



Public Service Commission

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RECORDS AND REPORTING

DATE: MAY 31, 2001

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

FROM: DIVISION OF ECONOMIC REGULATION (FLETCHER, MERCHANT, MONIZ, HICKS, WETHERINGTON, CROUCH, JAEGER, GERVAZI)

RE: DOCKET NO. 000737-WS - INVESTIGATION OF RATES OF ALOHA UTILITIES, INC. IN PASCO COUNTY FOR POSSIBLE OVERTURNINGS FOR THE ALOHA GARDENS WATER AND WASTEWATER SYSTEMS AND THE SEVEN SPRINGS WATER SYSTEM.

DOCKET NO. 010518-WS - NOTICE OF INTENT TO INCREASE WATER AND WASTEWATER RATES IN PASCO COUNTY, BASED UPON APPLICATION OF PROVISIONS OF SECTION 367.801(4)(a)&(b), F.S., BY ALOHA UTILITIES, INC.

AGENDA: 6/12/01 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: LAST DAY TO ORDER REFUND OF 1999 PRICE INDEX IS AUGUST 17, 2001

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\WP\000737.RCM

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CASE BACKGROUND

Aloha Utilities, Inc. (Aloha or utility), is a Class A water and wastewater utility in Pasco County. The utility consists of two distinct service areas, Aloha Gardens and Seven Springs. This recommendation relates to the Seven Springs water system. The utility's service area is located within the Northern Tampa Bay Water Use Caution Area as designated by the Southwest Florida Water Management District (SWFWMD). Critical water supply concerns have been identified by SWFWMD within this area.

By Order No. PSC-00-1289-FOF-WS, issued July 18, 2000, in Docket No. 000737-WS, the Commission initiated a formal investigation of the rates and charges of the Aloha Gardens water and wastewater systems and Seven Springs water system, based on the utility's 1999 annual report. Pursuant to Section 367.083, Florida Statutes, the official date of filing for this overearnings investigation was the issuance date of Order No. PSC-00-1289-FOF-WS. For the Seven Springs water system, the Commission held the following revenues subject to refund:

<u>System</u>	<u>Test Year Revenues</u>	<u>Amount Subject To Refund</u>	<u>% Subject To Refund</u>
Seven Springs Water	\$1,723,085	\$52,378	3.04%

By Order No. PSC-01-0101-PCO-WS, issued January 11, 2001, the Commission increased the corporate undertaking approved in Order No. PSC-00-1289-FOF-WS by \$70,910, resulting in total secured revenues of \$232,050 as a guarantee of any potential refund of water and wastewater revenues collected under the interim conditions.

The last rate case for Aloha was for the Seven Springs wastewater system in Docket No. 991643-SU. Order No. PSC-01-0326-FOF-SU (Final Order), issued on February 6, 2001, established final rates and charges for that system. Order No. PSC-01-0961-FOF-SU, issued April 18, 2001, addressed reconsideration of the Final Order, but did not affect the final rates.

On March 21, 2001, Aloha filed a notice to implement a 2000 index and pass-through rate adjustment for the Aloha Gardens water and wastewater systems and the Seven Springs water system. In this filing, Aloha waived implementing the pass-through increase in the statutory 45-day period, and requested that it be allowed to

implement both the price index and pass through increase in 60 days.

Moreover, by letter dated April 16, 2001, Aloha requested approval of a test year for its Seven Springs water system. Docket No. 010503-WU was assigned to this case. By letter dated April 27, 2001, the Chairman approved the utility's requested December 31, 2001 projected test year and required the minimum filing requirements to be filed by July 31, 2001.

At the May 15, 2001 Agenda Conference, the Commission determined that the Aloha Gardens water and wastewater systems had overearned and required refunds and rate reductions for those systems. At that same Agenda Conference, the Commission denied the utility's requested 2000 index and pass-through for the Aloha Gardens systems because the utility was found to be overearning and the increased expenses for the index and pass-through were considered in the Commission's overearnings determination. The Commission however did grant the utility's pass-through request for the Seven Springs water system, but deferred its decision on the requested 2000 index for this system. The PAA Orders memorializing both Commission decisions are scheduled to be issued on June 4, 2001.

To determine whether refunds are warranted for the Seven Springs water system, staff has utilized the simple average test year ended December 31, 2000. Staff has utilized the audited test year ended December 31, 1999 balances and the utility's 2000 annual report balances. To determine the appropriateness of the utility's existing rates on a prospective basis, staff has also utilized the simple average test year ended December 31, 2000 and included pro forma expense adjustments for known and measurable changes for the calendar year-end 2001. This is different from the Aloha Gardens systems, where staff used a 1999 test year and included proforma plant and expense adjustments for known and measurable changes in the calendar year-end 2000.

Pursuant to Order No. PSC-01-0997-PAA-WU, issued April 23, 2001, in Docket No. 010168-WU, the Commission found that the December 31, 1999 test year is inappropriate to determine the earnings level for the Seven Springs water system. The basis for this decision was that the service area is currently experiencing substantial customer growth without concurrent increases in plant. Whereby, this customer growth results in greater revenues and contributions-in-aid-of-construction which make the 1999 historical test year stale and unrepresentative of the current and prospective earnings for this system.

This recommendation addresses: 1) whether any refunds to Seven Springs water ratepayers are appropriate; 2) whether the existing rates for the utility's Seven Springs water system should be maintained; and 3) whether the utility should be granted a 2000 index for this system. The Commission has jurisdiction pursuant to Sections 368.081 and 367.082, Florida Statutes.

List of Acronyms and Technical Terms

The following is a list of acronyms and technical terms which have been used in the recommendation.

CIAC	Contributions in Aid of Construction
CTs	Contributed Taxes
DEP	Department of Environmental Protection
ERCs	Equivalent Residential Connections
MFRs	Minimum Filing Requirements
NARUC	National Association of Regulatory Utility Commissioners
NOI	Net Operating Income
O&M	Operation and Maintenance
ROE	Return on Equity
SWFWMD	Southwest Florida Water Management District
USOA	Uniform System of Accounts

DISCUSSION OF ISSUES

RATE BASE

ISSUE 1: Are any adjustments appropriate for the cost allocations to the Seven Springs water system for the new building and associated land?

RECOMMENDATION: Yes. Plant should be increased by \$1,019, and land should be reduced by \$970, to be consistent with the Commission's decision at the May 15, 2001 Agenda Conference. Further, for prospective rate setting purposes, O&M expenses for the Seven Springs water system should be reduced by \$6,117 to remove non-recurring rent expense. (FLETCHER)

STAFF ANALYSIS: In its 2000 annual report, Aloha recorded the office building improvements allocating based on the 14% each to Aloha Gardens water and wastewater and 36% each to Seven Springs water and wastewater. However, the utility allocated the building and associated land based on 12.5% each to Aloha Gardens water and wastewater and 37.5% each to Seven Springs water and wastewater. Aloha also recorded a \$82,830 value for the associated land related to the building. In addition, the utility recorded a 28.19% non-utility adjustment to the total cost of the building and associated land.

At the May 15, 2001 Agenda Conference, the Commission found the following adjustments appropriate for the Aloha Gardens systems: 1) the value of land associate with the new build is \$64,409; 2) the non-utility percentage is 29.40%; and 3) the appropriate allocation to the Seven Springs water system is 36% for the building related costs. Consistent with the Commission's prior decision, staff recommends that the above adjustments are appropriate for the Seven Springs water system. Accordingly, for the Seven Springs water system, plant should be increased by \$1,019, and land should be reduced by \$970, respectively.

In its 2000 annual report, Aloha included \$17,479 for rent of the former office building. Since this is a non-recurring cost, staff believes this cost should be removed for prospective rate setting purposes. The Seven Springs water system's allocated portion of the rent is \$6,117. As such, staff recommends that O&M expense of the Seven Springs water system should be reduced by \$6,117.

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ISSUE 2: What is the used and useful percentage of the utility's the Seven Springs water system?

RECOMMENDATION: The Seven Springs water system, plant and distribution lines, should be considered 100% used and useful.
(CROUCH)

STAFF ANALYSIS: The Seven Springs water distribution system is virtually all contributed. Recently, Aloha had to add two new supply wells and hydro-pneumatic tanks in order to meet increasing demand. Aloha is currently looking at possible scenarios whereby they can improve existing quality and quantity of its treated water and also meet the ever increasing demand caused by the rapid development in Aloha's service area. Staff recommends that the Seven Springs water plant be considered 100% used and useful when current use and 5 years growth allowance are considered.

ISSUE 3: Should an adjustment be made to accumulated depreciation associated with new computer equipment and system software?

RECOMMENDATION: Yes. The utility used an incorrect depreciation rate. As such, Seven Springs water accumulated depreciation and depreciation expense should be increased by \$6,032 and \$4,021, respectively. (FLETCHER)

STAFF ANALYSIS: In Audit Disclosure No. 3, staff auditors stated that Aloha capitalized new computer equipment and system software purchased in 1998 and 1999. The utility classified these costs as Office Furniture using a 15-year depreciable life. The allocated additions as of December 31, 1999 were \$40,212 for Seven Springs water.

According to Rule 25-30.140, Florida Administrative Code, computer equipment should be depreciated over six years instead of fifteen. To be consistent with the above rule, the depreciation rate for the computer equipment should be corrected for the simple average test year ending December 31, 2000. Based on the above, staff recommends that accumulated depreciation and depreciation and depreciation expense should be increased by \$6,032 and \$4,021, respectively.

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ISSUE 4: What is the appropriate amortization period and amount of contributed taxes (CTs) associated with the Seven Springs water system?

RECOMMENDATION: The appropriate amortization rate is 2.61%, and the appropriate annual amortization amount is \$30,691. Accordingly, staff recommends that accumulated amortization of CIAC should be decreased by \$5,115 and that the annual amortization of CTs should be decreased by \$11,523. (FLETCHER)

STAFF ANALYSIS: By Order No. PSC-01-0326-FOF-SU, issued February 6, 2001, in Docket No. 991643-SU, the Commission amortized CTs by the composite amortization rate of taxable CIAC from 1987 to 1996. Further, the Commission found that CTs and accumulated amortization of CTs should be treated as CIAC and accumulated amortization of CIAC, respectively. According to the utility's response to a staff data request, the composite amortization rate of taxable CIAC, from 1987 to 1996, for the Seven Springs water system was 2.61%.

Consistent with the theory of normalization, the Commission determined that the benefits of CTs shall be passed back to the ratepayers over the lives of the related assets. See Order No. 23541, issued October 1, 1990, in Docket No. 860184-PU. Staff believes the utility's 2.61% composite amortization rate complies with the Commission's directive in Order No. 23541 that the utility pass back the benefits of CTs to ratepayers over the lives of related assets. The 2.61% amortization rate yields an annual amortization of \$30,691. Therefore, based on the above, staff recommends that the appropriate amortization rate is 2.61% and the appropriate annual amortization amount is \$30,691.

According to its 1999 annual report, the utility amortized CTs using an amortization rate of 2.5% which resulted in an annual amortization amount of \$29,397. Pursuant to its 2000 annual report, Aloha amortized CTs using an amortization rate of 3.5% which resulted in an annual amortization amount of \$42,214. Based on a discussion with the utility's accounting consultant, Aloha erroneously amortized its CTs in 2000 using the current year's composite CIAC amortization rate. Based on the above, staff also recommends that accumulated amortization of CIAC should be decreased by \$5,115 and that the annual amortization of CTs should be decreased by \$11,523 (\$42,214 less \$30,691).

ISSUE 5: What is the appropriate working capital allowance for the Seven Springs water system?

RECOMMENDATION: The appropriate working capital allowance is \$343,090 for the Seven Springs water system. Accordingly, working capital for this system should be increased by \$124,667. Further, O&M expenses for this system should also be increased by \$65,735 to recognize one year's amortization of regulatory commission expense associated with Docket No. 960545-WS. (FLETCHER)

STAFF ANALYSIS: Rule 25-30.433(2), Florida Administrative Code, states that working capital for Class A utilities shall be calculated using the balance sheet approach. The following is staff's analysis of several recommended adjustments to the working capital allowance for the Seven Springs water system. Further, staff's analysis also addresses a corresponding adjustment to O&M expenses that results from our recommended adjustment to working capital.

Working Capital Adjustments Consistent with Docket No. 991643-SU

Pursuant to a staff data request, the utility's accounting consultant provided Aloha's 1999 and 2000 simple average working capital calculation. Based on our review, staff believes several adjustments are necessary to calculate this system's allocated working capital. First, in the utility's working capital calculation, the 1999 year-end balance of customer accounts receivable included income tax refund receivables of \$113,846. Staff notes that the utility's working capital calculation did exclude the income tax refund receivables from the 2000 year-end balance of customer account receivable. Consistent with the working capital approved in Docket No. 991643-SU, staff believes it is appropriate to exclude the income tax refund receivables from working capital.

Second, Aloha's calculation did not net the bad debt allowance with the customer accounts receivable in 2000. Staff notes that the utility's working capital calculation did net the bad debt allowance with the customer accounts receivable in 1999. Consistent with the Commission approved working capital in Docket No. 991643-SU, staff believes it is appropriate to include bad debt allowance associated with the customer accounts receivable in 2000.

Third, consistent with the working capital approved in Docket No. 991643-SU, staff believes it is appropriate to calculate this system's allocated working capital based on the following: 1) the exclusion of income tax deposits; 2) the exclusion of rate case

expense associated with Docket No. 991643-SU; and 3) the use of the same O&M expense percentage allocation.

Regulatory Commission Expense for Docket No. 960545-WS

In Dockets Nos. 970536-WS and 980245-WS, the Commission required that the costs incurred in 1998 and in subsequent years for Docket No. 960545-WS be deferred until these costs cease. Further, the Commission required that the unamortized balance of regulatory commission expense for Docket No. 960545-WS should be amortized over 5 years. See Order No. PSC-99-1917-PAA-WS, issued September 28, 1999.

On July 14, 2000, the Commission issued Order No. PSC-00-1285-FOF-WS (final order) for Docket No. 960545-WS. On July 31, 2000, Aloha filed a motion of clarification of the final order. By Order No. PSC-00-1628-FOF-WS, issued September 12, 2000, the Commission clarified its final order regarding the requirements of the pilot project. Although Aloha was required to file reports in 2001, staff believes that the case was substantially completed during 2000.

On June 7, 2000, staff propounded an undocketed data request to the utility regarding its regulatory commission expense associated with Docket No. 960545-WS. In the utility's response, Aloha provided support documentation for its actual costs incurred for that docket. The utility's 2000 annual report reflects that the balance of regulatory commission expense associated with Docket No. 960545-WS was \$328,676 and that no amortization of this expense had begun. Based on our review, staff believes the total cost of \$328,676, reflected in the utility's 2000 annual report, is reasonable.

Staff believes that it is appropriate to begin amortizing these costs in 2000, consistent with Order No. PSC-99-1917-PAA-WS. Based on the above, staff recommends that the working capital should be reduced to reflect one year's amortization of this regulatory commission expense. Further, staff also recommends that the O&M expense of the Seven Springs water system should be increased by \$65,735 ($\$328,676 \div 5$) for this amortization.

Specific Working Capital Increase for Pilot Project

By Order No. PSC-00-1285-FOF-WS, issued July 14, 2000, in Docket No. 960545-WS, the Commission ordered the utility to "implement a pilot project using the best available treatment alternative to enhance the water quality and to diminish the

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tendency of the water to produce copper sulfide in the customers' homes." According to its letter dated December 15, 2000 to staff, Aloha stated that the estimated cost of this pilot project would be \$380,000. Further, the utility stated that the cost should be amortized over five years, beginning immediately. Based on our review of the engineering cost estimate provided by the utility, staff believes the \$380,000 estimated is reasonable.

According to the NARUC USOA for Class A water utilities, Account 183 - Preliminary Survey and Investigation Charges is accounted for as follows:

This account shall be charged with all expenditures for preliminary surveys, plans, investigations, etc., made for the purpose of determining the feasibility of projects under contemplation. If construction results, this account shall be credited and the appropriate utility plant account charged. If the work is abandoned, the charge shall be to account 426 - Miscellaneous Nonutility Expenses, or to the appropriate operating expense account unless otherwise ordered by the Commission (See account 675 - Miscellaneous Expenses).

Staff believes that the estimates of the costs for the pilot project are reasonable and should be considered as preliminary survey and investigation charges. Since the results of pilot project are not yet completed, staff believes it is appropriate to recognize these costs in working capital only. Staff believes that the appropriate final treatment for these costs can be addressed in the upcoming rate case for this system. Accordingly, staff recommends that working capital for the Seven Springs water system should be increased by \$190,000 (\$380,000 divided by 2) the average balance of the estimated cost of the pilot project.

Conclusion

Based on the above adjustments, the appropriate working capital allowance is \$343,090 for the Seven Springs water system. Accordingly, staff recommends that working capital for this system should be increased by \$124,667. Further, staff recommends that O&M expenses for this system should also be increased by \$65,735.

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ISSUE 6: What is the appropriate rate base for the Seven Springs water system?

RECOMMENDATION: Consistent with other recommended adjustments, the appropriate rate base for the Seven Springs water system is \$1,222,488. (FLETCHER)

STAFF ANALYSIS: Based on the simple average test year balances and staff's recommended adjustments, staff recommends that the appropriate rate base for the Seven Springs water system is \$1,222,488 for both refund and prospective rate purposes. This represents an increase of \$113,570 from the utility's simple average rate base balance. Schedule No. 1-A depicts staff's rate base calculation. Staff's proposed adjustments to rate base are depicted on Schedule No. 1-B.

COST OF CAPITAL

ISSUE 7: What is the appropriate cost rate for long-term debt?

RECOMMENDATION: The appropriate weighted average cost rate for long-term debt is 10.28%. (FLETCHER)

STAFF ANALYSIS: According to the utility's 2000 annual report, Aloha calculated a weighted average cost rate of 10.33% for long-term debt. Staff recalculated the weighted cost rate for long-term debt to be 10.28%. Staff's calculation was based on the following: 1) use of the average balance of long-term debt using Aloha's 1999 and 2000 annual reports; 2) use of the cost rates reflected on Schedule F-17 on Aloha's 2000 annual report; 3) adjustment of cost rates for related party long-term debt to prime plus two percent, consistent with the Commission's decision in Docket No. 991643-SU; and 4) adjustment of two cost rates for the amortization of debt issuing expense, consistent with the Commission's decision in Docket No. 991643-SU.

Based on the above, staff recommends that the appropriate weighted average cost rate for long-term debt is 10.28%. Accordingly, staff recommends that the utility's weighted average cost rate of 10.33% for long-term debt should be reduced by 5 basis points.

ISSUE 8: What is the appropriate Return on Equity (ROE) to determine the overall cost of capital?

RECOMMENDATION: The appropriate ROE is 9.93% with a range of reasonableness of 8.93% to 10.93%. (FLETCHER)

STAFF ANALYSIS: The last authorized ROE for Seven Springs water was 10.12%. This cost rate was set by the Commission in Dockets Nos. 970536-WS and 980245-WS. Also, the Commission has established Aloha's preferred stock cost rate to be equal to that of common equity. See Order No. PSC-99-1917-PAA-WS, issued September 28, 1999.

By Order No. PSC-00-1162-PAA-WS, issued June 26, 2000, in Docket No. 000006-WS, the Commission approved its current leverage formula used to establish the authorized ROE for water and wastewater utilities. That Order was consummated by Order No. PSC-00-1299-CO-WS, issued July 18, 2000. At the May 15, 2001 Agenda Conference, the Commission has voted to issue the new leverage formula, but that PAA Order had not been issued as of the date of this recommendation and would not become effective until a Consummating Order was issued. Based on Aloha's adjusted capital structure, the current leverage formula yields a cost of equity of 9.93%. Therefore, staff recommends that the appropriate ROE to determine the overall cost of capital is 9.93% with a range of reasonableness of 8.93% to 10.93%.

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ISSUE 9: What is the appropriate weighted average cost of capital?

RECOMMENDATION: Consistent with other recommended adjustments, the appropriate weighted average cost of capital for the Seven Springs water is 9.98%. (FLETCHER)

STAFF ANALYSIS: Consistent with other recommended adjustments, the appropriate weighted average cost of capital for the Seven Springs water is 9.98%.

NET OPERATING INCOME

ISSUE 10: Should any adjustment be made for related party purchased water transactions?

RECOMMENDATION: Yes. The related party rates for purchased raw water of \$0.32 per thousand gallons should be reduced to \$0.10 per thousand gallons. This rate is equal to the rate charged by Mitchell, a non-related third party. This results in a \$95,070 reduction to O&M expenses for the utility's Seven Springs water system. Moreover, staff recommends that the issue regarding the reasonableness of the purchased raw water rates charged by Mitchell, Tahitian, and Interphase should be addressed in the upcoming rate case for the Seven Springs water system. (FLETCHER)

STAFF ANALYSIS: The Seven Springs water system consists of eight wells. Well No. 1 is owned by Mr. Jack Mitchell (Mitchell). Wells Nos. 3 and 4 are owned by Tahitian Development (Tahitian). Wells Nos. 6 and 7 are owned by Interphase, Inc. (Interphase). Lastly, Well No. 5 is no longer functioning, and Wells Nos. 2, 8, and 9 are owned by the utility. According to its responses to staff's discovery, Mitchell, Tahitian and Interphase own the land and original wells and are responsible for all property taxes. Further, Aloha has been responsible for all operating expenses (i.e., repairs and maintenance) and improvements to the original wells. Thus, staff believes that these purchased water transactions basically provide payment of royalties for raw water. The following is staff's analysis of these related party purchased water transactions.

Related Party Purchased Water Transactions

In its application for limited proceeding in Docket No. 010168-WU, the utility provided a schedule of the gallons of water sold to Aloha by Mitchell, Tahitian, and Interphase for the 2000 calendar year-end. Mitchell charges \$0.10 per 1,000 gallons and both Tahitian and Interphase charge \$0.32 per 1,000 gallons. According to the utility's 2000 annual report, Tahitian and Interphase are related parties of Aloha. Based on the utility's 2000 annual report and staff's search of the Secretary of State's online corporation database, Mitchell is not a related party of the utility.

According to the utility's response on February 24, 1999 to staff's discovery request, the Mitchell property is a 6,700 acre parcel of property in which Aloha has a right to locate its wells

and a 10-acre water plant site anywhere on the property. The only restriction is that each well site has a minimum circumference of approximately one acre. Under the agreement with Tahitian, the utility can extract water on a 30-acre parcel of land with the one acre restriction discussed above. Under the agreement with Interphase, Aloha can extract water on any parcels of a 638 acres tract, subject to the one acre restriction.

In our analysis of these purchased water transactions, staff believes it is appropriate to discuss the history of the purchased water transactions with Mitchell, Tahitian, and Interphase, and the Commission's prior decision in its 1995 overearnings investigation of Florida Cities Water Company (FCWC).

History of Purchased Water Transactions

Based on contracts provided by Aloha in response to discovery by staff, the agreements for purchase of water date back to 1972 for Mitchell, 1977 for Tahitian, and 1978 for Interphase. The 1972 agreement with Mitchell called for Aloha to pay \$0.05 per thousand gallons of water extracted from Mitchell's land. On October 1, 1975, Mitchell and Aloha executed another agreement which called for Aloha to pay \$0.10 per thousand gallons of water extracted. In Aloha's 1977 rate case, the Commission approved this \$0.10 per thousand gallon charge by Mitchell. See Order No. 8450, issued August 29, 1978, in Docket No. 770720-WS.

The 1977 agreement with Tahitian called for Aloha to pay \$0.10 per thousand gallons of water extracted. On December 28, 1988, this agreement was amended and Aloha was to pay \$0.25 per thousand gallons of water extracted. On January 1, 1992, Tahitian and Aloha amended their agreement again and Aloha was to pay \$0.32 per thousand gallons of water extracted. The 1978 agreement with Interphase called for Aloha to pay \$0.10 per thousand gallons of water extracted. This agreement was also amended which called for Aloha to pay \$0.32 per thousand gallons of water extracted. Staff notes that the term period for all the current agreements with Mitchell, Tahitian, and Interphase are perpetual.

Commission's Decision Regarding FCWC's Royalty for Raw Water

In Docket No. 951029-WU, an overearnings investigation, FCWC's operating expenses included a royalty fee for raw water extracted. The fee was based on a series of related party transactions that began in 1973. On April 23, 1973, a related party of FCWC granted an easement to another related party of FCWC to operate wellfields and do other work necessary for delivery of water on 149 of 16,000

acres. At this time, these same parties agreed on a royalty fee of \$0.03 per thousand gallons for all water pumped from the wells. On June 24, 1973, FCWC's related party sold the 16,000 acres to a third non-related party for \$800 per acre.

FCWC offered three options to compare the value of this easement. First, FCWC recommended using Lee County's 1978 comparable purchase price of land for the County's own wellfield. Second, FCWC proposed the above purchase price because FCWC's ultimate water usage allowance is twice as much as Lee County's allotted capacity. Thirdly, FCWC suggested an independent appraisal of the easement area.

By Order No. PSC-96-0859-FOF-WU, issued July 2, 1996, in Docket No. 951029-WU, the Commission found the following:

We find that the third approach of using a land appraisal to measure the worth of the easement provides a direct means of testing the fairness of the assessed royalty charge. . . . Using the respective weighted percentages, the total acreage assigned to FCWC is 613.75 acres. At the most conservative cost of \$800 per acre (the cost per acre in the 1973 sale to non-affiliated interests), the investment attributable to this land would be \$491,000. Based upon an 8.75% rate of return, the return is calculated to be \$42,963. With taxes estimated to be: \$8,347 for property taxes, \$8,867 for income taxes, and \$2,836 for gross receipts taxes, the total expense would be \$63,013. This is \$5,067 more than the royalty expense of \$57,946 used for the 1996 test year, and equates to a cost of \$0.0326 per 1,000 gallons.

Based on the above comparative analysis, the Commission found that the \$0.03 per thousand gallon royalty fee was a reasonable expenditure in relation to the value acquired.

Royalty Fees for Water Extraction by Aloha

Section 367.156, Florida Statutes, states in pertinent part that "[t]he commission shall continue to have reasonable access to all utility records and records of affiliated companies, . . . regarding transactions or cost allocations among the utility and such affiliated companies, and such records necessary to ensure that a utility's ratepayers do not subsidize nonutility activities."

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On February 24, 1999, staff requested, through discovery, that Aloha provide documentation of the original cost of the land on which the wells of Mitchell, Tahitian, and Interphase are located. The utility replied that these parcels of land have never been devoted to public use because Aloha does not own the land and that the cost or value of the land is unknown to Aloha.

On June 7, 2000, staff requested that Aloha provide the following: 1) the date the purchased water wells were placed into service; 2) an itemized cost breakdown of each well; and 3) an explanation of why the utility did not purchase the land on which each well is located. The utility stated that Tahitian's and Interphase's wells were placed into service by Aloha appropriately in the early to mid 1970s and 1980, respectively. However, Aloha stated that it has no records regarding these dates. Aloha asserted that it does not have information concerning the original cost of the wells.

With regard to the utility's decision not to purchase the land, Aloha stated that the wells were drilled and the agreements related to their use by the utility were entered into in the 1970s. The utility asserted that during this time there was a great deal of concern about saltwater intrusion into wells throughout the Highway 19 corridor in Pasco County. In fact, the utility stated that many of the wells of private utilities were taken offline, and those utilities began purchasing water from the Pasco Water Authority. In addition, Aloha indicated that neither the unrelated nor the related parties were or are interested in selling the property on which the well sites are located. Further, the utility suggested that to purchase new property for individual well sites and to utilize them, despite that many failing wells in the area at that time, would have been imprudent. Aloha stated that the arrangement with Mitchell, Tahitian, and Interphase was prudent because of the utility's right to withdraw water from a very large area of property and to the extent one well location produces unsatisfactory water the utility could easily move to other locations.

On September 25, 2000, pursuant to Section 367.156 (1) and (2), Florida Statutes, staff again requested the date that Tahitian's and Interphase's wells were placed into service and an itemized cost breakdown of these wells. Staff also requested the cost of the land on which these wells are located. Upon further research into annual reports previously filed with the Commission, the utility indicated that purchases from Tahitian began in 1978 and purchases from Interphase began in 1988. Regarding the original cost of the wells, Aloha asserted that the records that

the utility is required to keep in order to comply with the NARUC USOA does not require keeping expense related invoices or detail for any significant length of time. Further, Aloha stated that it was informed by both Tahitian and Interphase that their record retention is about seven years, which is imposed by the Internal Revenue Service. Concerning the cost of the land, Aloha stated that, to its knowledge, there has been no appraisal of these properties.

By their very nature, related party transactions require closer scrutiny. Although a transaction between related parties is not per se unreasonable, it is the utility's burden to prove that its costs are reasonable. Florida Power Corp. v. Cresse, 413 So. 2d 1187, 1191 (Fla. 1982). This burden is even greater when the transaction is between related parties. In GTE Florida, Inc. v. Deason, 642 So. 2d 545 (Fla. 1994) (GTE), the Court established that the standard to use in evaluating affiliate transactions is whether those transactions exceed the going market rate or are otherwise inherently unfair.

Regardless of the circumstances which resulted in the purchase water transactions with Mitchell, Tahitian, and Interphase, staff believes that the reasonableness of the charges is the issue. The royalty fee for the raw water was addressed throughly in the FCWC's 1995 overearnings investigation. Staff believes the same standards utilized to evaluate the appropriateness of the royalty fees for raw water should be applied in the instant case. As indicated above, the utility has maintained that its related parties do not have documentation of the original cost of the well and land when first devoted to service of Aloha ratepayers. However, since it is the utility's burden to prove that its costs are reasonable, staff believes the utility should have taken the appropriate steps to determine the original cost of the land and wells, as of the date the utility began extracting water from these wells, in order to determine if the utility's decision to purchase raw water was the most cost effective choice. Specifically, staff suggests that the appropriate steps might have been to have these lands appraised by an independent appraiser and to retain the services of a professional engineer to conduct an original cost study on the wells initially installed. Without this information, staff cannot evaluate the reasonableness of these royalty fees at this time.

Conclusion

Staff has reviewed Order No. 8450, issued August 29, 1978, in Docket No. 770720-WS. In that order, the Commission did not specifically discuss the approval of Mitchell's \$0.10 per thousand

gallon rate. However, the Commission did approve the Examiner's findings, which included the adjustment to increase purchased water expense to reflect the increase in Mitchell's rate from \$0.05 to \$0.10 per thousands gallons. Further, based on our review of the Commission staff's file for Docket No. 770720-WS, staff notes that the only support documentation for this adjustment was a one page engineering working paper that stated this rate was increasing based on a new contract. The docket file or order did not address the related party transactions with Tahitian.

Staff believes that, consistent with GTE, Aloha should not receive recovery of any related cost in excess of that which exceeds the going market rate. Since the Mitchell agreement is an arms-length transaction, staff believes that the \$0.10 per thousand gallon rate should be considered the market rate. As such, staff recommends that the related party rates of \$0.32 per thousand gallons should be reduced to \$0.10 per thousand gallons, which is equal to the rate charged by Mitchell, the non-related third party. Using the 2000 purchased gallons from these related parties that was provided by Aloha, this results in a \$95,070 reduction to O&M expenses for the utility's Seven Springs water system. Moreover, staff recommends that the issue regarding the reasonableness of the rates charged Mitchell, Tahitian, and Interphase should be addressed in the upcoming rate case for the Seven Springs water system.

ISSUE 11: Should any pro forma O&M expense adjustments be made to determine whether the Seven Springs water system's present rates should be continued?

RECOMMENDATION: Yes. Salaries and Wages - Employees should be increased by \$18,938 to recognize the allocated portion of three additional employees hired in 2001. Pensions and Benefits and payroll taxes should also be increased by \$18,938, \$6,496, and \$1,449, respectively. Further, O&M expenses should be increased by \$55,053 to recognize the significant increase of purchased water in 2001. (FLETCHER)

STAFF ANALYSIS: The following is staff's analysis of two pro forma O&M expense adjustments we believe are necessary to determine whether the Seven Springs water system's present rates should be continued.

Pro forma Adjustment to Salaries and Wages - Employees

By a letter to staff dated December 15, 2000, Aloha asserted that it was in the process of interviewing for a new receptionist position, which it planned to fill in January of 2001. In addition, the utility stated that it planned to hire an additional billing clerk and customer service representative. Aloha stated that the annual salaries for the receptionist, billing clerk, and customer service representative total \$52,000. At the May 15, 2001 Agenda Conference, Aloha stated that these employees have been hired.

Staff believes that it was reasonable for Aloha to fill these positions and the salaries appear reasonable. Since they were added in 2001, staff does not believe it is appropriate to make any adjustment to the 2000 amount. However, staff believes it is appropriate to recognize the increased O&M expense in 2001 for these three additional employees. Accordingly, staff recommends that Salaries and Wages - Employees for the Seven Springs water system should be increased by \$18,938. This amount represents the Seven Spring water system's allocated portion of the total annual salaries of the three additional employees. The corresponding adjustments for Pensions and Benefits and payroll taxes are an increase of \$6,496, and \$1,449, respectively.

Pro forma Adjustment to Purchase Water Expense

On December 18, 2000, the utility began purchasing significantly more water from Pasco County to reduce its pumping that was in excess of its SWFWMD water use permit capacity limit.

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Based on information received from Pasco County, Aloha purchased 77,832,000 gallons of water in 2000. In addition, the utility purchased 102,856,000 gallons from January to March of 2001 with no gallons purchased from March 20, 2001 to May 19, 2001, when Pasco County last read the meter for the Seven Springs water system. Staff believes the additional 25,024,000 gallons purchased in 2001 over the total gallons purchased in 2000 should be recognized as a 2001 pro forma O&M expense adjustment. Therefore, staff recommends that O&M expenses should be increased by \$55,053 (25,024,000 divided by 1,000 multiplied by Pasco County's rate of \$2.20 per thousand gallons) to recognize the significant increase of purchased water in 2001.

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ISSUE 12: What is the appropriate net operating income before any calculation for an increase or decrease for the utility's Seven Springs water system?

RECOMMENDATION: Based on recommended adjustments discussed in previous issues, the appropriate test year operating income is \$131,276 for refund purposes and \$83,988 for the purposes of determining the appropriateness of existing rates on a prospective basis. (FLETCHER)

STAFF ANALYSIS: Based on recommended adjustments discussed in previous issues, staff recommends that the test year operating income before calculation for an increase or decrease for the Seven Springs water system is \$131,276 for refund purposes and \$83,988 for the purposes of determining the appropriateness of existing rates on a prospective basis. Schedules Nos. 3-A and 3-B depict staff's NOI calculation and adjustments, respectively, for refund purposes. Schedules Nos. 3-C and 3-D reflect staff's NOI calculation and adjustments, respectively, for the purposes of determining the appropriateness of existing rates on a prospective basis.

REVENUE REQUIREMENT

ISSUE 13: What is the appropriate revenue requirement for the utility's Seven Springs water system?

RECOMMENDATION: The appropriate revenue requirement for the test year ending December 31, 2000 is \$1,779,101. Based on the adjusted test year revenues of \$1,794,660, the utility had excess revenues of \$15,559 (or 0.87%). The revenue requirement for the test year ending December 31, 2000, with 2001 pro forma expense adjustments, is \$1,858,492. This calculation reflects underearnings of \$63,832 (or 3.56%) from the adjusted test year revenues of \$1,794,660. (FLETCHER)

STAFF ANALYSIS: The revenue requirement is a summation measure that depends upon the provisions for rate base, cost of capital, and operating income. Based upon staff's proposed recommendations in prior issues, we recommend the following revenue requirements. The revenue requirement for the test year ending December 31, 2000 is \$1,779,101. Based on the adjusted test year revenues of \$1,794,660, the utility had excess revenues of \$15,559 (or 0.87%). The revenue requirement for the test year ending December 31, 2000, with 2001 pro forma expense adjustments, is \$1,858,492. This calculation reflects underearnings of \$63,832 (or 3.56%) from the adjusted test year revenues of \$1,794,660. Further, these recommended revenue requirements of the Seven Springs water system for refund and rate purposes are shown on Schedules Nos. 3-A and 3-C, respectively.

RATES AND RATE STRUCTURE

ISSUE 14: Did Aloha have excess earnings for the test year ended December 31, 2000, and if so, what is the appropriate regulatory treatment for these amounts?

RECOMMENDATION: Yes. Aloha's Seven Springs water system had excess earnings of \$15,559 for the test year ended December 31, 2000. However, refunds should not be required and, instead, the utility should be allowed to defer all overearnings to 2001. According to Rule 25-30.360, Florida Administrative Code, interest should be calculated on this amount based on the 30-day commercial paper rate. As of June 30, 2001, the amount of this liability is \$16,860. Upon issuance of the final order, the utility should defer \$15,559 and include the deferred revenues as a separate line item in its capital structure with a cost rate equal to the thirty-day commercial paper rate. (FLETCHER)

STAFF ANALYSIS: Based on staff's recommendation, Aloha's Seven Springs water system had excess earnings of \$15,559 for the test year ended December 31, 2000. Since the excess earnings are less than 1% of total revenues, staff believes the utility should be allowed to defer all overearnings to 2001. Staff believes that the cost of administering the refund could very easily be as much or more than the amount that should be refunded. Further, staff's analysis indicates that this system will not be overearning in 2001 due to increased O&M expenses for additional employees and increased purchased water costs. As such, staff does not believe the utility should be required to make any refunds. Deferring revenues will be more beneficial to customers, thereby lessening the amount of any potential future rate increase for this system.

Pursuant to Order No. PSC-00-1289-FOF-WS, the Commission held 3.04% of revenues subject to refund for the Seven Springs water system. As stated earlier, staff analysis indicates that this system had overearned in 2000 by 0.87% of revenues. As such, staff notes that the Commission held a sufficient amount of revenues to refund in order to defer all of the excess revenues in 2000.

The Commission has addressed revenue deferrals in the water and wastewater industry on several occasions. By Order No. PSC-98-1384-FOF-SU, issued October 14, 1998, in Docket No. 970991-SU, the Commission allowed Florida Cities Water Company (FCWC), to defer 1996 and 1997 excess earnings until 2000. In that case, the Commission found that water and wastewater utilities shall be afforded the opportunity to defer excess revenues, especially when long-term benefits exceed the short-term benefits of refunds and

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temporary rate reductions. See also Order No. PSC-99-1742-PAA-WS, issued September 7, 1999, in Docket No. 981258-WS; Order No. PSC-00-1165-PAA-WS, issued June 27, 2000, in Docket No. 990243-WS; and Order No. PSC-00-2117-PAA-SU, issued November 7, 2000, in Docket No. 000090-SU.

Staff believes that this case is similar to the cases noted above. Therefore, staff believes that the most prudent treatment for these excess earnings is to allow Aloha to defer these amounts to offset any underearnings in 2001. As discussed earlier, staff's analysis shows that the Seven Springs water system will already be slightly underearning in 2001. If Aloha continues to purchase greater quantities of water from Pasco County, the underearnings will be even greater.

For the foregoing reasons, staff recommends that no refunds should be required and that \$15,559 plus interest should be recorded on the utility's books as a deferred credit. According to Rule 25-30.360, Florida Administrative Code, interest should be calculated on this amount based on the 30-day commercial paper rate. As of June 30, 2001, the amount of this liability is \$16,860. Upon issuance of the final order, the utility should defer \$15,559 and include the deferred revenues as a separate line item in its capital structure with a cost rate equal to the thirty-day commercial paper rate.

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ISSUE 15: Should the present rates for the utility's Seven Springs water system be continued?

RECOMMENDATION: Yes. Based on staff's analysis, the prospective 2001 revenue requirement generates an achieved return below the minimum limit of the overall cost of capital. (FLETCHER)

STAFF ANALYSIS: Based on staff's analysis, the prospective 2001 revenue requirement generates an achieved return below the minimum limit of the overall cost of capital. Further, if the utility purchases additional water from Pasco County, the underearnings in 2001 will be greater. Aloha has filed for test year approval in Docket No. 010503-WU and is expected to file its MFRs by July 31, 2001 for the Seven Springs water system. Based on the above, staff recommends that it is inappropriate to lower rates as it would not allow the utility the opportunity to earn a fair rate of return on its investment and recover its prudent operating costs, as required by Section 367.081, Florida Statutes. Therefore, staff recommends that this system's present rates should be continued.

ISSUE 16: Should the Commission order Aloha Utilities, Inc., to refrain from increasing its Seven Springs water rates for the 2000 price index?

RECOMMENDATION: Yes. Since this system overearned during the December 31, 2000 test year, the Commission should order Aloha Utilities, Inc., to refrain from increasing its Seven Springs water rates pursuant to the provisions of Section 367.081(4)(a), Florida Statutes, for the 2000 price index. (FLETCHER, MONIZ, JAEGER, GERVASI)

STAFF ANALYSIS: On March 21, 2001, Aloha filed its Notice of Intent to Increase Its Rates (Notice) pursuant to the indexing and pass-through provisions of Sections 367.081(4)(a) and (b), Florida Statutes. In the Notice, Aloha requested that it be allowed to use the 2000 GNP Deflator Index factor set forth in Order No. PSC-00-0206-FOF-WS, issued February 1, 2000, in Docket No. 000005-WS. By the Notice, the utility sought to increase its water and wastewater rates for the Aloha Gardens service area, and its water rates for the Seven Springs service area.

At the May 15, 2001 agenda conference, the Commission denied the utility's requested 2000 index and pass-through for the Aloha Gardens water and wastewater systems in Docket No. 010518-WS, because these requested expenses were considered in the Commission's overearnings determinations for these systems. The Commission granted the utility's pass-through request for the Seven Springs water system. However, after discussion concerning whether the utility should be allowed to implement the 2000 index increase for the Seven Springs system, the Commission deferred its decision on the matter until after a decision is made on whether that system overearned in 2000.

Pursuant to Order No. PSC-00-0206-FOF-WS, the 2000 index application utilizes the historical 1999 year-end O&M expenses (absent certain specific accounts) and escalates them by the 2000 GNP Price Deflator Index factor of 1.36%. The purpose of the index provision is to allow utilities to increase their rates in order to offset the effects of inflation. If a utility overearns during a given year, staff believes that the effects of inflation have not harmed the utility and that an index for that year is unwarranted.

In Issue 14 of this recommendation, staff recommends that the Seven Springs water system overearned in 2000 by \$15,559. This recommendation takes into account the inflationary factor for the year 2000. If the Commission approves staff in Issue 14 or finds that the Seven Springs water system overearned at all in 2000,

staff recommends that the Commission order the utility to refrain from implementing the 2000 price index increase for this system. Staff notes that during discussion on this issue at the May 15, 2001, agenda conference, the utility agreed that it would be inappropriate for it to implement the 2000 price index increase if the Commission were to determine the utility to be in an overearnings posture.

Moreover, staff notes that Section 367.081(4)(d), Florida Statutes, authorizes the Commission to order a utility to refund, with interest, a price index (or pass-through) increase if, within 15 months after the filing of the annual report, "the [C]ommission finds that the utility exceeded the range of its last authorized rate of return on equity after an adjustment in rates . . . was implemented within the year for which the report was filed or was implemented in the preceding year." It makes no sense for the utility to implement a price index increase after the Commission has determined that the utility has overearned during that period, knowing that the Commission may order the price index increase to be refunded pursuant to Section 367.081(4)(d). Staff also notes, en passant, that pursuant to Section 367.081(4)(c), Florida Statutes, the utility filed an affirmation under oath as to the accuracy of the figures and calculations upon which the price index increase was based, stating that the change would not cause the utility to exceed the range of its last authorized rate of return on equity.

If the Commission does not approve Issue 14 of staff's recommendation and finds that the Seven Springs system did not overearn in 2000, the question remains as to whether the utility may implement the 2000 price index increase. As noted in our recommendation filed on this matter on May 3, 2001, in Docket No. 010518-WS, Section 367.081(4)(a), Florida Statutes, governs the implementation of a price index increase, and states in pertinent part:

The commission by rule shall establish the procedure to be used in determining such indices and a procedure by which a utility, without further action by the commission . . . may implement an increase or decrease in its rates based upon the application of the indices to the amount of the major categories of operating costs incurred by the utility during the immediately preceding calendar year, except to the extent of any disallowances or adjustments for those expenses of that utility in its most recent rate proceeding before the commission. . . . A utility may not use this procedure between the official

filing date of the rate proceeding and 1 year thereafter, unless the case is completed or terminated at an earlier date. A utility may not use this procedure . . . to increase its rates by application of a price index other than the most recent price index authorized by the commission at the time of filing. (emphasis added)

Rule 25-30.420, Florida Administrative Code, governs price index increases, and subsection (7) of that rule states: "No utility shall implement a rate increase pursuant to this rule within one year of the official date that it filed a rate proceeding, unless the rate proceeding has been completed or terminated."

Although Rule 25-30.420, Florida Administrative Code, refers to the date that the utility files a rate proceeding, the statutory reference is to "the rate proceeding," and states that the price index procedure may not be used "between the official filing date of the rate proceeding and 1 year thereafter, unless the case is completed or terminated at an earlier date." Pursuant to Section 367.083, Florida Statutes, the official date of filing for the overearnings investigation which is the subject of this docket is July 18, 2000, the issuance date of Order No. PSC-00-1289-FOF-WS, by which the investigation was initiated.

In our recommendation filed May 3, 2001, in Docket No. 010518-WS, based on our belief that an overearnings investigation is a Commission-initiated rate proceeding, and because we interpreted that "use of" the price index procedure began with the filing of the price index increase, staff recommended that the Commission find that Aloha may not use the price index procedure prior to the earlier of July 18, 2001, or the completion of the overearnings investigation for the Seven Springs water system.

However, upon further consideration of the arguments made during discussion on this issue at the May 15, 2001, agenda conference, staff is now in agreement with the utility and believes that the statutory prohibition against the use of the procedure between the official filing date of the rate proceeding and one year thereafter (unless the case is completed or terminated at an earlier date), indeed refers to the most recent rate proceeding filed by a utility, as opposed to an overearnings case initiated by the Commission.

This interpretation comports with Rule 25-30.420, Florida Administrative Code, and recognizes that a utility has no control over when the Commission initiates a rate proceeding, as opposed to when the utility files a rate proceeding of its own volition.

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Staff is also persuaded by the fact that if a utility is precluded from implementing a price index increase during the pendency of an overearnings investigation and the results of the investigation show that the utility was not overearning, the utility would have unduly lost its opportunity to collect the price index increase during the time that the investigation was ongoing for up to 12 months. Finally, and importantly, as previously noted, there are protections built into the price index statute which allow for the Commission to require a refund if a utility implements a price index increase for a period during which it is later determined to have overearned and utilities are required to affirm under oath that they do not believe the increase will cause them to overearn.¹

Moreover, staff notes that Rule 25-30.420(4), Florida Administrative Code, authorizes the Commission, upon a finding of good cause, to require that a price index rate increase be implemented under a bond or corporate undertaking in the same manner as interim rates. If, in the future, a utility insists upon filing and implementing a price index increase during the pendency of an overearnings investigation, the increase should be implemented under a bond or corporate undertaking in the same manner as interim rates, so that security will be in place in the event that a refund is ultimately required.

In summary, based upon our recommendation that the utility was overearning by \$15,559 for the year 2000, staff recommends that the Commission should order Aloha Utilities, Inc., to refrain from increasing its Seven Springs water rates pursuant to the price index provisions of Section 367.081(4)(a), Florida Statutes.

¹Staff further recognizes that it appears that the Commission has allowed the implementation of a price index increase in the past during the pendency of an overearnings investigation. See Dockets Nos. 930084-WU (Countywide Utility Company) and 961364-WS (Lindrick Service Corporation). However, staff notes that no discussion appears in the Orders issued in those dockets concerning the appropriateness of the implementation of those price index increases.

ISSUE 17: Should Docket No. 000737-WS be closed?

RECOMMENDATION: No. This docket should remain open pending staff's verification that the required refunds are made and the utility's submission of tariff sheets for the Aloha Gardens water and wastewater systems are consistent with the Commission's decision at the May 15, 2001 Agenda Conference. Upon staff's verification, this docket should be administratively closed, if no person whose substantial interests are affected by the Commission's May 15, 2001 PAA decision and this PAA for the Seven Springs water system files a protest within 21 days of the issuance of the respective Orders. Accordingly, if no protest is filed, the corporate undertaking for the Seven Spring water system should be released. (FLETCHER, JAEGER)

STAFF ANALYSIS: At the May 15, 2001 Agenda Conference, the Commission rendered a PAA decision requiring Aloha to make refunds to its Aloha Gardens water and wastewater customers and requiring Aloha to lower rates for these systems. This docket should remain open pending staff's verification that the required refunds are made and the utility's submission of tariff sheets for the Aloha Gardens water and wastewater systems are consistent with the Commission's decision at the May 15, 2001 Agenda Conference. Upon staff's verification, this docket should be administratively closed, if no person whose substantial interests are affected by the Commission's May 15, 2001 PAA decision and this PAA for the Seven Springs water system files a protest within 21 days of the issuance of the respective Orders. Accordingly, if no protest is filed, the corporate undertaking for the Seven Spring water system should be released.

ISSUE 18: Should Docket No. 010518-WS be closed?

RECOMMENDATION: Yes. If the Commission finds that Aloha overearned by \$15, 559 and no person whose substantial interests are affected by this PAA for the Seven Springs water system files a protest within 21 days of the issuance of the Order, the decision will become final and effective upon the issuance of a Consummating Order. Docket No. 010518-WS should be closed upon issuance of the Consummating Order. (FLETCHER, JAEGER)

STAFF ANALYSIS: If the Commission finds that Aloha overearned by \$15, 559 and no person whose substantial interests are affected by this PAA for the Seven Springs water system files a protest within 21 days of the issuance of the Order, the decision will become final and effective upon the issuance of a Consummating Order. Docket No. 010518-WS should be closed upon issuance of the Consummating Order.

DOCKET NO. 000737-WS, 010518-WS

DATE: May 31, 2001

**ALOHA UTILITIES, INC. - SEVEN SPRINGS SYSTEM
SCHEDULE OF WATER RATE BASE - FOR REFUND AND RATE PURPOSES
SIMPLE AVERAGE TEST YEAR ENDED 12/31/00**

**SCHEDULE NO. 1-A
DOCKET NO. 000737-WS**

DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUST- MENTS	ADJUSTED TEST YEAR PER UTILITY	STAFF ADJUST- MENTS	STAFF ADJUSTED TEST YEAR
1 UTILITY PLANT IN SERVICE	\$9,034,175	\$0	\$9,034,175	\$1,019	\$9,035,193
2 LAND & LAND RIGHTS	\$32,716	\$0	\$32,716	(\$970)	\$31,746
3 NON-USED & USEFUL	\$0	\$0	\$0	\$0	\$0
4 ACCUMULATED DEPRECIATION	(\$2,028,863)	\$0	(\$2,028,863)	(\$6,032)	(\$2,034,894)
5 CIAC	(\$8,854,421)	\$0	(\$8,854,421)	\$0	(\$8,854,421)
6 AMORTIZATION OF CIAC	\$1,887,823	\$0	\$1,887,823	(\$5,115)	\$1,882,708
7 DEFERRED INCOME TAXES	\$819,066	\$0	\$819,066	\$0	\$819,066
8 WORKING CAPITAL ALLOWANCE	<u>\$218,423</u>	<u>\$0</u>	<u>\$218,423</u>	<u>\$124,667</u>	<u>\$343,090</u>
RATE BASE	<u>\$1,108,918</u>	<u>\$0</u>	<u>\$1,108,918</u>	<u>\$113,570</u>	<u>\$1,222,488</u>

DOCKET NO. 000737-WS, 010518-WS
DATE: May 31, 2001

**ALOHA UTILITIES, INC. - SEVEN SPRINGS SYSTEM
ADJUSTMENTS TO RATE BASE - FOR REFUND AND RATE PURPOSES
SIMPLE AVERAGE TEST YEAR ENDED 12/31/00**

**SCHEDULE NO. 1-B
DOCKET NO. 000737-WS**

EXPLANATION	WATER
<u>PLANT IN SERVICE</u>	
Issue 1: To reflect the appropriate cost of new building and improvements.	<u>\$1,019</u>
<u>LAND</u>	
Issue 1: To reflect the appropriate cost land associated with the new building.	<u>(\$970)</u>
<u>ACCUMULATED DEPRECIATION</u>	
Issue 3: To reflect the correct depreciation rate for computer equipment.	<u>(\$6,032)</u>
<u>ACCUMULATED AMORTIZATION OF CIAC</u>	
Issue 4: Reflect the appropriate amortization of contributed taxes.	<u>(\$5,115)</u>
<u>WORKING CAPITAL</u>	
Issue 5: To reflect the appropriate working capital.	<u>\$124,667</u>

**ALOHA UTILITIES, INC. - SEVEN SPRINGS WATER SYSTEM
CAPITAL STRUCTURE - FOR REFUND AND RATE PURPOSES
SIMPLE AVERAGE TEST YEAR ENDED 12/31/00**

**SCHEDULE NO. 2
DOCKET NO. 000737-WS**

DESCRIPTION	TOTAL CAPITAL	SPECIFIC ADJUSTMENTS (EXPLAIN)	PRO RATA ADJUSTMENTS	CAPITAL RECONCILE TO RATE BASE	RATIO	COST RATE	WEIGHTED COST
PER UTILITY AVERAGE 2000							
1 LONG TERM DEBT	\$6,293,691	\$0	(\$5,535,748)	\$757,943	68.35%	10.33%	7.06%
2 SHORT-TERM DEBT	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
3 PREFERRED STOCK	\$600,000	\$0	(\$527,743)	\$72,257	6.52%	9.93%	0.65%
4 COMMON EQUITY	\$1,865,352	\$0	(\$1,640,709)	\$224,643	20.26%	9.93%	2.01%
5 CUSTOMER DEPOSITS	\$449,017 (1)	\$0	(\$394,942)	\$54,075	4.88%	6.00%	0.29%
6 OTHER	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
7 TOTAL CAPITAL	<u>\$9,208,059</u>	<u>\$0</u>	<u>(\$8,099,141)</u>	<u>\$1,108,918</u>	<u>100.00%</u>		<u>10.01%</u>
PER STAFF AVERAGE 2000							
8 LONG TERM DEBT	\$6,293,691	\$0	(\$5,458,123)	\$835,568	68.35%	10.28%	7.03%
9 SHORT-TERM DEBT	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
10 PREFERRED STOCK	\$600,000	\$0	(\$520,342)	\$79,658	6.52%	9.93%	0.65%
11 COMMON EQUITY	\$1,865,352	\$0	(\$1,617,702)	\$247,649	20.26%	9.93%	2.01%
12 CUSTOMER DEPOSITS	\$449,017	\$0	(\$389,404)	\$59,613	4.88%	6.00%	0.29%
13 OTHER	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
14 TOTAL CAPITAL	<u>\$9,208,059</u>	<u>\$0</u>	<u>(\$7,985,571)</u>	<u>\$1,222,488</u>	<u>100.00%</u>		<u>9.98%</u>
						LOW	HIGH
						RETURN ON EQUITY <u>8.93%</u>	<u>10.93%</u>
						OVERALL RATE OF RETURN <u>9.78%</u>	<u>10.18%</u>

Footnote:

(1) The source for the 1999 year-end balance is the utility's response to a staff's Interrogatory No. 37 provided in Docket No. 991643-SU.

**ALOHA UTILITIES, INC. - SEVEN SPRINGS SYSTEM
STATEMENT OF WATER OPERATIONS - FOR REFUND PURPOSES
SIMPLE AVERAGE TEST YEAR ENDED 12/31/00**

**SCHEDULE NO. 3-A
DOCKET NO. 000737-WS**

DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUST- MENTS	ADJUSTED TEST YEAR PER UTILITY	STAFF ADJUST- MENTS	STAFF ADJUSTED TEST YEAR	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	<u>\$1,794,660</u>	\$0	<u>\$1,794,660</u>	\$0	<u>\$1,794,660</u>	<u>(\$15,559)</u> -0.87%	<u>\$1,779,101</u>
OPERATING EXPENSES:							
2 OPERATION & MAINTENANCE	\$1,380,692	\$0	\$1,380,692	(\$29,334)	\$1,351,358		\$1,351,358
3 DEPRECIATION	\$69,796	\$0	69,796	4,021	73,817		73,817
4 AMORTIZATION	(\$42,214)	\$0	(42,214)	\$11,523	(30,691)		(30,691)
5 TAXES OTHER THAN INCOME	\$243,699	\$0	\$243,699	\$0	\$243,699	(\$700)	\$242,999
6 INCOME TAXES	<u>\$34,072</u>	\$0	<u>\$34,072</u>	<u>(\$8,871)</u>	<u>\$25,201</u>	<u>(\$5,591)</u>	<u>\$19,609</u>
7 TOTAL OPERATING EXPENSES	<u>\$1,686,045</u>	\$0	<u>\$1,686,045</u>	<u>(\$22,661)</u>	<u>\$1,663,384</u>	<u>(\$6,292)</u>	<u>\$1,657,092</u>
8 OPERATING INCOME	<u>\$108,615</u>	\$0	<u>\$108,615</u>	<u>\$22,661</u>	<u>\$131,276</u>	<u>(\$9,268)</u>	<u>\$122,008</u>
9 RATE BASE	<u>\$1,108,918</u>		<u>\$1,108,918</u>		<u>\$1,222,488</u>		<u>\$1,222,488</u>
10 RATE OF RETURN	<u>9.79%</u>		<u>9.79%</u>		<u>10.74%</u>		<u>9.98%</u>

**ALOHA UTILITIES, INC. - SEVEN SPRINGS SYSTEM
 ADJUSTMENTS TO OPERATING INCOME - FOR REFUND PURPOSES
 SIMPLE AVERAGE TEST YEAR ENDED 12/31/00**

**SCHEDULE NO. 3-B
 DOCKET NO. 000737-WS**

EXPLANATION	WATER
<u>OPERATION & MAINTENANCE EXPENSE</u>	
1 Issue 5: Amortize regulatory commission expenses of Docket No. 960545-WS.	\$65,735
2 Issue 10: Related party purchased water expense.	<u>(95,070)</u>
Total	<u>(\$29,334)</u>
<u>DEPRECIATION EXPENSE</u>	
Issue 3: To reflect the correct depreciation rate for computer equipment.	<u>\$4,021</u>
<u>AMORTIZATION EXPENSE</u>	
Issue 4: Reflect the appropriate amortization of contributed taxes.	<u>\$11,523</u>
<u>INCOME TAXES</u>	
To adjust to test year income tax expense.	<u>(\$8,871)</u>

DATE: May 31, 2001

**ALOHA UTILITIES, INC. - SEVEN SPRINGS SYSTEM
STATEMENT OF WATER OPERATIONS - FOR RATE PURPOSES
SIMPLE AVERAGE TEST YEAR ENDED 12/31/00**

**SCHEDULE NO. 3-C
DOCKET NO. 000737-WS**

DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUST- MENTS	ADJUSTED TEST YEAR PER UTILITY	STAFF ADJUST- MENTS	STAFF ADJUSTED TEST YEAR	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	<u>\$1,794,660</u>	<u>\$0</u>	<u>\$1,794,660</u>	<u>\$0</u>	<u>\$1,794,660</u>	<u>\$6,168</u> 0.34%	<u>\$1,800,828</u>
OPERATING EXPENSES:							
2 OPERATION & MAINTENANCE	<u>\$1,380,692</u>	<u>\$0</u>	<u>\$1,380,692</u>	<u>\$45,036</u>	<u>\$1,425,728</u>		<u>\$1,425,728</u>
3 DEPRECIATION	<u>\$69,796</u>	<u>\$0</u>	<u>69,796</u>	<u>4,021</u>	<u>73,817</u>		<u>73,817</u>
4 AMORTIZATION	<u>(\$42,214)</u>	<u>\$0</u>	<u>(42,214)</u>	<u>\$11,523</u>	<u>(30,691)</u>		<u>(30,691)</u>
5 TAXES OTHER THAN INCOME	<u>\$243,699</u>	<u>\$0</u>	<u>\$243,699</u>	<u>\$1,449</u>	<u>\$245,148</u>	<u>\$278</u>	<u>\$245,425</u>
6 INCOME TAXES	<u>\$34,072</u>	<u>\$0</u>	<u>\$34,072</u>	<u>(\$36,289)</u>	<u>(\$2,217)</u>	<u>\$2,217</u>	<u>(\$0)</u>
7 TOTAL OPERATING EXPENSES	<u>\$1,686,045</u>	<u>\$0</u>	<u>\$1,686,045</u>	<u>\$25,740</u>	<u>\$1,711,785</u>	<u>\$2,494</u>	<u>\$1,714,280</u>
8 OPERATING INCOME	<u>\$108,615</u>	<u>\$0</u>	<u>\$108,615</u>	<u>(\$25,740)</u>	<u>\$82,875</u>	<u>\$3,674</u>	<u>\$86,549</u>
9 RATE BASE	<u>\$1,108,918</u>		<u>\$1,108,918</u>		<u>\$1,222,488</u>		<u>\$1,222,488</u>
10 RATE OF RETURN	<u>9.79%</u>		<u>9.79%</u>		<u>6.78%</u>		<u>7.08%</u>

**ALOHA UTILITIES, INC. - SEVEN SPRINGS SYSTEM
 ADJUSTMENTS TO OPERATING INCOME - FOR RATE PURPOSES
 SIMPLE AVERAGE TEST YEAR ENDED 12/31/00**

**SCHEDULE NO. 3-D
 DOCKET NO. 000737-WS**

EXPLANATION	WATER
<u>OPERATION & MAINTENANCE EXPENSE</u>	
1 Issue 1: To remove rent expense from old building.	(\$6,117)
2 Issue 5: Amortize regulatory commission expenses of Docket No. 960545-WS.	65,735
3 Issue 10: Related party purchased water expense.	(95,070)
4 Issue 11: Proforma salaries.	18,938
5 Issue 11: Proforma benefits.	6,496
6 Issue 11: To reflect the significant increase of purchased water in the first quarter of 2001.	55,053
Total	<u>\$45,036</u>
<u>DEPRECIATION EXPENSE</u>	
Issue 3: To reflect the correct depreciation rate for computer equipment.	<u>\$4,021</u>
<u>AMORTIZATION EXPENSE</u>	
Issue 4: Reflect the appropriate amortization of contributed taxes.	<u>\$11,523</u>
<u>TAXES OTHER THAN INCOME</u>	
Issue 11: Increase Payroll tax associated with proforma salaries.	<u>\$1,449</u>
<u>INCOME TAXES</u>	
To adjust to test year income tax expense.	<u>(\$36,289)</u>