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Subject: Docket No.: 110200-WU; Application for Increase in Water Rates in Franklin County by Water Management Services, Inc.
Attachments: Post Hearing Statement of Issues and Positions 2-11-13.pdf

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b) Docket No. 110200-WU
Application for increase in water rates in Franklin County by Water Management Services, Inc.

c) Water Management Services, Inc.

d) 32 pages

e) Post Hearing Statement of Issues and Positions

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application for increase in water rates in Franklin County by Water Management Services, Inc.	DOCKET NO. 110200-WU

WATER MANAGEMENT SERVICES INC.'S
POST HEARING STATEMENT OF ISSUES AND POSITIONS

WATER MANAGEMENT SERVICES, INC. ("WMSI"), by and through its undersigned attorneys and pursuant to Order No. PSC-13-0019-PHO-WU files this Post Hearing Statement of Issues and Positions.

ISSUES AND POSITIONS:

RATE BASE

ISSUE 1: What is the appropriate working capital allowance?

WMSI is entitled to a working capital allowance based upon 1/8 of operating and maintenance expenses established in this docket.

In the PAA Order, this Commission found that utilizing the balance sheet approach WMSI had a negative working capital allowance which, consistent with Commission practice, was set at zero. While recognizing that a negative working capital is not typical of a "normal" utility, this Commission should have applied common sense to the problem. As Mr. Guastella opined, based upon his 50 years as a regulator and consultant to water utilities, the Commission's move from a negative working capital to a zero allowance does not adequately reflect the amount of the actual working capital requirement needed by WMSI. (Tr. 41) The lead/lag between expenses and revenues is real, which creates a need for working capital. With no equity allowance, no operating margin, and no income tax allowances, any increase in expenses above the level allowed will require the stockholder to subsidies the actual costs - - a stockholder for which no return has been allowed. (Tr. 41) Clearly, if working capital is not reflected in rates,

then it is inappropriately borne by the shareholders. (Tr. 46-47) Any normal viable company needs working capital in order to pay current liabilities as they become due. (Tr. 56)

Since the balance sheet approach does not work, and every utility needs working capital, the Commission should develop an outside of the box solution. Since the working capital needs of Class A and Class B utilities do not differ (only the sophistication of the accounting requirements), the reasonable and logical option is to establish working capital for WMSI at one-eighth (1/8) of the final approved operating and maintenances expenses. (Tr. 348)

ISSUE 2: What is the appropriate rate base for the test year ended December 31, 2010?

This is a fall-out calculation issue subject to the resolution of other protested issues.

COST OF CAPITAL

ISSUE 3: What is the appropriate weighted average cost of capital including the proper components, amounts, and cost rates associated with the capital structure for the test year ended December 31, 2010?

The appropriate weighted cost of capital is 5.96%.

One of the requirements for WMSI to obtain a $3,000,000 loan from Centennial Bank was $3,000,000 of life insurance on Gene Brown which consisted of two life insurance policies totaling that amount (Ex. 66 p. 215). Since Mr. Brown had been required to personally guarantee the loan, the lender wanted immediate payment if he died. (Tr. 349) WMSI pays $39,258 per year for the life insurance policies. (Tr. 63)

Ms. Allen, in preparing the MFRs, rolled this expense into the interest rate, which results in an effective interest rate of 8.46% on that loan. (Tr. 57) The cost of life insurance required in order to secure a loan is a reasonable and necessary expense. (Tr. 63)

Actually, the premiums should have been included as an operating expense, but it was not. (Tr. 349) Even OPC witness Schultz agreed that if a lender requires life insurance in connection with a loan, then it should be included as an operating expense (Tr. 205), and that would be more appropriate than factoring the expense into the interest rate on the loan. (Tr. 205-206)

WMSI is simply requesting that this mandated expense be reflected as a component of the cost of debt, just like any other expense required by loan covenants. This is reasonable and appropriate because ratepayers are benefitting from the water service that could not have been provided without the $3,000,000 loan, and that loan could not have been secured without Gene Brown's personal guarantee and policies of insurance on his life. (Tr. 349)

The compelling conclusion is that this Commission must either accept WMSI's methodology of incorporating the cost in the interest rate of the loan or include an operating expense in rates in the amount of $39,258 because it is an unavoidable cost to provide service. To do neither is unfair, unreasonable and contrary to sound ratemaking principles.

NET OPERATING INCOME

ISSUE 4: Should any adjustments be made to contractual services – accounting expense?

Yes. Accounting expenses should be increased by $1,548 over the PAA Order amount to reflect a five-year average.

WMSI's actual reasonable and necessary accounting fees for the test year were over $18,000, however, WMSI will need $9,550 on an on-going basis (Ex. 66, p. 214). In the PAA Order, the Commission reduced accounting expenses to the amount it approved based upon a 2009 test year, which amounted to a reduction of $5,883. The Commission did not even increase the expense to account for inflation in 2010-2013. (Tr. 57)

As explained by Ms. Allen, WMSI requires annual tax services and is in need of assistance with plant and depreciation records and general accounting oversight of the records maintained by the in-house accounting staff, which will likely far exceed the amount being requested by WMSI. (Tr. 65)

Although the actual accounting expense incurred in the test year is reasonable on a going forward basis, WMSI will accept the use of the five-year average methodology that was used in the prior rate case. (Tr. 348) When there is volatility in a particular expense, this Commission concluded that "we find that we can smooth out those costs by applying a five-year average for those expenses for ratemaking purposes." Order No. PSC-12-0206-PAA-WS at p.18. This Commission as recently as the January 24, 2013, Commission Conference reaffirmed the use of averaging of volatile expenses. Docket No. 110257-WS.

Thus, WMSI is entitled to an increase in accounting expense of $1,585 over the PAA amount. (Tr. 58; Ex. 6)

ISSUE 5: Should any adjustments be made to transportation expense?

Yes. Transportation expense should be increased by $8,916 over the PAA Order amount to reflect business usage of Mr. Brown's and Ms. Chase's vehicles.

The Commission in the PAA Order decreased transportation expense for Gene Brown and Sandy Chase because they did not maintain mileage logs during the test year relying upon the belief that "in the 1994 rate case, the Utility was effectively put on notice that travel records would be required in future proceedings" at p. 19. This statement is clearly erroneous as it relates to travel records of administrative staff. It is interesting that in the last rate case that transportation expenses were allowed for administrative staff without mileage records because the Commission recognized that Mr. Brown traveled to St. George Island at least once a week.

Following the last rate case, the Commission opened a Show Cause Proceeding as to why WMSI should not be fined for failure to comply with the transportation recordkeeping requirement in the 1994 Order with regard to administrative staff. In closing, the Show Cause Proceeding, without imposing any penalty, this Commission concluded:

> . . . However, upon reading our discussion in the 1994 Order, there is ambiguity concerning whether the directive for maintenance of accurate travel records found in the ordering paragraphs of the 1994 Order was directed solely at field employees, or if it included administrative employees, there is some question whether the recordkeeping contemplated in the 1994 Order contemplated the specific facts in this case.
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> . . .
>
> Therefore, the situation in this case was not addressed at all by the 1994 Order. Because this situation was not considered in the 1994 Order, we find that it cannot be said that the Utility violated the 1994 Order. Clearly, the Utility was warned that it needed to keep better travel records, and it has.
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> . . .
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> In the Final Order in this docket, we directed WMSI to "maintain travel records or logs for all vehicles used for utility purposes to enable this Commission to evaluate the appropriate level of Utility-related usage in future rate case proceedings." Hopefully, this directive will alleviate any problems in the future.
>
> PSC Order No. PSC-11-0250-FOF-WU at p. 4 & 5.

The Final Order referred to was issued January 3, 2011. The denial of administrative staff transportation expense in the instant case is directly contrary to Order No. PSC-11-0250-FOF-WU and transportation expense should be reinstated.

Thus, administrative staff was not required to maintain mileage logs during the test year. That requirement did not arise until January following the close of the 2010 test year, and administrative staff have kept mileage records as required by the January 3, 2011, Order. (Tr. 65)

OPC witness Schultz mistakenly believed that the 1994 Order required administrative staff to maintain mileage records. (Tr. 213) He apparently looked only at the PAA Order and failed to conduct due diligence to determine if there was any subsequent order to the contrary. Had he done so, he would have read Order No.: PSC -11-0250-FOF-WU, which provides otherwise. OPC also tried to make much to do about what the recordkeeping requirements of the IRS might be but was unable to do so. Even if OPC had been able to do so, what the IRS requires is really irrelevant to this Commission's determination of transportation expense, and even OPC witness Schultz admitted that just because the IRS may have a specific recordkeeping requirement that does not mean the Commission cannot impose a requirement greater or lesser than that of the IRS. (Tr. 213-214) He finally agreed that if WMSI met the Commission requirement then transportation expense should be allowed. (Tr. 216)

It is not fair or reasonable to require Gene Brown and Sandy Chase to use their personal vehicles for WMSI business at their own expense. (Tr. 346) Ms. Chase travels to St. George Island, the Commission, banks and for other business matters. (Tr. 92) Since Ms. Chase manages operations, travel to St. George Island is necessary (Tr. 364) The necessity for Mr. Brown to travel to St. George Island is unquestioned and the frequency is reflected in mileage logs for 2011. (Tr. 363-364) In the last rate case, this Commission recognized that Mr. Brown traveled to St. George Island once a week and allowed transportation expense accordingly.

It should be noted that in WMSI's last rate case Mr. Brown was allowed transportation expense of $3,000 with no records at all. The Commission in that Order did not make the mistake it made in the PAA Order of believing that the administrative staff had been told in 1994 to maintain mileage logs.

This Commission must either accept the mileage logs from 2011 as reasonable transportation expenses in 2010 (Ex. 70 p. 302) or impute a reasonable amount as it did in the last rate Order. But a total denial of transportation expenses is unsupported by law and the facts of this case.

The mileage records Mr. Brown and Ms. Chase maintained for 2011 are an accurate representation of the miles they traveled on WMSI business during 2010 and transportation expense must be increased by $8,916, over that total amount included in the PAA Order.

ISSUE 6: Should an adjustment be made to rate case expense previously authorized by Order No. PSC-11-0010-SC-WU, currently being amortized in customer rates, and if so, in what amount?

**No. This Commission has determined the reasonableness of the rate case expense and it is being paid by WMSI. **

OPC makes what it admits is a novel argument in asserting that unpaid rate case expense from the prior rate case that is embedded in current rates be removed, or to micromanage WMSI by establishing a repayment schedule. (Tr. 240) Neither suggestion has any support in law or fact.

WMSI's last rate case resulted in a revenue increase of $13,474 per year, but an amortization of rate case expense of $57,295. (PSC Order No. PSC-11-0010-SC-WU) Thus, with an almost $45,000 per year effective rate reduction, it should not be surprising that it is challenging for WMSI to pay all rate case expense from the last rate case immediately as OPC suggests. Further, WMSI has paid almost $59,000 in connection with the current rate case. (Ex. 81)

OPC's "concern" that prior rate case expense will not be paid is without any justification (Tr. 238-239), and is contrary to the undisputed testimony of Gene Brown. (Tr. 430-431 Ex. 65

p. 207, 208) OPC would have this Commission believe that WMSI began making payments to the Rady law firm after OPC raised the issue. However, that is mere supposition and is contrary to the record. Payments recommenced to the Rady firm as soon as a repayment amount was agreed to. (Ex. 65 p. 207) OPC witness Vandiver admits that there is no requirement that rate case expense be paid immediately or within the 4-year amortization period. (Tr. 258) OPC has cited no PSC Orders that have even insinuated that such a requirement exists. In typical OPC fashion, it expects a utility to pay rate case expense immediately even though it is received in rates over a 4-year period, and even if the consultants agree to accept payment over the 4-year period. (Tr. 250) There is no logic or reason in such a position. It is but another example of OPC doing whatever it can to financially stress WMSI.

The rate case expense has been amortizing for approximately two years, and OPC admits that, except for the Rady law firm, WMSI is paying rate case expense to consultants consistent with the amortization (Tr. 234, 259), so it appears that the Rady law firm bill is OPC's real concern. OPC seems to rely on the exchange of letters between the Rady law firm and WMSI in March, 2012. (Tr. 237; Ex. 51, p. 4-6)

Probably due to a lack of business acumen, OPC misconstrued WMSI's response as indicating that WMSI was not going to pay the amounts due the Rady law firm. Gene Brown is personally liable for the amounts due the Rady law firm. (Tr. 260; Ex. 52, p. 4-9) One would expect the response to a threatening letter to be in kind. Any disagreement between WMSI and the Rady law firm has been resolved. (Tr. 448-449)

WMSI and the Rady law firm agreed to $2,000 per month payments until paid or until WMSI was sold. (Tr. 332, 449) When OPC witness Vandiver complained that there was no agreement for the $2,000 per month payments, she meant written agreement since the

uncontroverted evidence is that such a verbal agreement exists. The Rady law firm has not expressed concern to OPC that it will not be paid. (Tr. 260-261) WMSI is currently paying $4,500 per month for attorneys and consultants in the last rate case which is about the 4-year amortization amount. (Tr. 333; Ex. 75, p. 12)

ISSUE 7: What is the appropriate amount of additional rate case expense associated with the protest of Order No. PSC-12-0435-PAA-WU?

**Based upon actual and estimated rate case expense, WMSI should recover $136,565 in rate case expense. **

An important fact that cannot be forgotten is that WMSI, and ultimately its customers, would not have incurred any of this rate case expense but for OPC's protest which no customer had requested be filed. It is unfortunate that as a result of OPC's personal vendetta against Gene Brown that WMSI has had to incur $136,565.38 in rate case expense to defend OPC's protest. (Tr. 333-334; Ex. 61)

WMSI filed this case under the PAA procedures in an effort to minimize rate case expense. Although the PAA Order did not include the revenue requirement to which WMSI believed it was entitled, the expense of a full evidentiary hearing did not justify a protest. However, OPC started this expensive process by protesting the PAA Order, and it is difficult to understand how OPC can now argue that WMSI's rate case expense is excessive.

OPC nitpicks WMSI's rate case expense in several respects, most of which are directed to legal rate case expense. OPC's non-legal rate case expense complaint is mainly about WMSI having two witnesses, Ms. Allen and Mr. Guastella, and duplicative testimony, which complaint is without factual support. Since Ms. Allen prepared the rate case MFRs, it is natural for her to testify, and when OPC protested Account 123, it was necessary to retain Mr. Guastella, who is a nationally recognized expert in water ratemaking. (Tr. 335) Generally, Ms. Allen testified on the

issue which WMSI cross-protested --- including the common issue of service availability charge, and Mr. Guastella testified on Account 123 and the ancillary issue of the reduction of Gene Brown's salary due to the misconception that the customers will pay more interest as a result of the extension of the DEP loan. WMSI's division of testimony is similar to that of OPC. The only difference is that OPC witness Vandiver is not an outside consultant, but an OPC employee paid by the citizens of Florida.

The total rate case expense for Ms. Allen and Mr. Guastella is $35,506. (Ex. 61) OPC witness Schultz's fees were $20,692 through the end of December, 2012. (Ex. 73, 74) Mr. Schultz was at both hearing days for the entire day, and it is logical to assume he spent one day prior to the final hearing preparing and incurred two travel days (compensated at ½ the regular rate). So even if Mr. Schultz did nothing more in January (which is unlikely), his total expense is approximately $24,000. If one were to assign reasonable compensation for Ms. Vandiver, the total expense for OPC's two witnesses is approximately the same as that of WMSI, thus, no adjustment is appropriate.

OPC witness Vandiver admitted that there are no attorneys more experienced at handling rates cases than WMSI's attorney, Martin Friedman. (Tr. 264) As such, OPC does not take exception with the hourly rate. (Tr. 264) Ms. Vandiver also acknowledged that while OPC and Commission Staff each had two attorneys at the final hearing, WMSI only had one. (Tr. 264-265)

Further, OPC argues that WMSI's "litigation strategy" of objecting to OPC "legitimate" discovery requests unreasonably increased legal rate case expense. (Tr. 242) However, upon closer analysis, Ms. Vandiver agreed that 17 of OPC's 22 discovery requests, which were subject to its Motion to Compel, were not legitimate discovery requests. (Tr. 268) The record clearly

shows that OPC's unreasonable discovery requests substantially increased legal rate case expense. After WMSI objected to initial discovery, OPC withdrew 4 interrogatories (and subparts) and 6 requests for production of documents. The obvious conclusion is that OPC agreed these were not reasonable discovery requests and WMSI's objections were valid. WMSI had to pay the expense of objecting to those unreasonable requests.

WMSI also had to incur the legal rate case expense to respond to OPC's Motion to Compel, which Ms. Vandiver later admitted was without merit. (Tr. 269) As to that Motion, it involved 22 discovery requests, and the prehearing officer denied all or part of 12 of the requests and modified another 5. (Tr. 268) Thus, in actuality, it is OPC's "scorched earth" discovery that has substantially increased WMSI's rate case expense.

OPC's assertion that WMSI should not recover legal rate case expense in connection with its Motion to Dismiss OPC's protest (Tr. 244-245) is equally without merit. That Motion raised an issue that had never been addressed by the Commission – whether OPC had standing to protest a PAA Order even though no customers had requested they do so. It was a legitimate Motion which, if granted, would have resulted in a substantial savings to customers and WMSI in rate case expense.

The epitome of nitpicking is OPC's position that the legal rate case expense associated with filing a notice of withdrawal of the prefiled testimony filed with the original application be withdrawn. (Tr. 246) Even if that was legitimate, Ms. Vandiver spent more time addressing it in her prefiled testimony than it took to withdraw the testimony. In fact, the pre-PAA Order testimony was irrelevant to the narrower issues raised by the parties' protests. The reasonable purpose was to "clean up" the record and address only the issues relevant to the protests.

OPC next believes that it is unreasonable for WMSI to raise issues by cross-protest and WMSI should pay legal rate case expense associated with those issues. (Tr. 272) Such a position is without any legal or factual support. It is reasonable and logical to expect WMSI to defend itself by raising issues by cross-petition in response to OPC's protest. WMSI should not be penalized for asserting such issues. OPC relies upon PSC Order No. PSC-94-0738-FOF-WU (Sunshine Utilities) for requesting a proration of legal rate case expense based upon WMSI's success on each issue. (Tr. 248-250) That Sunshine Utilities Order is not applicable for several important reasons. First and foremost, it was the utility that filed the appeal, not OPC, so its efforts were voluntary, not defensive as in this case. And secondly, that was an appeal to an appellate court not a protest of a PAA order. Upon cross-examination, Ms. Vandiver admitted that the time spent on each issue is not equal, that the vast majority of this case is about Account 123 (an issue raised by OPC), and finally concluded that a pro-rata reduction of rate case expense based upon the success on each issue is not reasonable. (Tr. 274) Thus, upon OPC's own admission, there should be no pro-rated reduction in rate case expense.

Finally, OPC raises the novel suggestion that the Commission monitor the payment of rate case expense by requiring quarterly reports. Ms. Allen did not agree that was necessary and was not concerned about being paid. (Tr. 95)

Ms. Allen's firm is being paid as agreed upon (Tr. 438), and the attorney's will be paid as soon as they can (Tr.437), and WMSI will pay all rate case expense. (Tr. 438-439) Additional reports are unnecessary and will serve no useful benefit to anyone since there is no requirement to pay rate case expense immediately.

This issue can be summed up with a simple question and answer:

Friedman: Wouldn't you agree that Water Management Services would not have incurred any rate case expense post-PAA, but for OPC's protest?

Vandiver: True.

(Tr. 266)

ISSUE 8: Should any adjustments be made to miscellaneous expense?

Yes. Miscellaneous expenses should be increased by $6,735 over the PAA Order amount.

This issue arises out of the bookkeeping entries in connection with the repair of lightening damage to a drive well. As a result of lightening damage, a drive well had to be replaced. The repairs were booked as an expense. As the result of an insurance claim, WMSI was paid $8,754 (Tr. 89-90; Ex. 8) which was as a credit to the expense account, thus reducing expenses by $8,754. (Tr. 85; Ex. 94)

The Staff later determined that $6,735 of the repair cost should be capitalized and removed it from expenses. However, through an oversight, the Staff failed to remove the off-setting credit to expenses. Thus, there was effectively a double reduction in expenses in connection with the drive well repair that was capitalized in the amount of $6,735. (Tr. 60, 69, 93-94)

By failing to remove the credit to expenses for the $6,735 that was removed from expenses and capitalized, assumes that WMSI will receive a check from the insurance company for $6,735 every year (Tr. 69), when that is not the case.

This oversight should be corrected by increasing miscellaneous expenses by $6,735.

ISSUE 9: How should the net gain on sale of land and other assets be treated?

> **No further gain on sale adjustments to those made in the PAA Order are justified. The Commission in the last rate case should never have given the customers the benefit on the gain on sale of the Tallahassee lots that were never in rate base.**

The undisputed policy of this Commission with regard to how gains on sale are addressed in the ratemaking process was articulated in Order No. PSC-96-1320-FOF-WS:

> "[W]hen a utility sells property that was formerly used and useful or included in uniform rates, the ratepayers should receive the benefit of the gain on sale of such utility property.' at p. 201

That policy was followed more recently in Order No. PSC-11-0514-PA-WS, when this Commission addressed a utility's argument at the Commission Conference that the property sold had never been included in rate base. In that Order, the Commission provided the utility an opportunity to "provide proof that the cost of this particular piece of land was not included in its rate base." at p. 32, which resulted in no gain on sale benefitting customers.

Public Counsel has acknowledged this policy through the testimony of its accounting witness in Order No. PSC-06-1320-FOF-WS: "Ms. Dismukes agreed that the gain on sale of assets that were not included in rate base should not be amortized above the line." at p. 197. OPC's witness in the instant case did not even know the Commission's policy on gain on sale (Tr. 219)

Thus, the fact that the Tallahassee investment lots owned by WMSI were erroneously included in plant-in-service in its 2006 Annual Report is irrelevant. (Ex. 75, p. 17) The issue is not whether the asset was plant-in-service, but whether it was in rate base. It is undisputed that the Tallahassee investment lots were never included in rate base or in any way in the rates ratepayers paid. (Tr. 327) There is no evidence in the record to the contrary. The lots were

purchased for investment purposes (Tr. 347) and never had anything to do with utility operations (Ex. 75, p.17)

Any change in such non-rule policy must provide an adequate explanation and be supported by competent substantial evidence. Palm Coast Utility Corporation v. Public Service Commission, 742 So. 2d 482 (Fla. 1st DCA 1999). There is insufficient evidence in this record to support any change in the existing policy that in order for ratepayers to benefit from a gain on sale such property must have been in rate base.

Public Counsel's position on this issue as articulated in the Prehearing Order is that this Commission gave the benefit of the gain on sale of the Tallahassee investment lots to the customers in WMSI's last rate case, and the amount has not yet been fully amortized. It is notable that OPC makes no attempt to assert that the Tallahassee investment lots were ever included in rate base. The best OPC can come up with is the futile argument that the lots were in UPIS for 2006–which is irrelevant to the gain on sale issue, and that in 2006 WMSI spent about $5,000 in professional fees relating to the potential development of the lots. However, those expenses were never embedded in rates either (Tr. 395), and would not have been even if WMSI had a 2006 test year rate case since they had nothing to do with water service to customers.

The fact that this Commission's Order in WMSI's previous rate case was affirmed by the Appellate Court without opinion gives no support to OPC's argument. As is well recognized, a per curiam appellate court decision with no written opinion has no precedential value and is not approval of the opinion and conclusions of law of the lower court. Dept. of Legal Affairs v. District Court of Appeal, 5th District, 434 So. 2d 310 (Fla. 1983).

Further, this Commission does not only have the authority to correct mistakes in prior orders, it "has a duty to correct such errors." (e.s.) Sunshine Utilities v. Florida Public Service Commission, 577 So. 2d 663 (Fla. 1st DCA 1991).

It is clear that giving ratepayers the benefit of the gain on sale of the Tallahassee investment lots is WMSI's last rate case was in error. The gain on sale issue in WMSI's prior rate case was not vetted in the formal hearing, but was addressed by the filing of a late filed exhibit. (Ex. 73, p. 00469) It is also notable that Order No. PSC-11-0010-SC-WU addressed the gain on sale in a mere four paragraphs and contains no finding that the Tallahassee investment lots were ever in rate base. Absent a finding that the Tallahassee investment lots had been included in rate base, it was erroneous to give the benefit of the gain on sale to customers. The fact that the Tallahassee investment lots may have been included in plant-in-service for "earning surveillance" purposes is irrelevant and a smoke screen in an effort to divert attention from the undisputed fact that the Tallahassee investment lots were never in rate base, or in any way paid for by customers. In none of the prior PSC orders has the fact that assets were plant-in-service been relevant to the Commission's policy on gain on sale. In fact, to do so would vitiate the Commission's policy and would give ratepayers a windfall on the sale of assets which were never in rates.

ISSUE 10: Have the Utility's advances to WMSI's President and associated companies had any adverse impact on the Utility or its ratepayers, and if so, what action, if any, should the Commission take?

**The Utility's advances to its President and associated companies have had no impact on rates charged to ratepayers, nor any adverse impact on the Utility. The customers pay no additional interest expense as a result of the re-amortization of the DEP loan to match the depreciation rate of the asset purchased with the loan. The Commission should continue to reject OPC's continued efforts to have this Commission micro-manage the Utility. **

OPC's position on Account 123 is long on rhetoric and short on facts and law. This issue has its genesis in the last rate case when OPC misled the customers by telling them that Gene Brown took $1.2 million of their money. Account 123 does not represent customer money. It is money received by WMSI that it has invested in associated companies. In fact, the NARUC title of Account 123 is Investment in Associated Companies. (Tr. 108)

Staff Audit. Subsequent to WMSI's last rate case, the PSC conducted a cash flow audit of WMSI. Ms. Dobiac explained the manner in which she conducted the 2004-2010 audit (Tr. 286-287), that was subsequently updated through 2011. (Tr. 291) There are two things that are important to understand about the audit. The first is that it confirmed the amount WMSI booked to Account 123 to the dollar. (Tr. 364, Ex. 56, p. 13) The other important thing to understand about the audit is what is defined as "utility activity." When one understands "utility activity" as defined in the audit, it becomes crystal clear that Gene Brown and affiliates have substantially subsidized WMSI.

"Utility activity" is not just revenue from ratepayers. It includes loans in WMSI's name of almost $2 million. (Tr. 296-297; Ex. 56, p. 19) These were loans that WMSI was only able to obtain only because of personal guarantees by Gene Brown and the pledge of personal assets (Tr. 329; Ex. 83, 83). "Utility activity" also includes the sale of assets of which $229,000 was from the sale of Tallahassee investment lots which have never been in rate base or otherwise included in rates customers paid. (Tr. 299, 327, 347) Also included in "utility activity" are the proceeds from a lawsuit settlement (Tr. 299), even though UPIS was reduced by that amount resulting in a lower revenue requirement. (Tr. 342) Finally, cash advances on the WMSI credit card are considered a "utility activity." (Tr. 300)

So it is clear that revenue from ratepayers during the seven-year period from 2004 to 2010 was $10,327,240 of the total cash receipts of $13,675,198. (Ex. 56, p. 19) The shortfall in customer revenues even according to the audit was over $3.3 million. That shortfall was made up through the efforts of Gene Brown and affiliates. (Tr. 326) Ms. Dobiac confirmed Gene Brown's statements that he was responsible for coming up with the shortfall. (Tr. 301) If one analyzes it another way, according to the audit, total revenues from "utility activity" and "non-utility activity" were $16,235,815, but only $10,255,048 came from ratepayers, so Gene Brown and affiliates had to come up with the $6 million difference. Even if you deducted the $1.2 million in Account 123, Gene Brown still had to come up with almost $5 million through various means including guaranteeing personal loans and using personal assets as security for loans. (Tr. 331; Ex. 56)

Subsequent to the Audit, Gene Brown has had to come up with $112,233 to help WMSI cash flow in 2011, and an another $95,824 during the first three quarters of 2012 to cover WMSI's cash shortfall, all by borrowings secured by non-utility assets, including a loan from Gene Brown's 401K. (Tr. 330; Ex. 79)

In response to the Staff Audit, WMSI prepared a Financial Sources and Uses Analysis. (Tr. 79.) This analysis confirmed the amounts in the Staff Audit, but more accurately reflected a comparison of revenues customers paid and the costs of operation of WMSI. (Ex. 79) While Ms. Dobiac used of a textbook definition of "utility activity," it is misleading. So, WMSI's analysis uses real world definitions, i.e., what customers actually contributed to the cash flow of WMSI versus the actual expenses. (Tr. 328; Ex. 79). So, in real world terms, not academic terms, Gene Brown had to come up with over $16 million, including refinancings to cover the revenue shortfall of WMSI. (Tr. 329; Ex. 78)

Account 123. In order to understand Account 123, one has to understand the historic development of WMSI. OPC witness Schultz's lack of understanding of ratemaking in Florida is really highlighted in his testimony on this issue. The fact that Schultz did not understand ratemaking for start-up utilities (Tr. 191) at least partially explains why he did not understand how WMSI got into a position where it had no equity. Fortunately, Mr. Guastella, one of the nation's foremost authorities in water and wastewater ratemaking (Ex. 10), testified on this issue, particularly as it relates to Account 123.

The Commission's ratemaking methodology assures that customers only pay for the water they receive on the basis of the allowable cost of providing water service, completely unaffected by Account 123. (Tr. 43) When a new water utility is formed, it has no assets, no customers and no revenue. Its shareholders and/or related entities must provide funds for planning, design, permitting and construction of a water system capable of providing water service that meets environmental requirements. (Tr. 43) Initial rates are established based upon the utility operating at 80% of design capacity. Rule 25-30.033 (1) (v), F.A.C. (Tr. 44) This is true of WMSI which has never had any equity. (Ex. 102, p. 2)

The significance of this historical development of rates and Account 123 is that the Commission sets rates that cover the following:

1) operation and maintenance of expenses, with no extra allowance for payments to stockholders or related entities.

2) annual depreciation that recovers the non-contributed original cost of the depreciable assets, with no extra allowance for payments to stockholders or related entities.

3) taxes, with no extra allowance for stockholders or related entities, and

4) return on rate base, with no extra allowance for payments to stockholders and related entities. Note that the return or net operating income is based on the cost of capital or rate of return applied to rate base funded by the

> stockholders or debt financing, with no extra allowance for payments of an intercompany account.

Neither Ms. Dobiac nor Mr. Schultz proposes a specific adjustment to the Commission's approved revenue requirement components, because they can't --- no revenue requirement component is impacted by Account 123. (Tr. 44)

There are no payments to shareholders built into WMSI's rates. WMSI's negative equity of $2.6 million shows that rates paid by customers over the years did not cover the full cost of operations. Clearly, the shareholders and affiliates have had to subsidize that revenue shortfall, the flow of funds represented by Account 123 has been between WMSI and related entities, not from customers to the related entities. (Tr. 45)

All funds transferred to and from related entities do not come from ratepayers, despite OPC's claims to the contrary, including telling customers that Gene Brown took $1.2 million of their money. (Tr. 45) Even OPC witness Schultz admitted that the source of funds in Account 123 was not customers' money. (Tr. 118)

Of all of the transactions that make up Account 123, OPC witness Schultz could only find an $85,000 entry with which he took exception since he did not like the level of documentation that was provided. (Tr. 120) However, even PSC witness Dobiac was satisfied that the $85,000 had been repaid. (Tr. 305-306; Ex. 88)

OPC seems to think that an investment in Account 123 must have some benefit to ratepayers. (Tr. 124, 133) However, such thinking is completely devoid of any legal authority. If there was any authority for such an absurd belief, OPC would have provided it. Account 123 is entitled, Investments in Associated Companies (Tr. 108), and there is no provision in the NARUC account addressing Account 123 that even remotely implies that whether or not an investment benefits customers has anything to do with the propriety of amounts booked to

Account 123. (Tr. 108-109). In fact, the NARUC definition implies just the opposite in Note D which addresses writing off amounts in this account. (Tr. 109)

OPC witness Schultz questions the value of the ownership of stock of BMG Management, Inc. Although Schultz was provided with information to substantiate the value was more than the $1.2 million reflected as Account 123, Schultz, as would have been expected, just did not like the level of documentation. (Tr. 192-193) In response, WMSI was not going to incur the substantial expense of appraisals as Schultz would have liked to have seen since the amount booked to Account 123 has no impact on customer rates. (Tr. 341-342) Again, Note D to the NARUC definition of Account 123 provides that fluctuations in Account 123 are not to be recorded, only permanent impairments. (Tr. 109)

OPC's efforts to challenge the value of BMG were futile. (Tr. 399-404) While the value of BMG varies, it has always exceeded the $1.2 million in Account 123. (Tr. 341.) The ability to use affiliated entities and Gene Brown for sources of funds to cover WMSI's shortfall in revenue has been critical to the ability of WMSI to provide everyday service, which is certainly a benefit to the customers. (Tr. 343; Ex. 80)

OPC witness Schultz's suggestion that this Commission order WMSI to liquidate BMG, in addition to constituting impermissible micromanagment, is not in the best interest of the customers or WMSI. In fact, BMG helped WMSI survive through tough times, and the assets are still available for collateral or sale purposes at the discretion of management, which has both the responsibility and the liability for all such matters. Even if this Commission had the power to order the liquidation of a non-regulated subsidiary such as BMG, it would be an imprudent and unfair decision. As this Commission decided at pages 55 and 56 of the January 3, 2011, Order regarding Account 123 in the last case; (1) there has been no misappropriation of funds; (2) the

amounts in question have been adjusted out of rate bases and expenses; (3) those amounts were not considered in the determination of rates; (4) that the quality of service was good; and (5) that the Commission should not micromanage the business decisions of regulated companies (not to mention non-regulated companies such as BMG), but should focus on the "end-product goal." Nothing has changed to justify a deviation from this Order entered on the same facts and figures just last year. The only difference is that WMSI has now established that the funds shown by Account 123 did not come from any customers and that WMSI continues to provide outstanding service to all of its customers, none of whom have been impacted in any way by anything having to do with Account 123. (Tr. 345-346)

Without money being advanced back and forth between WMSI and related entities for the past 38 years, WMSI could not have survived. DEP has a mortgage on all WMSI assets in connection with its loan, and such assets are also collateralized by the Centennial Bank loan, so the only assets available to secure loans are those from Gene Brown and affiliates. (Tr. 38)

OPC witness Schultz takes issue with WMSI's use of litigation proceeds. (Tr. 142-143) This is not an issue identified by any party and by no stretch of the imagination is it included in Account 123. In fact, over one half of the proceeds from that lawsuit settlement were used to pay down the DEP loan, and UPIS was reduced by the amount of the settlement which results in a reduced rate base which results in reduced rates to ratepayers. (Tr. 342) Further, this Commission has already considered and determined that WMSI's treatment of the settlement proceeds was appropriate. Order No. PSC-11-0156-FOF-WU at p. 12.

Last, OPC raises the question, but does not answer it, as to whether WMSI is a going concern. OPC witness Schultz's concern is based on conjecture instead of historical reality. (Tr. 48) OPC has gone to unprecedented lengths to attempt to financially strangle WMSI. OPC's

attorney's inappropriate action in contacting a bank with whom WMSI was negotiating a loan and killing that loan shows the fanaticism which OPC has towards WMSI and more specifically Gene Brown. (Tr. 337; Ex. 84) This fanaticism has clouded OPC's judgment, including protesting the PAA Order even though no customers had requested them to do so. OPC's attorney also forced DEP to issue a letter of technical default even though DEP had previously agreed with WMSI on how to address that technical default. (Tr. 378-379)

In OPC witness Schultz questioning of the negative equity and magnitude of debt relative to net investment, he shows his lack of understanding, or he has never considered the financial result of the Commission's policy regarding water utilities. The result of that policy for newly formed utilities is negative retained earnings, with earnings limited to rate base, not the full investment in the utility system. While the financial result may appear to be a going concern issue, it is actually a reflection of a rate setting policy to protect customers from paying more than the proportionate share of the cost of service. Knowingly or not, OPC witness Schultz takes the financial results of the Commission policy to protect customers—with which WMSI must comply—and unfairly uses it to suggest a potential going concern issue. (Tr. 48-49)

However, in the end, even OPC witness Schultz admits that additional audit work needs to be performed before he could say whether WMSI was operating as a going concern. (Tr. 126)

In WMSI's late rate case, in Order No. PSC-11-0010-SC-WU at p. 56, this Commission concluded:

> . . .we do not have express statutory authority to preclude a utility from making investments in associated companies. In addition, our practice has been not to micromanage the business decisions of regulated companies, but to instead focus on the end-product goal. Also, we note that the overall quality of service provided by the Utility is satisfactory. In fact, despite the difficult financial position of WMSI, as evidenced by their comments at the Service hearing, the customers continue to receive quality service and are satisfied with the responsiveness of Utility employees. [footnote citation omitted]

There has been no evidence presented by OPC in the instant case, nor any legal authority, to justify any conclusion different form that previously reached. The above conclusion is equally applicable from the record in the instant case and should be followed.

ISSUE 10(a): Should any adjustment be made to the WMSI President's salary?

** Yes. The salary and benefits for the President should be increased by $19,046 over the PAA Order amount.**

The basis for reducing the President's salary was articulated in the PAA Order as follows:

> The above-noted actions the Utility's President appear to result in additional costs over the term of the DEP loan of approximately $928,071. We do not believe that the customers should be required to pay all these additional costs. Given the actions of the Utility's President, we find that the allowance for the Utility's President's salary shall be reduced by 15 percent, which results in a reduction of $14,438. Accordingly, corresponding adjustments shall be made to reduce the allowance for the pensions and benefits expense and payroll taxes by $3,504 and $1,104, respectively, for a total adjustment of $19,046. At p. 27.

The glaring and obvious error with this conclusion is that customers are not going to have to pay any additional interest as a result of the extension of the DEP loan. Since the premise upon which the President's salary was reduced was erroneous, it should be reinstated.

Every witness that testified on this issue was in agreement that the extension of the DEP loan does not result in ratepayers paying any of the additional interest expense. (Guastella 38; Schultz 201) This is elementary ratemaking and the Commission's mistake should be evident without further discussion. This added interest costs due to extending the term of the DEP loan is not passed on to the customer. (Tr. 47) It did not add one penny to WMSI's revenue requirement. (Tr. 49) In fact, the extension provides for a lower cost of capital, therefore a lower rate of return --- a benefit to ratepayers. (Tr. 47)

OPC witness Schultz admits that a utility receives the money to repay a loan taken out to purchase an asset by recovering interest as reflected in the capital structure, and the principal through depreciation over the life of the asset. (Tr. 193) He also admitted that to the extent debt is greater than rate base, as is the case with WMSI, not all of the interest paid on debt is recovered in rates. (Tr. 203)

In his experience, OPC witness Schultz says that for loans for major assets, the loan never lasts the life of the asset. (Tr. 199) However, since that is the manner in which a utility obtains the revenues to make the loan payments, Gene Brown was able to negotiate a re-amortization of the DEP loan so that the amortization period of the loan closely matched the depreciation of the asset purchased with the loan. (Tr. 341) One would expect this to be the goal of any asset financing by a utility.

OPC witness Schultz also admitted that it is generally good business practice to repay a higher rate loan before a lower rate loan (Tr. 200-201), which is what Gene Brown is able to do because of extending the term of the DEP loan. OPC witness Schultz also recognized that if WMSI paid off the 2.99% DEP loan early, then the debt in the capital structure could convert to equity which carries a higher rate of return --- thus, higher rates to the ratepayer. (Tr. 202-203)

The same reasoning that this Commission espoused in response to OPC's attempt to have this Commission force WMSI to use funds in Account 123 to reduce debt in WMSI's last rate case is equally applicable to this proceeding:

> . . . However, the capital structure is reconciled to rate base, and any interest on the debt instruments to be included in the rates would be limited to that amount included in rate base. Therefore, the customers do not pay for any interest paid by the utility over and above the amount associated with used and useful rate base. Even if the full amount of $1.2 million was used to pay down the Utility's debt, the capital structure of WMSI would still consist almost entirely of debt. Finally, we note that if the Utility ever does obtain any equity investment, the current cost of equity is set at 10.85

> percent, which is almost three-times the current debt cost and overall cost of capital. Order No. PSC-11-0156-FOF-WU, at p. 5.

Thus, the ratepayers are not paying any higher rates due to the extension of the DEP loan and over the life of the loan will actually be paying less in rates. Thus, there is no rational or logical reason to reduce the President's salary due to the extension of the DEP loan.

If you analyze the MFRs (Schedule D-6) and the Annual Reports, as well as the PAA Order, they show that WMSI's interest cost prior to filing this current case was $305,970 per year, and that WMSI's allowed return on rate base was $143,802, which meant that the WMSI shareholders, not the ratepayers, have had to come up with the shortage of $162,168 per year. That shortage will increase to $294,163 per year under the PAA Order if nothing is changed. Under the PAA Order, WMSI's interest expense going forward will be $684,983, but WMSI's total allowed return on rate base is only $390,820, hence the $294,163 to be paid by Gene Brown and affiliates. And of course, that does not even relate to the extra principal reduction WMSI has to make each year that is not covered by the allowed depreciation on a rate base that is only about half of WMSI's debt. This cannot be made up by "regulatory lag" as suggested by OPC witness Schultz. Indeed, his insistence that WMSI should have stuck with a 20 year amortization would have added a couple hundred thousand per year to WMSI's overall debt service obligation going forward in this case.

In 2009, Gene Brown voluntarily reduced his salary from $150,000 to $110,000 because WMSI did not have the cash flow to pay his salary due to the poor economic conditions and revenue reduction due to the installation of shallow wells. (Tr. 336) This is a prime example of the idiom "no good deed goes unpunished."

Gene Brown's actual salary embedded in rates is only $96,000 since the Commission has determined that he spends 12.5% of his time on other than WMSI matters. (Tr. 336) What Gene

Brown has been able to do should not be chastised. As Mr. Guastella pointed out, Gene Brown has been able to successfully operate WMSI for 38 years, obtain financing despite the fact that the Commission's rate policies produce unavoidable deficit operations which make it difficult at best to attract capital and not on the strength of its own financial condition but only with his assistance and those of related entities, keep the overall cost of capital remarkably low and keep customers satisfied with the quality of service. As Mr. Guastella concluded: "On the basis of my experience in the regulation of hundreds of small water utilities and consulting for hundreds more, Mr. Brown should be complimented for an outstanding job against all odds." (Tr. 48)

OPC witness Schultz even echoed some of those comments that Gene Brown has made good moves in getting as much money as he can to operate the utility and to get things done. (Tr. 207) He admits that Gene Brown has been able to get financing when necessary and has been able to provide good service to WMSI customers. (Tr. 211)

Despite numerous challenges, Gene Brown has gone beyond what one would expect of a president. The last general rate case, before the debacle of the last case in which the Commission granted a $13,000 increase with which to pay four times that much in rate case expense, was based on a 1992 test year. The subsequent limited proceeding did not even provide for sufficient cash flow to pay the DEP loan. (Tr. 350; Ex. 78) Twenty (20) years without a rate case is extraordinary and then to basically get what was effectively a rate reduction certainly exacerbated WMSI's financial condition. Yet through it all, Gene Brown has put together a great team of employees who average over 20 years of service with WMSI and who are lauded by customers. (Tr. 339)

When the supply main to the mainland had to be replaced, Gene Brown secured 2.99% financing from DEP, but in doing so, he, his wife and affiliates had to guarantee the loan. (Tr.

337; Ex. 82) Gene Brown had to personally come up with $209,000 from his own resources to fund the DEP reserve deposit, none of which is included in rates. (Tr. 341)

Gene Brown recently negotiated a great deal on the property to construct the new water storage tank which saved $230,000. (Tr. 338-339) He saved WMSI over $100,000 when he negotiated a line of credit with no floor on the interest rate – which lenders almost never do. (Tr. 339) Gene Brown has had to personally guarantee virtually all debt of WMSI, as well as pledging personal non-utility assets. (Ex. 83) Had he not done so, the interest rate on loans, if they are available at all, would have been substantially higher.

Gene Brown has kept WMSI financially afloat notwithstanding OPC's interference, including Erik Sayler's contact with a potential lender that killed the financing to construct the new ground storage tank (Ex. 84) and forcing DEP to issue a technical default letter contrary to DEP's prior agreement with WMSI. (Tr. 378-379)

This Commission has put a high value on quality of service, certainly when it is less than exemplary, and it is disappointing that when a utility provides exemplary quality of service, the President is "rewarded" with a 15% salary reduction.

It is not reasonable to pay some who runs a company with good quality of service, who has obtained financing in spite of OPC's efforts to the contrary, who has personally guaranteed over $9 million of WMSI's debt, and who has pledged personal assets to secure financing for WMSI, only $96,000 per year, and now $82,000 with the arbitrary reduction.

Gene Brown's salary should be reinstated to $96,250, plus benefits.

REVENUE REQUIREMENT

ISSUE 11: What is the appropriate revenue requirement?

This is a fall-out calculation issue subject to the resolution of other protested issues.

ISSUE 12: Is a repression adjustment appropriate in this case, and, if so, what is the appropriate adjustment to make for this Utility?

Yes. This was not a protested issue and a repression adjustment should be made consistent with the PAA Order. The amount is a fall-out calculation issue subject to the resolution of other protested issues.

ISSUE 13: What are the appropriate water rates for the Utility?

This is a fall-out calculation issue subject to the resolution of other protested issues.

ISSUE 14: Should the Utility be authorized to revise certain service availability charges, and, if so, what are the appropriate charges?

Yes, The Utility should be authorized to impose a service availability charge in the amount of $10,004.

The purpose of the Commission's service availability policy is to balance the rates paid by the customers and the charges to new customers, and that the service availability charges will enable a utility to have sufficient capital in the form of CIAC to help attract additional capital. (Tr. 50)

The Commission's policy as articulated in Rule 25-30.580, F.A.C., is that at design capacity CIAC should not exceed 75% of the utility's depreciated facilities and plant. WMSI's Application for Revised Service Availability Charges calculates service availability charges pursuant to that Rule with the resulting charge of $10,004 per ERC. (Ex. 4)

Although Rule 25-30.580, F.A.C. uses the term "guideline" this Commission has often considered it more as a bright line such as in Order No. 22794 which states: "This would be a violation of Rule 25.30-580 Florida Administrative Code, which states that the contribution level shall be no greater than 75% when the system reaches build out." (e.s.) In WMSI's case, the

l;evel of CIAC has been 35% for 9 years. (Ex. 60, p. 81) Maintaining a low CIAC level further exacerbates WMSI's revenue shortfall.

WMSI should be allowed to recover 75% of the net investment in its facilities and plant through service availability charges. The Commission approved service availability charges resulting in 75% recovery through service availability charges for the only other water utility in Franklin County. (Tr. 335) Even at 75%, WMSI will have to come up with $1.75 million. (Tr. 335) The fact that the water main and storage tank benefit existing, as well as new customers, is not a legitimate basis to vary from the 75% guideline. (Tr. 335)

In Order No. PSC-07-0281-S-WU, this Commission considered a stipulation between OPC and Aloha Utilities to increase service availability charges in order to defray the cost to construct facilities to (1) implement chloramination of water as a disinfectant; (2) implement ion exchange water treatment at several plants; and (3) facilitate delivery of bulk water. At p. 2. These purposes provided a substantial benefit to existing customers. So there is no precedence to deny any increase in service availability charges because the improvements upon which the increase is based provide a substantial benefit to existing customers.

While there is a lot of rhetoric that the 75% is merely a guideline, this Commission generally approves service availability charges as requested by the utility so long as they are within the guideline. See, for instance, PSC Order No. PSC-03-0704-PAA-WS.

There is no evidence that the service availability charges as requested by WMSI are unreasonable and since they fall within the guidelines of Rule 25-030.580, F.A.C., they should be approved.

OPC does not dispute the amount of the service availability charges but asks that such charges be escrowed and subject to a true-up. (Tr. 250-251) If the service availability charges

are not increased to the maximum level as requested by WMSI, that position becomes moot since at a lower level there is not the possibility for the result to be out of compliance with the guidelines.

OTHER

ISSUE 15: Withdrawn

ISSUE 16: 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?

This is a fall-out calculation issue subject to the resolution of other protested issues.

ISSUE 17: 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?

This is a fall-out calculation issue subject to the resolution of other protested issues.

ISSUE 18: 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 as required by Section 367.0816, F.S.?

This is a fall-out calculation issue subject to the resolution of Issue 7.

ISSUE 19: Should this docket be closed?

Yes.

Respectfully submitted this 11th day of February, 2013, to:

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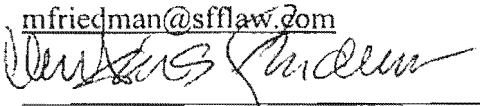

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CERTIFICATE OF SERVICE
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I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by U.S. Mail to the following parties this 11th day of February, 2013:

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