State of Florida

Public Service Commission

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FPSC - Records/Reporting

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

DATE: April 16, 1998

TO: Division of Records and Reporting

FROM: Division of Water and Wastewater (Walker)
Division of Legal Services (Ottinot)

RE: Docket No. 971667-WS - Application for approval of transfer of facilities of Florida Water Services Corporation to Orange County and cancellation of Certificates Nos. 084-W and 073-S in Orange County

This recommendation was deferred by a request from FWSC from the April 7, 1998 agenda to the April 28, 1998 agenda. After the request for deferral was granted, the staff recognized a need to correct the recommendation concerning cancellation of the water and wastewater certificates. FWSC's Water Certificate No. 084-W in Orange County should be retained since FWSC owns a water system, known as Druid Hills, that serves both Orange County and Seminole County. That system was not acquired by Orange County.

The changes affect the Case Background and Issue No. 1. The changes are shown on pages 2 through 5. Otherwise, the recommendation is unchanged.

FLORIDA PUBLIC SERVICE COMMISSION
Capital Circle Office Center • 2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

M E M O R A N D U M

APRIL 16, 1998

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING

FROM: DIVISION OF WATER & WASTEWATER (WALKER, [illegible])
DIVISION OF LEGAL SERVICES (OTTINOT)

RE: DOCKET NO. 971667-WS - APPLICATION FOR APPROVAL OF TRANSFER OF FACILITIES OF FLORIDA WATER SERVICES CORPORATION TO ORANGE COUNTY AND CANCELLATION OF CERTIFICATES NOS. 084-W AND 073-S IN ORANGE COUNTY.

AGENDA: APRIL 28, 1998 - REGULAR AGENDA - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: I:\PSC\WAW\WP\971667.RCM

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CASE BACKGROUND

Florida Water Services Corporation (FWSC) provides water and wastewater service throughout Florida. Most of its facilities are subject to this Commission's jurisdiction. In 1996, for facilities regulated by this Commission, FWSC recorded operating revenues of $23,324,759 for water service and $21,480,059 for wastewater service. The corresponding income amounts were $4,401,534 and $4,799,065, respectively.

By letter dated December 29, 1997, FWSC notified the Commission that it was selling all of its facilities in Orange County to Orange County. The scheduled closing date was December 30, 1997.

As discussed hereunder, the staff recommends that the Commission should issue an order acknowledging the subject transfer and canceling FWSC's [redacted] for Orange County. [redacted] Further, staff recommends that a docket be opened to evaluate sharing propositions due to sale of the Orange County facilities.

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DISCUSSION OF ISSUES

ISSUE 1: Should the Commission acknowledge the sale of Florida Water Service Corporation's facilities in Orange County to Orange County?

RECOMMENDATION: Yes, the Commission should acknowledge that FWSC has, [redacted] sold its Orange County facilities as of December 30, 1997. [redacted] FWSC is responsible for submission of a 1997 Annual Report and payment of 1997 Regulatory Assessment Fees through December 30, 1997. (WALKER, REDEMANN)

STAFF ANALYSIS: By letter dated December 29, 1997, FWSC notified the Commission that its facilities in Orange County were being sold to Orange County and that the anticipated contract signing and closing date was December 30, 1997. [redacted]

This filing concerns the intended transfer of utility assets to a governmental authority and was filed in accordance with Section 367.071(4), Florida Statutes and Rule 25-30.037, Florida Administrative Code (FAC). Pursuant to Section 367.071(4), a sale of facilities to a governmental authority shall be approved as a matter of right.

The application included a sworn statement by Orange County's public utilities director that he received a copy of FWSC's 1996 Annual Report. As directed by Section 367.071(4)(a), that document provides recent information concerning the utility's income and expense statement, its balance sheet, its rate base, and contributions-in-aid-of-construction amounts.

The application included a copy of the purchase and sale agreement, which is required pursuant to Rule 25-30.037(4)(c), Florida Administrative Code. As noted in the purchase agreement, FWSC will transfer its customers' security deposits to Orange

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County in return for Orange County's agreement to continue serving those customers. Furthermore, FWSC will offset each customer's final bill with accrued interest on the customer's deposit through the closing date.

As a tariff revision matter, FWSC has filed revised tariffs that eliminate all previous references to the Orange County facilities [redacted]. FWSC further reported that regulatory assessment fees for 1997 in Orange County will be paid in the manner and time prescribed by Rule 25-30.120(2)(a), Florida Administrative Code.

The application to transfer facilities to a governmental authority requires a statement regarding disposition of any outstanding refunds. FWSC reported that its Orange County facilities were included in Docket No. 920199-WS, wherein the utility's rates were restructured and potential refunds and surcharges were declared. Those refund and surcharge features are reviewed in Section 12 of the purchase agreement under the heading "Indemnities." Specifically, FWSC agreed to forego collection of any potential surcharges in Orange County, while accepting responsibility for any required refunds. In a letter dated March 25, 1998, FWSC stated that it would not seek recovery of Docket No. 920199-WS surcharge dollars attributable to Orange County plants from customers in other counties. Recently, the Commission decided that refunds and surcharges are not required in Docket No. 920199-WS unless an alternative funding source is found. However, that decision has been appealed. The Orange County facilities are also included in Docket No. 950495-WS, which case has also been appealed.

Since all of the filing requirements have been met, the staff recommends that the Commission should issue an order that acknowledges that Orange County has acquired FWSC's facilities in Orange County, effective as of December 30, 1997, [redacted] FWSC shall file a 1997 Annual Report and pay 1997 regulatory assessment fees through December 30, 1997.

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[redacted]

ISSUE 2: Should the Commission open a docket to examine whether FWSC's sale of its Orange County facilities involves a gain that should be shared with other customers?

RECOMMENDATION: Yes. The Commission should open an investigation to evaluate the gain on sale aspects for the Orange County facilities. (WALKER, OTTINOT)

STAFF ANALYSIS: Per the purchase agreement, the sales price for the Orange County facilities is $13,100,000, subject to adjustments and prorations permitted by the agreement. That sum exceeds the rate base values that the Commission has approved for those facilities, both before and after used and useful measures. In Docket No. 950495-WS, the most recent rate proceeding for FWSC, the approved rate base value for the combined water and wastewater facilities in Orange County was $8,503,366 for the projected test year ending December 31, 1996. Restoring used and useful adjustments, the aggregate rate base balance was $9,006,114. As the sale occurred in 1997, an updated rate base calculation will be needed to determine the gain, if any, due to sale of these facilities. Initial review indicates that FWSC will record a gain on this transaction. The staff recommends that the Commission open a separate docket to evaluate whether that gain should be allocated among customer and stockholder interests.

The proposition that gains on sales should be shared with customers has been considered in other dockets involving FWSC. In each case, the idea was presented that customers in other service areas were entitled to share the gain when another operating facility was sold.

Docket No. 911188-WS - Lehigh Utilities, Inc.

In Docket No. 911188-WS, a case involving Lehigh Utilities, Inc. (Lehigh), an affiliated company that is now an operating division of FWSC, the Commission considered the argument that Lehigh's customers should benefit because another operating facility (St. Augustine Shores) was condemned and sold to St. Johns County. A $4.2 million gain was reported. One argument for sharing the gain was the proposition that Lehigh's portion of common costs would increase after the sale, thus justifying some offset to expenses. Those supporting this offsetting adjustment noted that the Commission has required shared gains on sales in other cases involving other utilities.

Conversely, the utility argued that the gain on sale of the St. Augustine Shores facility should not be shared with Lehigh customers. Its arguments against the sharing concept included the

following: 1) St. Johns County regulated that facility, not this Commission; 2) the sale preceded FWSC's direct association with Lehigh; 3) denying investors an opportunity to offset erosion of earnings through capital gains impedes reinvestment of earnings and attraction of capital; 4) Lehigh's customers assumed no risk and contributed nothing to the St. Augustine Shores facility; 5) customers were lost when the St. Augustine Shores facility was sold; 6) customers do not acquire a proprietary interest in the utility's property; 7) ownership and risk of loss for non-utility and non-regulated property rests with the utility's shareholders; and 8) using the gain to offset otherwise entitled rate relief deprives the utility of just compensation.

After considering the record, the Commission voted that the gain on sale of the St. Augustine Shores should be not be counted under rate setting principles for Lehigh. In Order No. PSC-93-0301-FOF-WS, issued on February 25, 1993, the Commission stated:

> We agree with the utility that ratepayers do not acquire a proprietary interest in utility property that is being used for utility service. We also agree that it is the shareholders who bear the risk of loss on their investments, not the Lehigh ratepayers. Further, we find that Lehigh's ratepayers did not contribute to the utility's recovery of its investment in St. Augustine Shores. Based on the foregoing, we find no adjustment for the gain on the sale of the St Augustine Shores to be appropriate.

The Office of Public Council (OPC) participated in that case and filed a petition for reconsideration. OPC argued that the Commission's decision was not consistent with its decision in a case involving Mad Hatter Utilities, Inc., or with other cases involving retirement of obsolete equipment by regulated telephone companies. Further, OPC argued that gain on sale adjustments were approved for electric utilities. In response, Lehigh stated that, among differences, the Mad Hatter case involved abandoning two treatment plants to interconnect with Pasco County, whereas both customers and revenues were lost when the St. Augustine Shores facility was sold.

The Commission denied OPC's request to reconsider this issue. Instead, the Commission found that different facts and circumstances distinguished the Mad Hatter case and Lehigh cases, noting that loss of customers was a material difference.

Docket No. 920199-WS - Southern States Utilities, Inc.

The same opposing arguments regarding the St. Augustine Shores sale were repeated in Docket No. 920199-WS. The Commission also heard opposing arguments about shared interests relative to sale of a parcel of "condemned property" at University Shores. Those events preceded the test year used for Docket No. 920199-WS. OPC proposed above-the-line amortization of the gains on these sales to benefit customers.

In that docket, the Commission identified a projected $255,000 savings in administrative expenses following sale of the St. Augustine Shores (SAS) facility and reduced expenses accordingly. However, the Commission did not approve OPC's proposal to amortize that gain above-the-line. Instead, the Commission found that customers residing outside the SAS service area contributed nothing towards recovery of a return on investment for that facility. In Order No. PSC-93-0423-FOF-WS, issued March 22, 1993, the Commission stated that since the "remaining customers never subsidized the investment in the SAS system, they are no more entitled to share in the gain from that sale than they would be required to absorb a loss from it." With regard to the University Shores facility, the Commission found that those facilities were never included in any approved rate base amount. Thus, above-the-line amortization of that gain on sale was denied.

Docket No. 950495-WS - Southern States Utilities, Inc.

Similar issues regarding gains on sales were reviewed in Docket No. 950495-WS. Proponents again argued that the gain on sale of the St. Augustine Shores (SAS) facility should be amortized above-the-line as a reduction to the revenue requirement. Another facility, Venice Gardens Utilities (VGU), was sold to Sarasota County under circumstances somewhat similar to sale of the SAS facility. Sharing the gain on that facility was also proposed by OPC.

Threatened with condemnation, the VGU facility was regulated by Sarasota County before the county purchased that facility. The record indicated that VGU's rates were established under stand-alone principles. Again, like the SAS matter, the utility argued that customers outside VGU contributed nothing towards recovery of a return on that investment and assumed no risk. Also like the SAS case, sale of the VGU facility was accompanied by loss of customers.

The Commission reviewed the similarity of these sales in the following terms: "the sales of VGU and SAS were similar in many respects: they were involuntarily made by condemnation or under threat of condemnation; SSU lost the ability to serve the customers in both service areas, which were regulated by non-FPSC counties; and the facilities served customers who were never included in a uniform rate structure." The Commission thus concluded that no portion of the VGU or SAS gains should be allocated to the ratepayers. However, the Commission found that different circumstances might justify a different response: "(h)ad either the SAS and VGU facilities been regulated by the FPSC at the time of the sale or previously included in a uniform rate structure, the situation would be different."

Sale of the Orange County facilities

Before the Orange County facilities were sold to Orange County, those facilities were subject to this Commission's jurisdiction. To some extent, their service rates were established under uniform rate considerations in FWSC's recent rate proceedings. Thus, service rates for other FWSC operating facilities were influenced by ownership of the Orange County facilities. Initial review suggests that the Orange County facilities, mostly because of the University Shores facilities, contributed to betterment of FWSC's earnings profile under subsidy assumptions. Thus, their elimination would tend to worsen FWSC's return on investment condition rather than improve it. In other words, the Orange County facilities seemed to subsidize income for facilities outside Orange County to some extent.

Further study to examine sharing considerations for the Orange County gain on sale is recommended to permit timely examination of this topic. We recommend that a separate docket be opened to determine the actual gain on sale for Orange County and to evaluate whether that gain should be shared with customers.

ISSUE 3: Should this docket be closed?

RECOMMENDATION: Yes. This docket should be closed following acknowledgment of the sale to Orange County. (WALKER, OTTINOT)

STAFF ANALYSIS: This docket concerns a proposed transfer of facilities to a governmental agency, which must be approved as a matter of right. This docket should be closed after the approving order is issued.