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September 28, 2015

VIA E-FILING

Carlotta S. Stauffer, Commission Clerk
Office of Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399

Re: Docket No. 150071-SU – Application for increase in Wastewater rates in Monroe County by K W Resort Utilities Corp.
Our File No.: 34000.01

Dear Ms. Stauffer:

The following are the responses of K W Resort Utilities Corp. ("Utility" or "KWRU") to the OPC's Second "Concerns" Letter to Andrew Maurey dated September 10, 2015:

1. Affiliate Transactions. In Staff's deficiency letter dated July 30, 2015, Item 1 states that Rule 25-30.110(2), Florida Administrative Code (FAC) requires that the MFRs shall be consistent and reconcilable with the utility's Annual Report. Item 2 in Staff's deficiency letter, states that Rule 25-30.436 (4)(h), FAC, regarding affiliate charges, allocations, and contracts has not been provided.
Response: The explanation and documentation responsive to this "concern" was filed with its response to the Staff's Second Deficiency Letter on September 22, 2015, to which OPC was copied.

2. Appropriate Test Year. OPC is also concerned that the use of an historic test year ended December 31, 2014 in this docket will not be representative of the Utility's operations when the new rates are placed into effect. Rule 25-30.430(1), FAC, regarding test year approval, states:
Response: The Utility did consider the option of a projected test year, just as it had considered the option of whether to file under the PAA or full hearing rules. All options are open when considering a rate filing. The Utility concluded that the filing should be based on a historic test year with pro forma adjustments for known changes in capital additions and the related expenses associated with operating at AWT.

The Utility considered these factors:
A. A historic test year is always the first choice because it uses actual amounts that can be audited. A projected test year, by its nature, is based on estimates. That a historic test year is the preferred choice is supported by the wording in PSC Rule 25-430(2)(d), F.A.C., which states, "If a projected test year is requested, provide an explanation as to why the projected period is more representative of the utility's operations than a historical period."
B. The cost of filing based on a projected test year can be significantly higher because of the time and expertise required to prepare estimates as well as the cost associated with the challenges of competing experts.

C. Section 367.081(2)(a)2. requires the Commission to consider “utility property, including land acquired of facilities constructed or to be constructed within a reasonable time in the future, not to exceed 24 months after the end of the historical test year used to set final rates….” So the statute recognizes the benefit of using the combination a historic test year and pro forma additions. The pro forma plant additions in this filing are planned to be constructed within 2 years of the historic test year. Therefore, a projected test year was not a necessary option.

OPC suggests that the “extraordinary growth” the Uility referred to in support of a determination of 100% used and useful should also be the basis for using a projected test year. True growth in this Utility is extraordinary in comparison to other utilities but the growth rate is not extraordinary as compared to KWRU’s historic growth rate. The growth identified is consistent with past growth (and somewhat lower in recent years due to the issuing of dry permits) so it was not a factor in considering the projected test year option. Furthermoew, this growth necessitates a quick response by the Commission so that capacity additions are in place to keep up with growth.

The Commission has sufficient information with which to draw conclusions about used and useful without the complexities that arise when developing a full projected test year.

OPC also expressed concern that failure to use a projected test year would result in rates that would very likely put the Utility in an overearnings position. Since this case is based on a continuation of the average historical growth rate for this Utility, the rates approved are neither more or less likely to produce an overearnings situation than an increase for any utility based on that assumption. Even if that should happen, there is a means of relief for the customers through a Commission requested overearnings proceeding, wherein rates would be reduced and overearning returned to the customer. No such relief is available to the Utility should the Commission approve rates that produce less than the authorized earnings. Appropriate Test Year – Rule 25-30-430(1) provides that “Prior to filing of an application for a general rate increase, a utility shall submit to the Commission a written request for approval of a test year, supported by a statement of reasons and justifications showing that the requested test year is representative of utility operations. The Commission Chairman will then approve or disapprove the request within 30 days from the receipt of request. In disapproving the requested test year, the Chairman may suggest another test year. Within 30 days of the Chairman’s approval or disapproval of a test year, upon request of any interested person the full Commission may review the Chairman’s test year decision.” (e.s.) The test year has been approved and no request was timely made to review the Chairman’s test year.

As to operational expenses, all expenses were based on .550 MGD AADF. The Plant is currently operating at .490 MGD AADF (96% of capacity) and 3 month peak is .509 MGD. All figures provided are based on income and expenses as of the date new plant is operational at .550 MGD AADF. Therefore, considerations were made for new customers identified in development agreements that will connect immediately upon expansion.

3. AWT Upgrade in Prior Rate Case. In its last rate case, the Utility requested and received approval of plant and operating expense pro forma adjustments to upgrade the existing plant to AWT standards[1]. In fact, numerous references were made regarding the upgrade to AWT throughout the Order. OPC believes that KWRU should explain the differences in the upgrade to AWT in the last

rate compared to the upgrade in this current rate case and state when the prior upgrade was placed into service.

<u>Response</u>: In the last rate case, pro forma adjustments were made to plant and operating expenses. The plant has now been upgraded to AWT and the actual plant in service has been utilized. Pro Forma plant in service adjustments for AWT upgrades of the existing plant are not being requested in this rate case. The pro forma adjustments requested for AWT in this rate case are actual operations of the plant at AWT necessitated by the mandated contained in F.S. 403.087(10). All other pro forma expenses deal directly with the plant expansion.

As to pro forma operating expenses approved in the last rate case, as can be readily ascertained from annual reports filed since the last rate case was approved in 2008, i.e. 2009 – 2014, in no year did the utility realize the rate of return approved by the PSC except 2014. In 2014, KWRU's plant reached near capacity allowing for it to realize its rate of return. However, KWRU reaching capacity necessitated expanding the plant, along with the previously discussed increase in operations due to AWT. Therefore the prior adjustments to expenses were not only warranted but were too low causing the Utility to not recover its rate base or operating expenditures and lose money each year except the test year.

4. <u>Projected Revenues, Customers and Billing Determinants</u>. On MFR Schedule F-6 page 3 of 4, the Utility states the following:

Based on analysis of historic flows and building projects either known to have contacted KWRU or have obtained Development Agreements with Monroe County, the capacity increase determined to be necessary by the project engineers (350,000 GPO increase or from 499,000 GPO to 849,000 GPO along with a concomitant increase in disposal capacity) is expected to be more than 70% used in the year in which it is placed in service.

OPC believes that the Utility should provide a list of all known building projects that the Utility knows about, and commercial enterprises, organizations, and/or companies that have contacted KWRU, or have obtained Development Agreements with Monroe County that the Utility expects to connect to the system in the year of or subsequent to the year the upgraded plant is placed into service. For each customer, the Utility should also provide the meter size of the customer, the projected gallons of wastewater that each customer is expected to use, the CIAC charges that each customer is expected to pay, and the annual revenue impact of each customer based on the historical test year rates and the Utility's requested final rates by meter size.

<u>Response</u>: This request is speculative as to meter size for customers expanding. The Utility cannot predict meter size that a customer may require until the system is built. As to CIAC, most of the projected customers' CIAC through the test year are already included, i.e. Sunset Marina, Bernstein, Key West Harbour Yacht Club have already paid and are included in CIAC. Only two customers re not included in CIAC, and as of 2014 had not remitted payment for CIAC. These customers are anticipated to pay for CIAC in 2015 and 2016, however, any such payment will be reduced by capacity already reserved. The Utility cannot predict total gallonage treated, but the Utility's historical operations evidence that the expense of treating additional gallonage over the past six years has shown that an increase in gallonage and income derived therefrom is offset by the expense in treating the additional wastewater flows, i.e. an increase in 1,000 gallons of wastewater flows currently provides an approximate $4.91 income but costs nearly $4.91 to treat the wastewater. After conversion to AWT, the cost of treatment will far exceed $4.91, necessitating the proposed increase in usage rates. Cost of treatment is a variable cost directly related to customers. The addition of less than 200 EDUs identified as built up growth will provide a nominal increase in income based on a utility that already has 4,200 ERCs. A projected 7% increase in wastewater flows from built up demand will not lead to a corresponding 7% increase in net income, but rather an incrementally smaller increase in income equal to less than 1% of the income received after expenses.

5. Projected Revenues, Customers and Billing Determinants. The Utility should also provide the workpapers that reflect the calculations of the 472,208 and 33,338 gpd projected amounts of suppressed flows for 2015 and 2016, respectively that it mentions on MFR Schedule F-8.
   Response: Customer meter size is unknown at this juncture as the facilities have not connected their redevelopments to KWRU.

6. Litigation Legal Fees. Reviewing the annual reports of the Utility, it is not evident how and where the Utility accounted for the legal fees associated with the legal challenge for *Last Stand and George Halloran v. Florida Department of Environmental Protection and Key West Resort Utilities Corporation*. The Utility should explain how and where these charges were recorded and in what years, by amount per year, the charges were booked. The Utility should also explained why it has asked the ratepayers to pay for the legal fees when the Utility has requested that the legal fees be recovered by the Petitioner in the litigation.
   Response: The Last Stand challenge was filed in August 2014 and attempts to settle were made until mid-November 2014. After this date, between January 2015 and May 2015, over 120 pleadings were filed, tens of thousands of pages of discovery were produced and reviewed, 11 experts and 7 lay witnesses were deposed in different counties throughout the State of Florida, and a trial was held over 11 days in Key West. Each party's exhibits in the case encompassed a minimum of 8 4" three ring binders which were required to be reviewed and utilized at trial. Afterwards, proposed recommended orders were submitted in July 2015 with an allowance of up to 100 pages for the order, which KWRU's proposed recommended order was 80 pages. Therefore, the majority of expenditures occurred in 2015, not 2014, and have been identified as pro forma adjustments.

   The justification for the ratepayers being responsible for the expense is based on KWRU's requirement to expand due to being well over 90% of its current capacity based on its current customer base. In order to comply with DEP rule, KWRU applied for and was approved for a wastewater treatment plant expansion of its plant by FDEP from .499 MGD AADF to .849 MGD AADF and two additional injection wells for disposal encased to 90 feet open bore to 110 feet. These wells cost approximately $110,000 in total. Non-utility customers appealed FDEP's permit issuance under the auspice they are concerned about surface water quality and that the use of shallow injection wells will degrade the nearshore waters. They claim to use and enjoy the surface waters and argued that the plant should be designed to treat over 1 MGD AADF and that KWRU should use a deep injection well encased to 3,000 feet. If KWRU did not defend the case and agreed to the demands of non-utility customers, the cost of the plant would increase dramatically. The cost of the injection well would cost between $7 million and $9 million, not including the cost of a potential land acquisition required for installing the deep injection well which may not fit on KWRU's property. These costs would then be requested by KWRU to be borne by the ratepayers. As KWRU complied with DEP Rule and obtained permit issuance, it was in the ratepayers interest to defend the permit issued, keeping the cost of expansion as low as possible.

KWRU has met FDEP's requirements for permit issuance and FDEP and KWRU co-defended the administrative challenge. If OPC feels that KWRU should not defend the less expensive plant and injection wells and agree to install a $9 million injection well, KWRU would be violating PSC rule requiring fair and reasonable rates.

7. Working Capital. The Utility should explain why its cash balance increased from $431,973 in 2013 to $818,918 in $2014, which equates to an average test year balance of $625,446 included in working capital. The Utility should also explain why a cash balance that is 55% of its test year revenues is reasonable for setting rates. OPC notes that the Utility's average cash balance in the last rate case for the test year ended December 31, 2006 was $210,420.
Response: KWRU's working capital is necessary based on the AWT operational expenses. OPC fails to recognize the test year after pro forma adjustments is aligned with the test year working capital. Moreover, OPC fails to comprehend that the cost of defending the challenge in 6 above, cost of rate proceedings, cost of operating AWT prior to the rate increase has depleted KWRU's operating capital well below a reasonable working capital level required for a utility of KWRU's size. KWRU believes the working capital is reasonable in light of the regulatory environment existing in the Florida Keys Area of Critical Concern.

8. Working Capital The Utility has requested a balance of $467,625 for Other Miscellaneous Deferred Debits – Proforma in Working Capital. The Utility should provide all calculation, basis, workpapers, and support documentation to show to what this relates and why a pro forma adjustment of this level is appropriate for setting rates.
Response: The $467,625 is the cost currently expected to be incurred in defense of litigation brought against the Utility's operating permit modification application by Last Stand (see above). The Utility has proposed to defer the cost, and amortize it over the life of the permit.

9. Working Capital The Utility's requested balance of working capital in the current docket is $1,367,232. The Commission approved Working Capital balance in the last rate case was $464,578. As a comparison in this case, even including the requested pro forma expenses, the formula method (one-eighth of Operation and Maintenance Expense of $2,039,714) equates to $254,964. Both the prior working capital allowance and the formula method of calculating working capital are substantially lower than the Utility's requested balance. The Utility should provide support showing why the requested working capital allowance is reasonable, which is almost 3 times higher than the last allowed balance and over 5 times higher than the level that would be allowed using the formula basis.
Response: There is no reason to expect that working capital using a 13 month average would be similar to 1/8 of O&M. Nor would one expect working capital to be an amount similar to a filing 8 years prior to the current test period. However, if a comparison were made, much like the benchmark test to O&M expenses, the following conclusions could be drawn.

2008 working capital	$464,578
Benchmark per B-8 (revised) (154.84% + 17.43%)	172.27%
Expected 2014 working capital	$800,329
Additional per Benchmark	$1,264,907
Plus litigation defense	$467,625
Total benchmark threshold	$1,732,532
Per 2014 MFRs	$1,367,232

10. Affiliate Debt. The Utility should provide an explanation of why it is reasonable for the ratepayers to pay an interest rate of 6.00% on $852,903 in Advances from Associated Companies, when its interest rate with BB&T, a non-affiliate, is reflected at 4.00%.
    Response: WS Utilities is the sole shareholder of KWRU. It provided necessary capital between 2008 and 2011 which totaled $1.286 million dollars to ensure the utility was capable to meet operating and capital expenditures during the recession where capital funds from financial institutions was not readily available and the prior rate case did not sufficiently cover expenditures. This amount has been paid down from Contributions in Aid of Construction to $852,903. WS Utilities was unaware at the time it provided these needed equity contributions to sustain operations that it could classify its equity contribution as such and receive an 8.62% rate of return on its investment due to the immediacy of the need for funding. As it was identified by WS Utilities as a loan, it has remained on the books as such ever since. WS Utilities is amenable to reclassifying it as an equity contribution and receiving this higher rate of return on its capital.

    If the amount is to remain classified as a loan, WS Utilities was acting as a private lender at a time when financing was difficult at best. Moreover, it does not charge origination fees, i.e. points, that can be up to 1% of loan value, or closing costs associated with lending to its subsidiary, including requiring title insurance, which would increase the cost of the loan. Additionally, WS Utilities is an unsecured second lien holder that provided immediate funding in a time frame when financial institutions were reluctant to lend, especially to a Utility that did not have the income coverage ratios needed for traditional financing. Due to the risk associated with such a position, 6% is a reasonable interest rate for a loan of this nature.

11. Pro Forma Equity. On Schedule D-2 the Utility made a pro forma adjustment to increase Common Equity by $3,500,000. OPC believes that the Utility should provide all calculations, basis workpapers, and support documentation for the pro forma equity adjustment. The Utility should also explained why debt was not issued related to the construction of the expansion of the wastewater treatment plant.
    Response: All work papers have been provided as part of the audit and to the PSC. As to the use of debt, this is a confounding question in light of the inquiry in OPC question 10. OPC questioned why KWRU obtained a loan in question 10 and then questions why debt was not used in question. It is difficult to defend both positions that are in contradiction. Notwithstanding this issue with the OPC's inquiry, the PSC leverage formulas provided in KWRU's last rate case evidence a better rate of return on equity as opposed to debt. It is KWRU's understanding it should not utilize too much debt in expansion or on its books, therefore WS Utilities has determined to provide equity for the plant expansion.

Should you or staff have any questions regarding this filing, please do not hesitate to give me a call.

Very truly yours,

/s/ Martin S. Friedman

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For the Firm

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