

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation of possible
overearnings by Tierre Verde
Utilities, Inc. in Pinellas
County.

DOCKET NO. 011190-SU
ORDER NO. PSC-01-2094-FOF-SU
ISSUED: October 22, 2001

The following Commissioners participated in the disposition of
this matter:

E. LEON JACOBS, JR., Chairman
J. TERRY DEASON
LILA A. JABER
BRAULIO L. BAEZ
MICHAEL A. PALECKI

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

BY THE COMMISSION:

BACKGROUND

Tierre Verde Utilities, Inc. (Tierre Verde or utility) is a
Class B utility providing wastewater service in Pinellas County.
The utility is a wholly-owned subsidiary of Utilities, Inc.

The utility assets of Seagull Utility Company were purchased
by Tierre Verde in 1992 and the certificate was transferred by
Order No. PSC-93-0364-FOF-SU, issued March 9, 1993, in Docket No.
920716-SU. The utility has not had a rate proceeding since the
transfer; consequently, no return on equity (ROE) has been set for
Tierre Verde. As such, we shall use the leverage formula to
determine the cost of equity for interim purposes, pursuant to
Sections 367.081(4)(f) and 367.082(5)(b)3, Florida Statutes. Our
review of the utility's 2000 Annual Report indicates that the
utility achieved a 13.48% overall rate of return on its rate base.
This equates to a 19.19% ROE, which exceeds the ROE calculated by
the current leverage graph. Therefore, we find that it is
necessary and appropriate to initiate an investigation into the
potential annual overearnings of this utility.

DOCUMENT NUMBER DATE

13371 OCT 22 01

FPSC-01-2094-FOF-SU CLERK

We have jurisdiction pursuant to Sections 367.081, 367.082 and 367.121, Florida Statutes.

INITIATION OF OVEREARNINGS INVESTIGATION

Section 367.082, Florida Statutes, authorizes us to initiate an investigation of a utility's earnings upon a preliminary demonstration that the utility is earning a rate of return which is outside the range of reasonableness. To the extent that the achieved rate of return exceeds the required rate of return, we may require revenues to be collected subject to refund during the pendency of the investigation.

Our preliminary analysis, based on a review of the utility's 2000 Annual Report, indicates that during 2000 the utility's wastewater system earned a 13.48% overall rate of return. Using the utility's capital structure from the Annual Report and the return on equity calculated from the current leverage formula, we have calculated an ROE of 9.81% and an overall rate of return of 9.24%. We calculate that the utility achieved a 13.48% overall rate of return on its rate base, which equates to a 19.19% ROE, and which exceeds the ROE calculated by the current leverage graph. The current leverage graph was approved by Order No. PSC-00-1162-PAA-WS, issued June 26, 2000, in Docket No. 000006-WS (consummated by Order No. PSC-00-1299-CO-WS issued July 18, 2000).

Based upon our analysis, we find that a full investigation of this utility's earnings for wastewater service is appropriate. The test year for the investigation shall be the year ended December 31, 2000.

ANNUAL WASTEWATER REVENUES TO BE HELD SUBJECT TO REFUND

Pursuant to Section 367.082, Florida Statutes, in determining whether an interim decrease is appropriate, we shall determine, on a prima facie basis, if the utility's achieved rate of return exceeds its required rate of return. The achieved rate of return for interim purposes shall be calculated by applying appropriate adjustments consistent with those used in the utility's most recent rate proceeding, and annualizing any rate changes that occurred during the interim test year. The required rate of return is calculated by taking the test year cost of capital and using the

maximum of the range of the last authorized ROE. We have reviewed the utility's annual report to determine if the utility's reported rate base, cost of capital and net operating income amounts are consistent with the interim statute.

Rate Base

Tierre Verde is a Class B utility. Chapter 25-30.433(2), Florida Administrative Code, specifies that working capital for Class B and C utilities shall be calculated using the formula method (one-eighth of operation and maintenance expenses). The utility has presented working capital using the formula in the annual report and we find that no adjustment is necessary.

Based on our review, we find that no further adjustments to rate base are necessary. Our adjusted wastewater rate base is attached to this order as Schedule 1, which is incorporated herein by reference.

Cost of Capital

As discussed in the case background, Seagull Utility Company was transferred to Tierre Verde, a subsidiary of Utilities, Inc., by a sale of assets. By Order No. PSC-93-0364-FOF-SU, we approved the transfer of the certificate.

Tierre Verde has not had a rate proceeding since the transfer. In its 2000 Annual Report, the utility reflected a last authorized ROE of 13.03%. This was the ROE established for Seagull by Order No. 16781, issued October 27, 1986, in Docket No. 850883-SU.

In two other rate cases of subsidiaries of Utilities, Inc., where prior sales of assets occurred, we determined that the ROE of the prior utility did not carry over to the new company. As such, those two companies had no previously authorized ROE after the transfer. In determining interim rate increases, we used the leverage formula in effect at that time, pursuant to Section 367.081(4)(f), Florida Statutes. See Order No. 20066, issued September 26, 1988, in Docket No. 870981-WS (Miles Grant Water and Sewer Company); and Order No. PSC-96-0170-FOF-WS, issued February 6, 1996, in Docket No. 951027 (Lake Placid Utilities, Inc.).

We note that in Order No. PSC-95-1490-FOF-WS, issued November 30, 1995, in Docket No. 950337-WS, we established Allowance for Funds Used During Construction (AFUDC) rates for several of the Utilities, Inc. subsidiaries.¹ In that docket, we adjusted the requested AFUDC rate to reflect the current leverage formula for several of those systems, including Tierre Verde, which did not have an authorized ROE. A docket for approval of an AFUDC rate, outside of a rate case or limited proceeding, is not, in and of itself, a rate proceeding. As such, that type of proceeding does not establish an authorized ROE to be used for interim purposes pursuant to Section 367.082(5)(b)3, Florida Statutes.

Based on the above, we find that it is appropriate to use the current leverage formula approved by Order No. PSC-00-1162-PAA-WS. Using the utility's equity ratio, we have calculated a ROE of 9.81%, with a range of 8.81% to 10.81%. We find this calculation to be appropriate. Using the maximum of the range and the reported cost rates for other components in the utility's capital structure, yields a 9.70% overall cost of capital for interim purposes. Schedule 2, attached to this order and incorporated herein by reference, reflects our adjusted cost of capital.

Net Operating Income

The utility's Annual Report reflects wastewater operating revenues totaling \$485,829 for the year ending December 31, 2000. The utility implemented 1999 and 2000 index rate adjustments during the year 2000. Pursuant to Section 367.082(5)(b)(1), Florida Statutes, any rate changes implemented during the interim test year shall be annualized. We have increased wastewater revenues by \$11,216 to annualize the index adjustments and have made a corresponding increase to taxes other than income of \$505 for regulatory assessment fees.

In the Seagull transfer discussed previously, the utility recorded a positive acquisition adjustment, which we did not approve. While the utility's rate base reflected in its annual

¹AFUDC is an accounting entry designed to permit the utility recovery of the cost associated with financing on-going, long-term construction activities. AFUDC is not a tariffed rate or charge.

report does not include the acquisition adjustment, it did include \$10,086 for amortization of the acquisition adjustment as an above-the-line expense. Since we did not allow this amount in the transfer, we have removed the amortization from expense.

We have also recalculated income tax expense based on the adjusted rate base, cost of capital and operating income amounts. After making the above adjustments, the test year net operating income is \$62,586. This reflects an achieved overall rate of return of 13.48%. After review, we find this to be the appropriate operating income. The wastewater net operating income is attached as Schedule 3-A with the adjustments shown on Schedule 3-B, which are incorporated herein by reference.

Revenue Requirement

Using the required rate of return for interim decrease purposes of 9.70%, we find that the appropriate wastewater revenue requirement is \$467,557. This reflects a decrease of \$29,488 (or 5.93%) from the adjusted test year operating revenues of \$497,045. This represents the annual revenues that shall be held subject to refund pending our final determination of Tierre Verde's level of earnings in this docket.

APPROPRIATE SECURITY TO GUARANTEE THE AMOUNT SUBJECT TO REFUND

Pursuant to Section 367.082(2)(b), Florida Statutes, when revenues are held subject to refund and secured in a proceeding for an interim decrease, the utility is authorized to continue collecting the previously authorized rates. We have found that the amount of potential overearnings on an annual basis is \$29,488 for the wastewater system. Assuming a 10-month time frame, the potential refund amount is approximately \$25,000. We find this to be the correct amount, and Tierre Verde shall be required to hold the amount of \$25,000 subject to refund.

We have analyzed whether Tierre Verde can support a corporate undertaking in the amount of \$25,000. The criteria for a corporate undertaking includes sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. The 1998, 1999 and 2000 annual reports of Tierre Verde were used to determine the financial condition of the company. Our

analysis shows that Tierre Verde has had minimal liquidity and marginal interest coverage for the three-year period. However, for the same period, the company has reported sufficient common equity and positive income. Based upon Tierre Verde's high level of equity relative to the amount of the corporate undertaking, we find that Tierre Verde can support a corporate undertaking in the amount of \$25,000.

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

The utility shall keep an accurate and detailed account of all monies it receives. Pursuant to Rule 25-30.360(6), Florida Administrative Code, 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 shall be with interest and undertaken in accordance with Rule 25-30.360, Florida Administrative Code.

In no instance should maintenance and administrative costs associated with any refund be borne by the customers. The costs are the responsibility of, and shall be borne by, the utility. Finally, the utility shall be on notice that failure to comply on a timely basis with the requirements of this order will result in the initiation of a show cause proceeding.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that an investigation of the wastewater rates and charges of Tierra Verde Utilities, Inc. shall be initiated. It is further

ORDERED that all matters contained in the schedules attached hereto are by reference incorporated herein. It is further

ORDERED that Tierra Verde Utilities, Inc. shall provide a corporate undertaking in the amount of \$25,000 as set forth in the body of this Order, as a guarantee of any potential refund of revenues collected subject to refund. It is further

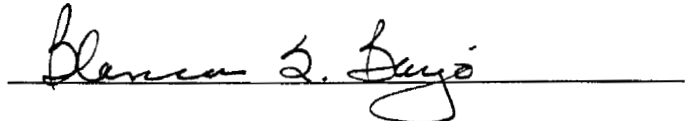
ORDER NO. PSC-01-2094-FOF-SU
DOCKET NO. 011190-SU
PAGE 7

ORDERED that no later than the 20th of each month, Tierra Verde Utilities, Inc. shall file monthly reports consistent with the requirements set forth in the body of this Order. 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 Tierre Verde shall be on notice that failure to comply on a timely basis with the requirements of this order will result in the initiation of a show cause proceeding. It is further

ORDERED that this docket shall remain open.

By ORDER of the Florida Public Service Commission this 22nd day of October, 2001.



BLANCA S. BAYÓ, Director
Division of the Commission Clerk
and Administrative Services

(S E A L)

LDH

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.

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 the Commission Clerk and Administrative Services, 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 the Commission Clerk and Administrative Services 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.

Any party adversely affected by this order, which is non-final in nature, may request (1) reconsideration within 15 days pursuant to 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 or wastewater utility. A motion for reconsideration shall be filed with the Director, Division of the Commission Clerk and Administrative Services, in the form prescribed by Rule 25-22.060, Florida Administrative Code. Citizens of the State of Florida v. Mayo, 316 So.2d 262 (Fla. 1975), states that an order on interim rates is not final or reviewable until a final order is issued. Such review may be requested from the appropriate court, as described above, pursuant to Rule 9.100, Florida Rules of Appellate Procedure.

TIERRE VERDE UTILITIES, INC. SCHEDULE OF WASTEWATER RATE BASE TEST YEAR ENDED 12/31/00			SCHEDULE NO. 1 DOCKET 011190-SU
DESCRIPTION	TEST YEAR PER UTILITY	COMMISSION ADJUSTMENTS	COMMISSION ADJUSTED TEST YEAR
1 UTILITY PLANT IN SERVICE	\$2,832,655	\$0	\$2,832,655
2 LAND	\$0	\$0	\$0
3 NON-USED & USEFUL COMPONENTS	\$0	\$0	\$0
4 ACCUMULATED DEPRECIATION	(\$1,597,537)	\$0	(\$1,597,537)
5 CIAC	(\$1,623,585)	\$0	(\$1,623,585)
6 AMORTIZATION OF CIAC	\$809,694	\$0	\$809,694
7 CWIP	\$0	\$0	\$0
8 ADVANCES FOR CONSTRUCTION	\$0	\$0	\$0
9 WORKING CAPITAL ALLOWANCE	\$43,117	\$0	\$43,117
10 OTHER	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
11 RATE BASE	<u>\$464,344</u>	<u>\$0</u>	<u>\$464,344</u>

TIERRE VERDE UTILITIES, INC. CAPITAL STRUCTURE TEST YEAR ENDED 12/31/00						SCHEDULE NO. 2 DOCKET 011190-SU	
DESCRIPTION	TOTAL CAPITAL	SPECIFIC ADJUSTMENTS (EXPLAIN)	PRO RATA ADJUSTMENTS	CAPITAL RECONCILED TO RATE BASE	RATIO	COST RATE	WEIGHTED COST
PER UTILITY 2000 - YEAR-END							
1 LONG TERM DEBT	\$223,244	\$0	\$0	\$223,244	48.08%	8.56%	4.12%
2 SHORT-TERM DEBT	\$22,781	\$0	\$0	\$22,781	4.91%	14.32%	0.70%
3 PREFERRED STOCK	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
4 COMMON EQUITY	\$209,576	\$0	\$0	\$209,576	45.13%	13.03%	5.88%
5 CUSTOMER DEPOSITS	\$0	\$0	\$0	\$0	0.00%	6.00%	0.00%
6 DEFERRED INCOME TAXES	\$8,743	\$0	\$0	\$8,743	1.88%	0.00%	0.00%
7 DEFERRED ITC'S-ZERO COST	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
8 DEFERRED ITC'S-WTD. COST	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
9 OTHER	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
10 TOTAL CAPITAL	<u>\$464,344</u>	<u>\$0</u>	<u>\$0</u>	<u>\$464,344</u>	<u>100.00%</u>		<u>10.70%</u>
PER STAFF 2000							
11 LONG TERM DEBT	\$223,244	\$0	\$0	\$223,244	48.08%	8.56%	4.12%
12 SHORT-TERM DEBT	\$22,781	\$0	\$0	\$22,781	4.91%	14.32%	0.70%
13 PREFERRED STOCK	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
14 COMMON EQUITY	\$209,576	\$0	\$0	\$209,576	45.13%	9.81%	4.43%
15 CUSTOMER DEPOSITS	\$0	\$0	\$0	\$0	0.00%	6.00%	0.00%
16 DEFERRED INCOME TAXES	\$8,743	\$0	\$0	\$8,743	1.88%	0.00%	0.00%
17 DEFERRED ITC'S-ZERO COST	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
18 DEFERRED ITC'S-WTD. COST	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
19 OTHER	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
20 TOTAL CAPITAL	<u>\$464,344</u>	<u>\$0</u>	<u>\$0</u>	<u>\$464,344</u>	<u>100.00%</u>		<u>9.24%</u>
					LOW	HIGH	
RETURN ON EQUITY					<u>8.81%</u>	<u>10.81%</u>	
OVERALL RATE OF RETURN					<u>8.79%</u>	<u>9.70%</u>	

TIERRE VERDE UTILITIES, INC. STATEMENT OF WASTEWATER OPERATIONS TEST YEAR ENDED 12/31/00				SCHEDULE NO. 3-A DOCKET 011190-SU	
DESCRIPTION	TEST YEAR PER UTILITY	COMMISSION ADJUSTMENTS	COMMISSION ADJUSTED TEST YEAR	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	<u>\$485,829</u>	<u>\$11,216</u>	<u>\$497,045</u>	<u>(\$29,488)</u> -5.93%	<u>\$467,557</u>
OPERATING EXPENSES					
2 OPERATION & MAINTENANCE	344,935	\$0	\$344,935		\$344,935
3 DEPRECIATION	36,279	\$0	\$36,279		\$36,279
4 AMORTIZATION	10,086	(\$10,086)	\$0		\$0
5 TAXES OTHER THAN INCOME	28,478	\$505	\$28,983	(\$1,327)	\$27,656
6 INCOME TAXES	<u>\$10,075</u>	<u>\$14,187</u>	<u>\$24,262</u>	<u>(\$10,597)</u>	<u>\$13,665</u>
7 TOTAL OPERATING EXPENSES	<u>\$429,853</u>	<u>\$4,606</u>	<u>\$434,459</u>	<u>(\$11,924)</u>	<u>\$422,535</u>
8 OPERATING INCOME	<u>\$55,976</u>	<u>\$6,610</u>	<u>\$62,586</u>	<u>(\$17,564)</u>	<u>\$45,022</u>
9 RATE BASE	<u>\$464,344</u>		<u>\$464,344</u>		<u>\$464,344</u>
10 RATE OF RETURN	<u>12.05%</u>		<u>13.48%</u>		<u>9.70%</u>

TIERRE VERDE UTILITIES, INC. ADJUSTMENTS TO OPERATING INCOME TEST YEAR ENDED 12/31/00		SCHEDULE NO. 3-B DOCKET 011190-SU
EXPLANATION	WASTEWATER	
<u>OPERATING REVENUES</u>		
1 Annualize 1999 Index	\$1,779	
2 Annualize 2000 Index	<u>9,437</u>	
Total	<u>\$11,216</u>	
<u>AMORTIZATION EXPENSE</u>		
Remove amortization of the acquisition adjustment	<u>(\$10,086)</u>	
<u>TAXES OTHER THAN INCOME</u>		
RAFs on revenue adjustments above	<u>\$505</u>	
<u>INCOME TAXES</u>		
To adjust to test year income tax expense	<u>\$14,187</u>	