



Public Service Commission

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RECORDS AND REPORTING

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DATE: JULY 23, 1998

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

FROM: DIVISION OF WATER AND WASTEWATER (GOLDEN, REDEMANN) *mad 65m PPK*
DIVISION OF LEGAL SERVICES (CROSBY) *AD*

RE: DOCKET NO. 961310-WU - APPLICATION FOR TRANSFER OF MAJORITY ORGANIZATIONAL CONTROL OF RESIDENTIAL WATER SYSTEMS, INC., HOLDER OF CERTIFICATE NO. 419-W IN MARION COUNTY, TO CHARLES DEMENZES.
COUNTY: MARION

AGENDA: AUGUST 4, 1998 - REGULAR AGENDA - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\WAW\WP\961310.RCM

CASE BACKGROUND

Residential Water Systems, Inc. (Residential or utility) is a Class C utility which provides water service in Marion County. According to the utility's 1997 Annual Report, it serves 528 water customers. Wastewater service is provided by septic tanks. In 1997, the utility had annual operating revenues of \$132,381 and a net operating income of \$7,855. The utility's facilities consist of one water treatment plant and one water transmission and distribution system.

On November 1, 1996, Residential filed an application for transfer of majority organizational control (TMOC) of Residential from Nancy Finney and Elaine Finney (Sellers) to Charles deMenzes (Buyer.) The utility's application was found to be deficient. The deficiencies were corrected on February 5, 1997. Although the utility corrected the deficiencies, staff had numerous concerns

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with respect to financial ability. In addition, during this timeframe, a utility audit was conducted by field audit staff for the purpose of preserving the books and records of the utility for future rate cases. It has been Commission practice that rate base is not established in TMOG proceedings, and thus, rate base audits are not conducted in TMOG cases. However, the results of the rate base audit brought up further concerns primarily stemming from the utility's lack of records to support its rate base. Additionally, the results of the audit conflicted significantly with an audit that was conducted for a staff-assisted rate case (SARC) in 1992. Although the audit was completed, the SARC application was withdrawn prior to completion of the case. Consequently, rate base has never been established for this utility. This information delayed the review process of this filing for an additional length of time, while staff considered the significance of various information in the context of a TMOG.

Section 367.071(1), Florida Statutes, states in part that no utility shall transfer its majority organizational control without approval of the Commission. Staff has reviewed the Stock Purchase Agreement and has found that although the parties have come to an agreement on the sale of the stock, the official closing is contingent upon the approval of the Commission. Also, in mid 1995, Nancy Finney and Elaine Finney entered into a contract with M.I.R.A. International, Inc. (MIRA) to manage and maintain Residential following the death of the utility's original founder, Charles Finney. MIRA is owned by the Buyer, Mr. deMenzes. One of the services provided by MIRA is the management of water and wastewater utilities. Mr. deMenzes managed the utility through MIRA for over a year before the parties entered into the Stock Purchase Agreement. Inasmuch as Mr. deMenzes was managing the utility prior to entering into the Stock Purchase Agreement, the utility has retained his management services pending completion of this docket. MIRA is paid a fee to manage the utility, and all revenues are paid to the Sellers. Therefore, although Mr. deMenzes is managing the utility through MIRA, ownership and control of the stock has not passed from the Sellers. The following is staff's recommendation regarding the utility's request to transfer majority organizational control.

DISCUSSION OF ISSUES

ISSUE 1: Should the transfer of majority organizational control of Residential Water Systems, Inc. from Nancy Finney and Elaine Finney to Charles deMenzes be approved?

RECOMMENDATION: Yes, the transfer of majority organizational control should be approved. (GOLDEN, REDEMANN)

STAFF ANALYSIS: As discussed in the case background, on November 1, 1996, Residential filed an application for transfer of majority organizational control from Nancy Finney and Elaine Finney to Charles deMenzes. The application is in compliance with the governing statute, Section 367.071, Florida Statutes, and other pertinent statutes and administrative rules concerning an application for transfer of majority organizational control. The application contains a check in the amount of \$1,500, which is the correct filing fee pursuant to Rule 25-30.020, Florida Administrative Code. The applicant has provided evidence that the utility owns the land upon which the utility's facilities are located as required by Rule 25-30.037(3)(i), Florida Administrative Code.

In addition, the application contains proof of compliance with the noticing provisions set forth in Rule 25-30.030, Florida Administrative Code, including notice to the customers of the system to be transferred. No objections to the notice of application have been received and the time for filing such has expired. A description of the territory served by the utility is appended to this memorandum as Attachment A.

The application states that the transfer is in the public interest because the Buyer's primary business is the management of utilities. Additionally, the application contains a statement that the Buyer will fulfill the commitments, obligations and representations of the Sellers with regard to utility matters.

Regarding the Buyer's technical ability, the Buyer has experience in managing and operating four water and/or wastewater utilities which are regulated by this Commission. Specifically, the application states that the Buyer is part owner and President of Tradewinds Utilities, Inc., and has managed and operated that utility since 1983. Also, he has managed and operated C.F.A.T. H20, Inc. and BFF Corporation for approximately seven years. Additionally, as discussed in the case background, he has been managing Residential through his management company, MIRA, since

mid 1995. Consequently, he is very familiar with the day to day operations of this utility. The Buyer has stated that upon Commission approval of the transfer, he will continue to manage and service the plant and utility customers, as he has done since mid 1995, assuring compliance with all Commission and Florida Department of Environmental Protection (DEP) requirements.

According to our records, the utility is current on its regulatory assessment fees and Annual Report for 1997 and all prior years. As part of MIRA's management responsibilities, Mr. deMenzes has prepared the utility's annual reports and submitted its regulatory assessment fees since 1995. Likewise, Mr. deMenzes will be responsible for filing the utility's annual report and regulatory assessment fees for the current year in which closing occurs and all subsequent years.

The application states that the Buyer has determined that the system will require certain upgrades which are already in process. Staff was recently informed by the utility that the upgrades have been completed. Staff has contacted the DEP and learned that there are no outstanding notices of violation.

Regarding the Buyer's financial ability, the Buyer has provided his personal financial statement, along with additional information regarding his sources of annual income. The application contains a copy of the Stock Purchase Agreement, First Addendum to the Stock Purchase Agreement, and Promissory Note from the First Bank of the Villages. According to these documents, the total purchase price for the stock is \$526,000. The purchase price is comprised of a \$50,000 cash down payment, \$15,000 cash payment for previous shareholder loans to the utility, assumption of a \$90,000 balloon mortgage from the First Bank of the Villages financed at a rate of 8.75% over 5 years, and \$395,355 which will be financed by the Sellers at 10% over 30 years. Additionally, the Buyer has agreed to obtain term life insurance, with the Sellers as beneficiaries, in an amount of at least 50% of the outstanding debt. The \$90,000 mortgage was obtained by the utility last year to finance the plant upgrades discussed above.

Staff was initially concerned about the Buyer's financial ability. Based upon a review of the utility's previous annual reports, Residential may not produce enough income to fully support the stock purchase. Further, our review of the Buyer's personal financial statement indicated that the portion of the Buyer's assets that could be considered liquid assets was not large enough to cover the monthly payments for the stock purchase over an extended period of time.

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At that point in our review, staff informed the Buyer that we were of the opinion that the transfer was not in the public interest due to financial considerations, and were considering recommending that the Commission deny the application. We shared our specific concerns with the Buyer and offered him the opportunity to provide additional information that might resolve our concerns, or alternatively, to withdraw the application. The Buyer provided additional information regarding income from MIRA which was not included in the application. In consideration of the additional financial information, staff believes the Buyer has the required financial ability to cover the monthly stock payments and ensure the continued operation of the utility.

Based on the above, staff believes the transfer of majority organizational control from Nancy Finney and Elaine Finney to Charles deMenzes is in the public interest and should be approved.

ATTACHMENT A

RESIDENTIAL WATER SYSTEMS, INC.

MARION COUNTY

TERRITORY DESCRIPTION

Township 16 South, Range 22 East, Sections 2 and 11

Section 2

Commence at the Southwest corner of Southeast 1/4 of said Section 2 at a point on the centerline of Southeast 41st Court then South 89°54'08" East along the South boundary line of said Section 2 a distance of 40 feet to the point of beginning, then continue along the said boundary on said bearing a distance of 269.78 feet to a point on said boundary then North 38°33'30" East a distance of 665.96 feet, then North 51°26'30" West a distance of 600 feet, then North 38°33'30" East a distance of 600 feet, then South 51°26'30" East a distance of 600 feet, then North 38°33'30" East a distance of 2143.08 feet, then North 89°48'19" West a distance of 2426.19 feet, then South 00°27'20" East a distance of 2657.15 feet to the point of beginning, a/k/a Highpointe Subdivision

AND

The South 660 feet of the Northeast 1/4 a/k/a Suntree Subdivision

AND

The Northwest 1/4 of the Southeast 1/4 of the Northeast 1/4 and Southwest 1/4 of Northwest 1/4 of Northeast 1/4 a/k/a Country Estates Buffington Addition Subdivision

AND

The North 1/2 of the Southwest 1/4 a/k/a Wineberry Subdivision

Section 11

The Northwest 1/4 of the Southeast 1/4 less the South 330 feet a/k/a Edgewood Subdivision

ISSUE 2: Should rate base be established?

RECOMMENDATION: No, different ownership of stock does not affect the rate base balance. (GOLDEN)

STAFF ANALYSIS: As discussed in the case background, Commission practice has been that rate base is not established in TMOG proceedings. The reason behind this approach is the philosophy that stock is publicly traded and has no regulatory relationship to rate base. Thus, different ownership of stock does not affect a utility's rate base balance. Consequently, stock purchase price and rate base are not considered in making a public interest determination of a TMOG. This same approach is followed even if the stock is privately held rather than publicly traded.

Because rate base is not considered in TMOG proceedings, rate base audits have historically not been conducted in TMOG proceedings. It is interesting to note that rate base is also not determined for TMOG's in the telecommunications, electric, or gas industries. However, the Division of Auditing and Financial Analysis (DAFA) initiated audits in several water and wastewater TMOG cases, including this case, for the purpose of preserving a record of the utility's books and records for future rate proceedings. The audit raised several concerns primarily stemming from a lack of records to support the utility's rate base. While the audit raised valid concerns, these are not the type of issues that are evaluated in TMOG proceedings. Staff believes a detailed review, such as would be conducted in a rate case, will be necessary to fully address the audit concerns and accurately determine this utility's rate base. Therefore, from a practical standpoint, staff believes that rate base should not be established in this docket because the type of review that is necessary to do so is well beyond the scope of this docket.

Further, staff believes that establishment of rate base in this docket would result in an unnecessary deviation from Commission practice. Staff does not believe the facts of this particular case warrant a deviation from past practice. The sale of the stock of Residential from Nancy Finney and Elaine Finney to Charles deMenzes will not alter the utility's asset and liability accounts. Accordingly, the transfer of stock ownership will not change the rate base balance. In consideration of the above, staff recommends that rate base not be established in this docket.

ISSUE 3: Should the rates and charges approved for this utility be continued?

RECOMMENDATION: Yes, the rates and charges approved for Residential Water Systems, Inc. should be continued. (GOLDEN)

STAFF ANALYSIS: The utility's approved rates were effective June 27, 1998 pursuant to an administratively approved price index adjustment. The utility's current miscellaneous service charges were approved administratively and became effective on April 24, 1990. Residential's current customer deposit and service availability charges were effective February 14, 1984 pursuant to Order No. 12842, issued on January 4, 1984, in Docket No. 830436-WU, which was an original certificate proceeding. The utility's approved rates and charges are as follows:

Monthly Service Rates

Residential and General Service

Base Facility Charge:

Meter Size:

5/8" x 3/4"	\$ 9.15
1"	\$ 22.89
1 1/2"	\$ 45.77
2"	\$ 73.25
3"	\$146.51
4"	\$228.92
Gallage Charge per 1,000 gallons	\$ 1.29

Customer Deposits

Residential	\$ 20.00
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Miscellaneous Service Charges

Initial Connection Fee	\$ 15.00
Normal Reconnection Fee	\$ 15.00
Violation Reconnection Fee	\$ 15.00
Premises Visit Fee (in lieu of disconnection)	\$ 10.00
Late Payment Fee	\$ 5.00

Service Availability Charges

Connection Charge	\$500.00
Meter Installation Fee: 5/8" x 3/4" Meter Size	\$ 70.00

Rule 25-9.044(1), Florida Administrative Code, provides that:

"In cases of change of ownership or control of a utility which places the operation under a different or new utility...the company which will thereafter operate the utility business must adopt and use the rates, classification and regulations of the former operating company (unless authorized to change by the Commission)..."

The Buyer has not requested a change in the rates and charges of the utility and staff sees no reason to change them at this time. Accordingly, staff recommends that the utility continue operations under the existing tariff and apply the approved rates and charges. The utility has filed a revised tariff reflecting the change in issuing officer due to the transfer of majority organizational control. Staff will approve the tariff filing effective for services rendered or connections made on or after the stamped approval date.

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ISSUE 4: Should this docket be closed?

RECOMMENDATION: Yes, this docket should be closed. (CROSBY)

STAFF ANALYSIS: No further action is required and the docket should be closed.