

TALBOTT: *WJ*
VANDIVER: *JV*

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

JANUARY 9, 1997

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

FROM: DIVISION OF LEGAL SERVICES (REYES) *BR*
DIVISION OF WATER AND WASTEWATER (ZHANG) *PH*

RE: DOCKET NO. 961471-WS - INITIATION OF SHOW CAUSE
PROCEEDINGS AND A LIMITED PROCEEDING FOR A POSSIBLE
WASTEWATER RATE REDUCTION FOR THE FOXWOOD/TURTLE LAKES
SYSTEM FOR MAD HATTER UTILITY, INC.

COUNTY: PASCO

AGENDA: JANUARY 21, 1997 - REGULAR AGENDA - INTERESTED PERSONS
MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: I:\PSC\WAW\WP\961471WS.CZ

CASE BACKGROUND

Mad Hatter Utility, Inc., (MHU or utility) is a Class B utility located in Lutz, Florida. The utility is located in the Northern Tampa Bay Water-Use Caution Area, as designated by the Southwest Florida Water Management District. MHU owns and operates water and wastewater systems in three separate communities: Linda Lakes, Foxwood, and Turtle Lakes. According to MHU's 1995 annual report, MHU serves 1,890 water customers and 1,804 wastewater customers.

MHU's last rate case was finalized on February 24, 1993, in Order No. PSC-93-0295-FOF-WS, Docket No. 910637-WS. In that Order,

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the Commission recognized the loss associated with MHU's abandonment of the Foxwood and Turtle Lakes wastewater plants, including land, and allowed recovery of the loss in rates over a period of eight years. The Commission further required the utility to report to the Commission any future sale of this abandoned land and any proposed rate reduction resulting therefrom.

Staff has received information that this land was sold and as of this date, the utility has failed to notify the Commission. This recommendation addresses the issues of MHU's violation of Order No. PSC-93-0295-FOF-WS with the initiation of a show cause proceeding and a proposed limited proceeding to address any possible wastewater rate reduction.

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DISCUSSION OF ISSUES

ISSUE 1: Should the Commission order Mad Hatter Utility, Inc. to show cause in writing within twenty days why it should not be fined \$5,000 for violation of Order No. PSC-93-0295-FOF-WS?

RECOMMENDATION: Yes, Mad Hatter Utility, Inc. should be ordered to show cause in writing within twenty days why it should not be fined \$5,000 for violation of Order No. PSC-93-0295-FOF-WS. The show cause order should contain the conditions set forth below. (REYES)

STAFF ANALYSIS: By Order No. PSC-93-0295-FOF-WS, issued February 24, 1993, in Docket No. 910637-WS, the Commission ordered MHU to report to the Commission any future sale of abandoned utility land and any proposed rate reduction resulting therefrom. On November 18, 1996, staff received information from an attorney representing Pasco County which indicates that the abandoned land referenced in Order No. PSC-93-0295-FOF-WS has been sold and a net gain on the sale was realized. To date, MHU has failed to report this sale to the Commission or any proposed rate reduction resulting therefrom. Section 367.161, Florida Statutes, authorizes the Commission to assess a penalty of not more than \$5,000 for each offense, if a utility is found to have knowingly refused to comply with, or to have knowingly violated any provision of Chapter 367, Florida Statutes, or any lawful rule or order of the Commission.

Staff believes MHU's violation of Order No. PSC-93-0295-FOF-WS rises in these circumstances to the level of warranting initiation of show cause proceedings. By Order No. PSC-93-0295-FOF-WS, the Commission recognized the loss associated with the abandonment of the Foxwood and Turtle Lakes plants, including the land, and allowed MHU to recover this loss through its wastewater rates over a period of eight years. That loss is still being recovered in current wastewater rates. The order also required MHU to report any future sale of this abandoned land and any proposed reduction in rates resulting therefrom. Order at p. 4.

According to the documentation provided to staff, sometime in 1994, Mr. Larry DeLucenay, president of the utility and one of the majority shareholders, through a series of financial transactions obtained a mortgage on the utility and then proceeded to foreclose on that mortgage in order to obtain clear title to the property. Mr. DeLucenay then sold the property to a developer at a sales price of \$195,000. A net gain of approximately \$132,734 was realized on the sale. The documentation further indicates that MHU's accountants evaluated this transaction in light of the Commission's order and advised the utility that the potential revenue decrease was not a material event that should be disclosed.

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However, even though MHU may have relied on its accountant's advise with regard to disclosure of the potential revenue decrease, MHU still had a duty to report the sale of the land to the Commission. To date, MHU has failed to report the sale or any proposed rate reduction resulting therefrom to the Commission in direct violation of Order No. PSC-93-0295-FOF-WS. The pertinent language of Order No. PSC-93-0295-FOF-WS is unmistakable, and MHU's failure to report the sale of abandoned land or any proposed rate reduction resulting therefrom in compliance with Order No. PSC-93-0295-FOF-WS is willful. For these reasons, staff recommends that the Commission order the utility to show cause in writing within twenty days why it should not be fined \$5,000 for violation of Order No. PSC-93-0295-FOF-WS.

The show cause order should incorporate the following conditions. MHU's response to the show cause order must contain specific allegations of fact and law. This opportunity to file a written response shall constitute MHU's opportunity to be heard prior to a final determination of noncompliance or assessment of penalty. A failure to file a timely written response to the show cause order shall constitute an admission of the facts herein alleged and a waiver of the right to a hearing. Should MHU file a timely written response that raises material questions of fact and request a hearing pursuant to Section 120.57(1), Florida Statutes, further proceedings may be scheduled before a final determination on this matter is made. If the utility fails to respond to the show cause order within 20 days of the issuance of the order, the fine of \$5,000 shall be imposed without further action of this Commission. If MHU fails to respond to reasonable collection efforts by this Commission, the fine shall be deemed uncollectible, and this matter shall be referred to the Comptroller's Office for further collection efforts based on this Commission's finding that, under the aforesaid circumstances, further collection efforts would not be cost effective. Reasonable collection efforts shall consist of two certified letters requesting payment. Any collection as a result of the action of the Office of the Comptroller shall be deposited in the State General Revenue Fund pursuant to Section 367.161, Florida Statutes. If, however, the utility responds to the show cause by remitting the \$5,000 fine, no further action is required.

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ISSUE 2: Should the Commission initiate a limited proceeding for possible rate reduction due to the sale of the utility land?

RECOMMENDATION: Yes. The sale of the land and the gain recognition should be scrutinized because they were complicated by a related party transaction between the utility and its majority shareholder. (ZHANG)

STAFF ANALYSIS: By Order No. PSC-93-0295-FOF-WS issued on February 24, 1993 in Docket No. 910637-WS., the Commission recognized the loss on abandonment of Foxwood/Turtle Lakes plants, including land, and allowed MHU to recover this loss through wastewater rates over a period of eight years. The loss on the abandonment of the land was established to be \$83,201, with an annual amortization of \$10,377. The Order clearly states: "the utility shall report to the Commission any future sales of abandoned land and shall also report any proposed rate reduction resulting therefrom." Order at p. 4. Although MHU has never submitted to this Commission any information regarding the sale of the land, it is still recovering through wastewater rates the loss on the abandonment of the land.

Based on the information received by staff, a series of steps occurred before the land was sold and a gain was realized. In 1993, the Foxwood Wastewater Plant was closed and the ponds began to dry up. In 1994, a developer in MHU's service area offered to purchase this percolation pond land for \$195,000 only if clear title could be given. However, the utility did not have clear title. In the process of refinancing MHU's troubled debt from Barnett Bank to CoBank, Mr. Larry DeLucenay, the majority shareholder and the president of MHU, signed a note payable to Barnett Bank for \$50,000. Barnett Bank then assigned its mortgage on this pond property to Mr. DeLucenay. Mr. DeLucenay demanded payment from MHU, his own company, and then, when he was not paid by MHU, he foreclosed on the property. Mr. DeLucenay then had clear title and was able to sell the property to the developer.

Although it appears that, when the sale occurred to the developer, MHU no longer held legal title and was not a party to that transaction, the land sale was consummated through a related party transaction between Mr. Larry DeLucenay and MHU, namely, Mr. DeLucenay's foreclosure of the property. Mr. DeLucenay is the president of MHU, and he and his wife, Mrs. Janice DeLucenay, together own 80.5% of MHU's voting stock. Because the foreclosure on the land was a related party transaction, any argument that a "sale" did not occur between MHU and Mr. DeLucenay is irrelevant.

Staff is concerned that this transaction may have been used as a means to circumvent the Commission's order and avoid passing the realized gain back to the customers of MHU. While there is

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documentation which suggests that the land may have had no book value because the encumbrances would have exceeded the total proceeds from the sale, this documentation is only an internal memorandum written by MHU's accountant opining that the potential revenue decrease was not a material event which should be disclosed. The veracity of this document and its underlying facts have not been verified by staff.

Based on the above discussion, staff believes that it is necessary to initiate a limited proceeding to determine whether or not the gain on the sale of the utility land should be attributable to the existing customers and rates should be reduced for the reasons herein.

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ISSUE 3: Should this docket be closed?

RECOMMENDATION: No, this docket should not be closed. (REYES, ZHANG)

STAFF ANALYSIS: If the Commission approves staff's recommendations in Issues 1 and 2, this docket should remain open until those issues are resolved.