



# Public Service Commission

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

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DATE: APRIL 11, 2002

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

FROM: DIVISION OF ECONOMIC REGULATION (CLAPP, KAPROTH, WALDEN)  
OFFICE OF THE GENERAL COUNSEL (CROSBY, HELTON)

*Handwritten initials and signatures:* @ 90, KK, AV, JS, JDS, TJA

RE: DOCKET NO. 011401-WU - APPLICATION FOR AUTHORITY TO  
TRANSFER FACILITIES OF HEARTLAND UTILITIES, INC., HOLDER  
OF CERTIFICATE NO. 420-W IN HIGHLANDS COUNTY, TO  
AQUASOURCE UTILITY, INC., HOLDER OF CERTIFICATE NO. 424-W,  
AND FOR CANCELLATION OF CERTIFICATE NO. 420-W.  
COUNTY: HIGHLANDS

AGENDA: 04/23/02 - REGULAR AGENDA - PROPOSED AGENCY ACTION ISSUES  
2 and 3 - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\WP\011401WU.RCM

### CASE BACKGROUND

Heartland Utilities, Inc. (Heartland or utility) is a Class C water-only utility serving approximately 37 customers in Highlands County. The utility is within the Southwest Florida Water Management District (SWFWMD) in the Highlands Ridge Water Use Caution Area. Wastewater service is provided by septic tanks. Pursuant to Order No. 12846, issued January 5, 1984, in Docket No. 830332-W, Heartland was granted Water Certificate No. 420-W for its two water systems: DeSoto City (DeSoto) and Sebring Country Estates (Estates). The certificate was amended to add Sebring Lakes (Lakes), pursuant to Order No. PSC-98-0797-FOF-WU, issued on June 8, 1998, in Docket No. 980433-WU, after the Department of Environmental Protection (DEP) requested service be extended because of contaminated wells. The DeSoto and Estates systems were

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subsequently transferred to the City of Sebring pursuant to Order No. PSC-01-1986-PAA-WU, issued on October 8, 2001, in Docket No. 001826-WU. The utility's 2000 annual report shows total operating revenue of \$179,907 and a net operating income of \$14,208.

On October 30, 2001, the buyer and seller filed a joint application for transfer of its final water system, Lakes, to AquaSource Utility, Inc. (AquaSource or buyer) under Certificate No. 424-W. According to the application, on September 10, 2001, the utility and the buyer entered into an asset purchase agreement for the utility's remaining system and the land upon which the facilities were located. The closing on the transfer took place on October 30, 2001. The Commission has jurisdiction to consider this matter pursuant to Section 367.071, Florida Statutes.

#### DISCUSSION OF ISSUES

**ISSUE 1:** Should the transfer of facilities of Heartland to AquaSource, the cancellation of Certificate No. 420-W, and the amendment of Certificate No. 424-W be approved?

**RECOMMENDATION:** Yes, the transfer of facilities of Heartland to AquaSource is in the public interest and should be approved. Certificate No. 420-W, held by Heartland, should be cancelled, and Certificate No. 424-W, held by AquaSource should be amended to include the territory served by Heartland. A description of the territory being transferred is appended to this recommendation as Attachment A. (CLAPP, KAPROTH, WALDEN)

**STAFF ANALYSIS:** As stated in the case background, AquaSource applied for a transfer of Water Certificate No. 420-W in Highlands County from Heartland on October 30, 2001. The application is in compliance with the governing statute, Section 367.071, Florida Statutes, and other pertinent statutes and administrative rules concerning an application for transfer. The utility service area includes approximately 37 customers and about 363 undeveloped lots.

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The application contains a check in the amount of \$750, which is the correct filing fee pursuant to Rule 25-30.020, Florida Administrative Code.

Section 367.071, Florida Statutes, requires that no utility shall sell, assign, or transfer its certificate of authorization, facilities or any portion thereof, or majority organizational control without prior approval of the Commission unless such sale, assignment, or transfer is made contingent upon Commission approval. The closing on the transfer of the utility facilities and purchase of the land upon which the utility facilities are located took place on October 30, 2001. According to an addendum to the purchase agreement, closing of the transfer is contingent upon Commission approval in compliance with the statute.

The application contains proof of compliance with the noticing provisions set forth in Rule 25-30.030, Florida Administrative Code. No objections to the application were received, and the time for the filing of such objections has expired. A description of the territory served by the utility is appended to this recommendation as Attachment A. The service area includes only the remaining service area as specified in Order No. PSC-01-1986-PAA-WU.

The application contains documentation to comply with Rules 25-30.037(2)(g), (h), (i), and (k), Florida Administrative Code, regarding terms of the sale and financing of the purchase. The application contains a copy of the asset purchase agreement which includes the sales price, terms of payment, and a list of the assets purchased and liabilities assumed of Heartland. The purchase price for the utility and land is \$90,000. The sale was a cash transaction from funds provided by operations of AquaSource. Therefore, no outside financing was required for the transaction.

The application also contains a statement, pursuant to Rule 25-30.037(2)(j), Florida Administrative Code, regarding how the transfer is in the public interest. AquaSource indicated that the transfer is in the public interest because AquaSource has the requisite technical and superior financial ability to own and operate the Heartland water facility. AquaSource has been providing operation, maintenance, and management services for municipal and private water utilities for more than 25 years and has been operating in Florida since 1999. AquaSource's application states that its financial ability is through the strength of its

parent, DQE, Inc., whose 2000 financial statement shows total capitalization of \$2.374 billion including \$1.025 billion in equity capital and \$1.349 billion in long-term debt. Additionally, the applicant stated that AquaSource will fulfill the commitments, obligations, and representations of the seller with regard to utility matters.

Rule 25-30.037(2)(1), Florida Administrative Code, requires the buyer to submit a proposed net book value of the systems at the time of transfer. For this purpose, the proposed net value of the utility is based upon Heartland's monthly financial statements. Rate base is discussed further in Issue 3.

The application states that the buyer has performed a reasonable investigation of the utility system as required by Rule 25-30.037(3)(p), Florida Administrative Code. Included is a statement that the buyer has reviewed the overall condition of the water treatment plants and facilities and found them to be in satisfactory condition. The buyer added that the systems seem to be in general compliance with the requirements of the Department of Environmental Protection (DEP). Staff has contacted DEP and verified that there are no outstanding notices of violation.

The water system has two 6" wells constructed in 1998, with a total permitted capacity of 280,000 gpd. Water is chlorinated for disinfection. The system is designed to serve 400 connections, and at the end of 2001, the system was serving 37 connections.

Rule 25-30.037(2)(q), Florida Administrative Code, requires the utility to provide proof of ownership or agreement for long term use of the land upon which its facilities are located. The application contains a recorded Warranty Deed transferring the property upon which the utility treatment facilities are located from Heartland to AquaSource.

According to our records, the utility is current on its regulatory assessment fees (RAFs) through 2000, and has filed an annual report for 2000, and all prior years. Rule 25-30.037(2)(r), Florida Administrative Code, requires the application to contain a statement regarding the disposition of any outstanding regulatory assessment fees, fines, or refunds owed. Heartland has paid the RAFs for January 1 through October 30, 2001. AquaSource is responsible for the RAFs for November and December 2001 and all

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future RAFs. AquaSource is responsible for filing the 2001 annual report and all future annual reports.

Based on the above, staff recommends that the transfer of facilities of Heartland to AquaSource is in the public interest and should be approved. Certificate No. 420-W, held by Heartland, should be cancelled, and Certificate No. 424-W, held by AquaSource should be amended to include the territory served by Heartland.

**ISSUE 2:** What is the rate base of Heartland at the time of transfer?

**RECOMMENDATION:** The rate base, which for transfer purposes reflects the net book value, is (\$13,206) for the water system as of October 31, 2001. AquaSource should be reminded of its obligation to maintain its books and records pursuant to Rule 25-30.115(1), Florida Administrative Code. (CLAPP)

**STAFF ANALYSIS:** Staff performed an audit by examining, on a test basis, the utility's books and records since the Lakes system's inception as approved in Order No. PSC-98-0797-FOF-WU. Rate base has never been set for the Lakes system. According to the utility's records, the proposed rate base is (\$14,066) for the water system as of December 31, 2001.

Even though the closing took place on October 30, 2001, the audit staff, with the approval of the buyer and seller, used the period ending October 31, 2001, for reporting purposes. The audit report contained three audit exceptions concerning the utility's books and records. These audit exceptions and staff's recommendations are discussed in detail below. The utility's proposed rate base and staff's recommended adjustments are shown on Schedule Nos. 1 and 2.

**Audit Exception No. 1.** This exception was the audit opinion that Heartland failed to maintain its books and records in accordance with the National Association of Regulatory Utility Commissioners (NARUC) Uniform System of Accounts. Pursuant to Rule 25-30.115(1), Florida Administrative Code, all water and wastewater utilities are to maintain their accounts and records in conformity with the NARUC Uniform System of Accounts.

Upon Commission approval of this transfer Heartland will no longer be a utility regulated by this Commission. Therefore, no action is recommended on this issue with regard to Heartland. However, staff recommends that AquaSource be reminded of its obligation to maintain its books and records pursuant to Rule 25-30.115(1), Florida Administrative Code.

**Audit Exception No. 2.** This exception was the audit opinion that utility's water Utility-Plant-in-Service (UPIS) account is understated. Heartland's books and records included the original cost associated with the water infrastructure for the Lakes system.

However, the audit staff determined, and the utility's general ledgers confirmed, that a portion of the contributions-in-aid-of-construction (CIAC) were not reflected in UPIS. The utility received a grant from DEP in 1998 to construct a stand alone water system to serve the Lakes development. The audit reflects DEP grants totaling \$297,010 for the construction of the water system. In addition, the utility collected \$13,892 in meter installation and customer connection charges pursuant to the utility's approved service availability policy. Therefore, it appears that the cost of the Lakes water system was fully funded by the DEP grants. However, staff was unable to verify the utility costs associated with the customer meter installations and customer connections.

The audit recommends that UPIS accounts be increased to reflect the plant costs associated with the meter installations and customer connections. The accounts that would be increased are Meters, \$10,670; Services, \$3,222; and Transmission & Distribution Equipment, \$6,230.

However, staff recommends that without the supporting documentation, the adjustments to UPIS should not be made. It appears that, because all utility costs were funded by DEP, the utility's collection of meter installation and customer connection costs resulted in contributions in excess of the plant costs. Therefore, staff recommends that the utility's rate base should not be adjusted to record the contributed property in UPIS.

**Audit Exception No. 3.** This exception was the audit opinion that the utility's books for Lakes, as of December 31, 2001, contained incorrect depreciation because of using wrong depreciation rates. Depreciation for Distribution Reservoirs, Services, and Water Treatment Equipment was recalculated pursuant to Rule 25-30.140, Florida Administrative Code, and the books were adjusted to the October 31, 2001, closing date, which reduced the reserve balances of Depreciation.

Therefore, staff recommends that accumulated depreciation be reduced by \$1,687 to remove the November and December accumulated depreciation recorded on the utility's books and increased by \$827 to reflect the appropriate depreciation rates pursuant to Rule 25-30.140, Florida Administrative Code. The net decrease to Accumulated Depreciation is \$860. These adjustments are shown on Schedule No. 2.

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Based on these adjustments, staff recommends that as of October 31, 2001, rate base for the Heartland system is (\$13,206) for the water system. The schedule of water rate base is shown on Schedule No. 1, with adjustments set forth on Schedule No. 2. The rate base calculations are used solely to establish the net book value at the time the property is transferred. As such, the calculations do not include the normal ratemaking adjustments for working capital calculations and used and useful adjustments. Further, staff recommends that AquaSource be reminded of its obligation to maintain its books and records pursuant to Rule 25-30.115(1), Florida Administrative Code.



**ISSUE 3:** Should an acquisition adjustment be approved?

**RECOMMENDATION:** No. An acquisition adjustment was not requested; therefore, an acquisition adjustment should not be included in the calculation of rate base for transfer purposes. (CLAPP)

**STAFF ANALYSIS:** An acquisition adjustment results when the purchase price differs from the rate base for transfer purposes. The acquisition adjustment resulting from the transfer of Heartland would be calculated as follows:

Purchase Price	\$90,000
Staff Calculated Rate Base	<u>(13,206)</u>
Positive Acquisition Adjustment	<u>\$103,206</u>

An acquisition adjustment was not requested by the buyer. The buyer stated that it considered the purchase price to be fair considering the number of customers, the monthly expenses, and the potential monthly income of the acquired utility.

In the absence of extraordinary circumstances, it has been Commission practice that a subsequent purchase of a utility system at a premium or discount shall not affect the rate base calculation. Since the buyer stated in its application for transfer that it was not seeking an acquisition adjustment, and there are no extraordinary circumstances regarding this purchase that would justify an acquisition adjustment to rate base, staff recommends that an acquisition adjustment not be included in the calculation of rate base. Staff's recommendation is consistent with previous Commissions decisions in this regard. See Order No. PSC-01-0425-PAA-WU, issued February 22, 2001, in Docket No. 001083-WU; Order No. PSC-01-1271-PAA-SU, issued June 6, 2001, in Docket No. 010382-SU; Order No. PSC-01-1655-PAA-WS, issued August 13, 2001, in Docket No. 000793-WS; and Order No. PSC-01-1917-PAA-WS, issued September 24, 2001, in Docket No. 001551-WS.

**ISSUE 4:** Should the rates and charges approved for this utility be continued?

**RECOMMENDATION:** Yes, AquaSource should continue charging the rates and charges approved for Heartland until authorized to change by the Commission in a subsequent proceeding. The tariff pages reflecting the transfer should be effective for services provided or connections made on or after the stamped approval date on the tariff sheets. (CLAPP)

**STAFF ANALYSIS:** The current rates for water service were approved by the Commission in an administrative price index proceeding effective August 23, 1999. The remainder of the utility's charges were approved pursuant to the staff-assisted rate case Order No. PSC-96-1389-FOF-WS, issued November 19, 1996, in Docket No. 960517-WS. The utility's approved rates and charges are as follows:

**Water Monthly Service Rates**  
**Residential and General Service**

Base Facility Charge

Meter Sizes:

5/8" x 3/4"	\$	7.68
3/4"		11.51
1"		19.18
1 1/2"		38.36
2"		61.38
3"		122.76
4"		191.81
6"		383.63

Gallonage Charge

Per 1,000 gallons	\$	1.74
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**Miscellaneous Service Charges**

Water

Initial Connection	\$15.00
Normal Reconnection	\$15.00
Violation Reconnection	\$15.00
Premises Visit (in lieu of disconnection)	\$10.00

Service Availability Charges

Water

Customer Connection and Meter Installation Fee	
5/8" x 3/4"	\$500.00
1" and larger	Actual

Rule 25-9.044(1), Florida Administrative Code, provides that:

In case of change of ownership or control of a utility which places the operation under a different or new utility . . . the company which will thereafter operate the utility business must adopt and use the rates, classification and regulations of the former operating company (unless authorized to change by the Commission).

AquaSource has not requested a change in the rates and charges of the utility. Accordingly, staff recommends that, pursuant to Rule 25-9.044(1), Florida Administrative Code, the utility continue operations under the existing tariff and apply the approved rates and charges until authorized to change by the Commission in a subsequent proceeding. AquaSource has filed revised tariff pages incorporating the addition of Heartland in its existing tariff. If the Commission approves staff's recommendation, the tariff filing should be effective for services rendered or connections made on or after the stamped approval date.

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**ISSUE 5:** Should this docket be closed?

**RECOMMENDATION:** Yes, if no timely protest is received to the proposed agency action issues, a Consummating Order should be issued upon the expiration of the protest period. Should no timely protests be received, the docket should be closed. (CROSBY, HELTON)

**STAFF ANALYSIS:** If no timely protest is received to the proposed agency action issues, a Consummating Order should be issued upon the expiration of the protest period. Should no timely protests be received, the docket should be closed.

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ATTACHMENT A

**HEARTLAND UTILITIES, INC**  
**Highlands County**  
**Water Service area for Sebring Lakes**

A portion of Sebring Lakes Unit 1-A, 1-B, 2-A, 2-B, and 2-C located in Highlands County, Florida, Sections 3 and 4, Township 36 South, Range 29 East, being more particularly described as follows:

Commence at the Southeast Corner of Section 3, Township 36 South, Range 29 East, Thence North 00°29'23" East along the East line of Section 3 a distance of 1298.93 feet to a point on the Westerly Right-of-way line of U.S. Highway 27, thence North 31°32'59" West along the Westerly right-of-way line of U.S. Highway 27 a distance of 400 feet more or less to a point on the North line of Josephine Creek and for a Point of Beginning:

Thence continue North 31°32'59" West along said West right-of-way line U.S. Highway 27 a distance of 1264.43 feet to a point on the North line of the South 1/2 of Section 3; thence South 89°41'36" West along the North line of the South 1/2 of Section 3 a distance of 3155.71 feet to the Southeast corner of the West 1/2 of the Northwest 1/4 thence North 0°53'45" East along the East line of the West 1/2 of the Northwest 1/4 a distance of 669.33 feet, to the Northeast corner of the South 1/2 of the Southwest 1/4 of the Northwest 1/4; thence South 89°46'12" West along the North line of the South 1/2 of the Southwest 1/4 of the Northwest 1/4 a distance of 1331.90 feet to a point on the West line of Section 3; thence North 1°01'32" East along the West line of Section 3 a distance of 2013.48 feet to the Northwest corner of Section 3; also being the Northeast corner of Section 4; thence South 89°55'46" West along the North line of Section 4 for a distance of 570 feet to a point on the Easterly line of Josephine Creek; thence run Southwesterly along the Easterly line of Josephine Creek a distance of 2,400 feet, more or less, thence Southerly along the Easterly line of Josephine Creek a distance of 900 feet; thence Easterly along the Northerly line of Josephine Creek a distance 8,100 feet, more or less, to the Point of Beginning.  
CONTAINING 250 ACRES MORE OR LESS.

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SCHEDULE 1

HEARTLAND UTILITY COMPANY, INC.  
SCHEDULE OF WATER RATE BASE  
AS OF OCTOBER 31, 2001

<u>DESCRIPTION</u>	<u>BALANCE PER UTILITY</u>	<u>STAFF'S ADJUSTMENTS</u>	<u>BALANCE PER STAFF</u>
Utility Plant in Service	\$290,780	\$0	\$290,780
Land	4,800	0	4,800
Contributions in Aid of Construction (CIAC)	(310,902)	0	(310,902)
Accumulated Depreciation	(30,313)	860 A	(29,453)
Amortization of CIAC	<u>31,569</u>	<u>0</u>	<u>31,569</u>
WATER RATE BASE	<u>(\$14,066)</u>	<u>\$860</u>	<u>(\$13,206)</u>

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SCHEDULE 2

HEARTLAND UTILITY COMPANY, INC.  
SCHEDULE OF WATER RATE BASE ADJUSTMENTS

	<u>EXPLANATION</u>	<u>STAFF RECOMMENDED ADJUSTMENT</u>
A	Accumulated Depreciation	
1)	To remove depreciation for partial year	\$1,687
2)	To correct depreciation per Rule	<u>(827)</u>
	TOTAL	\$860
	Total Adjustments	<u>\$860</u>