

FLORIDA PUBLIC SERVICE COMMISSION
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M E M O R A N D U M

SEPTEMBER 28, 1995

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (RAYO) *AW* *AS* *MS* *[Signature]*

FROM: DIVISION OF WATER AND WASTEWATER (WALDEN, WALKER, CLARK, GALLOWAY, CHASE, XANDERS) *CA* *[Signature]* *[Signature]* *[Signature]* *[Signature]* *[Signature]*

DIVISION OF LEGAL SERVICES (JAEGER) *[Signature]* *[Signature]* *[Signature]* *[Signature]*

RE: DOCKET NO. 950387-SU - APPLICATION OF FLORIDA CITIES WATER COMPANY, NORTH FORT MYERS DIVISION, FOR A RATE INCREASE TO ITS WASTEWATER CUSTOMERS

AGENDA: OCTOBER 10, 1995 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: 5-MONTH EFFECTIVE DATE: OCTOBER 19, 1995
(PAA Rate Case)

SPECIAL INSTRUCTIONS: I:\PSC\WAW\WP\950387SU.RCM

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FPSC-RECORDS/REPORTING 00410

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CASE BACKGROUND

Florida Cities Water Company (FCWC or utility) is a Class A utility that provides wastewater service to two communities in Ft. Myers, Florida: a northern sector and a southern sector. The North Ft. Myers wastewater system, the applicant in this proceeding, was serving about 2,559 customers at December 31, 1994. Because many multi-family units are master-metered, about 4,590 equivalent residential connections (ERCs) were actually being served. The utility serves an area that has been designated by the South Florida Water Management District (SFWMD) as a critical use area. Wastewater treatment is provided by a 1.0 MGD AWT facility, presently being expanded to 1.25 MGD. Effluent is disposed of by discharge to the Caloosahatchee River, and will soon be provided to a golf course in the service area.

On May 2, 1995, the utility filed an application for approval of increased rates pursuant to Section 367.081, Florida Statutes. The petition did not satisfy the minimum filing requirements (MFRs) and submission of additional data was necessary. The missing information was received on May 19, 1995, which date was declared as the official date of filing pursuant to Section 367.083, Florida Statutes. The utility's last rate case was finalized on July 1, 1992, by Order No. PSC-92-0594-FOF-SU, Docket No. 910756-SU. In 1994, the utility's rates were increased due to an index proceeding. The utility has asked the Commission to process this application under the proposed agency action (PAA) procedures identified in Section 367.081(8), Florida Statutes.

The utility did not request authority to implement interim rates. Schedules in the filing indicate receipt of a 6.71% return on average investment in 1994. The utility's last allowed overall rate of return was 9.14%. The utility reported that rate indexing procedures helped it maintain a satisfactory return. However, the utility now contends that rate increases are needed to reflect added investments and expenses. According to the utility, it will spend about \$1,600,000 in 1995 to increase the capacity of its wastewater plant from 1 MGD (million gallons per day) to 1.25 MGD. This construction project is scheduled to be completed on or before October 1, 1995. The utility believes the magnitude of this investment justifies an end-of-period rate base determination.

The approved test year for this docket is the twelve-month period ending December 31, 1995. That calendar period is based upon actual costs for the historical base year ended December 31, 1994, with applicable adjustments. During the base year, the utility's wastewater revenues were \$2,085,157. The corresponding

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net operating income for the period was \$474,319. The utility's proposed rates are designed to generate \$2,591,990 in annual operating revenues, reflecting a \$480,078 (22.73%) overall increase. The requested net operating income amount of \$763,108 will yield a 9.08% return on the projected \$8,404,278 rate base balance.

In this recommendation staff addresses for the first time the issue of reuse for this wastewater plant. The utility will be providing effluent reuse to be used for irrigation at the Lochmoor Country Club and has a contract for that provision. The cost of reuse is discussed, along with the revenue effect and spread.

Staff is recommending annual revenues of \$2,489,487, which is an increase over test year revenues of \$385,562 (18.33% increase).

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DISCUSSION OF ISSUES

ISSUE 1: Is the quality of service satisfactory?

RECOMMENDATION: Yes. The Quality of Service is considered satisfactory. (WALDEN)

STAFF ANALYSIS: In determining the overall quality of service provided by the utility, the staff engineer evaluated the following three components of utility operations: (1) quality of the utility's product, (2) the operational conditions of the plant and facilities, and (3) the utility's efforts to address customer satisfaction. Staff also reviewed the DEP correspondence contained in the MFRs addressing plant capacity and permits issued by that agency, as well as correspondence in the DEP's files in Ft. Myers.

The staff engineer conducted an on-site inspection of the facilities on June 21st. The plant appeared to be operating properly, and construction on the expansion was in progress. Concerning the quality of the wastewater treatment, Mr. James Grob with the DEP in Ft. Myers was contacted and stated that the plant was meeting treatment standards, and that additional capacity was under construction. He also noted that some odor complaints had been received and were being resolved as a result of the expansion and other modifications occurring during construction.

A review of the files at the DEP revealed complaints from Shuckers Restaurant (located adjacent to the wastewater treatment plant) who had experienced recurring odor problems from the plant. The DEP met with the utility and Shuckers' owner, and it was agreed that the utility would haul sludge only when the restaurant was closed; make some piping changes with the existing treatment tanks; and begin feeding an odor-reducing chemical at a lift station. It is believed this will mitigate the odor problem.

The staff conducted a meeting with the customers of this system on July 26, 1995, at the North Ft. Myers High School auditorium. About 400 customers attended, and about 35 spoke. In staff's opinion, customers are not satisfied with the utility and its operation. The customers are distressed over the rate increase, especially in light of the level of the existing rates. Several customers said that this system has the highest rates in the state. Witness Phinney stated that there is concern over the utility plant's capacity and timing of construction; the utility's violations of the Clean Water Act; and, odors from the plant. Other customers asked about the capacity being added as needed for growth, and not for existing customers. Witness Green stated that

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increased capacity requirements should be absorbed by the new customers. Witness Niccum agreed.

Witness Phinney stated that the odor from the plant was minimal before the utility began using ultraviolet light for disinfection of its effluent. Witness Victor also spoke about odors from the plant, as did Witness Walla. Ms. Walla presented a cover letter with 1065 letters attached, protesting the proposed rate increase. Several customers spoke of low water pressure and water quality not up to par.

Witnesses Weddle and Artis expressed their concerns that the Lochmoor Country Club would not be able to use as much effluent for irrigation, except in the dry season, as the utility plans to provide. Mr. Artis remarked that Florida Cities explained that the customers have a state-of-the-art wastewater treatment plant, but explained that really the utility has the plant, and the customers get to pay for it. He suggested that consideration be given to the cost impact on the customers, and that the utility and the PSC should stand up to the environmentalists and tell them that customers cannot continue to pick up the tab. Witness Shultz agreed the public cannot afford these costs. Several customers said the rates need to be decreased.

It was noted by several customers at the meeting that some billing errors had occurred. The company contacted customers who were affected by this event, explaining its contract meter reader had not been properly reading all meters, and that with the corrected bills, extra time would be allowed for payment.

Staff concludes from a review of the data that the quality of service provided by the utility in collecting, treating and disposing of the wastewater is satisfactory. Other than the odor problem discussed above, customer satisfaction, as gathered from testimony at the customer meeting, is tied to the level of rates. Until the monthly rates for service are lower, staff believes the customers will be dissatisfied with the service.

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RATE BASE

ISSUE 2: What is the appropriate amount of used and useful plant?

RECOMMENDATION: The plant is 100% used and useful. For the continued provision of wastewater service in this service area, the utility should file a copy of its master plan with the Commission within 120 days of the date of the PAA order. (WALDEN)

STAFF ANALYSIS: The utility is completing a plant expansion of this wastewater plant, enlarging the capacity from 1.0 MGD to 1.25 MGD. In September, 1994, the plant was exceeding its rated plant capacity when plant flows were 1.175 MGD. Average daily flows (ADF) for the year were 0.942 MGD. Correspondence between the utility and the DEP had occurred in 1992 indicating planning and design for construction of an expansion was needed, as the plant was treating flows greater than 90% of its rated capacity. As seen from the flows just cited, a plant expansion was needed. The utility was issued a construction permit from the DEP in June, 1994 for the expansion that is now nearing completion. It should be noted that the treatment plant has a hydraulic capacity of 1.5 MGD, but is limited in effluent disposal due to the river discharge and golf course irrigation.

Comparing the ADF in September, 1994 to the plant capacity after expansion yields a 94% used and useful allocation. When including margin reserve, the used and useful calculation is 98.6%. Rather than make a minimal used and useful adjustment in this case, staff believes it is more prudent to include as the margin reserve, the number of customers the utility could serve in the 75,000 gpd of remaining capacity (the difference between the plant capacity of 1.25 MGD and the ADF peak month of 1.175 MGD). At 256 gpd/ERC, this computes to 292 additional ERCs that can be connected to the plant without expansion.

In the MFRs, the utility requested that its collection system be considered 100% used and useful, in part, because it was fully contributed. The Commission has agreed with this explanation in prior cases, and since the extension policies of the utility have not changed, staff is recommending the collection system be deemed 100% used and useful.

Customers at the informal meeting expressed the need for future customers to shoulder the burden of the plant expansion, since the existing customers are not desirous of a larger plant. The plant capacity charges proposed in Docket No. 950586-SU of \$1800 will help defray the costs of the current expansion. As the

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plant's permitted capacity is increased when additional effluent disposal is available, these service availability fees will assist the utility in recovering the costs of expansion from future customers.

Staff is concerned about the future expansion needs of this utility, the small increments with which they have historically been made, and the financial impact upon the rate base. Additionally, the plant has apparently been designed with greater hydraulic capacity than the permitted capacity, with the limiting factor being effluent discharge constraints. Discharge to the Caloosahatchee River is permitted at 1.0 MGD, and all other effluent must be disposed of through reuse since percolation ponds are not a feasible alternative. Growth patterns for this service area fluctuate widely from year to year according to Schedule F-6 of the MFRs. Considerable undeveloped land is on the market in the utility's service area as observed during the engineer's on-site inspection.

The plant expansion just now being completed is essentially 100% used and useful at the time it goes on line. It is somewhat disconcerting to staff to address in a rate proceeding a plant expansion coming on line three years after a new plant is built (the 1.0 MGD plant went on line in September, 1992), and find it 100% used and useful when the expansion is completed. In response to staff's data requests, the utility explains that using a ten year linear regression of flow data as recommended by the DEP's Capacity Analysis Report guidelines, the next phase of expansion will be required about the year 2000.

There have been changes occurring in Florida Cities' North Ft. Myers service area, specifically including the plant expansion discussed above; effluent reuse with one of the golf courses; interest by the City of Cape Coral in effluent reuse in exchange for potable water; the utility's location in a critical use area as designated by the SFWMD; continued growth in the service area; and customer concerns expressed at the informal customer meeting in July.

Staff believes it would be beneficial for the utility to file with the Commission its current master plan for the continued provision of wastewater service to the North Ft. Myers service area. The time frame involved in the master plan should be the expected period of build out of the service area as it is today, or, if the utility expects to enlarge the territory, the build out of that service area. The plan should at least address growth needs; plant expansions to the build out capacity of 1.5 MGD and beyond 1.5 MGD, including capacity required and the costs of

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providing the needed capacity; the timing of plant expansions; changes in the permitted capacity of the plant as approved by the DEP; effluent disposal alternatives and the expected alternatives to be chosen; reuse opportunities and potential customers, and, the revenues or associated exchange of services; alternatives to plant expansions, such as bulk purchases from others; and, reductions to infiltration/inflow.

Staff believes that the utility already has most of this data due to the in-house planning performed by the staff engineers of Florida Cities or Avatar Utility Services. The utility has carefully planned its phased expansions, being sensitive to excess treatment capacity. Staff's request for a copy of the utility's master plan is not to be interpreted as direction from the staff or the Commission for an independent engineering evaluation to be performed by an outside engineering firm, causing a large expenditure of funds. Staff would like to review the utility's master plan and discuss it with the utility, focusing on a long range conceptual framework. Heretofore the utility has constructed its treatment plants after obtaining permits from the DEP, and then come to the Commission for inclusion of the facilities in rate base after the fact. Staff believes the utility should be allowed 120 days to provide its master plan.

In conclusion, staff is recommending the Commission find the wastewater treatment plant and collection system 100% used and useful.

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ISSUE 3: Should a margin reserve be allowed?

RECOMMENDATION: Yes. An amount equal to 292 ERCs should be allowed in margin reserve. (WALDEN)

STAFF ANALYSIS: As mentioned in Issue 2, the staff is recommending 292 ERCs be included in the margin reserve in this case. This is a divergence from the usual practice of the Commission. The usual practice is to recommend a margin reserve period of 18 months, but in this case, the period covers 3.95 years.

Schedule F-6 of the MFRs shows the utility's request of a three year margin reserve, using an average growth of 74 ERCs per year, or a projected 222 additional ERCs to be added during the margin reserve period. This leaves unused capacity of 1.4%. The utility explained in responses to staff's data requests that the three year margin reserve period is based upon actual experience in expanding its plant.

Staff believes in light of the flow data during the test year, the utility's projections of growth, and the 100% used and useful recommendation in Issue 2, the margin reserve period should be extended in this case. Staff therefore recommends inclusion of 292 ERCs in the margin reserve.

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ISSUE 4: Should adjustments be made to plant in service to remove capitalized legal fees and incorrect allocations of engineering fees?

RECOMMENDATION: Yes, plant in service should be reduced by \$223,175. (CLARK)

STAFF ANALYSIS: As noted in Audit Disclosure No. 2, the utility capitalized legal fees associated with a lawsuit that should have been reported as a below the line expense. On October 1, 1993, the United States Department of Justice, on behalf of the U.S. Environmental Protection Agency, filed a civil action against the company. Legal expenses of \$210,734 relating to this lawsuit were incurred during 1992, 1993, and part of 1994. Those payments were capitalized as part of an expansion project on the North Ft. Myers wastewater treatment plant. During 1994, the utility began expensing all additional legal fees pertaining to the lawsuit and reporting them below the line. Accordingly, legal fees totaling \$210,734 that were capitalized should be consistently treated as a below the line expense item and removed from plant in service. Therefore, an adjustment should be made to decrease plant in service by \$210,734. Corresponding adjustments should also be made to decrease accumulated depreciation and depreciation expense by \$23,661 and \$11,307, respectively.

Audit Disclosure No. 2 also noted the utility incorrectly allocated charges for engineering costs related to a project to relocate water mains and wastewater force mains. The engineering costs for the water and wastewater sections were billed together, and the utility elected to allocate the costs based upon each section's percentage of total contractor's cost. Initially, the utility correctly allocated engineering costs 20% to the wastewater section and 80% to the water section. However, the final five payments, totaling \$34,887 in 1993 and \$6,584 in 1994 were allocated 50% to water and 50% to wastewater. These payments were allocated \$17,443 in 1993 and \$3,292 in 1994 to wastewater. Consequently, an adjustment should be made to decrease wastewater plant in service by \$12,441 for engineering costs that belong in the North Ft. Myers water plant. Corresponding adjustments should also be made to decrease accumulated depreciation and depreciation expense by \$961 and \$411, respectively.

In total, staff recommends a reduction to plant in service, accumulated depreciation and depreciation expense of \$223,175, \$24,622, and \$11,718, respectively.

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ISSUE 5: What adjustments should be made to correct accounting errors?

RECOMMENDATION: The following adjustments should be made:
(CLARK)

| | Plant | Accum. Depr. | Depr. Expense |
|-----------------------------|--------------------|--------------------|------------------|
| Retirement Reclassification | \$ (9,057) | \$ (9,057) | \$ (482) |
| Incorrect Depr. Rate | | 9,127 | 3,028 |
| Double Posting Error | | 118 | |
| Capitalized Equipment | 1,352 | | 72 |
| Projected Retirements | <u>(26,130)</u> | <u>(26,130)</u> | <u>(1,390)</u> |
| Total | <u>\$ (33,835)</u> | <u>\$ (25,942)</u> | <u>\$ 1,228</u> |

STAFF ANALYSIS: Staff's Audit Disclosure No. 3 revealed that the utility made several accounting errors that require adjustments to plant in service, accumulated depreciation and depreciation expense.

The staff audit revealed that the utility misclassified two plant retirements. When assigning costs associated with Work Order No. 11-4214, \$1,368 of plant addition costs were charged to cost of removal. On Work Order No. 11-4197 the cost of removal was charged to a plant account, thereby understating the cost of removal by \$10,425. According to the Uniform System of Accounts, "When a retirement unit is retired from utility plant, with or without replacement, the book cost thereof shall be credited to the utility plant account in which it is included, ... If the retirement unit is of a depreciable class, the book cost of the unit retired and credited to utility plant shall be charged to the accumulated depreciation applicable to such property. The cost of removal and the salvage shall be charged or credited, as appropriate, to such depreciation account." The net effect of these two misclassifications is that the December 31, 1994 plant in service and accumulated depreciation accounts are overstated \$9,057 (\$10,425 - \$1,368). Therefore, an adjustment should be made to decrease plant in service by \$9,057. Corresponding adjustments should also be made to decrease accumulated depreciation and depreciation expense by \$9,057 and \$482, respectively.

As noted in the audit, the utility has not been recognizing enough depreciation expense for Account No. 345 - Power Operated Equipment. The utility has been depreciating this account over a 10-year period instead of 12 years as required by Rule 25-30.140(2)(a), Florida Administrative Code. In addition, the

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utility has been using a specific identification method to depreciate only certain assets within Account No. 345, instead of the asset class as required by Rule 25-30.140(4)(a), Florida Administrative Code. To correct this error, adjustments should be made to increase accumulated depreciation and depreciation expense by \$9,127 and \$3,028, respectively.

In 1991, the utility double posted a \$118 adjustment to the retirement cost of an item of power operated equipment. Consequently, an adjustment should be made to increase accumulated depreciation by \$118 to adjust for the posting error.

The utility incorrectly expensed a piece of laboratory equipment costing \$1,352 that should have been capitalized per FCWC's capitalization policy. Accordingly, plant in service should be increased \$1,352 to reflect the reclassification. A corresponding adjustment should be made to increase depreciation expense by \$72. In addition, operation and maintenance expenses should be decreased by \$1,352 to remove the capitalized equipment.

Staff auditors also revealed that the utility did not include the cost of plant retirements in their projections for 1995. The work orders used to project plant additions for 1995 include retirements of \$26,130. For rate making purposes only, accumulated depreciation and plant in service should be reduced an additional \$26,130, so that depreciation expense can be properly projected for the test year ended December 31, 1995.

In total, staff recommends a reduction to plant in service and accumulated depreciation of \$33,835 and \$25,942, respectively, and an increase to depreciation expense of \$1,228.

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ISSUE 6: Should the Commission approve a year-end rate base value in this proceeding?

RECOMMENDATION: Yes, the Commission should approve a year-end rate base value in this proceeding. The utility's investment in rate base is substantially enlarged under year-end considerations. Further, the improvements are in the public interest. (WALKER)

STAFF ANALYSIS: The utility requested approval of a year-end rate base value to reflect the full weight of additions to plant in service that are required to satisfy various permitting and other service conditions. In the absence of the most extraordinary conditions or circumstances, the Commission should apply average investment during the test year in determining rate base. Citizens of Florida v. Hawkins, 356 So. 2d 254 (Fla. 1978) at 257. The utility believes the magnitude of the investment associated with planned improvements is an extraordinary condition that justifies approval of an end-of-period rate base determination. According to the utility: "(w)ith the investment that will be placed into effect during the projected test year, the rate of return will be deteriorated to the point that FCWC's property will be being confiscated in violation of the federal and state constitutions."

Overall, the planned improvements are expected to cost \$1,728,332 for the wastewater division, a 14.9% increase compared to the beginning balance. Conversely, historical growth patterns suggest a 1.6% increase in the number of customers. The most significant construction project concerns expansion of the wastewater treatment plant from 1 MGD (million gallons per day) to 1.25 MGD. The projected cost of this expansion is \$1,611,673. In its application, the utility reported that this project would be complete on or before October 1, 1995. However, the accounting schedules in the MFRs depict completion in December of 1995. When a year-end appraisal is not used, the later a project's completion date, the smaller its consequent impact on rate base determination. Under the averaging practice, using the December 1995 in-service date shown in the MFRs, about 92% of the wastewater plant's construction cost (thirteen-month basis) would be eliminated. The utility believes that this equipment should be considered fully used and useful in this proceeding. The utility also believes that depreciation should be computed based upon the entire investment, independent of which month during the test year the facility is actually completed.

The staff recommends approval of a year-end rate base determination. The wastewater plant expansion project is a substantial improvement that serves the public interest. The

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project should be substantially complete by December of 1995, which in-service date satisfies the two-year limitation prescribed by Section 367.081(2)(a), Florida Statutes. In this case, an average rate base determination would distort the revenue requirement picture, since factors which are increasing the investment in operating plant are not matched by a concomitant growth in customers.

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ISSUE 7: Should CIAC be imputed for the wastewater division?

RECOMMENDATION: Yes. Consistent with Commission practice, CIAC should be imputed as a matching provision for the rate base component created by the margin reserve factor. Pursuant to this imputation adjustment, CIAC is increased by \$429,420, accumulated amortization is increased by \$22,845, and depreciation expense is reduced by \$22,845. (WALKER)

STAFF ANALYSIS: When the used and useful calculation includes an allowance for additional customer growth, also described as a margin reserve, it has been Commission policy to offset that growth factor with the added CIAC that will be collected when those customers are connected. In this docket, the imputation adjustment exactly matches the rate base component associated with margin reserve.

Based on a projected \$7,180,940 net investment in wastewater plant facilities at December 31, 1995, and in accordance with staff's used and useful recommendation, \$429,420 (5.98%) of that investment is attributable to margin reserve. For the purpose of making an imputation adjustment in this case, the plant's capacity that exceeds current demand is assigned to the margin reserve.

In a related proceeding, Docket No. 950586-SU, FCWC has asked the Commission to approve an \$1,800 plant capacity charge for wastewater service, or a sum that approximates the per customer investment in treatment facilities. The staff is recommending approval of that fee. Our used and useful calculation indicates that 74,700 gpd of plant capacity is available for customer growth and, accordingly, 292 customers (at 256 gpd) can connect to the plant before its capacity is fully utilized. Thus, the projected CIAC under these assumptions would be \$525,600 (\$1,800 x 292). However, since the rate base element that corresponds to margin reserve is only \$429,420, a similar limitation applies to the imputation factor. This imputation adjustment reduces depreciation expense by \$22,845, since imputed CIAC offsets the plant investment related to margin reserve. A \$22,845 pro forma provision for accumulated amortization is also needed.

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ISSUE 8: Should the provision for CIAC be reduced for the wastewater division?

RECOMMENDATION: Yes. CIAC should be reduced by \$85,792 to reflect reduced connection charges. This correction yields a corresponding \$927 reduction to Accumulated Amortization of CIAC and a \$4,564 net increase to depreciation expense. (WALKER)

STAFF ANALYSIS: In a related proceeding, Docket No. 950586-SU, the utility has requested approval of a \$1,800 plant capacity charge for wastewater service. The staff believes that this request should be approved. The utility's projected rate base for this proceeding includes a \$127,800 provision for projected CIAC during the test year. That projection was derived under the assumption that the requested \$1,800 plant capacity charge would be collected from 71 new customers during 1995. Correction of that estimate is required to show collection of the existing \$350 charge during most of 1995. The recommended reduction is \$85,792, which is based upon collection of the existing \$350 charge for approximately ten months and \$1,800 for the remaining two months. This correction also produces corresponding adjustments to accumulated amortization of CIAC and depreciation expense. The reduction to depreciation expense is \$4,564, which adjustment reflects amortization of the overstated CIAC.

The adjustment to accumulated amortization of CIAC would also be \$4,564. However, when that correction was identified, a posting error was detected in the MFRs concerning the pro forma provision for amortization of CIAC in 1995. Referring to Schedule B-14 (page 52), when depreciation expense is adjusted to reflect year-end conditions (Column 5), the utility failed to annualize amortization expense. When that factor is annualized, the reserve which appears on Schedule A-13 (page 16) is actually understated by \$3,637. Thus, the net correction recommended by staff is \$927.

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ISSUE 9: Should unfunded post-retirement benefits be included in the rate base calculation?

RECOMMENDATION: Yes. Since post-retirement benefits are currently unfunded, a \$81,855 reduction to rate base is recommended to reflect the average balance associated with the unfunded balance. (WALKER)

STAFF ANALYSIS: The utility has requested recovery of \$34,850 in operating expenses to represent post-retirement benefits (SFAS 106) for this utility system. SFAS 106 refers to the accounting standard that describes the practice of recognizing post-retirement benefits other than pensions (OPEBs). The Commission has approved recovery of these expenses for FCWC's other operating divisions in all recent rate proceedings, and recovery of this expense is also recommended in this proceeding.

This portion of staff's recommendation concerns the rate base treatment that is associated with the unfunded OPEB liability. FWCW does not currently fund its SFAS 106 obligation. According to Rule 25-14.012 (3), Florida Administrative Code:

Each utility's unfunded accumulated postretirement benefit obligation shall be treated as a reduction to rate base in rate proceedings. The amount that reduces rate base is limited to that portion of the liability associated with the cost methodology for post retirement benefits other than pensions.

Since FCWC does not presently fund its OPEB obligation, the unfunded liability account is properly included in the rate base determination. Referring to the utility's balance sheet for the projected test year ending December 31, 1995, the liability account titled "Post-Retirement Benefits" shows an average balance of \$1,240,226. The utility's wastewater division for the North Fort Myers service area is assigned 6.6% of the common investment in working capital (based upon its relative portion of FCWC's total expenses). We believe the same allocation treatment is reasonable for the purpose of dividing the OPEB obligation among the various systems. Therefore, we recommend approval of a \$81,855 reduction to rate base to represent this division's allocated share of the unfunded OPEB liability.

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ISSUE 10: Should working capital be adjusted?

RECOMMENDATION: Yes. A \$9,497 reduction to working capital is recommended to include unfunded pension costs in the utility's deferred credit balance. (WALKER)

STAFF ANALYSIS: FCWC's North Fort Myers wastewater division is a Class A Utility system. Therefore, the utility used the balance sheet approach to calculate its requested \$124,777 provision for working capital. The requested provision is an allocated portion of a common \$1,890,518 company-wide balance. This sum is allocated among the various operating systems based upon comparative operating and maintenance expenses.

The utility's working capital schedule includes current and deferred asset and liability accounts. We believe a deferred liability should be added for the calculation. This item is a deferred credit (liability) that relates to unfunded pension costs. Since most of the utility's pension costs are currently funded, they are not included in the working capital model. Some pension charges, however, are paid on a delayed basis even though they are included in current operating expenses. Therefore, they provide a cost-free source of funds for the utility and should be included in the working capital determination. The unfunded pension cost for the entire company is \$143,898, and the allocated portion for this proceeding is \$9,497.

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ISSUE 11: What rate base amounts should be approved?

RECOMMENDATION: The recommended rate base amount is \$7,784,770.
(WALKER)

STAFF ANALYSIS: Based upon a year-end rate base determination, and staff's recommended adjustments, the recommended rate base amount is \$7,784,770. Schedules that depict the wastewater rate base and adjustment schedules are attached as Schedules 1-A and 1-B.

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COST OF CAPITAL

ISSUE 12: What is the appropriate rate of return on equity?

RECOMMENDATION: Using the current leverage formula, the rate of return on equity should be 11.88%, with a range of 10.88% to 12.88%. (CLARK)

STAFF ANALYSIS: Based upon the components of staff's adjusted capital structure, as shown on Schedule No. 2, the equity ratio for FCWC is 27.38%. Using the current leverage formula approved in Order No. PSC-95-0982-FOF-WS, issued on August 10, 1995, the appropriate return on equity should be 11.88%. The appropriate range for the return on equity should be 10.88% to 12.88%.

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ISSUE 13: What is the appropriate cost for deferred investment tax credits?

RECOMMENDATION: The appropriate cost for deferred investment tax credits is 10.19%. (WALKER)

STAFF ANALYSIS: The utility's reported cost for Deferred Investment Tax Credits (ITC's), which is shown on page 84 of the MFRs, is 9.96%. The utility's calculation includes a component for customer deposits. Such inclusion is inappropriate since customer deposits should not be considered a source of outside funding for the purpose of this equation. Removal of that element necessitates a corresponding adjustment to the cost of deferred tax balances. Further, when our recommended 11.88% equity earnings provision is used, it likewise produces a changed rate for Deferred ITC's. Our recommended cost for deferred tax credits is 10.19%, which revision reflects the adjusted return on equity and removal of customer deposits.

ISSUE 14: What is the appropriate overall cost of capital?

RECOMMENDATION: The appropriate overall cost of capital should be 9.23%, with a range of 8.96% to 9.50%. (CLARK)

STAFF ANALYSIS: The staff's recommended overall rate of return is based on application of Commission practice and is derived as shown in Schedule No. 2. Based upon the recommended adjustments in previous issues, staff recommends an overall cost of capital of 9.23%, with a range of 8.96% to 9.50%.

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NET OPERATING INCOME

ISSUE 15: What is the appropriate provision for rate case expense?

RECOMMENDATION: The appropriate provision for rate case expense is \$41,295. Two adjustments are recommended: a \$4,502 reduction to match the last authorized provision for rate case expense and a \$2,576 reduction to reflect a revision to the current rate case estimate. (WALKER)

STAFF ANALYSIS: The utility's requested provision for rate case charges includes two components: a provision to amortize prior rate charges from Docket No. 910756-SU (\$24,418) and a provision to amortize current rate case costs (\$12,900). Two corrections are recommended by staff: an adjustment to correct the provision for amortization of prior costs (a \$4,503 reduction) and a smaller estimate regarding current costs (\$2,756).

A \$24,418 provision for prior rate costs was reported, which amount would represent amortization of an overall cost of \$97,672 over four years. The rate case cost actually approved in Docket No. 910756-SU was \$79,662. Amortization of the approved amount over four years yields a \$19,916 annual expense, or a \$4,502 reduction relative to the reported expense. Our recommendation concerning rate case expense includes this correction.

The second adjustment concerns the expected provision for current rate case charges. Originally, the utility estimated that its current rate application would cost \$51,600. Recently, we received information which indicates that the projected cost for a PAA proceeding will be \$41,295. We have reviewed the supporting documentation for the current docket, and we believe that all of the reported costs are reasonable and necessary. Accordingly, our recommendation includes a \$10,324 provision to amortize current rate case cost over four years. This provision produces a \$2,576 reduction to the requested sum.

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| | <u>Amount</u> <u>per MFRs</u> | <u>Revised Rate</u> <u>Case Expense</u> | <u>Reduction</u> <u>to Expense</u> |
|----------------|----------------------------------|--|---------------------------------------|
| Legal Fees | \$25,000 | \$16,580 | \$8,420 |
| FCWC Rate Dept | 18,000 | 8,425 | 9,575 |
| Admin Fees | 4,100 | 11,790 | (7,690) |
| Filing Fees | <u>4,500</u> | <u>4,500</u> | <u>0000</u> |
| Totals | <u>\$51,600</u> | <u>41,295</u> | <u>\$10,305</u> |

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ISSUE 16: What is the test year operating income before any revenue increase?

RECOMMENDATION: The test year operating income is \$488,812 for the wastewater system. (WALKER)

STAFF ANALYSIS: Based on the previous adjustments, staff recommends that the test year operating income is \$488,812 for the wastewater system. The operating statement is attached as Schedule No. 3-A and the adjustments are shown on Schedule No. 3-B.

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REVENUE REQUIREMENT

ISSUE 17: What is the appropriate revenue requirement?

RECOMMENDATION: The following revenue requirement should be approved: (WALKER)

| | <u>Total</u> | <u>Increase</u> | <u>% Change</u> |
|---------------------|--------------|-----------------|-----------------|
| Wastewater Division | \$2,489,487 | \$377,772 | 17.89% |

STAFF ANALYSIS: The revenue requirement is a summation measure that depends on previously approved provisions for rate base, cost of capital, and operating expenses. The utility requested approval of rates that would generate a \$2,591,990 revenue provision for wastewater service. Based upon staff's proposed recommendations concerning the underlying rate base, cost of capital, and operating income issues, we recommend approval of rates that are designed to generate a \$2,489,487 revenue requirement.

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RATES AND RATE STRUCTURE

ISSUE 18: How should the revenue increase be allocated among the water, wastewater, and reuse customers?

PRIMARY RECOMMENDATION: The water customers should be allocated \$130,000 of the revenue increase. This amount should be recovered from the water customers in a separate filing involving the water system. A reuse rate of \$.21 per 1,000 gallons should be established, resulting in a revenue allocation of \$22,995. The remainder of the revenue increase as determined in Issue 17 should be recovered from the wastewater customers. (CHASE, XANDERS)

ALTERNATIVE RECOMMENDATION: None of the revenue increase should be allocated to the water customers at this time. A reuse rate of \$.21 per 1,000 gallons should be established, resulting in a revenue allocation of \$22,995. The remainder of the revenue increase as determined in Issue 17 should be recovered from the wastewater customers. The utility should be required to keep the Commission informed of the progress of negotiations with the City of Cape Coral for exchange of reuse for potable water. (CHASE, XANDERS)

STAFF ANALYSIS: Traditionally, the allocation of a revenue requirement for a water or wastewater system has not been at issue. Costs associated with the provision of water service were allocated to the water customers, and those associated with the provision of wastewater service were allocated to the wastewater customers. However, with the evolution of reuse of reclaimed water as both a method of effluent disposal and a means of water conservation, we are seeing a shift in this paradigm. Clearly reuse for irrigation purposes reduces withdrawal from the aquifer which is a benefit to all water users in the area. In recognition that water customers benefit from the conservation facilitated by reuse, we must now consider whether a portion of the wastewater or reuse costs should be shared by the water customers.

In 1994, the Legislature recognized this benefit to water users by creating Section 367.0817, Florida Statutes, which, in part, clarified the Commission's authority to allocate the costs of providing reuse among any combination of the utility's customer base. Specifically, Section 367.0817(3), Florida Statutes, states "All prudent costs of a reuse project shall be recovered in rates. The Legislature finds that reuse benefits water, wastewater, and reuse customers. The commission shall allow a utility to recover the costs of a reuse project from the utility's water, wastewater, or reuse customers or any combination thereof as deemed appropriate .

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by the commission." This legislation recognizes that all customers benefit from the water resource protection afforded by reuse. In this analysis, Staff will discuss the arguments for allocating all of the wastewater costs to the wastewater customers, as well as those supporting a sharing of some of these costs with the water customers. Also, we will discuss the determination of the appropriate rate for reuse end users.

Background

Wastewater at the Florida Cities, North Fort Myers Division, is presently treated by an Advanced Wastewater Treatment (AWT) Plant. Its current capacity is 1.0 MGD and is being expanded to 1.25 MGD. This plant was constructed in 1992 to replace a tertiary treatment plant mainly because the utility was required by the Environmental Protection Agency (EPA) to go to advanced treatment in order to continue disposing of effluent into the Caloosahatchee River. All costs of this upgrade were borne by the wastewater customers in a rate case proceeding in Docket No. 910756-SU. Therefore, since 1992, FCWC has been treating wastewater to a standard sufficient for reuse, although it had no reuse customers in this service area. The provision of reuse as a source of irrigation would alleviate the need to dump all of the effluent into the Caloosahatchee River.

In March of this year, FCWC executed a contract with the Lochmoor Country Club (Lochmoor) for the provision of reuse as a means of irrigation on the golf course. According to the contract, Lochmoor has agreed to take 300,000 gallons per day at a rate approved by the Commission. In addition, by letter dated July 27, 1995, the utility indicated that there are several other potential reuse customers, although negotiations with these customers are in very early stages. These potential reuse customers include the El Rio Golf Course, a median located along Orange Grove Boulevard, the North Fort Myers High School, Palm Island Development, Tropic Isles Elementary School, and Tropic Terrace Condo Association. The reuse feasibility study which the utility submitted to DEP indicates these same potential customers. However, by letter dated August 31, 1995, the utility informed Staff that it is negotiating a contract with the City of Cape Coral for reuse in exchange for potable water. According to the letter, if this contract is executed, the City would take all of the utility's reuse over that provided to Lochmoor, eliminating the need for any other reuse customers. Therefore, it appears that there will be a market for the reclaimed water priced at a competitive rate, whether it be through direct sales to end users or through an exchange contract with the City of Cape Coral.

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Allocation to Water Customers (Primary)

The benefit of reuse to the water customers is derived from the water conservation provided by reuse as a source of irrigation. The utility is located within an area designated by the South Florida Water Management District as a Water Resource Caution Area, wherein critical water supply concerns have been identified. Using treated effluent for irrigation reduces withdrawal from the aquifer, thus protecting the water resource and making available more water for potable water users. Reuse is also a much more efficient and environmentally sound use of the effluent than continuing to discharge into the Caloosahatchee River. In addition, the water customers of FCWC may derive a direct benefit from reuse in the future if the contract is executed with the City of Cape Coral for potable water in exchange for the utility's remaining effluent. According to representatives of the utility, the exchange is being evaluated against the costs of constructing a membrane filter water plant. Depending on the terms of the contract, reuse could result in a source of additional water capacity that would be lower in cost than other supply alternatives. However, the contract is in the negotiation stage; therefore, this benefit to the water customers is somewhat speculative at this point. Regardless, Staff believes the water resource protection afforded by reuse is a benefit to the water customers of FCWC and should be recognized by a shift of a portion of the wastewater costs to the water customers.

One evolving issue in this area is how the Commission should determine the portion of the wastewater costs that should be shifted to the water customers in order to recognize the conservation benefits of reuse. Staff's first approach would be to base this amount on the additional costs incurred in order to implement reuse rather than some other means of effluent disposal which satisfies DEP requirements, such as percolation ponds. In this case, it is not possible to clearly identify these additional costs. Percolation ponds are not a viable option due to the lack of available land. In fact, the only other realistic alternative to reuse is to continue surface water discharge into the Caloosahatchee River. This river has been designated by the DEP as an Outstanding Florida Water, and to use it to dispose of effluent requires a treatment level even greater than that required by reuse.

As mentioned above, the treatment plant was constructed three years ago and the costs were incorporated in wastewater rates in Docket No. 910756-SU. With the exception of a pumping station,

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lines to the Lochmoor Country Club and chlorination facilities, there has not been any plant added since that time strictly for the provision of reuse. The amount of the total revenue requirement of the wastewater system associated with the treatment plant is \$1,300,931. This includes the revenue requirement associated with the net investment in the treatment plant plus the associated income taxes, depreciation expense, and regulatory assessment fees. The calculation of this revenue requirement is appended to this recommendation as Schedule 4.

As mentioned, it is difficult for us to look at the components of this revenue requirement and isolate the portion associated with the provision of reuse, thus making it difficult to determine how much should appropriately be shifted to the water customers. Further complicating the situation is the uncertainty of how the utility will ultimately dispose of the reuse. If the contract with the City of Cape Coral is executed, there will be a direct and measurable benefit to the water customers as explained above which could be the basis for the amount of revenue requirement shifted to the water customers. If, instead, the utility provides reuse for irrigation to other end users, there will be additional revenue from the sale of reuse which would serve to reduce the revenue requirement allocated to the wastewater customers.

Because of the unknowns in this case, Staff is unable to quantify the benefits to the water customers associated with reuse at this time. However, as previously noted, the Legislature has specifically found that reuse benefits water, wastewater and reuse customers. In this case, we believe it would be unfair to allocate the total burden of the revenue increase to the wastewater ratepayers simply because of this timing dilemma. The Commission must base its decision on the facts and circumstances before it at the time of the decision. Staff believes that allocating all of the increase to the wastewater customers would be sending an improper signal to the utility. The utility should be encouraged to actively pursue the sale or exchange of reuse. In our opinion, this can best be accomplished by recognizing the benefit to the water customers and shifting some of the revenue requirement to the water system in this case.

Because of the unique circumstances discussed above, Staff believes only a small portion of the total revenue requirement associated with the wastewater treatment plant should be allocated to the water customers at this time. We believe it is reasonable to allocate to the water customers 10% of this revenue requirement shown on Schedule 4, or \$130,000. Admittedly, this percentage is

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a judgment call. However, many things have worked together over several years to get the plant to where reuse is now feasible. Staff believes it is time to recognize that some of these wastewater plant costs benefit the water customers and shift some costs to the water system. In our opinion, 10% of the total revenue requirement associated with the treatment plant adequately recognizes the benefits to the water customers.

The utility has filed a wastewater-only proposed agency action rate case. Wastewater customers have been properly noticed of potential rate increases. However, the water customers were not noticed because the utility did not request a change in the water rates. As stated earlier, the statute allows the Commission to allocate revenue associated with reuse to water, wastewater, and/or reuse customers. Staff believes that in this situation, such an allocation to water customers is appropriate. However, Staff recognizes that there are problems with allowing the utility to change the water rates in this proceeding because the water customers have never been noticed of a potential change in rates. Further, the minimum filing requirements contain no information on water customers and usage, and therefore the effect on rates cannot be determined. In addition, the water customers of the North and South Fort Myers Divisions of FCWC are combined for ratemaking purposes. One issue that will have to be fully explored is whether the two separate groups of water customers should share equally in the allocation of reuse costs from the North Fort Myers Division. As a result, Staff believes that it is more appropriate to recover the revenue from water customers in a separate proceeding. Staff notes that the Commission has opened an overearnings investigation involving the water systems of FCWC in Docket No. 951029-WU. The issues surrounding the collection of the reuse costs from the water customers could be explored in that docket.

Allocation Solely to Wastewater Customers (Alternative)

There are valid arguments supporting the contention that there should be no sharing of the wastewater revenue requirement with the water customers. First, the utility was forced by the EPA to upgrade to advanced treatment in 1992 in order to continue to dispose of its effluent by surface water discharge into the river. It could be argued, therefore, that the construction of the AWT plant was required in order to continue to provide wastewater service, and the ability to provide reuse is simply a positive externality. Also, the provision of reuse is especially beneficial to the wastewater customers since it is becoming increasingly difficult for the utility to continue surface water discharge. To enlarge the current NPDES permit, which allows the utility to

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dispose into the river, would be very difficult, time consuming and ultimately unlikely. This makes reuse the only feasible option for effluent disposal in the future.

Another argument in support of allocating the entire wastewater costs to wastewater customers is the uncertainty of the contract with the City of Cape Coral for the exchange of reuse for potable water. Staff has identified this potential exchange as a direct benefit to the water customers from the provision of reuse, even though the contract is still in the negotiation stages. We applaud the utility's creative initiative in seeking a lower cost source of future water capacity and do not want to do anything that may discourage such actions. Therefore, until we know the outcome of the contract negotiations, it may be too soon to allocate any of the revenue requirement to the water customers.

One option available to the Commission is to allocate all of the wastewater revenue requirement to the wastewater customers and reuse end user at this time, and require the utility to keep the Commission informed of the progress of negotiations with the City of Cape Coral. In this way, if a contract is executed which results in a lower cost of additional water supply than would otherwise be available, the Commission could reevaluate the allocation of some costs to the water customers based on the analysis of this savings. This would be done in a separate proceeding which would include proper notice to all customers and a full exploration of the available options.

Reuse Rate

The utility has requested a rate of \$.13 per 1,000 gallons for the provision of reuse to the Lochmoor Country Club. This is the same reuse rate that is currently approved for the utility's South Fort Myers Division. The basis for this rate in the South Fort Myers division is that it was equal to the reuse rate of Lee County at the time and was, therefore, competitive with other reuse providers.

The utility provided a copy of the reuse contract between Lochmoor and FCWC. According to the contract, the Country Club has agreed to take 300,000 gallons per day at a rate approved by the Commission. According to the utility, the basis of this contract was the requested rate of \$.13 per 1,000 gallons. Lochmoor has historically used approximately 200,000 to 250,000 gallons per day.

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ISSUE 19: What are the appropriate rates for Florida Cities Water Company - North Ft. Myers Wastewater Division?

RECOMMENDATION: If the Commission approves staff's primary recommendation in Issue 18, the recommended rates should be designed to produce revenues of \$2,346,437. However, if the Commission approves the alternative recommendation in Issue 18, the recommended rates should be designed to produce revenues of \$2,476,530. The utility should be required to file revised tariff sheets and a proposed customer notice to reflect the appropriate rates. The approved rates should be effective for service rendered on or after the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1), Florida Administrative Code, provided the customers have received notice. The rates may not be implemented until proper notice has been received by the customers. The utility should provide proof of the date notice was given no less than 10 days after the date of notice. (GALLOWAY)

STAFF ANALYSIS: The permanent rates requested by the utility are designed to produce revenues of \$2,591,990. The requested revenues represent an increase of \$439,622 or 23.57%.

If the Commission approves staff's primary recommendation in Issue 18, staff recommends that the final rates approved for the utility should be designed to produce revenues of \$2,337,667 which is an increase of 11.11%, excluding miscellaneous service revenues, using the base facility charge rate design. This amount includes the revenues for reuse in the amount of \$22,995.

If, however, the Commission approves staff's alternative recommendation in Issue 18, staff recommends that the final rates approved for the utility should be designed to produce revenues of \$2,467,760 which is an increase of 17.29%, excluding miscellaneous service revenues, using the base facility charge rate design. This amount includes the revenues for reuse in the amount of \$22,995.

The approved rates should be effective for service rendered on or after the stamped approval date of the tariff, pursuant to Rule 25-30.475, provided the customers have received notice. The utility should be required to file and have staff's approval of revised tariff sheets and a proposed customer notice letter, pursuant to Rule 25-22.0407(10), Florida Administrative Code, prior to implementing the new rates.

A comparison of the utility's original rates, requested rates, and staff's recommended rates is shown on Schedule No. 5.

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The current reuse rate of Lee County is \$.21 per 1,000 gallons. We believe this is an appropriate rate for the provision of reuse in FCWC's North Fort Myers division. Discussions with representatives of the utility have indicated that many reuse purveyors in Lee County charge a rate of \$.21 per 1,000 gallons since that is what the county charges. This rate, therefore, will put the utility on par with other reuse providers in the area. Further, setting the charge equal to county's rate is consistent with the previous decision in the South Fort Myers division.

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ISSUE 20: What is the appropriate amount by which rates should be reduced four years after the established effective date to reflect the removal of the amortized rate case expense as required by Section 367.0816, Florida Statutes?

RECOMMENDATION: The water rates should be reduced as shown on Schedule No. 5-A, to remove \$10,324 of rate case expense grossed-up for regulatory assessment fees which is being amortized over a four year period. The decrease in rates should become effective immediately following the expiration of the four year recovery period, pursuant to Section 367.0816, Florida Statutes. The utility should be required to file revised tariff sheets and a proposed customer notice setting forth the lower rates and the reason for the reduction not later than one month prior to the actual date of the required rate reduction. (GALLOWAY)

STAFF ANALYSIS: Section 367.0816, Florida Statutes, requires that the rates be reduced immediately following the expiration of the four year period by the amount of rate case expense previously authorized in the rates. The reduction will reflect the removal of revenues associated with the amortization of rate case expense and the gross-up for regulatory assessment fees which is \$10,324. The removal of rate case expense will result in a reduction in rates recommended by staff on Schedule No. 5-A.

The utility should be required to file revised tariffs no later than one month prior to the actual date of the required rate reduction. The utility also should be required to file a proposed customer notice setting forth the lower rates and 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 for the reduction in the rates due to the removal of the amortized rate case expense.

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ISSUE 21: Should the docket be closed?

RECOMMENDATION: This docket should be closed if no person, whose interests are substantially affected by the proposed action, files a protest within the 21 day protest period. (JAEGER, GALLOWAY)

STAFF ANALYSIS: If a protest is not received within 21 days of issuance of the Proposed Agency Action order, the order will become final. The docket may be closed upon the utility's filing of and staff's approval of revised tariff sheets.

FLORIDA CITIES WATER CO. - NORTH FT. MYERS DIVISION
 SCHEDULE OF WASTEWATER RATE BASE
 TEST YEAR ENDED 12/31/95

SCHEDULE NO. 1-A
 DOCKET NO. 950387-SU

| COMPONENT | TEST YEAR PER UTILITY | UTILITY ADJUSTMENTS | ADJUSTED TEST YEAR PER UTILITY | STAFF ADJUSTMENTS | STAFF ADJUSTED TEST YEAR |
|-----------------------------------|-----------------------------|------------------------|--------------------------------------|----------------------|--------------------------------|
| 1 UTILITY PLANT IN SERVICE | \$ 11,649,007 | \$ 1,728,332 | \$ 13,377,339 | \$(257,010) | 13,120,329 |
| 2 LAND | 5,000 | 0 | 5,000 | 0 | 5,000 |
| 3 CONSTRUCTION WORK IN PROGRESS | 91,345 | (91,345) | 0 | 0 | 0 |
| 4 ACCUMULATED DEPRECIATION | (2,558,856) | (584,542) | (3,143,398) | 50,564 | (3,092,834) |
| 5 CIAC | (3,183,270) | (136,760) | (3,320,030) | (343,628) | (3,663,658) |
| 6 AMORTIZATION OF CIAC | 1,159,806 | 172,988 | 1,332,794 | 21,918 | 1,354,712 |
| 7 ADVANCES FOR CONSTRUCTION | 0 | 0 | 0 | 0 | 0 |
| 8 UNFUNDED FASB 106 OBLIGATION | 0 | 0 | 0 | (81,855) | (81,855) |
| 9 OTHER: ALLOC. OF GENERAL OFFICE | 0 | 27,799 | 27,799 | 0 | 27,799 |
| 10 WORKING CAPITAL ALLOWANCE | 0 | 124,774 | 124,774 | (9,497) | 115,277 |
| RATE BASE | \$ 7,163,032 | \$ 1,241,246 | \$ 8,404,278 | \$(619,508) | 7,784,770 |

**FLORIDA CITIES WATER CO. - NORTH FT. MYERS DIVISION
ADJUSTMENTS TO RATE BASE
TEST YEAR ENDED 12/31/95**

**SCHEDULE NO. 1-B
DOCKET NO. 950387-SU
PAGE 1 OF 1**

| EXPLANATION | WASTEWATER |
|---|---------------------|
| (1) UTILITY PLANT IN SERVICE | |
| a) Adjustment to reclassify costs associated with EPA lawsuit concerning discharge of pollutants (audit disclosure 2) | (210,734) |
| b) Reclassification of engineering charges (audit disclosure 2) | (12,441) |
| c) Adjustment to reclassify retirement cost (audit disclosure 3) | 1,368 |
| d) Adjustment to reclassify retirement entry | (10,425) |
| e) Projected provision for retirements in 1995 | (26,130) |
| f) Capitalize laboratory equipment | 1,352 |
| | <u>\$ (257,010)</u> |
| (2) ACCUMULATED DEPRECIATION | |
| a) Adjustment to reclassify retirement cost | (1,368) |
| b) Adjustment to reclassify retirement entry | 10,425 |
| c) Additional depreciation on power operated equipment | (9,127) |
| d) Adjustment to show double posting of retirement | (118) |
| e) Show provision for projected retirements in 1995 | 26,130 |
| i) Adjustment to reclassify litigation costs and engineering charges | 24,622 |
| | <u>\$ 50,564</u> |
| (3) CIAC | |
| a) Imputation of CIAC to offset margin reserve | \$ (429,420) |
| b) Adjustment to restate projected provision for CIAC in 1995 | 85,792 |
| | <u>\$ (343,628)</u> |
| (4) ACCUMULATED AMORTIZATION | |
| a) Pro Forma adjustment that imputes CIAC to offset margin reserve | 22,845 |
| b) Adjustment to correct reflect amortization per last proceeding | 1,659 |
| c) Pro Forma adjustment that restates 1995 CIAC expectation | (927) |
| | <u>\$ 21,918</u> |
| (5) UNFUNDED FASB 106 OBLIGATION | |
| Allocation of average balance for unfunded post retirement benefits | <u>\$ (81,855)</u> |
| (6) WORKING CAPITAL | |
| Adjustment to include deferred credits for unfunded pension costs | <u>\$ (9,497)</u> |

FLORIDA CITIES WATER CO.—NORTH FT. MYERS DIVISION
 CAPITAL STRUCTURE
 TEST YEAR ENDED 12/31/95

SCHEDULE NO. 2
 DOCKET NO. 950387—SU

| DESCRIPTION | TOTAL CAPITAL | SPECIFIC ADJUSTMENTS (EXPLAIN) | PRO RATA ADJUSTMENTS | CAPITAL RECONCILED TO RATE BASE | RATIO | COST RATE | WEIGHTED COST |
|--------------------------------|----------------------|--------------------------------|-----------------------|---------------------------------|----------------|---------------|---------------|
| PER UTILITY | | | | | | | |
| 1 LONG TERM DEBT | \$ 36,660,000 | \$ 0 | \$(32,600,479) | 4,059,521 | 48.30% | 9.53% | 4.60% |
| 2 SHORT-TERM DEBT | 0 | 0 | 0 | 0 | 0.00% | 0.00% | 0.00% |
| 3 PREFERRED STOCK | 9,000,000 | 0 | (8,003,391) | 996,609 | 11.86% | 9.00% | 1.07% |
| 4 COMMON EQUITY | 20,782,539 | 0 | (18,481,198) | 2,301,341 | 27.38% | 11.34% | 3.11% |
| 5 CUSTOMER DEPOSITS | 1,013,037 | 0 | (900,859) | 112,178 | 1.33% | 6.00% | 0.08% |
| 6 DEFERRED ITC'S—ZERO COST | 0 | 0 | 0 | 0 | 0.00% | 0.00% | 0.00% |
| 7 DEFERRED ITC'S—WTD COST | 1,678,281 | 0 | (1,492,438) | 185,843 | 2.21% | 9.96% | 0.22% |
| 8 DEFERRED INCOME TAXES | <u>6,762,006</u> | <u>0</u> | <u>(6,013,220)</u> | <u>748,786</u> | <u>8.91%</u> | <u>0.00%</u> | <u>0.00%</u> |
| 9 TOTAL CAPITAL | \$ <u>75,895,863</u> | \$ <u>0</u> | <u>\$(67,491,585)</u> | <u>8,404,278</u> | <u>100.00%</u> | | <u>9.08%</u> |
| PER STAFF | | | | | | | |
| 10 LONG TERM DEBT | \$ 36,660,000 | \$ 0 | \$(32,899,720) | 3,760,280 | 48.30% | 9.53% | 4.60% |
| 11 SHORT-TERM DEBT | 0 | 0 | 0 | 0 | 0.00% | 0.00% | 0.00% |
| 12 PREFERRED STOCK | 9,000,000 | 0 | (8,076,854) | 923,146 | 11.86% | 9.00% | 1.07% |
| 13 COMMON EQUITY | 20,782,539 | 0 | (18,650,838) | 2,131,701 | 27.38% | 11.88% | 3.25% |
| 14 CUSTOMER DEPOSITS | 1,013,037 | 0 | (909,128) | 103,909 | 1.33% | 6.00% | 0.08% |
| 15 DEFERRED ITC'S—ZERO COST | 0 | 0 | 0 | 0 | 0.00% | 0.00% | 0.00% |
| 16 DEFERRED ITC'S—WTD COST | 1,678,281 | 0 | (1,506,137) | 172,144 | 2.21% | 10.19% | 0.23% |
| 16 DEFERRED INCOME TAXES | <u>6,762,006</u> | <u>0</u> | <u>(6,068,415)</u> | <u>693,591</u> | <u>8.91%</u> | <u>0.00%</u> | <u>0.00%</u> |
| 17 TOTAL CAPITAL | \$ <u>75,895,863</u> | \$ <u>0</u> | <u>\$(68,111,093)</u> | <u>7,784,770</u> | <u>100.00%</u> | | <u>9.23%</u> |
| RANGE OF REASONABLENESS | | | | | LOW | HIGH | |
| RETURN ON EQUITY | | | | | <u>10.88%</u> | <u>12.88%</u> | |
| OVERALL RATE OF RETURN | | | | | <u>8.96%</u> | <u>9.50%</u> | |

FLORIDA CITIES WATER CO.—NORTH FT. MYERS DIVISION
 CAPITAL STRUCTURE
 TEST YEAR ENDED 12/31/95

SCHEDULE NO. 2
 DOCKET NO. 950387—SU

| DESCRIPTION | TOTAL CAPITAL | SPECIFIC ADJUSTMENTS (EXPLAIN) | PRO RATA ADJUSTMENTS | CAPITAL RECONCILED TO RATE BASE | RATIO | COST RATE | WEIGHTED COST |
|-----------------------------|----------------------|--------------------------------|-----------------------|---------------------------------|----------------|---------------|---------------|
| PER UTILITY | | | | | | | |
| 1 LONG TERM DEBT | \$ 36,660,000 | \$ 0 | \$(32,600,479) | 4,059,521 | 48.30% | 9.53% | 4.60% |
| 2 SHORT-TERM DEBT | 0 | 0 | 0 | 0 | 0.00% | 0.00% | 0.00% |
| 3 PREFERRED STOCK | 9,000,000 | 0 | (8,003,391) | 996,609 | 11.86% | 9.00% | 1.07% |
| 4 COMMON EQUITY | 20,782,539 | 0 | (18,481,198) | 2,301,341 | 27.38% | 11.34% | 3.11% |
| 5 CUSTOMER DEPOSITS | 1,013,037 | 0 | (900,859) | 112,178 | 1.33% | 6.00% | 0.08% |
| 6 DEFERRED ITC'S—ZERO COST | 0 | 0 | 0 | 0 | 0.00% | 0.00% | 0.00% |
| 7 DEFERRED ITC'S—WTD COST | 1,678,281 | 0 | (1,492,438) | 185,843 | 2.21% | 9.96% | 0.22% |
| 8 DEFERRED INCOME TAXES | <u>6,762,006</u> | <u>0</u> | <u>(6,013,220)</u> | <u>748,786</u> | <u>8.91%</u> | <u>0.00%</u> | <u>0.00%</u> |
| 9 TOTAL CAPITAL | \$ <u>75,895,863</u> | \$ <u>0</u> | <u>\$(67,491,585)</u> | <u>8,404,278</u> | <u>100.00%</u> | | <u>9.08%</u> |
| PER STAFF | | | | | | | |
| 10 LONG TERM DEBT | \$ 36,660,000 | \$ 0 | \$(32,899,720) | 3,760,280 | 48.30% | 9.53% | 4.60% |
| 11 SHORT-TERM DEBT | 0 | 0 | 0 | 0 | 0.00% | 0.00% | 0.00% |
| 12 PREFERRED STOCK | 9,000,000 | 0 | (8,076,854) | 923,146 | 11.86% | 9.00% | 1.07% |
| 13 COMMON EQUITY | 20,782,539 | 0 | (18,650,838) | 2,131,701 | 27.38% | 11.88% | 3.25% |
| 14 CUSTOMER DEPOSITS | 1,013,037 | 0 | (909,128) | 103,909 | 1.33% | 6.00% | 0.08% |
| 15 DEFERRED ITC'S—ZERO COST | 0 | 0 | 0 | 0 | 0.00% | 0.00% | 0.00% |
| 15 DEFERRED ITC'S—WTD COST | 1,678,281 | 0 | (1,506,137) | 172,144 | 2.21% | 10.19% | 0.23% |
| 16 DEFERRED INCOME TAXES | <u>6,762,006</u> | <u>0</u> | <u>(6,068,415)</u> | <u>693,591</u> | <u>8.91%</u> | <u>0.00%</u> | <u>0.00%</u> |
| 17 TOTAL CAPITAL | \$ <u>75,895,863</u> | \$ <u>0</u> | <u>\$(68,111,093)</u> | <u>7,784,770</u> | <u>100.00%</u> | | <u>9.23%</u> |
| RANGE OF REASONABLENESS | | | | | LOW | HIGH | |
| RETURN ON EQUITY | | | | | <u>10.88%</u> | <u>12.88%</u> | |
| OVERALL RATE OF RETURN | | | | | <u>8.96%</u> | <u>9.50%</u> | |

FLORIDA CITIES WATER CO.—NORTH FT. MYERS DIVISION
 STATEMENT OF WASTEWATER OPERATIONS
 TEST YEAR ENDED 12/31/95

SCHEDULE NO. 3-A
 DOCKET NO. 950387-SU

| DESCRIPTION | TEST YEAR PER UTILITY | UTILITY ADJUSTMENTS | UTILITY ADJUSTED TEST YEAR | STAFF ADJUSTMENTS | STAFF ADJUSTED TEST YEAR | REVENUE INCREASE | REVENUE REQUIREMENT |
|-----------------------------|--------------------------|------------------------|----------------------------------|----------------------|--------------------------------|---------------------|------------------------|
| 1 OPERATING REVENUES | \$ 2,085,157 | \$ 506,833 | \$ 2,591,990 | \$(480,275) | \$ 2,111,715 | \$ 377,772 | 2,489,487 |
| OPERATING EXPENSES | | | | | | 17.89% | |
| 2 OPERATION AND MAINTENANCE | \$ 919,804 | \$ 40,349 | \$ 960,153 | \$(8,431) | \$ 951,722 | \$ | 951,722 |
| 3 DEPRECIATION | 379,659 | 73,908 | 453,567 | (28,771) | 424,796 | | 424,796 |
| 4 AMORTIZATION | 949 | 0 | 949 | 0 | 949 | | 949 |
| 5 TAXES OTHER THAN INCOME | 205,132 | 37,790 | 242,922 | (21,612) | 221,310 | 17,000 | 238,309 |
| 6 INCOME TAXES | 105,294 | 65,998 | 171,292 | (151,805) | 19,487 | 135,758 | 155,245 |
| 7 TOTAL OPERATING EXPENSES | \$ 1,610,838 | \$ 218,045 | \$ 1,828,882 | \$(210,620) | \$ 1,618,263 | \$ 152,758 | 1,771,021 |
| 8 OPERATING INCOME | \$ 474,319 | \$ 288,788 | \$ 763,108 | \$(269,655) | \$ 493,452 | \$ 225,013 | 718,465 |
| 9 RATE BASE | \$ 7,163,032 | \$ 8,404,278 | \$ 7,784,770 | | \$ 7,784,770 | \$ | 7,784,770 |
| RATE OF RETURN | 6.62% | | 9.08% | | 6.34% | | 9.23% |

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**FLORIDA CITIES WATER CO.—NORTH FT. MYERS DIVISION
ADJUSTMENTS TO OPERATING STATEMENTS
TEST YEAR ENDED 12/31/95**

**SCHEDULE NO. 3-B
DOCKET NO. 950387—SU
PAGE 1 OF 1**

| EXPLANATION | WASTEWATER |
|--|---------------------|
| (1) OPERATING REVENUES | |
| a) Adjustment to restate miscellaneous revenues | \$ (7,987) |
| b) Adjustment to remove utility's proposed rate increase | (480,078) |
| c) Adjustment to revenues per billing analysis | 7,790 |
| | <u>\$ (480,275)</u> |
| (2) OPERATION & MAINTENANCE EXPENSES | |
| a) Adjustment to capitalize purchased lab equipment | (1,352) |
| b) Adjustment to restate test year provision for rate case expense | (4,503) |
| c) Adjustment to show reduced estimate for rate case expense | (2,576) |
| | <u>\$ (8,431)</u> |
| (3) DEPRECIATION EXPENSE | |
| a) Provision for increased depreciation expense — power equipment | \$ 3,028 |
| b) Remove depreciation expense related to litigation costs | (11,307) |
| c) Adjust depreciation expense to reflect reduction to engineering costs | (411) |
| d) Adjustment to depreciation expense to reflect assorted retirements | (1,800) |
| e) Provision to show imputation of CIAC | (22,845) |
| f) Provision to revise projected CIAC in 1995 | 4,564 |
| | <u>\$ (28,771)</u> |
| (4) TAXES OTHER THAN INCOME TAXES | |
| a) Regulatory assessment fees related to revenue adjustment | <u>\$ (21,612)</u> |
| (5) INCOME TAXES | |
| a) Income taxes associated with adjusted test year income | <u>\$ (151,805)</u> |
| (6) OPERATING REVENUES | |
| a) Adjustment to reflect recommended revenue requirement | <u>\$ 377,772</u> |
| (7) TAXES OTHER THAN INCOME TAXES | |
| a) Regulatory assessment taxes on additional revenues | <u>\$ 17,000</u> |
| (8) INCOME TAXES | |
| a) Income taxes related to recommended income amount | <u>\$ 135,758</u> |

Calculation of Revenue Requirement
 Associated with Wastewater Treatment Plant

| <u>Accounts</u> | <u>Plant</u> | <u>Accum Depr.</u> | <u>Net Plant</u> |
|--|------------------|------------------------|----------------------|
| 354 Structures | 540,246 | (113,735) | 426,511 |
| 380 Treatment plant | 5,638,536 | (1,179,846) | 4,458,690 |
| 380.1 Advanced Treatment | 1,679,387 | (92,303) | 1,587,084 |
| 381 Plant Sewers | 3,874 | (437) | 3,437 |
| 382 Outfall Sewer Lines | 692,083 | (90,104) | 601,979 |
| 389 Other | <u>134,217</u> | <u>(30,978)</u> | <u>103,239</u> |
| Plant @ 12/95 (year – end determination) | <u>8,688,343</u> | <u>(1,507,403)</u> | <u>7,180,940</u> |
| Net Investment | | | 7,180,940 |
| Cost of Capital | | | <u>9.23%</u> |
| Income Requirement | | | 662,801 |
| Income taxes on Net Investment | | | 143,135 |
| Depreciation | | | 457,019 |
| Regulatory Assessment Tax | | | <u>37,976</u> |
| Total – Revenue Requirement for Plant | | | <u>\$1,300,931</u> |

RATE SCHEDULE

**Wastewater
 Monthly Rates**

| RESIDENTIAL | Current Tariffed Rates | Utility Requested Final | Staff's Primary Recommended Final | Staff's Alternative Recommended Final |
|--|---------------------------------------|--|--|--|
| Base Facility Charge All Meter Sizes | \$24.37 | \$32.61 | \$28.56 | \$28.56 |
| Residential Gallonage Charge, per 1,000 gallons (Maximum 6,000 gallons) | \$4.62 | \$5.14 | \$4.65 | \$5.15 |

| GENERAL SERVICE & ALL OTHER CLASSES | Current Tariffed Rates | Utility Requested Final | Staff's Primary Recommended Final | Staff's Alternative Recommended Final |
|---|---------------------------------------|--|--|--|
| Base Facility Charge: | | | | |
| 5/8"x3/4" | \$24.37 | \$32.61 | \$28.56 | \$28.56 |
| 1" | \$60.94 | \$81.53 | \$71.41 | \$71.41 |
| 1-1/2" | \$121.87 | \$163.05 | \$142.80 | \$142.80 |
| 2" | \$194.99 | \$260.88 | \$228.52 | \$228.52 |
| 3" | \$389.98 | \$521.76 | \$457.03 | \$457.03 |
| 4" | \$609.35 | \$815.25 | \$714.11 | \$714.11 |
| 6" | \$1,218.69 | \$1,630.50 | \$1,428.23 | \$1,428.23 |
| General Service Gallonage Charge, per 1,000 gallons (No Maximum) | \$5.55 | \$6.17 | \$5.58 | \$6.18 |

| TYPICAL MONTHLY BILL COMPARISONS | Current Tariffed Rates | Utility Requested Final | Staff's Primary Recommended Final | Staff's Alternative Recommended Final |
|---|---------------------------------------|--|--|--|
| - Residential Usage (gallons) - | | | | |
| 3,000 | \$38.23 | \$48.03 | \$42.66 | \$44.16 |
| 5,000 | \$47.47 | \$58.31 | \$51.96 | \$54.46 |
| 10,000 | \$52.09 | \$63.45 | \$56.61 | \$59.61 |

| RECLAIMED WATER CUSTOMERS (REUSE) | Current Tariffed Rates | Utility Requested Final | Staff's Primary Recommended Final | Staff's Alternative Recommended Final |
|--|---------------------------------------|--|--|--|
| - Per 1,000 gallons - | \$0.00 | \$0.13 | \$0.21 | \$0.21 |

UTILITY: FLORIDA CITIES WATER COMPANY
 SYSTEM: NORTH FT. MYERS
 COUNTY: LEE COUNTY DIVISION
 DOCKET NO. 950387-SU

Schedule 5--A

RATE SCHEDULE

Schedule of Rate Decrease After Expiration of
 Amortization Period for Rate Case Expense

Wastewater

Monthly Rates

| <u>Residential</u> | <u>Staff Recommended Rates</u> | <u>Rate Decrease</u> |
|--|--|--------------------------|
| Base Facility Charge (meter size): All Meter Sizes | \$28.56 | \$0.13 |
| Gallage Charge, per 1,000 gallons (Maximum 6,000 gallons) | \$4.65 | \$0.02 |
| | | |
| <u>General Service and all other classes</u> | <u>Staff Recommended Rates</u> | <u>Rate Decrease</u> |
| Base Facility Charge (meter size): | | |
| 5/8"x3/4" | \$28.56 | \$0.13 |
| 1" | \$71.41 | \$0.32 |
| 1-1/2" | \$142.80 | \$0.64 |
| 2" | \$228.52 | \$1.02 |
| 3" | \$457.03 | \$2.04 |
| 4" | \$714.11 | \$3.19 |
| 6" | \$1,428.23 | \$6.37 |
| Gallage Charge, per 1,000 gallons | \$5.58 | \$0.02 |