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**DATE:** AUGUST 8, 2002  
**TO:** DIRECTOR, DIVISION OF THE COMMISSION CLERK ADMINISTRATIVE SERVICES (BAYÓ)  
**FROM:** DIVISION OF ECONOMIC REGULATION (FLETCHER, MERCHANT, G. EDWARDS) OFFICE OF THE GENERAL COUNSEL (HOLLEY)  
**RE:** DOCKET NO. 011682-SU - APPLICATION FOR INCREASE IN WASTEWATER SERVICE AVAILABILITY CHARGES IN LEE COUNTY BY FOREST UTILITIES, INC.

DOCKET NO. 011683-SU - PETITION BY FOREST UTILITIES, INC. FOR ESTABLISHMENT OF ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION (AFUDC) RATE IN LEE COUNTY.  
COUNTY: LEE

**AGENDA:** AUGUST 20, 2002 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

**CRITICAL DATES:** 8-MONTH EFFECTIVE DATE: AUGUST 31, 2002

**SPECIAL INSTRUCTIONS:** NONE

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\011682.RCM

CASE BACKGROUND

Forest Utilities, Inc. (Forest or utility) is a Class B wastewater-only utility in Lee County. As of December 31, 2001, the utility served 2,059 wastewater customers and reported operating revenues of \$646,606 and a net operating loss of \$18,585.

On December 31, 2001, the utility filed a petition for the establishment of an allowance for funds used during construction (AFUDC) rate and an application for increase in its wastewater service availability charges. Docket No. 011682-SU was established

DOCUMENT NUMBER 011682

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for the requested increase in service availability charges, and Docket No. 011683-SU was established for the AFUDC rate request.

During the years 2002 through 2010, the utility plans to complete substantial improvements to its collection system and its treatment plant and disposal facilities. Forest states that these improvements are necessary to maintain compliance with the Florida Department of Environmental Protection rules and to accommodate customer growth through buildout of the service area.

The utility requests establishment of an AFUDC rate in order for Forest to accurately accrue and recover its costs of providing service. AFUDC is an accounting entry designed to permit a utility recovery of the cost associated with financing eligible construction activities. AFUDC is not a tariffed rate or charge.

The utility's present system capacity charge was established in Order No. 14001, issued January 14, 1985, in Docket No. 840196-SU. Forest has proposed to increase its system capacity charge from \$625 to \$1,998 per residential equivalent residential connection (ERC).

This recommendation addresses what the appropriate service availability charges should be for the utility and the establishment of an AFUDC rate for Forest. The Commission has jurisdiction pursuant to Sections 367.0822, 367.101, and 367.121, Florida Statutes.

**DISCUSSION OF ISSUES**

**ISSUE 1:** What is the appropriate ROE for Forest?

**RECOMMENDATION:** The utility's ROE should be reduced to 11.34% with a range of 10.34% to 12.34%. (FLETCHER, HOLLEY)

**STAFF ANALYSIS:** Staff believes that the utility's current ROE of 15.60% is unreasonable given today's economic climate. Considering the length of time since the utility's last rate case, staff believes it is necessary to revise the utility's ROE to reflect the cost rate calculated using the Commission current leverage formula.

In its petition for an AFUDC rate, the utility utilized a cost rate of 9.93% for common equity, pursuant to the leverage formula established by Order No. PSC-00-1162-PAA-WS, issued June 26, 2000, in Docket No. 000006-WS. Pursuant to Order No. PSC-02-0898-PAA-WS, issued July 5, 2002, in Docket No. 020006-WS, the Commission ordered that the leverage formula methodology approved in that Order be applied to all water and wastewater utilities that currently have an authorized return on equity. Using this leverage formula, Forest's ROE would have been 11.10%, with a range of 10.10% to 12.10%. However, timely protests were filed to Order No. PSC-02-0898-PAA-WS. Thus, until a final decision is made in that docket, the Commission's 2001 leverage formula is still in effect.

In order to calculate the ROE on a prospective basis, staff believes that it is appropriate to use Forest's average capital structure for the year ended September 30, 2001, from the utility's petition. Using this capital structure, the resulting equity ratio is 33.75%. Consistent with the leverage formula from Order No. PSC-01-2514-FOF-WS, issued December 24, 2001, in Docket No. 010006-WS, the ROE for Forest is 11.34%. Based on discussions with the utility, Forest agrees that it is appropriate to use the current leverage formula established in Docket No. 010006-WS, in order to reset the utility's ROE. Therefore, staff recommends that the Commission reduce the utility's ROE to 11.34% with a range of 10.34% to 12.34%. This recommended ROE should be effective as of the date of the Commission's Order in this docket, Docket No. 011683-SU, is final and should be applied to any future proceedings of this utility, including, but not limited to, price indexes, interim rates, and overearnings.

**ISSUE 2:** What is the appropriate AFUDC rate for Forest?

**RECOMMENDATION:** An annual AFUDC rate of 10.73% should be approved as reflected on Schedule No. 1. The discounted monthly rate should be 0.893828%. The approved rate should be applicable for eligible construction projects beginning October 1, 2001. (FLETCHER)

**STAFF ANALYSIS:** Rule 25-30.116(2)(a), Florida Administrative Code, provides that an AFUDC rate shall be determined using the utility's most recent 12-month average embedded cost of capital. Forest calculated the average cost of capital using the 12-month period ended September 30, 2001. The utility's capital structure is comprised of common equity, long-term debt, customer deposits, and deferred income taxes. According to its petition, Forest has requested an AFUDC rate of 10.26%.

Based on our review, staff believes that, with the exception of the cost rate for common equity, the utility's capital structure reflected in its petition is reasonable. Rule 25-30.116(2)(b), Florida Administrative Code, provides that the cost rate for common equity shall be the midpoint of the last allowed return on common equity. As discussed in Issue 2, staff is recommending that the Commission reset the utility's cost of equity for all regulatory purposes, including the calculation of its AFUDC rate to 11.34%.

Based on the above adjustment, staff recommends that an annual AFUDC rate of 10.73% and a discounted monthly rate of 0.893828% be approved, as reflected on Schedule No. 1. Pursuant to Rule 25-30.116(5), Florida Administrative Code, the approved rate shall be applicable for eligible construction projects beginning October 1, 2001.

**ISSUE 3:** Should the utility's tariff filing to modify its system capacity charge be approved as filed?

**RECOMMENDATION:** No. Tariff Sheets Nos. 24.0 and 27.0 filed on December 31, 2001 should be denied. The Commission should discontinue the utility's existing system capacity charge and approve a plant capacity charge of \$932 per residential ERC and a plant capacity charge of \$5.482 per gallon for all others. Also, the Commission should approve a main extension charge of \$1,042 per residential ERC and a main extension charge of \$6.129 per gallon for all others. Further, the Commission should issue the order as Proposed Agency Action (PAA). If there is no timely protest to the Commission's PAA by a substantially affected person, the utility should file the appropriate revised tariff sheets and a proposed notice within twenty days of the effective date of the PAA Order. The revised tariff sheets should be approved administratively upon staff's verification that the tariffs are consistent with the Commission's decision and the utility's proposed notice is adequate. If the revised tariff sheets are approved, the service availability charges should become effective for connections made on or after the stamped approval date of the revised tariff sheets, pursuant to Rule 25-30.475(2), Florida Administrative Code, providing the appropriate notice has been made. The notice shall be mailed or hand delivered to all persons in the service area who have filed a written request for service within the past 12 calendar months or who have been provided a written estimate for service within the past 12 calendar months. The utility shall provide proof of the date the notice was given within 10 days after the date of the notice. (FLETCHER, G. EDWARDS)

**STAFF ANALYSIS:** On December 31, 2001, the utility filed an application to increase its system capacity charge from \$625 to \$1,998 per residential ERC. By Order No. PSC-02-0314-PCO-SU, issued March 11, 2002, the Commission suspended Forest's proposed system capacity charge.

During the years 2002 through 2010, Forest plans to complete the several improvements to its collection system and its treatment plant and disposal facilities. For its collection system, the utility has planned the following improvements: 1) inflow-infiltration evaluation and system rehabilitation, 2) lift station improvements, and 3) emergency lift station pump and portable generator. For its treatment plant and disposal facilities, Forest has planned the following improvements: 1) treatment plant

emergency generator with enclosure, 2) sludge drying bed expansion and holding bin, 3) automatic backwash effluent filter, 4) chlorine contact chamber and chlorine storage enclosure, 5) flow equalization tank addition, and 6) grit removal and automatic screening facilities. Forest states that these improvements are necessary to maintain compliance with the Florida Department of Environmental Protection rules and to accommodate customer growth through buildout of the service area.

Staff has reviewed the above projected plant additions. These projections were developed by Source, Inc. (Source), an engineering firm retained by the utility. Source's engineering report comprised of an itemized listing of all plant additions, the estimated cost of each addition, and the performance dates of each addition. Based on our review, the costs, functions, and performance dates of each additional plant component are reasonable. Further, Source projected the utility's growth through buildout to 2010. Source indicated that it determined the projected growth by utilizing the planned construction activity of developers in Forest's service area for existing and new development projects. Staff believes Source's method to project the growth of the utility's service area is reasonable because it takes into consideration all currently existing and planned development projects.

A system capacity charge is designed to defray a portion of the cost of the plant, as well as a portion of the cost of lines. A plant capacity charge represents the reimbursement by a developer or a customer to offset the cost of the treatment plant facilities. A main extension charge represents the reimbursement by a developer or a customer to offset the cost of the lines. The Commission has previously approved separate service availability charges for the cost of plant and the cost of lines, instead of one system capacity charge. See Order No. PSC-00-1528-PAA-WU, issued August 23, 2000, in Docket 991437-WU and Order No. PSC-99-1173-PAA-WU, issued June 7, 1999, in Docket No. 981243-WU. Therefore, staff recommends the cancellation of Forest's existing system capacity charge and the implementation of a plant capacity charge and a main extension charge.

Based on our review of the utility's application, staff believes four adjustments are necessary. First, the utility utilized its requested 10.26% rate to calculate the AFUDC for its projected plant investment in this service availability case. As

discussed in Issue 3, staff has recommended that the appropriate annual AFUDC rate should be 10.73%. As such, staff has utilized this rate of 10.73% to capitalize AFUDC on the utility's projected plant.

Second, Forest used an incorrect depreciation rate for Tools, Shop & Garage Equipment. Pursuant to Rule 25-30.140, Florida Administrative Code, the appropriate depreciation rate for that account is 6.25%. Staff has corrected this to calculate the projected accumulated depreciation.

Third, the utility projected 42 equivalent residential connections (ERCs) to be connected in 2002. Since the change in the service availability charges will be effective in September 2002, staff has assumed that three-fourths of the 42 ERCs for 2002 will be connected to the utility's wastewater system at Forest's \$625 existing system capacity charge.

Lastly, Forest's calculation of its projected accumulated amortization of CIAC contained an error. As a result, the utility's projected December 31, 2010, accumulated amortization of CIAC balance was overstated, which in turn understated the CIAC ratio at buildout. In our analysis, staff has appropriately matched CIAC additions from capacity charges for each year from 2002 to 2010 to calculate the projected accumulated amortization of CIAC.

Pursuant to 25-30.580(1), Florida Administrative Code, the maximum amount of CIAC, net of amortization, should not exceed 75% of the total original cost, net of accumulated depreciation, of the utility's facilities and plant when the facilities and plant are at design capacity. The purpose of this cut-off point is to encourage utilities to retain a 25% investment and maintain an interest in its facilities. Rule 25-30.580(2), Florida Administrative Code, also states that the minimum amount of CIAC should not be less than the percentage of such facilities and plant that is represented by the sewage collection system.

In determining what the appropriate plant capacity charge should be, staff took the total treatment plant in service of \$2,741,982 at buildout and divided it by the total plant capacity in ERCs of 2,941. This resulted in a plant capacity charge of \$932 per residential ERC and a plant capacity charge of \$5.482 per gallon for all others. This calculation is shown in Schedule No.

2. Using the \$932 plant capacity charge, staff kept adjusting the main extension charge until the projected CIAC ratio at buildout equaled 75%. As a result, staff's analysis indicated that the main extension charge should be \$1,042 per residential ERC and \$6.129 per gallon for all others. Schedule No. 4 reflects that staff's recommended charges are within the guidelines set forth in Rule 25-30.580(1) and (2), Florida Administrative Code.

Therefore, staff recommends that the Commission approve a plant capacity charge of \$932 and a main extension charge of \$1,042 and that the Commission should issue the order as PAA. These recommended service availability charges are shown on Schedule No. 3. If there is no timely protest to the Commission's PAA by a substantially affected person, the utility should file the appropriate revised tariff sheets and a proposed notice within twenty days of the effective date of the PAA Order. The revised tariff sheets should be approved administratively upon staff's verification that the tariffs are consistent with the Commission's decision and the utility's proposed notice is adequate. If the revised tariff sheets are approved, the service availability charges should become effective for connections made on or after the stamped approval date of the revised tariff sheets, pursuant to Rule 25-30.475(2), Florida Administrative Code, providing the appropriate notice has been made.

The notice shall be mailed or hand delivered to all persons in the service area who have filed a written request for service within the past 12 calendar months or who have been provided a written estimate for service within the past 12 calendar months. The utility shall provide proof of the date the notice was given within 10 days after the date of the notice.



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**ISSUE 4:** Should Docket No. 011682-SU be closed?

**RECOMMENDATION:** Docket No. 011682-SU should be closed upon staff's verification that Forest has filed revised tariff sheets consistent with the Commission's decision and that the appropriate notice has been made. If the Commission approves staff's recommendation on the previous issues and no timely protest on those issues are received upon expiration of the protest period, the PAA Order on the service availability charges will become final upon the issuance of a Consummating Order. Once staff has verified that the utility's revised tariff sheets are consistent with the Commission's decision and that the appropriate notice has been made, Docket No. 011682-SU should be closed administratively. (FLETCHER, HOLLEY)

**STAFF ANALYSIS:** Docket No. 011682-SU should be closed upon staff's verification that Forest has filed revised tariff sheets consistent with the Commission's decision and that the appropriate notice has been made. If the Commission approves staff's recommendation on the previous issues and no timely protest on those issues are received upon expiration of the protest period, the PAA Order on the service availability charges will become final upon the issuance of a Consummating Order. Once staff has verified that the utility's revised tariff sheets are consistent with the Commission's decision and that the appropriate notice has been made, Docket No. 011682-SU should be closed administratively.

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**ISSUE 5:** Should Docket No. 011683-SU be closed?

**RECOMMENDATION:** If no timely protest on the Commission approved AFUDC rate is received upon expiration of the protest period, the PAA Order on the AFUDC rate will become final upon the issuance of a Consummating Order, and Docket No. 011683-SU should be closed.  
(FLETCHER, HOLLEY)

**STAFF ANALYSIS:** If no timely protest on the Commission approved AFUDC rate is received upon expiration of the protest period, the PAA Order on the AFUDC rate will become final upon the issuance of a Consummating Order, and Docket No. 011683-SU should be closed.

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Forest Utilities, Inc.			Schedule No. 1			
Staff Recommended AFUDC Rate			Docket No. 011683-SU			
12-Month Period Ended September 30, 2001						
<u>Class of Capital</u>	<u>12-Month Average</u>	<u>Percent of Capital</u>	<u>Utility Requested Cost Rates</u>	<u>Utility Weighted Cost</u>	<u>Staff Recommended Cost Rates</u>	<u>Staff Weighted Cost</u>
Common Equity	\$164,461	33.75%	9.93%	3.35%	11.34%	3.83%
Long-Term Debt	312,322	64.09%	10.73%	6.88%	10.73%	6.88%
Customer Deposits	2,345	0.48%	6.00%	0.03%	6.00%	0.03%
Deferred Income Taxes	<u>8,174</u>	<u>1.68%</u>	0.00%	<u>0.00%</u>	0.00%	<u>0.00%</u>
Total	<u>\$487,302</u>	<u>100.00%</u>		<u>10.26%</u>		<u>10.73%</u>
Discounted Monthly AFUDC Rate				<u>0.854211%</u>		<u>0.893828%</u>

**Forest Utilities, Inc.** **Schedule No. 2**  
**Docket No. 011682-SU**

**ANALYSIS OF PLANT CAPACITY CHARGE**

<b><u>ACCT. NO.</u></b>	<b><u>ACCOUNT NAME</u></b>	<b><u>PLANT IN SERVICE AT BUILDOUT</u></b>
353	Land and Land Rights	\$26,690
354	Structures and Improvements	386,532
355	Power Generation Equipment	95,823
380	Treatment and Disposal Equipment	<u>2,233,608</u>
		<u>\$2,742,653</u>
Total Capacity in ERCs Plant is Capable of Serving		2,941
Total Treatment Plant in Service At Buildout		<u>\$2,742,653</u>
Divided by: Total Capacity in ERC		2,941
<b>Plant Capacity Charge Per ERC</b>		<b><u>\$933</u></b>

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Forest Utilities, Inc.  
Docket No. 011682-SU  
Service Availability Charges - Wastewater Only

Schedule No. 3

	<u>Present</u>	<u>Company Proposed</u>	<u>Staff Recommended</u>
<u>System Capacity Charge:</u>	\$625	\$1,998	No Charge
<u>Plant Capacity Charge:</u>			
Residential-per ERC (170 gpd)	None	None	\$933
All other-per gallon	None	None	\$5.488
<u>Main Extension Charge:</u>			
Residential-per ERC (170 gpd)	None	None	\$1,043
All other-per gallon	None	None	\$6.135

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UTILITY CO.: Forest Utilities, Inc.		SCHEDULE NO. 4									
Docket No.: 011682-SU											
Wastewater Operation											
<b>Staff Recommended:</b>											
Plant Capacity Charge:	\$933										
Main Extension Charge:	\$1,043										
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	
Capacity	500,000	500,000	500,000	500,000	500,000	500,000	500,000	500,000	500,000	500,000	500,000
Demand	362,950	370,090	386,750	405,450	432,650	454,155	471,240	482,545	493,000	499,970	499,970
% Used	72.59%	74.02%	77.35%	81.09%	86.53%	90.83%	94.25%	96.51%	98.60%	99.99%	99.99%
Growth (in ERCs)		42.0	98.0	110.0	160.0	126.5	100.5	66.5	61.5	41.0	
Utility Plant	\$3,302,461	\$3,439,691	\$3,913,663	\$4,558,176	\$4,818,936	\$5,209,147	\$5,951,891	\$5,993,591	\$6,350,498	\$6,392,198	
Accumulated Depreciation	(1,555,235)	(1,661,823)	(1,779,022)	(1,914,430)	(2,065,131)	(2,227,704)	(2,410,947)	(2,608,292)	(2,812,856)	(3,024,640)	
Net Plant	<u>\$1,747,226</u>	<u>\$1,777,868</u>	<u>\$2,134,641</u>	<u>\$2,643,746</u>	<u>\$2,753,805</u>	<u>\$2,981,443</u>	<u>\$3,540,944</u>	<u>\$3,385,299</u>	<u>\$3,537,642</u>	<u>\$3,367,558</u>	
CIAC	\$2,596,054	\$2,668,852	\$3,214,440	\$3,772,676	\$4,158,095	\$4,407,940	\$4,675,844	\$4,807,185	\$4,928,651	\$5,009,628	
Accumulated Amortization	(1,313,631)	(1,396,392)	(1,489,469)	(1,600,568)	(1,727,255)	(1,864,887)	(2,011,432)	(2,164,837)	(2,322,616)	(2,483,898)	
Net CIAC	<u>\$1,282,423</u>	<u>\$1,272,460</u>	<u>\$1,724,971</u>	<u>\$2,172,108</u>	<u>\$2,430,840</u>	<u>\$2,543,053</u>	<u>\$2,664,412</u>	<u>\$2,642,348</u>	<u>\$2,606,035</u>	<u>\$2,525,731</u>	
Net Investment	<u>\$464,803</u>	<u>\$505,408</u>	<u>\$409,670</u>	<u>\$471,638</u>	<u>\$322,965</u>	<u>\$438,390</u>	<u>\$876,532</u>	<u>\$742,951</u>	<u>\$931,607</u>	<u>\$841,827</u>	
CIAC Ratio:	73.40%	71.57%	80.81%	82.16%	88.27%	85.30%	75.25%	78.05%	73.67%	75.00%	