projects		(769,304)
Other		
Chuluota Wastewater	Alternative Effluent Disposal Project	(50,000)
Jasmine Lakes Wastewater	WWTP effluent pond rehabilitation	(400,000)
South Seas Wastewater	Effluent disposal	(80,000)
Valencia Terrace Water	Telemetry System	(25,000)
Village Water Wastewater	Effluent disposal site - Consent Order (under study)	(350,000)
Total Other		(905,000)
Admin	Allocate CIS, FIS, IS Admin using % Custs in filing	
	Aqua Spread – FIS	(19,989)
	Aqua Spread – IS	(32,265)
	Cust Serv Disp Area Renovations	(12,862)
	Desktop PCs	(900)
	Laptop PCs	(3,900)
	Network Infrastructure Enhancements	(15,000)
	Telephony; Avaya – Leesburg	(37,500)
Total Admin		(122,416)
Grand Total Pro Forma Additions		\$ (1,796,720)

Issue 7: What are the appropriate used and useful percentages for the water treatment and related facilities of each water system?

Position: * The appropriate used and useful percentages for water treatment and related facilities for the systems that have not been stipulated to by the parties are provided below. *

Discussion: The used and useful percentages for water treatment and related facilities should be calculated in accordance with the provisions of Commission Rule 25-30.4325, F.A.C. Tr. 299, 316. Proper application of this rule to the systems that have not been stipulated to by the parties results in the following used and useful percentages:

Water Treatment and Related Facilities		
County	System	Recommended U & U

Alachua	Arredondo combined	96%
Highlands	Lk Josephine/Sebr Lk	28%
Lake	Fern Terrace	56%
Lake	Silver Lk/Western Shores	89%
Lake	E Lk Harris/Friendly Ctr	49%
Lake	Hobby Hills	39%
Lake	Skycrest	67%
Pasco	Zephyr Shores	20%
Polk	Rosalie Oaks	10%
Putnam	Interlachen Lk/Park Manor	93%
Putnam	Welaka/Saratoga	53%
Seminole	Chuluota	86%
Volusia	Tomoka/Twin River	47%

Above recommendations have been rounded to the nearest percentages. Exh. 96.

To determine the proper capacity of the water treatment components of all of the water systems in this case OPC's engineer, Mr. Woodcock, inspected all of the systems, reviewed system permits, sanitary surveys, reviewed on-site O&M manuals and other data, as well as conducted rudimentary flow tests to verify well capacities when there was inadequate documentation of these capacities in the MFRs. Tr. 297-299, 301. These tests on the system pumps consisted of reading flow meters during their operation. Tr. 301. As a result of these inspections, reviews and tests, many adjustments were made to the company's filing which included adding wells when wells were omitted and increasing the capacity of some wells in accordance with the appropriate documentation or flow tests conducted on the wells. Tr. 301-302. The capacities of thirteen separate operating water systems were increased as a result of these inspections, reviews and tests. Tr. 301-302.

There were four instances where water systems were interconnected: East Lake Harris – Friendly Estates, St. Johns Highlands – Hermits Cove, Sebring Lakes – Lake Josephine and Welaka – Saratoga Harbour. Tr. 303. In each of these cases, it is necessary to calculate the used and useful percentages with the interconnected system operating together, as detailed in Exhibit 96. Tr. 303, 317. For the most part, this consists of calculating the firm reliable capacity using the combined wells of the systems. Tr. 303. However, in the case of Sebring Lakes-Lake Josephine, it was also necessary to combine the unaccounted for water analysis and growth factors based on a weighted average of the systems. Tr. 303.

Interconnected water systems generally operate as one system, so even though there may be two water treatment plants (one for each system), they provide capacity to the system as if they were a single water treatment system. Tr. 303. For used and useful purposes, this would require using the capacity of the wells for both water treatment plants and removing the largest well per Rule 25-30.4325, F.A.C. Tr. 303, 330. If the water systems are considered separately, the well at each water treatment

plant would be removed from the calculation and would overstate the used and useful percentage of the combined system. Tr. 303.

When the data of two or more separately operating water systems are combined in the MFR's, an individual used and useful percentage should be calculated for each stand alone system. Tr. 304-305, 317. After calculating the stand alone percentage, the systems should be combined, using the number of connected customers as a weighting factor, to produce an overall percentage for the MFR combined systems. Tr. 305, 317. Performing these calculations for stand alone systems combined for MFR purposes is consistent with Commission Rule 25-30.4325, F.A.C. Tr. 299, 316. Utilizing this proper methodology to the combined Ocala Oaks systems did not produce a material change to the overall used and useful percentage. Tr. 304-305. However, employing this correct methodology did result in a combined used and useful percentage of 47% for the Tomoka/Twin Rivers systems and 96% for the Arredondo Farm/Arredondo Estates systems. Tr. 305.

When fire flow is actually provided by a water system, it should be a part of the used and useful calculation. Tr. 306. In evaluating whether or not a system is actually able to provide fire flow, OPC's engineer reviewed the system maps submitted by the Utility. Tr. 306. His review consisted of looking for the presence of fire hydrants throughout the service area as well as evaluating the line sizes of the system that feeds the hydrants. Tr. 306. In cases where the hydrants were not located in sufficient numbers to cover the full service area or when the pipes for the hydrants were less than six inches in diameter, the system was considered not able to provide the fire flow and fire flow was not considered in the used and useful calculations. Tr. 306, 318. Based on his review, fireflow should not be considered in the following systems:

System	Problems with Fire Flow
Chuluota	Hydrants are not located throughout the service area.
Hobby Hills:	Maps show no fire hydrants or sufficiently sized lines.
Imperial Mobile Terrace	Maps show no fire hydrants or sufficiently sized lines.
Slv Lk Est-Western Shores	Hydrants are not located throughout the service area.
Skycrest	Hydrants are not located throughout the service area.
Sunny Hills	Hydrants are not located throughout the service area.
Tangerine	Hydrants are not located throughout the service area.

Tr. 206-307, 328.

As provided in subsection (4) of Commission Rule 25-30.4325, F.A.C., normally water treatment facilities for systems with one well will be considered 100% used and useful. Tr. 309. In 19 of the 22 one well systems in this case, Mr. Woodcock considered them to be 100% used and useful. Tr. 309. In the other three instances, he felt it was more appropriate to provide alternative used and useful percentages as permitted by subsection (3) of Rule 25-30.4325, F.A.C. Tr. 309, 316-317. The three systems that warrant an alternative calculation are the Fern Terrace system, which has a single 180 gpm pump and a calculated used and useful percentage of 56%; the Rosalie Oaks system, which has a single well 250 gpm and a calculated used and useful percentage of 10%, and the Twin Rivers system, which has a single well of 268 gpm and a calculated used and useful percentage of 28%. Tr. 310.

In determining whether an alternative calculation is appropriate for a single well system, the Commission should look at both the calculated used and useful percentage of the system that is being “considered” 100% used and useful, as well as the size of the supply well. Tr. 309. OPC’s engineer recommends that if the well is greater than 150 gpm and the calculated used and useful percentage is less than 75%, the Commission should further evaluate the used and useful percentage of the water treatment and related facilities. Tr. 309. This standard helps assure that alternative calculations only be considered for systems where further analysis would have a significant impact to the system in question. Tr. 309. The above criteria eliminates an alternative percentage which is relatively close to 100% without consideration of the system having one well. Tr. 309. With respect to the well pumps, Mr. Woodcock conservatively eliminates smaller capacity pumps where a small change in demand could have a large percentage impact on the used and useful percentage. Tr. 309. This recognizes the fact that a smaller well pump could easily approach 100% used and useful with only a few additional customers, whereas, a larger well serving the same customer base would not see as high of a used and useful increase. Tr. 309-310. Based on his review of the systems, he believes that 150 gpm is a conservative threshold to account for this. Tr. 310.

Mr. Woodcock admitted he had not analyzed the prudence nor determined the imprudence of the three water systems to which he recommends an “alternative calculation”. Tr. 336-338. For whatever reasons, in three instances, the company significantly failed to secure sufficient customers to utilize the water plants it constructed. This failure, which is completely outside of the control of the customers, has resulted in three water plants being materially underutilized in providing service to current customers and the statutory growth allowance.

Commission Rule 25-30.4325 (3), F.A.C., provides in part that: “An alternative calculation may also be provided, along with supporting documentation and justification, including ...factors involving treatment capacity...” It would be unfair to the ratepayers to automatically make treatment plant 100% used and useful for all one well systems without regard to the actual used and useful percentage of the treatment facilities. With the actual used and useful percentages for water treatment capacity at 10% (Rosalie Oaks), 28% (Twin Rivers) and 56% (Fern Terrace), the Commission should apply Rule 25-30.4325 (3), F.A.C., and use alternative calculations. Tr. 310, 340. To do otherwise would materially overstate the used and usefulness of the treatment facilities of these three systems.

Commission Rule 25-30.4325 (4), F.A.C. provides in part that: “A water treatment system is considered 100 percent used and useful if the service territory the system is designed to serve is **built out and there is no apparent potential for expansion of the service territory ...**” (Emphasis supplied). OPC’s and the company’s engineers differ on how to apply this provision of subsection (4) in their analyses of the used and usefulness of water treatment plant. First, their method of comparing the number of available lots to current customers differs. This subject will be addressed in the Discussion for Issue 10. Second, the company’s engineer, Mr. Guastella, recommends that if his ratio of ERC’s to total lots were found to be 90% or greater, after an allowance for margin reserve, then the system should be considered 100% used and useful. Tr.

284. Further, if in the opinion of Mr. Guastella a system is fully developed “as planned”, it too should also be considered 100% used and useful. Tr. 284.

After OPC’s engineer completed his comparison of available lots to current customers and the allowance for growth, the resulting ratio would be his recommended used and useful percentage, without rounding up or down. Tr. 310, 318. Mr. Woodcock disagrees with Mr. Guastella’s treatment of eight systems as being 100% used and useful because the systems are “fully developed as planned.” Tr. 312. Mr. Woodcock found that this criterion does not follow the “built out” language contained in Rule 25-30.4325 (4), F.A.C. Tr. 312. The rule states that a water treatment system is considered 100% used and useful if the service territory the system is designed to serve is **both** built out **and** there is no apparent potential for expansion of the service territory. Tr. 312. There are systems with underused treatment facilities that serve service territories that are built out or close to built out that have the potential to expand, that should not be considered 100% used and useful, because it is either not fully built out or there is a potential of expanding the service territory in order to utilize excess treatment capacity. OPC’s engineer found only four water systems that satisfied both of the criteria of being completely built out and having no potential for expansion. Tr. 312.

The engineers for the company and OPC stipulated to the used and useful percentages of 47 water systems, including many interconnected systems. As a consequence of their differences in applying Commission Rule 25-30.4325, F.A.C., there is disagreement concerning 19 water systems, including interconnected systems. OPC’s recommendation on the used and usefulness of these 19 water treatment facilities more accurately and fairly accounts for the percentage of the treatment facilities that are used and useful in providing service to current customers and the statutory growth allowance. OPC’s recommended used and useful percentages will help produce a revenue requirement and resulting rates that are just, reasonable, compensatory, and not unfairly discriminatory, as required by Chapter 367.081 (2)(a)1., F.S.

Issue 9: What are the appropriate used and useful percentages for the wastewater treatment and related facilities of each wastewater system?

Position: * The appropriate used and useful percentages for wastewater treatment and related facilities that have not been stipulated to by the parties are as provided below. *

Discussion: The used and useful percentages for wastewater treatment and related facilities should be calculated in accordance with the provisions of Commission Rule 25-30.432, F.A.C. Tr. 307, 318. Proper application of this rule to the systems that have not been stipulated to by the parties, results in the following used and useful percentages:

Wastewater Treatment and Related Facilities		
County	System	Recommended U & U
Alachua	Arredondo	77%

Lake	FI Central Comm Pk	44%
Lake	Kings Cove	55%
Lake	Morningview	25%
Lake	Summit Chase	42%
Lake	Valencia Terrace	56%
Lake	Venetian Village	30%
Lee	South Seas	47%
Polk	Rosalie Oaks	80%
Seminole	Chuluota	36%
Sumter	The Woods	61%
Volusia	Jungle Den	42%

Above recommendations have been rounded to the nearest percentage. Exh. 97

Mr. Woodcock's analysis of the wastewater treatment facilities consisted of reviewing the test year Discharge Monitoring Reports (DMRs) that are required to be filed monthly with the Florida Department of Environmental Protection (FDEP). Tr. 307. For many systems, he found that the DMR flows do not match with what is found in the MFRs. Tr. 307. However, in most cases it did not appear to be a significant difference. In his calculations, he used the flows that were presented in the DMRs. Tr. 307. The appropriate basis for the calculation was then determined from the system permits. In instances where the permit delineated two permitted capacities, one for treatment and one for effluent disposal, two separate used and useful percentages were produced. For these cases, he used the larger of the two used and useful values, unless there were unusual circumstances. Tr. 307, 318-321. Of the 25 wastewater systems, three receive treatment through agreements with other utilities and therefore no used and useful percentages were provided for these facilities. Tr. 307.

The company engineer's determination of the used and usefulness of collection lines materially impacted his recommended used and useful percentages for wastewater treatment facilities. Tr. 285, 356. If he could find a way to cause a collection system to be considered 100% used and useful, he would determine that the wastewater treatment facilities must also be considered 100% used and useful. Tr. 356. He employed numerous devices to help cause wastewater collection systems to be considered 100% used and useful, including employing his method for comparing available lots to connected customers, his recommendation to round up all used and useful percentages that exceed 90% to 100%, and his decision to consider systems 100% used and useful if there is no or virtually no room for growth where there are mains, or if nearly all of the lots are connected to mains. Tr. 285, 356.

In numerous instances, OPC's engineer determined that the actual wastewater treatment capacity to serve current customers plus the statutory growth allowance was less than 100%. Exh. 97. There were twelve such systems, with Morningview (25% U&U), Venetian Village (29.54% U&U) and Chuluota (35.63% U&U) having the lowest used and useful percentages, and Arredondo (76.67% U&U), The Woods (61.34%) and Valencia Terrace (56.25% U&U) having the highest used and useful percentages. Exh. 97. However, Mr. Guastella determined that all of the above twelve wastewater treatment facilities should be "considered" 100% used and useful because he

determined that all twelve of the wastewater collection systems should be "considered" 100% used and useful, regardless of the extent to which the wastewater treatment facilities were being utilities to serve current customers. Tr. 285, 356, Exh. 97.

In addition to the "built out" issue, a disagreement exists between the two engineering witnesses with regard to what is the appropriate capacity and resulting used and useful percentage of the Chuluota wastewater treatment plant. Tr. 318-321. company witnesses Lihvarcik and Luitweiler readily admit that after Aqua purchased the Chuluota system it immediately pursued construction, and by 2006 completed construction, of a new 400,000 gpd wastewater treatment plant (located on the same site as the old 100,000 gpd plant). Tr. 559-561, 1096-1097. They also admit that even by the end of 2008 the Chuluota wastewater treatment capacity is 400,000 gpd compared to an effluent disposal capacity of only 100,000 gpd. Tr. 560-561, 1096.

OPC's engineer determined that Chuluota's wastewater treatment plant is 35.63% used and useful, while the company's engineer recommends that it be considered 100% used and useful. Exh. 97, MFR Sch. F-6. While Chuluota's wastewater collection system can currently be considered built out, there are many areas within the service territory and areas contiguous to the service territory that can be provided wastewater service in the future, as well as governmental entities located nearby that could potentially purchase wastewater treatment from Aqua in the future. Whether it is appropriate to use Chuluota's actual designed capacity of 400,000 gpd or its FDEP permitted capacity of 100,000 gpd as the denominator of the used and useful fraction, accounts for the vast difference in the company's and OPC's recommendations concerning Chuluota's wastewater treatment used and useful percentage.

The company elected to quadruple the capacity of Chuluota's wastewater plant to 400,000 gpd, while leaving its disposal facilities unchanged at 100,000 gpd. Tr. 559-561, 1096-1097. For this reason, the wastewater plant's permitted capacity has remained unchanged and is limited by its 100,000 gpd disposal capacity. According to Mr. Woodcock, in making a used and useful determination, the Commission should look at the assets that are actually out there and what is the capacity of those assets physically. Tr. 321. Frequently, the two match up. Usually you see that a design capacity is the permitted capacity. Tr. 321. Chuluota is a special case, and that's why he considered the design capacity instead of the permitted capacity. Tr. 321.

As required by Commission Rule 25-30.432, F.A.C., the FDEP permitted capacity is usually used in the denominator of the used and useful equation. However, the rule expressly allows the Commission to consider other factors, including whether the permitted capacity differs from the design capacity. The company's election to create this mismatch between treatment and disposal capacities should not cause the Commission to grossly understate the actual treatment capacity that physically exists. This is particularly true since the company is attempting to recover all of its investment in this new wastewater treatment plant from its customers in this rate case.

Mr. Guastella and Mr. Woodcock have stipulated to the wastewater treatment used and useful percentages of 10 systems. As a consequence of their differences in applying Commission Rule 25-30.432, F.A.C., there is disagreement concerning 12 systems. Mr. Woodcock's recommendations concerning the used and usefulness of those 12 wastewater treatment plants more accurately and fairly accounts for the

percentage of the wastewater treatment facilities that are used and useful in providing service to current customers and the statutory growth allowance. OPC's recommended used and useful percentages will produce a revenue requirement and resulting rates that are just, reasonable, compensatory and not unfairly discriminatory, as required by Section 367.081 (2)(a)1., F.S.

Issue 10: What are the appropriate used and useful percentages for the water distribution and related facilities of each water system?

Position: * The appropriate used and useful percentages for the water distribution and related systems that have not been stipulated to by the parties are detailed below. *

Discussion: The appropriate used and useful percentages for the water distribution and related facilities that have not been stipulated to by the parties are as follows:

Water Distribution and Related Facilities		
County	System	Recommended U&U
Alachua	Arredondo Estates	89%
Highlands	Lake Josephine	66%
Lake	Morningview	88%
Lake	Palms Mobile Home Park	73%
Lake	Piney Woods	87%
Lake	Ravenswood	96%
Lake	Silver Lk Est/Western Shores	91%
Lake	Skycrest	68%
Lake	Valencia Terrace	91%
Lake	Venetian Village	75%
Pasco	Zephyr Shores	79%
Polk	Gibsonia Estates	92%
Polk	Orange Hill/Sugar Creek	94%
Polk	Rosalie Oaks	82%
Polk	Village Water	60%
Putnam	Beecher's Point	24%
Putnam	Palm Port	80%
Putnam	River Grove	95%
Putnam	Wootens	52%
Volusia	Tomoka	98%

Above recommendations have been rounded to the nearest percentage. Exh. 98.

For determining the used and useful percentage of the water distribution and wastewater collection systems, Mr. Woodcock used the equivalent residential connections (ERC) to available ERC method. Tr. 308. These calculations were determined based upon lot and customer counts from the maps provided with the MFRs. In his calculations, he assumes that the character of future development will be similar to that of past development in the service area, and that future development will

be as dense, with the same ratio of ERCs to developed lots, as is currently present in the service area. Tr. 308.

Mr. Guastella's used and useful calculations for the water and wastewater piping always uses the number of lots served by lines in the denominator. Tr. 310. For the numerator, he uses the greater of the customers identified on the MFR maps or the flow based ERCs. Tr. 310. This does not provide an accurate representation of the usage of the system, but seeks to achieve the highest used and useful percentages for the system. Tr. 310-311. When calculating used and useful, it is important to assure that the units of the numerator and denominator are comparable, or "apples to apples". Therefore, an appropriate used and useful calculation should use either developed lots to available lots or ERCs to available ERCs. Tr. 311.

Mr. Woodcock and Mr. Guastella also disagree on which systems are "built out" and that there is "no apparent potential for expansion of the service territory." These differences are addressed in the Discussion for Issue 7, including whether it is appropriate to round up or down the used and useful percentages of systems that are 90% used and useful, and whether a system should be deemed "built out" if it is fully developed "as planned."

The Commission should approve the used and useful percentages for the water distribution and related facilities of each system that has not been stipulated to by the parties based upon a fraction with comparable numerators and denominators, i.e., developed lots to available lots, or ERC's to available ERC's. This "apples to apples" comparison yields used and useful recommendations for water distribution and related facilities provided above.

Issue 11: What are the appropriate used and useful percentages for the collection lines and related facilities of each wastewater system?

Position: * The appropriate used and useful percentages for the wastewater collection lines of related facilities that have not been stipulated to by the parties are detailed below. *

Discussion: The appropriate used and useful percentages for the wastewater collection lines and related facilities that have not been stipulated to by the parties are as follows:

Wastewater Collection Lines and Related Facilities		
County	System	Recommended U&U
Lake	Morningview	93%
Lake	Valencia Terrace	97%
Pasco	Zephyr Shores	90%
Polk	Rosalie Oaks	96%
Putnam	Beecher's Point	51%
Seminole	Fla Central Commerce Pk	84%
Volusia	Jungle Den	92%

Above recommendations have been rounded to the nearest percentage. Exh. 98.

The different methodologies employed by the Citizens' and the company's engineers to determine the used and useful percentages of wastewater collection lines and related facilities are addressed in the Discussions for Issues 7 and 10. Additionally, in his testimony, Mr. Guastella only calculates a used and useful percentage for wastewater system piping to the gravity collection system, and not to force mains and lift stations. Tr. 311. Mr. Woodcock finds that this assumption ignores the fact that the collection lines, force mains and lift stations act as a system to convey wastewater from the customers to the wastewater treatment plant. Tr. 311. In evaluating the used and useful percentage of a wastewater system, prudent design would dictate that the lift stations and force mains are sized in a manner consistent with the gravity system. Therefore, if a collection system is 50% used and useful, it follows that the corresponding force mains and lift stations would have a similar used and useful percentage of 50%. Tr. 311. Therefore, the used and useful adjustment for wastewater collection lines and related facilities should always be applied to all collection lines, force mains and lift stations. Exh. 86., Schedule 28.

Using the proper methodology recommended by Mr. Woodcock will yield the used and useful percentages provided above for those wastewater lines and related facilities that have not been stipulated to by the parties.

Issue 12: What is the appropriate method for calculating the used and useful percentages of water treatment and related facilities for water systems that are interconnected?

Position: * A single used and useful percentage for water treatment and related facilities should be calculated for water systems that are interconnected so that the combined system can be evaluated as a single operating system. *

Discussion: See the Discussion for Issue 7 which addresses this issue.

Issue 13: What is the appropriate method for calculating the used and useful percentages of water treatment and related facilities of water systems that are actually stand alone systems that have been combined for rate base purposes in this proceeding?

Position: * After calculating the individual used and useful percentages for each stand alone system, the percentages should be combined, using the number of customers as a weighting factor, to produce an overall used and useful percentage for water treatment and related facilities of the MFR combined systems. *

Discussion: See Discussion for Issue 7 which addresses this issue.

Issue 14: Should any adjustments be made to test year accumulated depreciation?

Position: * Yes. Plant in service adjustments should be accompanied by an adjustment to accumulated depreciation as a fallout issue. In addition, Citizens agree with the specific adjustment proposed by staff. *

Discussion: Citizens agree with the following adjustments proposed by Ms. Dobiac:

System	Account	Adjustment	Reason for Adj.
Water			
Lake Suzy	Accumulated Depr.	\$108,901	Unsupported Balance
Sebring	Accumulated Depr.	\$4,005	Lack of Support Documentation
Lake Osborne	Accumulated Depr.	\$941	Lack of Support Documentation
Arredondo Estates/Farms	Accumulated Depr.	\$16,992	Lack of Support Documentation
Jasmine Lake	Accumulated Depr.	\$35,249	Lack of Support Documentation
Imperial Mobile Terrance	Accumulated Depr.	(\$58)	Correct Misclassification of Expense
Wastewater			
Lake Suzy	Accumulated Depr.	\$359,506	Unsupported Balance

Tr. 946-47, 949.

Issue 16: Should any adjustments be made to accounts receivable for officers and employees?

Position: * Yes. Accounts Receivable for officers and employees should be reduced by \$1,000 as these receivables are not necessary nor do they relate to the delivery of water and wastewater services. *

Discussion: Ms. Merchant testified that the \$1,000 for Accounts Receivable-Officers and Employees are not necessary, nor do they relate to the delivery of utility services. Additionally, the Commission has removed these types of costs from working capital in prior cases². Tr. 923-924. Aqua provided no testimony to rebut Ms. Merchant.

Issue 17: Should any adjustments be made to other deferred debits?

Position: * Yes. First, deferred debits should be corrected to reflect the appropriate unamortized balance of deferred maintenance. Second, deferred debits should be allocated to all of the company's systems instead of system specific charges. The total deferred debits that should be included in the working capital calculation should be \$217,890. *

Discussion: OPC disagrees with Aqua's specific assignment of deferred maintenance costs on a per system basis and also believes that the requested balance of deferred maintenance projects in aggregate is overstated. OPC witness Dismukes testified that

² See Order No. PSC-08-0327-FOF-EI, page 28, issued on May 19, 2008 in Docket Nos. 070300-EI and 070304-EI.

adjustments were necessary to reduce the test year amortization of deferred maintenance. See Issues 41 and 44. Consistent adjustments are also necessary to the balance of deferred maintenance in working capital.

Aqua's method of removing the deferred maintenance from the total company working capital is inappropriate and inconsistent with prior rate cases for companies with multiple systems³. Only extraordinary deferred assets have been specifically identified by system similar to the regulatory assets that Aqua has included in this case.

OPC witness Merchant testified that the company's proposed method to add deferred maintenance to any system's allocated working capital allowance is improper. While the amortization is appropriate on a system-specific basis, the deferred debit is recorded on a total company basis. To pull out certain items from the balance sheet approach for working capital is improper. This is no different than how net income, debt accounts receivables, payables, unbilled revenues or insurance prepayments are recorded on the total company balance sheet and allocated . Tr. 925-926.

Ms. Merchant also testified that the company uses the deferred debit funds on an as-needed basis and that working capital funds serve all systems in the company. One system may be a contributor to working capital while another system is a user. Working capital is a constantly flowing system of deposits and withdrawals and it is improper to single out just the deposits for individual systems with one-time deferred balances. Allocating utility-related common accounts on a consistent basis is the most economical and accurate basis, which generates a reasonable estimate of working capital for the total company. Tr. 924-926.

Utility witness Griffin stated that the company's method of tracking deferred debits by system was superior to Ms. Merchant's method. His reasons are that the company has underlying schedules to support the deferred debits, its method is rational and a supportable process, and it is inappropriate to create another allocation to spread the deferred debits to the total company. Mr. Griffin also stated that Ms. Merchant's testimony is contradictory because she recognizes that the expense is specifically identified but the deferred debit should be allocated and somehow that deferred debits are not shown on the balance sheet like net income and debt. Tr. 1504-1506.

Mr. Griffin's testimony doesn't make sense from an accounting perspective, as deferred debits are reported in total on the balance sheet as well as debt, but net income certainly is not a part of the balance sheet. He also ignored the fact that many of the balance sheet accounts can also be specifically identified on a system specific basis but are combined for determining a company's working capital requirement. Lastly, just because a company has a supporting schedule and believes that its method is rational does not justify why the long standing methodology of calculating working capital should be modified.

The company has requested a total balance of Other Deferred Debits of \$229,104. Based on Ms. Dismukes' adjustments, the requested balance of Other Deferred Debits should be reduced by \$11,213. This reflects a net balance of Other Deferred Debits of \$217,890. This adjusted balance of \$217,890 should be added to

³ See Order No. Order PSC-03-1440-FOF-WS, issued December 22, 2003, in Docket No. 020071-WS; and Order No. PSC-96-1320-FOF-EI, issued October 30, 1996, in Docket No. 950495-WS.

the total company working capital to be allocated among all AUF systems, including the systems not regulated by the Florida PSC. Tr. 925; Exh. 88 (PWM-2, Schedule 3(e)).

Issue 18: Should any adjustments be made to accrued taxes?

Position: * The company's requested negative (debit) deferred taxes should be adjusted to reflect a positive balance (credit) balance of \$657,340 that would normally belong in accrued taxes. *

Discussion: OPC witness Merchant testified that the 13-month average balance of accrued taxes in Aqua's working capital calculation was a negative \$1,155,342. She stated that instead of reflecting this liability account as a credit balance, AUF's books reflect essentially an asset or debit balance. Having a negative accrued tax account reflects an anomaly because of the large amounts of negative income taxes expensed during 2007, possibly because of non-regulated losses or having to write-off \$2.07 million in rate case expense related to the company's failed attempt to receive rate relief in its 2006 rate case. If a subsidiary participates in filing a consolidated tax return with its parent, the losing subsidiary's losses offset other corporate income tax owed. If those losses are offset, the subsidiary doesn't receive the tax loss benefits. This is what happened to create AUF's negative balance in accrued taxes. Tr. 927-929.

Aqua's negative balance of accrued taxes is a non-recurring anomaly that overstates the company's investment in working capital requirement. The staff auditors also questioned the derivation of the negative accrued tax balance, to what the amounts related, and what normalized test year level should be approved.

Because customers pay new rates, including income taxes, it is unfair for customers to also pay a return on negative accrued taxes. To remedy this, Ms. Merchant reflected a proforma \$657,340 balance (a \$1,812,682 increase to the company's negative balance) of accrued taxes to recognize the compensatory income taxes the company will receive. Exh. 88 (PWM-2, Schedule 3(e)).

Utility witness Griffin argued that the adjustment to deferred income taxes will offset the current taxes payable, thus decreasing the credit balance Ms. Merchant has calculated by \$395,098. Second, Ms. Merchant's adjustment was a full year effect. Had Ms. Merchant's adjustment been based on a thirteen month method, \$906,341 would be applied against the company's average accrued tax balance. Tr. 1510. These two adjustments total \$1,301,439 and would bring the balance in accrued taxes back to a negative balance of \$644,099.

The company failed to justify and completely ignores why the customers should pay higher working capital to support negative accrued taxes. Ultimately, the company has not met its burden to show why its requested accrued tax balance should be allowed. Ms. Merchant's estimate reflects a reasonable level of accrued taxes to be used to set future rates. This has not been disputed by the company, and the reasonableness of the \$657,340 amount used by Ms. Merchant is confirmed by the projected balance that the company requested in its last rate case. Tr. 933.

Issue 19: Should any adjustments be made to pensions and other operating reserves?

Position: * Yes. Pensions and other operating reserves should be increased by \$84,225, as these amounts are utility related and properly included as a reduction to working capital. *

Discussion: OPC witness Merchant testified that the average balance of Pension & Other Operating Reserves should be an additional liability included in the working capital calculation, as the accounts relate to utility operations. The Pension Reserve balance was included in the 2006 balance of Miscellaneous Current and Accrued Liabilities. However, the company did not include the balance of Pension Reserves or Other Operating Reserves in its 2007 liabilities. The company provided no testimony on this issue. Tr. 923; Exh. 88, PWM-2, Schedule 3(d)).

Issue 20: Should any adjustments be made to deferred rate case expense?

Position: * Yes. The appropriate balance of deferred rate case expense to be included in working capital should be \$399,301, which reflects one-half of the amount of rate case expense allowed by the Commission. *

Discussion: All parties and staff agree that the simple average balance during the 4-year amortization period of Commission approved rate case expense amount should be included in the working capital allowance. The appropriate amount of rate case expense is \$798,602, as addressed in Issue 52. Thus, the balance of deferred rate case expense to include in working capital should be \$399,301.

Issue 21: What is the appropriate working capital allowance?

Position: The appropriate working capital is \$812,792, which reflects a decrease of \$2,533,689 for all systems combined.

Discussion: The calculation of working capital is a summation issue subject to the resolution of other issues. As addressed in Issues 16-20, 41, 44, and 52, adjustments to working capital should be made for accounts receivable for officers and employees, other deferred debits, accrued taxes, pensions & other operating revenues, and deferred rate case expense.

Issue 22: Should a negative acquisition adjustment be included in rate base?

Position: * Yes, rate base should be reduced by \$1,892,074. The company knew when it purchased the Florida Water Service company systems that they were purchasing old and deteriorated systems that had not been maintained. These circumstances are extraordinary and warrant the inclusion of a negative acquisition adjustment in rate base. *

Discussion: On June 30, 2004, Aqua closed an agreement to buy land, facilities and certificates of Florida Water Services Corporation in Brevard, Highlands, Lake Orange, Pasco, Polk, Putnam, Seminole, Volusia, and Washington Counties. The purchase

price for these assets was \$13,038,951, and the rate base at time of transfer was \$15,741,914, resulting in a negative acquisition of \$2,702,963. Dismukes, Tr. 706-707.

If no adjustment is made in this case for a negative acquisition adjustment, customers will be paying depreciation expense on \$2.7 million of rate base for which Aqua paid nothing, as well as an overall rate of return on the existing plant balance for which Aqua paid nothing. Looked at another way, if no adjustment is made, Aqua will earn more than the rate of return set in this proceeding on its actual investment. In addition to all of that, customers are saddled with paying for the extra investment made by Aqua toward fixing the condition of these systems.

At the service hearings, Mr. Chris Franklin and Mr. John Lihvarcik made revealing comments about the condition of the assets purchased from Florida Water Services Corporation. At the first day of service hearings, Mr. Franklin described the systems purchased as "poorly capitalized and in many cases in decay and disrepair." He said that Aqua "faced immediately a triage situation where we had to decide where to spend our capital first to fix up these systems." Franklin, Palatka Service Hearing, Tr. 9. Five days later, he told customers in Sebring that the systems they purchased were "in large part in disrepair." Franklin, Sebring Service Hearing, Tr. 9. John Lihvarcik made similar comments at the last service hearing held at New Port Richey. According to Mr. Lihvarcik, the systems Aqua purchased "were decaying to a point that we had to make serious decisions about what to spend our capital on first. We focused first on meeting environmental compliance and water quality standards. Lihvarcik, New Port Richey Service Hearing, Tr. 14.

Other evidence corroborates the statements made by Mr. Franklin and Mr. Lihvarcik to customers at the service hearings. Mr. Lihvarcik and the company had the following comments about various systems:

Hobby Hills: "old, causing service line and main breaks;

Palms mobile home park: "old distribution system (which) requires a lot of maintenance;"

Valencia Terrace wastewater treatment plant: "old and requires numerous hours of operations to maintain optimum results;"

Tangerine water system: "the distribution system is aging and we have been receiving numerous service line and main line breaks. We are preparing plans to begin replacing the aging water mains and service lines;"

Pomona Park water system: "because of the age of the system we are beginning to replace the older service lines and water main."

Arrendondo Estates water: "we have numerous water service line and main breaks because of the age of the system."

Chuluota water system: "aging resulting in service line and water main breaks. Dismukes, Tr. 709-710

Before closing the purchase of the systems belonging to Florida Water Services Corporation, Preston Luitweiler wrote that "the steady stream of disclosures of issue over the past two weeks including the recent disclosure of the allocation issue at Chuluota has persuaded me that it will be essential to have someone who can focus on these issues from day one, preferably someone with good institutional knowledge of the issue, the FWS systems, and the Florida regulations and regulator." Problems with the

Chuluota system apparently got to the point that there was a suggestion by Aqua America that it might need to submit a claim for indemnification. In a letter to Mr. Roy Stahl of Aqua America from Mr. Forrest Ludsen (FWSC), the subject of Chuluota and indemnification arose: "Thank you for your letter of July 20, 2004. Needless to say, we do not agree with a number of the statements and conclusions which you have drawn, but we see no benefit to be derived by detailing the disagreements at this time. Florida Water is aware of the undertaking that it made with regard to the water quality incident in Chuluota that commenced on or about June 25, 2004, and intends to perform its obligation under the contract. If Aqua America determines to submit a claim for indemnification, we will review that claim and respond in accordance with our Agreement." Dismukes, Tr. 711-712.

The evidence brought forth in this case about the systems being in a state of decay and disrepair is quite different from the representations made to the Commission when the company asked the Commission to approve the purchase of the systems without recognizing an acquisition adjustment. At that time, the company told the Commission that it found the overall condition of the water and wastewater facilities to be in satisfactory condition and in general compliance with the requirements of the Florida Department of Environmental Protection. Order no. PSC-05-1242-PAA-WS issued December 20, 2005, at 6. The company also told the Commission that it was committed to providing its customers with the highest quality of water and wastewater service. *Id.* at 7.

The discussion on Issue 1 in this brief shows that the company utterly failed to meet that commitment to its customers to bring to them the highest quality of water and wastewater service. The company's own testimony in this case about the many systems being in a state of decay and disrepair refutes the representations made by the company in 2004 to induce approval of the purchases.

Based on the representations made by the company in the transfer docket, the Commission did not recognize an acquisition adjustment because (1) Aqua didn't request one, and (2) Aqua, in that case, did not identify any extraordinary circumstances. *Id.* at 22. The company may not have identified any extraordinary circumstances in the transfer docket; however, those circumstances are now abundantly evident in this case.

There is little doubt that Aqua was able to purchase the systems at a discount from book value because of the poor condition of the plant. This was all but admitted by Mr. Luitweiler when, in response to a question by Ms. Bradley, he stated that "the existence of problems in the system, compliance issues in the system, systems that need capital improvements, are an incentive for a buyer to sell at a lower price and a reason for a purchaser to expect a lower price." Luitweiler, Tr. 1119.

Rule 25-30.0371, F.A.C., provides that when the purchase price of a water or wastewater system is at least 80% of book value, a negative acquisition adjustment is not included in rate base unless there is proof of extraordinary circumstances. The condition of the assets acquired and the anticipated retirement of the acquired assets are two things the Commission considers when determining whether extraordinary circumstances have been demonstrated. Rule 25-30.0371(3)(a), F.A.C.

Here, the purchase price was slightly above the 80% threshold, so the test is whether there were extraordinary circumstances surrounding the purchase price at a discount from net value. At the time of purchase Aqua didn't request a negative acquisition adjustment and didn't identify any extraordinary circumstances, but why would it? Aqua had every incentive not to identify the extraordinary circumstances which are so evident in this proceeding because to have done so would have led to the recognition of a negative acquisition adjustment at the time of transfer.

The Commission should recognize the negative acquisition adjustment, to the extent allowed by Commission rules, based on the evidence in this proceeding. As it stands now, customers have received the worst of all scenarios. Customers are paying a return on and a return of \$2.7 million more in assets than Aqua paid for the systems. In addition, customers are paying for all of the additional investment Aqua has made to improve the systems bought in a state of decay and disrepair. And, after paying for all of that, customers receive bad service from Aqua.

The Commission can partly rectify this situation by recognizing 70% of the negative acquisition adjustment, or \$1,892,074. Rule 25-30.0371, F.A.C., provides that under no circumstance shall the purchaser be required to record on its books more than 70 percent of a negative acquisition adjustment. Therefore, even if the Commission recognizes the acquisition adjustment to the extent allowed by the rule, the company will still receive a return on, and return of, 30% of the acquisition adjustment.

This would not be the first time the Commission recognized an acquisition adjustment after initially approving a transfer without an acquisition adjustment. In the case of Jasmine Lakes Utilities, the Commission did not include an acquisition adjustment in the initial transfer case because the circumstances in the transfer case did not appear extraordinary at that time. Docket 900291-WS, order no. 23728 issued November 7, 1990. In the rate case proceeding that followed, additional evidence was presented to the Commission. The Commission found in that case it would have been patently unfair and unjust to the customers of Jasmine Lakes Utility for the investors to receive a return on that portion of the original purchase price that was less than rate base. In reaching that conclusion, the Commission relied on customer testimony, the need for repairs and improvements to the system at the time of the transfer, and the lack of responsibility in management. Docket 920148, order no. PSC-93-1675-FOF-WS issued November 18, 1993.

The Commission should do the same thing here. At the time of the transfer from Florida Water Services Corporation to Aqua, information was not provided to the Commission indicating the extent to which the purchased systems were in a state of decay and disrepair. Aqua told the Commission at that time the overall condition of the water and wastewater facilities was satisfactory and that it was committed to providing its customers with the highest quality of water and wastewater service. In this case, we have had ten service hearings where it has become overwhelmingly obvious that customers are not receiving the highest quality of water and wastewater service.

Even the company concedes that many of the systems were in a state of disrepair. This is new evidence unavailable at the time of transfer which the Commission should use to partially correct the injustice of requiring the customers to pay a return on and return of an investment that was not made by Aqua.

In the case of *Peoples Gas System, Inc. v. Mason*, 187 So.2d 335 (Fla. 1966), the Florida Supreme Court recognized the authority of the Commission to withdraw or modify an order based on adequate proof that such modification or withdrawal of approval is necessary in the public interest based on changed conditions or other circumstances not present in the proceedings which led to the order being modified. *Peoples Gas System* at 339. This is precisely the case in this proceeding because there is new evidence, unavailable in the transfer docket, which shows the extraordinary circumstances related to the negative acquisition adjustment. The First District Court of Appeal explained the *Peoples Gas System* case, and the case of *Austin Tupler Trucking, Inc., v. Hawkins*, 377 So.2d 679 (Fla. 1979), recognize an exception to the doctrine of administrative finality where there is a demonstrated public interest. The issue of prospective rate-making is never truly capable of finality. *Sunshine Utilities v. Florida Public Service Commission*, 577 So.2d 663, 666 (Fla. 1st D.C.A. 1991).

Customers have witnessed firsthand the problems associated with Aqua's dilapidated systems which have resulted in higher rates and water quality that is not fit to drink. Customers are being asked to pay for all of the investment made by Aqua toward fixing the systems and are, at the same time, bearing the brunt of bad water quality. It is too much to ask customers to also pay a return on and a return of an investment Aqua did not make. The Commission should recognize 70% of the negative acquisition adjustment, as allowed by its rules.

Issue 23: What is the appropriate rate base for the December 31, 2007, test year?

Position: * The appropriate rate base for the water operations is \$11,974,340 (excluding Tomoka/Twin Rivers) and the appropriate rate base for the wastewater operations is \$8,452,450.*

Issue 24: What is the appropriate capital structure to use for rate setting purposes?

Position: * The consolidated capital structure of Aqua America, Inc. should be used for rate setting purposes. *

Discussion: The Commission has two choices to determine the capital structure which will be used to set the rates paid by customers: It can use the actual, fully arms-length capital structure of Aqua America, Inc., which investors use to evaluate the stock offerings and credit worthiness of the company, or it can use the company created, equity-heavy capital structure of the subsidiary which serves little more than to increase the overall cost of capital for Florida customers. The actual fully arms-length capital structure selected by management, i.e. the actual consolidated capital structure of Aqua America, Inc., contains 44.03% common equity, 52.53% long-term debt and 3.43% short-term debt. Aqua Utilities Florida, in contrast, has requested an equity-heavy capital structure which contains 62.31% common equity. Rothschild, Tr. 126.

Holding companies with regulated subsidiaries have a special incentive to put extra equity on the books of regulated subsidiaries when the only point to such excess equity is to rationalize a higher than appropriate revenue requirement. Rothschild, Tr. 130. The capital structure of the subsidiary Aqua Utilities Florida is anything but arms-

length. There is no short-term debt whatsoever on the books of the subsidiary, and the long-term debt is simply a note between the subsidiary and the parent company. Anzaldo, Tr. 107. The company offered no substantive explanation for the reason that the less risky regulated subsidiary would require any more equity than the parent company, much less the extremely large difference between the equity ratio created for Florida of 62.31% and the equity ratio of 44.03% that the parent actually uses in the capital markets.

The Commission should use the capital structure that will balance safety and economy. The actual capital structure used by a company in the market is an indicator of what capital structures will produce the lowest overall cost of capital. Rothschild, Tr. 129 – 130.

Investors are most interested in the consolidated capital structure of a company. The company's witness Anzaldo grudgingly admitted that shareholders "mainly" look at the consolidated capital structure:

"Q. Would you agree that the capital structure shown on the consolidated statement of capitalization, that is the capital structure that is most -- in which investors are most interested?

A. It depends. When debt is issued as a subsidiary, they look at the subsidiary books also. But the shareholders mainly look at the consolidated, and S&P will look at the consolidated results also. I think they look at both. They look at us as a separate company and collectively what we do." Anzaldo, Tr. 224 – 225.

While investors may look to the capital structure of the subsidiary to evaluate debt issued by the subsidiary, Aqua Utilities Florida has no debt offered to the public. The sole debt in the subsidiary capital structure is a note to the parent. Shareholders, as well as Standard and Poors, look to the consolidated capital structure.

The capital structure at the parent company level is the capital structure where there is a true and complete interchange between outside equity investors and outside debt investors. Rothschild, Tr. 170. This is the capital structure which reveals what the company management chose to produce the lowest overall cost of capital. Rothschild, Tr. 160, 180.

The consolidated equity ratio of 44.03% takes into account all of the debt of the company, whether that debt is dedicated to particular projects in particular states, or not. A higher level of debt in one subsidiary doesn't affect the tradeoff between debt and equity at the parent level. Rothschild, Tr. 198. That debt dedicated to a particular state should be reflected as debt in that state, but the equity at the parent level supports all debt proportionately. Rothschild, Tr. 184, 206-207.

The Commission should not elevate form over substance by ignoring the consolidated capital structure when the utility is operated as a subsidiary. Rothschild, Tr. 193-194, 209. The dynamics between debt holders and equity holders remain the same whether the utility operates as a division or a subsidiary.

Issue 25: What is the appropriate amount of accumulated deferred taxes?

Position: * Accumulated deferred income taxes should be increased by \$830,318. This adjustment relates to the company's failure to consider the deferred tax impact related to proforma plant additions and allocated adjustments to increase plant for corporate IT and structures and improvements. *

Discussion: OPC Witness Merchant testified that the company admitted it did not include the deferred taxes in the capital structure related to the proforma additions to plant when the MFRs were originally filed. See Exh. 65 (no. 10), response to OPC Interrogatory 102. Ms. Merchant used the number provided by the company to recommend that deferred taxes associated with the pro forma plant adjustments for this case should be increased by \$830,318 (\$117,477 related to IT equipment and \$712,841 related to other 2008 proforma plant additions). Tr. 935-936. Ms. Merchant's calculations are reflected on Exhibit 88 (PWM-2, Schedule 4).

In his rebuttal, company witness Anzaldo criticized Ms. Merchant's adjustment stating that she used the year-end amount instead of the average taxes related to IT equipment and 2008 pro-forma additions, and inappropriately used total Florida values for taxes related to the IT equipment. Because the company used the half year convention for depreciation in the pro-forma rate base adjustment, it would not be appropriate to use the year end amount to adjust the average capital structure, according to Mr. Anzaldo. He also stated that the appropriate adjustment would be to use the average amount of \$356,421, for the 2008 pro forma adjustments.

Additionally, Mr. Anzaldo stated that the taxes of \$117,477 for IT equipment represents the total value for AUF, of which 65.85%, or \$77,353 should be allocated to systems included in the filing, then reflecting the average adjustment of \$38,677. Mr. Anzaldo also stated that Ms. Merchant's adjustment for 2007 Corporate IT and Corporate Structures and Improvements related deferred taxes of \$22,064 is duplicative. Citizens do not dispute this. Therefore, Mr. Anzaldo opined that the appropriate average deferred tax correction is \$395,098. Tr. 217-218.

There are several flaws contained in Mr. Anzaldo's rebuttal argument on deferred taxes. First, the amounts that Ms. Merchant used came directly from the company's response to Interrogatory 102 and the company did not revise its response to the interrogatory. It is unpersuasive for the company to change that answer in rebuttal testimony without documentation.

The company's argument about using the average versus the year-end is also flawed. This case is full of inconsistent treatment between average and year end test year adjustments. Witness Griffin stated if plant additions were made in the test year, those additions received average treatment. If the plant addition was made anytime during 2008 after the test year, the plant received full year treatment. Tr. 1518-1521. But proforma plant was depreciated on a half year convention, as well as the depreciation expense removal on retirements. See Exh. 180, MFR schedules A-3 and B-3, for any system. Taking all of the company adjustments as a whole and trying to fit this into a proper average test year is a model of inconsistency. The company cannot propose proper matching only when it suits them.

With respect to allocating all of AUF IT deferred taxes to only these systems filed in this rate case, that argument also does not hold water. The company was asked to

provide the proforma deferred tax adjustment on a per system basis in Interrogatory 102, and it failed to do so. Additionally, the company does not book pro forma plant adjustments per se – these are ratemaking adjustments calculated for the purpose of setting rates. Thus, the adjustments would not need to be made for a system that is not included in this current rate case. The company tried to make its case in its rebuttal testimony without documentary support. This adjustment should be denied because the company failed to meet its burden to show that the adjustment is appropriate.

Issue 27: What are the appropriate cost rates for short and long-term debt for the test year?

Position: * OPC accepts the 5.10% long term debt rate proposed by the company. However, if the Commission uses the consolidated capital structure for rate setting purposes, a computation using an allocation of the parent issued debt would be appropriate. *

Issue 28: What is the appropriate return on equity (ROE) for the test year?

Position: * If the Commission uses the consolidated capital structure of Aqua America, Inc., for rate setting purposes, the appropriate return on equity is no more than 9.47%. If the Commission uses the capital structure proposed by Aqua Utilities Florida, the appropriate return on equity is no more than 8.75%. *

Discussion: In rebuttal testimony Aqua's witness Moul described the tremendous turmoil in the financial markets we have recently experienced. Tr. 234. Although there has undoubtedly been an increase in financial market volatility, what Mr. Moul failed to recognize is the very different impact of the turmoil on the stock of Aqua America, Inc., compared to the market in general.

Exhibit 184 shows the dramatic drop of the S&P 500 index over the last year. At the beginning of 2008 the S&P 500 index was approximately 1450; at the time of the hearing, the S&P 500 index was 876.07 -- a drop of about 40%. Moul, Tr. 262 – 263. The one year low of 741.02, which occurred on November 21, 2008, was almost 50% below the value of the index at the beginning of the year. Exh. 184. The stock of Aqua America, on the other hand, has done extremely well compared to the index. In fact, compared to the 40% drop in the S&P 500 index, Aqua America was at approximately the same level at the time of the hearing that it was at the beginning of the year. Tr. 268, Exh. 186. Although there was some drop in the price of the stock of Aqua America during the first part of the year, there was a substantial rebound beginning in October, right at the time when the S&P 500 index was declining significantly.

These opposing movements of the market in general and the stock price of Aqua America can largely be explained by the flight to quality and safety which has occurred in the financial markets. At the time of the hearing, yields on one month and three month treasury bills were almost non-existent. Moul, Tr. 265. Yields on long term treasuries have declined as well. Moul, Tr. 266; Exh. 185. As of December 5, 2008, the 30 year treasury yield was 3.11%, which, except for the rate the day before, was the lowest rate in the entire year 2008. Exh. 185. Treasuries, of course, have the highest

quality rating, and the rates for treasuries are lower across the board. In the same vein, high risk securities have seen higher interest rates during this turmoil in the financial markets, while what is perceived as the lower risk corporate bonds are still paying very low rates. Rothschild, Tr. 163. For high risk companies, the reduction of the risk free rate is offset by an increase in the risk premium. Rothschild, Tr. 167. Those companies would be participating in the drop in the market, as many companies are struggling to earn any return at all. Not only did Aqua not participate in the overall drop of the S&P 500, but the stock price of Aqua increased substantially in the fourth quarter of 2008 just as the market was dropping and the yields on treasuries were dropping, as investors fled to safety.

All of this means that the cost of equity for utilities is now lower than it was at the time testimony was filed in this case, and this is particularly true for a water company providing such a vital service. Rothschild, Tr. 164. Equity returns for a water company are now in the single digit numbers. A cost of equity in the 9 percent range is appropriate today (Tr. 166), particularly when investors are willing to receive almost no return at all on short term treasuries and extremely low rates on long term treasuries.

Putting aside the effect of the recent financial turmoil, the actual earned return for large companies of average risk from 1926 through 2007 was 10.4 percent. Rothschild, Exh. 65, bates 2243. A credible number for today must be less than 10.4 percent. The question is how much less.

Mr. Rothschild's testimony filed on October 13 recommended that the Commission set Aqua's return on equity at 9.47% if the Commission uses the parent company capital structure, and at 8.75% if the Commission uses the capital structure created for the Florida subsidiary by the parent company. The recommendation is based on both a DCF and CAPM analysis, as well as two sensitivity analyses. His DCF analysis of comparable gas companies resulted in a range of 9.28% to 9.71%, and his risk premium/CAPM analysis resulted in a return on equity of 8.68%. Sensitivities to the DCF model included elimination of Equity Resources from the group of gas companies because of its substantial non-regulated activities, and a DCF analysis of Aqua America alone. Rothschild, Tr. 122 – 123. A DCF analysis of a gas company located in Rhode Island prepared by Mr. Moul, the witness for Aqua in this case, resulted in an indicated cost of equity in the upper 9s (Rothschild, Tr. 208), which is similar to the DCF results obtained by Mr. Rothschild for comparable gas companies in this case. See *also* Moul, Tr. 272 – 273.

With the acute flight to safety by investors which has taken place during the last few months, the recommendations made by Mr. Rothschild in October represent an upper bound on the return on equity which the Commission should approve.

If the Commission should nevertheless decide to use its leverage graph formula in this proceeding to set Aqua's authorized return on equity, there are two downward adjustments which should be made to the result obtained from the leverage graph formula. First, the leverage graph formula was promulgated by a staff recommendation dated May 8, 2008, and is based on data from March and April of 2008. The financial markets have changed markedly since that time. The 30 year treasury yield, for example, was 4.42% on March 3, 2008; 4.40% on April 1, 2008; and 4.49% on May 1, 2008. In contrast, the 30 year treasury yield on December 5, 2008, was 3.11%. Exh.

185. The Commission should make a significant downward adjustment to the leverage graph result in order to recognize the dramatic drop in interest rates that has taken place since the leverage graph was promulgated. Second, the leverage graph formula includes a small utility risk premium. The premium should be taken out of the formula in this case because it would not apply to Aqua. Exh. 65, bates 2214. At the time of the hearing, the market capitalization of Aqua America was well in excess of \$2.3 billion (Moul, Tr. 270 – 272), an amount far greater than the average water and wastewater utility company in Florida.

Issue 32: Should non-utility income be moved above the line for ratemaking purposes?

Position: * No. As long as non-utility expenses are correctly recorded below the line, it is not necessary to move non-utility income above the line. *

Issue 34: Should any adjustments be made to remove non-utility expenses?

Position: * Shareholder services of \$32,134 should be recorded as miscellaneous nonutility expenses and contractual services – other should be reduced by \$32,134. Test year expenses should be reduced by \$2,695 for Lake Suzy sewer consistent with Staff Audit Finding 15.*

Discussion: Citizens agree with Staff Audit Findings 12 and 15. Therefore, shareholder services of \$32,134 should be recorded as miscellaneous nonutility expenses and contractual services – other should be reduced by \$32,134 and test year expenses should be reduced by \$2,695 for Lake Suzy sewer consistent with Audit Findings 12 and 15, respectfully. Tr. 751.

Issue 36: Should any adjustment be made for charges from affiliates?

Position: *Yes. Test year expenses should be reduced by \$641,156 for the company's water operations and by \$329,646 for the company's wastewater operations for affiliated charges which are excessive when compared to other Class A water and wastewater companies that operate in the State of Florida.*

Discussion: The Commission should closely examine the relationship between AUF and its affiliates. In the absence of regulation, there is no assurance that affiliate transactions and allocations will not translate into unnecessarily high charges for AUF's customers. Tr. 675-76.

In addition, in the instant proceeding the company has claimed that there are economies of scale for the 82 water and wastewater systems that are part of the Aqua footprint. Both Mr. Franklin and Mr. Lihvarcik discuss the economies of scale of a being part of a bigger company which provides administrative support from its affiliated companies. Tr. 690-91. While in theory such an argument is appealing, the facts of the instant affiliate relationship do not show any economies of scale associated with the AUF systems being part of a larger organization. In fact, the evidence shows that the

opposite is true – there are diseconomies of scale associated with being part of the Aqua family.

These diseconomies were demonstrated by Citizens' witness Ms. Dismukes in her comparative analysis. As shown on Exhibit 86, Schedule 12, when compared to all Class A combined water and wastewater companies that operate in the State of Florida, AUF's costs are substantially higher than the average—just the opposite of what would be expected if there were economies of scale. Tr. 693.

AUF's water Operations and Maintenance (O&M) expense per ERC is \$293, compared to the average of all Class A water and wastewater companies of \$146 -- AUF's costs are more than 100% higher than the industry average. Of the 14 water companies depicted in Exhibit 86, Schedule 12, none have O&M costs per ERC which is higher than the company's costs. Tr. 693, Exh. 86, Schedule 14.

Likewise, with respect to the company's wastewater operations 2007 O&M expenses were \$450 per ERC compared to the average of only \$232, or 94% higher than average. Of the 14 wastewater companies shown, only two have higher costs per ERC than AUF. *Id.*

The Commission should be seriously concerned about the level of expenses charged to customers of AUF. Other comparable companies that operate under the same or similar conditions as AUF are able to operate with much lower expense levels. The comparable group used by Ms. Dismukes provides a wide distribution of water and wastewater companies that operate throughout the State of Florida. In fact, AUF operates in the same counties as the comparison group, in all but two instances⁴. Exh. 65, Tab 39, Dismukes Late-Filed Deposition Exh. 1.

AUF has provided no logical reason or explanation for why its costs should on average be 100% more than the average Class A water and wastewater company. Instead, Mr. Szczygiel complains that "there is no realistic way to verify in this proceeding that the comparison group used by Ms. Dismukes ... is an accurate and appropriate test group for purposes of setting AUF rates." Tr. 21. The company had ample time to file rebuttal testimony. Rather than develop an "appropriate test group", Mr. Szczygiel simply did nothing, most likely because all alternatives showed that the company's expenses were substantially higher than any reasonable comparison. Mr. Szczygiel claims that Ms. Dismukes comparison is not valid because only five companies have "the benefit of a service company." Tr. 1546. If anything, having more companies in the group that do not have "the benefit of a service company" should produce higher costs per ERC of the comparison group—indicating that Ms. Dismukes' adjustment is conservative.

Mr. Szczygiel also notes that Ms. Dismukes' exhibit did not contain Fern Crest. As noted on her schedule, at the time her schedule was prepared, Fern Crest's Annual Report had not been filed with the Commission. Exh. 86, Schedule 17. In addition, Mr. Szczygiel complains about the inclusion of North Sumter Utility because its costs are so low. Mr. Szczygiel is miffed about how North Sumter Utility can even operate. Without further evidence this is an unanswerable question, but not a sufficient reason to

⁴ AUF operates in DeSoto and Highlands County. There are no Class A water and wastewater companies that operate in these counties.

reject the analysis performed by Ms. Dismukes. If anything, it demonstrates the variety of companies included in her analysis. Moreover, if one were to exclude North Sumter from the comparative analysis for its low costs, one would also need to remove the highest cost company.

Even if the Commission were to adopt the recommendations of Mr. Szczygiel and exclude North Sumter and include Fern Crest in the analysis performed by Ms. Dismukes, the adjustment recommended by Ms. Dismukes would not change substantially. For the water operations the adjustment would be \$526,892, compared to Ms. Dismukes recommendation of \$620,868. For the wastewater operations there would be no change in the adjustment recommended by Ms. Dismukes because the disallowance is greater than the charges from AUF's affiliates.

In an attempt to counter the analysis performed by Ms. Dismukes, Mr. Szczygiel stated that "AUF has performed comparative cost reviews to test its efficiency and cost competitiveness with other large utility companies. A copy of that analysis is attached as Exhibit SS-18. Tr. 1549. This comparison, which Mr. Szczygiel suggests shows that charges from AUF's affiliates are reasonable, must be rejected as totally without merit and unsupported even by its sponsoring witness. Mr. Szczygiel admitted during his deposition that he knew nothing about the data submitted on this exhibit and it was not even prepared by him or under his direct supervision:

Q Mr. Szczygiel, let me ask you to turn to the Exhibit SS-18 attached to your rebuttal testimony.

A I'm there, Charlie.

Q How did you pick the companies that you used for the comparison?

A I didn't pick them. They were picked, let's say, by an outside law firm that we had engaged to do some research relative to service companies.

Q What research was that?

A I can't speak to it specifically. I wasn't the person that engaged the firm.

Q What was the reason for having the firm do that comparison?

A I would just be speculating if I gave you an answer.

Q What did you use as a source document for your exhibit?

A Well, I used the document that I attached. And as I look at that document, it says that -- what I'm assumed that people used was the FERC forms.

Q Mr. Szczygiel, are there any more documents other than these two pages?

A I don't know exactly. I would have to find out for you.

Q Did somebody provide this document to you that is your exhibit?

A Yes.

Q Who provided that to you?

A It was provided to me by Kim Joyce, our regulatory attorney. Exh. 65, Tab 32, Tr. 69-70.

Mr. Szczygiel also attempted to refute Ms. Dismukes analysis stating that she recommends an adjustment to affiliate expenses based upon her analysis of the "ratio of expenses to revenues." Mr. Szczygiel goes on to explain the flaws in such a comparison. Tr. 1548. Mr. Szczygiel's criticisms are totally unfounded, as the adjustment recommended by Ms. Dismukes is based upon cost per ERC, not a ratio of expenses to revenue. Tr. 697-98.

The Commission should reject all attempts by the company to refute Ms. Dismukes' analysis. As demonstrated above, the company's rebuttal was weak at best. The Commission should adopt the recommendations of Ms. Dismukes as the only credible analysis of the reasonableness of the charges from Aqua Services and Aqua America to the company. The adjustment recommended by Ms. Dismukes is soundly based upon an examination of the cost for salaries and wages, including salaries and wages of officers, benefits, and contractual services-management fee (these are the accounts which include the labor-related charges from Aqua Services) compared to other Class A water and wastewater companies. This comparison addresses the fundamental question of whether or not the labor-related charges from Aqua Services combined with the AUF's labor costs (both direct and allocated within AUF) exceed the going market rate when compared to comparably sized companies. Tr. 697.

Moreover, the company has not met its burden of proof. The Commission has clearly stated that the burden of proof lies with the utility on demonstrating the reasonableness of charges from affiliates:

"By their very nature, related party transactions require closer scrutiny. Although a transaction between related parties is not per se unreasonable, it is the utility's burden to prove that its costs are reasonable. Florida Power Corp. v. Cresse, 413 So. 2d 1187, 1191 (Fla. 1982). This burden is even greater when the transaction is between related parties. In GTE Florida, Inc. v. Deason, 642 So. 2d 545 (Fla. 1994) (GTE), the Court established that the standard to use in evaluating affiliate transactions is whether those transactions exceed the going market rate or are otherwise inherently unfair. (In re: Investigation of rates of Aloha Utilities, Inc. in Pasco County for possible overearnings for the Aloha Gardens water and wastewater systems and the Seven Springs water system." Commission Order No. PSC-01-1374-PAA-WS.

Therefore, the Commission must adopt the recommendation of Ms. Dismukes and reduce test year expenses for the water operations by \$641,156 and the wastewater operations by \$329,646 for the salaries, benefits, and management fees that are being allocated to the company from Aqua Services. Tr. 697-99.

Issue 38: Should any adjustments be made to advertising expenses?

Position: *Yes. The company included advertising expenses in the test year associated with image enhancement which the Commission has disallowed in the past. Therefore, test year expenses should be reduced by \$1,050.*

Discussion: During the test year the company expensed \$1,050 on an advertisement which is geared toward image enhancement and goodwill. The advertisement, which appeared in the Florida Insider magazine, includes the kinds of image enhancement advertising disallowed by the Commission in the past. The ad states: "Investing now in water quality ...before the well runs dry."⁵ Later in the ad there is a description of the company and how it is investing in Florida: "Aqua Utilities Florida is an investor-owned water and wastewater company whose business depends on sustainable water resources. Our capital spending for pumps, pipes, wells and treatment plants totaled approximately \$30 million between 2005 and 2007 – and we'll continue to invest in Florida's future in 2008." Tr. 727-28.

The Commission's policy is set forth in the order below:

"We agree with OPC that institutional or image advertising benefits the nonregulated portions of the business to a greater extent than the regulated operations and that the UTLD compensating payment is for benefits already funded by the ratepayers. We will continue our policy of excluding institutional or image advertising from the cost of service." Commission Order No. 24049.

The Commission should follow its precedent and disallow \$1,050 of advertising expenses included in the test year.

Issue 39: Should any adjustments be made to lobbying expenses?

Position: *Yes. Test year expenses should be reduced by \$39,387.*

Discussion: During the test year Aqua included expenses associated with Mr. George Lane, a rural marketing consultant and media management specialist. Mr. Lane provided the company with input on media articles and customer letters, managed situations where news media was involved, and assisted in potential acquisitions. In addition, the company utilized the services of Cynergy which provided legislative services to AUF. Tr. 728-29.

The company provided no rebuttal testimony on the lobbying charges by Cynergy and therefore it presumably agrees with the testimony of Ms. Dismukes. However, on the charges from Mr. Lane, the company claims that these expenses should be allowed because Mr. Lane recommended outlets for AUF to place required regulation notices and handled media situations. According to Mr. Szczygiel, "these are normal business operations." Tr. 1563. Mr. Szczygiel further claimed that Mr. Lane helped facilitate the purchase of water and wastewater systems and facilitated related meetings. *Id.* Neither of the functions performed by Mr. Lane should be charged to ratepayers. As addressed under Issue 48, the Commission has historically disallowed expenses associated with acquisition efforts. Concerning Mr. Lanes' recommendations about

⁵ Response to OPC Document Request 85.

outlets for regulation notices, there is no reason this could not have been handled by Aqua employees, as was apparently done during part of 2007 and will be in the future, since Mr. Lane has not been employed by the company since mid 2007. Tr. 729.

The Commission has historically disallowed such expenses in the past and should disallow the expenses incurred by Aqua. Accordingly, test year expenses should be reduced by \$39,387.

Issue 40: Should any adjustments be made for executive risk insurance?

Position: *Yes. Executive risk insurance should be reduced by \$12,339.*

Discussion: The company included \$12,339 of expenses in the test year for Directors and Officers Liability insurance. This insurance protects Aqua America's corporate directors and officers against claims, most often by stockholders and employees, alleging financial loss arising from mismanagement. The policies purchased by Aqua America contain two types of coverage. The first reimburses Aqua America when it is legally obligated (typically by corporate charter or state statute) to indemnify corporate directors and officers for their acts. The second provides direct coverage to directors and officers when the organization is not legally obligated to indemnify them. Tr. 733-34. In response to OPC Interrogatory 35, the company stated that for the period 2005-07, no claims were made against directors and officers and that no customers had ever filed a claim against an officer or director of the company. Tr. 734-735. Ms. Dismukes testified that customers should not be responsible for protecting the directors and officers of Aqua America. Since its stockholders are more likely to make a claim against the company, stockholders should absorb the cost. The Commission has agreed with this position in prior proceedings. Specifically, in a Mid-County rate case, the Commission found:

Mr. Larkin testified on behalf of OPC that Officers liability insurance is the type of insurance that UI pays to protect the officers of UI from being sued by the stockholders. There's no protection there for the ratepayer. If the stockholder is unhappy with the operation of UI because of something the officers did, if they sue the officers, they can't come to the ratepayer and say, "Our officers made a mistake. They ran this company into the ground. We're going to charge you." So there is no benefit to the ratepayer there. The same with the insurance that covers the pension plans, the ESOP plans. That's insurance to guarantee the fiduciary responsibility of those officers. If they don't treat those funds, or they waste or lose those funds -- the ratepayer is not responsible for replacing the pension funds. He's already made his contribution through his rates. If employees' pension funds go down the tube, then the people that are responsible are the officers, not the ratepayers. So the Staff correctly analyzed this, correctly took those dollar amounts out. To reargue this now is unfair to the ratepayer ... This is a policy that protects the Board of Directors from malfeasance in the operation of UI.

We agree with the utility that the NARUC USOA does not prohibit recovery of costs for premiums for Director/Officer Liability Insurance and ESOP & Pension Insurance. However, it does not automatically mean that the expense should be allowed. Mr. Larkin makes a compelling argument as to why this type of insurance should be disallowed. It appears to provide no benefit to the utility's ratepayers; only protection for its stockholders. The utility did not provide any persuasive evidence to contradict Mr. Larkin's claim. It is the utility's burden to show that its requested expenses are reasonable. *Florida Power Corporation v. Cresse*, 413 So.2d 1187, 1191 (1982). The utility has failed to prove the prudence of the costs related to the Director/Officer Liability insurance and the ESOP & Pensions insurance. Since they appear only to provide a safety net for UI's shareholders and no primary benefit to the ratepayers, we disallow \$ 1,738 for Director/Officer Liability insurance and \$ 310 for ESOP & Pensions insurance. Docket No. 971065-SS; Order No. PSC-99-1912-FOF-SS.

The Commission should continue with its past practice and disallow from the test year Directors and Officers Liability insurance in the amount of \$12,399.

Issue 41: Should any adjustments be made to contractual services – other and contractual services – testing expenses?

Position: * Yes. The Commission should reduce Contractual Services – Other by \$95,769 and Contractual Services - Testing by \$8,417. *

Discussion: The following Contractual Services–Other adjustments should be made:

Staff Audit Finding 17: Test year expenses for Village Water Wastewater should be reduced by \$11,841 for expenses for a permit that was never received. Tr. 751, Exh. 113.

Staff Audit Finding 10: Test year expenses should be reduced by \$10,065 consistent with Staff Audit Finding 10. Tr. 751, Exh. 113.

Staff Audit Finding 11: Consistent with Staff Audit Finding 11, Contractual Services-Other for Imperial Mobile Terrace should be reduced by \$4,986. Tr. 751, Exh. 113.

Leisure Lakes Water: Expenses should be reduced by \$2,348 for repairs and maintenance expenses that occurred during the test year that are not recurring. Ms. Dismukes testified that the company deferred and amortized such expenses for several systems in 2005. However during the test year, the company expensed similar repair costs all in one year. Therefore, the repairs and maintenance expenses should be amortized over three years to normalize the costs consistent with the company's treatment of similar repairs. Tr. 747.

Florida Central Commerce Wastewater: Test year expenses should be reduced by \$11,447 due to several abnormal expenses in the test year, including a large pond clean-up, repairs, grounds and pond maintenance, major maintenance for a pump, and lift station cleaning. Tr. 749.

Jungle Den: Test year water expenses should be reduced by \$1,000 for the repair of a water pipe. Wastewater expenses should be reduced by \$840 for lift station maintenance and cleaning. Both of these expenses are not normal recurring expenses and therefore should be amortized over three years. Tr. 750.

Sunny Hills Wastewater: Test year expenses should be reduced by \$1,575 in connection with a cleaning or pumping of the chlorine contact chamber of the sewer plant as that is not a recurring expense. Tr. 747-748.

Deferred Maintenance: During the test year the company included expenses associated with deferred maintenance that will be fully amortized by the end of the pro forma test year or should be amortized over a longer period of time. Ms. Dismukes recommended that test year expenses be reduced by \$22,632 to reflect the fact that 14 projects will be fully amortized before year-end 2008, and for nine projects, the company's amortization period was too short. Tr. 737-738; Exh. 86, Schedule 24.

With regard to the expenses with unsubstantiated shortened amortization periods, Mr. Griffin attempts to rebut Ms. Dismukes' recommendation in two areas. First, Mr. Griffin erroneously suggests that Staff Witness Mr. Winston agrees with the company's methodology of using three years instead of five to amortize maintenance and repair projects. Tr. 1507. According to Mr. Winston:

"Audit Finding 6 addresses the amortization of deferred debits. The audit work papers that are associated with the working capital allowance are filed with my testimony and are identified as Exhibit CJW-2. The Utility amortized the deferred debits accounts for the systems Grand Terrace, Picciola Island, and Jungle Den over three years. Commission Rule 25-30.433(8), Florida Administrative Code, provides that "nonrecurring expenses shall be amortized over a 5-year period unless a shorter or longer period of time can be justified." The Utility states that the deferred debits are comprised of permits and that these permits must be renewed every three years; therefore, a lesser period of time for amortization is justified." Tr. 1308.

It is clear from Mr. Winston's testimony that a shorter period of amortization is justified when permits are renewed every three years—not for all maintenance projects. Ms. Dismukes did not recommend a five-year amortization period for the water permits referred to above; in fact she recommended a 36-month amortization period consistent with Mr. Winston's recommendation. Exh. 86, Schedule 24. The disagreement lies with the other maintenance projects for Florida Central Commerce Park Wastewater, Harmony Homes Water, Imperial Terrace Water, Jasmine Lakes Wastewater, Lake Josephine Water, and Lake Suzy Wastewater, for which the company failed to show a shorter amortization period is justified. Therefore, to amortize those projects over three years instead of five overstates expenses. The Commission should adopt the five-year amortization period recommended by Ms. Dismukes. Tr. 737.

Second, Mr. Griffin disagrees with Ms. Dismukes recommendation that the company overstated test year expenses by failing to begin an amortization after the month the expense was incurred for Rosalie Oaks Wastewater, Summit Chase Wastewater, and Village Water Wastewater. In one instance, the company amortized an expense to clear the pond berm for the Village Water Wastewater system. The

expense was incurred in July 2004. Using a five-year amortization period, amortization would end June 2009. However, the amortization didn't begin until March 2005. The company then amortized the expense over the remaining period, leading to an amortization over 52 months instead of 60 and increasing the amortization amount—which increased test year expenses. Tr. 737.

For Severn Trent, an adjustment should be made for costs included in the test year associated with billings from Severn Trent because they are duplicative of services being provided by ACO in the amount of \$29,035 (This issue is also addressed under Issue 53). Tr. 715-716, Late Filed Exh. 215.

For contractual services-testing expenses, Ms. Dismukes testified that adjustments to the following systems should be made because test year expenses were abnormal compared to the 2005-07 three-year average: Fern Terrace Water \$474, Grand Terrace Water \$832, Jasmine Lakes Wastewater \$3,071, Lake Gibson Wastewater \$182, Pomona Park Water \$1,677, River Grove Water \$434, Zephyr Shores Water \$1,437. Tr. 746.

Although Mr. Szczygiel disagrees with Ms. Dismukes' recommendation, his rebuttal actually provides support for Ms. Dismukes recommendations. For example, Mr. Szczygiel claims that Fern Terrace's expenses were higher during the test year because there were outages due to electrical storms and that additional testing was required due to these outages caused by the storms. Because thunderstorms are a normal occurrence throughout the year in Florida, Mr. Szczygiel claims the abnormal expense should be allowed. However, what Mr. Szczygiel fails to consider is the fact that Ms. Dismukes' analysis compared the test year level of expenses to the prior two years and then only recommended an adjustment if the level of test year expenses increased by more than 25% compared to the three year average from 2005-07. Clearly, if the thunderstorms that caused the increased testing were normal recurring events, the same testing would have occurred in 2005 and 2006, which would not have yielded an adjustment by Ms. Dismukes. Tr. 746.

With respect to Jasmine Lakes Wastewater, the company claimed that additional sampling of the WWTP effluent for primary and secondary standards, as well as for sodium and chloride, was required. Also, the permit issued in 2006 required primary and secondary sampling of the effluent on an annual basis. Tr. 1557-1558. Again, Mr. Szczygiel's reasoning is flawed. The testing was required in 2006 and 2007 and therefore would have been included in the average used by Ms. Dismukes to develop her recommendation. Interestingly, Mr. Szczygiel never quantified the impact of the alleged new sampling requirements. Without further evidence the Commission should reject the company's claims and adopt the recommendations of Ms. Dismukes.

With respect to Pomona Park and Zephyr Shores water systems, Mr. Szczygiel claims that new wells were placed in service and AUF was required to test for these new wells. Tr. 1558. Again, the company failed to quantify the impact of this testing, and it failed to show that the testing was not a onetime event caused by the fact that new wells were installed. Therefore, the Commission should reject the company's claims and adopt the recommendations of Ms. Dismukes

Testing expenses should also be reduced by \$120 for the Rosalie Oaks wastewater system and \$190 for the Lake Suzy wastewater system consistent with Staff Audit Finding 16. Tr. 751, Exh. 113.

Issue 42: Should any adjustments be made to purchased power expenses?

Position: * Yes. Purchased Power Expense should be reduced by \$5,788 *

Discussion: Test year purchased power expenses should be reduced by \$1,993 caused by abnormal flushing. As Ms. Dismukes testimony shows, the amount of flushing that occurred during the test year in several instances was more than double the prior years and in a number of cases was more than 10 times greater than prior years. Tr. 746.

Mr. Szczygiel's attempts to rebut Ms. Dismukes' proposal have no merit and show his misunderstanding of her recommendations. For example, Mr. Szczygiel states: Ms. Dismukes is not allowing an expense related to flushing. It would not make sense to now reduce expenses of AUF for efforts to come into compliance with DEP standards. With respect to Tomoka / Twin Rivers, as addressed by DEP witness Patricia Carrico (pg 1 - 2), this system was cited for exceeding TTHM. Ms. Carrico, testifying on behalf of staff, indicates that increased flushing activities has resulted in AUF coming into compliance with these requirements. As I previously stated, Ms. Dismukes' recommended adjustment would penalize AUF for its efforts to address regulatory compliance. Tr. 1558.

Ms. Dismukes' recommendation does not penalize the company for flushing or coming into compliance with DEP requirements. Ms. Dismukes' recommendation amortizes the additional costs associated with this abnormal event over three years. The only instance in which the company's rationale for allowing the added expenses would be relevant is if the company was to be out of compliance with DEP requirements every year. Even under these extreme circumstances, the added costs should not be borne by customers as it would be considered imprudent to remain out of compliance with DEP year after year. The company only provided one example for one system where flushing was required by DEP for Tomoka/Twin Rivers. The flushing for Tomoka/Twin Rivers increased over 3,000% and the system achieved compliance; therefore, the levels of flushing should decrease going forward. For all other systems where Ms. Dismukes recommended an adjustment, the company provided no rebuttal testimony. Therefore, the Commission should adopt the recommendations of Ms. Dismukes and reduce chemical and purchased power expenses by \$1,993. Tr. 746.

In addition, the Commission should adopt the uncontested recommendation of Ms. Dismukes for the Lake Josephine water system and reduce power expenses by \$3,795 to recognize the higher level of expense due to abnormal flushing caused by rehab work. Tr. 747.

Issue 43: Should any adjustments be made to sludge hauling expenses?

Position: * Yes. Sludge hauling expenses should be reduced for the Sunny Hills sewer system by \$350. *

Discussion: During the test year the company incurred an abnormally high level of expenses which should be normalized. The Commission should adopt the uncontested adjustment of Ms. Dismukes and reduce sludge hauling expenses for Sunny Hills by \$350. Tr. 747.

Issue 44: Should any adjustments be made to maintenance expenses and materials and supplies expenses?

Position: * Yes. Materials and Supplies Expense should be reduced by \$3,829. *

Discussion: The Commission should make several adjustments to test year expenses.

First, expenses for the Oakwood water system should be reduced by \$197, because this expense account increased by over 95% from the prior year without explanation. Therefore, test year expenses should be reduced by \$197. Tr. 748.

Second, for the same reasons as given with respect to Oakwood, the Commission should reduce test year materials and supplies expense for Arredondo Estates wastewater by \$172. Tr. 748.

Third, the Commission should reduce test year material and supplies expense by \$3,324 for Imperial Mobile Terrace water due to abnormally high maintenance expenses incurred during the test year. Tr. 748-749.

Fourth, during the test year the company included expenses associated with deferred maintenance which will be fully amortized by the end of the pro forma test year. Accordingly, test year expenses should be reduced by \$136 for the Jungle Den wastewater system. Tr. 738, Exh. 86, Schedule 24.

Issue 45: Should any adjustments be made to fuel for power production expenses?

Position: * Yes. The Commission should reduce Fuel for Power Production Expense by \$7,450. *

Discussion: The Commission should make two adjustments to fuel for power production.

First, as agreed to by the company, the Commission should adopt Ms. Dismukes recommended adjustment for the Ravenswood water system and reduce fuel for purchased power by \$355. Tr. 749, 1564.

Second, fuel expense included in the test year is overstated due to the fueling of the generators purchased in preparation for hurricanes. The company has failed to demonstrate that these expenses are recurring on an annual basis. The Commission typically requires that costs associated with hurricanes be amortized over four years. Therefore, the additional fuel costs should be amortized over four years for the following systems: 48 Estates, Chuluota, Friendly Center, Grand Terrace, Haines Creek, Hobby Hills, Holiday Haven, Lake Josephine, Lake Suzy, Leisure Lakes, Ocala Oaks, Picciola Island, Rosalie Oaks, The Woods, Sebring Lakes, South Seas, Summit Chase, and Sunny Hills. Citizens recommend that the Commission adopt the recommendations of Ms. Dismukes and reduce test year expenses by \$7,095. Tr. 743-744.

Issue 46: Should any adjustments be made for chemical expenses?

Position: * Yes. Test year chemical expenses should be reduced by \$395 for abnormal line flushing. *

Discussion: Refer to the discussion under Issue 42. This adjustment is for the abnormal chemical expenses associated with excessive flushing. Tr. 746-47.

Issue 47: Should any adjustments be made to legal expenses?

Position: * Yes. Village Water legal expenses should be reduced by \$25,572. Jasmine Lakes' legal expenses should be increased by \$5,142. Legal expenses should be reduced by \$626 consistent with Staff Audit Finding 10. *

Discussion: Legal expenses were incorrectly booked to Village Water in the amount of \$25,572. These expenses should be removed. These legal expenses should have been charged to Jasmine Lake; however, the amount should be amortized over five years. Jasmine Lakes' legal expenses should be increased by \$5,142. Tr. 750. The company has agreed with the adjustments proposed by Ms. Dismukes; therefore, the Commission should adopt Ms. Dismukes recommendations. Tr. 1564.

The Commission should also reduce legal expenses by \$626 consistent with Staff Audit Finding 10 to remove prior period expenses allocated to the company by Aqua America, Inc. Tr. 751; Exh. 113, p. 22). The Commission historically disallows charges from prior periods.

Issue 48: Should any adjustment be made to salaries and wages?

Position: * Yes. Test year salaries and wages should be reduced by \$300,521. In addition, if the Commission does not adopt Ms. Dismukes' recommended adjustment for excessive affiliate charges, test year salaries and wages should be reduced by \$320,796. *

Discussion:

Acquisition-Related Salaries

The Commission should remove expenses related to the salaries and benefits for Mr. Carl Smith and Mr. Mark Kropilak. During the test year the company incurred wages and benefits for Mr. Smith in the amount of \$93,541. Mr. Smith is in charge of corporate development and acquisitions in the State of Florida. The company was also allocated charges of \$3,953 for Mr. Kropilak, who is in charge of acquisitions at the Aqua Services level. Tr. 730. Ms. Dismukes testified that the job descriptions for both of these individuals indicate that the functions they perform are not normal utility functions, but are instead associated with acquisition efforts which should be considered nonutility.

In his rebuttal, Mr. Szczygiel claimed that "...Mr. Smith's timesheets for the test year ended 2007, indicates that approximately 76% of his work hours were spent on matters other than acquisitions and corporate development." In an attempt to support this conclusion, Mr. Szczygiel attached copies of Mr. Smith's timesheets for 2007 as

Exhibit SS-13. Tr. 1538. However, an examination of these timesheets supports the conclusions and recommendations drawn by Ms. Dismukes. The time records show that of the 2,036 total hours, only 32 hours can be traced directly to AUF systems (for master planning and development matters), 1,179 hours were billed to "Wtr-General & Admin," 170 hours were billed to "Wtr-Customer Service," 188 hours were for paid time off, which leaves 467 hours tied to specific acquisition projects. Exh. 160. However, the company failed to provide any evidence that the hours Mr. Smith billed to the categories "Wtr-General & Admin" and "Wtr-Customer Service" were not related to acquisitions, tapping and coordinating main extensions outside the AUF service area, or working with developers on new satellite systems in Florida. Likewise, it is not clear that the 32 hours specific to AUF systems are related to utility functions, as opposed to development matters.

The company provided no rebuttal to the testimony of Ms. Dismukes on the salary allocated to the company from Mr. Kropilak.

The Commission has historically disallowed salaries and wages associated with acquisition efforts in other rate proceedings and it should continue with this practice in the instant proceeding. Tr. 731-732. In Southern States last rate case, the Commission found:

... [T]here is sufficient evidence in the record to indicate that the amount of acquisition related salaries recorded below-the-line was considerably lower than what should have reasonably been recorded. In effect, SSU conceded to this point in that the utility only disagreed with the portion of OPC's adjustment related to the percentage disallowance associated with Mr. Sweat's department. We do not find SSU's proposal to record 50 percent of this department's salaries and related expenses below-the-line to be reasonable. We note that 50 percent of Mr. Sweat's salary alone is more than what the utility originally recorded below-the-line. The record indicated that the level of effort expended on acquisitions has increased over previous years, but the amount of salaries SSU recorded be-low-the-line has decreased. We also note that SSU provided no evidence to support how its recommended 50 percent disallowance was determined, or any substantive basis as to why that percentage would be reasonable.

As in the case of salaries and expenses related to lobbying, SSU has shifted the burden of proof onto OPC to disprove the reasonableness of SSU's expenses by arguing that because OPC did not present historical time sheets or any other evidence, we should adopt the utility's suggested alternative. We reiterate that in a rate proceeding, it is the utility's burden to prove that its expenses are prudent and reasonable. Based on SSU's concession that the amount of acquisition related salaries recorded below-the-line was insufficient, in addition to the preceding discussion, we find that SSU has not met its burden of proof. While SSU argued that time sheets should be used as the determining factor, SSU did not adequately support its original estimate nor its proposed estimate with regard to the salaries for the corporate development section. Considering that Ms.

Dismukes used a conservative estimate to calculate the disallowance for all other employees who spend time related to acquisitions, we find that proposed adjustment to be reasonable. Therefore, test year expenses shall be reduced by \$175,928 for salaries and \$10,742 for related expenses. Commission Order No. PSC 96-1320-FOF-WS.

Citizens recommend that the Commission remove from test year expenses the acquisition-related salaries and benefits of Mr. Smith's charges in the amount of \$97,494 and Mr. Kropilak's charges in the amount of \$3,953. Tr. 783.

Meter Reader Salaries

Citizens agree with the company's adjustment to remove contract meter reader salaries in the amount of \$105,426 from test year expenses. Tr. 701. However, Aqua failed to recognize and include in the test year the additional cost savings that will be realized as a result of installing the radio frequency meters. These cost savings and benefits were discussed in the testimony of Mr. Franklin: "The RF meter will help ensure accurate usage reads which in turn, will result in fewer estimated bills." Tr. 427.

In addition, Itron, Inc. the company from which the RF meters were purchased, touts the following cost savings: "Other costs associated with manual meter reading that are all but eliminated with automation include salaries, benefits, vehicle costs, cellular phone expenses, handheld meter reading systems, maintenance and some general overhead expense, etc." Tr. 700-701. Other areas of cost reduction identified by Itron included: Reduction in accounts receivable, substantial reduction in re-bill costs, decreased customer calls and abandoned calls, increase in overall customer service satisfaction, minimizing employee safety and security concerns, increased leak detection, and increased revenues through accurate reporting of consumption. Tr. 701.

Ms. Dismukes testified that the company failed to recognize additional costs savings associated with installation of the RF meters. In addition, the company failed to demonstrate that the employees that will no longer be performing these meter reading functions will be productively utilized in another capacity or that they will not replace other employees. Tr. 703. Replacing other employees is consistent with the company's admission that due to current economic conditions it will be reducing expenses. Tr. 1517. Therefore, to recognize future cost savings Ms. Dismukes recommended that the Commission remove \$55,813 from test year salaries and wages related to the employees' time that will no longer be utilized for reading meters as a result of AUF's radio frequency meter conversions. Tr. 701-703⁶.

Considering the many avenues AUF has to realize savings, incorporating only the direct savings from elimination of outside contractors used for meter readings prior to the RF conversion substantially understates the benefits of moving to RF meters. Rather than ignore the cost savings associated with converting to RF meters, Citizens recommend that test year expenses be reduced by an additional \$55,813.

South Seas Outside Contractor

Aqua included a \$102,276 pro forma adjustment for a new contract operator at its South Seas system. However, it failed to reduce the salaries and wages of employees

⁶ This adjustment only removes the allocated salary associated with meter reading, not the entire salary of the employees in question.

that would be displaced as a result of the contractor. Mr. Szczygiel admitted to this omission during cross-examination:

Q And you have an adjustment to test year to increase the expenses by \$102,276 for a new operator at South Seas.

A That is correct.

Q Okay. Could you explain the basis for that adjustment?

A That was to have a contractor basically work at the South Seas operations. The South Seas operations are rather remote relative to our other operations, and it was felt through our operations group that it was the best decision to hire a contractor to oversee that plant. Tr. 415.

However, the company made no offsetting adjustments to test year wages and salaries for the fact that in-house employees would no longer be used to perform the services now being provided by the contract operator.

Q Okay. But you would agree you've made no adjustment to take out those expenses that are being replaced by the contract operator.

A Those expenses were reallocated to another system.

Q And what system was that they were allocated to?

A I believe it was Lake Suzy, but I'm not exactly sure. I'd have to recollect that one.

Q And do you have an adjustment somewhere that shows that or other, have you otherwise addressed that in your testimony?

A No, it's not -- I have no other adjustment. Tr. 417.

While the company suggests that the employee will or has been reallocated to another system, it is clear from the testimony of Mr. Szczygiel that no adjustment was made to test year expenses to remove these salaries, wages and benefits from South Seas. In addition, Mr. Szczygiel did not know where the person might be reallocated to, or if he would be reallocated at all. Therefore, the Commission should remove \$39,514 from South Seas' associated with the salaries, wages, and benefits associated with the employee that is no longer providing services to South Seas.⁷ Exh. 180, Vol. 1, South Seas MFR, p. 57.

Prior Period Allocation

Citizens recommend that consistent with Staff Audit Finding 10, pension and benefits should be reduced by \$1,540 for a prior period allocation from Aqua America. Tr. 751.

Issue 49: Should any adjustment be made to miscellaneous expenses?

Position: * Yes. Citizens agree with Staff. *

⁷ For South Seas, the total amount of direct expenses for Account 701 Salaries and Wages – Employees for 2007 was \$44,380 plus benefits \$(4,866.)

Discussion: Consistent with Staff Audit Findings 10 and 14, miscellaneous expenses should be reduced by \$24 and \$1,345, respectively. Tr. 751; Exh. 113, pp. 22, 36.

Issue 50: Should any adjustment be made to bad debt expense?

Position: * Yes. The company's test year bad debt expense is overstated due to numerous billing problems, meter misreads, and temporary suspension of collection efforts. Bad debt expense should be reduced by \$106,049.*

Discussion: AUF experienced abnormally high bad debt expense during the test year. It would be inappropriate for the Commission to require AUF's customers to pay for bad debt expense that will not or should not be incurred on a going-forward basis.

During 2007 the company experienced a bad debt to revenue ratio of 1.5%. This compares to the average for Commission-regulated Class A water and wastewater utilities that operate in Florida of 0.3%—a difference of 400%. In other words, AUF's bad debt as a percentage of revenue is 400% more than the average Class A combined water and wastewater company operating in the state of Florida. Using a comparison of bad debt per customer AUF's cost of \$5.26 compared to the average for all Class A companies of \$.94 yields a difference of over 450%. The difference between the company's bad debt and the average for comparable companies is significant and clearly demonstrates that the company's test year bad debt is abnormally high and should not be used to set rates. Tr. 739, 742. Likewise, prior years' bad debt expense is abnormally high due to the same problems that plagued the test year. Any suggestion that prior years data should be used to establish a normal level of bad debt expense should be rejected outright.

The company's higher than average bad debt is caused by events that should not recur into the future or are caused by problems which are solely the company's fault and should not be borne by its customers. Problems during the test year and in prior years which are undoubtedly causes for the significant bad debt expense carried by the company include numerous billing problems Ms. Dismukes testified that customers experienced significant billing problems associated with a change in the billing system as well as errors and omissions in the company's billing process. In addition, the installation of new meters contributed to billing errors and problems which contributed to higher than normal bad debt write-offs. Exhibit 86, Schedule 3 details the complaints filed at the Commission since the last rate case. Of the 179 complaints, 67% dealt with billing issues. Tr. 740.

The company admitted that it had significant billing problems, and its response to this was to install Radio Frequency meters. Mr. Griffin explained:

At the service hearings held in AUF's last rate case, there were numerous customers who expressed concerns over the accuracy of the meters, the accuracy of the meter readings, and whether the meters were being read. Throughout these service hearings, the Commissioners, Commission staff, and the OPC also expressed concerns over these meters. In response to these concerns, AUF made a decision to aggressively replace all of these aging meters with new RF meters. Tr. 1485-1486.

In response to questions about billing problems Mr. Franklin explained that the installation of RF meters would help ensure that billing and meter reading were “pristine” going forward.

Q. Were you aware that a number of people came to the hearings and complained about errors in bills and bills that were way in excess of what the actual amount used was?

A. I am aware that a number of people talked about billing errors, and we discussed at some length the complicated issue that occurs in a transition that occurs from one meter to the next. And I think the company has worked very, very hard to correct those errors and has replaced all the meters throughout the State of Florida under the AUF umbrella in an attempt to make sure that billing and meter reading are pristine moving forward. Tr. 1182.

The final conversion to the new billing system, the company’s awareness of its billing problems, combined with its new radio frequency meters should all result in a substantial reduction to the company’s bad debt expense. To account for this reduction on a going-forward basis, the Commission should adopt the recommendations of Ms. Dismukes and establish a normal level of test year bad debt using the average bad debt expense to revenue ratio and bad debt expense per customer for all Class A companies of \$25,242. This compares to Aqua’s test year bad debt of \$131,291. Tr. 742-43; Exh. 86, Schedule 25. Accordingly, bad debt should be reduced by \$106,049. Tr. 743. This methodology is consistent with the Commission’s finding in Docket No. 940109-WU, involving St. George Island Utility Company, Ltd, Order No. PSC-94-1383-FOF-WU, where the Commission used a methodology which examined “an amount [of bad debt] comparable to that experienced by other Class B utilities.

Issue 51: Should any adjustments be made for unamortized debt issuing costs?

Position: * An adjustment to unamortized debt issuance cost of \$1,345 should be made. *

Discussion: Citizens agree with Staff Audit Finding 14 that an adjustment to unamortized debt issuance cost of \$1,345 should be made. Tr. 751.

Issue 52: What is the appropriate amount of rate case expense?

Position: * The company’s requested rate case expense of \$1,778,586 is inflated and should be reduced by \$979,984 for a maximum allowable amount of \$798,602 *

Discussion: Citizens would note that in response to testimony on rate case expense, the company agreed to remove \$75,667 in legal and consulting fees which Ms. Dismukes found to be unreasonable. Tr. 775-79; Exh. 195. However, as addressed below, there are still additional costs which must be removed.

First, all costs associated with responding to the Staff’s MFR deficiencies should be removed. In Late-Field Exhibit 195 the company agreed to the removal of \$34,416 associated with responding to deficiencies as identified by Ms. Dismukes. Exh. 194, 195. However, the company failed to identify all costs associated with responding to the

Staff's deficiencies. The additional costs of \$45,954 were identified by Ms. Dismukes and depicted on Exhibit 194. Therefore, rate case expense should be reduced by \$80,370 associated with responding to deficiencies.

Second, all costs associated with bringing unnecessary Aqua persons to the service hearings should be disallowed. It is unclear why AUF needs an entourage to attend these service hearings. If it is an attempt to overcome Aqua's "out of town" feel, this is a cost Aqua should bear as it is akin to goodwill and should be borne by stockholders. Tr. 751.

Third, the Commission should remove the consulting fees of Mr. Prettyman of AUS for the work performed on the company's billing analysis. These costs should not be passed on to ratepayers. This effort was undertaken because of the company's past billing problems. The letter from Mr. Prettyman on the scope of services to be provided specifically included "...rather extensive analysis of some problem areas". Tr. 752. Many of Mr. Prettyman's tasks and work effort were required because of past billing errors and meter reading problems. Mr. Pettyman's tasks also involved review of the impact of the interim rates that were awarded in the last rate case that was withdrawn—these costs should not be included in the instant rate case.

In addition, if it were not for the company's billing and meter reading problems, the billing analysis performed by Mr. Prettyman could have been performed in-house without the need for an outside consultant. The consulting fees from AUS should be reduced by \$67,950 for these excessive charges. This amount is the result of Mr. Prettyman's total hours times the difference in his hourly rate of \$175 and the hourly rate of AUF's in-house consultants of \$100. Exh. 194, Tr. 753, 777.

Fourth, all costs included in the rate case associated with producing unnecessary hard copies of documents that were available electronically should be disallowed. This would include the costs of printing and compiling the documents as well as the persons that monitored the on-site reviews at the law office of Holland and Knight. This tactic not only created more costs for ratepayers, it also caused OPC to expend valuable resources to review documents which could have been provided more efficiently in an electronic format without all the wasted paper. An examination of the legal bills submitted by the company showed that at least \$6,984 was expended by the Holland and Knight law firm to produce hard copies of the documents which the Citizens' requested electronically. Ratepayers should not bear this cost. Tr. 753, 777; Exh. 195.

Fifth, the firm of Holland and Knight expended \$10,785 on matters relating to Lake Suzy legal issues which are not related to the rate case. A review of the legal bills shows that these costs were incurred due to ownership issues (Lake Suzy was owned by a Texas company) that required resolution. If these issues had been resolved at the time of acquisition, they would not be included in rate case expenses. In addition, these legal fees which were billed at higher hourly rate (\$420 versus \$365 for the rate case) and were not billed with other rate case legal expenses. Clearly, these costs (\$10,785) should be removed from rate case expense. Tr. 776-77.

Sixth, while the company agreed to the removal of expenses related to ethical issues associated with the employment of Mr. Rendell in the rate case, it failed to remove all of the expenses. In Exhibit 95, the company agreed with Ms. Dismukes that \$5,072 should be removed from rate case expense associated with these matters.

However, Exhibit 195 contained new invoices not contained in Exhibit 171, SS-24. An examination of these new invoices indicates that an additional \$3,565 must be disallowed. Exh. 195.

Seventh, AUF included legal fees associated with Holland and Knight's monitoring and possible intervention in the Commission's leverage formula proceeding. These costs were not required for, nor should they be considered part of, the rate case. Therefore, \$2,353 of Holland and Knight legal fees should be disallowed.

Eighth, legal fees associated with the substitution of counsel should be removed. This is a cost that should be borne by the company not ratepayers. Customers are already bearing the start-up costs associated with two sets of lawyers, to add the cost to substitute new counsel is inappropriate. Therefore, legal expenses should be reduced by \$160. Tr. Ex. 195.

Ninth, the company included considerable estimated hours above and beyond fees incurred through November 2008 to complete the case. An examination of these hours indicates that they are unreasonable given the work performed by the consultants and the amount of work required during and post hearing. Therefore the following expenses should be disallowed: \$8,200 for Mr. Ward, as his hours were budgeted at 242 to complete the case, Citizens believe that given his role in the proceeding that 160 is more reasonable; \$12,800 for Mr. Pasceri who estimated 240 hours—Citizens believe 80 hours is more reasonable, \$13,200 for Mr. Griffin who budgeted 252 hours—Citizens believe 120 is more reasonable; and \$9,520 for DTF Solutions who budgeted 199 hours—Citizens believe 80 hours is more reasonable. Tr. 779; Exh. 195.

In total, the above disallowances amount to \$181,381 above and beyond the \$75,667 the company's has agreed to remove from its original rate case expense request. Nevertheless, the Commission should consider this to be a minimum disallowance as not all of the Citizens' disallowance recommendations have been quantified.

However, the Commission should only pass on to customers 50% of the resulting minimum prudent rate case expense of \$798,602. Citizens recommend that rate case expense be shared 50/50 between stockholders and ratepayers. There is no reason to require customers to bear the entire burden of rate case expense. As Ms. Dismukes testified:

Customers do not directly benefit from a rate case and are not the party asking for rates to be increased. Aqua is the party asking for rates to be increased. Furthermore, the beneficiary of increased rates is predominately the company's stockholders. A primary motivation for filing a rate increase is to increase shareholder wealth. Tr. 757.

The practice of sharing rate case expenses between customers and stockholders has been found reasonable in other jurisdictions. In a recent case for Jersey Central Power and Light, the Board Staff noted that "[w]hile a rate case benefits the ratepayers through the continuation of safe, adequate and proper utility service, it also benefits shareholders, because the company has a renewed opportunity to earn a fair return on

equity.”⁸ In addition, the sharing of rate case expense will help ensure that the company holds down rate case expenses. Other states which have found sharing to be reasonable include Illinois⁹ and Minnesota¹⁰. Interestingly, one of the company’s witnesses in this proceeding, Mr. Prettyman, testified in a recent New Jersey case that he would not oppose the Staff’s testimony that rate case expense be shared equally between stockholders and ratepayers. Tr. 759.

Citizens recommend that the Commission adopt the recommendation of Ms. Dismukes that rate case expense be shared equally between stockholders and ratepayers. Therefore, the maximum rate case expense the Commission should allow is \$798,602.

Issue 53: Should an adjustment be made to the Utility’s normalization adjustments?

Position: *Yes, a number of adjustments should be made. *

Discussion: The Commission should make a minimum of seven changes to the company’s requested normalization adjustments. It should be noted that for the majority of the adjustments proposed by Ms. Dismukes, the company presented little or no direct testimony. In addition, as Ms. Dismukes testified, the company failed to provide workpapers supporting the adjustments in response to the Citizens’ discovery. Providing such information in rebuttal is too little too late. The company bears the burden of justifying all expenses, including proposed pro forma adjustments. The company has failed to meet this burden and the following adjustments should be made or disallowed.

Lake Suzy Land Lease

According to the direct testimony of Mr. Szczygiel, the company made an adjustment for a new lease of land associated with the Lake Suzy plant. Tr. 392. No other information was presented in the company’s testimony other than a partial sentence that there was a new land lease. The adjustment proposed by the company reduced test year expenses for Lake Suzy by \$22,615. However, according to Ms. Dismukes, after examining the workpaper supporting this normalization adjustment, it became apparent that the company reduced the lease revenue by an alleged loss on the sale of related property. The company did not justify why customers should absorb the alleged loss or that a loss was even incurred. Staff’s Audit Finding 18 found, after correcting the company’s general ledger for the value of the land, that there was not a loss, but instead a gain on the sale. After removing the loss and including the gain of the lease payment, test year expenses should be reduced by \$27,056¹¹. Tr. 714-15.

Unsupported Adjustments

The next three adjustments should be disallowed entirely. These are an increase in expenses of \$247,827 for alleged allocated payroll taxes from the administration

⁸ BPU Docket No. ER02080506; Docket No. ER02080507; Docket No. EO02070417; Docket No. ER02030173; Docket No. ER95120633, New Jersey Board of Public Utilities, May 17, 2004, Dated.

⁹ Docket No. 05-0597, Illinois Commerce Commission, July 26, 2006.

¹⁰ Docket No. E-001/GR-91-605, Minnesota Public Utilities Commission, June 12, 1992.

¹¹ \$27,056 is obtained by taking \$26,899 from Ms. Dismukes testimony and adding the gain on sale from Staff Audit Finding 18 of \$157. [Tr. 715 and Exhibit 113, p. 44]

department, a \$7,420 increase in expenses to normalize the service company's headcount, and a \$37,777 increase in expenses to normalize Aqua Customer Operations (ACO) costs.

OPC requested on several occasions that the company supply workpapers supporting all of its adjustments to the test year. In particular, OPC requested in Production of Documents Request 2: "Please provide all documents, accounting records, memoranda, workpapers, studies undertaken, and calculations that support all adjustments to the company's test year revenues, rate base and expenses, by system. Please provide all workpapers in electronic spreadsheet format with all formulas and links intact." While the company supplied some supporting spreadsheets, not all spreadsheets or other documents were provided. OPC requested on at least two more occasions for the company to produce the documents supporting its normalization and pro forma adjustments. Unfortunately, the company never supplied the workpapers supporting these normalization adjustments.

In Production of Documents Request 147, OPC specifically requested certain spreadsheets which were linked into the company MFRs. In response to Production of Documents Request 147 the company supplied some additional electronic spreadsheets. The information supplied in response to these document requests contained some of the workpapers that would support the company's normalization and pro forma adjustments; however, it did not include all of them. OPC also asked that the company provide all workpapers and other documents supporting its test year adjustments in one Production of Documents response, so that OPC could be certain that it had all documents the company believed to be responsive to OPC's Production of Documents Request 2. As a compromise, OPC agreed to have the company provide a matrix of every document that it believed it produced supporting its adjustments and the location of the supporting documentation. In its supplemental response to OPC Production of Documents Request 147, the company supplied the document shown on Ms. Dismukes Schedule 19. Tr. 716; Exh. 86.

By its own admission, the company did not supply these workpapers. In his rebuttal testimony, Mr. Szczgiel states: " In the event documents were inadvertently omitted in any of the discovery, AUF has the support and will supplement the appropriate discovery responses." Tr. 1530. Providing the documents after the fact, especially when OPC requested them on numerous occasions, is simply too little, too late.

In support of its adjustment for administrative payroll taxes, the company's direct case contained no discussion of this proposed adjustment and while it did provide a workpaper with a long list of numbers, the data was not explained. Tr. 717. Clearly, such omissions should not be rewarded by including the pro forma adjustment in the requested rate increase. In response to the testimony of Ms. Dismukes, in rebuttal the company supplied Exhibit SS-8, which consists of seven pages of numbers referred to in the testimony of Ms. Dismukes, with no explanation of the meaning of the numbers or how they were derived. The Commission should reject this adjustment as it has not been supported by the company and disallow \$182,853 (\$247,827 total company). Exh. 155 and Exh. 86, Schedule 19, p. 4.

With respect to the normalization for the service company headcount and ACO normalization, the company supplied no workpapers or other supporting documentation. Tr. 717. In rebuttal testimony, Mr. Szczgiel indicated that the workpapers that were provided were identified in Exhibit SS-7. Interestingly, the workpaper for both adjustments is identified as "OPC_POD_Set3_#147_Supplemental Attachment 2 of 3 (Potential O&M Expenses Adjsutments.xls)xls Enclosed" which is nothing more than what was reproduced by Ms. Dismukes on her Schedule 19. Exh. 86. The document produced to support these two adjustments was exactly the same document that was reproduced by Ms. Dismukes – no other support was provided by the company. In a second attempt to prove its case in rebuttal, the company produced Exhibit SS-9 which allegedly supports its \$4,886 (\$7,420 total company) service company head count adjustment. Ex. 156. Unfortunately, this document can not be read even with a magnifying glass.

In support of its ACO adjustment of \$24,875 (\$37,777 total company) Mr. Szczgiel again supplied the supporting workpapers, not in discovery, but in his rebuttal exhibits, specifically SS-10. Exh. 157. The Commission should not allow the adjustment because the Citizens only opportunity to review the alleged supporting workpapers was in rebuttal testimony to which the Citizens cannot respond. In addition, as Ms. Dismukes testified, there is no reason to "normalize" these expenses. The company's test year expenses include significant expenses associated with this operation that were not previously included in costs of AUF. These are costs associated with implementing the new centralized billing and customer operations at Aqua Services. Florida recently came under the allocation for these costs and it caused large cost increases in 2007. Tr. 715. The company has failed to meet its burden of proof first by failing to provide the workpapers supporting the cost increase, second by failing to explain why the costs should increase relative to the first nine months of the test year, and third by failing to justify the added costs over and above what was incurred for these functions when they were being provided by an unaffiliated company, Severn Trent.

Severn Trent

In addition, there are costs associated with the old billing system provided by Severn Trent also included in the test year. Citizens recommend that the Commission remove the costs included in the test year associated with billings from Severn Trent because it is duplicative of services being provided by ACO. In Late-Filed Exhibit 215, the company supplied the amount of Severn Trent expenses included in the test year that is duplicative of the functions being performed by the Aqua Services ACO department. This amount of \$29,035 should be excluded from test year expenses as it is duplicative and non-recurring.

2007 4% Wage Increase

Regarding the 2007 proposed 4% normalization wage increase and related FICA tax adjustments, the company's methodology overstates the amount of the increase. The company essentially compounded the impact of the pay increase effective on April 1, 2007, by increasing the salary amount as of December 31, 2007, (which included 9 months of the increase) by 1 %. However, as Ms. Dismukes testified, the correct method would be to apply the 4% to the salary amount before the increase. Tr. 718; Exh. 86, Schedule 20. The company agreed with the recommendation of Ms. Dismukes

that these expenses should be reduced by \$694 and \$53, respectively; therefore, the Commission should reduce these expenses accordingly. Tr. 718, 1532.

Issue 54: Should an adjustment be made to the Utility's pro forma expense adjustments?

Position: * Yes. *

Discussion: Aqua's market based adjustments should be reduced; the Service company salary and FICA increases should be removed; the ACO salary and FICA should be reduced; the Rates Manager and Controller salaries should be removed; the Rates Manager lease should be eliminated; Aqua Connections costs should be removed; the property tax, service company head count, and service company benefits and ACO benefit adjustments should be removed; Facility Operator wage increases should be reduced; and the Lake Suzy purchased water adjustment should be removed.

Market Based Salary Adjustment

The company's proposed market based adjustments should be reduced from 10% to 4% as the proposed 10% market-based increase is not supported. The company's adjustment should be reduced by \$70,594 and FICA taxes should be reduced by \$5,169. As Ms. Dismukes testified, the 10% proposed market based adjustment produces increases for the year 2008 of between 10% and 17% over 2007 pay levels. Tr. 719. Moreover, even without the proposed market based increase every position would exceed the low end of the market-based ranges included in the company's study. Tr. 720. Allowing for a 4% increase ensures that all operations employees will earn above the low-end of the market range and many will still earn above the midpoint of the market range with five still earning above the high end of the range. Given the economic conditions of today and the company's failure to demonstrate that its salaries are below normal, the Commission should reject the company's pro forma adjustment to increase salaries 10% above the normal 4% salary increase. The Commission should reject the adjustment in the amount of \$95,166 (\$134,191 total company).

The company made pro forma adjustments for new positions for a Lake County Facility Operator and Sebring Lakes Facility Operator. Rather than proposing a salary at 4% above the 2007 levels, the company proposed a salary at the alleged market based rate which resulted in an increase of 10% over the already projected 4% increase. For the same reasons just discussed, these extravagant increases should be disallowed. The adjustment for these positions is \$2,184 each. This allows for a 4% increase over 2007 pay levels. Exh. 86, Schedule 29.

2008 4% Salary Increase

The 2008 4% Service company proposed wage increase should be removed in the amount of \$19,413 and FICA taxes should be removed in the amount of \$1,485. Likewise, the 2008 4% ACO pro forma wage increase should be removed in the amount of \$8,236 and FICA taxes should be removed in the amount of \$630. In both instances the company failed to provide workpapers supporting how these adjustments were calculated. Exh. 86, Schedule 19.

Rates Manager

The pro forma adjustment for Rates Manager's salary in the amount of \$95,000 should be removed as the company has not demonstrated any benefits to customers associated with the Rates Manager's employment.

First, although the Rates Manager filed testimony in this proceeding, ultimately he did not provide any testimony. Instead, it was provided by Mr. Smeltzer, whose salary is already included in the test year.

Second, although the company proposes to expense this cost for the test year, the Rates manager's salary may not, in fact, be expensed on a going forward basis, but instead be capitalized. Exh. 65, Tab 10, Response to OPC Interrogatory 165; Tr. 721-22. In his deposition, Mr. Szczygiel testified that the Rates Manager had been involved in acquisitions since being hired and will continue to do so on a going forward basis. Exh. 65, Tab 32, at 30-31.

In addition, in his deposition, Mr. Szczygiel explained that prior to the employment of the Rates manager, there was no one that occupied a position of Rates Manager. This was a newly created position. Exh. 65, Tab 32, at 66. Given the reasons provided by Ms. Dismukes, the fact that this is a newly created position for this rate case, and that it is a time of belt tightening not expansion, the Commission should reject the company's proposed pro forma adjustment for the Rates Manager position of \$62,555 (\$95,000 total company). Consistent with the removal of the Rates Manager's salary, the pro forma adjustment for the associated lease expense of \$5,531 (\$8,400 total company) should be disallowed. Tr. 722.

Controller Salary

For many of the same reasons given above concerning the Rates Manager position, the Commission should reject the pro forma adjustment for a Controller. The company's direct case was devoid of any testimony on the subject of a Controller. Tr. 722. According to Mr. Szczygiel, this position has been empty since early 2007 and was only filled in March 31, 2008 — which indicates that the company was functioning adequately without a Controller-type position. Exh. 65, Tab 32, at 56-59. Rather than hiring additional employees, the company should be cutting back without jeopardizing the quality of the product and service it provides. The Controller position appears to be an area where the functions have been and could be performed on a going forward basis without the addition of a new employee. Therefore, the Commission should reject the company's requested pro forma adjustment for the Controller position of \$49,385 (\$75,000 total company).

Aqua Connects

The company is proposing to include a pro forma adjustment in test year expenses of \$39,508 (\$60,000 total company) for Aqua Connects costs. According to the company, the intent of these Aqua Connects or town hall meetings is to: "nurture our relationship with and educate Aqua's customers." Tr. 723. The Aqua Connects Guidebook explains the three situations where the Aqua Connects program is to be used:

- To welcome new customers where Aqua purchases water systems;
- To nurture relationships with customers well ahead of rate cases;
- In a contentious rate case, where these events can help educate

customers. Tr. 723-24; Exh. 86, Schedule 22 at 5.

According to the guidebook, these meetings will "create goodwill in communities and additionally will explain the necessity of a rate increase when appropriate." Tr. 724.

While there may be some educational aspects to the Aqua Connects program, the purpose of the program appears to be more for public relations and image enhancement. The three situations when the program is to be used are indicative of creating an environment of acceptance or creating goodwill to make it easier for customers to digest a rate increase or a purchase by Aqua America.

In similar situations the Commission has not permitted such costs to be passed on to ratepayers. For example, when discussing the inclusion of membership dues and contributions in a utility's test year expenses that are public relations oriented, the Commission found:

We acknowledge that some benefits may be accrued as a result of these expenses. However, we agree with OPC that costs related to contributions and membership dues, which are public relations oriented, should be disallowed. These costs serve to improve the image of the company, resulting in a direct benefit to the utility's shareholders, not to the customers. This treatment has been consistently applied by the Commission, as evidenced by Orders Nos. PSC-93-0301-FOF-WS at 19-20 and PSC 96-1320-FOF-WS at 151-153, which Orders were officially recognized in this proceeding.¹²

In another rate proceeding, the Commission found:

Mr. Ludsen's response to why open houses with customers, in addition to the Commission hearings, should be charged to customers was that it was a benefit to the case. If it benefited the case, then it benefited the customers. He did admit that those open houses were not required by the Commission.

.....

We believe that if SSU sees a need to inform its customers or the press about the issues in the case beyond what our rules require, then those expenditures must be borne by SSU, not the customers. Accordingly, all charges related to telemarketing, public relations, uniform rate bill inserts, mailings and door hangers, cellular telephone bills and bus transportation shall be removed. Mr. Ludsen was unable to justify why a banquet or lunch was necessary and reasonable; accordingly, this amount shall be removed. As agreed to by Mr. Ludsen, any legislative or lobbying charges shall also be removed.¹³

The Commission should follow its precedent and disallow the requested pro forma adjustment for Aqua Connects.

¹² Florida Public Service Commission, United Water Florida Inc., Docket No. 960451-WS PSC-97-0618-FOF-WS, May 30, 1997.

¹³ Commission Order No. PSC-96-1320-FOF-WS.

Lack of Supporting Documentation

The company requested several pro forma adjustments for which it provided no supporting workpapers or other supportive documents. Ms. Dismukes testified that the Commission should disallow all proposed adjustments where Aqua failed to provide supporting workpapers and documentation. OPC had requested electronic versions of all workpapers supporting the company's adjustments to its test year, and Ms. Dismukes was unable to locate any workpapers supporting the following adjustments. In its rebuttal testimony, the company claims that the supporting documents were provided in response to POD 3. However, at the same time AUF produced the workpapers in Mr. Szczygiel's Exhibit SS-22, basically an admission that the documents in question were in fact not produced earlier. Interestingly, the company failed to produce as part of Mr. Szczygiel's rebuttal exhibits the workpapers allegedly supporting the headcount adjustment. Tr. 1567. Therefore, the Commission should disallow the following adjustments:

- \$122,190 for property taxes on 2007 net additions;
 - \$4,996 for additional 2008 service company headcount;
 - \$13,227 for additional 2008 service company benefits; and
 - \$59,362 for additional 2008 Aqua Customer Operations employee benefits.
- Tr. 726.

Lake Suzy Purchased Water

For the Lake Suzy water system, AUF purchases all of its customers' water needs from DeSoto County. Aqua proposed a \$94,443 purchased water adjustment for Lake Suzy. The basis for the company's adjustment was a purchased water agreement between AUF and DeSoto County. Tr. 409; Exh. 187. The sponsor for the company's adjustment was Mr. Szczygiel. However, when cross-examined on the subject of the adjustment, he stated that he had not looked at the agreement. Moreover, Mr. Szczygiel was not even certain if the adjustment (assuming it was reasonable) was calculated correctly. Tr. 412.

An examination of Exhibit 187 shows that the proforma adjustment is based upon \$7,870.22 times 12 months which amounts to \$94,443. Exhibit 187 also shows that the amount of the increase proposed by the company is based upon a usage level of .302 MGD for the year 2009—almost three times the .1040 MGD used during the test year. It is clear from these simple facts that there are serious problems with the adjustment proposed by the company and the contract signed by the company.

Mr. Szczygiel testified that the .302 MGD figure in the contract was the maximum amount the company could buy. Tr. 413. However, this explanation, even if it were true, would not explain why the company proposed a \$94,443 proforma adjustment when all relevant facts indicate that the Lake Suzy system will not approach this level of usage. The five year average annual growth rate according to F-9 of the MFRs was only 1.4% and during the test year the growth was negative. Tr. 414. The contract, however, is a take or pay contract, which obligates the company to pay for consumption regardless of whether or not it is used. Tr. 413. Mr. Szczygiel was unable to explain why the company entered an agreement that would obligate its customers to pay for three times more water than they used. Tr. 414.

The company bears the burden of proving the each adjustment that it proposes in a rate proceeding. In the instant case, Aqua has clearly not met this burden. Aqua was unable to explain why it used a 2009 purchased water increase when its proforma test year was 2008; Aqua was unable to explain why it calculated its adjustment based upon usage that was almost three times the test year level with no evidence of future growth, Aqua was unable to explain why it entered into a take-or-pay contract; Aqua was unable to demonstrate the prudence of the contract that formed the foundation for the adjustment; and finally, Aqua's witness was unfamiliar with the adjustment and the reasons for the adjustment. Clearly, Aqua has not met its burden of proof on this matter. The Citizens urge Commission to reject the company's request to increase purchased water expenses for Lake Suzy by \$94,443.

Issue 55: Should any adjustments be made to test year depreciation expense?
Position: * Yes. Depreciation expense should be adjusted consistent with adjustments to plant in service. *

Issue 57: Should any adjustments be made to property taxes?
Position: * Yes. Property tax adjustments should be made consistent with adjustments to plant in service. *

Issue 58: What is the test year pre-repression water and wastewater operating income or loss before any revenue increase?
Position: * The appropriate pre-repression water and wastewater operating income before any revenue increase is \$219,425 (excluding Tomoka/Twin Rivers) for water and negative \$106,215 for wastewater. *

Issue 59: What is the appropriate pre-repression revenue requirement for the December 31, 2007 test year?
Position: * The appropriate pre-repression water and wastewater operating income before any revenue increase is \$893,528 (excluding Tomoka/Twin Rivers) for water and negative \$1,065,388 for wastewater. *

Issue 60: What, if any, is the appropriate methodology to calculate a repression adjustment?
Position: * OPC does not take issue with the use of a -.2 price elasticity of demand for water usage in excess of 5,000 gallons per month proposed in the company's filing. No greater price elasticity of demand should be allowed. *

Issue 66: What, if any, are the appropriate repression adjustments to be made?

Position: * The adjustments, if any, should be made using no more than a -2 price elasticity of demand for water usage in excess of 5,000 gallons per month. *

Issue 69: In determining whether any 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?

Position: * The Commission should follow the steps set forth in section 367.082, Florida Statutes, to compute the refund of interim rates. *

Issue 72: Should the Utility be authorized to charge Allowance for Funds Prudently Invested (AFPI) charges, and, if so, what are the appropriate charges?

Position: * The AFPI tariffs should reflect the revenue requirement and capital structure approved by the Commission and should be limited where there is no new growth. Hermits Cove water and Village Water wastewater charges should be corrected. Finally, AFPI charges should be cancelled for those systems indicated by OPC witness Merchant. *

Discussion: Ms. Merchant testified that AFPI allows the utility the opportunity to collect revenues from future customers to pay for the non-used and useful plant and expenses removed from the rate case revenue requirement. These revenues are collected, along with the CIAC charges, as prospective customers are added to the system.

First, the Commission should adjust each AFPI calculation for all corresponding changes in the revenue requirement calculations. Second, if the company has not shown that it has added any new growth-related plant that is subject to a non-used and useful adjustment above what was approved in the last rate case, the charge should be limited to the charge that exists in the current tariff. Third, in several instances the company has requested new charges which are less than those approved in the current tariff. Likewise, those charges should be limited to the charges requested. Fourth, the future ERCs for Hermits Cove water treatment and Village Water wastewater treatment should be corrected prior to determining whether the requested AFPI charge should be approved.

Ms. Merchant also testified that the approved AFPI tariff sheets should state the number of remaining connections to which each charge applies. The future connections to which the charges apply are currently shown on Aqua's existing AFPI tariff page and the purpose for having this crucial notation on the tariff is to place the company on notice that the charges are not unbounded and will expire when the stated numbers of connections have paid the charge.

Lastly, unless the Commission makes non-used and useful adjustments to these systems, the following AFPI tariffs should be cancelled: Beecher's Point, Chuluota, FL Central Commerce Park, Friendly Center, Hobby Hills, Jungle Den, Kingswood, Morningview, Palm Terrace, Piney Woods, Quail Ridge, River Grove, Silver lake Est/Western, Valencia Terrace, and Zephyr Shores. The company did not include an AFPI calculation in its petition for these systems and they are reflected as 100% used and useful in the company's MFRs. Tr. 936-938.

Utility witness Szczygiel argued that the limited charges would preclude the company from earning its return on prudently invested non-used and useful plant. Tr. 1573-1574. What Mr. Szczygiel failed to recognize is that his argument is inconsistent with Rule 25-30.434, FAC. Subsection (5) requires the utility to demonstrate why the 5-year limit is an appropriate timeframe for investment in future use plant, and subsection (6) states that the AFPI charge will cease accruing charges and will remain constant after the 5 year accrual period established by the Commission. Most of the tariffs included in AUF's AFPI filing were established in the last Southern States Utilities, Inc. (SSU) rate case, Docket No. 950495-WS, which were also reestablished as of the date of transfer from Florida Water (SSU's predecessor) to Aqua¹⁴. Because most of these tariffs have far exceeded the 5-year timeframe for prudent plant construction, the argument that the charge should be reestablished at a higher level and then allowed to escalate for another 5 years is not appropriate.

Issue 73: In accordance with Order No. PSC-08-0534-FOF-WS, what is the amount and who would have to pay the regulatory asset (or deferred interim revenues), if it is ultimately determined by the Commission that the Utility was entitled to those revenues when if first applied for interim rates?

Position: * The Commission should not approve a regulatory asset for any amount exceeding the amount identified in the interim rate order. To do otherwise would violate Section 367.082, Florida Statutes. *

Issue 76: Should this docket be closed?

Position: * No. *

Discussion: Instead of closing the docket, the Commission should implement the following:

1. Require the company to put the PSC Consumer Affairs number on the face of its bills.
2. Require the company to provide a monthly report to the Commission regarding its Florida customer complaints.
3. Require the company to report the resolution of each complaint and what action is being taken to prevent similar complaints in the future.
4. Require a monthly summary and tracking of complaints by category and analysis by staff.
5. Require staff to visit call centers to ensure that adequate monitoring programs and complaint tracking programs are in place and that the company analyzes their complaints and takes action.
6. Place a moratorium on extension of Aqua plant facilities until the company has proven that they can provide good service to the customers they already have.
7. Require a staff review and recommendation at the end of the first year that would include the progress achieved and recommend specific actions, including whether

¹⁴ See Order No. PSC-05-1242-PAA-WS, issued December 20, 2005, in Docket No. 040952-WS.

operating certificates should be withdrawn based on the company's progress in resolving customer service issues.

8. Allow the company to come back in and demonstrate that they have resolved their service problems.

9. Remove the penalty upon a finding by the Commission that the company's customer service quality and water quality is satisfactory. Poucher, Tr. 903-905.

Respectfully submitted,

s/ Charlie Beck

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CERTIFICATE OF SERVICE
DOCKET NO. 080121-WS

I HEREBY CERTIFY that a true and correct copy of the foregoing Citizens' has Brief been furnished by electronic mail and U.S. Mail to the following parties on this 30th day of December, 2008.

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