

State of Florida



Public Service Commission
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DATE: DECEMBER 5, 2002

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

FROM: DIVISION OF ECONOMIC REGULATION (BIGGINS, FITCH, HUDSON, DAVIS, LINGO, MASSOUDI) *db RF C SH*
OFFICE OF THE GENERAL COUNSEL (GERVASI) *mm* *198*

RE: DOCKET NO. 020406-WU - APPLICATION FOR STAFF-ASSISTED RATE
CASE IN POLK COUNTY BY PINECREST RANCHES, INC.
COUNTY: POLK

AGENDA: DECEMBER 17, 2002 - REGULAR AGENDA - PROPOSED AGENCY
ACTION EXCEPT FOR ISSUES 12, 14, and 15 - INTERESTED
PERSONS MAY PARTICIPATE

CRITICAL DATES: 15-MONTH EFFECTIVE DATE: OCTOBER 5, 2003 (SARC)

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\WP\020406.RCM

DOCUMENT NUMBER-DATE

13290 DEC-58

FPSC-COMMISSION CLERK

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CASE BACKGROUND

Pinecrest Ranches, Inc. (Pinecrest or utility) is a Class C utility which is currently providing water service to 129 mobile homes in a community in Polk County known as Citrus Highlands. During the 2001 test year a neighboring system serving 7 customers failed. The utility connected with these customers on an emergency basis and filed a quick take amendment in Docket No. 020823-WU to include these customers. There is not another utility in the area of the proposed new territory willing and capable of providing reasonably adequate service to the territory. The Utility is located in the Southern Water Use Caution Area of the Southwest Florida Water Management District (SWFWMD). According to the utility's 2001 annual report, the utility had operating revenues of \$20,195 and a net operating loss of \$11,799.

The utility received its certificate by Order No. PSC-97-0367-FOF-WU, issued April 2, 1997, in Docket No. 961253-WU. The utility's existing rates were approved in this Order. The utility filed for a transfer of majority organizational control of Pinecrest Ranches, Inc., holder of certificate No. 588-W in Polk County, from James O. Vaughn and Margaret S. Hankin to S. Norman Duncan and Richard S. Little. The transfer was granted by Order No. PSC-02-0893-FOF-WU, issued July 5, 2002, in Docket No. 011651-WU.

On May 8, 2002, the utility filed an application for a Staff Assisted Rate Case (SARC) and paid the appropriate filing fee on July 11, 2002. Staff has audited the utility's records for compliance with Commission rules and Orders and determined the components necessary for rate setting. Staff also conducted a field investigation of the utility's plant and service area and an original cost study was performed. The Commission has jurisdiction in this case pursuant to Section 367.0814, Florida Statutes.

A customer meeting was conducted on November 7, 2002, at the Chain of Lakes Complex in Winter Haven, Florida. Approximately fourteen customers attended the meeting. Five customers chose to give comments regarding the utility's quality of service and the proposed rate increase. Customers' complaints included dirty water, the strong smell of chlorine, and the water filters becoming dirty in a short span of time. Quality of service issue is 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 Pinecrest Ranches, Inc., considered satisfactory?

RECOMMENDATION: Yes. The quality of service provided by Pinecrest Ranches, Inc. should be considered satisfactory. However, the utility should be required to submit monthly reports for the next six months that chronicle the newly instituted flushing program. (DAVIS, MASSOUDI)

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 utility's product (water and wastewater); operational conditions of 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 county health departments (HRS) or lack thereof over the proceeding 3-year period shall also be considered. DEP and HRS officials' testimony concerning quality of service as well as the comments and testimony of the utility's customers shall be considered.

Staff's recommendation concerning the overall quality of service provided by the utility is derived from an evaluation of three separate components of water utility operations:

- (1) Quality of utility's product (compliance with drinking water standards),
- (2) Operational conditions of utility's plant or facility,
- (3) Utility's attempt to address customer satisfaction.

Pinecrest is a Class C utility which provides water service to a modular home community known as Citrus Highlands Subdivision in Polk County. The utility currently has the capacity to serve drinking water to 157 residential mobile homes (estimated to be 126 ERCs) without the construction of additional lines. The utility is located within Section 6, Township 30 South, Range 26 East in Polk County, Florida. The service territory is accessed by a county

maintained road known as Hankin Road which intersects with State Road 60 between Bartow and Lake Wales.

QUALITY OF UTILITY'S PRODUCT

The water system at Pinecrest is under the jurisdiction of the Polk County Health Department. The utility has conformed with all testing and chemical analysis required by this agency and the test results have been satisfactory.

The raw water being treated at the Pinecrest water treatment plant does contain Hydrogen Sulfide and iron. Both are secondary standards, and are not considered to be a health hazard. The utility operator is treating the Hydrogen Sulfide levels by going to "break-point" chlorination. This is considered to be a valid form of treatment though less effective than aeration. However, aeration for this system would require the construction of a cascading aeration unit, a ground storage tank, and high service pumps to pressurize/distribute the treated water. The installation of such equipment would cost approximately \$100,000. Staff believes it would be imprudent to require the installation of such equipment, and levy that size capital investment on customers. Instead, each customer that finds the taste, odor, and color of their water unacceptable should consider investing in a whole-house filtration unit that use carbon cartridges.

Consumptive use in Polk County is permitted by the Southwest Florida Water Management District. The utility formally obtained Water Use Permit No. 209128 on March 23, 1988, which expired on March 23, 1998. On January 21, 1998, the water management office issued a letter of extension for WUP No. 209128.01 that is valid until January 21, 2008. The parameters of the permit limit the utility to an average withdrawal of 58,000 gallons per day with a peak monthly withdrawal of 88,400 gallons. Currently, the utility is exceeding both parameters, and is being required to install meters as a conservation measure.

OPERATIONAL CONDITIONS AT THE PLANT

Maintenance at the plant-site appeared to have been given adequate attention, but, lacked detail. During the engineering field inspection, water plant equipment was working properly. Plant piping is showing some rust pitting which will need to be sanded and painted in the near future. The pavilion that covers

the primary well and the hydropneumatic tank is adequate, but, could be improved upon since it is open to view as one drives into the subdivision. The plant grounds within the fenced in area is somewhat organized and appears to have been recently mowed. The utility plant in service appears to be satisfactory.

UTILITY'S ATTEMPT TO ADDRESS CUSTOMER SATISFACTION

An informal customer meeting was held on November 7, 2002, at the Chain of Lakes Complex in Winter Haven. Staff conducted two meetings, one at 4:00 pm and another at 6:00 pm. The three customers that attended the 4:00 pm meeting were all in agreement that; the water was discolored, the Chlorine levels were inconsistent, there were unannounced water outages, and the \$153 meter installation fee was unacceptable. During the 6:00 pm meeting, fourteen customers out of the 129 active customer connections expressed concern with the rate increase. Of the customers that attended the evening meeting, five gave comments concerning the quality of service and the proposed rates. The quality of service issues raised by these customers were; the water was discolored, the Chlorine levels were inconsistent, there were unannounced water outages, and the \$153 meter installation fee was unacceptable.

It appears that the discussion of the meter installation charge in the staff report was misunderstood. The customers did not understand that they would not be subject to the \$153 as discussed in Issue No. 13.

Staff investigated the Chlorination and discolored water issues by calling the Polk county Health Department. It was determined that the raw water from the wells at Pinecrest contain Hydrogen Sulfide and Iron. The level of Iron does not exceed the Maximum Contaminant Level (MCL), and has not been an issue for compliance. Both are secondary standards which are not considered to be a health hazard, and the health department is not recommending additional treatment to remove either of the two organic compounds. The customers complained that, at times, there was a strong smell of chlorine in the drinking water and, at other times, the water would smell like rotten eggs. Hydrogen Sulfide, while not considered to be a health hazard, emits odors, and has a taste that some find to be unpleasant. The Chlorine pump is set on a timer that injects Chlorine during those times that the pump is

engaged. This treatment process is a recognized treatment for both disinfection and for the removal of Hydrogen Sulfide.

The interaction between the Chlorine and the Hydrogen Sulfide, by its nature, is constantly in flux. This causes treatment results to shift from moment to moment. In order to insure proper disinfection throughout the distribution system, the operator has been injecting sufficient Chlorine to neutralize the Hydrogen Sulfide at its highest concentration. When chlorine is fed into the raw water, it first reacts with any iron, manganese, or hydrogen sulfide that may be in the water. If any residual (unreacted) chlorine remains, it will next react with organic material (including bacteria) that is present. The goal of disinfecting the system is to kill the bacteria. By Rule 62-550.518(4), Florida Administrative Code (FAC), the utility is required to maintain a free Chlorine residual of 0.2 parts per million (ppm) throughout the system. However, while there is a 0.2 parts per million minimum free chlorine residual requirement, Rule 62-550.310(2)(a), FAC, will (beginning January 1, 2004) limit Chlorination to a maximum 4.0 ppm calculated as a running average to be computed quarterly using monthly averages of all samples taken. Mr. Duncan has made a commitment to staff that he will instruct his operator to be more diligent in overseeing higher dosages of Chlorine in the future.

The treatment process is further complicated by the existence of Iron. While Iron does not exceed the MCL, there is a sufficient level to react with the free Chlorine residual, causing the Iron to fall out of suspension, and creating sedimentation. It appears that this sedimentation has been allowed to collect in the distribution lines which can harbor additional bacteria. Additional bacteria has the potential to further compromise the free Chlorine residual and yield inconsistent levels of disinfectant in the lines. It is believed that a routine flushing program is needed to remove the sedimentation of Iron, eliminate the discolored water, and normalize the free Chlorine residual in the system. Mr. Duncan has already installed three "blow-off" valves and has started a flushing program. Currently, his schedule is to flush while the system is off-line during meter installations. Staff recommends that the utility be required to submit a monthly report for the next six months to chronicle the date and time flushings occur, the size and location of each valve flushed, and the lapse of time required for each blow-off to yield a transparent water stream.

Concerning water outages, the utility has recently been installing meters in compliance with directives by Commission staff. The customers complained that the water went out every Thursday of every week, and when they called the utility office, they were told someone had run over a water line. The morning after the customer meeting, staff discussed the outage complaints with Mr. Duncan. He stated that he had been installing the meters by using individual shut-off valves at each customer connection. That, recently, there have been several water line breaks, but, was unable to explain why there were water line breaks every Thursday of every week. In accordance with Rule 25-30.250, FAC, "Each utility shall make all reasonable efforts to provide continuous service. Should interruption in service occur, however, each utility shall reestablish service with the shortest delay consistent with the safety of its customers and the general public." This Rule also states: "Each utility shall schedule any necessary interruptions in service at a time anticipated to cause the least inconvenience to its customers. Each utility shall notify its customers prior to scheduled interruptions." Mr. Duncan has stated that he will make every effort to notify his customers of planned outages. Currently, he believes that from now until all meters, replacement valves, and blow-off valves are installed, he will need to schedule outages on select days from 10:00 am until 2:00 pm. However, all customers will be notified of this time schedule.

All things considered, it is believed that the new owner of the utility is putting forth a sufficient good faith effort to justify a "satisfactory" concerning his attempts to resolve customer complaints.

It is recommended that the quality of service be considered satisfactory. However, the utility should be required to submit monthly reports for the next six months that chronicles the newly instituted flushing program.

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ISSUE 2: Should the Commission approve a projected test year for this utility?

RECOMMENDATION: Yes, the Commission should approve a projected test year for the utility. The historic test year is not representative of the revenues and expenses associated with an emergency interconnect which added rate base, expenses, revenues, and customers that did not exist during the historic test year. Therefore, a projected test year ending December 31, 2002, should be approved. (FITCH, BIGGINS)

STAFF ANALYSIS: For audit purposes, staff selected a historical test year ending December 31, 2001. As discussed in the case background, the utility was recently purchased by a new owner. Also discussed in the case background was the emergency connection of seven customers that took place after the historic test year. The majority of the historic test year represents expenses associated with the previous owner and does not include the revenues and expenses associated with the seven emergency customers.

Staff's recommended projected test year is consistent with Order No. 15725, issued February 21, 1986, in Docket No. 840315-WS, In re: Application of Martin Downs Utilities, Inc. For an increase in water and wastewater rates to its customers in Martin County, Florida, in which the Commission found the following:

The test year is an analytical device used in rate making proceedings to compute current levels of investment and income in order to determine the amount of revenue that will be required to assure a company a fair return on its investment. Test year data must be adjusted to properly reflect conditions in the future period for which rates are being fixed.

Because of the above factors, staff believes that the historic test year is not representative of the change in revenues and expenses that occurred outside of the historic test year and that a projected test year would better match revenues and expenses for this utility on a going forward basis. Therefore, staff recommends that a projected test year ending December 31, 2002, should be approved.

ISSUE 3: What portions of Pinecrest Ranches, Inc., are used and useful?

RECOMMENDATION: The Pinecrest utility water treatment plant should be considered 100% used and useful and the water distribution system should be considered to be 92% used and useful. (DAVIS, MASSOUDI)

STAFF ANALYSIS:

Water Treatment Plant

The water treatment plant is a closed system operation that relies on two wells to meet instantaneous fluctuations in flow demands. The lowest capacity well is determined to have a capacity of 95 gpm. For a closed system plant, the firm reliable capacity (based on average gallons per day usage) is not the most appropriate method of evaluation to fully represent the instantaneous demand/performance a closed system is required to meet. Staff recommends that the used and useful calculation be based on the minimum design criteria of 1.1 gpm per customer. The General Waterworks Design Criteria of a minimum 1.1 gpm per customer is backed by the American Water Works Association (AWWA), which is to be met by the lowest capacity well. In this case, the utility is serving a 157 lot service area with an active customer count of 129. The minimum criteria that this utility currently needs to meet is 142 gpm. Consideration for fire-flow is not applicable since the fire service is a separate parallel fire protection system.

The number of active customers has decreased over the last five years which has produced a negative two (-2) ERCs by the regression analysis. Staff believes that a -2 ERCs factor for future growth is not applicable. One variable is that the utility has a new owner from a recent sale/purchase. The new owner appears to have a fresh energy that is anticipated to stimulate sales and seek out potential home buyers. This will create future growth. Also, in the last few years the economy and the events of September 11, 2001, has slowed travelers to Florida who normally visit during the winter months and purchase second homes. It is believed that tourism will return and growth in this area will resume within the next few years. Lastly, the 4 inch well serving customers outside of this utility's service area recently failed. This well served seven customers that would have been without drinking water had it

not been for Pinecrest Ranches making an emergency interconnection. Pinecrest Ranches, Inc. has now submitted an application with the Commission for an amendment to its certificate to encompass these customers as part of Pinecrest service territory. The utility owner intends to install a larger, permanent interconnect within the next few months. It is recommended that a growth factor of three ERCs over the statutory five growth period in accordance with Chapter 367.081(2)(b), Florida Statutes, should be considered reasonable and prudent for potential growth.

By the approved formula, used as an indicator of useful plant, the water plant is calculated to be 100% used and useful (Attachment "A", Sheet 1 of 2). It is recommended that the water treatment plant be considered 100% used and useful.

Water Distribution System

The distribution system was constructed to serve a 150 lot mobile home park known as Citrus Highlands. The seven (7) additional customers (due to the emergency outage) has increased this to 157 lots which is estimated to be 126 ERCs. Currently, the utility serves 129 customers (estimated to be 104 ERCs) including the seven additional customers served by the emergency interconnect. Growth over the last five years was calculated, using the linear progression method, to be -2 ERCs. For all the reasons noted above, staff is recommending a growth factor of 3 ERCs to calculate the statutory five year growth rate. By the formula approach, the Engineering staff recommends that the distribution system be considered 92% used and useful (Attachment "A", Page 2 of 2). There are two exceptions: Meters (Account No. 346), and meter installations (Account No. 347), which are installed for active customers only, should be considered 100% used and useful. It is recommended that 92% be applied to all other water distribution accounts.

ISSUE 4: What is the appropriate average test year rate base for the utility?

RECOMMENDATION: The appropriate average test year rate base for Pinecrest is \$55,120. The utility should be required to complete meter installations for all its customers, as discussed in the staff analysis, within six months of the issuance date of the Consummating Order. (FITCH, BIGGINS, DAVIS)

STAFF ANALYSIS: It was discovered during the staff audit that the utility did not have sufficient documentation for its plant assets; therefore, an original cost study was conducted by staff to determine plant values beginning in 1985, the utility's first year of operation. Because the utility did not have sufficient supporting documentation, staff has used the utility's 2001 annual report as a basis for staff's adjustments.

In Issue No. 3, staff has recommended a projected test year ending December 31, 2002. Rate base components have been calculated using the original cost study, staff's audit, and engineering report for a plant balance through December 31, 2002. A discussion of each component of rate base follows:

Utility Plant in Service (UPIS): According to the 2001 annual report, the utility reported \$172,079 for UPIS. Using the original cost study, staff determined UPIS to be \$131,736; therefore, staff has decreased UPIS by \$40,343.

The utility currently charges an unmetered flat rate for water service. The utility has been required to install meters pursuant to its Water Use Permit. In Issue No. 9, staff is recommending a BFC/gallonage charge rate structure. The utility must install meters for all its customer in order to charge a consumption based rate. The utility has already begun installing these water meters. Staff has increased UPIS by \$19,724 to include the installation of meters for all utility customers.

Staff made an adjustment to increase UPIS by \$316 to allow the cost to connect with the emergency customers. The utility connected these customers on an emergency bases and filed a quick take amendment in Docket No. 020823-WU. No other utility in the area is willing or capable of providing reasonably adequate service to the new territory. Staff's net adjustment to UPIS is a decrease

of \$20,303. Staff recommends water plant-in-service of \$151,776.

Land: The utility recorded \$16,500 for land. According to Audit Disclosure No. 3 the utility has 3.56 acres of land valued at \$16,500 on its books. This is the land where the utility's well is located. Per discussion with the prior owners of the utility, the land in question has been owned by the prior owners since the 1950s or 1960s and used as a citrus grove. In 1987 the owners developed the land, which is when the utility came into existence. When asked how the land came to be valued at \$16,500 on the utility's books, the prior owner's outside accountant stated that she was sure it was an allocation of the original cost of the larger piece of property that was being developed; however, she was unable to provide any support for the valuation.

As a result, the auditor did some research through the Polk County Property Appraiser's office in an attempt to find sales of like property that occurred between 6/30/1986 and 6/30/1987. The auditor confined the search to vacant property with a use code of "pasture" and found six sales that occurred during this time period. Staff compared this acre price with similar land purchased in 1985, and finds the \$16,500 to be reasonable.

Non-used and Useful Plant: Staff has determined the used and useful percentages for each plant account. The water treatment plant is 100% used and useful. Applying the non-used and useful percentages to the water distribution system results in average non-used and useful plant of \$1,023. The average non-used and useful accumulated depreciation is \$482. This results in net average non-used and useful plant of \$541. Used and useful adjustments have not been applied to contributed plant.

Contribution in Aid of Construction (CIAC): The utility's annual report listed \$1,150 for CIAC. Although the utility has tariffed tap-in fees, staff was unable to verify the reported CIAC. 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 CAC, 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 recorded an amount on its annual report, staff believes that the value of the lines were recovered through the cost of land sales. The previous owner's management spoke with staff and agreed that the lines were likely contributed. Therefore, staff has increased CIAC by \$99,202, consistent with Rule 25-30.570, Florida Administrative Code, to cover the cost of the transmission and distribution lines that was recovered through land sales. Staff recommends average CIAC of \$100,352.

Accumulated Depreciation: The utility's annual report listed \$84,904 for accumulated depreciation on its books during the historic test year. Staff has calculated accumulated depreciation using the prescribed rates in Rule 25-30.140, Florida Administrative Code. Staff's calculated accumulated depreciation as of December 31, 2001, is \$53,789. Staff decreased this account by \$31,115 to reflect test year depreciation per Rule 25-30.140 Florida Administrative Code. Staff increased this account by \$4,032 to include depreciation for the projected year. Staff also increased this account by \$584 to include depreciation on meters and the emergency interconnect. Staff made an averaging adjustment of \$2,016. Staff recommends average accumulated depreciation to be \$56,389 for the projected test year ending December 31, 2002.

Amortization of CIAC: The utility's annual report listed \$98 for amortization of CIAC. Staff has calculated amortization using specifically identified depreciation rates related to the contributed property. Staff's calculated amortization of CIAC is \$37,581 for the historic test year ending December 31, 2001. Therefore, staff increased this account by \$37,483 to reflect amortization calculated per staff. Staff also increased this account by \$2,806 to include amortization for the projected year. Staff made an adjustment to decrease this account by \$1,403 to reflect an averaging adjustment. Staff recommends the average amortization of CIAC to be \$38,984, for the projected test year ending December 31, 2002.

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

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approach be used for calculating working capital allowance. Applying that formula, staff recommends a working capital allowance of \$5,142 (based on O&M of \$41,132). Working capital has been increased by \$5,142 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 for Pinecrest is \$55,120. The utility should be required to complete meter installations for all its customers, as discussed in the staff analysis, within six months of the issuance date of the Consummating Order.

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

COST OF CAPITAL

ISSUE 5: What is the appropriate rate of return on equity and the appropriate overall rate of return for this utility?

RECOMMENDATION: The appropriate return on equity is 10.23% with a range of 9.23% - 11.23%. The appropriate overall rate of return is 10.23%. (FITCH, BIGGINS)

STAFF ANALYSIS: According to staff's audit, the utility's capital structure consists of common stock of \$100, retained earnings of \$3,469, and paid in capital of \$107,488. Staff did not make any adjustment to this account.

Using the current leverage formula approved by Order No. PSC-02-0898-PAA-WS, issued July 5, 2002, in Docket No. 020006-WS, the appropriate rate of return on equity is 10.23% for all equity ratios of 100%. Because the utility is 100% equity, the appropriate rate of return on equity is 10.23%

The utility's capital structure has been reconciled with staff's recommended rate base. Staff recommends a return on equity of 10.23% with a range of 9.23% - 11.23% and an overall rate of return of 10.23%.

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

NET OPERATING INCOME

ISSUE 6: What are the appropriate projected test year revenues?

RECOMMENDATION: The appropriate projected test year revenues for the utility are \$21,492. (FITCH, BIGGINS)

STAFF ANALYSIS: Because of a transfer in ownership, the new utility owner only had three months of revenue and expense items recorded during the audit. Staff has annualized the three months of data to reflect approximate annual operating revenues per utility. The utility's annualized service revenues, for the twelve month period ending December 31, 2001, were \$19,525. The utility had other annualized income that totaled \$1,600 (late fees of \$1,020, visitation fees of \$160, and reconnection fees of \$420). The utility's current rate structure is a flat rate structure of \$12.85 per unit.

The utility's existing rates became effective March 20, 2002. Staff has calculated annualized revenue using the existing rates times the number of customers for the test year ending December 31, 2002. Test year revenues have been increased by \$367 to reflect annualized revenue based on the existing rates and the number of customers projected for December 31, 2002.

Test year revenues are shown on Schedule No. 3-A. The related adjustments are shown on Schedule No. 3-B.

ISSUE 7: What is the appropriate amount of operating expense?

RECOMMENDATION: The appropriate amount for operating expenses for this utility is \$46,270. The utility should be required to provide the Commission with proof of liability insurance within six months of the issuance date of the Consummating Order. (FITCH, BIGGINS)

STAFF ANALYSIS: Because of a transfer in ownership, the new utility owner only had three months of expense recorded during the audit. Staff has annualized the three month data to reflect approximate annual operating expenses per utility. The utility's annualized operations and maintenance (O&M) expense was \$60,729 during the historic 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 three month period ending December 31, 2001. Using documents provided by the utility, the staff auditor determined the appropriate operating expenses for the test year and a breakdown of expenses by account. 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-Officers (603)- The annualized total in this account for the historic test year is \$2,000. The utility requested management fees which include duties that will be performed by the owner. Staff believes that the management fee requested is reasonable and has made an adjustment for the requested amount in Account No. 636. The management fee requested is adequate and includes the duties that would be performed by an officer; therefore, staff has reduced this account by \$2,000.

Purchased Power-(615) - The annualized total in this account for the historic test year is \$3,281. Although staff is using annualized expense for a three month period, staff believes that actual expense for a twelve month period should be used for purchased power and chemicals. Because purchased power and chemical expenses are variable and are influenced by seasonality, staff believes a three month annualization is not appropriate if actual data is available. Further, purchased power and chemical expenses are directly correlated with gallons treated. Because staff is using actual gallons treated for the twelve month period ending December 31, 2001, staff believes it is appropriate to use actual purchased power expense over that same period.

Staff was able to identify actual purchase power expense of \$5,134. Therefore, staff increased this account by \$1,853 (\$5,134-\$3,281) to reflect actual purchased power expense for the historic test year ending December 31, 2001. Staff also increased this account by \$263 to include electric expenses associated with the addition seven emergency customers. Staff decreased this account by \$3,238 to reflect a repression adjustment as discussed in Issue No. 10. Staff recommends purchased power expense of \$2,159.

Chemicals-(618) - The utility did not record chemical expense over the three month period audited. As discussed above, staff believes it is appropriate to use actual chemical and electric expense over the historic 12-month period.

Staff was able to estimate chemical expense based on flows for the historic 12-month period. Therefore, staff has increased this account by \$990 to reflect chemical expense for the historic test year ending December 31, 2001. Staff has also increased this account by \$51 to include chemical expense associated with the additional seven emergency customers. Staff decreased this account by \$624 to reflect a repression adjustment as discussed in Issue No. 10. Staff recommends chemicals expense of \$416.

Materials and Supplies-(620) - The utility's annualized total in this account for the historic test year was \$13,088. Staff reviewed all invoices whereby the utility purchased parts/supplies in order to make in-house system repairs, and believe that \$293 is reasonable for materials and supplies. Therefore, staff has reduced this account by \$12,795 (\$13,088-\$293).

Contractual Services-Professional-(631)- The utility did not record an amount for the three month period audited. The utility employs a CPA to help prepare taxes and annual reports in the amount of \$2,004 annually. Staff believes this amount to be prudent and reasonable for these services. Staff made an adjustment to increase this account \$2,004.

Contractual Service-Testing -(635)- The utility's annualized total in this account for the historic test year is \$4,155. 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-DEP Required Testing

<u>Test</u>	<u>Frequency</u>	<u>Annual Amount</u>
Microbiological	Monthly	\$480
Primary Inorganics	3 Years	\$49
Secondary Inorganics	3 Years	\$29
Asbestos	9 Years	\$35
Volatile Organics	Yearly	\$110
Pesticides & PCB	3 Years	\$146
Nitrates & Nitrites	Yearly	\$80
Radionuclides I	3 Years	\$42
Radionuclides II	3 Years	\$250
Unregulated Organics I	qty 1 st yr/ 9 yrs.	\$112
Unregulated Organics II	3 Years	\$18
Unregulated Organics III	3 Years	\$83
Lead & Copper	Biannual	<u>\$300</u>
Total		<u>\$1,734</u>

Staff has decreased this account by \$2,421 (\$4,155 - \$1,734) to reflect the DEP required testing.

Contractual Services Other-(636) - The utility's annualized total in this account for the historic test year is \$32,457. Staff removed \$26,810 to reflect the amount staff could not verify and amounts that should have been capitalized. Capitalized cost are accounted for through staff's original cost study. The utility requested \$12,000 for management/maintenance (40hrs a month at \$25 an hour). Mr. Duncan has taken ownership of this utility as a retirement project and appears to be willing to devote sufficient effort improving service to the customers fo the system. He will perform general system repairs, meet with officials having jurisdiction over the utility, orchestrate contract labor when

necessary, supervise upgrades and repairs, and receive all after hour customer calls. Staff believes this amount to be reasonable and increased this account by \$12,000.

The utility requested \$9,600 for bookkeeping/secretary services (80hrs a month @\$10hr x 12 months). During the test year Ms. Gossett and Ms. Griffith hired under the past owners, performed part time duties which included customer billings, all governmental paper work, and quarterly county service tax reports. The new owner has hired Ms. Kelley full time, which will relieve Ms. Gossett and Ms. Griffith of their duties. In addition to Ms. Kelley bookkeeping duties, she will be preparing reports for the accountant, answering the phone, preparing customer bills, collecting payments, banking, and all other office chores. Staff believes this amount is reasonable. The annualized total for the contractual services other account includes bookkeeping and secretary expenses of \$5,520. Therefore, staff has increased this account by \$4,080 (\$9,600-\$5,520) to include staff's recommended bookkeeping/secretary expense.

The utility employs an operator for a monthly fee of \$250. The utility did not record an amount for the operator during the test year. Therefore staff has increased this account by \$3,000 (\$250 x 12 months) to reflect operator expense. Staff believes this amount to be reasonable.

The utility requested \$2,052 annually for meter reading expense. This amount results in approximately \$1.33 per meter. Staff believes this amount is unreasonable. Staff believes that \$.50 per meter is reasonable and consistent with past Commission allowances. The utility's annualized total already includes \$127 for the meter reader. Therefore staff has increased this account by \$647 (\$.50 x 129 customers x 12 months - \$127) to reflect staff's recommended meter reader expense.

The water treatment plant is at a very visible location in the subdivision. Mowing and grounds keeping of the water plant must be performed on a regular basis. During the historic test year, the utility contracted a major clean-up (via a gardening service) for a cost of \$2,400. This occurred after the new owner assumed title of the utility and wanted to get control of the vegetation and trash at the water treatment plant site. This level of clean-up is considered to be a non-repeating occurrence and should be amortized over a period of five years pursuant to Rule 25-30.433(8), Florida

Administrative Code. The utility has entered into a contract for lawn service that is billed a flat rate of \$300 per month. This amount is not considered to be reasonable and prudent based on past Commission allowances for utilities this size. A more appropriate amount would be \$120 per month. It is recommended that \$1,920 per year ($\$2,400/5$ yrs + $\$120 \times 12$ months) be allowed for water plant grounds keeping.

Rent Expense-(640) - The utility did not record an amount in this account during the 3-month period. The utility shares a third of the cost of work space with two companies. The rent for this work space is \$600. Therefore staff has increased this account by \$2,400 ($600/3 \times 12$ months) to reflect rent.

Insurance Expense (655) - The utility's annualized total for the historic test year is \$2,230. The utility requested \$3,516 for insurance on the building the utility occupied. Staff believe that amount is unreasonable. Staff believes that amount should be included as part of the rent expense. The utility recorded \$312 ($\$104 \times 25\% \times 12$) for truck insurance. The owner uses his personal truck for 25% of the utility's business. Staff believes this amount is reasonable. The utility also requested \$694 for general liability insurance, staff also believes this amount to be reasonable. Therefore, staff has decreased this account by \$1,224 ($\$2,230 - \$312 - \694). The utility should be required to provide proof of liability insurance within six months of the issuance date of the Consummating Order.

Regulatory Commission Expense (665) - The utility did not record any amount in this account. The cost of this Staff Assisted Rate Case (SARC) consist of a filing fee of \$500. The utility is also required to send notices to customers during this proceeding. Staff has estimated noticing expense of \$48 postage expense, \$71 printing expense, and \$12 for envelopes. The above results in a total rate case expense of \$631. Rate Case expense has been amortized over a 4 year period; therefore, staff has increased this account by \$158 ($\$631 \div 4$).

Miscellaneous Expense (675) - The utility's annualized total for the historic test year is \$1,600. Staff increased this account by \$150 to reclassify this corporate filing fee from the taxes other than income account.

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Operation and Maintenance Expense (O&M Summary) - The total O&M adjustment is a decrease of \$19,597. Staff's recommended O&M expense is \$41,132 for water. O&M expenses are shown on Schedule 3-B.

Depreciation Expense - The utility did not record an amount in this account. Depreciation expense has been calculated using the prescribed rates in Rule 25-30.140, Florida Administrative Code. Staff's calculated depreciation is \$5,200; therefore, staff has increased this account by \$5,200 to reflect staff's calculated depreciation expense. Staff decreased this account by \$34 to reflect non-used and useful depreciation expense. Staff calculated test year amortization of CIAC, using composite depreciation rates, to be \$2,806; therefore, staff decreased this account by \$2,806 to reflect staff's calculated amortization of CIAC. CIAC and non-used and useful depreciation have a negative impact on depreciation expense. Staff's net depreciation expense is \$2,360.

Taxes Other Than Income - The utility recorded taxes other than income of \$1,532. Staff has increased this account by \$27 to reflect RAFs based on annualized revenues. Staff also decreased this account by \$150 to reclassify corporate filing fee to Account No. 675 (Miscellaneous Expense). Staff's net adjustment to this account is a decrease of \$123.

Income Tax - Pinecrest is a Sub-chapter S corporation; therefore, consistent with Rule 25-30.433(7) Florida Administrative Code an allowance for income tax has not been made.

Operating Revenues - Revenues have been increased by \$30,417 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 \$1,369 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 a \$46,270 operating expenses.

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

ISSUE 8: What is the appropriate revenue requirement?

RECOMMENDATION: The appropriate revenue requirement is \$51,909 for water. (FITCH, BIGGINS)

STAFF ANALYSIS: The utility should be allowed an annual increase of \$30,417 (141.53%) for water. This will allow the utility the opportunity to recover its expenses and earn a 10.23% return on its investment. The calculations are as follows:

	<u>Water</u>
Adjusted rate base	\$55,120
Rate of Return	x .1023
Return on investment	<u>\$5,639</u>
Adjusted O & M expense	\$41,132
Depreciation expense (Net)	\$2,360
Taxes Other Than Income	<u>\$2,778</u>
Revenue Requirement	<u>\$51,909</u>
Adjusted Test Year Revenues	<u>\$21,492</u>
Percent Increase/ (Decrease)	<u>141.53%</u>

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

ISSUE 9: Is a continuation of the utility's current flat rate structure for its water system appropriate in this case, and, if not, what is the appropriate rate structure?

RECOMMENDATION: No, a continuation of the utility's current flat rate structure for its water system is not appropriate in this case. The water system rate structure should be changed to a traditional base facility charge (BFC)/gallongage charge rate structure. A conservation adjustment should also be implemented so that a total of 70% of the revenue requirement is recovered through the gallongage charge. (HUDSON, LINGO)

STAFF ANALYSIS: The utility's current water system rate structure consists of a monthly flat rate of \$12.85. This rate structure is nonusage sensitive and discourages conservation at all levels of consumption. The Commission's preferred rate structure has been the traditional BFC/gallongage charge rate structure, because it is designed to provide for the equitable sharing by the rate payers of both the fixed and variable costs of providing service. This rate structure is also considered usage-sensitive because customers are charged for all water consumed. Therefore, customers are able to reduce their total bill by reducing their water consumption.

The utility currently has flat rates. Rule 25-30.255(1), Florida Administrative Code, requires that each utility measure water sold on the basis of metered volume sales unless the Commission approves a flat rate service arrangement for that utility. The utility's current flat rates were approved when it was granted a grandfather water certificate in Docket No. 961253-WU. See Order No. PSC-97-0367-FOF-WU, issued on April 2, 1997. According to staff's audit report, the utility decided to install meters and request metered rates. As discussed in Issue 4, the utility is in the process of installing the meters. Therefore, once all meters have been installed, staff recommends that the current flat rate structure be discontinued in favor of a usage-sensitive rate structure to be consistent with Commission policy and with the overall statewide goal of eliminating conservation-discouraging water rate structures.

Over the past few years, due to water supply concerns and requirements imposed on utilities by the Water Management Districts, the more conservation-oriented inclining-block rate structure has become the Commission's rate structure of choice. The absence of at least 12 months of metered consumption data precludes

implementation of an inclining-block rate structure at this time. Therefore, staff recommends that the traditional BFC/gallorage charge be implemented.

In lieu of metered consumption data, staff used the pumping and purchased water from the utility's 2001 annual report to estimate customers' average monthly consumption of approximately 18,879 gallons (18.879 kgal). Based on an average of 2.5 persons per household, the average gallons per day per capita (gpdc) use is approximately 252 gallons (18,900 gallons / 2.5 persons / 30 days).

Pinecrest Ranches is located in the Southwest Florida Water Management District (SWFWMD or District) within the Southern Water Use Caution Area (SWUCA). The gallons per day per capita (gpdc) target usage rate for utilities located in the SWUCA is 150 gpdc. The customers' gpdc of 252 gallons is substantially greater (approximately 68%) than the District's desired 150 gpdc target.

Although implementation of an inclining-block rate structure is not appropriate at this time, one method of making rates more conservation-oriented is by implementing a conservation adjustment, whereby more of the revenue recovery is shifted to the gallorage charge. Based on staff's initial assessment of fixed versus variable allocation of revenue requirement recovery, the utility would recover 43% (\$23,222) in the BFC charge and the remaining 57% (\$31,183) in the gallorage charge. This revenue recovery allocation is just outside the rate design guidelines of the SWFWMD, which state that no more than 40% be recovered through the BFC. Therefore, staff believes that additional costs should be shifted from the BFC to the gallorage charge in order to accomplish several rate design goals. Conservation adjustments were tried, in increments of 10%, from 0% to 30%. The results of this analysis are shown in the following table:

PRE-REPRESSION PRICE INCREASES AT VARIOUS CONSERVATION ADJUSTMENTS				
	Conservation Adjustment (CA) Percentages and Resulting BFC Allocations			
Monthly Consumption	CA=0% BFC=43%	CA=10% BFC=38%	CA=20% BFC=34%	CA=30% BFC=30%
0 kgal	16.3%	4.7%	-7.0%	-18.6%
1 kgal	24.5%	13.5%	2.5%	-8.5%
2 kgal	32.8%	22.4%	12.0%	1.6%
3 kgal	41.0%	31.3%	21.5%	11.8%
5 kgal	57.5%	49.0%	40.5%	32.0%
8 kgal	82.3%	75.6%	68.9%	62.3%
9 kgal	90.5%	84.5%	78.4%	72.5%
10 kgal	98.8%	93.4%	87.9%	82.6%
15 kgal	140.0%	137.7%	135.4%	133.2%
20 kgal	181.2%	182.1%	182.9%	183.7%
25 kgal	222.5%	226.5%	230.4%	234.3%

As shown above, the 30% conservation adjustment (relative to the other adjustments) accomplishes the following rate design goals: 1) it minimizes the price increases for nondiscretionary consumption of 5 kgal or less; and 2) it maximizes price increases at levels of consumption greater than the current monthly average 18.879 kgal/month.

Therefore, staff recommends that a continuation of the utility's current flat rate structure for its water system is not appropriate in this case. The water system rate structure should be changed to a traditional base facility charge (BFC)/gallage charge rate structure. A conservation adjustment should also be implemented so that a total of 70% of the revenue requirement is recovered through the gallage charge.

ISSUE 10: Is an adjustment to reflect repression of consumption appropriate in this case, and, if so, what is the appropriate repression adjustment?

RECOMMENDATION: Yes, a repression adjustment of 17,603 kgal is appropriate in this case. In order to monitor the effects of both the changes in rate structure and the recommended revenue change, 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 approved rates go into effect. (HUDSON, LINGO)

STAFF ANALYSIS: Based on information contained in our database of utilities receiving rate increases and decreases, there were four water utilities that converted from a flat rate structure to a traditional BFC/gallonage charge rate structure. The specific consumption reductions were 60%, 60%, 50% and 44%, respectively. Two utilities were removed from consideration because they also received substantial wastewater increases, which, we believe, placed upward pressure on the levels of water consumption reduction levels. This leaves two utilities in the sample: one of the remaining utilities experienced a 60% consumption reduction, while the other utility's corresponding consumption reduction was 44%.

Staff notes that the average monthly consumption for Pinecrest Ranches customers is approximately 18.879 kgal, which, we believe, represents a substantial amount of discretionary usage, making a high magnitude of repression likely. Furthermore, the magnitude of the revenue requirement increase (141.53%) indicates that the current rates are far from compensatory. We believe that, due to the severe rate shock to be experienced by the customers, the anticipated consumption reductions will in fact be substantial. Therefore, staff recommends a 60% repression adjustment be made to residential consumption; the resulting recommended reduction in consumption is 17,603 kgal.

In order to monitor the effects of both the changes in rate structure and the recommended revenue change, 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

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quarterly basis for a period of two years, beginning with the first billing period after the approved rates go into effect.

ISSUE 11: What are the appropriate monthly rates for service?

RECOMMENDATION: The appropriate monthly rates should be designed to produce revenues of \$50,309, excluding miscellaneous service charge revenues. The utility should file revised tariff sheets reflecting staff's recommended phase I rates and a proposed customer notice to reflect the Commission-approved phase I and phase II 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, the notice has been received by the customers, and staff has verified that the tariffs are consistent with the Commission's decision. The utility should provide proof of the date notice was given no less than 10 days after the date of the notice. Once the utility has completed the meter installations discussed in Issue No. 4, the utility should file revised tariff sheets reflecting staff's recommended phase II rates. The phase II rate tariffs should be approved once staff has verified that the tariffs are consistent with the Commission's decision. (HUDSON, BIGGINS, FITCH)

STAFF ANALYSIS: As discussed in Issue No. 8, the appropriate revenue requirement is \$51,909. The utility had other revenues totaling \$1,600 during the test year. Other revenues should be used to reduce the revenue requirement recovered through rates. Therefore, staff has designed rates to produce revenues of \$50,309 (\$51,909 - \$1,600).

As discussed in Issue No. 9, staff recommends that the water system rate structure be changed to a traditional BFC/gallonage charge rate structure with a conservation adjustment resulting in a final BFC cost recovery allocation of 30%. However, the utility has not completed installing meters for all its customers. The utility will not be able to charge a metered rate until all meters are installed. Therefore, staff has designed a phase I flat rate to be effective for the interim period prior to completion of the meter installation. As discussed in Issue No. 10, staff recommends that the appropriate repression adjustment is 17,603 kgal. The resulting monthly rates for service are those shown below.

MONTHLY RATES - WATER (PHASE I)
RESIDENTIAL AND GENERAL SERVICE

Base Facility Charge

<u>Meter Sizes</u>	<u>Existing Rates</u>	<u>Recommended Rates</u>
Flat Rate	\$12.85	\$32.37

MONTHLY RATES - WATER (PHASE II)
RESIDENTIAL AND GENERAL SERVICE

Base Facility Charge

<u>Meter Sizes</u>	<u>Existing Rates</u>	<u>Recommended Rates</u>
Flat Rate	\$12.85	N/A
5/8" x 3/4"	N/A	\$9.86
3/4"	N/A	\$14.79
1"	N/A	\$24.65
1 1/2"	N/A	\$49.30
2"	N/A	\$78.88
3"	N/A	\$157.76
4"	N/A	\$246.50
6"	N/A	\$493.00

Gallonnage Charge

Per 1,000 gallons	N/A	\$2.98
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Staff's recommended increase in revenue requirements is \$30,417 or approximately 141.53%. The rates approved for the utility should be designed to produce revenues of \$50,309.

Approximately 30% (\$15,328) of the service revenues are recovered through the recommended base facility charge. The fixed costs are recovered through the BFC based on the number of factored ERCs. The remaining 70% (\$34,981) of the service revenues represents revenues collected through the consumption charge based on the number of gallons. The phase I flat rate was calculated using the average bill based on staff's recommended BFC/ gallonage

charge rates (phase II rates). The following is a comparison of bills at 3,000, 5,000, and 10,000 Gallons:

<u>Gallons</u>	<u>Existing Rate</u>	<u>Recommended Rate Phase I</u>	<u>Recommended Rate Phase II</u>
3,000	\$12.85	\$32.37	\$18.80
5,000	\$12.85	\$32.37	\$24.76
10,000	\$12.85	\$32.37	\$39.66

The utility should file revised tariff sheets reflecting staff's recommended phase I rates and a proposed customer notice to reflect the Commission-approved phase I and phase II 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, the notice has been received by the customers, and staff has verified that the tariffs are consistent with the Commission's decision. The utility should provide proof of the date notice was given no less than 10 days after the date of the notice. Once the utility has completed the meter installations discussed in Issue No. 4, the utility should file revised tariff sheets reflecting staff's recommended phase II rates. The phase II rate tariffs should be approved once staff has verified that the tariffs are consistent with the Commission's decision.

ISSUE 12: What is the appropriate amount by which rates should be reduced four years after the established effective date to reflect the removal of the amortized rate case expense as required by Section 367.0816, Florida Statutes?

RECOMMENDATION: The water rates should be reduced as shown on Schedule 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 \$165 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 13: Should the utility's service availability charges be revised to include a meter installation fee, and if so, what is the appropriate fee?

RECOMMENDATION: Yes, the utility's current service availability charges should be revised to include a meter installation charge of \$153. The utility should file revised tariff sheets which are consistent with the Commission's vote within one month of the Commission's final vote. The revised tariff sheets should be approved upon staff's verification that the tariffs are consistent with the Commission's decision. If revised tariff sheets are filed and approved, the meter installation fee 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 currently does not have an existing tariff authorizing a meter installation fee. Staff is recommending in Issue No. 4 that the utility install meters for its customers so that consumption based rate can be charged. The meter installation fee applies to new customers only. Existing customers will not be charged a meter installation fee.

Staff was able to determine the meter installation cost to be \$153 per connection. Therefore, staff believes that the appropriate meter installation fee should be \$153. Because the utility does not have an existing meter installation charge, staff believes that allowing a \$153 meter installation charge is appropriate and will defray the cost associated with future growth.

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

<u>Meter Installation Charge</u>	<u>Existing Charge</u>	<u>Preliminary Charge</u>
5/8" x 3/4"	N/A	\$153.00
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

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on or after the stamped approval date of the revised tariff sheets,
if no protest is filed.

ISSUE 14: 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?

RECOMMENDATION: Yes. Pursuant to Section 367.0814(7), Florida Statutes, 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. (GERVASI, 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 shall be subject to the refund provisions discussed below.

The utility should be authorized to collect the temporary rates upon the 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 \$20,522. 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.

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DATE: DECEMBER 5, 2002

ISSUE 15: Should this docket be closed?

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 seven months from the issuance date of the Consummating Order to allow staff time to verify completion of meter installations as discussed in Issue No. 4, and to verify proof of insurance as discussed in Issue No. 7. Once staff has verified that these items have been completed, the docket should be closed administratively. (GERVASI, BIGGINS, FITCH)

STAFF ANALYSIS: 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 seven months from the issuance date of the Consummating Order to allow staff time to verify completion of meter installations as discussed in Issue No. 4, and to verify proof of insurance as discussed in Issue No. 7. Once staff has verified that these items have been completed, the docket should be closed administratively.

Attachment A, page 1 of 4

WATER TREATMENT PLANT - USED AND USEFUL DATA
Docket No. 020406-WU - Pinecrest Ranches, Inc.

1) Capacity of Plant	95 gallons per minute
2) Maximum Minute (129 cust X 1.1 gpm X 2)	284 gallons per minute
3) Average Minute Flow (129 cust X 1.1 gpm)	142 gallons per minute
4) Fire Flow Capacity	N/A gallons per minute
A) Fire Flow is provided by a separate well that supports a separate Fire Flow distribution system.	
5) Growth	21 gallons per minute
A) Test Year Customers in ERCs	
	98 Begin
	104 End
	101 Average
B) Customer Growth based on average fluctuations in the peak month for rented units.	
	3 ERCs
C) Statutory Growth Period	
	5 years
(B)x(C)x[(3)/(A)]	21 gallons per minute
6) Excessive Unaccounted Water	N/A gallons per minute
A) Total Unaccounted for Water	
	N/A gallons per minute
B) Reasonable Amount (10% of 3)	
	14 gallons per minute
C) Excessive Amount	
	N/A gallons per minute

USED AND USEFUL FORMULA

$$[(2)+(4)+(5)-(6)]/(1) = 100\%$$

DOCKET NO. 020406-WU
DATE: DECEMBER 5, 2002

Attachment A, page 2 of 4

WATER DISTRIBUTION SYSTEM - USED AND USEFUL DATA

Docket No. 020406-WU - Pinecrest Ranches, Inc.

1) Capacity of System (Number of Potential Customers, ERCs or Lots Without Expansion)	126	ERCs
2) Test year connections		
A) Beginning of Test Year	98	ERCs
B) End of Test Year	104	ERCs
C) Average Test Year	101	ERCs
3) Growth	15	ERCs
A) Customer growth based on anticipated fluctuations in the normal growth cycle.	3	ERCs
B) Statutory Growth Period	5	Years
(a)x(b) = 15 ERCs allowed for growth		

USED AND USEFUL FORMULA

$$[2+3]/(1) = 92\% \text{ Used and Useful}$$

PINECREST RANCHES, INC. TEST YEAR ENDING 12/31/02 SCHEDULE OF WATER RATE BASE		SCHEDULE NO. 1-A DOCKET NO. 020406-WU	
DESCRIPTION	BALANCE PER UTILITY	STAFF ADJUST. TO UTIL. BAL.	BALANCE PER STAFF
1. UTILITY PLANT IN SERVICE	\$172,079	(\$20,303)	\$151,776
2. LAND & LAND RIGHTS	16,500	\$0	\$16,500
3. NON-USED AND USEFUL COMPONENTS	0	(\$541)	(\$541)
4. CIAC	(1,150)	(\$99,202)	(\$100,352)
5. ACCUMULATED DEPRECIATION	(84,904)	\$28,515	(\$56,389)
6. AMORTIZATION OF CIAC	98	\$38,886	\$38,984
7. WORKING CAPITAL ALLOWANCE	<u>0</u>	<u>\$5,142</u>	<u>\$5,142</u>
8. WATER RATE BASE	<u>\$102,623</u>	<u>(\$47,503)</u>	<u>\$55,120</u>

PINECREST RANCHES, INC.
TEST YEAR ENDING 12/31/02

SCHEDULE NO. 1-B
DOCKET NO. 020406-WU

ADJUSTMENTS TO RATE BASE

WATER

UTILITY PLANT IN SERVICE

1. To adjust per Original Cost Study	(<u>\$40,343</u>)
2. To include meters	19,724
3. To connect with Emergency customers	<u>316</u>
Total	<u>(<u>\$20,303</u>)</u>

Non-Used and Useful

1. Non-used and Useful Plant	(<u>\$1,023</u>)
2. Non-used and Useful Accumulated Depreciation	<u>\$482</u>
Total	<u>(<u>\$541</u>)</u>

CIAC

Contribute lines per Rule 25-30.570	<u>(<u>\$99,202</u>)</u>
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ACCUMULATED DEPRECIATION

1. To reflect test year depreciation calculated per 25-30.140 FAC.	\$31,115
2. To include depreciation on projected year	(<u>\$4,032</u>)
3. To include depreciation on projected plant	(584)
4. Averaging Adjustment	<u>2,016</u>
Total	<u>\$28,515</u>

AMORTIZATION OF CIAC

1. To include amortization calculated per staff	\$37,483
2. To include depreciation on projected year	\$2,806
3. Average Adjustment	<u>(1,403)</u>
Total	<u>\$38,886</u>

WORKING CAPITAL ALLOWANCE

1. To reflect 1/8 of test year O & M expenses.	<u>\$5,142</u>
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PINECREST RANCHES, INC. TEST YEAR ENDING 12/31/02 SCHEDULE OF CAPITAL STRUCTURE				SCHEDULE NO. 2 DOCKET NO. 020406-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	3,469	0	\$3,469						
3. PAID IN CAPITAL	107,488	0	\$107,488						
4. OTHER COMMON EQUITY	<u>0</u>	<u>0</u>	<u>\$0</u>						
5. TOTAL COMMON EQUITY	\$111,057	\$0	111,057	(55,937)	55,120	100.00%	10.23%	10.23%	
6. LONG TERM DEBT		0	0	0	0	0.00%	0.00%	0.00%	
TOTAL LONG TERM DEBT	0	0	0	0	0	0.00%			
7. CUSTOMER DEPOSITS	<u>0</u>		<u>0</u>	<u>0</u>	<u>0</u>	<u>0.00%</u>	6.00%	<u>0.00%</u>	
8. TOTAL	<u>\$111,057</u>	<u>\$0</u>	<u>\$111,057</u>	<u>(\$55,937)</u>	<u>\$55,120</u>	<u>100.00%</u>		<u>10.23%</u>	
			RANGE OF REASONABLENESS				<u>LOW</u>	<u>HIGH</u>	
			RETURN ON EQUITY				<u>9.23%</u>	<u>11.23%</u>	
			OVERALL RATE OF RETURN				<u>9.23%</u>	<u>11.23%</u>	

PINECREST RANCHES, INC. TEST YEAR ENDING 12/31/02 SCHEDULE OF WATER OPERATING INCOME			SCHEDULE NO. 3-A DOCKET NO. 020406-WU		
	TEST YEAR PER UTILITY	STAFF ADJ. PER UTILITY	STAFF ADJUSTED TEST YEAR	ADJUST. FOR INCREASE	REVENUE REQUIREMENT
1. OPERATING REVENUES	<u>\$21,125</u>	<u>\$367</u>	<u>\$21,492</u>	<u>\$30,417</u> 141.53%	<u>\$51,909</u>
OPERATING EXPENSES:					
2. OPERATION & MAINTENANCE	60,729	(19,597)	41,132	0	41,132
3. DEPRECIATION (NET)	0	2,360	2,360	0	2,360
4. AMORTIZATION	0	0	0	0	0
5. TAXES OTHER THAN INCOME	1,532	(123)	1,409	1,369	2,778
6. INCOME TAXES	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
7. TOTAL OPERATING EXPENSES	<u>\$62,261</u>	<u>(\$17,360)</u>	<u>\$44,901</u>	<u>\$1,369</u>	<u>\$46,270</u>
8. OPERATING INCOME/(LOSS)	<u>(\$41,136)</u>		<u>(\$23,409)</u>		<u>\$5,639</u>
9. WATER RATE BASE	<u>\$102,623</u>		<u>\$55,120</u>		<u>\$55,120</u>
10. RATE OF RETURN	<u>-40.08%</u>		<u>-42.47%</u>		<u>10.23%</u>

PINECREST RANCHES, INC. TEST YEAR ENDING 12/31/02 ADJUSTMENTS TO OPERATING INCOME	SCHEDULE NO. 3-B DOCKET NO. 020406-WU PAGE 1 OF 2
	<u>WATER</u>
OPERATING REVENUES	
To adjust utility revenues to audited test year amount.	<u>\$367</u>
OPERATION AND MAINTENANCE EXPENSES	
1. Salaries and Wages - Officers (603)	
a. To remove undocumented expense and expenses accounted for in 636	<u>(\$2,000)</u>
2. Purchased Power (615)	
a. To reflect changes per actual bills	1,853
b. To include emergency customers usage	263
c. Repression adjustment	<u>(\$3,238)</u>
Total	<u>(\$1,122)</u>
3. Chemicals (618)	
a. Per Engineer test year/ increase for projected customers	990
b. To include emergency customers usage	51
c. Repression Adjustment	<u>(\$624)</u>
Total	<u>\$416</u>
4. Materials and Supplies (620)	
a. To reflect actual invoices	<u>(\$12,795)</u>
5. Contractual Services - Professional (631)	
a. To reflect professional accounting services	<u>2,004</u>
6. Contractual Services - Testing (635)	
a. DEP Required Testing	<u>(\$2,421)</u>
7. Contractual Services - Other (636)	
a. To remove undocumented and capitalized items	(26,810)
b. To include Management/Maintenance	12,000
c. To include meter reader	647
c. To include Bookkeeping/secretary services	4,080
d. To include operator services	3,000
e. To include mowing and ground keeping	1,920
Total	<u>(\$5,163)</u>
8. Rent (640)	
a. To include rent	<u>\$2,400</u>
9 Insurance Expenses (655)	
a. To remove insurance on rented building	<u>(\$1,224)</u>
10 Regulatory Commission Expense (665)	
a. To include Filing Fee and noticing	<u>\$158</u>
11 Miscellaneous Expense (675)	
b. Reclassify corporate filing fee to account 675	<u>\$150</u>
TOTAL OPERATION & MAINTENANCE ADJUSTMENTS	<u>(\$19,597)</u>

PINECREST RANCHES, INC.
TEST YEAR ENDING 12/31/02
ADJUSTMENTS TO OPERATING INCOME

SCHEDULE NO. 3-B
DOCKET NO. 020406-WU
PAGE 2 OF 2

DEPRECIATION EXPENSE

1. Depreciation expense per staff	\$5,200
2. Non used and useful depreciation	(\$34)
3. Test year amortization of CIAC.	<u>(2,806)</u>
Total	<u>\$2,360</u>

WATER

TAXES OTHER THAN INCOME

1. To include regulatory assessment fees on test year revenue	27
2. Reclassify corporate filing fee to account 675	(150)
Total	<u>(\$123)</u>

PINECREST RANCHES, INC. TEST YEAR ENDING 12/31/02 ANALYSIS OF WATER OPERATION AND MAINTENANCE EXPENSE		SCHEDULE NO. 3-C DOCKET NO. 020406-WU		
	TOTAL PER UTILITY	STAFF PER ADJUST.		TOTAL PER PER STAFF
(601) SALARIES AND WAGES - EMPLOYEES	0	0		0
(603) SALARIES AND WAGES - OFFICERS	2,000	(2,000)	[1]	0
(604) EMPLOYEE PENSION & BENEFITS	0	0		0
(610) PURCHASED WATER	0	0		0
(615) PURCHASED POWER	3,281	(1,122)	[2]	2,159
(616) FUEL FOR POWER PRODUCTION	0	0		0
(618) CHEMICALS	0	416	[3]	416
(620) MATERIALS AND SUPPLIES	13,088	(12,795)	[4]	293
(630) CONTRACTUAL SERVICES - BILLING	0	0		0
(631) CONTRACTUAL SERVICES - PROFESSIONAL	0	2,004	[5]	2,004
(635) CONTRACTUAL SERVICES - TESTING	4,155	(2,421)	[6]	1,734
(636) CONTRACTUAL SERVICES - OTHER	32,457	(5,163)	[7]	27,294
(640) RENTS	0	2,400		2,400
(650) TRANSPORTATION EXPENSE	1,490	0	[8]	1,490
(655) INSURANCE EXPENSE	2,230	(1,224)	[9]	1,006
(665) REGULATORY COMMISSION EXPENSE	0	158	[10]	158
(670) BAD DEBT EXPENSE	428	0		428
(675) MISCELLANEOUS EXPENSES	<u>1,600</u>	<u>150</u>	[11]	<u>1,750</u>
	60,729	(19,597)		41,132

PINECREST RANCHES, INC.
 TEST YEAR ENDING 12/31/02

SCHEDULE NO. 4
 DOCKET NO. 020406-WU

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

MONTHLY WATER RATES

RESIDENTIAL, MULTI-RESIDENTIAL, AND GENERAL SERVICE BASE FACILITY CHARGE:		MONTHLY RECOMMENDED RATES	MONTHLY RATE REDUCTION
Meter Size:			
5/8"X3/4"	\$	9.86	0.03
3/4"		14.79	0.05
1"		24.65	0.08
1-1/2"		49.30	0.16
2"		78.88	0.25
3"		157.76	0.50
4"		246.50	0.79
6"		493.00	1.57
RESIDENTIAL GALLONAGE CHARGE PER 1,000 GALLONS	\$	2.98	0.01