

State of Florida



Public Service Commission

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

DATE: August 11, 2011

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (T. Brown, Daniel, Fletcher, Maurey, Salnova, Walden) *AWPK*
Office of the General Counsel (Barrera, Crawford) *MBJC*

ALM *NS* *AW*

RE: Docket No. 110153-SU – Application for increase in wastewater rates in Lee County by Utilities, Inc. of Eagle Ridge.

AGENDA: 08/23/11 – Regular Agenda – Decision on Interim Rates – Participation is at the Discretion of the Commission

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Brown

CRITICAL DATES: 08/23/11 (60-Day Suspension Date)

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\110153.RCM.DOC

Case Background

Utilities, Inc. of Eagle Ridge (Eagle Ridge or Utility) is a Class B utility providing wastewater service to approximately 822 customers in Lee County. Wastewater rates were last established for this Utility in 2009.¹

On June 24, 2011, Eagle Ridge filed the application for rate increase at issue in the instant docket. The Utility requested that the application be processed using the Proposed

¹ See Order No. PSC-09-0264-PAA-SU, issued April 27, 2009, in Docket No. 080247-SU, In re: Application for increase in wastewater rates in Lee County by Utilities, Inc. of Eagle Ridge.

DOCUMENT NUMBER-DATE

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FPSC-COMMISSION CLERK

Docket No. 110153-SU
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Agency Action (PAA) procedure and requested interim rates. The test year established for interim and final rates is the 13-month average period ended December 31, 2010.

Eagle Ridge requested interim rates designed to generate annual revenues of \$1,149,400 for wastewater only. This represents a revenue increase on an annual basis of \$160,169 or 16.19 percent. The Utility requested final rates designed to generate annual wastewater revenues of \$1,235,092. This represents a revenue increase of \$238,843 (23.97 percent).

This recommendation addresses the suspension of Eagle Ridge's requested final rates and the Utility's requested interim rates. The Commission has jurisdiction pursuant to Sections 367.081 and 367.082, Florida Statutes (F.S.).

Discussion of Issues

Issue 1: Should the Utility's final wastewater rates be suspended?

Recommendation: Yes. Eagle Ridge's proposed final wastewater rates should be suspended.
(T. Brown)

Staff Analysis: Section 367.081(6), F.S., provides that the Commission may, for good cause, withhold consent to the implementation of the requested rates within 60 days after the date the rate request is filed. Further, Section 367.081(8), F.S., permits the proposed rates to go into effect (secured and subject to refund) at the expiration of five months from the official date of filing if: (1) the Commission has not acted upon the requested rate increase; or (2) if the Commission's PAA action is protested by a party other than the Utility.

Staff has reviewed the filing and has considered the information filed in support of the rate application and the proposed final rates. Staff believes that it is necessary to require further investigation of this information, including on-site investigations by staff accountants and engineers. To date, staff has initiated an audit of Eagle Ridge's books and records, as well as an audit of Utilities, Inc. (UI), the Utility's parent, to examine allocated investment and operating expenses. Both of these audits are tentatively due on September 6, 2011. In addition, staff sent its first data request on July 26, 2011. The Utility's response to this data request is due on August 25, 2011. Further, staff believes additional requests will be necessary to process this case. Based on the foregoing, staff recommends suspension of the Utility's proposed rate increase.

Issue 2: Should any interim revenue increase be approved?

Recommendation: Yes, Eagle Ridge should be authorized to collect annual wastewater revenues as indicated below:

	<u>Adjusted Test</u> <u>Year Revenues</u>	<u>\$ Increase</u>	<u>Revenue</u> <u>Requirement</u>	<u>% Increase</u>
Wastewater	\$989,749	\$132,768	\$1,122,517	13.41%

(T. Brown, Walden)

Staff Analysis: On June 24, 2011, Eagle Ridge filed its rate base, cost of capital, and operating statements to support its requested interim increase in wastewater rates. Pursuant to Section 367.082(1), F.S., in order to establish a prima facie entitlement for interim relief, the Utility shall demonstrate that it is earning outside the range of reasonableness on its rate of return. Pursuant to Section 367.081(2)(a), F.S., in a proceeding for an interim increase in rates, the Commission shall authorize, within 60 days of the filing for such relief, the collection of rates sufficient to earn the minimum of the range of rate of return. Based on the Utility's filing and the recommended adjustments below, staff believes that the Utility has demonstrated a prima facie entitlement in accordance with Section 367.082(1), F.S.

Pursuant to Section 367.082(5)(b)1, F.S., the achieved rate of return for interim purposes must be calculated by applying adjustments consistent with adjustments made in the Utility's most recent rate proceeding and annualizing any rate changes. Staff has reviewed Eagle Ridge's interim request, as well as Order No. PSC-09-0264-PAA-SU, in which the Commission last established rate base. Staff's recommended adjustments are discussed below. Staff has attached accounting schedules to illustrate staff's recommended rate base, capital structure, and test year operating income amounts. Rate base is labeled as Schedule No. 1-A, with adjustments shown on Schedule No. 1-B. Capital structure is labeled as Schedule No. 2. Operating income is labeled as Schedule No. 3-A, with adjustments shown on Schedule No. 3-B.

RATE BASE

The Utility did not include a used and useful (U&U) adjustment to its interim rate base based on its assumption that the wastewater systems are built out. However, pursuant to Section 367.082, F.S., the method used to calculate U&U in Eagle Ridge's last rate case must be used for interim purposes. In Docket No. 080247-SU, a composite U&U adjustment of 85.75 percent was made to the Utility's wastewater plants. Based on the methodology used in that case, staff has calculated a U&U adjustment of 87.37 percent for interim purposes. Accordingly, rate base should be reduced by \$262,031. Corresponding adjustments should also be made to reduce depreciation expense and property taxes by \$19,258 and \$489, respectively.

In its filing, Eagle Ridge recorded a working capital allowance of \$166,240 based on the balance sheet approach. Pursuant to Section 367.082(5)(b)1, F.S., the Utility must apply adjustments consistent with adjustments made in the Utility's most recent rate proceeding. In its last rate case, the Commission approved working capital based on the formula approach which is one-eighth of operation and maintenance (O&M) expenses. As discussed below, staff has

recommended adjustments to O&M expenses. Based on its recommended O&M expenses, staff has calculated working capital for interim purposes to be \$81,180. Thus, staff recommends that working capital should be decreased by \$85,060.

Based on the above, staff recommends rate base of \$2,316,481 for interim purposes.

COST OF CAPITAL

For purposes of its interim request, Eagle Ridge used a return on equity (ROE) of 11.34 percent and an overall cost of capital of 7.91 percent. Pursuant to Section 367.082(2)(a), F.S., the appropriate ROE for purposes of determining an interim rate increase is the minimum of the ROE range. In its last rate case, the Commission approved an ROE of 12.34 percent with a range of 11.34 percent to 13.34 percent. Accordingly, staff recommends that the appropriate ROE and a overall cost of capital for interim purposes are 11.34 percent and 7.79 percent, respectively.

NET OPERATING INCOME

Pursuant to Section 367.082(5)(b)1, F.S., the achieved rate of return for interim purposes must be calculated by applying adjustments consistent with adjustments made in the Utility's most recent rate proceeding and annualizing any rate changes. Based on staff's review, a few adjustments are necessary for interim purposes.

First, in its filing, Eagle Ridge calculated annualized revenues of \$991,495. As a result, the Utility made an annualized revenue reduction of \$2,264. When annualizing the rates in effect as of December 31, 2010, staff calculated annualized revenue of \$988,279. Thus, the annualized revenue reduction should have only been \$1,746. Accordingly, staff recommends that interim test year revenues be increased by \$518 (\$2,264 - \$1,746).

Second, Eagle Ridge included a net adjustment to decrease expenses by \$38,063 for salaries, employee pensions and benefits, and transportation expense. In its filing, the Utility stated these adjustments were to correct allocations and to annualize salary and related expenses. Staff believes the Utility's proposed adjustments for annualizing salary and related expenses are pro forma because they are outside the interim test year. Because Eagle Ridge did not provide a breakdown of what amount related to correcting allocations and to annualizing salary and related expenses, staff recommends that the net adjustment totaling \$38,063 be removed from the interim net operating income calculation. Further, a corresponding adjustment should be made to remove pro forma payroll taxes of \$3,258.

Third, as discussed above, staff has recommended a non-U&U adjustment to rate base. Accordingly, for interim purposes, depreciation expense and property taxes should be reduced by \$19,258 and \$489, respectively.

Based on the above, staff recommends that the appropriate test year operating income, before any revenue increase, is \$101,332.

REVENUE REQUIREMENT

Based on the above adjustments, staff recommends a revenue requirement of \$1,122,517. This represents an interim increase in annual revenues of \$132,768 (or 13.41 percent). This increase will allow the Utility the opportunity to recover its operating expenses and earn a 7.79 percent return on its rate base.

Issue 3: What are the appropriate interim wastewater rates?

Recommendation: The wastewater service rates for Eagle Ridge in effect as of December 31, 2010, should be increased by 13.41 percent, to generate the recommended revenue increase for the interim period. The approved rates should be effective for service rendered as of the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1)(a), F.A.C. The rates should not be implemented until staff verifies that the tariff sheets are consistent with the Commission’s decision, the proposed customer notice is adequate, the required security has been filed, and the customers have received the notice. The Utility should provide proof of the date notice was given within 10 days after the date of notice. (T. Brown)

Staff Analysis: Staff recommends that interim wastewater service rates for Eagle be designed to allow the Utility the opportunity to generate annual operating revenues of \$1,122,517. Before removal of miscellaneous revenues, this would result in an increase of \$132,768 or 13.41 percent. To determine the appropriate percentage increase to apply to the service rates, miscellaneous service revenues should be removed from the test year revenues. The calculation is as follows:

		<u>Water</u>
1	Total Test Year Revenues	\$989,749
2	Less: Miscellaneous Revenues	(952)
3	Test Year Revenues from Service Rates	<u>\$988,797</u>
4	Revenue Increase	\$132,768
5	% Service Rate Increase (Line 4/Line 3)	<u>13.43%</u>

The interim rate increase of 13.43 percent should be applied as an across-the-board increase to the service rates in effect as of December 31, 2010. The approved rates should be effective for service rendered as of the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1), F.A.C. The rates should not be implemented until staff verifies that the tariff sheets are consistent with the Commission’s decision, the proposed customer notice is adequate, the required security has been filed, and the customers have received the notice. The Utility should provide proof of the date notice was given within 10 days after the date of notice.

The Utility’s current rates, proposed interim and final rates, and staff’s recommended interim rates are shown on Schedule No. 4.

Issue 4: What is the appropriate security to guarantee the interim increase?

Recommendation: A corporate undertaking is acceptable contingent upon receipt of the written guarantee of the parent company, Utilities, Inc. (UI), and written confirmation of UI's continued attestation that it does not have any outstanding guarantees on behalf of UI-owned utilities in other states. UI should be required to file a corporate undertaking on behalf of its subsidiaries to guarantee any potential refunds of revenues collected under interim conditions. UI's total guarantee should be a cumulative amount of \$855,562, which includes an amount of \$77,484 subject to refund in this docket. Pursuant to Rule 25-30.360(6), F.A.C., the Utility should provide a report by the 20th of each month indicating the monthly and total revenue collected subject to refund. Should a refund be required, the refund should be with interest and in accordance with Rule 25-30.360, F.A.C. (Salnova, T. Brown)

Staff Analysis: Pursuant to Section 367.082, F.S., revenues collected under interim rates shall be placed under bond, escrow, letter of credit, or corporate undertaking subject to refund with interest at a rate ordered by the Commission. As recommended in Issue 2, the total annual interim increase is \$132,768. In accordance with Rule 25-30.360, F.A.C., staff calculated the potential refund of revenues and interest collected under interim conditions to be \$77,484. This amount is based on an estimated seven months of revenue being collected from staff's recommended interim rates over the Utility's current authorized rates shown on Schedule No. 4.

Eagle Ridge is a wholly-owned subsidiary of Utilities, Inc. (UI or Company), which provides all investor capital to its subsidiaries. UI has requested an incremental increase in its corporate undertaking in the amount of \$77,484 for the wastewater interim rate increase for its Eagle Ridge system. The current cumulative corporate undertaking amount outstanding for other UI systems is \$778,078. The new request would bring the cumulative amount outstanding to \$855,562.

The criteria for a corporate undertaking include sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. Staff reviewed UI's 2008, 2009, and 2010 financial statements to determine if the Company can support a corporate undertaking on behalf of its subsidiary. As the attached schedule shows, UI reported deficient liquidity in 2008 and 2009 and low levels of interest coverage over the review period. However, in 2010, the Company achieved sufficient liquidity, and its interest coverage ratio has also been trending upwards since 2008. In addition, UI reported adequate ownership equity over the three year review period. In 2008, the Company experienced a net loss in the amount of \$635,405, but improved profitability to sufficient levels in 2009, achieving net income in the amount of \$5,492,924. UI's profitability in 2010 increased from \$5,276,388 to \$15,576,121 by virtue of a one-time gain on the disposition of utility systems in the amount of \$10,299,733. The amount of the one-time gain is atypical of the amounts UI reported in prior-year financial statements and there is no indication a gain of that magnitude will occur in future years. Replacing the \$10 million gain with the Company's 5-year average gain on the disposition of utility systems, or \$4,076,430, UI's average net income over the 3-year period from 2008 to 2010 is \$4,736,779, which is 5.4 times greater than the requested cumulative corporate undertaking amount of \$855,562.

Based on staff's review of the financial reports submitted by UI, staff believes UI has adequate resources to support a corporate undertaking in the amount requested. Based on the analysis, staff determined that a cumulative corporate undertaking in the amount of \$855,562 is acceptable contingent upon receipt of a written guarantee by UI and written confirmation that UI does not have any outstanding guarantees on behalf of UI-owned utilities in other states.

Pursuant to Rule 25-30.360(6), F.A.C., the Utility should provide a report by the 20th day of each month indicating the monthly and total revenue collected subject to refund. Should a refund be required, the refund should be with interest and undertaken in accordance with Rule 25-30.360, F.A.C.

In no instance should maintenance and administrative costs associated with any refund be borne by the customers. The costs are the responsibility of, and should be borne by, the Utility.

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Date: August 11, 2011

Issue 5: Should this docket be closed?

Recommendation: No. The docket should remain open pending the Commission's PAA decision on the Utility's requested rate increase. (Barrera, T. Brown)

Staff Analysis: The docket should remain open pending the Commission's PAA decision on the Utility's requested rate increase.

Utilities, Inc. of Eagle Ridge Schedule of Wastewater Rate Base Test Year Ended 12/31/10			Schedule No. 1-A Docket No. 110153-SU		
Description	Test Year Per Utility	Utility Adjust- ments	Adjusted Test Year Per Utility	Staff Adjust- ments	Staff Adjusted Test Year
1 Plant in Service	\$6,897,768	(\$59,771)	\$6,837,997	\$0	\$6,837,997
2 Land and Land Rights	51,847	41	51,888	0	51,888
3 Non-used and Useful Components	0	0	0	(262,031)	(262,031)
4 Accumulated Depreciation	(3,161,316)	125,332	(3,035,984)	0	(3,035,984)
5 CIAC	(3,809,952)	1	(3,809,951)	0	(3,809,951)
6 Amortization of CIAC	2,355,036	98,346	2,453,382	0	2,453,382
7 Construction Work In Progress	3	(3)	0	0	0
8 Net Acquisition Adjustment	266,805	(266,805)	0	0	0
9 Working Capital Allowance	<u>0</u>	<u>166,240</u>	<u>166,240</u>	<u>(85,060)</u>	<u>81,180</u>
10 Rate Base	<u>\$2,600,191</u>	<u>\$63,381</u>	<u>\$2,663,572</u>	<u>(\$347,091)</u>	<u>\$2,316,481</u>

Utilities, Inc. of Eagle Ridge		Schedule No. 1-B
Adjustments to Rate Base		Docket No. 110153-SU
Test Year Ended 12/31/10		
Explanation		Wastewater
<u>Non-used and Useful</u>		
To reflect net non-used and useful adjustment.		<u>(\$262,031)</u>
<u>Working Capital</u>		
To reflect adjustment to working capital allowance.		<u>(\$85,060)</u>

Utilities, Inc. of Eagle Ridge Capital Structure-Simple Average Test Year Ended 12/31/10						Schedule No. 2 Docket No. 110153-SU			
Description	Total Capital	Specific Adjustments	Subtotal Adjusted Capital	Prorata Adjustments	Capital Reconciled to Rate Base	Ratio	Cost Rate	Weighted Cost	
Per Utility									
1 Long-term Debt	\$180,000,000	\$0	\$180,000,000	(\$178,818,319)	\$1,181,681	44.36%	6.64%	2.95%	
2 Short-term Debt	16,123,077	0	16,123,077	(16,017,180)	105,897	3.98%	3.88%	0.15%	
3 Preferred Stock	0	0	0	0	0	0.00%	0.00%	0.00%	
4 Common Equity	169,661,060	0	169,661,060	(168,547,335)	1,113,725	41.81%	11.34%	4.74%	
5 Customer Deposits	28,844	0	28,844	0	28,844	1.08%	6.00%	0.06%	
6 Deferred Income Taxes	<u>233,425</u>	<u>0</u>	<u>233,425</u>	<u>0</u>	<u>233,425</u>	<u>8.76%</u>	0.00%	<u>0.00%</u>	
7 Total Capital	<u>\$366,046,406</u>	<u>\$0</u>	<u>\$366,046,406</u>	<u>(\$363,382,834)</u>	<u>\$2,663,572</u>	<u>100.00%</u>		<u>7.91%</u>	
Per Staff									
8 Long-term Debt	\$180,000,000	\$0	\$180,000,000	(\$178,989,136)	\$1,010,864	43.64%	6.64%	2.90%	
9 Short-term Debt	16,123,077	0	16,123,077	(16,032,531)	90,546	3.91%	3.88%	0.15%	
10 Preferred Stock	0	0	0	0	0	0.00%	0.00%	0.00%	
11 Common Equity	169,661,060	0	169,661,060	(168,708,258)	952,802	41.13%	11.34%	4.66%	
12 Customer Deposits	28,844	0	28,844	0	28,844	1.25%	6.00%	0.07%	
13 Deferred Income Taxes	<u>233,425</u>	<u>0</u>	<u>233,425</u>	<u>0</u>	<u>233,425</u>	<u>10.08%</u>	0.00%	<u>0.00%</u>	
14 Total Capital	<u>\$366,046,406</u>	<u>\$0</u>	<u>\$366,046,406</u>	<u>(\$363,729,925)</u>	<u>\$2,316,481</u>	<u>100.00%</u>		<u>7.79%</u>	
						LOW	HIGH		
RETURN ON EQUITY						<u>11.34%</u>	<u>13.34%</u>		
OVERALL RATE OF RETURN						<u>7.79%</u>	<u>8.61%</u>		

Utilities, Inc. of Eagle Ridge Statement of Wastewater Operations Test Year Ended 12/31/10						Schedule No. 3-A Docket No. 110153-SU	
Description	Test Year Per Utility	Utility Adjust- ments	Adjusted Test Year Per Utility	Staff Adjust- ments	Staff Adjusted Test Year	Revenue Increase	Revenue Requirement
1 Operating Revenues:	<u>\$990,978</u>	<u>\$158,422</u>	<u>\$1,149,400</u>	<u>(\$159,651)</u>	<u>\$989,749</u>	<u>\$132,768</u> 13.41%	<u>\$1,122,517</u>
Operating Expenses							
2 Operation & Maintenance	\$683,190	(\$33,752)	\$649,438	\$38,063	\$687,501		\$687,501
3 Depreciation	165,260	(29,396)	135,864	(19,258)	116,606		116,606
4 Amortization	0	0	0	0	0		0
5 Taxes Other Than Income	67,378	10,387	77,765	(10,931)	66,834	5,975	72,808
6 Income Taxes	<u>6,834</u>	<u>69,198</u>	<u>76,032</u>	<u>(58,555)</u>	<u>17,477</u>	<u>47,712</u>	<u>65,189</u>
7 Total Operating Expense	<u>\$922,662</u>	<u>\$16,437</u>	<u>\$939,099</u>	<u>(\$50,681)</u>	<u>\$888,418</u>	<u>\$53,687</u>	<u>\$942,104</u>
8 Operating Income	<u>\$68,316</u>	<u>\$141,985</u>	<u>\$210,301</u>	<u>(\$108,969)</u>	<u>\$101,332</u>	<u>\$79,081</u>	<u>\$180,413</u>
9 Rate Base	<u>\$2,600,191</u>		<u>\$2,663,572</u>		<u>\$2,316,481</u>		<u>\$2,316,481</u>
10 Rate of Return	<u>2.63%</u>		<u>7.90%</u>		<u>4.37%</u>		<u>7.79%</u>

Utilities, Inc. of Eagle Ridge Adjustment to Operating Income Test Year Ended 12/31/10		Schedule No. 3-B Docket No. 110153-SU
Explanation	Wastewater	
<u>Operating Revenues</u>		
1	Remove requested interim revenue increase.	(\$160,169)
2	To reflect the appropriate amount of annualized revenues.	<u>518</u>
	Total	<u>(\$159,651)</u>
<u>Operation and Maintenance Expense</u>		
	Remove pro forma expense adjustments.	<u>\$38,063</u>
<u>Depreciation Expense - Net</u>		
	To remove net depreciation on non-U&U adjustment above.	<u>(\$19,258)</u>
<u>Taxes Other Than Income</u>		
1	RAFs on revenue adjustments above.	(\$7,184)
2	Remove pro forma payroll taxes.	(3,258)
3	Remove non-U&U property taxes.	<u>(489)</u>
	Total	<u>(\$10,931)</u>

Utilities, Inc. of Eagle Ridge		Schedule No. 4		
Wastewater Monthly Service Rates		Docket No. 110153-SU		
Test Year Ended 12/31/10				
	Rates in Effect 12/31/2010	Utility Requested Interim	Utility Requested Final	Staff Recomm. Interim
<u>Residential</u>				
Base Facility Charge All Meter Sizes:	\$20.62	\$23.96	\$25.75	\$23.39
Gallonge Charge - Per 1,000 gallons (10,000 gallon cap)	\$4.72	\$5.49	\$5.89	\$5.35
Cross Creek Flat Rate	\$23.98	\$27.87	\$29.96	\$27.20
<u>General Service</u>				
Base Facility Charge by Meter Size:				
5/8" x 3/4"	\$20.62	\$23.96	\$25.75	\$23.39
1"	\$51.55	\$59.91	\$64.39	\$58.47
1-1/2"	\$103.10	\$119.82	\$128.78	\$116.94
2"	\$164.95	\$191.70	\$206.03	\$187.10
3"	\$329.91	\$383.42	\$412.08	\$374.21
4"	\$515.49	\$599.10	\$643.88	\$584.71
6"	\$1,030.98	\$1,198.20	\$1,287.77	\$1,169.41
8"	\$0.00	\$0.00	\$0.00	\$0.00
Gallonge Charge, per 1,000 Gallons	\$5.67	\$6.58	\$7.08	\$6.43
<u>Typical Residential Bills 5/8" x 3/4" Meter</u>				
3,000 Gallons	\$34.78	\$40.43	\$43.42	\$39.45
5,000 Gallons	\$44.22	\$51.41	\$55.20	\$50.16
10,000 Gallons (Wastewater Gallonge Cap - 10,000 Gallons)	\$67.82	\$78.86	\$84.65	\$76.93
Average Usage of 5,100	\$44.69	\$51.96	\$55.79	\$50.69