

BEFORE THE PUBLIC SERVICE COMMISSION

In re: Petition by Utilities, Inc. for approval of allowance for funds used during construction (AFUDC) rate for its Florida subsidiaries including Water Service Corp.

DOCKET NO. 031006-WS
ORDER NO. PSC-04-0262-PAA-WS
ISSUED: March 8, 2004

The following Commissioners participated in the disposition of this matter:

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

NOTICE OF PROPOSED AGENCY ACTION ORDER APPROVING A UNIFORM ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION RATE

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. (UI) is the parent corporation of the following 16 utilities that provide water and wastewater services in the state of Florida: Alafaya Utilities, Inc., Bayside Utility Services, Inc., Cypress Lakes Utilities, Inc., Labrador Utilities, Inc., Lake Utility Services, Inc., Mid-County Services, Inc., Miles Grant Water and Sewer Company, Sandy Creek Utility Services, Inc., Sanlando Utilities Corporation, Tierra Verde Utilities, Inc., Utilities, Inc. of Eagle Ridge, Utilities, Inc. of Florida, Utilities, Inc. of Longwood, Utilities, Inc. of Pennbrooke, Utilities, Inc. of Sandalhaven, and Wedgefield Utilities, Inc. Water Service Corp. (WSC) is also a wholly-owned subsidiary of UI. WSC provides necessary administrative and financial services to all of UI's subsidiaries.

On October 27, 2003, UI filed a petition for the establishment of an allowance for funds used during construction (AFUDC) rate for all of its Florida subsidiaries and WSC. According to its petition, UI requests establishment of AFUDC rates in order to accurately accrue and recover its costs of providing service. AFUDC is an accounting entry designed to permit a utility to recover the cost associated with financing eligible construction activities, and is not a tariffed rate or charge.

DOCUMENT NUMBER 031006-WS

03249 MAR-08

FPSC-COMMISSION CLERK

In accordance with Rule 25-30.116(4), Florida Administrative Code, UI filed the following Schedules: Schedule A which shows the capital structure, cost rates, and weighted average cost of capital that are the basis for the AFUDC rate requested; Schedule B which shows the capital structure; and Schedule C which shows the calculation of the monthly AFUDC rate using the methodology set out in Rule 25-30.116(4). In Schedule A of its petition, UI states that the common equity and long-term debt amounts are derived from the capital structure of UI, and that the customer deposits and deferred income taxes reflect the total of those of the Florida subsidiaries.

This Order addresses the establishment of an AFUDC rate for the Florida subsidiaries and WSC. We have jurisdiction pursuant to Section 367.121, Florida Statutes.

AFUDC RATE

A. Establishment of AFUDC Rate for the Sixteen Subsidiaries

Rule 25-30.116(2)(a), Florida Administrative Code, provides that an AFUDC rate shall be determined using the utility's most recent 12-month average embedded cost of capital. UI calculated the average cost of capital using the 12-month period ended December 31, 2002. In its calculation, UI used a capital structure comprised of the total common equity and long-term debt of UI, along with the combined balances of the specific customer deposits and deferred income taxes for all the Commission-regulated Florida subsidiaries. According to its petition, UI has requested an annual AFUDC rate of 9.40% for all its utility systems in Florida.

The Florida subsidiaries included in UI's request include systems which have never had an AFUDC rate approved, and systems which have had rates approved at various times with currently approved rates ranging from 5.72% to 13.16%. As noted in Schedule A, attached to and made a part of this Order, the equity and long-term debt of UI is by far the largest portion of the overall capital structure of the subsidiaries. Therefore, we find that it is equitable to approve a uniform AFUDC rate for all of UI's Commission-regulated subsidiaries, and that it is prudent and cost effective to do this in this one proceeding.

We have reviewed the calculations submitted by UI. We note that UI calculated the cost of equity capital to be 11.32%, stating that this was derived from the current leverage formula as found in Order No. PSC-03-0707-PAA-WS, issued June 13, 2003, in Docket No. 030006-WS, In Re: Water and wastewater industry annual reestablishment of authorized range of return on common equity for water and wastewater utilities pursuant to Section 367.081(4)(f), F.S., which was consummated by Order No. PSC-03-0799-CO-WS, issued July 8, 2003. The utility used all sources of capital to determine the equity ratio used in the formula. Pursuant to Order No. PSC-03-0707-PAA-WS, the equity ratio to be used in the formula should be calculated as follows: "Equity Ratio = Common Equity/(Common Equity + Preferred Equity + Long Term Debt +

Short Term Debt).” Using only those components as defined in the Order, we calculate the cost of equity to be 11.27%.

Further, we believe that combining UI’s total equity and long-term debt with the Florida subsidiaries’ customer deposits and deferred income taxes results in a distorted weighted cost, which overstates the required rate of return. We find that it is more appropriate to reconcile UI’s capital to the combined rate base of the Florida subsidiaries, which is consistent with the methodology employed for UI’s Florida subsidiaries in calculating the cost of capital for rate setting purposes. For this purpose, with the exception of Utilities, Inc. of Pennbrooke, we used the rate bases provided in the 2002 Annual Reports of the Florida subsidiaries.

With respect to Pennbrooke Utilities, Inc., we approved the transfer of its certificates to UI in Order No. PSC-03-1000-PAA-WS (Transfer Order), issued September 5, 2003, in Docket No. 030236-WS, In Re: Application for transfer of facilities and Certificate Nos. 466-W and 400-S from Pennbrooke Utilities, Inc. to Utilities, Inc. of Pennbrooke, in Lake County (Consummating Order PSC-03-1104-CO-WS, issued October 6, 2003). In the Transfer Order, the water and wastewater rate bases of Utilities, Inc. of Pennbrooke were established as of April 30, 2003. This being the most recent rate base calculation for that system, we have used those rate bases for our calculation of the appropriate cost of capital and resulting AFUDC rate. As shown on Schedule A attached to this Order, we calculate the weighted cost of capital for all of UI’s Florida systems to be 9.03%. Therefore, we find that an AFUDC rate of 9.03% shall be approved and a discounted monthly rate of 0.751966% shall be applied to the qualified construction projects of UI’s Florida subsidiaries.

B. Question of AFUDC Rate for WSC

Rule 25-30.011, Florida Administrative Code, sets forth the application and scope of rules, including Rule 25-30.116, Florida Administrative Code, which regulate Florida water and wastewater utilities. Rule 25-30.011(1), Florida Administrative Code, states, in relevant part:

These rules and regulations shall, as appropriate, apply to all water systems and/or wastewater systems which are now, or may hereafter be, subject to the jurisdiction of the Florida Public Service Commission.

Section 367.021(11), Florida Statutes, defines a “system” as: “. . . facilities and land used or useful in providing service and, upon a finding by the commission, may include a combination of functionally related facilities and land.” Further, Section 367.021(12), Florida Statutes, defines a “utility” as:

. . . a water or wastewater utility and, except as provided in s. 367.022, includes every person, lessee, trustee, or receiver owning, operating, managing, or controlling a system, or proposing construction of a system, who is providing, or proposes to provide, water or wastewater service to the public for compensation.

WSC provides administrative support to UI's operating subsidiaries, but does not itself provide utility services to customers. Therefore, under the current circumstances, we find that WSC does not meet the above definitions of a "utility" or "system" subject to our regulation and jurisdiction. As such, we do not have jurisdiction to establish an AFUDC rate for WSC, and we are only approving an AFUDC rate for the 16 regulated utilities, but not for WSC.

C. Effective Date of AFUDC Rate

In its petition, UI requests that the approved rate be effective January 1, 2002. Rule 25-30.116(5), Florida Administrative Code, states that "(t)he new AFUDC rate shall be effective the month following the end of the 12-month period used to establish that rate and may not be retroactively applied to a previous fiscal year unless authorized by the Commission." UI used the 12-month period ended December 31, 2002, to establish its requested rate, and has not adequately explained why it believes we should authorize an effective date earlier than the date specified by Rule 25-30.116(5), Florida Administrative Code. Accordingly, pursuant to that rule, we find that the new AFUDC rate shall be effective for qualified construction projects beginning January 1, 2003.

By Final Order No. PSC-03-1440-FOF-WS, issued December 22, 2003, in Docket No. 020071-WS, In Re: Application for rate increase in Marion, Orange, Pasco, Pinellas, and Seminole Counties by Utilities, Inc. of Florida (Final Order), we recently approved individual AFUDC rates for the five county-wide systems operated by Utilities, Inc. of Florida (UIF). In this Final Order, we also approved a stipulation between the utility and the Office of Public Counsel (OPC) which provided that the effective date of the AFUDC rates approved therein would be December 22, 2003, the date of the Final Order.

Since we entered the Final Order discussed above, UI's capital structure has changed. When we set the county-wide AFUDC rates for the five systems that make up UIF, we based our decision on a thirteen-month average capital structure for the year ended December 31, 2001. However, our decision here is based on the capital structure for the year ended 2002, which was UI's current capital structure at the time of the petition. The utility's request to make the AFUDC rate uniform includes all of UI's subsidiaries, including UIF. Because the AFUDC rate calculated in this case is based on more recent capital structure data, we find that it is appropriate to include the five county-wide UIF systems in the calculation of the uniform AFUDC rate.

Although our decision to change the AFUDC rate and the effective date for these UIF systems changes the stipulation approved in our Final Order, OPC has advised our staff that it has no objection to this change. Therefore, the AFUDC rates approved in Order No. PSC-03-1440-FOF-WS will not go into effect, and the uniform AFUDC rates approved in this Order shall be effective January 1, 2003 and shall apply to all of UI's Commission-regulated subsidiaries, including UIF.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that Utilities, Inc., shall use a uniform allowance for funds used during construction rate of 9.03%, with a monthly discounted rate of 0.751966% beginning January 1, 2003, for its sixteen regulated utilities in Florida. It is further

ORDERED that we will establish no allowance for funds used during construction rate for Water Service Corp. because it is not a regulated utility subject to this Commission's jurisdiction. 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

ORDERED that if no timely protest to the proposed agency action is filed by a substantially affected person within 21 days of the date of issuance of this Proposed Agency Action Order, this docket shall be closed upon the issuance of a Consummating Order.

By ORDER of the Florida Public Service Commission this 8th day of March, 2004.

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

By: Kay Flynn
Kay Flynn, Chief
Bureau of Records

(SEAL)

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 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 March 29, 2004.

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.

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UTILITIES, INC.
COMMISSION APPROVED AFUDC RATE
TEST YEAR ENDED 12/31/02

SCHEDULE A
DOCKET 031006-WS

DESCRIPTION	TOTAL CAPITAL	SPECIFIC ADJUSTMENTS (EXPLAIN)	SUBTOTAL ADJUSTED CAPITAL	PRO RATA ADJUSTMENTS	CAPITAL RECONCILED TO RATE BASE	RATIO	COST RATE	WEIGHTED COST
PER UTILITY 2002 - 12-MONTH AVERAGE								
1 LONG TERM DEBT	\$90,172,122	\$0	\$90,172,122	\$0	\$90,172,122	50.42%	7.82%	3.95%
2 SHORT-TERM DEBT	0	0	\$0	0	\$0	0.00%	0.00%	0.00%
3 PREFERRED STOCK	0	0	\$0	0	\$0	0.00%	0.00%	0.00%
4 COMMON EQUITY	85,857,906	0	\$85,857,906	0	\$85,857,906	48.01%	11.32%	5.44%
5 CUSTOMER DEPOSITS	685,641	0	\$685,641	0	\$685,641	0.38%	6.00%	0.02%
6 DEFERRED INCOME TAXES	2,109,551	0	\$2,109,551	0	\$2,109,551	1.18%	0.00%	0.00%
7 DEFERRED ITC'S-ZERO COST	0	0	\$0	0	\$0	0.00%	0.00%	0.00%
8 DEFERRED ITC'S-WTD. COST	0	0	\$0	0	\$0	0.00%	0.00%	0.00%
9 OTHER	0	0	\$0	0	\$0	0.00%	0.00%	0.00%
10 TOTAL CAPITAL	<u>\$178,825,220</u>	<u>\$0</u>	<u>\$178,825,220</u>	<u>\$0</u>	<u>\$178,825,220</u>	<u>100.00%</u>		<u>9.40%</u>
PER COMMISSION 2002 - 12-MONTH AVERAGE								
11 LONG TERM DEBT	\$90,172,122	\$0	\$90,172,122	(\$67,565,982)	\$22,606,140	48.17%	7.82%	3.77%
12 SHORT-TERM DEBT	0	0	\$0	\$-0	0	0.00%	0.00%	0.00%
13 PREFERRED STOCK	0	0	\$0	\$-0	0	0.00%	0.00%	0.00%
14 COMMON EQUITY	85,857,906	0	\$85,857,906	(\$64,333,340)	21,524,566	45.87%	11.27%	5.17%
15 CUSTOMER DEPOSITS	685,641	0	\$685,641	\$0	685,641	1.46%	6.00%	0.09%
16 DEFERRED INCOME TAXES	2,109,551	0	\$2,109,551	\$0	2,109,551	4.50%	0.00%	0.00%
17 DEFERRED ITC'S-ZERO COST	0	0	\$0	\$-0	0	0.00%	0.00%	0.00%
18 DEFERRED ITC'S-WTD. COST	0	0	\$0	\$-0	0	0.00%	0.00%	0.00%
19 OTHER	0	0	\$0	\$-0	0	0.00%	0.00%	0.00%
20 TOTAL CAPITAL	<u>\$178,825,220</u>	<u>\$0</u>	<u>\$178,825,220</u>	<u>(\$131,899,322)</u>	<u>\$46,925,898</u>	<u>100.00%</u>		<u>9.03%</u>

DISCOUNTED MONTHLY AFUDC RATE

0.751966%