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July 29, 1998

Via Federal Express

Ms. Blanca Bayo, Director  
Department of Records and Reporting  
Florida Public Service Commission  
2540 Shumard Oak Boulevard  
Tallahassee, Florida 32399-0850

Re: Petition for a Limited Proceeding Regarding Other Postretirement Employee Benefits and Petition for Variance from or Waiver of Rule 25-14.012, Florida Administrative Code by United Water Florida Inc., Docket No.: 971596-WS

Dear Ms. Bayo:

Enclosed please find an original and seven (7) copies of the following schedules that have been prepared pursuant to a discussion among representatives of the Commission Staff and United Water Florida Inc. ("United Water Florida") following the July 21, 1998 agenda conference relating to United Water Florida's return on equity for 1994-1997:

- Schedule I - A year by year summary of United Water Florida's return on equity for 1994 through May 31, 1997, disclosing the impact on the return on equity if United Water Florida had expensed its Other Postretirement Employee Benefit ("OPEB") costs instead of deferring the OPEB costs.
- Schedule II - A year by year summary of United Water Florida's Rate Base for 1994 through 1997, prepared as a supporting schedule for Schedule I. The schedule includes adjustments to Working Capital, Acquisition Adjustments and Accumulated Amortization of Acquisition Adjustments for the treatment accorded these components of rate base in United Water Florida's last rate proceeding.
- Schedule III - Exhibit 1 from the Petition for a Limited Proceeding Regarding Other Postretirement Employee Benefits and Petition for Variance from or Waiver of Rule 25-14.012, by United Water Florida Inc. This schedule shows both the annual deferrals as well as the annual

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unfunded liability. The schedule also indicates the rate base deduction that was utilized in the last rate proceeding.

4. Schedule IV - A schedule showing the impact on United Water Florida's return on equity if the deferred OPEB costs were written off in 1997. If the Commission does not grant United Water Florida's request in this Docket, United Water Florida will be required to write off the entire \$1,100,098 during a single fiscal year.

The Commission's materiality test was set forth in In Re: Petition for Authority to Defer SFAS No. 106 Costs by Southern States Utilities, Inc. in Bradford, Brevard, Citrus, Clay, Collier, Duval, Hernando, Highlands, Lake, Lee/Charlotte, Marion, Martin, Nassau, Orange, Osceola, Pasco, Putnam, Seminole, Volusia, and Washington counties, and by Lehigh Utilities, Inc. in Lee County, Docket No. 921301-WS, Order No. PSC-93-1377-FOF-WS, issued September 20, 1993. The Commission stated:

When determining the appropriate final rates for a utility, a range of return on equity of plus or minus 100 basis points is allowed. Neither the utility's nor our calculation takes the utility below the authorized range of return allowed for common equity. Therefore, we find it appropriate to deny the utility's request.

As set forth on Schedule I, United Water Florida's return on equity was well below the 100 basis points range in each year and, in three of the four years, the return on equity was more than 200 basis points below the approved return on equity. Accordingly, the materiality test is satisfied for each year. In fact, in 1995 and 1996, the two years with the largest OPEB costs [(\$398,303 + \$465,242) ÷ \$1,100,098 = 75.5%], the impact of the OPEB costs alone exceeds the 100 basis points test.

Of course, the write off of the deferred OPEB costs of \$1,100,098 would occur in one year. As set forth in Schedule IV, using the 1997 test year, the write off would result in a reduction of 307 basis points to the return on equity for the water operations and a reduction of 301 basis points to the return on equity for the wastewater operations.

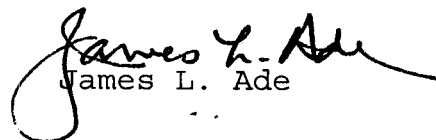
One point regarding the materiality test mentioned in the Staff Recommendation was whether the Commission should review the materiality test at the utility level or its parent or grandparent level. The Recommendation suggested that the materiality test

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should be employed at the parent or grandparent level. However, that position is contrary to the Commission's decision in Order No. 93-1377-FOF-WS. The utility company had provided a "total company" calculation which showed that the denial of the deferral would reduce the return on equity by 39 basis points. The Commission did not accept the utility company's "total company" calculation. Instead, the Commission recalculated the effect on the return on equity "using only Commission regulated systems information." United Water Florida's schedules show the effect on the return equity "using only Commission regulated systems information". This is consistent with the Commission's approach in In Re: Petition for Certain Accounting and Ratemaking Authority Associated with Implementation of Statement of Financial Accounting Standards No. 106 in Brevard, Collier and Lee Counties by Florida Cities Water Company, Docket No. 921158-WS, Order No. PSC-93-1328-FOF-WS, issued September 9, 1993 and in In Re: Petition for Certain Accounting and Ratemaking Authority Associated With Implementation of Statement of Financial Accounting Standards No. 106 in Osceola and Polk Counties by Poinciana Utilities, Inc., Docket No. 921159-WS, Order No. PSC-93-1328-FOF-WS, issued September 9, 1993. In that Order, the Commission "calculated the change in the utility's return on equity based on financial data from the utility's 1992 Annual Report." Clearly, the Commission focuses on the impact to the utility - not its corporate family.

If you or your staff have any questions concerning these schedules or if you would like to meet to discuss a possible resolution of this matter, please give me a call at (904) 354-2050.

Sincerely,

  
James L. Ade

JLA/msa  
Enclosures

cc: Ms. Rosanne Gervasi via Facsimile  
Mr. Marshall Willis  
Ms. Patricia Merchant  
Mr. Jan Kyle  
Mr. David E. Chardavoyne  
Mr. Walton F. Hill via Facsimile  
Mr. Robert J. Iacullo  
Mr. Gary R. Moseley  
Mr. Munipalli Sambamurthi

## Schedule 1

United Water Florida  
Deferred OPEB's  
ROE Impact

<u>Line No.</u>		<u>1994</u>	<u>1995</u>	<u>1996</u>	through 5/31 <u>1997</u>
1	Average Rate Base (1)	\$ 53,991,803	\$ 56,024,774	\$ 66,703,537	\$ 82,650,642
2	Equity Portion @ 43.51% (2)	23,491,833	24,376,379	29,022,709	35,961,294
3	Net Income (3)	2,179,961	2,413,686	3,102,145	1,432,327
4	ROE Achieved (line 3/line 2)	9.2797%	9.9017%	10.6887%	3.9830%
5	1997 ROE Achieved Annualized				9.5591%
6	ROE Allowed (2)	11.57%	11.57%	11.57%	11.57%
7	Deferred OPEB's	\$ 67,735	\$ 398,303	\$ 465,242	\$ 168,818
8	Tax at 34% (line 7 @ 34%)	<u>(23,030)</u>	<u>(135,423)</u>	<u>(158,182)</u>	<u>(57,398)</u>
9	Incremental Expense (line 7 - line 8)	\$ 44,705	\$ 262,880	\$ 307,060	\$ 111,420
10	Adjusted Net Income (line 3 - line 9)	2,135,256	2,150,806	2,795,065	1,320,907
11	Adjusted ROE (line 10/line 2)	9.0894%	8.8233%	9.6307%	3.6731%
12	1997 Adjusted ROE Annualized				8.8155%
13	Difference from Allowed ROE (line 6 - line 11/12)	2.4806	2.7467	1.9393	2.7545
14	Difference from Achieved ROE (line 4/5 - line 11/12)	<u>0.1903%</u>	<u>1.0784%</u>	<u>1.0580%</u>	<u>0.7436%</u>
15	1 See Schedule II				
16	2 Commission Decision Docket # 960451-WS				
17	3 Per Annual Report page F-3 ©				

**Schedule II**

**United Water Florida  
Rate Base**

<u>Line No.</u>		<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>
1	Utility Plant in Service	113,562,980	120,812,779	141,990,559	164,283,974
2	Accumulated Depreciation	(23,170,872)	(25,122,306)	(26,896,535)	(32,452,301)
3	CIAC	(51,911,723)	(54,295,639)	(57,613,514)	(60,900,488)
4	Advances	(152,370)	(152,370)	(152,370)	(326,865)
5	Accumulated Amort. CIAC	13,473,051	14,697,659	15,976,685	17,376,245
6	Acquisition Adjustments (1)	1,462,312	1,462,312	1,462,312	1,462,312
7	Accumulated Amort. Acq. Adj.	(302,252)	(375,368)	(448,484)	(521,600)
8	Working Capital (1)	<u>1,030,677</u>	<u>1,030,677</u>	<u>1,030,677</u>	<u>1,030,677</u>
9	Rate Base	53,991,803	58,057,744	75,349,330	89,951,954
10	average		56,024,774	66,703,537	82,650,642

Note 1 - Commission Docket # 960451-  
WS

source	annual rpt	annual rpt	current filing	current filing
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United Water Florida Inc.  
Schedule of Post Retirement Benefits Other Than Pension

Exhibit 1

Annual Expense Calculation

General Ledger Accounting Code Number

186.60 Deferred Post Retirement FSAS 106

<u>Year</u>	<u>Regulatory Asset</u>	<u>Amortization Period</u>	<u>Annual Cost</u>
1994	\$ 67,735	15 years	\$ 4,516
1995	398,303	15 years	26,554
1996	465,242	15 years	31,016
To 5/31/97	<u>168,818</u>	15 years	<u>11,255</u>
<b>Total</b>	<b><u>\$1,100,098***</u></b>		<b><u>\$ 73,340</u></b>

Calculation of Rate Base Impact:

General Ledger Accounting Code Number

236-60 Accrued Post Retirement FSAS 106

<u>Year</u>	<u>Unfunded Liability</u>	<u>Amortization Period</u>	<u>Rate Base Adjustment to Conform to Matching Principle</u>		
			<u>Rate Base Reduction</u>	<u>Annual Rate Base Reduction</u> <u>Dock 960451-WS</u>	<u>Adjustment</u>
1994	\$ 67,735	15 years	\$ 4,516		\$ <4,516>
1995	398,303	15 years	26,554	\$ 351,512	324,958
1996	253,002	15 years	16,867	365,644	348,777
To 5/31/97	135,190	15 years	9,013	426,764	417,751 **
7/12's of 1097 Annual Cost			<u>248,946</u>		<u>(248,946) **</u>
Rate Base Reduction	<u>\$ 854,230 ***</u>		<u>\$ 305,895</u>	<u>\$ 1,143,920</u>	<u>\$ 838,025</u>

Note: The expense allowance and rate base adjustment are to be allocated 36% and 64% to Water and Wastewater, respectively.

\*\*\* In conformance to the treatment of the operating expense the rate base reduction represents 7/12's of the original rate base deduction of \$426,764, and 1/15 of the five months unfunded liability in 1997.

\*\*\* Difference between the two general ledger accounts represents \$247,022 of VEBA payments and miscellaneous accounting adjustments of \$1,154.

**United Water Florida Inc.**  
**Abbreviated Income Statement**  
**IF Company's Request is Not Granted**

Exhibit 4

<u>Description</u>	<u>Water</u>			<u>Wastewater</u>		
	<u>Docket No.</u> <u>PSC-97-1146-FOF-WS</u>	<u>Adjustment</u>	<u>Results as</u> <u>Adjusted</u>	<u>Docket No.</u> <u>PSC-97-1146-FOF-WS</u>	<u>Adjustment</u>	<u>Results as</u> <u>Adjusted</u>
Operating Revenues	\$ 9,653,958	-	\$ 9,653,958	17,976,172	-	17,976,172
Operating expenses	6,084,918	398,035	6,084,918	12,065,584	704,083	12,769,647
Operating Income Before Income Taxes	3,569,040	(398,035)	\$ 3,569,040	5,910,588	(704,083)	5,206,525
Income Taxes	962,481	(33,307)	929,174	1,191,211	(59,213)	1,131,998
<b>Net Operating Income</b>	<b>2,606,559</b>	<b>(362,728)</b>	<b>\$ 2,243,831</b>	<b>4,719,377</b>	<b>(644,850)</b>	<b>4,074,527</b>
Rate Base	27,236,786		27,236,786	49,314,287	-	49,314,287
Rate of Return	9.57%		8.24%	9.57%		8.26%
Debt Portion	4.54%		4.54%	4.54%		4.54%
Common Equity Return	5.03%		3.70%	5.03%		3.72%
Grossed-up by equity portion of the capital structure (43.51	11.57%		8.50%	11.57%		8.56%
Diminution In Equity Return			3.07%			3.01%