State of Florida

Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

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

DATE: NOVEMBER 7, 2001

TO: DIRECTOR, DIVISION OF THE COMMISSION CLERK & ADMINISTRATIVE SERVICES (BAYÓ)

FROM: DIVISION OF ECONOMIC REGULATION (FITCH, BIGGINS, LINGO, MUNROE)
DIVISION OF LEGAL SERVICES (ESPINOZA)

RE: DOCKET NO. 010403-WU - APPLICATION FOR STAFF-ASSISTED RATE CASE IN HIGHLANDS COUNTY BY HOLMES UTILITIES, INC.
COUNTY: HIGHLANDS

AGENDA: 11/19/01 - REGULAR AGENDA - PROPOSED AGENCY ACTION, EXCEPT FOR ISSUES 16, 17, AND 18 - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: 15-MONTH EFFECTIVE DATE: SEPTEMBER 4, 2002 (SARC)

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\WP\010403.RCM.WPD

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CASE BACKGROUND

Holmes Utilities, Inc. (Holmes or utility) is an existing Class C utility which is currently providing water service to 64 single family residences. At build out, the utility anticipates serving 90 single family residences. The utility has been in existence and providing water service since 1987. Its facilities consist of one water treatment plant and one water transmission and distribution system. Wastewater is provided by septic tank. According to the utility's 2000 annual report, the utility had gross revenues of $8,669 and operating expenses of $17,659.

The current owners purchased the utility on August 1, 1995, and were not aware that the system was subject to Commission jurisdiction. The Commission became aware of the utility's existence due to an inquiry by a customer regarding Commission regulation of the utility. Holmes filed an application for a certificate on February 27, 1996, after being advised that it is subject to this Commission's jurisdiction and that it is in apparent violation of Section 367.031, Florida Statutes, for providing water service without a certificate.

The utility received its certificate by Order No. PSC-97-0568-FOF-WU, issued May 20, 1997, in Docket No. 960244-WU. The utility's existing rates were approved in that Order. On April 5, 2001, the utility filed an application for a Staff Assisted Rate Case (SARC) and paid the appropriate filing fee on June 4, 2001. This is the utility's first SARC. The Commission has not established rate base. The Commission has the authority to consider this rate case under Section 367.0814, Florida Statutes. Staff has audited the utility's records for compliance with Commission rules and Orders and determined the components necessary for rate setting. The staff engineer also conducted a field investigation of the utility's plant and service area and an original cost study.

A customer meeting was conducted on October 10, 2001, at the Highlands County Civic Center in Sebring, Florida. Approximately forty-two customers attended the meeting. Nine customers chose to give comments regarding the utility's quality of service and the proposed rate increase. Customers' complaints included low water pressure, black water, and lack of response to customer inquires. Quality of service issues will be discussed in Issue No. 1.

The following is a list of acronyms and commonly used technical terms which are used throughout this staff report:

COMPANY AND PARTY NAMES

DEP Department of Environmental Protection

FPSC Florida Public Service Commission

NARUC National Association of Regulatory Utility Commissioners

OPC Office of Public Counsel

SWFMD Southwest Florida Water Management District

GLOSSARY OF TECHNICAL TERMS

BFC Base Facility Charge - A charge designed to recover the portion of the total expenses required to provide water and sewer service incurred whether or not the customer actually uses the services and regardless of how much is consumed.

CIAC Contributions In Aid Of Construction - Any amount or item of money, services, or property received by a utility, from any person or governmental agency, any portion of which is provided at no cost to the utility, and which is utilized to offset the acquisition, improvement, or construction costs of the utility's property, facilities, or equipment used to provide utility services to the public. The term includes, but is not limited to, system capacity charges, main extension charges, and customer connection charges.

ERCs Equivalent Residential Connections - A statistic used to quantify the total number of water or wastewater connections that can be served by a plant of some specific capacity. The consumption of each connection is considered to be that of a single family residential connection, which is usually considered to be a unit comprised of 3.5 persons.

GPD Gallons Per Day - The amount of liquid that can be delivered or actually measured during a 24-hour period.

GPM	Gallons Per Minute - The amount of liquid that can be delivered or actually measured during a one-minute time period.
O&M	Operations and Maintenance Expense
RAF	Regulatory Assessment Fees
SARC	Staff Assisted Rate Case
UPIS	Utility Plant in Service - The land, facilities, and equipment used to generate, transmit, and/ or distribute utility service to customers.
Used and Useful	The amount of plant capacity that is used by current customers including an allowance for the margin reserve.
USOA	Uniform System of Accounts - A list of accounts for the purpose of classifying all plant and expenses associated with a utility's operations.

ISSUE 1: Is the quality of service provided by Holmes Utility considered satisfactory?

STAFF RECOMMENDATION: Yes, the quality of service provided by Holmes Utility should be considered satisfactory. (MUNROE)

STAFF ANALYSIS: Rule 25-30.433(1), Florida Administrative Code specifies that:

> The Commission in every rate case shall make a determination of the quality of service provided by the utility. This shall be derived from an evaluation of three separate components of water and wastewater utility operations: quality of the utility's product (water and wastewater); operational conditions of the utility's plant and facilities; and the utility's attempt to address customer satisfaction. Sanitary surveys, outstanding citations, violations and consent orders on file with the Department of Environmental Protection (DEP) and the county health departments or lack thereof over the preceding 3-year period shall also be considered. DEP and Health department officials' comments or testimony concerning quality of service as well as the complaints or testimony of utility's customers shall be considered.

Staff's analysis below addresses each of these three components.

Holmes is a Class C utility with a service area located northwest of Lake Placid, Florida, which is in Highlands County. The utility provides water service to 64 residential customers (64 ERCs). The utility obtains its raw water from one well adjacent to the water plant. The water treatment plant includes a 5,000 gallon hydropneumatic tank, a chlorine injection system, and a Sequest-All injection system to protect copper pipe.

QUALITY OF UTILITY'S PRODUCT

In Highlands County, the potable water program is regulated by the Florida Department of Environmental Protection (DEP). According to the DEP, the utility is currently up-to-date with all chemical analysis and all test results have been satisfactory for the past three years.

The water does contain sulfur, but is within acceptable limits. Although the distribution system is PVC, all residences are plumbed with copper, and some are experiencing "black water" (copper sulfate). The current utility owner added treatment to solve this problem, but the problem persists when residents are seasonal. The staff engineer and the utility are considering a residential flushing allowance for customers who leave their home water systems unused for extended periods of time, as the cost of added treatment would be prohibitive and the effectiveness of such additional treatment is unknown. The utility's testing program indicates that the utility serves water which meets or exceeds all standards for safe drinking water and the water quality is considered satisfactory.

OPERATIONAL CONDITIONS OF THE UTILITY'S PLANT AND FACILITIES

The quality of the utility's plant-in-service is generally reflective of the quality of the utility's product. The building which houses the tank, the chlorine system and Sequest-All system were found to be well maintained and in excellent condition. The DEP has had a few minor plant-in-service deficiencies over the last three years, but the utility was responsive and addressed these in a prompt manner. Currently, there are no outstanding violations, citations, or corrective orders. The operational conditions at the water treatment plant should be considered satisfactory.

UTILITY'S ATTEMPT TO ADDRESS CUSTOMER SATISFACTION

On October 10, 2001, two customer meetings were held at 3:00 PM and 6:00 PM in the Highlands County Civic Center in Sebring, Florida. Approximately 38 customers attended the 3:00 PM meeting and 4 customers attended at 6:00 PM. About 12 customers spoke at the two meetings.

Of those attending, eight customers spoke. Also Mr. Waller of Superior Water Works, a home filter company, made a statement upon a request from a customer of Holmes Utility. The complaints concerned the lack of the company's response to concerns, water aesthetics (smell, taste & turbidity), and occasional low pressure. After the meeting, Mr. Tuttle, homeowners association President, and Danny Holmes, the utility owner, met and agreed to schedule meetings with the customers.

On October 11, 2001 the staff engineer and Mr. Holmes met for a review of the distribution system. It was agreed that two short loops in the distribution system would improve the aesthetics and pressure. In the field, water was tested (chlorine levels, taste and filter check) at all of the homes of customers that spoke at the meeting. It was confirmed that the loops were needed and are recommended as a pro forma improvement in Issue No. 5. Customers were also informed as to what they could do to improve the aesthetics of their water.

Based upon all of the foregoing, staff recommends that the quality of services provided by Holmes is satisfactory.

ISSUE 2: Should the company have any excessive unaccounted for water recognized in the used and useful calculation?

STAFF RECOMMENDATION: No. Any amount over 10% of the water pumped and unaccounted for should be considered excessive. Holmes Utility's unaccounted for water was below this threshold. (MUNROE)

STAFF ANALYSIS: The distribution system is well maintained, and all events that cause unaccounted for water have been minimized. The gallons of water treated were approximately 3,300,000. The total water sold was 2,718,000, while approximately 570,000 gallons were used in flushing. The unaccounted for water is 12,000 gallons. This is 0.44% of the water sold, which is well below the generally allowed threshold of 10%.

ISSUE 3: What portions of water plant, transmission and distribution systems are used and useful?

STAFF RECOMMENDATION: The water treatment plant should be considered 100% used and useful. The water transmission and distribution system should be considered 90% used and useful. (MUNROE)

STAFF ANALYSIS: Water Treatment Plant - The water treatment plant is a small closed system which draws raw water from one well at a total rate of 350 gpm. The well is equipped with a 5-horsepower pump. Well-point draw down and groundwater recovery time limits the well to a reliable extraction time equal to a 12-hour day. Holmes' firm reliable capacity of the well (85 gpm X 60 m/hr X 12 hour day) is 61,200 gpd. The average daily flow calculated from the monthly operating reports is 9,041 gpd.

Under the American Water Works Association method recommended for small closed systems, 1.1 gpm per ERC normal demand, times a peaking factor of 2, results in a peak demand of 2.2 gpm per ERC. When this is multiplied by 80.5 ERCs, 64.5 average test year ERCs plus growth of 16 ERCs, the plant average demand is 89 gpm or 64,080 gpd (89 gpmin X 60 min/hr X 24 hr) while the peak demand is 177 gpm or 204,336 gpd.

Section 367.081(2)(b), Florida Statutes, requires that the Commission consider utility property needed to serve customers five years after the end of the test year used and useful in the Commission's final order on a rate request. This growth rate for equivalent residential connections should not exceed 5 percent per year. In accordance with Section 367.081(2)(b), Florida Statutes, a five year period has been used in staff's calculations.

Staff's normal method of projecting growth is regression analysis where the historical growth for the past five years is projected into the future to estimate the number of ERCs expected for a given year. In Holmes' service area, growth using regression analysis was calculated to be 3.2 ERCs per year. Over a five year statutory period, that equates to 16 ERCs or 25,344 gpd.

By the formula, it is recommended that the water treatment plant be considered 100% used and useful. The calculation is summarized in Attachment A, page 1 of 2, to this issue.

The 100% used and useful calculation should be applied to the following accounts:

304 Structures and Improvements
320 Water Treatment Equipment
309 Supply Mains
311 Pumping Equipment
320 Water Treatment Equipment
307 Wells and Springs

Water Transmission and Distribution System - The water transmission and distribution system is capable of serving 90 ERCs at build out. Year end data showed that the utility had 65 ERCs. When a growth factor of 16 ERCs is added, the utility distribution system is 90% used and useful.(See attachment A, page 2 of 2 for calculations.)

The 90% used and useful calculation should be applied to the following accounts:

330 Distribution Reservoirs and Standpipes
331 Transmission and Distribution Mains
333 Services

WATER TREATMENT PLANT - USED AND USEFUL DATA

Docket No. 010403-WU - Holmes Utility

1)	**Firm Reliable Capacity of Plant**		61,200	gallons per day
2)	**Maximum Day Flow** (AWWA) (64.5 ERCs x 1.1 gpm per ERC x 2 peaking factor x 60 min per hour x 24 hours per day)		204,336	gallons per day
3)	**Average Daily Flow (Actual)**		9,041	gallons per day
4)	**Fire Flow Capacity**		N/A	gallons per day
5)	**Growth**	16 ERCS or	25,344	gallons per day
	a) Test year Customers in ERCs:		Begin	64
			End	65
			Average	64.5
	b) Customer Growth in ERCs		3.2	ERCs
	c) Statutory Growth Period		5	Years
	(b)x(c)x 1.1 x 60 x 24 = 25,344 gallons per day for growth			
6)	**Excessive Unaccounted for Water**		0	gallons per day
	a) Total Unaccounted for Water		40	gallons per day
	Percent of Average Daily Flow		.44%	
	b) Reasonable Amount (10% of average Daily Flow)		904	gallons per day
	c) Excessive Amount		0	gallons per day

USED AND USEFUL FORMULA
[(2)+(4)+(5)-(6)]/(1) = **100% Used and Useful**

WATER DISTRIBUTION SYSTEM - USED AND USEFUL DATA

Docket No. 010403 - Holmes Utility

1)	**Capacity of System** (Number of Potential Customers, ERCs or Lots Without Expansion)	90	ERCs
2)	**Test year connections**		
	a) Beginning of Test Year	64	ERCs
	b) End of Test Year	65	ERCs
	c) Average Test Year	64.5	ERCs
3)	**Growth**	16	ERCs

(Due to plant additions in 1999, Use end of year customer count)

a) customer growth in ERCs	3.2	ERCs
b) Statutory Growth Period	5	Years

(a) x (b) = 16 ERCs allowed for growth

USED AND USEFUL FORMULA

[(2b)+(3)]/(1) = **90% Used and Useful**

ISSUE 4: Should an acquisition adjustment be approved in the determination of the utility's rate base?

STAFF RECOMMENDATION: No. An acquisition adjustment should not be approved in the determination of the utility's rate base. (FITCH, BIGGINS)

STAFF ANALYSIS: An acquisition adjustment results when the purchase price differs from the original cost calculation adjusted at the time of the acquisition. The acquisition adjustment resulting from the transfer of the utility would be calculated as follows:

August 1, 1995	Water
Plant in Service	$44,797
Accumulated Depreciation	($9,418)
Land	$13,643
CIAC	($5,325)
Amortization of CIAC	$611
Acquired Rate Base	$44,308
Purchase Price	($1)
Negative Acquisition Adjustment	($44,307)

In the absence of extraordinary circumstances, it has been Commission practice that a subsequent purchase of a utility system at a premium or discount should not affect the rate base calculation. See Order No. PSC-00-0682-FOF-WU, issued April 12, 2000, in Docket No. 990253-WU; Order No. PSC-00-0264-FOF-WS, issued February 8, 2000, in Docket No. 971220-WS; and Order No. PSC-99-1818-PAA-WS, issued September 20, 1999, in Docket No. 981403-WS. The circumstances in this exchange do not appear to be extraordinary; therefore, a negative acquisition adjustment should not be included in the calculation of rate base. Further, allowing a negative acquisition adjustment, in this case, would reduce the utility's rate base substantially below the level of O&M. Although

staff is not recommending the use of an operating ratio, any further reduction in rate base would cause staff to consider the operating ratio method. Under current Commission practice, an operating margin is determined by using 10% of O&M. The utility's current cost of capital is 8.5%. In this case, using either method, would result in virtually identical revenue requirements.

For the foregoing reasons, staff believes that an acquisition adjustment should not be approved in the determination of the utility's rate base.

ISSUE 5: What is the appropriate average test year rate base for the utility?

STAFF RECOMMENDATION: The appropriate average test year rate base for Holmes Utility is $24,135 for water. The utility should be required to complete all pro forma additions, as discussed in the staff analysis, within nine months of the effective date of the Commission Order.(FITCH, BIGGINS, MUNROE)

STAFF ANALYSIS: In this case, during the staff audit, it was discovered that the utility did not have original cost documentation for plant prior to 1996; therefore, an original cost study was completed by the staff engineer to determine plant values prior to 1996. The utility has plant documentation for UPIS since 1996.

Staff has selected a historical test year ended December 31, 2000, and the rate base components have been calculated using the original cost study, staff's audit, and engineering report for a plant balance through December 31, 2000. A discussion of each component of rate base follows:

Utility Plant in Service (UPIS): According to Audit Exception No. 2, the utility recorded $47,967 for UPIS. Using staff's original cost study and utility cost documentation, staff determined UPIS to be $52,034; therefore, staff has increased UPIS by $4,067 to reflect plant per the original cost study. UPIS has been decreased by $548 to reflect an averaging adjustment.

Pro Forma Plant: As discussed in Issue No. 1, staff is recommending that the utility loop its existing distribution system. This pro forma addition will help improve the quality of the water and water pressure throughout the system. Staff has increased this account by $8,663 to include pro forma distribution system looping. Staff has decreased this account by $4,332 to reflect an averaging adjustment.

Staff's net adjustment to UPIS is an increase of $7,850. Staff recommends UPIS of $55,817 for water.

Land: The utility recorded $745 for land. This amount consists of the cost associated with a title search for the land. According to the Highlands County Property Appraiser, the assessed value of the

land for 1987 was $3,000 per acre for the portion presently occupied by the Holmes water plant.

The utility occupies a quarter acre of land. Based on the per acre price established in 1987 (Holmes Utility first year of operation) staff's calculated land values are as follows:

Plant Site	Acres	Price Per Acre	Land Value
Water	0.25	$3,000	$750

Therefore, staff has increased this account by $750 to reflect the original cost of the land.

Non-used and Useful Plant: The staff engineer has determined the used and useful percentages for each plant account. The water treatment plant is 100% used and useful and the water distribution system is 90% used and useful. However, as discussed below, staff is recommending that CIAC be increased based on the value of the transmission and distribution lines consistent with Rule 25-30.570, Florida Administrative Code. This causes the transmission and distribution system to be fully contributed. The purpose of the used and useful adjustment is to remove from rate base the cost of UPIS not used by current customers. The purpose of CIAC is to remove from rate base that portion of UPIS that was not invested by the utility. Applying a used and useful adjustment to fully contributed plant would result in a double reduction to rate base. Therefore, a used and useful adjustment should not be made to this account.

Contribution in Aid of Construction (CIAC): The utility recorded $13,100 for CIAC. This amount included collections of tap in fees. These tap in fees do not cover the value of the transmission and distribution lines. Rule 25-30.570, Florida Administrative Code specifies that:

> If the amount of CIAC has not been recorded on the utility's books and the utility does not submit competent substantial evidence as to the amount of CIAC, the amount of CIAC shall be imputed to be the amount of plant costs charged to the cost of land sales for tax purposes if available, or the portion of the cost of the facilities and plant attributable to the water transmission and distribution system and the sewage collection system.

Although the utility did record an amount for CIAC, staff was able to identify these amounts as tap in fees. Staff was unable to find the cost of the lines in the utility's tax return; therefore, staff believes these lines were donated by the developer and they should have been included as CIAC. Therefore, staff has imputed CIAC of $9,600, consistent with Rule 25-30.570, Florida Administrative Code, to cover the cost of the transmission and distribution lines. This amount has been allocated in accordance with customer growth. Staff has also decreased this account by $1,400 to reflect an averaging adjustment. Staff has determined average CIAC of $21,300.

Accumulated Depreciation: The utility recorded $5,436 for accumulated depreciation on its books during the test year. Staff has calculated accumulated depreciation using the prescribed rates in Rule 25-30.140, Florida Administrative Code. Staff's calculated accumulated depreciation on December 31, 2000, is $17,985. Staff has increased this account by $12,549 for water to reflect staff calculated accumulated depreciation. Staff has decreased this account by $943 to reflect an averaging adjustment.

Staff has increased this account by $144 to reflect accumulated depreciation on the pro forma improvements. Staff has decreased this account by $57 to reflect an averaging adjustment on pro forma depreciation. Staff's net adjustment to accumulated depreciation is an increase of $11,663. Staff has determined average accumulated depreciation to be $17,099.

Amortization of CIAC: The utility recorded $894 for amortization of CIAC. Staff has calculated year end amortization using composite depreciation rates. Staff's calculated year-end amortization of CIAC is $3,227. This account has been increased by $2,333 to reflect staff calculated amortization of CIAC. Staff has decreased the account by $386 to reflect an averaging adjustment. Staff has determined the average amortization of CIAC to be $2,841.

Working Capital Allowance: The utility did not record a working capital allowance. Working capital is defined as the investor-supplied funds necessary to meet operating expenses or going-concern requirements of the utility. Consistent with Rule 25-30.433, Florida Administrative Code, staff recommends that the one-eighth of operation and maintenance (O&M) expense formula approach be used for calculating working capital allowance. Applying that formula, staff recommends a working capital allowance of

$2,381(based on O&M of $19,045). Working capital has been increased by $2,381 to reflect one-eighth of staff's recommended O&M expenses.

Rate Base Summary: Based on the foregoing, staff recommends that the appropriate average test year rate base is $24,135 for water.

Rate base is shown on Schedule No. 1-A. Related adjustments are shown on Schedule No. 1-B.

COST OF CAPITAL

ISSUE 6: What is the appropriate rate of return on equity and the appropriate overall rate of return for this utility?

STAFF RECOMMENDATION: The appropriate return on equity is 9.94% with a range of 8.94% - 10.94%. The appropriate overall rate of return is 8.50%. (FITCH, BIGGINS)

STAFF ANALYSIS: The utility's capital structure consists of common stock of $100, negative retained earnings of $26,295, and long term debt of $72,829. The utility's long term debt consists of a single loan with an interest cost of 8.50%. Staff made an adjustment of $26,195 to remove negative equity.

Using the current leverage formula approved by Order No. PSC-00-1162-PAA-WS, issued June 26, 2000, in Docket No. 000006-WS, the appropriate rate of return on equity is 9.94% for all equity ratios less than 40%. Since the utility's capital structure is 100% debt, the appropriate return on equity is 9.94%.

Because the utility's capital structure is 100% debt, the overall rate of return should be equal to the weighted average cost of debt of 8.50%. The utility's capital structure has been reconciled with staff's recommended rate base. Staff recommends a return on equity of 9.94% with a range of 8.94% - 10.94% and an overall rate of return of 8.50%.

The return on equity and overall rate of return are shown on Schedule No. 2.

NET OPERATING INCOME

ISSUE 7: What are the appropriate test year revenues?

STAFF RECOMMENDATION: The appropriate test year revenues for the utility are $10,522 for water. (FITCH, BIGGINS)

STAFF ANALYSIS: The utility recorded revenues, for the 12-month period ended December 31, 2000, of $8,669 for water. Per Audit Disclosure No. 4, the utility did not bill according to its tariff during the test year. Therefore, the utility's apparent violation of Section 367.081 and 367.091, Florida Statutes, is the subject of Issue No. 17 of this recommendation. The utility's tariff authorizes a block rate gallonage rate structure. The rate structure consists of 5,000 gallon blocks, each block is increased by $0.30 per 1,000 gallons. The utility billed all gallons above 15,000 gallons at the same rate as the 10,000-15,000 gallon block. The utility's current tariff authorizes a minimum base facility charge of $8.00 and a block rate gallonage charge as follows:

Gallonage Charge(per 1,000 gallons)	Existing Charges
0-5,000 gallons	$1.40
5,001-10,000 gallons	$1.70
10,001-15,000 gallons	$2.00
Over 15,000 gallons	Gallonage Charge increases by $0.30 for each 5,000 gallon block over 15,000 gallons

The utility's existing rates became effective July 18, 1997. Staff has calculated annualized revenue using the existing rates times the number of bills and consumption provided in the billing analysis. Test year revenues have been increased by $1,853 for water to reflect annualized revenue based on the existing rates.

Based upon the foregoing, staff recommends that the test year revenues are $10,522. Test year revenues are shown on Schedule No. 3-A. The related adjustments are shown on Schedule No. 3-B.

ISSUE 8: What is the appropriate amount of operating expense?

STAFF RECOMMENDATION: The appropriate amount of operating expenses for this utility is $22,113. (FITCH, BIGGINS)

STAFF ANALYSIS: The utility recorded operations and maintenance (O&M) expenses of $15,981 during the test year. The utility provided the auditor with access to all invoices, canceled checks and other utility records to verify its O&M and taxes other than income expense for the 12-month period ended May 31, 2000. Using the documents provided by the utility, the staff auditor determined the appropriate operating expenses for the test year and a breakdown of expenses by account class. The utility's books and records were maintained on a semi-accrual basis and used the NARUC account titles. Adjustments have been made to reflect the appropriate annual operating expenses that are required for utility operations on a going forward basis.

Operations and Maintenance Expenses (O&M)

Salaries and Wages-Employees-(601)- The utility recorded no salaried employees during the test year. Like many Class C utilities regulated by the Commission, Holmes performed services during the test year that it did not record as an expense. Both the staff auditor and engineer suggested that the utility should request salaries for these services. The utility requested $14,400 for a full time secretary and $19,200 for a full time manager/ maintenance person and submitted the following duties associated with each. The secretary duties include: making sure all reports are filed in a timely manner to all necessary agencies, taking care of the collections of connect and disconnect fees, banking, paying bills, office space, and making sure all necessary tax forms and reports are filed in a timely manner. The manager's duties include: being on call 24 hours per day 7 days per week, checking the facility seven days per week, handling all service calls, and overseeing all repair services contracted out. Staff could only justify a $5,000 annual increase for a utility of this size based on past Commission allowances. Staff included a $5,000 salaried allowance for its preliminary presentation at the customer meeting.

Staff spoke with the utility at the customer meeting and discussed the requested salaries. The utility representative stated that the utility did not need or want these salaries. The utility requested an increase for its contracted operator and

management. The utility stated that the above services could be performed through the increased contracted expense for the operator and management.

The contracted operator and management are a related party; however, the requested increase in contractual services is less than the preliminary recommended amount for salaries that staff brought before the customers at the customer meeting. Staff's preliminary recommendation included an increase for management services of $5,000 based on past Commission allowances for similar sized utilities. The utility is requesting a $1,920 annual increase for contractual services to cover the same responsibilities. Therefore, staff believes that the requested increase for contractual services is reasonable and has not made an adjustment to this account for salaries.

Purchased Power Expense- (615) - The utility recorded $613 in this account for the test year. Staff has decreased this account by $25 to reflect a 4% repression adjustment as discussed in Issue No. 11.

Chemicals Expense- (618) - The utility recorded $2,107 in this account for the test year. Staff has decreased this account by $84 to reflect a 4% repression adjustment as discussed in Issue No. 11.

Contracted Services-Billing-(630) - The utility recorded $863 for contracted service billing during the test year. The utility provided staff with cost documentation of $1.15 per bill. Therefore, staff has increased this account by $20 to reflect customers bills for the test period ($1.15*64 (customers)*12=883).

Contracted Services-Professional-(631) - The utility recorded $1,725 for contracted service professional expense. Although the utility uses the NARUC USOA account titles, it does not reconcile its books to the accrual basis monthly. A CPA reconciles the utility's books annually. Both the auditor and engineer have commented that the utility has well maintained books and records with the only exception being use of the cash method of accounting.

Because this utility is so small, the differences in cash versus accrual accounting are minimal. The utility's accountant, as well as staff, does not believe it is cost effective to reconcile the utility's books monthly. Because these amounts are so minimal and the utility's books are well maintained, staff believes that the utility is in substantial compliance with Rule

25-30.115, Florida Administrative Code, and the utility should continue its current accounting practices. The utility's accountant provided staff with a cost estimate of an additional $1,800 annually to reconcile the utility's books on a monthly basis.

Contractual Services-Testing-(635/735) - The utility recorded $1,795 for this expense during the test year. Each utility must adhere to specific testing conditions prescribed within its operating permit. These testing requirements are tailored to each utility as required by Rules 62-550 and 551, Florida Administrative Code, which are enforced by the DEP. The tests and the frequency at which those tests must be repeated for this utility are:

	Water	
Test	Frequency	Annual Amount
Bacteriological	Monthly	$2,160
Nitrates	Yearly	$70
Lead & Copper	3 Years	$167
Triannual sampling	3 Years	$934
Total		$3,331

Staff increased this account by $1,536 ($3,331-$1,795) to reflect DEP required testing.

Contractual Services Other-(636) - The utility recorded $6,960 for this expense during the test year. The utility requested a $2,400 increase; an increase from $440 to $600 per month for contracted operator/ management ($1,920), an increase of $35 to $45 per mowing for grounds keeping expense ($120), an increase in line flushing 18(a year)*$45-$35 ($180), and an increase for meter reading 18(hours per year)*$45-$35 ($180). The utility's related party (Pugh Utility) provides these services.

Staff believes that related party transactions require close scrutiny. However, the fact that the transaction is between related parties does not mean the transaction is unreasonable. It is the utility's burden to prove that its costs are reasonable. Florida Power Corp. v. Cressee, 413, So. 2d 1187, 1191 (Fl. 1982). The burden is even greater when the transaction is between related

parties. In GTE Florida Inc. v. Deason, 642 So. 2d 545 (Fl. 1994), the court established that the standard to use in evaluating affiliate transactions is whether those transactions exceed the going market rate or are otherwise inherently unfair. Staff believes that the test year cost for mowing, line flushing, and meter reading is reasonable for a utility of this size. Further, the utility could not provide staff with a reason for the hourly increase; therefore, staff has not made an adjustment for these items.

As discussed above, staff believes that the requested increase for the contractual operator and management is appropriate, considering that the utility will be able to perform the services discussed above for less than the preliminary amount of $5,000 which staff presented at the customer meeting. Staff believes that the utility has met its burden of proof for justifying the increase in operator and management fees. Therefore, staff has increased this account by $1,920 to reflect an increase in contractual operator and management.

Regulatory Commission Expense-(655/755) - The utility did not record an amount in this account during the test year. The utility paid a $500 rate case filing fee pursuant to Rule 25-30.020, Florida Administrative Code. Staff has increased this account by $125 ($500/4 years) to reflect rate case expense amortized over four years. During a rate proceeding, utilities are required to send notices to customers. Staff has estimated $60 of noticing cost and amortized them over four years, ($.34 stamp, $0.10 per page, 6 pages with 64 customers/4 years is $15). The total annual expense for this account is $140.

Miscellaneous Expense-(675/775) - The utility recorded $1,194 for this expense during the test year. Staff removed billing cards included in contracted service billing of $68. Staff also removed non-utility advertising cost of $375. Staff's net adjustment to this account is a decrease of $443.

Operation and Maintenance Expense (O&M Summary) - The total O&M adjustment is an increase of $3,064. Staff's recommended O&M expense is $19,045 for water. O&M expenses are shown on Schedule 3-B.

Depreciation Expense - The utility recorded depreciation expense net of CIAC of $789 ($1,085 Depreciation and $296 CIAC).

Depreciation expense has been calculated using the prescribed rates in Rule 25-30.140, Florida Administrative Code. Staff's calculated depreciation is $2,247; therefore, staff has increased this account by $1,162 to reflect staff calculated depreciation expense. Staff has calculated test year amortization of CIAC, using composite rates, of $764; therefore, staff has decreased this account by $468 to reflect staff calculated amortization of CIAC. CIAC has a negative impact on depreciation expense. Staff's calculated net depreciation expense is $1,483.

Taxes Other Than Income - The utility recorded taxes other than income of $888. Staff has increased this account by $83 to reflect RAFs based on annualized revenues.

Income Tax - Holmes Utility is a Sub-chapter S corporation; therefore, the utility pays no income taxes.

Operating Revenues - Revenues have been increased by $13,642 to reflect the increase in revenue required to cover expenses and allow the recommended return on investment.

Taxes Other Than Income - This expense has been increased by $614 to reflect RAFs of 4.5% on the increase in revenues.

Operating Expenses Summary - The application of staff's recommended adjustments to the audited test year operating expenses results in staff's calculated operating expenses of $22,113.

Operating expenses are shown on Schedule No. 3-A. The related adjustments are shown on Schedule No. 3-B.

REVENUE REQUIREMENT

ISSUE 9: What is the appropriate revenue requirement?

STAFF RECOMMENDATION: The appropriate revenue requirement is $24,164 for water. (FITCH, BIGGINS)

STAFF ANALYSIS: The utility should be allowed an annual increase of $13,642 (129.66%) for water. This will allow the utility the opportunity to recover its expenses and earn an 8.50% return on its investment. The calculations are as follows:

	Water
Adjusted Rate Base	$24,135
Rate of Return	x .0850
Return on Investment	$2,051
Adjusted O & M Expense	$19,045
Depreciation Expense (Net)	$1,483
Taxes Other Than Income	$1,585
Revenue Requirement	$24,164
Adjusted Test Year Revenues	$10,522
Percent Increase/(Decrease)	129.66%

Revenue requirements are shown on Schedules No. 3-A.

ISSUE 10: Is a revision to the utility's current inclining-block rate structure for its water system appropriate in this case, and, if so, what is the appropriate conservation adjustment, and what are the appropriate number of usage blocks and usage block rate factors?

STAFF RECOMMENDATION: Yes, a revision to the utility's current rate structure for its water system is appropriate. No conservation adjustment is recommended. The rate structure should be changed to a two-tier inclining-block rate structure. The recommended usage blocks are for monthly consumption of: 1) 0-10,000 gallons; and 2) in excess of 10,000 gallons (10 kgal), with usage block rate factors of 1.0 and 1.25, respectively. (LINGO, BRUCE)

STAFF ANALYSIS: The utility's current water system rate structure consists of an inclining-block rate structure, with no pre-set limit on the number of usage blocks ("infinitely-tiered"). The base facility charge (BFC) is $8.00 per month, plus a charge of $1.40 per one thousand gallons (1 kgal) sold for usage of 0 - 5 kgal. The remaining usage blocks are capped at 5 kgal increments (e.g., 10 kgal, 15 kgal, 20 kgal, etc.), with the usage charge in each subsequent block increasing by $.30 (e.g., $1.70 per kgal for usage at 5-10 kgal, $2.00 for usage at 10-15 kgal, etc). This rate structure was in place when the utility was issued a grandfather certificate.

Conservation Adjustment

In this case, absent any rate design adjustment, staff's preliminary revenue recovery allocation results in 42% of the revenues recovered through the BFC, with the remaining 58% of revenues recovered through the gallonage charge. In cases in which the percentage of revenues recovered through the BFC is greater than 40%, the Commission's practice is to implement a conservation adjustment such that the resulting revenue recovery allocation through the BFC is no greater than 40%. This is an important rate design goal because it results in a higher gallonage charge, thereby making that charge more conservation-oriented. This practice is also consistent with the conservation rate structure guidelines of the Southwest Florida Water Management District, within which the utility is located.

The principles of going concern and revenue stability should be considered in conjunction with any adjustment to a utility's

revenue recovery allocation. Although a conservation adjustment may increase revenue instability, the Commission's concerns in this regard are often mitigated by such factors as: 1) the percentage of bills and gallons recovered in the first block (in the case of an inclining-block rate structure); 2) a low seasonality of the utility's customer base; or 3) the average consumption per customer. Based upon our analysis, well over 50% of the utility's bills and gallons are accounted for in the 0 - 5 kgal usage block, which typically mitigates revenue stability concerns when shifting more of the cost recovery burden to the gallonage charge. However, due to the high seasonality of the utility's customer base coupled with the low average consumption per customer, staff does not believe sufficient mitigating factors exist in this case.

Staff's analysis indicates that the average number of bills in which only the BFC is charged ("0 gallonage bills") equals 8% during the months of November through April, while the corresponding average monthly consumption is approximately 4 kgal. However, during the months of May through October, the number of 0 gallonage bills more than triples to 28%, with customers' average consumption dropping to 3.3 kgal. Staff is concerned that a conservation adjustment may leave the utility with operating margins so small during the May - October time frame that the utility's ability to operate as a going concern may be compromised.

For example, approximately $20,740 of the utility's revenue requirement (or an average of $1,730 per month) is represented by cash outflow items such as O&M expenses and taxes other than income taxes. Staff believes it is important to design rates such that cash outflows are covered during each month of the year. As will be discussed below, staff recommends that the utility's infinitely-tiered inclining-block rate structure be revised to a two-tier inclining-block structure. Staff's preliminary recommended rates, before a repression adjustment, are a monthly BFC of $13.30, with a charge of $4.79 for each kgal sold in the 0-10 kgal usage block, and a charge of $5.99 per kgal in the 10+ kgal usage block.

Based on these preliminary rates, the revenue received during October, which represents the month with the lowest total customer consumption, is approximately $1,800 per month, leaving a preliminary operating margin during that month of approximately $70. In the event customers reduce their consumption more than staff has anticipated, the utility will incur increased revenue instability, and its ability to meet cash flow requirements will be

jeopardized. An increased gallonage charge (resulting from a conservation adjustment) under these circumstances would further exacerbate matters.

Based on the foregoing, we believe any conservation adjustment would decrease the utility's revenue stability, as well as endanger its ability to meet its cash flow requirements during certain months of the year. Therefore, staff does not believe a conservation adjustment is appropriate in this case.

Rate Structure

As discussed previously, the utility's current rate structure consists of a BFC with an infinitely-tiered inclining-block rate structure. The goal of this rate structure is to reduce average demand. Under an inclining-block rate structure, it is anticipated that demand in the higher usage block(s) will be more elastic than demand in the first block. Water users with low monthly usage will benefit because the gallonage charge is slightly lower than the true cost of service, while water users with high monthly use will pay increasingly higher rates because the gallonage charge(s) increase in subsequent usage blocks. Thus, the high water users have a greater incentive to conserve.

Approximately 95% of customers' bills are accounted for at monthly consumption per customer of 10 kgal or less, representing average monthly consumption of a mere 3.0 kgal. However, the remaining bills represent average monthly consumption of 15.3 kgal. In this case, staff believes it is important to target average monthly consumption greater than 10 kgal with a higher usage rate. We examined usage block rate factors of 1.25, 1.50, 1.75 and 2.0 for the second usage block. As discussed above, staff has expressed concerns about revenue instability and revenue sufficiency. Therefore, we recommend the least aggressive rate factor of 1.25 for the second usage block.

Based on the foregoing, a continuation of the utility's current inclining-block rate structure is not appropriate. Although it is unusual to go from a more conservation-oriented to a less conservation-oriented rate structure, due to the low average monthly consumption per customer, coupled with the above-referenced concerns, staff recommends that no conservation adjustment be made, and the implementation of a two-tier inclining-block rate structure with a greater rate differential between usage blocks. The

recommended usage blocks are for monthly consumption of: 1) 0-10,000 gallons; and 2) in excess of 10,000 gallons (10 kgal), with usage block rate factors of 1.0 and 1.25, respectively.

ISSUE 11: Is an adjustment to reflect repression of consumption appropriate in this case, and, if so, what is the appropriate repression adjustment?

STAFF RECOMMENDATION: Yes, a repression adjustment of 117 kgal to consumption is appropriate. In order to monitor the effects of both the change in rate structure and the recommended revenue increase, the utility should be ordered to prepare monthly reports detailing the number of bills rendered, the consumption billed and the revenue billed. These reports should be provided, by customer class and meter size, on a quarterly basis for a period of two years, beginning with the first billing period after the increased rates go into effect. (LINGO)

STAFF ANALYSIS: Typically, staff's repression analysis involves an examination of our database of utilities receiving rate increases and decreases. We look for utilities with comparable parameters to the utility being examined, and ultimately base our recommended repression adjustment on the past behavior of these like utilities. These parameters include, but are not limited to, similar: 1) rate structure changes; 2) average monthly consumption; and 3) price increases. However, on an overall basis, an examination of our database revealed no sufficiently similar utilities upon which staff could base a recommended repression adjustment. Therefore, staff has extrapolated from available information to develop our recommended repression adjustment.

Staff has found that for utilities that did not experience a rate structure change, an approximate 33% price increase in water-only cases have led to a corresponding 7% reduction in consumption (repression). By assuming a proportional relationship between the overall average and the actual price increase of the utility being examined, we have used this overall price/repression relationship as a starting point in cases where there are no comparable utilities in the database. That analysis in this case would yield the following proportional relationship:

$$\frac{\text{Avg } 33.33\% \text{ price increase}}{6.97\% \text{ consumption reduction}} = \frac{\text{New avg price increase of } 135.5\%}{X\% \text{ consumption reduction}}$$

Solving for X, the anticipated consumption reduction would be approximately 28%. However, based on overall historical usage patterns, staff does not believe 28% is an appropriate recommended repression adjustment. As discussed in the preceding issue,

Holmes' system-wide average monthly consumption per customer is 3.7 kgal, with approximately 95% of Holmes' bills representing average monthly consumption per customer of 3.0 kgal. We do not believe this consumption level is sufficient to sustain a 28% reduction. In fact, a 28% consumption reduction would result in average monthly consumption dropping to an exceptionally low 2.7 kgal per month.

In the alternative, staff analyzed the potential repression effects in three average monthly usage groups: 1) usage at 5 kgal or less; 2) usage between 5 kgal and 10 kgal; and 3) usage above 10 kgal. Our analysis of the anticipated repression in each of these three usage groups follows.

0 - 5 kgal per Month

Based upon our visual inspection of the service area, we do not believe that repression will occur at monthly usage levels below 5 kgal due to housing size and landscaping requirements.

5 kgal - 10 kgal per Month

As discussed above, an examination of our database revealed no similar utilities upon which staff could base a recommended overall repression adjustment. However, in our analysis of Holmes' customers using 5 kgal to 10 kgal per month, staff identified eight utilities which exhibited similar prior price and prior consumption characteristics. For these eight utilities, staff found that an approximate 39% price increase in water-only cases led to a corresponding 9.5% reduction in consumption (repression). For Holmes' customers using 5 kgal - 10 kgal per month, staff calculated an average price increase of 155.7% based on consumption of 7.5 kgal. We then assumed a proportional price/repression relationship as a starting point for Holmes' customers at the 5 kgal - 10 kgal monthly usage level. That analysis yields the following proportional relationship:

$$\frac{\text{Avg 38.8\% price increase}}{\text{9.5\% consumption reduction}} = \frac{\text{New avg price increase of 155.7\%}}{\text{X\% consumption reduction}}$$

Solving for X, the anticipated consumption reduction would be approximately 38% for monthly usage of 5 kgal - 10 kgal. Again, based on the housing types and landscaping requirements of the service area, we do not believe a 38% reduction in consumption at

this usage level can be sustained, as the predicted average monthly consumption would decrease to 4.6 kgal. In the alternative, staff calculated revised average monthly consumption levels based on repression adjustments of both 25% and 15% for the 5 kgal - 10 kgal group, which yielded post-repression estimates of 5.6 kgal and 6.4 kgal, respectively. Based on this analysis and the requirements discussed above, staff recommends that a 15% repression adjustment, which yields an anticipated reduction of 73 kgal in this usage group, is appropriate. The resulting post-repression estimated usage is 6.4 kgal per month.

10+ kgal per Month

An examination of our database revealed no sufficiently similar utilities upon which staff could base a recommended repression adjustment for monthly usage levels above 10 kgal. Absent any comparable utilities, and in consideration of the factors and discussion above, staff recommends that a 20% repression adjustment, which yields an anticipated reduction of 44 kgal in this usage group, is appropriate. We believe the resulting estimated post-repression usage for this usage group of 12.2 kgal per month is reasonable.

Summary

The above-referenced repression adjustments result in an overall repression adjustment of 4% and an anticipated 117 kgal reduction in consumption. Therefore, the appropriate number of gallons for ratesetting purposes is 2,750.55 kgal. In order to monitor the effects of both the changes in rate structure and the recommended revenue increases, the utility should be ordered to prepare monthly reports detailing the number of bills rendered, the consumption billed and the revenue billed. These reports should be provided, by customer class and meter size, on a quarterly basis for a period of two years, beginning with the first billing period after the increased rates go into effect.

ISSUE 12: What are the appropriate monthly rates for service?

STAFF RECOMMENDATION: The appropriate monthly rates should be designed to produce revenues of $24,164, excluding miscellaneous service charge revenues. The utility should file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-30.475(1), Florida Administrative Code. The rates should not be implemented until staff has approved the proposed customer notice, and the notice has been received by the customers. The utility should provide proof of the date notice was given no less than 10 days after the date of the notice. (LINGO, FITCH, BIGGINS)

STAFF ANALYSIS: As discussed in Issue No. 9, the appropriate revenue requirement, excluding miscellaneous service charges, is $24,164. As discussed in Issue No. 10, staff recommends that the water system rate structure be changed to a two-tiered inclining-block rate structure, with monthly usage blocks of 0 - 10 kgal and in excess of 10 kgal. As also discussed in Issue No. 10, staff recommends usage block rate factors of 1.0 and 1.25, respectively, and that no conservation adjustment be implemented. As discussed in Issue No. 11, staff recommends that the appropriate repression adjustment is 117 kgal. Therefore, the resulting monthly rates for service are those shown below.

Monthly Rates - Water
Residential and General Service
Base Facility Charge

Meter Sizes	Existing Rates	Staff's Recommended Rates
5/8" x 3/4"	$8.00	$13.30
3/4"	N/A	$19.95
1"	N/A	$33.25
1 ½"	N/A	$66.50
2"	N/A	$106.40
3"	N/A	$212.79
4"	N/A	$332.49
6"	N/A	$664.98

Monthly Rates - Water
Residential Gallonage Charge

	Existing Rates	Staff's Recommended Rates
Inclining Block Rate Structure Per 1,000 gallons		
0-5,000 gallons	$1.40	$5.00
5,001-10,000 gallons	$1.70	$5.00
Each additional 5,000 increment	additional $0.30 per increment	$6.25

Monthly Rates - Water
General Service Gallonage Charge

	Existing Rates	Staff's Recommended Rates
0-5,000 gallons	$1.40	N/A
5,001-10,000 gallons	$1.70	N/A
Each additional 5,000 increment	additional $0.30 per increment	N/A
Per 1,000 gallons	N/A	$5.05

Staff's recommended increase in revenue requirements is $13,642 or approximately 129.66%. The rates approved for the utility should be designed to produce revenues of $24,164 (excluding miscellaneous service charge revenues).

Approximately 43% ($10,281) of the revenue requirement is recovered through the recommended base facility charge. The fixed costs are recovered through the BFC based on the number of factored ERCs. The remaining 57% ($13,884) of the revenue requirement represents revenues collected through the consumption charge based on the number of gallons.

The utility should file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-30.475(1), Florida Administrative Code. The rates should not be implemented until staff has approved the proposed customer notice, and the notice has been received by the customers. The utility should provide proof of the date notice was given no less than 10 days after the date of the notice.

ISSUE 13: 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?

STAFF RECOMMENDATION: The water rates should be reduced as shown on Schedule 4, to remove rate case expense grossed-up for regulatory assessment fees and amortized over a four-year period. The decrease in rates should become effective immediately following the expiration of the four year rate case expense recovery period, pursuant to Section 367.0816, Florida Statutes. The utility should be required to file revised tariffs and a proposed customer notice setting forth the lower rates and the reason for the reduction no later than one month prior to the actual date of the required rate 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 the reduction in the rates due to the amortized rate case expense. (FITCH, BIGGINS)

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 the rate case expense previously included in the rates. The reduction will reflect the removal of revenues associated with the amortization of rate case expense and the gross-up for regulatory assessment fees which is $147 annually. Using the utility's current revenues, expenses, capital structure and customer base, the reduction in revenues will result in the rate decreases as shown on Schedule No. 4.

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 the reduction in the rates due to the amortized rate case expense.

ISSUE 14: What are the appropriate customer deposits for this utility?

STAFF RECOMMENDATION: The appropriate customer deposits should be the recommended charges as specified in the staff analysis. The utility should file revised tariff sheets, which are consistent with the Commission's vote. Staff should be given administrative authority to approve the revised tariff sheets upon staff's verification that the tariffs are consistent with the Commission's decision. If revised tariff sheets are filed and approved, the customer deposits should become effective for connections made on or after the stamped approval date of the revised tariff sheets, if no protest is filed. (FITCH, BIGGINS)

STAFF ANALYSIS: Rule 25-30.311, Florida Administrative Code, provides guidelines for collecting, administering and refunding customer deposits. It also authorizes customer deposits to be calculated using an average monthly bill for a two-month period. The utility's existing tariff does not authorize the utility to collect a customer deposit. Staff has calculated customer deposits using the recommended rates and an average monthly bill for a two-month period. A schedule of the utility's existing and staff's recommended deposits follows:

Water

Residential and General Service

Meter Size	Existing deposit	Recommended deposit
5/8" x 3/4"	N/A	$62.00
All over 5/8" x 3/4"	N/A	2 x average bill

The utility should file revised tariff sheets, which are consistent with the Commission's vote. Staff should be given administrative authority to approve the revised tariff sheets upon staff's verification that the tariffs are consistent with the Commission's decision. If revised tariff sheets are filed and approved, the customer deposits should become effective for connections made on or after the stamped approval date of the revised tariff sheets, if no protest is filed.

ISSUE 15: Should the utility's service availability charges be revised to include a tap in fee and a meter installation charge, and if so, what are the appropriate charges?

STAFF RECOMMENDATION: Yes, the utility's current service availability charges should be revised to include a tap in fee of $150 and a meter installation charge of $100. The utility should file revised tariff sheets which are consistent with the Commission's vote. Staff should be given administrative authority to approve the revised tariff sheets upon staff's verification that the tariffs are consistent with the Commission's decision. If revised tariff sheets are filed and approved, the service availability charges should become effective for connections made on or after the stamped approval date of the revised tariff sheets, if no protest is filed. (FITCH, BIGGINS)

STAFF ANALYSIS: The utility's existing tariff authorizes a tap in fee of $550. Staff is recommending a new tap in fee and a meter installation charge.

The utility's existing tap in fee was grandfathered in the certification docket. Staff was unable to determine cost justification for the $550 tap in fee. The utility has requested a new tap in fee and provided staff with cost justification. Pugh Utilities connects new customers to Holmes' system and charges Holmes a $250 "tap in fee" for this service. This "tap in fee" includes installation of a meter. Staff was able to determine the meter installation cost to be $100 per connection. Therefore, staff believes that the appropriate tap in fee should be $150 ($250 - $100). Because the utility does not have an existing meter installation charge, staff believes that allowing a $100 meter installation charge is appropriate.

Staff believes that both the meter installation charge and the tap in fee are reasonable and similar to past Commission allowances. A schedule of the utility's existing charges and staff's recommended charges are as follows:

	Existing Charge	Recommended Charge
Tap in Fee		
5/8" x 3/4"	$550.00	$150.00
All Over 5/8" x 3/4"	Actual Cost	Actual Cost

Meter Installation Charge	Existing Charge	Recommended Charge
5/8" x 3/4"	N/A	$100.00
All Over 5/8" x 3/4"	N/A	Actual Cost

If revised tariff sheets are filed and approved, the service availability charges should become effective for connections made on or after the stamped approval date of the revised tariff sheets, if no protest is filed.

ISSUE 16: Should the recommended rates be approved for the utility on a temporary basis, subject to refund, in the event of a protest filed by a party other than the utility?

STAFF RECOMMENDATION: Yes. Pursuant to Section 367.0814(7), Florida Statues, the recommended rates should be approved for the utility on a temporary basis, subject to refund, in the event of a protest filed by a party other than the utility. Prior to implementation of any temporary rates, the utility should provide appropriate security. If the recommended rates are approved on a temporary basis, the rates collected by the utility should be subject to the refund provisions discussed below in the staff analysis. In addition, after the increased rates are in effect, pursuant to Rule 25-30.360(6), Florida Administrative Code, the utility should file reports with the Commission's Division of Economic Regulation no later than the 20th of each month indicating the monthly and total amount of money subject to refund at the end of the preceding month. The report filed should also indicate the status of the security being used to guarantee repayment of any potential refund. (ESPINOZA, FITCH, BIGGINS)

STAFF ANALYSIS: This recommendation proposes an increase in water rates. A timely protest might delay what may be a justified rate increase resulting in an unrecoverable loss of revenue to the utility. Therefore, pursuant to Section 367.0814(7), Florida Statutes, in the event of a protest filed by a party other than the utility, staff recommends that the recommended rates be approved as temporary rates. The recommended rates collected by the utility should be subject to the refund provisions discussed below.

The utility should be authorized to collect the temporary rates upon staff's approval of appropriate security for the potential refund and the proposed customer notice. Security should be in the form of a bond or letter of credit in the amount of $9,243. Alternatively, the utility could establish an escrow agreement with an independent financial institution.

If the utility chooses a bond as security, the bond should contain wording to the effect that it will be terminated only under the following conditions:

1) The Commission approves the rate increase; or

2) If the Commission denies the increase, the utility shall refund the amount collected that is attributable to the increase.

If the utility chooses a letter of credit as a security, it should contain the following conditions:

1) The letter of credit is irrevocable for the period it is in effect.

2) The letter of credit will be in effect until a final Commission order is rendered, either approving or denying the rate increase.

If security is provided through an escrow agreement, the following conditions should be part of the agreement:

1) No refunds in the escrow account may be withdrawn by the utility without the express approval of the Commission.

2) The escrow account shall be an interest bearing account.

3) If a refund to the customers is required, all interest earned by the escrow account shall be distributed to the customers.

4) If a refund to the customers is not required, the interest earned by the escrow account shall revert to the utility.

5) All information on the escrow account shall be available from the holder of the escrow account to a Commission representative at all times.

6) The amount of revenue subject to refund shall be deposited in the escrow account within seven days of receipt.

7) This escrow account is established by the direction of the Florida Public Service Commission for the purpose(s) set forth in its

order requiring such account. Pursuant to Cosentino v. Elson, 263 So. 2d 253 (Fla. 3d DCA 1972), escrow accounts are not subject to garnishments.

8) The Director of Commission Clerk and Administrative Services must be a signatory to the escrow agreement.

This account must specify by whom and on whose behalf such monies were paid.

In no instance should the maintenance and administrative costs associated with the refund be borne by the customers. These costs are the responsibility of, and should be borne by, the utility. Irrespective of the form of security chosen by the utility, an account of all monies received as result of the rate increase should be maintained by the utility. If a refund is ultimately required, it should be paid with interest calculated pursuant to Rule 25-30.360(4), Florida Administrative Code.

The utility should maintain a record of the amount of the bond, and the amount of revenues that are subject to refund. In addition, after the increased rates are in effect, pursuant to Rule 25-30.360(6), Florida Administrative Code, the utility should file reports with the Commission Division of Economic Regulation no later than the 20th of each month indicating the monthly and total amount of money subject to refund at the end of the preceding month. The report filed should also indicate the status of the security being used to guarantee repayment of any potential refund.

ISSUE 17: Should Holmes Utilities, Inc. be ordered to show cause, in writing, within 21 days, why it should not be fined for failure to comply with its tariff, in apparent violation of Sections 367.081(1), and 367.091(3), Florida Statutes?

STAFF RECOMMENDATION: No, show cause proceedings should not be initiated at this time. The utility should hereby be put on notice that it must continue to comply with its tariff and bill accordingly in the future. (ESPINOZA, FITCH, BIGGINS)

STAFF ANALYSIS: Section 367.081(1), Florida Statutes, provides that a utility may only charge rates and charges that have been approved by the Commission. Section 367.091(3), Florida Statutes provides that "each utility's rates, charges, and customer service policies must be contained in a tariff approved by and on file with the Commission."

The current revenue tariff in effect for Holmes was established in Order No. PSC-97-0568-FOF-WU. It includes an inclining block rate structure that provides for a gallonage charge increase of $0.30 for each 5,000-gallon block. However, the utility capped the rate billed customers at 15,000 gallons, thus billing all gallons above 15,000 at the same rate as the 10,000 to 15,000 gallon block, contrary to the specification of the tariff. This resulted in undercharged revenue for the 12-month period ending December 31, 2000, for a total of $31.20.

Section 367.161, Florida Statutes, authorizes the Commission to assess a penalty of not more than $5,000 per day for each offense, if a utility is found to have knowingly refused to comply with, or to have willfully violated any Commission rule, order, or provision of Chapter 367, Florida Statutes. Utilities are charged with the knowledge of the Commission's rules and statutes. Additionally, "it is a common maxim, familiar to all minds that 'ignorance of the law' will not excuse any person, either civilly or criminally." Barlow v. United States, 32 U.S. 404, 411 (1833).

Thus, any intentional act, such as the utility's failure to adhere to its rate tariff would meet the standard for a "willful violation." In Re: Investigation Into The Proper Application of Rule 25-14.003, Florida Administrative Code, Relating To Tax Savings Refund for 1988 and 1989 For GTE Florida, Inc., Order No. 24306, issued April 1, 1991, in Docket No. 890216-TL, the Commission having found that the company had not intended to

violate the rule, nevertheless found it appropriate to order it to show cause why it should not be fined, stating that "'willful' implies an intent to do an act, and this is distinct from an intent to violate a statute or rule." Id. at 6.

Although regulated utilities are charged with knowledge of the Commission's rules and statutes, staff does not believe that Holmes' apparent violation of Sections 367.081(1) and 367.091(3), Florida Statutes, rises in these circumstances to the level which warrants the initiation of a show cause proceeding. As stated previously, the utility's failure to adhere to its revenue tariff resulted in a $31.20 undercharge, which staff believes is an immaterial amount. In addition, there were very few customers that consumed above 15,000 gallons for this period of time, and these customers benefitted from the utility's oversight by being charged the lower rate. Furthermore, upon being made aware of the oversight by staff, the utility is now charging the appropriate tariff rates.

For the foregoing reasons, staff does not believe that the utility's apparent violation of Sections 367.081(1) and 367.091(3), Florida Statutes rises in these circumstances to warrant a show cause proceeding. However, the utility should hereby be put on notice that it must continue to comply with its tariff and bill accordingly in the future.

ISSUE 18: Should this docket be closed?

STAFF RECOMMENDATION: No. If no timely protest is received upon expiration of the protest period, the PAA Order will become final upon the issuance of a Consummating Order. However, this docket should remain open for an additional nine months from the effective date of the Order to allow staff to verify completion of pro forma plant as described in Issue No. 5. Once staff has verified that this work has been completed, the docket should be closed administratively. (ESPINOZA, FITCH, BIGGINS)

STAFF ANALYSIS: Staff has recommended that the utility complete pro forma as described in Issue No. 5. If no timely protest is received upon expiration of the protest period, the PAA Order will become final upon the issuance of a Consummating Order. However, this docket should remain open for an additional nine months from the effective date of the Order to verify completion of the pro forma. Once staff has verified that the work has been completed, the docket should be closed administratively.

HOLMES UTILITIES, INC.
TEST YEAR ENDING 12/31/00
SCHEDULE OF WATER RATE BASE

SCHEDULE NO. 1-A
DOCKET NO. 010403-WU

DESCRIPTION	BALANCE PER UTILITY	STAFF ADJUST. TO UTIL. BAL.	BALANCE PER STAFF
1. UTILITY PLANT IN SERVICE	$47,967	$7,850	$55,817
2. LAND & LAND RIGHTS	745	750	1,495
3. NON-USED AND USEFUL COMPONENTS	0	0	0
4. CIAC	(13,100)	(8,200)	(21,300)
5. ACCUMULATED DEPRECIATION	(5,436)	(11,663)	(17,099)
6. AMORTIZATION OF CIAC	894	1,947	2,841
7. WORKING CAPITAL ALLOWANCE	0	2,381	2,381
8. WATER RATE BASE	$31,070	($6,935)	$24,135

HOLMES UTILITIES, INC. TEST YEAR ENDING 12/31/00 ADJUSTMENTS TO RATE BASE	SCHEDULE NO. 1-B DOCKET NO. 010403-WU
	WATER
UTILITY PLANT IN SERVICE	
1. Plant per original cost study (52,034)	$4,067
2. Averaging adjustment	(548)
3. Pro forma plant	8,663
4. Pro forma averaging adjustment	(4,332)
Total	$7,850
LAND AND LAND RIGHTS	
1. Land per original cost study	$750
CIAC	
1. CIAC imputed per staff	($9,600)
2. Averaging adjustment	1,400
Total	($8,200)
ACCUMULATED DEPRECIATION	
1. Accumulated depreciation per 25-30.140 FAC	($12,549)
2. Averaging adjustment	943
3. Pro forma depreciation	(114)
4. Pro forma averaging adjustment	57
Total	($11,663)
AMORTIZATION OF CIAC	
1. Amortization of CIAC per staff	$2,333
2. Averaging adjustment	(386)
Total	$1,947
WORKING CAPITAL ALLOWANCE	
1. To reflect 1/8 of test year O & M expenses.	$2,381

HOLMES UTILITIES, INC.
TEST YEAR ENDING 12/31/00
SCHEDULE OF CAPITAL STRUCTURE

SCHEDULE NO. 2
DOCKET NO. 010403-WU

CAPITAL COMPONENT	PER UTILITY	SPECIFIC ADJUST-MENTS	BALANCE BEFORE PRO RATA ADJUSTMENTS	PRO RATA ADJUST-MENTS	BALANCE PER STAFF	PERCENT OF TOTAL	COST	WEIGHTED COST
1. COMMON STOCK	$100	$0	$100					
2. RETAINED EARNINGS	(26,295)	26,195	(100)					
3. PAID IN CAPITAL	0	0	0					
4. OTHER COMMON EQUITY	0	0	0					
5. TOTAL COMMON EQUITY	($26,195)	$26,195	0	0	0	0.00%	9.94%	0.00%
6. LONG TERM DEBT	72,829	0	72,829	(48,694)	24,135	100.00%	8.50%	8.50%
	0	0	0	0	0	0.00%	0.00%	0.00%
7. TOTAL LONG TERM DEBT	72,829	0	72,829	(48,694)	24,135	100.00%		
8. CUSTOMER DEPOSITS	0	0	0	0	0	0.00%	6.00%	0.00%
9. TOTAL	$46,634	$26,195	$72,829	($48,694)	$24,135	100.00%		8.50%

RANGE OF REASONABLENESS	LOW	HIGH
RETURN ON EQUITY	8.94%	10.94%
OVERALL RATE OF RETURN	8.50%	8.50%

HOLMES UTILITIES, INC.
TEST YEAR ENDING 12/31/00
SCHEDULE OF WATER OPERATING INCOME

SCHEDULE NO. 3-A
DOCKET NO. 010403-WU

	TEST YEAR PER UTILITY	STAFF ADJ. PER UTILITY	STAFF ADJUSTED TEST YEAR	ADJUST. FOR INCREASE	REVENUE REQUIREMENT
1. OPERATING REVENUES	$8,669	$1,853	$10,522	$13,642 129.66%	$24,164
OPERATING EXPENSES:					
2. OPERATION & MAINTENANCE	15,981	3,064	19,045	0	19,045
3. DEPRECIATION (NET)	789	694	1,483	0	1,483
4. AMORTIZATION	0	0	0	0	0
5. TAXES OTHER THAN INCOME	888	83	971	614	1,585
6. INCOME TAXES	0	0	0	0	0
7. TOTAL OPERATING EXPENSES	$17,658	$3,841	$21,499	$614	$22,113
8. OPERATING INCOME/(LOSS)	($8,989)		($10,977)		$2,051
9. WATER RATE BASE	$31,070		$24,135		$24,135
10. RATE OF RETURN	-28.93%		-45.48%		8.50%

HOLMES UTILITIES, INC. SCHEDULE NO. 3-B
TEST YEAR ENDING 12/31/00
ADJUSTMENTS TO OPERATING INCOME

	WATER
OPERATING REVENUES	
Annualize revenue based on billing analysis	$1,853
OPERATION AND MAINTENANCE EXPENSES	
1. Purchased Power Expense (615)	
a. To reflect repression adjustment	($25)
2. Chemicals Expense (618)	
a. To reflect repression adjustment	($84)
3. Contractual Services - Billing (630)	
a. To reflect contracted billing	$20
4. Contractual Services - Testing (635)	
a. To reflect DEP required testing	$1,536
5. Contractual Services - Other (636)	
a. Increase to reflect contracted operator and management	$1,920
6. Regulatory Commission Expense (665)	
a. Notice mailing cost amortized over 4 years	$15
b. Amortized filing fee over 4 years	125
Total	$140
7. Miscellaneous Expense (675)	
a. Remove billing cards already recorded in accountant 630	($68)
b. Remove non utility advertising cost	(375)
Total	($443)
TOTAL OPERATION & MAINTENANCE ADJUSTMENTS	$3,064
DEPRECIATION EXPENSE	
1. To reflect test year depreciation calculated per 25-30.140, FAC	$1,162
2. Test year amortization of CIAC.	(468)
Total	$694
TAXES OTHER THAN INCOME	
1. To include regulatory assessment fees on test year revenue.	$83

HOLMES UTILITIES, INC.
TEST YEAR ENDING 12/31/00
ANALYSIS OF WATER OPERATION AND MAINTENANCE EXPENSE

SCHEDULE NO. 3-C
DOCKET NO. 010403-WU

	TOTAL PER UTILITY	STAFF PER ADJUST.		TOTAL PER PER STAFF
(601) SALARIES AND WAGES - EMPLOYEES	0	0		0
(603) SALARIES AND WAGES - OFFICERS	0	0		0
(615) PURCHASED POWER	613	(25)	[1]	588
(618) CHEMICALS	2,107	(84)	[2]	2,023
(620) MATERIALS AND SUPPLIES	0	0		0
(630) CONTRACTUAL SERVICES - BILLING	863	20	[3]	883
(631) CONTRACTUAL SERVICES - PROFESSIONAL	1,725	1,920	[4]	3,645
(635) CONTRACTUAL SERVICES - TESTING	1,795	1,536	[5]	3,331
(636) CONTRACTUAL SERVICES - OTHER	6,960	0		6,960
(650) TRANSPORTATION EXPENSE	0	0		0
(655) INSURANCE EXPENSE	724	0		724
(655) REGULATORY COMMISSION EXPENSE	0	140	[6]	140
(670) BAD DEBT EXPENSE	0	0		0
(675) MISCELLANEOUS EXPENSES	1,194	(443)	[7]	751
	15,981	3,064		19,045

RECOMMENDED RATE REDUCTION SCHEDULE

HOLMES UTILITIES, INC. — SCHEDULE NO. 4
TEST YEAR ENDING 12/31/00 — DOCKET NO. 010403-WU

CALCULATION OF RATE REDUCTION AMOUNT
AFTER RECOVERY OF RATE CASE EXPENSE AMORTIZATION PERIOD OF FOUR YEARS

MONTHLY WATER RATES

RESIDENTIAL AND GENERAL SERVICE		MONTHLY RECOMMENDED RATES	MONTHLY RATE REDUCTION
BASE FACILITY CHARGE:			
Meter Size:			
5/8"X3/4"	$	13.30	0.08
3/4"		19.95	0.12
1"		33.25	0.20
1-1/2"		66.50	0.40
2"		106.40	0.65
3"		212.79	1.29
4"		332.49	2.02
6"		664.98	4.03
RESIDENTIAL GALLONAGE CHARGE (per 1,000 gallons)			
0-10,000 gallons	$	5.00	0.03
above 10,000 gallons		6.25	0.04
GENERAL SERVICE GALLONAGE CHARGE			
Per 1,000 Gallons		5.05	0.03