

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

April 4, 1996

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

FROM: DIVISION OF APPEALS (HELTON) *nat DS*  
DIVISION OF WATER & WASTEWATER (WILLIAMS, SHAFER, STARLING, WALKER) *MD*  
DIVISION OF AUDITING & FINANCIAL ANALYSIS (CAUSSEUX)  
DIVISION OF RESEARCH & REGULATORY REVIEW (HARLOW) *APC*

RE: DOCKET NO. 960258-WS - PETITION TO ADOPT RULES ON MARGIN RESERVE AND IMPUTATION OF CONTRIBUTIONS-IN-AID-OF-CONSTRUCTION ON MARGIN RESERVE CALCULATION, BY FLORIDA WATERWORKS ASSOCIATION

AGENDA: 4/16/96 - REGULAR AGENDA - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: I:\PSC\APP\WP\

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CASE BACKGROUND

On March 1, 1996, pursuant to Section 120.54(5), Florida Statutes, and Rule 25-22.010, Florida Administrative Code, the Florida Waterworks Association (FWA or the association) petitioned the Commission to adopt a rule concerning margin reserve determinations for water and wastewater utilities.<sup>1</sup>

Commission staff has also been working on used and useful rules for water and wastewater utilities. As part of its extensive review of rules governing water and wastewater utilities in Docket No. 911082-WS, in 1993 the Commission proposed Rule 25-30.432 which addressed used and useful determinations in rate case proceedings. The proposed rule included calculations to determine margin reserve in addition to the provision that contributions-in-aid-of construction (CIAC) would not be imputed on the margin reserve calculation. However, after further considering its proposal, the

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<sup>1</sup> FWA's recommended rule is attached.

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Commission withdrew proposed Rule 25-30.432 to permit further analysis.

Accordingly, staff has conducted additional studies regarding appropriate used and useful calculations. This led to a comprehensive rule draft that established parameters to apply in calculating used and useful factors in rate proceedings, which was reviewed at a staff workshop in July of 1995. Staff's July 1995 draft provided for a three-year margin reserve, did not address any corresponding imputation of CIAC, and did not address the treatment of reuse facilities. During the workshop, FWA and its member companies identified margin reserve and the corresponding imputation of CIAC as their major topics of concern. In addition, representatives from the Florida Department of Environmental Protection supported a margin reserve period from five to ten years.

#### DISCUSSION OF ISSUES

**ISSUE 1:** Should the Commission grant the petition of Florida Waterworks Association to adopt rules on margin reserve and imputation of contributions-in-aid-of-construction on margin reserve calculation?

**RECOMMENDATION:** Yes, staff recommends that the Commission initiate rulemaking concerning used and useful determinations for water and wastewater utilities. Staff, however, does not recommend that FWA's suggested rule be proposed. Instead, staff recommends that it should return with a rule for the Commission to consider for proposal.

**STAFF ANALYSIS:** The Commission's current policy is to include in rate base an 18-month margin reserve of plant investment that is needed to accommodate future growth. This margin is offset by imputing any CIAC projected for collection during the margin reserve period. FWA disagrees with this policy. The association believes that there should be at least a five-year margin reserve, with no imputation of CIAC. If FWA's suggestion were followed, a utility would be allowed to earn a rate of return on the plant investment needed to serve five years of projected growth. According to FWA, this treatment is necessary because the Commission's current policy discourages utilities from considering economies of scale when planning for plant expansion. Instead, "utilities are under pressure to keep investment in margin reserve capacity at a minimum[,] . . . [which] tends to [cause] a higher cost of service and a lesser degree of reliability and quality of service." (Petition at p. 3)

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The rule FWA recommends for proposal sets the margin reserve period for water source and treatment facilities and wastewater treatment and effluent disposal facilities at five years, and provides that a utility may justify a different reserve period based on factors set forth in the rule. (Subsection (2)(a)) FWA's recommended rule also states that "CIAC shall not be imputed against the allowance for margin reserve." (Subsection (1)) In addition, the association recommends a 100 percent used and useful determination for reclaimed water reuse facilities. (Subsection (5))

Although the used and useful rule staff has been drafting is more comprehensive than FWA's recommended rule, it does not presently address either the CIAC imputation issue or the used and useful treatment of reuse facilities. In its petition, FWA argues that to expedite matters, the Commission should adopt the association's more limited version of the rule.

Staff recommends that the Commission should not propose FWA's attached rule. Instead, staff recommends that it be provided time to analyze the approach recommended by FWA. Once staff has merged the appropriate parts of both rules and considered the economic impact, the result will be presented to the Commission for its consideration.

**ISSUE 2:** Should the Commission set this matter for hearing as requested by Florida Waterworks Association?

**RECOMMENDATION:** No, FWA's hearing request is premature.

**STAFF ANALYSIS:** FWA requested that the Commission require all interested persons to file written testimony and exhibits by July 1996, and that a full Commission hearing be scheduled so the Commission can adopt a rule by the end of this year. If the Commission approves staff's recommendation in Issue 1, FWA's request for a hearing should be considered premature. After staff has formulated a draft and completed an Economic Impact Statement, it will come back to the Commission with a rule to recommend for proposal. Within 21 days from the date the proposed rule is published in the Florida Administrative Weekly, FWA or any other interested person may file comments or request a hearing.

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ISSUE 3: Should this docket remain open?

RECOMMENDATION: Yes.

STAFF ANALYSIS: If the Commission approves staff's recommendation, this docket should remain open so that a rule can be brought before the Commission to consider for proposal at a later date.

Attachment:  
FWA's recommended rule

1  
2 25-30.431 Margin Reserve

3 (1) Margin reserve is recognized as a component of used and  
4 useful rate base. The Commission shall include an allowance for  
5 margin reserve if requested by the utility. CIAC shall not be  
6 imputed against the allowance for margin reserve.

7 (2) The Commission recognizes that for a utility to meet its  
8 statutory responsibilities, it must have sufficient capacity and  
9 investment to meet the existing and changing demands of present  
10 customers and the demands of potential customers within a  
11 reasonable time and in an economic manner.

12 (a) Margin Reserve is defined as the investment needed to meet  
13 the changing demands of existing customers and the demands of  
14 potential customers in a reasonable time and in an economic manner.

15 (b) Margin Reserve Period is defined as the period during  
16 which current capacity is required to be available until the next  
17 economic capacity addition can be placed in service without causing  
18 a deterioration in the quality of service. In determining the  
19 margin reserve period, the Commission shall consider, but not be  
20 limited to, the rate of growth in customers and demand, the time  
21 needed to meet the guidelines of the Department of Environmental  
22 Protection for planning, design and construction of plant  
23 expansion, and the available technical and economic options  
24 available for sizing increments of plant expansion. Unless  
25 otherwise justified, the margin reserve period for water source and

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~~struck through~~ type are deletions from existing law.

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2 treatment facilities and wastewater treatment and effluent disposal  
3 facilities is set at five years.

4 (3) As a part of its rate filing, the utility shall submit  
5 historical, reliable data for a minimum of five years, if  
6 available, preceding the test year, and for the test year, for the  
7 year-end number of customers by class and meter size; the annual  
8 sales by class; the annual treated or pumped flows for the system;  
9 the water system maximum day, and if available, peak hour flows  
10 for each year; and the wastewater system annual average, maximum  
11 month average, and three-month average daily flows. The utility's  
12 most recent wastewater capacity analysis report, if any, filed with  
13 DEP shall also be submitted as part of the rate filing.

14 (4) For purposes of this rule, Margin Reserve (expressed in  
15 units of demand; e.g., GPD (gallons per day)) equals:

$$\text{EG} \times \text{MP} \times \text{D}$$

17 where:

18 EG = Equivalent Annual Growth in ERCs

19 MP = Margin Reserve Period

20 D = Demand/ERC on the plant component

21  
22 a. The equivalent growth (EG) in ERCs is measured in  
23 terms of the projected annual growth and shall be determined by the  
24 utility based on its knowledge of growth in its certificated area.  
25 The utility shall take into consideration the growth in ERCs over

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the last five years, including the test year, and other factors which in the judgement of the utility affect the pattern of growth.

b. As part of its filing, the utility shall provide a calculation of the EG based on (1) a simple average of the annual ERCs for the last five years and (2) a linear regression of annual ERCs for the last five years.

(5) Reclaimed Water Reuse Facilities constructed in accordance with Section 403.064, Florida Statutes, shall be considered 100% used and useful. Margin Reserve shall therefore not be a factor.

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