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September 29, 2014

Carlotta S. Stauffer, Director
Office of Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Re: Docket 130194 -- Application for staff-assisted rate case in Lake County by Lakeside Waterworks, Inc.

Dear Ms. Stauffer:

Attached is a list of issues that the Office of Public Counsel has prepared to identify concerns we have with the information included in the staff report that addresses the preliminary review of the requested rate increase. We are submitting this letter in an effort to be up front with our concerns and allow the staff and utility sufficient time to review our concerns and ask for any additional information that might be needed. If you should have any questions, please feel free to call or e-mail me.

Respectfully submitted,

s/ Denise N. Vandiver

Denise N. Vandiver
Legislative Analyst

c: Division of Accounting & Finance (Barrett)
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OPC Issues and Concerns
Lakeside Waterworks, Inc.
Docket No. 130194-WS

Quality of Service

1. The staff held a customer meeting on September 11, 2014. Approximately 25 customers spoke regarding the staff report on Lakeside Waterworks, Inc. (Lakeside). At least eight of these customers specifically identified quality of service issues ranging from poor quality of water to poor customer service. Several people commented that the water left black rings in toilets and most commented that they do not drink the water but buy bottled water. Several customers also expressed concern that the test results provided to them in an annual report appeared to be identical for the last two years. We believe staff should carefully review the testing results for primary and secondary standards to determine whether the utility is providing satisfactory service as well as reporting these results accurately to the customers.

Pro Forma Plant

2. The Staff Report included net pro forma plant additions of $1,632 for water and $923 for wastewater. This includes most of what the utility requested for 2013 and is net of 75% retirements. As discussed in a later issue addressing the utility's contract with U. S. Water Services Corporation (USWSC), Attachment G states that "Materials and reimbursable expenses will be billed at actual cost plus 18%" We have reviewed the invoices provided for the 2013 additions included in the staff report. The invoices do not identify the actual cost or the 18%. Therefore we have calculated what the 18% would be. As discussed more fully later, we believe that the 18% should be removed completely or at least adjusted to a more reasonable amount. We further believe that this issue should be addressed with all of the 2014 pro forma plant additions.

Invoice	Date	Total Invoice	Calculated Mark-up
787751	12/2/2013	5,296.43	807.93
788662	12/31/2013	1,232.68	188.04
Water		6,529.11	995.97
787750	12/2/2013	3,689.95	562.87
Wastewater		3,689.95	562.87

3. The utility also requested additional pro forma plant items for 2014. We are concerned with the utility's request and explanation regarding the work on the wastewater treatment plant. In response to staff's fourth data request, Question 24, the utility states that it plans to only replace certain portions of the wastewater treatment plant and then request to re-rate the plant to a lower capacity level. However, the utility has not provided any justification to support the economic feasibility of such a decision. If this action is taken we believe it will put the full burden of the plant on the current ratepayers. We believe that an analysis of the plant should be made to determine the excess costs that were invested to serve

future customers and that these costs should be written off as an imprudent investment that should not be placed on the current ratepayers.

4. The utility has also requested as part of the 2014 pro forma plant an $8,000 item to "demolish old aeration basin". This is not an item that should be added to utility plant balances. Commission Rule 25-30.140, Florida Administrative Code addresses depreciation for water and wastewater utilities. Rule 25-30.140(1)(h) defines the cost of removal as the "cost of demolishing, dismantling, tearing down or otherwise removing utility plant, including the cost of transportation and handling incidental thereto." The rule further requires that the cost of removal be recorded as an adjustment to accumulated depreciation and not as additional utility plant in service (Rule 25-30.140(1)(q)).

5. We are also concerned with the utility's request for meter replacements. In the Pro Forma Plant matrix provided by e-mail to staff, the utility states that the meters are 10 years old and need to be replaced or tested. The Commission's depreciation rule expects that meters will have a 17-20 year life. We do not believe that the meters need to be replaced based on a ten year life unless the utility can provide additional evidence that the meters are defective and why the customers should bear the cost of any early replacement.

<u>Operating Revenues</u>

6. Our review of the billing information included in the staff audit appears to indicate changes in the customers from the beginning of the year to when the new owner took over. Audit work paper 41.5 indicates 5 General Service customers beginning in December 2012 and work paper 41.7 indicates 6-8 customers beginning in December 2012. It is not clear from our calculations whether staff has annualized these "new" customers in the calculation of the billing determinants.

7. We reviewed the billing information included in the staff audit and are unable to reconcile the billing determinants to the water rates recommended in the staff report. It appears that if we apply the water rates on page 51 of the staff report to the billing determinants in the audit work papers, the rates would generate over $90,000, which is over 40% more than the revenue requirement in the staff report. We recognize that the staff report indicates projected repression of 1,813,000 gallons, and even if all of these gallons are considered at the highest gallonage rate, we believe that the rates result in higher revenues than the repressed revenue requirement of $66,264 (Page 30 of staff report).

<u>O&M Expenses</u>

<u>Purchased Power</u>

8. The staff report included purchased power expense of $2,472 for water and $5,586 for wastewater. This expense includes an adjustment of $483 for water and $731 for wastewater to reflect a rate increase from Duke Power Company. We are unable to determine the calculation of staff's adjustments but would like to make a comment

regarding the utility's request for this pro forma increase that was addressed in the utility's filing in Document No. 02748-14 made on June 5, 2014.

Our review of the utility's filing indicates that the utility submitted purchased power bills for the 12 month period July 2013 through June 2014. The utility applies the current electric rates to the consumption reflected in these bills. The only anomaly that we found in this calculation is the consumption reflected on the bills for the wastewater treatment plant. During the test year (July 1, 2012 – June 30, 2013), the bills reflected 26,702 kWh, for an average monthly kWh of 2,054. However, the bills submitted with the utility's request for a pro forma increase reflect 40,003 kWh for a monthly average of 3,334, a 62% increase. In particular, it appears that the months September through November of 2013 are more than double the test year average. We believe that before the utility's request for the pro forma increase in purchased power is used, the utility should explain the "unusual" kWh consumption and whether the amounts reflect normal, recurring expenses, or whether there was an unusual event which should not be reflected in rates on a going forward basis.

Contractual Services - Professional

9. The staff report included $5,240 (split equally between water and wastewater) for Contractual Services – Professional Expense. The majority of this amount ($4,550) was for legal expenses paid by the previous owner as part of the process to sell the utility to the current owners. These are not recurring expenses to the current utility and should not be included for recovery in rates as they were not incurred by the current owner.

Contractual Services – Other

10. The staff report included $38,197 for Contractual Services – Other for water and $35,730 for wastewater. These amounts reflect the annual expense for the management services agreement with USWSC. These amounts represent monthly charges of $3,183 for water operations and $2,978 for wastewater operations (approximately $17.39 and $17.02 monthly for each customer). The Office of Public Counsel remains very concerned about the level of charges included in the utility contract with USWSC. We would like to address the following issues regarding the contract: basis for the costs, market value, $400 limit for repairs, reasonableness of total costs, and Attachment G.

Basis for the Costs

The staff reports says on Page 21 that the USWSC contract is

> comprehensive in nature, and provides the Utility's customers with services that prior owners/operators did not provide. Staff notes that providing such services is the primary reason that the water and wastewater expenses have increased.

However, as Ms. McKenna and Mr. Papucci both asked at the customer meeting, there is no specific indication in the staff report as to what new services the customers are receiving. Nor, does the contract address the minimal level of service that is provided, such as how many hours a week or month an operator will be onsite and what level of customer service will be provided. Mr. Beverly testified at the customer meeting regarding his difficulties in reaching someone at the utility to initiate service at his new home.

In response to staff's fourth data request, the utility addressed the specific salaries that are included in the USWSC contract. In response to question 11, the utility identifies the amount of the administrative and management salaries as an ERC charge of $1.87 per month. Further, the utility identifies operational salaries for Lakeside of $8,720 for water and the same for wastewater. This equates to an ERC charge of approximately $1.84 per month. These total approximately $4 per month per customer. There is still $13 per month that is charged to Lakeside for testing, meter reading, billing, collection, accounting, and other services. (Lakeside incurs its own expenses for chemicals, purchased power, sludge hauling, insurance and bad debt.)

As stated in its response to staff's fourth data request, the contract is priced depending on numerous factors. We believe that the Commission should look further into the contract at these remaining services provided by the contract. We believe that the utility should provide further detail showing specific dollars developed for specific tasks, the estimated hours that each of the remaining services will require, and how often these services will be provided. The utility should also provide the methodology for computing the per ERC charge for its water and wastewater systems. Only after an analysis of the specific tasks performed and the basis for the costs charged to Lakeside will the reasonableness of the costs be determined.

Market Value

Because the utility and USWSC have several common officers, we do not believe that any transaction between the two companies is arms-length. The Commission has an obligation to carefully review such transactions so that regulated operations do not subsidize non-regulated operations. The staff report quotes the Supreme Court case that defined the standard of review for affiliate transactions when it stated "the standard must be whether the transactions exceed the going market rate or are otherwise inherently unfair". We are very concerned that staff believes this is a contract negotiated in a "market". There were no other bids submitted – whether because no other company is available or no other company wants to take time to compete for a contract with a company that is so closely affiliated with Lakeside.

Because there is no market based on similar bids, we believe that the utility should, at a minimum, provide any contracts (with all Appendices) between USWSC and non-affiliated utilities, especially all smaller utilities with 2,000 or fewer water accounts and 2,000 or fewer wastewater accounts.

$400 limit for repairs

We are also concerned with the provision that all repairs over $400 are at the utility's expense. Who decides whether a repair is a small simple item or a combined set of tasks that individually would be under the threshold, but on a combined basis total more than $400? Also, will this $400 limiting factor be applied before any 18% mark-up is applied? The decision to make an expense above or below the $400 threshold will be made by the principal owner of USWSC and reviewed by the same person on behalf of the utility and its ratepayers. USWSC has an incentive to incur expenses over $400, which would be outside the base contract, and would also be subject to the additional 18% mark-up.

Reasonableness of total costs

In response to our concerns regarding a similar contract in Docket No. 130153-WS with LP Waterworks, Inc. the utility responded in a letter filed May 7, 2014 and rebutted our comparison of the contract to an AWWA Benchmark Survey. We continue to struggle with interpreting the numbers presented in the AWWA study. However, the bottom line in our whole argument against the contract with USWSC is the substantial impact on the customers' monthly rates. The AWWA study also presents the bottom line comparison on page 52, which we present in the chart below that compares the AWWA average rates to the proposed rates for Lakeside.

Compare Lakeside to AWWA rates		
AWWA Report page 52		
AWWA Survey Residential Bill at 7,500 gallons		
Population 0 - 10,000		
	AWWA	Lakeside
Water Top Quartile	33.43	57.58
Water Median	43.79	57.58
Water Bottom Quartile	55.13	57.58
Sewer Top Quartile	30.40	61.55
Sewer Median	36.16	61.55
Sewer Bottom Quartile	43.97	61.55
Combined Top Quartile	84.06	119.13
Combined Median	84.06	119.13
Combined Bottom Quartile	84.06	119.13

Attachment G

We also have an issue with Attachment G to the contract. The copy of Attachment G that was provided by the utility (with no indication on its face that it is related to Lakeside) includes a provision that "materials and reimbursable expenses will be billed at actual cost plus: 18%" and "Operations Supplies provided will be billed at actual cost plus 18%". Wetzel Consulting, LLC (WetCon) prepared a report to the Florida Governmental Utility Authority (FGUA) regarding the FGUA contracts with USWSC. In this report, on page 4, the WetCon report identifies the 18% as a mark-up including 10% overhead and 8% profit. WetCon further concludes that these "numbers are on the high side of typical industry standards for such mark-ups which more commonly fall within the 12% to 15% range for the combined number." We agree. We believe that the utility response to staff's fourth data request appears to indicate that the USWSC overhead is recovered through the ERC Contract costs between Lakeside and USWSC. If USWSC recovers its overhead through the ERC charges and then adds on overhead through the 18%, we believe this allows a double recovery of these costs. Therefore, if any mark-up is included, it should not be more than the 8%. Certainly, given the non-arms length nature of this contract, the combined mark-up should be no more than the 12% recognized in the WetCon report (the low side of the identified industry standard.)

<u>Rent Expense</u>

11. The transfer order did not include any land as of December 31, 2012. Commission Order No. 13-0425-PAA-WS, issued September 18, 2013 in Docket No. 120317-WS, stated that

> Included in its application, the Utility provided a 99-year lease for the water and wastewater facilities including all lines and lift stations. We find that the lease satisfies the requirements of Rule 25-30.037(2)(q), F.A.C. Although the amount included in the lease may be considered rent expense for future ratemaking purposes, this amount has no effect on land and land rights. We find that the land and land rights for both water and wastewater are $0.

The lease is between the new owner and the prior owners and allows a base monthly rental expense of $400 plus an annual adjustment for CPI and any applicable sales tax (at 7%).

Commission Order No. PSC-96-0663-FOF-WS stated that "Florida is an original cost jurisdiction and Chapter 367, Florida Statutes, requires that this Commission consider the cost of utility assets at the time those assets were dedicated to public service." Further, Commission Rule 25-30.115, Florida Administrative Code, requires that all water and wastewater utilities maintain their accounts and records in conformity with the NARUC Uniform System of Accounts (USOA). The USOA requires in Accounting Instruction 18 that all amounts "shall be stated at the cost incurred by the person who first devoted the property to utility service." If instead of owning the land, the utility has a 99-year lease for the land, the Commission has a history of limiting the lease expense to recovery of "the annual rate of return, based on the utility's current capital structure, times the original cost of the land when placed in service."

Commission Order No. PSC-96-0062-FOF-WS indicates that the utility was established on April 21, 1983. Because the utility was built 30 years ago and this issue has not been addressed by the Commission our research into the original cost at the time it was first dedicated to public service has been difficult. The 1996 Commission Order grants the utility water and wastewater certificates and comments that the utility has a 99 year lease with Werner and Werner, Inc., the entity that owns the mobile home park. The principals of Werner and Werner, Inc. are the same as for the utility receiving the original certificate.

When the current owners purchased the utility, they entered into a 99 year lease with Werner and Werner, Inc. Commission Order No. PSC-13-0425-PAA-WS finds that the lease satisfies the requirements of Rule 25-30.037(2)(q) which requires long term continued use of the land. However, no previous Commission order has addressed the value of the land when it was first dedicated to public service.

We believe that the Commission should address this issue before it decides whether the rent expense is reasonable. Further, we do not believe that the escalation clause for the rent expense is reasonable as it would negate the Commission's policy to limit the rent expense to limit rent expense to an amount equivalent to the return on the original cost of the land when placed in service.

<u>Bad Debt Expense</u>

12. The staff report indicates that the test year bad debt expense is $865 for water and $638 for wastewater. These amounts are based on the new owner's monthly accrual of $144 for water and $106 for wastewater for January through June 2013. The staff report further increases these amounts to reflect a 2% level for bad debt expense for the test year (for an annual expense of $1,288 for water and $1,240 for wastewater.) This 2% was merely suggested by the utility in a letter filed with the Commission Clerk on January 22, 2014. The utility did not provide any support for why the 2% is reasonable for Lakeside. There is no historical data for bad debt and there is no aging report that indicates how many accounts are over 90 days late. The Commission has historically used a three-year average to determine a reasonable bad debt expense. In this case, we understand that there is a new owner and even if the three-year historical data was available, it may not be representative of operations under the new owner. However, the new owner has been operating the system for over a year and a half and should be able to provide some information regarding the amount of bad debt that is not covered by customer deposits.

    Bad Debt Expense is not included in the USWSC contract. However USWSC provides the meter reading, billing and collecting services. While Lakeside and USWSC are related entities, we believe that there is no incentive for USWSC to minimize bad debt expense as any losses are not passed through to USWSC.

    We have reviewed the bad debt expense granted by the Commission in staff assisted rate cases for the period January 2010 through June 2014. The average bad debt expense as a percentage of revenues was less than one percent (.72%) or $2.33 per customer on an annual basis. This is substantially less than the 2% of revenues in the staff report (or $7 per customer on an annual basis.) We recommend that because the utility has not met its burden to support a 2% bad debt expense, the staff should at a minimum, reduce the bad debt expense to no more than the historic average of .72% of the revenues on an annual basis.

Amortization Expense

13. The staff report includes $490 for Water amortization expense and $275 for Wastewater amortization expense and identifies these as the amortization of CIAC. The amounts included in Schedules 3-A and 3-B increase Operating Expenses. However, any amortization of the CIAC balances should be a reduction to the Operating Expenses. We believe staff should review these to correct any amortization of CIAC to be an offset to reduce Depreciation Expense.

Service Availability Fees and AFPI

14. The utility requested Service Availability Fees and Allowance for Funds Prudently Invested (AFPI) charges in a letter filed August 22, 2014 (Document No. 04677-14). We believe that the development of any fees and charges for the wastewater system should be consistent with any staff recommendation regarding the pro forma plant. In response to Staff's Fourth Data request, the utility discussed the pro forma wastewater plant. In its response to Questions 24, 27, and 32, the utility discussed its plan to re-rate the wastewater treatment plant. While we have discussed this issue in more detail earlier in this letter, we would also point out that any recommendation made by staff should be consistent with regard to the fees and charges. If the staff recommends that any changes should be made to the used and useful plant, then the same adjustments should be made to the calculations for any service availability fees and AFPI charges.