BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application for rate increase in Seminole County by Alafaya Utilities, Inc. DOCKET NO. 020408-SU ORDER NO. PSC-03-0380-PCO-SU ISSUED: March 19, 2003

The following Commissioners participated in the disposition of this matter:

LILA A. JABER, Chairman J. TERRY DEASON BRAULIO L. BAEZ RUDOLPH "RUDY" BRADLEY CHARLES M. DAVIDSON

ORDER SUSPENDING ALAFAYA UTILITIES' PROPOSED PERMANENT RATE INCREASE AND GRANTING INTERIM RATE INCREASE SUBJECT TO REFUND

BY THE COMMISSION:

CASE BACKGROUND

Alafaya Utilities, Inc. (Alafaya or utility), a subsidiary of Utilities, Inc., is a Class A wastewater utility located in Seminole County. Alafaya provides wastewater service to approximately 5,600 residential customers and 100 general service customers. Water service is provided in the area by the City of Oviedo. For the year ended December 31, 2001, the utility reported wastewater operating revenues of \$1,809,140, and a net operating income of \$303,246.

In 1986, Alafaya (formerly named Oviedo Utilities, Inc.) began serving customers. By Order No. 14841, issued September 3, 1985, in Docket No. 850209-SU, the Commission granted the utility's original certificate and set its rates and charges. Since it was an original certificate case, rate base was calculated based upon projections and estimates of 80% of plant capacity. By Order No. PSC-95-0489-FOF-SU, issued April 18, 1995, in Docket No. 941106-SU, the Commission approved the transfer of majority organizational control from the utility's previous parent corporation to

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Utilities, Inc. The transfer involved the sale of stock, and thus did not alter the book value of the utility's assets. By Order No. PSC-98-0391-FOF-SU, issued March 16, 1998, in Docket No. 960288-SU, the Commission approved a reuse project plan and set reuse rates and charges. Rate base was not established in any of those dockets or in any subsequent rate proceeding.

On September 30, 2002, the utility filed an application for approval of permanent and interim rate increases pursuant to Sections 367.081 and 367.082, Florida Statutes. By letter dated October 24, 2002, staff informed Alafaya of numerous minimum filing requirement (MFR) deficiencies. On January 10, 2003, Alafaya satisfied the MFRs, and this date was designated as the official filing date, pursuant to Section 367.083, Florida Statutes. The utility has requested that we process its case under the proposed agency action (PAA) procedures, pursuant to Section 367.081(8), Florida Statutes.

The utility's requested test year for both interim and final purposes is based on the year ended December 31, 2001. Alafaya has requested interim revenues of \$1,988,523. This represents an increase of \$177,045 or 9.77%. The requested final revenues are \$2,125,634. This represents an increase of \$314,156 or 17.34%.

This Order addresses the suspension of Alafaya's requested final rates and the appropriate interim rates. We have jurisdiction pursuant to Sections 367.081 and 367.082, Florida Statutes.

SUSPENSION OF RATES

Section 367.081(6), Florida Statutes, provides that the rates proposed by the utility shall become effective within sixty days after filing unless the Commission votes to withhold consent for implementation of the requested rates. Further, Section 367.081(8), Florida Statutes, permits the proposed rates to go into effect (secured and subject to refund) at the expiration of five months if: (1) the Commission has not acted upon the requested rate increase; or (2) if the Commission's PAA action is protested by a party other than the utility.

We have reviewed the filing and have considered the proposed rates, the revenues generated thereby, and the information filed in support of the rate application. We find that it is reasonable and necessary to require further amplification and explanation regarding this data, and to require production of additional or corroborative data. This further examination will include on-site investigations by staff accountants and engineers. Based on the foregoing, we find that it is appropriate to suspend the utility's proposed rate increase.

INTERIM REVENUES

Alafaya requested interim rates designed to generate annual revenues of \$1,988,523. This represents a revenue increase of \$177,045 (or 9.77%). The requested interim test year is the year ended December 31, 2001. The utility filed rate base, cost of capital, and operating statements to support its requested wastewater increase.

Section 367.082(5)(b)1., Florida Statutes, requires that the achieved rate of return for interim purposes be calculated by applying appropriate adjustments consistent with those used in the utility's most recent rate proceeding. We have reviewed the utility's application to determine if its interim request is consistent with Section 367.082, Florida Statutes.

Based on our review of the utility's interim request, we have made adjustments as discussed below. The attached accounting schedules illustrate the approved rate base, capital structure, and test year operating income amounts. The rate base schedule is Schedule 1. The capital structure is reflected on Schedule 2. The operating statement is Schedule 3-A, and the schedule of adjustments to the operating statement is Schedule 3-B.

RATE BASE

In its application, the utility used a thirteen-month average to calculate its requested rate base and cost of capital. Alafaya is a Class A utility and filed its MFRs consistent with the averaging requirement of Rule 25-30.433(4), Florida Administrative Code.

After reviewing the utility's interim rate base, we believe two adjustments are appropriate. Alafaya made two adjustments to its interim rate base. First, Alafaya reduced rate base by \$1,009,020 for non-used and useful plant. This amount was calculated using a portion of the utility's pro forma plant additions requested in its final rate request. Since the pro forma additions occurred beyond the interim test year and were excluded from plant for interim, those additions should correspondingly be removed from the non-used and useful calculation. After excluding the pro forma additions, we calculated a non-used and useful plant component of \$1,005,255. As such, the rate base is increased by \$3,765. As a result, we made a corresponding adjustment to increase depreciation expense by \$573.

Second, Alafaya increased rate base by \$112,900 to reflect its requested working capital allowance. The utility calculated its working capital using the balance sheet approach, which is in accordance with Rule 25-30.433(2), Florida Administrative Code. However, in its calculation, Alafaya included \$82,875 of deferred rate case expense associated with this docket. These expenses are pro forma in nature and beyond the interim test year. As such, we find that the working capital allowance is reduced by \$82,875.

Based on our review, the appropriate rate base for interim purposes is \$4,212,314. Schedule 1 details the approved rate base.

COST OF CAPITAL

The utility's capital structure is based on that of its parent company, Utilities, Inc., which includes long-term debt, short-term debt, common equity, and accumulated deferred income taxes. In addition, Alafaya made a specific adjustment to include customer deposits. The utility reflected an interim cost of capital of 8.98%. Based on our review, two adjustments to Alafaya's capital structure are appropriate.

First, on MFR Schedule D-1, the utility reflected a cost rate of .03% for short-term debt. However, on MFR Schedule D-4, the utility reflected a short-term debt cost rate of 2.54%. We believe that the .03% is erroneous. Thus, we find that the appropriate cost rate for short-term debt is 2.54%.

Second, the utility reflected a cost rate of 11.05% for common equity. The utility's calculation is based on the Commission's 2001 leverage formula and reflects the mid-point of Alafaya's range. Pursuant to Section 367.082(5)(b)2., Florida Statutes, the required rate of return for interim purposes shall be calculated using the minimum of the range of the last authorized rate of ROE. In Alafaya's 1996 reuse case, the Commission approved a reuse project plan, set reuse rates and charges, and established a ROE of 10.06%, with a range of 9.06% to 11.06%. See Order No. PSC-98-0391-FOF-SU, issued March 16, 1998, in Docket No. 960288-SU. The Commission has not reestablished a ROE for Alafaya since the reuse proceeding. As a result, the 1996 docket shall be considered the utility's last rate proceeding for purposes of establishing the last authorized ROE. Therefore, in accordance with the interim statute, we find that the appropriate cost rate for common equity is 9.06%.

Based on the above adjustments, we find that the interim weighted average cost of capital is 8.30%.

NET OPERATING INCOME

Operating Expenses

The utility made several adjustments to operating expenses for interim purposes. We have reviewed the adjustments made by the utility, and we find that several adjustments are appropriate, as discussed below.

First, as a result of allocation adjustments from its sister company (Utilities, Inc. of Florida), Alafaya decreased salaries by \$32,641, increased benefits by \$38,259, and increased payroll taxes by \$18,197. These adjustments are pro forma in nature. As such, these adjustments are disallowed. Disallowance of these adjustments results in a reduction to O&M expenses of \$5,618, and a reduction to taxes other than income of \$18,197.

Further, Alafaya included one year of amortization of rate case expense for this docket and increased property taxes associated with pro forma plant additions. Since both of these adjustments are also beyond the interim test year, these adjustments shall be removed for interim purposes. As such,

operation and maintenance expenses are reduced by \$27,625, and taxes other than income are reduced by \$52,796.

Net Operating Income

Based on the utility's filing and the above adjustments, test year operating income, before any revenue increase, is \$321,989. This represents an achieved rate of return of 7.64%.

REVENUE REQUIREMENT

Based on the above, we find an interim revenue requirement of \$1,857,865 appropriate. This represents an interim increase in annual revenues of \$46,387 or 2.56%. This will allow the utility the opportunity to recover its operating expenses and earn a 8.30% required rate of return on its rate base.

INTERIM RATES

The interim rates shall be designed to allow the utility the opportunity to generate annual operating revenues of \$1,857,865, which represents an increase of \$46,387. To determine the appropriate increase to apply to the wastewater and reuse service rates, miscellaneous service revenues shall be removed from the test year revenues. The calculation is as follows:

1	Total Test Year Revenues	\$1,811,478
2	Less: Miscellaneous Service Revenues	18,208
3	Test Year Revenues from Service Rates	<u>\$1,793,270</u>
4	Revenue Increase	<u>\$46,387</u>
5	<pre>% Service Rate Increase (Line 4/Line 3)</pre>	2.59%

This increase of 2.59% in rates shall be applied as an across the board increase to service rates in effect as of December 31, 2001, which are also the utility's current rates.

Alafaya has a residential reuse monthly availability fee and monthly flat rate, as well as a general service reuse gallonage charge. According to MFR Schedule E-2, the utility had no

residential reuse customers and only had one general service reuse customer, during the interim test year. All of these rates are included in above the line revenues. As such, the 2.59% rate increase shall also be applied to these reuse rates.

The interim rates shall be implemented for service rendered on or after the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1), Florida Administrative Code, provided the customers have received notice. The revised tariff sheets shall be approved upon staff's verification that the tariff sheets are consistent with our decision, that the proposed notice to the customers is adequate, and that the required security discussed below has been filed. The utility shall provide proof to staff of the date notice was given within 10 days after the date of the notice.

Schedule 4 reflects Alafaya's current rates, the requested interim and final rates, and the approved interim rates.

SECURITY TO GUARANTEE INTERIM INCREASE

Pursuant to Section 367.082, Florida Statutes, revenues collected under interim rates shall be placed under bond, escrow, letter of credit, or corporate undertaking subject to refund with interest at a rate ordered by the Commission. As approved herein, the total annual interim increase is \$46,387. In accordance with Rule 25-30.360, Florida Administrative Code, we have calculated the potential refund of revenues and interest collected under interim conditions to be \$31,057. This amount is based on an estimated eight months of revenue being collected from the approved interim rates over the utility's previously authorized rates shown on Schedule 4.

The utility has requested a corporate undertaking to secure any interim increase granted. Alafaya is a wholly-owned subsidiary of UI, which provides all investor capital to its subsidiaries. As such, we reviewed the financial statements of the parent company. UI currently is guaranteeing a total of \$534,776 with a corporate undertaking on behalf of its Florida subsidiaries. This request will bring the total cumulative amount to \$565,833.

The criteria for a corporate undertaking includes sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. We reviewed UI's financial statements from 1999 to 2001 to determine the financial condition of the parent company. Our analysis shows that UI has minimal liquidity and experienced a significant decline in net income and interest coverage from 2000 to 2001. However, if the one-time \$9.8 million merger-related charge is excluded, UI's financial would show a 3-year trend of stable performance equity capitalization, interest coverage, and profitability. Based upon this analysis, we find that a cumulative corporate undertaking of \$565,833 is acceptable contingent upon the receipt of the written guarantee of UI and written confirmation that UI does not have any outstanding guarantees on behalf of UI-owned utilities in other states.

Pursuant to Rule 25-30.360(6), Florida Administrative Code, the utility shall provide a report by the 20th day of each month indicating the monthly and total revenue collected subject to refund. Should a refund be required, the refund shall be with interest and undertaken in accordance with Rule 25-30.360, Florida Administrative Code.

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

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the proposed final rates of Alafaya Utilities, Inc. are hereby suspended. It is further

ORDERED that the request for an interim rate increase is hereby granted as set forth in the body of this Order. It is further

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

ORDERED that the approved interim rates shall become effective for service rendered on or after the stamped approval date on the

tariff sheets, provided the customers have received notice. It is further

ORDERED that the tariff sheets shall be approved upon verification that they are consistent with our decision herein, that the proposed notice to the customers is adequate, and that the appropriate security is provided. It is further

ORDERED that Alafaya Utilities, Inc. shall provide a corporate undertaking guaranteed by Utilities, Inc., its parent company, in the cumulative amount of \$565,833, as security for the potential refunds of revenues collected under interim conditions. Utilities, Inc. shall also provide written confirmation that it does not have any outstanding guarantees on behalf of any subsidiaries in other states. It is further

ORDERED that the utility shall provide a report by the 20th day of each month indicating the monthly and total revenue collected subject to refund, pursuant to Rule 25-30.360(6), Florida Administrative Code. It is further

ORDERED that this docket shall remain open pending the Commission's final action on the utility's requested rate increase.

By ORDER of the Florida Public Service Commission this <u>19th</u> day of <u>March</u>, <u>2003</u>.

BLANCA S. BAYÓ, Director Division of the Commission Clerk and Administrative Services

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Any party adversely affected by this order, which is non-final in nature, may request (1) reconsideration within 15 days pursuant to Rule 25-22.060, Florida Administrative Code, or (2) judicial review by the Florida Supreme Court, in the case of an electric, gas or telephone utility, or the First District Court of Appeal, in the case of a water or wastewater utility. A motion for reconsideration shall be filed with the Director, Division of the Commission Clerk and Administrative Services, in the form prescribed by Rule 25-22.060, Florida Administrative Code. <u>Citizens of the State of Florida v. Mayo</u>, 316 So.2d 262 (Fla. 1975), states that an order on interim rates is not final or reviewable until a final order is issued. Such review may be requested from the appropriate court, as described above, pursuant to Rule 9.100, Florida Rules of Appellate Procedure.

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ALAFAYA UTILITIES, INC. SCHEDULE OF WASTEWATER RATE BASE TEST YEAR ENDED 12/31/01 SCHEDULE 1 DOCKET NO. 020408-SU

DESCRIPTION	TEST YEAR UTILITY PER ADJUST- UTILITY MENTS		ADJUSTED TEST YEAR PER UTILITY	COMMISSION ADJUST- MENTS	COMMISSION ADJUSTED TEST YEAR	
1 UTILITY PLANT IN SERVICE	\$14,109,471	\$0	\$14,109,471	\$0	\$14,109,471	
2 LAND	26,255	0	26,255	0	26,255	
3 NON-USED & USEFUL COMPONENTS	0	(1,009,020)	(1,009,020)	3,765	(1,005,255)	
4 ACCUMULATED DEPRECIATION	(4,018,476)	0	(4,018,476)	0	(4,018,476)	
5 CIAC	(9,225,895)	0	(9,225,895)	0	(9,225,895)	
6 AMORTIZATION OF CIAC	2,518,883	0	2,518,883	0	2,518,883	
7 CONSTRUCTION WORKING IN PROGRESS	1,777,306	0	1,777,306	0	1,777,306	
8 WORKING CAPITAL ALLOWANCE	<u>0</u>	<u>112,900</u>	112,900	(82,875)	<u>30,025</u>	
RATE BASE	<u>\$5,187,544</u>	<u>(\$896,120)</u>	<u>\$4,291,424</u>	(\$79,110)	<u>\$4,212,314</u>	

To reflect the appropriate non-used and useful adjustment.
To remove pro forma deferred rate expense from working capital.

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ALAFAYA UTILITIES, INC. CAPITAL STRUCTURE TEST YEAR ENDED 12/31/0	1		SCHEDULE 2 DOCKET NO. 020408-SU					
DESCRIPTION	TOTAL CAPITAL	SPECIFIC ADJUST- MENTS (EXPLAIN)	PRO RATA ADJUST- MENTS	CAPITAL RECONCILED TO RATE BASE	RATIO	COST RATE	WEIGHTEL COST	
ER UTILITY 2001 - 13-MONT	H AVERAGE							
1 LONG TERM DEBT	\$72,269,231	\$0	(\$69,912,573)	\$2,356,658	44.26%	8.82%	3.90	
2 SHORT-TERM DEBT	13,780,077	0	(13,330,644)	449,433	8.44%	0.03%	0.00	
3 PREFERRED STOCK	0	0	0	0	0.00%	0.00%	0.00	
4 COMMON EQUITY	73,349,305	0	(70,957,714)	2,391,591	44.92%	11.05%	4.96	
5 CUSTOMER DEPOSITS	110,199	0	0	110,199	2.07%	6.00%	0.12	
6 DEFERRED INCOME TAXES	<u>498,163</u>	<u>0</u>	(482,000)	<u>16,163</u>	0.30%	0.00%	0.00	
7 TOTAL CAPITAL	<u>\$160,006,975</u>	<u>\$0</u>	(\$154,682,931)	\$5,324,044	100.00%		8.98	
ER COMMISSION 2001 - 13-M	ONTH AVERAGE							
8 LONG TERM DEBT	\$72,269,231	\$0	(\$70,415,180)	\$1,854,051	44.02%	8.82%	3.88	
9 SHORT-TERM DEBT	13,780,077	0	(13,426,552)	353,525	8.39%	2.54%	0.21	
0 PREFERRED STOCK	0	0	0	0	0.00%	0.00%	0.00	
1 COMMON EQUITY	73,349,305	0	(71,467,545)	1,881,760	44.67%	9.06%	4.05	
2 CUSTOMER DEPOSITS	110,199	0	110,199	110,199	2.62%	6.00%	0.16	
3 DEFERRED INCOME TAXES	<u>498,163</u>	<u>0</u>	<u>(\$485,383)</u>	<u>\$12,780</u>	0.30%	0.00%	0.00	
4 TOTAL CAPITAL	<u>\$160,006,975</u>	<u>\$0</u>	<u>(\$155,794,661)</u>	<u>\$4,212,314</u>	<u>100.00%</u>		8.30	
			RETURN ON EQUITY		<u>LOW</u> 9.06%	HIGH		
	OVERALL RATE OF RETURN					<u>11.06%</u> <u>9.198</u>		

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ALAFAYA UTILITIES, INC.SCHEDULE 3-ASTATEMENT OF WASTEWATER OPERATIONSDOCKET NO. 020408-SUTEST YEAR ENDED 12/31/01DOCKET NO. 020408-SU							
DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUST- MENTS	ADJUSTED TEST YEAR PER UTILITY	COMMISSION ADJUST- MENTS	COMMISSION ADJUSTED TEST YEAR	REVENUE INCREASE	REVENUE ['] REQUIREMENT
1 OPERATING REVENUES	\$1,809,140	<u>\$179,383</u>	<u>\$1,988,523</u>	(\$177,045)	\$1,811,478	<u>\$46,387</u> 2.56%	<u>\$1,857,865</u>
OPERATING EXPENSES 2 OPERATION & MAINTENANCE	\$1,162,351	\$33,243	\$1,195,594	(\$33,243)	\$1,162,351		\$1,162,351
3 DEPRECIATION	150,171	(42,783)	107,388	573	107,961		107,961
4 AMORTIZATION	0	0	0	0	0		(
5 TAXES OTHER THAN INCOME	133,212	78,734	211,946	(78,960)	132,986	2,087	135,073
6 INCOME TAXES	<u>60,160</u>	<u>27,958</u>	88,118	(1,927)	<u>86,191</u>	16,670	102,861
7 TOTAL OPERATING EXPENSES	<u>1,505,894</u>	<u>97,152</u>	<u>1,603,046</u>	(113,557)	1,489,489	18,757	1,508,247
8 OPERATING INCOME	<u>\$303,246</u>	<u>\$82,231</u>	<u>\$385,477</u>	<u>(\$63,488)</u>	<u>\$321,989</u>	<u>\$27,630</u>	<u>\$349,618</u>
9 RATE BASE	<u>\$5,187,544</u>		<u>\$4,291,424</u>		<u>\$4,212,314</u>		<u>\$4,212,314</u>
10 RATE OF RETURN	<u>5.85%</u>		<u>8.98</u> %		7.648		8.309

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ALAFAYA UTILITIES, INC. SCHEDULE 3-B ADJUSTMENTS TO OPERATING INCOME DOCKET NO. 020408-SU TEST YEAR ENDED 12/31/01 EXPLANATION WASTEWATER OPERATING REVENUES To remove requested interim revenue increase (\$177,045) **OPERATION & MAINTENANCE EXPENSE** 1 To remove pro forma salary and benefit adjustments. (\$5,618) 2 To remove amortization of rate case expense. (\$27,625) Total (\$33,243) DEPRECIATION EXPENSE-NET To reflect appropriate net depreciation on non-U&U plant. <u>\$573</u> TAXES OTHER THAN INCOME 1 RAFs on revenue adjustments above. (\$7,967) 2 To remove pro forma payroll taxes. (18, 197)3 To remove pro forma property taxes. (52, 796)Total (\$78,960) INCOME TAXES To adjust to test year income tax expense <u>(\$1,927)</u>

ALAFAYA UTILITIES, INC. WASTEWATER MONTHLY SERVICE RATES TEST YEAR ENDED 12/31/01	SCHEDULE 4 Docket No. 020408-SU				
	_	-	Utility Requested Final	Comm'n Approved Interim	
<u>Residential</u> Base Facility Charge: Meter Size:					
5/8" x 3/4"	\$12.85	\$14.11	\$15.08	\$13.18	
Gallonage Charge, per 1,000 Gallons (10,000 Gallons Cap)	\$1.76	\$1.93	\$2.07	\$1.81	
<u>General Service</u> Base Facility Charge: Meter Size:					
5/8" x 3/4"	\$12.85	\$14.11	\$15.08	\$13.18	
1"	\$32.15	\$35.29	\$37.70	\$32.98	
1 1/2"			\$75.40		
2 "		•	\$120.64	-	
3 "		•	\$226.20		
4 "	\$321.45	\$352.87	\$377.00	\$329.77	
Gallonage Charge, per 1,000 Gallons	\$1.76	\$1.93	\$2.07	\$1.81	
Reuse Service					
Monthly Residential Availability Fee					
Monthly Residential Flat Rate	\$9.07	•		•	
General Service Gallonage Charge	\$0.60	\$0.66	\$0.70	\$0.62	
	Typica	l Resident	ial Bills		
5/8" x 3/4" Meter Size	AA A A A A A A A A A A A A A A A A A A	<u> </u>	401 00	610 C1	
3,000 Gallons	\$18.13		-		
5,000 Gallons	\$21.65		•		
10,000 Gallons	\$30.45	\$33.41	\$35.78	\$31.28	