

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

July 2, 1996

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

FROM: DIVISION OF APPEALS (MOORE) *CM DS*  
DIVISION OF WATER & WASTEWATER (HILL, WILLIAMS, SHAFER, *gmu*  
CROUCH, STARLING, WALKER) *NW*  
DIVISION OF AUDITING & FINANCIAL ANALYSIS (CAUSSEAU) *ARC JA*  
DIVISION OF RESEARCH & REGULATORY REVIEW (HARLOW, HEWITT) *9071 SA PD*

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

AGENDA: 7/16/96 - REGULAR AGENDA - INTERESTED PERSONS MAY  
PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: I:\PSC\APP\WP\960258WS.RCM

CASE BACKGROUND

In 1993, as part of an extensive review of rules governing water and wastewater utilities in Docket No. 911082-WS, the Commission proposed a rule to address used and useful determinations in rate case proceedings. The staff-recommended proposed rule included calculations to determine margin reserve and addressed imputation of CIAC. After further consideration, however, the Commission withdrew the proposed used and useful rules to permit further analysis.

Accordingly, staff conducted additional studies concerning appropriate used and useful calculations. This led to a comprehensive draft of a rule that established parameters to apply in calculating used and useful factors in rate proceedings. This rule was reviewed at a staff workshop in July, 1995. Staff's proposed draft provided for a three-year margin reserve, but it did not address imputation of CIAC, nor any particular treatment

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regarding reuse facilities. During the workshop, FWA and its member companies identified margin reserve and the corresponding imputation of CIAC as their major concerns. Representatives from the Florida Department of Environmental Protection supported a margin reserve period from five to ten years.

On March 1, 1996, the Florida Waterworks Association (FWA) petitioned the Commission to adopt rules concerning margin reserve for certain components of water and wastewater plant, the treatment afforded reuse facilities, and the imputation of CIAC. FWA's recommended rule set the margin reserve period for water source and treatment facilities and wastewater treatment and effluent disposal facilities at five years, unless other factors justify a different reserve period, and specified that CIAC shall not be imputed against the allowance for margin reserve. In addition, FWA recommended a 100 percent used and useful determination for reclaimed water reuse facilities.

At the April 16, 1996, agenda conference, Commissioners and staff discussed proposing a rule to codify current policy and conducting a hearing so that evidence and argument supporting a change in the current policy may be presented. By Order No. PSC-96-0586-FOF-WS, issued May 6, 1996, the Commission granted FWA's petition, but declined to propose the rule it advocated, noting that the rule did not codify the Commission's current policy.

#### DISCUSSION OF ISSUES

**ISSUE 1:** Should the Commission propose a rule that codifies its current policy on margin reserve and imputation of contributions-in-aid-of-construction on margin reserve calculations for water and wastewater utilities?

**RECOMMENDATION:** Yes.

**STAFF ANALYSIS:** The Commission's current policy regarding used and useful determinations is to include, unless otherwise justified, an 18-month margin reserve for water source and treatment facilities and wastewater treatment and disposal facilities to accommodate future growth. This margin is usually offset by imputing the projected CIAC during the margin reserve period. As the Commission's policy regarding margin reserve has not been codified, it is an issue in virtually every rate case.

Staff recommends that the Commission should propose a rule that codifies its current policy concerning allowance of a margin reserve and any corresponding imputation of CIAC. Although these

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rules do not enjoy universal support, their proposal will set the procedural stage for a hearing and further consideration.

The recommended rule includes a definition of "margin reserve"; provides that upon request and justification, margin reserve will be included in the used and useful determination in file and suspend ratemaking proceedings; that unless otherwise justified, the margin reserve period will be 18 months for water source and treatment facilities and wastewater treatment and effluent disposal facilities, and 12 months for water transmission and distribution lines and the wastewater collection system; and describes the mechanical aspects and data submission requirements. (Attachment 1) If margin reserve is authorized, a corresponding provision for the imputation of CIAC is prescribed; however, it is limited to the rate base component associated with margin reserve.

An Economic Impact Statement has been prepared and is attached. (Attachment 2)

**ISSUE 2:** Should the Commission set this matter for hearing?

**RECOMMENDATION:** Yes.

**STAFF ANALYSIS:** The FWA requested in its rulemaking petition that this matter be set for a hearing. The Commission denied the request as premature; however, since that time a rule codifying current policy has been drafted and an Economic Impact Statement has been completed. Once the Commission votes to propose a rule, a hearing may be conducted. In addition, staff believes a hearing is necessary for the Commission to hear evidence and argument supporting a change in its current policy. The dates December 10 and 11, 1996, have been reserved for a Commission rule hearing.

**ISSUE 3:** Should this docket remain open?

**RECOMMENDATION:** Yes.

**STAFF ANALYSIS:** If the Commission proposes a rule and sets the matter for hearing, the docket should remain open pending adoption of a rule.

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(c) The demand per ERC (D) represents customer demand applied in the used and useful calculations for water and wastewater facilities.

(8) Contributions-in-aid-of-construction (CIAC) shall be imputed when a margin reserve is authorized. This provision shall be determined using the number of ERCs included in the margin reserve period and the projected CIAC that will thereby ensue. However, the imputed CIAC shall not exceed the rate base component associated with margin reserve.

Specific Authority: 367.121, F.S.

Law Implemented: 367.081, F.S.

History: New

CODING: Words underlined are additions; words in ~~struck through~~ type are deletions from existing law.

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2 25-30.431 Margin Reserve

3 (1) "Margin reserve" is defined as the amount of plant  
4 capacity needed to meet the expected demand due to customer growth.

5 (2) "Margin reserve period" is defined as the time period  
6 needed to install the next economically feasible increment of plant  
7 capacity that will preclude a deterioration in the quality of  
8 service.

9 (3) Margin reserve is an acknowledged component of the used  
10 and useful rate base determination that shall be included in file  
11 and suspend rate cases when requested and justified.

12 (4) In determining the margin reserve period, the Commission  
13 shall consider the rate of growth in customers; the time needed to  
14 meet the guidelines of the Department of Environmental Protection  
15 (DEP) for planning, designing, and constructing of plant expansion;  
16 the technical and economic options available for sizing increments  
17 of plant expansion; and other factors that affect growth.

18 (5) Unless otherwise justified, the margin reserve period for  
19 water source and treatment facilities and wastewater treatment and  
20 effluent disposal facilities will be 18 months. Unless otherwise  
21 justified, the margin reserve period for water transmission and  
22 distribution lines and the wastewater collection system will be 12  
23 months.

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2       (6) The utility shall submit as part of its rate filing its  
3 most recent wastewater capacity analysis report, if any, filed with  
4 DEP.

5       (7) For purposes of this rule, margin reserve, expressed in  
6 units of demand; e.g., gallons per day (GPD), equals:

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

8       where:

9       EG = Equivalent Annual Growth in ERCs

10       MP = Margin Reserve Period

11       D = Demand per ERC

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13       (a) The equivalent annual growth in ERCs (EG) is measured in  
14 terms of the projected annual growth and shall be calculated in  
15 Schedules F-9 and F-10 of Form PSC/WAW 19 for Class A utilities and  
16 Form PSC/WAW 20 for Class B utilities, incorporated by reference in  
17 Rule 25-30.437. The Commission shall consider the growth in ERCs  
18 over the last 5 years, including the test year, and other factors  
19 that affect growth.

20       (b) As part of its filing, the utility shall provide a  
21 calculation of the EG based on a simple average of the annual ERCs  
22 for the last 5 years; a linear regression of annual ERCs for the  
23 last 5 years; and other factors that affect growth.

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M E M O R A N D U M

June 26, 1996

TO: DIVISION OF APPEALS (Moore)  
FROM: DIVISION OF RESEARCH AND REGULATORY REVIEW (Harlow)  
SUBJECT: ECONOMIC IMPACT STATEMENT FOR DOCKET NO. WS-960258; PROPOSED REVISIONS TO RULE 25-30.431, FAC, MARGIN RESERVE

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SUMMARY OF THE RULE

The proposed rule reflects the 1991 Commission standard operating procedure (SOP number 2406, effective 3/29/91) and recent Commission file and suspend rate case rulings regarding margin reserve and the imputation of contributions-in-aid-of-construction (CIAC). The proposed rule defines margin reserve for water and wastewater utilities as the amount of plant capacity needed to meet the expected demand resulting from customer growth. The rule specifies that, upon the utility's request and when justified, a provision for margin reserve shall be included in the used and useful determination in file and suspend rate case proceedings. The rule also indicates the data submission requirements for margin reserve, the specific calculation of margin reserve, and the additional information which will be considered by the Commission in margin reserve determinations. Unless otherwise justified, the rule sets the margin reserve period as follows: eighteen months for water source and treatment facilities, eighteen months for wastewater treatment and effluent disposal facilities, twelve months for water transmission and distribution facilities, and twelve months for wastewater transmission and collection facilities. If margin reserve is authorized, a corresponding provision for the imputation of CIAC is prescribed. However, CIAC imputation is limited to the rate base component associated with margin reserve.

DIRECT COSTS TO THE AGENCY AND OTHER STATE OR LOCAL GOVERNMENT ENTITIES

No direct costs to the Commission or other state or local government entities are expected to result from adoption of the proposed rule. However, the

adoption of a rule regarding margin reserve and CIAC imputation may reduce the Commission staff effort required to prepare for and attend hearings on these issues in file and suspend rate case proceedings.

COSTS AND BENEFITS TO THOSE PARTIES DIRECTLY AFFECTED BY THE RULE

In order to determine the costs and benefits to those parties directly affected by the proposed rule, both the 1991 Commission SOP on margin reserve and recent case history were reviewed. Little material impact is expected because the proposed rule reflects the Commission SOP and recent Commission file and suspend rate case rulings regarding margin reserve and imputation of CIAC.

A review of the file and suspend rate cases completed from 1993 through 1995 revealed that in a slight majority of the cases, the Commission determined that utility plant was 100 percent used and useful. Therefore, margin reserve was not a relevant issue in those cases. It appears that in the majority of the cases for which plant was less than 100 percent used and useful (and margin reserve was requested by the utility), the Commission has adhered to an eighteen-month guideline for measuring a margin reserve period for plant other than lines. While all of these decisions did not follow the margin reserve period guidelines, the rule allows for deviation from the proposed reserve period if justified by a Commission review of other pertinent information. All but one of the file and suspend rate cases in the past three years included imputation of CIAC if margin reserve was approved.

The proposed rule requires two additional data filings that are not currently in the SOP for those utilities requesting margin reserve; however, the cost impact on the utility is expected to be minimal. The rule requires utilities to submit their most recent wastewater capacity analysis report to the Commission. This should result in minimal costs for the utilities because the report is currently prepared for the Department of Environmental Protection. Utilities are also expected to provide a linear regression of annual equivalent residential connections (ERCs) for the last five years. Although this calculation is currently performed by Commission staff, it is relatively straight forward and can be performed with a hand calculator.

The adoption of a Commission rule regarding margin reserve is expected to benefit ratepayers, the utilities, and Commission staff by reducing file and suspend rate case expenses. Rule adoption should help reduce rate case expenses by limiting testimony on margin reserve to special circumstances.

#### REASONABLE ALTERNATIVE METHODS

One alternative to the adoption of the proposed rule is to retain the non-rule practice. However, staff believes that without the adoption of a rule, both Commission and utility staff time and effort will continue to be expended on re-hearing these issues during file and suspend rate case proceedings. Staff believes a rule should be adopted concerning margin reserve and the imputation of CIAC in order to reduce uncertainty regarding the Commission treatment of used and useful plant capacity. Both ratepayers and utilities would benefit from the reduced uncertainty and rate case expense reductions which should result from rule adoption. While numerous alternatives to the specifics of the proposed rule are possible, staff believes that the alternative guidelines which deviate from current Commission policy will be most efficiently presented at hearing.

#### IMPACT ON SMALL BUSINESSES

Little direct impact on small businesses is foreseen, as the adoption of the proposed rule would impose minimal additional expected costs on water and wastewater utilities in general, including those which qualify as a small business as defined in Section 288.703(1), Florida Statutes (1995). Water and wastewater companies may experience a reduction in rate case expenses if the rule is adopted. No material impact is expected for other small businesses, as the rule is not expected to significantly affect the price of water and wastewater services.

#### IMPACT ON COMPETITION

No material impact on competition is expected because the proposed rule essentially adopts current Commission policy and imposes minimal additional expected costs. In addition, utilities may experience some rate case expense reductions if the rule is adopted.

IMPACT ON EMPLOYMENT

Minimal impact on employment is expected to result from the proposed rule. However, rule adoption may lead to a reduction in both Commission and utility staff effort required to prepare for and attend file and suspend rate case proceedings.

METHODOLOGY

Several meetings were held with other Commission staff to discuss: (1) the current Commission policy on margin reserve and the imputation of CIAC, (2) the 1991 Commission SOP on margin reserve, (3) recent Commission rate case rulings regarding margin reserve, and (4) the proposed rule. Portions of transcripts of Commission workshops and hearings on used and useful and margin reserve were also reviewed. Finally, the 1991 Commission margin reserve SOP and the Commission file and suspend rate case decisions from the last three years were analyzed for consistency with the proposed rule.

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