

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation into
ratemaking consideration of gain
on sale from sales of facilities
of Utilities, Inc. of Florida to
the City of Maitland in Orange
County and the City of Altamonte
Springs in Seminole County.

DOCKET NO. 991890-WS
ORDER NO. PSC-02-0657-PAA-WU
ISSUED: May 14, 2002

The following Commissioners participated in the disposition of
this matter:

J. TERRY DEASON
BRAULIO L. BAEZ
MICHAEL A. PALECKI

NOTICE OF PROPOSED AGENCY ACTION
ORDER DECLINING TO SHARE GAINS ON SALE

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

Utilities, Inc. of Florida (UIF or utility), on a total
company basis, is a Class A utility providing water and wastewater
service to systems in the following counties: Marion, Orange,
Pasco, Pinellas, and Seminole. Involved in this docket are the
utility's systems in Orange and Seminole Counties. The Orange and
Seminole County systems are located in a water caution area in the
St. Johns River Water Management District Water Conservation Area.

According to its 2000 annual report, UIF's systems in Orange
and Seminole County reported the following:

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<u>County</u>	<u>Water Customers</u>	<u>Wastewater Customers</u>	<u>Water Operating Revenues</u>	<u>Wastewater Operating Revenues</u>
Orange	327	N/A	\$ 87,624	N/A
Seminole	2,645	1,430	\$674,136	\$426,468

By Order No. PSC-99-2171-FOF-WU, issued November 8, 1999, in Docket No. 981589-WU, we approved the sale of UIF's Druid Isles water system and a portion of its Oakland Shores water system to the City of Maitland and ordered the opening of a docket to examine whether the sale involves a gain that should be shared with the utility's remaining customers in Orange County. By Order No. PSC-99-2373-FOF-WS, issued December 6, 1999, in Docket No. 991288-WS, we approved the sale of UIF's Green Acres facilities to the City of Altamonte Springs and ordered the opening of a docket to examine whether the sale involves a gain that should be shared with the utility's remaining customers in Seminole County. On December 10, 1999, we opened this docket to address the ratemaking considerations of these sales.

On February 10, 2000, our staff sent the utility its first set of interrogatories. On March 21, 2000, UIF filed its responses to our first set of interrogatories. On April 13, 2000, our staff sent a questionnaire to other state utility commissions regarding any policies on sharing of gains with ratepayers. We have jurisdiction to consider this matter pursuant to Sections 367.081 and 367.121, Florida Statutes.

GAIN OF SALE REALIZED ON SALE TO THE CITY OF MAITLAND

On February 15, 1999, the utility transferred its Druid Isle water system and a portion of its Oakland Shores water system to the City of Maitland (hereafter referred to as the "Maitland Sale") in Orange County. The transfer included all 51 customers of the Druid Isle system and 40 of the 293 customers of the Oakland Shores system. By Order No. PSC-99-2171-FOF-WU, issued November 8, 1999, in Docket No. 981589-WU, we approved the Maitland Sale. In its response to discovery, the utility calculated the following net gain for the Maitland Sale:

Proceeds from Sale	\$159,000
Deductions:	
Book Basis of Plant	31,267
Selling Costs	<u>27,832</u>
Pre-Tax Gain	\$ 99,901
Taxes (38.27%)	<u>38,232</u>
Net Gain	<u>\$ 61,669</u>

Based on our review, the utility's calculation appears reasonable. Thus, we find that a gain of \$61,669 was realized on the Maitland Sale.

GAIN OF SALE REALIZED ON SALE TO THE CITY OF ALTAMONTE SPRINGS

On August 18, 1999, the utility transferred its Green Acres Campground water and wastewater facilities to the City of Altamonte Springs (hereafter referred to as the "Altamonte Sale") in Seminole County. By Order No. PSC-99-2373-FOF-WS, issued December 6, 1999, in Docket No. 991288-WS, we approved the Altamonte Sale. In its response to our first set of interrogatories, the utility calculated the following net gain for the Altamonte Sale:

Proceeds from Sale	\$427,000
Deductions:	
Book Basis of Plant (Booked as CIAC)	N/A
Selling Costs	<u>18,422</u>
Pre-Tax Gain	\$408,578
Taxes (34%)	<u>138,917</u>
Net Gain	<u>\$269,661</u>

Based on our review, the utility's calculation appears reasonable. Thus, we find that a gain of \$269,661 was realized on the Altamonte Sale.

DECLINING TO ORDER THAT THE GAINS ON SALE BE SHARED

As part of the discovery process, UIF was asked to state its position on the proper allocation of the realized gains. We also reviewed our past practice regarding gains on sale of utility assets and other state commissions' policies on the sharing of gains with ratepayers.

Utility's Position

In its response to our discovery request, UIF stated that it believes that gains and losses from the sale of facilities should flow to the shareholders. The utility's rationale is that gains and losses on the sale of utility facilities are properly assigned to the owner of the facilities, and that use of the facilities and payment to the utility for the cost of service do not vest an ownership interest with the customer. Moreover, the utility stated that if we were to adopt a policy that gains are to be shared, such a policy should be adopted on a going-forward basis.

The utility was also asked whether it believed that the remaining customers in Orange and Seminole Counties contributed to a portion of the utility's recovery of its investment in the systems which were sold. UIF responded that the remaining customers pay rates based on the cost of providing service, and that there is really no way to know whether, over a period of time, one customer contributed to a portion of other facilities that are unrelated, except by virtue of their common rate.

Commission Practice Regarding Gain on Sales

We have identified a number of other cases in which we allocated all or a substantial part of the gains on sale of utility assets to ratepayers; however, all of these cases involved the sale of specific assets, not complete systems including customer bases. We are aware of four recent cases in which we have addressed the gains on sale of utility facilities which included customer bases. While there may have been other similar sales including customer base, we were unable to find any orders addressing disposition of resulting gains from such sales.

By Order No. PSC-93-0301-FOF-WS, issued February 25, 1993, in Docket No. 911188-WS, we considered whether the customers of Lehigh Utilities, Inc. (Lehigh) should share in the gain on sale of the St. Augustine Shores (SAS) water and wastewater facilities to St. Johns County as a result of a condemnation. Both SAS and Lehigh had been owned by Southern States Utilities, Inc. (SSU). We decided that sharing the gain was not appropriate, stating:

We agree with the utility that ratepayers do not acquire a proprietary interest in utility property that is being used for utility service. We also agree that it is the shareholders who bear the risk of loss in their investments, not the Lehigh ratepayers. Further, we find that Lehigh's ratepayers did not contribute to the utility's recovery of its investment in St. Augustine Shores. Based on the foregoing, we find no adjustment for the gain on the sale of St. Augustine Shores to be appropriate.

In 1992, shortly after the Lehigh docket was filed, SSU filed an application for a rate increase for several of its systems under our jurisdiction. In Docket No. 920199-WS, the issue of the gain on sale of SAS was again considered in the context of whether the gain should be shared with the remaining shareholders of SSU. By Order No. PSC-93-0423-FOF-WS, issued March 22, 1993, we found the following:

We agree with Mr. Sandbulte that customers who did not reside in the SAS service area did not contribute to recovery of any return on investment in the SAS system. Further, when this system was acquired by St. Johns County, SSU's investment in the SAS system and its future contributions to profits were forever lost. Thus, the gain on the sale serves to compensate the utility's shareholders for the loss of future earnings. Arguably, if the sale of this system had been accompanied by a loss, any suggestion that the loss be absorbed by the remaining SSU customers would be met with great opposition. However, the rationale for sharing a loss is basically the same as the rationale for sharing a gain. Since SSU's remaining customers never subsidized the investment in the SAS system, they are no more entitled

to share in the gain from that sale than they would be required to absorb a loss from it.

The issue of the gain on the SAS sale was considered once again in SSU's subsequent rate case, Docket No. 950495-WS, along with several additional gains, including the sale of SSU's Venice Gardens (VGU) system to Sarasota County, also under condemnation. The Office of Public Counsel (OPC) argued that the remaining ratepayers should benefit from the gain because SSU had been found to be a single system and ratepayers had been required to pay a return on used and useful property. Further, OPC argued that the jurisdictional systems were absorbing administrative and general expenses and general plant costs that otherwise would have been paid by the VGU ratepayers. OPC also reiterated its objection to our decision in Docket No. 920199-WS regarding the SAS gain.

SSU rebutted OPC's arguments, stating that the remaining customers did not contribute to SSU's recovery of its investment and did not bear the risk of loss. Further, SSU noted that the sale of VGU involved not only the sale of SSU's assets but also the loss of customers, and that our policy concerning gains and losses should be consistent with the (then) recently confirmed acquisition adjustment policy.

In Order No. PSC-96-1320-FOF-WS, issued October 30, 1996, we voted not to allocate any of the gains of the sales of SAS or VGU to the ratepayers, stating in relevant part:

We first observe that the sales of VGU and SAS were similar in many respects: they were involuntarily made by condemnation or under threat of condemnation; SSU lost the ability to serve the customers in both service areas, which were both regulated by non-FPSC counties; and the facilities served customers who were never included in a uniform rate structure. By Order No. PSC-93-0423-FOF-WS, issued on March 22, 1993, we found that the gain on the sale of the SAS facilities should not be allocated to the ratepayers...

This part of Order No. PSC-93-0423-FOF-WS was affirmed by the First District Court of Appeal in the Citrus County decision.

Although OPC argued that the ratepayers have benefitted from the gains on the sale of property devoted to public service in previous dockets and absorbed a loss on the sale of the Skyline facility, we do not find the circumstances to be the same. Had either the SAS and VGU facilities been regulated by the FPSC at the time of the sale or previously included in a uniform rate structure, the situation would be different. However, we conclude that similar treatment should be afforded based on the previous decision in Docket No. 920199-WS. The record lacks sufficient evidence to support the contrary. Therefore, we shall not allocate either the VGU or SAS gains to the ratepayers.

Most recently, we considered the gain of sale of two facilities, including customer base, in Docket No. 001826-WU. In this case, Heartland Utilities, Inc. requested our approval for the transfer of two of its three facilities to the City of Sebring at an estimated gain of \$1,035,774. Approximately 700 customers were served by the systems sold, compared with 37 customers served by the remaining system. In Order No. PSC-01-1986-PAA-WU, issued October 8, 2001 (Consummating Order PSC-01-2179-CO-WU, issued November 6, 2001), we voted not to address the gain on sale at that time, because it did not appear, based on available facts, that the remaining customers had subsidized the cost of the systems transferred.

Based on our analysis of the above cases, we find that we have generally based our decisions on treatment of gains on sale of utility property on the following key factors:

1. Whether the property sold was used and useful in providing utility services;
2. Whether the property was included in uniform rates;
3. Whether a system, including customer base, was sold, as opposed to specific assets;
4. The extent to which ratepayers would have borne the risk, had the sale been at a loss; and

5. Consistency with other Commission practice, such as the calculation of rate base when a facility is purchased for more or less than its net book value.

Other State Commission Practice of Gain on Sales

On April 13, 2000, our staff sent a questionnaire to 48 state commissions regarding any policies or practices on gains on sales of a portion of a utility's facilities which were previously included under a uniform rate structure. We received thirteen responses to our questionnaire. Based upon these responses, it is the general practice of several state commissions, such as Montana, New York, Ohio, Oregon, Washington, and West Virginia, to allocate 100% of the gain of all property to the ratepayers. The Idaho Commission's practice is that any gain on sale of nondepreciable property should flow to the shareholders and gains on the sale of depreciable property should be shared with ratepayers. The South Carolina Commission's practice is to allocate 100% of the gain on sale of all utility property to the shareholders. The commissions of Alabama, Arkansas, Illinois, and Wisconsin have no established policy or practice regarding gains on sales of a portion of a utility's facilities. Except as noted in the following paragraphs, the responses were general, and did not consistently differentiate between property used in providing utility service and other property, or between sale of utility assets and sale of facilities including customers.

The responses received from New York and Idaho each included a reference to the sale of facilities including customer base. The New York Public Service Commission (NYPSC) stated:

(i)n instances where the purchaser is a municipality/authority that acquires a complete water system, the transfer is subject to NYPSC approval. Generally, acquisition/takeovers of small water companies are welcomed by the NYPSC. Municipalities/authorities provide the ability to finance current capital requirements, which many existing systems are unable to do without surcharges to their customers. Sales to municipalities generally do not produce rate increases. Further, where the municipality offers compensation for the system the transfer is an arms length transaction.

Once the system is sold generally the NYPSC has no further authority.

The response from the Idaho Public Utilities Commission (IPUC), included a case in which it addressed a transfer of electrical distribution facilities and service territory between two electric power utilities with adjacent service territories along the Idaho-Washington state line. In approving the transfer, the IPUC determined that a \$1,502,435 gain on the sale of depreciable plant should be distributed to the customers being transferred as a final bill credit, reasoning that the customers had paid rates based on a revenue requirement that included the assets to be transferred and therefore had an equitable interest.

We note that the examples of treatment of complete facility sales cited above from New York and Idaho involve different fact patterns from the case at hand. In view of this, and in view of the uncertainty of the details of the policies of other states responding to staff's query, we find that it is most appropriate to rely on our own previous practice in this case.

Applicability of Commission Practice to this Case

Maitland Sale - The Maitland Sale involved the sale of facilities included in rate base, along with the customer base serviced by these facilities. Based on our review of the utility's cancelled tariff sheets, all systems in Orange County have been under a uniform rate structure since 1981; however, we agree with UIF that it would be very difficult to determine how much any customer or group of customers contributed to the utility's investment in, or operation of, the facility. Further, we find that we have consistently acknowledged that, where the utility is losing the revenue stream provided by the customer base transferred, it is reasonable for the shareholders to be compensated by receiving the gain on sale of the facility. Finally, we have a well-established practice of not allowing utilities to increase rate base when facilities are purchased at greater than net book value (absent a showing of extraordinary circumstances). See Order No. PSC-98-1092-FOF-WS, issued August 12, 1998, in Docket No. 960235-WS. Allocating gains on sale to utility shareholders is consistent with this practice, because ratepayers would have paid rates based only on the original cost of

the facility. We also agree with the arguments presented in the SSU cases discussed previously that paying rates for utility service does not vest ratepayers with an ownership interest in the utility's assets. This argument was also raised by UIF. We have found these arguments persuasive in most of the cases similar to this one. Accordingly, the gain on this sale shall not be shared with the remaining ratepayers in Orange and Seminole Counties.

Altamonte Sale - Based on a discussion with the utility, UIF essentially sold the right to provide water and wastewater service to the Green Acres Campground. The campground was the only customer served by the facility. Based on our review of the utility's cancelled tariff sheets, all systems in Seminole County have been under a uniform rate structure since 1977; however, prior to the sale, the Green Acres Campground facilities sold were recorded on UIF's books as CIAC. Therefore, we find that the remaining ratepayers in Seminole County did not subsidize these facilities. Further, the same rationale discussed in the Maitland Sale applies to the sale of this system. Accordingly, the gain on this sale shall not be shared with the remaining ratepayers in Seminole County.

We note that our decision herein is meant to apply strictly to the instant facts and circumstances, and only in the context of the water and wastewater industry. No thorough analysis has been made regarding the appropriate treatment of gains on sale with respect to other regulated industries, nor is that issue before us in this case. Our decision herein is not intended to affect our discretion or jurisdiction to address the issue of gains on sale in other regulated industries.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that a gain of \$61,669 was realized on the sale of UIF's Druid Isle water system and a portion of its Oakland Shores water system to the City of Maitland in Orange County. It is further

ORDERED that a gain of \$269,661 was realized on the sale of UIF's Green Acres Campground water and wastewater facilities to the City of Altamonte Springs in Seminole County. It is further

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ORDERED that the remaining Orange and Seminole County Utilities, Inc. of Florida customers shall not receive recovery of the realized gains from the Maitland or Altamonte sales. It is further

ORDERED that the provisions of this Order, issued as proposed agency action, shall become final and effective upon the issuance of a Consummating Order unless an appropriate petition, in the form provided by Rule 28-106.201, Florida Administrative Code, is received by the Director, Division of the Commission Clerk and Administrative Services, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings" attached hereto. It is further

If no timely protest is filed by a substantially affected party, this docket shall be closed upon the issuance of a consummating order.

By ORDER of the Florida Public Service Commission this 14th day of May, 2002.

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

By: Kay Flynn
Kay Flynn, Chief
Bureau of Records and Hearing
Services

(S E A L)

JSB

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 that is available under Section 120.57, 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 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 the Commission Clerk and Administrative Services, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on June 4, 2002.

In the absence of such a petition, this order shall become final and effective upon the issuance of a Consummating Order.

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