State of Florida

Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

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

DATE: June 1, 2009

TO: Ann Cole, Commission Clerk - PSC, Office of Commission Clerk

FROM: Richard P. Redemann, Professional Engineer III, Division of Economic Regulation

RE: Docket No. 080597-WS – Application for general rate increase in water and wastewater systems in Lake County by Southlake Utilities, Inc.

The attached emails from the utility and staff should be placed in the above docket file. They include Interrogatory No. 8 and the Utility's Outline for a Conference Call. The discussion involves the Wastewater Treatment Plant Used and Useful.

1. Email from John Guastella dated May 21, 2009 – Sam's email

2. Email from John Guastella dated May 22, 2009

3. Email from John Guastella dated May 22, 2009 – Outline of 3/4/09 Conference Call.

4. Email from John Guastella dated May 22, 2009 – Interrogatory 8, FDEP's 3/5/04 letter, page 2, paragraph 8.

5. Email from John Guastella dated May 29, 2009, Email from Richard Redemann dated May 21, 2009, and email dated May 21, 2009 from John Guastella.

cc: Division of Economic Regulation (Daniel, Rieger)
Division of Regulatory Compliance (Casey, Mann, Beard)
Office of the General Counsel (Brown)

C:/msword/080597 emails.doc

Attachment 1

Richard Redemann

From: jfg [jfg@guastella.com]
Sent: Thursday, May 21, 2009 4:06 PM
To: Richard Redemann
Cc: msmurthi@comcast.net; JAde@jaxbusinesslaw.com
Attachments: SLU WWTF UsedUseful05212009.doc

Hi Richard,

As I stated in my voice mail message to you, I am attaching a write up taken from Sam's recent email to me that further addresses the WWTP used & useful issue. If you are still not satisfied that the WWTP is 100% used & useful or have any questions about this and the previous discussions and data sent to you, please call me to discuss your concerns. I would also certainly call Patty if she has similar or other concerns. All of the Company representatives and I are of the opinion that there are three or four reasons why the WWTP should be considered 100% U&U whether considered together or even independently. So, we would like to follow up on anything specific in those reasons that may still be of some concern.

Please call me at (561) 747-9867 at your convenience.

Thanks,
John

Southlake WWTF U/U (From Sam)

In order to provide a better feel for the nature of the problems and site limitations confronted at Southlake WWTF, I am providing my understanding of the chronological summary of construction activity prior to my involvement at Southlake WWTF and my thoughts on why the plant should be considered 100% U/U.

The Southlake WWTF design and construction began in March 1993, by Allens Environmental Equipment, Inc., by relocating a dismantled 500,000-gpd capacity steel plant on Southlake WWTF site. The site set aside for wastewater treatment purposes was 10 acres. In addition to constructing the 0.5 mgd plant, they also constructed an additional steel clarifier (again a dismantled plant from elsewhere) to the west of the 0.5 mgd plant to provide for 50% redundancy as required by FDEP regulations to deal with emergencies. Later, they added an outer ring of steel on extended concrete pad for aeration basin. This west plant had no functioning aeration system and sludge digestion capabilities. The plant as constructed could not be put to any process use. It was nothing more than a huge holding tank. Flow could not be diverted easily between the two plants. Construction proceeded on available funds basis. It was essentially a stop and go situation. By the time construction was completed and the accounts were settled, it was end of 1997. This plant was rerated by FDEP at 600,000-gpd capacity in 2002 at my request. Chlorination was the limiting factor. This plant was rerated by FDEP at 600,000-gpd capacity in 2002 at Southlake's request.

Between the two plants the total treatment capability was 1.5 mgd when properly equipped. It is the combination of these two (east and west) plants that provided the flexibility in design, which was taken advantage of in the most recent improvements, completed in year 2006. The west aeration basin was partitioned to provide for aerobic digestion and other treatment process requirements. Flow transfer capabilities between the two plants were added. The new treatment capacity is rated at 1.15 mgd being limited by the available RIB capacity at the plant site. If additional RIB capacity is acquired by acquiring additional land west to the existing plant site, the plant capacity can be rerated at 1.5 mgd.

As best as we could determine, the cost of construction of the initial plants both east and west was $766,095. Based on 0.6 mgd capacity, the per-gallon average cost works out to $1.28. This does not include land cost. Similarly, the 2006 improvements cost 2,088,274 for an additional capacity of 515, 000 gpd. This incremental capacity works out to $4.05 per gallon excluding land cost. The land cost based on $300,000 for the 10-acre WWTF site is $0.26 per gallon. The total average cost including land costs works to $2.47 per gallon presently. As I explained to Mr. Redemann, his comparison of average unit costs of plants that were built in discrete steps over a long period with separation time between units to those built consecutively with short construction separation time is misleading and does not contribute to proper understanding of unit costs. Indeed, a good reason to consider Southlake WWTF 100% used and useful is that future unit costs would be much higher than present unit costs, and average per gallon costs will gradually creep up to the detriment of the customer.

Supposing, for arguments sake, that the west plant did not exist and Southlake were to construct a new 300,000-gpd plant to provide for today's total capacity requirement of 0.9 mgd, the construction cost of the new plant would be two million dollars. If another 0.3 mgd tank were to be built later to provide for the then determined additional needs (total 1.2 mgd), the cost of construction for this future 0.3 mgd plant would be far in excess of two million dollars to provide for inflation in the intervening period. Besides, we would have significantly reduced the land available for RIBs at the present site and would have had to acquire additional land west of the present plant site for effluent disposal.

If we were to partition the west tank to provide just the marginal requirement of 0.3 mgd (bringing the total capacity 0.9 mgd) extensive partitioning of the plant would have to be done. Moreover,

some portions of the tank would remain unused. The cost of such construction would be just the same as extensive retrofitting would have to be done. Under this scenario, we would have had a hodgepodge of structures and nightmarish operational problems.

Sound engineering transcends regulatory used & useful constraints. By utilizing what was already there, Southlake was able to provide an additional 0.25 mgd capacity (over the 0.9 mgd immediate capacity providing a total capacity of 1.15 mgd) for the same cost without compromising RIB capacity requirement. Significant economies of scale were achieved by overall considerations in the design and construction of facilities for processes such as chlorination, head works, and reuse treatment and pumping facilities etc as compared with the incremental approach. It did not make sense to consider abandoning what was there and construct incremental plants merely for the purpose of satisfying theoretical ratemaking used & useful issues.

The argument of availability of plenty of vacant land west of WWTF is also not very sound because if the land is acquired before its need could be established and put to use, it would once again raise the U/U consideration. In addition, there are technical reasons for not acquiring additional land for RIBs now.

The required total wastewater treatment capacity for Southlake service area when fully developed is estimated to be 2.2 mgd. The total RIB capacity that can be provided at Southlake WWTF is around 1.75 mgd regardless of land availability because of the FDOT pond influence. The maximum quantity of effluent that can be reused considering the potential customers is less than 1 mgd. Therefore, taking into consideration the requirement of reclaimed water reuse, the RIB capacity required is around 1.15 mgd, which matches the available RIB capacity at the present site. If additional land were to be acquired today to provide for full treatment capacity, the additional land would be non-used and useful. Besides the owner of the land may not want to sell otherwise higher use developable land for lesser use effluent disposal as it would not be in his best economic interest. The need for additional land for future RIBs cannot be established until the reuse issue is settled. Thus, the improvements done at Southlake WWTF utilizing existing structures provided the most cost effective and optimal solution to capacity requirements, and the best value to the customer.

In addition as I stated in earlier discussions, the following reasons should also be considered in determining whether Southlake's WWTF is 100% used and useful.

Based on the information available in 2002 and 2003 on developer activity in the service area, the projected flow for 2008 was 0.93 MGD (AADF) and 1.21 MGD (MMADF). The three-month ADF was 1.12 MGD. The facility had a functioning unit rated at 0.75 MGD and an empty shell of a plant sitting on concrete pad without operating equipment. The functioning unit was struggling to comply with effluent quality requirements at all times. The flows at the plant exceeded at times the capacity of the plant. The Max Day flows (some times reaching 1.4 MGD) were far in excess of the capacity of the plant. There was no redundancy at the plant contrary to FDEP rules. We were sitting on potential violations and enforcement action by FDEP.

With certain modifications and partitioning of the units, we determined that it was possible to process 1.5 MGD, which gives 0.75 MGD for each unit. This provided the necessary redundancy to be able to handle flows with one unit out of service (FDEP rule requirement). Even using FPSC numbers (864,921 AADF including margin reserve) the plant should be considered 100% used and useful because with one unit out of service, again, an FDEP requirement, the plant should be able to process this flow.

Assuming, based on hindsight, that the utility could have constructed the capacity in increments of 0.3 MGD from 1998 to present; four units of independently functioning units would have to be constructed to provide 1.15 MGD capacity. Based on FPSC projected flows of 0.865 MGD, three such units would have to be constructed. The cost of such three plant units would be in the range

of six to seven million dollars. This would not have provided any redundancy. The operational problems would have been phenomenal without centralized control systems. The present construction for the same capacity is almost a fourth of the cost of such an incremental construction.

The site being limited to 10 acres to start with, the footprint required for constructing three incremental units is far greater than what it is under present configuration. We were able to optimize the existing tank structures by strategically modifying them to match the disposable capacity of the RIBs (per ponds). Under FPSC scenario, additional land would be required for perc ponds to match the capacity of three incremental units. By doing what was done, Southlake and its customers got the best value for their money.

Attachment 2

Richard Redemann

From: jfg [jfg@guastella.com]
Sent: Friday, May 22, 2009 3:28 PM
To: Richard Redemann
Cc: msmurthi@comcast.net; JAde@jaxbusinesslaw.com; Patti Daniel
Subject: RE:

Hi Richard,

The FDEP rule requirement was provided as an attachment to our response to IROG 8 of Staff's 1st Set; it is contained in FDEP's 3/5/04 letter, page 2, paragraph 8. Yesterday, I sent an email telling you this, and for your convenience I attached a pdf of our responses to Staff's IROG along with that attachment. I also attached an outline I had previously provided for discussion of U&U of the WWTP at the 3/04/09 conference call. For some reason that I can't figure out, the email kept sending for the last 20 hours but it seems never delivered and it would not let me delete the email or stop the send process. I finally rebooted. In any event, you now know where to find the FDEP requirement and also our other reasons for treating the WWTP as 100% U&U. I'm not attaching anything to this email, but I will just send a separate email to you, not the others who are copied, and hopefully you will receive it. If that doesn't work, I'll fax it to you.

Sorry for the delay.

John

From: Richard Redemann [mailto:RRedeman@PSC.STATE.FL.US]
Sent: Thursday, May 21, 2009 4:38 PM
To: jfg
Cc: msmurthi@comcast.net; JAde@jaxbusinesslaw.com; Patti Daniel
Subject: RE:

Hello John,

Can you provide the the FDEP Rule requirement for 50% redundancy? We spoke to Denise Judy, the supervisor of permitting, and she would not confirm the 50% redundancy requirement. She explained it depended on the total components of the plants.

Thanks, Richard

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Cc: msmurthi@comcast.net; JAde@jaxbusinesslaw.com
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Please call me at (561) 747-9867 at your convenience.

Thanks,
John

Attachment 3

Richard Redemann

From: jfg [jfg@guastella.com]
Sent: Friday, May 22, 2009 4:49 PM
To: Richard Redemann
Subject: Southlake - U&U WWTP
Attachments: Discussion Outline 3-04-09 Conference CAll - Attachment IROG 8.doc not included

Richard, I'm sending individual attachments one email at a time.

John

Southlake Utilities, Inc.
FPSC Docket No. 080597-WS

Information for Discussion Purposes
March 4, 2009 Conference Call – 1:00 PM

Wastewater Treatment Plant – Used & Useful Considerations:

1. For an historical perspective, on the basis of available information regarding development activity in 2002 and 2003, the projected flow for 2008 was 0.93 MGD (AADF) and 1.21 MGD (MMADF), and the three month ADF was projected at 1.12 MGD. The then existing plant had one unit with a functioning rate at 0.75 MGD and an empty shell of a plant that had no operating equipment installed. The plant was struggling to consistently comply with treatment requirements, and at times the flows exceeded the plant capacity, sometimes reaching 1.4 MGD. The Company faced potential violations and enforcement action because, contrary to FDEP requirements, the plant did not have redundancy – two units each capable of meeting average annual flows.

2. Accordingly, the units were partitioned and modified so that each would independently provide capacity of 0.575 MGD (AADF) and 0.750 MGD (MMADF), and therefore meeting the FDEP redundancy requirement that the demands could be met with one unit out of service. On the basis of these design criteria alone, the plant should be considered 100% used & useful.

3. Assuming for discussion purposes that in order to have a ratio of demand to capacity at 100% for used and useful considerations, a decision had been made to expand the plant with 0.3 MGD increments, four units would have to have been constructed to obtain the current 1.15 MGD AADF capacity. Because the currently projected AADF is about 0.9 MGD, only three units would produce a ratio of demand to capacity of 100%. However, the cost of that incremental construction of three units would be in the range of $6 to $7 million or considerable more than the cost of the actual construction – and there would be considerably more difficult operational problems without centralized control systems.

4. Moreover, the treatment plant site was 10 acres and the footprint required for the construction of three units is far greater than the actual construction. As constructed, the Company was able to optimize the then existing tank structures by strategically modifying them to match the disposable capacity of the RIBs (perc ponds). Under the hypothetical "three unit" scenario, additional land would have been required for perc

ponds in order to match the capacity of the three units – adding yet another higher cost than was actually incurred.

The Company's revised used & useful calculations for the wastewater treatment plant produce a ratio of projected demands to capacity of 78.6% on the basis of actual average annual flows. As is always anticipated, the design flows are greater than the ultimate actual flows. Accordingly, there should invariably be a "cushion" of capacity above actual demands even after a given system reaches full development. Considering the prudence of the investment given the above items of lower actual cost than otherwise, the need to meet FDEP redundancy requirements and the practical land limitations that precluded any other incremental construction, the wastewater treatment plant should be considered 100% used & useful.

Attacnment 4

Richard Redemann

From: jfg [jfg@guastella.com]
Sent: Friday, May 22, 2009 4:51 PM
To: Richard Redemann
Subject: Southlake
Attachments: SLU - Unverifited Answers to Staff's 1st set of IROGs.pdf - IROG 8, FDEP's Letter page 2, paragraph 8.

Richard, this is the email that worries me in terms of its size.

8. Provide an explanation of the statement on Schedule F-6 that there is an insignificant cost difference between a 1.15 mgd and .950 mgd wastewater treatment plant.

Response:

Attached as Exhibit "C" is an outline entitled, "Information for Discussion Purposes, March 4, 2009 Conference Call", that was provided to Staff for discussion at the March 4, 2009 conference call, which addresses the issue of the used and usefulness of the wastewater treatment plant and included comments with respect to relative costs. During that conference call, Staff requested additional information as to documentation regarding the plant operation and original plant expansion; also attached as Exhibit "D" entitled "DEP Correspondence" are exchanges of correspondence regarding that issue. We also call your attention to paragraph 8 of the DEP 3/5/04 letter, at which DEP states that with the largest unit out of service at least 50% of the designed flow can be treated. This statement confirms the design criteria mentioned iii paragraph 2 of the conference call outline, another issue raised by Staff during the conference call.

Paragraph 3 of the conference call outline indicates that the current facilities are considerably less costly than if the expansion had been undertaken in 0.3 MGD increments which would be in the range of $6 to $7 per gallon of treatments capacity. Staff asked for cost justification for that estimate. That estimate was based on general knowledge of Sam Munipalli and John Guastella, and in order to provide further support in response to Staff's request, Sam Munipalli requested and obtained cost information from CH2M Hill by emails from Mr. Al Aikens who stated that "the cost for a secondary Greenfield WWTP discharging to RIBs is on the order of $6 to $9 per gpd and would probably be closer to the $9 figure. Mr. Aikens also provided the following results of construction costs from WWTPs of similar capacity and level of treatment to Southlake's:

Milley's Creek WWTP (Montgomery, AL) - Greenfield 1.5 mgd plant at approximately $13M which equates to $8.67/gal.

Mooreville WWTP, NC - two mgd package plants added to an existing facility with influent pump station just for the package plants and filtration an UV disinfection upgrades for the entire plant is around $17.3M (engineer's estimate based on 100% bid documents). Taking a swag at backing out the excess filtration and UV disinfection capacity cost, it is estimated about $15M which equates to $7.50/gal.

Ave Maria WRF near Naples, FL was 1.25 MOD and the cost was $6.22/gal. This did not include site work. If you add the site work the plant would be around $8/gal.

FDEP's letter dated 3/4/09, page 2 paragraph 8

8. The proposed facility must be constructed to meet Class III reliability requirements. The following items must be provided to satisfy these requirements: trash removal at the headworks; multiple action of air diffusers, sized so that with the largest section out of service the oxygen transfer is not be measurably impaired; a minimum of two clarifiers and two chlorine contact chambers, sized and piped so that with the largest unit out of service at least 50% of the design flow can be treated; a backup power supply, capable to maintaining power for pumps, disinfection, critical lighting and ventilation. Please revise the drawings and the engineering report to identify these provisions.

Attachment 5

Richard Redemann

From: jfg [jfg@guastella.com]
Sent: Friday, May 29, 2009 6:23 PM
To: Richard Redemann
Cc: John Mann; JAde@jaxbusinesslaw.com; msmurthi@comcast.net
Subject: RE:

Hi Richard,

While I agree that the FDEP requirement does not mean that all current flows must be met with one tank out of service, it clearly does mean that the existing WWTP could not have been constructed with smaller capacity units. The actual historical basis for the construction of the WWTP, as previously provided in response to IROG 8 and its attachments, shows that in order to meet the FDEP requirement, the units were partitioned and modified so that each would provide capacity of 0.575 MGD (AADF) in order to meet the redundancy requirement of 50% of the ***design flow*** of 1.15 MGD, not a projected actual flow. In other words, the plant could not have been constructed with one unit being smaller than the 0.575 MGD capacity to meet the current ***actual flow*** of about 0.9 MGD, because that configuration would have been in violation of the FDEP requirement. For this reason alone, the cost must be considered 100% U&U because the construction was in compliance with a requirement of another governmental regulator, as required by 367.081(2)a 2.c, F.S., which states:

> "Notwithstanding the provisions of this paragraph, the commission shall approve rates for service which allow a utility to recover from customers the full amount of environmental compliance costs. Such rates may not include charges for allowances for funds prudently invested or similar charges. For purposes of this requirement, the term "environmental compliance costs" includes all reasonable expenses and fair return on any prudent investment incurred by a utility in complying with the requirements or conditions contained in any permitting, enforcement, or similar decisions of the United States Environmental Protection Agency, the Department of Environmental Protection, a water management district, or any other governmental entity with similar regulatory jurisdiction."

This is one of a number of other independent reasons that the WWTP should be treated as 100% U&U, for example:

1. We provided Staff with information and supporting cost documentation, as a follow up to IROG 8 and our conference calls, that shows that even under a hypothetical assumption that the plant could have been constructed with smaller increments without violating FDEP conditions, the cost of constructing, over time, either 3 or 4 increments of capacity at 0.3 MGD would have been higher than the existing cost.

2. As we stated in the MFRs, the cost of the plant had to be based on *design* flows that require capacity greater than the projection of *actual* flows, so that the cost to serve only existing customers could not be any less. Thus, when ratios of actual flow to capacity produce U&U percentages of nearly 80% (78.6%), and the collection system is essentially built out, it would be entirely reasonable for Staff and the Commission to recognize that the Company absolutely had to incur the entire cost as reflected in rate base in order to serve the existing customers, and that under the resulting rates the customers would not pay a penny more than the unavoidable minimum cost necessary to serve them.

3. And yet another consideration is contained in the detailed description by Sam Munipali that I

emailed to you on May 21st which explains how the construction phases of the plant progressed, also resulting in an unavoidable cost to serve existing customers, and at a cost per gallon that is much lower than the unit costs of other wastewater plants, about $4 per gallon compared with $6 to $10 per gallon.

Richard, I'm sure you and other Staff know that this first major rate filing since the Company's inception is critical, and this U&U issue is one of the most significant in terms of its impact on the ability of the Company have a real opportunity to earn a reasonable return on its investment. A downward adjustment of about 21% of the cost of the WWTP would eliminate over 60% of the net operating income from the wastewater operations, and about a 25% reduction in the combined water and wastewater net operating income. The Company's combined water and wastewater rate base is about $6.4 million, and there is an ongoing struggle with the Water Management District to avoid spending about $20 million on reuse facilities and water treatment for the lower Floridan aquifer. Although none of the WMD's issues are a part of this rate filing in terms of costs included in the revenue requirement, and we are hoping that the Company will be successful in working with the WMD and FPSC in a cooperative effort, already begun, to set realistic and only essential priorities with respect to future capital requirements, the Company must begin to earn a reasonable return on existing investment if there will be any chance of attracting capital in the future in order to meet any significant level of non-revenue producing environmental capital improvements. If the Company's future earnings are inadequate because of a WWTP U&U adjustment, the cost rate of debt for new capital, if at all possible to attract, would likely be higher than the cost rate would be if a potential lender found that the rate decision in this case allowed the Company to earn on all of its existing investment. Thus, a U&U adjustment now could very likely result in higher rates for the customers in the future.

The Company's rates are not only among the lowest in the state, they will remain the lowest if the entire requested rate increase is allowed. The per-gallon cost of the WWTP is among the lowest if not the lowest in the state. The one customer that attended the customers meeting, did not complain about the rates or the service, but merely did not understand the reason for a change in her bill from one month to the next – a non-issue. I trust that Staff understands that we are not trying to establish a major change to a U&U policy, but simply apply recognized considerations to a cost that was necessary to serve the existing customers, the disallowance of which would do more harm than good in terms of the Company's financial strength and the future rates. We certainly appreciate the accommodations Staff has made to give us opportunities to address such issues, and would seek a meeting with Staff before it makes a final decision with respect to this or other issues related to the Staff Audit report.

John

From: Richard Redemann [mailto:RRedeman@PSC.STATE.FL.US]
Sent: Tuesday, May 26, 2009 5:03 PM
To: jfg
Subject: RE:

John, the DEP letter indicates that Southlake was required to construct a minimum of two clarifiers and two chlorine contact chambers, sized and piped so that with the largest unit out of service at least 50% of the design flow can be treated. Is that the redundancy requirement you are referring to? If so, that does not appear to mean that they need to be able to treat all of the

flows with one tank out of service. Is that correct?

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