

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

December 5, 1996

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

FROM: DIVISION OF WATER & WASTEWATER (TOMLINSON, BRADY) *BSM*
DIVISION OF LEGAL SERVICES (AGARWAL) *RA*

RE: DOCKET NO. 960040-WS - WATER OAK UTILITIES CO., INC. -
APPLICATION FOR TRANSFER OF CERTIFICATE NO. 454-W AND
388-S IN LAKE COUNTY FROM WATER OAK UTILITIES CO., INC.
TO SUN COMMUNITIES FINANCE LIMITED PARTNERSHIP.
COUNTY: LAKE

AGENDA: DECEMBER 17, 1996 - REGULAR AGENDA - PROPOSED AGENCY
ACTION ON ISSUE NOS. 2 AND 3 - INTERESTED PERSONS MAY
PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\WAW\WP\960040WS.RCM

DOCUMENT NUMBER-DATE

13007 DEC-5 96

FPSC-RECORDS/REPORTING

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CASE BACKGROUND

Water Oak Utilities Co., Inc. (Water Oak or utility) provides water and wastewater service in Lake County and serves approximately 664 water and wastewater customers. The utility's 1995 annual report shows that the consolidated operating revenue for the system was \$153,104 and the consolidated net operating income of \$4,092. The utility is a Class C utility company under Commission jurisdiction. On January 9, 1996, Water Oak applied for a transfer of the water and wastewater system (Water Certificate No. 454-W and Wastewater Certificate No. 388-S in Lake County) to Sun Communities Finance Limited Partnership (Sun Communities).

Section 367.031, Florida Statutes, requires each utility subject to the Commission's jurisdiction to obtain a certificate of authorization or request an exemption. Section 367.071, Florida Statutes, states that no utility shall sell, assign, or transfer its certificate of authorization, facilities or any portion thereof, or majority organizational control without approval of the Commission. Staff has reviewed the Purchase and Sale Agreement (Agreement) and has found that although the parties have come to an agreement on the sale, the official closing is contingent upon the approval of the Commission.

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DISCUSSION OF ISSUES

ISSUE 1: Should the transfer of Water Certificate No. 454-W and Wastewater Certificate No. 388-S from Water Oak Utilities Co., Inc. to Sun Communities Finance Limited Partnership be approved.

RECOMMENDATION: Yes, the transfer of Water Certificate No. 454-W and Wastewater Certificate No. 388-S should be approved.
(TOMLINSON, BRADY)

STAFF ANALYSIS: As stated in the case background, Sun Communities applied for a transfer of the Water Oak water and wastewater system (Water Certificate No. 454-W and Wastewater Certificate No. 388-S in Lake County) to Sun Communities Finance Limited Partnership on January 9, 1996. The application is in compliance with the governing statute, Section 367.071, Florida Statutes, and other pertinent statutes and administrative rules concerning an application for transfer. The application contains \$3,000, which is the correct filing fee pursuant to Rule 25-30.020, Florida Administrative Code. The applicant has provided evidence that the utility owns the land upon which the utility's facilities are located as required by Rule 25-30.037(2)(q), Florida Administrative Code.

In addition, the applicant contains proof of compliance with the noticing provisions set forth in Rule 25-30.030, Florida Administrative Code. On March 14, 1996, one letter which appeared to be an objection was received from a customer who was concerned about the future impact of the transfer on the residents of Water Oak Estates. After discussions with the Office of Public Counsel, the customer decided that he did not wish to pursue this as an intervenor in this docket, but would rather have his name added to the "interested persons" list. On April 22, 1996, staff notified the customer that his name had been added to the interested persons list. The time for filing objections has expired.

A description of the territory served by the utility is appended to this memorandum as Attachment A.

With regard to the purchaser's technical ability, Sun Communities will be retaining the services of Midstate Utilities, Inc., who previously operated the utility for Water Oak. Staff has contacted the Department of Environmental Protection (DEP) and has learned that there are no outstanding notices of violation against this utility. Regarding the purchaser's financial ability, Sun Communities supplied a financial statement to staff. The statement indicates that approximately 93% of the company's net worth is invested in real estate, and that it has approximately \$17 million

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in liquid assets. While staff does have some concerns about the liquidity of the assets, we believe the owner possesses the overall financial ability to operate the water and wastewater facility. As stated previously, the annual report for 1995 shows that the consolidated annual operating revenue for the system was \$153,104 and the consolidated net operating income was \$4,092. Since the system is small, staff believes that the assets of the new owner should be adequate to ensure the continued operations of the utility.

Sun Communities has provided a copy of the Agreement and a statement which includes the purchase price, terms of payment, and a list of the assets purchased and the liabilities assumed. Based on the application, there are no developer agreements which the buyer is obligated to assume or fulfill. In addition, there are no customer deposits, guaranteed revenue contracts, developer agreements, customer advances, or leases. Further, the utility currently has no outstanding debts. Sun Communities provided a statement that it will fulfill the commitments, obligations, and representations of the transferor.

Based on the above, staff believes it is in the public interest to grant the application of Sun Communities for transfer of Water Certificate No. 454-W and Wastewater Certificate No. 388-S. The territory description is in Attachment A.

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ATTACHMENT A

WATER OAK UTILITIES CO., INC.

WATER AND WASTEWATER SERVICE AREA

LAKE COUNTY

Water Oak Country Club Estates
Township 18 South, Range 24 East. part of Sections 8, 9, 16 and 17,
Lake County, Florida.

That part of Sections 8, 9, 16 and 17, Township 18 South, Range 24 East, Lake County, Florida, more particularly described as follows: From the Southwest corner of Section 9, Township 18 South, Range 24 East, run North 0°49'12" West along the West boundary of said Section 9, a distance of 1966.92 feet to the Point of Beginning of the following described parcel of land. From said Point of Beginning, run North 89°05'05" East 663.81 feet, thence North 0°48'03" West 658.14 feet, thence North 88°52'06" East 1992.09 feet, thence South 0°44'36" East 2662.63 feet, thence South 0°37'08" East 652.20 feet, thence South 88°50'55" West 693.57 feet, thence south 0°58'16" East 648.51 feet, thence South 89°10'10" West 210.50 feet, thence South 01°05'42" East 331.21 feet, thence South 89°14'10" West 420.39 feet, thence South 0°51'00" East 645.84 feet, thence South 88°12'58" West 688.37 feet, thence South 01°04'23" East 331.10 feet, thence South 0°19'46" East 617.74 feet, thence South 89°14'12" West 658.49 feet, thence South 0°11'48" East 104.66 feet, thence South 89°41'02" West 1169.33 feet, thence North 03°01'45" West 1404.74 feet to the point of curvature of a curve concave Southwesterly and having a radius of 2010.08 feet, thence Northwesterly along said curve through a central angle of 14°11'17" an arc length of 497.75 feet to the end of said curve, thence North 72°46'58" East 10.0 feet to a point on a curve concave Southwesterly and having a radius of 2020.08 feet, thence Northwesterly along said curve through a central angle of 26°16'46" an arc length of 926.54 feet to the end of said curve, thence North 02°03'58" West 16.21 feet, thence North 89°41'20" East 779.89 feet, thence North 0°57'45" West 663.88 feet, thence North 89°36'12" East 10.31 feet, thence North 0°44'46" West 1932.18 feet, thence North 89°45'28" East 978.53 feet, thence North 0°49'12" West 37.36 feet to the Point of Beginning and end of this description. Less: A parcel of land in Section 16 and 17, Township 18 South, Range 24 East, Lake County, Florida, described as follows: Commencing at the West 1/4 corner of Section 16, Township 18 South, Range 24 East, run South 0°15'20" East along the West line of said section 91.09 feet to the Point of Beginning, thence South 89°43'16" East 321.31

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feet, thence North 28°53'58" West 349.39 feet, thence South 87°48'04" West 299.33 feet, thence South 0°25'57" East 292.05 feet, thence South 89°43'16" East 144.46 feet to the Point of Beginning. LESS: road right of way over and across the North side thereof. SUBJECT TO an easement over and across the East 6.0 feet of the Northeast 1/4 of the Southwest 1/4 of Section 9, Township 18 South, Range 24 East.

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ISSUE 2: What is the rate base of Water Oak Utilities Co., Inc., at the time of transfer?

RECOMMENDATION: The rate base, which for transfer purposes reflects the net book value, is \$90,539 for the water system and \$134,156 for the wastewater system as of November 30, 1993. (TOMLINSON)

STAFF ANALYSIS: According to the application, the net book value of the system being transferred was \$111,268 for the water system and \$234,324 for the wastewater system pursuant to Order No. 18255, issued on October 6, 1987. In Water Oaks's last rate case, Docket No. 870122-WS, all parties reached a stipulated settlement, which was appended to Order No. 18255, issued October 6, 1987.

Staff conducted an audit of the utility's books and records to determine the rate base (net book value) at the time of transfer. The beginning balances were reconciled with Order No. 18255 and subsequent additions were traced to supporting documents. Depreciation and amortization balances were recalculated and contributions-in-aid-of-construction (CIAC) were traced to the utility's general ledger. Cash deposit records and tax returns were reviewed for unrecorded CIAC. CIAC was confirmed using the tariff rates and number of customers. Overall, the utility's books and records were maintained in substantial compliance with Commission directives.

Staff examined plant balances from January 1, 1986 through November 30, 1993. The utility was unable to provide supporting documentation for recorded plant additions of \$9,603 for its water system and \$7,502 for its wastewater system. Accordingly, the audit staff recommended removal of the unsupported additions, \$9,603 for water and \$7,502 for wastewater. Corresponding reductions of \$4,207 for water and \$2,383 for wastewater were necessary to eliminate accumulated depreciation relative to the unsupported plant balances.

In addition, the utility capitalized certain operating expenses to plant-in-service and reclassification of those misclassified charges is necessary. The misclassified charges include payments for legal, electrical, sludge hauling, and miscellaneous services. Since those charges were properly expensed, the recommended reductions to plant are \$1,096 for water and \$3,655 for wastewater. The corresponding reductions to accumulated depreciation balances are \$75 and \$624. The utility also capitalized certain non-recurring repair expenditures that are more properly classified as deferred maintenance charges. The recommended adjustments reduce plant in service by \$2,469 for water

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and \$3,177 for wastewater. The corresponding reductions to accumulated depreciation are \$343 and \$391. Further, the audit examination disclosed that an expenditure for pumping equipment on non-utility property was improperly charged to the utility system. Correction of this error results in a \$479 reduction to plant in service and a corresponding \$112 reduction to accumulated depreciation.

However, the audit examination disclosed that certain additions to plant-in-service were improperly expensed during the audit review period. The misclassified charges, which relate to major capital improvements for the water system, totaled \$8,702. Accordingly, the staff recommends increasing water plant by this \$8,702 amount. The corresponding adjustment to accumulated depreciation is \$1,033.

The audit examination also disclosed that the utility capitalized certain expenditures due to transferring ownership of the utility from the original owner, Mel Bishop Enterprises, Inc., to the present owners. However, the original organization expenditures were not removed, and since the system is now being sold to a new entity, those intermediate organization charges should be removed. Accordingly, staff recommends removal of the subject organization expenditures, or \$8,244 for the water division and \$7,494 for the wastewater division.

Finally, an adjustment is proposed to reflect accumulated amortization relative to the initial organization cost, a \$2,700 total expenditure equally shared by the water and wastewater divisions. The recommended adjustment increases accumulated depreciation by \$335 for \$410 for the respective water and wastewater divisions.

The net effect of the above adjustments reduces plant-in-service for water service by \$13,189 and \$21,748 for wastewater service. The corresponding reductions to accumulated depreciation are \$3,369 and \$2,988.

The audit examination also disclosed that the utility failed to book certain accounting entries that were required in a prior docket. Those adjustment entries were required to achieve a stipulated settlement of a dispute regarding service availability charges. Water Oak Utilities Company, Inc., was granted original rates and charges by Commission Order No. 16528, issued on August 27, 1986, in Docket No. 850517-WS. That order directed the utility to collect plant capacity charges of \$200 for water service and \$200 for wastewater service. These charges were designed to produce a net Contributions in Aid of Construction (CIAC) to net

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plant-in-service balance of about 75% for the water system and about 62% for the wastewater system. The connection charges were calculated based upon projected completion costs for 2,000 total customers. A further assumption was made that the developer of the mobile home park would construct all of the utility's assets. However, about two weeks before the original certificates were issued, Mr. Bishop sold the utility system to a new group of owners. On February 4, 1987, the new owners filed a request for cancellation of the \$200 plant capacity charges in view of a bargain purchase agreement between the new owners and Mr. Bishop.

The Commission considered the request to rescind the requirement for collection of CIAC in Docket No. 870122-WS. The utility initially argued that meters were installed to encourage conservation, not to achieve compensatory earnings. However, the Commission in proposed agency action Order No. 17651, issued June 3, 1987, rejected the utility argument since "(t)hrough a change in ownership, management or policy, the utility could bring a rate case before the Commission and ask for a full rate of return..." On July 22, 1987, the utility protested the Commission's decision and requested a formal hearing. On August 11, 1987, the utility filed a proposed offer of settlement that enlarged upon the reasons for removal of CIAC charges. The proposal essentially explained how an agreement between Mr. Bishop and the new owners would accomplish the same objective as collection of CIAC. More specifically, the utility proposed that a negative acquisition adjustment should be recorded to distinguish between the expected future cost to serve the fully developed community, an obligation partially assumed by the developer, and the utility's share of that cost. Relying upon engineering studies, the utility estimated that \$1,075,564 would be needed to serve 2,000 mobile homes, or a \$767,500 addition to the plant investment level at December 31, 1985. The utility's share of this added construction cost would be \$179,130, an amount that would be funded through \$55 incremental payments to the developer for each newly developed lot and each customer connection. After further review, the Commission agreed to waive collection of CIAC charges provided that a negative acquisition adjustment was recognized to offset the lost CIAC. Reflecting on the unusually favorable purchase agreement, the Commission in Order No. 18255, issued October 6, 1987, declared that subsequent rate base determinations would thereafter include this negative acquisition adjustment.

Unfortunately, an error in the proposed stipulation produced an incorrect provision for the negative acquisition adjustment. Instead of the \$588,370 properly stated difference between the projected construction cost (\$767,500) and the utility's contribution (\$179,130), Order No. 18255 incorrectly

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specified that a \$729,972 credit acquisition adjustment should be recorded. This error resulted from an incorrect comparison of gross plant and depreciated plant balances. Order No. 18255 further specified that a \$767,500 provision for the expected future additions to plant in service should be recorded. However, the real significance of the stipulation was the Commission's decision to require rate base inclusion of a negative acquisition adjustment, the projected \$588,030 difference between the developer's contribution and the utility's reimbursement provision.

The audit investigation disclosed that, between 1987 and 1989, the utility paid the developer \$60,015 pursuant to the purchase agreement. Presumably, a \$119,115 remaining obligation exists pursuant to the purchase agreement. If the utility can document that it actually paid this additional sum, rate base inclusion of an additional charge may be appropriate in a later proceeding. However, the most important element of the stipulation that was not recorded concerns the negative acquisition adjustment, or a sum designed to reflect the developer's contribution towards the construction cost. It is that component that ultimately persuaded the Commission to cancel the CIAC charges. That omission is corrected through a journal entry that adds \$588,370 (\$282,678 for water and \$305,692 for wastewater) to plant with a matching \$588,370 (\$282,678 for water and \$305,692 for wastewater) entry to a negative acquisition adjustment account. These offsetting accounts have no impact on the rate base determination.

Staff's calculation of rate base is shown on Schedule No. 1 for the water system and Schedule No. 2 for the wastewater system. Adjustments to rate base are itemized on Schedule Nos. 3 and 4. Based on the adjustments set forth herein, Staff recommends that rate base for Water Oak be established as \$90,539 for the water system and \$134,156 for the wastewater system as of November 30, 1993. This rate base calculation is used purely to establish the net book value of the property being transferred and does not include the normal ratemaking adjustments of working capital calculations and used and useful adjustments.

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SCHEDULE NO. 1

WATER OAK UTILITIES COMPANY, INC.

SCHEDULE OF WATER RATE BASE

As of November 30, 1993

<u>Description</u>	<u>Balance Per Utility</u>	<u>Staff Adjustments</u>	<u>Balance Per Staff</u>
Utility Plant in Service	\$190,190	\$269,489	\$459,679
Land	\$3,050	\$0	\$3,050
Contributions In-Aid-of Construction	\$0	\$0	\$0
Amortization of CIAC	\$0	\$0	\$0
Accumulated Depreciation	(\$92,881)	\$3,369	(\$89,512)
Acquisition Adjustment	<u>\$0</u>	<u>(\$282,678)</u>	<u>(\$282,678)</u>
Total	\$100,359	(\$9,820)	\$90,539

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SCHEDULE NO. 2

WATER OAK UTILITIES COMPANY, INC.

SCHEDULE OF WASTEWATER RATE BASE

As of November 30, 1993

<u>Description</u>	<u>Balance Per Utility</u>	<u>Staff Adjustments</u>	<u>Balance Per Staff</u>
Utility Plant in Service	\$322,981	\$283,864	\$606,845
Land	\$30,580	\$0	\$30,580
Contributions In-Aid-of Construction	\$0	\$0	\$0
Amortization of CIAC	\$0	\$0	\$0
Accumulated Depreciation	(\$200,565)	\$2,988	(\$197,577)
Acquisition Adjustment	\$0	<u>(\$305,692)</u>	<u>(\$305,692)</u>
Total	\$152,996	(\$18,840)	\$134,156

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SCHEDULE NO. 3

WATER OAK UTILITY COMPANY, INC.

SCHEDULE OF WATER RATE BASE ADJUSTMENTS

<u>EXPLANATION</u>	<u>ADJUSTMENT</u>
<u>Utility Plant in Service</u>	
1) Adjustment to remove unsupported additions	(\$9,603)
2) Adjustment to remove improperly capitalized operating expenses	(\$1,096)
3) Adjustment to exclude capitalized repair charges	(\$2,469)
4) Adjustment to remove pumping equipment on golf course	(\$479)
5) Remove capitalized organization charges	(\$8,224)
6) Adjustment to capitalize improperly expensed additions to plant	\$8,702
7) Adjustment to reflect expected additions by developer entity	<u>\$282,678</u>
Total Adjustments to Utility Plant	<u>\$269,489</u>
<u>Accumulated Depreciation</u>	
1) Adjustment to remove unsupported additions	\$4,207
2) Adjustment to remove improperly capitalized operating expenses	\$75
3) Adjustment to exclude capitalized repair charges	\$343
4) Adjustment to remove pumping equipment on golf course	\$112
5) Adjustment to capitalize improperly expensed additions to plant	(\$1,033)
6) Adjustment to reflect amortization of Organization costs	<u>(\$335)</u>
Total Adjustments to Acc. Depreciation	<u>\$3,369</u>
<u>Acquisition Adjustment</u>	
To show acquisition adjustment per stipulation in Order No. 18255	<u>(\$282,678)</u>

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SCHEDULE NO. 4

WATER OAK UTILITY COMPANY, INC.

SCHEDULE OF WASTEWATER RATE BASE ADJUSTMENTS

<u>EXPLANATION</u>	<u>ADJUSTMENT</u>
<u>Utility Plant in Service</u>	
1) Adjustment to remove unsupported additions	(\$7,502)
2) Adjustment to remove improperly capitalized operating expenses	(\$3,655)
3) Adjustment to exclude capitalized repair charges	(\$3,177)
4) Remove capitalized organization charges	(\$7,494)
5) Adjustment to reflect expected additions by developer entity	<u>\$305,692</u>
Total Adjustments to Utility Plant	<u>\$283,864</u>
<u>Accumulated Depreciation</u>	
1) Adjustment to remove unsupported additions	\$2,383
2) Adjustment to remove improperly capitalized operating expenses	\$624
3) Adjustment to exclude capitalized repair charges	\$391
4) Adjustment to reflect amortization of Organization costs	<u>(\$410)</u>
Total Adjustments to Acc. Depreciation	<u>\$2,988</u>
<u>Acquisition Adjustment</u>	
To show acquisition adjustment per stipulation in Order No. 18255	<u>(\$305,692)</u>

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ISSUE 3: Should a positive acquisition adjustment be approved?

RECOMMENDATION: No, a positive acquisition adjustment should not be included in the calculation of rate base for transfer purposes. (TOMLINSON)

STAFF ANALYSIS: An acquisition adjustment results when the purchase price differs from the rate base for transfer purposes. The acquisition adjustment resulting from the transfer of Water Oak would be calculated as follows:

Purchase Price:	\$750,000
Staff Calculated Rate Base:	<u>224,695</u>
Positive Acquisition Adjustment:	<u>\$525,305</u>

In the absence of extraordinary circumstances, it has been Commission practice that a subsequent purchase of a utility system at a premium or discount shall not affect the rate base calculation. The circumstances in this exchange do not appear to be extraordinary. An acquisition adjustment was not requested by the applicant. Therefore, Staff recommends that a positive acquisition adjustment should not be included in the calculation of rate base.

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ISSUE 4: Should Sun Communities adopt and use the rates and charges approved by this Commission for Water Oak?

RECOMMENDATION: Yes, Sun Communities should continue charging the rates and charges approved for this utility system. The tariff reflecting the change in ownership should be effective for services provided or connections made on or after the stamped approval date. (TOMLINSON)

STAFF ANALYSIS: The utility's current approved rates and charges were effective September 19, 1986 pursuant to Order No. 16528 issued in Docket No. 850517-WS. The Commission approved these rates when Water Oak received its original certificate. Since that time the rates have been indexed each year.

Rule 25-9.044(1), Florida Administrative Code, provides that:

In cases of change of ownership or control of a utility which places the operation under a different or new utility... the company which will thereafter operate the utility business must adopt and use the rates, classification and regulations of the former operating company (unless authorized to change by the Commission)...

Sun Communities has not requested a change in the rates and charges of the utility. Accordingly, Staff recommends that the utility continue operations under the existing tariff and apply the approved rates and charges. The utility has filed a tariff reflecting the transfer of ownership. Staff will approve the tariff filing effective for services provided or connections made on or after the stamped approval date.

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ISSUE 5: Should this docket be closed?

RECOMMENDATION: Yes, upon expiration of the protest periods, this docket should be closed if no timely protest is filed by a substantially affected person to the proposed agency action issues. (AGARWAL)

STAFF ANALYSIS: If there is no timely protest filed by a substantially affected person to the proposed agency action issues (Issues Nos. 2 and 3), no further action will be required and the docket should be closed.