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July 23, 1999

BY HAND DELIVERY

Ms. Blanca S. Bayó
Director, Records & Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: Mid-County Services, Inc. - Docket No. 971065-SU

Dear Ms. Bayó:

Enclosed for filing, on behalf of Mid-County Services, Inc., are the original and fifteen copies of its Post Hearing Brief.

If you have any questions regarding this filing, please call.

Very truly yours,

Richard D. Melson

RDM/clp
Enclosures

cc: Ms. Brubaker
Mr. Wenz
Mr. Rasmussen
Mr. Seidman

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application for rate increase in Pinellas County by Mid-County Services, Inc.	)	Docket No. 971065-SU
	)	Filed: July 23, 1999

MID-COUNTY SERVICES, INC.'s POST-HEARING BRIEF

Mid-County Services, Inc. (Mid-County) hereby files its post-hearing brief setting forth its position on each issue in this case, together with a discussion of the evidence supporting that position.

MATTERS DEEMED STIPULATED

The hearing in this case is the result of Mid-County's protest of Notice of Proposed Agency Action Order No. PSC-98-0524-FOF-SU ("PAA Order"). After hearing extensive argument at the outset of the hearing, the Commission ruled that several issues identified in the Prehearing Order -- Issue 5 (effluent disposal used and useful), Issue 6 (wastewater collection system used and useful), Issue 9 (return on equity) and Issue 10 (overall rate of return) -- related to matters that were not the subject of a timely protest to the PAA Order in this docket and therefore are deemed to be stipulated pursuant to Section 120.80(13)(b), Florida Statutes. (Tr. I:87-89)

Based on this ruling, and pursuant to the Commission's findings in the PAA Order:

(a) The effluent disposal system is 100% used and useful.

(b) The wastewater collection system is 100% used and useful.

(c) The proper level of allowed return on equity is 10.16%, with a range from 9.16% to 11.16%.

(d) The appropriate overall rate of return is 9.34%, with a range of 8.89% to 9.79%.

ISSUES REMAINING FOR RESOLUTION

Issue 1: How should construction work in progress (CWIP) be treated?

Utility: The entire cost of the main relocation project ($189,138) should be included in rate base, as should the entire cost of the remaining projects ($101,933) shown as CWIP in the MFRs, after staff's adjustment of $4,500. There should not be a negative balance in the CWIP account after the inclusion of these projects in plant in service.

The utility had a number of construction projects in progress at the end of the 1996 test year which were subsequently placed in service during 1997. At the time the MFRs were filed, the estimated cost of these projects totaled $296,659. (Ex. 4, MFR Sched. A-6) About two-thirds of this estimated amount, or $195,891, was related to two main relocation projects required by the widening of U.S. 19 and Belcher Road. The balance of the estimated amount, or $100,768, related to a number of other projects. By the time of the final hearing, the utility presented final cost figures for these projects which differed by

less than ½ of 1% from the original cost estimates. As shown by Late-Filed Exhibit 2 to the deposition of Mr. Wenz, the final cost of the main relocation projects was $189,138 and the final cost of the other projects was $106,433, for a total actual cost of $295,571. (Ex. 9)

In its PAA Order, the Commission made a $4,500 adjustment to the CWIP balance to eliminate a charge which had been booked twice, then it reclassified the rest of the estimated cost of these projects ($292,159) as utility plant in service. (PAA Order at 13-14) At the same time, the CWIP balance as presented in the MFRs was reduced by the full $296,659, leaving a negative CWIP balance of $148,329. (PAA Order, Sched. 1-A) This treatment had the effect of including only one-half of the cost of these projects in rate base.

Upon reviewing the PAA Order, the utility realized for the first time that it had mistakenly included only one-half of the CWIP balance in rate base in the MFRs. (Wenz, Tr. II:130, 141-144) Since these projects were placed in service well before the time that the rates from this proceeding will go into effect, it is appropriate to include their entire cost in rate base. (Wenz, Tr. II:137, III:394) The utility therefore protested the portion of the PAA Order related to the ratemaking treatment of CWIP in order to urge the Commission to include the entire balance of these projects in rate base.

It is appropriate include the full amount of these projects in rate base. (Wenz, Tr. II:151) The two main relocation projects were not discretionary; they were required by the widening and improvement of US 19 and Belcher Road. Because this project was non-elective, the cost of the project is an appropriate pro forma addition to the 1996 test year rate base. (Wenz, Tr. II:130; Crouch, Tr. III:343) The remaining projects should also be included in rate base because (a) they were completed well before the rates from this case will go into effect, (b) they were required to continue to provide high quality service to existing customers, (c) they did not provide additional capacity to serve future customers, and (d) they were capital in nature since they improved the efficiency and extended the life of the related plant. (Wenz, Tr. II:154-155, III:394)

There is no testimony against including in rate base the full amount associated with the main relocation project. With respect to the other projects, Mr. Larkin suggested that the utility should be limited to including the average balance in rate base. (Larkin, Tr. II:272-273) None of the staff witnesses addressed the appropriate ratemaking treatment of the other projects, although Mr. Winston did state that the estimated project costs in the MFRs should be updated to actual amounts before determining how much should be included in rate base. (Winston, Tr. III:313-A) As previously stated, these actual

amounts were included in Late-Filed Exhibit 2 to Mr. Wenz' deposition, so this staff concern has been satisfied. (Ex. 9)

In prehearing filings, the Office of Public Counsel took the position that since the utility had mistakenly included only one-half of the CWIP balance in rate base in the MFRs, and since the Commission had included the full amount "requested" by the utility in rate base in the PAA Order, the Commission should refuse to take testimony in support of including additional CWIP in rate base. After hearing argument on this point at the outset of the hearing, the Commission ruled that it would take testimony on the amount of CWIP to be included in rate base, but would reserve judgment on whether recovery of the full amount is justified under the circumstances of this case. (Tr. I:106-108)

The Commission's general policy is that the overall dollar amount of a rate increase that can be granted is limited to the amount requested by the utility in its application for rate relief. Below that ceiling, the Commission and the parties are free to seek adjustments up or down to individual components of the ratemaking equation in order to reflect appropriate ratemaking policy or to correct errors or mistakes in the MFRs. The fact that this case was initially processed using the Commission's proposed agency action procedures -- rather than being scheduled from the outset for a full evidentiary hearing -- provides no basis to deviate from this long-standing Commission practice. If an error is made, and if that error relates to a

matter put into issue by a timely protest of the PAA order, then that error should be corrected.

In this case the uncontroverted testimony shows that, at a minimum, the entire cost of the main relocation project should be included in rate base. This is more than the amount of CWIP that was included in rate base in the PAA Order. Unless the Commission accords the proper ratemaking treatment to this amount, the utility will be unfairly penalized for a mistake in the MFRs which it identified in its protest and put before the Commission in a timely manner. Similarly, there is no reason the Commission should refuse to consider and decide the appropriate ratemaking treatment of the remaining CWIP projects at issue.

The utility concedes that, *at some point*, the Commission can prevent a party from introducing new issues or attempting to correct an earlier mistake. In a PAA case, that point occurs by operation of law at the time when the timely protests have defined the issues to be litigated. There is no basis in logic or law to cut off that right at any earlier point in time.

Issue 1A: Did the PAA grant the entire revenue requirement associated with the CWIP sought by Mid-County in its original filing?

Utility: Yes, but the original filing mistakenly included only an average balance for CWIP instead of the full cost of the projects.

See Issue 1, above, for a discussion of why the mistake in the original MFRs should not prevent the Commission from properly including in rate base the entire CWIP balance related to the projects which were in progress during the test year.

Issue 2: What is the appropriate methodology for calculating used and useful for the wastewater treatment plant?

Utility: The appropriate used and useful methodology is to divide the permitted capacity of the wastewater treatment plant by either the maximum month average daily flow or the three maximum month average daily flow. In this case, either methodology results in 100% used and useful, after taking into account an appropriate margin reserve.

The Commission's long-standing policy has been to determine the used and useful percentage for a wastewater treatment plant by dividing the permitted capacity of the plant by the average daily flow for the peak (maximum) month. See Florida Cities Water Company v. State of Florida, Florida Public Service Commission, 705 So.2d 620, 624-626 (Fla. 1st DCA, 1998), and the PSC orders cited therein. In the Florida Cities rate case, the Commission for the first time used "annual average daily flow" in the numerator of the used and useful calculation. On appeal, the court held that this represented a policy shift that was essentially unsupported by the record. In doing so, the court rejected the PSC's argument that it was merely correcting a historical mathematical miscalculation. The court therefore remanded the case to the Commission "to give a reasonable

explanation, if it can, supported by record evidence (which all parties must have an opportunity to address) as to why average daily flow in the peak month was ignored." Id. at 626.

The court followed and extended this precedent in two subsequent cases. In Southern States Utilities v. Florida Public Service Commission, 714 So.2d 1046 (Fla. 1st DCA, 1998) (en banc), the Commission again had calculated the used and useful investment in wastewater treatment plant using "average annual daily flow" divided by permitted capacity. In this case, the Commission abandoned its claim of mathematical error. Instead, the Commission relied on the fact that DEP was now showing the permitted capacity in terms of annual average daily flow on the face of its wastewater treatment plant permits as a rationale for its change in policy. The court rejected this new rationale, stating that:

> The use of the PSC's new method to calculate used and useful percentage is a shift in PSC policy, which no change in the wording of a permit justifies, unless the change in wording corresponds to a real change in operating capacity.
>
> Id. at 1056.

Accord, Palm Coast Utility Corporation v. State of Florida, Florida Public Service Commission, ___ So.2d ___ (Fla. 1st DCA, 1999).

The PAA Order in this case applied the same used and useful methodology -- average annual daily flow divided by permitted

capacity -- which the First District Court of Appeal has three times rejected. The rationales given in the PAA Order for this methodology were "mathematical logic" and the new DEP practice of showing the basis for permitting on the face of the permit. (PAA Order at 4-5) These are essentially the same rationales that were soundly rejected by the court in the decisions cited above.

The facts in this case are not in dispute. The permitted capacity of Mid-County's wastewater treatment plant is 900,000 gallons per day (GPD). This permitted capacity is stated in terms of annual average daily flow. The DEP permit, which increased the permitted capacity of the plant from 800,000 GPD to 900,000 GPD was issued on April 1, 1994. (Crouch, Tr. III:338; Ex. 19, RGC-5) The average annual daily flow during the 1996 test year was 720,956 GPD; the peak month average daily flow was 828,000 GPD. (Ex. 11, FS-1) If a used and useful percentage is calculated using peak month average daily flow divided by permitted capacity, the result is 92%. Calculated using annual average daily flow divided by permitted capacity, the result drops to 80.11%.

The history of the Commission's used and useful determinations for Mid-County is also not in dispute. The current DEP permit increasing the permitted capacity from 800,000 to 900,000 GPD was issued after the proposed agency action order in Mid-County's prior 1992 test year rate case, but before the issuance of the final order in that case. The used and useful

percentage contained in the proposed agency action order in Mid-County's 1992 test year rate case was calculated by dividing the maximum month average daily flow by the permitted capacity of the plant. (Order No. PSC-93-1713-FOF-SU at 6) When the permitted capacity of the plant was increased prior to the entry of the final order in that case, this same methodology was used to calculate the reduced used and useful percentage stipulated to by the utility and the Commission staff. (Seidman, Tr. II:184; Crouch, Tr. III:342-343, 348-350)

The effect of the Commission's proposed change in used and useful methodology is significant. Before margin reserve, the used and useful calculation in Mid-County's 1992 test year rate case produced an 83% used and useful percentage.[1] This represents a Commission determination that 83% of Mid-County's investment in its wastewater treatment plant at that time was appropriately included in rate base and the costs were appropriately recovered from its customers.

Since the 1992 test year rate case: (a) there have been no changes in the physical capacity of the plant; (b) there have been no changes in the basis of the plant's design flow; and (c)

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[1] Based on Exhibit 11, FS-1, the prior maximum month average daily flow of 748,000 divided by the permitted capacity of 900,000 yields a used and useful percentage of 83.11%. This was increased by an approximate 5% margin reserve (see Order No. PSC-93-1713-FOF-SU at 6) to produce the 88% used and useful percentage stipulated to by the Commission staff and approved by the Commission in Order No. PSC-94-1042-FOF-SU. (See Crouch, Tr. III:342-343)

there have been no changes in the DEP permit. (Seidman, Tr. II:184) In contrast, between the 1992 test year and the 1996 test year: (a) the number of equivalent residential connections served increased by 11.7%; (b) the annual average daily flows increased by 9.14%; and (c) the maximum month average daily flows increased by 10.7%. (Seidman, Tr. III:185; Ex. 11, FS-1) Despite this significant *increase* in customers served and flows treated, the methodology supported by Mr. Crouch would *decrease* the percentage of investment recoverable from ratepayers (before margin reserve) from 83% to 80.1%. This means that dollars the Commission had previously concluded were prudently invested to serve existing customers in 1992 are now removed from rate base, even though there has been roughly a 10% increase in the level of service actually provided. This result is not only counter-intuitive, it is wrong. (See Seidman, Tr. II:186)

The court in the Florida Cities, Southern States, and Palm Coast cases did hold out the possibility that the Commission could justify a shift in its policy by evidence of something more than a mere change in the DEP's stated basis for permitting or a desire to correct a past "error" in mathematical calculations. No such evidence has been produced in this case.

Mr. Crouch's testimony on the appropriate calculation of used and useful percentage is all a variation on the two themes that have been rejected by the court. The first fundamental

point of Mr. Crouch's testimony is what he calls the "elementary mathematical fact" that the numerator and denominator of the used and useful fraction must be stated in units that are "dimensionally consistent," and that anything else is an improper "mathematical mismatch." (Crouch, Tr. III:336-337, 339-340, 353-354)) This position is nothing more than a restatement, in somewhat greater detail, of the "mathematical error" rationale that the court has previously held is an insufficient basis to support a change in Commission policy.

Mr. Crouch's second fundamental point is that "when DEP started listing the flow basis in the permits (the denominator), it became imperative that the same basis be used in the numerator flow data." (Crouch, Tr. III:337) Again, this is simply a restatement of the "DEP permit" rationale that the court has previously held is also an insufficient basis to support a change in Commission policy.

Moreover, cross-examination showed that Mr. Crouch's conclusion about the logical need for "dimensional consistency" is flawed. As Mr. Crouch admitted, physics and mathematics abound with examples where different units of measurement are divided to produce meaningful results. For example, miles are divided by hours, or yards are divided by seconds, to express what is called "speed." (Crouch, Tr. III:354) Similarly, the Commission has historically divided peak month average daily flow by permitted capacity to express what is called "used and

useful." (See Crouch, Tr. III:355-356; Ex. 22) There is nothing mathematically incorrect about this calculation so long as the units of measurement are understood. (Crouch, Tr. III:355)

Mr. Biddy's testimony makes essentially the same points as Mr. Crouch's, that there should be consistency between the flow basis stated in the DEP permit and the flow basis used in the numerator of the used and useful calculation. (Biddy, Tr. II:226-228; 238) This testimony is entitled to little weight, since it *contradicts* testimony that Mr. Biddy gave in both the Southern States rate case and the Palm Coast rate case. In those cases, Mr. Biddy calculated used and useful percentages by dividing peak flows by a denominator containing permitted capacity on an average annual daily flow basis. (Biddy, Tr. II:248-249) This is the precise method which he now urges that the Commission must reject as being a calculation with no meaning. (Biddy, Tr. II:247-248)

Mr. Seidman, on the other hand, presented substantial testimony in support of the methodology the Commission has applied in the past. First, as noted above, the change in policy proposed in this case would have the illogical result that fewer dollars of wastewater plant investment would be recoverable today than in the last rate case, despite the fact that the amount of utility services provided has grown by roughly 10% in the intervening years. Second, and equally important, the

Commission's historical approach of dividing peak month average daily flows by the permitted capacity of the plant is the appropriate measure of that portion of Mid-County's wastewater treatment plant assets that are used and useful in the public service. (Seidman, Tr. II:173) The calculation of a used and useful percentage is not an end in itself. (Seidman, Tr. III:417) Instead, the use of a formula for calculating used and useful reflects the Commission's attempt to simplify the measurement of whether facilities are reasonably necessary to furnish adequate service to the utility's customers, so as to be recoverable from current customers under Section 367.081(2)(a), Florida Statutes. (Seidman, Tr. II:178-179, 180-181, III:416-417)

The staff and OPC's position that annual average daily flows should be used in the numerator of the used and useful fraction in this case ignores the facts that:

(a) Wastewater plants must be capable of treating all hourly, daily, monthly and seasonal variations in flow, not just average flows. DEP's permitting review has always considered whether a plant is sufficient to treat all flows, whenever they occur. The change in DEP's practice regarding showing the basis of design on the face of the permit does not change the basis for DEP's permit review, nor does it change operational capability of any plant. (Seidman, Tr. III:420) The record does not show, as required by the portion of the Southern States case quoted

earlier, that "the change in wording corresponds to a real change in operating capacity."

(b) Even though the Mid-County plant is permitted on an average daily flow basis, DEP rules require the comparison of peak flows to permitted capacity to determine when a capacity expansion will be required. (Seidman, Tr. III:425)

(c) Permitting the Mid-County plant on an average daily flow basis gives the utility maximum flexibility to accommodate changes in daily and monthly flows without the necessity to engage in costly plant upgrades. If used and useful is calculated on an average daily flow basis, however, Mid-County will never be able to achieve a 100% used and useful level before another plant upgrade is required. Economic regulation by the Commission should not penalize Mid-County for having obtained a permit on a basis that lowers the overall cost to the utility and its customers. (Seidman, Tr. III:423-427, 437-438)

For all these reasons, the record shows that the Commission's long-standing policy of using peak flows in the numerator of the used and useful calculation is the correct ratemaking policy, and that methodology should not be changed in this case.

Finally, Mr. Biddy contends that the Commission should use the Mid-County plant's original design capacity of 1.1 MGD as the denominator of the used and useful fraction, instead of the DEP permitted capacity of 0.9 MGD. (Biddy, Tr. II:231-234) This

ignores the fact that while the plant was originally designed to treat 1.1 MGD, it proved incapable of meeting subsequently adopted, more stringent treatment standards at that level. In order to meet these new DEP requirements, 200,000 gallons of aeration basin were reconfigured as equalization. As a result of this changes, the plant is currently capable of treating only 900,000 GPD, the amount for which it is permitted. (Seidman, Tr. III:475-476, 478-479)

Mr. Biddy then contends that the plant could be restored to it former design capacity by the addition of one or two blowers at a fairly nominal cost, and that this is a reason for treating the plant as though it is larger than its permitted capacity. (Biddy, Tr. III:501-502) This testimony is speculative, since Mr. Biddy admits that he has not examined the details of the plant design, which is the level of investigation that would be required to make a definitive judgment on whether and how the plant capacity could be expanded, and at what cost. (Biddy, Tr. III:502-503) Even viewed most favorably to Mr. Biddy's position, the evidence shows that (i) the plant as currently configured cannot treat more than 900,000 GPD without some additional capital expenditure (Seidman, Tr. III:428-429), and (ii) the utility has no operational need for that additional capacity. (Biddy, Tr. III:502) What Mr. Biddy is suggesting is that the utility should be required to spend dollars for capacity it does not need because the incremental cost of adding that capacity is

less than the average cost of the embedded capacity, and because making that expenditure would reduce the total dollars of plant investment deemed used and useful for ratemaking purposes. In other words, the utility should spend unnecessary capital dollars in order to reduce its rate base. This is ratemaking run amok.

Issue 3: Should the utility be granted margin reserve, and if so, what is the appropriate amount which should be used?

Utility: Yes. The appropriate margin reserve period is that sufficient to install the next economically feasible increment of plant capacity. For Mid-County, that period is five years and represents capacity equal to 13.6% of test year flows.

A regulated utility must maintain, at all times, sufficient capacity to meet its statutory responsibilities. Those responsibilities include meeting the changing demands of existing customers and the demands of potential customers in a reasonable period of time. The Commission has identified as "margin reserve" the portion of plant that must be in place and available to serve until the next economic capacity addition can be placed in service. (Seidman, Tr. II:187) In light of the permitting requirements of DEP, the margin reserve period should be a minimum of five years, to take into account the time required to plan, design, permit and construct an economically sized addition to plant. (Seidman, Tr. II:187-188)

The particular history of Mid-County demonstrates that a five year margin reserve is justified for this utility. That history shows that under prior ownership the utility was making continual expansions, on a three to four year cycle, which lacked sufficient capacity to allow for longer, more economical sizing. When the utility outgrew these early expansions after another four year period, it faced building moratoriums while an adequately sized plant expansion was under design and construction. The lack of sufficient margin reserve capacity during this period resulted in a deterioration in service until the capacity addition could be placed in service. (Seidman, Tr. III:441-443) Given this history, it is clearly prudent to anticipate a five year margin reserve requirement for Mid-County. (Seidman, Tr. III:443)

Mr. Crouch agrees that DEP may require a utility to plan for expansion of facilities as much as five years in advance. (Crouch, Tr. III:341) However, he attempts to justify a shorter margin reserve period by focusing on the portion of the five year period during which the utility is likely to be expending significant funds on actual construction. (Crouch, Tr. III:341; Seidman, Tr. III:440) This misses the point. The margin reserve does *not* represent dollars associated with a future plant addition. It reflects dollars associated with *existing* plant that is required to continue to provide service during the period

that a future plant addition is planned, designed and constructed. If the time period required to plan and install the next economically feasible increment of plant capacity is five years, as Mr. Crouch seems to agree, but the margin reserve is limited to 18 months, then the utility goes uncompensated for its existing investment in 3-1/2 years worth of capacity. (Seidman, Tr. III:440-441)

There is another factor that the Commission should consider in determining the appropriate margin reserve to be allowed in this case. On June 1, 1999, Governor Bush signed into law amendments to Chapter 367, Florida Statutes. (Chapter 99-319, Laws of Florida) These amendments add a new paragraph 2 to Section 367.081(2)(a) which specifies that utility property needed to serve customers within 5 years after the end of the test year shall be considered used and useful in setting rates. While this amendment does not bind the Commission with respect to rate cases pending on March 11, 1999 (see Section 9 of Chapter 99-319), there are strong policy reasons that the Commission should apply that same 5-year principle in this case:

(1) The Commission is not required to apply the 18-month margin reserve period advocated by staff, since that standard is not contained in an effective Commission rule.[2]

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[2] A proposed Commission rule which would have applied an 18-month margin reserve period as a rebuttable presumption was initially invalidated by the Division of Administrative Hearings. The DOAH decision was reversed on appeal in an opinion filed on

(2) The Legislature has declared that the state's policy on a going-forward basis is to allow a utility to recover the cost of 5-years' worth of margin reserve plant. In the absence of a rule specifying a different standard for pending cases, the Commission has the flexibility to implement this policy direction in such cases.

(3) The utility's testimony provides ample record support for applying the 5-year standard in this case.

(4) If the Commission does not grant a 5-year margin reserve in this case, it will simply give Mid-County the financial incentive to refile either a limited proceeding or a full rate case under the amended statute in order to recover its investment in plant that the Legislature has now declared must be considered used and useful for ratemaking purposes. The cost of this unnecessary proceeding would ultimately be borne by Mid-County's ratepayers.

Issue 4: What is the appropriate used and useful percentage of the wastewater treatment facility?

Utility: The wastewater treatment plant should be considered 100% used and useful.

May 10, 1999. Florida Public Service Commission v. Florida Waterworks Association, ___ So.2d ___ (Fla. 1st DCA, 1999). Because of the subsequent enactment of Chapter 99-319, however, the proposed rule has not been, and is not expected to be, filed for adoption. (See Crouch, Tr. III:345)

Under the Commission's long-standing used and useful methodology, which is supported by the testimony of Mr. Seidman, the appropriate used and useful percentage for Mid-County, before margin reserve, is 92%, based on a peak month flow of 828,000 GPD compared to a plant capacity of 900,000 GPD.

The appropriate margin reserve in this case is 13.6%, which represents 5 years of growth at the 73 ERC/year rate calculated by the Commission staff using its normal linear regression methodology. (See Seidman, Tr. II:201-203; III:447; Ex. 11, FS-2)

These combine to produce an overall 100% used and useful percentage.[3]

Issue 5: This issue is deemed stipulated. (Tr. I:87-89)

Issue 6: This issue is deemed stipulated. (Tr. I:87-89)

Issue 7: Should Contributions in Aid of Construction (CIAC) be imputed on the margin reserve, and if so, what amount?

Utility: No, CIAC should not be imputed on margin reserve.

The imputation of CIAC against margin reserve is inappropriate because it results in a mismatch of investment and contributions from different accounting periods. Margin reserve plant is a component of plant that is used and useful in the

[3] Even using the shorter 18-month margin reserve period advocated by staff would result in an overall used and useful percentage of 96%.

public service. Margin reserve plant is in service during the test year and the investment in that plant has been made during or prior to the test year. The effect of imputing CIAC is to reduce that required investment by funds which may be received in some future period. This imputation artificially reduces the amount of used and useful investment included in rate base, with the result that the utility is denied the opportunity to ever earn a return on that portion of its investment. (Seidman, Tr. II:190-191)

CIAC is received when a new customer comes on line. At that time, plant which had been "used and useful" as margin reserve plant becomes "used and useful" as plant serving the new customer. If the CIAC received from the customer is imputed to reduce rate base, then it would also be necessary to impute additional margin reserve plant to replace that now dedicated to the new customer's use. (Seidman, Tr. III:457-458) If CIAC is imputed without a corresponding imputation of additional plant, then over the life of the assets the utility never catches up and is never made whole in its ability to recover the cost of its necessary and prudent investment. (Seidman, Tr. III:458)

In this case, because of the level of Mid-County's service availability charges, the imputation of even 50% CIAC would result in none of the utility's investment in margin reserve being included in rate base. (Seidman, Tr. II:191; PAA Order at 10)

In deciding whether or not to impute CIAC on margin reserve in this case, the Commission should consider the state's new policy as established by Chapter 99-319, Laws of Florida. Under the amendments to Section 367.081(1), Florida Statutes, the Commission is prohibited from imputing prospective future contributions-in-aid-of-construction against the utility's investment in property used and useful in the public service. While this amendment does not bind the Commission with respect to cases pending on March 11, 1999, there is nothing which would prevent the Commission from declining to impute CIAC in this case. In particular: (a) the Commission has no rule requiring imputation; (b) the policy reasons against imputation are amply supported by the testimony of Mr. Seidman; and (c) if the Commission does impute CIAC, it will create an incentive for the utility to refile a limited proceeding or a full rate case to take advantage of the new provisions in Chapter 367, with the cost of that proceeding ultimately being borne by Mid-County's customers.

Issue 8: What is the appropriate rate base for the test year?

Utility: The appropriate rate base for the test year is $1,801,604.

The appropriate rate base, taking into account the effect of the preceding issues, is $1,801,604. This is the rate base shown on Exhibit 8 (CJW-1), adjusted downward by the difference

($1,088) between the original estimated cost of the CWIP projects and the actual cost as discussed in Issue 1, above.

Issue 9: This issue is deemed stipulated. (Tr. I:87-89)

Issue 10: This issue is deemed stipulated. (Tr. I:87-89)

Issue 11: Should operation and maintenance (O&M) expense be reduced for life insurance policies for officers, directors and key employees?

Utility: Yes, by $1,636. However no adjustment should be made for directors and officers liability insurance or for liability insurance related to the company's retirement plans.

The Commission accepted the parties' stipulation that the parent company's 1996 insurance expense, and the allocation of a portion of that expense to Mid-County, is correctly shown on Page 2 of Schedule HYS-1 of Exhibit 18. (Tr. I:41-42)

Mid-County agrees to a reduction of $1,636 in insurance expense, which represents Mid-County's allocated portion of the "key man life insurance" and "life insurance" shown on that schedule. Mid-County recognizes that under the NARUC Uniform System of Accounts, amounts paid for key-man life insurance are classified as miscellaneous nonutility expense.

The record provides no basis, however, to disallow recovery of the allocated cost of the accidental death insurance or the director/officer and pension plan fiduciary liability policies.

There is nothing in the NARUC System of Accounts which warrants treating these premiums as anything other than utility operations expense. (Wenz, Tr. III:393) The record shows that the individual employees of the company, not the company itself, are the beneficiaries of the accidental death insurance. (Wenz, Tr. II:138) Under the NARUC system of accounts, the cost of this type of insurance is properly recoverable through rates. (Sweeney, Tr. III:321)

Similarly, the premiums on the fiduciary liability polices are a legitimate utility expense. These policies protect the utility, and ultimately its ratepayers, from potential litigation costs and liabilities in the same manner as any other liability insurance. These policies also help the utility attract and retain qualified management personnel. As such, they provide a benefit to utility customers and their cost is properly recoverable through rates. (Wenz, Tr. II:138, III:392-393)

Issue 12: Are the allocations from Utilities, Inc. a reasonable distribution of the cost of the services provided to Mid-County?

Utility: Yes. The appropriate method to allocate common costs is based on customer equivalents as presented in the MFRs and in the company's testimony. This method results in a fair and reasonable allocation of costs to Mid-County.

Mid-County is a wholly-owned subsidiary of Utilities, Inc., which owns and operates utilities in 15 states. Water Services

Corporation ("WSC"), another subsidiary of Utilities, Inc. manages the operations of the approximately 300 utility systems owned by Utilities, Inc. throughout the country. WSC provides management, administrative, engineering, accounting, regulatory, billing, data processing and other services to the operating companies. Mid-County receives all of these services from WSC, with the exception of billing, which is provided by Pinellas County. (Wenz, Tr. II:132-133)

The costs associated with WSC are assigned to the various utility operating companies, including Mid-County, either directly or by various allocation formulas. The allocation formulas are based on customer equivalents, bills printed, accounts payable invoices keyed, payroll, the duties of WSC personnel, and other factors. These services are billed to the individual operating companies at cost, with no mark-up. (Wenz, Tr. II:132) Detailed information on the allocations to Mid-County during the 1996 test year are included in Exhibit 6.

The only issue regarding cost allocations relates to the methodology used to allocate common costs for which a more direct allocation methodology cannot be identified. For many years, Utilities, Inc. has used a customer equivalent methodology to allocate these common costs. The customer equivalent methodology treats each residential living unit as a customer equivalent, whether that unit is a separately metered detached single-family residence, a separately metered unit in a mobile home park, or a

unit in a master-metered apartment, condominium, or mobile home park. (Wenz, Tr. II:132-133)

In the PAA Order in this case, the Commission declined to use this customer equivalent allocation methodology and instead reallocated common costs to Mid-County based on equivalent residential connections, reflecting the gallons of wastewater treated. The effect of this change is to reduce the common costs allocated to Mid-County by almost $110,000. (PAA Order at 21)

The record demonstrates that Utilities, Inc.'s customer equivalent methodology results in a fair and reasonable allocation of common costs to Mid-County and should be reinstated as the basis for setting rates in this docket. (Wenz, Tr. III:398)

The use of the customer equivalent methodology is supported by the following factors:

(a) This methodology has been used for many years to allocate costs for all of the Utilities, Inc. operating utilities in the fifteen jurisdictions in which it does business and it has been accepted for ratemaking purposes by the regulators in those other states. (Wenz, Tr. II:133-134)

(b) This methodology has been used by the Utilities, Inc. systems in Florida for many years, and has consistently been accepted by the Commission for ratemaking purposes. (Wenz, Tr. II:133-134)

(c) The Commission staff performed an audit of the allocation methodology in 1997 and that audit did not suggest any modifications to the methodology. (Wenz, Tr. II:134)

(d) Unless a single, consistent methodology is used for all systems in all jurisdictions, there will never be a complete allocation of the common costs, and the utility will be denied an opportunity to recover all of its prudently incurred costs. For example, if the staff's suggested ERC methodology is used only for Mid-County, then Mid-County (and its stockholders) will be denied recovery of $110,000 of common costs that cannot be recovered from any system in any jurisdiction. (Wenz, Tr. II:133, 139; III:396)

The use of the staff's proposed equivalent residential connection (ERC) methodology should be rejected for the following reasons:

(a) The use of the ERC methodology is unfair and unreasonable in this case, since it understates the proper allocation to Mid-County. (Wenz, Tr. III:404-405)

(b) The staff's methodology makes the assumption that gallons treated is a more rational basis for allocating common costs than number of customers. (Wenz, Tr. III:397) In fact, if the common costs at issue varied with gallons treated, they would have been allocated on that basis. (Wenz, Tr. III:397) It is precisely because the costs do not vary on this basis that another allocator must be used.

(c) Even if the Commission were inclined to accept the staff's methodology, there is no evidence in the record to support its application to the facts of this case. The staff's methodology requires accurate information on the relative number of wastewater ERCs (i.e. gallons of wastewater treated) during the test year for all of the Utilities, Inc. systems nationwide. That information does not appear anywhere in the record in this proceeding. In particular, since this information is not used by Utilities, Inc. as the basis for any of its allocations, it does not appear in the cost allocation documentation which was presented as Exhibit 6.

In an apparent effort to sidestep this lack of data, staff appears to have compared "ERCs" for Mid-County to "customer equivalents" for all of the other Utilities, Inc. systems. There is no basis in the record to support making such an apples-and-oranges comparison.[4]

Issue 13: What is the appropriate amount of rate case expense?

Utility: The appropriate rate case expense is $171,707, consisting of $126,954 of current rate case expense and $44,753 from the prior rate case.

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[4] Mr. Davis did present what purports to be ERC data for all of the Florida subsidiaries of Utilities, Inc. (Ex. 23, Sched. BFD-1) However, cross-examination revealed that this exhibit erroneously compares single family residential gallons treated for Mid-County to total gallons treated for the other utilities. (Davis, Tr. III:380-381, 384) Thus the conclusions that Mr. Davis draws from this data about Mid-County absorbing a disproportionate share of the cost of common services is based on faulty data. (See Davis, Tr. III:368)

Pursuant to the final order from Mid-County's last rate case, Mid-County is entitled to recover, in this case, any prudent rate case expense in excess of $110,000 incurred in connection with the prior case. (Order No. PSC-94-1042-FOF-SU) The Commission staff reviewed the $162,854 of rate case expenses incurred in the last rate case and disallowed $8,101 of that amount, leaving an audited balance of $154,753. (Sweeny, Tr. III:324; Ex. 18, HYS-1, page 5) Mid-County accepted the audit adjustment, and no party has challenged that amount. Accordingly, Mid-County is entitled to recover $44,753 of prior rate case expense in this proceeding, which is the amount allowed and included in the PAA Order. (PAA Order at 23)

The actual and estimated rate case expense for the current case totals $126,954, as shown on Exhibit 24 (CJW-6). This amount includes the $50,206 incurred and allowed through the date of the PAA Order, plus $76,748 in additional expenses associated with the trial of this case. Detailed back-up documentation was provided to support these amounts. (Ex. 24)

The Office of Public Counsel has not challenged the accuracy or prudency of any of these amounts. Mr. Larkin nevertheless took the position that Mid-County should be limited to recovering from ratepayers the amount of rate case expense awarded in the PAA Order. His position is that (1) ratepayers should not be required to pay the cost of the utility rearguing policy issues where the Commission's decision was consistent with past

precedent, and (2) since ratepayers are already bearing the cost of expenses incurred in a prior service availability charge hearing which did not benefit them, they should not be asked to pay additional expenses in connection with the current case. (Larkin, Tr. II:275-279, 298) Neither of these is valid reason to disallow any of the utility's rate case expense.

First, there is nothing improper related to the issues raised by the protest. The used and useful issue is one on which the courts have three times ruled against the methodology included in the PAA Order. The margin reserve and imputed CIAC issues are ones that are not governed by any Commission rule, and on which the Legislature has now declared the policy of the state to be consistent with Mid-County's position. (See Wenz, Tr. II:399-400) The cost allocation issue is one where Mid-County is defending the disallowance of a methodology that has been approved by the Commission in the past. It is ludicrous to suggest that these issues are a simple "reargument" of established Commission policy, and are not proper subjects for a protest. With respect to the key-man and CWIP issues, Mr. Larkin states that the utility should have attempted to work these issues out with the staff. What Mr. Larkin overlooks is the fact that once a preliminary Commission decision on these issues is included in a PAA Order, the issues pass out of the staff's control, and the only way to have them revisited is by protesting the order and requesting a hearing.

Second, Mr. Larkin is wrong factually when he says that the hearing in the prior case did not benefit current customers and he is wrong legally when he suggests that the prior case expenses have any bearing on the recovery of current rate case expense. The hearing in the prior rate case involved a dispute between the utility and the developer over the proper level of service availability charges. The utility ultimately prevailed -- both before the Commission and on appeal -- in obtaining a substantial *increase* in such charges. Since service availability charge collections are booked as CIAC, which *reduces* rate base, customers in this case have benefitted, in the form of a lower revenue requirement, from the increased service availability charges paid over the past several years. They will continue to benefit as these higher service availability charges are collected in the future.

Issue 14: What is the appropriate net operating income for the test year?

Utility: The appropriate amount of net operating income is approximately $163,700. This is a fall-out from the above issues, coupled with the rulings in the PAA Order that were not protested.

The appropriate net operating income is approximately $163,700. This reflects the net operating income of $158,702 shown on Schedule CJW-2 of Exhibit 11, increased by approximately $5,000 to reflect the amortization of approximately $20,000 in

additional rate case expense compared to the $151,779 amount included in that schedule. (See Wenz, Tr. II:135)

As noted in Issue 15, below, the revenue requirement in this case will limited by the amount of Mid-County's original rate request. Thus the net operating income identified above will be insufficient to fully recover Mid-County's operating expenses and to provide a fair rate of return on its investment in property used and useful in the public service.

Issue 15: What is the appropriate revenue requirement for the test year?

Utility: The appropriate revenue requirement is $1,225,899, which is the amount originally requested in Mid-County's application for rate increase. This amount is a fall-out of the above issues, coupled with the rulings in the PAA Order that were not protested.

The appropriate revenue requirement is $1,225,899, which is the amount originally requested in Mid-County's application for rate increase. As the result of the utility's position on the above issues, a revenue requirement greater than that requested in the original application is needed to produce the 9.34% overall rate of return approved in the PAA Order. The approval of the originally requested revenue requirement of $1,225,899 will therefore produce less than a fair rate of return for Mid-County.

Issue 16: What are the appropriate wastewater rates for the test year?

Utility: The appropriate rates are those designed to recover the revenue requirement established in Issue 15 through a rate structure that is consistent with the parties' stipulation.

The appropriate wastewater rates are those which are designed to recover the revenue requirement established in Issue 15, based on test year billing determinants. With regard to rate design, the Commission approved a stipulation at the outset of the hearing under which the meter equivalency factors to be used for determining rates are the hydraulic factors in the Clow pipe economy usage scale as set forth on Exhibit 23, Schedule BFD-2. (Tr. I:41-42; see Order No. PSC-99-1203-PHO-SU at 19-20) Mid-County has not recalculated rates based on this new rate structure.

Issue 17: What is the appropriate amount of rate reduction in four years as required by Section 367.081(6), Florida Statutes.

Utility: In determining the appropriate rate reduction, the Commission must consider both the amount of allowed rate case expense and the portion of that expense that will actually be recovered through the approved rates.

Ordinarily, the appropriate amount of rate reduction would simply be the amount necessary to remove from rates the annual amortization ($42,927) related to the total rate case expense of $171,707 that should be allowed under Issue 13. However, since the total revenues requested in Mid-County's application are *less* than what is required to produce a fair rate of return based on the record in this case, the approved rates will not actually

permit Mid-County to recover both a fair rate of return on its investment and the full amount of its approved rate case expense. In this situation, the four-year reduction should be limited to the amount of rate case expense actually recovered through the approved rates.

Issue 18: What is the appropriate amount of the interim refund, if any?

Utility: No interim refund is required. This determination is a fall-out of the above issues.

Based on the utility's positions on the above issues, no interim refund is required.

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RESPECTFULLY SUBMITTED this 23rd day of July, 1999.

HOPPING GREEN SAMS & SMITH, P.A.

By: _____

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing was furnished to the following by hand delivery this 23rd day of July, 1999.

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