

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Investigation into rates ) DOCKET NO. 951029-WU  
and charges of Florida Cities ) ORDER NO. PSC-95-1211-FOF-WU  
Water Company - Lee County Water ) ISSUED: October 2, 1995  
Division - for potential )  
overearnings in Lee County. )  
\_\_\_\_\_ )

The following Commissioners participated in the disposition of this matter:

SUSAN F. CLARK, Chairman  
J. TERRY DEASON  
JOE GARCIA  
JULIA L. JOHNSON  
DIANE K. KIESLING

ORDER INITIATING INVESTIGATION INTO RATES AND CHARGES  
AND MAKING REVENUES SUBJECT TO REFUND

BY THE COMMISSION:

BACKGROUND

Florida Cities Water Company (FCWC or utility) provides water and wastewater service for two neighboring service areas in Fort Myers, Florida. Located in Lee County, these service areas have different rates for wastewater service, but they share common rates for water service. In 1994, FCWC's reported revenues for water service were \$8,852,776; the corresponding net operating income amount was \$3,102,703. The utility's service area has been designated a critical use area by the South Florida Water Management District.

Our review of the utility's 1994 annual report indicates that the utility's water division may be exceeding its last authorized return on equity investment. Our initial review indicates that the revenue surplus, measured with respect to the utility's last authorized return on equity, may approach 5 percent on an annual basis. Using a more recent calculation of the utility's cost of equity capital, an even larger overearnings posture is suggested.

INITIATION OF OVEREARNINGS INVESTIGATION AND PLACING REVENUES  
SUBJECT TO REFUND

Based upon a desk audit of FCWC's 1994 annual report, we began an informal investigation into potential overearnings for FCWC's

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water systems in Lee County. The 1994 annual report indicated that FCWC was earning a 13.05 percent overall return on rate base. Based upon this data, and additional information concerning the utility's projected earnings in 1995 and 1996, we find it appropriate that this docket be opened to investigate the potential overearnings of the utility. Further, this investigation will permit the Commission to establish the utility's rate base, which was last set by this Commission in 1986.

In the utility's last rate case for its Lee County water system (Docket No. 851107-WU, Order No. 16768, issued October 24, 1986), the Commission approved a range of reasonableness for total capital of 11.65 percent to 12.53 percent. The corresponding range for equity investment was 13.23 percent to 15.23 percent. Using that 15.23 percent upper boundary for equity earnings, and appropriate interest rates for other components in the capital structure, a 10.04 percent overall cost of capital is now indicated. After considering a correction to normalize income taxes in 1994, our preliminary review suggests that the utility achieved a 19 percent return on equity investment in 1994 with respect to water service in Lee County.

We have attached accounting schedules to illustrate the approved water rate base (Schedule 1-A and 1-B), capital structure (Schedule 2), and test year operating income (Schedules 3-A and 3-B). Based on our calculations, FCWC shall hold annual revenues of \$444,152 subject to refund. With total annualized revenues being calculated to be \$8,894,003, reducing that amount by \$444,152 to \$8,449,851, equates to 4.99 percent of those revenues being subject to refund.

#### Rate Base

Our calculation of the utility's rate base balance is based upon information shown in the utility's 1994 annual report. Since month by month balances are not reported, average provisions were computed using the beginning and ending balances. For annual report filing purposes, the estimated provision for working capital is derived using the formula approach. However, Section 367.082(5)(b)1, Florida Statutes, requires us to use adjustments consistent with the utility's last rate proceeding in calculating interim rates. Consistent with the treatment allowed in FCWC's last rate case, we have calculated working capital using the balance sheet method. Our rate base amount also reflects an allocated portion of FCWC's unfunded FASB 106 obligation (post-retirement benefits). Based on our analysis, we find that the rate base amount for the utility's water division is \$23,523,378.

### Cost of Capital

The capital structure for interim refund purposes reflects the utility's outstanding capital balances (average balances) shown in the utility's 1994 annual report. The interest factor used for debt capital was also derived from that report. In accordance with Section 367.082(2)(b), Florida Statutes, the amount held subject to refund should be calculated using the upper limit of the last authorized return on equity investment. Pursuant to Order No. 16768, issued in Docket No. 851007-WU, that upper limitation on equity earnings was 15.23 percent. Using that factor, and applicable interest rates and preferred stock factors for other capital components, the weighted cost of capital for the purpose of holding refunds subject to refund is 10.04 percent.

### Net Operating Income

On or about July 1, 1994, the utility implemented an index adjustment that increased revenues by \$82,454, or about 1 percent on an annual basis. In accordance with the interim statute, the full revenue impact of that adjustment has been annualized. The other components in the test year operating statement were drawn from the utility's 1994 annual report with one exception. That exception concerns the allowance for income taxes, which has been corrected to eliminate the tax impact of certain "below-the-line" litigation costs.

Our review indicates that the utility's revenue requirement, employing a \$23,523,378 rate base and a 10.04 percent overall cost of capital, is \$8,449,851. However, annualized revenues were \$8,894,003. Therefore, a \$444,152 reduction relative to annualized 1994 revenues shall be held subject to refund pursuant to Section 367.082, Florida Statutes.

### SECURITY

Pursuant to Section 367.082, Florida Statutes, the utility is authorized to continue collecting the previously authorized rates. As set out above, the amount of potential overearnings for the water systems is \$444,152 on an annual basis. Pursuant to an index application filed in 1994, which was effective for service rendered after July 1, 1994, the utility implemented a 1 percent rate increase. According to Section 367.081(4)(d), Florida Statutes, an index is subject to refund for up to fifteen months after the date of filing of the annual report for the year the index was implemented. The utility's 1994 annual report was filed on May 2, 1995, consequently, fifteen months from that date is August 2, 1996. Since that index is already subject to refund, only \$361,698

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in annual revenues should be collected under guarantee, subject to refund with interest. Assuming a 9-month time frame, the potential refund is \$283,196 including interest.

The Division of Auditing and Financial Analysis has advised that a corporate undertaking signed by Florida Cities Water Company would be sufficient to protect the potential refund. Therefore, the utility shall provide a corporate undertaking in the amount of \$283,196 as guarantee of any potential refund of water revenues collected under the interim conditions.

Also, by no later than the twentieth (20th) day of each month, the utility shall file a report showing the amount of revenues collected each month subject to refund. Should a refund be required, the refund shall be with interest and undertaken in accordance with Rule 25-30.360, Florida Administrative Code.

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

Based on the foregoing, it is, therefore,

ORDERED by the Florida Public Service Commission that an investigation of the water rates and charges of Florida Cities Water Company shall be initiated. It is further

ORDERED that all matters contained in the schedules attached hereto are by reference incorporated herein. It is further

ORDERED that Florida Cities Water Company shall place \$444,152 annually of its revenues for water service, subject to refund with interest in accordance with Rule 25-30.360, Florida Administrative Code, to the extent set forth in the body of this order. It is further

ORDERED that Florida Cities Water Company shall provide the Commission with a corporate undertaking in the amount of \$283,196 as a guarantee of any potential refund of water revenues collected under interim conditions. It is further

ORDERED that by no later than the twentieth day of each month, the utility shall file a report showing the amount of revenues collected each month and the amount of revenues collected to date relating to the amount subject to refund. It is further

ORDERED that this docket shall remain open.

FCWC - LEE COUNTY WATER SCHEDULE OF WATER RATE BASE TEST YEAR ENDED 12/31/94			SCHEDULE NO. 1-A DOCKET NO. 123456-WS		
COMPONENT	TEST YEAR PER UTILITY	UTILITY ADJUSTMENTS	ADJUSTED TEST YEAR PER UTILITY	COMMISSION ADJUSTMENTS	COMMISSION ADJUSTED TEST YEAR
1 UTILITY PLANT IN SERVICE	\$ 58,936,278	\$ 0	\$ 58,936,278	(\$ 688,425)	58,247,853
2 LAND	368,175	0	368,175	0	368,175
3 NON-USED & USEFUL COMPONENTS	0	0	0	0	0
4 ACCUMULATED DEPRECIATION	(13,488,453)	0	(13,488,453)	782,004	(12,706,449)
5 CIAC	(29,879,780)	0	(29,879,780)	489,787	(29,389,993)
6 AMORTIZATION OF CIAC	7,217,548	0	7,217,548	(419,911)	6,797,637
7 ACQUISITION ADJUSTMENTS -NET	0	0	0	0	0
8 UNFUNDED FASB 106 OBLIGATION	0	0	0	(174,324)	(174,324)
9 DEFERRED TAXES	0	0	0	0	0
10 WORKING CAPITAL ALLOWANCE	445,506	0	445,506	(65,027)	380,479
<b>RATE BASE</b>	<b>\$ 23,599,274</b>	<b>\$ 0</b>	<b>\$ 23,599,274</b>	<b>(\$ 75,896)</b>	<b>23,523,378</b>

FCWC - LEE COUNTY WATER ADJUSTMENTS TO RATE BASE TEST YEAR ENDED 12/31/94		SCHEDULE NO. 1-B DOCKET NO. 123456-WS PAGE 1 OF 1	
EXPLANATION		WATER	WASTEWATER
(1) <u>UTILITY PLANT IN SERVICE</u> Adjustment to reflect average balance		\$	<u>(688,425)</u>
(2) <u>ACCUMULATED DEPRECIATION</u> Adjustment to reflect average balance		\$	<u>782,004</u>
(3) <u>CIAC</u> Adjustment to reflect average balance		\$	<u>489,787</u>
(4) <u>ACCUMULATED AMORTIZATION</u> Adjustment to reflect average balance		\$	<u>(419,911)</u>
(5) <u>UNFUNDED FASB 106 OBLIGATION</u> Adjustment to reflect average balance		\$	<u>(174,324)</u>
(6) <u>WORKING CAPITAL</u> Adjustment to reflect allocated portion of average balance - balance sheet approach		\$	<u>(65,027)</u>

FCWC - LEE COUNTY WATER CAPITAL STRUCTURE TEST YEAR ENDED 12/31/94				SCHEDULE NO. 2 DOCKET NO. 123456-WS			
DESCRIPTION	TOTAL CAPITAL	SPECIFIC ADJUSTMENTS (EXPLAIN)	PRO RATA ADJUSTMENTS	CAPITAL RECONCILED TO RATE BASE	RATIO	COST RATE	WEIGHTED COST
<b>PER UTILITY</b>							
1 LONG TERM DEBT	\$ 28,797,273	\$ 0	\$ 0	28,797,273	42.57%	9.37%	3.99%
2 SHORT-TERM DEBT	0	0	0	0	0.00%	0.00%	0.00%
3 PREFERRED STOCK	9,000,000	0	0	9,000,000	13.30%	9.00%	1.20%
4 COMMON EQUITY	20,003,934	0	0	20,003,934	29.57%	15.23%	4.50%
5 CUSTOMER DEPOSITS	493,367	0	0	493,367	0.73%	6.00%	0.04%
6 DEFERRED ITC'S	1,800,381	0	0	1,800,381	2.66%	11.34%	0.30%
7 DEFERRED INCOME TAXES	7,549,182	0	0	7,549,182	11.16%	0.00%	0.00%
8 TOTAL CAPITAL	\$ <u>67,644,137</u>	\$ 0	\$ 0	<u>67,644,137</u>	<u>100.00%</u>		<u>10.04%</u>
<b>PER COMMISSION</b>							
9 LONG TERM DEBT	\$ 28,797,273	\$ 0	(18,782,966)	10,014,307	42.57%	9.37%	3.99%
10 SHORT-TERM DEBT	0	0	0	0	0.00%	0.00%	0.00%
11 ADVANCES-ASSOCIATED CO	9,000,000	0	(5,870,233)	3,129,767	13.30%	9.00%	1.20%
12 COMMON EQUITY	20,003,934	0	(13,047,527)	6,956,407	29.57%	15.23%	4.50%
13 CUSTOMER DEPOSITS	493,367	0	(321,798)	171,569	0.73%	6.00%	0.04%
14 DEFERRED ITC'S	1,800,381	0	(1,174,295)	626,086	2.66%	11.34%	0.30%
15 DEFERRED INCOME TAXES	7,549,182	0	(4,923,939)	2,625,243	11.16%	0.00%	0.00%
16 TOTAL CAPITAL	\$ <u>67,644,137</u>	\$ 0	<u>(44,120,758)</u>	<u>23,523,379</u>	<u>100.00%</u>		<u>10.04%</u>
<b>RANGE OF REASONABLENESS</b>					<b>LOW</b>	<b>HIGH</b>	
RETURN ON EQUITY					<u>13.23%</u>	<u>15.23%</u>	
OVERALL RATE OF RETURN					<u>9.44%</u>	<u>10.04%</u>	

FCWC - LEE COUNTY WATER STATEMENT OF WATER OPERATIONS TEST YEAR ENDED 12/31/94			SCHEDULE NO. 3-A DOCKET NO. 123456-W5				
DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUSTMENTS	UTILITY ADJUSTED TEST YEAR	COMMISSION ADJUSTMENTS	COMMISSION ADJUSTED TEST YEAR	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	\$ 8,852,776	\$ 0	\$ 8,852,776	\$ 41,227	\$ 8,894,003	(444,152)	8,449,851
OPERATING EXPENSES:		0.00%				-4.99%	
2 OPERATION AND MAINTENANCE	\$ 3,564,050	\$ 0	\$ 3,564,050	\$ 0	\$ 3,564,050	\$	3,564,050
3 DEPRECIATION	896,417	0	896,417	0	896,417		896,417
4 AMORTIZATION	0	0	0	0	0		0
5 TAXES OTHER THAN INCOME	1,050,853	0	1,050,853	1,855	1,052,708	(19,987)	1,032,721
6 INCOME TAXES	238,753	0	238,753	516,750	755,503	(159,613)	595,890
7 TOTAL OPERATING EXPENSES	\$ 5,750,073	\$ 0	\$ 5,750,073	\$ 518,605	\$ 6,268,678	(179,600)	6,089,078
8 OPERATING INCOME	\$ 3,102,703	\$ 0	\$ 3,102,703	(477,378)	2,625,325	(264,552)	2,360,773
9 RATE BASE	\$ 23,599,274	\$ 23,599,274	\$ 23,599,274	\$ 23,523,378	\$ 23,523,378		23,523,378
RATE OF RETURN	13.15%		13.15%		11.16%		10.04%

**FCWC - LEE COUNTY WATER  
 ADJUSTMENTS TO OPERATING STATEMENTS  
 TEST YEAR ENDED 12/31/94**

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EXPLANATION	WATER	WASTEWATER
<b>(1) OPERATING REVENUES</b>		
Adjustment to annualize 1994 index adjustment	\$ <u>41,227</u>	
<b>(2) TAXES OTHER THAN INCOME</b>		
Associated provision for regulatory assessment fees	\$ <u>1,855</u>	
<b>(3) INCOME TAXES</b>		
Adjustment to show provision for income taxes on stand alone basis	\$ <u>516,750</u>	
<b>(4) OPERATING REVENUES</b>		
Estimate of potential overearnings in 1994	\$ <u>(444,152)</u>	
<b>(5) TAXES OTHER THAN INCOME</b>		
Associated provision for regulatory assessment fees	\$ <u>(19,987)</u>	
<b>(6) INCOME TAXES</b>		
Associated income taxes	\$ <u>(159,613)</u>	