

FLORIDA PUBLIC SERVICE COMMISSION
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M E M O R A N D U M

JANUARY 4, 1995

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYO)

FROM: DIVISION OF WATER & WASTEWATER (KAPROTH) *[Handwritten initials]*
DIVISION OF LEGAL SERVICES (PELLEGRINI) *[Handwritten initials]*

RE: DOCKET NO. 960011-WU - INDIANTOWN COMPANY, INC. -
INVESTIGATION OF WATER AND WASTEWATER RATES FOR POSSIBLE
OVEREARNINGS
COUNTY: MARTIN

AGENDA: 1/16/96 - REGULAR AGENDA - DECISION ON SETTING REVENUES
SUBJECT TO REFUND - ON ISSUE 1 PARTIES MAY PARTICIPATE -
ON ISSUES 2 AND 3 PARTICIPATION IS LIMITED TO
COMMISSIONERS AND STAFF

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: I:\PSC\WAW\WP\960011WU.RCM

DOCUMENT NUMBER-DATE

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FPSC-RECORDS/REPORTING

CASE BACKGROUND

Indiantown Co. Inc. (Indiantown or utility) is a Class B utility providing water and wastewater service for approximately 1,677 water and 1,585 wastewater customers in Martin County. The utility's systems are located in the St. Johns River Water Management District Water Conservation Area which is a designated critical water use area. For the test year end December 31, 1994, the utility reported water operating revenues of \$449,029 and a net operating income of 82,218. Wastewater operating revenues were \$502,022 with a net operating income of \$61,486.

Based on a desk audit of the 1994 Annual Report for Indiantown Company, Inc., staff began an informal investigation into potential overearnings. The 1994 Annual Report indicated that Indiantown's water system was earning an achieved overall rate of return of 67.27%. Staff requested an audit of the utility's books. Based on the auditor's suggested adjustments, it appears that the utility is earning an overall rate of return of 111.91% for the water system. As a result of the audit findings, we are recommending that this docket be opened for an investigation of potential overearnings.

Indiantown's last rate case was finalized on April 27, 1983, in Order No. 11891, Docket No. 810037-Ws. In that order, rate base was set and an overall rate of return of 9.87% was approved. In Order No. PSC-95-1328-FOF-WS, issued on November 1, 1995, Docket No. 950371-WS, the utility's return on equity was re-established at 10.43%. Index increases were granted in 1986, 1987, 1988, 1989, 1993 and 1994. A pass-through increase was granted in 1991.

DISCUSSION OF ISSUES

ISSUE 1: Should the Commission initiate an overearnings investigation of Indiantown Utilities, Inc.?

RECOMMENDATION: Yes. The Commission should initiate an investigation of the composition and level of water rates to determine potential overearnings. Water and wastewater rate base should also be established since both were last set by the Commission as of April 27, 1983. (KAPROTH)

STAFF ANALYSIS: Based on a desk audit of the 1994 Annual Report for Indiantown Company, Inc., staff began an informal investigation into potential overearnings. The 1994 Annual Report indicated that Indiantown's water system was earning an achieved overall rate of return of 67.27%. Staff requested an audit of the utility's books for the test year ended June 30, 1995. Staff's audit indicated that the water system was earning an overall rate of return of 111.91%. Based on this, staff believes that this docket should be opened to investigate the potential overearnings of the utility. Furthermore, staff believes that water and wastewater rate base should be established since both were last set by the Commission as of April 27, 1983.

ISSUE 2: Should any amount of annual water revenues be held subject to refund?

RECOMMENDATION: Yes. Indiantown should hold annual water revenues of \$126,779 subject to refund. No wastewater revenues should be held subject to refund. The following amounts are recommended: (KAPROTH)

	<u>Total Revenues</u>	<u>Amount Subject To Refund</u>	<u>% Subject To Refund</u>
Water	\$328,587	\$126,779	27.84%

STAFF ANALYSIS: Staff believes that Indiantown's water system may be overearning. Our preliminary analysis, also reveals that the wastewater system is not earning its overall rate of return. After staff has completed its investigation, we will be able to determine if the utility is, in fact, overearning.

Staff has attached accounting schedules to illustrate the recommended water and wastewater rate base, capital structure, and test year operating income amounts. The rate base schedules are numbered 1-A and 1-B. The capital structure is schedule number 2. Schedules 3-A and 3-B are reserved for the operating statements. Staff has not attached schedules explaining any recommended adjustments as the adjustments are either per audit, self explanatory or described in our recommendation. Below, staff will discuss necessary adjustments.

For purposes of this interim recommendation, the schedules reflect the test year average balances per the auditors, as well as specific audit adjustments. Since there was no filing on the part of the utility, the amounts per audit do not necessarily reflect the utility's position. These balances do not include any utility calculations for working capital or the overall cost of capital.

RATE BASE

Working Capital

Section 367.082(5)(b)1, Florida Statutes requires that, in calculating interim rates, adjustments be made consistent with those in the utility's last rate proceeding. Consistent with the treatment allowed in Indiantown's last rate proceeding, in Order No. 11891, staff has calculated working capital using the balance sheet method. The staff auditor used the formula method to calculate a working capital allowance of \$31,255 for water and \$38,924 for wastewater. Based on staff's preliminary review and the use of the balance sheet method, staff recommends a working capital allowance of \$44,349 for water and \$44,349 for wastewater.

Also, staff recommends that rate base for interim purposes be established as \$93,219 and \$766,838 for water and wastewater, respectively.

COST OF CAPITAL

In Order No. PSC-95-1328-FOF-WS, issued on November 1, 1995, Indiantown's return on equity was established at 10.43%, with a range of 9.43% to 11.43%. Consistent with Section 367.082(2)(b), Florida Statutes, the appropriate rate of return on equity for interim refund purposes is calculated using the maximum of the range of the last authorized rate of return on equity. Using the high-end of the range to calculate any potential overearnings, staff has established an overall rate of return of 9.61% for interim purposes.

NET OPERATING INCOME

Staff believes that one adjustment is necessary to the auditor's balances. It appears that test year income tax expense was not appropriately allocated between water and wastewater. We have adjusted the test year balances before determining the revenue requirements. Accordingly, income tax expense, should be increased by \$6,334 for water and decreased by \$6,340 for wastewater.

Revenue Requirement

Water operating revenues adjusted per the staff auditors total \$455,366. This represents a 89.39% overall rate of return. Staff's calculation indicates a revenue requirement of \$328,587 for the interim test year, representing a decrease of \$126,779. Accordingly, 27.84% of test year water revenues should be held subject to refund pending the final determination by the Commission. The wastewater system is earning a 6.40% on an annual basis which is less than the minimum range on the overall rate of return. Accordingly, no adjustments are necessary to wastewater.

ISSUE 3: What is the appropriate security to guarantee the amount subject to refund?

RECOMMENDATION: A corporate undertaking in the amount of \$92,428, guaranteed by Indiantown Company, Inc. should be accepted as security. (KAPROTH)

STAFF ANALYSIS: Pursuant to Section 367.082, Florida Statutes, when revenues are held subject to refund, the utility is authorized to continue collecting the previously authorized rates. As recommended in Issue 2, the amount of potential overearnings in the water system is \$126,779 on an annual basis. On May 13, 1994, the utility implemented a price index of \$8,713 for the water system. 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 9, 1995, consequently, fifteen months from that date is August 9, 1996. Since the index is already subject to refund, only \$118,066 in annual revenues should be collected under guarantee, subject to refund with interest. Assuming a 9-month time frame, the potential refund amount is \$92,428.

The Division of Auditing and Financial Analysis has advised that a corporate undertaking signed by Indiantown Company, Inc. would be sufficient to protect the potential refunds. Therefore, staff recommends that the utility be allowed to provide a corporate undertaking in the amount of \$92,428 as guarantee of any potential refund of water revenues collected under interim conditions.

Also, by no later than the twentieth (20) day of each month, the utility should 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. Should a refund be required, the refund should 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. The costs are the responsibility of, and should be borne by, the utility.

INDIANTOWN COMPANY, INC.
 SCHEDULE OF WATER RATE BASE
 TEST YEAR ENDED 12/31/94

SCHEDULE NO. 1 - A
 DOCKET NO. 960011 - WU

COMPONENT	TEST YEAR PER AUDIT	AUDIT ADJUSTMENTS	BALANCE PER AUDIT	STAFF ADJUSTMENTS	ADJUSTED AVERAGE BALANCE
1 UTILITY PLANT IN SERVICE	\$ 1,338,954	\$ 31,502	\$ 1,370,456	\$ 0	1,370,456
2 LAND & LAND RIGHTS	4,469	0	4,469	0	4,469
3 NON-USED & USEFUL COMPONENTS	0	0	0	0	0
4 ACCUMULATED DEPRECIATION	(703,669)	0	(703,669)	0	(703,669)
5 CIAC	(554,484)	(47,114)	(601,598)	0	(601,598)
6 AMORTIZATION OF CIAC	154,212	0	154,212	0	154,212
7 ACQUISITION ADJUSTMENTS - NET	0	0	0	0	0
8 ADVANCES FOR CONSTRUCTION	(175,000)	0	(175,000)	0	(175,000)
9 UNFUNDED POST-RETIREMENT BENEFITS	0	0	0	0	0
10 DEFERRED TAXES	0	0	0	0	0
11 WORKING CAPITAL ALLOWANCE	0	31,255	31,255	13,094	44,349
12 OTHER	0	0	0	0	0
RATE BASE	\$ 64,482	\$ 15,643	\$ 80,125	\$ 13,094	93,219

INDIANTOWN COMPANY, INC.
 SCHEDULE OF WASTEWATER RATE BASE
 TEST YEAR ENDED 12/31/94

SCHEDULE NO. 1 - B
 DOCKET NO. 960011 - W1

COMPONENT	TEST YEAR PER AUDIT	AUDIT ADJUSTMENTS	BALANCE PER AUDIT	STAFF ADJUSTMENTS	ADJUSTED AVERAGE BALANCE
1 UTILITY PLANT IN SERVICE	\$ 2,454,386	\$(27,931)	\$ 2,426,455	\$ 0	2,426,455
2 LAND	383	0	383	0	383
3 NON-USED & USEFUL COMPONENTS	0	0	0	0	0
4 ACCUMULATED DEPRECIATION	(974,317)	0	(974,317)	0	(974,317)
5 CIAC	(893,905)	47,402	(846,503)	0	(846,503)
6 AMORTIZATION OF CIAC	232,471	0	232,471	0	232,471
7 ACQUISITION ADJUSTMENTS - NET	0	0	0	0	0
8 ADVANCES FOR CONSTRUCTION	(116,000)	0	(116,000)	0	(116,000)
9 UNFUNDED POST-RETIRE BENEFITS	0	0	0	0	0
10 DEFERRED TAXES	0	0	0	0	0
11 WORKING CAPITAL ALLOWANCE	0	38,924	38,924	5,425	44,349
12 OTHER	0	0	0	0	0
RATE BASE	\$ 703,018	\$ 58,395	\$ 761,413	\$ 5,425	766,838

INDIANTOWN COMPANY, INC.
CAPITAL STRUCTURE
TEST YEAR ENDED 12/31/94

SCHEDULE NO. 2
DOCKET NO. 960011 - WU

DESCRIPTION	TOTAL CAPITAL	SPECIFIC ADJUSTMENTS (EXPLAIN)	PRO RATA ADJUSTMENTS	CAPITAL RECONCILED TO RATE BASE	RATIO	COST RATE	WEIGHTED COST
PER UTILITY 1995							
1 LONG TERM DEBT	\$ 0	\$ 0	\$ 0	73,499,527	56.66%	8.91%	5.05%
2 SHORT-TERM DEBT	0	0	0	0	0.00%	0.00%	0.00%
3 PREFERRED STOCK	0	0	0	0	0.00%	0.00%	0.00%
4 COMMON EQUITY	0	0	0	55,112,011	42.49%	11.19%	4.75%
5 CUSTOMER DEPOSITS	0	0	0	1,167,998	0.90%	6.00%	0.05%
6 DEFERRED INCOME TAXES	0	0	0	0	0.00%	0.00%	0.00%
7 DEFERRED ITC'S - WTD COST	0	0	0	956,792	0.74%	9.86%	0.07%
8 ADJUSTMENT FOR GAS	0	0	0	(1,025,477)	-0.79%	11.19%	-0.09%
9 TOTAL CAPITAL	\$ 0	\$ 0	\$ 0	129,710,851	100.00%		9.84%
PER STAFF 1994							
10 LONG TERM DEBT	\$ 307,402	\$ 0	(276,072)	31,330	3.64%	10.74%	0.39%
11 SHORT-TERM DEBT	0	0	0	0	0.00%	0.00%	0.00%
12 PREFERRED STOCK	1,233,500	0	(1,107,783)	125,717	14.62%	6.00%	0.88%
13 COMMON EQUITY	5,947,507	0	(5,341,345)	606,162	70.48%	11.43%	8.06%
14 CUSTOMER DEPOSITS	41,673	0	0	41,673	4.85%	6.00%	0.29%
15 DEFERRED INCOME TAXES	55,175	0	0	55,175	6.42%	0.00%	0.00%
15 DEFERRED ITC'S - WTD COST	0	0	0	0	0.00%	0.00%	0.00%
16 OTHER	0	0	0	0	0.00%	0.00%	0.00%
17 TOTAL CAPITAL	\$ 7,585,257	\$ 0	(6,725,200)	860,057	100.00%		9.61%

RANGE OF REASONABLENESS	LOW	HIGH
RETURN ON EQUITY	9.43%	11.43%
OVERALL RATE OF RETURN	8.21%	9.61%

INDIANTOWN COMPANY, INC.
STATEMENT OF WATER OPERATIONS
TEST YEAR ENDED 12/31/94

SCHEDULE NO. 3-A
DOCKET NO. 960011-WU

DESCRIPTION	TEST YEAR PER AUDIT	AUDIT ADJUSTMENTS	BALANCE PER AUDIT	STAFF ADJUSTMENTS	AVERAGE BALANCE	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	\$ 449,029	\$ 6,337	\$ 455,366	\$ 0	\$ 455,366	(\$ 126,779)	328,587
OPERATING EXPENSES:						-27.84%	
2 OPERATION AND MAINTENANCE	\$ 253,468	(\$ 3,428)	\$ 250,040	\$ 0	\$ 250,040	\$	250,040
3 DEPRECIATION	38,122	11,510	49,632	0	49,632		49,632
4 AMORTIZATION	(15,682)	(9,193)	(24,875)	0	(24,875)		(24,875)
5 TAXES OTHER THAN INCOME	45,303	0	45,303	0	45,303	(5,705)	39,598
6 INCOME TAXES	45,600	0	45,600	6,334	51,934	(46,704)	5,229
7 TOTAL OPERATING EXPENSES	\$ 366,811	(\$ 1,111)	\$ 365,700	\$ 6,334	\$ 372,034	(\$ 52,409)	319,624
8 OPERATING INCOME	\$ 82,218	\$ 7,448	\$ 89,666	(\$ 6,334)	\$ 83,332	(\$ 74,370)	8,963
9 RATE BASE	\$ 64,482	\$	80,125	\$	93,219	\$	93,219
RATE OF RETURN	127.51%		111.91%		89.39%		9.61%

**INDIANTOWN COMPANY, INC.
STATEMENT OF WASTEWATER OPERATIONS
TEST YEAR ENDED 12/31/94**

**SCHEDULE NO. 3-B
DOCKET NO. 960011-WU**

DESCRIPTION	TEST YEAR PER AUDIT	AUDIT ADJUSTMENTS	BALANCE PER AUDIT	STAFF ADJUSTMENTS	AVERAGE BALANCE	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	\$ 502,022	\$ 4,681	\$ 506,703	\$ 0	\$ 506,703	\$ 0	506,703
OPERATING EXPENSES						0.00%	
2 OPERATION AND MAINTENANCE	\$ 312,859	\$(1,467)	\$ 311,392	\$ 0	\$ 311,392	\$	311,322
3 DEPRECIATION	62,321	46,546	108,867	0	108,867		108,867
4 AMORTIZATION	(22,913)	(21,018)	(43,931)	0	(43,931)		(43,931)
5 TAXES OTHER THAN INCOME	54,369	(668)	53,701	0	53,701	0	53,701
6 INCOME TAXES	33,900	0	33,900	(6,340)	27,560	0	27,560
7 TOTAL OPERATING EXPENSES	\$ 440,536	\$ 23,393	\$ 463,929	\$(6,340)	\$ 457,589	\$ 0	457,589
8 OPERATING INCOME	\$ 61,486	\$(18,712)	\$ 42,774	\$ 6,340	\$ 49,114	\$ 0	49,114
9 RATE BASE	\$ 703,018		\$ 761,413		\$ 766,838		\$ 766,838
RATE OF RETURN	8.75%		5.62%		6.40%		6.40%