

FLORIDA PUBLIC SERVICE COMMISSION
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Tallahassee, Florida 32399-0850

M E M O R A N D U M

March 20, 1997

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

FROM: DIVISION OF LEGAL SERVICES (REYES) *REYES*
DIVISION OF WATER & WASTEWATER (JOHNSON, MCCASKILL) *JOHNSON* *MCCASKILL*

RE: DOCKET NO. 961417-SU - RESPONSE TO COMMISSION ORDER TO
SHOW CAUSE BY HUDSON UTILITIES, INC. IN PASCO COUNTY

AGENDA: APRIL 1, 1997 - REGULAR AGENDA - ISSUE 3 AND 5 ARE
PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY
PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\LEG\WP\961417SU.RCM

CASE BACKGROUND

Section 367.081(4)(b), Florida Statutes, provides that the approved rates of any utility which receives all or any portion of its utility service from a governmental authority or from a water or wastewater utility regulated by the Commission and which redistributes that service to its utility customers shall be automatically increased or decreased without hearing, upon verified notice to the Commission 45 days prior to its implementation of the increase or decrease that the rates charged by the governmental authority or other utility have changed.

On December 12, 1995, after a public hearing, the Pasco County Board of County Commissioners approved a rate change for all customers encompassing the period of January 1, 1996 through September 30, 1999. As a result of this rate change, the rates for all bulk water and/or wastewater customers were decreased effective January 1, 1996. On December 20, 1995, the Commission staff received from Pasco County copies of the notices it sent to utilities regulated by the Florida Public Service Commission (PSC), advising the utilities of the bulk water and/or wastewater rate change. There are nine PSC regulated utilities which purchase water and/or wastewater from Pasco County. According to the notice, Pasco County extended the January 1, 1996 effective date until April 1, 1996 in order to allow the utilities sufficient time

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to contact the Commission and/or incorporate the new charges into its rate structure.

The bulk water and/or wastewater rate change approved by Pasco County qualifies for a pass-through rate adjustment for PSC regulated utilities pursuant to Section 367.081(4)(b), Florida Statutes. Section 367.081(4)(e), Florida Statutes, provides that a utility may not adjust its rates under this subsection more than two times in any 12 month period. Therefore, on March 29, 1996, staff sent letters to the nine affected utilities regarding the Pasco County rate change advising them that because Pasco County approved two rate changes in 1996, the utilities had the option of using the pass-through statute to adjust their rates accordingly. Specifically, staff informed the utilities that one of the rate changes could be filed as a pass-through in conjunction with an index and the other pass-through adjustment could be filed separately to be effective for October 1, 1996.

To date, only three of the nine (Utilities Inc. of Florida, Betmar Utilities, Inc. and Jasmine Lakes Utilities Corporation) have filed for a pass-through rate reduction. Another utility, Virginia City Utilities, Inc. (Virginia City) had a staff assisted rate case in Docket No. 960625-WU, through which the county's decreased rates were incorporated. The five utilities which have not filed a pass-through rate reduction are: Hudson Utilities, Inc., d/b/a Hudson Bay Company (Hudson or utility); Forest Hills Utilities, Inc. (Forest Hills); Mad Hatter Utility, Inc. (Mad Hatter or MHU); Aloha Utilities, Inc. (Aloha); and Southern States Utilities, Inc. (SSU). By Order No. PSC-96-1226-FOF-WS, issued September 27, 1996, in Docket No. 960878-WS, each of these five utilities were order to show cause in writing why their rates should not be adjusted, effective April 1, 1996, to reflect the reduction in purchased water and/or wastewater costs to bulk water and/or wastewater customers in Pasco County. On October 17, 1996, Hudson filed its response to the show cause order.

Hudson is a Class B wastewater utility providing service to the public in Pasco County. As of December 31, 1995, the utility served 1,172 wastewater customers. The utility had gross operating revenues of \$629,192 for the wastewater system. The utility reported a net operating income of \$17,394 for the wastewater system. The purpose of this recommendation is to determine whether Hudson's rates should be reduced to reflect the reduction in purchased wastewater costs.

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DISCUSSION OF ISSUES

ISSUE 1: Should Hudson Utilities, Inc.'s request for a waiver of that provision set forth in Order No. PSC-96-1226-FOF-WS requiring the utility to file the information required by Rule 25-30.425(1)(a) through (f), Florida Administrative Code, along with a calculation of the rate reduction, be granted?

RECOMMENDATION: No, Hudson Utilities, Inc.'s request for a waiver should be denied. Pursuant to Order No. PSC-96-1226-FOF-WS, the utility should have filed the information required by Rule 25-30.425(1)(a) through (f), Florida Administrative Code, along with a calculation of the rate reduction. Staff recommends that the Commission reach a decision regarding the proposed decrease based on the information presently available. (REYES)

STAFF ANALYSIS: As stated earlier, on October 17, 1996, Hudson filed its response to Order No. PSC-96-1226-FOF-WS, issued September 27, 1996, in Docket No. 960878-WS. Order No. PSC-96-1226-FOF-WS required Hudson to show cause in writing why its rates should not be adjusted to reflect the reduction in purchased bulk water and/or wastewater costs in Pasco County.

In its written response to the show cause order, Hudson requests a waiver of that provision of the Order set forth in Order No. PSC-96-1226-FOF-WS requiring the utility to file the information required by Rule 25-30.425(1)(a) through (f), Florida Administrative Code, along with a calculation of the rate reduction, for a period of twenty days after the Commission votes on whether Hudson must reduce its rates, if such rate reduction is ordered.

When this issue was first addressed by the Commission at the September 3, 1996 Agenda Conference, much discussion centered around the alleged immateriality of the proposed decreases. A review of the tape of that agenda conference indicates that the Commission was concerned about spending valuable time and resources on these proposed reductions when they may in fact be immaterial. This concern culminated in the Commission's decision to require each of the affected utilities to show cause why their rates should not be reduced. The Commission decided to formally require the utilities to provide this information rather than having staff informally confer with the utilities to determine the materiality of the proposed decreases. It is clear from the Commission's discussion at agenda that the Commission intended for its show cause order to elicit the necessary information from the utility which would allow the materiality of the proposed decrease to be evaluated. That information is set out in Rule 25-30.425(1)(a) through (f), Florida Administrative Code. Staff believes the Order

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correctly reflects the Commission's decision. Accordingly, staff believes that the utility should have filed that information in accordance with the terms of the Order.

Order No. PSC-96-1226-FOF-WS clearly states, "For purposes of determining whether a rate adjustment is appropriate, each utility shall file the information required by Rule 25-30.425(1)(a) through (f), Florida Administrative Code, along with a calculation of the rate decrease." Hudson has failed to provide this information in its response to the show cause order. Instead, Hudson simply makes the same legal arguments it did at the September 3, 1996 Agenda Conference.

The utility has had ample opportunity to either voluntarily implement the decrease or to provide documentation to support its allegations of immateriality. When staff first became aware of the bulk rate decrease by Pasco County, staff immediately advised each of the affected utilities of the option of using the pass-through statute to adjust its rates. Hudson failed to respond. Furthermore, at the September 3, 1996 Agenda Conference, Hudson raised an allegation of immateriality, but failed to provide any documentation or other evidence which would support that allegation. Finally, Hudson has failed to provide any supporting documentation in its response to the show cause order. Staff believes that the three opportunities provided to the utility to either voluntarily reduce its rates or to provide the Commission with documentation which would support its allegation of immateriality are more than adequate. Therefore, staff recommends that the Commission deny the utility's request for a waiver of that provision of the Order and recommends that the Commission reach a decision regarding the proposed decrease based on the information presently available.

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ISSUE 2: Does the Commission have the authority to reduce Hudson Utilities, Inc.'s rates to reflect a reduction in purchased water and/or wastewater costs?

PRIMARY RECOMMENDATION: The Commission has the authority to reduce Hudson Utilities, Inc.'s rates to reflect a reduction in purchased water and/or wastewater costs only if the utility meets or exceeds the minimum of its authorized range of return on equity. (REYES)

ALTERNATE RECOMMENDATION: Yes, the Commission has the authority to reduce Hudson Utilities, Inc.'s rates because Section 367.081(4)(b), Florida Statutes, requires a utility's rates to be reduced to reflect a reduction in purchased water and/or wastewater costs. (REYES)

PRIMARY STAFF ANALYSIS: The utility asserts in its response that it disagrees with the proposition that the Commission has the statutory authority to require a decrease in rates of a regulated utility to reflect a reduction in bulk purchased water and/or wastewater costs. The utility argues that such an interpretation of Section 367.081(4)(b), Florida Statutes, is inconsistent with the plain meaning and intent of the statute. The utility further asserts that it does not believe the Commission may implement pass-throughs in a Section 367.0822, Florida Statutes, limited proceeding. Moreover, the utility asserts that the legislature did not intend to mandate pass-through increases or decreases.

Section 367.081(4)(b), Florida Statutes, provides in part:

The approved rates of any utility which receives all or any portion of its utility service from a governmental authority or from a water or wastewater utility regulated by the Commission and which redistributes that service to its utility customers shall be automatically increased or decreased without hearing, upon verified notice to the Commission 45 days prior to its implementation of the increase or decrease that the rates charged by the governmental authority or other utility have changed. (emphasis added)

This statute establishes a procedure by which certain operating costs incurred by water and wastewater utilities are passed through to the utility's customers without further action by the Commission. The statute mandates that the utility's rates shall be automatically increased or decreased upon verified notice to the Commission.

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The language in Section 367.081(4)(b), Florida Statutes, clearly and unambiguously addresses both decreases and increases. In prior decisions, the Commission has found that rate reductions associated with decreases in the rates for purchased water and/or wastewater service are appropriate. In these cases, however, the utility initiated the proceeding. By Order No. 11026, issued July 26, 1982, in Docket No. 820264-W, the Commission approved a reduction in the rates for Florida Water Service, Inc. to pass-through a decrease in the purchased water rate charged to Florida Water Service, Inc. by its supplier, Village of Palm Springs. In addition, by Order No. 20728, issued February 13, 1989, in Docket No. 890049-SU, the Commission approved a rate reduction for Hudson Utilities, Inc. using the limited proceeding statute to pass-through a reduction in the cost of purchased sewage treatment by Pasco County.

Noticeably absent from this statute is any language vesting the Commission with discretion in the implementation of pass-through increases or decreases. Specifically, the statute states that the utility's rates "shall be automatically increased or decreased without hearing. . . ." Section 367.081(4)(b), Florida Statutes. Therefore, the Commission has no discretion to deny pass-through increases or decreases once notice is given to the Commission. This interpretation is supported by the statute's legislative history which indicates that the legislature intended to allow utilities to pass increased costs on to consumers sooner than the law in effect at that time allowed. SB 297, 6th Leg., Spec. and 2nd Sess., 1980 Fla. Sess. Law Ch. 80-99 (enacted). Obviously, the goal was to keep the utility whole by providing a mechanism whereby the utility could recoup certain increased costs without resort to a rate case.

The statute further provides that the rates shall be automatically increased or decreased upon verified notice to the Commission 45 days prior to its implementation of the increase or decrease. The statute is unclear because it does not specify whether the utility's initiation of the pass-through process is mandatory or permissive.

Some of the affected utilities have argued that decreases should only be required in the event that the utility is overearning at the time the decrease occurs. While staff agrees that decreases should be implemented when a utility is overearning, as stated earlier, staff believes a more restrictive interpretation of the statute is required.

It is a basic tenet of statutory construction that statutes will not be interpreted so as to yield an absurd result. See Dorsey v. State, 402 So.2d 1178 (Fla. 1981). The practical

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application of primary staff's interpretation of the statute is to reduce the utility's rates to reflect the reduction in purchased water and/or wastewater costs so long as the utility is not underearning. Staff recognizes that an interpretation which would require a utility that is underearning to reduce rates when certain decreases occur is not practical because such an action serves only to preserve an undesirable situation. Arguably, the customers of such a utility benefit by the utility retaining the revenue stream and in doing so mitigating its loss position. Not only does this reduce financial pressure on the utility, but it may also forestall future rate proceedings.

However, when the utility is within its authorized range of return, staff believes that the utility should have no discretion in its initiation of decreases and any reduction should be passed through. If a utility is already earning within its authorized range, decreasing rates in accordance with the decrease in costs will leave the utility in the same earnings position and will benefit customers through a rate reduction. In fact, a reduction in costs without a corresponding reduction in revenues could conceivably result in creating an overearnings situation. In any event, if a utility within its authorized range does not decrease its rates commensurate with its decrease in costs, the utility clearly gains and the customers clearly lose. If the utility does implement a corresponding decrease in rates, the utility is no worse off from an earnings stand point and the customers receive the benefit of the reduction in purchased costs to which they are rightfully entitled. From a policy perspective, this is a preferred result because it is fair, just, and equitable.

As to the Commission's authority to require regulated utilities to decrease their rates, contrary to the utility's assertions, staff believes that the Commission is vested with the authority to order a reduction in rates when the utility fails to initiate a decrease pursuant to Section 367.081(4)(b), Florida Statutes. Section 367.011(2), Florida Statutes, vests the Commission with the exclusive jurisdiction over each utility with respect to its authority, service, and rates. Section 367.121, Florida Statutes, provides that the Commission shall have the power to prescribe fair and reasonable rates and to do all things necessary or convenient to the full and complete exercise of its jurisdiction and the enforcement of its orders and requirements.

Staff also believes that the Commission may address such decreases in a limited proceeding pursuant to Section 367.0822(1), Florida Statutes. Section 367.0822(1), Florida Statutes, specifically allows the Commission on its own motion to require a rate adjustment if a matter is within its jurisdiction. Clearly, the Commission has exclusive jurisdiction over each regulated

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utility with respect to rates. See Section 367.011(2), Florida Statutes. Furthermore, Section 367.0822, Florida Statutes, provides that if the issue of rate of return is not specifically addressed in the limited proceeding, the Commission may adjust rates so long as the adjustment does not effect a change in the utility's last authorized rate of return. Pass-through increases and decreases have no effect on a utility's earnings because the change in revenue equals the change in expense. In other words, pass-through increases and decreases are earnings neutral, and the utility's rate of return is not affected by a pass-through adjustment. Therefore, the Commission may properly order such pass-through adjustments pursuant to Section 367.0822, Florida Statutes. Furthermore, staff notes that the Commission has previously ordered a pass-through rate reduction in a limited proceeding. See Order No. 20728.

Based on the foregoing, staff believes that it is appropriate for the Commission to require pass-through decreases in the event that the utility meets or exceeds the minimum of its authorized range of return on equity to reflect the reduction in purchased water and/or wastewater costs to bulk water and/or wastewater customers in Pasco County.

ALTERNATE STAFF ANALYSIS: For the sake of brevity, the statute has not been restated here. For purposes of clarification, the difference between staff's primary and alternate recommendations is that alternate staff believes that pass-through decreases should be required regardless of the utility's earnings level.

Section 367.081(4)(b), Florida Statutes, provides that the rates shall be automatically increased or decreased "upon verified notice to the Commission 45 days prior to its implementation of the increase or decrease" Absent any discretionary language, the statute can be interpreted as giving rise to an implied duty on the part of the utility to provide the Commission with verified notice and to initiate such increases and decreases when they become effective. As it relates to passing through increased costs, this duty coincides with the utility's responsibility to keep itself whole, thereby maintaining its own financial viability. Further, as it relates to passing through decreased costs, this duty provides symmetry within the statute and recognizes that the consumers, not the utility, are entitled to the benefits of such decreases. Failure to pass-through the decreased costs to the consumer would result in a windfall to the utility.

Furthermore, such a non-discretionary interpretation of the statute is in keeping with the overall purpose of Chapter 367, Florida Statutes, which is to vest in one entity, the Florida Public Service Commission, exclusive jurisdiction over the rates

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charged by investor-owned utilities and the duty to set just, fair, and reasonable rates. As recognized by the Court in GTE Fla. Inc. v. Clark, 668 So.2d 971, 978 (Fla. 1996), "utility ratemaking is a matter of fairness. Equity requires that both ratepayers and utilities be treated in a similar manner." Any interpretation which suggests that the utility has discretion in initiating any decreases would be in direct contravention of that goal because, as a profit seeking entity, the utility will invariably request recognition of pass-through increases but not decreases. Accordingly, it is not fair or equitable to only recognize pass-through increases without recognizing the pass-through decreases. Furthermore, such a discretionary grant of authority would be in direct opposition to the Commission's exclusive jurisdiction to set rates.

It could be argued that a utility earning less than a fair rate of return or within its authorized range should not be required to make an adjustment to reflect a decrease. However, such an argument is simply without merit because, as stated in the primary analysis, pass-through increases and decreases have no effect on a utility's earnings because the change in revenue equals the change in expense. In other words, pass-through increases and decreases are earnings neutral, and the utility's rate of return is not affected by a pass-through adjustment. Therefore, the utility will be in the same relative position after the pass-through increase or decrease. In fact, Order No. 11026 states in part, "We believe a careful reading of the statute and rule indicates that the intent is to leave the utility in the same relative position after the decrease when the law has been complied with."

Support for such an argument might be based upon Section 367.081(4)(c), Florida Statutes, which requires a utility to affirm under oath that implementing a change under this subsection "will not cause the utility to exceed the range of its last authorized rate of return on equity." However, such an argument would be misguided because it fails to recognize the earnings neutrality of pass-through adjustments as explained earlier.

Price indexes, which are authorized pursuant to Section 367.081(4)(a), Florida Statutes, may cause a utility to overearn, but pass-throughs will not cause overearnings given their earnings neutrality. Therefore, such an argument regarding Section 367.081(4)(c), Florida Statutes, does not provide support for an interpretation of utility discretion in the initiation of pass-through rate adjustments, but merely evidences a latent ambiguity in this subsection. Therefore, to resolve this latent ambiguity, the intent of paragraph (c) must be read as pertaining only to the index provision in paragraph (a) and not the pass-through provision in paragraph (b). Furthermore, any citation to the legislative

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history of Section 367.081(4), Florida Statutes, which may suggest that pass-throughs are not in fact earnings neutral does not change the reality of the dynamics of pass-throughs but instead merely evidences the legislature's oversight of the earnings neutral nature of pass-throughs.

A review of the legislative history provides no evidence that the foregoing statutory interpretation is in conflict with the legislative intent. In fact, the legislative history is directed almost exclusively at the ability of the utility to pass-through increased costs. As stated earlier, it appears that the legislature's main focus was on providing the utility a mechanism whereby certain increased costs could be passed on to the utility's customers more quickly. Little mention was made of pass-through decreases, which leads to the conclusion that decreases were not the legislature's focal point. It is only logical that the legislature would focus its concern on increases given the dynamics of a capital economy whereby prices are continually increasing and very seldom decrease. However, this should not in any way be interpreted as evidence of legislative intent to vest utilities with the ability to reap a windfall at the expense of the public.

As stated earlier in the primary recommendation, staff believes that contrary to the utility's assertions, the Commission is vested with the authority to order a reduction in rates when, as here, the utility fails to comply with Section 367.081(4)(b), Florida Statutes. Furthermore, as previously explained, staff believes that the Commission may address such decreases in a limited proceeding pursuant to Section 367.0822(1), Florida Statutes.

Based on the foregoing, staff believes that Section 367.081(4)(b), Florida Statutes, requires a utility's rates to be reduced to reflect a reduction in purchased water and/or wastewater costs. Staff further believes that, contrary to the utility's assertions, the Commission does have the authority to require Hudson to reduce its rates to reflect the reduction in purchased wastewater costs to bulk wastewater customers in Pasco County.

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ISSUE 3: Should Hudson Utilities, Inc.'s rates be reduced to reflect a reduction in purchased wastewater costs to bulk wastewater customers in Pasco County?

PRIMARY RECOMMENDATION: No. Hudson's achieved rate of return on equity is less than the minimum of its authorized range of return on equity; therefore, Hudson Utilities' rates should not be reduced to reflect a reduction in purchased wastewater costs. (JOHNSON, MCCASKILL)

ALTERNATE RECOMMENDATION: Yes. Hudson Utilities's rates should be reduced by \$57,104 or \$.92 per thousand gallons to reflect a reduction in purchased wastewater costs to bulk wastewater customers. The utility should file revised tariff sheets and a proposed customer notice reflecting the appropriate rates and the reason for the reduction. 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. The rates should not be implemented until proper notice has been received by the customers. The utility should provide proof of the date notice was given within 10 days after the date of the notice. (JOHNSON, MCCASKILL)

PRIMARY STAFF ANALYSIS: On April 1, 1996, Pasco County reduced its bulk wastewater rate from \$3.11 to \$2.20. On October 1, 1996, the rate was increased from \$2.20 to \$2.23. As a result, the net decrease in Pasco County's rate was \$.88, on a prospective basis, as of October 1, 1996. However, Hudson Utilities elected not to reduce its wastewater rates to reflect the reduced cost of purchased wastewater.

As discussed in Issue 1, Hudson requested a waiver of that provision of the Order which requires each utility to file the information required by rule 25-30.425(1)(a) through (f), Florida Administrative Code. The utility maintains that Hudson is a relatively small, financially strapped wastewater utility with limited resources, and that in light of its current financially distressed status, it would be imprudent to require Hudson to undergo the expense and effort to comply with the filing requirements in the Order unless and until the Commission determines that Hudson is required to decrease its rates to pass-through Pasco County's reduction in its bulk wastewater rates.

In addition, the utility's position is that in the case of an underearning utility, such as Hudson, the Legislature intended to allow the utility to forego a pass-through decrease if the impact of foregoing the pass-through decrease leaves the underearning utility in an improved financial situation yet below the bottom of the range of its last authorized rate of return on equity. The

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utility states that in 1995, Hudson had an achieved rate of return of less than 1 percent. Further, the utility contends that by not passing through Pasco County's reduction in purchased sewage treatment costs, Hudson's 1995 earnings climb to a meager 2.74%, well below its authorized 12.73% rate of return.

Hudson's last authorized rate of return on equity was established as 13.51%, with a range of 12.51% - 14.51%, by Order No. 23810, issued November 27, 1990, in Docket No. 900293-SU. The utility provided Exhibit A in its response to the show cause order. Exhibit A reflects an achieved rate of return for the utility of .90% for 1995. Based on this achieved rate of return, the utility's achieved rate of return of equity is calculated to be a negative (297%). Further, in Exhibit A, the utility calculated a reduction in purchased wastewater costs of \$56,393. This reduction was calculated by multiplying the gallons of wastewater treated by Pasco County in 1995 (61,970,000), by the reduction in purchased wastewater cost per thousand gallons on April 1, 1996 (\$3.11 - \$2.20 = \$.91). Exhibit A also reflects the impact on earnings of a reduction in purchased wastewater expense of \$56,393, without a corresponding reduction in revenues. As a result of this adjustment, the utility calculated an achieved rate of return of 2.74%. Based on this rate of return, the utility's achieved rate of return on equity is calculated to be a negative (240.62%).

Staff used the information contained in the utility's 1995 Annual Report to calculate a reduction for purchased wastewater costs of \$57,104, resulting in a decrease of \$.92 per thousand gallons of wastewater treated. The reduction was calculated by computing the difference in purchased wastewater costs at the old rate (\$3.11) and the new rate (\$2.23) and then dividing by the gallons of sewage treatment sold for the most recent twelve month period. According to the utility's 1995 Annual Report, 61,970,000 gallons of sewage treatment was purchased and sold. Using the old Pasco County bulk wastewater rate of \$3.11 per thousand gallons of sewage treated, the total purchased wastewater cost is calculated to be \$192,727 (61,970 x 3.11). The new reduced bulk rate of \$2.23 results in a total cost of \$138,193 (61,970 x 2.23). The difference between the cost at the old rate and the new rate results in an annual decrease of \$57,104 $((\$192,727 - \$138,193) / (.955))$. The decrease of \$57,104 divided by the total gallons of sewage treatment sold of 61,970 results in a \$.92 change to the gallonage charge. Staff's calculations of the decrease are shown on Schedule No. 1.

As discussed above, the utility's achieved rate of return for 1995 was .90% prior to any adjustment for the purchased wastewater cost reduction. This results in an achieved return on equity of negative (297%). When the utility's revenues and expenses are

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reduced by staff's calculated reduction of \$57,104, the utility's achieved rate of return is calculated to be .91%, with a return on equity of negative (297%). However, if the utility's expenses are adjusted without a corresponding reduction in revenues, the rate of return is calculated to be 2.68%, with a achieved return on equity of a negative (243%).

Staff believes a utility's rates should be reduced to reflect a reduction in purchased water and/or wastewater costs only in the event that the utility meets or exceeds the minimum of its authorized range of return on equity. The utility is earning well below its minimum 12.51% authorized rate of return on equity. Therefore, staff recommends that no reduction in rates be required.

ALTERNATE STAFF ANALYSIS: As discussed above, in its response to the Commission's show cause order, the utility provided Exhibit A which reflects a reduction in purchased wastewater costs of \$56,393. This reduction was calculated by multiplying the gallons of wastewater treated by Pasco County in 1995 (61,970,000) by the reduction in purchased wastewater per thousand gallons on April 1, 1996 (\$3.11 - \$2.20 = \$.91). Exhibit A also shows that if the utility foregoes its calculated decrease of \$56,393 in revenues, the achieved rate of return would climb to 2.74%, which is well below the bottom of the range of its last authorized rate of return. However, as discussed in Issue 2, staff believes that Section 367.081 (4)(b), Florida Statutes, requires a utility's rates to be reduced to reflect a reduction in purchased water and/or wastewater costs.

Staff used the information contained in the utility's 1995 Annual Report to calculate a reduction for purchased wastewater costs of \$57,104, resulting in a decrease of \$.92 per thousand gallons of wastewater treated. The reduction was calculated by computing the difference in purchased wastewater costs at the old rate and the new rate and then dividing by the gallons of sewage treatment sold for the most recent twelve month period. According to the utility's 1995 Annual Report 61,970,000 gallons of sewage treatment was purchased and sold. Using the old Pasco County bulk wastewater rate of \$3.11 per thousand gallons of sewage treated, the total purchased wastewater cost is calculated to be \$192,727 (61,970 x 3.11). The new reduced bulk rate of \$2.23 results in a total cost of \$138,193 (61,970 x \$2.23). The difference between the cost at the old rate and the new rate results in an annual decrease of \$57,104 $((\$192,727 - \$138,193) / (.955))$. The decrease of \$57,104, divided by the total gallons of sewage treatment sold of 61,970 results in a \$.92 change to the gallonage charge. Staff's calculations of the decrease is shown on Schedule No. 1.

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Based on the foregoing, staff recommends that the utility's revenues be reduced by \$57,104, resulting in a rate reduction of \$.92 to the utility's gallonage charge.

In addition to adjusting its wastewater rates, the utility should file revised tariff sheets, along with a proposed customer notice reflecting the appropriate rates and the reason for the reduction. The rates should be effective for service rendered as of the stamped approval date on the tariff sheets provided the customers have received notice. The tariff sheets should be approved upon staff's verification that the tariffs are consistent with the Commission's decision and that the customer notice is adequate. The utility should provide proof of the date notice was given within 10 days after the date of notice. If the effective date of the new rates falls within a regular billing cycle, the initial bills at the new rate may be prorated. The old charge should be prorated based on the number of days in the billing cycle before the effective date of the new rates. The new charge should be prorated based on the number of days in the billing cycle on or after the effective date of the new rates. In no event should the rates be effective for service rendered prior to the stamped approval date.

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ISSUE 4: Does the Commission have the authority to require Hudson Utilities, Inc. to refund excess purchased wastewater costs collected from April 1, 1996 to the effective date of the new rates?

RECOMMENDATION: Yes, the Commission has the authority to require Hudson Utilities, Inc. to refund excess purchased wastewater costs collected from April 1, 1996 to the effective date of the new rates. (REYES)

STAFF ANALYSIS: Hudson argues that Commission may not require a retroactive reduction in rates to the date of the decrease in costs. Hudson contends such action would plainly constitute retroactive ratemaking and is contrary to law.

Staff believes that such a reduction would not constitute retroactive ratemaking. Retroactive ratemaking only occurs when a new rate is applied to prior consumption. See Citizens of State v. Public Service Commission, 448 So.2d 1024 (Fla. 1984); Gulf Power Co. v. Cresse, 410 So.2d 492 (Fla. 1982).

If the Commission determines that the decrease should have been passed through by the utility when it became effective and requires the utility to implement the pass-through decrease with an effective date of April 1, 1996, the Commission's action does not constitute retroactive ratemaking. Because the utility failed to pass-through the decreased costs when they became effective, the utility will have collected rates from its customers to which it was not lawfully entitled. The customers are entitled to a refund of the excess rates they have been charged by this utility. Ordering a refund of these excess charges does not constitute retroactive ratemaking in staff's opinion.

"This is not a case where a new rate is requested and then applied retroactively." GTE Fla. Inc. v. Clark, 668 So. 2d 971, 972 (Fla. 1996). Any refund required in these circumstances would be designed simply to return to the customers the excess charges which the utility was not entitled to collect. Failure to require a refund results in an inequity to the customers and a windfall to the utility. Such a result is in direct contravention of the legislative mandate that rates should be fair, just, and reasonable.

Furthermore, an argument could be raised that pass-through decreases may not be given a retroactive application because pass-through increases historically have been applied only prospectively. However, a retroactive application of decreases is supported by policy considerations, whereas a retroactive application of increases is not.

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Pass-through decreases should be applied retroactively because the responsibility of notifying the Commission of a pass-through rate adjustment lies with utility, and not the customer. If decreases are only applied prospectively, the utility will receive a windfall in the form of excess revenues which will necessarily accompany any delay in notifying the Commission of a decrease. This creates an incentive for the utility to forestall recognition of the pass-through adjustment for as long as possible. Increases, on the other hand, should only be applied prospectively because the utility's customers must be given notice and an opportunity to adjust consumption before the adjustment is implemented. This result also serves to provide an incentive for the utility to immediately initiate increases, thereby preventing the utility's financial viability from being eroded by increased purchased costs.

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ISSUE 5: Should Hudson Utilities, Inc. be required to refund excess purchased wastewater costs collected from April 1, 1996 to the effective date of the new rates?

RECOMMENDATION: Yes, if the Commission approves staff's alternate recommendation in Issue 2 and approves staff's recommendation in Issue 4, the utility should refund excess purchased wastewater costs collected from April 1, 1996 to the effective date of the new rates. The utility should calculate the refund due customers based on the difference in the cost of the number of gallons of wastewater treated at the old rate and the new rate. The utility should submit a schedule showing by month actual wastewater gallons treated for the period of April 1, 1996, through the date the utility implements the new rates, and a schedule showing the calculation of refunds per customers. The refunds should be made with interest as required by Section 25-30.360(4), Florida Administrative Code, within 90 days of the effective date of the Order. The utility should be required to submit the proper refund reports pursuant to Rule 25-30.360(7), Florida Administrative Code. The utility should treat any unclaimed refunds as CIAC pursuant to Rule 25-30.360(8), Florida Administrative Code.

If the Commission votes for the primary recommendation in Issue 2 and votes yes on Issue 4, no refund is required. As discussed in Issue 3, the utility's achieved rate of return on equity is well below the minimum of its authorized range of return; therefore, no reduction is required. (JOHNSON, MCCASKILL)

STAFF ANALYSIS: If the Commission approves staff's alternate recommendation in Issue 2 and approves staff's recommendation in Issue 4, Hudson should refund all excess purchased wastewater costs collected from April 1, 1996 to the effective date of the new rates. The utility should calculate the refund due customers based on the difference in the cost of the number of gallons of wastewater treated at the old rate and the new rate. The utility should submit a schedule showing by month actual wastewater gallons treated for the period of April 1, 1996, through the date the utility implements the new rates, and a schedule showing the calculation of refunds per customer. The refunds should be made with interest as required by Section 25-30.360(4), Florida Administrative Code, within 90 days of the effective date of the Order. The utility should be required to submit the proper refund reports pursuant to Rule 25-30.360(7), Florida Administrative Code. The utility should treat any unclaimed refunds as CIAC pursuant to Rule 25-30.360(8), Florida Administrative Code.

4/1/96 through 9/30/96 - the difference in \$3.11 and \$2.20 x gallons treated for the period 4/1/96 through 9/30/96.

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10/1/96 through the effective date of new rates - the difference in \$3.11 and \$2.23 x gallons treated for the period 10/1/96 through the effective date of the new rates.

If the Commission votes for the primary recommendation in Issue 2 and votes yes on Issue 4, no refund is required. As discussed in Issue 3, the utility's achieved rate of return on equity is well below the minimum of its authorized range of return; therefore, no reduction is required.

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ISSUE 6: Should this docket be closed?

RECOMMENDATION: Upon expiration of the protest period, if a timely protest is not received from a substantially affected person, and upon verification that the utility has reduced its rates to reflect the reduction in purchased wastewater costs to bulk wastewater customers in Pasco County and has refunded the excess purchased wastewater costs collected from April 1, 1996 to the effective date of the new rates, and upon the utility's filing of and staff's approval of the proposed customer notice and the revised tariff sheets, this docket should be closed administratively. If the Commission votes that no reduction or refund is required, then the docket should be closed upon expiration of the protest period.
(REYES)

STAFF ANALYSIS: Upon expiration of the protest period, if a timely protest is not received from a substantially affected person, and upon verification that the utility has reduced its rates to reflect the reduction in purchased wastewater costs to bulk wastewater customers in Pasco County and has refunded the excess purchased wastewater costs collected from April 1, 1996 to the effective date of the new rates, and upon the utility's filing of and staff's approval of the proposed customer notice and the revised tariff sheets, this docket should be closed administratively. If the Commission votes that no reduction or refund is required, then the docket should be closed upon expiration of the protest period.

PURCHASED SEWAGE TREATMENT CALCULATION

WASTEWATER

PURCHASE SEWAGE TREATMENT ANNUALIZED AT OLD RATE		(192,727)
PURCHASE SEWAGE TREATMENT ANNUALIZED AT NEW RATE	-	138,193
LESS ACTUAL PURCHASED SEWAGE TREATMENT COSTS	\$	(54,534)
DIVIDED BY EXPANSION FACTOR FOR RAFS		0.955
DECREASE IN PURCHASED SEWAGE TREATMENT COSTS	\$	(57,104)
DIVIDE BY GALLONS SEWAGE TREATED	-	61,970
DOLLAR CHANGE TO GALLONAGE CHARGE ONLY	\$	(0.92)

**** (OLD RATE = \$3.11, NEW RATE \$2.23, GAL. TRT. 61,970,000)**