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RECORDS AND
REPORTING

-M-E-M-O-R-A-N-D-U-M-

DATE: MARCH 18, 1999

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYÓ)

FROM: DIVISION OF LEGAL SERVICES (GERVASI, JAEGER) *JS*
DIVISION OF WATER AND WASTEWATER (CHASE, RENDELL, WILLIS) *WAS*

RE: DOCKET NO. 950495-WS - APPLICATION FOR RATE INCREASE AND INCREASE IN SERVICE AVAILABILITY CHARGES BY SOUTHERN STATES UTILITIES, INC. FOR ORANGE-OSCEOLA UTILITIES, INC. IN OSCEOLA COUNTY, AND IN BRADFORD, BREVARD, CHARLOTTE, CITRUS, CLAY, COLLIER, DUVAL, HIGHLANDS, LAKE, LEE, MARION, MARTIN, NASSAU, ORANGE, OSCEOLA, PASCO, PUTNAM, SEMINOLE, ST. JOHNS, ST. LUCIE, VOLUSIA, AND WASHINGTON COUNTIES.

AGENDA: MARCH 30, 1999 - REGULAR AGENDA - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: AT THE CHAIRMAN'S REQUEST, PORTIONS OF THE MARCH 4, 1999, RECOMMENDATION HAVE BEEN REFILED

FILE NAME AND LOCATION: S:\PSC\LEG\WP\950495.RCM

CASE BACKGROUND

By Final Order No. PSC-96-1320-FOF-WS, issued October 30, 1996, the Commission disposed of the petition of Southern States Utilities, Inc., now Florida Water Services Corporation (Florida Water or utility) for a rate increase. On June 10, 1998, the First District Court of Appeal issued its opinion on review of the Final Order. Southern States Utils., Inc. v. FPSC, 714 So. 2d 1046 (Fla. 1st DCA 1998). Among other things, the Court reversed the Commission's decision to use annual average daily flows (AADF) in the numerator of the used and useful equation for eight wastewater treatment plants, and to use the lot count method in determining

DOCUMENT NUMBER-DATE

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FPSC-RECORDS/REPORTING

DOCKET NO. 950495-WS
DATE: MARCH 18, 1999

used and useful percentages for the water distribution and wastewater collection systems serving mixed use areas. The Court remanded these issues to the Commission, giving the Commission the discretion to reopen the record for the taking of evidence on these issues, if it exists. By Order No. PSC-99-0093-FOF-WS (First Order on Remand), issued January 15, 1999, by final agency action, the Commission opted to reopen the record to take additional evidence on these discretionary issues. Accordingly, an administrative hearing has been scheduled to take place on June 16-18, 1999. Any potential surcharges that may result from the Commission's decision on remand concerning these discretionary issues will be determined after the hearing.

The Court also reversed the Commission on three other issues; including the used and useful adjustment for reuse facilities, the equity adjustment, and admitted errors. The Court did not provide the Commission the discretion to reopen the record on these issues. Therefore, the Commission was required by law to correct these errors on remand. By Order No. PSC-99-0093-FOF-WS, by final agency action, the Commission authorized the utility to implement increased rates to correct these errors.

Additionally, the Commission proposed to authorize the utility to implement a surcharge related to these nondiscretionary issues, in order to provide the utility an opportunity to recover the revenue which it should have been authorized to collect had the Commission properly addressed these three issues in the Final Order. By the proposed surcharge methodology which the Commission approved, the utility would, among other things, use the same base facility surcharge of \$.12 per month for water customers and \$1.53 per month for wastewater customers for that portion of the 27 month appeal and remand period that each customer was served by the utility. The proposed surcharge methodology is set forth at pages 25-26 of the First Order on Remand. Moreover, the Commission ordered that if protested, the issue of what action should be taken with regard to this surcharge shall be made an issue in the scheduled remand hearing.

On February 5, 1999, the Sugarmill Woods Civic Association, Inc. (Sugarmill Woods) timely filed a protest to the proposed agency action portion of Order No. PSC-99-0093-FOF-WS. On February 12, 1999, the utility filed an answer to Sugarmill Woods' protest.

On February 19, 1999, staff met with the parties in an effort to identify the issues for the hearing on remand. The purpose of an early issue identification is to assist in focusing testimony. Direct testimony is due to be filed on behalf of all parties and

DOCKET NO. 950495-WS
DATE: MARCH 18, 1999

staff on April 20, 1999. However, there was some disagreement as to what issues should be considered on remand.

On March 4, 1999, staff filed a recommendation for the March 16, 1999 agenda conference, concerning issue identification and recommending that Sugarmill Woods' protest should be granted.

On March 1, 1999, Florida Water filed a Motion to Transfer Remand Proceeding to the Division of Administrative Hearings (DOAH). On March 9, 1999, staff late-filed an issue 3 to our March 4, 1999, recommendation, to recommend that the Motion to Transfer be denied.

At the March 16, 1999, agenda conference, the Commission voted to grant Sugarmill Woods' protest to the proposed agency action portion of Order No. PSC-99-0093-FOF-WS, to approve staff's recommendation concerning issue identification on remand, and to deny Florida Water's Motion to Transfer the remand proceeding to DOAH.

Nevertheless, after the Commission ruled on the above-described recommendation, the utility requested that the issues concerning Sugarmill Woods' protest and concerning issue identification on remand (issues 1 and 2 of the March 4, 1999, recommendation, respectively) be reconsidered because parties did not speak to these issues prior to the Commission's vote. The Chairman has requested that staff refile the two issues. For informational purposes, staff notes that a separate order reflecting only the Commission's vote on the utility's Motion to Transfer (issue 3 of the March 4, 1999, recommendation) will be issued shortly.

DISCUSSION OF ISSUES

ISSUE 1: Should the Petition for Formal Hearing by Sugarmill Woods concerning the proposed surcharges be granted?

RECOMMENDATION: Yes. Pursuant to Order No. PSC-99-0093-FOF-WS, the issue of what action should be taken with regard to surcharges should be made an issue in the scheduled remand hearing. (GERVASI, JAEGER, CHASE, RENDELL)

STAFF ANALYSIS: As stated in the case background, on February 5, 1999, Sugarmill Woods (petitioner) timely filed a protest to the proposed agency action portion of Order No. PSC-99-0093-FOF-WS.

DOCKET NO. 950495-WS
DATE: MARCH 18, 1999

The protest is styled as a petition for formal hearing, and complies with the procedural requirements of Rule 28-106.201, Florida Administrative Code.

With respect to whether its interests are substantially affected by the Commission's proposed decision concerning surcharges for the nondiscretionary issues, the petitioner points out that at page 21 of Order No. PSC-99-0093-FOF-WS, the Commission recognized that "[b]ecause [its] decision on which surcharge option to require the utility to implement will affect the specific amount due from the customers, it will necessarily affect the substantial interests of the customers."

The petitioner further states that its substantial interests are affected because it is unlawfully and unconstitutionally deprived of its property. The petitioner argues that the Commission proposed to approve surcharges that are based on a uniform rate structure, which is in direct opposition to the Court's decision on appeal. According to the petitioner, in its remand opinion, the Court minimally approved the Commission's use of the capband rate structure, having met petitioner's complaints of undue discrimination and an unlawful taking with the observation that this rate structure does not cause any customers to pay more than 7 percent subsidies to customers in other systems. The petitioner argues that the Court did not state that the capband rate structure would be judicially approved irrespective of the level of subsidies that were compelled from system to system, and it certainly did not approve the use of the uniform rate structure.

With respect to whether there are any disputed issues of material fact, the petitioner disputes the Commission's finding that the proposed surcharge methodology "will be apportioned in such a manner that each affected customer will be held responsible for his or her pro-rata share." Order No. PSC-99-0093-FOF-WS at 25. According to the petitioner, this finding is not only factually incorrect, but dishonest. The surcharge revenues owing to the utility as a result of the nondiscretionary remand issues result from three issues; reuse, admitted errors in used and useful calculations, and equity adjustments. Of the three, only the equity adjustment has any revenue implication on the petitioner's water and wastewater systems. The petitioner's prospective rate increases are \$.13 per 10,000 gallons, which is a less than one percent increase, for water, and \$.59 for 6,000 gallons, which is a little more than a two percent increase, for wastewater. The petitioner argues that these are the comparative amounts or percentages that its customers should be required to pay as

DOCKET NO. 950495-WS
DATE: MARCH 18, 1999

surcharges for the approximately 27 months that they were being undercharged as a result of the equity adjustment errors.

According to the petitioner, surcharges must be based only on the revenue impact of the Court's reversals that directly impacted the stand-alone revenue requirement of each water and wastewater system, or, at most, the rate impact of a given system's stand-alone rate increase from a reversal item as flowed through the capband rate structure, utilizing the same methodology approved by the Court. The petitioner demands that the Commission withdraw approval of the proposed surcharges and approve surcharges that are based solely upon either the petitioner's stand-alone revenue increase as a result only of the equity adjustments compelled by the Court's reversal, or surcharges based upon the stand-alone revenue increases flowing from the equity adjustment and incorporated in the Court-approved capband rate structure.

On February 12, 1999, Florida Water filed an answer to Sugarmill Woods' petition for formal hearing, pursuant to Rule 28-106.203, Florida Administrative Code. According to the utility, because the petitioner failed to allege a disputed issue of material fact, the legal issues raised in the petition should be addressed in a Section 120.57(2), Florida Statutes, informal proceeding.

Florida Water argues that Sugarmill Woods' petition should be addressed in the same manner in which the Commission resolved the Office of Public Counsel's (OPC) petition for formal administrative hearing in the GTE remand proceeding in Docket No. 920188-TL. In that remand proceeding, following the reversal and remand by the Florida Supreme Court in GTE Florida Inc. v. Clark, 668 So. 2d 971 (Fla. 1996), the Commission issued a proposed agency action order requiring surcharges. OPC protested the order and requested a Section 120.57(1) formal hearing. GTE filed a motion to dismiss OPC's protest, which the Commission denied. However, by Order No. PSC-96-1021-FOF-TL, issued August 7, 1996, the Commission elected to set the matter for a 120.57(2) informal hearing upon finding that there did not appear to be any disputed issues of material fact, but that there did appear to be disputed issues of law, especially with regard to the appropriate interpretation of the Court's decision.

The utility argues that as in the GTE remand proceeding, Sugarmill Woods' petition fails to present any disputed issue of material fact and raises only questions of law by alleging that the Commission has unlawfully utilized a uniform rate structure to collect surcharges in violation of the Court's decision on appeal

and by criticizing the Commission for failing to impose surcharges pursuant to the capband rate structure. According to the utility, addressing the legal issues raised by Sugarmill Woods through an expedited Section 120.57(2) proceeding will benefit all ratepayers by limiting the interest on surcharges which continues to accrue.

Staff notes that Florida Water does not dispute that Sugarmill Woods' substantial interests are affected by the proposed action which the Commission took concerning the calculation of the surcharge. As noted by Sugarmill Woods, the Commission's decision on which surcharge option to require the utility to implement will affect the specific amount due from the customers. Because its substantial interests will be affected by the Commission's decision, staff recommends that pursuant to Section 120.569, Florida Statutes, the Commission must afford Sugarmill Woods its right to a hearing on the matter.

The question remaining is whether Sugarmill Woods should be afforded a formal hearing, as requested, or an informal hearing, as argued by the utility. Section 120.569, Florida Statutes, requires that unless waived by all parties, a Section 120.57(1) formal proceeding applies whenever the proceeding involves a disputed issue of material fact, and that unless otherwise agreed, a Section 120.57(2) informal proceeding applies in all other cases.

Staff disagrees with the utility that Sugarmill Woods' petition fails to present any disputed issue of material fact. At issue here is the methodology by which surcharges should be collected. As evidenced by the First Order on Remand, there are several methodologies that could potentially be used to calculate the surcharges, from which the Commission must choose.

This determination differs from the surcharge determination that the Commission made in the GTE case. In GTE, OPC's protest concerned whether local rates should have been surcharged, and whether GTE should have been required to surcharge both current and former customers. Order No. PSC-96-1021-FOF-TL at 3. In that case, the utility proposed, and the Commission approved, a one-time surcharge of \$8.65 per access line, applicable to those subscribers of local exchange access services, including flat and measured residential and business access lines, network access registers, semipublic coin lines, PATS lines, and shared tenant service trunks, who received service during the period of time that incorrect rates were being charged. Orders Nos. PSC-96-0667-FOF-TL, issued May 17, 1996, and PSC-96-1021-FOF-TL. No other methodology for calculating the surcharge was proposed or considered. Therefore, unlike in the instant case, the surcharge

methodology by which the surcharges were to be calculated was not a disputed issue of material fact.

Which surcharge methodology the Commission chooses to authorize in this case is a mixed question of law and fact. Whether the Commission must authorize the collection of surcharges as calculated through the capband rate structure is, as the utility argues, a disputed issue of law. This is a threshold issue which may drive the Commission's decision on which surcharge methodology to authorize. However, if the Commission determines, as it proposed to do by the First Order on Remand, that it is not bound by law to authorize the utility to calculate the surcharge pursuant to the capband rate structure, the issue becomes which surcharge methodology should be authorized. This is a disputed issue of material fact. Various factual matters should be considered in determining which methodology to choose, including, but not necessarily limited to: the cumulative amount of surcharge by service area; how the utility should be allowed to recover the uncollectible surcharge amount; whether customers who left the system should be charged; which methodology should be used to calculate customer specific surcharges; and whether interest should be allowed and if so, how it should be calculated.

The Commission could conceivably set for an informal Section 120.57(2) hearing the threshold issue of whether it must authorize the collection of surcharges as calculated through the capband rate structure. If it determines, after the preliminary informal hearing, that it is not legally bound to authorize that methodology, which methodology should be used to calculate the surcharge could then be included as an issue for the formal hearing. However, all direct testimony for the formal hearing on remand is due to be filed on April 20, 1999. Parties and staff need to know now whether to proffer evidence on surcharge methodologies in their prefiled testimonies and/or exhibits. Due to these time constraints, and because the Commission will conduct a formal hearing on the remand issues regardless of whether the issue of surcharge methodologies is included therein, staff believes that rather than scheduling an additional, informal hearing on the legal surcharge issue, which may necessitate the rescheduling of prehearing activities and potentially the formal hearing, it would be more time- and cost-efficient to include surcharge methodologies as an issue to be heard at the formal hearing. The legal issue(s) involved can, of course, be briefed by the parties after the hearing, and should be considered by the Commission in making its post-hearing decision.

DOCKET NO. 950495-WS
DATE: MARCH 18, 1999

Due to the above-mentioned time constraints, and for the foregoing reasons, staff recommends that Sugarmill Woods' petition for formal hearing should be granted. Pursuant to Order No. PSC-99-0093-FOF-WS, because the issue of what action should be taken with regard to surcharges has been protested, it should be made an issue in the scheduled remand hearing.

ISSUE 2: What are the issues that should be considered at the formal hearing scheduled to take place on remand in this docket?

RECOMMENDATION: The issues that should be considered at the formal hearing are as set forth in the staff analysis provided below. (GERVASI, JAEGER, WILLIS)

STAFF ANALYSIS: On February 19, 1999, staff met with the parties in an effort to identify the issues for the hearing on remand for the purposes of assisting all parties and staff in focusing on the appropriate issues when preparing testimony and to minimize unnecessary prehearing statement differences. Because the parties and staff disagreed on the wording of three issues, it was suggested that either the Prehearing Officer or the Commission establish the issues. The Prehearing Officer agreed that it would be more expedient to bring this issue to the full Commission for consideration.

At the meeting, staff provided a preliminary list of issues, and requested that the parties provide us with their suggested changes in writing, for consideration in making this recommendation. After the meeting, in response to staff's request, the utility, the City of Marco Island (City), and OPC provided responses to staff's proposed issues list.

Upon consideration of the parties' responses to staff's proposed issue list, and in order to put all parties on notice of what the issues are in advance of the due date for the pre-filing of direct testimony, we recommend that the Commission approve the following issues for inclusion in the Prehearing Order:

PART I

ISSUE 1: What flows should be used in the numerator of the used and useful equation to calculate used and useful plant for Florida Water Service Corporation's Buenaventura Lakes, Citrus Park, Marco Island and Marco Shores wastewater treatment plants?

ISSUE 2: In mixed use areas, for the water transmission and distribution and the wastewater collection systems, what method should be used to calculate used and useful transmission, distribution, and collection facilities, and what are the appropriate used and useful percentages?

- ISSUE 3: What is the appropriate amount for reconsideration, appellate, and remand rate case expense for this proceeding?
- ISSUE 4: What are the final water and wastewater revenue requirements?
- ISSUE 5: What are the water and wastewater rates for Florida Water Services Corporation?
- ISSUE 6: What is the 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, Florida Statutes?
- ISSUE 7: Should any portion of the interim increase granted be refunded, and if so, what is the amount?
- ISSUE 8: Based on the changes to the used and useful percentages, what are the allowance for funds prudently invested charges, and are any refunds of the charges collected required?

PART II

- ISSUE 9: What is the appropriate action that should be taken with regard to surcharges?
- ISSUE 10: Should the utility be allowed to collect interest on the surcharges, and, if so, how should interest be calculated?
- ISSUE 11: Should the utility be required to file tariff sheets and a proposed customer notice reflecting approved surcharges?

The following is a discussion of the parties' suggestions regarding the issues.

The City suggests that Issue 1 be worded as follows:

- ISSUE 1: What method should be used to calculate used and useful plant for Florida Water Service Corporation's Buenaventura Lakes, Citrus Park, Marco Island and Marco Shores wastewater treatment plants, and what is the appropriate used and useful percentage?

DOCKET NO. 950495-WS
DATE: MARCH 18, 1999

OPC suggests that Issue 1 be worded in substantially the same way, as follows:

ISSUE 1: What method should be used to calculate the used and useful percentages for the wastewater plants serving Buenaventura Lakes, Citrus Park, Marco Island and Marco Shores, and what are the appropriate used and useful percentages?

Staff believes that the issue, as worded both by the City and by OPC, is too broad. The reviewing Court expressly directed the Commission to "give a reasonable explanation, if it can, supported by record evidence (which all parties must have an opportunity to address) as to why average daily flow in the peak month was ignored." Southern States Utils., Inc. v. FPSC, 714 So. 2d at 1056 (citing Florida Cities Water Co. v. FPSC, 705 So. 2d 620, 626 (Fla. 1st DCA 1998)). The Court concluded that "[w]hile [it did] not rule out the possibility that evidence can be adduced on remand to show that calculating a used and useful fraction by comparing average annual daily flows to plant capacity as stated on operating permits is preferable to the PSC's prior practice, . . . remand for the taking of such evidence (if it exists) is necessary." Id. Staff believes that the issue, as suggested by staff, is more closely tailored to comply with the Court's directive.

Issue 2 above is worded as suggested by the City in response to staff's request for written input into the phrasing of issues, except that the last phrase was suggested by the City in singular form (i.e., "and what is the appropriate used and useful percentage"), and staff recommends the use of the plural form, as suggested by OPC. OPC suggested very similar language for Issue 2, as follows:

ISSUE 2: What method should be used to calculate the used and useful percentages for the water and wastewater lines serving mixed use areas, and what are the appropriate used and useful percentages?

Because the language as suggested by the City more specifically defines the lines as being the water transmission and distribution and wastewater collection systems, staff recommends that its suggested language for this issue be approved.

Florida Water argues that Issues 1 and 2 should be worded as follow:

ISSUE 1: What grounds justify departure from Commission policy of using average daily flow in the peak month in the calculation of the level of used and useful investment for Florida Water Services Corporation's Buenaventura Lakes, Citrus Park, Marco Island and Marco Shores wastewater treatment plants?

ISSUE 2: What grounds justify departure from Commission policy of rejecting the use of the lot count method for calculating the level of Florida Water Services Corporation's used and useful investment in water transmission and distribution and wastewater collection lines for areas served by meters larger than 5/8" x 3/4" meters?

Florida Water submits that the wording of these two issues, as originally proposed by staff, ignores the holding of the Court in Southern States Utils. v. FPSC, 714 So. 2d 1046 (Fla. 1st DCA 1998). This argument maintains its relevancy with respect to Issues 1 and 2 as proposed above. The utility points out that the Court held that the Commission unlawfully departed from its established policy by using AADF in the maximum month in the used and useful calculation and by using the lot count method to calculate used and useful for water transmission and distribution lines and wastewater collection lines serving mixed use areas. Because the Court remanded these issues to the Commission to give the Commission an opportunity to give a reasonable explanation on remand and adduce supporting evidence, if it can, to justify these policy shifts, the utility argues that these two issues should be worded to respond to the Court's holdings.

Staff agrees with the utility's characterizations of the Court's holdings concerning these two issues. However, we believe that Issues 1 and 2, as suggested above, are responsive to the Court's holdings on these issues. It is not necessary to expressly state what the Court held in the wording of the issues in order to be responsive to the Court's directives. The issues concern the methodologies that should be used in the used and useful calculations. Regardless of how the issues are phrased, if the Commission chooses to use a methodology which represents what the Court has found to be a policy shift, it must give a reasonable explanation therefor on remand, which explanation must be supported by the record. Parties will, of course, be given an opportunity to brief the issues after the hearing, and can provide their legal opinions at that time concerning whether any particular methodology can lawfully be used based on the Court's opinion and upon the evidence that will have been adduced at hearing.

DOCKET NO. 950495-WS
DATE: MARCH 18, 1999

Florida Water and OPC concur with staff's wording for proposed Issues 3-11. The City substantially concurs with staff's wording for these proposed issues, as well. Issue 3 above is worded as suggested by the City, to change the word "provision," as originally suggested by staff, to "amount," which does not change the meaning of the issue. Issues 4-11, above, are worded as initially proposed by staff.

Finally, Florida Water submits that the following additional issue must be resolved on remand:

ADDITIONAL ISSUE: If the used and useful calculations result in used and useful percentages lower than those allowed in previous rate cases, which percentages should be used?

The utility argues that in appealing the Final Order, it raised both evidentiary and constitutional infirmities in the Commission's conclusions with respect to the use of AADF in calculating used and useful for wastewater treatment plants and the use of the lot count method for calculating used and useful for water transmission and distribution and wastewater collection lines. With respect to both issues, the Court agreed with the utility that the record lacked competent substantial evidence to support the Commission's policy shift and remanded both issues for further proceedings. According to the utility, having reversed on the evidentiary deficiencies undermining the Commission's used and useful determinations, the Court found it unnecessary to address any of the constitutional questions that the utility raised. Southern States Utils., Inc. v. FPSC, 714 So. 2d at 1059.

Florida Water asserts that on remand, the Commission must address the issue of whether an existing level of used and useful investment may be lowered by importing a new used and useful methodology. The utility states that this issue raises questions of fact, policy and constitutional law which are integrally tied to the used and useful determinations which will be made by the Commission on remand. According to the utility, by ignoring this issue, the Commission invites a piecemeal approach to the issues on remand, potentially requiring additional appeals, Commission hearings, and unnecessary additional expenditures.

Staff disagrees that this additional issue should be included as an issue on remand in this docket. The Court gave the Commission specific authority to reopen the record to adduce additional evidence, if it can, on Issues 1 and 2 only. All other issues as suggested by staff above are fallout issues from Issues

DOCKET NO. 950495-WS
DATE: MARCH 18, 1999

1 and 2 (with the exception of the surcharge issues contained in Part II, above, which stem from the Commission's duty, derived from case law, to allow the utility an opportunity to collect those revenues which it would have collected had the Commission not erred in issuing its final action.) The Court did not provide the Commission with the authority to resolve the utility's suggested additional issue.¹ Nor did the Court state why it found it unnecessary to rule upon this or any of the constitutional questions raised by the utility on appeal of the Final Order.

Staff recommends that the Commission should decline to rule upon this, or any, additional issue which the Court has not specifically provided the Commission the authority to rule upon. Moreover, resolution of this suggested additional issue requires the interpretation of constitutional law; specifically the taking of property without just compensation. The Commission is a creature of statute, and Chapter 367 does not provide it the authority to resolve such constitutional questions. The appellate court, sitting in its review capacity, is the proper forum "to resolve this type of constitutional challenge because [it has] the power to . . . require any modifications in the administrative decision-making process necessary to render the final agency order constitutional." Key Haven Associated Enters., Inc. V. Board of Trustees of Internal Improvement Trust Fund, 427 So. 2d 153, 158 (Fla. 1982).

For the foregoing reasons, the issues as recommended above by staff should be considered at the formal hearing scheduled to take place on remand in this docket.

¹"A remand phrased in language which limits the issues for determination will preclude consideration of new matters affecting the cause." City of Palm Bay v. DOT, 588 So. 2d 624, 627 (Fla. 1st DCA 1991) (citations omitted).