

FLORIDA PUBLIC SERVICE COMMISSION
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M E M O R A N D U M

MAY 30, 1996

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

FROM: *W* DIVISION OF WATER & WASTEWATER (WILLIS, CROUCH, MUNROE)
Be MERCHANT, BINFORD, RENDELL, AUSTIN
AS DIVISION OF LEGAL SERVICES (CAPELESS) *ABC*

RE: DOCKET NO. 960192-WS - HOBE SOUND WATER COMPANY - LIMITED
PROCEEDING FOR RATE INCREASE
COUNTY: MARTIN

AGENDA: JUNE 11, 1996 - REGULAR AGENDA - PROPOSED AGENCY ACTION -
INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\WAW\WP\960192WU.RCM

DOCUMENT NUMBER-DATE
05953 MAY 30 1996
FPSC-RECORDS/REPORTING

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CASE BACKGROUND

Hobe Sound Water Company (Hobe Sound or utility) is a Class A utility located in Martin County which provides water service to approximately 1265 customers. The service area includes customers both in Hobe Sound and on Jupiter Island. South Florida Water Management District (SFWMD) has determined this area to be a critical water usage area. The water company is a wholly-owned subsidiary of the Hobe Sound Water Company operating under the provisions of Certificate No. WU-43.

On September 8, 1977, SFWMD issued Water Use Permit 43-00076-W was issued to Hobe Sound Water Company authorizing the withdrawal of ground water from the surficial aquifer for a period of ten years. The Permit was renewed on July 14, 1988 for an abbreviated duration of five years. This Permit increased the utility's withdrawal allocation from 1.61 MGD to 2.92 MGD and required a salt water tracking program. A tracking program was submitted to SFWMD and initiated.

By Order NO.PSC-94-1452-FOF-WU, issued December 20, 1994, in Docket No. 940475-WU, the utility's last rate case proceeding, the Commission approved the utility's current rate structure. This structure is unique in that it is a three tier increasing block rate, which was designed to encourage conservation in an area where usage per capita is extremely high. The consumption under this rate is down approximately seven percent since the 1993 high in spite of a one percent increase in customers.

After Hobe Sound filed the 1994 rate increase, salt water intruded into the well field east of highway US1. Despite the monitor system, there was no advanced warning of this occurrence. The loss of supply wells resulted in a critical supply problem. Hobe Sound's response to this problem was (1) an emergency interconnect with a near by utility (Hydratech Utilities, Inc.) and (2) an accelerated supply program on the west side of highway US1.

On June 19, 1995 the utility and SFWMD entered into a Consent Agreement (Order No. 95-42). As a result of this agreement, the utility had to accomplish the following: (1) improve ground water monitoring, (2) incorporate operation restraints when any salt water intrusion is detected, (3) investigate interconnect options, and (4) pay civil penalties.

On February 16, 1996 Hobe Sound filed the current request for a limited proceeding as the most cost efficient method to recover expenses and increased costs. In addition to the supply wells and interconnect with Hydratech Utilities Inc., the costs of developing

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and implementing a Consent Agreement with SFWMD, and an improved ground water program including new monitor wells were also included in this filing.

By motion filed May 13, 1996, the Town of Jupiter Island requested leave to intervene in this docket. The Prehearing Officer is addressing that motion. This recommendation addresses the utility's request for a limited proceeding.

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ISSUE 1: Is the quality of service satisfactory?

RECOMMENDATION: Yes, the quality of service is satisfactory.
(MUNROE)

STAFF ANALYSIS: In accordance with Section 25-30.225, Florida Administrative Code, the Commission Staff, in order to determine the overall quality of service provided by a utility, shall evaluate three separate components of operations. These are (1) quality of the utility's product, (2) the operational conditions of the utility's plant and facilities, and (3) the utility's attempt to address customer satisfaction.

Quality of the Product

After contacting DEP officials, the fact that there is a problem with excessive iron levels in water drawn from the new supply wells west of highway US 1 was communicated. The utility is in the process of addressing this problem with an iron filtration project which is not a part of this rate proceeding. Full documentation of this project was supplied to staff. The iron filtration project is currently under way.

Operational Conditions

DEP officials further indicated the plant and facilities were found to be in good working order, and no violations were noted.

Customer Satisfaction

A customer meeting was held on March 20, 1996 in the Hobe Sound Elementary School cafeteria. This meeting was attended by approximately eighteen persons, nine of which spoke as witnesses. Of the nine four customers had problems with the water quality all of which were related to high iron levels. This problem is being addressed by the utility.

Considering these three components of quality of service and the iron filtration project which has been initiated by the utility, the overall quality of service is found to be satisfactory.

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ISSUE 2: Should the capital projects requested by the company for consideration in this proceeding be included in rate base?

RECOMMENDATION: Yes. The monitor program including monitor wells, new supply wells and interconnect are considered necessary and prudent. (MUNROE)

STAFF ANALYSIS: According to South Florida Water Management District, because of threat of salt water intrusion, a revised monitoring program, which included monitoring wells, was a requirement set forth by their agency. The other two projects (New Supply Wells and an Emergency Interconnect) were endorsed by SFWMD agency as viable solutions to supply problems brought on by the occurrence of salt water intrusion into supply wells east of highway US1.

The salt water monitor program implemented in 1994 proved to be ineffective. This is proven by the undetected intrusion of salt water into the east well field. Because of the threat of further salt water intrusion, a new more effective monitor system was required.

With contaminated supply wells, the utility installed the emergency interconnect with Hydratech Utilities, Inc. as a short term solution. Next, new supply wells were installed, tested, permitted, and connected in a timely manner. Although the Hydratech interconnect was a temporary solution, it was economically the most viable option, and does serve as a supply backup should some problem arise.

In view of these facts and after a review of the cost associated these projects, staff recommends they be included in rate base as they are both prudent and necessary.

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ISSUE 3: What is the appropriate increase in the revenue requirement for this utility?

RECOMMENDATION: The appropriate water increase should be \$175,531 which results in an increase over test year revenues of 11.91%. (BINFORD)

STAFF ANALYSIS: In its limited proceeding application, the utility requested a \$232,234 (15.76%) increase. The utility's proposed increase was made up of several component increases to rate base with specific adjustments to operating expense. The components that were included in rate base were interconnection and production wells, and unamortized balance of the Consent Agreement and groundwater monitoring wells. The adjustments to operating expenses included rate case expense, amortization of the Consent Agreement and ground monitoring wells, and property taxes. The utility's revenue increase is comprised of return on rate base items plus the increase in operating expenses and gross-up for taxes. Staff has reviewed the application as well as supporting documentation. Based on this review, staff recommends adjusting the revenue increase from \$232,234 (15.76%) to \$175,531 (11.91%) over test year revenues. Staff's revenue requirement calculation is attached as Schedule 1. Staff's recommended adjustments are discussed below and shown on Schedule 2. Schedule 3 contains the components for revenue requirement and depreciation calculations.

Groundwater Monitoring Wells

In the utility's application, it included \$59,009 in groundwater monitoring costs to be amortized over five years. It included a simple average of the beginning year balance and the first year's unamortized balance as an increase to rate base. When staff inquired about the \$59,009 in groundwater monitoring costs, the utility identified the cost as preliminary survey and investigation (PS&I) charges. According to NARUC Accounting Instructions, if construction results, plant accounts should be charged the amount of expenditures for PS&I which are determined to contribute directly and immediately to the construction, without duplication. Based on our analysis, these PS&I charges are appropriately related to the construction of the monitoring wells.

Therefore, staff recommends capitalizing the groundwater monitoring costs of \$59,009 to the wells and springs plant account. Accordingly, accumulated depreciation and depreciation expense should be increased by \$4,297 and \$1,975, respectively. A schedule for the calculation of depreciation is attached as Schedule 3. Also, amortization expense should be decreased by \$11,802.

Consent Agreement

The primary, overall intent of the Consent Agreement is to resolve an on-going SFWMD enforcement action and also provide a legal mechanism for the utility to continue to provide water for its public water supply customers. It was also designed to provide the SFWMD maximum assurances that the water resources will be protected during the interim period in which the Consent Agreement is effective. The charges related to the Consent Agreement consisted of legal fees and engineering fees. In its application, the utility amortized the total amount of \$221,032 over three years. As such, it included \$73,677 as annual amortization. As with the groundwater monitoring costs, the utility also included a simple average of the beginning year balance of the Consent Agreement and the first year's unamortized balance as an increase to rate base.

The Consent Agreement, which was designed to be in effect for three years, states that an extension may be granted if the utility, in good faith, attempted to implement the requirements contained in the Consent Agreement. The Consent Agreement may be extended for a maximum two-year duration only if, in the SFWMD's reasonable discretion, good faith efforts of the utility are adequately documented. The duration of the Consent Agreement shall not, including any extensions, exceed a duration of five years from the effective date. Based on the language of the Consent Agreement, it appears that the burden is on the utility to make a good faith effort to comply with the Consent Agreement. Regardless, staff believes that a five-year amortization period is appropriate. This is also consistent with Rule 25-30.433(8), Florida Administrative Code, regarding non-recurring expenses. Therefore, staff recommends reducing the amortization of the Consent Agreement from \$73,677 to \$44,206.

Staff also believes that it is inappropriate to include a simple average of the first year of unamortized balance in the rate base. A more appropriate balance to include would be the average unamortized balance over the five-year life of the Consent Agreement that incorporates a normalized balance for return to be based upon. If the first year average were allowed, the customers would be paying the highest return for the remaining four years. Accordingly, only 50% of the total cost or \$110,516 should be included as an addition to rate base.

Rate Case Expense

In its application, the utility originally requested recovery of \$60,000 in rate case expense for the limited proceeding. Upon

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staff's request, the utility provided support for current rate case expense and an estimate to complete the case. The revised total submitted on May 13, 1996, was \$40,288. Based on our review the requested amount of legal expenses appear reasonable. However, the total number of estimated hours to complete for the consulting firm was 91 hours (51 hours for the principle, 40 hours for the financial analyst). Staff compared this estimate to complete the limited proceeding with other estimates to complete full rate increase cases. Staff believes that the estimate to complete for this limited proceeding is excessive. We believe that 40 hours is a more reasonable number (24 hours for the principle, 16 hours for the financial analyst). Based on staff's findings, rate case expense should be reduced to \$30,948.

	<u>Original</u>	<u>Utility Adjust.</u>	<u>Revised</u>	<u>Staff Adjust.</u>	<u>Staff Adj. Bal.</u>
Guastella	55,000	<19,891>	35,109	<9,340>	25,769
Melson	<u>5,000</u>	<u>0</u>	<u>5,179</u>	<u>0</u>	<u>5,179</u>
	<u>60,000</u>	<u><19,891></u>	<u>40,288</u>	<u><9,340></u>	<u>30,948</u>
Amortization	<u>15,000</u>		<u>10,072</u>		<u>7,737</u>

Other Adjustments

In addition to the above adjustments, corresponding adjustments have been made to depreciation expense, property taxes, and interest expense (debt return). The total revenue increase also reflects a gross-up for income taxes and regulatory assessment fees.

Based on the adjustments discussed above, staff recommends that the appropriate revenue increase should be \$175,531.

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ISSUE 4: What are the appropriate water rates for Hobe Sound Water Company?

RECOMMENDATION: The recommended rates should be designed to allow the utility the opportunity to generate additional annual revenues of \$175,531 for water service. This results in a water increase of 11.91%. The utility should be required to file revised tariff sheets and a proposed customer notice to reflect the appropriate rates. The approved rates should be effective for service rendered on or after the stamped approval date on the tariff sheet pursuant to Rule 25-30.475(1), Florida Administrative Code, provided the customers have received notice. The rates should not be implemented until proper notice has been received by the customers. The utility should provide proof of the date notice was given within 10 days after the date of the notice. (AUSTIN)

STAFF ANALYSIS: The permanent rates requested by the utility are designed to allow the utility to generate additional revenues of \$232,234 for water. The requested revenues represent an increase of 15.76% for water service.

Staff recommends that the final rates approved for the utility should be designed to allow the utility the opportunity to generate additional annual revenues of \$175,531 which is an increase of 11.91% for water rates.

The approved rates should be effective for service rendered on or after the stamped approval date of the tariff pursuant to Rule 25-30.475(1), Florida Administrative Code, provided the customers have received notice. The utility should be required to file and have staff's approval of the revised tariff sheets. The utility should also be required to file and have approval of a proposed customer notice, pursuant to Rule 25-22.0407(10), Florida Administrative Code, prior to implementing the new rates. The utility should provide proof of the date the notice was given within 10 days after the date of notice.

A comparison of the utility's original rates, requested rates, and staff recommended rates is shown on Schedule No. 4.

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ISSUE 5: What is the appropriate amount by which rates should be reduced four years after the established effective date to reflect the removal of the amortized rate case expense as required by Section 367.0816, Florida Statutes?

RECOMMENDATION: The water rates should be reduced, as shown on Schedule No. 5, to remove \$8,102 for rate case expense, grossed-up for regulatory assessment fees, which is being amortized over a four year period. The decrease in rates should become effective immediately following the expiration of the four year recovery period, pursuant to Section 367.0816, Florida Statutes. The utility should be required to file revised tariff sheets and a proposed customer notice setting forth the lower rates and the reason for the reduction not later than one month prior to the actual date of the required rate reduction. (AUSTIN)

STAFF ANALYSIS: Section 367.0816, Florida Statutes, requires that the rates be reduced immediately following the expiration of the four year period by the amount of rate case expense previously authorized in the rates. The reduction will reflect the removal of revenues associated with the amortization of rate case expense, grossed-up for regulatory assessment fees, which is \$8,102. The removal of rate case expense will result in the reduction of rates recommended by staff on Schedule No. 5.

The utility should be required to file revised tariff sheets no later than one month prior to the actual date of the required rate reduction. The utility also should be required to file a proposed customer notice setting forth the lower rates and the reason for the reduction.

If the utility files this reduction in conjunction with a price index or pass-through rate adjustment, separate data should be filed for the price index and/or pass-through increase or decrease, and for the reduction in the rates due to the amortized rate case expense.

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ISSUE 6: Should the docket be closed?

RECOMMENDATION: This docket should be closed if no person whose interests are substantially affected by the proposed action, files a protest within the 21 day protest period. (CAPELESS, AUSTIN)

STAFF ANALYSIS: If a protest is not received from a substantially affected person within 21 days of issuance of the Proposed Agency Action order, the order will become final. This docket should be closed at the conclusion of the protest period, if no protest is filed, and upon staff's approval of the revised tariff sheet.

REVENUE REQUIREMENT CALCULATION (Limited Proceeding)

Return on Equity	\$30,305	
Equity with Tax Gross-up		\$48,589
O & M Expense	7,737	
Depreciation	19,561	
Amortization	44,206	
Property Taxes	10,440	
Debt Return	37,099	
RAFs	<u>7,899</u>	
		<u>126,942</u>
Revenue Deficiency		175,531
Adjusted Revenue At Existing Rates		1,473,744
Rate Increase Required		11.91%

Calculation of Equity Return:

1 Limited Proceeding Rate Base Items	\$720,364
2 Weighted Cost of Equity	4.21%
Return on Equity	30,305

Calculation of Regulatory Assessment Fee:

3 Equity w/ Tax Gross-up (Line 1 x 1.60333)	48,589
4 O & M Expense	7,737
5 Depreciation	19,561
6 Amortization	44,206
7 Property Taxes	10,440
8 Debt Return (Line 1 x 0.0515)	<u>37,099</u>
	167,632
Divided By: (1 - Regulatory Assessment Fee)	<u>95.50%</u>
9 Revenue Requirement	<u>175,531</u>

PROOF:

$$175,531 \times 4.50\% = 7,899$$

ADJUSTMENT SCHEDULE

	Per Utility's Schedules	Staff Adjustments	Per Staff's Schedules
Consent Order	184,194	(73,678)	110,516
UPIS Additions	149,713	59,009	208,722
Accum. Depr. on Above	(2,330)	(4,297)	(6,627)
Groundwater Monitoring	53,108	(53,108)	0
UPIS Additions	420,687	0	420,687
Accum. Depr. on Above	(12,926)	(8)	(12,934)
Increase in Rate Base	<u>792,446</u>	<u>(72,082)</u>	<u>720,364</u>
Expenses & Return			
O & M Expense	15,000	(7,263)	7,737
Depreciation	17,586	1,975	19,561
Amortization	85,479	(41,273)	44,206
Property Taxes	9,461	979	10,440
Debt Return	40,807	(3,708)	37,099
RAFs	10,451	(2,552)	7,899
Subtotal	178,784	(51,842)	126,942
Equity w/Tax Gross-up	53,450	(4,861)	48,589
Revenue Increase	<u>232,234</u>	<u>(56,703)</u>	<u>175,531</u>
Test Year Revenue	1,473,744		1,473,744
Rate Increase Percentage*	<u>15.76%</u>		<u>11.91%</u>

*Revenue Increase divided by Test Year Revenue

Components of Revenue Requirement Calculation

RATE BASE

Consent Order - Avg Unamortized Balance	110,516	
UPIS Additions	420,687	
Accum. Depr. on Above	(12,934)	
UPIS Additions	208,722	
Accum. Depr. on Above	(6,627)	
	<u>\$720,364</u>	

EXPENSES

Rate Case Expense-Guastella	25,769	
Rate Case Expense-Melson	5,179	
	30,948	7,737 4 Yr Amort

AMORTIZATIONS

			<u>Avg Unamortized Bal</u>
Consent Order	\$221,032	44,206 5 Yr Amort	110,516 (50%)

PROPERTY TAXES

Mill Rate per \$1000 of UPIS Additions	16.5972	10,440
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WEIGHTED COST OF CAPITAL

Long Term Debt	4.85%
Short Term Debt	0.30%
Equity	4.21%
Weighted Cost of Capital	<u>9.36%</u>

Depreciation Calculation:

<u>Account/Description</u>	<u>Depre Rate</u>	<u>Plant Additions</u>	<u>Depre Expense</u>	<u>Accum Depre</u>	
304.2 Structures & Improvements	3.03%	14,209	431		
307.2 Wells & Springs	3.33%	107,043	3,565		
309.2 Supply Mains	2.86%	148,014	4,233		
311.2 Pumping Equipment	5.00%	44,104	2,205		
331.4 Transm & Distribution Mains	2.33%	<u>107,317</u>	<u>2,500</u>		
Interconnection & Production Wells (Online 6/95)		420,687	12,934	12,934	1 Yr Depr
307.2 Wells & Springs	3.33%	117,368	3,908		
307.2 Wells & Springs (1)	3.33%	59,009	1,965		
331.4 Transm & Distribution Mains	2.33%	<u>32,345</u>	<u>754</u>		
Monitoring Wells (Online 1/96)		208,722	6,627	6,627	1 Yr Depr

NOTE:

(1) Capitalized PS&I charges to plant.

RATE SCHEDULE

WATER

Monthly Rates

	Rates Prior to Filing	Utility Requested Final	Staff Recommended Final
<u>Residential and General Service</u>			
Base Facility Charge:			
Meter Size:			
5/8"x3/4"	\$12.14	\$14.05	\$13.59
3/4"	\$18.21	--	\$20.38
1"	\$30.35	\$35.13	\$33.96
1-1/2"	\$60.69	\$70.25	\$67.92
2"	\$97.11	\$112.41	\$108.68
3"	\$194.22	\$224.83	\$217.35
4"	\$303.46	\$351.28	\$339.60
<u>Gallonage Charge, per 1,000 Gallons</u>			
<u>Residential Service</u>			
Gallons 10,000 and under	\$0.78	\$0.90	\$0.87
Gallons 10,001 to 40,000	\$1.76	\$2.04	\$1.96
Gallons over 40,000	\$2.34	\$2.70	\$2.62
<u>General Service</u>			
Per 1,000 gallons	1.46	1.69	1.63
<u>Average Residential Bill - In Each Tier</u>			
5M Gallons	\$16.04	\$18.55	\$17.94
20M Gallons	\$47.24	\$54.85	\$52.79
130M Gallons	\$316.34	\$365.05	\$354.19

RATE SCHEDULE

Schedule of Rate Decrease After Expiration of
 Amortization Period for Rate Case Expense

Water

Monthly Rates

	Staff Recommended Rates	Rate Decrease
<u>Residential, General Service</u>		
Base Facility Charge (meter size):		
5/8"x3/4"	\$13.59	\$0.07
3/4"	\$20.38	\$0.10
1"	\$33.96	\$0.17
1-1/2"	\$67.92	\$0.33
2"	\$108.68	\$0.53
3"	\$217.35	\$1.06
4"	\$339.60	\$1.66
<u>Gallonage Charge, per 1,000 gallons</u>		
<u>Residential Service</u>		
Gallons 10,000 and under	\$0.67	\$0.00
Gallons 10,001 to 40,000	\$1.96	\$0.01
Gallons over 40,000	\$2.62	\$0.01
<u>General Service</u>		
Per 1,000 gallons	\$1.63	\$0.01