

RECEIVED-FPSC

State of Florida



09 NOV 17 11:10 AM '09

Public Service Commission

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

COMMISSION
CLERK

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

DATE: November 17, 2009

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Fletcher, Bulecza-Banks, Springer) *Bo* *ALM* *mal* *ALM*
Office of the General Counsel (Klancke) *CMK* *JSB*

RE: Docket No. 090381-SU – Application for increase in wastewater rates in Seminole County by Utilities Inc. of Longwood.

AGENDA: 12/01/09 – Regular Agenda – Decision on Interim Rates – Participation is Limited to Commissioners and Staff

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Klement

CRITICAL DATES: 60-Day Suspension Date Waived Through 12/01/09

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\090381.RCM.DOC

RECEIVED-FPSC
09 NOV 17 AM 10:22
COMMISSION
CLERK

Case Background

Utilities, Inc. of Longwood is a Class B utility providing wastewater service to approximately 1,560 customers in Seminole County. In 1996, the Commission approved the transfer from Longwood Utilities, Inc. to Utilities, Inc. of Longwood (Longwood or Utility), as well as established rate base as of July 31, 1995.¹ The Utility is a wholly-owned subsidiary of Utilities, Inc. (UI). Longwood has never had a rate case.

¹ See Order No. PSC-96-0448-FOF-SU, issued March 29, 1996, in Docket No. 950959-SU, In re: Application for transfer of facilities and Certificate No. 232-S in Seminole County from Longwood Utilities, Inc. to Utilities, Inc. of Longwood.

DOCUMENT NUMBER-DATE
11361 NOV 17 09
FPSC-COMMISSION CLERK

On September 29, 2009, Longwood filed its application for approval of final and interim rate increases in the instant docket. The Utility had a few deficiencies in the Minimum Filing Requirements (MFRs). As of the filing of this recommendation, those deficiencies remain outstanding. The Utility requested that the application be processed using the Proposed Agency Action (PAA) procedure. The test year established for interim and final rates is the historical twelve-month period ended December 31, 2008.

Longwood requested interim rates designed to generate annual wastewater revenues of \$865,697, an increase of \$123,367 or 16.62 percent. The Utility requested final rates designed to generate wastewater revenues of \$943,939, an increase of \$199,144 or 26.74 percent.

The 60-day statutory deadline for the Commission to suspend the Utility's requested final rates is November 28, 2009. However, by letter dated October 8, 2009, Longwood agreed to extend the statutory time frame through December 1, 2009. This recommendation addresses the suspension of Longwood's requested final rates and the Utility's requested interim rates. The Commission has jurisdiction pursuant to Sections 367.081 and 367.082, Florida Statutes (F.S.).

Discussion of Issues

Issue 1: Should the Utility's proposed final wastewater rates be suspended?

Recommendation: Yes. Longwood's proposed final wastewater rates should be suspended. (Fletcher)

Staff Analysis: Section 367.081(6), F.S., provides that the Commission may, for good cause, withhold consent to the implementation of the requested rates within 60 days after the date the rate request is filed. Further, Section 367.081(8), F.S., permits the proposed rates to go into effect (secured and subject to refund) at the expiration of five months from the official date of filing if: (1) the Commission has not acted upon the requested rate increase; or (2) the Commission's PAA action is protested by a party other than the Utility.

Staff has reviewed the filing and has considered the information filed in support of the rate application and the proposed final rates. Staff recommends that it is necessary to require further investigation of this information, including on-site investigations by staff accountants and engineers. Based on the foregoing, staff recommends that it is appropriate to suspend the Utility's proposed rate increase.

Issue 2: Should an interim revenue increase be approved?

Recommendation: Yes. On an interim basis, the Utility should be authorized to collect annual wastewater revenues as indicated below:

	<u>Adjusted Test Year Revenues</u>	<u>\$ Increase</u>	<u>Revenue Requirement</u>	<u>% Increase</u>
Wastewater	\$742,330	\$109,159	\$851,489	14.70%

(Fletcher)

Staff Analysis: In its MFRs, Longwood requested interim rates designed to generate annual revenues of \$865,697. This represents a wastewater revenue increase of \$123,367 (16.62 percent). The Utility has filed rate base, cost of capital, and operating statements to support its requested wastewater increase.

Pursuant to Section 367.082(5)(b)1., F.S., the achieved rate of return for interim purposes must be calculated by applying appropriate adjustments consistent with those made in a utility's most recent rate proceeding. As stated in the case background, Longwood has never had a rate case, but the Commission established rate base as of July 31, 1995, in Docket No. 950959-SU. Staff has reviewed Longwood's interim request, as well as prior orders concerning the Utility's rate base. Staff's recommended adjustments are discussed below. Staff has attached accounting schedules to illustrate staff's recommended rate base, capital structure, and test year operating income amounts. The rate base schedule is shown on Schedule No. 1, the capital structure schedule is shown on Schedule No. 2, and the operating income schedule is shown on Schedule No. 3-A, with the adjustments shown on Schedule No. 3-B.

RATE BASE

Staff reviewed the Utility's MFRs. As a result of this review, staff believes one adjustment is necessary to the requested rate base. Longwood reflected a working capital allowance of \$88,078. Pursuant to Rule 25-30.433(2), Florida Administrative Code (F.A.C.), working capital for class B utilities shall be calculated using the formula method which is one-eighth of operation and maintenance (O&M) expenses. When dividing the Utility's adjusted O&M expenses by eight, it yields a working capital allowance of \$68,004, which represents a reduction of \$20,074 to Longwood's requested working capital. Therefore, staff's recommended interim rate base is \$1,622,279. Schedule No. 1 details staff's recommended interim rate base.

COST OF CAPITAL

In its MFRs, Longwood used a simple-average capital structure consisting of allocated investor sources of capital from UI, and the Utility included specifically-identified customer deposits and accumulated deferred income taxes. Staff reviewed Longwood's requested capital structure and discovered that the Utility erred in using the mid-point of its return on equity (ROE) of 11.13 percent. Section 367.082(5)(b)3., F.S., requires that the minimum of the range of the last authorized rate of return on equity (ROE) be used when calculating the cost of capital

for an interim rate increase. Therefore, for interim purposes, staff recommends that the appropriate cost of equity should be 10.13 percent. Accordingly, staff's recommended weighted cost of capital for interim purposes is 6.41 percent. Schedule No. 2 details staff's recommended capital structure.

NET OPERATING INCOME

Based on staff's review, no adjustments are necessary. Thus, staff recommends that the appropriate test year operating income, before any revenue increase, is \$38,959. Schedule No. 3-A details staff's recommended net operating income.

REVENUE REQUIREMENT

The Utility requested an interim revenue requirement of \$865,697. Based on the above, staff recommends an interim revenue requirement of \$851,489. This represents an interim revenue increase of \$109,159, or 14.70 percent. This will allow Longwood the opportunity to recover its operating expenses and earn a 6.41 percent return on its rate base.

Issue 3: What are the appropriate interim wastewater rates?

Recommendation: The wastewater service rates for Longwood in effect as of December 31, 2008, should be increased by 15.25 percent to generate the recommended revenue increase for the interim period. The approved rates should be effective for service rendered as of the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1)(a), F.A.C. The rates should not be implemented until staff verifies that the tariff sheets are consistent with the Commission's decision, the proposed customer notice is adequate, and the required security discussed in Issue 4 has been filed. The Utility should provide proof of the date notice was given within 10 days after the date of notice. (Fletcher)

Staff Analysis: Staff recommends that interim wastewater service rates for Longwood be designed to allow the Utility the opportunity to generate annual operating revenues of \$851,489. This reflects an increase of \$109,159, or 14.70 percent, before removal of miscellaneous and other revenues. To determine the appropriate percentage increase to apply to the service rates, miscellaneous service revenues should be removed from the test year revenues. In its MFRs, Longwood included miscellaneous and other revenues of \$26,369. Staff's calculation is as follows:

	<u>Wastewater</u>
1 Total Test Year Revenues	\$742,330
2 Less: Miscellaneous Revenues	<u>26,369</u>
3 Test Year Revenues from Service Rates	\$715,961
4 Revenue Increase	<u>\$109,159</u>
5 % Service Rate Increase (Line 4/Line3)	<u>15.25%</u>

Longwood incorrectly applied an increase of approximately 6.78 percent to its test year residential and general service rates to calculate its requested interim Base Facility Charge (BFC) and gallonage rates. As stated earlier, staff is recommending an across-the-board increase of 15.25 percent to the Utility's test year base facility and gallonage charges. As such, the Utility understated its requested interim rates. Approving interim rates greater than those requested by the Utility, due to an erroneous application of the across-the-board rate increase in the MFRs, is consistent with a prior Commission order.²

The interim rate increase of 15.25 percent for wastewater should be applied as an across-the-board increase to the service rates in effect as of December 31, 2008. The approved rates should be effective for service rendered as of the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1)(a), F.A.C. The rates should not be implemented until staff verifies that the tariff sheets are consistent with the Commission's decision, the proposed

² See Order No. PSC-06-0925-PCO-WS, issued November 6, 2006, in Docket No. 060246-WS, In re: Application for increase in water and wastewater rates in Polk County by Gold Coast Utility Corp.

Docket No. 090381-SU
Date: November 17, 2009

customer notice is adequate, and the required security discussed in Issue 4 has been filed. The Utility should provide proof of the date notice was given within 10 days after the date of notice.

The Utility's test year, proposed interim and final wastewater rates, and staff's recommended interim wastewater rates are shown on Schedule No. 4.

Issue 4: What is the appropriate security to guarantee the interim increase?

Recommendation: The Utility should be required to open an escrow account or file a surety bond or letter of credit to guarantee any potential refund of revenues collected under interim conditions. If the security provided is an escrow account, the Utility should deposit \$9,097 into the escrow account each month. Otherwise, the surety bond or letter of credit should be in the amount of \$63,720. Pursuant to Rule 25-30.360(6), F.A.C., the Utility should provide a report by the 20th of each month indicating the monthly and total revenue collected subject to refund. Should a refund be required, the refund should be with interest and undertaken in accordance with Rule 25-30.360, F.A.C. (Fletcher, Springer)

Staff Analysis: Pursuant to Section 367.082, F.S., revenues collected under interim rates shall be placed under bond, escrow, letter of credit, or corporate undertaking subject to refund with interest at a rate ordered by the Commission. As recommended in Issue 2, the total annual interim increase is \$109,159. In accordance with Rule 25-30.360, F.A.C., staff calculated the potential refund of revenues and interest collected under interim conditions to be \$63,720. This amount is based on an estimated seven months of revenue being collected from staff's recommended interim rates over the Utility's current authorized rates shown on Schedule No. 4.

Longwood is a wholly-owned subsidiary of Utilities, Inc. (UI), which provides all investor capital to its subsidiaries. The Commission approved a corporate undertaking in the amount of \$75,165 to secure interim increases granted in Docket No. 080249-WS for UI's Labrador Utilities, Inc. subsidiary.³ As such, staff reviewed the financial statements of UI. As a result of staff's interim recommendations in this docket and Docket Nos. 090392-WS⁴ and 090402-WS,⁵ the total requested cumulative corporate undertaking amount is \$683,154, of which \$63,720 is subject to refund for this docket.

The criteria for a corporate undertaking includes sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. Staff reviewed the financial statements of the parent company to determine if UI can support a corporate undertaking on behalf of its subsidiaries. UI's 2006, 2007, and 2008 financial statements were used to determine the financial condition of the Company. Net income has been on average two times greater than the requested cumulative corporate undertaking amount over the three year period. However, UI experienced a net loss in 2008. The Company has also experienced a steady decline in its interest coverage ratio and relative level of net income over the three year review period. In addition, UI's average equity ratio has decreased to 40.7 percent from 44.8 percent in 2007.

Staff believes UI has inadequate liquidity, profitability, and interest coverage to support a corporate undertaking in the amount requested. While the existing corporate undertaking amount of \$75,165 secured on behalf of Labrador Utilities, Inc. is still appropriate, staff

³ See Order No. PSC-08-0751-PCO-WS, issued November 13, 2008, In re: Application for increase in water and wastewater rates in Pasco County by Labrador Utilities, Inc.

⁴ In re: Application for increase in water and wastewater rates in Lake County by Utilities Inc. of Pennbrooke.

⁵ In re: Application for increase in Water and Wastewater rates in Seminole County by Sanlando Utilities Corporation.

recommends that UI be required to secure a surety bond, letter of credit, or escrow agreement to guarantee any new monies collected subject to refund.

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

The Utility should deposit \$9,097 into the escrow account each month for possible refund. The escrow agreement should also state that if a refund to the customers is required, all interest earned on the escrow account shall be distributed to the customers, and if a refund to the customers is not required, the interest earned on the escrow account shall revert to the Utility.

If the security provided is a surety bond or a letter of credit, said instrument should be in the amount of \$63,720. If the Utility chooses a surety bond as security, the surety bond should state that it will be released or terminated only upon subsequent order of the Commission. If the Utility chooses to provide a letter of credit as security, the letter of credit should state that it is irrevocable for the period it is in effect and that it will be in effect until a final Commission order is rendered releasing the funds to the Utility or requiring a refund.

Regardless of the type of security provided, the Utility should keep an accurate and detailed account of all monies it receives. Pursuant to Rule 25-30.360(6), F.A.C., the Utility shall provide a report by the 20th day of each month indicating the monthly and total revenue collected subject to refund. Should a refund be required, the refund should be with interest and undertaken in accordance with Rule 25-30.360, F.A.C.

In no instance should maintenance and administrative costs associated with any refund be borne by the customers. Such costs are the responsibility of, and should be borne by, the Utility.

Docket No. 090381-SU
Date: November 17, 2009

Issue 5: Should this docket be closed?

Recommendation: No. The docket should remain open pending the Commission's final action on the Utility's requested rate increase. (Klancke, Fletcher)

Staff Analysis: The docket should remain open pending the Commission's final action on the Utility's requested rate increase.

Utilities, Inc. of Longwood Schedule of Wastewater Rate Base Test Year Ended 12/31/08			Schedule No. 1 Docket No. 090381-SU		
Description	Test Year Per Utility	Utility Adjust- ments	Adjusted Test Year Per Utility	Staff Adjust- ments	Staff Adjusted Test Year
1 Plant in Service	\$3,634,524	\$61,644	\$3,696,168	\$0	\$3,696,168
2 Land and Land Rights	229,215	210	229,425	0	229,425
3 Non-used and Useful Components	0	0	0	0	0
4 Accumulated Depreciation	(1,896,917)	376,863	(1,520,054)	0	(1,520,054)
5 CIAC	(1,661,914)	0	(1,661,914)	0	(1,661,914)
6 Amortization of CIAC	1,264,556	(453,906)	810,650	0	810,650
7 CWIP	218,314	(218,314)	0	0	0
8 Acquisition Adjustment	101,733	(101,733)	0	0	0
9 Working Capital Allowance	<u>0</u>	<u>88,078</u>	<u>88,078</u>	<u>(20,074)</u>	<u>68,004</u>
10 Rate Base	<u>\$1,889,511</u>	<u>(\$247,158)</u>	<u>\$1,642,353</u>	<u>(\$20,074)</u>	<u>\$1,622,279</u>

Utilities, Inc. of Longwood Capital Structure-Simple Average Test Year Ended 12/31/08							Schedule No. 2 Docket No. 090381-SU		
Description	Total Capital	Specific Adjustments	Subtotal Adjusted Capital	Prorata Adjustments	Capital Reconciled to Rate Base	Ratio	Cost Rate	Weighted Cost	
Per Utility									
1 Long-term Debt	\$180,000,000	\$0	\$180,000,000	(\$179,370,487)	\$629,513	38.33%	6.65%	2.55%	
2 Short-term Debt	32,637,500	0	32,637,500	(32,523,420)	114,080	6.95%	5.23%	0.36%	
3 Preferred Stock	0	0	0	0	0	0.00%	0.00%	0.00%	
4 Common Equity	158,054,717	0	158,054,717	(157,501,818)	552,899	33.66%	11.13%	3.75%	
5 Customer Deposits	29,428	0	29,428	0	29,428	1.79%	6.00%	0.11%	
6 Deferred Income Taxes	<u>316,564</u>	<u>0</u>	<u>316,564</u>	<u>0</u>	<u>316,564</u>	<u>19.27%</u>	0.00%	<u>0.00%</u>	
7 Total Capital	<u>\$371,038,209</u>	<u>\$0</u>	<u>\$371,038,209</u>	<u>(\$369,395,725)</u>	<u>\$1,642,484</u>	<u>100.00%</u>		<u>6.77%</u>	
Per Staff									
8 Long-term Debt	\$180,000,000	\$0	\$180,000,000	(\$179,380,263)	\$619,737	38.20%	6.65%	2.54%	
9 Short-term Debt	32,637,500	0	32,637,500	(32,525,130)	112,370	6.93%	5.23%	0.36%	
10 Preferred Stock	0	0	0	0	0	0.00%	0.00%	0.00%	
11 Common Equity	158,054,717	0	158,054,717	(157,510,537)	544,180	33.54%	10.13%	3.40%	
12 Customer Deposits	29,428	0	29,428	0	29,428	1.81%	6.00%	0.11%	
13 Deferred Income Taxes	<u>316,564</u>	<u>0</u>	<u>316,564</u>	<u>0</u>	<u>316,564</u>	<u>19.51%</u>	0.00%	<u>0.00%</u>	
14 Total Capital	<u>\$371,038,209</u>	<u>\$0</u>	<u>\$371,038,209</u>	<u>(\$369,415,930)</u>	<u>\$1,622,279</u>	<u>100.00%</u>		<u>6.41%</u>	
						LOW	HIGH		
RETURN ON EQUITY						<u>10.13%</u>	<u>12.13%</u>		
OVERALL RATE OF RETURN						<u>6.41%</u>	<u>7.08%</u>		

Utilities, Inc. of Longwood Statement of Wastewater Operations Test Year Ended 12/31/08						Schedule No. 3-A Docket No. 090381-SU	
Description	Test Year Per Utility	Utility Adjust- ments	Adjusted Test Year Per Utility	Staff Adjust- ments	Staff Adjusted Test Year	Revenue Increase	Revenue Requirement
1 Operating Revenues:	<u>\$770,736</u>	<u>\$94,961</u>	<u>\$865,697</u>	<u>(\$123,367)</u>	<u>\$742,330</u>	<u>\$109,159</u> 14.70%	<u>\$851,489</u>
Operating Expenses							
2 Operation & Maintenance	\$577,507	(\$33,473)	\$544,034		\$544,034		\$544,034
3 Depreciation	87,195	(5,309)	81,886	0	81,886		81,886
4 Amortization	0	0	0	0	0		0
5 Taxes Other Than Income	82,706	6,268	88,974	(5,552)	83,422	4,912	88,335
6 Income Taxes	<u>(9,872)</u>	<u>49,486</u>	<u>39,614</u>	<u>(45,585)</u>	<u>(5,971)</u>	<u>39,228</u>	<u>33,257</u>
7 Total Operating Expense	<u>737,536</u>	<u>16,972</u>	<u>754,508</u>	<u>(51,137)</u>	<u>703,371</u>	<u>44,140</u>	<u>747,512</u>
8 Operating Income	<u>\$33,200</u>	<u>\$77,989</u>	<u>\$111,189</u>	<u>(\$72,230)</u>	<u>\$38,959</u>	<u>\$65,019</u>	<u>\$103,977</u>
9 Rate Base	<u>\$1,889,511</u>		<u>\$1,642,353</u>		<u>\$1,622,279</u>		<u>\$1,622,279</u>
10 Rate of Return	<u>1.76%</u>		<u>6.77%</u>		<u>2.40%</u>		<u>6.41%</u>

Utilities, Inc. of Longwood		Schedule 3-B
Adjustment to Operating Income		Docket No. 090381-SU
Test Year Ended 12/31/08		
Explanation		Wastewater
<u>Operating Revenues</u>		
Remove requested interim revenue increase.		<u>(\$123,367)</u>
<u>Taxes Other Than Income</u>		
RAFs on revenue adjustment above.		<u>(\$5,552)</u>

Utilities, Inc. of Longwood Wastewater Monthly Service Rates Test Year Ended 12/31/08			SCHEDULE NO. 4 Docket No. 090381-SU		
	Test Year Rates	Utility Requested Interim (1)		Utility Requested Final	Staff Recomm. Interim
Residential					
Base Facility Charge All Meter Sizes:	\$34.98	\$41.01	*	\$39.09	\$40.31
General Service					
Base Facility Charge by Meter Size:					
5/8" x 3/4"	\$15.14	\$17.75	*	\$17.14	\$17.45
1"	\$37.83	\$44.35	*	\$42.85	\$43.60
1-1/2"	\$75.67	\$88.71	*	\$85.71	\$87.21
2"	\$121.06	\$141.92	*	\$137.14	\$139.52
3"	\$242.14	\$283.86	*	\$257.13	\$279.06
Gallage Charge, per 1,000 Gallons	\$2.83	\$3.32	*	\$3.57	\$3.26
Typical Residential Bills 5/8" x 3/4" Meter					
3,000 Gallons	\$34.98	\$41.01		\$39.09	\$40.31
5,000 Gallons	\$34.98	\$41.01		\$39.09	\$40.31
10,000 Gallons	\$34.98	\$41.01		\$39.09	\$40.31
(Wastewater Gallage Cap - 10,000 Gallons)					
Footnote:					
(1) Corrected for mathematical error in across-the-board increase.					