

ORIGINAL

STATE OF FLORIDA

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DIVISION OF LEGAL SERVICES
NOREEN S. DAVIS
DIRECTOR
(850) 413-6199

Public Service Commission

June 24, 1999

Mark Rubin, Esquire
P.O. Box 402279
Miami Beach, Florida 33140

RE: Docket No. 981258-WS - Investigation of water and wastewater rates for Lake Haven Utility Association, Ltd. d/b/a Lake Wales Utility Co., Ltd. (Lake Wales or utility) in Polk County for possible overearnings.

Dear Mr. Rubin:

On June 3, 1999, a member of the Commission's staff, Elda Quijano, and utility manager, David Pearce, discussed by telephone the possible overearnings situation of Lake Wales' water and wastewater systems. Pursuant to Ms. Quijano's conversation with Mr. Pearce, the following are the Commission staff's preliminary findings in this matter and some ideas that may dispose of any overearning.

Based on staff's analysis of the utility's financial statements, we believe that numerous adjustments (see enclosure) are necessary to correctly reflect the 1998 test year. After making these adjustments, it appears that the utility has excess earnings of \$10,202 for 1998. However, after applying the pro forma plant and expense items that the utility stated would be incurred in 1999, staff believes that the utility's 1999 earnings will be within or even below a fair rate of return. Accordingly, we believe that a prospective rate reduction may not be warranted. Furthermore, if we apply the excess earnings in 1998 to offset any potential underearnings in 1999, this may postpone or avoid the need for future rate increases.

Lake Wales has low service rates, good customer service, and minimal water and wastewater treatment plant requirements which result in a small rate base. It is also staff's understanding that the utility has been trying to keep expenses low to be cost effective. Thus, we believe that a refund and/or possible rate reduction may not be beneficial to the customers and shareholders.

Staff is very interested in working with Lake Wales in order to reach a mutual agreement that can be presented to the Commission. Enclosed please find those adjustments which we find to be appropriate, along with our calculation of excess earnings. If the utility wishes, it can file with the

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Commission an offer of settlement which adopts these adjustments and defers the excess earnings to offset any potential underearnings in 1999.

It will be necessary for you to submit your offer on or before July 9, 1999 to expedite the processing of this case. If the utility does not submit a settlement offer, staff will proceed with a recommendation to the Commission. Please be aware that the opinions expressed in this letter are the opinions of the Commission staff, and in no way bind the Commission. If you have any questions, please contact me at (850) 413-6202.

Sincerely,



Samantha Cibula
Staff Attorney

Enclosures

cc: Division of Water and Wastewater (Willis, Merchant, Quijano)
Division of Records and Reporting

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LAKE WALES UTILITY CO., LTD.
 POSSIBLE OVEREARNING INVESTIGATION
 DOCKET NO. 981258-WS

PROPOSED ADJUSTMENTS FOR THE YEAR ENDED DECEMBER 31, 1998.

RATE BASE

1. Plant in Service - water should be increased by \$1,242 to capitalize the cost of meters purchased on March 20, 1997 that were expensed on the company's books in 1997 (Audit Control No. 98-286-2-1, Disclosure No. 5).
2. The utility's water depreciation rates should be adjusted as set forth in Rule 25-30.140, Florida Administrative Code. Water accumulated depreciation should be decreased by \$6,695 and depreciation expense should be increased by \$1,287 in order to calculate the refund amount. The utility made the necessary adjustment in 1998 but failed to adjust the prior year 1997.

	<u>UPIS</u>	<u>ACC DEP</u>
#304 Structures and Improvements	79	79
#307 Wells and Springs	-	(8,049)
#311 Pumping Equipment	77	795
#320 Water Equipment	(80)	70
#330 Distribution and Reservoirs	-	184
#331 Transmission and Distribution	-	(187)
#334 Meter and Meter Installation	* 1,242	1,109
#335 Hydrants	-	-
#340 Office Furniture and Equipment	-	(25)
#345 Power Operated Equipment	(77)	(671)

* See No. 1 above

3. The utility's wastewater depreciation should be adjusted as set forth in Rule 25-30.140, Florida Administrative Code. Wastewater accumulated depreciation should be increased by \$12,558 and depreciation expense should be increased by \$1,987 in order to calculate the refund amount. The utility made the necessary adjustment in 1998 but failed to adjust the prior year 1997.

	<u>ACC DEP</u>
#354 Structures - Improvements	268
#360 Collection Sewers - Force	524
#361 Collection Sewers - Gravity	(240)
\$363 Services to Customers	67

#371 Pumping Equipment	32
#380 Treat/Disposal Equipment	12,451
#390 Office Furniture and Equipment	(503)
#394 Laboratory Equipment	(20)
#395 Power Operated Equipment	-
#398 Other Tangible Plant	(22)

4. The utility's amortization rate for CIAC - water should be adjusted as set forth in Rule 25-30.140, Florida Administrative Code. In calculating the refund amount, an adjustment should be made to increase accumulated amortization of CIAC by \$1,190 and CIAC amortization expense by \$659.
5. The utility's amortization rate for CIAC - wastewater should be adjusted as set forth in Rule 25-30.140, Florida Administrative Code. In calculating the refund amount, an adjustment should be made to increase accumulated amortization of CIAC by \$2,905 and CIAC amortization expense by \$1,421.
6. The working capital allowance should be calculated using the formula method (one-eighth of operation and maintenance expenses), pursuant to Rule 25-30.433, Florida Administrative Code. The appropriate working capital allowance is \$28,699 (\$231,902 x 1/8) which is a decrease of \$289 to the utility's calculated balance.
7. For purposes of calculating the refund amount, the appropriate test year rate base should be \$68,638 for water and \$241,248 for wastewater, or a total of \$309,886.

CAPITAL STRUCTURE

8. The appropriate rate of return on equity for prospective rate setting purposes should be 8.93%, with a range of 7.93% - 9.93%. This is calculated using the current leverage formula approved in Docket No. 990006-WS, at the agenda dated June 1, 1999. For purposes of this settlement, the maximum of the range of 9.93% should be used to determine any excess earnings.
9. The appropriate range for the overall cost of capital for prospective rate setting purposes should be 7.94% to 9.92%. For purposes of this settlement, the maximum of the range of 9.92% should be used to determine any excess earnings.

NET OPERATING INCOME

10. Contractual Services - Other - This account should be

increased to include the cost of the water tank renovation of \$21,152 in 1997 which was amortized for 5 years. Therefore, the amount of \$4,230 ($\$21,152/5$ years) should be added to Operating and Maintenance Expense. However, the utility's annual report should be decreased by \$2,312 to correct entries made using the cash basis instead of the accrual accounting.

11. Taxes Other than Income - the utility's first revised annual report erroneously includes the 1997 regulatory assessment fees with the 1998 fees. This results in an overstatement of \$6,450 for water and \$8,494 for wastewater.
12. The utility does not use the accrual basis of accounting. As provided for by NARUC Uniform System of Accounts, Accounting Instruction No. 30, monthly accounting using the accrual method should be used.

REVENUE REQUIREMENT

13. In calculating the amount of excess earnings, the appropriate revenue requirement for combined water and wastewater is \$316,659, which results in a decrease in revenue of \$10,202, or a 3.12% decrease.

RATES

14. The total amount of excess earnings for the test year ended December 31, 1998, equals \$10,202 of operating income, excluding interest. This amount of deferred income should be recorded on the utility's books as a deferred credit. Interest should be calculated on this. As of May 31, 1999, the amount of this liability is \$10,454.
15. The utility should submit semi-annual operation reports for its water and wastewater systems. These include the schedules of rate base, net operating income and the balance sheet. The first report for the year ending June 30, 1999 will be due on August 31, 1999. The second report will be the PSC annual report which will be due on March 31, 2000, with a stipulation that an automatic extension will not be requested or granted as provided for by Rule 25-30.110(3)(c), Florida Administrative Code. If, upon staff's review of the semi-annual reports for 1999, it appears that the utility is not spending the amounts it informed the Commission that it would and as a result earned excess revenues, the utility agrees that the amounts deferred will continue to be subject to refund until they are utilized or until December 31, 2000. However, if upon staff's review of the semi-annual reports for

1999, it appears that the utility has enough underearnings to cover the deferred excess earnings, then staff will inform the utility that the semi-annual reports will no longer be required. If overearnings continue into 1999, staff will then reconsider whether deferral of excess earning is appropriate.

16. For future rate setting purposes, any remaining balance of deferred income will be included in-Lake Wales' capital structure, as a separate line item, with interest accrued at the thirty-day commercial paper rate.
17. The utility's corporate undertaking may be released upon staff's verification that the overearnings have been addressed.

PRO FORMA ADJUSTMENTS FOR THE YEAR ENDED DECEMBER 31, 1999

RATE BASE

18. Plant in Service - The utility will have the following additional capital expenditures for 1999 (estimated cost):

Computer Systems Replacement and Upgrade	\$5,444
Transportation Equipment	\$6,455
Radio Communication Equipment	\$2,100
Collection Sewers - Gravity (storm water dishes)	\$2,400

OPERATING INCOME

19. The utility does not expect a growth in revenues for water and wastewater for 1999.
20. The utility expects to increase its operating and maintenance expenses for water and wastewater in 1999 due to the following recurring expenses.

Additional Employee (operation/maintenance)	\$11,200
Increased Insurance Costs	\$4,550
Additional Vehicle Lease	\$4,396
Present employee wage increase	\$3,920
Uniform maintenance/replacement	\$1,200
Labor costs (grounds maintenance, spray field maintenance, equipment operator, etc.)	\$10,560
Water Plant Ground Storage Tank	\$2,000
Liquid Sludge Disposal	\$4,200
Collection System Cleaning and Repair	<u>\$5,000</u>

Total Expected Additional Expenses **\$47,026**