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October 17, 1996

VIA HAND DELIVERY

Blanca S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399

Re: Aloha Utilities, Inc.; Docket No. 960878-WS
Proposed Rate Reduction to Reflect a Decrease in Purchased
Water and Wastewater Costs to PSC Regulated Utilities By Pasco
County
Our File No. 26038.01

Dear Ms. Bayo:

This letter is written on behalf of Aloha Utilities, Inc. in response to the Commission Show Cause Order No. PSC-96-1226-FOF-WS, dated September 27, 1996. Aloha Utilities, Inc. should not be required to reduce rates or refund monies based upon a reduction in purchased water and wastewater costs for the following general reasons:

A. The pass-through provisions of the statute upon which the Commission order relies does not authorize the Public Service Commission to require a decrease in rates because of a reduction in purchased water or wastewater costs or as a result of a reduction in any of the other categories of costs listed in the pass-through section of the Chapter 367, Florida Statutes.

B. If this statutory provision did authorize the Commission to require a negative pass-through based upon a reduction in costs, that negative pass-through or any other determination to require rate reductions must still be based upon a finding by the Commission that failure to pass that cost reduction through will cause the Utility to overearn. No such finding has been made in that order and no such finding can be made with regard to the Aloha systems without detailed inquiry as to those facts. No attempt to ascertain these facts has been undertaken.

C. Even to the extent the Commission finds that the pass-through or other statutory provisions are available to the Commission to require a reduction in rates and to the extent the

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Commission finds that overearnings exist, the Commission has no authority under this statute or any other to require a retroactive reduction in rates to the date of the decrease in costs. If for no other reason, this is evident by the fact that the Commission has long held that a Utility may not implement a positive pass-through in rates retroactive to the effective date of the cost increase. Such a determination, positive or negative, plainly represents retroactive rate making and is contrary to law.

Aloha Utilities, Inc., however, believes that it can come to some agreement with the Commission to voluntarily pass-through the reduced cost, on a prospective basis, for the one system where the reduction may cause overearnings as a result of this decreased cost.

Aloha operates two separate water systems and two separate sewer systems, with separate sets of rates and totally separate physical operations within Pasco County. In order to fully understand Aloha's position in this regard, the facts and circumstances surrounding each of those systems and their purchased utility services, must be reviewed separately. Those facts are discussed below:

1. Seven Springs Water System - The Seven Springs water system purchases only a small portion of its water from Pasco County. Prior to approximately 1993, no purchases were made. In 1993 and 1994, relatively minor purchases (under 20 million gallons for each year) were made from Pasco County. In 1995, these purchases increased to 61 million gallons for the calendar year, by far the highest level ever purchased by the Utility. As a result of the addition of two additional source of supply wells by the Seven Springs water system in late 1995, the Utility has purchased from Pasco County in the first 8 months of 1996, only 2,086,000 gallons of water. This minor level of purchases is expected to be continued on a prospective basis. On an annualized basis, Aloha will therefore purchase no more than approximately 3 million gallons of water from Pasco County yearly. Even with the reduction in water costs effective October 1, 1996 (\$.16 from the rate in effect in 1995), the total impact of the reduction at 3 million gallons a year will be only \$480 on an annual basis. The reduction under any such pass-through would therefore be so immaterial as not to affect rates at all and surely cost more to process than the total reduction to be passed through.

In addition, it should be noted that the Commission has never recognized the cost of water purchased from Pasco County in the rates of the Seven Springs water system. The interconnection was made only in recent years in order to allow for emergency purchases during peak periods and as stated previously, those are anticipated to be immaterial on a going forward basis because of the addition of two new supply wells. The gallonage charge imposed on Seven Springs customers for water is substantially below the charge imposed by Pasco County.

Based on these facts, the Seven Springs water system is not appropriate for any pass-through of reductions in purchased water costs.

2. Seven Springs Sewer System - The Seven Springs sewer system has no purchased sewage treatment from Pasco County or any other entity.

3. Aloha Gardens Sewer System - The Aloha Gardens Sewer System purchases all of its sewage treatment from Pasco County. However, that system is operating at a 21% loss for calendar year 1995. Even with the reduction in costs occasioned by the reduced cost of purchased sewage treatment, that system will still operate a 4% loss on a prospective basis. Therefore, not only is the Utility not achieving its authorized rate of return, it is not even breaking even, and will not break even based upon the reduction in costs of purchased sewage treatment from Pasco County.

The rates established for this Utility are presumed reasonable until demonstrated otherwise. Neither the pass-through mechanism or any other mechanism can serve to reduce a Utility's rates so that it is kept in the same loss position as existed prior to a reduction in costs. This cannot be the conclusion reached by the Commission either as a result of the reading of the plain wording of the pass-through or other statutory sections of Chapter 367, or of general regulatory theory. Therefore, based on the above facts, no negative pass-through is appropriate for the Aloha Gardens sewer system.

4. Aloha Gardens Water System - The Aloha Gardens Water System purchases approximately 2/3 of its water from Pasco County. During calendar year 1995, the Utility experienced a return of 5.5% on its rate base. Because the Aloha Gardens water system has a relatively small rate base, the cost reduction on an annualized

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basis for purchased water will result in a \$16,000 savings based on 1995 purchases.

While the Utility believes that the pass-through statute does not authorize the Commission to require such a reduction, the Utility does agree that there is a potential for overearnings in 1996 as a result of this decrease in costs. It is apparent, however, that some portion of this reduced costs will only bring the Utility closer to, or up to, its authorized rate of return. However, in order to avoid responding to detailed inquiries and litigation in this matter and the costs occasioned thereby, the Utility is willing to reduce rates on a prospective basis only for the entire cost reduction based upon 1995 purchases of water in its Aloha Gardens water system. This will constitute a reduction of approximately \$16,000 to \$18,000 in annual revenue.

To the extent that the Commission proposes to require a refund for a system other than the Aloha Gardens water system and to the extent it proposes to retroactively apply any reduction based upon the reduced cost of purchased water, Aloha Utilities, Inc. requests a 120.57(1) hearing in order to address the legal and factual issues underlying any such proposed reduction.

To the extent the Commission agrees with Aloha's assessment and agrees to accept the prospective reduction in rates for the Aloha Gardens water system in settlement of this show cause proceeding, the Utility will immediately file the information necessary to pass-through a reduction in rates for the Aloha Gardens water system on a prospective basis, including all of the information, tariffs and customer notice necessary to effectuate that reduction.

The second ordering paragraph of Order No. PSC-96-1226-FOF-WS requires that each utility named in the order, file the information required by Rule 25-30.425(1)(a) through (f), Florida Administrative Code, along with a calculation of the rate reduction. Not only does the undersigned believe that this requirement is contrary to the Commission's actual decision at Agenda, but the filing of that information prior to a determination of what, if any, rate reduction is appropriate as to each Utility system is premature and a waste of the Utility's time and resources and consulting fees. Because of the substantial time and cost involved in the preparation of any such information, the Utility hereby requests a waiver of that provision of the order until such

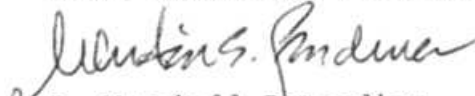
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time as a determination is made as to the amount, if any, of a rate reduction for the utility systems.

Should you or any members of the Staff have any questions in this regard, please let me know.

Sincerely,

ROSE, SUNDSTROM & BENTLEY


F. Marshall Deterding
For the Firm

FMD/lts
cc: Mr Stephen Watford
Robert C. Nixon, CPA