

State of Florida



Public Service Commission
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DATE: NOVEMBER 20, 2003

TO: DIRECTOR, DIVISION OF THE COMMISSION CLERK &
ADMINISTRATIVE SERVICES (BAYÓ)

FROM: DIVISION OF ECONOMIC REGULATION (MERTA) SM
OFFICE OF THE GENERAL COUNSEL (JAEGER) JAG

RE: DOCKET NO. 030423-WU - INVESTIGATION INTO 2002 EARNINGS OF
RESIDENTIAL WATER SYSTEMS, INC. IN MARION COUNTY.

AGENDA: 12/03/03 - REGULAR AGENDA - PARTICIPATION IS AT THE
DISCRETION OF THE COMMISSION

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\WP\030423.RCM

CASE BACKGROUND

Residential Water Systems, Inc. (RWS or utility), is a Class C water utility serving approximately 632 customers in Marion County in Sun Tree, High Point, Edgewood, Country Estates, Buffington Addition, Dalton Woods, and Wineberry subdivisions.

An analysis of the RWS 2002 Annual Report indicated that the utility may have exceeded its authorized rate of return and was overearning by \$21,838. Pursuant to Order No. PSC-03-0709-PCO-WU, issued June 13, 2003, in this docket, the Commission initiated an investigation of the rates and charges of RWS. In that Order, the Commission found that there was a potential overearnings on an annual basis of \$21,838, but that only \$19,365 had to be held subject to refund and protected by some sort of security. The difference in the amount held subject to refund and protected by a security arrangement is the 2002 price index increase. Pursuant to Section 367.081(4)(d), Florida Statutes, the revenues associated

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with a price index are already subject to refund and need not be protected by a security arrangement.

Staff analyzed historical data for 2002 and projected data for 2003 and 2004. Based on staff's analysis, it appears the utility may be overearning by approximately \$73,101 in 2003. The overearnings in 2004 are projected to be approximately \$79,227. As a result, the amount held subject to refund and the guarantee required to secure any potential refund should be increased.

At the request of the utility, a meeting was held October 27, 2003, to discuss the overearnings which was attended by the utility's attorney, Office of Public Counsel, and staff. The utility requested copies of the audit workpapers and other staff documents. By letter dated November 6, 2003, the utility requested additional time to analyze the information provided by staff. In an effort to work with the parties to reach a possible settlement, staff postponed filing its final recommendation on the overearnings. However, because of the extension of time requested by the utility, and to insure that the Commission captures the appropriate amount of possible overearnings, staff recommends that additional revenues be held subject to refund.

Staff's recommendation addresses the appropriate amount of the additional amount to be held subject to refund and the appropriate security for this additional amount. The Commission has jurisdiction pursuant to Sections 367.081 and 367.082, Florida Statutes.

DISCUSSION OF ISSUES

ISSUE 1: Should additional revenues be held subject to refund and additional security be required?

RECOMMENDATION: Yes, in addition to the \$19,365 already being held subject to refund, \$51,653 in additional annual revenues should be held subject to refund, and this amount should be protected by a bond, letter of credit, or escrow account. If the utility chooses to use its existing escrow account, it should deposit an additional 25.07% of revenues each month in the escrow account, for a total of 31.25% (6.18% already being deposited). If the utility chooses to use a bond or letter of credit, the amount of the bond or letter of credit should be \$36,919. Pursuant to Rule 25-30.360(6), Florida Administrative Code, the utility should be required to provide a report by the 20th of each month indicating the monthly and total revenue collected subject to refund. The utility should be put on notice that failure to comply with these requirements will result in the initiation of a show cause proceeding. (MERTA)

STAFF ANALYSIS: By Order No. PSC-03-0709-PCO-WU, the Commission calculated the potential refund of revenues for 2002 to be \$21,838. This amount was based upon the unaudited 2002 Annual Report of RWS. Per the Order, staff instituted an audit and investigation of 2002 earnings. Based on its analysis of audited data for 2002, and projections for 2003 and 2004, staff believes that RWS will overearn by approximately \$73,101 in 2003 and by \$79,227 in 2004.

As discussed in the Case Background, in its November 6, 2003 letter, the utility requested additional time to analyze staff work papers. The utility also requested a possible second meeting with staff. In an effort to work with the parties to reach a possible settlement, staff postponed filing its final recommendation on the overearnings. However, because of the extension of time requested by the utility, staff recommends that additional revenues be held subject to refund.

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 stated above, the amount of potential overearnings on an annual basis for 2003 is \$73,101. However, \$2,083 of the potential overearnings are the result of a 2003 price index. Pursuant to Section 367.081(4)(d), Florida Statutes, the revenues associated with the price index and

pass-through rate adjustments are already subject to refund, and are not required to be protected by a bond or corporate undertaking. In addition, \$19,365 is also subject to refund per Order No. PSC-03-0709-PCO-WU. Thus, \$51,653 (73,101 - 2,083 - 19,365) in additional annual revenues should be collected under guarantee, subject to refund with interest. Assuming an 8-month time frame, the potential refund amount is \$34,435. Pursuant to Order No. PSC-03-0709-PCO-WU, the Commission determined that 6.18% of revenues collected shall be deposited in an escrow account each month in order to secure \$19,365 of potential overearnings. Upon further consideration, staff believes that the percentage contained in the Order was incorrect. The percentage to correct the error and to guarantee the potential overearnings for 2003, is 25.07% of monthly revenues. As stated above, the utility is currently escrowing 6.18% of revenues collected for a possible refund. Therefore, if RWS chooses to use its existing escrow account for the additional revenues held subject to refund also, then it should be required to deposit 31.25% (6.18% + 25.07%) of revenues collected into its escrow account each month as security to secure for a possible refund.

Based on the above, staff has reviewed the financial data of the utility in order to determine whether RWS can support a corporate undertaking. The criteria for a corporate undertaking includes sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. Staff has reviewed the 2000, 2001, and 2002 annual reports of RWS to determine the financial condition of the utility. Staff's analysis shows that RWS has adequate liquidity and interest coverage. However, the utility has negative equity and its average annual net income over the three-year period is significantly less than the amount under request. Based upon this analysis, staff recommends that RWS cannot support a corporate undertaking. 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 a bond or a letter of credit, said instrument should be in the amount of \$36,919. If the utility chooses a bond as security, the bond should state that it will be released or should terminate only 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

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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 should provide a report by the 20th day 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.

The utility should be put on notice that failure to comply with these requirements will result in the initiation of a show cause proceeding.

ISSUE 2: Should this docket be closed?

RECOMMENDATION: No. The docket should remain open pending the Commission's final action on the investigation into 2002 earnings. (MERTA, JAEGER)

STAFF ANALYSIS: The docket should remain open pending the Commission's final action on the investigation into 2002 earnings.