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Representatives



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J.R. Kelly
Public Counsel

February 29, 2016

Braulio Baez, Executive Director
Via email
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Re: Docket No. 150071-SU, In Re: Application for increase in wastewater rates in Monroe County by K W Resort Utilities Corp.

Dear Mr. Baez:

The Office of Public Counsel has been closely monitoring K W Resort Utilities Corporation's (KWRU or Utility) rate case filing since the test year approval letter was submitted on March 3, 2015. We have several concerns we would like to highlight.

Concerns with Phase II Rates (Issue 16)

The historic December 31, 2014 test year the utility requested is inadequate for setting prospective Phase II rates. The Utility stated that pro forma adjustments would be made as a result of changes in operations related to upgrading the existing plant to advanced wastewater treatment (AWT) standards even though the Commission had previously authorized rates for operating at AWT in the Utility's last rate case. The Utility's test year letter also stated: "The Company anticipates including pro forma plant additions . . . consist[ing] of an additional 350,000 gpd in treatment capacity, and upgrades to meet the AWT standards. . . ." (emphasis added); however, it did not clearly indicate that it would request pro forma plant for this approximately 75% increase in plant capacity nor indicate that the plant expansion was directly related to future growth and not current demand. Further, the increased plant capacity may well be placed into service more than two years after the proposed December 31, 2014 historic test year, thus making the historic test year inadequate for the purpose of setting prospective rates. Had the Utility affirmatively stated that it would include growth related plant in its test year request letter, the Commission could have required the utility to file a projected test year, which could have alleviated many of OPC's concerns regarding the appropriate test year. Including the growth-related plant expansion and

related expenses in a historic test year, without including expected revenues, is not representative enough to set prospective rates unless adjustments are made to the filing in many areas that have not been addressed by the Utility or Commission Staff in the Phase II proposed rates.

For example, in 2015 (outside the test year), the Utility collected substantial amounts of contributions in aid of construction (CIAC) from existing and future customers. It may have also charged higher rates (due to account re-rating) than assumed in the 2014 billing determinants for certain general service customers. In addition, the recommendation does not address the fact there will be additional customer bills, consumption and revenues added in the first year once the additional capacity is added to the system. Phase II rates should have included projected future growth and revenues. By not utilizing a projected test year that takes into account these components for the substantial increase in the Utility's capacity in 2017, the Phase II rates could severely overstate the rates to the historical 2014 customers for plant additions. Without taking these factors into consideration, the Utility could easily exceed the Phase II revenues in the first year.

Generally, pro forma plant and expenses added to a historic test year should relate to non-growth related costs, such as environmental requirements or improvements to the current plant operations. These types of cost recovery fit easily into the historic test year concept because current customers receive the benefits. It matches current costs to current customers. When substantial growth-related plant is added to a historical test year without any adjustments for new customers and CIAC, it will force the existing customers to pay for the substantial investment that is clearly driven by the need to serve future customers. Staff's recommended Phase II rates use 2014 billing determinates (2014 customers and gallons sold) without projecting any future growth or future revenues. The Commission should not establish any prospective Phase II rates associated with the plant expansion project until adequate adjustments have been made to update the test year rate base and to project for the future customers, bills, and gallons. Staff's recommendation only considers the additional plant and expenses associated with the plant expansion and completely ignores the additional rate base and billing determinants that will be in effect the first year that the plant is scheduled to be placed in service.

Notwithstanding the matching problems associated with not using a projected test year, there is the added possibility that the plant construction will be completed after the 24-month deadline for considering pro forma plant pursuant to the requirements in Chapter 367, Florida Statutes. Despite assertions to the contrary, it is likely that the new plant expansion will be placed into service after January 1, 2017, more than two years after the December 31, 2016 historic test year. If future growth and future customers are driving the need for plant expansion, then revenues from future customers should be incorporated into Phase II rates. Phase II rates, as currently designed, do not

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follow the basic principle that “costs should follow the cost causer”, and future customers are driving these costs.

There is another reason why Phase II rates are not ripe for consideration by this Commission at this time. On February 22, 2016 and four days after staff filed its recommendations, the Utility filed several un-vetted and untested documents that, if incorporated into Phase II rates, will significantly increase Phase II rates imposed upon current customers. This attempt to inject new information into this proceeding after staff’s recommendation was filed is further evidence of the speculative nature of the Utility’s pro forma plant costs and expenses in Phase II.

OPC has additional concerns with Phase II rates which will be addressed if and when Phase II is set for an evidentiary hearing.

Concerns with Phase I rates (Issues 11 & 23)

Issue 11 addresses the issue of litigation expenses related to Phase II plant expansion (Last Stand Legal Fees). OPC has concerns with allowing deferred Phase II plant expansion litigation expenses to be amortized and recovered in Phase I rates. These litigation expenses are clearly related to obtaining the DEP permit for substantial plant capacity expansion, and not maintaining the existing plant operating permit. Since these costs are associated with the expansion of the plant capacity addressed by Phase II rates (Issue 17) and not the operating permit for existing plant capacity, these litigation expenses should be capitalized to the cost of the plant expansion, should be removed from Phase I rates, and should not be amortized over the 5-year life of the operating permit. The legal dispute centered on whether the expanded plant design should use deep well injection as opposed to shallow well injection to dispose of treated effluent. Legal fees associated with litigating the DEP permit for the type of plant to be built clearly correspond to the Utility Plant and should be capitalized consistent with the NARUC Uniform System of Accounts Accounting Instruction No. 19 (subpart 15). The *Utility Plant – Components of Construction Cost* states: “The cost of construction properly included in the utility plant accounts shall include, where applicable, the direct and overhead costs as listed and defined hereunder:” and itemizes the components of construction costs to be included in utility plant. Subpart 15 states: “15. ‘Legal expenditures’ includes the general legal expenditures incurred in connection with construction and the court and legal costs directly related thereto, other than legal expenses included in ‘protection,’ item 7, and in ‘injuries and damages’, item 8.” Therefore, it is clear that the litigation expenses for obtaining the DEP permit for the Phase II plant expansion should be capitalized, and not expensed or amortized.

Issue 23 concerns the elimination of the plant capacity charge. OPC and the Utility both believe that the elimination of the plant capacity charge is premature at this time. Phase II rates as recommended by staff do not include all the costs associated with the Phase II plant expansion.

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The Utility says it has collected over \$300,000 in additional CIAC outside the test year and that “the plant expansion will cost in excess of \$1 million more than was used in the calculations in the Staff Recommendation.” (February 22, 2016 email to staff).

Conclusion

For these reasons, while Phase I rates (as adjusted at least for removal of capitalized legal expenses) are ripe for consideration, Phase II rates are not. There is no statutory requirement that the Commission must make a decision on Phase II rates at this time, especially since the plant expansion will be placed into service more than two years after the December 31, 2014 test year. As such, the Commission has three options as it relates to Phase II rates.

First, deny Phase II rates for the utility’s failure to meet its burden of proof. It is axiomatic that the utility has the burden of proof to show its costs are reasonable. *See e.g., Florida Power Corp. v. Cresse*, 413 So.2d 1187, 1191 (Fla. 1982). The Utility can file for a new rate case or request a limited proceeding after the utility places the expanded plant into service, which will likely occur sometime after December 31, 2016.

Second, defer a decision on Phase II rates so the utility can provide this Commission all the information required to establish Phase II rates: namely, updated rate base, accumulated depreciation, and CIAC impacts of the future growth associated with the plant expansion. This will ensure that costs follow the cost causer since plant expansion is being driven solely by future growth and not existing customers.

Third, set the proposed Phase II rates straight for a Section 120.57(1), F.S., evidentiary hearing. An evidentiary hearing will allow Phase II rates to be fully vetted along with adjudicating any protested Phase I issues (if any) that the parties raise. The Commission has previously set proposed agency action (PAA) proceedings straight for hearing, and should do so in this case. *See e.g.,* Order No. PSC-06-0771-PCO-EI, issued September 18, 2006, in Docket No. 060162-EI (“After considerable discussion and deliberation, we decided on our own motion to set this matter directly for a formal administrative hearing. . . .”); Order No. PSC-07-0870-FOF-TP, issued October 30, 2007, in Docket No. 060582-TP (“Given the concerns expressed at the June 19, 2007 agenda, we find that a hearing for this docket would be appropriate”); Order No. PSC-99-0537-PCO-TP, issued March 23, 1999, in Docket No. 990193-EP (“It is evident that the facts in this case are disputed and convoluted in nature. . . . We shall, therefore, set this matter for hearing”).

Case law supports setting the proposed Phase II rates for an administrative hearing because there are disputed issues of material fact contained within the Utility’s own rate filings. “A party whose substantial interests are or will be affected by agency action is entitled to a Section 120.57 hearing.” *Friends of Hatchineha, Inc. v. State, Dep’t of Environmental Regulation*, 580 So. 2d 267, 271 (Fla.

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1DCA 1991) (quoting *McDonald v. Department of Banking & Finance*, 346 So. 2d 569, 578, 1977 (Fla. 1DCA 1977)) (emphasis added). “If there is a ‘disputed issue of material fact,’ the agency must provide a trial type hearing upon request ‘unless waived by all parties.’ ” *Friends of Hatchineha, Inc. v. State, Dep’t of Environmental Regulation*, 580 So. 2d 267, 271 (Fla. 1DCA 1991) (quoting *McDonald v. Department of Banking & Finance*, 346 So. 2d 569, 578, 1977 (Fla. 1DCA 1977)).

In conclusion, any of the three options will allow the Commission to establish Phase II rates that will be more representative of the operations that will be in effect when the new plant goes into service. If there are any questions regarding this letter, OPC will be available to address those at the March 1, 2016 agenda conference.

Sincerely,

/s/ Erik L. Sayler

Erik L. Sayler

CC: Office of Commission Clerk (Stauffer via email)
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Docket File (Docket No. 150071 via e-file)