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**DATE:** March 11, 1997

**TO:** Division of Auditing and Financial Analysis (Vandiver)

**FROM:** Division of Water and Wastewater (Walker) *W*

**RE:** Docket Nos. 970209-WS and 970210-WS - Applications to Transfer Operating Facilities to United Water Florida Inc. - Amendment of Certificates to Include Territories Served by Sunray Utilities in St. John and Nassau Counties

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An audit of the utility's books and records is needed for the above referenced proceeding. An ASR (Audit Service Request) form is attached. Completion of the audit report by May 2, 1997 is necessary.

**Attachments**

**CC:** Division of Records and Reporting (2 copies)  
Division of Legal Services (Capeless, Reyes)  
Division of Water and Wastewater (Redemann)

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FPSC-RECORDS/REPORTING



A rate base determination is needed to establish Sunray's investment in rate base facilities for its operating systems in Nassau and St. Johns Counties. Pursuant to the purchase agreement dated August 21, 1996, United will pay Sunray the "verified" net book value for the acquired systems. Per the application and Sunray's books, the 12/31/95 rate base balances were \$2,081,949 in St. Johns County and \$1,995,764 in Nassau County. However, the purchase price will be adjusted as needed to match the audited sums. Because of this parity, United will not record acquisition adjustment for this transaction.

The books and records for Sunray are available for review at two locations: through 1989 at Jacksonville Utilities Management (address: 1300 Riverplace Blvd, Suite 620, Jacksonville, Florida 32307 and telephone: (904) 399-8802) and since 1989 at Sunray Utilities (address: 501 Centre Street, Fernandina Beach, Florida 32035 and telephone: (904) 261-2918). The auditors should contact Mr. Sambamurthi at United Florida Water Inc. to schedule and coordinate audit visits. In addition, Ms. Kelly Adkins at (904)321-5544 at Rayonier (parent company for Sunray) may be contacted for assistance in scheduling the audit investigation.

#### HIGH PRIORITY - STANDARD REQUIREMENTS

1. The rate base objectives per the rate case audit guide of the DAFA audit manual should be used in auditing utility plant, accumulated depreciation, CIAC, and accumulated amortization. Sunray's existing rates were granted using projected data concerning expected future expenses and investment levels. The utility's actual rate base values have not been audited by the Commission. The audit inspection will therefore need to address all rate base components since Sunray's inception.
2. Determine whether any assets on the seller's books are not being transferred (i.e., vehicles and computer equipment), and exclude those items from the rate base calculation.
3. Verify that land dedicated to utility service is included in the proposed transfer to United Water.
4. Please advise N.D. Walker if any problems arise during the audit examination.'

#### NASSAU LAKES SUBDIVISION

As discussed in the Case Background, RAD objected to Sunray's certification on the basis that RAD's Nassau Lakes subdivision was not included in Sunray's requested territory. Sunray indicated that it was willing to provide service to RAD. However, it appears that RAD wanted to defer inclusion of its land in Sunray's territory until the Commission determined the utility's initial rates and charges. Recently, RAD has reportedly lost its title to the Nassau Lakes subdivision through mortgage foreclosures, although its right of redemption had not been extinguished. Given such uncertainties, we decline to include RAD's property within Sunray's territory at this time. In the event that RAD or its successor(s) in interest desire service from the utility, they should submit a completed application for service to the utility. The utility would then proceed with notices and an application for Commission approval of an extension of its certificates pursuant to Sections 367.041 or 367.061, Florida Statutes.

#### RATES

Sunray has an existing 150,000 gallons per day (gpd) water treatment plant located within the Otter Run development. The plant was constructed at a cost of \$269,500 and was in service on January 1, 1988. The water treatment system in place is designed to serve 429 ERCs. The utility intends to construct a 1.0 million gallon per day (MGD) water treatment plant by January 1, 1989, at a projected cost of \$850,000. The water treatment facilities would then have the capacity to serve approximately 2,257 ERCs.

Sunray also has an existing 187,000 gpd extended aeration wastewater treatment plant. The plant was constructed at a cost of \$667,000 and was in service on January 1, 1988. The existing sewer system is designed to serve 668 ERCs. The plant will be converted to the contact stabilization mode of treatment and the capacity expanded to 500,000 gpd at an estimated cost of \$120,000. The utility expects that the expansion will occur by January 1, 1990, and the treatment facilities at that time would have the capacity to serve approximately 1,786 ERCs.

Sunray plans to construct the utility system in phases. Normally, in original certification proceedings, we calculate rates which will allow the utility to earn a fair rate of return on investment when the treatment plants reach 80% of capacity. In this case, we have calculated rates based on 80% of Phase I plant and expenses.

The projected completion of Phase I is mid-1992 for the water system and late 1991 for the sewer system, according to projections of committed plant based on developer construction permits issued by the Florida Department of Environmental Regulation (DER). As its dates of projected completion, the utility used the dates that DER will commit capacity from the treatment plants to specific developments. According to the utility, when permits are granted for the construction of lines to serve developments, DER considers the treatment plant capacity needed to serve these customers as "committed" regardless of when the active customers will actually be connecting to the system.

We used these projections of "committed" plant to determine service availability charges only, as discussed in this Order. For purposes of calculating initial service rates, we based our projections on the rate of growth in active customers

reduced insurance expense-other for "sudden pollution and contamination" insurance obtained by the utility. The policy provides ten million dollars in coverage. Since the coverage is independent of the number of systems operated, we believe that the utility's St. Johns County division should share the cost of this policy. It appears that the St. Johns County system is projected to have a similar number of customers through its Phase I; therefore, we believe a 50/50 allocation of cost is reasonable.

Depreciation expense was adjusted to reflect the adjustments made to water and sewer utility plant-in-service and to reflect the use of Commission approved depreciation rates.

We have adjusted the utility's property taxes for water and sewer to reflect 80% of design capacity for utility plant-in-service. Income taxes and regulatory assessment fees were calculated at the approved level of gross revenue. The Schedule of Operations appears on Schedules Nos. 4 and 5, with our adjustments appearing on Schedule No. 6.

We find the utility's pro forma capital structure to be reasonable. Therefore, the only adjustment necessary was to reconcile the capital structure to rate base. We calculated the return on common equity to be 14.33%, using the current Commission-approved leverage formula, as authorized by Order No. 19178, issued on July 26, 1988. The utility's capital structure appears on Schedule No. 7.

The above schedules are presented only as a tool used in establishing initial rates. They are not intended to establish rate base. This is consistent with Commission policy in original certification proceedings. However, we do establish a return on equity of 14.33% to be used in future proceedings involving such things as calculations of allowance for funds used during construction (AFUDC), interim rates and tax savings.

The utility has not proposed any specific water and sewer rates. Based upon our approved revenue requirements of \$400,506 for water and \$543,783 for sewer, the following rates are approved, effective for meter readings on or after thirty days from the stamped approval date on the original water and sewer tariffs. The tariffs will be approved upon staff's verification that they are consistent with this Order and after the period for objections to this proposed agency action has expired.

WATER SERVICE

(Monthly Rates)

RESIDENTIAL AND GENERAL SERVICE

<u>Meter Size</u>	<u>Base Facility Charge</u>
5/8" x 3/4"	\$ 7.51
3/4"	11.27
1"	18.78
1 1/2"	37.55
2"	60.08
3"	120.16
4"	187.75
6"	375.50
Gallage Charge (per 1,000 Gallons)	\$ .95

the developers in Phase I, with the exception of a small amount related to the Marsh Lakes subdivision. The utility asserted that in order to obtain permits from DER for the construction of the distribution and collection systems for new developments, the utility must represent that capacity is currently available to serve the number of ERCs represented by the development. In other words, according to DER, this reserved capacity is considered "committed" to that developer at the time permits are obtained to construct the lines.

We agree with the utility that the rate of DER-committed plant rather than active customers should be used in this case to determine service availability charges. Documents provided by the utility indicate that DER uses this committed capacity concept for this utility. Therefore, for practical purposes, the future appearance of customers bears no relationship to the time that plant investment must be in place.

Use of the utility's concept of DER-committed ERCs rather than the more traditional concept of connection of active customers shortens the length of time until the plants will reach capacity. The projected time to build-out is 1992 for the water system and 1991 for the sewer system using the concept of committed plant based on developer construction permits. Using active customer connections, that time is extended until the years 2000 and 1998 for the water and sewer systems, respectively.

Calculation of system capacity charges using the committed capacity concept employed by Sunray and the adjusted utility plant-in-service may be displayed as follows:

	<u>Water System</u>	<u>Sewer System</u>
	2,257 ERCs	1,786 ERCs
Year plant reaches Capacity	1992	1991
Utility Plant-in-Service	\$2,897,418	\$3,089,906
Land	18,149	255,000
Accumulated Depreciation	260,832	270,234
Net Plant	2,654,735	3,074,672
CIAC	2,115,479	2,450,267
Accumulated Amortization	125,679	142,803
Net CIAC	1,989,800	2,307,464
Net CIAC/Net Plant	74.95%	75.05%
Proposed Capacity Charge	\$ 368	\$ 370

We note that the above capacity charges are designed to generate net levels of CIAC consistent with the guidelines of Rule 25-30.580, Florida Administrative Code. We find that the above capacity charges are reasonable. They are, therefore, approved.

The utility has also filed a tariff provision for the gross-up of CIAC for income tax purposes. Since the utility is a corporation subject to federal income taxes, we find that this tariff provision should be approved.