

MEMORANDUM

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April 11, 1996

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FPSC-RECORDS/REPORTING  
3:05

TO: DIVISION OF RECORDS AND REPORTING  
FROM: DIVISION OF LEGAL SERVICES (VACCARO/REYES) *BLR JAT*  
RE: DOCKET NO. 960234-WS - INVESTIGATION OF RATES OF GULF  
UTILITY COMPANY IN LEE COUNTY FOR POSSIBLE OVEREARNINGS.

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Attached is ORDER INITIATING INVESTIGATION INTO RATES AND CHARGES AND MAKING REVENUES SUBJECT TO REFUND, with attachments, to be issued in the above-referenced docket. (Number of pages in Order - 11)

TV, BLR/mw

Attachment

cc: Division of Water and Wastewater (Merchant)

I: 960234-O.TV

*(attachments pgs 7-11 not in (1115))*

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Investigation of rates ) DOCKET NO. 960234-WS  
of Gulf Utility Company in Lee ) ORDER NO. PSC-96-0501-POF-WS  
County for possible ) ISSUED: April 11, 1996  
overearnings. )  
\_\_\_\_\_ )

The following Commissioners participated in the disposition of this matter:

SUSAN F. CLARK, Chairman  
J. TERRY DEASON  
JOE GARCIA  
JULIA L. JOHNSON  
DIANE K. KIESLING

ORDER INITIATING INVESTIGATION INTO  
RATES AND CHARGES AND MAKING REVENUES  
SUBJECT TO REFUND

BY THE COMMISSION:

BACKGROUND

Gulf Utility Company (Gulf or the utility) is a Class A utility providing water and wastewater service for approximately 6,529 water and 2,070 wastewater customers in Lee County which is within a Water Caution Area. For the test period ending June 30, 1995, the utility reported water operating revenues of \$2,089,347 and a net operating income of \$557,814. Wastewater operating revenues were \$1,042,151, with a net operating income of \$133,046.

Gulf's last rate case was finalized on July 1, 1991, in Order No. 24735, Docket No. 900718-WU. In that order, rate base was set and an overall rate of return of 13.11% was approved.

INITIATION OF OVERTURNINGS INVESTIGATION AND  
PLACING REVENUES SUBJECT TO REFUND

Based on a desk audit of the 1994 annual report for Gulf Utility Company, we began an informal investigation into potential overearnings. The 1994 annual report indicated that Gulf's water system was earning an achieved overall rate of return of 24.08%. We requested an audit of the utility's books for the test year ended June 30, 1995. Our audit indicated that the water system was earning an overall rate of return of 19.52%. Based on the results of our audit, we find it appropriate that this docket be opened to

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investigate the potential overearnings of the utility. Furthermore, the water and wastewater rate base should be established since both were last set by us as of July 1, 1991.

Accounting schedules are attached to illustrate interim water and wastewater rate base, capital structure, and test year operating income amounts. The rate base schedules are numbered 1-A and 1-B. The capital structure is Schedule No. 2. Schedules Nos. 3-A and 3-B are reserved for the operating statements.

For the purposes of this Order, the schedules reflect the test year ending balances as provided by the auditors, as well as specific audit adjustments. Since there was no filing on the part of the utility, the amounts according to the audit do not necessarily reflect the utility's position. These balances do not include any utility calculations for working capital, income taxes or the overall cost of capital.

#### RATE BASE

##### Utility Plant in Service/Accumulated Depreciation

The last rate order contained an adjustment to water plant to adjust for the cost of a Lexus automobile. The adjustment in Order No. 24735 reduced plant by \$20,721 and reduced accumulated depreciation by \$9,648. Audit Exception No. 1 notes that these adjustments are not booked. Consistent with Section 367.082(2)(b), Florida Statutes, for interim refund purposes, we find it appropriate to book the adjustments from this Order. The amount removed is 72% of the cost of the vehicle. Therefore, we have also adjusted accumulated depreciation and depreciation expense at 72% of the total amount. We find that accumulated depreciation totals \$15,822. One half is allocated to water and one half shall be allocated to wastewater. We computed depreciation expense at 16.67% of the \$20,721 and allocated it equally to water and wastewater, at \$1,726 each.

##### Working Capital

Section 367.082(5)(b)1, Florida Statutes requires that, in calculating interim rates, adjustments be made consistent with those in the utility's last rate proceeding. Consistent with the treatment allowed in Gulf's last rate proceeding, in Order No. 24735, we have calculated working capital using the formula method. We have used the balance sheet method to calculate a working capital allowance of \$308,293 for water and \$145,079 for

wastewater. Based on our preliminary review and the use of the formula method, we find a working capital allowance of \$147,065 for water and \$82,565 for wastewater is appropriate.

We find it appropriate to establish rate base for interim purposes at \$2,152,968 and \$2,868,619 for water and wastewater, respectively.

#### COST OF CAPITAL

In Order No. 24735 we established Gulf's return on equity at 13.11%, with a range of 12.11% to 14.11%. Consistent with Section 367.082(2)(b), Florida Statutes, the appropriate rate of return on equity for interim refund purposes is calculated using the maximum of the range of the last authorized rate of return on equity. Using the high-end of the range to calculate any potential overearnings, we have established an overall rate of return of 9.82% for interim purposes.

#### NET OPERATING INCOME

In addition to the rate base adjustments consistent with the last rate case such as adjusting the cost of the Lexus (Audit Exception No. 1), we have adjusted transportation expenses to remove \$5,082 (\$3,524 water and \$1,558 wastewater) of expenses related to the repair of the Lexus in the test year.

According to the NARUC chart of accounts, charitable contributions are to be charged to account 426, a below the line account. The utility has included \$1,210 (\$839 water and \$371 wastewater) of charitable contributions in accounts 675.8 and 775.8, miscellaneous expenses. We have reclassified these expenses to remove them from net operating income.

We have also calculated income tax expense for the test year. Income tax expense of \$143,639 for water and a negative \$45,804 for wastewater is appropriate for interim purposes.

We find it appropriate to establish interim net operating income, at \$420,264 for the water system and \$182,505 for the wastewater system.

#### Revenue Requirement

Water operating revenues, as adjusted by us, total \$2,089,347 and net operating income totals \$420,264. This represents a 19.52% overall rate of return. Our calculation indicates a revenue requirement of \$1,735,855 for the interim test year, representing

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an annual decrease of \$353,492. Accordingly, 16.92% of test year water revenues shall be held subject to refund pending our final determination. The wastewater system is earning an overall rate of return of 6.36% on an annual basis which is less than the minimum range on the overall rate of return. Accordingly, we have made no adjustments to wastewater.

#### SECURITY

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. The amount of potential overearnings in the water system is \$353,492 on an annual basis. Assuming a 6-month time frame, the potential refund amount is \$176,746. Interest, calculated in accordance with Rule 25-30.360, Florida Administrative Code, is \$2,457, making the total \$179,203, which should be collected under guarantee, subject to refund with interest.

Our Staff has indicated that Gulf Utility Company does not qualify for a corporate undertaking. Based on our financial analysis, the utility has adequate liquidity and is profitable. However, the utility has an extremely low equity ratio and inadequate interest coverage, and its combined net income for the past three years is less than the amount under consideration. Therefore, we find that the utility cannot support the necessary corporate undertaking. Therefore, the utility shall secure revenue subject to refund with a surety bond, letter of credit, or escrow agreement.

This brief financial analysis is only appropriate for deciding if the utility can support a corporate undertaking in the amount proposed and should not be considered a finding regarding our position on other issues in the earnings investigation.

Also, by no later than the twentieth (20) day of each month, the utility shall file a report showing the amount of revenues collected each month and the amount of revenues collected to date relating to the amount subject to refund. Should a refund be required, the refund shall be with interest and undertaken in accordance with Rule 25-30.360, Florida Administrative Code.

In no instance shall maintenance and administrative costs associated with any refund be borne by the customers. The costs are the responsibility of, and shall be borne by, the utility.

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The utility has indicated that it will be filing a rate case for its wastewater system. This investigation of Gulf's water earnings shall be combined with the utility's wastewater rate case at the appropriate time.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that an investigation of the water rates and charges of Gulf Utility Company shall be initiated. It is further

ORDERED that the utility hold annual water revenues of \$353,492 as a guarantee of any potential refund of water revenues collected under interim conditions by means of a surety bond, letter of credit, or escrow agreement. It is further

ORDERED that by no later than the twentieth (20) day of each month, the utility shall file a report showing the amount of revenues collected each month and the amount of revenues collected to date relating to the amount subject to refund. Should a refund be required, the refund shall be with interest and undertaken in accordance with Rule 25-30.360, Florida Administrative Code. It is further

ORDERED that no maintenance or administrative costs associated with any refund shall be borne by the customers. It is further

ORDERED that this investigation of Gulf Utility Company's water earnings shall be combined with its wastewater rate case. It is further

ORDERED that this docket shall remain open.

By ORDER of the Florida Public Service Commission, this 11th day of April, 1996.

  
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BLANCA S. BAYÓ, Director  
Division of Records and Reporting

( S E A L )  
ATTACHMENT PAGES 7-11 ARE NOT AVAILABLE IN ELECTRONIC MEDIUM.  
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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water and/or wastewater utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900 (a), Florida Rules of Appellate Procedure.

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ATTACHMENT A  
 PAGE 1 OF 5

GULF UTILITY COMPANY  
 SCHEDULE OF WATER RATE BASE  
 TEST YEAR ENDED 6/30/85

SCHEDULE NO. 1-A  
 DOCKET NO. 960234-WS

COMPONENT	TEST YEAR PER AUDIT	AUDIT ADJUSTMENTS	BALANCE PER AUDIT	STAFF ADJUSTMENTS	STAFF ADJ. AVERAGE BALANCE
1 UTILITY PLANT IN SERVICE	\$14,802,928	\$ (10,361)	\$14,792,565	\$ 0	\$14,792,565
2 LAND & LAND RIGHTS	200,160	0	200,160	0	200,160
3 NON-USED & USEFUL COMPONENTS	(881,728)	0	(881,728)	0	(881,728)
4 ACCUMULATED DEPRECIATION	(3,368,641)	7,911	(3,360,730)	0	(3,360,730)
5 CIAC	(11,114,615)	0	(11,114,615)	0	(11,114,615)
6 AMORTIZATION OF CIAC	2,391,645	0	2,391,645	0	2,391,645
7 ADVANCES FOR CONSTRUCTION	(21,394)	0	(21,394)	0	(21,394)
8 WORKING CAPITAL ALLOWANCE	<u>309,293</u>	<u>(161,228)</u>	<u>147,065</u>	<u>0</u>	<u>147,065</u>
<b>WATER RATE BASE</b>	<b><u>\$ 2,316,646</u></b>	<b><u>\$ (163,678)</u></b>	<b><u>\$ 2,152,968</u></b>	<b><u>\$ 0</u></b>	<b><u>\$ 2,152,968</u></b>



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ATTACHMENT A  
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GULF UTILITY COMPANY  
 SCHEDULE OF WASTEWATER RATE BASE  
 TEST YEAR ENDED 6/30/95

SCHEDULE NO. 1-B  
 DOCKET NO. \_\_\_\_\_-WS

COMPONENT	TEST YEAR PER AUDIT	AUDIT ADJUSTMENTS	BALANCE PER AUDIT	STAFF ADJUSTMENTS	STAFF ADJ. AVERAGE BALANCE
1 UTILITY PLANT IN SERVICE	\$11,218,844	\$ (10,360)	\$11,208,284	0	\$11,208,284
2 LAND	473,487	0	473,487	0	473,487
3 NON-USED & USEFUL COMPONENTS	0	0	0	0	0
4 ACCUMULATED DEPRECIATION	(2,382,387)	7,811	(2,374,456)	0	(2,374,456)
5 CIAC	(8,088,847)	0	(8,088,847)	0	(8,088,847)
6 AMORTIZATION OF CIAC	1,567,808	0	1,567,808	0	1,567,808
7 ADVANCES FOR CONSTRUCTION	0	0	0	0	0
8 WORKING CAPITAL ALLOWANCE	<u>145,079</u>	<u>(62,514)</u>	<u>82,565</u>	<u>0</u>	<u>82,565</u>
WASTEWATER RATE BASE	<u>\$ 2,823,582</u>	<u>\$ (64,823)</u>	<u>\$ 2,858,819</u>	<u>\$ 0</u>	<u>\$ 2,858,819</u>

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ATTACHMENT A  
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GULF UTILITY COMPANY  
 CAPITAL STRUCTURE  
 TEST YEAR ENDED 6/30/85

SCHEDULE NO. 2  
 DOCKET NO. 960234-WS

PER AUDIT	TOTAL CAPITAL	SPECIFIC ADJUSTMENTS	PRO RATA ADJUSTMENTS	CAPITAL RECONCILED TO RATE BASE	RATIO	COST RATE	WEIGHTED COST
LONG TERM DEBT	\$ 9,895,000	\$ 0	\$ (5,647,747)	\$ 4,247,253	84.58%	10.34%	8.75%
SHORT-TERM DEBT	75,360	0	(43,012)	32,348	0.84%	11.72%	0.08%
PREFERRED STOCK	0	0	0	0	0.00%	0.00%	0.00%
COMMON EQUITY	778,813	0	(433,718)	343,194	6.83%	13.11%	0.90%
CUSTOMER DEPOSITS	185,564	0	(101,858)	83,606	1.66%	6.21%	0.10%
DEFERRED INCOME TAXES	720,086	0	(404,800)	315,186	6.28%	0.00%	0.00%
DEFERRED ITC'S-WTD COST	0	0	0	0	0.00%	0.00%	0.00%
OTHER	0	0	0	0	0.00%	0.00%	0.00%
TOTAL CAPITAL	<u>\$11,652,823</u>	<u>\$ 0</u>	<u>\$ (6,621,338)</u>	<u>\$ 5,021,587</u>	<u>100.00%</u>		<u>9.82%</u>

RANGE OF REASONABLENESS	LOW	HIGH
RETURN ON EQUITY	12.11%	14.11%
OVERALL RATE OF RETURN	9.75%	9.89%

GULF UTILITY COMPANY  
 STATEMENT OF WATER OPERATIONS  
 TEST YEAR ENDED 8/30/95

SCHEDULE NO. 3-A  
 DOCKET NO. 960234-WS

DESCRIPTION	TEST YEAR PER AUDIT	AUDIT ADJUSTMENTS	BALANCE PER AUDIT	STAFF ADJUSTMENTS	STAFF ADJ. AVERAGE BALANCE	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	\$ 2,089,347	\$ 0	\$ 2,089,347	\$ 0	\$ 2,089,347	\$ (353,482)	\$ 1,735,855
OPERATING EXPENSES:						-16,922	
2 OPERATION AND MAINTENANCE	\$ 1,180,884	\$ (4,363)	\$ 1,176,521	\$ 0	\$ 1,176,521	\$	\$ 1,176,521
3 DEPRECIATION	511,856	(1,726)	510,130	0	510,130		510,130
4 AMORTIZATION	(348,307)	0	(348,307)	0	(348,307)		(348,307)
5 TAKES OTHER THAN INCOME	187,100	0	187,100	0	187,100	(15,807)	171,183
6 INCOME TAXES	<u>0</u>	<u>143,639</u>	<u>143,639</u>	<u>0</u>	<u>143,639</u>	<u>(139,223)</u>	<u>13,416</u>
7 TOTAL OPERATING EXPENSES	<u>\$ 1,531,533</u>	<u>\$ 137,550</u>	<u>\$ 1,669,083</u>	<u>\$ 0</u>	<u>\$ 1,669,083</u>	<u>\$ (146,129)</u>	<u>\$ 1,522,853</u>
8 OPERATING INCOME	<u>\$ 557,814</u>	<u>\$ (137,550)</u>	<u>\$ 420,264</u>	<u>\$ 0</u>	<u>\$ 420,264</u>	<u>\$ (287,361)</u>	<u>\$ 212,903</u>
9 RATE BASE	<u>\$ 2,316,648</u>		<u>\$ 2,152,968</u>		<u>\$ 2,152,968</u>		<u>\$ 2,152,968</u>
10 RATE OF RETURN	<u>24.02%</u>		<u>19.52%</u>		<u>19.52%</u>		<u>9.89%</u>
11 RETURN ON EQUITY					<u>150.82%</u>		<u>14.11%</u>

GULF UTILITY COMPANY  
 STATEMENT OF WASTEWATER OPERATIONS  
 TEST YEAR ENDED 6/30/95

SCHEDULE NO. 3-B  
 DOCKET NO. 960234-WS

	TEST YEAR PER AUDIT	AUDIT ADJUSTMENTS	BALANCE PER AUDIT	STAFF ADJUSTMENTS	STAFF ADJ. AVERAGE BALANCE	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	\$ 1,042,151	\$ 0	\$ 1,042,151	\$ 0	\$ 1,042,151	\$ 0	\$ 1,042,151
OPERATING EXPENSES						0.00%	
2 OPERATION AND MAINTENANCE	\$ 662,450	\$ (1,929)	\$ 660,521	\$ 0	\$ 660,521	\$	\$ 660,521
3 DEPRECIATION	397,201	(1,726)	395,475	0	395,475		395,475
4 AMORTIZATION	(270,482)	0	(270,482)	0	(270,482)		(270,482)
5 TAXES OTHER THAN INCOME	119,946	0	119,946	0	119,946	0	119,946
6 INCOME TAXES	0	(45,894)	(45,894)	0	(45,894)	0	(45,894)
7 TOTAL OPERATING EXPENSES	\$ 899,195	\$ (49,459)	\$ 850,646	\$ 0	\$ 850,646	\$ 0	\$ 850,646
8 OPERATING INCOME	\$ 133,946	\$ 49,459	\$ 183,505	\$ 0	\$ 183,505	\$ 0	\$ 183,505
9 RATE BASE	\$ 2,822,582		\$ 2,822,519		\$ 2,822,519		\$ 2,822,519
10 RATE OF RETURN	4.54%		6.26%		6.36%		6.26%
11 RETURN ON EQUITY					-36.38%		-36.38%