

Ann Cole

From: Tim Devlin
Sent: Friday, February 18, 2011 3:57 PM
To: Ann Cole
Cc: Commissioners Advisors; Chuck Hill; Marshall Willis; Cheryl Bulecza-Banks; Mary Anne Helton; Jennifer Crawford; Erik Saylor; Bart Fletcher
Subject: FW: request for oral modification to Item No. 7 (Docket No. 100426-WS - Application for increase in rates by Lake Utility Services, Inc.)

Approved.

From: Andrew Maurey
Sent: Thursday, February 17, 2011 10:45 AM
To: Tim Devlin
Cc: Marshall Willis; Cheryl Bulecza-Banks; Mary Anne Helton; Jennifer Crawford; Erik Saylor; Bart Fletcher
Subject: request for oral modification to Item No. 7 (Docket No. 100426-WS - Application for increase in rates by Lake Utility Services, Inc.)

Staff requests approval to make an oral modification to Item No. 7 on the February 22, 2011 Commission Conference. Specifically, staff requests approval to modify Issue 4 of the recommendation filed in Docket No. 100426-WS - Application for increase in rates by Lake Utility Services, Inc. (LUSI).

Pursuant to Section 367.082, F.S., revenues collected under interim rates shall be placed under bond, escrow account, letter of credit, or corporate undertaking subject to refund with interest. Issue 4 addresses staff's recommendation regarding the appropriate method to secure interim revenues collected by LUSI. Each of these methods of security has a cost. Because a corporate undertaking is the least expensive of the methods, it is typically the preferred option by utilities. A corporate undertaking is granted to utilities with a strong financial position relative to the amount in question. When a company owns multiple utilities, it is necessary to conduct the analysis based on the cumulative amount subject to refund for all utilities with active cases.

Subsequent to the filing of the above referenced staff recommendation, counsel for Utilities, Inc. (UI) filed documentation regarding the refund amount associated with its Utilities, Inc. of Florida (UIF) system. As a result of this new information, the cumulative amount of revenues subject to refund is materially less than the amount recognized in the original analysis. After conducting the analysis based on this revised cumulative corporate undertaking amount, staff recommends that UI can support a corporate undertaking in the amount requested. Please find below the revised Issue 4 in type and strike format.

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. The cumulative amount of revenue that needs to be protected is \$930,102. The Utility should be required to open an escrow

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~~account or file a surety bond or letter of credit to guarantee any potential refund of revenues collected under interim conditions. If the security provided is an escrow account, the Utility should deposit 24.22 percent of water revenues into the escrow account each month. Otherwise, the surety bond or letter of credit should be in the amount of \$778,078. 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. (Fletcher, Buys)~~

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 \$1,332,875. 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 \$778,078 in the instant docket. 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.

LUSI is a wholly-owned subsidiary of Utilities, Inc. (UI), which provides all investor capital to its subsidiaries. In Docket No. 090462-WS, the Commission approved a corporate undertaking in the amount of \$599,271 to secure interim increases granted for Utilities, Inc. of Florida, which is also a wholly-owned subsidiary of UI.^[1] Of the \$599,271 amount, approximately ~~\$152,024~~~~\$428,000~~ is due to be refunded to the customers.^[2] As a result of staff's interim recommendation in this docket, the total cumulative corporate undertaking amount is ~~\$930,102~~~~\$1,206,078~~, of which \$778,078 is subject to refund in this docket. As such, staff reviewed the financial statements of UI to determine if UI can support a cumulative corporate undertaking in the amount of ~~\$930,102~~~~\$1,206,078~~.

The criteria for a corporate undertaking include sufficient liquidity, interest coverage, equity ownership, and profitability to guarantee any potential refund. Generally, if a utility has favorable measures, ratios, and trends in these areas, staff will recommend that the utility be allowed a corporate undertaking. Staff reviewed UI's 2007, 2008, and 2009 unaudited financial statements to determine if UI can support an additional corporate undertaking on behalf of its subsidiary, LUSI. According to its financial statements, UI reported adequate equity ownership, but weak liquidity and insufficient interest coverage and profitability over the review period.

For all three years, UI had negative working capital and a current ratio less than one indicating insufficient liquidity. Liquidity refers to a company's ability to meet short-term and maturing long-term debt obligations. These ratios attempt to determine whether the utility will have sufficient current (or liquid) assets in the form of cash or cash equivalents, which can be converted into cash quickly without loss of value, to pay its current liabilities. The current ratio indicates how many times a utility's current liabilities are covered by its current assets. A current ratio less than one indicates that a utility may not have enough cash or cash equivalents to pay its current liabilities. The interest coverage ratio indicates how many times a utility's interest expense is covered by its earnings. A utility with an interest coverage ratio less than two may have difficulty borrowing additional funds.

Over the three-year period, UI maintained sufficient equity ownership with an equity ratio of 40 percent. Staff believes the standard for this measure should be an equity ratio of at least 30 percent. This standard is based on the benchmark established by Standard & Poor's for BBB-rated water utilities.

UI's reported net income of \$1,680,575 in 2007. In 2008, UI 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 \$5,662,600. Over the three-year period, UI's net income averaged \$2,235,923, which is only ~~2.418~~ times the requested cumulative corporate undertaking amount of ~~\$930,102~~~~\$1,206,078~~. The preferred average amount of net income should be at least four times greater than the requested corporate undertaking amount.

On the day prior to filing this recommendation, LUSI submitted UI's unaudited financial statements for 2010. For 2010, UI reported sufficient liquidity, equity ownership and profitability. UI's interest coverage ratio is 1.63, which is below the preferred limit of 2.0, but has been trending upwards since 2008. For 2010, UI had positive working capital and a current ratio of 1.11. 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. Excluding the \$10 million gain on the disposition of utility systems in 2010, UI's average net income over the three-year period from 2008 to 2010 is \$4,736,779, or 5.1 times the ~~remains insufficient for a~~ cumulative corporate undertaking in the amount of ~~\$930,102~~~~\$1,206,078~~.

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 this analysis, staff recommends that a cumulative corporate undertaking in the amount of \$930,102 is acceptable contingent upon receipt of the written guarantee of UI and written confirmation that UI does not have any outstanding guarantees on behalf of UI-owned utilities in other states. ~~insufficient liquidity, interest coverage, and profitability to support a corporate undertaking in the amount requested. While the existing corporate undertaking amount of \$599,271 secured on behalf of Utilities, Inc. of Florida is still appropriate, staff recommends that UI be required to secure a surety bond, letter of credit, or escrow agreement to guarantee any new monies collected subject to refund.~~

~~If the security provided is an escrow account, said account should be established between the Utility and an independent financial institution pursuant to a written escrow agreement. The Commission should be a party to the written escrow agreement and a signatory to the escrow account. The written escrow agreement should state the following: that the account is established at the direction of the Commission for the purpose set forth above; no withdrawals of funds shall occur without the prior approval of the Commission through the Commission Clerk, of Office of Commission Clerk; the account shall be interest bearing; information concerning that escrow account shall be available from the institution to the Commission or its representative at all times; the amount of revenue subject to refund shall be deposited in the escrow account within seven days of receipt; and, pursuant to Cosentino v. Elson, 263 So. 2d 253 (Fla 3d DCA 1972), escrow accounts are not subject to garnishments.~~

~~If the security provided is an escrow account, the Utility should deposit 24.22 percent of water revenues into the escrow account each month. The escrow agreement should also state that if a refund to the customers is required, all interest earned on the escrow account should be distributed to the customers, and if a refund to the customers is not required, the interest earned on the escrow account should revert to the Utility.~~

~~If the security provided is a surety bond or a letter of credit, said instrument should be in the amount of \$778,078. If the Utility chooses a surety bond as security, the surety bond should state that it will be released or terminated only upon subsequent order of the Commission. If the Utility chooses to provide a letter of credit as security, the letter of credit should state that it is irrevocable for the period it is in effect and that it will be in effect until a final Commission order is rendered releasing the funds to the Utility or requiring a refund.~~

~~Regardless of the type of security provided, the Utility should keep an accurate and detailed account of~~

~~all monies it receives.~~ Pursuant to Rule 25-30.360(6), F.A.C., the Utility shall 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. Such costs are the responsibility of, and should be borne by, the Utility.

[1] See Order No. PSC-10-0300-PCO-WS, p. 6.

[2] See Order No. PSC-10-0585-PAA-WS, p. 43.

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