

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application for an increase in) DOCKET NO. 910477-SU
wastewater rates for SOUTH FORT MYERS) ORDER NO. 25586
SYSTEM in Lee County by FLORIDA CITIES) ISSUED: 1-9-92
WATER COMPANY.)
_____)

Pursuant to notice, a prehearing conference was held on December 18, 1991, before Commissioner J. Terry Deason, as Prehearing Officer, in Tallahassee, Florida.

APPEARANCES: B. KENNETH GATLIN, Esquire, Gatlin, Woods,
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Tallahassee, Florida 32308
On behalf of Florida Cities Water Company

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On behalf of Citizens

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On behalf of the Commission Staff

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Counsel to the Commission

PREHEARING ORDERI. Case Background

On August 14, 1991, Florida Cities Water Company (FCWC or utility) completed the minimum filing requirements (MFRs) for a general rate increase and that date was established as the official date of filing for this case. FCWC's South Fort Myers' wastewater system is the subject of this case. The approved test year for

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this proceeding is the projected twelve-month test year ending December 31, 1991. FCWC has requested final rates designed to generate annual wastewater revenues of \$2,895,803, or an increase of \$592,480 (25.72%).

By Order No. 25182, issued October 9, 1991, this Commission suspended FCWC's proposed rates and granted the utility, subject to refund, an interim wastewater rate increase designed to generate \$2,652,715 in revenues, or an increase of \$412,165 (18.4%).

This case is scheduled for an administrative hearing on January 15 and 16, 1992.

II. Prefiled Testimony and Exhibits

Testimony of all witnesses to be sponsored by the utility, the Office of Public Counsel (OPC), and the Staff of this Commission (Staff) has been prefiled. All testimony which has been prefiled in this case will be inserted into the record as though read after the witness has taken the stand and affirmed the correctness of the testimony and associated exhibits. All testimony remains subject to appropriate objections. Each witness will have the opportunity to orally summarize his or her testimony at the time he or she takes the stand. Upon insertion of a witness' testimony, exhibits appended thereto may be marked for identification. After all parties and Staff have had the opportunity to object and cross-examine, the exhibit may be moved into the record. All other exhibits may be similarly identified and entered into the record at the appropriate time during the hearing.

Witnesses are reminded that, on cross-examination, responses to questions calling for a simple yes or no answer shall be so answered first, after which the witness may explain his or her answer.

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III. Order of Witnesses

<u>Witness</u>	<u>Appearing for</u>	<u>Issues #</u>
<u>Direct</u>		
Douglas T. Harrison	FCWC	2-4, 7-11, 13-16, 18, 20, 27-31, 33, 35-37
Larry E. Griggs	FCWC	1, 5, 6, 19
Joseph Schifano	FCWC	
Thomas C. DeWard	OPC	4, 12, 17, 21-25
J. Patrick Parrish	OPC	4, 7, 8
James V. Grob	Staff	1
Gregory L. Shafer	Staff	8
Jocelyn Y. Stephens	Staff	Any relating to audit

<u>Witness</u>	<u>Appearing for</u>	<u>Issues #</u>
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Rebuttal

Douglas T. Harrison	FCWC	12, 21-25
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At the prehearing, the parties agreed to having the prefilled testimony of Staff witness Grob inserted into the record without requiring his presence for cross-examination and to accommodating the utility has indicated that Mr. Larry Coel, the preparer of the MFRs, will be available at the hearing to testify, if needed. The utility has also indicated that Mr. Griggs and Mr. Schifano will be available as possible rebuttal witnesses.

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IV. Basic Positions

- FCWC: The necessity for a rate increase arises from the fact that FCWC is not now and will not in the future earn a fair and reasonable rate of return on its investment in property used and useful by its customers for the test year ending December 31, 1991. The applicant, under present rates, had a rate of return of only 6.31% on a rate base of \$7,354,364. For the test year ending December 31, 1991, under present rates, the rate of return will be only 6.37% on a rate base of \$7,554,679. FCWC is requesting in this proceeding authority to increase its wastewater rates so as to produce additional operating revenues in the amount of \$592,480 based on the test year ending December 31, 1991, so as to allow FCWC an opportunity to earn a fair and reasonable rate of return of 11.04% on its rate base of \$7,554,679 for the test year ending December 31, 1991.
- OPC: Florida Cities Water Company in this rate case has overstated its rate base and return requirements, which include a requested recovery of federal and state income tax expense. Miscellaneous service revenues are understated and projected expenses are overstated.
- The capital structure proposed by the utility does not accurately reflect the capital structure which will exist during the time these proposed rates will be in effect. The company has also under-stated the amount of cost-free deferred taxes which is included in the capital structure. The company's used and useful calculations for the wastewater treatment and disposal plant and the collection and pumping plant are overstated.
- Staff: The information gathered through discovery and prefiled testimony indicates, at this point, that the utility is entitled to some level of increase. The specific level cannot be determined until the evidence presented at hearing is analyzed.

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V. Issues and Positions

QUALITY OF SERVICE

ISSUE 1: Is the quality of service satisfactory?

POSITIONS

FCWC: Yes. (Griggs)

OPC: No position at this time.

STAFF: No position pending testimony at hearing. (Grob)

RATE BASE

ISSUE 2: Should the costs to complete the wastewater treatment plant be included in rate base?

POSITIONS

FCWC: Agree with Staff. (Harrison)

OPC: No position at this time.

STAFF: The costs to bring the plant to its ultimate capacity, five million gallons per day (mgd), should be included in rate base.

ISSUE 3: What is the proper amount of completion costs to be included in rate base?

POSITIONS

FCWC: Agree with Staff. (Harrison)

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OPC: No costs beyond the test year should be included in rate base.

STAFF: The proper amount to be included is \$1,750,000.

ISSUE 4: What is the appropriate amount of used and useful treatment plant?

POSITIONS

FCWC: 53.3% (Harrison)

OPC: Used and useful for the wastewater treatment and disposal plant are overstated. The treatment and disposal plant are 42% used and useful. (Parrish, DeWard)

STAFF: Using the five mgd capacity of the plant, test year flow data and an allowance for margin reserve, the wastewater treatment plant is 42% used and useful.

ISSUE 5: Should the treatment plant flows be adjusted for flow meter error? If so, what adjustment should be made?

POSITIONS

FCWC: No. There is no flow meter error. (Griggs)

OPC: No position at this time.

STAFF: Agree with FCWC.

ISSUE 6: What is the quantity of wastewater treated in 1991?

POSITIONS

FCWC: No position at this time; however, the necessary information will be provided prior to hearing. (Griggs)

OPC: No position at this time.

STAFF: No position at this time.

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ISSUE 7: What is the appropriate amount of used and useful collection system?

POSITIONS

FCWC: 100% (Harrison)

OPC: Used and useful for the wastewater collection and pumping plant are overstated. (Parrish)

STAFF: No position at this time.

ISSUE 8: Should used and useful include an allowance for margin reserve, and, if so, how should margin reserve be calculated?

POSITIONS

FCWC: If FCWC's proposed used and useful calculation is not used, an allowance for margin reserve should be made. (Harrison)

OPC: No, inclusion of a margin reserve introduces costs associated with growth for recovery from current ratepayers. Current ratepayers should not be forced to pay for plant which is not serving them. In the instant case, the utility in its MFRs has not requested a margin reserve and none should be granted. (Parrish)

STAFF: Treatment plant used and useful should include a margin reserve. The margin reserve should be calculated using multiple regression analysis. (Shafer)

ISSUE 9: What portion of CIAC, in both ERCs and dollar amount, represents amounts paid by customers not currently being served?

POSITIONS

FCWC: ERCs, 1,355. Dollar amount, \$772,350. (Harrison)

OPC: No position at this time.

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STAFF: According to the FCWC's late-filed deposition exhibit, ERCs equal 1,355 and represent a dollar amount of \$772,350.

ISSUE 10: Should prepaid CIAC associated with margin reserve be included in rate base as an offset to margin reserve?

POSITIONS

FCWC: No. (Harrison)

OPC: Yes, if a margin reserve is included.

STAFF: Yes.

ISSUE 11: Did the utility understate accumulated amortization of CIAC by \$19,000?

POSITIONS

FCWC: Yes. (Harrison)

OPC: No position at this time.

STAFF: Yes. The average rate base should be increased by \$19,000.

ISSUE 12: Has the utility correctly stated its accumulated depreciation associated with nonused and useful plant?

POSITIONS

FCWC: Yes. (Harrison)

OPC: No. The utility has overstated the accumulated depreciation associated with nonused and useful plant. (DeWard)

STAFF: No position at this time.

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ISSUE 13: What is the appropriate amount of working capital to include in rate base?

POSITIONS

FCWC: Agree with Staff. (Harrison)

OPC: The appropriate amount of working capital should be that which is demonstrated using the balance sheet method.

STAFF: The appropriate amount of working capital to be included in rate base is one-eighth of operations and maintenance expenses (O & M). The actual amount is a fall-out number.

ISSUE 14: What is the test year rate base?

POSITIONS

FCWC: Rate base for the period ending 12-31-91 is \$7,554,679. (Harrison)

OPC: Fall-out number.

STAFF: Fall-out number.

COST OF CAPITAL

ISSUE 15: What is the appropriate balance of preferred stock to be included in the capital structure?

POSITIONS

FCWC: 4,500,000. (Harrison)

OPC: No position at this time.

STAFF: No position at this time.

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ISSUE 16: What is the weighted average cost of debt?

POSITIONS

FCWC: 10.05%. (Harrison)
OPC: No position at this time.
STAFF: No position at this time.

ISSUE 17: What is the appropriate amount of accumulated deferred taxes to be included in the capital structure before any pro rata reconciliation?

POSITIONS

FCWC: Agree with Staff. (Harrison)
OPC: The utility has not properly accounted for deferred taxes in its capital structure and has understated this cost-free source of capital. (DeWard)
STAFF: The appropriate amount of accumulated deferred taxes to be included in the capital structure before pro rata reconciliation is \$4,003,879.

ISSUE 18: What is the weighted average cost of capital including the proper components, amounts, and cost rates associated with the capital structure for the projected test year ending December 31, 1991?

POSITIONS

FCWC: The rate of return that should be allowed is 11.04%. (Harrison)
OPC: The Commission should utilize the utility's actual capital structure reflecting the actual changes that take place in 1991, computed on an average basis.
STAFF: No position at this time.

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NET OPERATING INCOME

ISSUE 19: What adjustments should be made to pumping and treatment expenses if the plant is treating 28% more wastewater than it is billing for?

POSITIONS

FCWC: None. (Griggs)

OPC: The costs of treating excess infiltration should be removed.

STAFF: No position at this time.

ISSUE 20: Should expenses greater than the benchmark be reduced if not justified?

POSITIONS

FCWC: FCWC's expenses are not greater than the benchmark. (Harrison)

OPC: Yes.

STAFF: Although expenses in the aggregate are less than the benchmark, further explanation of some expenses may be appropriate.

ISSUE 21: Should an adjustment be made to property tax expense to reflect the nonused and useful portion of the plant?

POSITIONS

FCWC: No, taxes associated with nonused and useful property are not included. (Harrison)

OPC: Yes. This expense should be adjusted to eliminate the expense associated with nonused and useful property. (DeWard)

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STAFF: No, taxes associated with nonused and useful property are not included in the property tax returns shown in FCWC's late-filed deposition exhibit. However, if the Commission does not approve FCWC's used and useful, an adjustment may be necessary.

ISSUE 22: Has the utility properly accounted for its miscellaneous service revenues?

POSITIONS

FCWC: Yes. (Harrison)

OPC: No. The company has understated its miscellaneous service revenues. (DeWard)

STAFF: No position at this time.

ISSUE 23: Has the company properly accounted for its test period expense for insurance claims?

POSITIONS

FCWC: Yes. (Harrison)

OPC: No. The utility is attempting to include a nonrecurring out-of-period expense in its rate request. (DeWard)

STAFF: No position at this time.

ISSUE 24: Has the company correctly projected its major maintenance, chemical, sludge removal, purchased power, and contractual service expenses?

POSITIONS

FCWC: Yes. (Harrison)

OPC: No. Comparing the company's projections using annualized actual eight months of expenditures through August 31, 1991, confirms that the company's projected expenses in these categories are in the aggregate overstated. (DeWard)

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STAFF: No position at this time.

ISSUE 25: Has the company correctly stated its regulatory Commission expense?

POSITIONS

FCWC: The regulatory commission expense stated in the MFRs is understated. (Harrison)

OPC: No. The company has overstated this expense. (DeWard)

STAFF: No position at this time.

ISSUE 26: What is the appropriate amount of income tax expense to be included in the test year?

POSITIONS

FCWC: Fall-out number.

OPC: Fall-out number.

STAFF: Fall-out number.

ISSUE 27: Is a parent debt adjustment appropriate?

POSITIONS

FCWC: Agree with Staff. (Harrison)

OPC: Yes.

STAFF: Yes. However, the amount of the adjustment is dependent on the final determination of rate base and capital structure.

ISSUE 28: What is the appropriate amount of rate case expense?

POSITIONS

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FCWC: Actual rate case expense to date and projected rate case expense through completion of the case will be filed on or before January 6, 1992. (Harrison)

OPC: No position pending testimony at the hearing and review of late-filed exhibit.

STAFF: No position at this time.

ISSUE 29: What is the appropriate level of test year operating income?

POSITIONS

FCWC: As stated in the MFRs. (Harrison)

OPC: Fall-out number.

STAFF: Fall-out number.

ISSUE 30: What are the appropriate test year revenues before any revenue increase?

POSITIONS

FCWC: As stated in the MFRs. (Harrison)

OPC: No position at this time.

STAFF: No position at this time.

REVENUE REQUIREMENT, RATES, AND CHARGES

ISSUE 31: What is the total revenue requirement?

POSITIONS

FCWC: \$2,895,803. (Harrison)

OPC: Fall-out number.

STAFF: Fall-out number.

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ISSUE 32: Is an adjustment necessary to comply with Section 367.0815, Florida Statutes, regarding the apportionment of rate case expense?

POSITIONS

FCWC: No.

OPC: Uncertain at this time. However, the requirements of this statute should be imposed to the extent it brings the company to the bottom of the range of its authorized rate of return.

STAFF: No position at this time.

ISSUE 33: What are the appropriate rates?

POSITIONS

FCWC: As stated in the MFRs. (Harrison)

OPC: No position at this time.

STAFF: Fall-out number.

ISSUE 34: Should the final rates approved in this case be reduced four years from their effective date in accordance with Section 367.0816, Florida Statutes?

POSITIONS

FCWC: FCWC does not know the procedure that the Commission might follow four years hence regarding Section 367.0814, Florida Statutes. If the procedure is in compliance with the requirements of Section 367.081(2)(a), Florida Statutes, the Florida Constitution, and the U.S. Constitution, then perhaps FCWC's rates might be reduced.

OPC: Yes.

STAFF: Yes.

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ISSUE 35: Should a charge be established for reclaimed water? If so, what amount should be charged?

POSITIONS

FCWC: Yes, and the charge should be as requested in the MFRs. (Harrison)

OPC: The company should try to arrange sales of the reclaimed water, and all revenues should be credited back to the customers.

STAFF: No position at this time.

ISSUE 36: Should the service availability charges be adjusted to comply with the guidelines set forth in Rule 25-30.580, Florida Administrative Code?

POSITIONS

FCWC: The charges are currently within the guidelines. (Harrison)

OPC: No position at this time.

STAFF: No position at this time.

ISSUE 37: Should the miscellaneous service charges be adjusted to conform with Staff Advisory Bulletin No. 13, Second Revision?

POSITIONS

FCWC: Yes. (Harrison)

OPC: No position at this time.

STAFF: Yes.

VI. Proposed Stipulations

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At the Prehearing Conference, the parties and Staff stipulated to the following: (1) Rate base should be reduced by \$1,638 to remove an unapproved acquisition adjustment. (2) The appropriate cost of equity should be based on the leverage formula in effect at the time of the agenda conference for the final order in this case. (3) The cost rate of the investment tax credits (ITCs) should be calculated using investor sources of capital only.

VII. Rulings

(1) On October 25, 1991, FCWC filed a Motion To Substitute Witnesses wherein it requested permission to substitute Mr. Larry Griggs, Mr. Joseph Schifano, and (apparently) Mr. Douglas T. Harrison as witnesses for Mr. Antone A. Reeves, III, for whom prefiled testimony had been timely submitted. According to the motion, all of the testimony of Mr. Reeves would be adopted without changes or new additions except for the educational and business backgrounds of the three adopting witnesses. No timely objections to this motion were filed.

On December 13, 1991, FCWC filed an Amended Motion To Substitute Witnesses, a Motion To Correct Testimony of Larry E. Griggs and Joseph Schifano, and Amended Testimony for Mr Griggs and Mr. Schifano. In its Amended Motion To Substitute Witnesses, FCWC clarifies which witnesses are adopting which portions of Mr. Reeves's testimony. In its Motion to Correct, FCWC states that there was a mistake in its original Motion to Substitute and that, as a result, not all of Mr. Reeves' testimony was adopted. By the amended testimony, all of Mr. Reeves testimony is adopted.

At the Prehearing Conference, no one objected to either of the latter two FCWC motions. Since the substitution is reasonable and since all of Mr. Reeves testimony is now accounted for, FCWC's Motion to Correct is granted, and its Motion to Substitute is granted as amended.

(2) At the Prehearing Conference, OPC requested that it be allowed to file supplemental prefiled testimony on the issue of margin reserve. No objection to the request was made. OPC was therefore given until January 3, 1992, to file said supplemental testimony.

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VIII. Exhibits

<u>Witnesses</u>	<u>Proffered By</u>	<u>I.D. No.</u>	<u>Description</u>
Douglas T. Harrison	FCWC	DTH-1 (Composite)	MFRs
	FCWC	DTH-2	Rate Case Expense Exhibit (to be filed by January 6th)
	FCWC	DTH-3	Organizational Structure of A v a t a r Utilities, Inc.
	FCWC	DTH-4	Functional Organizational Chart
Thomas C. DeWard	OPC	TCD-1 (Composite)	Schedules Nos. 1 through 9
Gregory L. Shafer	Staff	GLS-1	Examples of linear regression
Jocelyn Y. Stephens	Staff	JYS-1	Audit report


Parties and Staff reserve the right to identify exhibits for the purpose of cross-examination.

Based upon the foregoing, it is

ORDERED by Commissioner J. Terry Deason, as Prehearing Officer, that this Prehearing Order shall govern the conduct of these proceedings unless modified by the Commission.

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By ORDER of Commissioner J. Terry Deason, as Prehearing
Officer, this 9th day of January, 1992.



J. TERRY DEASON, Commissioner
and Prehearing Officer

(S E A L)

MJF