



Public Service Commission

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DATE: JULY 20, 2000

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYO)

FROM: DIVISION OF ECONOMIC REGULATION (BUTTS, RENDELL, CROUCH)
DIVISION OF LEGAL SERVICES (BRUBAKER)

RE: DOCKET NO. 991835-WS - APPLICATION FOR ALLOWANCE FOR FUNDS PRUDENTLY INVESTED (AFPI) CHARGE FOR ADDITIONAL WATER IMPROVEMENTS AND FOR ADDITIONAL LINES ASSOCIATED WITH WASTEWATER EXTENSION INTO GEORGE MAYO SUBDIVISION IN MARION COUNTY, BY TRADEWINDS UTILITIES, INC.
COUNTY: MARION

AGENDA: 08/01/00 - REGULAR AGENDA - TARIFF FILING - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: 8-MONTH EFFECTIVE DATE: 08/06/00 (AFPI)

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\WP\991835.RCM

CASE BACKGROUND

Tradewinds Utilities, Inc. (Tradewinds or utility) is a Class C water and wastewater utility located in Marion County. The following information was obtained from the utility's 1999 annual report:

	Number of Customers	Annual Revenues	Operating Expenses	Net Operating Income
Water	450	\$104,056	\$102,902	\$ 1,154
Wastewater	270	\$166,118	\$138,913	\$27,205

The utility service area is located in the St. Johns River Water Management District.

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FPSC-RECORDS/REPORTING

DOCKET NO. 991835-WS
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On December 6, 1999, the utility filed proposed tariffs along with an application for authority to initiate allowance for funds prudently invested (AFPI) charges for water and wastewater, pursuant to Section 367.091, Florida Statutes, and Rules 25-30.565 and 25-30.434, Florida Administrative Code. The utility requested approval of AFPI charges to recover non-used and useful plant. The utility stated that the Department of Environmental Protection (DEP) provided a loan from the State of Florida's Revolving Fund in the amount of \$632,700, in connection with improving the quality of water being served to the utility's customers in the George Mayo Subdivision in accordance with the Safe Water Drinking Act.

A filing fee is not required for an AFPI proceeding. The utility is requesting AFPI charges for the recovery of the carrying cost for the additional water plant and lines.

By Order No. PSC-00-0368-TRF-WS, issued February 21, 2000, the Commission suspended the utility's proposed water AFPI charges pending further investigation by staff, and approved wastewater AFPI charges as filed.

This recommendation addresses the utility's request for water AFPI charges.

DISCUSSION OF ISSUES

ISSUE 1: Should Tradewinds Utilities, Inc.'s proposed Water Tariff Sheet No. 18.1 containing AFPI charges be approved?

RECOMMENDATION: No, Water Tariff Sheet No. 18.1 should be denied. For the reasons stated in the staff analysis, and due to missing and conflicting information, staff recommends that if the utility wishes to recover the carrying costs on the non-used and useful plant that it consider filing for a Staff Assisted Rate Case. (BUTTS, RENDELL, CROUCH)

STAFF ANALYSIS: As stated earlier, on December 6, 1999, the utility filed proposed tariffs along with an application for authority to initiate AFPI charges for water and wastewater, pursuant to Section 367.091, Florida Statutes, and Rules 25-30.565 and 25-30.434, Florida Administrative Code. In this AFPI filing, the utility has requested approval to recover the carrying costs on the non-used and useful plant. The utility stated that it received a loan from DEP's State of Florida's Revolving Fund to help improve the quality of water being provided to the customers in the George Mayo Subdivision. The George Mayo Subdivision consists of 40 connections, or 133 equivalent residential connections (ERCs). Currently, according to the utility, there are 18 of these customers being served.

An AFPI charge is a mechanism designed to allow a utility to earn a fair rate of return on a portion of the plant facilities which were prudently constructed and held for future use for future customers that will be served by that plant in the form of a charge paid by those customers. This charge allows the recovery of carrying costs on the non-used and useful plant. By providing this type of charge, the existing customers do not pay for plant expansion used to serve future customers. Future customers bear their equitable share of the carrying costs related to the plant facilities being constructed to provide service to them.

This one-time charge is based on the number of future ERCs and is generally applicable to all prospective customers who have not already prepaid the service availability charge. The charge should be assessed based on the date the future customers make some form of prepayment or on the date the customer connects to the system, whichever comes first.

Staff sent a data request on February 9, 2000, requesting additional information. The utility responded to staff's request by a letter dated March 10, 2000. The responses included a list of Tradewinds' Utility Plant in Service (UPIS) connected with the water

improvements involving AFPI charges. The account numbers, plant description, date installed, and requested values submitted by the utility are listed below:

<u>Account No.</u>	<u>Plant Description</u>	<u>Date Installed</u>	<u>Amount</u>
303	Land (10 acres)	05/30/99	\$162,500
304	Struct. & Improv.	05/30/99	\$ 16,694
311	Well Pumps	04/30/99	\$ 1,367
330	Elevated Tank	05/30/99	\$267,644
331	Distr. Lines	11/01/98	\$110,883
333	Services	11/01/98	\$ 37,009
334	Meters	05/30/99	\$ 6,031
335	Hydrants	11/01/98	\$ 8,000
	Total		<u>\$610,128</u>

Staff is concerned with several of the components requested by the utility to determine the appropriate AFPI charges. Based upon staff's review of the components involving the utility's water AFPI filing, and for the reasons set forth in this analysis, staff is recommending that the utility's requested AFPI charges on its water system should be denied. Staff will address each concern with the utility's AFPI filing below.

Related Party Transaction - Land

The first concern is a related party transaction involving the land that occurred between the utility and its president. By Order No. PSC-94-0245-FOF-WS, issued March 4, 1994, in Docket No. 930524-WS, the Commission determined that Tradewinds' used and useful land value on its water system was \$20,000. However, this Order also states that in 1992, the utility purchased an additional 20 acre tract of land for spray irrigation in order to dispose of treated wastewater effluent. The utility recorded the value of the land at \$99,000. During that rate case, it was discovered that only 6.6 acres of the 20 acres were considered used and useful. Further, of the 6.6 acres, 4.5 acres were for the spray field and 2.1 acres were for the buffer zone. The Commission adjusted the additional land value by (\$66,330) to reflect the 6.6 acres that were actually used and useful to an approved amount of \$32,670.

According to the utility and information from the Marion County Property Appraiser's Office (MCPAO), 10.25 acres of the 20 acres

referenced above was sold from the utility to a related stockholder of the utility. It was later discovered that the related stockholder was Mr. DeMenzes, the utility's president. The County's Official Records of Transfer (CORT) at the MCPAO stated that in December of 1998 there were two separate transfers involving 10.25 acres of unqualified property. In each case, the transfer was initiated by a Quit Claim Deed.

As stated earlier, staff discovered that the stockholder who purchased and then resold the land was the utility's president, Mr. Charlie DeMenzes. According to Statement of Financial Accounting Standard No. 57, examples of related party transactions include, but are not limited to, transactions between an entity and its principal owners or members of their immediate families. Principal owners are defined as owners of record who own more than 10 percent of the voting interest of the company. Per Tradewinds' 1999 Annual Report, the stockholder in this scenario has 100% ownership in this utility. Staff believes that the sale and resale of this property between the utility and the stockholder and vice-versa was a related party transaction.

Related party transactions require heightened scrutiny. Although a transaction between related parties is not per se unreasonable, it is the utility's burden to prove that its costs are reasonable. Florida Power Corporation v. Cresse, 413 So. 2d 1187, 1191 (Fla. 1982). This burden is even greater when the transaction 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 evidence to contrary. The standard is to evaluate affiliate transactions and determine whether those transactions exceed the going market rate or are otherwise unfair.

As stated earlier, on February 9, 2000, staff sent a data request concerning the land included in the AFPI filing. Staff attached a copy of the order from the utility's last rate case to its data request for review by the utility's president. Pursuant to this order, the Commission established a value on the same land within the utility's wastewater system in connection with the sprayfield and buffer zone. A summary of the information staff requested is below:

- An explanation as to why the utility was attempting to recover land investment from its water system when it was previously included in wastewater plant-in-service.

- Address or provide documentation on the sale of 10.25 acres of land from the utility to the stockholder.
- Provide documentation why 10.25 acres of land was immediately repurchased by the utility from the stockholder.

However, the utility requested additional time to respond on March 10, 2000. To date, staff has not received any additional information concerning the data request.

Staff has concerns over the significant increase in land value that the utility has reported, and whether the increased cost for land is prudent. Staff believes that to include the total amount requested by the utility on the land is inappropriate for this filing. Staff believes that the utility has failed to meet its burden to provide the requisite information on the land transaction.

As for attempting to establish a used and useful percentage on the land mentioned previously, staff could not determine what portion of the land was considered to be used and useful. However, the utility stated that the ten acres were needed for the installation of a 200,000 gallon elevated storage tank, which is discussed below, but it did not provide staff with information on the quantity of land that was needed for the tank.

Further, staff believes the utility should consider filing for a Staff Assisted Rate Case (SARC), if it wishes to recover the cost associated with this investment.

Elevated Tank

Staff's second concern involves the elevated storage tank. According to the guidelines in DEP's loan contract in connection with improving the water quality in the George Mayo Subdivision, the utility was to install a 200,000 gallon elevated tank for fire flow and potable water. The utility requested full recovery of installing the tank through this AFPI proceeding. The utility anticipated passing on the total cost of the tank to future customers located only in the George Mayo Subdivision. Staff does not believe that the cost of the tank should be allocated only to the customers located in this subdivision. The water distribution main/lines associated with the tank in the subdivision are interconnected with the existing water mains/lines in the service area.

Because of this interconnection, staff disagrees with the utility's attempt to require the customers in the subdivision to pay for all the cost associated with the tank. To be more specific, the interconnection with existing lines is an indication that current customers are also benefitting from the tank investment. Due to the interconnection, the current customers in the utility's existing service area will also receive water from this tank for fire flow or potable water purposes. Therefore, the current customers should be allocated their fair share of paying the cost of this investment.

In order for the utility to earn a fair rate of return on this investment, it should require existing customers and all future customers to pay their fair share of the cost of this asset. Staff believes that to require only the customers in the George Mayo subdivision to pay the total cost of the tank would be unfair and discriminatory.

If the utility chooses to file for a SARC, staff believes it would be more appropriate to consider a request to recover the costs of the tank from all utility customers in that proceeding. In that proceeding, staff can complete a full analysis of the utility's plant, books, and records, etc. Staff believes that this will allow the utility an opportunity to earn a fair rate of return on its investment.

Used and Useful and Future ERCs

Staff's next concern involves the appropriate amount of used and useful percentage and future ERCs over which the AFPI charges should be spread. Upon reviewing the AFPI application, additional data responses, and analyzing the utility's 1999 annual report, staff has determined conflicting information concerning the utility's request for AFPI charges on its water system.

Based on information received from the utility, staff could not make a determination as to what percentage of the tank is used and useful. Further, staff could not make a reasonable determination from the information provided as to how many future ERCs the utility could connect.

According to the utility's 1999 annual report, the utility is currently serving 285 ERCs, and the maximum number of ERCs to be served is 1,600. On March 30, 2000, staff issued its data request for additional information involving current and maximum ERCs for the utility's water system. On April 11, 2000, the utility responded with the following information: its current number of ERCs is 260, and its

maximum number of ERCs is approximately 500. Staff believes that the number of ERCs from the utility's 1999 annual report and the data received from the utility should be equal or similar in number. However, to reconcile the number of ERCs, staff initiated its own calculations based on the annual report and information received from the utility.

It is difficult to determine an accurate used and useful percentage applicable to this plant due to the conflicting and missing flow and ERC statistics. The system is currently capable of serving approximately 943 ERCs which is derived by taking the reliable capacity of the two wells pumping for twelve hours each (283,000 gpd) plus the capacity of the new storage tank (200,000) or 483,000 gpd. When the fire flow of 120,000 gallons is subtracted, it leaves a total of 363,000 gpd available for customers. The average use per ERC is 385 gpd, resulting in 943 potential customers or ERCs. The utility has stated that it is currently serving 450 ERCs and did not provide any growth figures to staff; therefore, staff has calculated the used and useful percentages as follows:

Current per ERC flows gpd	173,250
GPD Fire Flow	<u>+120,000</u>
Current system's total gpd	293,250
Current system's total gpd	293,250
Divided by the full capacity	<u>483,000</u>
Used and useful percentage	60.7%

If 60.7% of the utility's plant is considered used and useful, then 39.3% is considered to be non-used and useful. Thus, 39.3% of the plant could be applied to the utility's request for AFPI charges.

It must be emphasized that many of these figures represent staff's best estimate due to missing and conflicting data provided to staff by the utility. Staff is concerned that there is too much inaccurate information in this AFPI proceeding. According to the 1999 annual report, staff's data request, and calculations performed by staff, the dissimilarities in these numbers are too great for staff to definitively calculate either the appropriate non-used and useful or future ERCs to which AFPI charges should be allocated.

Meter and Meter Installation Fees

Staff's next concern is the inclusion of meter costs requested by the utility. Included in its AFPI filing is the cost of installing

meters in the amount of \$6,031. According to the utility's current water tariff on file with the Commission, and pursuant to Docket No. 930524-WS, by Order No. PSC-94-0245-FOF-WS, issued March 4, 1994, the utility was given authorization to implement a meter installation charge. In that order, the utility was authorized to charge the following for meter installation:

5/8" x 3/4"	\$100
1"	\$130
1 1/2"	\$180
2"	Actual Cost

A meter installation fee is the mechanism in place for the utility which allows an opportunity to recover the cost of providing and installing meters for its customers. Staff believes that it would be inappropriate to include the cost of meter installations in the AFPI calculation since these amounts have already been recovered through other approved charges.

Conclusion

As stated previously, staff has several concerns with the utility's AFPI filing. We have reviewed the utility's AFPI application, information provided in response to data requests, and the utility's 1999 annual report. Based on this analysis, staff does not have sufficient information to determine appropriate AFPI charges. Therefore, for the reasons stated, and due to missing and conflicting information, we recommend that if the utility wishes to recover the carrying costs on the non-used and useful plant that it consider filing for a SARC.

For the foregoing reasons, staff recommends that the utility's Water Tariff Sheet No. 18.1 should be denied.

DOCKET NO. 991835-WS
DATE: JULY 20, 2000

ISSUE 2: Should this docket be closed?

RECOMMENDATION: Yes. If no timely protest is received upon the expiration of the protest period, the Order will become final upon the issuance of a Consummating Order, and this docket should be closed.
(BRUBAKER, BUTTS)

STAFF ANALYSIS: If no timely protest is received upon the expiration of the protest period, the Order will become final upon the issuance of a Consummating Order, and this docket should be closed.