

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

MEMORANDUM

SEPTEMBER 4, 1996

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

FROM: DIVISION OF WATER & WASTEWATER (CASEY, RIEGER) *SR*
DIVISION OF LEGAL SERVICES (CAPELESS) *MSC JV*

RE: DOCKET NO. 960984-SU - INVESTIGATION OF POSSIBLE
OVEREARNINGS BY NORTH PENINSULA UTILITIES CORPORATION

COUNTY: VOLUSIA

AGENDA: 9/16/96 - REGULAR AGENDA - DECISION ON SETTING REVENUES
SUBJECT TO REFUND - ON ISSUE 1 INTERESTED PERSONS MAY
PARTICIPATE - ON ISSUES 2, 3 AND 4, PARTICIPATION IS
LIMITED TO COMMISSIONERS AND STAFF

CRITICAL DATES: NONE

LOCATION OF FILE: S:\PSC\WAW\WP\960984SU.RCM

CASE BACKGROUND

North Peninsula Utilities Corporation (North Peninsula or utility) is a Class C wastewater only utility providing wastewater service to approximately 475 customers in Volusia County. For the year ending December 31, 1995, the utility reported wastewater operating revenues of \$143,189 and a net operating income of \$22,459.

The utility's 1995 annual report indicated that North Peninsula's wastewater system was earning an overall rate of return of 17.26%. On July 26, 1996, staff received a 1996 index and pass-through application for North Peninsula. This index and pass-through rate adjustment which will be effective September 28, 1996, will increase customer rates by 1.74% or \$2,538. Based on the results of staff's review of the utility's 1995 annual report and the application for a 1996 price index and pass-through rate adjustment, staff is recommending that a formal investigation of potential overearnings should be initiated.

The last staff assisted rate case for this utility was completed in 1986 through Order No. 16184, issued June 4, 1986, in Docket No. 850121-SU, when the utility was known as Shore Utility.

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Corporation. A transfer docket was opened in 1989 to transfer Shore Utility Corporation to North Peninsula. The Commission approved the transfer by Order No. 22345, issued December 27, 1989, in Docket No. 891016-SU. Rate base was established during this transfer proceeding for book value of the property being transferred and did not include the normal ratemaking adjustments of working capital calculations and used and useful adjustments. According to the utility's 1995 annual report, customers have increased by 254 (114.93%), utility plant has increased by \$252,433 (43.86%), and annual revenue has increased by \$120,664 (535.69%) since the 1989 transfer docket.

North Peninsula has not applied for a staff assisted rate case since the transfer, but has received price index rate increases in 1991, 1992, 1993, 1994, and 1995. The utility has also received pass-through rate increases in 1993, 1994, and 1995.

Staff's preliminary analysis shows the utility will overearn by approximately \$12,311 or 8.45% on an annual basis. Issue No. 2 details how staff determined the amount of annual revenue which should be subject to refund. Issue No. 3 defines how much of the estimated overearnings should be held as security based on the estimated timeframe of six months to complete the investigation.

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DISCUSSION OF ISSUES

ISSUE 1: Should the Commission initiate an overearnings investigation of North Peninsula Utilities Corporation?

RECOMMENDATION: Yes. The Commission should initiate an investigation of the utility's wastewater rates to determine potential overearnings. (CASEY)

STAFF ANALYSIS: Based on a desk audit of the 1995 annual report for North Peninsula and the utility's application for a 1996 price index and pass-through rate increase, staff is recommending a formal investigation of possible overearnings. The utility's 1995 annual report indicated that North Peninsula's wastewater system was earning an overall rate of return of 17.26%. Based on an analysis of the utility's 1995 annual report, its capital structure would be 100% debt at a cost of 1 1/2% over prime or 9.75% (calculated August 28, 1996). Based on this and the utility's application for a 1996 price index and pass-through rate increase, staff recommends that an investigation of the potential overearnings of the utility should be initiated.

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

RECOMMENDATION: Yes. North Peninsula should hold annual wastewater revenues of \$12,311 subject to refund. The following amounts are recommended: (CASEY)

| | <u>Revenues</u> | <u>Amount Subject To Refund</u> | <u>% Subject To Refund</u> |
|----------------------|-----------------|---------------------------------|----------------------------|
| 1995 Revenue | \$143,189 | \$ 9,773 | 6.83% |
| Index & Pass-Through | <u>\$ 2,538</u> | <u>\$ 2,538</u> | 100.00% |
| Total | \$145,727 | \$12,311 | 8.45% |

STAFF ANALYSIS: Staff believes that North Peninsula's wastewater system may be overearning. Our preliminary analysis reveals that the wastewater system is earning an overall rate of return of 17.26%. North Peninsula's rate of return has not been previously set by the Commission. Staff is using an estimated overall rate of return of 9.75% for the utility to estimate possible overearnings. The utility appears to be in a negative equity position with only \$295,000 of long term debt at 1 1/2% over prime in its capital structure. The prime rate as of August 28, 1996, is 8.25%. Therefore, staff estimates the utility's overall rate of return to be 9.75% for interim purposes.

North Peninsula's 1996 price index and pass-through rate increase will become effective September 28, 1996, and will produce an additional \$2,538 in revenue. Staff is recommending holding 6.83% of 1995 annual revenues and 100% of the price index and pass-through revenue subject to refund. Once the staff audit is complete, we will be able to determine if the utility is, in fact, overearning. The calculation of refund liability would be determined as follows:

| | |
|---|------------------|
| Overall Achieved Return | 17.26% |
| Overall Required Return | <u>9.75%</u> |
| Reduction Required | 7.51% |
| Multiply by Rate Base | <u>\$130,135</u> |
| Estimated annual revenues subject to refund | \$ 9,773 |
| Estimated annual revenues subject to refund | \$ 9,773 |
| 1996 price index & pass-through revenue | <u>\$ 2,538</u> |
| Total revenues subject to refund | \$ 12,311 |
| Projected annual revenues | \$145,727 |
| Operating revenue % subject to refund | 8.45% |

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

RECOMMENDATION: The security should be in the form of a bond or letter of credit in the amount of \$6,381. Alternatively, the utility could establish an escrow agreement with an independent financial institution. If security is provided through an escrow agreement, the utility should escrow 8.45% of its monthly revenues as detailed in Issue No. 2 (CASEY)

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 wastewater system is \$12,311 on an annual basis. Assuming a six-month time frame for staff to complete the investigation, the potential refund amount is \$6,156. Interest, calculated in accordance with Rule 25-30.360, Florida Administrative Code, is \$225, making the total \$6,381, which should be collected under guarantee, subject to refund with interest.

The security should be in the form of a bond or letter of credit in the amount of \$6,381. Alternatively, the utility could establish an escrow agreement with an independent financial institution.

If the utility chooses a bond as security, the bond should contain wording to the effect that it will be terminated only under the following conditions:

- 1) The Commission approves the rate increase; or
- 2) If the Commission denies the increase, the utility shall refund the amount collected that is attributable to the increase.

If the utility chooses a letter of credit as security, it should contain the following conditions:

- 1) The letter of credit is irrevocable for the period it is in effect.
- 2) The letter of credit will be in effect until the final Commission order is rendered, and the amount of refund, if any, is determined.

If security is provided through an escrow agreement, the utility should escrow 8.45% of its monthly revenues as detailed in

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Issue No. 2, and the following conditions should be part of the escrow agreement:

- 1) No funds in the escrow account may be withdrawn by the utility without the express approval of the Commission.
- 2) The escrow account shall be an interest bearing account.
- 3) If a refund to the customers is required, all interest earned by the escrow account shall be distributed to the customers.
- 4) If a refund to the customers is not required, the interest earned by the escrow account shall revert to the utility.
- 5) All information on the escrow account shall be available from the holder of the escrow account to a Commission representative at all times.
- 6) The amount of revenue subject to refund shall be deposited in the escrow account within seven days of receipt.
- 7) This escrow account is established by the direction of the Florida Public Service Commission for the purpose(s) set forth in its order requiring such account. Pursuant to Cosentino v. Elson, 263 So. 2d 253 (Fla. 3d DCA 1972), escrow accounts are not subject to garnishments.
- 8) The Director of Records and Reporting must be a signatory to the escrow agreement.

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

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ISSUE 4: Should this docket be closed?

RECOMMENDATION: No, this docket should remain open pending determination of whether the utility is overearning. (CAPELESS, CASEY)

STAFF ANALYSIS: Staff believes North Peninsula may be overearning. A formal investigation has been recommended. A staff audit and engineering analysis will be performed and staff will return to Agenda with a recommendation regarding possible overearnings of North Peninsula.