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Attachments: Citizens' Post-Hearing Statement 10-27-08.pdf

Electronic Filing

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b. Docket No. 070293-SU

In re: Application for increase in wastewater rates in Monroe County by KW Resort Utilities, Corp.

c. Document being filed on behalf of the Office of Public Counsel.

d. There are a total of 38 pages.

e. The document attached for electronic filing is ***Citizens' Post-Hearing Statement***.

Thank you for your attention and cooperation to this request.

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Application for increase in Wastewater rates in Monroe County By KW Resort Utilities, Corp.	Docket No. 070293-SU
	FILED: October 27, 2008

CITIZENS' POST-HEARING STATEMENT

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Application for increase in Wastewater rates in Monroe County By KW Resort Utilities, Corp.	Docket No. 070293-SU
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CITIZENS' POST-HEARING STATEMENT

The Citizens of the State of Florida, through the Office of Public Counsel, pursuant to the Prehearing Order, Order No. PSC-08-06070PHO-SU, issued September 19, 2008, hereby submit this Post-hearing Statement.

BASIC POSITION

Under normal circumstances, a utility hires employees who perform substantially all of the ongoing, routine utility functions, and the utility pays market–based salaries which the Commission can examine for reasonableness. In this case, however, KW Resort Utility Corporation (KWRU, the Company or the Utility) has NO employees of its own. Instead, KWRU has various affiliates (e.g., a golf course, a management firm, a law firm, and a service company) whose employees perform all utility functions. Accordingly, KWRU relies on related party transactions for even the most mundane utility functions. KWRU is owned and operated one hundred percent by unregulated affiliates. [T. 149 and 327]. This business structure that was chosen by Mr. Smith, the owner and President of KWRU, requires a heightened scrutiny of all transactions for reasonableness, and has given rise to many areas wherein KWRU's customers are paying excessive amounts and duplicate charges for certain services.

Subsequent to its initial filing, KWRU has stipulated to eleven separate adjustments – some quite substantial – to correct errors and misclassifications that Staff auditors found in the

initial filing. Further, at the hearing KWRU agreed that based on the Staff audit, five additional adjustments should be made beyond those that were included in the stipulations [T.476 – 481]. Finally, in addition to the Staff audit adjustments, KWRU chose not to put any sworn testimony into the record to oppose fifteen additional adjustments on which OPC presented testimony [Issues 3, 4, 5, 6, 7, 8 (2 subparts), 9, 11, 20 (2 subparts), 30 (4 subparts)]. .[1] By not even attempting to carry its burden of proof on those issues, KWRU effectively conceded them. In aggregate, then, KWRU has now conceded thirty-two separate errors that needed to be corrected in its initial filing. The effort to track down and identify all of these errors – particularly in light of the complexities associated with multiple related parties who form the operations – is one that required a great deal of time and resource on the part of the PSC Staff, the OPC, and the utility itself. Nevertheless, this expensive undertaking proved to be necessary, in light of all the errors that even the utility now concedes were embedded in its initial filing.

Due to the extensive nature of the affiliate relationships in this proceeding, it is essential to understand the sheer magnitude of the affiliations of Mr. Smith and his family and their connection to the KWRU. WS Utility is the sole shareholder of KWRU. WS Utility, Inc., holds the financing note of KWRU, and is owned by Mr. William L Smith, Jr., (70%), his daughter Mrs. Leslie Johnson (10%), and his sons Messrs. Barton Smith (10%) and Alexander Smith (10%) [T. 224].

Mr. Smith is an owner, partner, employee, stockholder, officer, director, secretary or

[1] The subject matter in some of these issues is discussed in the Monroe County Commission's Response to the Grand Jury Report. The County Commission's Response was attached to Mr. DeChario's rebuttal testimony, and has been identified as Exhibit 30. The due process problem this presents is four-fold: (1) the author of the County's Response was not sworn; (2) the author was not presented for cross-examination; (3) KWRU's "sponsoring" witness – Mr. DeChario -- did not address these subjects in his own testimony, thus rendering the hearsay totally uncorroborated; and (4) by not addressing these subjects, Mr. DeChario's made them beyond the scope of his own testimony, thereby providing a shield from OPC cross-examination (note that both of KWRU's attorneys joined to object vociferously on precisely these grounds on another matter [T. 490- 494], and succeeded in preventing OPC from cross-examining on statements made by someone other than Mr. DeChario [T. 492]). As a result, then, assertions of the Monroe County Response that KWRU did not corroborate through its own sworn testimony is not competent, substantial evidence upon which the PSC can base a finding.

treasurer at least 17 companies.[2] Green Fairways owned 100% by Mr. Smith, provides "management, construction and financing services" to KWRU [T. 225-25]. However, the contract between Green Farirways and KWRU was signed by Mr. Smith on behalf of both companies [T. 150-51]. The agreement is obviously not an arms-length agreement and cannot be used to test the reasonableness of charges from Green Fairways to the Company.

Mr. Smith is also a senior partner and attorney for the law firm Smith, Hemmesch & Burke, which sometimes provides legal services to the Utility. In addition, Mr. Smith has an 83% ownership interest in 900 Commerce, from which the Utility purchased a generator in 2005. Key West Golf Club ("KWGC"), 78% of which is owned by Mrs. Smith, provides administrative services to the Company. [T. 225-26]. Unfortunately, there is no written agreement or contract between KWGC and the Utility [T. 341, 370]. Keys Environmental, Inc. ("Keys Environmental" or "KEI") provides operations, maintenance, and repair services to the Utility and is owned by Mr. Chris Johnson (Mr. Smith's son-in-law) [T. 225-26]. Again, the contractual arrangement between KEI and the Utility is lacking. The amount for which KEI is to be compensated is blank. [Exhibit 25, p.20]

The burden of proof lies with the KWRU in this proceeding. The affiliate relationships intensify that burden. The Commission has expressed the heighted burden associated with affiliate relatuionships:

> It is the utility's burden to prove that its costs are reasonable. *Florida Power Corp. v. Cresse, 413 So.2d 1187, 1191 (1982).* This burden is even

[2] KW Resort Utility Corporation (owned 100% by WS Utility, Inc.); WS Utility, Inc. (70% ownership); Green Fairways (100% ownership); Key West Golf Club (Owned 78% by Gwen Smith, Mr. Smith's wife); Keys Environmental, Inc (100% owned by Chris Johnson, Mr. Smith's son-in-law); Johnson Constructors (50% owned by Chris Johnson, son-in-law of Mr. Smith); Smith, Hemmesch & Burke (partner); Benicia Partners, LLC (20.5% ownership); 900 Commerce (83%); Courtland Court (50% ownership); Smith & Kreisler (50% ownership); Antioch Golf, LLC (10% ownership); Rail Golf, LLC (65% ownership); Deer Creek Golf, LLC (75% ownership); Gulf County Land, LLC (33% ownership); Norcor Tradewinds, LLC (1% ownership); Norcor Caldwell, LLC (1% ownership).

> greater when the purchase is between related parties. In *GTE Florida Inc. v. Deason, 642 So.2d 545 (Fla. 1994),* the Court established that when affiliate transactions occur, that does not mean that "unfair or excessive profits are being generated, without more." The standard established to evaluate affiliate transactions is whether those transactions exceed the going market rate or are otherwise inherently unfair. The evidence in the GTE Florida case indicated that its related party costs were no greater than they would have been had services and supplies been purchased elsewhere.
>
> The facts in this case differ from those established in the GTE Florida case. The distinction is that in the GTE Florida case, there was evidence in the record that showed that the utility's cost was equal to or less than what an arms-length transaction would have been. Other than the testimony provided by Mr. Seidman that either of the above charges are reasonable, PCUC did not provide any documentation to support these costs. As such, we find that the utility has essentially failed to prove the prudence of these charges.
>
> We find that the utility failed to meet its burden to justify its costs. Accordingly, we have reduced affiliate charges by $ 25,412 ($31,765 less 20% non-used and useful) and then allocated 59.63% to water and 40.37% to wastewater.[3]

Every transaction in the instant proceeding involves an affiliate. Therefore, for each expense included in the test year and for the investment included in rate base, the Commission must determine if the transaction is at or below what an arms-length transaction would have been or if the transaction is otherwise fundamentally unfair. In some instances, KWRU (after its direct case) attempted to present information suggesting that the affiliate transactions were reasonable because they were comparable to what other utilities paid for the service or what companies would provide the service to KWRU for. Each of these analyses or comparisons were flawed as addressed below. Furthermore, the Commission must examine each transaction to determine it is otherwise unfair.

[3] Florida Public Service Commission, Order PSC-96-1338-FOF-WS, November 7, 1996.

ISSUES AND POSITIONS

ISSUE 1; Is the quality of service provided by KW Resort Utilities Corp. satisfactory?

OPC: No. KWRU has shown a pattern of abuse in its treatment of customers that would not be tolerated in a competitive market. If the Commission grants a return, it should be set at the bottom of the authorized range.

DISCUSSION:

Customer relations are an integral component of virtually every business enterprise. In a competitive market, customers who are mistreated will find another supplier of the service. The marketplace thereby assures that customers receive adequate service, including proper treatment. For a protected monopoly like KWRU, however, the Commission is the only entity with the direct authority to assure appropriate treatment of utility customers. The regulatory framework was not created to be a safe haven to allow a utility company to abuse its customers with impunity. When a utility mistreats its customers, the Commission historically has penalized the utility, just as the marketplace would have penalized such behavior if competition were present. The record contains many examples of customers who testified about KWRU's abusive and intimidating tactics -- tactics that, in a competitive enterprise, would alienate customers and diminish revenues. Diane Beraldsen complained of intimidation tactics:

> Last night we had a meeting at the church for us public citizens, and I was offended when Bill and his workers from Key West, well, they're not really his workers, but the people associated with his companies came to our meeting because I felt infiltrated. And it's a tactic that I found very aggressive. He took up our time explaining his side of the story, all of his expenses, but I really felt intimidated by it. That meeting was for us, and they were asked to leave and they did leave finally. [T-28]

Glen Owens recounted why and how his group successfully fought so hard to avoid being served by KWRU:

> After conversations with friends and acquaintances who lived or owned property on Stock Island and after reading a report from the grand jury that had investigated the process by which the sewer system was built on Stock Island, the M-10 Coalition determined that we wanted no part of the private/public approach for our wastewater system. We were appalled at the problems the residents of Stock Island were being forced to endure, some of which are being described to you today. [T-45]

Kim Wiggington testified about customers who have been forced to pay fees for services that they are not receiving:

> A number of properties cannot connect. To this day there are people who are not connected to the system who have paid their capacity reservation fees, have put their structure on their, infrastructure on their property and paid the utility fees but are unable to connect to the collection system. [T-49]

Ms. Wiggington also testified about intimidation and heavy-handed tactics:

> I was in a meeting last night and heard people say that they were fearful of speaking to you today. They were fearful of being at that meeting because of retaliation both from the utility and from, in the past, some county officials. I've heard this over and over again for the last five years.
>
> There has been heavy-handed customer relations, there have been heavy contract negotiations.
>
> There have been other actions of heavy-handedness: Targeting low-income customers for code enforcement action. This has been validated by county record in an email from the utility's representatives to county officials. During contract negotiations he recommended the county authorities and the utility jointly target income households with code enforcement action. That's a quote. [T-50, 51]

And further:

> The notice came from the utility. The utility hired and paid armed deputies to deliver nonlegal letters to customers for 30-day notice service availability when there was no service available. But we had already signed previously a registered letter, the exact same copy. All three are in here: One with a deputy's signature, one was registered, the registered envelope, and one that we got by regular mail. [T-57]

Concerns of the same or similar nature were voiced by several other customers [T-90-115; T-136-143] If a company that operated in a competitive enterprise were to engage in this type of behavior, it would certainly lose customers [T-49]. The only reason these customers continue to do business with KWRU is that they are forced by law. The Commission should acknowledge the utility's deficiencies in how it treats its customers and set any allowed return at the bottom of the authorized range.

ISSUE 2: **Should KWRU's test year rate base be adjusted for Keys Environmental hook-up fees?**

OPC: Yes. KWRU pays its affiliate, KEI, a monthly fee under a management contract that requires KEI to perform the inspections as part of its contractual obligation. Since the monthly fee is paid by customers through their rates, the additional hook-up inspection fee constitutes a double charge for the same task.

DISCUSSION:

KWRU has no employees. Instead, KWRU pays affiliate companies to perform all necessary functions to run the utility operations. For the management and operation of the utility, KWRU has hired Keys Environmental, Inc. (KEI) under a contract entitled MANAGEMENT AGREEMENT. Notwithstanding that it was contractually obligated to operate the utility, KEI charged each customer varying amounts to inspect the customer's connection into the utility's wastewater main. When a customer connects to the system, that customer must hire and pay his or her own private contractor for all material and labor to actually run the lateral and make the connection to the main. KEI then inspects that work to approve the connection and charges the customer an additional fee. This additional fee amounts to a double charge because the customers are already being charged the monthly fee paid to KEI to operate the utility under the MANAGEMENT AGREEMENT, and KEI is obligated under that agreement to perform the inspections.

The agreement requires that KWRU pay KEI a monthly fee, and in exchange, KEI is to perform "management and administrative duties hereunder." On page 19, under the heading "Additional Services at Additional Cost" the contract provides: "In the event [KWRU] requests that [KEI] perform any services not otherwise included within the responsibilities of [KEI] under this agreement, [KEI] shall perform such services at an additional cost to [KWRU] of $65.00 per hour." Thus, the contract itself is explicit that KWRU is not to make additional payments for tasks that KEI would already be expected to perform under the contract.

At the outset of the agreement, under the heading "Responsibilities," KEI agrees "to operate, manage and maintain the Property and the System in a diligent, careful and vigilant manner in compliance with all applicable laws and regulations...." That sentence is followed immediately by a statement that any further descriptions of KEI's responsibilities under the contract "would not limit the generality of" KEI's duty to operate manage and maintain the property and the system. In other words, KEI's obligations under the contract were to be interpreted in the most general – that is, the broadest – light. The task of inspecting customers' connections to the system is clearly within KEI's responsibility to "manage the property in compliance with applicable regulations. The contract clearly obligates KEI to inspect the connections. To

bolster that interpretation, the contract contains at least two additional provisions that would obligate KEI to perform the inspections.
First, on page 6, the contract provides:

> [KEI] shall secure, as fully as practicable, the compliance of all Customers with all rules and regulations affecting the System....
>
> [KEI] shall monitor the System and cause the property and the System to be maintained in good operating condition in accordance with ... approved tariffs....

The contract obligates KEI to assure that customers comply with the tariff and with all regulations affecting the system. KWRU's tariffs require customer connections to be inspected before they can be approved to connect into the system. Accordingly, KEI is obligated to inspect the connections as part of its contractual responsibilities.

Finally, it is worth noting that the contract explicitly describes several tasks for which KEI is entitled to additional payments from KWRU (see pages 6 and 7 of the contract). Inspection fees are not even mentioned on the version of the existing contract that was provided to PSC Staff auditors on 10/27/07. If inspection fees were to call for an additional charge, they should have been specified, as were the other specified tasks.

In an effort to support KWRU's erroneous position, Mr. DeChario offered the following explanation:

> By agreement of the parties, the intent was to not cover this additional service under the general contract. [T. 453]

The hole in Mr. DeChario's logic is at the very heart of the problem with the utility's case. Mr. DeChario implies that because the utility owner concedes the contract interpretation, it must be valid. The argument sounds good, and it would have application IF this were an arm's length transaction in a competitive market. If this were an arm's length transaction in a competitive market, one could presume that KWRU's concession is legitimate because it would run counter to its own financial interest. With an affiliate transaction in a monopolistic situation, however, the presumption is precisely the opposite. By conceding the interpretation, Mr. Smith actually enriches his family because the additional fees are paid by captive customers to Mr. Smith's son-in-law. Thus, the presumption argued by Mr. DeChario is invalid, and the parties' self-serving interpretation cannot be relied upon.

The MANAGEMENT AGREEMENT is clear. It allows additional fees only for services that are NOT included under the contract. The contract section that specifically identifies some tasks that are to be considered as additional, notably omits any reference to the inspections. The contract requires KEI to:

(1) Operate, manage and maintain the Property and System in compliance with all applicable regulations;
(2) Secure the compliance of all customers with all regulations affecting the system;
(3) Cause the property to be maintained in accordance with approved tariffs.

The contractual language clearly obligates KEI to inspect customer connections as part of its overall obligation to manage, maintain and operate the system in compliance with all regulations. The customers pay the monthly management fee in exchange for the service to be rendered under the contract. The customers have been improperly charged for the inspection fee. The fees that have been improperly collected should be reflected as an offset to rate base. Plant in service should be reduced by $252,690.

ISSUE 3: Should KWRU's test year rate base be adjusted for KWRU's contribution to the decommissioning of jail facilities?

OPC: Yes. KWRU presented no evidence on this issue. The customers should not be required to pay for the financial obligation of the County.

DISCUSSION:
In its Prehearing position, KWRU lists three witnesses that supposedly address this issue. In fact, however, none of the listed witnesses gave a single word of testimony on this issue. Mr. DeChario was asked specifically whether he provided any testimony on this issue and responded as follows:

> By Mr. Burgess:
> Q. Mr. DeChario, first I'm looking at the Prehearing Order and I see that you're being offered in cross, in rebuttal testimony to respond on Issues 2 through 40. And when I look at your testimony, I see that there are a number of those issues that are inclusive there that your prefiled testimony does not address. And so I want to get straight because I don't want to ask any questions beyond the scope of your testimony that's filed. So I want to first make sure that I am accurate when I, when I, when I, in my understanding of what issues you did not address, so I'm going to ask you some specific questions.
>
> Issue 3, the decommissioning of jail facilities; I don't see anything in your rebuttal testimony that addresses this. Am I correct?
>
> A. I get a little confused because of all the responses to the various document requests and what not.
>
> Q. Right. And that's sort of where I am too. And I don't want

out of that confusion to start going into issues that are beyond the scope of your testimony.

A. One moment. It does not appear to be directly in my direct rebuttal testimony nor in the rebuttal testimony I proffered in response to staff's testimony wherein Ms. Piedra provided the audit report. And in response to her testimony I provided our audit responses.

Q. Okay. So neither in the rebuttal testimony that you filed nor the responses, KWRU responses to the audit findings which are attached to your rebuttal testimony, in neither of those is there any specific response on this issue?

A. That is correct.

The utility has the burden of proof in seeking to increase its rates. It has ample opportunity to present its evidence to support its positions: first, through direct testimony; second after Staff auditors and OPC witnesses have explicitly raised specific issues, the utility has its second opportunity to address those issues in testimony. This procedural framework is established to assure due process to all parties to a case. By choosing not to sponsor prefiled testimony on the issue, the utility prevented OPC from cross-examining the utility's position on the issue [T. 475].

The only testimony presented on the issue was that of Ms. Dismukes, who testified that the agreement under which KWRU assumed an obligation to pay the decommission costs had been breached by the other party, thereby relieving KWRU of any obligation to assume the cost in question. Originally, Monroe County agreed to deed over its lift stations to KWRU, and KWRU was to bear the cost of removing the treatment facility. Subsequently, however, Monroe County determined that it could not legally give public property to a private entity. It is axiomatic that when one party to an exchange fails to produce, the second party is relieved from its obligation also. Because Monroe County removed the value of the substations from the quid pro quo equation, KWRU was under no obligation to use customer money to dismantle the county's treatment facilities [T. 357 - 359]. This is not a cost that should be borne by KWRU's other customers and should be removed from rate base.
[T. 264]

ISSUE 4: **Should KWRU's test year rate base be adjusted for Green Fairways Jail Project management fee?**

OPC: Yes. KWRU presented no testimony on this issue. The $32,198 that KWRU paid to Green Fairways (owned by Mr. Smith) is duplicative of the management fee that KWRU also paid to Weiler Engineering.

DISCUSSION:
KWRU paid Weiler Engineering a management fee to oversee the South Stock Island (SSI) project. KWRU also paid Green Fairways, which is owned by Mr. Smith, a management fee of $32,198. When Monroe County auditors asked for Green Fairways completion logs, they noted that the logs "were completed by the engineering firm and consisted of daily work reports of approximately one page per day." Obviously, Weiler Engineering oversaw the project. Further, KWRU has shown no documentation that would support or justify paying its affiliate, Green Fairways, the $32,198. The Commission should not force customers to pay for unjustified payments to a related party [T. 265]. Here again, KWRU did not prefile any rebuttal or direct testimony on this issue. Mr. DeChario offers a very general comment about supervision of subcontractors [T. 455], but he explicitly directs his comment to a different issue raised in Ms. Dismukes' prefiled testimony (Mr. DeChario rebuts "Dismukes Testimony page 55," which is page 271 of this transcript; Issue 4, however, is addressed on page 49 of Dismukes' prefiled testimony, which is page 265 of this transcript). Once again, then, KWRU did not prefile testimony for the record on this issue and has failed to carry its burden of proof. The $32,198 of unsubstantiated charges should be removed.

ISSUE 5: **Should KWRU's test year rate base be adjusted for Green Fairways SSI Project management fee?**

OPC: Yes. As with Issue 4, KWRU paid Weiler Engineering a management to oversee the South Stock Island project. It also paid Green Fairways $301,180 for "administration" of the SSI project. Customers should not be forced to pay these duplicative, unsubstantiated fees.

DISCUSSION:
Again, KWRU chose not to prefile any sworn testimony rebutting the prefiled testimony of Ms. Dismukes on this issue, thereby leaving nothing for the parties to cross examine and offering nothing upon which a finding can be made.

As Ms. Dismukes stated in her prefiled testimony:

> However, when asked in connection with the Monroe County Audit for work completion logs for Green Fairways, the auditors for Monroe County noted that the logs "were completed by the engineering firm and consisted of daily work reports of approximately one page per work day."[82] It does not appear that Green Fairways administered the project; instead, this function appears to have been performed by the engineering firm. Consequently, these costs should not be passed on to ratepayers as they received no benefit from them. [T-265]

There has been no documentation to demonstrate that Green Fairways actually

administered the project. Customers should not be forced to pay $301,180 to a related party without explicit proof (timesheets, etc.) that the work was performed.

ISSUE 6: **Should KWRU's test year rate base be adjusted for Smith, Hemmesch, and Burke legal fees?**

OPC: Yes. Monroe County refused to reimburse $25,000 that KWRU had paid to Mr. Smith's law firm because no supporting documentation was provided. KWRU's customers should not now be saddled with a charge that Monroe refused to pay.

DISCUSSION:
Monroe County had agreed to reimburse KWRU for all reasonable expenditures from the South Stock Island (SSI) contracts. During the course of the contracts, KWRU submitted to Monroe County a claim for legal expense paid to the law firm of Smith, Hemmesch & Burke (of which Mr. Smith is senior partner). KWRU claimed that the law firm negotiated contracts on the SSI projects. The Monroe County auditors, however, found that KWRU could not provide any supporting documentation for the charge. As a result, Monroe County refused to reimburse KWRU for the legal fee, notwithstanding the contract. Through this rate filing, KWRU is now is asking the Commission to force its customers to pay it the charge that Monroe County refused to pay for lack of documentation. As Ms. Dismukes states, the charges should be removed [T.265]. Once again, this is an issue for which KWRU did not prefile rebuttal testimony. After searching the record, OPC was able to find a reference to this issue only on page 31 of Exhibit 30, which was a response by the Monroe County Commission to the Grand Jury report. The due process problem this presents is that the author of the County Commission Response was not present to be cross-examined, and the hearsay testimony was not corroborated in the utility's prefiled testimony. No one was presented to answer why the PSC should be expected to force customers to pay a cost that KWRU's own contractual partner refused to pay because of insufficient documentation by KWRU.

ISSUE 7: **Should KWRU's test year rate base be adjusted for Mr. Johnson's moving expenses?**

OPC: Yes. KWRU paid $8,602 to move Chris Johnson and his family, and included that cost as a capital component of the SSI project. Mr. Johnson manages KEI and is Mr. Smith's son-in-law. This is not a proper capital component of the SSI project and should be removed from KWRU's rate base. [T. 266]

DISCUSSION:
Again, KWRU chose not to rebut the testimony prefiled by Ms. Dismukes on this issue. Mr. DeChario stated:

By Mr. Burgess:
Q. Am I correct also that Issue 7, the, Mr. Chris Johnson's moving expenses, which is also a –well is also not addressed in your rebuttal testimony?

A. This is correct. [T.476]

Ms. Dismukes identified and testified to this issue in her prefiled testimony. Despite being on notice that this was an issue in contention, KWRU chose not to submit evidence on the issue. The only evidence in the record is that submitted by Ms. Dismukes [T. 266]. The utility has the burden of proof and chose not to attempt to carry that burden. KWRU's stated position in the Prehearing Order asserts a fact that is purportedly supported by Mr. DeChario's testimony. As Mr. DeChario's own words cited above show, he did NOT testify on the issue. KWRU should not now be allowed to bootstrap a factual assertion that it chose not to address in prefiled testimony.

ISSUE 8: **Should KWRU's test year rate base be adjusted for Johnson Constructors charges for JAS Corp.?**

OPC: Yes. These are duplicative and undocumented charges that are being paid to Mr. Johnson's firm and to Mr. Johnson's father's firm. Plant should be reduced by $34,650: (1) $30,000 for the undocumented invoice submitted by Johnson Constructors and (2) $4,650 for JAS Corp. KWRU did not prefile testimony on this issue.

DISCUSSION:
(1)The Commission should remove $30,000 of a charge from Johnson Constructors because it has no support. Exhibit 13 is an invoice from Johnson Constructors to KWRU for the AWT project. The invoice is for $100,495.88 and covers twenty-nine different items. As every invoice should, this invoice provides a description of every item except one: a $30,000 charge for which the invoice is completely blank as to its purpose. Before customers are forced to pay for something, the Commission should require a utility to provide at least a scintilla of underpinning. Accordingly, Ms. Dismukes sought an explanation:

> Fourth, as shown on Schedule 9, there is a $30,000 charge from Johnson constructors for which there is no supporting documentation. It is not clear what services were provided for this amount. Absent supporting documentation for this charge, I recommend that it be removed from the cost of the AWT upgrade. [T. 272]

Ms. Dismukes thereby identified the issue, explained what was deficient in the filing, and invited the utility to present any supporting information. She did not say the amount was not paid or even that it was not reasonable, only that it needed support before the customers pay for it. Notwithstanding this conspicuous

invitation to support its filing, KWRU again chose not to address the issue. Nowhere in his testimony does Mr. DeChario utter a single word about this invoice, about the missing description, or about the lack of documentation. Again, the utility has the burden of proof. The issue was identified and explained, and the utility chose not to describe the purpose of the charge. With no explanation in the record, the Commission itself has no way of knowing the purpose of the charge or whether it is reasonable. It is axiomatic that if the Commission does not know what a charge is for, then it will not make customers pay for it. The $30,000 should be removed.

(2)The second adjustment the Commission should make is to remove the duplicative charges from JAS Corp. KWRU paid Johnson Constructors a fee for management services for the Advanced Waste Treatment (AWT) upgrade. KWRU also paid JAS Corp a fee for management services. Johnson Constructors is owned by Chris Johnson and JAS Corp is owned by his father, Jim Johnson. Ratepayers should not be forced to pay for two supervisors for the project. The rate base should be reduced by the fees and travel expenses that were charged by Jim Johnson. Jim Johnson charged $2,000 for management services and $2,650 for travel expenses for a total of $4,650.

ISSUE 9: **Should KWRU's test year rate base be adjusted for Mr. London's consulting fees?**

OPC: Yes. The Commission should remove from the rate base $32,500 of payments that were made to former Monroe County Commissioner John London. KWRU did not prefile sworn rebuttal testimony on this issue.

DISCUSSION:

KWRU capitalized to rate base $32,500 of payments that were made to John London, a former Monroe County Commissioner. KWRU stated the payments were for Mr. London to serve "as liaison between Monroe County and the Utility in its efforts to expand operations to South Stock Island." There are several reasons that these charges should be removed from rate base. These payments were made pursuant to an oral contract and no invoices exist. The utility has not demonstrated that the customers derived any benefit from the expenditures. Further, the utility has not explained why any such costs should not have been expensed in the period in which they were incurred, rather than being carried in the rate base. Ms Dismukes testified that for all of these reasons, the charges should be removed from rate base. [T. 263].

Once again, however, it appears that KWRU chose not to address this issue it any of its sponsored testimony. OPC was not able to find any utility testimony that addresses these points. Customers should not be forced to pay for expenditures for which there exists no documentation as to the specific tasks that were performed, nor support for the benefits derived by the customers.

ISSUE 10: **Should KWRU's test year rate base be adjusted for White and Case Legal Charges Related to Monroe County Audit Report?**

OPC: Yes. Rate base should be reduced by the $27,500 paid to the law firm of White and Case.

DISCUSSION:
Prior to the test year, KWRU paid the law firm of White and Case $27,500 for legal services in responding to the Monroe County Audit report. The first question the Commission needs to consider is whether the customers should bear this cost at all. If the Commission determines this to be a cost that was not required for utility operations, then the cost should be borne by shareholders, rather than customers.

KWRU hired White and Case when Monroe County was conducting an audit of KWRU's use of the funds that it received from the county. There were no legal proceedings. As KWRU provided the county auditors with any necessary financial information, it could do so without any legal entanglement. For some reason, KWRU chose to hire legal counsel. In its rebuttal testimony, KWRU states that it was required to participate in the audit, but it does not provide any explanation of what tasks the law firm actually performed or why such legal involvement was necessary [T. 450, 451]. Moreover, Ms. Dismukes testified that White and Case went to a meeting that was requested by KWRU in connection with the Utility's request to discuss monies withheld by the County [T. 353, 354]. There was no indication that this meeting was a requirement of the County as suggested by KWRU. Despite the issue being raised in both the Staff audit and Ms. Dismukes' testimony, the utility failed to even offer the Commission a cogent reason for hiring a law firm (particularly when the utility owner and president is a lawyer).

The utility has not demonstrated that White and Case performed any function that was necessary to the provision of utility service to its customers. Accordingly, the Commission should remove the $27,500 from rate base

ISSUE 11: **Should KWRU's test year rate base be adjusted for the Key West Citizen PR Advertisement?**

OPC: Yes. The $422 that KWRU spent for a newspaper advertisement should be removed from rate base. KWRU did not attempt to rebut this issue.

DISCUSSION:
Prior to the test year, KWRU spent $422 for a newspaper advertisement, then

capitalized the expense and put it into rate base. In her prefiled testimony, Ms. Dismukes stated why she believed that it should be removed from rate base [T. 266]. KWRU chose not to address the issue. Mr. DeChario stated:

> By Mr. Burgess:
> Q. Am I correct also that Issue 11, the $422 for the Key West Citizens ad, that there is not anything in your prefiled rebuttal testimony?
>
> A. That's correct. [T.476]

There is no evidence in the record to support the utility's position. The $422 for a newspaper advertisement should be removed from rate base.

ISSUE 12: Should adjustment be made to the utility's pro forma plant additions?

OPC: Yes, two adjustments: (1) the redundant $111,374 administration fee paid to Green Fairways should be removed; and (2) the $13,547 of costs incurred because of an unnecessary delay should be removed.

DISCUSSION:
KWRU had agreements with two different companies, Johnson Constructors and Green Fairways, to serve as contractor for the AWT conversion project. Both companies are affiliates to KWRU. In addition, a third company, Weiler Engineering, is also being paid for the responsibility of administering the contract [T. 271]. KWRU has not demonstrated the need for the excessive oversight responsibility and does not adequately document the actual services being provided by Green Fairways. As testified by Ms Dismukes:

> Like the situation with South Stock Island Project, it is not clear what services are being provided by Green Fairways, other than the submission of invoices to KWRU for payment. [T-271]

Even knowing this issue had been raised, the only rebuttal offered in defense was some broad language about the need for "a chain of supervision..." [T. 455]. This broad platitude does not address the concern that was raised. OPC's concern is that functions that are categorized as project management were performed by three separate companies, two of which are affiliate companies. Because of the nature of these relationships, the customers should have a right to expect reasonably detailed explanations of the specific functions that are being performed when the functions of two affiliates are described with the same language. KWRU should be required to explain specifically what Green Fairways added that was not already being performed by Johnson Constructors and Weiler Engineering. KWRU was given the opportunity to provide such an explanation to the Commission, but instead chose to simply state that there needs to be a chain of

supervision. Accordingly, the $111,374 of fees for Green Fairways should be removed from the rate base.

The second point on this issue is that one of the subcontractors, US Filter Davco, charged $13,547 of additional costs for change orders (e.g., $3,300/ mo. for house rental) that were caused by a delay. As explained by Ms. Dismukes:

> Upon examination of the Change Orders provided in response to Citizens' Interrogatory 56, it is evident that the change orders were due to the Utility's failure to have the permits in place to do the job as originally scheduled. The change orders reflect additional housing costs associated with the delayed project. The first request for a change order states: "We were originally suppose to start the job on 11/8/06. So we rented a house for $3,300.00 a month. The customer was red tagged and could not pour the slab until the permits were done." [T-270]

Customers should not pay for living expenses because a subcontractor was brought in too early and had to wait for the permit (particularly with 3 companies administering the contract). In addition, if as the Utility claims, it was under the impression that no permits were required [T. 424], customers should not be held responsbile for the acts or omissions of either the County or the Company. The $13,547 in change orders should be removed from rate base, along with the $111,374 in redundant management fees.

ISSUE 13: What are the used and useful percentages of the utility's wastewater treatment plant and collection and reuse systems?

OPC: The wastewater treatment plant is 72.14% used and useful, rather than the 100% that the utility is seeking. Rate base should be reduced by $1,324,595 to reflect the used and useful adjustment.

DISCUSSION:

OPC does not disagree with the application of a 100% used and useful ratio for the collection. For the wastewater treatment plant (WWTP), however, the proper used and useful ratio should be 72.14%. The Commission should calculate used and useful consistent with the provisions of Chapter 25-30.432, F.A.C. In applying that standard, the Commission should use a capacity of 0.499 MGD on an annual average basis because that is the current FDEP permitted capacity [T. 390]. The annual average test year flow is 0.288 according to the utility's Discharge Monitoring Reports. Over the last five years, customer growth has averaged approximately 10%, but Chapter 25-30.431, F.A.C., limits the calculated future growth rate to 5% per year. Accordingly, a growth factor of 25% should be applied to allow for five years of growth, resulting in an adjusted test year flow of 0.360 MGD [T. 390, 391]. The adjusted test year flow is 72.14% of the current

capacity, using consistent measures for the flow rate and using the future growth allowed by Commission rule. The Commission should adjust the WWTP by the 72.14% used and useful percentage, calculated consistent with Commission rules.

ISSUE 14: What is the appropriate test year balance of accumulated depreciation?

OPC: This is subject to the resolution of other issues. If the Commission agrees with OPC's positions, the accumulated depreciation is $2,216,294.

ISSUE 15: What are the appropriate test year balances of contributions-in-aid (CIAC) and accumulated amortization of CIAC?

OPC: This is subject to the resolution of other issues. If the Commission agrees with OPC's positions, the balance of CIAC is $4,695,791 and accumulated amortization of CIAC is $793,415.

ISSUE 16: What is the appropriate working capital allowance?

OPC: The utility's filed working capital allowance should be reduced by the $168,265 in temporary cash investments that were improperly included and by the unamortized balance of rate case expense.

ISSUE 17: What is the appropriate rate base?

OPC: This is subject to the resolution of other issues. If the Commission agrees with OPC's positions, the rate base is ($2,779,630).

DISCUSSION:

KWRU has criticized OPC's calculation of a negative rate base. Contrary to KWRU's contentions, however, it is entirely appropriate to recognize a negative rate base when the accepted adjustments lead to a negative number. In fact, the customers will be overcharged unless the negative number is used in the ratesetting process.

To illustrate the point, consider the following hypothetical that is intentionally oversimplified to focus on this specific point. Suppose:

(1) A utility owner collects $2 million from his customers to build a plant;
(2) The owner builds the plant, but it ends up costing only $1 million;
(3) The owner's total annual cost to operate every aspect of the utility is $100,000.

Now, given these "facts," suppose the owner now tells his customers that they must pay him $100,000 per year to cover his cost to operate the plant. Will the result be fair? Of course not. The very first thing the outraged customers would

say to the owner is: "You're holding one million dollars of OUR cash! Either (a) give us all of our money back right now, or (b) use a portion of OUR money each year to offset some of your operating costs until you have used up all of our money. Further, by holding our money, you are able to earn interest on our money, while we cannot. The interest you are earning on our money should also be used to offset your operating costs."

And if any one of us were placed in the position of the hypothetical customers, we would voice precisely the same position, and we would be right in that position. So now move the hypothetical into the realm of regulatory treatment. OPC's approach would say: "You have plant in service of $1 million and aggregate CIAC of $2 million, for a negative rate base of $1 million." The natural accounting and amortization effect of OPC's approach would accomplish exactly what the hypothetical customers insisted in their alternative (b) above. By recognizing a negative rate base, the excess CIAC amortization would offset operating expense, and the negative return would recognize that the owner is earning interest on someone else's money and would use that interest to offset the operating costs – exactly as alternative (b).

On the other hand, the accounting effect of KWRU's approach would say: "We agree with the owner above. We think you should totally ignore the fact that the owner spent only $1 million, while he collected $2 million from customers. We think you should pretend that the owner only collected $1 million." That is exactly what happens when you refuse to recognize that a rate base is negative.

Consider what it is that causes a negative rate base calculation to begin with. The only situation that causes a negative rate base is CIAC (that is, money collected from outside sources) that exceeds the net plant in service plus working capital. Mathematically, there is no other way. If an owner collects more from outside sources than has actually been put toward the plant needed to provide service (like the owner in the hypothetical), then the excess SHOULD be recognized in some way as an offset to the cost of operations. Otherwise customers would be charged unfairly, just as in the hypothetical.

The same should apply to KWRU. If the Commission concludes that KWRU has collected more in CIAC than it has legitimately invested in the plant necessary to provide service, then it should not pretend otherwise. The amount of net CIAC is $3,902,376. The next question is whether the utility's actual net investment exceeds the net CIAC. The only method to make that determination is to begin with the utility's claimed investment and remove those items that should not have been included. After these removals, what remains is the utility's actual valid investment. If this actual investment is below the net CIAC, it means that the utility has taken more money from outside sources that it has invested for providing service. If the collections from outside sources exceed the amount actually invested, the excess collections should be used to offset the cost of operations, just as in the hypothetical. OPC contends that after the valid adjustments are made, KWRU's rate base is negative. To artificially set a negative

rate base at zero would result in unfair rates.

ISSUE 18: **What is the appropriate return on common equity?**

OPC: OPC had not adjusted KWRU's requested ROE.

ISSUE 19: **What is the appropriate weighted average cost of capital including the proper components, amounts, and cost rates associated with the capital structure?**

OPC: OPC is not recommending specific adjustments to the costs or ratios in the capital structure. The amount of each component will depend on the aggregate outcome of all decisions involving rate base.

ISSUE 20: **Should any adjustment be made to test year revenues?**

OPC: Yes. Test year revenues should be adjusted: (1) to avoid a mismatch, revenues should incorporate the same FKAA billing data that KWRU is using in its proposed rate design; (2) to reflect the historical level of rental income; and (3) to reflect revenue collected from Monroe County.

DISCUSSION:
KWRU historically billed on a flat rate because it did not have individual water usage information. KWRU now has access to Florida Keys Aqueduct Authority (FKAA) information and is proposing to use the information to change its billing structure. The FKAA information, however, shows a greater number of separate residential customers than KWRU had been using. To assure consistency between test year revenue and the proposed rate design, test year revenues should be increased by $158,151 to reflect the actual billing data that KWRU will use in setting the rates that will be charged to customers [T. 273]. By its own admission, the utility chose not to file testimony on this issue [T. 477], so the only testimony in the record on this issue is that provided by Ms. Dismukes. In the Prehearing Order, KWRU berates OPC's position as nonsensical, but by failing to bring forward any testimony on the issue, KWRU has failed to carry its burden of proof. In addition, although the Utility suggests that the data utilized by Ms. Dismukes is for the year ending 2007 --- as Ms. Dismukes testified there is no way the billing determinate data can be for the year-ending 2007, as KWRU filed its rate case on August 3, 2007 --- five months prior to the end of 2007. Moreover, as Ms. Dismukes explained, she utilitzed the data presented on Schedule E—2(a), which clearly indicates that it is for the year-ending December 31, 2006 [T. 349, 350 , Exhibit 3, p. 70].

A trailer owned by KWRU is occupied by KEI and by Weiler Engineering. During the test year, Weiler's monthly rental fee went from $1,750 down to $800,

without any explanation. To reflect the historic rate, revenue should be increased by $14,600 [T. 274]. Here again, the utility chose not to file testimony on this issue [T. 477, 478], so again notwithstanding its contrary position in the Prehearing Order, the utility concedes the issue by not attempting to carry its burden of proof.

During the test year, KWRU charged Monroe County $19,575 for maintenance of some of the county's lift stations and wastewater system. KWRU recorded this income below the line. KEI performed this service with the personnel that KWRU is paying a monthly fee for. Without documentation that the KWRU costs of performing this service has been removed from test year expenses, the income should be recorded above the line for ratemaking purposes [T. 275]. This recommendation was made by Ms. Dismukes as well as the Staff Auditors [Exhibit 23, p. 27].

ISSUE 21: Should any adjustments be made to sludge removal expenses?

OPC: Yes. KWRU's test year sludge hauling expenses were abnormally high. The expense should be reduced by $7,819 to reflect a normalized level [T. 281].

DISCUSSION:
OPC's witness Dismukes recommended that the Commission reduce test year expenses for abnormally high sludge hauling expenses by $7,819 [T. 282]. Although the Company would not agree with OPC's recommendation, in Stipulation Number 5, the Company agreed that sludge hauling expenses were excessive. In fact, the Utility agreed to reduce test year expenses $9,129 to reflect the amortization of non-recurring amounts incurred during the test year. Therefore, this issue is moot as it has been stipulated to by the Company.

ISSUE 22: Should any adjustments be made to chemicals expense?

OPC: Yes. Chemical expenses were abnormally high during the test year and should be reduced by $16,480 [T. 285].

DISCUSSION:
Test year chemical expenses should be reduced by $16,480 to recognize that expenses were abnormally high during the test year. According to witness Dismukes, since 2003, chemical expenses have increased by 145%: 64% in 2004, 124% in 2005 and 85% in 2006 [T. 283]. In response to OPC's Interrogatory 49, the Company was unable to adequately explain the cause of several large increases in chemical expenses in 2006. In addition, even when the growth in customers and flow is taken into consideration, chemical expenses increased dramatically—from $7 per ERC in 2002 to $36 per ERC in 2007—an increase of over 400% [T. 284].

In rebuttal testimony, the Company took issue with Ms. Dismukes cost per ERC

analysis, claiming that the ERCs used by Ms. Dismukes were not ERCs, but were meter equivalents [T. 449]. However, the ERC information utilized by Ms. Dismukes came from the Company's MFRs, Schedule F10, which states that the unit of measure is ERCs, not meter equivalents as claimed by Mr. DeChario [Exhibit 15, p. 4 and Exhibit 3, Schedule F-10]. Consequently, the conclusions drawn by Ms. Dismukes were valid and took into consideration increases in customers and flow.

The Utility also attempted to show that the increase in chemical expenses was normal because another utility, Key Haven Utility, also experienced a similar increase in expenses [T. 450]. However, this comparison cannot be used to justify the expenses incurred by KWRU for many reasons. First, to the extent that an abnormal occurrence, i.e. hurricane Wilma, contribute to the increase and abnormal level of expenses, the comparison to Key Haven merely shows that the same abnormal event impacted Key Haven and should not be charged to ratepayers on a recurring basis. Second, the cost of chemicals to Key Haven relative to KWRU should be different. On a per unit basis, the cost should be substantially less for KWRU because it is 3.8 times larger and therefore has substantially greater purchasing power than Key Haven [Exhibit 28 – KWRU has 1,708 ERCs whereas Key Haven has 444]. Third, to assess the reasonableness of KWRU's expenses based upon the expenses of just one of utility is questionable at best, especially in light of the fact that any abnormal event affecting KWRU could have easily affected Key Haven.

For these reasons the Citizens' recommend that the Commission adopt the recommendations and analysis of Mr. Dismukes and reduce test year expenses by $16,480 because they were abnormal and nonrecurring [Tr. 283-85].

ISSUE 23: Should KWRU's test year expenses be adjusted for the reduction of infiltration and inflow related to the re-sleeving of its lines?

OPC: Yes. Test year expenses should be reduced for the reduction in flow associated with re-sleeving the collection systems.

DISCUSSION

Beyond debate, the re-sleeving, of itself, will result in a decrease in electrical and chemical expenses, and the move to AWT, of itself, will increase those same expenses. Unfortunately, KWRU did not make a separate adjustment for re-sleeving, but rather estimated expectations for the two considerations combined, and claims a net increase of $177,583.

In making its estimate of the increased costs associated with AWT, KWRU assumed a flow rate of 400,000 GPD. Three adjustments are needed to correct the errors in the analysis performed by KWRU. First, a reduction in chemicals and purchased power expenses should be made to recognize the reduced effluent that will be treated. The Company, however, failed to provide any documentation

supporting the cost savings associated with the reduced flow and therefore, no adjustment has been quantified [Tr. 301-303]. Second, test year revenues are based on a flow rate of 287,000 GPD, which is significantly less than the assumption made by the Company in the development of the increased costs associated with AWT. To correct for this mismatch, the Company's proforma expense adjustment for AWT needs to be reduced by $109,704. Third, the Company's projected expenses contemplate purchasing the chemicals from KEI, an affiliate. KEI charges KWRU a markup of 30% over cost. There is nothing that prevents KWRU from purchasing supplies directly from KEI's source, other than the business arrangement chosen by KWRU's owner. Customers should not pay 30% above cost just to enrich KWRU's affiliate, and these expenses should be reduced by another $33,344 [T. 302 – 307]. Therefore, the Company's AWT proforma adjustment should be reduced by a total of $143,048.

ISSUE 24: Should KWRU's test year expenses be adjusted to remove any markup in pro forma expenses?

OPC: Yes. KWRU pays KEI to perform all of its routine utility functions. KEI, an affiliate, charges KWRU a 30% markup on the actual costs of chemicals and sludge hauling services. It is unconscionable to force KWRU's customers to pay 30% more for an integral part of the service merely to enrich an affiliate company.

DISCUSSION:

KEI, the affiliated company that operates and maintains the Utility, charges a 30% mark-up over costs for materials and supplies purchased on behalf of KWRU. In a typical arrangement, KWRU would hire its own employees to run the operations and purchase the chemicals and other supplies itself (at no markup) from the same source that KEI is using. Ms. Dismukes testified that this matter was discussed in the confidential portion of Mr. Johnson's deposition and in response to the Citizens' POD 28 the Company provided an invoice from KEI with a notation suggesting that certain charges are marked up over cost. Specifically, the invoice stated: "Pass Thru to KWRU No Mark-up Auto Accessory. KEI has 0 tangible property." This invoice is contained in Exhibit 9. Such a practice is entirely inappropriate and unjustified. For all intents and purposes, KEI is the Utility and performs only minor services for other entities. In addition, these services are a function of the services it provides to the Utility. If KWRU purchased the chemicals and moved the sludge, the Commission would not permit it to mark-up its expenses by more than the actual costs [T. 236-237].

The Company attempted to justify this inappropriate markup by claiming that in arms-length transactions, companies often charge a mark-up over cost [T. 445]. Specifically, Mr. DeChario suggested that because a US Water bid stated that chemicals and residuals management would be billed to KWRU on per occurrence basis with an appropriate allowance for overhead and margin, that this

DISCUSSION:
In response to the Citizens' Interrogatory 20, the Company explained that the costs charged to its advertising account were principally "for the work of William Barry and are related to public relations rather than advertising. Certain public relations activities, including door hanging, letters to the editor, etc. were published, but there was no "advertising"." [T. 294]. Exhibits 17 and 18 contain the types of public relations activities and work product prepared by Mr. Barry on behalf of the Utility. These exhibits show that the costs incurred by the Company for the services of Mr. Barry are designed to enhance the public opinion of the Company [T. 295].

The Commission has historically and consistently disallowed costs which are designed to enhance the utility's image, finding that such costs benefit stockholders, not ratepayers.

> We acknowledge that some benefits may be accrued as a result of these expenses. However, we agree with OPC that costs related to contributions and membership dues, which are public relations oriented, should be disallowed. These costs serve to improve the image of the company, resulting in a direct benefit to the utility's shareholders, not to the customers. This treatment has been consistently applied by the Commission, as evidenced by Orders Nos. PSC-93-0301-FOF-WS at 19-20 and PSC 96-1320-FOF-WS at 151-153, which Orders were officially recognized in this proceeding.[4]

In a large water and wastewater case involving Southern States Utilities, Inc., the Commission made several findings on what was appropriate to charge customers as it related to public relations-related expenses.

> Mr. Ludsen disagreed with OPC that a public relations retainer is generally not a proper charge for rate case expense. Although he did not know specifics about the charge, Mr. Ludsen stated that the uniform rate investigation benefitted this case because of broader customer input. Mr. Ludsen did not think that SSU was trying to enhance its image, but instead trying to inform customers through brochures about the issues in the case.
>
> ...
>
> Mr. Ludsen's response to why open houses with customers, in addition to the Commission hearings, should be charged to customers was that it was a benefit to the case. If it benefitted the case, then it benefitted the customers. He did admit that those open houses were not required by the Commission.
>
> ...

[4] Florida Public Service Commission, United Water Florida Inc., Docket No. 960451-WS PSC-97-0618-FOF-WS, May 30, 1997.

...

We believe that if SSU sees a need to inform its customers or the press about the issues in the case beyond what our rules require, then those expenditures must be borne by SSU, not the customers. Accordingly, all charges related to telemarketing, public relations, uniform rate bill inserts, mailings and door hangers, cellular telephone bills and bus transportation shall be removed. Mr. Ludsen was unable to justify why a banquet or lunch was necessary and reasonable; accordingly, this amount shall be removed. As agreed to by Mr. Ludsen, any legislative or lobbying charges shall also be removed.[5]

As the Commission has found in the past, the costs associated with the public relations efforts should be disallowed and not recovered from ratepayers. Therefore, test year expenses should be reduced by $26,653 [T. 299].

ISSUE 27: Should KWRU's test year expenses be adjusted for Mr. Smith's Management Fees Charged by Green Fairways?

OPC: Mr. Smith's salary should be reduced by $30,000.

DISCUSSION:

KWRU pays Green Fairways, an affiliate, a management fee of $60,000 for the services of its owner, Mr. Smith. The Company provided no documentation supporting the reasonableness of this charge. Mr. Smith did not produce any timesheets in support of the time he allegedly spends managing the Utility versus the numerous other companies that he owns or operates. Assuming that Mr. Smith spends between 25% and 50% of his time managing the Utility, his salary equates to an annualized salary of between $120,000 and $240,000—a large salary for a small Class A wastewater company. Even assuming that Mr. Smith spends 25% of his time in Key West (approximately one week a month), it must be remembered that even while in Key West, Mr. Smith spends time managing the Key West Golf Course as well.

Ms. Dismukes testified that she found it difficult that believe that Mr. Smith spends 50% of his time managing the Utility when he owns numerous other businesses. If Mr. Smith maintained time records it would be easier to determine how much time he typically spends on utility business. There is no excuse for Mr. Smith's failure to keep time records. As a lawyer, he should be used to maintaining time records [T. 244-45].

Interestingly, Mr. Smith provided no rebuttal testimony to that of Ms. Dismukes

[5] Florida Public Service Commission, Southern States Utilities, Inc. Docket No. 950495-WS; Order No. PSC-96-1320-FOF-WS, October 30, 1996

concerning the reasonableness (or lack thereof) of Mr. Smith's requested salary. Instead, Mr. DeChario, a consultant, provided a flawed "comparative analysis" of the supposed salary of Mr. Smith to other wastewater companies [T. 454 and Ex 29]. Mr. DeChario's Exhibit 29 purports to show that Mr. Smith's salary is less than 1/3rd the average of other wastewater companies. However, under cross-examination, Mr. DeChario admitted that his analysis compared the salaries and wages all officers in NARUC Account 703 to just the salary (management fee) paid to Mr. Smith as President of the Utility.

There are several flaws in this analysis. Account 703 contains the salaries and wages of all officers, not just the President of the comparison utilities. Therefore, the analysis Mr. DeChario performed compares apples to oranges. In discussing his comparison,

Q And if you fall into the area where it calls for examination of the source documents, then, then we'll, we'll end it before we try to get too far. In the, in the salaries that you have incorporated for, for the comparisons -

A Yes, sir.

Q -- now is that not, was that not drawn from the annual report's officers' salaries so that in some cases there was more than one?

A Yes.

Q And in the case of K W Resort what you've got is Mr. Smith's salary.

A Yes.

Q Now is there not a CFO for the golf course that also serves as CFO for K W Resort?

A I'm sorry. Say that again.

Q Is there not a Chief Financial Officer for the golf course which also, who also serves as Chief Financial Officer for and is designated as Chief Financial Officer for K W Resort?

A I don't recall that off the top of my head.

Q Okay.

A If you could throw me a name, I could probably verify it.

Q. Well, that would show up in the MFRs. I mean, I'm not looking to go back to that. But we'd find that in the MFRs if it were so, the officers of the company.

A I -- yes.

Q Okay. And if that is so, that needs to be added into to make an apples to apples comparison if the rest of these are, in fact, multiple officers.

A. You mean as far as these other utilities go?

Q Yes.

A I'm not quite sure I understand where you're going, what you're trying to find out, what you're asking me.

Q You -- did you not agree that the salary that you have listed that you drew from the annual report in some cases, in a number of cases includes more than one officer, more than just the president's salary?

A Yes. These, I would imagine, without going and looking at corporate, the state corporate records, that, you know, if they're -- I would imagine they are all listed as officers of the corporation on those documents. That's why they would become, be listed as officers in the annual report.

Q Yes. And if, in fact, these numbers that you have under salary are aggregates of more than one person, then in order to bring this column into where it's reasonably comparable to what you used for K W Resort, you need to subtract out just, and come up with just the president's salary; isn't that right?

A I don't know if that would be wholly correct since we

Q Well, then wouldn't you need to look at K W Resort's officer salaries as a whole and include the Chief Financial Officer?

A I suppose I could go either way.

Q Thank you.

COMMISSIONER ARGENZIANO: Can I ask a question?

CHAIRMAN CARTER: Would you yield, Mr. Burgess?

MR. BURGESS: Oh, absolutely.

CHAIRMAN CARTER: Commissioner Argenziano, you're recognized, Commissioner.

COMMISSIONER ARGENZIANO: Actually, Mr. Burgess, if I, are you, are you indicating that the comparison before us is including the aggregate salaries of all the officers and not just one?

BURGESS: Yes, ma'am.

THE WITNESS: Not in every case. I'm sorry.

COMMISSIONER ARGENZIANO: So then it's not a comparison of one salary.

MR. BURGESS: Not in every case.

COMMISSIONER ARGENZIANO: But it could be in some.

MR. BURGESS: In a number of cases.

COMMISSIONER ARGENZIANO: That would be nice to know.

MR. BURGESS: But, yes, this is something that, you know, I, I suppose that we have on record the, the annual reports of these. So we'll deal with that.

COMMISSIONER ARGENZIANO: Thank you. [Tr. 496 - 499]

There are numerous problems with the comparative analysis performed by Mr. DeChario. First, his analysis compares apples to oranges as discussed above. Second, and related, the salary of the Chief Financial Officer of KWRU is excluded from the KWRU salaries and wages, but included in the comparative companies where applicable. [Ex. 3, Volume IV; T. 496-499]. Third, there is no way to determine if the hours devoted by the officers of the comparative companies is representative of the hours Mr. Smith spends on utility matters. Clearly, it would be inappropriate to compare Mr. Smith's salary, who works only part-time for KWRU to a like president that works full-time in that capacity. Fourth, the $60,000 paid to Mr. Smith through Green Fairways is only part of the compensation Mr. Smith receives for the services he provides to the Utility. During the test year, Mr. Smith was actually paid $ 185,000.

Simply put, the flaws in Exhibit 29 render it unusable to establish a reasonable salary for Mr. Smith. The Commission should reject this analysis, and adopt the recommendation of Ms. Dismukes that Mr. Smith's salary should be reduced. Ms. Welch also testified that based upon her experience the salary of Mr. Smith was a little on the high side [T. 49].

It is the Company's burden to demonstrate the reasonableness of the salary of its President. It has failed to meet it burden under a variety of standards. The

Commission should establish a salary of $30,000, which equates to an annual salary of $120,000 assuming Mr. Smith devotes 25% of his time to the Utility's business.

ISSUE 28: **Should test year expenses be adjusted for certain transactions between Keys Environmental and KWRU?**

OPC: Yes. Expenses should be reduced by: (1) $1,313 for lab expenses; (2) $15,000 in hookup fees that should have been capitalized; (3) $51,663 of misclassified expenditures identified by Staff audit; and (4) $3,077 that should be recovered from third parties.

DISCUSSION:
OPC is confused by the position that the utility has taken in the Prehearing Order on this issue. This issue consists of four adjustments, all of which were identified and recommended by the Staff auditors [Exhibit 23; p. 13, 14]. In its response to the Staff Audit, the utility did not take issue with any of these findings [T. 481]. Further, the utility agreed that it had stipulated to one of these four adjustments, and that it did not file testimony on any of the remaining adjustments [T. 480, 481]. Since the utility did not object to the Audit Finding and did not file rebuttal testimony, OPC cannot find anything upon which KWRU can base its contention. The utility has failed to carry its burden. All four adjustments should be made.

ISSUE 29: **Should any other adjustments be made to contractual services – other expenses?**

OPC: Yes. Test year expenses should be reduced by $12,038 for bonuses paid to Key West Golf Course employees.

DISCUSSION:
During the test year KWGC paid bonuses to its employees in the amount of $12,038. Part of the bonuses were for year-end bonuses and the remainder were characterized as EDU bonuses and are paid for each new customer connected to the system.

The Company pays KWGC a management fee of $8,000 a month. Any bonuses paid to employees of the golf course should be covered in this fee. The management fee pays for the services provided by the employees that received the bonuses and therefore should be part of the management fee paid the golf course [T. 232 and 341].

Moreover, under a properly run utility, arrangements between a nonregulated affiliate and a regulated utility should be reduced to writing. However, in the instant case, there is no agreement between KWRU and KWGC that might have shed some light on the financial arrangement between the Utility and the

employees of KWGC which were paid the bonuses [T. 341]. Again, it is the Utility's burden to demonstrate that the charges from its affiliates are reasonable and fair. The Company failed to meet this burden. In the absence of documentation or a contract supporting the reasonableness of these charges, they should be rejected, as the Commission has done in other proceedings for a utility's failure to demonstrate the reasonableness of affiliate charges. In Order No. 96-1338, the Commission stated:

> It is the utility's burden to prove that its costs are reasonable. *Florida Power Corp. v. Cresse, 413 So.2d 1187, 1191 (1982).* This burden is even greater when the purchase is between related parties. In *GTE Florida Inc. v. Deason, 642 So.2d 545 (Fla. 1994),* the Court established that when affiliate transactions occur, that does not mean that "unfair or excessive profits are being generated, without more." The standard established to evaluate affiliate transactions is whether those transactions exceed the going market rate or are otherwise inherently unfair. The evidence in the GTE Florida case indicated that its related party costs were no greater than they would have been had services and supplies been purchased elsewhere.
>
> The facts in this case differ from those established in the GTE Florida case. The distinction is that in the GTE Florida case, there was evidence in the record that showed that the utility's cost was equal to or less than what an arms-length transaction would have been. Other than the testimony provided by Mr. Seidman that either of the above charges are reasonable, PCUC did not provide any documentation to support these costs. As such, we find that the utility has essentially failed to prove the prudence of these charges.
>
> We find that the utility failed to meet its burden to justify its costs. Accordingly, we have reduced affiliate charges by $ 25,412 ($31,765 less 20% non-used and useful) and then allocated 59.63% to water and 40.37% to wastewater.[6]

ISSUE 30: **Should any adjustments be made to miscellaneous expenses?**

OPC: Yes. Three adjustments: (1) $19,106 in travel and local lodging for Mr. Smith; (2) $2,525 in expenses to transport a car purchased in Illinois and to pay a Key West hotel bill for Mr. Johnson; (3) $420 in fees paid to Monroe County Sheriff's Office; (4) $161 paid to Rotary Club and Blossoms Flowers.

[6] Florida Public Service Commission, Order PSC-96-1338-FOF-WS, November 7, 1996

DISCUSSION:

(1) Mr. Smith is a partner in multiple business ventures in Illinois, San Francisco and Key West. Mr. Smith's wife owns a house in Key West. KWRU has included $13,106 for Mr. Smith's travel expenses from Illinois and $6,000 for lodging in Key West for Mr. Smith. This travel expense is over and above the $185,000 compensation that Mr. Smith charged KWRU during the test year. Typically, there is no need for such travel because a utility's highest ranking and highest paid officer is expected to work full-time for the utility, and therefore lives in proximity to the utility. Suppose a Chicago businessperson were appointed to be a Florida Public Service Commissioner. Suppose that appointee said: "I plan to stay in Chicago, and I expect Florida taxpayers to pay all my travel expenses, including lodging for a house it Tallahassee that I already own." Might there be a public outcry? Just like all Florida taxpayers, KWRU ratepayers should not be improperly charged for expenses that arise only because of the personal and business choices of Mr. Smith.

If Mr. Smith chooses to continue his business activities in Illinois, then utility customers should not pay for Mr. Smith's travel costs or his cost to stay in Key West. As Mr. Smith stated, however, the Illinois business does not bear any of the cost at all [T. 162]. He charges all of it to the Florida businesses. Most egregious of all is the $1,000/month that is charged to KWRU customers for Mr. Smith to stay at his wife's house in Key West. This is not a type of cost that should be allowed, and to add insult to injury, the cost itself is a fiction. Mr. Smith stays at his wife's house and pays nothing. Customers should not be forced to pay these non-existent costs.

(2) Charges totaling $2,525 were incurred for (i) moving expenses to drive a car that was purchased in Illinois and driven to Key West, and (ii) hotel charges in Key West for Chris Johnson. There is no reason for customers to bear the cost to transport a car. There are automobile dealerships in the Keys and Miami. Ms. Dismukes testified about the impropriety of these costs [T. 291]. By its own admission, the utility did not provide any defense on this issue [T. 481]. By not carrying its burden of proof, KWRU has conceded the issue.

(3) KWRU spent $420 in fees to the Monroe County Sheriff's Office to deliver hook-up notices to customers. The reason this is improper goes back to the issue of customer service. A competitive enterprise would never use such tactics of intimidation if it wanted to keep its customers. There was a great deal of testimony about the intimidating effect of this tactic [e.g., T. 50, 51]. KWRU represented that it used this only as a last resort, but actual documented evidence showed that the utility's claim was not true [T 57].

(4) KWRU made a $100 donation to the Rotary Club and $61 to Blossoms Flowers. As testified by Ms. Dismukes, both of these are non utility related and should be removed [T. 300]. As the utility admitted, it did not present any testimony on this adjustment [T. 482] and has thereby conceded the issue.

ISSUE 31: **What is the appropriate amount of rate case expense?**

OPC: No rate case expense should be allowed because the rate case was not warranted. Even if some rate case expense is allowed it should be adjusted to remove the excess costs that were incurred to uncover and correct all of the errors in the initial submission.

DISCUSSION:
KWRU is asking that a total of $609,778 be paid by customers to put on this case. After all proper adjustments are made to correct the many errors in the filing, the revenue requirement shows that rates were adequate – even excessive – before the rate case was filed. The fact is, then, that this case never should have been filed in the first place. Customers should never be forced to pay for a utility's imprudent decision to file for a rate increase when none is warranted [T. 313, 314].

Even if the Commission determines that some increase is proper, however, it should reduce the rate case expense to remove all of the unnecessary cost that was incurred solely and directly because of the utility's own actions. KWRU has been liberal in putting blame on OPC for causing unnecessary rate case expense [T. 459 – 462]. This testimony totally ignores that the number and the magnitude of the utility's own errors and dealings have justified OPC's challenge of the rate filing. By conceding thirty-one separate errors, KWRU has effectively demonstrated the justification for OPC's involvement. Rather than blame OPC, the utility should acknowledge its own actions that were responsible for additional expense.

There are three fundamental areas where the utility's own choices were the singular cause of unnecessary and excessive expense: (1) the utility's choice of operations, with total reliance on interdependent affiliate companies to provide the service; (2) the utility's error laden filing which caused a great deal of time and attention to correct; and (3) the utility's untimely and unresponsive answers to OPC's interrogatories and requests for production of documents.

Under normal circumstances, a utility hires employees who perform substantially all of the ongoing, routine utility functions, and the utility pays market-based salaries which the Commission can examine for reasonableness. In this case, however, KWRU has no employees of its own. Instead, KWRU has various affiliates (e.g., golf course, management firm, law firm, service company) whose employees perform all utility functions. Accordingly, KWRU relies on related party transactions for even the most mundane utility functions. This business structure that was chosen by Mr. Smith, the owner of KWRU, requires a heightened scrutiny of all transactions for reasonableness, and has given rise to many areas wherein KWRU's customers are paying excessive amounts and duplicate charges for certain services [T. 222 -228]. In the instant proceeding, the Company never mentioned or discussed the numerous affiliate relationships that existed between Mr. Smith, KWRU, and Mr. Smith's family members. This information had to be extracted with great effort through the discovery process.

Moreover, because of these affiliate relationships, OPC had to examine more than one set of books and ask for the financial informaiton concerning each of the affiliates that provides services to the Utility. Customers should not be held accountable for the rate case expense that was directly caused by Mr. Smith's decision to have the Utility operated 100% by affiliates.

Subsequent to its initial filing, KWRU has stipulated to eleven separate adjustments – some quite substantial – to correct errors and misclassifications that Staff auditors found in the initial filing. Further, at the hearing KWRU agreed that based on the Staff audit, five additional adjustments should be made beyond those that were included in the stipulations [T.476 – 481]. Finally, in addition to the Staff audit adjustments, KWRU chose not to put any evidence into the record to oppose sixteen additional adjustments on which OPC presented testimony [T. 476 -486]. By not even attempting to carry its burden of proof on those issues, KWRU effectively conceded them. In aggregate, then, KWRU has now conceded thirty-two separate errors that needed to be corrected in its initial filing. The effort to track down and identify all of these errors – particularly in light of the multiple related parties who form the operations – is one that required a great deal of time and resource on the part of the PSC Staff, the OPC, and the utility itself. Nevertheless, this expensive undertaking proved to be necessary, in light of all the errors that even the utility now concedes were embedded in its initial filing.

The Company's failure to provide adqueate and timely responses to OPC's discovery necessitated that OPC file three motions to compel. These motions to compel resulted in an additional three procedural schedules in this proceeding, either requiring the Company for the most part to properly respond to OPC's discovery, or to modify the procedural schedule to give OPC additional time to file testimony due to KWRU's failure to provide timely and responsive answers. In addition, because of KWRU's failure to provide adequate responses, OPC was forced to ask follow-up discovery questions to try and obtain the information originally requested. Any suggestion that OPC caused the excessive rate case expense in this proceeding should be rejected by the Commission.

OPC recommends that the Commission disallow all rate case expense as a rate decrease should be authorized by the Commission, not an increase.

ISSUE 32: Should any adjustment be made to test year depreciation expense?

OPC: Yes. Depreciation expense should be adjusted to reflect changes in plant in service.

ISSUE 33: What is the test year wastewater operating income or loss before any revenue increase?

OPC: The appropriate net operating income before any decrease or increase is subject to

the resolution of other issues.

ISSUE 34: **What is the appropriate revenue requirement?**

OPC: The appropriate revenue requirement is ($415,540).

ISSUE 35: **What is the appropriate rate structure for this Utility?**

OPC: No Position.

ISSUE 36: **What are the appropriate monthly residential and general service rates?**

OPC: No Position.

ISSUE 37: **What are the appropriate monthly bulk and reuse service rates?**

OPC: No Position.

ISSUE 38: **In determining whether a 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?**

OPC: The entire amount of the interim should be refunded, along with the appropriate interest.

ISSUE 39: **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, Florida Statutes?**

OPC: No rate case should be granted, so no subsequent decrease is necessary.

ISSUE 40: **Should the utility be required to provide proof, within 90 days of an effective order finalizing this docket, that it has adjusted its books for all the applicable NARUC USOA primary accounts associated with the Commission adjustments?**

OPC: Yes.

ISSUE 41: **Should this docket be closed?**

OPC: Yes, after the permanent rates are set and the interim rates have been refunded.

Dated this 27th day of October, 2008.

Respectfully submitted,

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In Re: Application for increase in)
Wastewater rates in Monroe County)
By KW Resort Utilities, Corp.)
_____)

Docket No. 070293-SU

FILED: October 27, 2008

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of The Office of Public Counsel's Post Hearing Statement was furnished to the following, by electronic and U.S. Mail, on this 27th day of October, 2008.

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