

State of Florida



Public Service Commission  
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TALLAHASSEE, FLORIDA 32399-0850

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COMMISSION CLERK

DATE: SEPTEMBER 20, 2001

TO: DIRECTOR, DIVISION OF THE COMMISSION CLERK & ADMINISTRATIVE SERVICES (BAYÓ)

FROM: DIVISION OF ECONOMIC REGULATION (B. DAVIS, D. DRAPER, MERCHANT) *DM*  
DIVISION OF LEGAL SERVICES (BRUBAKER) *JB RS*

*ALM*

RE: DOCKET NO. 011188-WS - INVESTIGATION OF POSSIBLE OVEREARNINGS BY SANLANDO UTILITIES CORPORATION IN SEMINOLE COUNTY.  
COUNTY: SEMINOLE

AGENDA: 10/02/01 - REGULAR AGENDA - DECISION ON SETTING REVENUES SUBJECT TO REFUND - INTERESTED PERSONS MAY PARTICIPATE ON ISSUE 1 ONLY - PARTICIPATION IS LIMITED TO COMMISSIONERS AND STAFF ON ISSUES 2 - 3

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\WP\011188.RCM

CASE BACKGROUND

Sanlando Utilities Corporation (Sanlando or utility) is a Class A water and wastewater utility located in Altamonte Springs, Florida, which operates three water and two wastewater plants. Sanlando's service area lies within the St. Johns River Water Management District (SJRWMD), which has declared its entire district as a water use caution area.

The utility's last rate proceeding was an overearnings investigation in Docket No. 980670-WS. By Order No. PSC-00-1263-PAA-WS, issued July 10, 2000, the overearnings investigation was consolidated with Sanlando's reuse project application, Docket No. 971186-SU. These dockets were disposed of by Order No. PSC-00-

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2097-AS-WS, issued November 6, 2000. This order approved a settlement agreement which included disposition of 1999 excess earnings and established a return on equity (ROE) of 8.89%, with a range of 7.89% to 9.89%. The major components of the settlement agreement also provided that Sanlando reduce its monthly water base facility charge in order to reduce annual water revenues by \$120,000. In addition, for at least two (2) years after completion of construction of the reuse project approved by the Commission in Order No. PSC-00-1263-PAA-WS, Sanlando shall not file a rate case nor implement a water price index rate increase during that time frame. Sanlando may, however, implement a wastewater price index rate increase beginning with the 2001 price index. The stipulation also affirmed the provisions and rulings in Order No. PSC-00-1263-PAA-WS and charged the 1999 water and wastewater overearnings to contributions in aid of construction (CIAC).

Based on staff's review of the utility's 2000 Annual Report, the utility achieved a 29.69% overall rate of return on its water rate base and a 22.30% overall rate of return on its wastewater rate base. This equates to a 52.56% ROE for the water system and a 38.22% ROE for the wastewater system. Both of these exceeded the 8.89% ROE authorized by Order No. PSC-00-2097-AS-WS. Staff believes it is necessary and appropriate to initiate an investigation into the potential annual overearnings of this utility.

The Commission has jurisdiction pursuant to Sections 367.081, 367.082 and 367.121, Florida Statutes.

**DISCUSSION OF ISSUES**

**ISSUE 1:** Should the Commission initiate an overearnings investigation of Sanlando Utilities Corporation?

**RECOMMENDATION:** Yes. The Commission should initiate an investigation of the utility for possible overearnings. The test year for the investigation should be the year ended December 31, 2000. The docket should remain open pending the Commission's completion of the investigation. (B. DAVIS)

**STAFF ANALYSIS:** Section 367.082, Florida Statutes, authorizes the Commission to initiate an investigation of a utility's earnings upon a preliminary demonstration that the utility is earning a rate of return which is outside the range of reasonableness. To the extent that the achieved rate of return exceeds the required rate of return on rate base, the Commission may require revenues to be collected subject to refund pending the completion of the investigation.

Staff's preliminary analysis, based on the review of the utility's 2000 Annual Report, indicates that the utility's water system earned a 28.78% overall rate of return and the wastewater system earned a 22.30% overall rate of return. Using the utility's 2000 capital structure from the Annual Report, adjusted to reclassify net debit deferred taxes to rate base, the maximum of the range of reasonableness for the rate of return is 9.36%. Staff believes that these achieved returns for water and wastewater clearly exceeded the last authorized return.

In June 2001, staff spoke with the utility regarding the 2000 earnings levels for several of the Utilities, Inc. systems. By facsimile dated July 23, 2001, Mr. Carl Wenz responded for the utility. Regarding the Sanlando system, Mr. Wenz objected to staff's proposal to "rewrite" the terms of the settlement by recommending that an overearnings investigation be initiated. He stated that all parties were involved in the terms of the settlement and that overearnings in 2000 and 2001 may exceed the estimates but that underearnings in the latter two years could also exceed the estimates. Mr. Wenz continued that how accurate the estimates compare to the actual earnings is irrelevant since the settlement was agreed upon in good faith. In conclusion, Mr. Wenz stated that Sanlando intends to honor the settlement agreement and expects the other parties to do the same.

DOCKET NO. 011188-WS  
DATE: SEPTEMBER 20, 2001

Staff notes that the settlement approved by Order No. PSC-00-2097-AS-WS fully addressed the overearnings known at that time, but did not address any overearnings incurred subsequent to 1999 and before the completion of the reuse project. The settlement also prohibits Sanlando from requesting a rate case or filing for a water price index until two years after the completion of the reuse facilities. However, the settlement does not, nor could it, prohibit the Commission from prescribing fair and reasonable rates pursuant to Section 367.121(1)(a), Florida Statutes. By capturing these possible overearnings and requiring the utility to hold them subject to refund as recommended in Issue 2, staff believes that the Commission will be complying with its statutory mandate to prescribe fair and reasonable rates.

Based on the above, staff believes that a full investigation of this utility's earnings for water and wastewater service is appropriate. The test year for the investigation should be the year ended December 31, 2000. The docket should remain open pending the Commission's completion of the investigation.

**ISSUE 2:** Should any amount of annual water and wastewater revenue be held subject to refund and, if so, what is the appropriate amount?

**RECOMMENDATION:** Yes, the utility should hold annual water revenue of \$632,257 and annual wastewater revenue of \$462,360, for a total annual revenue of \$1,094,617 subject to refund. The following amounts are recommended:

	<u>Water</u>	<u>Wastewater</u>
Revenue Requirement	\$1,564,269	\$2,543,091
2000 Test Year Revenue	\$2,196,526	\$3,005,451
Amount Subject to Refund	\$632,257	\$462,360
Percent Subject to Refund	28.78%	15.38%

(B. DAVIS)

**STAFF ANALYSIS:** Pursuant to Section 367.082, Florida Statutes, in determining whether an interim decrease is appropriate, the Commission shall determine, on a prima facie basis, if the utility's achieved rate of return exceeds its required rate of return. The achieved rate of return for interim purposes shall be calculated by applying adjustments consistent with those made in the utility's most recent rate proceeding, and annualizing any rate changes that occurred during the interim test year. The required rate of return is calculated by taking the test year cost of capital and using the maximum of the range of the last authorized ROE. Staff has reviewed the utility's annual report to determine if the utility's reported rate base, cost of capital and net operating income amounts are consistent with the interim statute.

**Rate Base**

Order No. PSC-00-1263-PAA-WS established rate base in the last overearnings proceeding. In that Order, the Commission included the total balance of Sanlando's construction work in progress (CWIP). To be consistent, staff has included CWIP in rate base for this evaluation. Also in that Order, the Commission calculated the allowance for working capital using the balance sheet approach. In its annual report, the utility presented working capital using the formula method or 1/8 of operation and maintenance expense. Staff has adjusted working capital to reflect the balance sheet method to

be consistent with the method used in the last rate proceeding. Based on the above, staff recommends that working capital be reduced by \$67,917 and \$127,838 for water and wastewater, respectively.

In its capital structure, the utility included debit deferred income taxes as a reduction to capital. Rule 25-30.433(3), Florida Administrative Code, specifies that used and useful debit deferred taxes shall be offset against used and useful credit deferred taxes in the capital structure. Any resulting net debit deferred taxes shall be included as a separate line item in the rate base calculation. Staff has adjusted the capital structure and rate base amounts to show the net debit deferred taxes as a regulatory asset on a separate line in the rate base amounts.

Based on our review, no further adjustments to rate base are necessary. Staff's adjusted rate base amounts are \$1,938,708 and \$2,128,680 for water and wastewater, respectively. Schedules 1-A and 1-B reflect staff's recommended rate base for water and wastewater, respectively. The adjustments to rate base are attached as Schedule 1-C.

### Cost of Capital

For ratemaking purposes, Sanlando's capital structure reflects the debt and equity ratios of the parent's capital structure. In most instances, the subsidiaries of Utilities, Inc. have capital structures that consist of 100% equity since no debt is issued at the subsidiary level. Customer deposits and deferred income taxes are specifically identified and reflected at each subsidiary's level. This is consistent with the ratemaking treatment used for all other Florida-regulated Utilities, Inc. subsidiaries. See Order No. PSC-98-0524-FOF-SU, issued April 16, 1998, in Docket No. 971065-SU, for Mid-County Services, Inc., another wholly-owned subsidiary of Utilities, Inc.

Using the maximum of the range of the previously authorized return on equity of 9.89% from Order No. PSC-00-2097-AS-WS and the reported cost rates for other components in the utility's adjusted capital structure, yields a 9.36% overall cost of capital for interim purposes. Schedule No. 2 reflects staff's adjusted cost of capital.

**Net Operating Income**

The 2000 Annual Report reflects water operating revenues totaling \$2,316,526 and wastewater operating revenues totaling \$3,005,451. One of the terms approved in the settlement by Order No. PSC-00-2097-AS-WS was for the utility to reduce its base facility charge in order to reduce its water revenue by \$120,000. Staff has applied this reduction to the utility's 2000 water revenue. The adjusted water revenue is \$2,196,526. Staff has made a corresponding reduction to taxes other than income of \$5,400 for regulatory assessment fees associated with the revenue reduction.

Staff has also recalculated income tax expense based on the adjusted rate base, cost of capital and operating income amounts. After making the above adjustments, staff recommends that the test year net operating income should be \$558,040 for water and \$474,623 for wastewater. This reflects an achieved overall rate of return of 28.78% for water and 22.30% for wastewater. The water and wastewater schedules of net operating income are attached as Schedules 3-A and 3-B, respectively, with the adjustments shown on Schedule 3-C.

**Revenue Requirement**

Using the required rate of return for interim purposes of 9.36%, staff recommends that the water revenue requirement should be \$1,564,269 and the wastewater revenue requirement should be \$2,543,091. This reflects a decrease of \$632,257 (or 28.78%) from the adjusted test year water operating revenues of \$2,196,526 and a decrease of \$462,360 (or 15.38%) from the adjusted test year wastewater operating revenues of \$3,005,451. This represents the annual revenues that should be held subject to refund pending the Commission's final determination of Sanlando's level of earnings in this docket.

**ISSUE 3:** What is the appropriate security to guarantee the amount subject to refund?

**RECOMMENDATION:** The utility should be required to file a corporate undertaking to guarantee the amount subject to refund within 10 days of the effective date of the order opening this investigation. The corporate undertaking should be in the amount of \$930,000. Pursuant to Rule 25-30.360(6), Florida Administrative Code, the utility should be required to provide a report by the 20th of each month indicating the monthly and total revenue collected subject to refund. The utility should be put on notice that failure to comply in a timely manner with these requirements on a timely basis will result in the initiation of a show cause proceeding. (D. DRAPER, B. DAVIS)

**STAFF ANALYSIS:** Pursuant to Section 367.082(2)(b), Florida Statutes, when revenues are held subject to refund and secured in a proceeding for an interim decrease, the utility is authorized to continue collecting the previously authorized rates. The amount of potential overearnings on a combined annual basis is \$1,094,617 for the water and wastewater systems. Assuming a 10-month time frame, the potential amount subject to refund is \$930,000.

Staff has analyzed whether Sanlando can support a corporate undertaking in the amount of \$930,000. The criteria for a corporate undertaking include sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. The 1998, 1999 and 2000 annual reports of Sanlando were used to determine the financial condition of the utility. Staff's analysis shows that the utility has minimal liquidity for the three-year period, but adequate equity, positive income and strong interest coverage for the same period. Based upon this analysis, staff recommends that Sanlando can support a corporate undertaking in the amount of \$930,000.

This brief financial analysis is only appropriate for deciding whether the utility can support a corporate undertaking in the amount proposed and should not be considered a finding regarding staff's position on other issues in this investigation.

The utility shall keep an accurate and detailed account of all monies it receives. Pursuant to Rule 25-30.360(6), Florida Administrative Code, the utility should provide a report by the 20th day of each month indicating the monthly and total revenue



DOCKET NO. 011188-WS  
DATE: SEPTEMBER 20, 2001

collected subject to refund. Should a refund be required, it shall be made with interest and undertaken in accordance with Rule 25-30.360, Florida Administrative Code.

In no instance should maintenance and administrative costs associated with any refund or other dispositions be borne by the customers. The costs are the responsibility of, and should be borne by, the utility. Finally, the utility should be on notice that failure to comply on a timely basis with the requirements of the Commission's order will result in the initiation of a show cause proceeding.

SANLANDO UTILITIES CORPORATION SCHEDULE OF WATER RATE BASE TEST YEAR ENDED 12/31/00			SCHEDULE NO. 1-A DOCKET 011188-WS
DESCRIPTION	TEST YEAR PER UTILITY	STAFF ADJUSTMENTS	STAFF ADJUSTED TEST YEAR
1 UTILITY PLANT IN SERVICE	\$13,157,058	\$0	\$13,157,058
2 LAND & LAND RIGHTS	\$322,873	\$0	\$322,873
3 NON-USED & USEFUL COMPONENTS	\$0	\$0	\$0
4 ACCUMULATED DEPRECIATION	(\$6,498,769)	\$0	(\$6,498,769)
5 CIAC	(\$10,988,429)	\$0	(\$10,988,429)
6 AMORTIZATION OF CIAC	\$5,658,815	\$0	\$5,658,815
7 CWIP	\$197,746	\$0	\$197,746
8 DEFERRED INCOME TAXES	\$0	\$23,599	\$23,599
9 WORKING CAPITAL ALLOWANCE	<u>\$133,732</u>	<u>(\$67,917)</u>	<u>\$65,815</u>
10 <b>RATE BASE</b>	<u>\$1,983,026</u>	<u>(\$44,318)</u>	<u>\$1,938,708</u>

SANLANDO UTILITIES CORPORATION SCHEDULE OF WASTEWATER RATE BASE TEST YEAR ENDED 12/31/00			SCHEDULE NO. 1-B DOCKET 011188-WS
DESCRIPTION	TEST YEAR PER UTILITY	STAFF ADJUSTMENTS	STAFF ADJUSTED TEST YEAR
1 UTILITY PLANT IN SERVICE	\$14,249,984	\$0	\$14,249,984
2 LAND	\$202,552	\$0	\$202,552
3 NON-USED & USEFUL COMPONENTS	\$0	\$0	\$0
4 ACCUMULATED DEPRECIATION	(\$8,336,144)	\$0	(\$8,336,144)
5 CIAC	(\$11,571,227)	\$0	(\$11,571,227)
6 AMORTIZATION OF CIAC	\$6,757,721	\$0	\$6,757,721
7 CWIP	\$675,375	\$0	\$675,375
8 DEFERRED INCOME TAXES	\$0	\$26,538	\$26,538
9 WORKING CAPITAL ALLOWANCE	\$251,719	(\$127,838)	\$123,881
10 <b>RATE BASE</b>	<u>\$2,229,980</u>	<u>(\$101,300)</u>	<u>\$2,128,680</u>

SANLANDO UTILITIES CORPORATION ADJUSTMENTS TO RATE BASE TEST YEAR ENDED 12/31/00		SCHEDULE NO. 1-C DOCKET 011188-WS	
EXPLANATION	WATER	WASTEWATER	
<b><u>DEFERRED INCOME TAXES</u></b> To show debit deferred taxes	<u>\$23,599</u>	<u>\$26,538</u>	
<b><u>WORKING CAPITAL</u></b> To show balance sheet working capital	<u>(\$67,917)</u>	<u>(\$127,838)</u>	

DOCKET NO. 011188-WS  
 DATE: SEPTEMBER 20, 2001

SANLANDO UTILITIES CORPORATION CAPITAL STRUCTURE TEST YEAR ENDED 12/31/00						SCHEDULE NO. 2 DOCKET 011188-WS	
DESCRIPTION	TOTAL CAPITAL	SPECIFIC ADJUSTMENTS	PRO RATA ADJUSTMENTS	CAPITAL RECONCILED TO RATE BASE	RATIO	COST RATE	WEIGHTED COST
<b>PER UTILITY</b>							
1 LONG TERM DEBT	\$2,030,946	\$0	\$0	\$2,030,946	48.21%	8.56%	4.13%
2 SHORT-TERM DEBT	\$207,239	\$0	\$0	\$207,239	4.92%	14.32%	0.70%
3 PREFERRED STOCK	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
4 COMMON EQUITY	\$1,906,602	\$0	\$0	\$1,906,602	45.26%	8.89%	4.02%
5 CUSTOMER DEPOSITS	\$118,355	\$0	\$0	\$118,355	2.81%	6.00%	0.17%
6 DEFERRED INCOME TAXES	(\$50,137)	\$0	\$0	(\$50,137)	-1.19%	0.00%	0.00%
7 OTHER	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
8 <b>TOTAL CAPITAL</b>	<u>\$4,213,005</u>	<u>\$0</u>	<u>\$0</u>	<u>\$4,213,005</u>	<u>100.00%</u>		<u>9.02%</u>
<b>PER STAFF</b>							
9 LONG TERM DEBT	\$2,030,946	\$0	(\$95,919)	\$1,935,027	47.57%	8.56%	4.07%
10 SHORT-TERM DEBT	\$207,239	\$0	(\$9,788)	\$197,451	4.85%	14.32%	0.70%
11 PREFERRED STOCK	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
12 COMMON EQUITY	\$1,906,602	\$0	(\$90,047)	\$1,816,555	44.66%	8.89%	3.97%
13 CUSTOMER DEPOSITS	\$118,355	\$0	\$0	\$118,355	2.91%	6.00%	0.17%
14 DEFERRED INCOME TAXES	(\$50,137)	\$50,137	\$0	\$0	0.00%	0.00%	0.00%
15 OTHER	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
16 <b>TOTAL CAPITAL</b>	<u>\$4,213,005</u>	<u>\$50,137</u>	<u>(\$195,754)</u>	<u>\$4,067,389</u>	<u>100.00%</u>		<u>8.91%</u>
						<b>LOW</b>	<b>HIGH</b>
						<u>7.89%</u>	<u>9.89%</u>
						<b>OVERALL RATE OF RETURN</b>	<u>9.36%</u>

DOCKET NO. 011188-WS  
 DATE: SEPTEMBER 20, 2001

SANLANDO UTILITIES CORPORATION STATEMENT OF WATER OPERATIONS TEST YEAR ENDED 12/31/00				SCHEDULE NO. 3-A DOCKET 011188-WS	
DESCRIPTION	TEST YEAR PER UTILITY	STAFF ADJUSTMENTS	STAFF ADJUSTED TEST YEAR	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	<u>\$2,316,526</u>	<u>(\$120,000)</u>	<u>\$2,196,526</u>	<u>(\$632,257)</u> -28.78%	<u>\$1,564,269</u>
<b>OPERATING EXPENSES:</b>					
2 OPERATION & MAINTENANCE	1,069,858	0	1,069,858		1,069,858
3 DEPRECIATION	140,309	0	140,309		140,309
4 AMORTIZATION	4,399	0	4,399		4,399
5 TAXES OTHER THAN INCOME	150,443	(5,400)	145,043	(28,452)	116,591
6 INCOME TAXES	<u>\$314,612</u>	<u>(\$35,735)</u>	<u>\$278,877</u>	<u>(\$227,212)</u>	<u>\$51,665</u>
7 TOTAL OPERATING EXPENSES	<u>\$1,679,621</u>	<u>(\$41,135)</u>	<u>\$1,638,486</u>	<u>(\$255,664)</u>	<u>\$1,382,823</u>
8 OPERATING INCOME	<u>\$636,905</u>	<u>(\$78,865)</u>	<u>\$558,040</u>	<u>(\$376,593)</u>	<u>\$181,446</u>
9 RATE BASE	<u>\$1,983,026</u>		<u>\$1,938,708</u>		<u>\$1,938,708</u>
10 RATE OF RETURN	<u>32.12%</u>		<u>28.78%</u>		<u>9.36%</u>

DOCKET NO. 011188-WS  
 DATE: SEPTEMBER 20, 2001

SANLANDO UTILITIES CORPORATION STATEMENT OF WASTEWATER OPERATIONS TEST YEAR ENDED 12/31/00				SCHEDULE NO. 3-B DOCKET 011188-WS	
DESCRIPTION	TEST YEAR PER UTILITY	STAFF ADJUSTMENTS	STAFF ADJUSTED TEST YEAR	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	<u>\$3,005,451</u>	<u>\$0</u>	<u>\$3,005,451</u>	<u>(\$462,360)</u> -15.38%	<u>\$2,543,091</u>
<b>OPERATING EXPENSES</b>					
2 OPERATION & MAINTENANCE	2,013,751	\$0	\$2,013,751		\$2,013,751
3 DEPRECIATION	117,666	\$0	\$117,666		\$117,666
4 AMORTIZATION	2,205	\$0	\$2,205		\$2,205
5 TAXES OTHER THAN INCOME	174,321	\$0	\$174,321	(\$20,806)	\$153,515
6 INCOME TAXES	<u>\$227,170</u>	<u>(\$4,285)</u>	<u>\$222,885</u>	<u>(\$166,157)</u>	<u>\$56,728</u>
7 TOTAL OPERATING EXPENSES	<u>\$2,535,113</u>	<u>(\$4,285)</u>	<u>\$2,530,828</u>	<u>(\$186,963)</u>	<u>\$2,343,865</u>
8 OPERATING INCOME	<u>\$470,338</u>	<u>\$4,285</u>	<u>\$474,623</u>	<u>(\$275,397)</u>	<u>\$199,226</u>
9 RATE BASE	<u>\$2,229,980</u>		<u>\$2,128,680</u>		<u>\$2,128,680</u>
10 RATE OF RETURN	<u>21.09%</u>		<u>22.30%</u>		<u>9.36%</u>

<b>SANLANDO UTILITIES CORPORATION</b>		<b>SCHEDULE. 3-C</b>	
<b>ADJUSTMENTS TO OPERATING INCOME</b>		<b>DOCKET 011188-WS</b>	
<b>TEST YEAR ENDED 12/31/00</b>			
<b>EXPLANATION</b>	<b>WATER</b>	<b>WASTEWATER</b>	
<b><u>OPERATING REVENUES</u></b>			
Revenue Adjustment from Stipulation	<u>(\$120,000)</u>	<u>\$0</u>	
<b><u>TAXES OTHER THAN INCOME</u></b>			
RAFs on revenue adjustments above	<u>(\$5,400)</u>	<u>\$0</u>	
<b><u>INCOME TAXES</u></b>			
To adjust to test year income tax expense	<u>(\$35,735)</u>	<u>(\$4,285)</u>	