



# Public Service Commission

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## -M-E-M-O-R-A-N-D-U-M-

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COMMISSION  
CLERK

**DATE:** FEBRUARY 7, 2002

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

**FROM:** DIVISION OF ECONOMIC REGULATION (KYLE, MERCHANT)  
OFFICE OF THE GENERAL COUNSEL (BRUBAKER)

*[Handwritten signatures and initials]*

**RE:** DOCKET NO. 991890-WS - INVESTIGATION INTO RATEMAKING  
CONSIDERATION OF GAIN ON SALE FROM SALES OF FACILITIES OF  
UTILITIES, INC. OF FLORIDA TO THE CITY OF MAITLAND IN  
ORANGE COUNTY AND THE CITY OF ALTAMONTE SPRINGS IN  
SEMINOLE COUNTY.

**AGENDA:** 02/19/02 - REGULAR AGENDA - PROPOSED AGENCY ACTION -  
INTERESTED PERSONS MAY PARTICIPATE

**CRITICAL DATES:** NONE

**SPECIAL INSTRUCTIONS:** NONE

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\991890.RCM

### CASE BACKGROUND

Utilities, Inc. of Florida (UIF or utility), on a total company basis, is a Class A utility providing water and wastewater service to systems in the following counties: Marion, Orange, Pasco, Pinellas, and Seminole. Involved in this docket are the utility's systems in Orange and Seminole Counties. The Orange and Seminole County systems are located in a water caution area in the St. Johns River Water Management District Water Conservation Area.

According to its 2000 annual report, UIF's systems in Orange and Seminole County reported the following:

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| <u>County</u> | <u>Water<br/>Customers</u> | <u>Wastewater<br/>Customers</u> | <u>Water<br/>Operating<br/>Revenues</u> | <u>Wastewater<br/>Operating<br/>Revenues</u> |
|---------------|----------------------------|---------------------------------|---|--|
| Orange        | 327                        | N/A                             | \$ 87,624                               | N/A  |
| Seminole      | 2,645                      | 1,430                           | \$674,136                               | \$426,468                                    |

By Order No. PSC-99-2171-FOF-WU, issued November 8, 1999, in Docket No. 981589-WU, the Commission approved the sale of UIF's Druid Isles water system and a portion of its Oakland Shores water system to the City of Maitland and ordered the opening of a docket to examine whether the sale involves a gain that should be shared with the utility's remaining customers in Orange County. By Order No. PSC-99-2373-FOF-WS, issued December 6, 1999, in Docket No. 991288-WS, the Commission approved the sale of UIF's Green Acres facilities to the City of Altamonte Springs and ordered the opening of a docket to examine whether the sale involves a gain that should be shared with the utility's remaining customers in Seminole County. On December 10, 1999, the Commission opened this docket to address the ratemaking considerations of these sales.

On February 10, 2000, staff sent the utility its first set of interrogatories. On March 21, 2000, UIF filed its responses to our first set of interrogatories. On April 13, 2000, staff sent a questionnaire to other state utility commissions regarding any policies on sharing of gains with ratepayers.

This recommendation addresses the proper regulatory treatment of any gains resulting from the sale of a portion of the utility's facilities. The Commission has jurisdiction pursuant to Sections 367.081 and 367.121, Florida Statutes.

DISCUSSION OF ISSUES

ISSUE 1: Was a gain realized on the sale of UIF's Druid Isle water system and a portion of its Oakland Shores water system to the City of Maitland in Orange County?

RECOMMENDATION: Yes. Staff believes a gain of \$61,669 was realized on the sale of UIF's Druid Isle water system and a portion of its Oakland Shores water system to the City of Maitland in Orange County. (KYLE)

STAFF ANALYSIS: On February 15, 1999, the utility transferred its Druid Isle water system and a portion of its Oakland Shores water system to the City of Maitland (hereafter referred to as the "Maitland Sale") in Orange County. The transfer included all 51 customers of the Druid Isle system and 40 of the 293 customers of the Oakland Shores system. By Order No. PSC-99-2171-FOF-WU, issued November 8, 1999, in Docket No. 981589-WU, the Commission approved the Maitland Sale. In its response to staff's discovery, the utility calculated the following net gain for the Maitland Sale.

|                     |                  |
|---------------------|------------------|
| Proceeds from Sale  | \$159,000        |
| Deductions:         |                  |
| Book Basis of Plant | 31,267           |
| Selling Costs       | <u>27,832</u>    |
| Pre-Tax Gain        | \$ 99,901        |
| Taxes (38.27%)      | <u>38,232</u>    |
| Net Gain            | <u>\$ 61,669</u> |

Based on staff's review, the utility's calculation appears reasonable. Thus, staff believes that a gain of \$61,669 was realized on the Maitland Sale.

**ISSUE 2:** Was a gain realized on the sale of UIF's Green Acres Campground water and wastewater facilities to the City of Altamonte Springs in Seminole County?

**RECOMMENDATION:** Yes. Staff believes a gain of \$269,661 was realized on the sale of UIF's Green Acres Campground water and wastewater facilities to the City of Altamonte Springs in Seminole County. (KYLE)

**STAFF ANALYSIS:** On August 18, 1999, the utility transferred its Green Acres Campground water and wastewater facilities to the City of Altamonte Springs (hereafter referred to as the "Altamonte Sale") in Seminole County. By Order No. PSC-99-2373-FOF-WS, issued December 6, 1999, in Docket No. 991288-WS, the Commission approved the Altamonte Sale. In its response to staff's first set of interrogatories, the utility calculated the following net gain for the Altamonte Sale.

|                                      |                  |
|--------------------------------------|------------------|
| Proceeds from Sale                   | \$427,000        |
| Deductions:                          |                  |
| Book Basis of Plant (Booked as CIAC) | N/A              |
| Selling Costs                        | <u>18,422</u>    |
| Pre-Tax Gain                         | \$408,578        |
| Taxes (34%)                          | <u>138,917</u>   |
| Net Gain                             | <u>\$269,661</u> |

Based on staff's review, the utility's calculation appears reasonable. Thus, staff believes that a gain of \$269,661 was realized on the Altamonte Sale.

**ISSUE 3:** Should the gains on the Maitland and Altamonte sales be shared with the remaining ratepayers of UIF?

**RECOMMENDATION:** No. The remaining Orange and Seminole County UIF customers should not receive recovery of the realized gains from the Maitland or Altamonte sales. (KYLE, BRUBAKER)

**STAFF ANALYSIS:** As part of staff's discovery process, UIF was asked to state its position on the proper allocation of the realized gains. Staff also researched the Commission's practice regarding gains on sale of utility assets and other state commissions' policies on the sharing of gains with ratepayers.

#### **Utility's Position**

In its response to staff's discovery request, UIF stated that it believes that gains and losses from the sale of facilities should flow to the shareholders. The utility's rationale is that gains and losses on the sale of utility facilities are properly assigned to the owner of the facilities, and that use of the facilities and payment to the utility for the cost of service do not vest an ownership interest with the customer. Moreover, the utility stated that if the Commission were to adopt a policy that gains are to be shared, such a policy should be adopted on a going-forward basis.

The utility was also asked whether it believed that the remaining customers in Orange and Seminole Counties contributed to a portion of the utility's recovery of its investment in the systems which were sold. UIF responded that the remaining customers pay rates based on the cost of providing service, and that there is really no way to know whether, over a period of time, one customer contributed to a portion of other facilities that are unrelated, except by virtue of their common rate.

#### **Commission Practice Regarding Gain on Sales**

Staff's research has identified a number of other cases in which the Commission allocated all or a substantial part of the gains on sale of utility assets to ratepayers; however, all of these cases involved the sale of specific assets, not complete systems including customer bases. Staff is aware of four recent cases in which the Commission has addressed the gains on sale of utility facilities which included customer bases. While there may

have been other similar sales including customer base, staff was unable to find any orders addressing Commission action on disposition of resulting gains from such sales.

In Docket No. 911188-WS, the Commission considered whether the customers of Lehigh Utilities, Inc. (Lehigh) should share in the gain on sale of the St. Augustine Shores (SAS) water and wastewater facilities to St. Johns County as a result of a condemnation. Both SAS and Lehigh had been owned by Southern States Utilities, Inc. (SSU). The Commission decided that sharing the gain was not appropriate, stating:

We agree with the utility that ratepayers do not acquire a proprietary interest in utility property that is being used for utility service. We also agree that it is the shareholders who bear the risk of loss in their investments, not the Lehigh ratepayers. Further, we find that Lehigh's ratepayers did not contribute to the utility's recovery of its investment in St. Augustine Shores. Based on the foregoing, we find no adjustment for the gain on the sale of St. Augustine Shores to be appropriate.

In 1992, shortly after the Lehigh docket was filed, SSU filed an application for a rate increase for several of its systems under the Commission's jurisdiction. In Docket No. 920199-WS, the issue of the gain on sale of SAS was again considered in the context of whether the gain should be shared with the remaining shareholders of SSU.

By Order No. PSC-93-0423-FOF-WS, issued March 22, 1993, in that docket, the Commission found the following:

We agree with Mr. Sandbulte that customers who did not reside in the SAS service area did not contribute to recovery of any return on investment in the SAS system. Further, when this system was acquired by St. Johns County, SSU's investment in the SAS system and its future contributions to profits were forever lost. Thus, the gain on the sale serves to compensate the utility's shareholders for the loss of future earnings. Arguably, if the sale of this system had been accompanied by a loss, any suggestion that the loss be absorbed by the remaining SSU customers would be met with great

opposition. However, the rationale for sharing a loss is basically the same as the rationale for sharing a gain. Since SSU's remaining customers never subsidized the investment in the SAS system, they are no more entitled to share in the gain from that sale than they would be required to absorb a loss from it.

The issue of the gain on the SAS sale was considered once again in SSU's subsequent rate case, Docket No. 950495-WS, along with several additional gains, including the sale of SSU's Venice Gardens (VGU) system to Sarasota County, also under condemnation. The Office of Public Counsel (OPC) argued that the remaining ratepayers should benefit from the gain because SSU had been found to be a single system and ratepayers had been required to pay a return on used and useful property. Further, OPC argued that the jurisdictional systems were absorbing administrative and general expenses and general plant costs that otherwise would have been paid by the VGU ratepayers. OPC also reiterated its objection to the Commission's decision in Docket No. 920199-WS regarding the SAS gain.

SSU rebutted OPC's arguments, stating that the remaining customers did not contribute to SSU's recovery of its investment and did not bear the risk of loss. Further, SSU noted that the sale of VGU involved not only the sale of SSU's assets but also the loss of customers, and that the Commission's policy concerning gains and losses should be consistent with the (then) recently confirmed acquisition adjustment policy.

In Order No. PSC-96-1320-FOF-WS, issued October 30, 1996, the Commission voted not to allocate any of the gains of the sales of SAS or VGU to the ratepayers, stating in relevant part:

We first observe that the sales of VGU and SAS were similar in many respects: they were involuntarily made by condemnation or under threat of condemnation; SSU lost the ability to serve the customers in both service areas, which were both regulated by non-FPSC counties; and the facilities served customers who were never included in a uniform rate structure. By Order No. PSC-93-0423-FOF-WS, issued on March 22, 1993, we found that the gain on the sale of the SAS facilities should not be allocated to the ratepayers...

This part of Order No. PSC-93-0423-FOF-WS was affirmed by the First District Court of Appeal in the Citrus County decision.

Although OPC argued that the ratepayers have benefitted from the gains on the sale of property devoted to public service in previous dockets and absorbed a loss on the sale of the Skyline facility, we do not find the circumstances to be the same. Had either the SAS and VGU facilities been regulated by the FPSC at the time of the sale or previously included in a uniform rate structure, the situation would be different. However, we conclude that similar treatment should be afforded based on the previous decision in Docket No. 920199-WS. The record lacks sufficient evidence to support the contrary. Therefore, we shall not allocate either the VGU or SAS gains to the ratepayers.

Most recently, the Commission considered the gain of sale of two facilities, including customer base, in Docket No. 001826-WU. In this case, Heartland Utilities, Inc. requested Commission approval for the transfer of two of its three facilities to the City of Sebring at an estimated gain of \$1,035,774. Approximately 700 customers were served by the systems sold, compared with 37 customers served by the remaining system. In Order No. PSC-01-1986-PAA-WU, issued October 8, 2001 (Consummating Order PSC-01-2179-CO-WU, issued November 6, 2001), the Commission voted not to address the gain on sale at that time, because it did not appear, based on available facts, that the remaining customers had subsidized the cost of the systems transferred.

Based on our analysis of the above cases, staff believes that this Commission has generally based its decisions on treatment of gains on sale of utility property on the following key factors:

1. Whether the property sold was used and useful in providing utility services;
2. Whether the property was included in uniform rates;
3. Whether a system, including customer base, was sold, as opposed to specific assets;



4. The extent to which ratepayers would have borne the risk, had the sale been at a loss; and
5. Consistency with other Commission practice, such as the calculation of rate base when a facility is purchased for more or less than its net book value.

Other State Commission Practice of Gain on Sales

On April 13, 2000, staff sent a questionnaire to 48 state commissions regarding any policies or practices on gains on sales of a portion of a utility's facilities which were previously included under a uniform rate structure. We received thirteen responses to our questionnaire. Based upon these responses, it is the general practice of several state commissions, such as Montana, New York, Ohio, Oregon, Washington, and West Virginia, to allocate 100% of the gain of all property to the ratepayers. The Idaho Commission's practice is that any gain on sale of nondepreciable property should flow to the shareholders and gains on the sale of depreciable property should be shared with ratepayers. The South Carolina Commission's practice is to allocate 100% of the gain on sale of all utility property to the shareholders. The commissions of Alabama, Arkansas, Illinois, and Wisconsin have no established policy or practice regarding gains on sales of a portion of a utility's facilities. Except as noted in the following paragraphs, the responses were general, and did not consistently differentiate between property used in providing utility service and other property, or between sale of utility assets and sale of facilities including customers.

The responses received from New York and Idaho each included a reference to the sale of facilities including customer base. The New York Public Service Commission (NYPSC) stated:

(i)n instances where the purchaser is a municipality/authority that acquires a complete water system, the transfer is subject to NYPSC approval. Generally, acquisition/takeovers of small water companies are welcomed by the NYPSC. Municipalities/authorities provide the ability to finance current capital requirements, which many existing systems are unable to do without surcharges to their customers. Sales to municipalities generally do not produce rate increases. Further, where the municipality offers compensation for

the system the transfer is an arms length transaction. Once the system is sold generally the NYPSC has no further authority.

The response from the Idaho Public Utilities Commission (IPUC) included a case in which it addressed a transfer of electrical distribution facilities and service territory between two electric power utilities with adjacent service territories along the Idaho-Washington state line. In approving the transfer, the IPUC determined that a \$1,502,435 gain on the sale of depreciable plant should be distributed to the customers being transferred as a final bill credit, reasoning that the customers had paid rates based on a revenue requirement that included the assets to be transferred and therefore had an equitable interest.

Staff notes that the examples of treatment of complete facility sales cited above from New York and Idaho involve different fact patterns from the case at hand. In view of this, and in view of the uncertainty of the details of the policies of other states responding to staff's query, staff believes that it is most appropriate to rely on the previous practice of this Commission in this case.

#### Applicability of Commission Practice to this Case

**Maitland Sale:** The Maitland Sale involved the sale of facilities included in rate base, along with the customer base serviced by these facilities. Based on our review of the utility's cancelled tariff sheets, all systems in Orange County have been under a uniform rate structure since 1981; however, staff agrees with UIF that it would be very difficult to determine how much any customer or group of customers contributed to the utility's investment in, or operation of, the facility. Further, staff believes that the Commission has consistently acknowledged that, where the utility is losing the revenue stream provided by the customer base transferred, it is reasonable for the shareholders to be compensated by receiving the gain on sale of the facility. Finally, staff believes the Commission has a well-established practice of not allowing utilities to increase rate base when facilities are purchased at greater than net book value (absent a showing of extraordinary circumstances). See Order No. PSC-98-1092-FOF-WS, issued August 12, 1998, in Docket No. 960235-WS. Allocating gains on sale to utility shareholders is consistent with this practice, because ratepayers would have paid rates based only

on the original cost of the facility. Staff also agrees with the arguments presented in the SSU cases discussed previously that paying rates for utility service does not vest ratepayers with an ownership interest in the utility's assets. This argument was also raised by UIF. Staff believes that the Commission has found these arguments persuasive in most of the cases similar to this one. Accordingly, staff recommends that the gain on this sale not be shared with the remaining ratepayers in Orange and Seminole Counties.

**Altamonte Sale:** Based on a discussion with the utility, UIF essentially sold the right to provide water and wastewater service to the Green Acres Campground. The campground was the only customer served by the facility. Based on our review of the utility's cancelled tariff sheets, all systems in Seminole County have been under a uniform rate structure since 1977; however, prior to the sale, the Green Acres Campground facilities sold were recorded on UIF's books as CIAC. Therefore, staff believes the remaining ratepayers in Seminole County did not subsidize these facilities. Further, staff believes the same rationale discussed in the Maitland Sale applies to the sale of this system. Accordingly, staff recommends that the gain on this sale not be shared with the remaining ratepayers in Seminole County.

Staff notes that this recommendation is meant to apply strictly to the instant facts and circumstances, and only in the context of the water and wastewater industry. No thorough analysis has been made regarding the appropriate treatment of gains on sale with respect to other regulated industries, nor is that issue before the Commission in this case. Staff's recommendation herein is not intended to affect the Commission's discretion or jurisdiction to address the issue of gains on sale in other regulated industries.

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**ISSUE 4:** Should this docket be closed?

**RECOMMENDATION:** Yes. If no timely protest is filed by a substantially affected party, this docket should be closed upon the issuance of a consummating order. (BRUBAKER)

**STAFF ANALYSIS:** If no timely protest is filed by a substantially affected party, this docket should be closed upon the issuance of a consummating order.