



Public Service Commission
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COMMISSIONER &
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DATE: SEPTEMBER 6, 2001
TO: DIRECTOR, DIVISION OF THE COMMISSION CLERK &
ADMINISTRATIVE SERVICES (BAYÓ)
FROM: DIVISION OF REGULATORY OVERSIGHT (CLAPP, WALDEN) *AW*
DIVISION OF LEGAL SERVICES (CROSBY, GERVASI) *RS*
RE: DOCKET NO. 001826-WU - APPLICATION FOR TRANSFER BY
HEARTLAND UTILITIES, INC. (HOLDER OF CERTIFICATE NO. 420-W
IN HIGHLANDS COUNTY) OF DESOTO CITY AND SEBRING COUNTRY
ESTATES WATER SYSTEMS TO CITY OF SEBRING.
COUNTY: HIGHLANDS
AGENDA: 09/18/01 - REGULAR AGENDA - PROPOSED AGENCY ACTION FOR
ISSUE NO. 2 - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\RGO\WP\001826WU.RCM

CASE BACKGROUND

Heartland Utilities, Inc. (Heartland or utility) is a Class C utility serving approximately 740 residential water customers in Highlands County. Pursuant to Order No. 12846, issued January 5, 1984, in Docket No. 830332-W, Heartland was granted Water Certificate No. 420-W. The utility is within the Southwest Florida Water Management District (SWFWMD) in the Highlands Ridge Water Use Caution Area. Wastewater service is provided by septic tanks. The utility consists of three service areas, DeSoto City (DeSoto), Sebring Country Estates (Estates) and Sebring Lakes (Lakes). The utility's 2000 annual report shows total operating revenue of \$179,907 and a net operating income of \$14,208.

On December 27, 2000, the utility filed an application for transfer of the DeSoto and Estates water systems to the City of

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Sebring (City). The actual transfer includes all 364 customers of DeSoto and all 339 customers of Estates. This leaves the utility with only the Lakes service area, which includes approximately 37 customers and about 363 undeveloped lots. It is contemplated that the remaining service area will not meet the small systems exemption under Section 367.022(6), Florida Statutes, at build out.

The purpose of this recommendation is to address whether the transfer of two of Heartland's three systems to the City should be approved as a matter of right, to amend Certificate No. 420-W, and to determine whether the Commission should open an investigation on the gain on sale. The Commission has jurisdiction pursuant to Section 367.071, Florida Statutes.

DISCUSSION OF ISSUES

ISSUE 1: Should the transfer of a portion of Heartland's water systems to the City be approved as a matter of right and should Water Certificate No. 420-W be amended to reflect the deletion of territory?

RECOMMENDATION: Yes. The transfer of a portion of Heartland's water systems to the City should be approved as a matter of right pursuant to Section 367.071(4)(a), Florida Statutes, and Water Certificate No. 420-W should be amended to reflect the territory deletion effective January 3, 2001, which is the closing date of the sale. A description of the territory remaining after the partial transfer is appended to this issue as Attachment A. (CLAPP, WALDEN)

STAFF ANALYSIS: The utility has provided water service to the Estates and DeSoto water systems since 1964. The Highlands County Commission transferred jurisdiction of its water and wastewater utilities to the Florida Public Service Commission on September 7, 1982. The utility was issued Certificate No. 420-W pursuant to Order No. 12846, issued January 5, 1984, in Docket No. 830332-W. The utility's territory was amended to include the Lakes water system pursuant to Order No. PSC-98-0797-FOF-WU, issued on June 8, 1998, in Docket No. 980433-WU, after the Department of

Environmental Protection (DEP) requested service be extended because of contaminated wells. Issue 2 discusses this situation in more detail.

On December 27, 2000, this Commission received an application to transfer two systems, Estates and DeSoto, from Heartland to the City pursuant to Section 367.071, Florida Statutes, and Rule 25-30.037(4), Florida Administrative Code. Included with the application is a copy of the transfer agreement between the two parties. The application states a proposed closing date of January 3, 2001, and staff has confirmed that the actual closing took place on that day. Therefore, January 3, 2001, is the effective date of the sale.

Pursuant to Section 367.071(4)(a), Florida Statutes, the sale of facilities to a governmental authority shall be approved as a matter of right. As such, no notice of the transfer is required and no filing fees apply. The application had deficiencies which were corrected as of February 23, 2001. The application is in compliance with Section 367.071(4)(a), Florida Statutes, and Rule 25-30.037(4), Florida Administrative Code.

The application contains a statement that the City obtained Heartland's most recent income and expense statement, balance sheet, statement of rate base for regulatory purposes, and contributions-in-aid-of-construction pursuant to Rule 25-30.037(4)(e), Florida Administrative Code. A statement that the customer deposits and interest thereon will be paid to the City for the benefit of the customers as required by Rule 25-30.037(4)(g), Florida Administrative Code, was also included in the application. Additionally, pursuant to the requirements of Rule 25-30.037(4)(h), Florida Administrative Code, a statement was included that Heartland would pay outstanding regulatory assessment fees (RAFs) as part of its regular annual filing. The utility has filed all RAFs and annual reports through 2000. A description of the territory remaining after the partial transfer is appended to this issue as Attachment A.

Staff recommends that the application is in compliance with all provisions of Rule 25-30.037, Florida Administrative Code. Pursuant to Section 367.071(4)(a), Florida Statutes, the transfer of facilities to a governmental authority shall be approved as a matter of right. Therefore, staff recommends that the Commission approve, as a matter of right, the transfer of the DeSoto and

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Estates water systems to the City. Because Heartland is transferring only two of its three water systems, Certificate No. 420-W should be amended to reflect the territory deletion effective January 3, 2001.

HEARTLAND UTILITIES, INC

HIGHLANDS COUNTY

WATER SERVICE AREA FOR SEBRING LAKES

A PORTION OF SEBRING LAKES UNIT 1-A, 1-B, 2-A, 2-B, AND 2-C LOCATED IN HIGHLANDS COUNTY, FLORIDA, SECTIONS 3 AND 4, TOWNSHIP 36 SOUTH, RANGE 29 EAST, BEING MORE PARTICULARLY DESCRIBED AS FOLLOWS:

COMMENCE AT THE SOUTHEAST CORNER OF SECTION 3, TOWNSHIP 36 SOUTH, RANGE 29 EAST, THENCE NORTH $00^{\circ} 29' 23''$ EAST ALONG THE EAST LINE OF SECTION 3 A DISTANCE OF 1298.93 FEET TO A POINT ON THE WESTERLY RIGHT-OF-WAY LINE OF U.S. HIGHWAY 27, THENCE NORTH $31^{\circ} 32' 59''$ WEST ALONG THE WESTERLY RIGHT-OF-WAY LINE OF U.S. HIGHWAY 27 A DISTANCE OF 400 FEET MORE OR LESS TO A POINT ON THE NORTH LINE OF JOSEPHINE CREEK AND FOR A POINT OF BEGINNING:

THENCE CONTINUE NORTH $31^{\circ} 32' 59''$ WEST ALONG SAID WEST RIGHT-OF-WAY LINE U.S. HIGHWAY 27 A DISTANCE OF 1264.43 FEET TO A POINT ON THE NORTH LINE OF THE SOUTH 1/2 OF SECTION 3; THENCE SOUTH, $89^{\circ} 41' 36''$ WEST ALONG THE NORTH LINE OF THE SOUTH 1/2 OF SECTION 3 A DISTANCE OF 3155.71 FEET TO THE SOUTHEAST CORNER OF THE WEST 1/2 OF THE NORTHWEST 1/4 THENCE NORTH $0^{\circ} 53' 45''$ EAST ALONG THE EAST LINE OF THE WEST 1/2 OF THE NORTHWEST 1/4 A DISTANCE OF 669.33 FEET, TO THE NORTHEAST CORNER OF THE SOUTH 1/2 OF THE SOUTHWEST 1/4 OF THE NORTHWEST 1/4; THENCE SOUTH $89^{\circ} 46' 12''$ WEST ALONG THE NORTH LINE OF THE SOUTH 1/2 OF THE SOUTHWEST 1/4 OF THE NORTHWEST 1/4 A DISTANCE OF 1331.90 FEET TO A POINT ON THE WEST LINE OF SECTION 3; THENCE NORTH $1^{\circ} 01' 32''$ EAST ALONG THE WEST LINE OF SECTION 3 A DISTANCE OF 2013.48 FEET TO THE NORTHWEST CORNER OF SECTION 3; ALSO BEING THE NORTHEAST CORNER OF SECTION 4; THENCE SOUTH $89^{\circ} 55' 46''$ WEST ALONG THE NORTH LINE OF SECTION 4 FOR A DISTANCE OF 570 FEET TO A POINT ON THE EASTERLY LINE OF JOSEPHINE CREEK; THENCE RUN SOUTHWESTERLY ALONG THE EASTERLY LINE OF JOSEPHINE CREEK A DISTANCE OF 2,400 FEET, MORE OR LESS, THENCE SOUTHERLY ALONG THE EASTERLY LINE OF JOSEPHINE CREEK A DISTANCE OF 900 FEET; THENCE EASTERLY ALONG THE NORTHERLY LINE OF JOSEPHINE CREEK A DISTANCE 8,100 FEET, MORE OR LESS, TO THE POINT OF BEGINNING.

CONTAINING 250 ACRES MORE OR LESS.

ISSUE 2: Should the Commission open a docket to examine whether Heartland's sale of its facilities involves a gain that should be shared with Heartlands's remaining customers?

RECOMMENDATION: No. The Commission should not open a docket to examine whether Heartland's sale of its facilities involves a gain that should be shared with Heartland's remaining customers. (CLAPP, CROSBY)

STAFF ANALYSIS: The proposition that a gain on sale should be shared with customers has been considered in other dockets. In each case, the Commission evaluated whether or not ratepayers in the remaining utility service area were entitled to share the gain when another portion of the utility's operating facility was sold. See Order No. PSC-93-0301-FOF-WS, issued February 25, 1993, in Docket No. 911188-WS; Order No. PSC-93-0423-FOF-WS, issued March 22, 1993, in Docket No. 920199-WS; and Order No. PSC-96-1320-FOF-WS, issued October 30, 1996, in Docket No. 950495-WS.

The Commission last established rate base in a staff assisted rate case for Heartland's water systems by Order No. PSC-96-1389-FOF-WU, issued November 19, 1996 in Docket No. 960517-WU, for the test year ending December 31, 1995. At that time, the utility consisted only of the Estate and DeSoto systems. Uniform rates were established for the utility and rate base was set at \$139,226. The base facility charge for a 5/8"x3/4" meter was \$7.58 and the gallonage charge was \$1.74 per thousand gallons.

The utility began service to Lakes in 1998 pursuant to a request from the Florida Department of Environmental Protection (DEP), because 18 of the approximately 40 homes in the development had contaminated wells. Heartland submitted an application to the Commission to amend its service territory to add the Lakes. The utility received a \$250,000 grant from DEP to assist in providing service to Lakes, including \$11,700 for reimbursement of connection fees and \$238,300 towards the cost of constructing the new water treatment plant and lines. The utility estimated the total cost of construction of this stand alone system to be approximately \$320,500. The Lakes system is approximately four miles from the DeSoto system and approximately ten miles from the Estates system.

In conjunction with the amendment, Heartland also filed a special service agreement to allow Heartland to charge its existing

rates to the Lakes system. Stand-alone rates have never been calculated for the Lakes system.

The purpose of a gain on sale investigation would be to determine whether the remaining customers of Heartland (Lakes customers) subsidized the investment in the overall Heartland systems during the years that the three systems were combined for ratemaking purposes (June, 1998-January, 2001) such that they should share in the profits from the sale of these systems. If the Lakes customers had subsidized the DeSoto and Estates customers through payment of monthly rates, it would be appropriate to pursue an investigation on possible gain on sale.

According to the Option to Purchase Agreement, the DeSoto and Estates systems were sold to the City for \$1,175,000. The rate base for the two systems was established as of December 1995 at \$139,226. This would result in a potential gain on sale of \$1,035,774 to be shared with the 37 Lakes customers.

The Staff has used data from the utility's 2000 Annual Report to provide some level of quantitative analysis of Lakes' operating expenses versus utility revenues. A review of the water sold and existing connections for the three systems based upon the 2000 annual report reveals the following information.

	DESOTO	ESTATES	LAKES
a) Connections	364	339	37
b) Gallons Sold (000 omitted)	30,347	29,290	1,717
c) Base facility charge \$7.58 x connections x 12 months	\$33,109	\$30,835	\$3,366
d) Gallonage charge \$1.74/1000 x gallons sold	<u>\$52,804</u>	<u>\$50,965</u>	<u>\$2,988</u>
e) Estimated Annual Revenue (c+d)	\$85,913	\$81,800	\$6,354

Based upon the above, the Lakes system produces an annual gross revenue of about \$6,354, or about 3.6% of the gross revenue for all three systems of \$174,067. Based on the 2000 annual report, the net operating income for the three systems was \$14,208. Assuming the net operating income was proportionate to the gross revenues, the Lakes system would have been allocated approximately \$511 of the \$14,208 net income.

Staff recognizes that without an audit, there is no way to actually quantify rate base and the cost of service for Lakes's customers. However, baseline information appears to indicate that Lakes' customers may have been subsidized by DeSoto and Estates customers, rather than the other way around. Furthermore, the addition of the Lakes customers to the Heartland utility occurred at the request of DEP, rather than being initiated by the utility, in order to service a distressed area. In addition, the Lakes' system was added after Heartland's 1996 staff assisted rate case. Lastly, if a gain on sale were approved with respect to this sale, it could result in the utility's rate base being reduced to \$0 or even a negative amount which could be very troublesome given the size of this utility.

Should the Commission decide to initiate an investigation to examine whether Heartland's sale of the DeSoto and Estates facilities involves a gain that should be shared with Heartland's remaining Lakes customers, a separate docket should be opened.

Based on the above facts, Staff believes that it appears not to be prudent to initiate an investigation. Therefore, staff recommends that a docket not be opened to examine whether Heartland's sale of its facilities involves a gain that should be shared with Heartland's remaining Lakes customers.

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ISSUE 3: Should this docket be closed?

RECOMMENDATION: Yes, if no protest is received to the proposed agency action issue, the docket should be closed upon the issuance of a Consummating Order. (CROSBY)

STAFF ANALYSIS: If no protest is received to the proposed agency action issue, the docket should be closed upon the issuance of a Consummating Order.

