**FLORIDA PUBLIC SERVICE COMMISSION**

 **Fletcher Building, 101 East Gaines Street**

 **Tallahassee, Florida 32399-0850**

 **M E M O R A N D U M**

 **FEBRUARY 9, 1995**

**TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYO)**

**FROM: DIVISION OF LEGAL SERVICES (PELLEGRINI, JABER)**

 **DIVISION OF WATER & WASTEWATER (CASEY, FERGUSON)**

**RE: DOCKET NO. 941107-WU - FORTY-EIGHT ESTATES WATER SYSTEM -APPLICATION FOR A STAFF ASSISTED RATE CASE**

**COUNTY: LAKE**

**AGENDA: FEBRUARY 21, 1995 - REGULAR AGENDA - INTERESTED PERSONS MAY PARTICIPATE**

**CRITICAL DATES:15-MONTH EFFECTIVE DATE: MARCH 19, 1996**

 **(SARC)**

**SPECIAL INSTRUCTIONS:THIS ITEM SHOULD BE HEARD BY THE FULL COMMISSION.**

**I:\PSC\WAW\WP\941107.RCM**

 **CASE BACKGROUND**

 Forty Eight Estates Water System (48 Estates or utility) is a Class C water utility, serving 71 customers in Lake County. This utility was organized in 1971. Although Lake County came under Commission jurisdiction on June 13, 1972, this utility was not brought to the attention of the Commission until a customer inquiry in December 1986. Mr. Stanley Busk acquired ownership in 1985. On January 22, 1987, 48 Estates applied for a certificate for its existing water system and was granted Certificate No. 498-W by Order No. 18839, issued February 10, 1988.

 The utility has never submitted an annual report to the Commission. Show cause actions have been brought against the utility by the Commission for failure to file 1988, 1989, 1990 and 1991 annual reports and no reports were received for 1992 and 1993. Past due regulatory assessment fees total $896.07 for 1988, 1992 and 1993.

 On August 9, 1994, Judge Jerry T. Lockett in the Circuit Court of the Fifth Judicial Circuit in Lake County issued an order in Case No. 88-1353-CA-01, declaring 48 Estates abandoned and appointing J. Swiderski Utilities, Inc. (JSU or receiver) as receiver of the system. The abandonment was precipitated by a Department of Environmental Protection (DEP) suit against the owner, Mr. Busk, for not maintaining required standards for the utility. DEP issued an order requiring immediate repairs and upgrades to the water system to bring it in compliance within 30 days, which the utility owner subsequently failed to do.

 The Commission acknowledged JSU as receiver by Order No. PSC-94-1356-FOF-WU, issued November 7, 1994. JSU is a utility operating two other systems in Lake County: Summit Chase, which serves 219 water and 218 wastewater customers, and Kings Cove, which serves 148 water and 143 wastewater customers. JSU, on behalf of 48 Estates, filed this staff assisted rate case on October 17, 1994. The original tariff for 48 Estates included no base facility charge, only a gallonage charge of $1.16 per 1,000 gallons with a minimum charge of $6.25. The rates had not changed since the utility's original certification.

 By Order PSC-94-1556-FOF-WU, issued December 13, 1994, the Commission granted the following emergency rate relief to this utility, subject to refund.

 WATER

 MONTHLY RATES

 Residential

 Emergency

Base Facility Charge Temporary

 Meter Size Original Approved

 5/8" x 3/4" N/A $ 7.79

 Gallonage Charge

 Per 1,000 gallons $ 1.16\* $ 1.23

 \* Minimum Charge of $6.25

The increase in rates amounted to a 79.27% increase. The receiver was to provide security in the form of a bond, or escrow, or letter of credit in the amount of $5,102. By letter, dated December 28, 1994, JSU requested a waiver of the security requirement (Attachment "A"). The receiver believes that it is not fair and reasonable to require him to provide $5,102 of security when he has obligated over $9,000 of his own money to correct the deficiencies of the 48 Estates water system.

 JSU's request for a waiver of the security is the subject of this recommendation.

 **DISCUSSION OF ISSUES**

**ISSUE 1:** Should J. Swiderski Utilities, Inc.'s request on behalf of Forty-Eight Estates Water System for a waiver of security as provided in Order No. PSC-94-1556-FOF-WU for the collection of temporary emergency rates be granted?

**Primary Recommendation:** No. The utility should be required to collect the authorized emergency rates, secured and subject to refund, as previously ordered by the Commission in Order No. PSC-94-1556-FOF-WU. (PELLEGRINI, JABER)

**Alternative Recommendation:** Yes. The request of the utility that the Commission waive the security requirement for the collection of the authorized emergency rates subject to refund, as ordered by the Commission in Order No. PSC-94-1556-FOF-WU, should be granted. (CASEY)

**Primary Staff Analysis** As stated in the case background, by Order PSC-94-1556-FOF-WU, the Commission granted 48 Estates emergency rate relief, subject to refund. The utility was required to provide security in the form of a bond, escrow, or letter of credit in the amount of $5,102, prior to the implementation of the emergency rates. By letter, dated December 28, 1994, JSU requested a waiver of the security requirement. In the letter, JSU asserts that he has invested over $9,000 of his own money in 48 Estates "to keep the plant in operation," since his receivership appointment.

 The temporary emergency rates granted 48 Estates are somewhat analogous to interim rates in that they are only effective until final rates are approved in the pending staff-assisted rate case. However, Section 367.082(2)(a), Florida Statutes, requires that the difference between interim rates and previously authorized rates be collected under bond, escrow, letter of credit, or corporate undertaking subject to refund with interest at a rate ordered by the commission. This condition is considered to be necessary to protect both the utility and the customers. The utility can collect increased rates earlier than it would if it had to wait until the end of the proceeding and the customers are protected by the secured refund provision. Interim rates, pursuant to Section 367.082, Florida Statutes, are unavailable in staff-assisted rate cases. However, the Commission, recognizing that some temporary ratemaking vehicle is appropriate for the Class C utilities, has found it appropriate in limited cases to approve emergency, temporary rates, subject to refund. The Commission has always recognized that, such rates have no express statutory authority. The Commission has authorized emergency rates sparingly -- only in exceptional circumstances -- in the exercise of the Commission's liberally construed police power, pursuant to Section 367.011(3), Florida Statutes, to protect the public health, safety and welfare.

 Section 367.0814, Florida Statutes, provides the Commission with the statutory authority for the staff assisted rate case process. Nowhere in that statute does it provide for the implementation of emergency or temporary rates without security. In fact, Section 367.0814(5), Florida Statutes, provides that "in the event of a protest or appeal by a party other than the utility, the Commission may provide for temporary rates subject to refund." (emphasis added). Rule 25-30.360(6), Florida Administrative Code, requires that money collected subject to refund shall be secured by a bond unless the Commission authorizes some other type of security such as placing the money in escrow, approving a corporate undertaking, or providing a letter of credit. Even though we recognize that a refund may be unlikely in these cases, the Commission must have the assurance that the monies are available for refund, should the Commission find one necessary. The security provision is essential.

 In each instance, but one, where the Commission has approved or denied emergency, temporary rates, such rates have been held to be subject to refund, with security. See Order No. PSC-94-1053-FOF-WS, issued August 29, 1994; Order No. 94-1556-FOF-WU, issued December 13, 1994; Order No. PSC-93-1844-FOF-WS, issued December 28, 1993; and Order No. PSC-93-0633-FOF-SU, issued April 22, 1993.

 The absence of security for the protection of customers is without Commission precedent until recently. By Order No. PSC-95-0098-FOF-WU, issued January 19, 1995, In Re: Application for Staff-Assisted Rate Case in Alachua County by LANDIS ENTERPRISES, INC., the Commission did approve emergency rate relief without the requirement for security. However, the Commission made clear that its decision to authorize the collection of temporary, emergency rates without a requirement for security was specific to the facts and circumstances pertaining to that particular utility and was not to have precedential value. At the December 8, 1994, Agenda Conference, one commissioner stated that:

[I]n the next item we also have Mr. Landis asking for emergency rate relief, and in that one Staff has recommended to deny it and when you compare the two cases and you look at the rationale behind it, I'm comfortable in this one case under the facts here of at least allowing this money to be available for day-to-day expenses ... I don't think there is any precedence to this. We are making it explicitly clear that its based solely on the facts here and is not precedential. (emphasis supplied)

Moreover, another commissioner dissented in that order, stating that:

I have had reservations about the legal authority of granting the so-called "emergency temporary rates" in the past. Interim rates are explicitly authorized in the law and have specific statutory guidelines for granting a rate increase without a hearing beforehand and are always subject to refund after the opportunity to be heard has been provided. "Emergency temporary rates," by contrast, have no specific legislative authorization and certainly no statutory guidelines for their determination. Even so, I have withheld my objections on those rare occasions where we authorized emergency temporary rates because they have always been subject to refund after the opportunity for hearing. It seemed that customers were not harmed and more likely were helped because the systems that served them were able to continue to be viable. (emphasis supplied)

Id. at 6. The dissenting commissioner expressed concern that fundamental due process principles were compromised by the order:

[T]he already tenuous nature of this type of rate relief has been transformed into something that is legally untenable. These rates are not subject to refund and are no longer "temporary," but in fact are permanent until the assumed rate increase in the staff-assisted rate case occurs. No matter what happens in any subsequent proceeding, these revenues will not be subject to refund. Although I agree that it appears very likely that this system will need a substantial rate increase, the majority's assumptions - no matter how good they are - are no substitute for the hearing process that is the bedrock of this agency's public protection mandate.

Id. In the instant case, the Commission has already found that emergency rates are warranted. There is no dispute in this regard. However, the Commission has also already found it appropriate to require security for the emergency rate increase. At no time prior to the Commission's order, or immediately subsequent thereto, did JSU, an experienced receiver and utility owner, express any position concerning the imposition of a security requirement. The utility did not ask for reconsideration, which would have been the proper recourse in this situation.

 A close analysis of JSU's letter reveals that JSU is actually reacting to another decision by this Commission regarding the Kings Cove docket (Docket No. 940496-WS). In the letter, JSU threatens to refrain from advancing 48 Estates additional funds. JSU specifically states, at page 2:

 The PSC has failed to have Kings Cove in the black each of the past 4 years even with each year's price index request. Now once again after an audit report and a recommendation the commissioners have lowered the rates ... Therefore if the recommended rates do not stand I am withdrawing in the future from any advance in cash or credit to 48 Estates. Enclosed you will find an electric bill. There is no money anywhere to pay it and I am not going to advance because of the failure of the PSC to make Kings Cove profitable. I am not going to extend the trust to 48 Estates.

JSU concludes the letter stating that, "until the recommended rates are enforced for Kings Cove I am making no future loans to 48 Estates nor do I have any interest in recording the deed to the 48 Estates water plant."

 JSU has not adequately shown why security cannot be put in place prior to implementation of the emergency rates. JSU has made references to an unrelated docket and inappropriate threats. The Commission should not react to this kind of tactic. Instead, JSU should be reminded of the terms and provisions of the court order appointing JSU as receiver. That order specifically states that:

6. The receiver is vested with all the usual powers, rights, and duties of receivers appointed by the court, and in particular, with the following powers, rights, and duties:

 (a) The Receiver shall take custody and control of all keys relating to the system and all books and records of the system, including, but not limited to, customer lists, billing records, and accounts payable and receivable; manage and conserve all assets, both tangible and intangible; and collect the rates, charges, rents, issues, and profits due and becoming due during the pendency of the receivership.

 (b) The Receiver ... shall, to the maximum practical extent, consistent with applicable law, operate, maintain, repair, modify and improve the system as necessary to bring the system into compliance with applicable law, the Consent Final Judgment, and other orders of the Court, and shall seek imposition of such rates and charges from the Florida Public Service Commission as are necessary to operate the system in compliance.

 We do not believe that the imposition of a security requirement on the receiver in this instance represents an undue hardship. While we agree that removing the requirement to post security for the collection of temporary emergency rates in some circumstances enhances the attractiveness of beleaguered utilities, such as 48 Estates, to potential new owners or receivers, other, less troubling measures are available. For instance, in this case, the Commission could consider the following:

1. establish a procedure to allow funds to be released monthly from the escrow so that the utility may meet its current administrative and operational obligations; and
2. establish releases of escrow fund interest earnings to the receiver rather than to the utility itself, as is presently normal practice, if the receiver has invested his own money.

 As to the first suggestion involving the monthly release of escrow monies, the Commission has, in the past, undertaken a similar approach. By Order No. 21122, issued April 24, 1989, In Re: Application of ST. GEORGE ISLAND UTILITY COMPANY, LTD., for an increase in water rates in Franklin County, the Commission ordered the utility to place into escrow the increased revenues, with the provision that "if this escrow requirement impedes SGI's ability to operate, funds may be released from escrow upon submittal of appropriate invoices and verification by Commission staff." With due consideration for the problem of small utility system viability, we believe that a similar methodology could be used. The monthly administrative and operational expenses for Class C utilities should be similar from month to month, and not particularly numerous or complicated. Staff could verify the amounts of these expenses by inspecting invoices or cancelled checks each month throughout the escrow period and release matching amounts from the escrow or, permit the monthly release from the escrow of an amount determined after review of the first month's expenses which would serve as a proxy for the subsequent months. The effort would not seem, in any case, to be unreasonable. The receiver would be permitted access to the escrow in order to satisfy the utility's current obligations, yet the escrow would remain protectively in effect.

 Ratepayers do not only need to be protected for purposes of potential refunds. Some utilities in the past, not necessarily this utility, have used funds for purposes other than those required or anticipated by the Commission. The security provision protects both the customer and the utility, because the funds can be available to the utility before the conclusion of the rate case and potential refunds are protected also. A review of the invoices on a monthly basis followed by Staff-authorized releases from the escrow account would ensure that the bills were being paid when due and that the money was expended for the appropriate purpose.

 As to the second suggestion, it proposes to release the interest from the escrow account directly to the receiver. Currently, the Commission allows the interest earned on the escrow (if no refund is required) to revert to the utility. Because, in these situations, Staff is proposing an increase to cover only administrative and operational expenses, the likelihood of a refund is small. Therefore, the Commission, could actually authorize the release of the interest directly to the receiver.

 It is important to note here that we agree with the need to address the viability of small systems. We have attempted to research and offer immediate and long-term solutions to the potential problems. Above, we have tried to address immediate relief for 48 Estates. On a long-term basis, the Commission could consider the following:

1. encourage the use of the non-rate base rate setting rule, Rule 25-30.456, Florida Administrative Code, to hasten the availability of final rates.
2. allow receiver fees in addition to normally allowed management fees; and
3. sponsor legislation that would authorize emergency temporary rates during the pendency of staff-assisted rate cases, and address the issues of security requirements and current administrative and operational obligations.

 As to the first point, to the best of Staff's knowledge, it is the Commission's current practice to give the normal owner salary to the receiver operating a utility. The Commission could consider allowing additional receiver fees or salaries if the receiver has invested his own funds.

 Second, Rule 25-30.456, Florida Administrative Code, offers staff assistance in alternative rate setting. To the best of Staff's knowledge, this has not yet been used. This alternative rate setting process does not require the Commission to make a rate base determination. This process does not require an original cost study nor an audit of any rate base items. Therefore, it appears to be a faster process.

 Finally, new legislation is the ideal solution to this perceived problem. Staff recognizes that this Commission must provide incentives for receivers and/or future utility owners of non-viable water and wastewater systems. The Commission could sponsor legislation to address the emergency rates and the need or lack of need for security.

 For all of the reasons set forth above, in the primary recommendation, Staff recommends that JSU be required to collect the authorized emergency rates, subject to refund, as previously ordered by the Commission in Order No. PSC-94-1556-FOF-WU.

**ALTERNATE STAFF ANALYSIS:** The reason emergency rates are granted is because the utility is unable to pay critical day to day cash operating expenses due to insufficient revenues. Since emergency rates are an immediate and necessary cash infusion to keep the utility on its feet, staff believes it is unreasonable and unfair to deny the utility access to the funds.

 Forty-Eight Estates is operating at a loss, because the existing rates do not generate enough funds to pay for day-to-day operations. The approved emergency rates cover only operation and maintenance expenses grossed up for regulatory assessment fees. No depreciation expense or return on rate base was included in determining them. As such, the emergency rates were not intended to be compensatory. Revenues were set at a minimum level necessary to cover the day-to-day operations, which provides adequate protection from harm to both the utility and the ratepayers.

 The Commission has in at least two previous cases granted emergency rates without requiring security. In Order No. 11682, Order Granting Emergency Rate Increase to Abandoned Utility in Receivership, In Re: Staff assisted rate case and interim rate increase to WEST ORLANDO UTILITIES, INC., in Orange County, Florida, issued March 7, 1983, the Commission granted an emergency rate increase without requiring the increased revenues to be collected subject to security. However, the Commission reserved its prerogative to authorize the increased rates as interim rates consistent with Section 367.082, Florida Statutes, upon appropriate protest and formal hearing. Also, as already noted, the Commission voted recently to waive security for emergency temporary rates in Order No. PSC-95-0098-FOF-WU.

 The primary recommendation states that the imposition of a security requirement does not represent an undue hardship on the receiver in this instance. It then suggests several measures other than removing the security requirement to enhance the attractiveness of beleaguered utilities, such as 48 Estates. Staff believes that although receiver fees, mentioned in the primary recommendation, may be a good concept, they would have to be examined in the context of the full rate case, just as management fees, and they do not address the immediate problem. Releasing escrow funds interest earnings to the utility would only give the utility approximately $25/month in this case, and administrative costs to do that would negate any relief. Implementing the non-rate base rate setting rule accomplishes the same thing as the Commission has already achieved when approving the emergency rates, but slower, and still does not address the security problem.

**PURPOSE OF ESCROW**

 Escrowing revenues serves one of two purposes. It protects those revenues for potential refunds and/or it attempts to protect against the potential malfeasance of the utility owner or receiver.

**ESCROW FOR POTENTIAL REFUNDS**

 Staff believes that in a typical receivership situation, emergency rates do not need to be placed subject to refund. Before recommending emergency rates staff assures itself that the rates are noncompensatory and, thereby, unlikely to be refunded. This is accomplished in part by requiring a utility to substantiate its emergency rate request with documentation of its cash expenses. Staff brings a substantial amount of expertise to the analysis of emergency relief. Even without sufficient expense documentation, as may happen when a receiver is appointed and previous invoices/records are unobtainable, staff is confident of its ability to determine minimum cash expense requirements with some reasonable certainty so as to make any misjudgement of little or no consequence. Providing further protection is the fact that in emergency rates no depreciation expense or rate of return is included.

 Staff also believes that the imposition of security requirements places an undue and unnecessary hardship on a receiver, whether or not the receiver has "deep pockets." Imposition of security requires the receiver to fund operating losses for six to eight months until the SARC is completed. In the rate case, the receiver is not able to recover the interest expense or opportunity costs incurred in financing the losses. Moreover, many receivers find it difficult if not impossible to obtain loans pending the rate increase due to insufficient revenue stream with which to repay.

**ESCROW TO PREVENT MISUSE OF FUNDS**

 The primary recommendation suggests releasing the escrow funds monthly, presumably upon presentation of paid invoices, so that the utility may meet its current obligations. Staff assumes the purpose of this approach is to prevent misuse of funds. One problem with this approach is that it goes against the concept of holding funds "subject to refund." Other problems are that it adds unnecessary administrative costs, additional regulatory delays and provides little protection against malfeasance. If the Commission is concerned about malfeasance, all the revenues need to be protected, not just the portion escrowed. The commission simply cannot ensure the proper use of funds for any utility, whether in receivership or not. In fact, the Commission cannot ensure that the utility will even escrow the funds (see Shady Oaks, Dockets Nos. 900025-WS and 930944-WS).

 One final point on malfeasance. Small, abandoned utilities are not attractive targets for someone to "rip off." It has been staff's experience that most receivers have good intentions of meeting regulatory obligations and improving the utility's operations. Unfortunately, after a few months the receiver all too often realizes that the regulatory obstacles are so onerous that abandonment becomes the only option (e.g., LCM, Docket No. 920828-SU; Pine Island, Dockets Nos. 910276-WS and 940982-WS; Lake Alto, Docket No. 940973-WU; and PBV, Docket No. 940974-WU).

 Notwithstanding the above arguments, staff believes the circumstances in the present case warrant special consideration. Staff is recommending that this utility be granted the requested waiver of security to provide emergency rate protection in order to support the receiver's efforts, under already difficult circumstances, to bring the utility to a solvent basis as soon as possible.

 The utility's receiver, Mr Swiderski, presently owns two other utility systems in Lake County, which are in good standing with all regulatory agencies. Over the years he has proven to be responsible and conscientious in maintaining his utilities and in meeting regulatory requirements. Upon being appointed receiver of Forty-Eight Estates, he immediately began making necessary improvements to satisfy DEP requirements. Mr. Swiderski states that he has obligated over $9,000 (funds paid and accounts payable) in 48 Estates since being appointed receiver. Staff believes this demonstrates his good faith and reputability as a receiver.

 The preliminary accounting report for this rate case shows this utility will need an overall increase of over 200% to achieve compensatory rates. The Commission approved 79.15% non-compensatory emergency rate increase only covers a portion of the day to day operating expenses.

 In light of the above facts, staff believes that any concerns about malfeasance or refunds are unwarranted in this case. Staff therefore recommends that the utility be released from its obligation to provide security for refund.

**ISSUE 2:** Should this docket be closed?

**RECOMMENDATION:** No, this docket should remain open for the processing of the staff-assisted rate case. (CASEY, PELLEGRINI)

**STAFF ANALYSIS:** This petition for waiver of security was filed within the context of a staff-assisted rate case. Staff has scheduled a recommendation considering all pertinent aspects of the staff-assisted rate case for the May 16, 1995, Agenda Conference. Staff will make a recommendation regarding closing the docket at that time.

 **ATTACHMENT A**

 J. SWIDERSKI UTILITIES, INC.

 REQUEST FOR WAIVER OF SECURITY FOR EMERGENCY RATES

 FOR FORTY EIGHT ESTATES WATER SYSTEM

 **NOT AVAILABLE ON SYSTEM**

I:\PSC\LEG\WP\941107-R.CJP