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August 23, 1996

HAND DELIVERY

Division of Administrative Hearings
1230 Apalachee Parkway
Tallahassee, Florida 32399-1550

960258-WS

RE: Southern States Utilities v. Florida Public Service
Commission

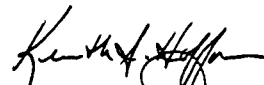
To Whom it May Concern:

Enclosed on behalf of Southern States Utilities, Inc. are an original and one copy of a Petition for Administrative Determination of Invalidity of Proposed Rule.

Please open a docket for consideration of this Petition.

Please acknowledge receipt of the foregoing by stamping the enclosed extra copy of this letter and returning same to my attention. Thank you for your assistance.

Sincerely,



Kenneth A. Hoffman

KAH/emj
Enclosure

cc: Blanca S. Bayo, Director
Division of Records & Reporting
Charles H. Hill, Director
Division of Water & Wastewater
Christiana Moore, Esquire
Division of Appeals
David E. Smith, Esquire, Director
Division of Appeals
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Florida Waterworks Association

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DOCUMENT NUMBER-DATE

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1996 RECORDS/REPORTING

960258-WS

STATE OF FLORIDA
DIVISION OF ADMINISTRATIVE HEARINGS

SOUTHERN STATES UTILITIES, INC.,

Petitioner,

DOAH CASE NO: _____

v.

FLORIDA PUBLIC SERVICE COMMISSION,

Respondent.

_____ /

PETITION FOR ADMINISTRATIVE
DETERMINATION OF INVALIDITY OF PROPOSED RULE

The Petitioner, Southern States Utilities, Inc. ("SSU"), by and through its undersigned counsel, and pursuant to Section 120.54(4), Florida Statutes, hereby seeks an administrative determination of the invalidity of proposed rule 25-30.431, Florida Administrative Code, as proposed by the Florida Public Service Commission ("PSC"). In support of this Petition, SSU states:

1. SSU is an investor-owned water and wastewater utility providing water service in 104 service areas and wastewater service in 48 service areas in the State of Florida. SSU's home office address is 1000 Color Place, Apopka, Florida 32703. For the purposes of this proceeding, the address and telephone number of Petitioner SSU should be considered that of its undersigned counsel.

2. The affected agency is the PSC at the address of 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850.

3. SSU's land, facilities and the rates and charges for 97 of its water and 44 of its wastewater service areas are subject

DOCUMENT NUMBER-DATE

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FLORIDA PUBLIC SERVICE COMMISSION

to and regulated by the PSC's statutes, rules and regulations, including the proposed rule. As such, SSU is substantially affected by proposed rule 25-30.431.

4. The proposed rule was noticed in the Florida Administrative Weekly on August 2, 1996, at Volume 22, Number 31, in PSC Docket No. 960258-WS. The text of the proposed rule is attached hereto as Exhibit A. Apart from isolated exceptions, the proposed rule would codify the PSC's non-rule policy on applicable rate-making treatment in rate case proceedings for setting a margin reserve and the imputation of contributions-in-aid-of-construction ("CIAC") on the margin reserve. The proposed rule further mandates the imputation of contributions-in-aid-of-construction (CIAC) when a margin reserve is authorized. A projection of future customers' payments of service availability charges during the margin reserve period is imputed or used as an offset to the margin reserve component of rate base. The rule limits the amount of imputed CIAC to the amount of the margin reserve.

BACKGROUND

5. Under Chapter 367 of the Florida Statutes, and the Florida and Federal Constitutions, a water and/or wastewater utility is entitled to recover in rates those expenses reasonably necessary to provide service to its customers, and to earn a fair rate of return on its "rate base," that is, the investment in plant used and useful in providing service. West Ohio Gas Co. v.

Public Utilities Commission, 234 U.S. 63, 55 S.Ct. 316, 79 L.Ed. 761 (1935); City of Miami v. Florida Public Service Commission, 208 So.2d 249 (Fla. 1968); Gulf Power Company v. Bevis, 289 So.2d 401 (Fla. 1974); § 367.081(2)(a), Fla. Stat. (1995).

6. The proposed rule purports to implement Section 367.081(2)(a), Florida Statutes, which inter alia, requires the PSC to fix water and wastewater rates which provide a "fair return on the investment of the utility in property used and useful in the public service." (emphasis added). The margin reserve is considered part of a water and/or wastewater utility's used and useful property for purposes of establishing rates.

7. A water and/or wastewater utility subject to the proposed rule is required by statute to provide safe, efficient and sufficient service, not less safe, less efficient, or less sufficient than is consistent with the approved engineering design of the system and the reasonable and proper operation of the utility in the public interest. § 367.111(2), Fla. Stat. (1995). This obligation to serve applies to both existing and future customers located within the utility's certificated service area. § 367.111(1), Fla. Stat. (1995).

8. To meet the statutory responsibility of "readiness to serve," a water and wastewater utility must have sufficient capacity to meet the existing and changing demands of existing customers and the demands of potential customers within a reasonable time and in an economic manner. The investment in that readiness to serve capacity is properly recognized in rate

setting as a margin reserve.

MARGIN RESERVE

9. The proposed rule defines the term margin reserve as "the amount of plant capacity needed to meet the expected demand due to customer growth" and declares that margin reserve is "an acknowledged component of the used and useful rate base determination." Margin reserve period is defined as the "time period needed to install the next economically feasible increment of plant capacity that will preclude a determination in the quality of service." Presumptively valid margin reserve periods are prescribed, "unless otherwise justified." In determining whether another margin reserve period is justified, the proposed rule provides that the PSC shall "consider" the rate of customer growth; the time needed to meet the guidelines of the Department of Environmental Protection ("DEP") for planning, design, and construction of plant expansion; and the technical and economic options available for sizing increments of plant expansion.

10. Investment in "margin reserve" is investment in plant used and useful in providing service. § 367.081(2)(a), Fla. Stat. (1995). The proposed rule would deprive affected public utilities of an opportunity to earn a fair rate of return on this investment for two reasons. First, the proposed rule provides for presumptively valid assumptions that significantly understate a reasonable margin reserve. If the margin reserve is understated, the amount of capacity recognized by the PSC will be

insufficient for the utility to meet its "readiness to serve" obligations in a timely, economic and environmentally safe manner. Second, as discussed later in this Petition, by imputing or offsetting CIAC that might be paid over the margin reserve period, against the margin reserve, the amount of investment in margin reserve on which a utility is allowed to earn a return is dramatically reduced or even eliminated.

11. A capacity reserve, to assure a utility's ability to provide reliable service and to meet statutory requirements, is a necessity long recognized by the PSC for water, wastewater and electric utilities. Under Chapter 366, electric utilities, like water and wastewater utilities, are authorized to recover "the actual legitimate costs of the property . . . actually used and useful in the public service" as well as a return on "the money honestly and prudently invested . . . in such property used and useful in serving the public. . . ." § 366.06(1), Fla. Stat. (1995) (emphasis added). Although the purpose of the reserve is similar for these types of utilities, they have different names and are measured in different ways. The investment in capacity reserve for water and wastewater utilities is called a "margin reserve" and has historically been expressed in terms of equivalent annual growth. The investment in capacity reserve for electric utilities is called a "reserve margin" and has historically been expressed as a percentage of annual peak load

demand.¹ Specifically, in its regulation of electric utilities, the PSC requires that a minimum 15% reserve margin be maintained.² However, the actual margins maintained by and allowed for electric utilities are often greater as a result of long-run economic choices, and often these margins include capacity capable of serving the equivalent of five to 20 years' annual growth. This reflects well established PSC policy in electric rate cases for including the cost of capacity and land in rate base even if those assets are not used in the near term, if they enhance reliability or contribute to long-term economies. With regard to electric utilities, the PSC views the reserve as a current requirement, sets a minimum and allows the reserve to be greater than the minimum if economically justified.

12. The PSC encourages economic choices for electric utilities by allowing them to recover the cost of service associated with these assets through the rates of existing customers, even though it is acknowledged that to some extent they will be used to serve future customers and possibly not for many years. Since electric utilities typically do not collect CIAC through service availability charges, as is common with water and wastewater utilities, imputation of CIAC against these assets is not an issue. Electric capacity costs are evaluated in terms of their prudence, without regard to the fact that these

¹ Either "reserve" can be expressed in terms of percentage of peak load demand or equivalent annual growth.

² See Fla. Admin. Code R. 25-6.035(1).

costs are recovered through current customers.

13. Although electric and water/wastewater "reserves" have similar purposes and are authorized pursuant to substantially similar language, the PSC has historically given them inconsistent ratemaking treatment and would continue to do so under the proposed rule. Unlike with electric utilities, the PSC views the reserve for water and wastewater utilities as capacity held only for future customers, sets an 18 month growth maximum, and prohibits a margin reserve above the 18 months even if economically justified.

14. The proposed rule codifies this policy by defining margin reserve as "the amount of plant needed to meet the expected demand due to customer growth." The proposed rule ignores the benefits of margin reserve to existing customers, that is, the availability of capacity which ensures that future customers will not overload existing facilities and impact on the quality and safety of service provided. A utility should have in place sufficient capacity to prevent deterioration in reliability and quality of service, until the next economic increment can be placed in service. Many factors affect the length of time between capacity increments. The utility must take into consideration, in addition to the time actually needed for construction, the DEP planning and permitting process; the permitting and approval processes of local governments and water management districts; design, bidding and bid evaluation; and testing, inspection, certification and startup. Concerns for

strict environmental protection at all levels of government has substantially increased the length of time between conception and completion of facility construction. Obtaining a consumptive use permit alone may well take four years. Meeting environmental and conservation concerns in a manner acceptable to permitting agencies often leads to several alternatives being designed and considered before being accepted, a process that can entail many months or even years. During the period from conception to completion, capacity must be available to provide service. And as this time increases, the capacity reserve requirement also increases. These factors are essentially ignored under existing PSC policy and the proposed rule. In practice, after "consideration" of such factors, the PSC routinely disregards them and establishes margin reserves at the presumptively valid levels set forth in the proposed rule. As a result, the amount of plant in which a utility should economically invest to serve the public is either not being built or, when it is built, its cost is not being allowed to be recovered through rates.

15. The definitions and measure of margin reserve for water and wastewater utilities to be included as used and useful under the proposed rule are inadequate to allow a utility to build plant in economic increments, unlike that which is allowed for electric utilities. The proposed rule discourages water and wastewater utilities from constructing plants which maximize economies of scale. Such economies of scale benefit both existing and future customers.

16. The proposed rule also discourages water and wastewater utilities from maintaining compliance with DEP rules concerning the planning, construction and permitting of wastewater market facilities. Rule 62-600.405(8), Florida Administrative Code, establishes a five year period for planning, construction and permitting of wastewater treatment facilities once a professional engineer submits a capacity analysis report to DEP confirming that the existing permitted capacity of a wastewater treatment facility will be equaled or exceeded within the next five years. The engineering, construction, permitting, consulting and legal expenses incurred by the utility over this five year period to install this next increment of wastewater plant cannot be recovered by a utility which is limited to an eighteen month margin reserve. The utility is in a constant "Catch 22." If it ignores the DEP rules, it is subject to fines. If it complies with DEP rules, it incurs costs that are not recoverable through rates under the proposed rule.

IMPUTATION OF CIAC

17. The effect of the proposed rule is to offset water and wastewater utilities' actual investment represented by margin reserve by imputing uncollected amounts of CIAC that might be collected in a period following a rate case test year equal in length to the margin reserve period. While the PSC has recognized that margin reserve is necessary for a utility to meet its statutory obligations and that it properly is a part of used

and useful plant, it nonetheless denies utilities the ability to earn on their investment in margin reserve by imputing uncollected CIAC as an offset to such investment. The net result of imputing CIAC is to dramatically reduce the amount of margin reserve on which a utility is allowed to earn a return. In some cases, the imputation of CIAC has entirely offset allowed margin reserve. This imputation policy serves to subvert the PSC's margin reserve policy and to confiscate the utilities' investment in plant used and useful in the public service.

18. The imputation policy has been justified by the PSC purportedly on the grounds of "fairness," that, without imputation, future customers may be subsidized by current customers. The policy rests on the assumption that the amount of capacity represented by the margin reserve exists solely to serve future customers, that those future customers are near term, and that those customers, with absolute certainty, will appear, and will appear in the time frame of the margin reserve period. This oversimplified connection between margin reserve and future customers ignores the legitimate purposes of a margin reserve. Margin reserve provides a cushion such that a utility can be prepared to meet the anticipated peak load conditions of its existing customers, with a reasonable degree of reliability, even when unanticipated outages occur. Margin reserve provides a cushion such that a utility can be prepared to meet changing load conditions of its existing customers, over and above the peak loads historically experienced, with a reasonable degree of

reliability. Margin reserve includes capacity over and above that required for existing loads that may exist merely because the economic sizing and timing of plant expansion dictate that result. As a fallout, margin reserve provides capacity adequate to meet ongoing projected growth. This is true for water and wastewater utilities as it is true for electric utilities.

19. The imputation policy assumes that there would be no margin if there were no growth. No such assumption regarding the relationship between reserve capacity and the ability to serve growth is made for electric utilities. Reserve capacity is necessary even without growth, for water and wastewater, and electric utilities. The imputation policy also assumes that CIAC is forthcoming from growth and, therefore, CIAC should be imputed. But if it is logical to assume that CIAC is forthcoming from growth and should be imputed, then it is just as logical to assume that revenues, expenses, additional investment requirements and any other factors associated with growth should also be imputed. But the PSC doesn't do this because, in fact, neither argument is logical. The basis for ratemaking is the test period with all revenues, expenses, investment and offsets to investment, including CIAC, matching. The imputation policy, based on an illogical mismatching of period investment with out-of-period contributions, denies a utility the ability to earn on its investment in margin reserve. The policy results in a subsidy to current customers by passing on to either the future customer or to the stockholder, the cost of maintaining a

reliable level of service. The imputation policy in fact thwarts margin reserve policy because by offsetting real investment in margin reserve by imputed CIAC, it sends a signal to keep margin reserve at a minimum in order to reduce the risk of an inadequate return, even if reliability is affected. This policy also ignores that during the margin reserve period, the utility is continuing to make further investments by planning and constructing facilities to serve additional new customers who will connect beyond the margin reserve period. By the time the first customer connects to the plant allowed in margin reserve and pays his service availability charges (CIAC), the utility must be able to provide service for yet another future customer.

20. The PSC provides for an Allowance for Funds Prudently Invested ("AFPI"). The AFPI charge is described as "a mechanism which allows a utility to earn a fair rate of return on prudently constructed plant held for future use from the future customers to be served by that plant in the form of a charge paid by those customers." Fla. Admin. Code R. 25-30.434(1). While costs associated with prudently invested "used" plant are recovered through rates to current customers, the costs associated with prudently invested "non-used" plant may be recovered through an AFPI charge from future customers. However, an AFPI charge, even where authorized, does not recover earnings lost on the portion of margin reserve offset by imputed CIAC. Margin reserve is a component of used and useful plant and no portion of its cost is recovered through an AFPI charge. There is no opportunity to

earn on the investment in margin reserve against which CIAC has been imputed, from either current or future customers. Those earnings are lost forever.

THE ECONOMIC IMPACT STATEMENT

21. SSU has standing to challenge the proposed rule on the basis of the defective Economic Impact Statement ("EIS") purporting to support the proposed rule. See § 120.54(2)(d), Fla. Stat. (1995); Florida East Coast Industries, Inc. v. State of Florida, Department of Community Affairs, 21 Fla.L.Weekly D1532 (Fla. 1st DCA July 2, 1996).

22. The defective EIS was attached to the PSC Staff's written recommendation for the PSC to adopt the proposed rule. A copy of that written recommendation and the EIS are attached hereto as Exhibit B.

23. The proposed rule must be invalidated because the PSC failed to adhere to the procedure for preparation of the EIS as provided in Section 120.54, Florida Statutes, and because the PSC has failed to consider information submitted to it which demonstrates that the EIS fails to present specific analysis concerning the costs, benefits, impacts and substantive alternatives to the proposed rule. Such failures substantially impair the fairness of the PSC's rulemaking proceeding currently scheduled for December 10-11, 1996 in Docket Number 960258-WS and the fairness of the instant proceeding.

24. The EIS fails to adequately analyze and provide the information required for each part of Section 120.54(2)(c),

Florida Statutes. The specific defects in the EIS include, but are not limited to, the following:

(a) The EIS purporting to support the proposed rule is fatally flawed as to each of the elements required by Section 120.54(2)(c), Florida Statutes, because the EIS evaluates merely the economic impacts of transforming a policy statement into a rule -- not the economic impacts of the proposed rule itself.

(b) The EIS fails to adequately address the estimated cost to state agencies and local government entities directly affected by the proposed rule and how such costs could be reduced by alternatives to the proposed rules which would serve to minimize rate case expense, regulatory and permitting fees and expenses, and consulting and legal fees incurred in connection therewith.

(c) The EIS fails to adequately address the estimated cost or economic benefits to all persons directly affected by the proposed rule. Although the EIS contends that rate case expense in water and wastewater utility rate cases will be reduced as a result of the proposed rule, such a contention is not realistic. The proposed rule authorizes a party to attempt to justify a margin reserve beyond the limited presumptively valid margin reserve periods in the proposed rule. The issues of margin reserve and imputation of CIAC will continue to be vigorously litigated in rate cases since the margin reserves and imputation of the CIAC policies set forth in the proposed rule are not acceptable to the utility industry for the reasons stated in this

petition. As in the past, water and wastewater utilities with adequate financial resources will contest the margin reserve and imputation of CIAC policies codified in the proposed rule.

(d) Similarly, the EIS fails to address the specific negative economic impacts of the proposed rule on affected utilities and customers such as: (1) the cost of depriving a utility of its ability to earn on investment in existing economically sized facilities; (2) the costs for utilities and customers of discouraging economic sizing for failure installations; and (3) the costs to utilities and customers of more frequent rate case filings which have been and will continue to be a product of the PSC margin reserve and imputation of CIAC policies codified in the proposed rule.

(e) Although the EIS openly acknowledges that "numerous alternatives to the specifics of the proposed rule are possible,"³ the EIS fails to provide any substantive determination of whether less costly methods or less intrusive methods exist for achieving the purpose of the proposed rule.

(f) Similarly, the EIS fails to provide any in-depth description, analysis or substantive discussion of alternative proposed rules addressing margin reserves and imputation of CIAC nor a statement of reasons for rejecting those alternatives in favor of the proposed rule.

(g) The EIS fails to include a detailed statement and analysis of the data and methodology used in making the estimates

³ Economic Impact Statement, pg. 9 of Exhibit B.

required by Section 120.54(2)(c), Florida Statutes.

DISPUTED ISSUES OF MATERIAL FACT

25. Disputed issues of material fact to be resolved in this proceeding include, but are not limited to:

(a) whether proposed Rule 25-30.431, F.A.C., constitutes an invalid delegation of delegated legislative authority;

(b) whether proposed Rule 25-30.431, F.A.C. is arbitrary and capricious;

(c) whether to satisfy its statutory responsibility of readiness to serve, a water and/or wastewater utility must have a margin reserve sufficient capacity to meet the existing and changing demands of existing customers and the demands of potential customers within a reasonable time and in an economic manner;

(d) whether the PSC must recognize the investment necessary to comply with a water and/or wastewater utility's statutory responsibility of readiness to serve, as a part of used and useful plant;

(e) whether application of the proposed rule would understate a reasonable margin reserve;

(f) whether the margin reserve set forth in the proposed rule impairs or eliminates a water and/or wastewater utility's ability to recover and earn a return on prudently incurred and/or environmentally mandated costs;

(g) whether the margin reserve set forth in the

proposed rule discourages employment of economies of scale in construction of water and wastewater treatment facilities, and, if so, the impact on existing and future customers;

(h) whether application of the proposed rule would likely cause affected utilities to size their facilities to reduce the risk of an inadequate return, disregarding economies of scale, with a net result, over the longer run, of a higher cost of service and, hence, higher rates, with reduced assurance of reliability and sufficiency of service;

(i) whether the imputation of CIAC as an offset to margin reserve would understate the investment in property used and useful in providing service and deny the utility an opportunity to earn a fair rate of return on such property;

(j) whether the proposed rule is unfairly and unduly discriminatory when compared to PSC policy for other PSC-regulated utilities;

(k) whether the PSC's Economic Impact Statement fails to comply with the requirements of Section 120.54(2)(c), Florida Statutes; and

(l) whether there are lower cost regulatory alternatives available for codification of a margin reserve policy by rule which would lower the costs of regulation for water and wastewater utilities and/or affected customers and agencies.

ULTIMATE FACTS ENTITLING SSU TO RELIEF

26. SSU alleges that each of the disputed issues of material fact described in paragraph 25 are to be found in the affirmative, and that those facts demonstrate that:

- (a) the proposed rule is an invalid exercise of delegated legislative authority;
- (b) the proposed rule is arbitrary and capricious;
- (c) the proposed rule enlarges, modifies or contravenes the provisions of law implemented;
- (d) the proposed rule fails to establish adequate standards for agency decisions or vests unbridled discretion in the PSC;
- (e) the EIS in the proposed rule fails to meet the requirements of Section 120.54(2)(c), Florida Statutes;
- (f) the proposed rule fails to consider lower cost regulatory alternatives available to accomplish the purposes of a margin reserve rule for ratemaking purposes;
- (g) the proposed rule effects an unconstitutional confiscation of a water or wastewater utility's property;
- (h) the proposed rule violates a water and/or wastewater utility's constitutional rights to due process and just compensation for taking of property to possess and protect property; and
- (i) the proposed rule violates the constitutional rights of affected utilities to equal protection of the law.

WHEREFORE, Petitioner Southern States Utilities, Inc.

requests that:

(a) the Director of the Division of Administrative Hearings determine that this Petition satisfies the requirements of Section 120.54, Florida Statutes, and assign a Hearing Officer to conduct a formal hearing in accordance with Section 120.57(1), Florida Statutes;

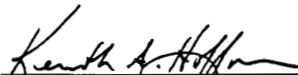
(b) petitions filed by any other similarly situated parties be consolidated with this Petition;

(c) the assigned Hearing Officer enter a Final Order determining that proposed rule 25-30.431 constitutes an invalid exercise of delegated legislative authority and is therefore void;

(d) the assigned hearing Officer enter a Final Order finding that proposed rule 25-30.431 violates the constitutional rights of affected utilities to due process, to just compensation for taking of property, to possess and protect property, and to equal protection of the law; and

(e) such other relief as may be deemed just and proper.

Respectfully submitted this 23rd day of August, 1996.



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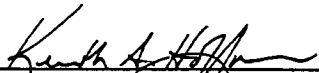
and

BRIAN P. ARMSTRONG, ESQ.
MATTHEW FEIL, ESQ.
Southern States Utilities, Inc.
1000 Color Place
Apopka, FL 32703
(407) 880-0058

ATTORNEYS FOR SOUTHERN STATES
UTILITIES, INC.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by hand delivery to Christiana Moore, Esq., Division of Appeals, Florida Public Service Commission, 2540 Shumard Oak Boulevard, Tallahassee, Florida 322399-0850; David E. Smith, Esq., Director, Division of Appeals, Florida Public Service Commission, 2540 Shumard Oak Boulevard, Tallahassee, Florida 322399-0850; and Wayne L. Schiefelbein, Esq., Gatlin, Woods & Carlson, 1709-D Mahan Drive, Tallahassee, Florida 32308 on this 23rd day of August, 1996.


KENNETH A. HOFFMAN

I:\USERS\ROXANNE\SSU.PET

TIME AND DATE: 9:30 a.m., December 10, 1996, continuing on December 11, 1996, if necessary
 PLACE: Room 148, Betty Easley Conference Center, 4075 Esplanade Way, Tallahassee, Florida
 PERSONS WHO INTEND TO PARTICIPATE IN THIS RULEMAKING PROCEEDING SHOULD FILE A NOTICE OF INTENT TO PARTICIPATE WITH THE FPSC, DIVISION OF RECORDS AND REPORTING, WITHIN 21 DAYS OF THE DATE OF THIS NOTICE. AN ORDER WILL BE ISSUED ESTABLISHING PREHEARING AND HEARING PROCEDURES TO BE FOLLOWED. WRITTEN COMMENTS AND TESTIMONY ON THE PROPOSED RULE MAY BE FILED NO LATER THAN OCTOBER 18, 1996. RESPONSIVE COMMENTS AND TESTIMONY MAY BE FILED NO LATER THAN NOVEMBER 15, 1996. THE PERSON TO BE CONTACTED REGARDING THE PROPOSED RULE AND ECONOMIC STATEMENT IS: Director of Appeals, Florida Public Service Commission, 2540 Shumard Oak Blvd., Tallahassee, Florida 32399

THE FULL TEXT OF THE PROPOSED RULE IS:

25-30.431 Margin Reserve.

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

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

(3) Margin reserve is an acknowledged component of the used and useful rate base determination that when requested and justified shall be included in rate cases filed pursuant to section 367.081, Florida Statutes.

(4) Unless otherwise justified, the margin reserve period for water source and treatment facilities and wastewater treatment and effluent disposal facilities will be 18 months. Unless otherwise justified, the margin reserve period for water transmission and distribution lines and the wastewater collection system will be 12 months. In determining whether another margin reserve period is justified, the Commission shall consider the rate of growth in the number of equivalent residential connections (ERCs); the time needed to meet the guidelines of the Department of Environmental Protection (DEP) for planning, designing, and constructing of plant expansion; and the technical and economic options available for sizing increments of plant expansion.

(5)(a) Margin reserve for water source and treatment facilities and wastewater treatment and effluent disposal facilities shall be calculated as follows:

$$EG \times MP \times D = MR$$

where:

PUBLIC SERVICE COMMISSION

DOCKET NO. 960258-WS

RULE TITLE:

Margin Reserve

RULE NO.:

25-30.431

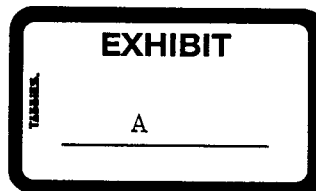
PURPOSE AND EFFECT: The purpose of this rule is to codify the current policy on margin reserve and imputation of contributions-in-aid-of-construction (CIAC) on margin reserve calculations for water and wastewater utilities.

SUMMARY: Rule 25-30.431 defines "margin reserve"; provides that upon request and justification, margin reserve will be included in the used and useful determination in certain rate cases; 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. 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.

SPECIFIC AUTHORITY: 367.121 FS.

LAW IMPLEMENTED: 367.081 FS.

A HEARING WILL BE HELD AT THE TIME, DATE AND PLACE SHOWN BELOW:



- EG = Equivalent Annual Growth in ERCs, determined pursuant to (c) or (d) below
- MP = Margin Reserve Period determined pursuant to subsection (4)
- D = Demand per ERC (customer demand applied in the used and useful calculations for water and wastewater facilities)
- MR = Margin reserve expressed in gallons per day (GPD)

(b) Margin reserve for water transmission and distribution lines and the wastewater collection system shall be calculated as follows:

$$EG \times MP = MR$$

where:

- EG = Equivalent Annual Growth in ERCs determined pursuant to (c) or (d) below
- MP = Margin Reserve Period determined pursuant to subsection (4)
- MR = Margin reserve expressed in ERCs

(c) The equivalent annual growth in ERCs (EG) is measured in terms of the projected annual growth and shall be calculated in Schedules F-9 and F-10 of Form PSC/WAW 19 for Class A utilities and Form PSC/WAW 20 for Class B utilities, incorporated by reference in Rule 25-30.437.

(d) The utility shall also submit a linear regression analysis using average ERCs for the last 5 years. The utility may submit other information that will affect growth in ERCs.

(6) As part of its application filed pursuant to Rule 25-30.437, the utility shall submit its most recent wastewater capacity analysis report, if any, filed with DEP.

(7) Contributions-in-aid-of-construction (CIAC) shall be imputed when a margin reserve is authorized. The amount of imputed CIAC shall be determined based on the number of ERCs included in the margin reserve period and the projected CIAC that will be collected from those ERCs. However, the imputed CIAC shall not exceed the rate base component associated with margin reserve.

Specific Authority 367.121 FS, Law Implemented 367.081 FS, History- New

NAME OF PERSON ORIGINATING PROPOSED RULE:
 Charles H. Hill
 NAME OF SUPERVISOR OR PERSON WHO APPROVED THE PROPOSED RULE: Florida Public Service Commission
 DATE PROPOSED RULE APPROVED: July 16, 1996

If any person decides to appeal any decision of the Commission with respect to any matter considered at the rulemaking hearing, if held, a record of the hearing is necessary. The appellant must ensure that a verbatim record, including testimony and evidence forming the basis of the appeal is made. The Commission usually makes a verbatim record of rulemaking hearings.

Any person requiring some accommodation at this hearing because of a physical impairment should call the Division of Records and Reporting at (904)413-6770 at least five calendar days prior to the hearing. If you are hearing or speech impaired, please contact the Florida Public Service Commission using the Florida Relay Service, which can be reached at: 1(800)955-8771 (TDD).

FLORIDA PUBLIC SERVICE COMMISSION
Capital Circle Office Center • 2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

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, *from*
 CROUCH, STARLING, WALKER) *NS*
 DIVISION OF AUDITING & FINANCIAL ANALYSIS (CAUSSEAU) *APC*
 DIVISION OF RESEARCH & REGULATORY REVIEW (HARLOW, HEWITT) *ST PA*

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

CRITICAL DATES: NONE

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

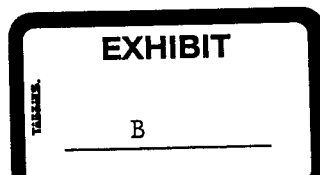
CASE BACKGROUND

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.

CTM/

1
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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~~struck through~~ type are deletions from existing law.

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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:

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

8 where:

9 EG = Equivalent Annual Growth in ERCs

10 MP = Margin Reserve Period

11 D = Demand per ERC

12
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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2 (c) The demand per ERC (D) represents customer demand applied
3 in the used and useful calculations for water and wastewater
4 facilities.

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

11 Specific Authority: 367.121, F.S.

12 Law Implemented: 367.081, F.S.

13 History: New

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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

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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