

Hong Wang

070693

From: Carol Purvis on behalf of Ann Cole
Sent: Friday, April 18, 2008 4:45 PM
To: Hong Wang; Carol Purvis
Subject: FW: Revision of Recommendation

CMP
 COM
 CTR
 ECR
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 OTH Cole
 Wang
 Willis
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fyi

From: Mary Bane
Sent: Friday, April 18, 2008 4:32 PM
To: Cheryl Bulecza-Banks
Cc: Chuck Hill; Tim Devlin; Marshall Willis; Rick Wright; Keino Young; Michael Springer; Tom Walden; Bart Fletcher; William C. Garner; Roberta Bass; Lorena Holley; Larry Harris; Bridget Groom; Ann Cole; Betty Ashby; Mary Bane
Subject: RE: Revision of Recommendation

Approved. Plesae deliver the revised rec to the aides ASAP.

From: Cheryl Bulecza-Banks
Sent: Friday, April 18, 2008 3:52 PM
To: Mary Bane
Cc: Chuck Hill; Tim Devlin; Marshall Willis; Rick Wright; Keino Young; Michael Springer; Tom Walden; Bart Fletcher
Subject: Revision of Recommendation

Staff requests approval to file a revised recommendation for Item 9 scheduled for Tuesday's agenda. Item 9 relates to an interim increase request by Lake Utility Services, Inc. The modifications are necessary to correct errors discovered after the recommendation was filed. The company has refused to waive the 60-day deadline so this item cannot be deferred.

Revisions to the recommendation are necessary because the amount of accumulated depreciation included in the wastewater rate base was overstated due to a mathematical error. Also, in reconciling the rate base to the capital structure, staff incorrectly prorated its adjustments over deferred taxes and customer deposits. Current Commission practice is to only prorate costs over investor sources of capital. With respect to water rates, one of the company's systems (Lake Utility Services, Inc. - Excluding Lake Groves) bills its customers on a bimonthly basis. In its presentation of rates for this system, staff showed the rates on a monthly basis. While the base facility charge was correctly calculated, the gallonage charge was inadvertently halved. Staff originally presented the rates for this system on a monthly basis because the company's proposed final rates were on a monthly basis. Staff has determined that it would be better to present the rates on a bi-monthly basis because the customers will continue to be billed on a bi-monthly basis throughout the interim period. As a result, staff has changed its presentation of rates for one of the systems, "Lake Utility Services, Inc. - Excluding Lake Groves."

As a result of the above corrections, the wastewater rate base increased from \$2,107,837 to \$2,729,211, a difference of \$621,374. The overall cost of capital decreased from 7.43% to 7.34%. Based on the change in depreciation and cost of capital, the water revenue requirement decreased by \$14,060 and the revenue requirement for wastewater increased \$57,903. As this is an interim increase, all revenues collected are subject to refund pending the determination of the final increase, if any.

The impact of staff's revisions on rates is shown below:

Lake Utility Services, Inc. – Excluding Lake Groves (currently billed bi-monthly)

Residential Customer – 5/8" x 3/4" – Water Rates

Monthly Rate	Original Rec	Rate Based on Staff's Revisions	DOCUMENT NUMBER DATE
			03111 APR 18 08

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FPSC-COMMISSION CLERK

In Original Rec	Converted to Bi-Monthly	Bi-Monthly	Difference - Decrease
\$6.65	\$13.30	\$13.24	(\$0.06)

Lake Utility Services, Inc. – Lake Groves (currently billed monthly)

Residential Customer – 5/8” x 3/4” – Water Rates

Rate in Original Rec	Rate Based on Staff's Revisions	Difference - Decrease
\$13.39	\$13.33	(\$0.06)

Lake Utility Services, Inc. – (currently billed monthly)

Residential Customer – 5/8” x 3/4” – Wastewater Rates

Rate in Original Rec	Rate Based on Staff's Revisions	Difference - Increase
\$21.73	\$22.79	\$1.06

Staff will, after approval, walk copies of the type and strike changes below to the Commissioner/Commissioner Assistants and explain the changes made. The appropriate revisions are as follows:

A detailed type and strike of the issues is detailed below.

Issue 2: Yes, the Utility should be authorized to collect annual water and wastewater revenues as indicated below: (Wright, Fletcher)

	Adjusted Test Year Revenues	\$ Increase	Revenue Requirement	% Increase
Water	\$2,912,625	\$189,131 \$175,071	\$3,101,756 \$3,087,696	-6.49% 6.01%
Wastewater	\$869,985	\$329,679 \$387,582	\$1,199,664 \$1,257,567	-37.89% 44.55%

Under the rate base section of Issue 2, the utility's wastewater rate base will be changed from \$2,107,837 to \$2,729,211.

RATE BASE

Based on an analysis of the MFRs and Order No. PSC-04-0404-PAA-WS from the utility's last rate proceeding, staff believes that a few adjustments are necessary to the Utility's rate base. LUSI included adjustments to Utility Plant to add the estimated cost of water and wastewater plant additions that were put in service by December 31, 2007 and the cost of reuse plant that will be completed in 2008 with the total adjustment to water in the amount of \$9,616,143 and

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the adjustment to wastewater in the amount of \$7,629,553. LUSI also made adjustments to increase accumulated depreciation to December 31, 2008 for water in the amount of \$769,612 and for wastewater in the amount of \$310,687 corresponding to the adjustments to Utility Plant described above. The Utility made additional adjustments to Contributions in Aid of Construction (CIAC) to increase the amount for water by \$434,188 and to wastewater by \$25,934 to adjust average CIAC to year end as of December 31, 2007. Finally, LUSI made adjustments to increase accumulated amortization of CIAC in the amounts of \$380,464 for water and \$178,615 for wastewater to adjust to year end as of December 31, 2007. All the aforementioned rate base adjustments should be considered pro forma adjustments and therefore excluded from the historical period ending June 30, 2007. Pursuant to Section 367.082(5)(b) (1), F.S., the achieved rate of return shall be calculated by applying appropriate adjustments consistent with the most recent individual rate proceeding of the utility and annualizing any rate changes occurring during the interim test year may be made. Therefore, staff recommends that LUSI's interim water rate base should be \$8,143,847. The Utility's wastewater rate base should be ~~\$2,107,837~~ \$2,729,211.

Under the cost of capital base section of Issue 2, the utility's interim weighted average cost of capital will be changed from 7.43% to 7.34%.

COST OF CAPITAL

On MFR Schedule D-2(Interim), LUSI reflected a balance of \$81,053 for accumulated deferred income taxes (ADITs). According to MFR Schedule A-18, the Utility's 13-month average debit ADITs is (\$101,241) and the Utility's credit ADITs, shown on MFR Schedule A-19 is \$0. Rule 25-30.433(3)&(4), Florida Administrative Code (F.A.C.), states:

(3) Used and useful debit deferred taxes shall be offset against used and useful credit deferred taxes in the capital structure. Any resulting net debit deferred taxes shall be included as a separate line item in the rate base calculation. Any resulting net credit deferred taxes shall be included in the capital structure calculation. No other deferred debits shall be considered in rate base when the formula method of working capital is used.

(4) The averaging method used by the Commission to calculate rate base and cost of capital shall be a 13-month average for Class A utilities.

The (\$101,241) is a result of netting the debit balances of ADIT against the credit balances of ADIT. The resulting balance should have been classified as a credit rather than a negative debit amount. Therefore, in accordance with Rule 25-30.433(3) and (4), F.A.C., staff recommends that the 13-month average net credit ADITs balance of \$101,241 is the appropriate amount to be included in the capital structure calculation rather than the \$81,053 shown in Schedule D-2.

By Order No. PSC-07-0006-PAA-WS, the utility's minimum of the range of its last authorized ROE is 8.81%. Based on the above, staff recommends that the interim weighted average cost of capital is ~~7.43%~~ 7.34%.

Under the revenue requirement section of Issue 2, interim revenue requirements will change from as follows:

REVENUE REQUIREMENT

Based on the above adjustments, staff recommends revenue requirements of ~~\$3,101,756~~ \$3,087,696 for water and ~~\$1,199,664~~ \$1,257,567 for wastewater. This represents interim increases in annual revenues of ~~\$189,131~~ \$175,071 (or ~~6.49~~ 6.01%) for water and ~~\$329,679~~ \$387,582 (or ~~37.89~~ 44.55%) for wastewater. This will allow the utility the opportunity to recover its water and wastewater operating expenses and earn a ~~7.43~~ 7.34% return on its water and wastewater rate bases.

In Issue 3, the present increase in water rates changes from 6.58% to 6.09% and from 38.38% to 45.01% for wastewater.

Issue 3:

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What are the appropriate interim water and wastewater rates?

Recommendation:

The water and wastewater service rates for LUSI in effect as of June 30, 2007, should be increased by ~~6.58%~~ 6.09% and ~~38.28%~~ 45.01%, respectively, to generate the recommended revenue increase for the interim period. The approved rates should be effective for service rendered as of the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1)(a), F.A.C. The rates should not be implemented until staff verifies that the tariff sheets are consistent with the Commission decision, the proposed customer notice is adequate, and the required security has been filed. The Utility should provide proof of the date notice was given within 10 days after the date of notice. (Wright, Fletcher)

Staff recommends that interim water and wastewater service rates for LUSI be designed to allow the Utility the opportunity to generate annual operating revenues of ~~\$3,101,756~~ \$3,087,696 for water operations and ~~\$1,199,664~~ \$1,257,567 for wastewater operations. Before removal of miscellaneous revenues, this would result in increases of ~~\$189,131~~ \$175,071 or ~~6.49~~ 6.01% for water and ~~\$329,679~~ \$387,582 or ~~37.89~~ 44.55% for wastewater. To determine the appropriate percentage increase to apply to the service rates, miscellaneous service revenues should be removed from the test year revenues. The calculation is as follows:

	<u>Water</u>	<u>Wastewater</u>
1 Total Test Year Revenues	\$2,912,625	\$869,985
2 Less: Miscellaneous Revenues	<u>39,572</u>	<u>8,837</u>
3 Test Year Revenues from Service Rates	\$2,873,053	\$861,148
4 Revenue Increase	<u>\$189,131</u>	<u>\$329,679</u>
	<u>\$175,071</u>	<u>\$387,582</u>
5 % Service Rate Increase (Line 4/Line3)	<u>6.58%</u>	<u>38.28%</u>
	6.09%	45.01%

The interim rate increase of ~~6.58~~ 6.09% for water and ~~38.28~~ 45.01% for wastewater should be applied as an across-the-board increase to the service rates in effect as of June 30, 2007. The approved rates should be effective for service rendered as of the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1), F.A.C. The rates should not be implemented until staff verifies that the tariff sheets are consistent with the Commission decision, the proposed customer notice is adequate, and the required security has been filed. The Utility should provide proof of the date notice was given within 10 days after the date of notice.

The Utility's test year, proposed interim and final rates, and staff's recommended interim rates are shown on Schedule No. 4-A and No. 4-B for water and Schedule No. 4-C for wastewater.

In Issue 4, the amount of the required corporate undertaking increases from \$305,175 to \$330,964. The total interim increase increases from \$518,810 to \$562,653.

Issue 4:

What is the appropriate security to guarantee the interim increase?

Recommendation:

A corporate undertaking is acceptable contingent upon receipt of the written guarantee of the parent company, Utilities, Inc. (UI), and written confirmation of UI's continued attestation that it does not have any outstanding guarantees on behalf of UI-owned utilities in other states. UI should be required to file a corporate undertaking on behalf of its subsidiaries to guarantee any potential refunds of revenues collected under interim conditions. UI's total guarantee should be the amount of ~~\$305,175~~ \$330,964. Pursuant to Rule 25-30.360(6), F.A.C., the Utility should provide a report by the 20th of each month indicating the monthly and total revenue collected subject to refund. Should a refund be required, the refund should be with interest and undertaken in accordance with Rule 25-30.360, F.A.C.

(Wright, Fletcher, Springer)

Staff Analysis:

Pursuant to Section 367.082, F.S., revenues collected under interim rates shall be placed under bond, escrow, letter of credit, or corporate undertaking subject to refund with interest at a rate ordered by the Commission. As recommended in Issue 2, the total annual interim increase is ~~\$518,810~~ \$562,653 for water and wastewater. In accordance with Rule 25-30.360, F.A.C., staff has calculated the potential refund of revenues and interest collected under interim conditions to be ~~\$305,175~~ \$330,964. This amount is based on an estimated seven months of revenue being collected from staff's recommended interim rates over the utility's current authorized rates shown on Schedules Nos. 4A, 4B and 4C.

LUSI is a wholly-owned subsidiary of UI, which provides all investor capital to its subsidiaries. As such, staff reviewed the financial statements of UI. As a result of staff's interim recommendation, the total requested cumulative corporate undertaking amount is ~~\$305,175~~ \$330,964 subject to refund for this docket.

The criteria for a corporate undertaking includes sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. Staff has reviewed UI's financial statements from 2004 to 2006 to determine the financial condition of the parent company. Staff's analysis shows that UI has experienced a significant decline in liquidity and interest coverage during 2005 compared to prior years. However, UI's average equity ratio over the three-year period has been 40%. UI's financial performance has demonstrated adequate levels of both profitability and equity capitalization to offset the recent decline in liquidity and interest coverage. Based upon this analysis, staff recommends that a cumulative corporate undertaking of ~~\$305,175~~ \$330,964 is acceptable contingent upon the receipt of the written guarantee of UI and written confirmation that UI does not have any outstanding guarantees on behalf of UI-owned utilities in other states.

Pursuant to Rule 25-30.360(6), F.A.C., the Utility shall 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, F.A.C.

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.