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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. The document(s) attached for electronic filing:
 Citizens' Post-Hearing Brief in the above mentioned docket.

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FPSC-COMMISSION CLERK

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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CITIZENS' POST-HEARING BRIEF

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CITIZENS' POST-HEARING BRIEF

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 Post-Hearing Brief.

STATEMENT OF BASIC POSITION

AUF has requested two rate increases in less than a three year period and barely 13 months after the last requested rate increase went into effect. 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 initiated, 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 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. Based on the

testimony received from customers, if AUF were not providing a monopolistic service, customers would choose another water and wastewater provider and AUF would be going out of business. In fact, some customers have installed private wells to avoid paying AUF's high costs. (TR 1131) AUF customers have also 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. (TR 1412-1414, H.E. 205) AUF customers have testified to numerous billing problems including high bills, back-billing and erroneous bills based on malfunctioning meters. (TR 1056-1059) AUF has been under a monitoring plan since its last rate case, yet analysis of the customers' testimony from the last two years shows no marked improvement. (TR 1414) Based on AUF's persistent quality of service problems, the Company's Return On Equity (ROE) should be decreased by 100 basis points, which is consistent with past Commission practice. (TR 1069-1080)

Next, AUF has requested higher used and useful (U&U) 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. (TR 603-608) Given that AUF's rates are some of the highest in Florida, the Commission should apply the correct used and useful percentages. In addition, pro forma plant projects should not be included in this rate proceeding if the physical construction of the project has not started. To date, construction has not begun on the Leisure Lakes AdEdge Water Treatment Project (\$150,000), the Peace River Water Treatment Project (\$50,000), and the Sunny Hills Water System Water Tank Replacement Project (\$120,000); therefore, these amounts should not be included in rate base. (TR 230, 234, 233)

Moreover, AUF has requested operating expenditures that are too high and unjustified. AUF's affiliated allocation methodology, costs, and charges are significantly overstated. First, Aqua's methodology has failed to charge its non-regulated affiliates appropriately, thereby causing AUF's customers to pay higher than fair costs. (TR 1087) Second, AUF's affiliated costs are significantly higher than Florida's average costs for equivalent services. (TR 1119) Based on Citizens' affiliate costs analysis, almost the entire amount of AUF's requested increase in affiliated charges since the last rate case should be denied for a reduction of \$976,845.

The PAA Order included adjustments for affiliated IT costs, incentive compensation, and salaries and wages that should continue to be made. Testimony shows that the Consumer Price Index (CPI) was less than 2% for 2010 over 2009, no cost of living increases to Social Security

were granted in 2009 or 2010, and the Florida Unemployment Rate has continued to climb from 4.7% in 2007 to 12.0% in 2010. (TR 643, H.E. 308, H.E. 309) In addition, numerous customers at the Service Hearings testified that they have had trouble paying their current bills, which would be magnified by any increases. (Ms. Cook, Sebring TR 34, Mr. Storch, Eustis TR 69, Ms. Ricketts, Eustis TR 115) AAI Incentive Compensation charges are allocated to AUF by its parent, Aqua America, and are included in the analysis of affiliate costs, and thus, are part of the \$976,845 reduction to affiliate costs recommended by OPC. However, if Incentive Compensation is not considered separately, the Commission should remove the \$106,258 included in the test year for 2010 as well as all amounts from 2009 and all adjustments for normalization and pro forma increases. Further, the Commission should deny all increases in compensation, resulting in a total adjustment of \$220,410 for salaries and wages and \$16,861 for the related payroll taxes. Corporate IT charges should be adjusted to reflect an allocation of the IT costs among all systems that are benefitting from the service and should be depreciated over a ten year period.

AUF's requested rate case expense is also too high. (TR 643-644, 1141-1142) 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. (TR 651) In addition, AUF has failed to justify all of its rate case expense. (TR 658-659) 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. (TR 1140-1141) Therefore, the Commission should approve Citizens' adjustments and decrease AUF's requested rate case expense.

Further, AUF's test year billing determinants are understated. Due to the customers' installation of private wells, the projected revenue from the last rate case was 16% less than expected. (TR 1131) 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. (TR 1131-1132) Therefore, test year billing determinants should be increased. Similarly, AUF's actions have caused higher costs that have resulted in increased bad debt expense. (TR 1128-1129) Thus, AUF's requested bad debt expense is overstated. The Commission should use the peer comparison to set bad debt expense. (TR 1125-1131) This will result in a reduction in bad debt expense of \$310,816.

Based upon Citizens' analysis of AUF's requested increases, used and useful percentages, pro forma plant increases and operating expenditure increases, AUF's request 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 that the ratemaking process 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 produces 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.

ISSUES AND POSITIONS

QUALITY OF SERVICE

Issue 1: What is AUF's quality of service?

OPC: *AUF's quality of service is unsatisfactory. AUF has on-going poor water quality issues, billing problems, and poor customer service.*

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 affects all of its systems, which were found to have "marginal" quality of service in the last rate case with the exception of the Chuluota system. In the previous rate case, the Chuluota system's quality of service was found to be unsatisfactory and remains unsatisfactory today. See, Order No. PSC-09-0385-FOF-WS, issued May 29, 2009, in Docket No. 080121-WS at p. 21. 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.

As Citizens' witness Vandiver testified, of the 156 speakers at the customer meetings held in October and November 2010, 27% complained about the poor quality of the plant maintenance, including unkempt property, odors from plant facilities, line breaks, and malfunctioning lift station alarms. (TR 638) She also stated that 35% addressed the poor customer service related to rude customer service representatives, billing problems, and difficulties in reaching a Company representative in an emergency situation. (TR 638) 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. (TR 638)

During the Service Hearings held in August, September and October 2011, the customers were still complaining about the poor quality of plant maintenance, water quality, and customer service. Citizens' witness Dismukes testified that she reviewed both the complaints from the 2010 customer meetings and the 2011 Service Hearings, and determined that the complaints were of a similar nature. (TR 1257) Witness Poucher also reviewed the Service Hearing testimony and PSC complaints. (TR 724, 1425) He stated that AUF complaints were 44% of the total water and wastewater complaints received by the PSC in 2010. (TR 911-912)

Billing Issues

Citizens witness Poucher summarized customers' testimony at these hearings, and found billing issues including back-billing, high bills, and malfunctioning meters, are a significant problem. (TR 732) Citizens' witness Dismukes testified "[t]he company appears to have major problems with issuing bills in a timely and consistent manner. This puts unnecessary hardships on customers and makes budgeting very difficult." (TR 1056) Customers should be able to rely on accurate and timely billing. Witness Poucher testified that in his opinion ". . . Aqua has failed to identify its operational problems in Florida and come up with a comprehensive action plan for improvement." (TR 739) In addition, AUF's on-line bill paying requires the customer to allow AUF access to their bank accounts, or to pay a \$3.20 fee every time they pay with a credit card. (H.E. 199 at pp. 100-101)

Moreover, AUF's practice of offering to suspend seasonal customer bills results in these customers experiencing extremely high bills when they return to Florida. Ms. Chambers stated in her deposition that the customers are back billed for the base facility charge for the time they

are out of the state. (H.E. 199 at p. 137) Although AUF provides a long bill message on the first bill received to allow for a payment over a longer period of time (H.E. 199 at p. 137), this practice contributes to back-billing and high bill problems complained of by customers.

As noted by witness Poucher, AUF's back-billing practices are a major problem, especially back-billing for periods over 365 days. (TR 732) AUF witness Chambers claimed that she knew of only one PSC complaint where the customer was back-billed for greater than 365 days. (H.E. 199 at pp. 61, 62) However, as witness Poucher stated, 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. (TR 734, 735) He also noted nine of these customers were ". . . examples of where the company made adjustments in back-billing following receipt of a complaint." (TR 735) In fact, AUF witness Chambers claimed in her deposition, that for back-bills covering more than 365 days, ". . . there have been on a rare occasion where we have, through human error, billed somebody for a longer period of time than 12 months, but we have corrected the, the situation that that has occurred." (H.E. 199 at p. 68) However, she acknowledged that only recently has AUF ". . . automated that process instead of relying on an individual to code the bill. Prior we were doing it manually." (H.E. 199 at pp. 131-134) Only after Mr. Poucher's criticism in his testimony that there was no automated program to stop the back-billing problem, did AUF put an automated coding on these types of bills. (TR 737, H.E. 199 at 131-133) Ms. Chambers also acknowledged that the total back-bills for 2009 was 142, for 2010 was 187, and for the first three months of 2011 was already 97. (TR 329, H.E. 300, 301) Allowing this problem to fester until asking for a rate increase demonstrates the Company's lack of proactive management to its customer service problems. Further, AUF's back-billing procedures are noncompliant with applicable Commission regulations, and AUF should be required to implement procedures that fully comply with the Commission's rules.

Customer Service Quality

As witness Dismukes noted in her testimony, when a customer survey on the call center was sent out to customers who had submitted complaints and inquiries, the overall satisfaction level was only a 2.28 on a scale of 1 (poor) to 5 (excellent). (TR 1050) Ms. Dismukes testified that "[t]here were numerous complaints about the Company's slow response time in resolving problems as well criticisms of how they were treated by the customer service representatives."

(TR 1051) AUF witness Chambers who heads their customer service centers acknowledged that in situations where a supervisor is not immediately made available to speak with a customer, an electronic work queue (EWQ) is created. (H.E. 199 at p. 89) She further indicated that an EWQ will be closed after only one attempt to call the customer is made, irrespective of whether a voice message is left or not. (H.E. 199 at pp. 89-91, TR 307) The failure of the Company to make more than one attempt to return a call, confirms the customers' testimony regarding the difficulty in getting problems resolved.

Witness Poucher pointed out that twenty percent of AUF customers have to wait 90 seconds or more to reach an Aqua customer service representative (CSR) which is not good customer service. (TR 752) Witness Chambers acknowledged that the 90 second metrics only started after a customer selected the option of speaking with a CSR. (TR 340) She stated that the call centers were staffed based on the results of a customer survey conducted before the Florida systems were added. While she lauded the survey result of an 81 percent customer satisfaction with the call center, that demonstrates that 19 percent were dissatisfied with the speed of answer time. (TR 341) Again, the Company's own data supports the customers' impression regarding slow response times. In fact, the number of blocked calls has risen dramatically in the last few months in 2011. (H.E. 199)

Moreover, customers have also complained of rude customer service when they finally reached a CSR. (TR 1052, 1053, H.E. 330) When Ms. Chambers was asked about the reportedly rude services based on customer service hearing testimony, she had to admit that during at least one of the customer service tapes she listened to, the CSR was ". . . not as helpful as they could have been . . ." (TR 1761) She also acknowledged that she did not specifically listen to the tape for at least one customer who complained of rudeness, but rather made just a generic sampling of the some of the customers who testified. (TR 1761)

Water Quality And DEP

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. (TR 1060-1062) Specifically, Ms. Dismukes identified where the customers at the Eustis, Oviedo, Palatka, Gainesville, Sebring, and New Port Richey customer meetings stated that the water is unusable. These customers asserted that their water smelled,

tasted bad, and left residue. (TR 1060-1063) Ms. Dismukes testified that of particular concern were 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. (TR 1060-1063) Witness Dismukes also reviewed the Service Hearing transcripts and noted that similar water quality complaints were made by the customers in sworn testimony. (H.E. 330) In fact, customers at the Chipley, Eustis, Gainesville, Palatka, Sebring, Lakeland, and New Port Richey Service Hearings complained of water quality issues ranging from unusable water to discolored, brown water. (H.E. 330)

Moreover, AUF's systems have on-going issues with DEP. Over the last three years, AUF has had multiple DEP compliance issues. The overall analysis of AUF's systems related to DEP show persistent water quality problems. Citizens' witness Woodcock testified that 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. (TR 627) Volusia County Health Department witness Carrico acknowledged that all three systems subject to Volusia County oversight had been the subject of compliance enforcement actions. (TR 407-408) DEP witness Greenwell also testified that several of the water systems under his jurisdiction have had consent orders (Peace River Heights, two, and Zephyr Shores, one) during the last three years. (TR 439) He noted that one of the Peace River Consent Order remains open. (TR 445) Polk County Health Department witness Sloan testified that the Breeze Hill water system had compliance deficiencies during 2010 and 2011. (TR 967-968) She also noted that warning letters were issued for failing to timely submit samples for AUF's Orange Hill, Sugar Creek, Gibsonia Estates, and Rosalie Oaks water systems during the last three years. (TR 967-969) She testified that a new warning notice was issued for Village Water for failure to monitor for lead and copper. (TR 970) DEP witness Montoya testified that during the last three years, the consent orders for Silver Lake Oaks and Interlachen Lake Estates had been closed. (TR 1018) She noted that a warning letter was issued in August 2011 for Interlachen Lake Estates due to a failure to notify DEP of a positive E. coli test on one of their wells. (TR 1019) DEP witness Penton testified that in 2010 the Sunny Hills water system had a consent order for multiple violations. (TR 1033)

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. (TR 627) Witness Greenwall testified that several AUF wastewater systems had consent orders issued from 2007 through 2010 (Village Water WWTF, Rosalie Oaks WWTF, and Jasmine Lakes WWTF). (TR 441- 442) The Village Water consent order has remained open since August 2007 and is still open. (TR 454- 455) He also testified that Palm Terrace WWTF received a warning letter for being out of compliance with its operating permit that is still open. (TR 451-452). DEP witness Miller testified that a noncompliance letter was issued for the Chuluota wastewater system due to an on-going exceedence of their effluent sprayfields permitted limits. He also noted that Jungle Den's wastewater facility had deficiencies in 2010 that resulted in a noncompliance letter. Further, he stated that the Fairways and Mount Plymouth systems had consent orders issued for operating without permits for two months due to their late filing for permit renewal. (TR 953-954)

Over the last three years, DEP has identified 183 instances where AUF issued boil water notices, with 111 issued for unplanned outages. (TR 1413) The Company self reported that customers received timely notices of these boil water incidences despite the Company's acknowledgement that its implementation was not perfect. However, multiple customers testified that they never saw nor received a notice from the utility. (TR 1065-1066, 1414, 1445, 1626-1634) Many customers testified that they had not received boiled water notices or stop boil water notices (TR 1066) Thus, they never had notice that a potential health hazard event had even occurred. Witness Carrico for Volusia County acknowledged that the boiled water notices were self reported events by the Company. (TR 421)

As witness Vandiver testified, it is troubling that the DEP and Health Department witnesses identified pages of violations, non-compliances, and other deficiencies, and yet they deem the overall quality of the plant operation to be satisfactory. (TR 1412) However, as many of the DEP and Health Department witnesses noted in cross examination, they only looked at the systems under their individual jurisdictions not at AUF operations as a whole. (TR 421-422, 455, 970-971, 1025, 1039) As Ms. Vandiver noted, the overall picture painted by the DEP and Health Department witnesses is of a Company that habitually fails to follow the rules that are put in place to protect the customers. (TR 1412) The numerous violations, consent orders, and non-

compliance incidents over the last three years, demonstrates that the Company is routinely out of compliance with DEP and water standards that frequently results in an unsatisfactory product.

Conclusion

As Ms. Vandiver testified, when one compares the magnitude of the customer testimony to the number of quality issues listed by the staff witnesses including the DEP and Health Department witnesses, it is apparent that these witnesses frequently address the same issues. (TR 1414) She further testified that “[t]he customers are the ones who are harmed when poorly maintained facilities result in sewage spills or main breaks. And the customers are subject to the potential health risks when the company fails to adequately and properly issue BWN’s [boiled water notices].” (TR 1414) Furthermore, there were over a thousand pages of customer testimony from Service Hearings and customer meetings which were summarized by Citizens’ witnesses showing that most of the customers are dissatisfied with AUF’s service. Based on the testimony from customers, Citizens witnesses, and DEP and Health Department witnesses, and in light of AUF’s history of poor service and lack of compliance with its DEP and Health Department standards, the quality of service for the product and customer service is clearly unsatisfactory.

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.*

100 Basis Point Reduction

As witness Dismukes testified, customers are still complaining about the same quality of service issues that were raised in the two preceding rate cases involving AUF. (TR 1070) 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 ROE reductions in situations where the Company has failed to meet DEP standards, as witness Vandiver indicated in her testimony 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. (TR 1411-1414) Witness Dismukes further noted that the Company still has problems with water quality. She noted that many customers have found the water to be undrinkable and complained about odor, color, and contamination. Some customers complained the water has made them sick. Witness Dismukes also noted that many other customers complained about poor customer service including billing issues. (TR 1070)

In the PAA Order, the Commission reduced AUF's ROE by 25 basis points for its marginal service for all systems, except the Chuluota system which was not part of this rate request. Order No. PSC-11-0256-PAA-WS, issued June 13, 2011 at p. 63. In AUF's last rate case, the Commission stated "[b]ecause of the poor service experience by AUF's customers, we have calculated the mid-point of the return on equity (ROE) with this in mind." *Id.* at 21. Despite the Company's request to use the leverage formula which would have resulted in an ROE of 10.77, the Commission approved an ROE of 9.75. *Id.* at 67, 68, 70. This resulted in the Commission approving an ROE that was over 100 basis points lower than the leverage formula for all of AUF's other systems in the last rate case, thus an additional specific rate reduction was unnecessary. However, the Chuluota system was further assessed a ROE reduction of 100 basis points for its unsatisfactory service. Order No. PSC-09-0385-FOF, issued May 29, 2009 at p. 70. As the Commission noted, "[t]he Courts have affirmed reductions to ROE for poor quality of service or mismanagement, as long as the reductions kept the Utility's rate of return within the fair rate of return range." *Id.* at 69. The Commission has a history of reducing ROE for utilities that have provided either marginal or unsatisfactory quality customer service. *Id.* at 69. As witness Dismukes testified, the Commission has previously made ROE reductions, including a 1% or 100 basis points reduction for Pine Island Utility and Consolidated Utilities Company, a 50 basis points reduction for Aloha Utilities and Ocean Reef Club, and a 25 basis points reduction for Southern States Utilities (the predecessor for most of the AUF systems). (TR 1072-1076)

In a competitive market, the Company would have lost customers due to its poor customer and quality of service. (TR 1077) As witness Dismukes testified, “. . . in a regulated environment, customers, for the most part, are forced to stay with their utility provider regardless of the quality of service provided or the rates that they pay.” She further noted that some customers have gone to the extreme of digging or using private wells to reduce their reliance on Aqua. (TR 1077) Despite the customers’ overall dissatisfaction with its service, AUF has not done enough to improve its product or service to change its customer’s opinion. (TR 1076)

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 Aqua America’s 2010 total revenue and .6 percent of AUF Florida’s 2010 total revenue. In contrast, a 100 basis points reduction would be approximately 2.6 percent of AUF Florida’s total revenues, but still only .05 percent of Aqua America’s total revenue. (TR 1077) The reduction of 100 basis points is necessary to effect the change in AUF’s behavior that is long overdue without creating financial jeopardy to the Company. 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.

Monitoring Plan

Based on the Commission’s concerns due to AUF’s marginal service in the last rate case, a Quality of Service Monitoring Plan was implemented. Id. at 22. Despite the Commission’s indication that “while preliminary results show substantial improvement in AUF’s customer service, additional monitoring was required to ultimately render a determination as to the adequacy of AUF’s quality of service.” Order No. PSC 10-0297-PAA-WS, issued May 10, 2010, in Docket No. 080121-WS. The Commission ordered Commission staff to continue monitoring the customer service provided by AUF through calendar year 2010, including customer complaints, meter reading and billing accuracy, and environmental compliance, as part of a Phase II Monitoring Plan. Id. at p. 2. The Phase II monitoring overlapped the filing of the instant rate case, and therefore, it was incorporated into this case. As testified to by the customers and summarized by Citizens’ witnesses, numerous problems have not been resolved including customer service, billing accuracy, estimated bills, and water quality. (TR 1076) As succinctly stated by witness Poucher, if the Final Phase II Quality of Service Monitoring Report was intended to demonstrate that Aqua service was satisfactory, it failed. (TR 747) Witness

Vandiver's analysis of the AUF final report demonstrates that the Company failed to meet its own metrics during some of the months of additional monitoring. She noted that overall there was no significant improvement in the quality of service based on the eight months of additional monitoring. (TR 639-642) In the PAA Order, the Commission found AUF's service to be marginal. Order No. PSC-11-0256-PAA-WS, issued June 13, 2011, at p. 63. As witness Poucher stated "Aqua has a rich history of bad service that it relies on to deliver an overpriced and undrinkable product." (TR 756) As he emphasized, "... bad service should never be tolerated by the Florida Public Service Commission."

Witness Dismukes testified that, in the other jurisdictions where Aqua America subsidiaries operate, some states have instituted various forms of monitoring programs due to poor customer service. (TR 1067-1069, H.E. 351) In 2010, the New York Commission approved an agreed upon customer service incentive mechanism which put at risk up to \$96,000 per year starting in 2012 based on meeting targeted performance levels. (H.E. 351) The Indiana Utility Regulatory Commission in 2011 approved the continuation of AUF filing quarterly reports of the complaints it receives from its customers. In Missouri in 2008, the Company was required to initiate a task force to address timely meter reading and provide quarterly reports on the number of reads outside the 26 to 35 day window for a period of 18 months. In 2010, Aqua Virginia was required to file a detailed report within 60 days of the actions taken with regard to its customer complaints. AUF operates regulated and nonregulated subsidiaries in 13 states (TR 1082); therefore, basically, a third of Aqua America's regulated subsidiaries required action due to its poor quality of service over the past few years.

Although the Company's witnesses do not believe on-going monitoring is necessary, the facts in this case clearly demonstrate otherwise. When asked for suggestions on how to proceed with further monitoring, Citizens' witnesses provided several ideas. Witness Poucher suggested that the Company, staff, OPC, and other intervenors work together collaboratively to develop a plan similar to the process used to develop the Phase II monitoring plan. He stated that the idea was for AUF to report on their complaints, analyze them, report what they did to resolve them, and how similar complaints could be prevented in the future. (TR 909-910) Witness Vandiver also suggested continuing a monitoring plan with some developed metrics. (TR 702) She indicated that DEP compliance, billing issues, and customer service issues are some of the areas that should be included for monitoring. (TR 702- 703) Witness Vandiver indicated, however,

that without a penalty to get the Company's attention to correct their mistakes, a monitoring plan alone could just be a method of observing AUF providing bad service without correcting the problems. (TR 706-707)

Conclusion

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 a satisfactory quality of 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. Based on the Commission's concerns regarding AUF's quality of service in the last rate case, a Monitoring Plan was implemented and a monitoring plan should be continued for this rate case. Further, the Commission should reduce AUF's ROE 100 basis points for its unsatisfactory product and service.

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 pro forma plant project should not be included in this rate proceeding if the physical construction of the project has not begun. To date, construction has not begun on the Leisure Lakes AdEdge Water Treatment Project (\$150,000), the Peace River Water Treatment Project (\$50,000), and the Sunny Hills Water System Water Tank Replacement Project (\$120,000) and these amounts should not be included in rate base.*

The Company requested pro forma plant for several systems. OPC protested the inclusion of several of these items due to the uncertainty of the completion of the projects. Witness Woodcock testified that he was concerned that even though the equipment for improvements may have been purchased, there is no commitment that they will actually be installed and placed into operation. (TR 626) Further, he testified that even though the projects may be bid out to a contractor to install, there may be other reasons that could delay or prevent the projects from

being completed. However, once construction is under way there is a higher likelihood that the facilities will be completed. (TR 626) The three remaining systems which have yet to start construction are the Leisure Lakes AdEdge Water Treatment Project, the Peace River Water Treatment Project, and the Sunny Hills Water System Water Tank Replacement Project.

The Company included \$150,000 in its MFR's for the Leisure Lakes AdEdge Water Treatment Project. (H.E. 234) Witness Luitweiler testified in his direct testimony that the Company expected to bid the construction by early November, 2011. (TR 223) As of the date of his deposition on November 16, 2011, the Company still had not signed a contract. (H.E. 198 at p. 30) At the hearing, Witness Luitweiler testified that the current estimated date for the bids to be awarded was the middle of December. (TR 234) Based on Witness Woodcock's concern that any project is uncertain until construction actually begins, this project is still very uncertain. The test year for this case ended April 30, 2010, and if any construction begins in the next month, it will be well over 20 months after the test year before this project might be completed. Therefore, the \$150,000 for the Leisure Lakes project should not be included in rate base.

The Company included \$50,000 in the MFR's for the Peace River Water Treatment Project. (H.E. 239) Witness Luitweiler testified in his direct testimony that the Company expected to bid the construction by early October, 2011. (TR 224) As of the date of his deposition on November 16, 2011, the Company had still not signed a contract. (H.E. 198 at p. 18) At the hearing, Witness Luitweiler testified that the contract for construction had been awarded and executed but did not address whether there has been Notice to Proceed issued. (TR 230) Based on Witness Woodcock's concern that any project is uncertain until construction actually begins, this project is still very uncertain. The test year for this case ended April 30, 2010, and if any construction begins in the next month, it will be well over 20 months after the test year before this project might be completed. Therefore, the \$50,000 for the Peace River project should not be included in rate base.

The Company included \$120,000 in the MFR's for the Sunny Hills Water System Water Tank Replacement Project. (H.E. 232) Witness Luitweiler testified in his direct testimony that the Company expected construction to be completed by December 15, 2011. (TR 224) In his deposition, Witness Luitweiler testified that a Notice to Proceed had been issued and that he would provide that as a Late Filed Exhibit No. 4. (H.E. 198 at pp. 25-26) However, a review of the late filed exhibits does not show a Notice to Proceed. At the hearing, Witness Luitweiler was

asked about the status of the project and still did not mention that construction had started. (TR 233) Based on Witness Woodcock's concern that any project is uncertain until construction actually begins, this project is still very uncertain. The test year for this case ended April 30, 2010, and if any construction begins in the next month, it will be well over 20 months after the test year before this project might be completed. Therefore, the \$120,000 for the Sunny Hills project should not be included in rate base.

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. (TR 604) 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. (TR 604)

For systems where changes have resulted in U&U percentages which are lower than calculated in prior orders, Aqua witness Rendell argues that the courts of Florida require the Commission to "adhere to its prior practices in calculating used and useful percentages," and cannot deviate from those practices unless there are bona fide facts supporting a change. Southern States Utilities v. Florida Water Services Corp., 714 So 2d 1046, 1057 (Fla 1st DCA 1998). (TR 477) However, under cross-examination witness Rendell conceded that the court actually held that the Commission can change its policy any time based upon evidence adduced at the hearing. (TR 522)

The growth allowance in the U&U calculations relies upon a 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. (TR 604)

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 a reduction in the number of customers. (TR 605) 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. (TR 606) 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. (TR 606)

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. Before an overly broad application of the rule is utilized to assume 100% U&U for these facilities, some level of reasonableness against the actual U&U calculations should be considered. However, Staff has stretched the interpretation of this rule beyond its reasonable limits to determine systems to be 100% U&U where said systems are not built out and where a potential does exist for expansion of the service territory. (TR 606)

It is important to note that this is a two part test, both the design service area must be built out AND there must be no potential for expansion. (TR 607) Rule 25-30.4325, F.A.C., also states "...and no apparent potential for expansion of the service territory..." Before any U&U treatment determination of buildout is made, the area surrounding the certificated service area must be considered for potential expansion. If there is undeveloped property contiguous to or in close proximity to the current service territory that can be served in the future by the stranded capacity, a potential for growth exists. Under these circumstances, Rule 25-30.4325 (4), F.A.C., precludes such a system from being considered 100% U&U. (TR 607)

Even for systems that meet the "built out" requirements of Rule 25-30.4325, F.A.C., an alternative calculation should be contemplated under Rule 25-30-4325 (3), F.A.C., if the water treatment facilities are less than 75% U&U. (TR 612, 613) OPC's witness Woodcock recommends a 75% U&U threshold because a 25% swing accounts for the incremental sizing of

facilities and differences in design estimates and actual usages. (H.E. 284 at pp. 4, 5) Based on the opinion of witness Woodcock, with proper design and all other things being equal, the buildout of a design service area would not vary more than 25% from actual build out conditions. Proper engineering design requires reasonable estimates of demands. It is just as important to not over design facilities as it is to not under design them. Over designed facilities result in an unused investment in capacity and increased operations and maintenance costs. (H.E. 284 at pp. 4, 5) Even after the redundancies and allowances to ensure that customers will receive reliable service and the utility will have a margin of capacity for growth, many of the "built out" systems in the proceeding have U&U percentages less than 50%. (H.E. 284 at pp.4, 5)

In the past, the Staff has considered older systems with little to no growth over the previous five years as 100% U&U. Also for systems that are 95% U&U, Staff has simply rounded them up to 100%. While Staff has used this methodology in the past, it is not supported in any U&U rule. (TR 607) Given the recent recession and downturn in the housing market, many more systems will be experiencing little or no growth simply as a consequence of factors in the overall state and national economy. Continuing with this unsupported policy will only result in more systems being considered 100% U&U when, in fact, a portion of the facilities are not providing service to the customers. This results in higher rate bases and ultimately higher rates for the customers. (TR 607, 608)

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. (TR 617) In deviating from the requirements of the one well rule, OPC witness Woodcock established conservative thresholds so that an alternative calculation would not be employed unless it had a material effect upon the U&U percentage. (TR 617) With respect to the well pumps, OPC's conservative threshold eliminates the smaller capacity pumps where a small change in demand could have a large percentage impact on the U&U percentage. (TR 617) This recognizes the fact that a smaller well pump could easily approach 100% U&U with only a few additional customers. Whereas, a larger well serving the same customer base would not see as high of a U&U increase. Based on a review of the systems, OPC witness Woodcock believes that 150 gpm is a conservative threshold to account for these impacts. (TR 617, 618) A 150 gpm threshold incorporates the regulatory upper limit for single well systems, 150 connections, and a standard engineering rule

of thumb of 1 gpm per connection (H.E. 284 at pp. 9, 10)

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. (TR 618)

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. (TR 616)

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:

Arredondo Estates -80%; Arredondo Farms -61%; Breeze Hill – 26%; Carlton Village – 91%; East Lake Harris/Friendly Center – 41%; Fern Terrace -68%; Hobby Hills -41%; Interlachen/Park Manor – 76%; Lake Josephine/Sebring Lakes – 25%; Picciola Island – 56%; Rosalie Oaks – 12%; Silver Lake Estates/ Western Shores – 74%; Tomoka View – 43%; Twin Rivers –24%; Venetian Village – 63%; Welaka – 74%; Zephyr Shores – 26% (H.E. 75 at pp. 1-18)

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, 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, Twin Rivers, Venetian Village, Village Water, Welaka, and Wootens?

OPC: *U&U should be calculated using the “lot count” methodology unless the service territory includes commercial and multi-family customers, in which case the total number of customers served should be compared to the total number of customers to be served at buildout.*

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. (TR 623) 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. (TR 623, 624)

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 build-out, based upon the service area maps provided in the MFR's. (TR 623-625)

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

Arredondo Estates – 90%; Arredondo Farms – 88%; Beecher's Point – 58%; Breeze Hill – 92%; Gibsonia Estates – 84%; Interlachen/Park Manor – 79%; Kingswood – 98%
Oakwood -98%; Orange Hill/Sugar Creek -94%; Palms Mobile Home Park – 79%; Palm Port – 94%; Peace River – 79%; Piney Woods – 89%; Ravenswood – 88%; River Grove – 99%; Rosalie Oaks – 80%; Silver Lake Estates/Western Shores – 88%; Silver Lake Oaks – 83%; Skycrest – 93%; Stone Mountain – 48%; Sunny Hills – 11%; Twin Rivers – 98%; Venetian Village – 81%; Village Water – 68%; Welaka -51%; Wootens – 43%; The Woods – 70%. (H.E. at p.1)

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.

(TR 603-606)

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. (TR 619-620). 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 that is not used and useful in providing service to customers, contrary to the requirements of Section 367.081(2)(a), Florida Statutes. (TR 620-622)

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

Arredondo Farms – 66%; Breeze Hill – 24%; Fairways – 42%; Florida Central
Commerce Park – 41%; Holiday Haven – 62%; Jungle Den – 37%; Kings Cove – 46%;
Leisure Lakes – 32%; Morningview – 33%; Palm Port – 51%; Peace River – 56%;
Rosalie Oaks – 50%; Silver Lake Oaks – 34%; South Seas – 40%; Summit Chase – 36%;
Sunny Hills – 23%; Valencia Terrace – 40%; Venetian Village – 49%; 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 U & U percentages for wastewater collection plant should be calculated in the same manner as calculating the U&U percentage for water distribution plant. (TR 623-625)

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

Beecher's Point – 45%; Breeze Hill – 94%; Fairways – 99%; Holiday Haven – 69%;
Jungle Den – 87%; Peace River – 79%; Rosalie Oaks – 93%; Silver Lake Oaks – 83%;
Sunny Hills – 36%; Village Water – 42%; The Woods – 61%

Issue 8: Should any adjustment be made to deferred Rate Case expense? (Fallout Issue)

OPC: *Deferred Rate Case expense should be reduced by \$219,711.*

The PAA Order reduced the deferred rate case expense for the prior case by \$29,902 to reflect the actual 13 months before the rates would be put into effect. The same methodology should be used as in the PAA Order, resulting in a reduction to deferred rate case expense for the prior case of \$170,678 (\$467,872 - \$297,194). As discussed further in Issue 22, rate case expense for the current rate case should be \$404,638; one-half of the total Rate Case expense equals \$202,319. Therefore Deferred Rate Case expense for the current rate case should be decreased in the amount of \$49,033 (\$251,352 - \$202,319). Based on these adjustments, the total adjustment to Deferred Rate Case expense should be \$219,711.

Issue 9: What is the appropriate Working Capital allowance? (Fallout Issue)

OPC:...*Working capital allowance should be reduced consistent with OPC's recommended adjustments, resulting in a Working Capital allowance of \$2,400,778.*

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, and Working Capital Adjustments.

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.

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.

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.*

AUF claimed test year revenues have decreased by 16 percent below the Commission's repressed consumption calculations determined in the last rate case. (TR 1131) Citizens witness Dismukes acknowledged that 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 area. (TR 1131)

As Ms. Dismukes asserted, the Company is in a much better position than customers to bear the revenue loss associated with customers either reducing consumption due to financial hardship, unreasonably high rates, or to AUF's poor quality of service. (TR 1131) She noted that these factors are largely beyond the control of the customers, but are more within the control of the Company. (TR 1131) Witness Dismukes testified that there is an inherent risk for any company to lose revenue due to reasons like economic downturns, competition, conservation, and alternative suppliers. She noted that the ROE includes a component to compensate the stockholders for risk. (TR 1131)

Witness Szczygiel claimed that Ms. Dismukes adjustment, if adopted, would be confiscatory and contrary to long-standing policy when customer consumption is reduced due to factors beyond the utility's control. (TR 1492) However, only in a monopoly situation would it be unanticipated that customers would stop using a service when the pricing gets beyond the ability of the customer to pay. Witness Szczygiel testified that consumption dropped by 20.8% over the last four years and overall consumption dropped 24%. (TR 1495) This drop in consumption corresponds to the increases in rates over the same four year period. Contrary to the Company's position that the drop in consumption was beyond its control, the timing and requested amount of any rate increase has been completely within the Company's control.

Witness Szczygiel's claim that such an adjustment would be confiscatory and deny an adequate rate of return (TR 1496), is erroneous. The Commission has discretion to adjust the ROE based on the relative risk of the shareholders. Witness Dismukes agreed that making her

billing adjustment would increase regulatory risk. She noted, however, that the relative impact on Aqua America is very small, a .02% impact on their return on equity. (TR 1231) Witness Dismukes testified that 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 further reduction to the ROE. (TR 1131)

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. Accordingly, 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 nonregulated operation so that its regulated operations including AUF do not subsidize the nonregulated operation. *

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. (TR 1081) 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. Id. Citizens' witness Dismukes conducted a review of the affiliate transactions between AUF and its affiliated companies. (TR 1043)

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. (TR 1082) AUF has contracted with one of the non-regulated subsidiaries, Aqua Services, Inc. (ASI) to provide managerial, operational, and regulatory

support. (TR 1084) As witness Dismukes noted, the costs allocated to AUF from AAI and ASI are approximately 20% of the total operations and maintenance expense 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. (TR 1084-1085)

ASI and AUF have a service contract that governs the charges to be allocated to AUF. Witness Dismukes noted that there is a Corporate Charges Allocations Manual that describes the allocation methodology. She identified that 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. (TR 1085-1087) AUF witness Szczygiel offered a red herring argument for the first time in rebuttal testimony that AUF's change in methodology resulted in what he is labeling "In-State administrative costs." (TR 1458) However, these "In-State administrative" costs were included in the accounts Contract Services-Management Fees and Contract Service-Other which were part of the affiliate transactions as indicated in the MFRs and PAA Order and were protested by OPC. (H.E. 277, Order No. PSC-11-0256-PAA-WS at pp. 64-67, TR 107-109, 1236)

Ms. Dismukes' analysis of the affiliate transaction shows that despite the stated allocation methodology, it appears that it has not been uniformly applied between AUF and its affiliated sister companies. (TR 1087) As witness Dismukes testified, ASI performs services for non-regulated affiliates; however, it does not consistently allocate costs to them. She testified that there are four affiliates that do not receive allocations from ASI. (TR 1087) In the last rate case, the Company acknowledged the need to allocate costs to at least one of its non-regulated affiliates. (TR 1088) However, all non-regulated affiliates should be consistently allocated ASI costs.

Witness Dismukes indicated that the regulated and non-regulated Aqua companies have common officers and directors. She also testified that the Company has failed to demonstrate that the salaries and benefits of these common officers are allocated to the non-regulated companies. (TR 1091) Although AUF's witness Szczygiel conceded that there are some common officers between the regulated and non-regulated affiliates, he claimed that this fact should not dictate whether or not to allocate these officer salaries. (TR 1463) However, the

failure to allocate common costs to AAI's non-regulated operations causes AAI's regulated operations to subsidize the non-regulated operations. (TR 1091) Therefore, the costs charged to AUF from AAI and ASI are overstated.

Witness Dismukes testified that 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 allocated costs to these client companies. (TR 1089) While witness Szczygiel admitted that Aqua Operations covers multi-state non-regulated contracts, he argued that the state level handles the contract. (TR 1463) As witness Dismukes pointed out, while the Company claims it did not allocate costs because no corporate services were 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. (TR 1089) Witness Dismukes testified that 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. (TR 1089)

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.*

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. Id. at p. 545. As witness Dismukes pointed out, AUF offered a market analysis with numerous shortcomings as support for its position that its affiliate costs do not exceed market rates. (TR 1092) Witness Dismukes described her general concerns with Mr. Szczygiel's analysis.

Market Analysis Flaws

First, the analysis fails to take into account the likely discount a nonaffiliated company would offer if it provided the level of service provided by ASI. (TR 1092) While witness Szczygiel contended that discounts are not a certainty in the market, he acknowledged that AUF

received fee reductions from some of its consultants and attorneys. (TR 1466, 1527) Second, witness Dismukes indicated that 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. Third, companies typically use outside counsel or consultants for specialized areas of law or professional services, not day to day operations. Therefore, these are not a realistic comparisons. (TR 1092, H.E. 115-117)

Ms. Dismukes made a calculation to adjust for the 2080 hours per year assuming a 40-hour work week for 52 weeks in her analysis of legal costs. Mr. Szczygiel's market study did not make it clear he used 1,838 hours per year to recognize the time they actually worked, not unproductive time like vacation, holiday, and sick days. This was only addressed in his rebuttal testimony. (TR 1094-1095, 1465, H.E. 115-117) However, since the average billable hours were 1,482 for lawyers in Florida, the ASI hourly rate is still implicitly understated and not comparable to the professional legal hourly rate. (TR 1095, 1102) Moreover, AUF also has outside counsel for its rate case which bills at a rate of \$390 per hour which is higher than the average Florida bar rate of \$232. (TR 1095)

For the engineering costs, Ms. Dismukes pointed out that AUF at first only used rates for two engineering firms at \$122 per hour, compared to the in-house rate of \$82 per hour. She noted that although AUF claimed this included "overhead," the Company failed to provide the overhead amounts or an explanation of how it was determined. (TR 1093) Further, Witness Szczygiel admitted that he did not know if the in-house engineers performed actual design work. He testified that "[l]ike our internal attorneys, you might argue that they're more administrative, . . ." (TR 173)

With respect to the internal accounting services, witness Dismukes stated that the Company used an internal rate of \$57 per hour compared to the rates of various positions in CPA firms ranging from \$88 to \$161 per hour. (TR 1095-1096). In addition to the obvious skill level discrepancy between an in-house accounts payable clerk and a CPA, Ms. Dismukes noted that it would be highly unlikely for the Commission to approve a rate of \$88-\$166/hour rate for a person performing accounts payable, payroll, and accounts receivable accounting functions. (TR 1096) Moreover, Ms. Dismukes testified that while Mr. Szczygiel compared ASI's accounting personnel to a CPA firm, there was only one AUF employee who was a CPA. (TR 1256)

Finally, the management services comparison suffers from the same deficiencies as AUF's accounting functions. In addition to the skill level differences between management consultants and in-house management, the market study failed to account for the fact that management functions differ across industries. (TR 1097) Ms. Dismukes pointed out that it would be highly unlikely that the Commission would permit the Company to bill its customers for up to 100,000 hours at managerial hourly rates ranging from \$140-\$356/hour. (TR 1098)

As stated by witness Dismukes “. . . no conclusions can be drawn from the Company's analysis because it is not a valid market comparison.” (TR 1098) She advised that the Commission should reject AUF's analysis because it fails to support the contention that the affiliate charges are charged at the lower of cost or market, or do not exceed the going market rate. (TR 1101) Further, she warned that AUF's analysis merely provided a broad view of the various professional consultants billing rates. Ms. Dismukes also noted that the analysis failed to demonstrate that the level of service provided by ASI would be required if AUF were a standalone water company. (TR 1101) Moreover, the comparison of professional management rates excluded normal travel and computer costs associated with day to day operations without good cause. (TR 1102) 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. (TR 1105)

Peer Group Comparison

AUF witness Szczygiel claimed that affiliate charges have decreased since the last rate case, however, this is only because AUF relabeled certain costs as “In-State Administrative” costs despite being directly charged under the category sundry affiliate charges. (TR 1085-1087, 1455-1460) As Ms. Dismukes points out, Contract Service-Management Fees increased by 281% since the last rate case significantly more than the reduction due to shifting from the Miscellaneous Expenses. (TR 1105, 1106) Ms. Dismukes also noted that Contractual Services-Other increased 68% for water and only decreased 20% for wastewater since the last rate case. (TR 1106) Witness Dismukes testified that the information that AUF eventually supplied did not shed any light on the reasons for the high increases in management fees in the test year. (TR 1109) Further, AUF witness Szczygiel acknowledged that AUF's operation and maintenance expense ratio is over 50%, while the total Aqua America operation and maintenance ratio was 12% less at 38%. (TR 114-115)

Due to the Company's failure to provide any reasonable explanation for this high management fee increase, Ms. Dismukes developed a peer group analysis of the customer and administrative expenses for similarly situated water/wastewater companies. (TR 1110, H.E. 121-124) Through her peer group selection process, Ms. Dismukes' analysis addressed the criticism raised in the last rate case and in the PAA Order regarding the use of the peer group analysis. (TR 1111-1118) Ms. Dismukes made the following refinements to her analysis: 1) the companies with costly treatment processes were removed; 2) only utilities operating in the same counties as AUF were included; 3) companies that did not record salaries and wages were removed; 4) only Class B and C companies were used; 5) utilities that were sold were excluded; and 6) utilities with inconsistent ERC and customer data were excluded. (TR 1109-1122, H.E. 121)

While AUF may argue that the Commission has not used peer group analysis, this is erroneous. As demonstrated by Hearing Exhibit 331, the Commission has used peer group analysis to test the reasonableness of a company's requested cost. And as witness Dismukes noted, the peer group analysis is similar to a comparison of companies used for the purposes of establishing ROE. (TR 1173) She also noted that other jurisdictions, and in particular the American Water Company's subsidiaries, have used a peer analysis to present their conclusions as to the appropriateness of their affiliate and service company charges. (TR 1173)

Ms. Dismukes' peer analysis demonstrates that AUF's Administrative and General (A&G) expenses on a customer or equivalent residential connection (ERC) basis are significantly higher than the peer group. (TR 1119) Similarly, witness Dismukes' comparison of a typical bill shows that of the 18 counties AUF operates in, AUF has the highest water rates in 12 counties and the highest wastewater rate in 14 counties. (TR 1121, H.E. 125) For example, in Polk County AUF's water rates and wastewater rate are 116% higher and 119% higher, respectively, than the average of the other utility companies. (TR 1121, H.E. 125 at p. 6) She asserted that the layers of management associated with ownership by AAI have not produced any cost savings for customers and have resulted in excessive costs. (TR 1121, 1240-1241) Based on her peer group analysis, witness Dismukes testified that 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. (TR 1122)

Moreover, as a secondary analysis, Ms. Dismukes also examined the increase in management fees and customer operating expenses since the last rate case. The Company has provided no documentation supporting the increases in management fees and customer operations allocations since the previous rate case. (TR 1123) Witness Dismukes indicated that in order to ensure that customers do not pay for increases the Company cannot explain, the Commission should adjust expenses to the level consistent with growth in customers and inflation. Ms. Dismukes testified that adjusting test year affiliate expenses to the level consistent with customer growth and inflation would result in a reduction to test year expenses of \$882,388 for water operations and \$348,674 for wastewater operations. (TR 1123)

Conclusion

As witness Dismukes concluded, the affiliate relationship between the Aqua operating systems and its parent and Service Company do not appear to provide sufficient benefits to justify the added costs. 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. (TR 1123) Moreover, as Ms. Dismukes testified, the layers and layers of management are causing excessive administrative and general expenses to be allocated down to Florida. (TR 1261) Thus, the Commission should reject AUF's flawed market study. Using Ms. Dismukes comprehensive analysis, the test year expenses should be reduced by \$976,845.

Issue 18: What is the appropriate amount of Corporate Information Technology ("IT") charges allocated to AUF by its parent, Aqua America, Inc.?

OPC: *Corporate IT charges should be adjusted to reflect an allocation of the IT costs among all systems that are benefitting from the service and should be depreciated over a ten year period.*

Witness Szczygiel testified that during the past three years, AAI has made IT investments and these costs are allocated to AUF through a sundry allocation that assigns the costs based on the number of customers. (TR 87) He further stated that these costs are allocated at the time of the project and the allocation is not updated for new systems that are added and also benefit from the IT improvements. (TR 125) If this logic were expanded to expenses, you would never charge the management fees to any new systems acquired as the management was put into place before

the system was added. Witness Szczygiel further testified that, because the Company does not reallocate these costs, there is no need for an adjustment to remove increased allocation for systems that are divested. (TR 13)

Thus, based on the Company's assertion that the IT assets were allocated at the time of the last rate case and there has been no updated allocation, the Company has justified that an adjustment is not necessary to remove any increases to IT allocation due to the sale of divested systems. However, since the time of the last rate case, Aqua America has purchased 23 systems in 2010 and 18 systems in 2009. (H.E. 287 at p. 14) The Company has not justified why IT costs should not be allocated in a similar fashion as other administrative expenses. These allocations should be updated to reflect the acquisition of new systems that will benefit from the services.

Witness Szczygiel also testified that he did not disagree with the depreciation life of 10 years for the Corporate IT assets. (TR 88) Therefore, the Commission should adjust depreciation expense to reflect a 10 year depreciation life.

Issue 19: Should any adjustments be made to Incentive Compensation?

OPC: *Yes. AAI Incentive Compensation charges are allocated to AUF by its parent, Aqua America, and are included in the analysis of affiliate costs, and thus, are part of the \$976,845 reduction to affiliate costs recommended by OPC. However, if this issue is considered separately, The Commission should remove the \$106,258 included in the test year for 2010 as well as all amounts from 2009 and all adjustments for normalization and pro forma increases.*

Management salaries incurred at AAI are included in the Management Fee accounts and include incentive compensation increases for 2009 and 2010. Schedule B-3 of the MFRs includes adjustments to accounts 634, 636, 734, and 736 for normalization and pro forma adjustments for a 2.9% wage increase effective April 1, 2010 and 2011 as well as a 17.34% benefit cost. In Hearing Exhibit 173 (Staff's 2nd ROG #10), the Company identified all incentive and bonus program costs incurred by AAI and its subsidiaries. These costs total \$106,258.

Witness Vandiver testified that in light of the economic climate in Florida and throughout the U.S., no increases in salaries are appropriate at this time. (TR 643) Testimony also showed that the CPI was less than 2% for 2010 over 2009 (TR 643) and there have been no cost of living increases granted to Social Security in 2009 or 2010. (H.E.308)

Witness Szczygiel testified that without the incentive compensation, it makes it difficult for AAI to retain qualified management. (TR 89) However, the Florida Unemployment Rate has

continued to climb from 4.7% in 2007 to 12.0% in 2010. (H.E. 309) Periods of high unemployment are not the time that a company typically loses employees to other companies.

In addition, the Company's own Annual Report indicates that one of the justifications for incentive compensation is the Operating Ratio. (H.E. 287) While Page 7 of the Annual Report shows an Operating Ratio of 38.6% for Aqua America, Inc., the MFRs in the current case show that the Operating Ratio for the systems in this rate case are at 59% and 52% for water and wastewater, respectively, based on the requested Revenue Requirement. (H.E. 241) If you calculate these same operating ratios on the test year revenues, these are up to 63.5% and 55.1%, virtually the same as in the prior case. There has been no improvement in the Operating Ratio for customers in Florida.

Numerous customers at the service hearings testified that they have had trouble paying their current bills, much less any increases. (Ms. Cook, Sebring TR 34, Mr. Storch, Eustis TR 69, Ms. Ricketts, Eustis TR 115) When ratepayers are suffering in these difficult economic times, they should not be forced to pay for Aqua's salary increases.

Florida is not the first state to look closely at the salaries paid to the Aqua executives. The North Carolina Commission issued an order including a statement that ". . . there has been a dramatic increase in the compensation for four top executives over the past three years that has not been proven to be a reasonable increase to be recovered from ratepayers." (H.E. 286 at p. 13).

Based on all these facts, there should be no incentive compensation allowed for 2009 or 2010. The Commission should remove the \$106,258 included in the test year for 2010 as well as all amounts from 2009 and all adjustments for normalization and pro forma increases included in Schedules B-3 of the MFR's.

Issue 20: Should any adjustments be made to Salaries and Wages - Employees expense?

OPC: *Yes. The Commission should deny all increases in compensation, resulting in a total adjustment of \$220,410 for salaries and wages and \$16,861 for the related payroll taxes.*

AUF Witness Rendell testified in his direct testimony that the Company requested a cost-of-living salary increase for all its employees and a targeted pro forma market-based salary increase for its operators and field technicians. (TR 490) However, on cross-examination, Witness Rendell changed his testimony and stated that the increases were not for cost of living.

(TR 524, 576-577) These adjustments are found to accounts 601 and 701 on Schedule B-3 of the MFR's. Witness Vandiver summarized these adjustments in DNV-3 (H.E. 83) and shows that these adjustments total \$220,410 for an increase in salaries and wages 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.

Based on the arguments in Issue 19, OPC does not believe that any salary increases should be allowed. The economic market is poor, unemployment rates are high, and customers are struggling to pay the current bills. Therefore, the Commission should deny the increase 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: *Yes. 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.*

As Ms. Dismukes testified, the Company has experienced billing problems from as far back as 2007. (TR 1128) The customer testimony at the Service Hearings is replete with complaints about billing problems. Ms. Evans testified at the Gainesville hearing that she received a large back-bill and was put on a payment plan that changed from month to month and was continually threatened that if she was a penny short or late, the water would be cut off. (SH TR 44-46) Ms. Helm testified at the same meeting that she had to call every month to get a bill. She testified she actually called at least twelve times over three months. (SH TR 82) Ms. Longnecker testified at the Eustis Service Hearing that she was helping four little old ladies that had all received a back-bill. She quoted the letter one lady received that stated the bill covered 232 days of usage from October 2010 to June 2011. (SH TR 35-37) Mr. Storch testified at the same meeting that he called to tell the Company that his irrigation meter was not working and nothing was done. Then "all of a sudden" he gets a bill for \$1,600 and when he called, they adjusted it because it was for a period over 12 months. (SH TR 67-68)

These are only a sampling of the customer complaints about billing problems that continue to pervade the Company's system. While the Company continues to try to minimize the issue by referencing that the back-bill rate is .07 percent (TR 324), the Company ignored the fact that it is back-billing an increasing number of customers each year. A review of the number of

back-bills shown in Exhibit 300 shows that the Company had 141 backbills in 2009, 186 in 2010, and 97 in the first three months of 2011. Mr. Szczygiel testified all the residential meters had been installed prior to the last rate case (TR 150); however, the Company continues to have billing problems.

AUF's requested test year bad debt level of \$389,421 is significantly greater than the average for comparable water utilities and results from its poor service and billing practices. (H.E. 127 at p. 2) The difference is substantial enough that the Commission should clearly place the burden on the Company to demonstrate why the ratepayers should be burdened with the additional costs. (TR 1130) Ms. Dismukes provides a comparative analysis of the Company's bad debt to a peer group of water and wastewater utilities and recommends an adjustment of \$310,816 to reduce the test year expense to \$78,605. (H.E. 127 at p. 2)

The Bad Debt Expense included in the MFRs is higher than the utility even budgets in its own financial records. Mr. Szczygiel testified that the Company uses 1.5% in its budget process for bad debt. (TR 129) If this amount is applied to the Company's requested revenues, it results in a decrease of \$131,631. If it is applied to the PAA revenues, it results in a decrease of \$148,754.

The Company has a proven record of poor billing practices and the Commission should not set rates with the expectation that these practices will continue. 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.

Issue 22: What is the appropriate amount of rate case expense?

OPC: *Rate case expense is overstated and should be reduced by \$265,000 from the MFRs requested amount. Ratepayers should not have to pay any more than those costs that are reasonable and necessary*.

Rate case expense is overstated and should be reduced by \$265,000 from the MFRs requested amount. 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 (H.E. 86), and again to \$1,584,791 as of October 31, 2011 (H.E. 197, LFE #12).

Section 367.081(7). Florida Statutes, requires that the Commission disallow all rate case expenses determined to be unreasonable. Witness Szczygiel agreed that it is the Company's burden to prove that rate case expense is reasonable. (TR 142) The Company submitted almost 900 pages of invoices and timesheets (H.E. 197, LFE #12) to document rate case expense. However, nowhere in these documents does the Company explain how it is reasonable to spend \$1.5 million for a requested \$4.1 million increase. The last rate case, two years ago, was a fully litigated rate case and a much more complex hearing. (TR 1159) It had 76 issues with 23 issues stipulated or typical fall-out issues, leaving 53 litigated issues, and the Commission approved a total rate case expense of \$1,501,609.¹ Because the current case initially went through the PAA process and only specific issues were protested, the issues are substantially less. The Prehearing Order in this case includes 39 issues; 20 of these issues were identified as fall-out issues, leaving 19 litigated issues,² roughly 40% of the issues in the prior case. The PAA Order in this case approved rate case expense of \$778, 269,³ less than half of AUF's current request.

While the Company attempts to justify the huge rate case expense by shifting the blame to the amount of discovery, Witness Vandiver disagreed that rate case expense is solely dependent on the discovery. (TR 690) Witness Dismukes stated that rate case expense could be lower if the Company did not put up "such a fight to produce the documents." (TR 1184) The Company further argued that OPC had propounded 796 Interrogatories and 299 Requests for Documents, yet as Witness Vandiver pointed out, the Company is counting sub-parts that are not separate questions but a description of the details that should be included in the response. (TR 691) If the Company made an honest effort to provide responses and did not fight the process, the detailed sub-parts would not be necessary. The number of Interrogatories in this case was 310 compared to 445 in the last case and the number of Requests for Documents was 231 in this case and 244 in the last case.

¹ Docket No. 080121-WS, In re: Application for increase in water and wastewater rates in Alachua, Brevard, DeSoto, Highlands, Lake, Lee, Marion, Orange, Palm Beach, Pasco, Polk, Putnam, Seminole, Sumter, Volusia, and Washington Counties by Aqua Utilities Florida, Inc., Order No. PSC-09-0385-FOF-WS, issued May 29, 2009, p. 103.

² Docket No. 100330-WS, 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., Order No. PSC-11-0544-PHO-WS, issued November 23, 2011.

³ Docket No. 100330-WS, 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., Order No. PSC-11-0256-PAA-WS, issued June 13, 2011, p. 84.

A review of the details provided by the Company shows that the requested expense is unreasonable and 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. (TR 1228) Therefore, it is reasonable that if the rate case expense benefits both ratepayers and shareholders, the expense should be shared between them. Witness Dismukes testified that New Jersey, Illinois, and Minnesota have policies of sharing the rate case expense. (TR 1130-1140) When asked, Witness Dismukes also stated that these policies are based on Commission orders and not rules. (TR 1234) Therefore, the reasonable rate case expense that should be allowed is only 50% of the incurred amount, so that all parties that benefit share in the costs.

There are numerous issues regarding the prudence of the rate case expense that were documented. Almost 50% of the rate case expense detailed in Hearing Exhibit 197, Late Filed Exhibit #12, is attributable to legal fees. The Commission order in the last rate case shows that less than 17% of the approved rate case expense was for legal fees. Witness Vandiver testified that the Company should be able to hire any attorney it chooses; however, if the cost of that decision is exorbitantly high, the shareholders should share in the cost. (TR 651) The legal fees in this case include some of the higher rates in the state based on a survey published by the Florida Bar. (H.E. 85) Witness Szczygiel pointed out the qualified attorneys the Company have in house are charged out at hourly rates of \$95 and \$109. (TR 1540) He described the exceptional qualifications of Ms. Joyce with AUF who also worked for five years at the Pennsylvania Public Service Commission. (TR 1541) Even with competent in-house counsel, the Company felt obliged to incur 2,498 hours of outside legal expenses at an average rate of \$315, almost three times the charge-out rate of the in-house counsel. If the full amount of all unreasonable expenses is passed through to the ratepayers as rate case expense, the utility has no incentive to hold costs to a reasonable level. Customers should not have to bear unreasonable costs. Witness Vandiver proposes an adjustment to bring the hourly rates to an amount that is charged by 70% of the respondents to the Bar Survey. (TR 651)

Witness Dismukes also discussed how the Company incurred higher rate case expense by frustrating the discovery process and causing unnecessary delay by producing hard copies of documents, when electronic copies were available. (TR 1135) This 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.

During his cross examination, Mr. Szczygiel reviewed several invoices for legal expenses and agreed that the method of billing does not allow for specific identification of time spent on each task. (TR 1545-1550) Without that sort of detail, it is impossible to review the specific tasks for reasonableness. The attorney for YES Communities took notice of two Florida court cases – one was the United States District Court for the Middle District of Florida and the other was for the Southern District of Florida.⁴ Both of these cases point out that in calculating reasonable and appropriate fees, the Court must consider the number of hours expended together with the customary hourly fees. The Courts further found that a reduction in fees is appropriate for block billing, “which refers to the practice of including multiple tasks in a single time entry” *Id.* at v. 3.1 In addition, there are descriptions that are general in nature (for instance the second charge on AUF 024884 that states “AUF billable time to be edited later”) such that no determination of reasonableness can be made. Thus, additional costs should be removed from rate case expense as the legal invoices do not allow for a full review of reasonableness.

Rate case expense also includes a revised amount of \$216,203 for corporate capital charges. (H.E. 197, LFE #12) These are charges for in-house employees that worked on the rate case. Witness Vandiver testified that inclusion of post test year costs for in-house employees results in a double counting of expenses that increases the burden on the ratepayers. (TR 647) In addition, the documentation provide by the Company on Bate Stamped Pages 24009-24048 in the Late Filed exhibit was not provided until late November, 2011. Nowhere else did the Company shown any description of specific task performed by the employees related to the hours expended. Under cross-examination, Witness Szczygiel testified that time sheets were entered contemporaneously; however, the specific tasks were entered only when the Company was preparing the Late Filed exhibit in November 2011. (TR 1556) Witness Szczygiel said that an analyst prepared a spreadsheet of the hours recorded and then interviewed the employees to

⁴ Four Green Fields Holdings, LLC v Four Green Fields, An Irish Pub, Inc., 2011 U.S. Dist. LEXIS 126707(2011); Tarmar Diamonds, Inc. v. Splendid Diamonds, LLC, 2011 U.S. Dist. LEXIS 10313 (2011).

fill in the tasks. (TR 1557) The spreadsheets include hours for the time period April 2010 through October 2011, indicating that the Company attempted to go back over a year and a half later to complete a listing of tasks for each employee. The two court cases referenced earlier also address the lack of contemporaneous, complete and standardized time records which accurately reflect the work done as a basis for reducing fees. Four Green Fields at p. 3; Tamar Diamond at p. 5.

In addition, Witness Szczygiel testified that only 40 hours per week is charged but that the employees routinely work well over that. (TR 1581) Yet his testimony never addresses how the actual time charged is reconciled to the 40 hours per week and how the “free hours” are allocated or whether specific systems were not charged. The Exhibit also does not show any non-productive time such as for training and administration. Even under questioning by Commissioner Balbis, Witness Szczygiel did not fully explain why there was no administrative time shown. (TR 1586) Even Commissioner Balbis commented on the lenient timekeeping detail that Aqua maintains, yet still expects the ratepayers to shoulder the costs. (TR 1587) The in-house employee charges should not be allowed to be recovered through rate case expense.

The Company also included inflated costs in rate case expense due to the fact that it keeps its books and records out-of-state. Witness Vandiver testified that 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. (TR 623) Further, 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, the Commission removed all of these costs from rate case expense.⁵ All costs included in the documentation for flying between Pennsylvania and Florida should be removed as well as all additional shipping due to the company’s location in another state.

As Witness Dismukes pointed out, the utility brought numerous people to the Service Hearings (TR 1135); however, the purpose of these extraneous people is suspect when the Company only chose to provide written responses to the Commissioners on a “representative” basis. (TR 1680) This is typical of the Company’s response to customers and their concerns that

⁵ Docket No. 090392-WS, In re: Application for increase in water and wastewater rates in Lake County by Utilities, Inc. of Pennbrooke, Order No. PSC-10-0400-PAA-WS, issued June 18, 2010, p. 23.

they can all be lumped together and dismissed with a summary statement. The Company should certainly not be allowed the additional costs of attending the Service hearings and providing supplemental testimony if it was not prepared in a good faith effort to address each of the customers so the Commissioners would have complete information.

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.

The total of these adjustments at the time of the Prehearing Statement 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.

Witness Dismukes also testified that the Commission should not encourage utilities to file rate cases one on top of another with little time in between, such as happened with this case. (TR 1140) She recommends that the Commission should defer the rate case expense approved in this proceeding until the rate case expense from the prior proceeding has been fully amortized. This methodology would shift the burden of “pancaking” rate cases back on the shoulders of stockholders as it is the stockholders that benefit 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: DELETED

REVENUE REQUIREMENT

Issue 25: What is the appropriate pre-repression revenue requirement for the April 30, 2010, test year? (Fallout Issue)

OPC: *The total water revenue requirement should be consistent with OPC's recommended adjustments, the total water revenue requirement.*

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: **DELETED**

Issue 27: What are the appropriate rate structures for the Utility's water and wastewater systems? (Fallout Issue)

OPC: No position

Issue 28: What is the appropriate level of rate consolidation for the water systems in this case? (Fallout Issue)

OPC: No position

Issue 29: What is the appropriate level of rate consolidation for the wastewater systems in this case? (Fallout Issue)

OPC: No position

Issue 30: What are the appropriate resulting repression adjustments for this Utility? (Fallout Issue)

OPC: No position

Issue 31: What are the appropriate monthly rates for the water and wastewater systems for the Utility? (Fallout Issue)

OPC: No position

Issue 31A: (Added) Are the resulting rates affordable within the meaning of fair, just and reasonable pursuant to Sections 367.081 and 367.121, Florida Statutes?"

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. Residential customer rates should be capped at an affordable level. The Commission should make the Citizens, recommended adjustments resulting in a total reduction of \$2.3 Million.*

Sections 367.081 and 367.121, Florida Statutes, require that rates be fair, just and reasonable, as well as compensatory and nondiscriminatory. Witness Poucher noted that the dictionary definition of compensatory includes the concept of providing payment equivalent to the value of the service or product sold and should consider the value of the product and services they are receiving from Aqua. (TR 1432)

The language of Sections 367.081 and 367.121, Florida Statutes, also includes the concept that the resulting rates be affordable. (TR 746) 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. Witness Vandiver testified that the Merriam Webster dictionary defines affordable as "to manage to bear without serious detriment." (TR 1415) In fact, the Commission already recognizes this concept of affordability in describing its mission on its webpage where 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.) Witness Szyzciel acknowledged that that the industry mission of the investor-owned water utility industry is to provide quality and reliable water service at an affordable price to customers while earning a fair return for shareholders. (TR 139)

As witness Vandiver testified, the affordability of rates should be a critical component of the Commission's determination of the prudence of the utility's costs. (TR 1418) 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 budget, 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 adjustments must be made to individual expenditures that may have been considered reasonable on their own.

Witness Poucher testified that the historic concepts of fair, reasonable, and affordable impose obligations upon utility companies that provide monopoly services to their customers just like Aqua. (TR 746) Mr. Poucher posited that fair and reasonable means that rates must be non-discriminatory and should be affordable within the budgets of the overwhelming majority of the customer body without unusual sacrifice. He highlighted some of the customer comments in his testimony regarding affordability including customers not watering lawns, reducing hygiene usage, and otherwise not being able to pay their bills. (TR 1438-1420) Ms. Vandiver also testified that her review of customer testimony supported the fact that the level of rates is burdensome and has caused customers to move, abandon homes, and change their standard of living, as well as has well reduced the value of their homes. (TR 1417)

Witness Poucher, who has dealt with the concept of affordability in the telephone industry, stated that affordable rates in connection with universal service means two standard deviations above and below the nationwide average. (TR 946-947) He suggested the Commission should be looking at comparative rates for all water companies that operate in Florida as a matter of practice. (TR 747) Witness Dismukes compared the typical monthly bills approved in the PAA Order to those of other water and wastewater companies operating in the same counties in Schedule 22. (TR 1120, H.E. 125) As noted previously, Ms. Dismukes' comparison demonstrates that AUF's charges are the highest most of the time. (TR 1121) For AUF's 26 water company systems, 25 of AUF's water systems have higher rates than the average of the other systems. (TR 1121) She also noted that for all 17 of AUF wastewater systems, the rates are higher than the average of the remaining utilities' rates in the same county. (TR 1121)

Witness Vandiver testified that based on her review of the customer testimony at the Service Hearings, she did not believe that the rates are affordable. (TR 1415, H.E. 207) 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. (TR 1415-1417)

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. As witness Vandiver noted that the Commission has recognized that the regulatory framework can provide a disincentive to

keep costs low. (TR 1418) She cited the Commission's language in a 1990 telephone case that stated:

Confronted with this penalty for efficiency, regulated companies have the perverse incentive to engage in inefficient activities such as inflating the rate base by purchasing unnecessarily expensive or extravagant items, a practice known as "gold plating". Under traditional rate base regulation such behavior would be rewarded because the company would receive both a return on its investment and reimbursement of expenses.

(TR 1418, Order No. 23186, issued July 13, 1990, in Docket No. 870347-TL) Ms. Vandiver asserted that the Commission should consider evaluating the utility's operations to determine that the utility does not have just such a perverse incentive to continue to raise expense so that it may continue to increase its corporate revenues. She pointed out that even Staff witness Stallcup recognized that the rates approved in the PAA order were higher than most people, including himself, would expect water and wastewater rates to be. (TR 1392, 1418) While Mr. Stallcup's testimony implied that the Commission is constrained by the statutory requirement that the rates be compensatory to give AUF's all of its requested expenses, that implication is not necessarily required by the statute. (TR 1393) As witness Poucher testified, the term compensatory should not be used in isolation to justify increasing the revenue requirement which leads to higher rates. (TR 1438) AUF witness Szczygiel claimed that the rate case is driven in large part by efforts to improve water quality and environmental compliance. (TR 1498) However, a large portion of the requested revenue requirement increase is being driven by over 200% increase in less than two year for ASI affiliate costs. (TR 1105-1106)

In addition, 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. 126. Given that AUF's requested rate increase is less than two years later, the comparative analysis of the average water and wastewater rates are even more applicable in the present rate case. If less than two years ago the "affordability limits" was \$65.26 for water and \$82.5 for wastewater, it is reasonable to conclude that AUF's current increase request will only result in rates that further exceed these limits.

Conclusion

Citizens' analysis of AUF's current rates shows that they have some of the highest rates in the state without any increases. (TR 1120, H.E. 125) As indicated in previous issues, AUF has overstated its rate base and net operating expenses that is leading to rates that are not fair, just, or reasonable. 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 B and C water and wastewater companies demonstrates that AUF has not delivered these benefits to its customers. (TR 1123) 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.

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

Issue 33: What are the appropriate customer deposits for the Utility? (Fallout Issue)

OPC: No position

Issue 34: What is the appropriate four-year rate case expense reduction for Docket No. 080121-WS? (Fallout Issue)

OPC: *The appropriate four-year rate case expense reduction for Docket No. 080121-WS should be as ordered in PSC-09-0385-FOF-WS.*

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

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

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: *Rate Case expense should not be amortized in the current case until the rate case expense in the prior case has been fully amortized. Four years after the initiation of the amortization of the rate case expense in the current case, the rates should be adjusted to remove the \$404,638 in rate case expense.*

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

Issue 39: Should this docket be closed?

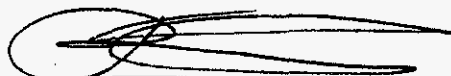
OPC: *The docket should remain open to continue monitoring AUF's quality of service.*

The docket should remain open to continue monitoring AUF's quality of service or, in the alternative, a separate docket should be established to monitor AUF's quality of service. Citizens' witness recommended continued monitoring of Aqua's Quality of Service. The company, staff, OPC, and other intervenors should work together collaboratively to develop a plan similar to the process used to develop the Phase II monitoring plan. AUF should provide reports on their complaints that analyze them, provide the resolution of each complaint, and how similar complaints can be prevented in the future. (TR 909-910) Further, any future monitoring plan should be developed with metrics that allow the Commission to measure improvement in DEP compliance, billing issues, customer service issue. (TR 702- 703) Further, multiple

customer survey should be used to measure customer satisfaction over a period of time. (TR 917-918)

Dated this 30th day of December, 2011.

Respectfully submitted,



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CERTIFICATE OF SERVICE

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

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