

State of Florida



Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

RECEIVED-FPSC

JUL 22 AM 11:38

COMMISSION
CLERK

-M-E-M-O-R-A-N-D-U-M-

DATE: July 22, 2004

TO: Director, Division of the Commission Clerk & Administrative Services (Bayó)

FROM: Division of Economic Regulation (Fletcher, Merchant, Redemann, Daniel, Bruce, Lingo, Stallcup, Willis) Office of the General Counsel (Jaeger)

Handwritten initials and signatures: JBS, DM, PAR, AB, TSD, and others.

RE: Docket No. 030444-WS – Application for rate increase in Bay County by Bayside Utility Services, Inc.

AGENDA: 08/03/04 – Regular Agenda – Proposed Agency Action Except for Issues 21 and 22 – Interested Persons May Participate

CRITICAL DATES: 5-Month Effective Date (PAA Rate Case): Extended Through 08/03/04

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\030444.RCM.DOC

DOCUMENT NUMBER-DATE

07982 JUL 22 04

FPSC-COMMISSION CLERK

Table of Contents

<u>Issue</u>	<u>Description</u>	<u>Page No</u>
-	Case Background	4
1	Quality of Service (Redemann)	5
	<u>Rate Base</u>	
2	Pro Forma Plant Additions (Fletcher, Redemann).....	9
3	Uncontested Rate Base Adjustments (Fletcher)	11
4	Allocation Adjustments (Fletcher).....	13
5	Used and Useful Distribution and Collection Systems (Redemann)	15
6	Appropriate Working Capital (Fletcher).....	16
7	Appropriate Rate Base (Fletcher)	16
	<u>Cost of Capital</u>	
8	Weighted Cost of Capital (Fletcher).....	17
	<u>Net Operating Income</u>	
9	Salaries and Benefits (Fletcher)	18
10	Uncontested Expense Adjustments (Fletcher)	19
11	Unaccounted for Water (Redemann)	20
12	Material and Supplies Expenses (Fletcher, Redemann)	21
13	Bad Debt Expenses (Fletcher)	21
14	Rate Case Expense (Fletcher)	22
15	Test Year Operating Income (Fletcher)	24
	<u>Revenue Requirement</u>	
16	Appropriate Revenue Requirement (Fletcher).....	24
	<u>Rates and Rate Structure</u>	
17	Water and Wastewater Rate Structures (Bruce, Fletcher)	25
18	Repression Adjustments (Lingo)	27
19	Water and Wastewater Monthly Service Rates (Fletcher, Bruce, Lingo).....	28
20	Interim Refund (Fletcher)	29
21	Four-Year Rate Reduction (Fletcher)	30

<u>Issue</u>	<u>Description</u>	<u>Page No</u>
	<u>Other Issues</u>	
22	Proof of Adjustments Requirement (Fletcher)	31
23	Close Docket (Fletcher, Jaeger).....	31

<u>Sch No</u>	<u>Accounting and Rate Schedules</u>	<u>Page No</u>
1-A	Water Rate Base.....	32
1-B	Wastewater Rate Base.....	33
1-C	Adjustments to Rate Base	34
2-A	Capital Structure	35
2-B	Adjustments to Capital Structure	36
3-A	Water Operating Statement.....	37
3-B	Wastewater Operating Statement	38
3-C	Adjustments to Operating Statement	39
4-A	Water Rates	40
4-B	Wastewater Rates.....	41

Case Background

Bayside Utility Services, Inc. (Bayside or utility) is a class C water and wastewater utility currently serving approximately 283 residential customers and 4 general service customers. Bayside is a reseller utility purchasing water and wastewater service from the City of Panama City Beach and, as such, is considered non-jurisdictional by the Northwest Florida Water Management District. The utility provides service to the Bayside Mobile Home Park and has been providing wastewater service since 1973.

By Order No. PSC-98-1269-FOF-WS, issued September 24, 1998, in Docket No. 971401-WS, In re: Application for staff-assisted rate case in Bay County by Bayside Utilities, Inc., the Commission approved a rate increase based on a historical test year ended December 31, 1997. By Order No. PSC-99-1818-PAA-WS, issued September 20, 1999, in Docket No. 981403-WS, In re: Application for transfer of Certificates Nos. 469-W and 358-S in Bay County from Bayside Utilities, Inc. to Bayside Utility Services, Inc., the Commission approved the certificate transfer to Bayside Utility Services, Inc. Bayside is a wholly-owned subsidiary of Utilities, Inc. (UI)

On November 17, 2003, the utility filed for approval of final and interim rate increases, pursuant to Sections 367.081 and 367.082, Florida Statutes (F.S.). The information submitted did not satisfy the minimum filing requirements (MFRs) for a general rate increase. Subsequently, on February 17, 2004, the utility satisfied the MFRs and this date was designated as the official filing date, pursuant to Section 367.083, F.S. This utility has requested that the Commission process this case under the Proposed Agency Action (PAA) procedure.

The test year for interim and final purposes is the historical test year ended December 31, 2002. Bayside has requested interim water and wastewater revenues of \$120,894 and \$153,427, respectively. The interim revenue request represents an increase of \$55,000 (or 83.47%) for water and \$60,814 (or 65.66%) for wastewater. The utility has requested final water and wastewater revenues of \$147,563 and \$174,060, respectively. This represents an increase of \$81,669 (or 123.94%) for water and \$81,447 (or 87.94%) for wastewater.

By Order No. PSC-04-0414-PCO-WS, issued April 22, 2004, in this docket, the Commission approved an interim revenue increase of \$42,547 (or 64.57%) for water and \$51,145 (or 55.22%) for wastewater.

By letter dated May 27, 2004, the utility extended the five-month statutory deadline for the Commission to vote on the utility's requested final rates to August 3, 2004. This recommendation addresses the revenue requirement and rates that should be approved on a prospective basis. The Commission has jurisdiction pursuant to Sections 367.081 and 367.082, F.S.

Discussion of Issues

QUALITY OF SERVICE

Issue 1: Is the quality of service provided by Bayside Utility Services, Inc. considered satisfactory, and, if not, what action, including pro forma plant improvements, is needed to improve the quality of service?

Recommendation: No. The quality of service provided by Bayside Utility Services, Inc. should be considered marginal at this time. Staff believes that the utility is taking appropriate action to improve the quality of service. The utility has requested pro forma plant improvements to improve the quality of service, which is discussed in more detail in Issue 2. Further, due to the numerous problems with the original construction of the collection system, the utility should file a plan of improvement for the wastewater collection system within 120 days of the consummating order finalizing the initial PAA order for this docket. (Redemann)

Staff Analysis: Pursuant to Rule 25-30.433(1), Florida Administrative Code (F.A.C.), in every water and wastewater rate case, the Commission shall determine the overall quality of service provided by a utility by evaluating three separate components of water and wastewater operations. These components are: (1) the quality of the utility's product; (2) the operating conditions of the utility's plant and facilities; and (3) the utility's attempt to address customers' satisfaction. The rule further states that sanitary surveys, outstanding citations, violations, and consent orders on file with the Department of Environmental Protection (DEP) and the County Health Department over the preceding three-year period shall be considered, along with input from the DEP and health department officials and consideration of customer comments or complaints. Staff's analysis addresses each of these three components.

Quality of Utility's Product

The utility purchases water and wastewater service from the City of Panama City Beach (the City) and resells that service to its 287 connections in Bay County. Bayside has neither a water treatment plant nor a wastewater treatment plant. The City must comply with standards set by the Environmental Protection Agency (EPA) and enforced by the Florida Department of Environmental Protection (DEP). The DEP has no citations pending against the City for the water system, but a corrective order has been issued against the wastewater system. The City is required to stop discharging effluent into West Bay. According to the DEP, the City is making progress towards correcting the effluent disposal problem. Water service provided to Bayside meets or exceeds all quality standards for safe drinking water.

Since the water service provided by the City is meeting or exceeding the required standards, the quality of the utility's water product is considered satisfactory. While the municipality's effluent disposal does not meet the DEP criteria, Bayside can not be held accountable for the effluent disposal problem. Therefore, the quality of the utility's wastewater product is considered satisfactory.

Operational Conditions at the Plant

Since there is neither a water treatment plant nor a wastewater treatment plant, the issue of operational conditions at the plant is moot. However, after reviewing the amount of water purchased versus the amount of water sold, staff believes that the utility has an unacceptable amount of unaccounted-for water. Historically, an unaccounted for water percentage of 10% has been acceptable to the PSC. Bayside's unaccounted for water is 14.54%, which exceeds the 10% threshold by 4.54% for the test year. This is addressed in more detail in Issue 11 of the recommendation.

Utility's Attempt to Address Customer Satisfaction

Customer meetings were held during the afternoon and evening of April 15, 2004, at the Panama City Beach Senior Center in Panama City Beach. Attending the 4:00 p.m. meeting was the former owner/manager of the utility. Also, in attendance was the president of the homeowner's association, and one other homeowner. The former owner/manager of the utility discussed numerous issues and concerns with staff. Staff discussed the issues during the course of this meeting. The major issues related to:

1. Numerous back-ups of wastewater that spill and saturate the ground under and around mobile homes in the park.
2. Numerous water outages with the whole park being shut down for repairs.
3. Delayed reaction time to accomplish repairs due to the operator's base of operation being 40 miles away, and the time it takes to get him to the site and make the repair.
4. Difficulty in contacting anyone in the Altamonte Springs office for any reason.
5. The perception that maintenance was non-existent and comments that the emergency light on the middle lift station had been on for three days.

At the evening meeting, approximately 73 customers were present. The former owner/manager spoke first and advised those in attendance of the issues discussed with staff in the earlier meeting. After this presentation, 20 other customers came forward with comments and concerns. Three customers in attendance declined to address specific points, but stated they supported issues discussed during previous comments. The issues discussed were lack of maintenance, no preventative maintenance, sewage spills, slow reaction time to emergencies, frequent leaks, hired maintenance person not making repairs himself, and out-sourcing the work for repairs.

With respect to the customers that have experienced problems with sewage back-ups, staff recognizes that this problem has existed during the past two rate cases, and continues today. The former manager believes that the back-up problems experienced by the customers is due to only one pump in the middle lift station.

By Order No. PSC-98-1269-FOF-WS, p. 4, the Commission found:

Concerning those customers that have experienced problems with sewage back-

ups, it is difficult to determine if the backup problems are due to lift station malfunctions or clogs in the laterals. Should the problem be with the lift stations, the problem appears to have been corrected with recent upgrades (central lift station now has dual pumps)...

By letters dated May 6, 2004 and June 14, 2004, Bayside provided a response to the comments presented at the customer meeting. The utility stated that the former owner agreed to install a second pump at the Middle Lift Station at the time of the 1998 staff-assisted rate case, but the pump was never installed. Subsequently, the prior owner agreed to install the second pump and electrical controls in coordination with the development of 75 trailer sites in Bayside's service area. The DEP specifically required that the pump be installed as a condition to the wastewater construction permit issued by the DEP for the 75-unit development. The utility states that, to date, the previous owner has not initiated construction, and DEP has not required Bayside to modify the lift station ahead of the development activity.

Staff did observe that the emergency light at the middle lift station was on the day after the customer meeting. These lights are the primary indicator of a malfunction, and alerts the utility and the general public of any and all problems before a possible health hazard occurs.

The utility states that the water and wastewater facilities are visited each business day by utility staff, and the utility's operations staff makes every effort to respond promptly to emergencies and effectuate repairs as soon as possible after being notified. The typical daily workload and small frequency of emergency repairs is insufficient to justify a staff person on a continuous basis during the workday.

Staff notes that the service area is primarily a mobile home park that was built in the late 1960's to early 1970's. The original construction of the wastewater collection system consisted of four-inch lines which were used as service laterals that includes up to five homes before reaching the utility's collection main. During the late 1960's and early 1970's, most mobile homes were single-wide trailers that were typically eight, ten and twelve feet in width. However, today the smallest single-wide is typically twelve feet in width and most residences are now double-wide mobile homes.

As observed in the utility's last rate case, tree roots and other encumbrances periodically clog the wastewater laterals serving these homes which require the lines to be cleared of obstructions. It appears from customer testimony, that when this happens, a dispute occurs between the customer and the utility as to who is responsible. The utility contends that in each case, a licensed plumber is called by the customer to make the repair. If the plumber determines that the clog is located beyond the customer's property, the utility will reimburse the plumber's charges.

In its MFRs, the utility stated it had 8 repairs to mains and associated plant and 24 incidents requiring sewer cleaning of obstructions involving the wastewater system. For the water system there were 15 repairs to services and 8 repairs to main breaks. The utility states that the work was required to bring the system to a higher level of operation.

With respect to customer service in the Altamonte Springs office, the utility stated that its customer service representatives are available throughout the business day in the Altamonte Springs office to address customer issues. After normal business hours, calls are forwarded to an answering service. The answering service routinely contacts the operations dispatcher as needed to relay after-hours problems to field staff.

Staff believes that the quality of customer satisfaction for drinking water and domestic wastewater service appears to be marginal. On May 24, 2004, staff had an informal meeting with the utility and the Office of Public Counsel. The purpose of the meeting was to discuss where the responsibility for sewer lines begins and ends and the utility's request for pro forma plant projects. To follow up on the meeting, the utility was to advise staff on where the utility thought its responsibility for the sewer laterals end and also any improvements the utility was going to make to the wastewater collection system in order to improve the quality of wastewater service.

While staff considers the quality of service to be marginal at this time, staff believes that the utility is taking appropriate action to improve the quality of service. The utility has requested pro forma plant improvements to improve the quality of service, which is discussed in more detail in Issue 2. Due to the numerous problems with the original construction of the collection system, staff also recommends that the utility should file a plan of improvement for the wastewater collection system within 120 days of the consummating order finalizing the initial PAA order for this docket.

RATE BASE

Issue 2: What are the appropriate pro forma plant projects for this docket and when should they be completed?

Recommendation: The Commission should allow \$25,000 in pro forma plant for wastewater lift station improvements in this recommendation. Pro forma plant should be reduced by \$80,000 for water and \$25,000 for wastewater. Corresponding adjustments should be made to reduce both accumulated depreciation and depreciation expense by \$4,248 for water and \$556 for wastewater. Also, corresponding adjustments should be made to reduce property taxes by \$34 for water and \$6 for wastewater. The lift station improvements should be completed within 90 days of the consummating order finalizing the initial PAA order for this docket. The utility should be required to complete the water main and wastewater gravity main improvements projects within 180 days of the consummating order finalizing the initial PAA order for this docket. Upon the completion of these projects, the utility should submit supporting documentation reflecting the actual costs and prudence associated with these projects. Staff will review this information and file another recommendation addressing whether a Phase II rate increase should be considered. (Fletcher, Redemann)

Staff Analysis: In its filing, the utility requested recovery of the following pro forma plant projects.

<u>Project</u>	<u>Water</u>	<u>Wastewater</u>
Automatic Meter Reading Equipment	\$55,000	
Water Main Improvements	25,000	
Lift Station Improvements	-	\$25,000
Gravity Main Improvements	-	25,000
Total	<u>\$80,000</u>	<u>\$50,000</u>

Bayside has rescheduled the automatic meter reading project for completion in 2006. Staff believes that the installation of automatic meter reading equipment is not needed at this time for Bayside's customers because this utility only has 287 customers. Also, staff believes that more pressing improvements need to be made before automatic meter reading equipment is considered.

In addition, the utility provided vendor estimates totaling \$22,800 for its lift station improvements project and stated that the estimated completion date is December 31, 2004. The purpose of this project is to rehabilitate Bayside's three existing lift stations. This project includes, but is not limited to, installing pumps, pipes, and valves, and replacing electrical components. Staff has reviewed vendor estimates provided by the utility and believes these improvements are necessary to insure the proper operation of these lift stations. With a 10% allowance for administrative and general (A&G) overheads, staff recommends that the utility's requested \$25,000 pro forma amount for this project is reasonable. Staff also recommends that

these improvements should be completed within 90 days of the consummating order finalizing the initial PAA order for this docket. Since A&G overheads are normal costs incurred as a part of the construction process, staff also believes that a multiplier for A&G overheads in the amount of 10% should be allowed.

At present, Bayside has not provided any supporting documentation for the water main and wastewater gravity main improvements projects. The proposed water main improvements involve installing isolation valves and loop connections. Bayside stated that the existing distribution system lacks sufficient valves and that these improvements will reduce the impact of maintenance activities to the customers. The proposed gravity main improvements involve reshaping the manhole invert channels and grouting the interior of the manholes. The utility stated that these improvements will allow proper flow velocity through each manhole, reduce the frequency of sewer blockages due to grease and sediment accumulation, reduce groundwater infiltration, and protect the ground surface from sinking. Staff believes that both of these projects are necessary and would improve the quality of service to the customers. The utility has provided no support for these projects and even commented that the costs could be higher than those included as pro forma adjustments in its MFRs. As such, staff does not believe it is appropriate to include these projects at this time.

Thus, staff recommends that the appropriate amount of pro forma plant that should be included for PAA rates at this time is \$25,000 for the lift station improvements. As a result, staff recommends that pro forma plant should be reduced by \$80,000 for water and \$25,000 for wastewater. Corresponding adjustments should be made to reduce both accumulated depreciation and depreciation expense by \$4,248 for water and \$556 for wastewater. Also, corresponding adjustments should be made to reduce property taxes by \$34 for water and \$6 for wastewater.

Further, staff recommends that the utility be required to complete the water main and wastewater gravity main improvements projects within 180 days of the consummating order finalizing the initial PAA order for this docket. Upon the completion of these projects, the utility should submit supporting documentation reflecting the actual costs and prudence associated with these projects. Staff will review this information and file another recommendation addressing whether a Phase II rate increase should be considered.

Issue 3: Are there any rate base adjustments that should be made as a result of staff's audit?

Recommendation: Yes. Based on uncontested audit adjustments, plant should be decreased by \$52,982 for water and \$6,050 for wastewater, and accumulated depreciation should be increased by \$3,888 for water and \$63,053 for wastewater. In addition, accumulated amortization of CIAC should be increased by \$4,317 for water. Further, corresponding adjustments should be made to decrease depreciation expense by \$1,494 for water and to increase depreciation expense by \$6,045 for wastewater. (Fletcher)

Staff Analysis: Staff auditors recommended the following rate base adjustments.

<u>Audit Adjustments</u>	<u>Water</u>	<u>Wastewater</u>
1. Prior Order Commission Adjustments – Exceptions Nos. 1,5, and 7		
Decrease Plant	(\$8,350)	
Increase Plant		\$8,162
Increase Accumulated Depreciation	7,528	49,260
Increase Accumulated Amortization of CIAC	4,317	0
2. Remove Acquisition Related Costs – Exception No. 2		
Decrease Plant	(\$39,365)	(\$18,798)
Decrease Accumulated Depreciation	(2,569)	(1,639)
Decrease Depreciation Expense	(984)	(514)
3. Misclassified Plant and Expenses – Exception No. 3		
Decrease Plant	(\$3,215)	(\$1,548)
Decrease Accumulated Depreciation	(70)	(43)
Decrease Depreciation Expense	(70)	(43)
4. Adjustments for Common Plant Allocations – Exception No. 4		
Decrease Plant	(\$2,052)	
Decrease Accumulated Depreciation	(1,001)	
Decrease Depreciation Expense	(440)	
Increase Plant		\$6,134
Increase Accumulated Depreciation		1,001
Increase Depreciation Expense		440

<u>Audit Adjustments</u>	<u>Water</u>	<u>Wastewater</u>
5. Correcting Depreciation Rates – Exception No. 6		
Increase Accumulated Depreciation		\$14,474
Increase Depreciation Expense		6,162

The utility agrees with all of the above audit adjustments. Therefore, staff recommends that plant be decreased by \$52,982 for water and \$6,050 for wastewater and that accumulated depreciation be increased by \$3,888 for water and \$63,053 for wastewater. In addition, staff recommends that accumulated amortization of CIAC be increased by \$4,317 for water. Further, corresponding adjustments should be made to decrease depreciation expense by \$1,494 for water and to increase depreciation expense by \$6,045 for wastewater.

Issue 4: Should any adjustments be made to the utility's Water Service Corporation allocations?

Recommendation: To appropriately allocate rate base and other costs, plant for both water and wastewater should be decreased by \$533, and depreciation expense for both water and wastewater should be decreased by \$57. In addition, operation and maintenance (O&M) expenses should be reduced by \$1,426 for both water and wastewater. Further, Utilities, Inc. (UI), the utility's parent, should revise its allocation methodology beginning January 1, 2004, to a weighted average of each calendar year in order to properly spread costs to customers. (Fletcher)

Staff Analysis: In Issue 3, staff recommended adjustments to include additional common plant that Bayside excluded in its MFRs and to correct the allocation between its water and wastewater systems. In its MFRs, the utility reflected allocated expenses of \$5,309 for both water and wastewater. Water Service Corporation (WSC) is a Utilities, Inc. subsidiary which provides administrative services such as billing to UI's operating subsidiaries. WSC allocates common plant and expenses based on customer equivalents (CEs) primarily, but WSC does utilize other methodologies to allocate computer costs and insurance expenses. Based on further review, staff believes additional adjustments are necessary to the WSC allocations to Bayside.

First, UI used a factor of 1.5 to determine Bayside's CEs of 431 (287 customers multiplied by 1.5). According to UI's allocation methodology, the number of customers for water distribution or wastewater collection are multiplied by a factor of 0.5 each in order to determine the proper amount of CEs. Since Bayside is a reseller of water and wastewater service, WSC should have used an allocation factor of 1 which would be 287 CEs.

Second, UI uses a June 30th cutoff date to determine which UI subsidiaries should be included in the allocation process. UI asserted that a cutoff date after June 30th would unfairly allocate expenses to a subsidiary that was owned for less than six months. UI stated that it considered including newly acquired companies based on the date of acquisition, using a weighted average, but UI rejected that as too cumbersome. Staff notes that UI acquired three large utility systems after June 30, 2002, and the Florida subsidiaries added 854 CEs during the last half of 2003. Staff believes that a June 30th cutoff for determining the number CEs of each system does not adequately spread each year's common costs. We believe that a weighted average of all systems better matches the costs on a per system basis. Since the test year in this docket is December 31, 2002, staff believes it would be inappropriate to exclude the additional CEs from the allocation process because resources were expended for those customers during 2002. Thus, staff recommends that UI should revise its allocation methodology beginning January 1, 2004, to a weighted average of each calendar year in order to properly spread costs to customers.

Third, excess liability insurance is allocated based on number of miles of sewer mains, gallons of water sold, and operator's salary. In response to Staff's Second Data Request, Bayside stated that WSC incorrectly reflected gallons sold on 2001 data and that the correct gallons sold for 2002 is 11,661,000 as shown on MFR Schedule F-1. Regarding operator salaries, staff notes that WSC excluded operators' salaries for three utilities acquired after June 30, 2002. Staff believes it would create a mismatch if the salaries for the additional three utilities were not considered in the allocation process.

Fourth, WSC allocates worker's compensation insurance based on operator salaries only. This insurance also applies to office employees. Staff believes it is appropriate to allocate this insurance based on operator and office salaries.

By applying the above adjustments to the utility's allocation methodology, staff recommends that plant for both water and wastewater should be decreased by \$533. Depreciation expense for both water and wastewater should be decreased by \$57. In addition, staff recommends that O&M expenses should be reduced by \$1,426 for both water and wastewater. Further, staff recommends that UI should revise its allocation methodology beginning January 1, 2004, to a weighted average of each calendar year in order to properly spread costs to customers.

Issue 5: What are the used and useful percentages for the utility's water distribution and wastewater collection systems?

Recommendation: The water distribution and wastewater collection systems should be considered 100% used and useful. (Redemann)

Staff Analysis: By Order No. PSC-98-1269-FOF-WS, in Bayside's last rate case, the Commission found that since the utility no longer had water and wastewater treatment plant facilities, a used and useful determination for treatment was not applicable. Bayside's only water facilities are the interconnecting pipe work to the city's main which is considered a component of the distribution system. Wastewater generated by the residents of Bayside is transported to the Panama City Beach system via three in-line lift stations which are considered components of the collection system.

By Order No. PSC-98-1269-FOF-WS, the Commission also found that Bayside's water distribution and wastewater collection systems were 100% used and useful. The network of water distribution and wastewater collection mains are designed to serve the existing capacity of 287 connections. The water and wastewater service area is built out. Therefore, staff recommends that both the water distribution system and the wastewater collection system be considered 100% used and useful.

Issue 6: What is the appropriate working capital allowance?

Recommendation: The appropriate amount of working capital is \$10,019 for water and \$10,787 for wastewater based on the formula method. (Fletcher)

Staff Analysis: Rule 25-30.433(2), F.A.C., requires that Class B utilities use the formula method, or one-eighth of O&M expenses, to calculate the working capital allowance. The utility has properly filed its allowance for working capital using the formula method. Staff has recommended several adjustments to the utility's O&M expenses. Due to the adjustments recommended in other issues, staff recommends that working capital of \$10,019 and \$10,787 should be approved for water and wastewater, respectively. This reflects a decrease of \$1,754 to the utility's requested working capital allowance of \$11,773 for water and a decrease of \$2,611 from the utility's requested allowance of \$13,398 for wastewater.

Issue 7: What is the appropriate rate base?

Recommendation: Consistent with other recommended adjustments, the appropriate simple average rate base for the test year ending December 31, 2002 is \$66,672 for water and \$194,663 for wastewater. (Fletcher)

Staff Analysis: Consistent with other recommended adjustments, the appropriate simple average rate base for the test year ending December 31, 2002 is \$66,672 for water and \$194,663 for wastewater. Staff recommended water and wastewater rate bases are shown on Schedules Nos. 1-A and 1-B, respectively. The adjustments are shown on Schedule No. 1-C.

←

COST OF CAPITAL

Issue 8: Are any adjustments necessary to Bayside's capital structure and what is the appropriate weighted cost of capital including the proper components, amounts and cost rates associated with the capital structure for the test year ending December 31, 2002?

Recommendation: Deferred taxes should be increased by \$21,718 to reflect the correct balance and the special tax depreciation allowance claim by the utility. The appropriate cost of equity should be 11.21%, with a range of 10.21% to 12.21%, and the overall cost of capital should be 8.28%, with a range of 7.90% to 8.67%. (Fletcher)

Staff Analysis: In its MFRs, the utility used the debt and equity ratios of its parent, UI, to prorate Bayside's share of the parent's capital. The utility reflected accumulated deferred income taxes that are specifically attributable to Bayside, but it included the deferred taxes as a negative number. The utility included the actual balance of customer deposits. Using the Commission's 2003 leverage formula, the utility reflected a cost of 11.77% for equity, and requested an overall cost of capital of 9.18%. Staff recommends a few adjustments to the utility's capital structure which are discussed below.

First, the utility and staff agree that Bayside misstated its test year deferred taxes balance in its MFRs. To correct this, staff recommends that deferred taxes should be increased by \$14,610. Second, the utility and staff agree that Bayside's MFRs do not reflect the effect of the utility's claim of a special tax depreciation allowance. Staff recommends that Bayside's deferred taxes should be increased by \$7,108 to reflect the impact of the utility's claim of the special tax depreciation allowance on historical plant, as well as for staff's previously recommended pro forma plant. Thus, staff recommends that the appropriate balance of deferred taxes should be \$14,413, which represents an increase of \$21,718.

Further, the current leverage formula was approved by Order No. PSC-04-0587-PAA-WS, issued June 10, 2004, in Docket No. 040006-WS, In re: Water and wastewater industry annual reestablishment of authorized range of return on common equity for water and wastewater utilities pursuant to Section 367.081(4)(f), F.S. Based on the current leverage formula and the utility's equity ratio, staff recommends the appropriate cost of equity should be 11.21%, with a range of 10.21% to 12.21%. Based on the above, staff recommends that an overall cost of capital should be 8.28%, with a range of 7.90% to 8.67%. Staff's recommended cost of capital is shown on Schedule No. 2.

NET OPERATING INCOME

Issue 9: Should an adjustment be made to employee salaries?

Recommendation: Yes. To reflect current staffing levels, employee salaries should be reduced by \$9,589 for both water and wastewater. Corresponding adjustments should also be made to reduce pensions and benefits by \$3,652 for both water and wastewater. Further, corresponding adjustments should be made to reduce payroll taxes by \$734 for both water and wastewater. (Fletcher)

Staff Analysis: In its MFRs, the utility reflected adjusted employee salaries of \$22,618 for water and \$20,985 for wastewater. The requested expense reflects a 3% salary increase for 2003. In its analysis, staff requested the utility to explain why direct operator salaries increased \$23,889 (or 178%) collectively for both water and wastewater from 2001 to 2002. Bayside stated that the increase related to one operator changing from part-time to full-time employment, as well as the addition of another full-time operator in 2002.

Upon review of the utility's supporting documentation, staff discovered that the utility's 2002 salaries included amounts of four employees who have been replaced. Further, in 2003, there were four additional employees of Bayside which did not have any salaries in the 2002 test year. Also, one employee did not spend any time on Bayside in 2003 even though a portion of his salary was attributable to the utility in 2002. With the known changes in staffing, staff believes corresponding direct operator salaries should also be changed to the 2003 levels. Further, by using the 2003 salary levels, the utility's 3% salary increase for 2003 direct operators salaries should be removed as well.

According to the utility's 2003 staffing information, there are seven employees that spend a small portion of their hours on Bayside. Basically, there are two employees that deal with the day-to-day operations of the utility. The utility stated that one operator spends half of his work week at Bayside. Based on the duties and time typically spent at the utility, staff believes this operator's salary is reasonable. The utility stated that the other operator typically spends 6 to 10 hours per week at Bayside. In order to corroborate this, staff requested this operator's timesheets for the years 2001 to 2003. The utility has not provided these timesheets to date. Using a 10 hour per week estimate, 25% of this operator's salary should be allocated to Bayside. However, during the 2002 test year, UI attributed 57% of this operator's salary to the utility.

Therefore, to reflect the appropriate staffing levels and adjust operator time based on typical hours worked, staff recommends that employee salaries should be reduced by \$9,589 for both water and wastewater to reflect the appropriate direct operator salaries. Corresponding adjustments should also be made to reduce pensions & benefits by \$3,652 for both water and wastewater. Further, corresponding adjustments should be made to reduce payroll taxes by \$734 for both water and wastewater.

Issue 10: Are there any operating expense adjustments that should be made as a result of staff's audit?

Recommendation: Yes. Based on uncontested audit adjustments, O&M expenses should be reduced by \$714 for water and \$679 for wastewater. (Fletcher)

Staff Analysis: In its MFRs, Bayside made pro forma adjustments to increase health care costs by \$1,293 for both water and wastewater. This represents an increase of 25.86% over test year expenses. The utility made pro forma adjustments to increase insurance costs by \$534 for water and \$749 for wastewater. This represents an increase of 36.88% over test year expenses.

In Audit Disclosure No. 3, staff auditors stated that actual health care costs increased by 9.83% and actual insurance costs increased by 42.93%. As a result, the staff auditors recommended that a net O&M expense reduction of \$714 for water and \$679 for wastewater should be made. In its audit response, Bayside agreed with the auditors' recommendation. Based on the above, staff recommends that O&M expenses should be reduced by \$714 for water and \$679 for wastewater.

Issue 11: Should an adjustment be made for unaccounted for water?

Recommendation: Yes. A reduction of 4.54%, or \$2,184, should be made to purchased water. The utility should investigate the source of water loss and provide a report identifying the cause of the unaccounted for water within 90 days of the consummating order finalizing the initial PAA order for this docket. (Redemann)

Staff Analysis: In its MFRs, the utility stated that the excessive unaccounted for water is believed to be attributed to meter error and undetected leaks. It is Commission practice to allow 10% of the total water produced or purchased as acceptable unaccounted for water. In most instances, the chemical and electrical costs associated with unaccounted for water in excess of 10% have been reduced by the Commission so that ratepayers do not bear those excessive costs. Since this utility does not provide water treatment it does not have direct costs for chemicals and purchased power. In this case, staff recommends that a reduction to purchased water for the amount of purchased water in excess of 10% should be made. In addition, the utility should investigate the source of water loss and provide a report identifying the source of the unaccounted for water within 90 days of the consummating order finalizing the initial PAA order for this docket. Staff believes that it is important to reduce the amount of unaccounted for water because water is a limited resource that should be protected.

The total amount of water purchased of 14,084,269 gallons, less the amount of water sold of 11,661,000 gallons and less the amount of water accounted for by the utility of 375,000 gallons, equals an unaccounted for water amount of 2,048,269 gallons. Dividing 2,048,269 by 14,084,269 and multiplying by 100% equals 14.54% unaccounted for water. The excess amount of unaccounted for water is 4.54%.

Account No. 610 shows a purchased water expense of \$48,112. Staff recommends a 4.54% reduction or \$2,184 ($\$48,112 \times .0454 = \$2,184$) to purchased water.

Issue 12: Should an adjustment be made to materials and supplies expense?

Recommendation: Yes. To normalize the test year expense level, material and supplies expense should be reduced by \$1,020 for water and \$10,257 for wastewater. (Fletcher, Redemann)

Staff Analysis: In its MFRs, the utility reflected test year material and supplies (M&S) expense of \$7,838 for water and \$25,345 for wastewater. Based on staff's review, M&S expense has fluctuated greatly since UI acquired Bayside. To test the reasonableness of the test year level, staff compared M&S expenses for two years prior and one year after the 2002 test year. According to its annual reports from 2000-2003, the utility incurred average water M&S expenses of \$6,707 and \$14,909 for wastewater. To normalize the test year M&S expense, staff believes the appropriate expense level for rate setting purposes is the four-year average from 2000 to 2003, while also indexing of the 2000 and 2001 expenses by the Commission-approved price indices. With the indexing adjustments, the four-year average is \$6,836 for water and \$15,086 for wastewater. As a result, staff recommends that material and supplies expense should be reduced by \$1,020 for water and \$10,257 for wastewater.

Issue 13: Should an adjustment be made to bad debt expense?

Recommendation: Yes. To normalize the test year expense level, bad debt expense should be reduced by \$435 for water and \$592 for wastewater. (Fletcher)

Staff Analysis: In its MFRs, Bayside reflected test year bad debt expense of \$2,219 for water and \$3,112 for wastewater. Staff requested that the utility provide a schedule listing the customer's name, the water and wastewater amount written-off for each customer, and how long the balance due account was outstanding before it was written-off. In its response to staff's data request, the utility stated it was unable to provide this information for the 2002 test year. Due to the transient nature of the utility's customer base, bad debt expense tends to materially fluctuate. Staff believes the difference between the four-year average from 2000 to 2003 and the 2002 test year amount should be removed in order to normalize test year bad debt expense. As a result, staff recommends that bad debt expense should be reduced by \$435 for water and \$592 for wastewater.

Issue 14: What is the appropriate amount of rate case expense?

Recommendation: The appropriate rate case expense for this docket is \$59,369. This expense is to be recovered over four years for an annual expense of \$14,842. To remove duplicate and unsupported costs, the test year amortization should be decreased by \$5,656 for both water and wastewater. (Fletcher)

Staff Analysis: In its MFRs, the utility reflected a \$102,909 estimate for rate case expense to process this case. Staff requested an update of the actual rate case expense incurred, with supporting documentation, as well as the estimated amount to complete the case. The utility submitted a revised estimated rate case expense through completion of the PAA process of \$63,134. The components of the estimated rate case expense are as follows:

	<u>MFR</u> <u>Estimated</u>	<u>Actual</u>	<u>Additional</u> <u>Estimated</u>	<u>Total</u>
Filing Fee	\$2,000	\$2,000	\$0	\$2,000
Legal Fees	42,750	13,700	12,000	25,700
Consultant Fees	25,000	13,671	6,450	20,121
WSC In-house Fees	13,909	4,332	8,023	12,355
Miscellaneous Expense	<u>19,250</u>	<u>1,494</u>	<u>1,464</u>	<u>2,958</u>
Total Rate Case Expense	<u>\$102,909</u>	<u>\$35,197</u>	<u>\$27,937</u>	<u>\$63,134</u>

Pursuant to Section 367.081(7), F.S., the Commission shall determine the reasonableness of rate case expenses and shall disallow all rate case expenses determined to be unreasonable. The utility has provided our staff with documentation to justify its requested rate case expense. However, it would constitute an abuse of discretion to automatically award rate case expense without reference to the prudence of the costs incurred in the rate case proceedings. Meadowbrook Util. Sys., Inc. v. FPSC, 518 So. 2d 326, 327 (Fla. 1st DCA 1987), rehearing denied, 529 So. 2d 694 (Fla. 1988). Despite this fact, the Commission have a broad discretion with respect to allowance of rate case expense. Florida Crown Util. Servs., Inc. v. Utility Regulatory Bd. Of Jacksonville, 274 So. 2d 597, 598 (Fla. 1st DCA 1973). Staff has examined the requested actual expenses, supporting documentation, and estimated expenses as listed above for the current rate case. Staff believes that the revised estimate is reasonable with three exceptions, as discussed below.

Staff's first adjustment relates to rate case expense incurred to correct deficiencies in the MFR filing. In its response to Staff's Second Data Request, the utility's consultant stated that of the 24.66 hours spent on staff's MFR deficiency letters, only 2.33 hours related to actual deficiencies. The utility's consultant asserted that the remaining 22.33 hours should be considered responses to data requests instead of MFR deficiencies. Staff disagrees with the consultant's assertion above. Instead, staff believes that 23.66 hours were spent on MFR deficiencies. Staff has analyzed the utility's response to our deficiency letters. Of the 15 major

parts, we believe that only 2 items were supplemental data requests as opposed to deficiencies. As such, staff recommends that \$2,500 should be removed for consultant fees and expenses. In addition, staff recommends that the utility's in-house and legal fees should be reduced by \$295 and \$483, respectively, to correct the MFRs.

Second, the utility's attorney filed numerous amendments to WSC's In-house fees and expenses. Staff believes it is appropriate to reduce the attorney's total hours by one hour to remove these duplicative costs. As such, staff recommends that the utility's legal fees should be reduced by \$240.

The Commission has previously disallowed rate case expense associated with correcting MFR deficiencies because of duplicate filing costs. See Order No. PSC-01-0326-FOF-SU, issued February 6, 2001, in Docket No. 991643-SU, In re: Application for increase in wastewater rates in Seven Springs in Pasco County by Aloha Utilities, Inc. Accordingly, staff recommends that \$3,518 be removed as duplicative and unreasonable rate case expense.

In its MFRs, the utility included \$214 for both water and wastewater related to rate case expense amortization for a previous case. Since the utility's last rate proceeding was more than four years ago, staff recommends that O&M expenses should be reduced by \$214 for both water and wastewater.

Staff recommends that the appropriate total rate case expense is \$59,369. A breakdown of the allowance of rate case expense is as follows:

	MFR	Utility Revised	Staff	
	<u>Estimated</u>	<u>Actual & Estimated</u>	<u>Adjustments</u>	<u>Total</u>
Filing Fee	\$2,000	\$2,000	\$0	\$2,000
Legal Fees	42,750	25,700	(723)	24,977
Consultant Fees	25,000	20,121	(2,500)	17,621
WSC In-house Fees	13,909	12,355	(295)	12,060
Miscellaneous Expense	<u>19,250</u>	<u>2,711</u>	<u>0</u>	<u>2,711</u>
Total Rate Case Expense	<u>\$102,909</u>	<u>\$62,887</u>	<u>(\$3,518)</u>	<u>\$59,369</u>
Current Amortization	\$25,728		(\$10,885)	\$14,842
Prior Amortization	<u>428</u>		<u>(428)</u>	<u>0</u>
Total Annual Expense	<u>\$26,156</u>		<u>(\$11,313)</u>	<u>\$14,842</u>

The recommended total rate case expense should be amortized over four years, pursuant to Section 367.0816, F.S. Based on the data provided by the utility and the staff recommended adjustments mentioned above, staff recommends that the rate case expense should be reduced by \$11,313, for a total annual rate case expense of \$14,842. Dividing the \$14,842 expense equally between water and wastewater, results in an annual amortization expense of \$7,421 for each, respectively. This results in a test year amortization reduction of \$5,656 for both water and wastewater.

Issue 15: What is the test year water and wastewater operating income before any revenue increase?

Recommendation: Based on the adjustments discussed in previous issues, the operating income before any provision for increased revenues is (\$13,251) for water and (\$7,472) for wastewater. (Fletcher)

Staff Analysis: As shown on attached Schedules Nos. 3-A and 3-B, after applying staff's adjustments, net operating income before any revenue increase is (\$13,251) and (\$7,472) for water and wastewater, respectively. Staff's adjustments to operating income are listed on Schedule No. 3-C.

REVENUE REQUIREMENT

Issue 16: What is the appropriate revenue requirement?

Recommendation: The following revenue requirements should be approved. (Fletcher)

	<u>TY Revenues</u>	<u>\$ Increase</u>	<u>Rev Requirement</u>	<u>% Increase</u>
Water	\$65,894	\$31,517	\$97,411	47.83%
Wastewater	\$92,613	\$39,609	\$132,222	42.77%

Staff Analysis: Bayside requested final rates designed to generate annual revenues of \$147,101 and \$174,060 for water and wastewater, respectively. These revenues exceed test year revenues by \$81,669 (123.94%), and \$81,447 (87.94%) for water and wastewater, respectively.

Based upon staff's recommendations concerning the underlying rate base, cost of capital, and operating income issues, we recommend approval of rates that are designed to generate a water revenue requirement of \$97,411 and a wastewater revenue requirement of \$132,222. These revenues exceed staff's adjusted test year revenues by \$31,517, or 47.83%, for water, and \$39,609, or 42.77%, for wastewater. These increases are shown on attached Schedules Nos. 3-A and 3-B. These increases will allow the utility the opportunity to recover its expenses and earn an 8.28% return on its investment in water and wastewater rate base.

RATES AND RATE STRUCTURE

Issue 17: What are the appropriate water and wastewater rate structures?

Recommendation: The appropriate water rate structure is a continuation of the current base facility (BFC) and uniform gallonage charge rate structure. The water rates should be designed such that 40% of the revenue requirement from rates (pre repression) is recovered in the BFC. No conservation adjustment is recommended. Further, the appropriate wastewater rate structure is a continuation of the current BFC and gallonage charge rate structure with a 6,000 gallon cap for residential customers and a differential in the gallonage charge between residential and general service. (Bruce, Fletcher)

Staff Analysis: The utility's current water rate structure consists of the BFC and uniform gallonage charge rate structure, in which the BFC is \$13.25 per month and all usage per month is charged \$2.11 per 1,000 gallons (kgal). Bayside purchases water and wastewater service from the City of Panama City Beach and is considered non-jurisdictional by the Northwest Florida Water Management District.

It has been the Commission's practice over the past several years to implement an inclining block rate structure whenever possible. However, staff's analysis indicates that the utility customers' overall average monthly consumption is approximately 3.8 kgal and that the customer base is highly seasonal. According to staff's analysis, at least 75% of the utility's residential bills and gallons are captured at 5 kgal or less. This is consistent with a high degree of customer seasonality and nondiscretionary consumption, leading staff to believe that a continuation of the base facility and uniform gallonage rate structure is appropriate for this utility.

Based on staff's initial analysis of fixed versus variable cost allocation of pre-repression revenue requirement recovery, the utility would recover 40% (\$39,488) in the BFC charge and the remaining 60% (\$59,322) in the gallonage charge. It has been Commission practice to recover no more than 40% through the BFC. This rate structure guideline was developed by the Southwest Florida Water Management District (SWFWMD) and has been generally adopted by the remaining four Water Management Districts and this Commission. Because of the seasonal customer base, staff believes that a BFC allocation no greater than 40% is appropriate to safeguard the utility's revenue stability. Therefore, no conservation adjustment is recommended.

Staff attempts to design rates such that customers who are at average consumption will receive a price increase approximately equal to the revenue requirement increase. A review of the effect of staff's recommended rate structure indicates that customers at the average level of consumption will receive a price increase in their monthly bill of 54%, which is approximately equivalent to the overall pre-repression revenue requirement increase for water.

Wastewater

Bayside's current wastewater rate structure is the base facility charge and gallonage charge rate structure with a 6,000 gallon cap for residential customers and a differential in the gallonage charge between residential and general service. The differential is designed to

Docket No. 030444-WS

Date: July 22, 2004

water usage is returned. This wastewater gallonage rate differential is employed by the Commission in wastewater rate setting and is widely recognized as an industry standard. Based on the above, staff believes that the utility's current rate structure is appropriate and recommends no changes in this case.

Issue 18: Are adjustments to reflect repression of consumption appropriate due to the price changes in this case, and, if so, what are the appropriate repression adjustments for the water and wastewater systems?

Recommendation: Yes, a repression adjustment of 563 kgal is appropriate for the water system, with a corresponding adjustment of 453 kgal for the wastewater system. In order to monitor the effects of the recommended revenue changes, the utility should be ordered to prepare monthly reports detailing the number of bills rendered, the consumption billed and the revenue billed. These reports should be provided, by type of service, customer class and meter size, on a quarterly basis for a period of two years, beginning with the first billing period after the rate changes go into effect. (Lingo)

Staff Analysis: Based on information contained in our database of utilities receiving rate increases and decreases, there were two water utilities whose prior prices and prior average consumptions closely matched those of Bayside. Furthermore, the average water price increase experienced by the two utilities of approximately 54% matches the corresponding pre-repression water increase expected by the Bayside customers.

The reductions in water quantity demanded for the two utilities were 6.8% and 3.2%, respectively. Due to the narrow range of reductions exhibited by the two utilities, coupled with the close match of the utilities' prior prices and average consumptions to Bayside, staff believes it is reasonable to base Bayside's anticipated water consumption reduction on an average of the two utilities' consumption reductions. This results in an anticipated annual reduction in residential water consumption for Bayside of 5.0%, or 563 kgal, while the corresponding adjustment for the wastewater system is 453 kgal. The overall reductions in consumption are 4.8% for both the water and wastewater systems.

In order to monitor the effects of the recommended revenue changes, the utility should be ordered to prepare monthly reports detailing the number of bills rendered, the consumption billed and the revenue billed. These reports should be provided, by type of service, customer class and meter size, on a quarterly basis for a period of two years, beginning with the first billing period after the rate changes go into effect.

Issue 19: What are the appropriate water and wastewater rates?

Recommendation: The appropriate water and wastewater monthly rates are shown on Schedules Nos. 4-A and 4-B, respectively. Excluding miscellaneous service revenues, the recommended water and wastewater rates are designed to produce revenues of \$96,456 and \$130,880, respectively. The utility should file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-30.475(1), F.A.C. In addition, the rates should not be implemented until staff has approved the proposed customer notice. The utility should provide proof of the date the notice was given no less than 10 days after the date of the notice. (Fletcher, Bruce, Lingo)

Staff Analysis: As discussed in Issue 16, the appropriate water and wastewater revenue requirements are \$97,411 and \$132,222, respectively. After excluding miscellaneous service revenues, the water and wastewater revenues to be recovered through rates are \$96,456 and \$130,880, respectively. As discussed in Issue 17, the rate structure for both water and wastewater should not change.

The utility should file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-40.475(1), F.A.C. The rates should not be implemented until staff has approved the proposed customer notice. The utility should provide proof of the date notice was given no less than 10 days after the date of the notice.

A comparison of the utility's original rates, requested rates, and staff's recommended water and wastewater rates are shown on Schedules Nos. 4-A and 4-B, respectively.

Issue 20: In determining whether any portion of the interim increase granted should be refunded, how should the refund be calculated, and what is the amount of the refund, if any?

Recommendation: The proper refund amount should be calculated by using the same data used to establish final rates, excluding rate case expense. This revised revenue requirement for the interim collection period should be compared to the amount of interim revenues granted. Based on this calculation, the utility should be required to refund 15.37% of water and 14.81% of wastewater revenues collected under interim rates. The refund should be made with interest in accordance with Rule 25-30.360(4), F.A.C. The utility should treat any unclaimed refunds as CIAC pursuant to Rule 25-30.360(8), F.A.C. (Fletcher)

Staff Analysis: By Order No. PSC-04-0414-PCO-WS, issued April 22, 2004, the Commission authorized the collection of interim water and wastewater rates, subject to refund, pursuant to Section 367.082, F.S. The approved interim revenue requirements are shown below:

	<u>Revenue Requirement</u>	<u>Revenue Increase</u>	<u>Percentage Increase</u>
Water	\$108,441	\$42,547	64.57%
Wastewater	\$143,758	\$51,145	55.22%

According to Section 367.082, F.S., any refund should be calculated to reduce the rate of return of the utility during the pendency of the proceeding to the same level within the range of the newly authorized rate of return. Adjustments made in the rate case test period that do not relate to the period interim rates are in effect should be removed. Rate case expense is an example of an adjustment which is recovered only after final rates are established.

In this proceeding, the test period for establishment of interim and final rates is the twelve month period ended December 31, 2002. Bayside's approved interim rates did not include any provisions for pro forma or projected operating expenses or plant. The interim increase was designed to allow recovery of actual interest costs, and the floor of the last authorized range for equity earnings. To establish the proper refund amount, staff has calculated a revised interim revenue requirement utilizing the same data used to establish final rates. Rate case expense, the pro forma adjustments, and the repression adjustments were excluded because those items are prospective in nature and did not occur during the interim collection period.

Using the principles discussed above, staff has calculated the interim revenue requirement for the interim collection period to be \$91,922 for water and \$122,670 for wastewater. The water and wastewater revenue levels are less than the interim revenues which were granted in Order No. PSC-04-0414-PCO-WS. Therefore, staff recommends a refund of 15.37% of interim rates for water and 14.81% for wastewater. The refunds should be made with interest in accordance with Rule 25-30.360(4), F.A.C. The utility should be required to submit proper refund reports pursuant to Rule 25-30.360(7), F.A.C. The utility should treat any unclaimed refunds as CIAC pursuant to Rule 25-30.360(8), F.A.C.

Issue 21: What is the appropriate amount by which rates should be reduced four years after the established effective date to reflect the removal of the amortized rate case expense as required by Section 367.0816, F.S.?

Recommendation: The rates should be reduced as shown on Schedules Nos. 4-A and 4-B to remove \$7,771 separately for both water and wastewater rate case expense, grossed-up for regulatory assessment fees, which is being amortized over a four-year period. The decrease in rates should become effective immediately following the expiration of the four-year rate case expense recovery period, pursuant to Section 367.0816, F.S. The utility should be required to file revised tariffs and a proposed customer notice setting forth the lower rates and the reason for the reduction no later than one month prior to the actual date of the required rate reduction. (Fletcher)

Staff Analysis: Section 367.0816, F.S., requires rates to be reduced immediately following the expiration of the four-year amortization period by the amount of the rate case expense previously included in the rates. The reduction will reflect the removal of revenues associated with the amortization of rate case expense and the gross-up for regulatory assessment fees which is \$7,771 for both water and wastewater. The decreased revenues will result in the rate reduction recommended by staff on Schedules Nos. 4-A and 4-B.

The utility should be required to file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-40.475(1), F.A.C. The rates should not be implemented until staff has approved the proposed customer notice. The utility should provide proof of the date notice was given no less than 10 days after the date of the notice.

If the utility files this reduction in conjunction with a price index or pass-through rate adjustment, separate data shall be filed for the price index and/or pass-through increase or decrease, and for the reduction in the rates due to the amortized rate case expense.

OTHER ISSUES

Issue 22: Should the utility be required to provide proof that it has adjusted its books for all Commission approved adjustments?

Recommendation: Yes. To ensure that the utility adjusts its books in accordance with the Commission's decision, Bayside should provide proof, within 90 days of the consummating order finalizing this docket, that the adjustments for all the applicable NARUC USOA primary accounts have been made. (Fletcher)

Staff Analysis: To ensure that the utility adjusts its books in accordance with the Commission's decision, staff recommends that Bayside should provide proof, within 90 days of the consummating order finalizing this docket, that the adjustments for all the applicable NARUC USOA primary accounts have been made.

Issue 23: Should this docket be closed?

Recommendation: No. If no person whose substantial interests are affected by this initial PAA decision files a protest within twenty-one days of the issuance of the order, a consummating order will be issued. Staff should be given administrative authority to verify that the revised tariff sheets and customer notice have been filed by the utility and approved by staff, and the refund has been completed and verified by staff. Once these actions are complete, the corporate undertaking should be released. This docket should remain open for staff to verify that the additional recommended plant improvements, discussed in Issue 2, have been completed and to file another PAA recommendation to address a Phase II rate increase for those plant projects. (Fletcher, Jaeger)

Staff Analysis: No. If no person whose substantial interests are affected by this initial PAA decision files a protest within twenty-one days of the issuance of the order, a consummating order will be issued. Staff should be given administrative authority to verify that the revised tariff sheets and customer notice have been filed by the utility and approved by staff, and the refund has been completed and verified by staff. Once these actions are complete, the corporate undertaking should be released. This docket should remain open for staff to verify that the additional recommended plant improvements, discussed in Issue 2, have been completed and to file another PAA recommendation to address a Phase II rate increase for those plant projects.

BAYSIDE UTILITY SERVICES, INC. SCHEDULE OF WATER RATE BASE TEST YEAR ENDED 12/31/02			SCHEDULE NO. 1-A DOCKET 030444-WS		
DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUST- MENTS	ADJUSTED TEST YEAR PER UTILITY	STAFF ADJUST- MENTS	STAFF ADJUSTED TEST YEAR
1 UTILITY PLANT IN SERVICE	\$235,308	\$80,000	\$315,308	(\$133,515)	\$181,793
2 NON-USED & USEFUL COMPONENTS	0	0	0	0	0
3 ACCUMULATED DEPRECIATION	(113,161)	(4,248)	(117,409)	360	(117,049)
4 CIAC	(52,911)	0	(52,911)	0	(52,911)
5 AMORTIZATION OF CIAC	40,503	0	40,503	4,317	44,820
6 ACQUISITION ADJUSTMENT	(8,656)	8,656	0	0	0
7 WORKING CAPITAL ALLOWANCE	<u>0</u>	<u>11,773</u>	<u>11,773</u>	<u>(1,754)</u>	<u>10,019</u>
8 RATE BASE	<u>\$101,083</u>	<u>\$96,181</u>	<u>\$197,264</u>	<u>(\$130,592)</u>	<u>\$66,672</u>

BAYSIDE UTILITY SERVICES, INC.
SCHEDULE OF WASTEWATER RATE BASE
TEST YEAR ENDED 12/31/02

SCHEDULE NO. 1-B
DOCKET 030444-WS

DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUST- MENTS	ADJUSTED TEST YEAR PER UTILITY	STAFF ADJUST- MENTS	STAFF ADJUSTED TEST YEAR
1 UTILITY PLANT IN SERVICE	\$382,444	\$50,000	\$432,444	(\$31,583)	\$400,861
2 NON-USED & USEFUL COMPONENTS	0	0	0	0	0
3 ACCUMULATED DEPRECIATION	(152,932)	(1,556)	(154,488)	(62,497)	(216,985)
4 CIAC	0	0	0	0	0
5 AMORTIZATION OF CIAC	0	0	0	0	0
6 ACQUISITION ADJUSTMENT	(29,367)	29,367	0	0	0
7 WORKING CAPITAL ALLOWANCE	<u>0</u>	<u>13,398</u>	<u>13,398</u>	<u>(2,611)</u>	<u>10,787</u>
3 RATE BASE	<u>\$200,145</u>	<u>\$91,209</u>	<u>\$291,354</u>	<u>(\$96,691)</u>	<u>\$194,663</u>

BAYSIDE UTILITY SERVICES, INC.		SCHED. NO. 1-C	
ADJUSTMENTS TO RATE BASE		DOCKET 030444-WS	
TEST YEAR ENDED 12/31/02			
EXPLANATION	WATER	WASTEWATER	
<u>PLANT IN SERVICE</u>			
1 To remove unsupported pro forma plant.(Issue 2)	(\$80,000)	(\$25,000)	
2 To reflect uncontested audit adjustments.(Issue 3)	(52,982)	(6,050)	
3 To reflect the appropriate allocated rate base.(Issue 4)	<u>(533)</u>	<u>(533)</u>	
Total	<u>(\$133,515)</u>	<u>(\$31,583)</u>	
<u>ACCUMULATED DEPRECIATION</u>			
1 To remove unsupported pro forma plant. (Issue 2)	\$4,248	\$556	
2 To reflect uncontested audit adjustments.(Issue 3)	<u>(3,888)</u>	<u>(63,053)</u>	
Total	<u>\$360</u>	<u>(\$62,497)</u>	
<u>ACCUM. AMORT. OF CIAC</u>			
To reflect uncontested audit adjustments.(Issue 3)	<u>\$4,317</u>	<u>\$0</u>	
<u>WORKING CAPITAL</u>			
Adjust working capital based on staff's adjusted O&M expenses. (Issue 6)	<u>(\$1,754)</u>	<u>(\$2,611)</u>	

BAYSIDE UTILITY SERVICES, INC.						SCHEDULE NO. 2-A			
CAPITAL STRUCTURE - SIMPLE AVERAGE						DOCKET 030444-WS			
TEST YEAR ENDED 12/31/02									
DESCRIPTION	TOTAL CAPITAL	SPECIFIC ADJUSTMENTS (EXPLAIN)	SUBTOTAL ADJUSTED CAPITAL	PRO RATA ADJUSTMENTS	CAPITAL RECONCILED TO RATE BASE	RATIO	COST RATE	WEIGHTED COST	
PER UTILITY									
1 LONG TERM DEBT	\$94,090,081	\$0	\$94,090,081	(\$93,839,343)	\$250,738	51.32%	7.56%	3.88%	
2 SHORT-TERM DEBT	11,824,500	0	11,824,500	(11,793,011)	\$31,489	6.44%	3.93%	0.25%	
3 PREFERRED STOCK	0	0	0	0	\$0	0.00%	0.00%	0.00%	
4 COMMON EQUITY	77,021,455	0	77,021,455	(76,816,243)	\$205,212	42.00%	11.77%	4.94%	
5 CUSTOMER DEPOSITS	8,484	0	8,484	0	\$8,484	1.74%	6.00%	0.10%	
6 DEFERRED INCOME TAXES	(7,305)	0	(7,305)	0	(\$7,305)	-1.50%	0.00%	-0.00%	
7 TOTAL CAPITAL	<u>\$182,937,215</u>	<u>\$0</u>	<u>\$182,937,215</u>	<u>(\$182,448,597)</u>	<u>\$488,618</u>	<u>100.00%</u>		<u>9.18%</u>	
PER STAFF									
8 LONG TERM DEBT	\$94,090,081	\$0	\$94,090,081	(\$93,967,444)	\$122,637	46.93%	7.56%	3.55%	
9 SHORT-TERM DEBT	11,824,500	0	11,824,500	(11,809,088)	15,412	5.90%	3.93%	0.23%	
10 PREFERRED STOCK	0	0	0	0	0	0.00%	0.00%	0.00%	
11 COMMON EQUITY	77,021,455	0	77,021,455	(76,921,065)	100,390	38.41%	11.21%	4.31%	
12 CUSTOMER DEPOSITS	8,484	0	8,484	0	8,484	3.25%	6.00%	0.19%	
13 DEFERRED INCOME TAXES	(7,305)	<u>21,718</u>	<u>14,413</u>	0	<u>14,413</u>	<u>5.52%</u>	0.00%	<u>0.00%</u>	
14 TOTAL CAPITAL	<u>\$182,937,215</u>	<u>\$21,718</u>	<u>\$182,958,933</u>	<u>(\$182,697,598)</u>	<u>\$261,335</u>	<u>100.00%</u>		<u>8.28%</u>	
						LOW	HIGH		
RETURN ON EQUITY						10.21%	12.21%		
OVERALL RATE OF RETURN						7.90%	8.67%		

**BAYSIDE UTILITY SERVICES, INC.
CAPITAL STRUCTURE
TEST YEAR ENDED 12/31/02**

**SCHED. NO. 2-B
DOCKET 030444-WS**

EXPLANATION

ACCUMULATED DEFERRED INCOME TAXES

Correct the balance and reflect the utility's special tax depreciation claim. (Issue 8)

\$21,718

Docket No. 030444-WS
 Date: July 22, 2004

BAYSIDE UTILITY SERVICES, INC. STATEMENT OF WATER OPERATIONS TEST YEAR ENDED 12/31/02						SCHEDULE NO. 3-A DOCKET 030444-WS	
DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUST- MENTS	ADJUSTED TEST YEAR PER UTILITY	STAFF ADJUST- MENTS	STAFF ADJUSTED TEST YEAR	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	<u>\$64,713</u>	<u>\$82,850</u>	<u>\$147,563</u>	<u>(\$81,669)</u>	<u>\$65,894</u>	<u>\$31,517</u> 47.83%	<u>\$97,411</u>
OPERATING EXPENSES:							
2 OPERATION & MAINTENANCE	\$91,698	\$15,350	\$107,048	(\$26,895)	\$80,153		\$80,153
3 DEPRECIATION	5,985	4,248	10,233	(5,799)	4,434		4,434
4 AMORTIZATION	0	0	0	0	0		0
5 TAXES OTHER THAN INCOME	4,719	3,876	8,595	(4,443)	4,152	\$1,418	5,571
6 INCOME TAXES	<u>(14,723)</u>	<u>18,302</u>	<u>3,579</u>	<u>(13,173)</u>	<u>(9,594)</u>	<u>11,326</u>	<u>1,732</u>
7 TOTAL OPERATING EXPENSES	<u>\$87,679</u>	<u>\$41,776</u>	<u>\$129,455</u>	<u>(\$50,310)</u>	<u>\$79,145</u>	<u>\$12,744</u>	<u>\$91,890</u>
8 OPERATING INCOME	<u>(\$22,966)</u>	<u>\$41,074</u>	<u>\$18,108</u>	<u>(\$31,359)</u>	<u>(\$13,251)</u>	<u>\$18,772</u>	<u>\$5,521</u>
9 RATE BASE	<u>\$101,083</u>		<u>\$197,264</u>		<u>\$66,672</u>		<u>\$66,672</u>
10 RATE OF RETURN	<u>(22.72%)</u>		<u>9.18%</u>		<u>(19.88%)</u>		<u>8.28%</u>

Docket No. 030444-WS

Date: July 22, 2004

BAYSIDE UTILITY SERVICES, INC. STATEMENT OF WASTEWATER OPERATIONS TEST YEAR ENDED 12/31/02						SCHEDULE NO. 3-B DOCKET 030444-WS	
DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUST- MENTS	ADJUSTED TEST YEAR PER UTILITY	STAFF ADJUST- MENTS	STAFF ADJUSTED TEST YEAR	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	<u>\$90,721</u>	<u>\$83,339</u>	<u>\$174,060</u>	<u>(\$81,447)</u>	<u>\$92,613</u>	<u>\$39,609</u> 42.77%	<u>\$132,222</u>
OPERATING EXPENSES							
2 OPERATION & MAINTENANCE	\$104,533	\$15,514	\$120,047	(\$33,752)	\$86,295		\$86,295
3 DEPRECIATION	10,559	1,556	12,115	5,432	17,547		17,547
4 AMORTIZATION	0	0	0	0	0		0
5 TAXES OTHER THAN INCOME	5,920	3,904	9,824	(4,405)	5,419	1,782	7,202
6 INCOME TAXES	<u>(12,203)</u>	<u>17,532</u>	<u>5,329</u>	<u>(14,505)</u>	<u>(9,176)</u>	<u>14,234</u>	<u>5,058</u>
7 TOTAL OPERATING EXPENSES	<u>108,809</u>	<u>38,506</u>	<u>147,315</u>	<u>(47,230)</u>	<u>100,085</u>	<u>16,016</u>	<u>116,102</u>
8 OPERATING INCOME	<u>(\$18,088)</u>	<u>\$44,833</u>	<u>\$26,745</u>	<u>(\$34,217)</u>	<u>(\$7,472)</u>	<u>\$23,592</u>	<u>\$16,120</u>
9 RATE BASE	<u>\$200,145</u>		<u>\$291,354</u>		<u>\$194,663</u>		<u>\$194,663</u>
10 RATE OF RETURN	<u>(9.04%)</u>		<u>9.18%</u>		<u>(3.84%)</u>		<u>8.28%</u>

BAYSIDE UTILITY SERVICES, INC.
ADJUSTMENTS TO OPERATING INCOME
TEST YEAR ENDED 12/31/02

SCHED. NO. 3-C
DOCKET 030444-WS

EXPLANATION	WATER	WASTEWATER
<u>OPERATING REVENUES</u>		
Remove requested final revenue increase	<u>(\$81,669)</u>	<u>(\$81,447)</u>
<u>OPERATION & MAINTENANCE EXPENSE</u>		
1 To reflect the appropriate WSC allocated costs.(Issue 4)	(\$1,426)	(\$1,426)
2 To reflect the appropriate operator salaries. (Issue 9)	(9,589)	(9,589)
3 To reflect the appropriate pensions and benefits. (Issue 9)	(3,652)	(3,652)
4 To reflect the appropriate health care and insurance costs. (Issue 10)	(714)	(679)
5 To adjust purchased water for excessive unaccounted for water. (Issue 11)	(2,184)	(
6 To normalize test year materials and supplies expenses. (Issue 12)	(1,020)	(10,257)
7 To normalize test year bad debt expense. (Issue 13)	(435)	(592)
8 To reflect the appropriate rate case expense. (Issue 14)	(5,656)	(5,656)
9 To reflect the repression adjustment to O&M expenses. (Issue 18)	<u>(2,217)</u>	<u>(1,900)</u>
Total	<u>(\$26,895)</u>	<u>(\$33,752)</u>
<u>DEPRECIATION EXPENSE-NET</u>		
1 To remove unsupported pro forma plant. (Issue 2)	(\$4,248)	(\$556)
2 To reflect uncontested audit adjustments. (Issue 3)	(1,494)	6,04.
3 To reflect the appropriate allocated rate base. (Issue 4)	<u>(57)</u>	<u>(57)</u>
Total	<u>(\$5,799)</u>	<u>\$5,43</u>
<u>TAXES OTHER THAN INCOME</u>		
1 RAFs on revenue adjustments above.	(\$3,675)	(\$3,665)
2 To adjust property taxes for unsupported pro forma plant. (Issue 2)	(34)	(6
3 To reduce payroll taxes on above salary adjustments. (Issue 9)	<u>(734)</u>	<u>(734)</u>
Total	<u>(\$4,443)</u>	<u>(\$4,405)</u>
<u>INCOME TAXES</u>		
To adjust to test year income tax expense.	<u>(\$13,173)</u>	<u>(\$14,505)</u>

BAYSIDE UTILITY SERVICES, INC.		SCHEDULE NO. 4-A				
WATER MONTHLY SERVICE RATES		DOCKET 030444-WS				
TEST YEAR ENDED 12/31/02						
	Rates Prior to Filing	Commission Approved Interim	Utility Requested Final	Staff Recomm. Final	Four-year Rate Reduction	
<u>Residential Service</u>						
Base Facility Charge:						
5/8" x 3/4"	\$13.25	\$21.93	\$29.91	\$12.76	\$1.02	
3/4"	\$19.86	\$32.87	\$44.84	\$19.15	\$1.53	
1"	\$33.13	\$54.84	\$74.80	\$31.91	\$2.55	
Gallage Charge, per 1,000 Gallons						
	\$2.11	\$3.49	\$4.76	\$5.19	\$0.41	
<u>General Service</u>						
Base Facility Charge:						
5/8" x 3/4"	\$13.25	\$21.93	\$29.91	\$12.76	\$1.02	
3/4"	\$19.86	\$32.87	\$44.84	\$19.15	\$1.53	
1"	\$33.13	\$54.84	\$74.80	\$31.91	\$2.55	
1-1/2"	\$66.25	\$109.66	\$149.57	\$63.82	\$5.09	
2"	\$105.99	\$175.43	\$239.29	\$102.11	\$8.15	
3"	\$211.99	\$350.88	\$478.59	\$204.23	\$16.29	
4"	\$331.22	\$548.23	\$747.77	\$319.10	\$25.46	
6"	\$662.43	\$1,096.44	\$1,495.52	\$638.20	\$50.91	
Gallage Charge, per 1,000 Gallons						
	\$2.11	\$3.49	\$4.76	\$5.19	\$0.41	
<u>5/8" x 3/4" meter</u>						
<u>Typical Residential Bills</u>						
3,000 Gallons	\$19.58	\$32.40	\$44.19	\$28.33		
5,000 Gallons	\$23.80	\$39.38	\$53.71	\$38.71		
6,000 Gallons	\$25.91	\$42.87	\$58.47	\$43.90		

**BAYSIDE UTILITY SERVICES, INC.
WASTEWATER MONTHLY SERVICE RATES
TEST YEAR ENDED 12/31/02**

**SCHEDULE NO. 4-E
DOCKET 030444-WS**

	Rates Prior to Filing	Commission Approved Interim	Utility Requested Final	Staff Recomm. Final	Four-year Rate Reduction
--	--------------------------------------	--	--	------------------------------------	---

Residential

Base Facility Charge:

All meter sizes \$16.91 \$28.18 \$32.00 \$21.86 \$1.28

Gallage Charge - Per 1,000
gallons (6,000 gallon cap)

\$4.18 \$6.97 \$7.91 \$7.10 \$0.42

General Service

Base Facility Charge:

Meter Size:

5/8" x 3/4" \$16.91 \$28.18 \$32.00 \$21.86 \$1.28

1" \$25.38 \$42.29 \$48.03 \$54.64 \$3.21

1-1/2" \$42.29 \$70.47 \$80.03 \$109.28 \$6.42

2" \$84.56 \$140.90 \$160.02 \$174.85 \$10.28

3" \$135.31 \$225.47 \$256.06 \$349.69 \$20.55

4" \$272.81 \$454.58 \$516.26 \$546.40 \$32.11

6" \$422.84 \$704.58 \$800.17 \$1,092.80 \$64.23

8" \$845.70 \$1,409.19 \$1,600.37 \$1,748.47 \$102.77

Gallage Charge, per 1,000 Gallons \$5.00 \$8.33 \$9.46 \$8.51 \$0.50

5/8" x 3/4" meter

Typical Residential Bills

3,000 Gallons \$31.91 \$53.17 \$60.38 \$43.16

5,000 Gallons \$41.91 \$69.83 \$79.30 \$57.36

6,000 Gallons \$46.91 \$78.16 \$88.76 \$64.46

(Wastewater Gallage Cap - 6,000 Gallons)