

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Proposed Revisions of)
PSC Water and Wastewater Rules)

Docket No. 911082-WS
Filed: April 23, 1993

COMMENTS OF THE FLORIDA WATERWORKS ASSOCIATION
ON PROPOSED RULES

The Florida Waterworks Association by and through its undersigned counsel, pursuant to the Notice of Rulemaking published in the Florida Administrative Weekly, Volume 19, No. 13, beginning at page 1740, files the following comments:

(1) The Florida Waterworks Association has filed a Petition for Administrative Determination of Invalidity of Proposed Rules with the Division of Administrative Hearings. A copy of the petition is attached hereto and by reference made a part hereof. The petition seeks to challenge proposed rule 25-30.433 (3), Florida Administrative Code. This proposed rule would in effect deny recognition for rate making of the unamortized balance of most deferred debits.

(2) Proposed rule 25-30.433(3) provides as follows:

In a rate case proceeding, the following provisions shall apply, unless, for good cause shown, the applicant or any intervenor demonstrates that these rules result in an unreasonable burden. In these instances, fully supported alternatives will be considered by the Commission. Any alternatives proposed by the utility must be filed with the minimum filing requirements.

. . .

(3) Debit deferred taxes created due to income taxes associated with used and useful Contributions-in-Aid-of-Construction (CIAC) shall be offset against credit deferred taxes in the capital structure. Any resulting net debit deferred taxes shall be included as a separate line item in the rate base calculation. No other

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deferred debits shall be considered in rate base when the formula method of working capital is used.¹

There is no definition of what constitutes "good cause," "unreasonable burden," or "fully supported alternatives." No standards or criteria are set forth for any such determination.

(3) When the formula method of working capital is used, the proposed rule specifically excludes from rate base all deferred debits except debit deferred taxes created due to income taxes associated with CIAC. All deferred debits represent an investment in property of the utility. Utility funds represented by deferred debits that are used and useful in providing utility service should be included in rate base. However, the proposed rule denies the utility the opportunity to earn on this investment when the formula method of working capital is used. Moreover, proposed rule 25-30.433 (2) provides that the formula method shall be used. Therefore, even if one were to interpret the proposed rules to allow deferred debits to be included in rate base when any other method for working capital is used, the rules do not allow for another method.

The components which typically may be included in rate base are physical plant, cash working capital, and deferred debits. Physical plant is the most readily recognizable component of rate base. It is the investment in the lines, pumps, treatment facilities, tools, vehicles and other tangible equipment. The

¹Subsection (2) of the rule provides that "working capital shall be calculated as one-eighth of operation and maintenance expenses." This is commonly referred to at the Florida Public Service Commission as the formula method of working capital.

proposed rules adequately address the treatment of physical plant in rate base.

Cash working capital is less easily grasped. It represents, at a minimum, the investment necessary to fund daily operating expenditures. An expanded definition could also include investment necessary to fund other non-plant items utilized to serve the public. Whether such items are included as cash working capital or as part of one of the other components is of no consequence as long as they are included in rate base, one way or another. In proposed rule 25-30.433(2), working capital is defined as one-eighth of operating and maintenance expenses. As such it includes only the investment necessary to fund daily operating expenditures and does not include funding for any other non-plant items.

Deferred debits represent expenses paid in the current period that have an economic value over one or more periods. Any portion of such expenses that have a benefit in the current period are a current expense and as such are recovered in operating and maintenance expenses. The remaining portion is an investment of funds, a return on which can only be recovered if it is included in rate base. An example of a deferred debit is the cost of painting a storage tank, which may be repeated once every several years. The entire cost is not included as an expense to be recovered in only one year, but is spread over the several years until it is repeated.² Other examples include rate case expense, of which one-

²Subsection (8) of proposed rule 25-30.433 provides that "nonrecurring expenses shall be amortized over a 5-year period unless a shorter or longer period of time case be justified." Such

fourth may be recovered each year for four years;³ and the income taxes paid on contributions in aid of construction.⁴

Deferred debits are costs which have been capitalized, but have a shorter life than a utility plant asset, and are not included in rate base nor the working capital which has been calculated using the formula method. Below is a demonstration of how these are not included in working capital under that circumstance.

Painting a 2 million gallon storage tank:

Initial cost	\$40,000
Number of years until repeated	5 years
Amount included in current year expense	\$ 8,000
Amount in working capital using formula method (1/8 of one year expense)	\$ 1,000
UTILITY ACTUAL INVESTMENT	\$40,000

The above calculation demonstrates that although the utility made an investment of \$40,000, and unless it is separately provided for, each year the utility would only earn a return on one-eighth

regulatory treatment does not in itself allow also for a return on the necessary investment in the unamortized balance of such nonrecurring costs.

³Section 367.0816, Florida Statutes, provides that "(t)he amount of rate case expense determined by the commission . . . to be recovered through a public utilities rate shall be apportioned for recovery over a period of 4 years. At the conclusion of the recovery period, the rate of the public utility shall be reduced immediately by the amount of rate case expense previously included in rates."

⁴The challenged proposed rule does allow for recognition of net debit deferred taxes in the rate base calculation. However, the proposed rule explicitly excludes rate base consideration of any other deferred debits when the formula method of working capital is used.

of one year of expense, or \$1,000. The utility would not earn a return on \$39,000 of its investment.

(4) Another deferred debit is a deferred tax debit. Debit deferred taxes represent taxes paid that are associated with plant that has value over many years. The primary source of debit deferred taxes is the tax on contributions-in-aid-of-construction (CIAC). The Internal Revenue Code treats CIAC as taxable income in the year in which it is received. The Commission treats CIAC as an offset to plant investment that is amortized over the life of the plant. The income tax associated with CIAC is classified as a debit deferred tax. It is reduced at the same rate that the CIAC is amortized.

Credit deferred taxes represent taxes that would have been due currently but are deferred to a future period through an allowed tax deferral mechanism such as accelerated depreciation. The amount of tax not paid currently, but due in the future, is accumulated as a credit deferred tax.

The typical regulatory treatment of debit deferred taxes is to include the used and useful portion in rate base to be earned on because it is an investment of the utility. The typical treatment of credit deferred taxes is to include it as a cost free component of capital because it is a "zero cost" tax benefit that can be used to finance investment. Since sources of capital cannot be readily traced to their specific use, it is prorated to rate base. The accepted regulatory treatment is that all investment, utility or non-utility, used and useful or non used and useful, is funded

proportionately by all capital sources. That is an acceptable, fair, procedure with historical precedent at the Commission.

If the proposed rule left the used and useful portion of debit deferred taxes as a rate base component, and the credit deferred taxes as a capital component to be prorated to rate base, that would be fair and acceptable. However, the proposed rule does not do that. It requires the used and useful portion of debit deferred taxes be netted against the "total" credit deferred taxes, thereby reducing the "used" debit with both used and non-used or even non-utility credits. If the balance after netting is a credit, it is included as capital to be prorated to rate base, which further reduces the used debits by prorating a portion to non-used or non-utility purposes. The result is an understatement of the cost of capital associated with serving the public. If the balance after netting is a debit, it is included in rate base. But the amount remaining, having been reduced by non-used or non-utility credits, is an understatement of the investment in property serving the public.

(5) As stated in Accounting for Public Utilities (Hahne, Aliff and Touche, 1992), at pp. 5-1 and 5-2,

The financial analyst's perspective of working capital reflects a measure of financial liquidity (i.e., the availability of cash on hand and other current assets that are readily convertible to cash that may be used to meet liabilities that must be paid in the current business cycle). This financial liquidity measure is based on a comparison of current assets to current liabilities at a point in time.

The ratemaking perspective of working capital is quite different. For ratemaking purposes, working capital is a measure of investor funding of daily operating

expenditures and a variety of nonplant investments that are necessary to sustain ongoing operations of the utility.

Unfortunately, the working capital calculation based upon test year current assets minus current liabilities (the "balance sheet method") often does not recognize the utility's actual expected working capital needs during the time the new rates will be in effect. Because the cost of processing a rate case is so high, small water and wastewater companies do not seek rate increases until they find themselves in a very low earnings position, or more often than not, in a loss position during the historic test period utilized for justifying an increase. Under those circumstances, the utility is often in a position of being "cash poor" (low levels of current assets) and delaying payment of currently due bills (increased current liabilities) in order to maintain itself with such deficient revenues. Therefore, a company in such a financially weakened state is very likely to produce a balance sheet which shows very low or possibly even a negative working capital "requirement."

Often too, the utility may be part of a larger group of companies with only one balance sheet, and the components of working capital must be allocated in some creative fashion to the one system for which a rate adjustment must be made.

As a result of these problems with the balance sheet approach to working capital being applied to a historic test year, a different calculation to determine the actual investment made by the utility to finance its day to day operations costs is often

made. Commonly this is attempted by using 1/8th of operation and maintenance expenses ("the formula method") as an estimate of the utility's expected working capital needs. This is the method proposed by Rule 25-30.433(2), Florida Administrative Code.

In the past when the balance sheet method was utilized the Commission added to that calculation the amount of any average unamortized balance in deferred debits and categorized them for rate setting purpose as a portion of that working capital calculation. However, with the advent of the Commission's use of the formula approach, the Commission has proposed to eliminate any consideration of deferred debits. As a result, a whole group of assets in which the utility maintains an investment are being excluded from consideration in providing the utility a reasonable return. Deferred debits which are neither long term assets (e.g., utility plant and service) nor current assets (working capital), but do constitute a medium term asset and investment of the utility, must be considered and included in the utility investment on which it is provided an opportunity to earn a return.

Each financial transaction a utility incurs should be considered in rate setting. These transactions are either revenues, expenses, investment (rate base), or capital. Deferred debits can represent considerable investment by the utility, and should be included in rate base.

The exclusion of this investment would clearly contravene the provisions of the law purportedly implemented by the challenged proposed rule, in that it would prevent the Commission from fixing

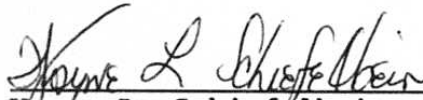
compensatory rates based on consideration of the cost of providing the service, which must include the utility's working capital requirements, maintenance, operating expenses, and a fair return on utility investment.

(6) There is no theoretical basis for exclusion of an investment in deferred items from the rate base calculation. An investment in a medium term asset, such as major repairs or maintenance or rate case expense, should reasonably be included in rate base for rate setting purposes, so long as it is determined to be a prudent investment. To allow recognition of short term investments through the working capital allowance and long term investments through plant in service, and then to exclude deferred debits, violates the statutory requirement that the Florida Public Service Commission must consider in fixing just, reasonable and compensatory rates.

(7) The Florida Public Service Commission Staff has suggested that the reasons for elimination of deferred items is somehow to streamline the rate setting process and to eliminate an issue of contention related to working capital. This rationale is not supported by logic and reason. A decision to automatically disallow deferred items will in effect open a door to innumerable contests of what is an appropriate deferred debit. Opponents of the utility in a rate proceeding will clearly try to categorize everything possible as a deferred item in order to eliminate consideration of the investment in those items in rate setting, thereby complicating the rate setting process rather than

simplifying it. The way to simplify issues related to deferred debits is to require that all be amortized over a five year period, unless a more appropriate amortization period is demonstrated, and the average unamortized balance be included as a separate line item in rate base. This will go much farther to eliminate issues related to deferred items than to suggest that they be excluded from the rate base calculation altogether.

Respectfully submitted,



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Attorneys for the
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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by hand delivery to Christiana Moore, Esquire, Division of Legal Services, Florida Public Service Commission, 101 East Gaines Street, Tallahassee, Florida 32399-0850, on this ____ day of April, 1993.


Wayne L. Schiefelbein

**STATE OF FLORIDA
DIVISION OF ADMINISTRATIVE HEARINGS**

FLORIDA WATERWORKS ASSOCIATION,

Petitioner,

v.

DOAH Case No. _____
Filed: April 23, 1993

THE FLORIDA PUBLIC SERVICE
COMMISSION,

Respondent.

_____ /

**PETITION FOR ADMINISTRATIVE DETERMINATION
OF INVALIDITY OF PROPOSED RULES**

The Petitioner, the Florida Waterworks Association, by and through its undersigned counsel, and pursuant to Section 120.54(4), Florida Statutes, hereby seeks an administrative determination of the invalidity of proposed rule 25-30.433(3), Florida Administrative Code, as proposed by the Florida Public Service Commission. In support of this Petition, the Florida Waterworks Association states:

(1) For the purposes of this proceeding, the address and telephone number of the Petitioner, the Florida Waterworks Association, should be considered that of its undersigned attorneys.

(2) The affected agency is the Florida Public Service Commission at the address of the Fletcher Building, 101 East Gaines Street, Tallahassee, Florida 32399-0850.

(3) The Florida Waterworks Association is comprised of investor-owned water and/or wastewater utility companies in the State of Florida, and is the Florida Chapter of the National Association of Water Companies, Inc. The Florida Waterworks

Association exists to assist its members with regulatory, technical and operational matters. A substantial number of the members of the Florida Waterworks Association are utilities regulated by the Florida Public Service Commission, and are subject to its rules and regulations. As such, the Florida Waterworks Association is substantially affected by proposed rule 25-30.433(3).

(4) The challenged proposed rule was noticed in the Florida Administrative Weekly on April 2, 1993, at Volume 19, Number 13. The Public Service Commission has designated the rulemaking proceeding as Docket Number 911082-WS. Challenged proposed rule 25-30.433(3) would establish applicable rate-making treatment in rate case proceedings for debit deferred taxes and other deferred debits in determining the utility's capital structure and rate base.

(5) Challenged proposed rule 25-30.433(3) provides as follows:

In a rate case proceeding, the following provisions shall apply, unless, for good cause shown, the applicant or any intervenor demonstrates that these rules result in an unreasonable burden. In these instances, fully supported alternatives will be considered by the Commission. Any alternatives proposed by the utility must be filed with the minimum filing requirements.

. . .

(3) Debit deferred taxes created due to income taxes associated with used and useful Contributions-in-Aid-of-Construction (CIAC) shall be offset against credit deferred taxes in the capital structure. Any resulting net debit deferred taxes shall be included as a separate line item in the rate base calculation. No other

deferred debits shall be considered in rate base when the formula method of working capital is used.¹

(6) (a) The Florida Waterworks Association asserts that the challenged proposed rule constitutes an invalid exercise of delegated legislative authority for the reason that the rule contravenes the specific provisions of the law implemented and the agency has thereby exceeded its grant of rulemaking authority. More specifically,

(b) The challenged proposed rule states that it implements Section 367.081, Florida Statutes. In pertinent part, the statute implemented provides as follows:

(2)(a) The commission shall . . . fix rates which are just, reasonable, compensatory, and not unfairly discriminatory. In every such proceeding, the commission shall consider . . . the cost of providing the service, which shall include, but not be limited to . . . the requirements of the utility for working capital; maintenance, . . . tax, and operating expenses incurred in the operation of all property used and useful in the public service; and a fair return on the investment of the utility in property used and useful in the public service

(c) The investment of the utility in property used and useful is commonly referred to as "rate base." Rate base consists of several components, the total of which represents the amount of investment required to provide service. The investments which make up a rate base can generally be categorized as long term, or physical plant; short term, or working capital; and medium term, or deferred debits.

¹Subsection (2) of the rule provides that "working capital shall be calculated as one-eighth of operation and maintenance expenses." This is commonly referred to at the Florida Public Service Commission as the formula method of working capital.

(d) The proposed rule requires that portions of debit deferred taxes deemed "used and useful" by the Commission be netted against total credit deferred taxes, thereby reducing the "used" debit with both "used" and "non-used" or even non-utility credits. If the balance after netting is a credit, it is included as a component of the utility's capital structure to be prorated to rate base, which further reduces the "used" debits by prorating a portion to "non-used" or non-utility purposes. The result is an understatement of the cost of capital associated with serving the public. If the balance after netting is a debit, it is included in rate base. But the amount remaining, having been reduced by "non-used" or non-utility credits, is an understatement of the investment in property serving the public. The rates resulting therefrom cannot be just or reasonable and will therefore circumvent the requirements of Section 367.081, Florida Statutes.

(e) The proposed rules further specifically eliminates consideration of all deferred debits (other than debit deferred taxes as outlined above) in the calculation of the utility's investment on which it is allowed to earn a return. The exclusion of this investment clearly contravenes the provisions of law purportedly implemented by the challenged proposed rules, in that they would prevent the Commission from fixing compensatory rates based upon consideration of the cost of providing service, which must include a return on the utility's investment in long term assets (net plant in service), short term assets (working capital), and medium term assets (deferred debits).

(7) (a) The Florida Waterworks Association asserts that the challenged proposed rule is vague, fails to establish adequate standards for agency decisions, or vests unbridled discretion in the agency. More specifically,

(b) The challenged proposed rule provides for its applicability "unless, for good cause shown, the applicant or intervenor demonstrates that these rules result in an unreasonable burden. In these instances, fully supported alternatives will be considered by the Commission."

(c) There is no definition of what constitutes "good cause," "unreasonable burden," or "fully supported alternatives." No standards or criteria are set forth for any such determination.

(8) There is no theoretical basis for exclusion of an investment in deferred items from the rate base calculation. An investment in a medium term asset, such as major repairs or maintenance or rate case expense, should reasonably be included in rate base for rate setting purposes, so long as it is determined to be a prudent investment. To allow recognition of short term investments through the working capital allowance and long term investments through plant in service, and then to exclude deferred debits, is arbitrary and capricious and bears no reasonable relationship to the statutory requirements that the Florida Public Service Commission must consider in fixing just, reasonable and compensatory rates.

(9) The Florida Waterworks Association asserts that the challenged proposed rule violates the U.S. and Florida

Constitutions. It has long been the law of the land that a public utility is entitled to recover in rates those expenses reasonably necessary to provide service to its customers and to earn a fair rate of return on investment in plant used and useful in providing service. West Ohio Gas Co. v. Public Utilities Commission, 234 US 63, 55 S. Ct. 316, 79 L.Ed. 761 (1935). See also Gulf Power Company v. Bevis, 289 So.2d 401 (Fla. 1974).

That a utility must incur costs in connection with medium term assets, is demonstrated by review of Section 367.081(6) and (7) and Section 367.145(2), Florida Statutes. The latter statutory provision specifically requires the payment of a filing fee for a utility seeking a rate relief. This fee, in addition to the other costs of a rate case proceeding, are then required by the aforementioned Section 367.081(7), Florida Statutes and by Section 367.081(6), Florida Statutes, to the extent reasonable, to be recognized as a cost of service, and amortized over a four year period.

Rate case expenses involving rate case application filing fees, attorneys fees, consultants and witness fees, travel costs and a plethora of other items are absolutely essential for a utility to successfully maintain a rate proceeding.

Even where rates in effect are found to be excessive, in proceedings by a utility commission to determine their reasonableness, the utility must nonetheless be allowed its fair and proper expenses for presenting its side to the Commission.

Driscoll v. Edison Light & Power Company, 307 U.S. 104, 59 S.Ct.

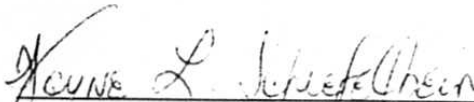
715, 83 L.Ed. 1134 (1939). See also Meadowbrook Utility Systems, Inc. v. Florida Public Service Commission, 518 So.2d 326 (1st DCA 1988).

To allow only recovery of an amortized portion of otherwise prudent rate case expense and other deferred debits in a utility's rates while prohibiting any return on the necessary investment therein representing the unamortized balance of the deferred debits, would violate the right of a utility to due process, to just compensation for taking of property, and the right to possess and protect property. Fla. Const., Art. I, Secs. 2, 9; Art X, Sec. 6, F.S.A.; U.S. Const. Amends. V and XIV. See also Gulf Power Company v. Bevis, 289 So.2d 401 (Fla. 1974); City of Miami v. Florida Public Service Commission, 208 So.2d 249 (Fla. 1969).

WHEREFORE, the Petitioner, the Florida Waterworks Association seeks a formal hearing pursuant to Section 120.57(1), Florida Statutes, for the purpose of determining that proposed rule 25-30.433(3) constitutes an invalid exercise of delegated legislative authority.

Respectfully submitted, this 23rd day of April, 1993.

GATLIN, WOODS, CARLSON & COWDERY



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Attorneys for the
Florida Waterworks Association

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by hand delivery to Christiana Moore, Esquire, Florida Public Service Commission, 101 East Gaines Street, Tallahassee, Florida 32399-0850, and to Rob Vandiver, Esquire, General Counsel, Florida Public Service Commission, 101 East Gaines Street, Room 212, Tallahassee, Florida 32399-0850, on this 23rd day of April, 1993.



WAYNE L. SCHIEFELBEIN