

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation into rates
and charges of Florida Cities
Water Company - Lee County
Division (South Ft. Myers
Wastewater System) for potential
overearnings.

DOCKET NO. 970991-SU
ORDER NO. PSC-98-1384-FOF-SU
ISSUED: October 14, 1998

The following Commissioners participated in the disposition of
this matter:

JULIA L. JOHNSON, Chairman
J. TERRY DEASON
SUSAN F. CLARK
JOE GARCIA
E. LEON JACOBS, JR.

NOTICE OF PROPOSED AGENCY ACTION
ORDER ACCEPTING SETTLEMENT OFFER, SETTING RETURN ON EQUITY,
AND KEEPING DOCKET OPEN

BY THE COMMISSION:

NOTICE is hereby given by the Florida Public Service
Commission that the action discussed herein is preliminary in
nature and will become final unless a person whose interests are
substantially affected files a petition for a formal proceeding,
pursuant to Rule 25-22.029, Florida Administrative Code.

BACKGROUND

Florida Cities Water Company (FCWC, Florida Cities, or
utility) is a Class A utility that provides wastewater service for
two communities in Ft. Myers, Florida: a northern sector and a
southern sector. This docket relates to the South Ft. Myers
wastewater facility. As of December 31, 1997, this facility was
serving approximately 8,637 equivalent residential connections
(ERCs). The utility serves an area that has been designated by the
South Florida Water Management District as a critical use area.
For the twelve months ended December 31, 1997, the South Ft. Myers
wastewater system reported operating income of \$937,965.

DOCUMENT NUMBER-DATE

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FPSC-RECORDS/REPORTING

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On July 10, 1996, Lee County approached FCWC regarding treatment and disposal of reclaimed water from its Ft. Myers Beach wastewater treatment plant. On August 28, 1996, FCWC and Lee County entered into an agreement effective July 10, 1996, which provided for Lee County to interconnect its reclaimed water distribution facilities with FCWC's wastewater transmission facility as a temporary solution. At that time, the agreement was not expected to extend beyond July 1998. However, it has since been extended to January 10, 1999.

In Docket No. 961231-WS, FCWC requested that the revenues received pursuant to the agreement be treated as non-recurring so they would not be considered in determining the level of regulated earnings for FCWC. The utility requested that if the revenues from this agreement result in overearnings, the Commission should defer those overearnings to subsequent years. Pursuant to Order No. PSC-97-0019-FOF-WS, issued January 6, 1997, we found it appropriate to treat the estimated annual revenues of \$122,912 associated with the agreement as non-recurring. This order also required FCWC to file semi-annual earnings reports to allow our staff to monitor the utility's earnings. If the revenues associated with this agreement were to place FCWC outside its approved rate of return, the matter was to be addressed in a subsequent docket.

A review of FCWC's 1996 annual report indicated that the utility's wastewater system in South Ft. Myers was exceeding its last authorized return on equity investment. FCWC's agreement with Lee County was the main reason the South Ft. Myers wastewater system was overearning. According to the 1996 annual report, the utility achieved a 10.06 percent overall rate of return and an 18.08 return on equity for wastewater service in South Ft. Myers. The utility also filed for an index in 1996, which was effective for service rendered after June 14, 1996.

In the utility's last rate proceeding for the South Ft. Myers wastewater system, by Order No. PSC-93-1288-FOF-SU, issued September 7, 1993, we approved a range of reasonableness for total capital investment from 8.60 to 9.18 percent. That order also set the return on equity at 12.44 percent, with a range of 11.44 percent to 13.44 percent.

Pursuant to Order No. PSC-97-1125-PCO-SU, issued September 25, 1997, we opened this docket and initiated an overearnings investigation for FCWC's South Ft. Myers wastewater system. By that Order, we held revenues subject to refund pending the final

resolution of this docket. That Order also recognized that the revenues from the 1996 price index, pursuant to the provisions of Section 367.081(4)(d), Florida Statutes, were already subject to refund. Pursuant to that section, we initially had fifteen months from the filing of the 1996 annual report to order a refund of the price-index revenues. However, by letter dated August 7, 1998, the utility extended that time until October 7, 1998. Further, by conversation dated September 9, 1998, the utility has extended this time until December 16, 1998. This Order addresses the resolution of these non-recurring overearnings, and FCWC's proposal to defer its overearnings.

OFFER TO DEFER OVEEREARNINGS

By Order No. PSC-97-1125-PCO-SU, issued September, 25, 1997, we determined that the amount of potential overearnings was \$316,076, on an annual basis. However, on June 14, 1996, FCWC was given the authority to increase its annual revenues by \$35,096 or 1.13 percent for a 1996 price index and according to Section 367.081(4)(d), Florida Statutes, an index is subject to refund for up to fifteen months after the date of filing of the annual report for the year the index was implemented. Therefore, only \$280,980 (\$316,076 less \$35,096) or 7.34 percent in annual wastewater revenues were specifically held subject to refund. Using a 12-month time frame, the potential refund, with interest, was estimated to be \$296,566.

After the above order was issued, our staff had continuing discussions with the utility about the overearnings situation. On February 17, 1998, our staff received a letter from FCWC with an informal proposal addressing the South Ft. Myers wastewater overearnings. The utility noted that the overearnings were a direct result of the revenues associated with the Lee County agreement that was scheduled to end in 1998. FCWC proposed that since it was probable that the South Ft. Myers Wastewater system would be underearning after the Lee County revenues had ceased, it would be more appropriate to apply the temporary overearnings to the potential future underearnings.

Upon review, our staff requested additional supporting documents. The utility provided the requested information on June 15, 1998. Staff reviewed this information and advised the utility that its original proposal needed to be amplified and amended to clarify the exact amount of the settlement offer. On August 6,

1998, the utility filed a formal settlement offer to dispose of the overearnings.

The utility's settlement offer is as follows:

(1) The utility filed for a price index in 1996, which was effective for service rendered after June 14, 1996. FCWC has requested to defer \$21,606 in price index revenues, including interest, received for the test year ended December 31, 1996.

(2)(a) Pursuant to Order No. PSC-97-1125-PCO-SU, issued September 25, 1997, in this docket, the Commission held \$296,566 in annual revenues, subject to refund with interest. According to the utility's supporting documents, the South Ft. Myers wastewater system had excess revenues of \$339,314 for the test year ended December, 31, 1997. Using the following formula, the utility determined that 31.23 percent (or \$105,978) of its 1997 excess revenues was held subject to refund:

# of days from 9/9/97 (Commission Vote) to 12/31/97	114
# of days in 1997	365
Ratio	31.23%

(2)(b) As a settlement, the utility will also defer fifty percent or \$116,668 of the 1997 excess revenues remaining after the removal of the \$105,978. These revenues were not held subject to refund. In exchange for this offer, the utility has requested that it not be required to reduce rates, nor be required to make any refunds.

(3) FCWC will continue to file its semi-annual earnings reports for the South Fort Myers wastewater system.

(4) 1998 overearnings will be addressed in 1999.

(5) All deferred revenues will be included in the South Ft. Myers wastewater system's capital structure, as a separate line item, with interest accrued at the thirty-day commercial paper rate.

(6) The rate of return on equity for 1998 and later years will be based on the current leverage graph formula.

(7) Any remaining balance in deferred 1997 revenues as of December 31, 2000, will be added to CIAC.

We note that while we have not used this approach for water or wastewater utilities, by Proposed Agency Action Order No. PSC-95-0580-FOF-EI, Docket No. 950379-EI, issued May 10, 1995, we allowed Tampa Electric Company (TECO) to defer its 1995 and 1996 excess revenues until 1997. Revenues above its authorized return on equity were deferred and included in the capital structure as a separate line item. Similarly, we also allowed Chesapeake Utilities Corporation and Gulf Telephone Company to defer excess revenues.

We can find no material differences between those cases and the FCWC case. Therefore, we find that water and wastewater utilities shall be afforded the opportunity to defer excess revenues, especially, when the long-term benefits exceed the short-term benefits of refunds and temporary rate reductions. Further, by deferring revenues to offset a projected revenue deficiency, the utility's next rate case may be postponed by the application of past overearnings to future periods, rather than refunding the overearnings to the rate payers. Along with postponing a rate case, disposing of the overearnings through a deferral aids in keeping rates levelized. Stable rates are normally less confusing to ratepayers than fluctuating rates.

However, we have a concern with the utility's calculation of its overearnings for 1997. Using the maximum of the range of its last overall rate of return (or 9.18 percent) and an operating income of \$937,965, when grossed up for taxes and regulatory assessment fees, the utility determined that it had \$339,314 in excess earnings (\$937,965 less \$735,860) for the test year ended December 31, 1997. Pursuant to Section 367.082(4), Florida Statutes, a refund is calculated by comparing a utility's achieved rate of return to the newly authorized rate of return, which is set by using the leverage graph formula.

Based upon the components of the utility's adjusted capital structure, as shown on Schedule No. 2, the equity ratio for FCWC is 39.21 percent. Using the current leverage formula approved by Order No. PSC-97-0660-FOF-WS, issued June 10, 1997, in Docket No. 970006-WS, the appropriate return on equity is 10.46 percent. The appropriate range for the return on equity shall be 9.46 percent to 11.46 percent.

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Based on these calculations, the utility's cost of capital for the test year ended December 31, 1997, is 8.61 percent, which is less than the 9.18 percent used by the utility. Using the new rate of return, we calculate the utility's 1997 revenue requirement and excess earnings to be \$3,357,594 and \$349,032, respectively. The overearnings we calculate are \$9,718 greater than the \$339,314 calculated by the utility.

Even with this adjustment though, and taking into account the 1996 price index for 1996 and 1997 (plus interest), and the revenues held subject to refund for 1997 (\$106,037), we find that the maximum amount we could require the utility to refund to be \$184,050. However, the utility has offered to defer more than this amount.

Based on the above and the fact that the utility has offered to defer more revenues than would be required if it were to refund or to lower rates, FCWC shall be allowed to: defer \$21,606 in price index revenues for 1996; defer \$222,646 in excess revenues for 1997; defer all revenues for 1998 in excess of the mid-point of its authorized return on equity; and defer all the above through the test year ending December 31, 2000. Any remaining balance in deferred revenues as of December 31, 2000, will be added to CIAC. The utility shall continue to file its semi-annual earnings reports, to allow our staff to continue to monitor the earnings situation of the South Ft Myers wastewater facility.

Finally, the deferred revenue shall be included in the capital structure as a separate line item. The cost rate shall be the thirty-day commercial paper rate as specified in Rule 25-30.360, Florida Administrative Code. This docket shall remain open until all overearnings have been addressed. We will address the 1998 excess earnings in 1999 after our staff have reviewed the utility's calculations and its 1998 rate of return.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the offer of Florida Cities Water Company - Lee County Division, the South Ft. Myers Wastewater System, to defer revenues shall be accepted as set forth in the body of this Order. It is further

ORDERED that the provisions of this Order, issued as proposed agency action, shall become final and effective unless an appropriate petition, in the form provided by Rule 28-106.201,

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Florida Administrative Code, is received by the Director, Division of Records and Reporting, 2540 Chambered Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings or Judicial Review" attached hereto. It is further

ORDERED that Florida Cities Water Company shall continue to file semi-annual earnings reports. It is further

ORDERED that the schedules attached to the Order are incorporated and made a part of the Order. It is further

ORDERED that Florida Cities Water Company shall include the deferred revenues as a separate line item in the capital structure for the South Ft. Myers Wastewater System, with a cost rate equal to the thirty-day commercial paper rate. It is further

ORDERED that, when we calculate overearnings for 1998, the current leverage graph formula shall be used. It is further

ORDERED that any remaining balance in deferred revenues as of December 31, 2000, shall be added to contributions in aid of construction. It is further

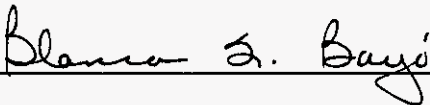
ORDERED that any excess earnings for 1998 will be addressed in 1999. It is further

ORDERED that, using the current leverage formula, the rate of return on equity shall be 10.46 percent, with a range of 9.46 percent to 11.46 percent. It is further

ORDERED that this docket shall remain open until all overearnings have been addressed.

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By ORDER of the Florida Public Service Commission this 14th
day of October, 1998.



BLANCA S. BAYÓ, Director
Division of Records and Reporting

(S E A L)

RRJ

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), 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.

Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

The action proposed herein is preliminary in nature. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, in the form provided by Rule 28-106.201, Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting, 2540 Chambered Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on November 4, 1998.

In the absence of such a petition, this order shall become effective on the day subsequent to the above date.

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Any objection or protest filed in this docket before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

If this order becomes final and effective on the date described above, any party substantially affected may request judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or by the First District Court of Appeal in the case of a water 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 of the effective date 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.