BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for approval of regulatory accounting treatment in Duval, Nassau, and St. Johns Counties by United Water Florida Inc., holder of Certificates Nos. 236-W and 179-S, and request for relief.	DOCKET NO. 001514-WS ORDER NO. PSC-01-1164-PAA-WS ISSUED: May 22, 2001

The following Commissioners participated in the disposition of this matter:

E. LEON JACOBS, JR., Chairman
J. TERRY DEASON
LILA A. JABER
BRAULIO L. BAEZ
MICHAEL A. PALECKI

ORDER DENYING PETITION FOR APPROVAL OF REGULATORY ACCOUNTING TREATMENT FOR COSTS ASSOCIATED WITH IMPLEMENTATION OF VOLUNTARY EARLY RETIREMENT PROGRAM

BY THE COMMISSION:

NOTICE is hereby given by the Florida Public Service Commission that the action discussed herein will become final unless a person whose interests are substantially affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

BACKGROUND

United Water Florida Inc. (UWF or utility) is a Class A utility providing service to approximately 31,000 water customers and 24,000 wastewater customers in Duval, Nassau, and St. Johns Counties. According to its 1999 annual report, the utility's operating revenues were $11,515,168 for its water service and $18,126,745 for its wastewater service. The utility's current rates were approved pursuant to Order No. PSC-99-1070-FOF-WS, issued May 25, 1999, in Docket No. 980214-WS. By Order No. PSC-99-1070-FOF-WS, we also approved a rate of return of 8.22 percent, with a range of 7.78 percent to 8.66 percent.

On September 18, 2000, UWF filed a petition for approval of regulatory accounting treatment for costs associated with implementation of a voluntary early retirement program implemented in 1999. We have jurisdiction to consider this petition pursuant to Section 367.121, Florida Statutes.

PETITION

In its petition, UWF stated that the utility offered a voluntary early retirement program in 1999. The early retirement program was available to all UWF employees with 15 or more years of service who were 54 years of age on December 31, 1999. Additionally, this offer was made to employees with 10 or more years of service who were 62 or older on December 31, 1999. According to the petition, the early retirement program was designed to capture efficiencies through work force reductions. UWF anticipated that several of the employees with longer service terms and higher salaries and benefits would elect to take advantage of the early retirement program. UWF expected to utilize the result of the early retirements to restructure its staff and employ lower cost employees to replace the former higher cost employees. As a result, the utility anticipated developing a staff whose members would have longer remaining years of service and who were subject to reduced future turnover while reducing the overall cost of salaries and benefits for such a staff. Such benefits would act to reduce expenses in UWF's next rate case.

The utility stated that 12 UWF employees elected early retirement under the early retirement program, and that the actuarially determined cost to UWF of the program was $1,055,418. UWF stated that it intends to accrue the cost in deferred accounts, which it states would create a regulatory asset. The utility further requested that the reasonableness and prudence of these costs be considered in the utility's next rate case, and that amortization of the regulatory asset not begin until after our action in such rate case. UWF also stated that its accounting for the cost of the early retirement program was in accordance with Statement of Financial Accounting Standards (SFAS) No. 87, Employers' Accounting for Pensions, as prescribed by Rule 25-30.117, Florida Administrative Code. Further, the utility stated that its proposed treatment of the cost as a regulatory asset was in accordance with SFAS No. 71, Accounting for the Effects of Certain Types of Regulation.

We have several concerns with the utility's request. First, our practice has been to approve deferral accounting in very limited circumstances. Second, treating the early retirement program costs as a regulatory asset pursuant to SFAS No. 71 is inappropriate because the utility has not met the criterion of reasonable assurance of favorable Commission action. Further, we are concerned that UWF's request addresses only deferral of the costs incurred in implementing the early retirement program, but not the resulting savings. These concerns are addressed in more detail below.

Deferral Accounting

We approve or require deferral of costs or losses in certain circumstances. These include amortization of rate case expense pursuant to Section 367.0816, Florida Statutes, and amortization of non-recurring items in a rate proceeding. See Rule 25-30.433(8), Florida Administrative Code. We have also denied deferral of previously incurred costs. See Order No. PSC-98-1583-FOF-WS, issued November 25, 1998, in Docket No. 971663-WS, in which we stated:

> (t)he utility argues that the Commission has allowed recovery of other out of test year litigation expenses on the basis that these expenses are extraordinary and non-recurring. As noted above, FCWC cites to Order No. 6094, issued April 5, 1974, in Docket No. 74061-EU, and Order No. 5044, issued February 4, 1971, in Docket No. 70214-W, as support for its position. However, we note that the expenses approved in those dockets were requested in rate cases, and not for costs incurred prior to the date the application was filed, as is the case here. As courts have made clear, there is no reasonable claim for costs incurred prior to the date the application was filed or for cost categories discovered after the rate case is approved. We find that the prohibition against retroactive ratemaking protects the public by ensuring

> that present consumers will not be required to pay for past deficits of the company in their future payments. This practice is fair to the public utility, for it can act as speedily as it sees fit to move for a modification of inadequate rates. It is also fair to the consumers, as they are safeguarded from surprise surcharges related to past accounting periods.

In its petition, UWF states that the early retirement program and its results are unusual and extraordinary because of the magnitude of the costs, and because this is the first time such a program has been offered on a company-wide basis. Nevertheless, we find that the decision to implement such a program is an ordinary part of doing business, and, unlike events such as natural disasters, management had control over the choice of implementing the program and its timing. In Order No. PSC-92-1197-FOF-EI, issued October 22, 1992, in Docket No. 910890-EI, we denied a request by Florida Power Corporation (FPC) to create and amortize a regulatory asset related to pension expense, stating:

> We believe the regulatory asset and its amortization should be disallowed for ratemaking purposes. First, in order to record an asset or a liability under FAS No. 71, there must be an indication from us that the asset or liability will be recoverable. In this case, there was no such indication. It was inappropriate for FPC to use FAS No. 71 without our prior approval.
>
> Second, we do not believe pension expense should be "tracked." Pension expense will be run through earnings and will fluctuate. Earnings should be reviewed in aggregate with no true-up provision for certain expenses. If a true-up is allowed for one expense, it can easily be argued that all the expenses should be trued-up. Other expenses also change, but the change itself does not justify deferring the expenses. Utilities are given an opportunity to recover their costs, not a guarantee. If costs change, the entire cost to serve must be reevaluated. Individual changes in costs should not be deferred for future recovery in another rate case.

Further, in Order No. PSC-98-0329-FOF-GU, issued February 24, 1998, in Docket No. 971310-GU, we denied a request for deferral accounting for environmental costs by Peoples Gas System, Inc., stating:

> The Company has been deferring all environmental costs since September 30, 1994, instead of expensing them. According to Peoples Gas, its position since that time, supporting deferral accounting, is that environmental costs are outside the Company's control in both magnitude and timing and are so unpredictable and erratic from year to year that deferral accounting is the only appropriate accounting method with which to account for them. Peoples Gas also believes that its accounting for these costs is correct and consistent with the method used in its last rate case.
>
> We find that the Company should be expensing these costs because it was allowed $1,248,000 in expenses in its last rate case and does not have our specific authority to defer these costs. A review of prior orders addressing Peoples Gas' environmental costs shows that the Commission has not authorized Peoples Gas to utilize deferral accounting on an ongoing basis.

We have recently denied two requests for deferral by this utility. <u>See</u> Order No. PSC-98-1243-FOF-WS, issued September 21, 1998, in Docket No. 971596-WS (finding that allowing a rate increase to reflect amortization of OPEB costs deferred from 1994 through May, 1997, or to reflect an adjustment of the rate base reduction ordered in the utility's last rate case would be a form of retroactive ratemaking); <u>see also</u> Order No. PSC-01-0857-PAA-WS, issued April 2, 2001, in Docket No. 000610-WS (finding that treating the administrative costs incurred in connection with an application for service availability charges as a regulatory asset would not meet the "reasonable assurance" criterion required by SFAS No. 71).

<u>Qualification as a Regulatory Asset Pursuant to SFAS No. 71</u>

We find that it is inappropriate to permit an indefinite deferral of recognition of the costs until the next full rate case.

Such treatment would not meet the criteria for establishing a regulatory asset pursuant to SFAS No. 71, which states in relevant part:

> 9. Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An enterprise shall capitalize all or part of an incurred cost which would otherwise be charged to expense if both of the following criteria are met:
>
> a. It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.
>
> b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost. (emphasis added)

Our interpretation of SFAS 71 is that in order to defer any cost that otherwise would have been expensed, the utility must have our approval to recover the cost in future rates. By not addressing the prudence of the early retirement program or specific amounts in this case, the utility is not reasonably assured of future revenue recovery. Thus, deferring these amounts would be in violation of SFAS No. 71. This is consistent with our decision in Order No. PSC-01-0857-PAA-WS.

Deferral of Costs Versus Deferral of Savings

In its petition, UWF has requested deferral of the cost of implementing the early retirement program, but it did not consider the impact of the savings that would result immediately after implementation. In order to gain an understanding of the possible financial impact of the early retirement program, we requested supplemental data from UWF. In its response, UWF provided additional documentation, including copies of the actuarial reports, details of specific employees electing early retirement, estimates of the effect on return on equity of expensing the entire cost in 1999 versus amortizing the cost over a three-year period, and explanations of discrepancies between the 1999 annual report and our prior decisions. In response to our staff's second data request, the utility provided a breakdown of projected savings by specific employee, including benefits, as well as estimates of the salaries and benefits of replacement employees, where applicable.

Also in response to our staff's second data request, the utility provided a calculation of net operating income and rate base which incorporated amounts reported in its 1999 annual report with certain adjustments. Total reported rate base was $97,977,080, and net operating income was reported as $7,153,718 (exclusive of any portion of the cost of the early retirement program). Using these figures, the achieved rate of return for 1999 was 7.30 percent. The utility's calculation of the after tax effect of the early retirement program cost is $664,913, if the entire amount was expensed in 1999, or $221,637 for each of three years, if amortized. As shown in Attachment 1, which is incorporated herein by reference, the effect of the early retirement program cost without consideration of benefits would be to decrease the rate of return to 6.62 percent, if the entire amount was written off in 1999, and to 7.07 percent, if amortized over a three year period.

In its petition, the utility states that, as a result of the early retirement program, the next rate case will reflect reduced payroll costs. We note, however, that the utility will benefit from these reduced costs from the inception of the program. As shown in Attachment 2, which is incorporated herein by reference, we have calculated the annual net savings of implementing the early retirement program to be $210,869. When this amount is offset against the cost of the program, the achieved rate of return would be 6.84 percent, if the entire early retirement cost was written off in one year, or 7.29 percent, if amortized. If a deferral were permitted, an appropriate amortization period for the early retirement program costs would be three years or more. As shown in Attachment 1, the projected savings would materially offset an annual amortization of the cost within three years. Further, assuming a three-year amortization period, the projected effect on rate of return would be only one basis point. In view of the immateriality of the effect on rate of return, combined with the fact that the utility was already earning below its approved rate of return, we find that accounting for the cost under normal accounting methods does not impose a hardship on the utility.

We find that the impact of utilizing standard accounting methods is not sufficiently material to create an extraordinary circumstance. Furthermore, our practice has been to deny requests for deferral accounting in similar situations. Accordingly, UWF's petition for approval of regulatory accounting treatment for costs associated with implementation of a voluntary early retirement program is hereby denied.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that United Water Florida Inc.'s petition for approval of regulatory accounting treatment for costs associated with implementation of a voluntary early retirement program is hereby denied. It is further

ORDERED that Attachments 1 and 2, appended hereto, are incorporated herein by reference. It is further

ORDERED that the provisions of this Order shall become final unless an appropriate petition in the form provided by Rule 28-106.201, Florida Administrative Code, is received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings or Judicial Review" attached hereto. It is further

ORDERED that in the event this Order becomes final, this docket shall be closed.

By ORDER of the Florida Public Service Commission this 22nd day of May, 2001.

BLANCA S. BAYÓ, Director
Division of Records and Reporting

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NOTICE OF FURTHER PROCEEDINGS

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

The action proposed herein is preliminary in nature. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, in the form provided by Rule 28-106.201, Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on June 12, 2001.

In the absence of such a petition, this Order shall become final and effective upon the issuance of a Consummating Order.

Any objection or protest filed in this docket before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

Attachment 1

Rate of Return Impact of ER Program Costs Without Consideration of Benefits

Year Ended 12/31/1999

1	Rate Base per Utility	97,977,080
2	Net Operating Income, per Utility	7,153,178
3	After-Tax Cost of Writeoff of Total ER Program Expenses - 1 yr	(664,913)
4		6,488,265
5	Rate of Return (Ln 4/Ln 1)	6.62%
6	Net Operating Income, per Utility	7,153,178
7	Amortized After-Tax Cost of Total ER Program Expenses - 3 Yrs	(221,637)
8		6,931,541
9	Rate of Return (Ln 8/Ln 1)	7.07%
	Calculation of Rate of Return Including Costs and Benefits	
10	Rate Base per Utility - 1999	97,977,080
	Expensed in 1 Year	
11	Net Operating Income, per Utility	7,153,178
12	After-Tax Cost of Writeoff of Total ER Program Expenses - 1 yr	(664,913)
13	Net Annual Payroll Savings (From Attachment 2)	210,869
14	Adjusted Net Operating Income	6,699,134
15	Rate of Return (Ln 14/Ln 10)	6.84%
	Amortized Over 3 Years	
16	Net Operating Income, per Utility	7,153,178
17	Amortized After-Tax Cost of Total ER Program Expenses - 3 Yrs	(221,637)
18	Net Annual Payroll Savings (From Attachment 2)	210,869
19	Adjusted Net Operating Income	7,142,410

20	Rate of Return Including Costs and Benefits (Ln 19/Ln 10) (Amortized Over 3 Years)	7.29%
21	1999 Achieved Rate of Return Without ER Program	7.30%

Attachment 2

Calculation of Annual Net Payroll Savings

Detail of Expected Savings from Employees Electing Early Retirement

	Titles	Current Employees Salary	Current Employees Benefits (42 %)	Replacement Employees Proposed Salary	Replacement Employees Benefits (51.7%)	Total Savings
1	Operator 3	41,461	17,414			58,875
2	Operator 2	37,315	15,672	(36,795)	(19,023)	(2,831)
3	Lead Operator	43,216	18,151	(43,569)	(22,525)	(4,727)
4	T & D Maintenance Supervisor	51,880	21,790			73,670
5	Working Crew Leader	38,569	16,199			54,768
6	Maintenance Operator	40,841	17,153			57,994
7	Maintenance Operator	40,841	17,153			57,994
8	Maintenance Supervisor	49,346	20,725	(38,000)	(19,646)	12,425
9	SCADA Operator	41,667	17,500	(44,096)	(22,798)	(7,727)
10	New Business Coordinator	48,817	20,503	(54,500)	(28,177)	(13,357)
11	Customer Service Representative	29,282	12,298	(23,192)	(11,990)	6,398
12	Customer Service Representative	29,035	12,195			41,230
13	Total	492,270	206,753	(240,152)	(124,159)	334,712

14	Expected ER Program Savings	334,712
15	Tax Effect (37%)	(123,843)
16	Net Annual Savings of ER Program	210,869