

Dorothy Menasco

From: DAVIS.PHYLLIS [DAVIS.PHYLLIS@leg.state.fl.us]
Sent: Wednesday, November 02, 2011 1:16 PM
To: Filings@psc.state.fl.us
Cc: 'Bruce.may@hkclaw.com'; Caroline Klancke; 'gigi.rollini@hkclaw.com'; Ralph Jaeger; CHRISTENSEN.PATTY; 'Kenneth.curtin@arlaw.com'; 'kelly.sullivan.woods@gmail.com'; Lisa Bennett; 'cecilia_bradley@oag.state.fl.us'; REILLY.STEVE; VANDIVER.DENISE
Subject: 100330-WS Electronic Filing - OPC's Amended Prehearing Statement
Attachments: 100330-WS Amended Prehearing Statement.pdf

Electronic Filing

a. Person responsible for this electronic filing:

Patricia A. Christensen, Associate Public Counsel
Office of Public Counsel
c/o The Florida Legislature
111 West Madison Street, Room 812
Tallahassee, FL 32399-1400
(850) 488-9330
christensen.patty@leg.state.fl.us

b. Docket No. 100330-WS

In Re: Application for increase in water/wastewater rates in Alachua, Brevard, DeSoto, Hardee, 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 35 pages.

e. The document attached for electronic filing is Citizens' Amended Prehearing Statement.

Phyllis W. Philip-Guide
Assistant to Patricia A. Christensen
Associate Public Counsel.
Office of Public Counsel
Telephone: (850) 488-9330

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08079 NOV-2 =

FPSC-COMMISSION CLERK

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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

DOCKET NO. 100330-WS

November 2, 2011

AMENDED PREHEARING STATEMENT OF THE OFFICE OF PUBLIC COUNSEL

The Citizens of the State of Florida, through the Office of Public Counsel, pursuant to the Order Establishing Procedure in this docket, Order No. PSC-11-0309-PCO-WS, issued July 25, 2011, submit this Amended Prehearing Statement. The shaded areas are the amended portions.

APPEARANCES:

PATRICIA A. CHRISTENSEN, Esquire
Associate Public Counsel
Steven Reilly, Esquire
Associate Public Counsel
Office of Public Counsel
c/o The Florida Legislature
111 West Madison Street, Room 812
Tallahassee, Florida 32399-1400
On behalf of the Citizens of the State of Florida.

1. **WITNESSES:**

1) **WITNESSES**

WITNESS

ISSUES

A. WOODCOCK

1-7

DOCUMENT NUMBER-DATE

08079 NOV-2 =

FPSC-COMMISSION CLERK

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1, 2, 24, 26, 39

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3. STATEMENT OF BASIC POSITION

AUF has requested two rate increases in less than a three year period and barely a month after the last requested rate increase had been in place for a year. AUF's back to back rate increases are unfair and unreasonable, and will cause customers to pay unaffordable rates. Several issues have contributed to AUF's unsustainable rate increase cycle. These issues are: AUF's unsatisfactory quality of service, AUF's use of higher used and useful percentages than the systems require, AUF's inclusion of pro forma plant adjustments in the test year for projects that have not been started, and AUF's requested increases in operating expenses that are too high and not justifiable.

On the Commission's website, the Commission's mission statement states that it is committed to making sure that Florida's consumers receive some of their most essential services -- electric, natural gas, telephone, water, and wastewater -- in a safe, affordable, and reliable manner. The Commission should exercise its regulatory authority over AUF in the key areas of rate base/economic regulation and service issues by finding that it provides unsatisfactory service at unaffordable rates.

AUF's customers have consistently testified at the customer meetings held in October and November 2010 and the Service Hearings held in August, September and October 2011 regarding their dissatisfaction with AUF's quality of product and service. But for AUF providing a monopolistic service, based on the testimony received customers, would be choosing another water and wastewater provider and AUF would be going out of business. In fact, customers have testified to installing wells to avoid paying AUF's high costs. AUF customers have reported problems with the water quality and AUF has had interactions with the Department of Environmental Protection (DEP) for 45% of its systems in the last three years. AUF customers

have testified to numerous billing problems including high bills, back billing and malfunctioning meters. AUF has been under a monitoring plan since its last rate case, yet analysis of the customers' testimony from the last two years show no marked improvement. Based on AUF's persistent quality of service problems, the company's return on equity should be decreased by 100 basis points, which is consistent with past Commission practice.

Next, AUF has requested higher used and useful percentages than are justified by the amount of plant that it has in service for the current customer base. Higher used and useful percentages result in rates that are higher than they should be. Given that AUF's rates are some of the highest rates in Florida, the Commission should apply the correct used and useful percentages. In addition, all the pro forma adjustments for Lake Josephine Leisure Lakes, Peace River, and Sunny Hills should be denied if AUF cannot demonstrate it has started construction or provide other relevant documentation.

Moreover, AUF has requested operating expenditures that are too high and unjustified. AUF's affiliated allocation methodology, revenues, costs, and charges are significantly overstated. First, AUF's methodology has failed to charge its non-regulated affiliates appropriately, thereby causing AUF Florida's customers to pay higher than fair costs. Second, AUF's affiliated costs are significantly higher than Florida's average costs for equivalent services. The PAA Order included adjustments for affiliated IT costs, incentive compensation, and salaries and wages that should continue to be made. Based on Citizens' affiliate costs analysis, AUF's requested increase in affiliated costs should be denied in almost its entirety for a reduction of \$976,845.

AUF's requested rate case expense is also too high. While AUF has the right to hire any attorney they want to represent them, AUF customers should not have to contribute more than the average cost for engaging such an attorney in Florida. In addition, AUF has failed to justify all of its rate case expense. Even though customers may receive some benefits from having periodic rate cases to ensure rates are based on current costs, AUF's "pancaked" rate cases are too frequent to justify the customers' bearing all of the rate case expenses. Therefore, the Commission should make Citizens' adjustments to rate case expense.

AUF has used billing determinants that are too low. Due to customers' installing wells the projected revenue from the last rate case was 16% less than expected. Given that the revenue shortfall was due to AUF's actions and its poor quality of service and product, the current customers should not be penalized. Therefore, the billing determinants should be adjusted higher. Similarly, AUF's actions have caused higher costs that have resulted in increased bad debt expense. Thus, AUF's requested bad debt expense is too high. The Commission should use the appropriate three year average and exclude the test year period which is being tested. This will result in a reduction in bad debt expense of \$310,816.

Based upon Citizens' analysis of AUF's requested increases, AUF's requested used and useful percentages, pro forma plant increases and operating expenditure increases will result in rates that are not affordable within the meaning and intent of fair, just, or reasonable rates pursuant to Sections 367.081 and 367.121, Florida Statutes. These statutes require the ratemaking process to produce rates that are fair, just, and reasonable. Even if the individual components would otherwise be reasonable when reviewed in isolation, if the end result unaffordable rates, then further cost reductions must be made under the statutory constraint that rates must be fair, just, and reasonable. The Commission should make all of Citizens' recommended adjustments resulting in further reductions of approximately \$2.3 million from the PAA Order which approved a \$2.6 million increase.

4. STATEMENT OF FACTUAL ISSUES AND POSITIONS

QUALITY OF SERVICE

Issue 1:

What is AUF's quality of service?

OPC:

AUF's overall quality of service is unsatisfactory. AUF has on-going poor water quality issues, billing problems, and poor customer service. Despite an on-going monitoring program, AUF still has persistent, deeply embedded poor quality of service issues in Florida. As testified to by AUF's customers at the service hearings and summarized by OPC's witnesses, water

quality, billing problems and poor customer service are the main problems. And the testimony confirms that no significant improvements have been made.

AUF's quality of service problems affect all of its systems, which were found to have "marginal" quality of service in the last rate case (Docket No. 080121-WS) with the exception of the Chuluota system. In the previous rate case (Docket No. 080121-WS), the Chuluota system's quality of service was found to be unsatisfactory and remains unsatisfactory today. However, since the Chuluota system is not part of Aqua's Petition for rate increase in the current docket (100330-WS), it should not be included in the Commission's decision in this docket on the quality of service.

Customers at the customer meetings held in October and November 2010 complained about the poor quality of the plant maintenance, including unkempt property, odors from plant facilities, line breaks, and malfunctioning lift station alarms. They also complained about poor customer service relating to rude customer service representatives, billing problems, and difficulties in reaching a Company representative in an emergency situation. Despite the Company being under a Monitoring Plan during the historic test year, the customer complaints did not decrease significantly in 2010, only 19% when compared to the previous year.

During the Service Hearings held in August, September and October 2011, the customers still complained about the poor quality of plant maintenance, water quality, and customer service. Based on the customers' testimony at these hearings billing issues (including back billing, high bills, malfunctioning meters) are a significant problem. Customers should be able to rely on accurate and timely billing. AUF has failed to have any meaningful plan or procedure to deal with the high bill issues. According to the Commission's complaint records, 16 customers were back billed for over one year of service in violation of Rule 25-30.340, F.A.C. AUF's back billing procedures are noncompliant with the applicable regulations, and AUF should be required to implement procedures that fully comply with the Commission's rules.

While some of AUF's systems offer water that is usable for its intended purposes, many systems provide water that is of such poor quality that customers have to purchase bottled water

for drinking and cooking. Specially, customers at the Eustis, Oviedo, Palatka, Gainesville, Sebring, and New Port Richey service hearings testified that the water is unusable. They testified that their water smelled, tasted bad, and left residue. Of particular concern are the customer's complaints regarding the lack of timely boiled water notices and timely response to leak hazards which increase the potential for health problems.

Moreover, AUF's systems have on-going issues with DEP. Over the last three year years, AUF has had multiple DEP compliance issues. The overall view of AUF's systems related to DEP show persistent water quality problems. Since 2007, AUF has had 26 primary water quality violations, 20 total coliform violations, 15 secondary violations and 15 violations for late or not reported parameters. Over the last 18 months (January 2010 through July 2011), AUF has continued to have DEP violations: 3 primary water violations, 6 total coliform violations, 2 secondary violations, and 1 violation for late or not report parameters. The AUF wastewater systems have been out of significant compliance 39 times since 2007. And over the last 18 months (January 2010 through July 2011), AUF has been out of significant compliance 11 times. Over the last three years, DEP has identified 183 instances where the Company issued boil water notices. Contrary to the Company's self reporting that customers received timely notice of these boil water incidence, multiple customers testified that they never saw nor received a notice from the utility. Many customers testified that they only received a stop boil water notice, and never realized that a potential health hazard event had even occurred.

Issue 2: What, if any, additional actions should be taken by the Commission based on AUF's quality of service?

OPC:

The Commission should reduce AUF's ROE 100 basis points for its unsatisfactory service. Also, a Monitoring Plan should be reinstated to address the quality of service problems regarding water quality, billing problems, and customer service.

Based on the testimony at the Service Hearings in August, September and October 2011, comments received at the customer meetings in October and November 2010, customer correspondence, and DEP reports, Florida customers are not getting an adequate quality water product or service that they are paying for even though they pay some of the highest water rates

in the state. Not only is the water quality for many systems unsatisfactory, the customer service and billing is also unsatisfactory. The Commission should reduce AUF's ROE 100 basis points for its unsatisfactory product and service.

Section 367.111(2), Florida Statutes, provides that a public utility shall provide service and:

. . .such service shall not be less safe, less efficient, or less sufficient than is consistent with the approved engineering design of the system and the reasonable and proper operation of the utility in the public interest. If the Commission finds that a utility has failed to provide its customers with water or wastewater service that meets the standards promulgated by the Department of Environmental Protection or the water management districts, the commission may reduce the utility's return on equity until the standards are met.

While the Commission is not limited to only situations where the Company has failed to meet DEP standards, there is sufficient evidence in this case to find that AUF has failed to provide over the course of many years quality water that consistently meets the DEP standards.

In AUF's last rate case, the Commission reduced AUF's ROE by 25 basis points for its marginal service for all systems, except the Chuluota system which was reduced 100 basis points for its unsatisfactory service. Based on the Commission's concerns, a Quality of Service Monitoring Plan was implemented. The Commission has a history of reducing ROE for poor customer service including a 1% or 100 basis point reduction for Pine Island Utility and Consolidated Utilities Company, 50 basis points for Aloha Utilities and Ocean Reef Club, and a 25 basis point reduction for Southern States Utilities (the predecessor for most of the AUF systems). Given AUF's on-going, and persistent poor quality of service in both product and customer service, AUF's ROE should be reduced by 100 basis points.

In a competitive market, the Company would have lost customers due to its poor customer service. In fact, some customers have testified that they have installed wells, significantly reduced their usage and in extreme circumstances sold or abandoned their homes, all because of the poor quality of product and service provided by AUF. Other customers testified that they cannot sell homes in part due to the Company's reputation for poor water quality, high bills and poor customer service. Many AUF customers have done everything they

can to signal to the company their dissatisfaction short of not buying AUF's product or service which they cannot do since this is a monopoly service. Despite the customers' overall dissatisfaction with its service, AUF has not done enough to improve its product or service to change their customer's opinion. Unfortunately a 25 basis point deduction to its ROE for most of its system was not sufficient to get the Company to significantly improve its product and quality of service such that they would be acceptable to the customers.

A reduction of 25 basis points amounts to a reduction in revenue of less than \$90,000 on a combined basis, which is less than .01 percent of AUF America's 2010 total revenue and .6 percent of AUF Florida's 2010 total revenue. In contrast, a 100 basis point reduction would be approximately 2.6 percent of AUF Florida's total revenues, but would still be only .05 percent of Aqua America's total revenue. The reduction of a 100 basis point is necessary to effect the change in AUF's behavior that is long overdue without creating financial jeopardy.

RATE BASE

Issue 3:

What is the appropriate amount of pro forma plant, and related depreciation and property taxes, for the following specific protested pro forma plant projects; Breeze Hill Wastewater I&I Project, Lake Josephine and Sebring Lakes AdEdge Water Treatment Project; Leisure Lakes AdEdge Water Treatment Project; Peace River Water Treatment Project; Tomoka Twin Rivers Water Treatment Plant Tank Lining Project; Sunny Hills Water System Water Tank Replacement Project?

OPC:

A proforma plant project should not be included in this rate proceeding if the physical construction of the project has not begun. Even though a project has been planned and equipment purchased, the project for any number of reasons might not be constructed as planned or even constructed at all and placed into service. To date, construction has not begun on the Lake Josephine/Sebring Lakes Water Treatment Project and the Leisure Lakes Water Treatment Project. Construction has begun on the other protested proforma projects, and therefore, the proper documented costs should be included for recovery in this proceeding. These projects include: Breeze Hill Wastewater I&I Project, Peace River Water Treatment Project, Tomoka Twin Rivers Water Treatment Plant Tank Lining Project and the Sunny Hills Water Systems Tank Replacement Project.

Issue 4:

What are the appropriate used and useful percentages or the associated composite used and useful percentages for the following specific protested water treatment and related facilities of Arredondo Estates, Arredondo Farms Breeze Hill, Carlton Village, East Lake Harris/Friendly Center, Fern Terrace, Hobby Hills, Interlachen/Park Manor, Lake Josephine/Sebring Lakes, Picciola Island, Rosalie Oaks, Silver Lake Estates/Western Shores, Tomoka View, Twin Rivers, Venetian Village, Welaka, and Zephyr Shores?

OPC:

The proper calculation of the U&U percentages for water treatment and storage plant should be based upon the requirements of Section 367.081 (2)(a), Florida Statutes, and Commission Rule 25-30.4325, F.A.C.

The U&U percentage of utility plant should be re-evaluated in each rate proceeding in order to account for changes to utility plant and changes to customer growth and usage of utility facilities. Over time there can be material changes in the growth of the service area, how the system is operated, and the usage patterns of the customer base. There also may be new or different information submitted in the MFR's that corrects inaccurate information from a prior case.

The growth allowance in the U&U calculations relies upon some projection of historical five year data. Since the five year historical data will change, it is not unreasonable to expect that this growth allowance will change from rate case to rate case. This will sometimes increase the U&U percentage, and sometimes decrease the U&U percentage. However, the change in system growth should be evaluated in every rate case and incorporated into the U&U calculations, whether or not the change increases or decreases the U&U percentage.

Commission Rule 25-30.4325 (2), F.A.C., requires the Commission's U&U evaluation of water treatment and storage facilities to consider whether flows have decreased due to conservation or to reduction in the number of customers. Staff has relied upon this rule to justify not adjusting flows down, which would produce a U&U percentage lower than the previous order. Ignoring a decrease in system flow data does not effectively capture the portion of the system that is actually serving customers. Capacity that is not used as result of a decline in

customer usage should not be considered U&U, because it is no longer providing service to customers.

Commission Rule 25-30.4325 (4), F.A.C., provides that water treatment plants should be considered 100% U&U if the service territory the system was **designed** to serve is **built out** and there is **no apparent potential for expansion** of the service territory. Staff has stretched the interpretation of this rule beyond its reasonable limits in determining systems to be 100% U&U which are not built out and where a potential does exist for expansion of the service territory.

If a system is served by a single well that is greater than 150 gpm, and the calculated U&U percentage is less than 75%, the Commission should utilize an alternative calculation, as permitted by Commission Rule 25-30.4325 (3), F.A.C. For these few systems (four), the Commission should recognize the actual U&U of the treatment facilities, so that the cost of the significant stranded treatment capacity is not borne by the ratepayers.

For two systems, Silver Lake Oaks and Lake Josephine/Sebring Lakes, OPC does not recommend a fire flow allowance because there are insufficient hydrants in the system to provide complete coverage or the lines are undersized to provide fire flow.

Consistent with the requirements of Section 367.081(2)(a), Florida Statutes, and Commission Rule 25-30.4325 (3), F.A.C., the calculated U&U should be used for systems that are built out but have a calculated U&U percentage of less than 75%. This gives recognition to the fact that there is a large amount of stranded capacity in these systems that will never provide service to the customers.

Properly applying the requirements of Section 367.081 (2) (a), Florida Statutes, and Commission Rule 25-30.4325, F.A.C., results in the following U&U percentages for the protested systems:

- a. Arredondo Estates -80%
- b. Arredondo Farms -61%
- c. Breeze Hill – 26%

- d. Carlton Village – 91%
- e. East Lake Harris/Friendly Center – 41%
- f. Fern Terrace -68%
- g. Hobby Hills -41%
- h. Interlachen/Park Manor – 76%
- i. Lake Josephine/Sebring Lakes – 25%
- j. Picciola Island – 56%
- k. Rosalie Oaks – 12%
- l. Silver Lake Estates/ Western Shores – 74%
- m. Tomoka View – 43%
- n. Twin Rivers –24%
- o. Venetian Village – 63%
- p. Welaka – 74%
- q. Zephyr Shores – 26%

Issue 5:

What are the appropriate used and useful percentages and the associated composite used and useful percentages for the following specific protested water distribution systems of Arredondo Estates, Arredondo Farms, Beecher's Point, Breeze Hill, Fairways, Gibsonia Estates, Interlachen/Park Manor, Kingswood, Lake Josephine/Sebring Lakes, Oakwood, Orange Hill/Sugar Creek, Palm Port, Palms Mobile Home Park, Peace River, Piney Woods, Ravenswood, River Grove, Rosalie Oaks, Silver Lake Estates/Western Shores, Silver Lake Oaks, Skycrest, Stone Mountain, Sunny Hills, The Woods, Tomoka View, Twin Rivers, Valencia Terrace, Venetian Village, Village Water, Welaka, Wootens, and Zephyr Shores.

OPC :

The U&U percentage of water distribution systems should be calculated according to the concepts presented in Issue 4, and should be re-evaluated for each new rate case to produce the most accurate percentage. The percentage should not be inappropriately rounded up, but only rounded to the nearest full single percentage point. This level of accuracy avoids overstating, and in some cases, grossly overstating the U&U percentage of treatment facilities.

Generally, the U&U percentage should be the fraction of the total number of lots with active customers over the total number of lots served by the water distribution system. If the service territory includes commercial or multi-family customers, a comparison should be made

of the active number of customers to the total number of customers to be served by the water distribution system at buildout, based upon the service area maps provided in the MFR's.

The proper U&U percentages for water distribution plant for the protested systems are as follows:

- a. Arredondo Estates – 90%
- b. Arredondo Farms – 88%
- c. Beecher's Point – 58%
- d. Breeze Hill – 92%
- e. Gibsonia Estates – 84%
- f. Interlachen/Park Manor – 79%
- g. Kingswood – 98%
- h. Oakwood -98%
- i. Orange Hill/Sugar Creek -94%
- j. Palms Mobile Home Park – 79%
- k. Palm Port – 94%
- l. Peace River – 79%
- m. Piney Woods – 89%
- n. Ravenswood – 88%
- o. River Grove – 99%
- p. Rosalie Oaks – 80%
- q. Silver Lake Estates/Western Shores – 88%
- r. Silver Lake Oaks – 83%
- s. Skycrest – 93%
- t. Stone Mountain – 48%
- u. Sunny Hills – 11%
- v. Twin Rivers – 98%
- w. Venetian Village – 81%
- x. Village Water – 68%
- y. Welaka -51%
- z. Wootens – 43%

- aa. The Woods – 70%

Issue 6:

What are the appropriate used and useful percentages and the associated composite used and useful percentages for the following specific protested wastewater treatment and related facilities of Arredondo Farms, Breeze Hill, Fairways, Florida Central Commerce Park, Holiday Haven, Jungle Den, Kings Cove, Leisure Lakes, Morningview, Palm Port, Peace River, Rosalie Oaks, Silver Lake Oaks, South Seas, Summit Chase, Sunny Hills, The Woods, Valencia Terrace, Venetian Village, and Village Water?

OPC:

The proper calculation of the U&U percentage for wastewater treatment plant should be based upon the requirements of Section 367.081(2) (a), Florida Statutes, and Commission Rule 25-30.432, F.A.C. The U&U percentage should be calculated in accordance with the concepts presented in Issue 4, and should be updated and re-evaluated to account for any changes to the plant, or its operation, and for customer growth or usage. These changes should be incorporated into the U&U calculation whether they result in an increase or decrease in the U&U percentage.

When the collection system is not built out it is not proper to deem the wastewater treatment plant to be 100% U&U, especially when the actual U&U percentage of the wastewater treatment plant is significantly less than 100% U&U. Even for systems that are built out with no potential for expansion, if the actual U&U percentage is less than 75%, the actual calculated U&U percentage should be used. To do otherwise would force the customers to bear the full cost of the significant stranded wastewater treatment capacity, not used and useful in providing service to customers, contrary to the requirements of Section 367.081(2)(a), Florida Statutes.

The proper U&U percentages for the protested wastewater treatment facilities are as follows:

- a) Arredondo Farms – 66%
- b) Breeze Hill – 24%
- c) Fairways – 42%
- d) Florida Central Commerce Park – 41%
- e) Holiday Haven – 62%
- f) Jungle Den – 37%
- g) Kings Cove – 46%

- h) Leisure Lakes – 32%
- i) Morningview – 33%
- j) Palm Port – 51%
- k) Peace River – 56%
- l) Rosalie Oaks – 50%
- m) Silver Lake Oaks – 34%
- n) South Seas – 40%
- o) Summit Chase – 36%
- p) Sunny Hills – 23%
- q) Valencia Terrace – 40%
- r) Venetian Village – 49%
- s) The Woods – 62%

Issue 7: What are the appropriate used and useful percentages and the associated composite used and useful percentages for the following specific protested wastewater collection systems of Beecher's Point, Breeze Hill, Fairways, Holiday Haven, Jungle Den, Peace River, Rosalie Oaks, Silver Lake Oaks, Sunny Hills, The Woods, and Village Water?

OPC:

Utilizing the same concepts presented in Issue 4, the U&U percentage for wastewater collection plant should be calculated in the same manner as calculating the U&U percentage for water distribution plant.

The proper U&U percentages for the wastewater collection systems of the protested systems are as follows:

- a. Beecher's Point – 45%
- b. Breeze Hill – 94%
- c. Fairways – 99%
- d. Holiday Haven – 69%
- e. Jungle Den – 87%
- f. Peace River – 79%
- g. Rosalie Oaks – 93%
- h. Silver Lake Oaks – 83%
- i. Sunny Hills – 36%
- j. Village Water – 42%
- k. The Woods – 61%

Issue 8: Should any adjustments be made to Deferred Rate Case expense? (Fallout Issue)

OPC:

Deferred Rate Case expense should be reduced by \$132,500.

Issue 9:

What is the appropriate Working Capital allowance? (Fallout Issue)

OPC:

Working capital allowance should be reduced consistent with OPC's recommended adjustments. This results in a reduction of \$733,753 to water working capital and \$205,108 to wastewater, for a total adjustment of \$938,861.

Issue 10:

What is the appropriate rate base for the April 30, 2010, test year? (Fallout Issue)

OPC:

Rate base should be reduced consistent with OPC's recommended adjustments to Used and Useful and Pro Forma Plant Adjustments. This results in a reduction of \$1,882,840 to water rate base and \$3,541,976 to wastewater rate base for a total reduction of \$5,424,816.

COST OF CAPITAL

Issue 11:

What is the appropriate amount of accumulated deferred taxes to include in the capital structure? (Fallout Issue)

OPC:

Accumulated deferred taxes should be reduced consistent with OPC's recommended adjustments.

Issue 12:

What is the appropriate Commission-approved leverage formula to use in the case?

OPC:

No position at this time.

Issue 13:

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

OPC:

No position at this time.

NET OPERATING INCOME

Issue 14: What are the appropriate billing determinants for the test year?

OPC:

Test year revenue should be increased to reverse the test year impact of reduced usage that is either due to the Company's high rates, poor customer service, or factors beyond the control of the customers. The test year revenue should be increased by \$372,925.

Test year revenues have decreased by 16 percent below the Commission's repressed consumption calculations in the last rate case. According to the Company, the majority of the reduced consumption was due to the unanticipated installation of a large number of private irrigation wells in its service areas. Only in a monopoly situation would it be unanticipated that customers would stop using a service when the pricing got beyond the ability of the customer to pay.

Moreover, the reduction in consumption due to customer financial hardship, the unreasonably high rates, and poor quality of service are factors largely beyond the control of the customers and are more in the control of the Company. Inherent risk for any company is the loss of revenue due to reasons like economic downturns, competition, conservation, and alternative suppliers. The ROE includes a component to compensate the stockholders for risk. It would be unfair to the customers to make the Company whole for lost revenue due to reduced sales, under the current circumstances. If the Commission requires the customers to bear the risk of lost revenue, then this shift in risk should be reflected in a reduction to the ROE.

Since the increased reduction in consumption has been caused by the direct actions of the Company which have resulted in the high rates and poor customer service, the customers should be held harmless. Test year revenues should be increased by \$372,925.

Issue 15:

What is the appropriate amount of test year revenues? (Fallout Issue)

OPC:

The amount of test year revenues should be consistent with OPC's recommended adjustments. This results in water test year revenues of \$8,756,984 and wastewater test year revenues of \$4,784,757

Issue 16:

Should adjustments be made to the allocation methodology used to allocate costs and charges to AUF by Aqua America, Inc. and its affiliates?

OPC:

Yes, Aqua America should be required to allocate common costs to its non-regulated operations so that its regulated operations including AUF do not subsidize the non-regulated operations.

Given that affiliate transactions are not arms length dealings, the Commission has an obligation to closely scrutinize cost allocation techniques and methods of charging affiliates to ensure that the company's regulated operations are not subsidizing the non-regulated operations. The standard for reviewing affiliate transactions is stated in *GTE Florida, Inc. v. Deason*, 642 So. 2d 545 (Fla. 1994). In the *GTE* case, the standard the Court established was whether affiliate transactions exceed the going market rate or are otherwise inherently unfair.

Aqua America, Inc. (AAI) is the parent company of AUF and is a publically traded company with both regulated and non-regulated subsidiaries operating in 13 states. AAI has nine non-regulated subsidiaries. AUF has contracted with one of the non-regulated subsidiaries, Aqua Services, Inc. (ASI) to provide managerial, operational, and regulatory support. The costs allocated to AUF from AAI and ASI are approximately 20% of the total operations and maintenance and Administrative and General expense included in the test year. AUF allocated some of its common costs to its Florida systems in the amount of \$1.2 million.

ASI and AUF have a service contract that governs the charges to be allocated to AUF. There is a Corporate Charges Allocations Manual that describes the allocation methodology. ASI has a combined method for determining the costs charged to the affiliates. "Service expenses" are the labor and overhead of the employees of AAI and ASI charged to an affiliate or a group of affiliates based on the time related directly to work done for them. "Sundry expenses" are the remaining expenses that are direct or indirect charges and identified by activity codes. Despite the stated allocation methodology, it appears that it has not been uniformly applied between AUF and its affiliated sister companies.

First, ASI performs services for non-regulated affiliates; however, it does not consistently allocate costs to them. There are four affiliates that do not receive allocations from ASI. In the last rate case, the Company acknowledged the need to allocate costs to at least one of its non-regulated affiliates. However, all non-regulated affiliates should be consistently allocated ASI costs.

Second, certain operating companies provide contract operator services; however, no common costs are allocated for these services. Although several AAI subsidiaries provide operator and management services to non-regulated companies, neither AAI nor ASI allocates costs to these client companies. While the Company claims it does not allocate costs because no corporate services are provided directly, the Company failed to take into account that the indirect costs increase due to the additional oversight and management of the affiliates that provide these services. The failure to take these additional costs into account and allocate them accordingly, results in an over-allocation of costs to the regulated companies without similar allocations to the non-regulated operations.

Third, there is no allocation of costs made to non-regulated affiliates, even when they have common officers and directors. The Company has failed to demonstrate that the salaries and benefits of these common officers are allocated to the non-regulated companies.

The failure to allocate common costs to AAI non-regulated operations causes AAI regulated operations to subsidize the non-regulated operations. Therefore, the costs charged to AUF from AAI and ASI are overstated.

Issue 17:

Should any adjustments be made to affiliate revenues, costs and charges allocated to AUF's systems?

OPC:

Yes. Affiliate costs and charges allocated to AUF's systems should be reduced by \$976,845 million.

Affiliate costs and charges allocated to AUF are overstated. In the GTE case, the Florida Supreme Court established the standard for evaluating affiliate transactions as whether affiliate transactions exceed the going market rate or are otherwise inherently unfair. In the current case, AUF offered a seriously flawed market analysis to support its position that its affiliate costs do not exceed market rates. First, the analysis does not take into account the likely discount a nonaffiliated company would offer. Second, the analysis assumes that every hour the ASI personnel work each day could be billed at a rate comparable to a skilled lawyer, consultant, certified public accountant, or professional engineer regardless of the level of expertise of the ASI employee. This is not a realistic comparison. Third, companies typically use outside counsel or consultants for specialized areas of law or professional services, not day to day operations.

Moreover, the Company's market analysis merely provided a view of the various stand alone billing rates for various professional services such as legal, engineering, accounting, and management. The analysis includes rates that are overstated, a sample that is under representative, and a failure to differentiate between levels of skills. Moreover, the comparison of professional management rates excluded normal travel and computer costs associated with day to day operations without good cause. Correcting for just these inherent flaws in the Company's market analysis reduces the management charges included in the test year amount by \$79,968.

In addition, comparing similarly situated Class A, B, and C water/wastewater utilities' management fees further demonstrates that AUF's management costs are inherently unfair. Based on this analysis, similar to a comparison of companies for purposes of establishing ROE, AUF's Administrative and General (A&G) expenses on a per customer or equivalent residential connection (ERC) basis are significantly higher than the peer group. Reviewing the typical monthly bill for AUF as compared to systems operating in the same counties shows that AUF's systems rates are 116% higher than average. Given that the layers of management associated with ownership by AAI have not produced any cost savings for customers, and, in fact, have resulted in excessive costs, test year expenses should be lowered to be consistent with costs that other water and wastewater systems incur. Using the peer group analysis, AUF's test year expense for ASI management fees should be reduced by \$664,023 for water operations and \$312,822 for wastewater.

Even when the peer group analysis is not used, adjusting affiliate expenses to the level consistent with customer growth and inflation would result in a reduction of \$882,388 for water operations and \$348,674 for wastewater operations. The Company has provided no documentation on the increases in management fees and customer operations allocations since the previous rate case. AUF has not demonstrated any economies of scale or other commensurate benefits for customers to support that Aqua's business plan of buying small, troubled systems and then seeking rate increases is viable in the long term.

Issue 18:

What is the appropriate amount of Corporate Information Technology ("IT") charges allocated to AUF by its parent, Aqua America, Inc.?

OPC:

Corporate Information Technology charges allocated to AUF by its parent, Aqua America, is included in the analysis of affiliate costs, and thus, are part of the \$976,845 reduction to affiliate costs recommended by OPC.

Corporate Information Technology charges are allocated to AUF from AAI as part of its affiliated costs. Based on the peer group analysis, AUF's allocated affiliate costs are

significantly overstated and have not resulted in savings for customers. Based on the peer group analysis, AUF's test year expense for ASI management fees, including IT costs, should be reduced by \$664,023 for water operations and \$312,822 for wastewater. Even when the peer group analysis is not used, adjusting affiliate expenses to the level consistent with customer growth and inflation would result in a reduction of \$882,388 for water operations and \$348,674 for wastewater operations.

Issue 19:

Should any adjustments be made to Incentive Compensation?

OPC:

The incentive compensation of \$22,623 in bonus and dividend compensation for AAI's corporate management aligns the interest of management with shareholders, and therefore should be borne by shareholders. Thus, O&M expense should be reduced by \$22,623.

AUF included in its MFR's incentive compensation for \$22,623 in bonus and dividend compensation for its affiliate management at AAI. This type of incentive compensation aligns the interest of the executives with the shareholders. Moreover, the Company has not justified the amount of affiliate charges in this case. Incentive compensation charges are allocated to AUF from AAI as part of its affiliated costs. Based on the peer group analysis, AUF's allocated affiliate costs are significantly overstated and have not resulted in savings for customers. Based on the peer group analysis, AUF's test year expense for ASI management fees, including incentive compensation costs, should be reduced by \$664,023 for water operations and \$312,822 for wastewater. Even when the peer group analysis is not used, adjusting affiliate expenses to the level consistent with customer growth and inflation would result in a reduction of \$882,388 for water operations and \$348,674 for wastewater operations.

Issue 20:

Should any adjustments be made to Salaries and Wages - Employees expense?

OPC:

Yes, the Commission should deny any increase in compensation in light of the economic climate in Florida and throughout the U.S. Denying the requested increase would result in a total adjustment of \$220,410 for salaries and wages and \$16,861 for the related payroll taxes.

AUF requested an increase in salaries and wages totaling \$220,410 and \$16,861 for related payroll taxes. These requested increases included five adjustments: two for normalization of the 4% increases for direct salaries and “admin” salaries; two for the pro forma effects of the 4% direct and “admin” salaries; and pro forma increases to salaries based on a utility market study.

CPI for 2010 over 2009 has been less than 2%. Numerous customers at the service hearings testified that they have had trouble paying their current bills, much less any increases. They also testified that due to the economy they have to work more than one job to pay their bills or have had their hours cut. When ratepayers are suffering in these difficult economic times, they should not be forced to pay for Aqua’s salary increases. The Commission should deny any increase in compensation in light of the economic climate in Florida and throughout the U.S. Denying the requested increase would result in a total adjustment of \$220,410 for salaries and wages and \$16,861 for the related payroll taxes.

Issue 21:

Should any adjustments be made to Bad Debt expense?

OPC:

The bad debt allowance should be reduced to \$78,605 resulting in a \$310,816 adjustment which is consistent with good billing, customer service, and meter reading practices. AUF’s requested test year bad debt level is \$389,421, significantly greater than the average for comparable water utilities and results from its poor service and billing practices.

AUF’s requested test year bad debt level is \$389,421. Using a three-year average of the Company’s bad debt, the Commission made a reduction to the requested bad debt of \$3,199. However, this methodology does not account for the Company’s significant contribution to the

reason bad debt is so high due to its unsatisfactory customer service, poor billing practices, and meter reading practices. Considering these specific circumstances, the three year average unjustly penalizes customers for AUF's bad service by imposing higher bad debt.

Moreover, the three year average used in the PAA Order to test the reasonableness of the bad debt level was flawed. The average included the full test year period and a second period which included six months of the test year, thereby double counting six months of the test year. In addition, the inclusion of the test year includes test year expenses that inappropriately distort the average. If the test year is abnormally high or low, it will raise or lower the comparative average. It is incorrect to include in the average the data that is being tested for reasonableness (i.e. the test year bad debt). In addition, the average used in the PAA Order included some outliers that should not have been included, such as the bad debt of \$172,880 for the year ending April 2009 for wastewater Rate band 2, which is 45% of the total system bad debt for that period. The bad debt for prior and post April 2009 period was significantly less (\$27,979 for 2008 and \$8,746 for 2010). *Correcting for the inherent problems with the time periods used in the PAA Order, the test year bad debt would be reduced by \$81,633.*

However, the three year average still includes the impacts of AUF's poor customer service and billing practices that have been on-going since 2007. The testimony overwhelmingly demonstrates that customers are still experiencing billing problems associated with untimely or inadequate information, meter reading inconsistencies, and estimated bills which undoubtedly have lead to higher bad debt expenses in the test year as compared to companies with good billing practices. In fact, comparing AUF's test year bad debt expense to the average for comparable companies results in a reduction of bad debt of \$310,816 to a level of \$78,605.

Issue 22:

What is the appropriate amount of rate case expense?

OPC:

Rate case expense is overstated and should be reduced by \$265,000. Ratepayers should not have to pay any more than those costs that are reasonable and necessary. The MFRs included \$670,268 for rate case expense and further increased this amount to \$1,249,320, as of July 31,

2011. This expense requested by the utility is inflated with costs that the ratepayers should not have to bear. Further, while 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. Therefore, the Company should be required to share rate case expense 50/50 between ratepayers and stockholders, the same as in a 2007 case for an AUF affiliate in New Jersey.

The specific expenses that the company included in rate case expense included expenses to correct MFR deficiencies, prepare for issues that are not in the current case, and expenses that did not have any supporting documentation. These costs should be removed.

The Company also included excessive rate case expense associated with bringing unnecessary Aqua persons to the service hearings. To the extent that Aqua believes that it is necessary to have 5 or more employees attend these service hearings that is a cost the Company should bear, not the ratepayers.

The Company also frustrated the discovery process and caused unnecessary delay and costs because it produced hard copies of documents. Most if not all of these documents were available electronically. The inefficiency and intentional obfuscation should not be permitted and the Commission should disallow all costs included in the rate case associated with producing unnecessary hard copies of documents that are available electronically during the discovery process. 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.

The company also included inflated costs in rate case expense due to the fact that it keeps its books and records out-of-state. The Commission has maintained in prior dockets that rate case expense should be disallowed when it is incurred due to the books and records being maintained out-of-state. The Commission has stated "We do not believe that the ratepayers should bear the related costs of having the records located out of state. This is a decision of the shareholders of the Utility, and therefore, they shall bear the related costs. Therefore, all of these costs should be removed from rate case expense." See Order No. PSC-10-0400-PAA-WS, p. 23.

Rate case expense also includes \$51,817 for corporate capital charges. This includes time spent by in-house staff, which also charged time to Operation and Maintenance expenses. Without proof as to where their time was charged during the test year to verify that these are not double counting salary expense, these charges should be removed from rate case expense.

Rate case expense also included charges related to the Quality of Service issues from the last rate case. Because the commission found in the last case that the quality of service was marginal, it required a monitoring program. The Company should not be allowed to recover charges related to this monitoring program that was a result of its marginal service provided. Therefore, these costs should be removed.

Approximately 42% of the rate case expense was attributable to legal fees. These legal fees included some of the higher rates in the state based on a survey published by the Florida Bar. If a Utility chooses to hire a law firm that charges some of the higher rates in the state, the shareholders should bear some of the burden. Customers should not have to bear any unreasonable costs. If the full amount of all reasonable or unreasonable expense is passed through to the ratepayers as rate case expense, the utility has no incentive to hold costs to a reasonable level. Therefore, these excessive costs should be removed from rate case expense.

These adjustments bring the revised requested rate case expense of \$1,249,320 to \$809,275. If this adjusted amount is split 50/50 between the ratepayers and shareholders, the amount that should be allowed in expenses is \$404,638.

The Commission should also defer the rate case expense approved in this proceeding until the rate case expense from the prior proceeding has been fully amortized. The Commission should not encourage utilities to file rate cases one on top of another with little time in between. The burden of "pancaking" rate cases is placed squarely on the shoulders of ratepayers. Yet, again, it is the stockholder that benefits the most from rate cases.

Issue 23: What is the test year pre-repression water and wastewater operating income or loss before any revenue increase? (Fallout Issue)

OPC:

The test year pre-repression water and wastewater operating income or loss before any revenue increase should reflect OPC's recommended adjustments.

Issue 24:

Are the total operating expenses prudently incurred such that the resulting rates are affordable within the meaning and intent of fair, just, and reasonable pursuant to Sections 367.081 and 367.121, Florida Statutes? [AUF does not agree that this is an appropriate issue]

OPC:

No. AUF has overstated its operating expenses such that the resulting rates are not affordable within the meaning and intent of fair, just, and reasonable pursuant to Sections 367.081 and 367.121, Florida Statutes. The Commission should adopt the Citizens' recommended adjustments resulting in a total reduction of \$2.3 Million from the PAA Order.

Sections 367.081 and 367.121, Florida Statutes, require that rates are fair, just and reasonable, as well as compensatory and nondiscriminatory. The language of Sections 367.081 and 367.121, Florida Statutes, includes the concepts that the resulting rates be affordable. Rates are the end product of the ratemaking process. The construction of the statutory language requires that the Commission evaluate whether the end result of the ratemaking process produces a fair, just and reasonable result. Embedded into the language is the implicit acknowledgement that, while an individual cost on its own may be prudently incurred, that same cost may not be considered prudently incurred when evaluated as part of a group of costs. Simply reviewing the individual inputs for prudence and assuming that if the individual inputs are prudent the end result therefore must be prudent is a false assumption. As with any budgets like the state budget, if the end result would cause the rates (or in the state example - taxes) to go higher than Floridians can afford and stifles economic activity, then cuts must be made to individual expenditures that may have been considered reasonable on their own. Therefore, the Commission has an obligation to determine if the end results, i.e. final rates approved, are fair, just, and reasonable such that the rates are affordable to customers and will not cause undue

hardship. In fact, the Commission already recognizes this concept in describing its mission on its webpage what it states that it “is committed to making sure that Florida’s consumers receive some of their most essential services – electric, natural gas, telephone, water and wastewater – in a safe, affordable and reliable manner”. (Emphasis added.)

Almost all of Aqua’s customers testified that Aqua’s rates are unaffordable. Customers testified that their neighbors are moving out of Aqua developments. Others testified that they or their neighbors have been unable to sell their existing properties because of the high Aqua rates. In addition, customers indicated that AUF’s rates are contributing to a downward spiral in the number of occupied homes in developments served by AUF due to their high rates and poor quality of service. In fact, the combination of AUF’s poor service and high rates have caused AUF customers to organize against them.

As indicated in previous issues, AUF has overstated its rate base and net operating expenses which is leading to some of the highest rates in the state. While AUF’s business model has been to buy small, troubled systems and supposedly bring better management and economies of scales, the peer group analysis of comparable Class A, B, and C water and wastewater companies demonstrates that AUF has not delivered these benefits to its customers. Therefore, the Commission should make the Citizens’ recommended adjustments resulting in a total reduction of \$2.3 Million from the PAA Order.

REVENUE REQUIREMENT

Issue 25:

What is the appropriate pre-repression revenue requirement for the April 30, 2010, test year? (Fallout Issue)

OPC:

Consistent with OPC’s recommended adjustments, the total water revenue requirement should be \$8,933,855 and wastewater revenues requirement should be \$5,185,208.

RATES AND CHARGES

Issue 26:

What are the appropriate rate cap thresholds to be used to cap residential customer bills for the water and wastewater systems?

OPC:

Rate cap residential customer bills should be capped at an affordable level. In the last rate case, the Commission found it appropriate to cap the rates. In Order No. PSC-09-0385-FOF-WS, issued May 29, 2009, the Commission stated on page 127:

Implicit in the rates approved by this Commission in all cases is the determination that the resulting bills are affordable. An analysis of the results in the table based on our prior decisions reveals that the average water bill from the cases presented is \$33.39, while the corresponding wastewater bill is \$44.60. In the Affordability Table, the calculated standard deviation is \$16.26 for the water systems and \$19.16 for the wastewater systems. The standard deviation measures the spread of the data on either side of the average. Based on the respective system averages plus 1.96 standard deviations (which captures approximately 95 percent of the variation), the affordability limits are \$65.26 for the water system and \$82.15 for the wastewater system. Rounding each of these values to the nearest \$0.25 results in affordability values of \$65.25 for the water system and \$82.25 for the wastewater system. All other factors being equal, we find these values, based on our historical decisions, are reasonable.

Id. at p. 127. Given that AUF's requested rate increase is less than two years later, the comparative analysis of the average water and wastewater rates are applicable in the present rate case. If less than two years ago the "affordability limits" for water was \$65.25 for water and \$82.25 for wastewater, it is unreasonable to conclude that AUF's current increase request will not result in rates that exceed these limits.

Irrespective of staff's previous analysis, Citizens' analysis of AUF's current rates shows that they have some of the highest rates in the state without any increases. As indicated in previous issues, AUF has overstated its rate base and net operating expenses that is leading to some of the highest rates in the state. While AUF's business model has been to buy small, troubled systems and supposedly bring better management and economies of scales, the peer group analysis of comparable Class A, B, and C water and wastewater companies demonstrates that AUF has not delivered these benefits to its customers. Citizens contend that the overall rates requested by AUF are overstated. Therefore, the Commission should make the Citizens' recommended adjustments resulting in a total reduction of \$2.3 million from the PAA Order.

Issue 27:

What are the appropriate rate structures for the Utility's water and wastewater systems? (Fallout Issue)

OPC:

No Position at this time.

Issue 28:

What is the appropriate level of rate consolidation for the water systems in this case? (Fallout Issue)

OPC:

No Position at this time.

Issue 29:

What is the appropriate level of rate consolidation for the wastewater systems in this case? (Fallout Issue)

OPC:

No Position at this time.

Issue 30:

What are the appropriate resulting repression adjustments for this Utility? (Fallout Issue)

OPC:

No Position at this time.

Issue 31:

What are the appropriate monthly rates for the water and wastewater systems for the Utility? (Fallout Issue)

OPC:

No Position at this time.

OTHER ISSUES

Issue 32:

What are the appropriate allowance for funds prudently invested charges for the Utility's Breeze Hill wastewater treatment plant? (Fallout Issue)

OPC:

No Position at this time.

Issue 33:

What are the appropriate customer deposits for the Utility? (Fallout Issue)

OPC:

No Position at this time.

Issue 34:

What is the appropriate four-year rate case expense reduction for Docket No. 080121-WS? (Fallout Issue)

OPC:

No Position at this time.

Issue 35: 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? (Fallout Issue)

OPC:

No Position at this time.

Issue 36: In determining whether any portion of the implemented PAA rates should be refunded, **how should the refund be calculated**, and what is the amount of the refund, if any? (Fallout Issue)

OPC:

No Position at this time.

Issue 37:

What is the appropriate amount by which rates should be reduced four years after the established effective date to reflect the removal of the amortized rate case expense for the instant case as required by Section 367.0816, F.S.? (Fallout Issue)

OPC:

No Position at this time.

Issue 38:

In accordance with Order No. PSC-10-0707-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 it first applied for interim rates?

OPC:

No Position at this time.

Issue 39:

Should this docket be closed?

OPC:

The docket should remain open to continue monitoring AUF's quality of service.

5. STIPULATED ISSUES

OPC is not aware of any stipulated issues at this time.

6. PENDING MOTIONS

OPC has a Joint Motion to Move Brief filing Date.

7. PENDING CONFIDENTIALITY CLAIMS OR REQUESTS

OPC has no pending requests for confidentiality at this time.

8. OBJECTIONS TO WITNESS QUALIFICATIONS AS AN EXPERT

OPC has no objections to any witnesses' qualifications at this time.

9. COMPLIANCE WITH ORDER NO. PSC-11-0309-PCO-WS

OPC has complied with all requirements of the Order Establishing Procedure entered in this docket.

Dated this 2nd day of November, 2011.

Respectfully submitted,



Patricia A. Christensen
Florida Bar No. 0989789
Associate Public Counsel
Office of Public Counsel
c/o The Florida Legislature
111 West Madison Street, Room 812
Tallahassee, FL 32399-1400
(850) 488-9330

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was furnished by e-mail and

U.S. Mail this 2nd day of November, 2011 to:

Ralph Jaeger
Caroline Klancke
Office of General Counsel
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

D. Bruce May
Holland & Knight LLP
Post Office Drawer 810
Tallahassee, FL 32399-1400

Joseph D. Richards
Pasco County Attorney's Office
8731 Citizens Drive, Suite 340
New Port Richey, FL 34654

Kenneth M. Curtin
Adams and Reese LLP
150 Second Avenue North, Suite 1700
St. Petersburg, Florida 33701

Kimberly A. Joyce
762 West Lancaster Avenue
Bryn Mawr, PA, 19010

Cecelia Bradley
Office of the Attorney General
The Capitol – PL
Tallahassee, FL 32399-1050



Patricia A. Christensen