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December 9, 1996

HAND DELIVERY

Ms. Blanca S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, Florida 32399-0850

RE: Docket No. **960329-WS**
Application of GULF UTILITY COMPANY for an increase in Wastewater Rates, approval of a decrease in Water Rates and approval of Service Availability Charges in Lee County, Florida

Audit Control #96-233-4-1

Dear Ms. Bayo:

Enclosed for filing are an original and fifteen copies of Gulf Utility Company's Response to the November 25, 1996 Audit Report prepared by the Staff Analyst.

Please acknowledge receipt of the foregoing by stamping the enclosed extra copy of this letter and return same to my attention.

Very truly yours,

B. Kenneth Gatlin

B. Kenneth Gatlin

BKG/met
Enclosures
cc: Maggie O'Sullivan, Esq.
Yen Ngo, Staff Analyst

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Gulf Utility Company
19910 S. Tamiami Trail
P.O. Box 350
[illegible], FL 33928-0350
941/498-1000
FAX 941/498-0675

December 6, 1996

Blanca S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
Division of Water and Sewer
2540 Shumard Oak Blvd.
Tallahassee, Fl 32399-0850

RE: Docket No. 9600329WS; Audit Control #96-233-4-1

Dear Ms. Bayo:

The following is the Company's response to the November 25, 1996 audit report prepared by the staff analyst.

EXECUTIVE SUMMARY

RESPONSE:

The last sentence under the Executive Summary indicates that there is some discrepancy between the year to date figures and the test year as projected by Applicant. It would be unusual if there were not differences. The Applicant filed this case on a projected test year. At the time the projections were made they were accurate as they could be on the current information. Gulf is attempting in this case to recover its cost that will occur during the time that the rates will be in effect. Gulf believes the most accurate way to do this is to use the projected test year method. Some of the projections of individual accounts will be higher and some will be lower, however, the bottom line of the revenue requirement will be reasonably accurate.

AUDIT SCOPE - NET OPERATING INCOME

RESPONSE:

The Company has made Estimated tax deposits of $260,000 for 1996 Federal Income Tax and $40,000 for 1996 State Income Tax. The Company stated that no additional tax deposits were anticipated.

AUDIT EXCEPTION NO. 1

SUBJECT: ADJUSTMENTS FROM PRIOR ORDERS NOT POSTED

RESPONSE:

The Company maintains only one set of books, namely the same for regulatory, tax and financial purposes. The books reflect the actual amount the Company has invested in the car, as it should. In Order No. 24735, the Commission accepted the cost of the car, then allocated a portion to non-used and useful property. The proposed adjustment does not reflect the cost of the car. The car cost $38,700, of which $10,500 was reimbursed by the President, leaving the Company's investment of $28,200 which is recorded on the books. Staff's adjustment of $20,721, would leave $7,479 which is not reflective of the cost of the car. The car will be fully depreciated in 1996. No adjustment should be made to the plant accounts.

AUDIT EXCEPTION NO. 2

SUBJECT: COMPOSITE AMORTIZATION RATES FOR CIAC

Comparison of accumulated amortization on page 6 is misleading by comparison of 8/96 balance to Company's 12/96 balance. One reason for the difference shown is simply timing. For example, amortization of Nov. 1995 additions are in Staff balance for 9 months while a full 13 months amortization is embedded in the Company's 12/96 average balance.

AUDIT EXCEPTION NO. 5

SUBJECT: WORKING CAPITAL FORECAST

RESPONSE:

The Company takes exception to including the $314,362.08 for CIAC tax payable in current liabilities. With the repeal of the taxability of CIAC, this amount will not exist in the future when the new rates become effective. Although, classified as a "payable" on the general ledger this amount is not a payable in the generally understood meaning of the term. Rather, the balance in the CIAC tax payable account is the cumulative contributed taxes (gross-up) collected for the year. It does not represent a payable to contributors or the IRS. Since receipts of gross-up are deposited in an escrow account, such funds do not represent a source of working capital to Gulf. No decision has been made by the Commission concerning a refund of any gross-up collected in the year 1996.

Also, staff's average Customer Accounts Receivable amount should be increased 5.8% to reflect the overall increase in revenues from the proposed rates and growth for the remainder of 1996.

Payable amounts for capital projects (FGCU & other) should not be included in the working capital calculation because they are not normal monthly operating accounts payable. Accounts payable balance for January, February and March 1996 (Schedule A-19 Page 1 of 4; page 63) were actual and included the following amounts for other capital projects, respectively; $392,656, amounts for oth capital projects, respectively; $392,656, $413,442, $394,849.

Monies available to pay for capital projects are invested and are not included in the working capital calculation. Since invested monies are **excluded** from the calculation and if the liability for capital projects (FGCU & others) are **included**, there would be no off set of assets to the liability-capital project payables.

The average balance of the total deferred rate case expense allowed by the Commission in this case should be used.

Prepaid preliminary survey charges relate to developer agreements and do not relate to day to day operations.

If interest payable is included, interest receivable also should be included.

The clearing account credit balance of $2,430.00 represents a refund from Lee County which was credited to the Water Plant in 1996. This amount was for construction fees paid to Lee County by Gulf for water plant construction. It was not related to day to day operations.

AUDIT EXCEPTION NO. 6

SUBJECT: DEPRECIATION

RESPONSE:

The Company had an error in calculating the depreciation expense of water transmission mains and wastewater collection mains. Computation of depreciation for the test year and the MFRs are as follows:

Florida Public Service Commission
Gulf Utility Company's Response to Audit Exceptions

WATER:

Mains per MFR-corrected	$ 181,296
MFRs page 89	92,464
Difference	$ 88,832

WASTEWATER:

Collection mains MFR-corrected	$ 219,521
MFRs page 91	176,751
Difference	$ 42,770

The "Per Company forecast B-13 should read

	WATER	WASTEWATER
B-13	$592,458.00	$503,233.00
Diff. between Gulf's calculation & audit report	$ 13,404.10	$ 3,918.74

AUDIT DISCLOSURE NO. 1

SUBJECT: PROPERTY TRANSACTION WITH AFFILIATE

RESPONSE:

This was a routine business transaction in February 1990 where common stock was issued for $160,928 of assets. The Company must raise 5-6 million dollars of outside capital by the year 2000. The ability to attract additional debt and equity based on historic interest coverage tests and earnings will be problematic. But looking to the future, the Company must have stable earnings and a sustained level of income to raise this amount of money. Investors and lenders have many options beyond this Company.

The Company started operation in 1982 and through 1987 had negative retained earnings of $329,788. In 1988,the growth of the area required expansion and enlargement of both water and wastewater facilities and to finance that construction program, the current stockholders converted $626,800 of loans to equity capital plus the Company issued $10,000,000 of industrial revenue bonds. In 1990, to further strengthen the equity base, common stock was issued for the $160,928 of assets.

As for the Company's earnings, at the end of 1990, the cumulative net increase in net worth from earnings for the 9 year period was a negative $19,756, and through the 13 years ending 12/31/95, the cumulative net income was a negative $13,427. This data is taken from Exhibit JWM-2 attached to Mr. Moore's testimony.

The Company's accounting of this transaction should be approved. The current stockholders have shown their commitment to provide quality service to the area, and the larger equity base from the Company's accounting of this transaction will benefit the consumer over the long pull.

Date Asset Transferred	Description	Amount as of 12/31/95	Account Description
7/31/90	Water System	$68,113.26	Water Plant,#1011
	Wastewater System	$92,815.00	WW Plant,#1012
12/20/90	Water System	$15,399.05	Water Plant,#1011

AUDIT DISCLOSURE NO. 3

SUBJECT: AFFILIATED TRANSACTIONS

RESPONSE:

The Company has made a detailed study of the services Gulf Utility provides for Caloosa Group, Inc. The personnel who provide these services, the time spent providing this service, and costing out this time using salaries, plus wage benefits of each employee, and found the amount Caloosa reimburses the employees for such services was reasonable. A detailed study was also made of the use of common facilities, office supplies, etc. which was allocated to the Caloosa Group on a square footage basis. The study indicates a reasonable charge was $2,000 per year in contrast to the present charge of $600. The above conclusions are supported in Mr. Cardey's testimony, page 12-15.

Mr. Moore's business expenses, AWWA conference and administrative expense relate to Gulf operations only. Any business expenses he incurred while conducting Caloosa business were reimbursed by Caloosa or out of pocket.

If Caloosa were to employ part-time employees other than Gulf employees, health insurance and IRA benefits would not be available to the employees. It is not customary for part-time employees to receive either benefit.

AUDIT DISCLOSURE NO. 4

SUBJECT: NEW OFFICE RENT

RESPONSE:

The reasonableness of a rental charge depends upon a number of factors, including the following:

1. Service tot he customer improved with a drive-up payment window and a more convenient location for the customers.

2. The Company could not finance a new office building. With $5-6 million of outside financing required in the next 5 years to construct central utility plant, raising capital to finance this construction has the highest priority.

3. An independent appraiser gave his opinion that $15 per square foot, including taxes, maintenance and insurance was a reasonable charge. The maintenance costs are estimated and a portion may be refunded based on actual costs. Also, an independent appraisal was given by Allied Appraisers & Consultants, Inc., MAI, certified appraisers. A copy of the relative portions is attached hereto as Appendix A.

4. The Lee Memorial Hospital in 1996 has leased two-thirds of the building at comparable rental charges.

It is the judgment of management that the rental charge is reasonable.

AUDIT DISCLOSURE NO. 6

SUBJECT: PROJECTED PLANT

The construction of the Corkscrew Water Treatment Plant Expansion, the effluent line construction and the Florida Gulf Coast University water and wastewater mains will be complete as of December 31, 1996. The remaining work is paperwork attendant to the acceptance of the assets by the Utility.

AUDIT DISCLOSURE NO. 7

SUBJECT: CIAC

The MFRs for 1996 uses the proposed capacity fees while the general ledger reflects present capacity fees a comparison of the fees are:

	PER ERC	
	WATER	**WASTEWATER**
Present	$800	$550
Proposed	$550	$800

AUDIT DISCLOSURE NO. 8

SUBJECT: PREPAID CIAC

RESPONSE:

A "test year" synchronizes four basic determinants in setting rates namely (1) the revenues produced under the rate structure, (2) the expenses, including depreciation and taxes incurred to produce these revenues, (3) the property (rate base) that produces the service, and (4) return on said rate base. Audit disclosure No. 8 destroys the orthodox method of ratemaking outlined above as well as the fundamentals in the MFRs and should be rejected.

AUDIT DISCLOSURE NO. 9

SUBJECT: REVENUE PROJECTIONS

RESPONSE:

The revenue forecast in the MFRs is reasonable. A large shopping center starts taking service in December 1996, and a full years' revenue from Florida Gulf Coast University was included in the MFRs.

	Company MFRs	
	Water	Wastewater
Shopping Center	$ 30,782	$ 44,372
University	35,018	64,030
Subtotal	65,800	108,402
All others	2,229,556	1,196,328
Total	$2,295,356	$1,304,730

AUDIT DISCLOSURE NO. 14

SUBJECT: EXPENSE FORECAST

RESPONSE:

On page 40, under "Corkscrew Additions", $44,175.04 should be an addition to Salaries & Wages-Adm & General, not Salaries-Officers. This additional expense is for two (2) licensed water operators,

	PER ERC	
	WATER	**WASTEWATER**
Present	$800	$550
Proposed	$550	$800

AUDIT DISCLOSURE NO. 8

SUBJECT: PREPAID CIAC

RESPONSE:

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All others	2,229,556	1,196,328
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AUDIT DISCLOSURE NO. 14

SUBJECT: EXPENSE FORECAST

RESPONSE:

On page 40, under "Corkscrew Additions", $44,175.04 should be an addition to Salaries & Wages-Adm & General, not Salaries-Officers. This additional expense is for two (2) licensed water operators, required by DEP minimum staffing requirements based on increase in plant flows at Corkscrew WTP. A copy of the rule is attached.

Should you have any questions, please contact me at (941) 498-1000.

Sincerely,

Carolyn B. Andrews

Carolyn B. Andrews
Chief Financial Officer

(b) Category II

Treatment Process	Class A	Class B	Class C	Class D
Demineralization including reverse osmosis, desalinization, electrodialysis and ultra filtration.	6.5 MGD and above Staffing by Class C or higher operator: 24 hours/day for 7 days/week. The lead/chief operator must be Class A.	1.0 MGD up to 6.5 MGD Staffing by Class C or higher operator: 16 hours/day for 7 days/week. The lead/chief operator must be Class B, or higher.	0.5 MGD up to 1.0 MGD Staffing by Class C or higher operator: 6 hours/day for 5 days/week and one visit on each weekend day.	None
			0.1 MGD up to 0.5 MGD Staffing by Class C or higher operator: 3 hours/day for 5 days/week and one visit each weekend day.	
			less than 0.1 MGD Staffing by Class C or higher operator: 1 hour/day for 5 days/week and one visit on each weekend day.	
			For all of the above plants the lead/chief operator must be Class C, or higher.	

ALLIED APPRAISERS & CONSULTANTS, INC.

Appraisers • Brokers • Consultants • Market Analysts

1642 MEDICAL LANE · FORT MYERS, FL 33907-1192 · (941) 939-1557 · FAX (941) 275-1196

H. NEAL SCOTT, MAI
STATE-CERTIFIED GENERAL APPRAISER
CERTIFICATE NO. RZ 0000743

July 24, 1996

Relevant portions complete Appraisal
List for review at my office.

Mr. Walter L. Ballard
Northern Trust Bank
26790 S. Tamiami Trail
Bonita Springs, Florida 33923

Re: Self-Contained Appraisal #960701 - Gulf Utility Office Building, 19910 South Tamiami Trail, Estero, Florida

Dear Mr. Ballard:

As requested, I have made a personal inspection and self-contained appraisal report of the Gulf Utility office building that is located at 19910 South Tamiami Trail in Estero, Florida. The purpose of this appraisal is to estimate the market value of the leased fee interest in the subject property as though the building was completed as of July 1, 1996.

The legal description is lengthy and can be found in the body of this report. The attached appraisal report contains the data, analyses, limiting conditions, and conclusions of value. The property was assumed to be free of all liens and encumbrances except for typical conventional financing. It was also assumed the rental space was completed as per the lease agreement.

It is our opinion the market value of the leased fee interest in the subject property as of July 1, 1996, was:

ONE MILLION THREE HUNDRED TWENTY-FIVE THOUSAND DOLLARS

($1,325,000.00)

I certify that, during the completion of the assignment, I have personally inspected the property that is the subject of this report. I would like to recognize the assistance of Amanda Davis in the data collection for this report.

Mr. Walter L. Ballard
Page 2
July 24, 1996

We certify we have no past, present or future interest in the real estate and to the best of our knowledge the facts contained herein are true and correct.

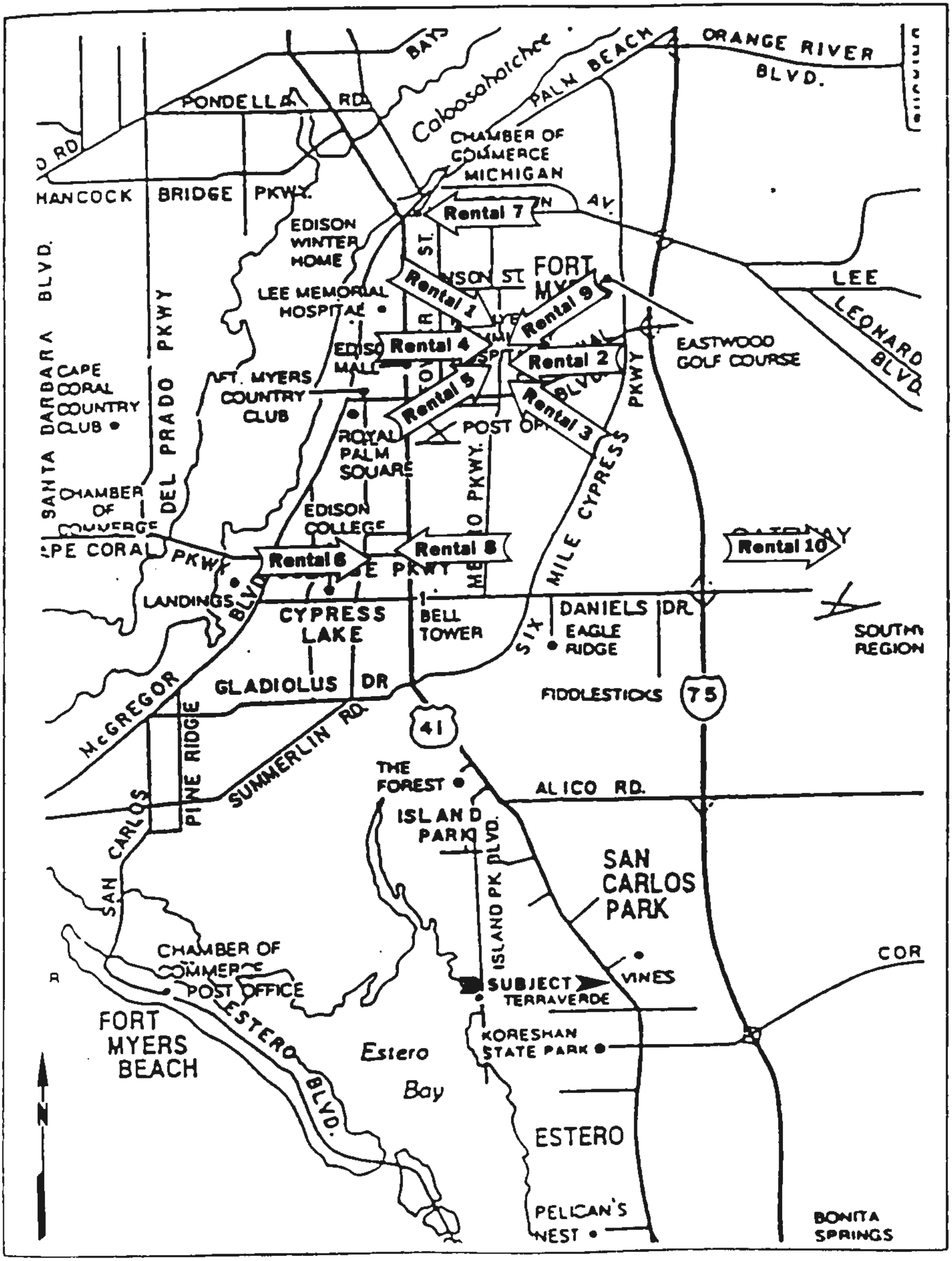
We appreciate this opportunity to be of service.

Respectfully submitted,

ALLIED APPRAISERS & CONSULTANTS, INC.

H. NEAL SCOTT, MAI, SRA
State-Certified General Appraiser
Certificate No. RZ 0000743

:bp



COMPARABLE RENTAL MAP

RENTAL SURVEY

Rental	Building Address	Year Built	Leasable Area (Sq.Ft.)	Rental Rate Per Sq.Ft.	Occupancy	Expenses
1	Metro Center I 2891 Centerpointe Drive Fort Myers, Florida	1990	37,350 ±	$9.00 Triple Net	90%	$4.66 CAM
2	General Electric Building 4315 Metro Parkway Fort Myers, Florida	1986	72,458 ±	$10.00 Triple Net	100%	$8.00 CAM
3	Metro Park Executive Center 4415 Metro Parkway Fort Myers, Florida	1985	60,596 ±	$11.00 to $16.00 Triple Net	86%	$6.50 CAM
4	Fairfax Center 4210 Metro Parkway Fort Myers, Florida	1988	57,496 ±	$16.00 Gross	100%	$6.80 Expense Stop
5	Fairfax Center II 4310 Metro Parkway Fort Myers, Florida	1989	61,289 ±	$17.50 Gross	97%	$6.30 Expense Stop
6	One University Park 12800 University Drive Fort Myers, Florid	1990	132,500 ±	$13.50 to $15.00 Triple Net	97%	$7.13 Expense Allowance
7	Barnett Centre 2000 Main Street Fort Myers, Florida	1988	121,190 ±	$12.50 Triple Net	95%	$5.90 CAM
8	SunTrust Financial Center 12730 New Brittany Boulevard Fort Myers, Florida	1988	61,424 ±	$12.00 Triple Net	67%	$6.00 CAM
9	General Electric Building 4211 Metro Parkway Fort Myers, Florida	1994	66,265 ±	$10.20 Triple Net	100%	Pass-Thru
10	Sony Office Building Gateway Boulevard Fort Myers, Florida	1996	67,226 ±	$10.11 Triple Net	100%	Pass-Thru

Analysis of Comparable Rentals

Rental No. 1 is the Metro Center I office building that is located at 2891 Centerpointe Drive in the Metro Park Subdivision northwest of the subject property. This is a 3-story, concrete block and glass office building that was built in 1990 and contains 37,350± square feet of net leasable area. The rental agent indicates the current base rent is $9.00 per square foot plus a CAM of $4.66 per square foot. Typical lease term is 5 years with a 4% per year escalator and current occupancy at 90%. This is one of the newer buildings in the Metro Park Subdivision. The overall quality is inferior to the subject.

Rental No. 2 is the General Electric Building located at 4315 Metro Parkway in the Metro Park Subdivision. This 5-story, concrete block and glass office building was built in 1986 and is 100% occupied by General Electric. The lease was renegotiated in 1991 and is currently $10.00 per square foot on a triple net basis plus an $8.00 CAM charge. Because one tenant leases the entire 72,458± square feet, the lease rate would be less than could be anticipated for the subject.

Rental No. 3 is the Metro Park Executive Center located at 4415 Metro Parkway, which is just south of the General Electric Building, all in the Metro Park Subdivision. This building was built in 1985 and contains 60,596± square feet of net leasable area. Currently rental rate is $11.00 per square foot plus a CAM charge of $6.50 per square foot. Current occupancy is 86%. This building is considered similar to the subject property.

Rental No. 4 is Fairfax Center located at 4210 Metro Parkway which has 57,496± square feet of net leasable area and was built in 1988. This center is three stories with current a rental rate at $16.00 per square foot on a gross basis. There is an operating expense stop of $6.80 per square foot. Current occupancy is 100%.

Rental No. 5 is the Fairfax Center II, which is located at 4310 Metro Parkway directly south of the Fairfax Center in the Metro Park Subdivision. Fairfax Center II was built in 1989, contains 61,289± square feet of net leasable area, and currently leases at $17.50 per square foot on a gross basis. There is an expense stop of $6.30 per square foot.

Rental No. 6 is the One University Park office building that is located at 12800 University Drive in south Fort Myers, more specifically at the southeast corner of College Parkway and Summerlin Road. This 6-story, concrete block and glass building was built in 1990 and contains 132,500± square feet. It currently leases for $13.00 to $15.00 per square foot on a triple net basis plus CAM of $7.13 per square foot. Currently, occupancy is at 97%. This rental is considered superior to the subject property in both location and building design.

Rental No. 7 is the Barnett Centre that is located at 2000 Main Street in downtown Fort Myers. This is a 9-story, concrete block and glass building, built in 1988, and contains 121,190± square feet of net leasable area. Current rental rate is $12.50 per square foot plus a $5.90 per square foot CAM charge. Occupancy is at 95%. This building is considered superior to the subject property.

Rental No. 8 is the SunTrust Financial Center located at 12730 New Brittany Boulevard in South Fort Myers. This location is off College Parkway. This is a 6-story, concrete block and glass building that was built in 1988 and contains 61,424± square feet of net leasable area. Current rental rate is $12.00 per square foot plus a $6.00 per square foot CAM charge. Current occupancy of 67% is misleading as the top floor was never finished.

Rental No. 9 is the General Electric Building located at 4211 Metro Parkway in the Metro Park Subdivision. This 3-story, concrete block and glass office building was built in 1994 and is 100% occupied by General Electric. The lease was negotiated in 1993 and is currently $10.20 per square foot on a triple net basis. The tenant pays all expenses. This is a single tenant (66,265± square foot) building. Therefore, the rent per square foot would be less than anticipated for the subject.

Rental No. 10 is the Sony Building that is located on the east side of Gateway Boulevard in the Gateway subdivision in east Lee County. This 2-story, concrete block and glass office building was completed in 1996 and is 100% occupied by Sony Corporation. The rent for the first 5 years is $10.11 per square foot on a triple net basis. The tenant pays all expenses.

In analyzing the rental rates on a per square foot basis, the specifics of the lease terms must be identified. Of the ten rental comparisons considered, eight are on a triple net basis and two are on a gross lease basis. The rentals range from $9.00 to $16.00 per square foot on a triple net basis. The Fairfax Center and the Fairfax Center II are both on a gross lease basis. When the expense stops are deducted, they indicate net rental rates of $9.20 and $11.20 respectively. Fairfax Center is at $16.00 per square foot gross, whereas Fairfax Center II is at $17.50 per square foot on a gross basis. Fairfax Center experienced a much higher rental rate when it was built and suffered from loss of tenants when Fairfax Center II was built. In order to entice new tenants they have substantially lowered the rents. One University Park and

Barnett Centre, along with the SunTrust Financial Center, are considered to have slightly superior locations to the subject property, and the highest rental paid is One University Park. The four buildings on a triple net basis in Metro Park that are considered similar to the subject property are Metro Center I, the two General Electric buildings, and Metro Park Executive Center. These indicate rental rates of $9.00 to $16.00 per square foot on a triple net basis.

After considering the comparable rentals, it is our opinion the market rent for the subject property is between $10.00 and $12.00 per square foot on a triple net basis.

The appraisers have also considered the rental rate of the smaller office buildings that are located in the Gateway Subdivision as follows:

[illegible]				
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Fairway Office Center 11922 Fairway Lakes Drive Gateway	3,762± square feet	$12.00 per square foot triple net	3-5 years	100%
Fairway Office Center 11928 Fairway Lakes Drive Gateway	3,762± square feet	$12.00 per square f. x triple net	3-5 years	100%
Fairway Office Center 11920 Fairway Lakes Drive Gateway	3,762± square feet	$12.00 per square foot triple net	3-5 years	80%
Fairway Office Center 11900 Fairway Lakes Drive Gateway	2,980± square feet	$15.50 per square foot triple net	3-5 years	100%
Fairway Office Center 11930 Fairway Lakes Drive Gateway	3,762± square feet	$12.00 per square foot triple net	3-5 years	100%

These rentals indicate the projected market rent of $12.00 to $15.50 per square foot on a triple net basis for the subject is reasonable.

Contract Rent

The subject property contains 11,278± square feet of net leasable area of which 3,982± square feet is leased to Gulf Utility Company and 6,396± square feet is leased to Lee Memorial Health Systems. The remaining 900± square feet is vacant, but Lee Memorial Health Systems has a first right of refusal and may lease this space. The leases are at $12.00 per square foot on a triple net basis, and it is anticipated the vacant space will be leased at the same rate. A synopsis of the leases is as follows:

Unit 1

Landlord	Caloosa Group, Inc.
Tenant	Gulf Utility Company
Term	5 years
Size	3,982± square feet
Rents	$47,172.00 annual $3,931.00 monthly in advance
Rent/Sq.Ft.	$12.00
Expenses	Tenant pays prorated share of all expenses
Increases	CPI

Unit 2

Landlord	Caloosa Group, Inc.
Tenant	Hospital Board of Directors of Lee County d/b/a Lee Memorial Health Systems
Term	5 years
Size	6,396± square feet
Rents	$77,520.00 annual $6,460.00 monthly in advance
Rent/Sq.Ft.	$12.00
Expenses	Tenant pays prorated share of all expenses
Increases	CPI

A full copy of the leases can be found in the addendum of this report. The first year's income indicates a rental rate of $12.00 per square foot of net leasable area on a triple net basis and is in line with the market. Therefore, the contract rents are considered to be at market.

In the valuation of the subject property, the appraisers will value the subject by a discounted cash flow analysis.