

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Application for Rate) DOCKET NO. 920808-SU
Increase by South Fort Myers) ORDER NO. PSC-93-1288-FOF-SU
Division of FLORIDA CITIES WATER) ISSUED: 09/07/93
COMPANY in Lee County.)
_____)

The following Commissioners participated in the disposition of this matter:

J. TERRY DEASON, Chairman
SUSAN F. CLARK

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FINAL ORDER ESTABLISHING INCREASED RATES
FOR WASTEWATER SERVICE

BY THE COMMISSION:

CASE BACKGROUND

Florida Cities Water Company, South Ft. Myers wastewater system, (FCWC or utility) is a class A utility which, as of June 30, 1992, provided wastewater service to 5,009 customers (a total of 7,469 equivalent residential connections (ERCs)) in Ft. Myers, Florida. This Commission last established rates for the South Ft. Myers Division of FCWC's wastewater system by Order No. PSC-92-0266-FOF-SU, issued on April 28, 1992.

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On December 3, 1992, the 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. The approved test year for this proceeding is the historical test year ending June 30, 1992. FCWC has requested final rates designed to generate annual wastewater revenues of \$3,092,782, or an increase of \$396,326 (14.69 percent).

By Order No. PSC-93-0216-FOF-SU, issued February 10, 1993, this Commission suspended FCWC's proposed rates and denied FCWC an interim wastewater rate increase, thereby requiring the rates to remain unchanged for interim purposes. FCWC had requested an interim rate increase of \$396,093 (14.68 percent). We ordered the utility to place 9.72 percent of all revenues collected on or after January 19, 1993, subject to refund due to potential overearnings. In addition, this Commission ordered FCWC to file and have approved a corporate undertaking in the amount of \$200,490, as guarantee for any potential overearnings refund.

The utility is located in a critical use area of the South Florida Water Management District. FCWC has an effluent reuse program in place, and it provides wastewater effluent to three golf courses for irrigation at the rate of 13 cents per thousand gallons.

On February 12, 1993, the Office of Public Counsel (OPC) filed a notice of intervention in this case. By Order No. PSC-93-0254-PCO-SU, issued February 16, 1993, we acknowledged OPC's intervention.

An administrative hearing on this matter was held at the Sheraton Harbor Place in Ft. Myers, Florida, on May 27, 1993.

FINDINGS OF FACT, LAW, AND POLICY

Having considered the evidence presented, the briefs of the parties, and the recommendation of our staff, we hereby enter our findings of fact, law, and policy.

STIPULATIONS

Prior to the hearing, the utility, OPC, and the staff of this Commission proposed to stipulate the following:

(1) The testimony of Staff Witness James Grob should be entered into the record as though read, and his appearance at hearing should be waived.

(2) The allocation of general plant to the wastewater division should be \$46,660. Therefore, general plant should be reduced by \$38,007, and the correct allocation factor should be 11 percent.

(3) The cost of equity should be set by the leverage formula in effect at the time of the Commission's vote on final rates in this case. An allowed range of plus or minus 100 basis points should be recognized for ratemaking purposes.

(4) Test year miscellaneous service revenue should be increased by \$9,476.

(5) Test year legal expenses should be reduced by \$999 for the legal expenses charged to the utility from Avatar Utilities.

(6) Property taxes should be reduced by \$45,431 to properly reflect the assessment of property taxes to the South Ft. Myers wastewater division of Florida Cities Water Company.

Upon consideration, we believe that these proposed stipulations are reasonable and hereby accept them.

QUALITY OF SERVICE

Staff witness James Grob, of the Florida Department of Environmental Protection (DEP), formerly the Department of Environmental Regulation, testified that FCWC's plant was properly permitted and that the maintenance of FCWC's treatment plant and collection facilities was satisfactory. He also testified that the utility is in compliance with the regulations of DEP. Mr. Grob's testimony was stipulated into the record.

Utility witness Larry Griggs testified that the utility is in compliance with the regulations of the United States Environmental Protection Agency and DEP. He also testified that the quality of service being provided by the utility was satisfactory and that the utility receives few customer complaints pertaining to quality of service concerns.

No customers attended the hearing to offer testimony on this issue. Based upon the record, we do not believe that there is any

evidence which demonstrates that FCWC's quality of service is less than satisfactory. In consideration of the foregoing, we find that FCWC's quality of service is satisfactory.

RATE BASE

Our calculation of the appropriate rate base for the purpose of this proceeding is depicted on Schedule No. 1-A, and our adjustments are itemized on Schedule No. 1-B, attached to this Order. Those adjustments which are self-explanatory or essentially mechanical in nature are reflected on those schedules without further discussion in the body of this Order. The major adjustments are discussed below.

Exclusion of Costs to Complete Second Train -
(Second 2.5 mgd plant)

The utility's plant structures, which are in place but not fully operational, will ultimately provide 5.0 million gallons per day (mgd) of treatment. However, the mechanical equipment required to operate the plant at the capacity of 5.0 mgd would cost \$1,400,500 to complete. In other words, in order for the utility to place into operation the second half of its capacity, the additional 2.5 mgd of the total 5.0 mgd, it would cost the utility \$1,400,500. The additional 2.5 mgd is considered the second of the plant's two trains. Currently, the activated portion of the plant's treatment capacity is 2.5 mgd. Therefore, we considered whether the plant is a 2.5 or a 5.0 mgd plant for purposes of establishing the appropriate rate base.

Utility witness Douglas Smith testified that his engineering firm, Black and Veatch, was retained to review the plant design and construction and determine the amount of current investment attributed to the 2.5 mgd portion of the plant now in active service. The utility also asked his firm to determine the amount of time and cost required to activate the additional 2.5 mgd of capacity. The analysis is detailed in Exhibit No. 1.

The utility has requested that we determine rate base from the cost of the 2.5 mgd plant, which is the facility currently providing service to the existing customers. Witness Smith's analysis demonstrates that the investment in the activated plant is \$9,740,827; the investment in the inactive plant is \$3,170,010; and, the remaining investment to be made to activate the entire plant is \$1,400,500.

OPC's witness Michael Murphy characterized the plant as a 5.0 mgd facility with a permitted capacity of 2.5 mgd. He acknowledged that the capacity is limited by the absence of mechanical and electrical equipment to treat the full 5.0 mgd design flow. In addition, Witness Murphy testified that he agreed with utility witness Smith's opinion concerning the plant's active capacity.

We agree that the current plant capacity is 2.5 mgd. The second train, or treatment unit, is not in service and is not needed to serve the existing customers. The company's analysis prepared by Black and Veatch shows the costs of the activated 2.5 mgd plant on a stand alone basis. Since that is the only portion of the plant that is in service and no additional capacity is required at this time, we find that the costs to complete the plant to its ultimate design capacity of 5.0 mgd shall not be included in this proceeding.

Economies of Scale Approach

As a result of the Black and Veatch study, Utility witness Smith concluded that the utility has \$9,740,827 invested in the advanced wastewater treatment plant to serve the active 2.5 mgd train. There is \$3,170,010 invested in the inactive 2.5 mgd train, and \$1,400,500 will be needed for new equipment to activate the second train to bring the ultimate plant capacity to 5.0 mgd. The substance of Witness Smith's testimony is that if the utility had built only a 2.5 mgd plant instead of the 5.0 mgd, the investment would have been \$9,740,827.

In preparing the study, components were divided into three categories for analysis: components that are not related to plant capacity; components required for the activated 2.5 mgd train; and, components that will serve the activated 2.5 mgd train and the additional treatment train. A summary of the plant investment of \$9,740,827 has been provided by category. A cost estimate totalling \$1,400,500 for completing the plant for its 5.0 mgd capacity is also provided.

Witness Smith testified that the administration building at the plant would require no structural additions to be adequate for the ultimate 5.0 mgd capacity. He also stated the existing outfall line would require no modifications, since the piping and associated items were designed to handle 5.0 mgd. The cost of increasing the capacity of the outfall line from 2.5 mgd to 5.0 mgd was 8 percent, which is the increase in pipe cost from 18" to 24".

OPC argues in its brief that the utility's economy of scale approach applies all benefits to the future customers, explaining that both current and future customers contribute to the capacity which gives rise to the economies of scale associated with building a larger plant. OPC's Witness Murphy testified that he believes it is good engineering practice to consider economies of scale, but that the degree of which would depend upon the situation. In reviewing the \$12.9 million investment in treatment plant and the \$9.7 million supported by the utility in this rate proceeding, Witness Murphy concluded it was reasonable.

The Black and Veatch study shows the activated 2.5 mgd plant costing \$3.90 per gallon (\$9,740,000 divided by 2.5 million gallons), a higher cost than Witness Murphy would allow. The 5.0 mgd plant at buildout is estimated to cost \$14,300,000, which calculates to be \$2.86 per gallon, which is within the \$2-\$3 range that Mr. Murphy estimates is a reasonable cost.

Witness Murphy stated a 2.5 mgd plant should cost in the neighborhood of \$3 per gallon, or a total of \$7.5 million. He also testified that a 5.0 mgd plant would cost about \$2 per gallon, or \$10 million, which reflects economies of scale. In reviewing the Black and Veatch study, he did not have a problem with the report. He stated that the \$12.9 million invested was not an estimate, but it was the amount of actual dollars spent as a result of receiving bids for the project.

We have reviewed the study prepared by Witness Smith, and we agree with the theory applied and the vast majority of the reductions made to the costs of the wastewater treatment plant to consider it the activated 2.5 mgd plant. We also agree with the conclusions of Witness Murphy that while the cost of the wastewater plant seems high, it was taken from actual dollars spent based upon bid prices, and, that the reductions made to arrive at the \$9,740,827 are reasonable.

Based upon information in the record, the administration building and the effluent outfall line and appurtenances are sized for ultimate buildout. In the study, an 8.2 percent reduction was made to pipe costs because the effluent main was oversized, which represents the cost differential for an increase from 18" to 24" pipe. Much of the construction cost is not related to pipe size. We agree this is a reasonable reduction for the effluent line using an economy of scale approach.

However, we do not believe that the same economies of scale apply to the administration building. We find it appropriate to make a 24.55 percent reduction to the building cost since it is sized for the 5.0 mgd plant and no improvements will be needed. A reduction is required because, as in a home, construction cost is based upon square feet of space and not upon the differential in material cost, as for the effluent main. The 24.55 percent reduction equals \$64,744 and is the same ratio as that for the Black and Veatch analysis of the 2.5 mgd train to the total investment in the treatment facilities. Investments are shown on page 24 of Exhibit 1.

We also agree with OPC's position that economies of scale are not realized by the current customers when using the utility's approach. However, the customers are not harmed since the investment required is that which would have been made to construct a 2.5 mgd plant. The economies of scale begin to be realized when the second train is activated.

Therefore, we find it appropriate to accept the utility's economy of scale approach, with a reduction in the allocation of the administration building. This calculation brings the total investment in the activated 2.5 mgd plant to \$9,740,827 less \$64,744, or \$9,676,083. This is gross investment and does not include adjustments for used and useful which are discussed below.

Used and Useful--Treatment Plant

The utility advocates using a flow-based methodology in making the used and useful calculation and adding a margin reserve, recognizing the costs of the activated 2.5 mgd train. The most significant concern regarding the used and useful calculation in this case is the determination of the size of the facility. Utility witness Keith Cardey testified that adding small increments of capacity over time as growth is experienced is not a sound principle. The utility, recognizing this, considered building different sized plants including a 2.0, 3.5 and a 5.0 mgd plant. There is no dispute that larger plants cost less per gallon to build. A 3.5 mgd plant would have been sufficient to serve the existing service area in 1982 but not adequate to serve areas that had package plants or adjacent areas without service. Anticipating displacing some of these package plants and enlarging the service area, the utility decided to build a 5.0 mgd plant.

The utility had based this decision in part upon the expected growth in the service area. Witness Cardey testified that the utility's obligation is to provide service to existing customers as well as to meet any reasonable demand for service. The utility was being required, at a minimum, to upgrade its facilities to meet DEP effluent standards. The estimated cost to upgrade the then existing 2.0 mgd facility was \$6.9 million. Based upon these facts as well as construction considerations, the utility built the 5.0 mgd plant now in place.

OPC Witness Murphy testified that a plant should be designed to handle some future growth. He stated that he was also aware that Ft. Myers was the fastest growing area in the United States at the time of the plant construction and would reflect that fact in considering population projections for sizing the plant. He testified that a plant should be constructed to accommodate growth for a five to ten year period. FCWC's 5.0 mgd plant has been in place eight years and should provide capacity for another 29 years at the current flow and growth rate.

OPC asked numerous questions about the utility's planning process and the analysis that transpired prior to the decision to build the 5.0 mgd plant. Witness Cardey explained that the population growth anticipated by the utility had not materialized. The utility had planned to enlarge its certificated area, and it had designed the plant for that purpose. However, Lee County is now serving 5,000 to 6,000 of the ERCs that FCWC had anticipated serving. The utility had been negotiating with developers as part of the planning for the new plant, but these meetings took place prior to an attempt to enlarge the utility's certificated territory. Lee County had taken over service in the area by making contracts with the area's largest developer. Witness Cardey did not know if the County's impact fees were lower than the utility's. FCWC's impact fees include a plant capacity fee of \$570 per ERC, guaranteed revenues, and allowance for funds prudently invested (AFPI). Additionally, a developer is required to construct all lines and deed them to the utility at no cost.

In reviewing the South Lee County Facilities Plan Update prepared in 1982, the County's plan anticipated an unusually high growth rate. In the area this report addresses, which is adjacent to Florida Cities' area, called Iona-McGregor which is west of Pine Ridge Road and south of Gladiolus Road, extensive future development was anticipated, with perhaps as many as 20,900 units. Buildout was planned to be reached in 37 years. Excluded from this

area was that portion within the FCWC's wastewater franchise. A number of active package plants are in or near the Iona-McGregor area, and therefore, are adjacent to or are within Florida Cities' service area. The Plan Update recommended that the County adopt a 20 year management plan and construct a 9.0 mgd plant. Another recommendation was for the County to upgrade the existing Beach Plant into operable condition prior to any expansion.

There was a great deal of discussion related to Lee County's wastewater facilities' service and its availability, and how that may have affected the utility's decision to build the 5.0 mgd plant now in place. However, based upon the record, we believe that the utility's 5.0 mgd plant is overbuilt. It appears from Witness Cardey's testimony that the County now serves approximately 5,000 ERCs which FCWC had expected to serve. The testimony does not show why this happened or the time frame in which it occurred.

By Order No. 17813, dated July 7, 1987, this Commission granted additional wastewater service territory to FCWC that included areas in eleven land sections. The record does not show how many new ERCs have been added from this area, nor how much land is still available for development. Regardless, the utility's plant has additional capacity.

Based on the record, we agree with the utility that for used and useful purposes the costs apportioned to the activated 2.5 mgd train should be considered, and we, therefore, recognize the capacity as being 2.5 mgd. This capacity is essentially what the existing customers need to meet the average demand of 2.291 mgd, plus a margin reserve. Margin reserve is discussed later in this Order.

The utility asserts that the flows for this facility are 2.291 mgd, and a 40-45 month period is appropriate for a margin reserve allowance for a 2.5 mgd plant as stated in Exhibit No. 9. The utility is requesting a margin reserve of 2.3 years.

OPC correctly asserts that the utility built a 5.0 mgd plant. In past rate proceedings involving this utility, we recognized this and imputed the costs to activate the second train prior to calculating the used and useful portion of plant. OPC's calculation for used and useful is the 2.291 mgd flow divided by the 5.0 mgd ultimate plant capacity.

As explained earlier in this Order, we find it appropriate that 2.5 mgd be recognized as the available treatment plant capacity. To arrive at the used and useful percentage of the wastewater treatment plant and disposal facilities using the flow method, we divide the sum of the average daily flows and the margin reserve by the capacity of the plant. Accordingly, we have divided the sum of the 2.291 average daily flow and .136 mgd margin reserve (calculated below) by the 2.5 mgd capacity of the plant. The quotient is .97. Therefore, we find that the wastewater treatment plant and disposal facilities are 97 percent used and useful.

Margin Reserve

The utility requested a margin reserve in its MFRs, and it asserted that a margin reserve is a necessary investment which benefits all customers, including existing customers. The utility stated that a margin reserve equivalent to growth at 400 customers per year for 2.3 years, at .021 mgd, is appropriate in this case, and that we should recognize both permitting and construction lead time is required to activate additional capacity.

FCWC cited several past Commission orders which addressed the concept of margin reserve. In Order No. 22843, the Commission stated:

We believe that PCUC must have sufficient capacity to serve new customers at the time those customers connect. Section 367.111(1), Florida Statutes, requires each utility to provide service to the area described in its certificate within a reasonable time. The concept of margin reserve recognizes costs which the utility has incurred to provide service to customers in the near future. (Order No. 22843 [Palm Coast Utilities], p. 9)

This Commission has applied this same idea in other rate cases where margin reserve was considered:

Margin reserve represents capacity that the utility must have available beyond that which is demanded by the test year's customers. The purpose of the margin reserve is to enable the utility to connect new customers during the next eighteen months or so--the normal construction time for building new plant--without plant expansion. (Order No. PSC-92-0266-FOF-SU [Florida Cities, South Ft. Myers],

p. 7 and Order No. 23660 [Florida Cities Golden Gate], p. 11)

According to Witness Smith, the second 2.5 mgd treatment train can be activated, which will allow the plant to reach its optimal capacity of 5.0 mgd. The principal concrete structures and most of the underground piping were installed in 1985 for the 5.0 mgd plant. The permitting process for the second train will take between nine and 15 months, and another 18 months would be required for construction of the additional equipment.

In the MFRs, the utility shows an average growth per year of approximately 400 ERCs. Witness Cardey supports this annual growth, explaining the average daily flow per ERC is 226 gpd. He refers to the Black and Veatch study which explains that 30 months are needed to activate the second 2.5 mgd of capacity at the existing plant.

OPC's witness Murphy testified that present customers should pay for a reasonable amount of excess capacity. In terms of margin reserve, he found 18 months to be reasonable. Witness Murphy testified that to plan, design, and permit a new 5.0 mgd plant would take three to four years. He did not believe the margin reserve period should begin when the planning and design work starts. The construction period would be about 18 months, indicating that the majority of time is taken up in planning and design. According to Witness Murphy, if the costs of construction are to be considered in ratemaking, those costs should be recognized when construction starts, not when planning begins. Calculating the amount of plant for the margin reserve would involve the gallons per day per ERC and the annual growth rate of ERCs for the 18 month period. This would be added to [average daily flow from] the maximum monthly flow.

There is no argument that the construction period for constructing a new plant is 18 months. Whether or not the design and permitting period should be included in the margin reserve period is a different argument, according to the record.

This Commission has a long standing practice of including a margin reserve period of 18 months, as presented by the above cited orders. We are persuaded by Witness Murphy's testimony that costs, and therefore investment, should be recognized when construction starts, not when planning begins. We also believe that the

majority of investment is involved in construction, not in planning and design.

We have some concern about the utility's claim concerning the time required for activating the second 2.5 mgd train. According to Witness Smith's testimony, the time frames discussed appear to be liberal, allowing extra time for a worst case analysis. Construction time of eighteen months to activate the existing structure seems to be the very outside amount that it could possibly take. We do not believe that it is a normal time frame.

For these reasons, we find it appropriate to include a margin reserve in the treatment plant used and useful calculation. We shall recognize an eighteen month margin reserve period, and calculate the needed capacity to be 400 ERCs per year, at 226 gpd/ERC, for 1.5 years. This equates to additional demand and margin reserve of .136 mgd.

Used and Useful--Collection System

In the MFRs, the utility states that the on-site collection systems are designed and constructed in accordance with the regulations of the utility and DEP. Once constructed by the developers, those lines are deeded to the utility. FCWC concludes the collection system is 100 percent used and useful.

By Order No. PSC-92-0266-FOF-SU, issued April 28, 1992, this Commission found FCWC's collection system to be 100 percent used and useful. The utility had argued that since areas developed with the utility's funds had been fully developed and all other on-site lines were contributed, the collection system was 100 percent used and useful. (Order at p. 8) These circumstances remain the same in this case. Therefore, we find that the wastewater collection system is 100 percent used and useful.

Accrual of Depreciation on Non-used and Useful

The utility has proposed that we discontinue accruing depreciation on non-used and useful utility plant. The utility argues that because of slow growth, and the subsequent lack of collection of AFPI charges, it has lost the ability to recover its investment in plant. As a result of not being able to collect the carrying costs associated with the oversized plant that was built in 1986, the utility is now petitioning this Commission to change its long standing position on the accrual of depreciation on non-

used and useful plant. Utility witness Harrison claims that these accruals of depreciation on non-used and useful plant will prohibit recovery of investment, and create a mismatch between the amortization of CIAC and the accrual of depreciation. He further argues that future ratepayers will unjustly benefit by having a lower rate base from the accrual of depreciation on assets that were heretofore non-used and useful.

OPC argues that the Commission policy should not be changed. OPC witness Dismukes testified that she believes that the utility had an opportunity to collect this depreciation through AFPI. It is her position that the utility should not be able to change the rules of the game, now that time has proven that growth projections for this plant did not support the decision to build excessive capacity. She cited the Commission order for this utility's AFPI case in 1986:

We believe that five years is a reasonable period in which excess plant costs should be found as prudent. Carrying costs incurred beyond five years should be considered as excessive unless extraordinary or unusual circumstances are demonstrated. (Order No. 16818, issued November 6, 1986, p. 18)

OPC witness Dismukes further clarified the relationship between AFPI and the accrual of depreciation on non-used and useful plant by stating:

My rationale is basically that the Commission, in the '84 docket, basically said that you can collect AFPI for five years, Anything beyond that, [according to] my reasoning, would be the responsibility of the utility; the utility would have to absorb these costs. [These] costs would not be passed on to ratepayers, either future or current.... So if we stopped depreciating the plant, then in essence, you're not requiring the Company to absorb those costs. To me, that's how it [depreciation on non-used and useful plant] ties back to the [AFPI]. (TR 298)

OPC argues that the record in this case does not show "extraordinary or unusual" circumstances other than unachieved

customer growth. Therefore, OPC asserts, the AFPI mechanism should not be changed to suit this particular utility. Since the record does not contain a showing of extraordinary or unusual circumstances, OPC argues in its brief that a change in Commission policy is not warranted in this proceeding.

We agree with OPC that the utility has not made a showing of extraordinary circumstances that would justify a change in Commission policy. The record is devoid of such evidence. FCWC shareholders should bear the responsibility of having built an oversized plant for which recovery has not been received due to slow growth. We believe that future ratepayers should not be responsible for an old system with a full life, or an under-depreciated plant. The utility is requesting that this Commission change its rules because the utility has failed to collect AFPI charges. If we had known in 1986 what the future growth rate would be for this utility, we might have decided that the plant was excessive and not allowed AFPI at all. The shareholders, who must bear some responsibility, took the risk of this decision and built a plant that may not reach buildout until well beyond the turn of the century. Based on the use of the AFPI process, the constant diminution of assets over time, depreciation, and the principle that shareholders should bear the risk when collection of AFPI does not provide recovery of investment in an oversized plant, we find it appropriate that the accrual of depreciation on non-used and useful plant shall be continued and that Commission policy shall not be changed.

Imputation of CIAC on Margin Reserve

Utility witness Cardey testified that the utility is obligated to serve future customers, and that this obligation "rolls" forward as new customers connect to the system. The requirement to have excess capacity, a margin of reserve, is ongoing and should not be diminished through the imputation of CIAC. Witness Cardey contends that costs associated with margin reserve plant are incurred by the utility on a current basis. He opines that as customers connect to the system, the need for yet additional plant to serve new growth does not diminish. In addition to this argument, the utility argues in its brief that the MFRs contain a provision for CIAC from 920 prepaid connections, and that to impute CIAC against any margin reserve would be a double counting of CIAC.

OPC witness Murphy testified that if a margin reserve is granted, CIAC should be imputed against this allowance. OPC's

position is that the Commission should follow the "long standing" policy of imputing CIAC against any provision for margin reserve.

While we agree that our policy of imputing CIAC against margin reserve should be followed, we disagree with OPC that any imputation of CIAC should be made in this case. We concur with the utility's position that its prepaid ERCs, greater than 900 connections, more than offset the amount of ERCs in the approved margin reserve, as shown in Exhibit No. 34. The imputation of additional CIAC against the margin reserve would result in double counting of CIAC since these prepaid amounts already have been booked as CIAC.

While the philosophical arguments regarding imputation of CIAC are waged in every case, this rate case involves a simple accounting issue. Since the record reflects that guaranteed revenue from these prepaid ERCs is included in test year revenue, that the number of prepaid ERCs is greater than the number of Commission approved margin reserve ERCs, and that these prepaid amounts are accounted for as CIAC, to record additional CIAC would result in an overstatement of the CIAC related to margin reserve. Therefore, we find that no imputation of CIAC against margin reserve shall be made.

Rate Base Treatment of OPEBs' Unfunded Liability

In this Order, we approve the utility's use of Financial Accounting Standard (FAS) 106 for ratemaking purposes. The appropriate regulatory treatment of the unfunded liability that results from the implementation of FAS 106 must be considered and determined. Utility Witness Harrison testified that if the utility is allowed to recover the FAS 106 expense in rates, then the unfunded liability should either reduce rate base or be treated as a zero-cost source of capital. According to Exhibit No. 18, the amount of the unfunded liability for the South Ft. Myers wastewater system is \$51,480. In its brief, OPC argues that the unfunded liability should be included in the cost of capital at zero cost.

It has been our practice to reduce rate base in the amount of the unfunded liability. We have taken this approach and reduced rate base in Orders Nos. PSC-92-1197-FOF-EI and PSC-93-0301-FOF-WS. Therefore, we find it appropriate to require that the utility's rate base be reduced in the amount of its unfunded liability resulting from the implementation of FAS 106.

Deferred Taxes Related to OPEBS

In its brief, the utility contends that if rate base is reduced by the unfunded liability for Other Pension and Employee Benefits (OPEBS), debit deferred income taxes related to OPEBS should also be recognized. OPC did not present a position on this issue. We agree that this tax/book difference, a mechanical fall-out of our decision to reduce rate base due to the unfunded liability resulting from FAS 106, should be considered in the rate base determination. Therefore, we find it appropriate that the unfunded OPEB liability discussed earlier in this Order shall be offset by the related deferred income taxes on OPEBS. Based upon the \$25,740 average balance for the unfunded OPEB liability, and a 37.63 percent incremental income tax rate, rate base should be increased by \$9,686.

Working Capital

In its MFRs, the utility used the formula method, or one-eighth of operation and maintenance expenses (1/8th of O&M) to calculate the working capital allowance. FCWC's use of the formula approach is consistent with what is required by the MFRs Form PSC/WAS 17, which is incorporated in Rule 25-30.437, Florida Administrative Code. The MFRs' instructions state that the utility should calculate working capital using the formula method. There was no evidence in the record to support the use of any method other than the formula method. OPC did not address this matter in its brief.

In consideration of the above, we have calculated working capital using the formula method. In a later section of this Order, we find that the proper amount of test year operating and maintenance expense is \$1,224,064. Therefore, we have included one-eighth of that amount, \$153,008, in rate base as the utility's working capital allowance.

Test Year Rate Base

In consideration of the foregoing, we find that test year rate base is \$8,293,488.

COST OF CAPITAL

Our calculation of the appropriate cost of capital is depicted on Schedule No. 2-A, and our adjustments are itemized on Schedule No. 2-B. Those adjustments which are self-explanatory or which are essentially mechanical in nature are reflected on those schedules without further discussion in the body of this Order. The major adjustments are discussed below.

Treatment of AFPI Accruals

The utility has proposed that both the equity and associated income taxes attributable to AFPI accruals should be removed from the capital structure. The utility's proposed capital structure does not include deferred taxes related to accrual of AFPI charges. OPC witness Dismukes testified that, consistent with its treatment in the utility's last rate proceeding, the provision for deferred taxes should include AFPI-related items. She, therefore, proposed increasing the deferred tax account by \$3,896,000. Utility witness Harrison testified that Ms. Dismukes' calculation was correct. He also agreed that this deferred tax amount was properly included if the equity capital balance included earnings related to AFPI charges. The equity balances in both the utility's proposed and the Commission's approved capital structure include earnings related to AFPI charges.

In its brief, the utility stated that this Commission authorized the utility to accrue AFPI for a five year period, from 1986 to 1990, after the Fiesta Village wastewater treatment plant was built. It further states that this AFPI accrual was authorized so that the utility would remain whole with respect to the non-used and useful portion of Fiesta Village that was not included in the approved service rates. According to utility witness Harrison, only the equity return component of the AFPI accrual increased net income because the other portions of the AFPI charge were designed to recover other Fiesta Village operating costs, including depreciation, interest, and taxes.

The deferred tax treatment proposed by OPC witness Dismukes concerning AFPI accruals is the same method adopted by this Commission in the utility's last North Ft. Myers rate case, in Docket No. 910756-SU. In that case the Commission held:

Based on Mr. Harrison's testimony, we find that the utility removed the cost-free capital from the capital

structure. Accordingly, we find it appropriate to include deferred taxes in the amount of \$3,948,000. (Order No. PSC-92-0594-FOF-SU, p. 12)

We also adopted this treatment regarding deferred taxes in the utility's last proceeding for its Barefoot Bay division:

We believe that the utility has taken a piecemeal approach to defining capital investment. If AFPI related taxes should be excluded from the capital structure because AFPI accrual is a non-cash transaction, an associated reduction to the equity balance should be made for the same reason. AFPI charges are designed to allow the utility to recover prudently incurred carrying costs, depreciation charges, interest expense, property taxes, and equity return for non-used and useful facilities. Were we to reduce equity capital to be consistent with the exclusion of deferred taxes, the utility would be penalized for having to defer recovery of prudently incurred carrying charges.

Further, we believe the utility's proposed adjustment to exclude the cost free deferred tax account is an attempt to trace funds to a particular asset. Generally, this Commission rejects all such proposals. We normally reconcile rate base and capital structure on a prorata basis and do not assign particular capital accounts to specific asset accounts, which is effectively what FCWC has asked us to do.

In consideration of the foregoing, we have increased the provision for cost free tax accounts by \$3,863,500. This adjustment reduces the weighted cost of capital. (Order No. PSC-92-0563-FOF-WS, pp. 6-7)

Therefore, we find it appropriate that the capital structure shall include the \$3,896,000 provision for accumulated deferred taxes related to AFPI accruals. As noted above, this treatment is consistent with previous Commission decisions.

Investment Tax Credits

As shown in the MFRs, FCWC included Job Development Investment Tax Credits (JDITCs) in the capital structure at the utility's requested 9.77 percent overall cost of capital. OPC witness

Dismukes testified that, consistent with Commission policy, JDITCs should receive the cost of capital associated with investor supplied funds and that this would raise the cost to 10.64 percent. In its brief, FCWC agreed that Ms. Dismukes is correct concerning the recalculation of the proper rate for JDITCs; however, the utility maintains that the appropriate cost rate is 10.54 percent.

As noted, the utility and OPC agree that the cost rate for JDITCs are properly adjusted to reflect investor supplied funds. We believe that such recalculation is appropriate. The different cost rates discussed in the record result from different calculations of the weighted cost of capital for investor supplied funds. We find that the appropriate cost rate is 10.26 percent. This rate is mechanically derived based upon the appropriate cost of capital.

Overall Rate of Return

Utility witness Harrison argues that after removal of the common equity attributable to the AFPI and utilization of OPC's ITC costing methodology, the utility's appropriate overall rate of return is 9.65 percent.

Our only adjustment regarding investor capital is the reduction in the cost of debt from 9.92 percent to 9.15 percent based on the adjustment to the interest rate of the utility's short term line of credit. Witness Harrison testified that the interest rate for FCWC's line of credit is the prime rate, and he agrees that the current prime rate is 6.00 percent. In its MFRs, the utility assigned an 8.50 percent interest rate to the line of credit. In its brief, the utility states that a 7.5 percent interest rate for the line of credit would be appropriate. OPC argues in its brief that the current prime rate of 6.00 percent is the appropriate rate.

In the last rate case for FCWC South Ft. Myers' wastewater system, we found that the current prime rate should be used for the line of credit. (See Order No. PSC-92-0266-FOF-SU, p. 13) Generally, we have used the most current interest rate for floating short-term debt such as the line of credit. (See West Florida Natural Gas, Order No. PSC-92-0580-FOF-GU) Therefore, we believe that the appropriate interest rate for the line of credit is 6.00 percent. With this adjustment, we find that the appropriate overall cost of debt is reduced from 9.92 percent to 9.15 percent.

Pursuant to a stipulation among all of the parties, the appropriate cost of equity is 12.44 percent based on the leverage formula in Order No. PSC-92-0686-FOF-WS. The balances for deferred taxes and ITCs were discussed earlier in this Order.

Therefore, based on the proper components, amounts, and cost rates associated with the capital structure for the test year ending June 30, 1992, the weighted average cost of capital is 8.89 percent.

NET OPERATING INCOME

Our calculation of net operating income is depicted on Schedule No. 3-A and our adjustments are itemized on Schedule No. 3-B. Those adjustments which are self-explanatory or which are essentially mechanical in nature are reflected on those schedules without further discussion in the body of this Order. The major adjustments are discussed below.

OPERATION AND MAINTENANCE EXPENSE (O & M)

Test Year Rental Income

OPC argues that the utility's test year rental income should be increased by \$2,627 to adjust for the collection of office rent. OPC witness Dismukes testified that FCWC received \$19,904 of rental income during the test year to sublease its Sarasota Division office to a third party and to rent land for an antenna in its Barefoot Bay division. Ms. Dismukes proposed allocating 13 percent of this rental income, or \$2,627, to the South Ft. Myers wastewater division.

However, as argued by utility witness Harrison, the record shows that expenses and rental income for these properties are booked below the line and received directly by the other divisions. He testified that they are not allocated to any other division and are not in any way associated with operations in South Ft. Myers. Accordingly, he argued that none of the rental income should be allocated to the South Ft. Myers wastewater division.

During cross-examination, OPC witness Dismukes testified that the utility did not present evidence to prove that the expenses associated with the rental income were not allocated to the utility's South Ft. Myers wastewater division. In the absence of any evidence that the related expense was not allocated to the

South Fort Myers division, OPC asserts that income for the test period should be increased by \$2,627 for rental income.

Based on the record, we believe that this rental income should not be included in operating revenues for the South Ft. Myers division. Mr. Harrison testified that expenses related to this rental property are not included in test year expenses. There is no showing in the record that any of the expenses related to this rental income were in fact passed down to the South Ft. Myers division. Since neither this rental income nor related expenses are properly considered above-the-line operating items, OPC's proposal to increase operating revenues for this rental income is rejected.

Therefore, based on the record, we find that it is not appropriate to make an adjustment to the utility's test year rental income.

OPEB Expenses

FCWC's witness Harrison states that FCWC will incur an increase in operating expenses as a result of FAS 106. He states that FAS 106 requires accrual accounting for the cost of post-retirement benefits other than pensions. He states that the total amount of additional operating expenses due to FAS 106 is \$332,400 on a total FCWC basis and that the amount allocated to the South Ft. Myers wastewater system is \$43,212 based on a 13 percent allocation factor. Other than the expense amount, the utility has capitalized \$7,000 of FAS 106 costs but has not added this amount to rate base. Under cross examination, witness Harrison states that FCWC updated its FAS 106 costs in April 1993 based on a new study. Based on the new study, FCWC asserts that the FAS 106 expense amount is \$46,669, as shown in Exhibit No. 19. OPC did not address this issue.

We find it appropriate to permit the utility to use FAS 106 for ratemaking purposes. We believe that the accrual accounting prescribed by FAS 106 is appropriate for ratemaking purposes. We have approved the concept of using FAS 106 for ratemaking purposes in several recent rate cases, such as the Florida Power Corporation and Lehigh Utilities, Inc. rate cases. (See Orders Nos. PSC-92-1197-FOF-EI and PSC-93-0301-FOF-WS)

We believe that the appropriate amount of FAS 106 expense for this proceeding should be \$43,212. This is the amount presented in

the utility's MFRs and in witness Harrison's testimony. Though the utility provided Late-filed Exhibit No. 10 which showed a higher FAS 106 expense based on the updated study, this amount was not supported by the testimony in the record.

Major O & M Expenses

Utility witness Harrison testified that the utility incurred \$12,950 during the test year in expenses related to televising and cleaning some of its sewer lines. The utility had recently expanded its program in this area. In 1990 and 1991, there were no charges of this magnitude.

OPC argued that this item should be amortized over four years since this expense had not been incurred in prior years and Witness Harrison did not know whether this would be a normal, ongoing expense. If the expense were capitalized, it would be reduced by \$9,712.

Upon our review of the amount of infiltration and inflow (I & I), we find that no adjustment to O & M is needed. The \$12,950 in maintenance expenses was incurred for televising and cleaning sewer lines which resulted in a decreased I & I for the utility. The results desired were achieved, and if this expense continues, I & I should be reduced even further. Therefore, we find that no adjustment to O & M is necessary.

Infiltration and Inflow

The utility has more than 46 miles of pipe in its wastewater collection system. Utility witness Griggs testified that when the water sales (of wastewater customers) of 566 million gallons are compared to wastewater treated of 717 million, the difference is 151,000,000 on an annual basis, or 400,000 gpd. Therefore, assuming all water sold is returned as wastewater, the percentage amount of infiltration is 26.7 percent. This assumption suggests that 47 million gallons of water is being returned to the utility as wastewater that is above the amount of wastewater billed to the customers, due to the 6,000 gallon cap now in place. In its brief, the utility suggests that infiltration is within acceptable levels and refers to Order No. PSC-92-0266-FOF-SU.

Witness Harrison testified that the utility had spent \$12,950 in televising and cleaning sewer lines during the test year, in an effort to expand its I & I program. Even though the utility

believes its I & I is within acceptable limits, it would like to make additional improvements.

In its brief, OPC compared the data on Schedule F-2 and E-2 in the MFRs, as shown in Exhibit No. 9, and concluded that 90 percent of the water sales are returned as wastewater. OPC suggests that a 7 percent allowance for inflow be made and a reduction to one-half the remainder gallons as excessive infiltration to expenses be made representing the costs to treat the excess flows.

We do not agree with OPC's suggested adjustment. There is nothing in the record to support a 7 percent inflow allowance or the suggested infiltration adjustment. In Order No. PSC-92-0266-FOF-SU we addressed the point, and in it, we concluded that infiltration of 10,800 gpd per mile was acceptable. (Order at p. 16) In this case, the infiltration is 8,500 gpd per mile, showing a decrease from the last rate case.

The I & I has decreased since the last case, apparently due in part to the line repair from the televising and cleaning. The amount does not appear to be excessive when compared to design standards as mentioned in the last rate case order.

Therefore, based on the foregoing, we find it appropriate that no adjustment be made to operating expenses for excess wastewater treated compared to wastewater billed.

Purchased Power Expense

The utility argued that no adjustment should be made to purchased power even though it earned savings from the Florida Power & Light Commercial/Industrial Load Control Program Agreement (Agreement). The utility maintained that pursuant to the Agreement, the amount billed each month during the entire test period under the billing tariff reflected the lower demand charge and thereby included the savings in the total amount due. FCWC witness Griggs testified that the utility had achieved considerable savings in purchased power through participation in FP&L's commercial and industrial load control program. Exhibit No. 8 documents the savings achieved, and the MFRs reflect those savings. OPC in its brief agrees that no adjustment is necessary. Based on the record, we find it appropriate to make no adjustment to purchased power expense.

Chamber of Commerce Dues

Utility witness Harrison testified that the \$203 paid out for its Chamber of Commerce dues is a reasonable business expense which benefits the customers and the utility, and should, therefore, be included in the cost of service.

OPC witness Dismukes testified that this Commission has historically not allowed utilities to recover from ratepayers the expenses for Chamber of Commerce dues. She stated that the utility did not present any evidence to contradict this practice, so test year expenses should be reduced by \$203.

This Commission has concluded in the past that Chamber dues serve to improve the image of the utility with direct benefits accruing to the stockholders of the utility. Based on the evidence in the record, we are not convinced that these expenses should be charged to the ratepayers. Therefore, we find that an adjustment of \$203 shall be made to remove the expenses for the Chamber of Commerce dues.

Test Year Rental Expense

In her testimony, OPC witness Dismukes advocated a \$455 reduction to test year expense, on the basis that rental expense was higher for the test year than it had been, on average, for the period 1989 through 1991.

FCWC witness Harrison testified that while Ms. Dismukes' proposed adjustment is relatively immaterial, the principle involved is important. Mr. Harrison testified as follows:

Ms. Dismukes has chosen one expense to normalize what she considers to be abnormally high when the test year is compared to the years 1989, 1990, and 1991. What Ms. Dismukes has failed to do is normalize expenses that are abnormally lower when the test year is compared to the years 1989, 1990, and 1991. For instance, transportation expense for the test year was \$26,395. Transportation expense for the years 1989, 1990, and 1991 was \$29,581, \$33,904, and \$29,454 respectively which yields an average annual expense level of \$30,980. Following Ms. Dismukes' ratemaking approach, one should increase transportation expense by \$4,585. Ms. Dismukes' adjustment should be

rejected on the basis that you can't choose just one expense account to normalize and ignore the rest.

In its brief, OPC argues that test year rental expenses were abnormally high due to rental of equipment. Therefore, OPC contends that, consistent with Commission practice, such abnormally high expenses should be reduced and amortized to reflect a normal level of ongoing expenses.

We agree with the utility that selecting certain expenses to normalize is inappropriate, especially when normalization of other expenses would increase the level of test year expenses and, accordingly, the utility's revenue requirement. Therefore, we find that it is not appropriate to make an adjustment to the test year expense for rental of equipment.

Allowance for Officer Salaries

The utility's MFRs reflect a test year expense of \$12,079 for officers' salaries allocated to the South Ft. Myers wastewater division. According to the utility, this amount is ordinary, necessary, reasonable, and consistent with the affiliated group's long standing allocation methodology. Furthermore, due to the several companies that own FCWC, the utility argues that it is forced to pay its allocated share of two president's salaries. Utility witness Burgess further agreed that FCWC is allocated a share of the salaries for two executive vice presidents.

In its brief, OPC argues that the utility presented no evidence as to the necessity for the multiple layers of presidents and executive vice presidents. Therefore, OPC contends that test year expenses should be reduced by \$3,378 to exclude excessive officers' salaries. Accordingly, OPC argues that unless this Commission adopts OPC's position advocating the reduction of test year expenses as discussed below, the disputed salaries should be excluded.

We believe that the record does not show that the amount of officers' salaries allocated to this division are excessive. While OPC argues that several parent companies allocate payroll costs to this system, OPC did not show that these costs are excessive. As shown on Schedule B-8 of the MFRs, in Exhibit No. 9, the test year expense for officers' salaries is actually less than the similar expense in 1990, the test year in the utility's last rate case. Therefore, we find that officers' salaries shall not be reduced.

Allocations of Affiliated Transactions

OPC has taken the position that 50 percent, which equals \$41,560, of the allocation from affiliated transactions should be removed from test year expenses. OPC witness Dismukes made several arguments in support of OPC's proposed reduction to affiliated charges. She argued that the utility lacked supporting documentation concerning the reasonableness and the necessity for the affiliated charges, and that the intracompany invoices were not sufficiently descriptive. Also, she stated that there appeared to be a duplication of services among the affiliated companies. In addition, there may be improper allocations by the parent company to non-regulated businesses. Moreover, OPC argued that the equity earnings of affiliate companies appear to be excessive when compared to the utility's rate of return. Further, the utility bears the burden of proving that the charges are reasonable and necessary in order to recover them as expenses. Based on these arguments, Ms. Dismukes recommended that 50 percent of the allocation from affiliated companies, \$41,560, should be removed.

The utility's position is that the allocated charges from affiliated companies are reasonable. The utility maintains that the corporate structure is allowing the utility to provide the most efficient and effective service to its customers. FCWC argued that support charges are being logically and appropriately assigned to the operating companies that are benefiting from them with no cross-subsidization.

The utility, in response to OPC witness Dismukes assertions that charges from affiliated companies were too high, hired the firm of Meltzer & Associates to provide testimony in support of the allocations. While the witness from this firm, Mr. Burgess, did not provide specific details about the allocation process within the Avatar family of companies, he did state that he thought the charges from the parent and the service companies were reasonable, cost effective, and logically allocated. Utility witness Burgess also testified that this Commission had reviewed these allocations over a twenty year period and that there had never been a reduction to these allocations. Based on the premise that these charges are necessary and beneficial, the utility argued that none of the affiliated charges should be reduced.

We believe that even though there are several affiliated companies, that the descriptive documentation on related companies was not very informative, and that some divisions in the Avatar

family of companies are earning a high rate of return, the record is devoid of evidence that the specific affiliated charges passed down to FCWC are excessive. According to Exhibit 23, charges from affiliated companies have actually declined since 1991. The benchmark analysis in the MFRs did not reveal any excessive charges from transactions with the affiliate companies.

We agree with OPC that it is the utility's burden to prove that these charges are reasonable and necessary. The documentation that was supplied by the utility in this case did support the contention that expense is being incurred and paid for, and without some evidence that the specific charges themselves are duplicative or excessive, no adjustment is warranted. We believe that the record does not show that the amount of affiliated charges to this division are excessive. We find that it is inappropriate to make a reduction when the record does not support an argument that any specific charge is unreasonable. Therefore, we find that no adjustment shall be made to the allocation of transactions with affiliated companies.

Rate Case Expense

OPC argued that the appropriate rate case expense is \$0 because the rate case was unnecessary in that the utility could have and should have applied for the same increases during the 1992 rate case hearing. In the alternative, if the Commission does not disallow all rate case expense, it is OPC's position that the only expense that could be justified is \$39,875 which appears to be the original contract amount for the study prepared by Black and Veatch.

The utility has requested the amount of \$244,154 as rate case expense. It argued that there is sound justification for the two successive rate proceedings. FCWC did not request implementation coverage of FAS 106 in the 1992 rate case because compliance costs with FAS 106 were not fixed, known and measurable when the initial case was filed. The 1990 cessation of AFPI accruals created a need for immediate revenue increases irreconcilable with delays to allow preparation of the Investment Allocation Analysis.

The utility's projected provision for rate case expense in the MFRs was \$182,000. This provision was updated in Exhibit 10 to \$244,154. The components of these provisions are as follows:

	<u>MFRs</u>	<u>Exhibit No. 10</u>
Engineering	\$ 85,000	\$ 96,322
Legal	60,000	55,333
Accounting	30,000	83,724
Miscellaneous	7,000	8,775
Total	<u>\$182,000</u>	<u>\$244,154</u>

In its brief, OPC challenged the amount of rate case expense in two ways. The first argument supporting OPC's primary recommendation of a \$0 allowance for rate case expense, is based on the idea that this entire proceeding was extremely duplicative, in effect a replay of the utility's last rate case, in Docket No. 910477-SU.

OPC's alternative recommendation, in case a portion of rate case expense was allowed, is that the original contract price for the engineering study, \$39,875, should be allowed, not the requested amount of \$63,147. While this is a partial recognition of the costs incurred to assimilate the cost allocation study conducted by Black & Veatch, OPC recommended the reduction based on the failure of the utility to provide supporting documentation for this service contract. However, we discovered that the supporting invoices were submitted in Exhibit 10, only the document for the original contract was not provided.

Utility witness Harrison testified that this rate case primarily involved two issues: 1) the investment allocation analysis; and 2) the request for OPEB relief. Mr. Harrison defended the timing of the successive rate cases during his testimony by stating that OPEB values had not been calculated and that losses in income from diminished AFPI accruals forced the utility to request rate relief.

The utility defended its request for rate case expense in the brief by claiming that "ample documentation of rate case expense" has been submitted in Exhibits Nos. 10, 12, 13 and Late-filed Exhibits Nos. 11, 14, 32 and that it has met the burden of supporting its request. With the exception of the original engineering contracts, the record reflects that this documentation was available and generally supported the quarter of a million dollars that was spent on this case.

In all rate cases, we analyze and scrutinize supporting documentation to determine if the rate case expense request is justifiable. It is the utility's burden to prove that its

requested rate case expense is both reasonable and prudent. While the utility did provide documentation to support the rate case expense requested, it did not meet the burden of proving that this case was prudent and that it was not, in many respects, duplicative of the utility's rate proceeding that was heard by this Commission in 1992.

Utility witness Harrison claimed that due to AFPI income accruals ending in 1990, the utility needed to file a second rate case application in 1991. As a result of the historical growth of the utility, or more precisely, the lack thereof, we believe that the utility's management should have been aware that a revenue problem would occur when income from AFPI accruals ended. Utility witness Harrison also testified that compliance costs with FAS 106 were not fixed, known and measurable when the 1991 case was filed. It appears to us that if the best interest of the ratepayers were considered, the management would have made decisions and timed events with the goal of reducing costs. In the alternative, the utility could have postponed the last rate case until this amount could be calculated.

The management of the utility has the discretion to initiate a rate case. However, along with this discretion comes the responsibility to only incur just and reasonable expenses in pursuit of a rate change. We believe that it is neither just nor reasonable for this utility to have two complete rate proceedings in two years. The record, the issues, and the substance of the current case is replete with duplicative activity (MFR preparation, discovery, testimony, notices, hearing, among others) from the last rate case heard in Docket No. 910477-SU.

As evidenced by our decisions in the Utilities Inc. of Florida rate case and limited proceeding, we have denied rate case expense when cases are shown to be duplicative, as in Orders Nos. PSC-93-0430-FOF-WS, and 25821, issued March 22, 1993, in Docket No. 920834-WS and February 22, 1992, in Docket No. 910020-WS, respectively. In that case, Utilities Inc. sought to have rate base established for the first time, but had not, according to this Commission, adequately documented the original cost of the system. In the subsequent limited proceeding, we allowed the rate case expense directly associated with the provision of an original cost study, and disallowed all other rate case expense.

FCWC, in its brief, attempted to distinguish the case at hand with the above precedent by stating that the OPEB issue and the

cost study were sufficient reasons for filing another case. To the contrary, we believe that both of these cases involve successive rate filings which are primarily concerned with the calculation of rate base (original cost study vs. a cost allocation study). We believe that it is not appropriate to ask the ratepayers to pay more than double the expense merely because the management at FCWC has decided to change its strategy for adjusting used and useful and has made a FAS 106 calculation.

We think it is appropriate that stockholders of FCWC share some of this burden, as the choice for this cycle of rate proceedings was the responsibility of their management. In cases where we find that successive rate proceedings are duplicative, we believe that shareholders shall bear the expense of mismanagement. Rate case expense must be kept at a minimum, and any utility's rate case strategy should be guided with a goal of minimizing the cost to ratepayers.

Based on the foregoing, we do not believe that the utility has supported, thus justified, its entire request for rate case expense. We find that it is appropriate, however, to allow the cost of engineering work and miscellaneous expenses (noticing, filing fee, etc.). Earlier in this Order, we used the engineering study conducted and prepared by Black and Veatch as the basis for determining the used and useful percentage in this case.

Therefore, we find that it appropriate to allow the utility total rate case expense in the amount of \$100,000, comprised of \$85,000 for engineering and \$15,000 for miscellaneous expenses. The utility shall submit a detailed statement of the actual rate case expense incurred within 60 days after the final order is issued, or if applicable, within sixty days after the issuance of an order entered in response to a motion for reconsideration of such final order. The information shall be submitted in the form prescribed for Schedule B-10 of the MFRs.

Income Tax Expense

This is the mathematical calculation based on the level of revenues and expenses approved by this Commission in this case. The appropriate amount of income tax expense included in the test year is \$213,166.

Operating Income

The adjusted income level, or the difference between the utility's test year revenues and operating expenses, shows the expected earnings amount (or loss condition) if current rates were retained. Based on previously discussed adjustments, the resulting income from wastewater system revenues is \$642,195. The wastewater operating income and the adjustments to operating income are shown in Schedules Nos. 3-A and 3-B respectively.

REVENUE REQUIREMENT

In its MFRs, the utility requested a revenue requirement of \$3,092,782. This revenue requirement exceeds test year revenues by \$386,850, or an increase of 14.62 percent. Based on the adjustments discussed above, the annual revenue requirement for this utility before the rate case expense apportionment required by Section 367.0815, Florida Statutes, is \$2,865,928, or an increase of \$159,996, (5.91 percent).

RATES AND RATE STRUCTURE

We have calculated new rates designed to allow the utility the opportunity to achieve the revenue requirement approved herein. We find that these new rates are fair, just, and reasonable, and are not unduly discriminatory. The utility's existing rates, its requested final rates, and the rates which we hereby approve are set forth below for comparison. We have designed these rates using the base facility charge (BFC) rate structure. The BFC rate structure allows the utility to more accurately track its costs and allows the customers to have some control over their bills. Each customer pays for his or her pro rata share of the fixed costs necessary to provide utility service through the base facility charge.

The permanent rates requested by the utility are designed to produce revenues of \$3,092,782 for wastewater service. The requested revenues represent an increase of \$386,850 or 14.62 percent, after adjustment for miscellaneous service revenues. The final rates which we have approved are designed to produce revenues of \$2,865,928, which is an increase of \$159,996 or 5.91 percent.

WASTEWATER

RESIDENTIAL

<u>Meter Size</u>	<u>Utility Present Rates</u>	<u>Commission Approved Interim Rates</u>	<u>Utility Proposed Final Rates</u>	<u>Commission Approved Final Rates</u>
All Sizes	\$ 14.09	\$ 14.09	\$ 14.06	\$ 14.33
<u>Gallonge Charge</u>	\$ 2.40	\$ 2.40	\$ 3.09	\$ 2.64
Maximum Gallons	6M	6M	6M	6M
Minimum Bill	\$ 14.09	\$ 14.09	\$ 14.06	\$ 14.33
Maximum Bill	\$ 28.49	\$ 28.49	\$ 32.60	\$ 30.17

General Service

(includes Commercial, Multi-Family and Public Authority)

<u>Meter Size</u>	<u>Utility Present Rates</u>	<u>Commission Approved Interim Rates</u>	<u>Utility Proposed Final Rates</u>	<u>Commission Approved Final Rates</u>
5/8" x 3/4"	\$ 14.09	\$ 14.09	\$ 14.06	\$ 14.33
1"	35.23	35.23	35.15	35.83
1/2"	70.45	70.45	70.30	71.65
2"	112.72	112.72	112.48	114.64
3"	225.44	225.44	224.96	229.28
4"	352.25	352.25	351.50	358.25
6"	704.50	704.50	703.00	716.50
<u>Gallonge Charge</u> (No Maximum)	\$ 2.88	\$ 2.88	\$ 3.71	\$ 3.17

The rates which we have approved herein shall be effective for meter readings taken on or after 30 days from the stamped approval date on the revised tariff sheets. The utility shall submit revised tariff sheets reflecting the approved rates along with a proposed customer notice listing the new rates and explaining the reasons therefor. The revised tariff sheets will be approved upon our staff's verification that the tariff sheets are consistent with our decision herein and that the proposed customer notice is adequate.

Four Year Statutory Rate Reduction

Section 367.0816, Florida Statutes, states,

The amount of rate case expense determined by the commission... to be recovered through...rate[s] shall be apportioned for recovery over a period of 4 years. At the conclusion of the recovery period, the rate[s]...shall be reduced immediately by the amount of rate case expense previously included in rates.

In its brief, the utility expressed concern that the Commission may require it to make a larger four year reduction in revenue for rate case expense than has been amortized in this case, relating a continuation in customer growth to the payment of a larger revenue reduction than what is associated with this specific rate case expense. We do not believe that this is a legitimate concern. In the past, this Commission has always been specific with regard to the procedures which should be used in the four year reduction of rates for rate case expense, identifying the exact amount to be reduced by meter size in each specific rate case.

Also, the four year amortized reduction of the rate case expense is not based on future customer growth but is an amount determined during the present rate case to be applied at the end of the four year period. The wastewater rates, as shown on Schedule No. 4 attached hereto, shall result in an annual reduction in revenues of \$25,000. The revenue reductions reflect the annual rate case amounts amortized (expensed) plus the gross-up for regulatory assessment fees.

The utility shall file revised tariffs no later than one month to the actual date of the required rate reduction. The utility

also shall file a proposed customer notice setting forth the lower rates and the reason for the reduction.

If the utility files this reduction in conjunction with a price index or pass-through rate adjustment, separate data shall be filed for the price index and/or pass-through increase or decrease and the reduction in the rates due to the amortized rate case expense.

NO REFUND OF INTERIM RATES REQUIRED

On February 10, 1993, we issued Order No. PSC-93-0216-FOF-SU in this docket, suspending the utility's rates and holding the amount of \$262,087 subject to refund. We held these amounts subject to refund in the event that the utility was overearning.

According to Section 367.082, Florida Statutes, any refund should be calculated to reduce the rate of return of the utility during the pendency of the proceeding to the same level within the range of the newly authorized rate of return. Adjustments made in the rate case test period that do not relate to the period interim rates are in effect should be removed. Examples of these adjustments would be an attrition allowance or rate case expense, which are recovered only after final rates are established.

In this proceeding the test period for establishment of revenue held subject to refund was the twelve months ended June 30, 1992. The test year for final rates is the same time period. The approved interim calculation did not include any provisions for pro forma consideration of increased operating expenses or increased plant. The interim increase was designed to allow recovery of actual interest costs, and the floor of the last authorized range for equity earnings.

To establish the proper refund amount, we have calculated a revised revenue requirement excluding the provision for rate case expense in this proceeding. This pro forma expense was excluded because it was not an actual expense during the interim collection period. We believe that no further adjustments are appropriate. We calculated the revised interim revenue requirement using the recommended cost of capital, which includes the return on equity that, by statute, is the prescribed return to test for excessive earnings.

The utility's adjusted interim revenue requirement is \$2,760,455. This amount is \$326,078 greater than the level of interim rates approved per Order No. PSC-93-0216-FOF-SU (\$2,434,377). Accordingly, we find that no refund is required.

CONCLUSIONS OF LAW

1. This Commission has jurisdiction to establish FCWC's rates and charges pursuant to Section 367.081, and 367.101 Florida Statutes.
2. As the applicant in this case, FCWC has the burden of proof that its proposed rates and charges are justified.
3. The rates approved herein are just, fair, reasonable, compensatory, not unfairly discriminatory, and set in accordance with the requirements of Section 367.081, Florida Statutes, and other governing law.
4. Pursuant to Chapter 25-9.001(3), Florida Administrative Code, no rules and regulations, or schedules of rates and charges, modifications or revisions of the same, shall be effective until filed with and approved by the Commission.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the application of Florida Cities Water Company, South Ft. Myers, for an increase in its wastewater rates in Lee County is approved as set forth in the body of this Order. It is further

ORDERED that each of the findings made in the body of this Order are by reference incorporated herein. It is further

ORDERED that all that is contained in the schedules attached hereto are by reference incorporated herein. It is further

ORDERED that Florida Cities Water Company, South Ft. Myers is authorized to charge the new rates and charges as set forth in the body of this Order. It is further

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DOCKET NO. 920808-SU
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ORDERED that the rates approved herein shall be effective for meter readings taken on or after 30 days after the stamped approval date on the revised tariff pages. It is further

ORDERED that prior to its implementation of the rates and charges approved herein, Florida Cities Water Company, South Ft. Myers, shall submit and have approved a proposed notice to its customers showing the increased rates and charges and explaining the reasons therefor. The notice will be approved upon our staff's verification that it is consistent with our decision herein. It is further

ORDERED that Florida Cities Water Company, South Ft. Myers, shall submit, within 60 days of the date of this Order, an itemized report of the actual rate case expense incurred as set forth in the body of this Order. In the event a motion for reconsideration is filed, the rate case expense information shall be filed within sixty (60) days of the issuance of an order entered on the motion for reconsideration. It is further

ORDERED that Florida Cities Water Company shall reduce its wastewater rates by \$25,000 each year for four consecutive years in order to amortize the rate case expense awarded in this proceeding plus the gross up for regulatory assessment fees. It is further

ORDERED that Florida Cities Water Company shall file revised tariffs no later than one month from the actual date of the required rate reduction for purposes of amortization of rate case expense. In addition, Florida Cities Water Company shall file a proposed customer notice of the lower rates and the reason for the reduction for our staff's review and verification. It is further

ORDERED that the docket may be closed upon our staff's verification that the utility has filed and staff has approved the revised tariff sheets.

By ORDER of the Florida Public Service Commission, this 7th day of September, 1993.

STEVE TRIBBLE, Director
Division of Records and Reporting

(S E A L)
LK

by: Kay Flynn
Chief, Bureau of Records

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), 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.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of Records and Reporting within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, 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 sewer utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Civil Procedure. The notice of appeal must be in the form specified in Rule 9.900 (a), Florida Rules of Appellate Procedure.

FLORIDA CITIES WATER COMPANY			SCHEDULE NO. 1-A			
SCHEDULE OF WASTEWATER RATE BASE			DOCKET NO. 920808-SU			
TEST YEAR ENDED 6/30/92						
COMPONENT	TEST YEAR PER UTILITY	UTILITY ADJUSTMENTS	ADJUSTED TEST YEAR PER UTILITY	COMMISSION ADJUSTMENTS	COMMISSION ADJUSTED TEST YEAR	
1 UTILITY PLANT IN SERVICE	\$ 23,788,540	\$ (448,545)	\$ 23,339,995	\$ (89,487)	\$ 23,250,508	
2 LAND	6,327	0	6,327	0	6,327	
3 NON-USED & USEFUL COMPONENTS	0	(3,170,010)	(3,170,010)	(274,186)	(3,444,196)	
4 ACCUMULATED DEPRECIATION	(5,326,053)	1,004,610	(4,321,443)	8,559	(4,312,884)	
5 CIAC	(9,891,544)	0	(9,891,544)	0	(9,891,544)	
6 AMORTIZATION OF CIAC	2,543,331	0	2,543,331	0	2,543,331	
7 ACQUISITION ADJUSTMENT	467	(467)	0	0	0	
8 ADVANCES FOR CONSTRUCTION	(20,747)	0	(20,747)	0	(20,747)	
9 DEFERRED TAXES	0	0	0	9,686	9,686	
10 WORKING CAPITAL ALLOWANCE	147,099	14,300	161,399	(8,391)	153,008	
RATE BASE	\$ 11,247,420	\$ (2,600,112)	\$ 8,647,308	\$ (353,820)	\$ 8,293,488	

FLORIDA CITIES WATER COMPANY
 ADJUSTMENTS TO RATE BASE
 TEST YEAR ENDED 6/30/92

SCHEDULE NO. 1-B
 DOCKET NO. 920808-SU

EXPLANATION	WASTEWATER
(1) <u>UTILITY PLANT IN SERVICE</u>	
a) Adjustment to reallocate general plant	\$ (38,007)
b) Adjustment to remove unfunded opeb's	\$ (51,480)
	<u>\$ (89,487)</u>
(2) <u>LAND</u>	\$ <u>0</u>
(3) <u>NON-USED AND USEFUL PLANT</u>	
a) Used and useful adjustment to wastewater treatment plant	\$ (356,973)
b) Adjustment for accumulated depreciation related to used and useful adjustment	\$ 82,787
	<u>\$ (274,186)</u>
(4) <u>ACCUMULATED DEPRECIATION</u>	
a) Adjustment to reallocate general plant	\$ <u>8,559</u>
(5) <u>CIAC</u>	\$ <u>0</u>
(6) <u>ACCUMULATED AMORTIZATION</u>	\$ <u>0</u>
(7) <u>DEFERRED INCOME TAXES</u>	
a) Reduced provision for deferred taxes - post-retirement benefits	\$ 9,686
	<u>\$ 0</u>
	<u>\$ 9,686</u>
(8) <u>WORKING CAPITAL</u>	
a) Adjustment to agree with recommended operating expenses	\$ <u>(8,391)</u>

FLORIDA CITIES WATER COMPANY CAPITAL STRUCTURE TEST YEAR ENDED 6/30/92						SCHEDULE NO. 2-A DOCKET NO. 920808-SU				
DESCRIPTION	ADJUSTED TEST YEAR PER UTILITY	WEIGHT	COST	UTILITY WEIGHTED COST	COMMISSION RECONC. ADJ. TO UTILITY EXHIBIT	BALANCE PER COMMISSION	WEIGHT	COST	WEIGHTED COST PER COMMISSION	
1 LONG TERM DEBT	\$ 3,795,556	43.89%	9.92%	4.35%	\$ (367,732)	\$ 3,427,824	41.33%	9.15%	3.78%	
2 SHORT-TERM DEBT	0	0.00%	0.00%	0.00%	0	0	0.00%	0.00%	0.00%	
3 PREFERRED STOCK	1,237,945	14.32%	9.00%	1.29%	(119,938)	1,118,007	13.48%	9.00%	1.21%	
4 COMMON EQUITY	2,644,394	30.58%	12.44%	3.80%	(256,201)	2,388,193	28.60%	12.44%	3.58%	
5 CUSTOMER DEPOSITS	0	0.00%	0.00%	0.00%	0	0	0.00%	0.00%	0.00%	
7 INVESTMENT TAX CREDITS	282,097	3.26%	9.77%	0.32%	(27,330)	254,767	3.07%	10.26%	0.32%	
8 DEFERRED INCOME TAXES	687,316	7.95%	0.00%	0.00%	417,382	1,104,698	13.32%	0.00%	0.00%	
9 TOTAL CAPITAL	\$ 8,647,308	100.00%		9.76%	\$ (353,820)	\$ 8,293,488	100.00%		8.89%	
RANGE OF REASONABLENESS							LOW	HIGH		
							-----	-----		
RETURN ON EQUITY							11.44%	13.44%		
							-----	-----		
OVERALL RATE OF RETURN							8.60%	9.16%		
							-----	-----		

FLORIDA CITIES WATER COMPANY ADJUSTMENTS TO CAPITAL STRUCTURE TEST YEAR ENDED 6/30/92		SCHEDULE NO. 2-B DOCKET NO. 920808-SU			
DESCRIPTION	SPECIFIC ADJUSTMENT (1)	SPECIFIC ADJUSTMENT (2)	PRO RATA RECONCILE	NET ADJUSTMENT	
1 LONG TERM DEBT	\$ 23,798,569	\$ 0	\$ (24,166,301)	(\$ 367,732)	
2 SHORT-TERM DEBT	0	0	0	0	
3 PREFERRED STOCK	7,762,055	0	(7,881,993)	(119,938)	
4 COMMON EQUITY	16,580,654	0	(16,836,855)	(256,201)	
5 CUSTOMER DEPOSITS	0	0	0	0	
6 INVESTMENT TAX CREDITS	1,768,784	0	(1,796,114)	(27,330)	
7 DEFERRED INCOME TAXES	4,309,549	3,896,000	(7,788,167)	417,382	
8 TOTAL CAPITAL	\$ 54,219,611	\$ 3,896,000	\$ (58,469,431)	(\$ 353,820)	

FLORIDA CITIES WATER COMPANY
STATEMENT OF WASTEWATER OPERATIONS
TEST YEAR ENDED 6/30/92

SCHEDULE NO. 3-A
DOCKET NO. 920808-SU

DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUSTMENTS	UTILITY ADJUSTED TEST YEAR	COMMISSION ADJUSTMENTS	COMMISSION ADJUSTED TEST YEAR	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	\$ 2,645,715	\$ 447,067	\$ 3,092,782	\$(386,850)	\$ 2,705,932	\$ 159,996	\$ 2,865,928
OPERATING EXPENSES				14.62%		5.91%	
2 OPERATION AND MAINTENANCE	\$ 1,176,795	\$ 114,401	\$ 1,291,196	\$(67,133)	\$ 1,224,064	\$	\$ 1,224,064
3 DEPRECIATION	330,316	95,561	425,877	(19,829)	406,048		406,048
4 AMORTIZATION	2,408	0	2,408	0	2,408		2,408
5 TAXES OTHER THAN INCOME	272,839	20,118	292,957	(17,408)	275,549	7,200	282,749
6 INCOME TAXES	68,590	166,913	235,503	(79,834)	155,669	57,497	213,166
7 TOTAL OPERATING EXPENSES	\$ 1,850,948	\$ 396,993	\$ 2,247,941	\$(184,204)	\$ 2,063,737	\$ 64,697	\$ 2,128,434
8 OPERATING INCOME	\$ 794,767	\$ 50,074	\$ 844,841	\$(202,646)	\$ 642,195	\$ 95,299	\$ 737,494
9 RATE BASE	\$ 11,247,420		\$ 8,647,308		\$ 8,293,488		\$ 8,293,488
RATE OF RETURN	7.07%		9.77%		7.74%		8.89%

FLORIDA CITIES WATER COMPANY
ADJUSTMENTS TO OPERATING STATEMENTS
TEST YEAR ENDED 6/30/92

SCHEDULE NO. 3-B
DOCKET NO. 920808-SU

EXPLANATION	WASTEWATER
(1) OPERATING REVENUES	
a) Reverse utility's proposed rate increase	\$ (396,326)
b) Adjustment for misc. service revenue	9,476
	<u>\$ (386,850)</u>
(2) OPERATING EXPENSES	
a) Reduce test year legal expenses	\$ (999)
b) Reduce test year property taxes	(45,431)
c) Remove chamber of commerce dues	(203)
d) Adjust provision for rate case expense	(20,500)
	<u>\$ (67,133)</u>
(3) DEPRECIATION EXPENSE	
a) Adjustment for nonused and useful plant	\$ (18,175)
b) Adjustment to reallocate general plant	(1,654)
	<u>\$ (19,829)</u>
(4) TAXES OTHER THAN INCOME TAXES	
a) Regulatory assessment fees related to revenue adjustment	\$ (17,408)
(5) INCOME TAXES	
a) Income taxes associated with adjusted test year income	\$ (79,834)
(6) OPERATING REVENUES	
a) Adjustment to reflect recommended revenue requirement	\$ 159,996
(7) TAXES OTHER THAN INCOME TAXES	
a) Regulatory assessment taxes on additional revenues	\$ 7,200
(8) INCOME TAXES	
a) Income taxes related to recommended income amount	\$ 57,467

Rate Schedule

Schedule of Commission Approved
 Rates and Rate Decrease in
 Four Years

Wastewater
 Monthly Rates

Residential

<u>Base Facility Charge by Meter Size</u>	<u>Commission Approved Rates</u>	<u>Rate Decrease</u>
All Sizes	\$ 14.33	\$.13
<u>Gallonage Charge</u>	\$ 2.64	\$.02

General Service

<u>Base Facility Charge by Meter Size</u>	<u>Commission Approved Rates</u>	<u>Rate Decrease</u>
5/8" x 3/4"	\$ 14.33	\$.13
1"	35.83	.33
1/2"	71.65	.65
2"	114.64	1.04
3"	229.28	2.09
4"	358.25	3.26
6"	716.50	6.52
<u>Gallonage Charge</u>	\$ 3.17	\$.03

M E M O R A N D U M

September 7, 1993

TO: DIVISION OF RECORDS AND REPORTING
FROM: DIVISION OF LEGAL SERVICES (KNOWLES) *LK*
RE: DOCKET NO. 920808-SU - APPLICATION FOR RATE INCREASE BY
SOUTH FORT MYERS DIVISION OF FLORIDA CITIES WATER COMPANY
IN LEE COUNTY.

Attached is a Final Order Establishing Increased Rates for Wastewater Service, with attachments, to be issued in the above-referenced docket. (Number of pages in Order - 44)

LK/dr

Attachment

cc: Division of Water and Wastewater (Willis, Crouch, Mann,
Merchant, Messer, Rasberry, Walden)

Division of Auditing and Finance (Vandiver)

I:920808.LK