

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation into 2002  
earnings of Residential Water  
Systems, Inc. in Marion County.

DOCKET NO. 030423-WU  
ORDER NO. PSC-03-0709-PCO-WU  
ISSUED: June 13, 2003

The following Commissioners participated in the disposition of  
this matter:

LILA A. JABER, Chairman  
J. TERRY DEASON  
BRAULIO L. BAEZ  
RUDOLPH "RUDY" BRADLEY  
CHARLES M. DAVIDSON

ORDER INITIATING EARNINGS INVESTIGATION AND  
MAKING REVENUES SUBJECT TO REFUND

BY THE COMMISSION:

Residential Water Systems, Inc. (RWS or utility) is a Class C  
water utility serving approximately 632 customers in Marion County  
in Sun Tree, High Point, Edgewood, Country Estates, Buffington  
Addition, Dalton Woods, and Wineberry subdivisions. According to  
its 2002 Annual Report, the utility reported operating revenues of  
\$198,018 and operating expenses of \$177,150. This resulted in a  
net operating income of \$20,868.

Pursuant to Order No. 12842, issued January 4, 1984, in Docket  
No. 830436-W, this Commission granted RWS Certificate No. 419-W.  
The facility was not yet constructed; however, rate base, and rates  
and charges were tentatively established at that time based on  
estimates of investment and expenses. By Order No. PSC-98-1152-  
FOF-WU, issued August 25, 1998, in Docket No. 961210-WU, this  
Commission approved a transfer of majority organizational control  
from Nancy and Elaine Finney to Charles deMenzes.

A review of the RWS 2002 Annual Report indicates that the  
utility may have exceeded its authorized rate of return. Section  
367.082, Florida Statutes, authorizes this Commission to initiate  
an investigation of a utility's earnings upon a preliminary

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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 authorized rate of return applied to rate base, we may require revenues to be collected subject to refund pending the result of the investigation. We have jurisdiction pursuant to Sections 367.081 and 367.082, Florida Statutes.

#### INITIATION OF OVEREARNINGS INVESTIGATION

Our preliminary analysis indicates that during 2002, the utility's water system earned a 15.25% return. Using the utility's 2002 capital structure, the maximum of the range of reasonableness for the rate of return is 5.09%.

Therefore, based on the results of our preliminary analysis, we find it is necessary and appropriate to initiate an audit of the utility's books and records and a full investigation into the potential overearnings of this utility.

#### ANNUAL WATER REVENUES TO BE HELD SUBJECT TO REFUND

As stated above, it appears that RWS may be overearning. Pursuant to Section 367.082(5)(b)1., Florida Statutes, the achieved rate of return for setting revenues subject to refund shall be calculated by applying appropriate adjustments consistent with those used in the utility's most recent rate proceeding. We set the initial rates for this utility by Order No. 12842, issued January 4, 1984, in Docket No. 830436-W. The utility's investment and expenses were based on estimates because the facilities had not been constructed. The attached schedules illustrate our preliminary calculation of rate base, capital structure, and operating income amounts, and are discussed in detail below.

#### RATE BASE

##### Averaging Methodology

Pursuant to Rule 25-30.433(4), Florida Administrative Code, the averaging method used by this Commission to calculate rate base and the cost of capital for a Class C utility is the simple beginning and end-of-year average. The utility's 2002 Annual

Report reflects RWS's year-end financial data. Therefore, we have used the simple average of 2001 and 2002 to analyze the utility's water system.

#### Working Capital Allowance

Working Capital is defined as the investor-supplied funds necessary to meet operating expenses or going-concern requirements of the utility. Consistent with Rule 25-30.433(2), Florida Administrative Code, we have used the one-eighth of the operations and maintenance (O&M) expense formula approach to calculate the working capital allowance. Applying that formula, we calculate a working capital allowance of \$17,315. This represents one-eighth of the average of 2001 and 2002 O&M expenses of \$118,167 and \$158,876, respectively.

#### Rate Base Summary

Based on the foregoing, the appropriate test year rate base is \$205,279. Our calculation of rate base is shown on Schedule No. 1.

#### COST OF CAPITAL

Consistent with Section 367.082(5)(b), Florida Statutes, the required rate of return shall be calculated using the last authorized rate of return on equity, the current embedded cost of fixed-rate capital, and the actual cost of other sources of capital. This section also requires that the return on equity for an interim decrease shall be calculated using the maximum of the range of the utility's last authorized return on equity. In Order No. 12842, this Commission authorized a 16.35% return on equity; however, RWS's current capital structure is 99% debt. Therefore, the overall rate of return is based on the weighted cost of debt and customer deposits.

We have reconciled the utility's capital structure with our calculated rate base. We calculate the overall rate of return to be 5.09%. Our calculation of the overall rate of return is shown on Schedule No. 2.

OPERATING INCOME

Operating Revenue

Section 367.082(5)(b)1., Florida Statutes, states that any rate changes which occurred during the test year must be annualized in order to calculate the achieved rate of return. On May 31, 2002, the utility implemented a price index rate adjustment. Therefore, we have annualized revenues using the year-end number of customers and the rates in effect at year end. Based on this calculation, we have increased revenues by \$10,927.

Taxes Other Than Income

We increased Taxes Other Than Income by \$492 to reflect regulatory assessment fees (RAFs) on the annualized revenue discussed above. In addition, our adjustments cause a revenue decrease of \$21,838. The revenue decrease generates a reduction in RAFs of \$983.

REVENUE REQUIREMENT

Based on the above adjustments, the revenue requirement is \$187,108, which represents a decrease of \$21,838 or 10.45%. However, pursuant to Section 367.081(4)(d), Florida Statutes, the revenue associated with the price index rate adjustment remains subject to refund 15 months after the filing of the utility's annual report for the year the increase was implemented. As stated above, RWS implemented its price index increase, an annual increase of \$2,473, on May 31, 2002. The utility filed its 2002 Annual Report on February 12, 2003; therefore, the revenues generated by the price index are subject to refund through May 12, 2004. Based on the above, we find that in addition to the price-index revenues of \$2,473 already subject to refund, \$19,365 (\$21,838 - \$2,473) in additional revenues shall be held subject to refund pending the final determination by this Commission.

Our calculations of the adjusted revenue, operating expenses, and revenue requirement are shown on Schedule No. 3.

APPROPRIATE SECURITY TO GUARANTEE THE AMOUNT SUBJECT TO REFUND

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 on an annual basis is \$21,838. However, \$2,473 of the potential overearnings are the result of a 2002 price index. Pursuant to Section 367.081(4)(d), Florida Statutes, the revenues associated with the price index and pass-through rate adjustments are already subject to refund, and are not required to be protected by a bond or corporate undertaking. Therefore, only \$19,365 in annual water revenues shall be collected under guarantee, subject to refund with interest. Assuming an 8-month time frame, the potential refund amount is \$12,910.

Based on the above, we have reviewed the financial data of the utility in order to determine whether RWS can support a corporate undertaking of \$12,910. The criteria for a corporate undertaking includes sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. A review of the 2000, 2001, and 2002 annual reports of RWS shows that RWS has adequate liquidity and interest coverage. However, the utility has negative equity, and its average annual net income over the three-year period is significantly less than the amount under request. Based upon this analysis, we find that RWS cannot support a corporate undertaking in the amount of \$12,910. Therefore, the utility shall provide a letter of credit, bond, or escrow agreement to guarantee the funds collected subject to refund.

If the security provided is an escrow account, said account shall be established between the utility and an independent financial institution pursuant to a written escrow agreement. The Commission shall be a party to the written escrow agreement and a signatory to the escrow account. The written escrow agreement shall state the following:

1. The account is established at the direction of this Commission for the purpose set forth above;
2. No withdrawals of funds shall occur without the prior approval of the Commission through the Director of the Commission Clerk and Administrative Services;

3. The account shall be interest bearing;
4. Information concerning that escrow account shall be available from the institution to the Commission or its representative at all times;
5. The amount of revenue subject to refund shall be deposited in the escrow account within seven days of receipt; and
6. Pursuant to Cosentino v. Elson, 263 So. 2d 253 (Fla 3d DCA 1972), escrow accounts are not subject to garnishments.

The utility shall deposit 6.18% of water revenues collected into the escrow account each month to secure for a possible refund. The escrow agreement shall also state the following:

1. If a refund to the customers is required, all interest earned on the escrow account shall be distributed to the customers; and
2. If a refund to the customers is not required, the interest earned on the escrow account shall revert to the utility.

If the security provided is a bond or a letter of credit, said instrument should be in the amount of \$12,910. If the utility chooses a bond as security, the bond shall state that it will be released or shall terminate only upon subsequent order of the Commission addressing overearnings or requiring a refund. If the utility chooses to provide a letter of credit as security, the letter of credit shall state that it is irrevocable for the period it is in effect, and that it will be in effect until a final Commission order is rendered addressing overearnings or requiring a refund.

Irrespective of the type of security provided, 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.

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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. Finally, the utility shall be on notice that if it does not comply with the requirements stated in this Order, show cause proceedings will be initiated.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that an investigation of the water rates and charges of Residential Water Systems, 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 Residential Water Systems, Inc., shall hold annual water revenues of \$19,365 subject to refund. It is further

ORDERED that Residential Water Systems, Inc., shall provide a bond or letter of credit in the amount of \$12,910, as set forth in the body of this Order, as a guarantee of any potential refund. It is further

ORDERED that, in lieu of a bond or letter of credit, Residential Water Systems, Inc., shall obtain an escrow agreement and make monthly deposits of revenue as set forth in the body of this Order. It is further

ORDERED that Residential Water Systems, Inc., shall keep an accurate and detailed account of all monies it receives. It is further

ORDERED that pursuant to Rule 25-30.360(6), Florida Administrative Code, and consistent with the requirements set forth in the body of this Order, Residential Water Systems, Inc., shall file monthly reports no later than the 20th 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. It is further

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ORDERED that Residential Water Systems, Inc., 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 pending an audit of the utility's books and records and the Commission's completion of the earnings investigation.

By ORDER of the Florida Public Service Commission this 13th Day of June, 2003.

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 )

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.

Any party adversely affected by this order, which is preliminary, procedural or intermediate in nature, may request: (1) reconsideration within 10 days pursuant to Rule 25-22.0376, 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. Judicial review of a preliminary, procedural or intermediate ruling or order is available if review of the final action will not provide an adequate remedy. Such review may be requested from the appropriate court, as described above, pursuant to Rule 9.100, Florida Rules of Appellate Procedure.

RESIDENTIAL WATER SYSTEMS, INC. TEST YEAR ENDING 12/31/02 SCHEDULE OF WATER RATE BASE		SCHEDULE NO. 1 DOCKET NO. 030423-WU	
DESCRIPTION	BALANCE PER UTILITY	COMM ADJUST. TO UTIL. BAL.	BALANCE PER COMM
1. UTILITY PLANT IN SERVICE	\$676,297	\$0	\$676,297
2. LAND & LAND RIGHTS	0	\$0	\$0
3. NON-USED AND USEFUL COMPONENTS	0	\$0	\$0
4. CIAC	(504,436)	\$0	(\$504,436)
5. ACCUMULATED DEPRECIATION	(173,259)	\$0	(\$173,259)
6. AMORTIZATION OF CIAC	189,362	\$0	\$189,362
7. WORKING CAPITAL ALLOWANCE	<u>0</u>	<u>\$17,315</u>	<u>\$17,315</u>
8. WATER RATE BASE	<u>\$187,964</u>	<u>\$17,315</u>	<u>\$205,279</u>

RESIDENTIAL WATER SYSTEMS, INC.			SCHEDULE NO. 2					
TEST YEAR ENDING 12/31/02			DOCKET NO. 030423-WU					
SCHEDULE OF CAPITAL STRUCTURE								
CAPITAL COMPONENT	PER UTILITY	SPECIFIC ADJUST-MENTS	BALANCE		BALANCE PER COMMN	PERCENT OF TOTAL	COST	WEIGHTED COST
			BEFORE PRO RATA ADJUSTMENTS	PRO RATA ADJUST-MENTS				
1. COMMON STOCK	\$100	\$0	\$100					
2. RETAINED EARNINGS	(43,246)	0	(\$43,246)					
3. PAID IN CAPITAL	400	0	\$400					
4. OTHER COMMON EQUITY	<u>0</u>	<u>42,746</u>	<u>\$42,746</u>					
5. TOTAL COMMON EQUITY	(\$42,746)	\$42,746	0	0	0	0.00%	17.35%	0.00%
6. LONG TERM DEBT								
Ingersoll-Rand Financial Ser.	20,226	0	20,226	(6,101)	14,125	6.88%	3.90%	0.27%
Wachovia Bank	84,065	0	84,065	(25,359)	58,706	28.60%	8.75%	2.50%
N/P State of Florida	<u>186,648</u>	<u>0</u>	<u>186,648</u>	<u>(56,305)</u>	<u>130,343</u>	<u>63.50%</u>	<u>3.55%</u>	<u>2.25%</u>
TOTAL LONG TERM DEBT	290,939	0	290,939	(87,765)	203,174	98.97%		
7. CUSTOMER DEPOSITS	<u>3,015</u>	<u>0</u>	<u>3,015</u>	<u>(910)</u>	<u>2,105</u>	<u>1.03%</u>	<u>6.00%</u>	<u>0.06%</u>
8. TOTAL	<u>\$251,208</u>	<u>\$42,746</u>	<u>\$293,954</u>	<u>(\$88,675)</u>	<u>\$205,279</u>	<u>100.00%</u>		<u>5.09%</u>
RANGE OF REASONABLENESS						<u>LOW</u>	<u>HIGH</u>	
RETURN ON EQUITY						<u>16.35%</u>	<u>18.35%</u>	
OVERALL RATE OF RETURN						<u>5.09%</u>	<u>5.09%</u>	

RESIDENTIAL WATER SYSTEMS, INC. TEST YEAR ENDING 12/31/02 SCHEDULE OF WATER OPERATING INCOME		SCHEDULE NO. 3 DOCKET NO. 030423-WU			
	TEST YEAR PER UTILITY	COMMISSION ADJUSTMENT	COMMN ADJ. TEST YEAR	ADJUST. FOR DECREASE	REVENUE REQUIREMENT
1. OPERATING REVENUES	<u>\$198,018</u>	<u>\$10,927</u>	<u>\$208,945</u>	<u>(\$21,838)</u> -10.45%	<u>\$187,108</u>
OPERATING EXPENSES:					
2. OPERATION & MAINTENANCE	158,876	0	158,876	0	158,876
3. DEPRECIATION (NET)	6,145	0	6,145	0	6,145
4. AMORTIZATION	0	0	0	0	0
5. TAXES OTHER THAN INCOME	12,129	492	12,621	(983)	11,638
6. INCOME TAXES	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
7. TOTAL OPERATING EXPENSES	<u>\$177,150</u>	<u>\$492</u>	<u>\$177,642</u>	<u>(\$983)</u>	<u>\$176,659</u>
8. OPERATING INCOME/(LOSS)	<u>\$20,868</u>		<u>\$31,304</u>		<u>\$10,449</u>
9. WATER RATE BASE	<u>\$187,964</u>		<u>\$205,279</u>		<u>\$205,279</u>
10. RATE OF RETURN	<u>11.10%</u>		<u>15.25%</u>		<u>5.09%</u>