



Public Service Commission

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DATE: DECEMBER 3, 1998

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

FROM: DIVISION OF WATER AND WASTEWATER (FLETCHER, MERCHANT) *S.M.*
DIVISION OF LEGAL SERVICES (MCRAE)

RE: DOCKET NO. 981609-WS - EMERGENCY PETITION BY D.R. HORTON
CUSTOM HOMES, INC. TO ELIMINATE AUTHORITY OF SOUTHLAKE
UTILITIES, INC. TO COLLECT SERVICE AVAILABILITY CHARGES
AND AFPI CHARGES IN LAKE COUNTY.
COUNTY: LAKE COUNTY

AGENDA: DECEMBER 15, 1998 - REGULAR AGENDA - INTERESTED PARTIES
MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\WAW\WP\981609.RCM

CASE BACKGROUND

Southlake Utilities, Inc. (Southlake or utility) is a Class C utility providing service to approximately 238 water and 237 wastewater customers in Lake County. According to the utility's 1997 annual report, the water system had actual operating revenues of \$88,341 and a net operating loss of \$73,058. The wastewater system had actual operating revenues of \$84,552 and a net operating loss of \$168,550. The utility is not located in a water use caution area designated by the Southwest Florida Water Management District.

On November 16, 1998, D.R. Horton Custom Homes, Inc. (Horton or developer) filed a petition, pursuant to Section 367.101, Florida Statutes, and Rules 25-22.036(4)(b), 25-30.580, and 28-106.301, Florida Administrative Code, to immediately eliminate the authority of Southlake Utilities, Inc., to collect service availability and allowance for funds prudently invested (AFPI) charges.

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Another related docket is currently pending for this utility. On August 4, 1998, Horton filed a complaint, pursuant to Rules 25-22.036 and 25-30.560, Florida Administrative Code, against Southlake regarding the collection of AFPI charges under a developer's agreement entered into by both parties on September 17, 1996. Staff is in the process of reviewing the complaint and has not brought it before the Commission as of this date.

DISCUSSION OF ISSUES

ISSUE 1: Should the Commission initiate an investigation of Southlake's service availability and AFPI charges?

RECOMMENDATION: Yes. The Commission should initiate an investigation of the utility's service availability and AFPI charges to determine the appropriateness of continuing such charges. (FLETCHER)

STAFF ANALYSIS: Based on Southlake's 1997 Annual Report, the utility is over contributed to the extent it has no investment in plant. With regard to its water system, the plant in service net of accumulated depreciation was \$366,506 and contributions in aid of construction (CIAC) net of accumulated amortization of CIAC was \$766,141. Hence, the utility has a contribution level of 209.04% for its water system. With regard to its wastewater system, the plant in service net of accumulated depreciation was \$903,530 and CIAC net of accumulated amortization of CIAC was \$1,180,944. Thus, the utility has a contribution level of 130.70% for its wastewater system. Therefore, staff recommends that the Commission initiate an investigation of the utility's service availability and AFPI charges at this time.

ISSUE 2: Should Southlake's prospective service availability and AFPI charges be held subject to refund?

RECOMMENDATION: Yes. Staff believes that Southlake's prospective service availability and AFPI charges should be held subject to refund. (FLETCHER)

STAFF ANALYSIS: On January 2, 1991, the Commission issued Order No. 23947, in Docket No. 900738-WS, granting Southlake Certificates Nos. 533-W and 464-S. In that same docket, the Commission issued Order No. 24564, on May 21, 1991, establishing the customer rates of the utility, including service availability and AFPI charges. Consistent with Commission practice, Southlake's original rates and charges were based upon estimated rates at 80% of build-out and a plant completion date of July 1, 1991. The Commission determined that the plant capacity charges should be such that the estimated contribution level of the utility would be 75 percent of net plant at the time the systems reach capacity. Further, the Commission approved AFPI charges designed to enable the utility to recover the return on the plant needed to serve future customers at the time they connect to the system. The Commission found that the amount of the AFPI charges were to be based upon the date future customers connected to the system normally coinciding with the payment of the service availability charges.

In Docket No. 950933-WS, the utility filed an application, on August 8, 1995, to obtain approval of a change in the start date of the AFPI charges and to adjust the specified AFPI amounts to reflect actual construction costs. In its application, the utility proposed water and wastewater treatment plant balances as of December 31, 1994, as the test year for its calculations. The utility also requested a waiver of Rule 25-30.434(4), Florida Administrative Code, which requires the effective date of the charge to be the month following the end of the test year. The utility requested that the charges be effective as of January 1, 1993, instead of January 1, 1995. The utility agreed to collect its then currently tariffed AFPI charges subject to refund of any amounts exceeding the charges approved in that docket.

The Commission addressed Southlake's application in Order No. PSC-96-1082-FOF-WS, issued August 22, 1996. In that order, the Commission denied the utility's request to change the start date of the original AFPI charges. The Commission also denied the utility's request for waiver of Rule 25-30.434(4), Florida Administrative Code, because the utility failed to demonstrate unreasonable difficulty or unusual hardship that prevented compliance with the AFPI Rule.

As stated above, the original AFPI charges were based on a plant completion date of July 1, 1991. The Commission found that

the plant was not completed by that date; the utility did not notify the Commission of the delay; and the utility did not begin providing full water and wastewater service until June 1994. Further, the Commission found that the AFPI charges based on a plant completion date of July 1, 1991, were inappropriate because the charges accrued did not reflect the actual cost incurred by the utility. Furthermore, because the plant construction was completed in 1994, a test year of December 31, 1994, was deemed appropriate. Although a test year ending June 1994 would have been more appropriate, the utility did not provide accounting information as of that date. Rule 25-30.434(4), Florida Administrative Code, states that the beginning date for accruing the AFPI charge shall agree with the month following the end of test year that was used to establish the amount of non-used and useful plant. Therefore, the utility's beginning date for accruing the AFPI charge became January 1, 1995.

By Order No. PSC-96-1082-FOF-WS, the Commission authorized Southlake's current AFPI charges for water and wastewater. The utility was ordered to refund all AFPI charges collected prior to January 1, 1995, under the existing tariff. As for the AFPI charges collected after this date, the utility was ordered to refund any amount exceeding the amount allowed in the new tariff approved by the Commission. The Commission determined the amount that was to be refunded to customers would be based on the date the customer became active. Specifically, the Commission found that the date customers become active was the date meters were set and service was available for each building, whether or not the individual apartment units were occupied.

Southlake's current service availability charges were approved, pursuant to Order No. 24564, issued on May 21, 1991. Southlake currently has authorized plant capacity charges of \$420 for water service and \$775 for wastewater service and meter installation fees of \$130 for 5/8' x 3/4' meters, \$210 for 1" meters, and actual costs for all meters over 1".

According to Rule 25-30.580(1)(a), Florida Administrative Code, a utility's service availability policy shall be designed in accordance with the following:

The maximum amount of contribution-in-aid-of-construction, net of amortization, should not exceed 75% of the total original cost, net of accumulated depreciation, of the utility's facilities and plant when the facilities and plant are at their designed capacity.

As discussed in Issue 1, based on Southlake's 1997 Annual Report, the utility is over contributed to the extent that it has

no investment in plant. The utility has a contribution level of 209.04% for its water system and 130.70% for its wastewater system.

Section 367.081(2) (a), Florida Statutes, states in part:

The Commission shall, either upon request or its own motion, fix rates which are just, reasonable, compensatory, and not unfairly discriminatory. In every such proceeding, the Commission shall consider the value and quality of the service and the cost of providing the service, . . . and a fair return on the investment of the utility in property used and useful in the public service (emphasis added)

Rule 25-30.434(1), Florida Administrative Code, states:

An Allowance for Funds Prudently Invested (AFPI) charge is a mechanism which allows a utility the opportunity to earn a fair rate of return on prudently constructed plant held for future use from the future customers to be served by that plant in the form of a charge paid by those customers.

Section 367.101(1), Florida Statutes, states that:

The Commission shall set just and reasonable charges and conditions for service availability. The Commission by rule may set standards for and levels of service - availability charges and service-availability conditions. Such charges and conditions shall be just and reasonable. The Commission shall, upon request or its own motion, investigate agreements or proposals for charges and conditions for service availability.

On a prima facie basis, it appears that as of 1997 the utility had no investment in plant due to its contribution levels for water and wastewater. If our investigation reveals that the above is true, then the utility would have a negative rate base and accordingly no investment in either used and useful or non-used and useful plant. As such, Southlake should not be allowed to collect service availability and AFPI charges. However, if the utility's plant investment has increased in 1998 or the utility plans to increase its plant investment in 1999, it could provide the basis for the continued collection of service availability and AFPI charges. Staff believes that further discovery is necessary to determine whether the service availability and AFPI charges should be continued, reduced or eliminated. Thus, staff has requested that an audit of the utility and an engineer field inspection be performed. Based on the above, staff recommends that the utility's prospective service availability and AFPI charges collected be held

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subject to refund with interest, pending the completion of this investigation.

ISSUE 3: What is the appropriate security to guarantee the amount of prospective service availability and AFPI charges collected subject to refund?

RECOMMENDATION: The utility should be required to file an escrow agreement to guarantee the amount of prospective service availability and AFPI charges collected subject to refund. Pursuant to an escrow agreement, the utility would be required to deposit the monthly amount of prospective service availability and AFPI charges collected, until completion of this investigation. Pursuant to Rule 25-30.360(6), Florida Administrative Code, the utility should be required to provide a report by the 20th day of each month indicating the monthly and total amount of service availability and AFPI charges collected subject to refund as of the end of the preceding month. (FLETCHER)

STAFF ANALYSIS: Since the number of future customers to be connected to the utility's system is not readily certain, the most appropriate security for service availability and AFPI charges would be an escrow agreement. An escrow agreement is the only security that can guarantee, with certainty, the amount of prospective service availability and AFPI charges collected. Therefore, staff recommends that the utility provide an escrow agreement to guarantee the funds collected subject to refund.

An escrow account should be established between the utility and an independent financial institution pursuant to a written escrow agreement. The Commission should be a party to the written escrow agreement and a signatory to the escrow account. The written escrow agreement should state the following: that the account is established at the direction of this Commission for the purpose set forth above; that no withdrawals of funds shall occur without the prior approval of the Commission through the Director of the Division of Records and Reporting; that the account shall be interest bearing; that information concerning that escrow account shall be available from the institution to the Commission of its representative at all times; that the amount of prospective service availability and AFPI charges collected subject to refund shall be deposited in the escrow account within seven days of receipt; and that pursuant to Cosentino v. Elson, 263 So. 2d 253 (Fla. 3d DCA 1972), escrow accounts are not subject to garnishments.

The escrow agreement should also state the following: that if a refund to the customers/developers is required, all interest earned on the escrow account shall be distributed to the customers/developers; and if a refund to the customers/developers

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is not required, the interest earned on the escrow account shall revert to the utility. Should a refund be required, the refund should be with interest and undertaken in accordance with Rule 25-30.360, Florida Administrative Code.

In no instance should maintenance and administrative costs associated with any refund be borne by the customers. The cost are the responsibility of, and should be borne by, the utility.

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ISSUE 4: Should this docket be closed?

RECOMMENDATION: No, this docket should remain open pending Staff's investigation of the utility's contribution levels and the appropriateness of continuing the service availability and AFPI charges. (MCRAE, FLETCHER)

STAFF ANALYSIS: Based on Staff's review of the utility's 1997 annual report, the utility is over-contributed to the extent that there is no investment in plant. Hence, staff has requested the Division of Auditing and Financial Analysis conduct an audit of the utility's service availability and AFPI charges. Therefore, this docket should remain open pending Staff's investigation of the utility's contribution levels and the appropriateness of continuing the service availability and AFPI charges.