

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

DECEMBER 26, 1996

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

FROM: DIVISION OF WATER & WASTEWATER (MONIZ, ^{SW}AUSTIN, ^{FAV}MERCHANT) ^{PNM}
DIVISION OF LEGAL SERVICES (JAEGER) ^{bl}

RE: DOCKET NO. - 961364-WS - LINDRICK UTILITY CORPORATION. -
INVESTIGATION OF WATER AND WASTEWATER RATES FOR POSSIBLE
OVEREARNINGS
COUNTY: PASCO

AGENDA: 1/7/97 - REGULAR AGENDA - DECISION ON INITIATING AN
INVESTIGATION AND SETTING REVENUES SUBJECT TO REFUND - ON
ISSUE 1 PARTIES MAY PARTICIPATE - ON ISSUES 2 AND 3
PARTICIPATION IS LIMITED TO COMMISSIONERS AND STAFF

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\WAW\WP\961364.RCM

DOCUMENT NUMBER-DATE
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FPSC-RECORDS/REPORTING

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CASE BACKGROUND

Lindrick Service Corporation (Lindrick or utility) is a Class B utility providing water and wastewater service for approximately 2,255 water and 2,221 wastewater customers in Pasco County. For the test year ended December 31, 1995, the utility reported water operating revenues of \$583,545 and a net operating loss of \$163,575. Wastewater operating revenues were \$605,249, with a net operating income of \$7,485.

Lindrick's last rate case was finalized on November 16, 1983, in Order No. 12691, Docket No. 830062-WS. In that order, rate base was established and the return on equity was set at 14.38% for both water and wastewater. In Docket No. 860089-SU, the Commission initiated an overearnings investigation and lowered rates for the wastewater system only. Pursuant to Order No. 16142, issued May 23, 1986, the return on equity was lowered to 12.65% for the wastewater system. The Commission approved index and pass-through increases in both March and December of 1995.

The purpose of this docket is to initiate an investigation to address the potential for overearnings of Lindrick Utilities and to hold revenues subject to refund.

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DISCUSSION OF ISSUES

ISSUE 1: Should the Commission initiate an overearnings investigation of Lindrick Service Corporation?

RECOMMENDATION: Yes. The Commission should initiate an investigation of the composition and level of wastewater rates to determine potential overearnings. Rate base and rate of return on equity should also be set for both water and wastewater. (MONIZ)

STAFF ANALYSIS: The utility's 1994 Annual Report was not filed until June of 1995. Upon its review of the annual report, staff discovered several deficiencies. Hence, the utility was sent a letter notifying it of these deficiencies. Staff received the utility's responses on September 29, 1995. At which time staff discovered that Lindrick was earning a 45.42% overall rate of return for its wastewater system. Based on this, staff began an informal investigation into potential overearnings. However, due to other statutory time constraints in other dockets, staff was unable to proceed with the investigation until the beginning of 1996. At this time, staff requested an audit of the utility's books for the test year ended December 31, 1995.

Based upon the staff auditor's suggested adjustments, it appears that the utility is underearning by \$34,584 for its water system and overearning by \$154,668 for its wastewater system. As a result of the audit findings, we are recommending that this docket be opened for an investigation of potential overearnings. Furthermore, staff believes that rate base and return on equity should be set for both water and wastewater, since several years have elapsed since this utility's last rate case.

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

RECOMMENDATION: Yes, Lindrick should hold annual wastewater revenues of \$119,130 subject to refund. No water revenues should be held subject to refund. The following amount is recommended: (MONIZ)

	<u>Total</u>	Amount Subject <u>To Refund</u>	% Subject <u>To Refund</u>
Wastewater	\$706,130	\$119,884	16.98%

STAFF ANALYSIS: Test year wastewater operating revenues as adjusted by staff auditors totaled \$706,130 for the year ended December 31, 1995. The annual revenue requirement calculated by staff, based on the auditor's adjusted rate base and net operating income totals \$570,402 for wastewater. Based on our preliminary analysis, the water system is operating at a loss, which is more than offset by the potential overearnings. After staff has completed its investigation, we will be able to determine if the utility is, in fact, overearning.

Staff has attached accounting schedules to illustrate the recommended water and wastewater rate base, capital structure, and test year operating income amounts. The rate base schedules are numbered 1-A and 1-B. The capital structure is schedule number 2. Schedules 3-A and 3-B are reserved for the operating statements.

For purposes of this interim recommendation, the schedules reflect average test year balances per the auditors, as well as specific audit adjustments. Since there was no filing on the part of the utility, the amounts per audit do not necessarily reflect the utility's position. These balances do not include any utility calculations for working capital, income taxes or the overall cost of capital.

RATE BASE

Section 367.082(5)(b)1, Florida Statutes requires that, in calculating the amount to be held subject to refund, adjustments be made consistent with those made in the utility's last rate proceeding. The staff auditor reviewed the utility's books to determine if all adjustments were made to reflect the Commission ordered adjustments per Order No. 16142, issued May 23, 1986. The audit report revealed that the utility had failed to book the correct amount of CIAC and also failed to use Commission approved guideline depreciation rates. Consequently, the auditor made

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adjustments to correct CIAC, accumulated amortization of CIAC, and accumulated depreciation. These adjustments are explained on the rate base adjustment schedule, 1-B.

Additionally, the auditor used the balance sheet method to calculate working capital, which is consistent with the treatment used in Lindrick's last wastewater rate proceeding. Based on the staff auditor's calculation, the utility's working capital is negative. The Commission has previously found that balance sheets of utilities that generate a negative working capital allowance are not typical of a "normal" utility or the expected future condition of the utility. In Seacoast Utilities, Inc., Docket No. 820073-WS, Order No. 13317, issued May 21, 1984, the Commission used a zero working capital allowance in lieu of the negative amount. For the purposes of establishing final rates for Lindrick, staff will investigate why a negative working capital exists. We believe it is appropriate on an interim basis to reflect a working capital allowance of zero.

Based on the staff auditor's adjustments, we recommend that rate base for interim purposes be established as \$106,985 for wastewater.

COST OF CAPITAL

Pursuant to Order No. 16142, Lindrick's return on equity for its wastewater system was set at 12.65%, with a range of 11.65% to 13.65%. Consistent with Section 367.082(2)(b), Florida Statutes, the appropriate rate of return on equity to determine the amount to be held subject to refund is calculated using the maximum of the range of the last authorized rate of return on equity. Using the high-end for the purpose of holding revenues subject to refund, staff has established an overall rate of return of 12.11% for interim purposes.

NET OPERATING INCOME

Due to numerous problems encountered with the utility's books and records, the staff auditors have proposed several adjustments to the utility's operating expenses. These adjustments correct errors, remove undocumented charges, remove non-utility charges, correct out of period charges, reclassify costs and disallow charges. Section 367.082(5)(b)1, Florida Statutes, requires that all adjustments be consistent with those made in the utility's last rate proceeding. In accordance with the above statute, we believe all of the auditor's suggested adjustments are applicable, except the \$21,685 adjustment to disallow the salary and benefits for the Secretary-Treasurer. Since this adjustment was not considered in the last rate proceeding, we do not believe it is appropriate to

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make an adjustment for the purpose of holding revenues subject to refund. Hence, wastewater operation and maintenance expenses should be increased by \$21,685. An explanation of all specific adjustments made are reflected on Schedule C-2.

In addition the auditor did not include an allowance for income taxes or regulatory assessments fees. Therefore, staff has included an allowance for both in its revenue requirement calculation.

Revenue Requirement

Staff's calculation indicates a wastewater revenue requirement of \$570,402 for the interim test year, representing a decrease of \$135,728 or 19.22%. However, the Commission granted Lindrick a 1994 index and pass-through increase on March 6, 1995. The utility received a 1995 index and pass-through on December 8, 1995. These two adjustments increased annual wastewater revenues by \$6,948, and \$8,896, respectively. Pursuant to Section 367.081(4)(d), Florida Statutes, the revenues associated with these increases are already subject to refund. Accordingly, staff recommends that \$119,884 (\$135,728 less \$15,844) in wastewater revenues be held subject to refund pending the final determination by the Commission.

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

RECOMMENDATION: The utility should be required to file a bond, letter of credit or escrow agreement to guarantee the amount subject to refund. The letter of credit or bond should be in the amount of \$61,575. In lieu of a letter of credit or bond, the utility may obtain an escrow agreement which requires the utility to deposit an amount monthly, as discussed below, until completion of the overearnings investigation. Pursuant to Rule 25-30.360(6), Florida Administrative Code, the utility shall provide a report by the 20th of each month indicating the monthly and total revenue collected subject to refund. (AUSTIN)

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. The amount of potential overearnings in the wastewater system is \$135,728 on an annual basis. As mentioned in Issue 2, \$15,844, of the potential overearnings, is a result of two index and pass-throughs. Pursuant to Section 367.081(4)(d), Florida Statutes, the index and pass-throughs are already subject to refund. Therefore, only \$119,884 in annual revenues should be collected under guarantee, subject to refund with interest. Assuming a 6-month time frame, the potential refund amount is \$61,575.

Based on the financial analysis by the Division of Auditing and Financial Analysis of the utility's financial statements, the utility cannot support a corporate undertaking for \$61,575 due to marginal interest coverage and minimal profitability. In addition, the combined net income from the profitable years is less than the amount under request, and the average net income over the last three years is negative. Therefore, staff recommends that the utility provide a letter of credit, bond or escrow agreement to guarantee the funds collected subject to refund.

If the security provided is an escrow account, said account should be established between the utility and an independent financial institution pursuant to a written escrow agreement. The Commission should be party to the written escrow agreement and a signatory to the escrow account. The written escrow agreement should state the following: That the account is established at the direction of this Commission for the purpose set forth above, that no withdrawals of funds should occur without the prior approval of the Commission through the Director of the Division of Records and Reporting, that the account should be interest bearing, that information concerning that escrow account should be available from the institution to the Commission or its representative at all

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times, and that pursuant to Cosentino v. Elson, 263 So. 2d 253 (Fla 3d. DCA 1972), escrow accounts are not subject to garnishments.

The utility should deposit the funds to be escrowed, \$10,263, into the escrow account each month. If a refund to the customers is required, all interest earned by the escrow account should be distributed to the customers. If a refund to the customers is not required, the interest earned by the escrow account should revert to the utility.

If the security provided is a bond or a letter of credit, said instrument should be in the amount of \$61,575. If the utility chooses a bond as security, the bond should state that it will be released or should terminate upon subsequent order of the Commission addressing overearnings or requiring a refund. If the utility chooses to provide a letter of credit as security, the letter of credit should state that it is irrevocable for the period it is in effect and that it will be in effect until a final Commission order is rendered addressing overearnings or requiring a refund.

Irrespective of the type of security provided, the utility should keep an accurate and detailed account of all monies it receives. Pursuant to Rule 25-30.360(6), Florida Administrative Code, the utility shall provide a report by the 20th of each month indicating the monthly and total revenue collected 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.

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

LINDRICK UTILITY CORPORATION
 SCHEDULE OF WASTEWATER RATE BASE
 TEST YEAR ENDED 12/31/96

SCHEDULE NO. 1-A
 DOCKET NO. 961364

COMPONENT	BALANCE PER UTILITY 12/31/96	AUDIT ADJUSTMENTS	BALANCE PER AUDIT 12/31/96	STAFF ADJUSTMENTS	BALANCE PER STAFF 12/31/96
1 UTILITY PLANT IN SERVICE	\$ 2,554,556	0	\$ 2,554,556	0	2,554,556
2 LAND & LAND RIGHTS	19,353	0	19,353	0	19,353
3 NON-USED & USEFUL COMPONENTS	0	0	0	0	0
4 CWIP	0	0	0	0	0
5 ACCUMULATED DEPRECIATION	(1,118,651)	(232,601)	(1,351,252)	0	(1,351,252)
6 CIAC	(2,074,790)	(108,656)	(2,183,446)	0	(2,183,446)
7 AMORTIZATION OF CIAC	796,962	279,888	1,076,850	0	1,076,850
8 DEBIT DEFERRED INCOME TAXES	(24,901)	0	(24,901)	0	(24,901)
9	15,825	0	15,825	0	15,825
10 ADVANCES FOR CONSTRUCTION	0	0	0	0	0
11 WORKING CAPITAL ALLOWANCE	0	0	0	0	0
12 OTHER	0	0	0	0	0
RATE BASE	\$ 188,354	(61,369)	\$ 106,985	0	106,985

LINDRICK UTILITY CORPORATION
ADJUSTMENTS TO RATE BASE
YEAR ENDED 12/31/95

SCHEDULE NO. 1-B
DOCKET NO. 961364

EXPLANATION	WASTEWATER
ACCUMULATED DEPRECIATION	
To reflect commission approved guideline depreciation rates (Audit Exception #3)	<u>(232,601)</u>
CIAC	
To correct balance (Audit Exception # 2)	<u>(108,656)</u>
ACCUM. AMORT. OF CIAC	
To correct balance (Audit Except #2)	<u>279,888</u>

LINDRICK UTILITY CORPORATION
 CAPITAL STRUCTURE
 TEST YEAR ENDED 12/31/95

SCHEDULE NO. 2
 DOCKET NO. 961364

DESCRIPTION	TOTAL CAPITAL	SPECIFIC ADJUSTMENTS (EXPLAIN)	PRO RATA ADJUSTMENTS	CAPITAL RECONCILED TO RATE BASE	RATIO	COST RATE	WEIGHTED COST
PER UTILITY 1995 - YEAR-END							
1 LONG TERM DEBT	0	0	0 \$	0	0.00%	0.00%	0.00%
2 SHORT-TERM DEBT	374,323	0	0	374,323	39.55%	9.75%	3.86%
3 PREFERRED STOCK	0	0	0	0	0.00%	0.00%	0.00%
4 COMMON EQUITY	572,070	0	0	572,070	60.45%	10.93%	6.61%
5 CUSTOMER DEPOSITS	0	0	0	0	0.00%	0.00%	0.00%
6 DEFERRED INCOME TAXES	0	0	0	0	0.00%	0.00%	0.00%
7 DEFERRED ITC'S-ZERO COST	0	0	0	0	0.00%	0.00%	0.00%
8 OTHER	0	0	0	0	0.00%	0.00%	0.00%
9 TOTAL CAPITAL	<u>946,393</u>	0	0 \$	<u>946,393</u>	<u>100.00%</u>		<u>10.46%</u>
PER COMMISSION 1995 - 13-MONTH AVERAGE							
10 LONG TERM DEBT	0	0	0 \$	0	0.00%	0.00%	0.00%
11 SHORT-TERM DEBT	374,323	0	(333,254)	41,069	39.55%	9.75%	3.86%
12 PREFERRED STOCK	0	0	0	0	0.00%	0.00%	0.00%
13 COMMON EQUITY	572,070	0	(509,305)	62,765	60.45%	13.65%	8.25%
14 CUSTOMER DEPOSITS	0	0	0	0	0.00%	6.00%	0.00%
15 DEFERRED INCOME TAXES	0	0	0	0	0.00%	0.00%	0.00%
15 DEFERRED ITC'S-ZERO COST	0	0	0	0	0.00%	0.00%	0.00%
16 OTHER	0	0	0	0	0.00%	0.00%	0.00%
17 TOTAL CAPITAL	<u>946,393</u>	0	<u>(842,559) \$</u>	<u>103,834</u>	<u>100.00%</u>		<u>12.11%</u>

RANGE OF REASONABLENESS	LOW	HIGH
RETURN ON EQUITY	11.65%	13.65%
OVERALL RATE OF RETURN	10.90%	12.11%

LINDRICK UTILITY CORPORATION
 STATEMENT OF WASTEWATER OPERATIONS
 TEST YEAR ENDED 12/31/95

SCHEDULE NO. 3-A
 DOCKET NO. 961364

DESCRIPTION	BALANCE PER UTILITY 12/31/95	AUDIT ADJUSTMENTS	BALANCE PER AUDIT 12/31/95	WAW STAFF ADJUSTMENTS	BALANCE PER STAFF 12/31/95	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	\$ 606,393		\$ 606,393		\$ 606,393		
OPERATING EXPENSES		\$ 99,737	\$ 706,130	0	706,130	(135,726)	570,402
2 OPERATION AND MAINTENANCE	\$ 526,652	(97,715)	\$ 428,937	21,685	450,622		450,622
3 DEPRECIATION	57,998	26,072	84,070	0	84,070		84,070
4 AMORTIZATION	(37,850)	(513)	(38,163)	0	(38,163)		(38,163)
5 TAXES OTHER THAN INCOME	56,819	0	56,819	4,488	61,307	(6,106)	55,199
6 INCOME TAXES	0	0	0	56,687	56,687	(50,967)	5,720
7 TOTAL OPERATING EXPENSES	\$ 603,819	(72,156)	\$ 531,663	82,860	614,523	(57,075)	557,448
8 OPERATING INCOME	\$ 2,574	171,893	\$ 174,467	(82,860)	91,607	(78,654)	12,953
9 RATE BASE	\$ 168,354		\$ 106,985		106,985		106,985
RATE OF RETURN	1.53%		163.08%		85.63%		12.11%

LINDRICK UTILITY CORPORATION
 ADJUSTMENTS TO OPERATING STATEMENTS
 TEST YEAR ENDED 12/31/96

SCHEDULE NO. 3-B
 DOCKET NO. 961364

EXPLANATION	WASTEWATER
AUDIT ADJUSTMENTS	
OPERATING REVENUES	\$ <u>99,737</u>
To annualize revenues (Audit Disclosure # 3)	
OPERATION & MAINTENANCE EXPENSE	(737)
1 To adjust unsupported expenses (Audit Disc # 6)	(19,656)
2 To remove salary for Sec/Tres (AD 9)	(8,660)
3 To remove non-utility related transportation expenses (AD 10)	(12,629)
4 To remove employee benefits for Sec/Tres & non-employee personnel (AD 11)	16,761
5 To reclassify purchased power and remove out of period charges (AD 12)	(12,173)
6 To remove duplicative & non-supported expenses (AD 13)	(33,076)
7 To remove capitalized, undocumented, & duplicative costs (AD 14)	(3,869)
8 To remove duplicative rental expenses (AD 15)	(19,414)
9 To adjust Contract Serv for duplicative, capitalized, and undocumented charges (AD 16)	(4,262)
10 To remove non-utility related insurance expenses (AD 17)	\$ <u>(97,715)</u>
Total	
DEPRECIATION EXPENSE-NET	\$ <u>26,072</u>
To reflect guideline rates (AE 3)	
AMORTIZATION OF ACQUISITION ADJUSTMENT	\$ <u>(513)</u>
To reflect correct amount (AD 1)	
WATER & WASTEWATER STAFF ADJUSTMENTS	
OPERATION & MAINTENANCE EXPENSE	19,656
1 To add back salary for Sec-Tres	<u>2,029</u>
2 To add back benefits for Sec-Tres	<u>21,685</u>
TAXES OTHER THAN INCOME TAXES	\$ <u>4,488</u>
Regulatory assessment fees on annualized revenues	
INCOME TAXES	\$ <u>56,687</u>
To adjust to test year income tax expense	
OPERATING REVENUES	\$ <u>(135,728)</u>
Adjustment to reflect revenue requirement	
TAXES OTHER THAN INCOME TAXES	\$ <u>(6,108)</u>
Regulatory assessment taxes on additional revenues	
INCOME TAXES	\$ <u>(50,967)</u>
Income taxes related to revenue requirement	