State of Florida

Public Service Commission

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

DATE: NOVEMBER 7, 2002

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

FROM: DIVISION OF ECONOMIC REGULATION (FITCH, DAVIS, HINGO)
OFFICE OF THE GENERAL COUNSEL (VINING)

RE: DOCKET NO. 011677-WU - APPLICATION FOR STAFF-ASSISTED RATE CASE IN POLK COUNTY BY TEVALO, INC. D/B/A MCLEOD GARDENS WATER COMPANY.
COUNTY: POLK

AGENDA: 11/19/02 - REGULAR AGENDA - PROPOSED AGENCY ACTION EXCEPT FOR ISSUES 12, 15, and 16 - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: 15-MONTH EFFECTIVE DATE: WAIVED (SARC)

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\WP\011677.RCM

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CASE BACKGROUND

Tevalo, Inc. d/b/a McLeod Gardens Water Company (McLeod Gardens or utility) is a Class C water utility providing service to approximately 57 residential customers in Polk County. Wastewater service is provided through septic tanks. At build-out, the McLeod Gardens subdivision, developed by Tevalo, Inc., will serve a maximum of 176 lots. The utility's 2001 annual report shows total operating revenue of $11,976 and a net operating loss of $5,532.

The utility filed an application for certification as a utility in existence on September 12, 2000. The utility received its certificate by Order No. PSC-01-2317-PAA-WU, issued November 27, 2001, in Docket No. 001381-WU. The utility's existing rates were approved in that Order. On December 27, 2001, the utility filed an application for a Staff Assisted Rate Case (SARC) and paid the appropriate filing fee on February 25, 2002. This is the utility's first SARC. The Commission has not established rate base for this utility. The Commission has the authority to consider this rate case under Section 367.0814, Florida Statutes. Staff has audited the utility's records for compliance with Commission rules and Orders and determined the components necessary for rate setting. Staff also conducted a field investigation of the utility's plant and service area and a supplemental original cost study.

On June 27, 2002, staff conducted an informal customer meeting in the service area. Seven customers attended the meeting and four customers chose to give comments. The majority of the customer comments were about the quality of the water, specifically the constant fluctuations between high levels of chlorine and high levels of hydrogen sulfide. Customers also raised health concerns related to the chlorine and hydrogen sulfide levels. All the customers who gave comments mentioned that they had difficulty contacting the utility. All of these comments will be addressed in Issue No. 1.

Several customers raised concerns about subsidizing future growth. This item is addressed in Issue Nos. 2 and 14.

The following is a list of acronyms and commonly used technical terms which are used throughout this recommendation:

COMPANY AND PARTY NAMES

DEP	Department of Environmental Protection
FPSC	Florida Public Service Commission
NARUC	National Association of Regulatory Utility Commissioners
OPC	Office of Public Counsel
SWFMD	Southwest Florida Water Management District

GLOSSARY OF TECHNICAL TERMS

BFC Base Facility Charge - A charge designed to recover the portion of the total expenses required to provide water and sewer service incurred whether or not the customer actually uses the services and regardless of how much is consumed.

CIAC Contributions In Aid Of Construction - Any amount or item of money, services, or property received by a utility, from any person or governmental agency, any portion of which is provided at no cost to the utility, and which is utilized to offset the acquisition, improvement, or construction costs of the utility's property, facilities, or equipment used to provide utility services to the public. The term includes, but is not limited to, system capacity charges, main extension charges, and customer connection charges.

ERCs Equivalent Residential Connections - A statistic used to quantify the total number of water or wastewater connections that can be served by a plant of some specific capacity. The consumption of each connection is considered to be that of a single family residential connection, which is usually considered to be a unit comprised of 3.5 persons.

GPD Gallons Per Day - The amount of liquid that can be delivered or actually measured during a 24-hour period.

GPM Gallons Per Minute - The amount of liquid that can be delivered or actually measured during a one-minute time period.

O&M	Operations and Maintenance Expense
RAF	Regulatory Assessment Fees
SARC	Staff Assisted Rate Case
UPIS	Utility Plant in Service - The land, facilities, and equipment used to generate, transmit, and/ or distribute utility service to customers.
Used and Useful	The amount of plant capacity that is used by current customers including an allowance for the margin reserve.
USOA	Uniform System of Accounts - A list of accounts for the purpose of classifying all plant and expenses associated with a utility's operations.

ISSUE 1: Is the quality of service provided by McLeod Gardens considered satisfactory?

RECOMMENDATION: Yes. However, the utility should be required to install the automatic chlorination system within four months of the Consummating Order. (T.DAVIS)

STAFF ANALYSIS: Rule 25-30.433(1), Florida Administrative Code, states that:

> The Commission in every rate case shall make a determination of the quality of service provided by the utility. This shall be derived from an evaluation of three separate components of water and wastewater utility operations: quality of utility's product (water and wastewater); operational conditions of utility's plant and facilities; and the utility's attempt to address customer satisfaction. Sanitary surveys, outstanding citations, violations and consent orders on file with the Department of Environmental Protection (DEP) and county health departments (HRS) or lack thereof over the proceeding 3-year period shall also be considered. DEP and HRS officials' testimony concerning quality of service as well as the comments and testimony of the utility's customers shall be considered.

Staff's recommendation concerning the overall quality of service provided by the utility is derived from an evaluation of three separate components of water and wastewater utility operations:

(1) Quality of Utility's Product (compliance with drinking water standards),
(2) Operational Conditions of Utility's Plant or Facility,
(3) Utility's Attempt to Address Customer Satisfaction.

QUALITY OF UTILITY'S PRODUCT

The Department of Environmental Protection (DEP) has conveyed all enforcement of community water systems in Polk County to the county health office. The potable water program is regulated by

the Environmental Engineering Division of the Polk County Department of Health. According to county health records for the last three years, the utility has kept current with all chemical analyses. Those analyses' results have been satisfactory with the exception of a higher than normal presence of Hydrogen Sulfide in the raw water. Hydrogen Sulfide is a secondary standard, is not considered to be a health hazard, and no corrective mandates have been issued to reduce Maximum Contaminant Levels (MCL). However, the utility's operator is treating the raw water with chlorination to reduce the Hydrogen Sulfide levels. The quality of the utility's product is considered to be satisfactory.

Consumptive use in Polk County is permitted by the Southwest Florida Water Management District. The utility formally obtained its Water Use Permit (WUP No. 7172.03) on January 20, 1998, which expired on July 18, 1999. On July 28, 1998, the water management office issued a letter of extension for WUP No. 7172.03 to July 18, 2010. Currently, the utility does not appear to be exceeding its water withdrawal allowances.

OPERATIONAL CONDITIONS AT THE PLANT

The quality of the utility's plant-in-service is generally reflective of the quality of the utility's product. Over the last three years the county has cited the utility for a few violations. The Polk County Health Department has required the utility to provide a back-up well, cited the utility for insufficient chlorination/treatment, and issued a violation letter for replacing the turbine pump with a submersible pump without notifying the Department. In each case, the utility responded satisfactorily and the deficiencies were resolved. During the rate case, staff made suggestions concerning maintenance/repairs of the building which houses the well and pump at the water treatment plant. Those repairs were completed prior to the customer meeting. The quality of the water treatment plant-in-service is considered to be satisfactory.

UTILITY'S ATTEMPT TO ADDRESS CUSTOMER SATISFACTION

An informal customer meeting was held on June 27, 2002, at 6:00 pm in the Chain of Lakes Complex on Cypress Gardens Boulevard in Winter Haven. Seven customers attended the meeting. Four customers offered comments concerning the utility's quality of service. The first speaker was Mr. Rosser who, in addition to

being a customer of McLeod Gardens, is the Superintendent over water and wastewater facilities for a neighboring city. He identified the utility's problems as: excessive Hydrogen Sulfide, erratic control over Chlorine dosages, and the utility not returning phone calls when messages were left on the answering machine. Mr. Rosser also asked if the building contractors were paying their fair share for water use, and what were the draw-down effects from other wells. Another customer, Mr. Turly, agreed with all of Mr. Rosser's comments, but added that (at times) the pressure in the system was low. The other two customers that spoke did so in support of the comments made by Mr. Rosser and Mr. Turly.

During staff's investigation of the Hydrogen Sulfide and Chlorination issues, it was determined that the two are interrelated. The customers complained of excessive chlorine in the drinking water at times and a strong sulfur taste/odor. Hydrogen Sulfide, while not considered to be a health hazard, does emit odors and has a taste that some find to be unpleasant. The Chlorine pump is set on a timer that only injects Chlorine while the pump is engaged. This treatment process is a recognized treatment for disinfection and for the removal of Hydrogen Sulfide. The process is complicated by unfettered flat-rate water use that shortens the retention time in the pressure tank, and encourages inconsistent interaction of the Hydrogen Sulfide with the Chlorine dosages.

The interaction between the Chlorine and the Hydrogen Sulfide is, by its nature, constantly in flux and results shift from moment to moment. In order to insure that the water remains protected throughout the distribution system and the required level of free residual is maintained, the operator has been injecting sufficient Chlorine to neutralize the Hydrogen Sulfide at its highest concentration. When chlorine is fed into the raw water, it first reacts with any iron, manganese, or hydrogen sulfide that may be in the water. If any residual (un-reacted) chlorine remains, it will next react with organic material (including bacteria) present. By Rule 62-550.518(4), Florida Administrative Code, the utility is required to maintain a free Chlorine residual of 0.2 parts per million throughout the system. However, while there is a 0.2 parts per million minimum free chlorine residual requirement, the maximum limit is a standard of 4 parts per million calculated as a running average computed quarterly using monthly averages of all samples taken. A review of the utility's Monthly Operator's Reports for

the test year did not yield a quarterly average that exceeded 4 parts per million.

The "rate of feed" is adjusted by the operator during his required visits to the plant to maintain the minimum 0.2 ppm level of free Chlorine; however, the required on-site operator time for this water plant is three one-hour visits per week plus one weekend visit. It is between these on-site visitations that the interaction becomes unstable and the proper dosage levels gets out of balance. Mr. Dosser illustrated his awareness of this by recommending the utility either interconnect to a larger system or install an automatic disinfection feed system with sensor/control to regulate the Chlorine dosage levels between operator visits.

In reaction to the comments expressed at the customer meeting, the utility owner requested a waiver of the statutory deadline in order to investigate options to remedy these problems. During the construction of Phase III, an 8 inch stub-out was extended outside of the subdivision with the sole purpose of interconnecting with the City of Bartow. At the time Phase III was constructed, Bartow was not ready to interconnect McLeod Gardens, and the utility was hopeful that the situation had changed. The City of Bartow is still not ready to interconnect McLeod Gardens to its system. After the utility's latest attempt to interconnect failed, it obtained a cost estimate for the installation of an automatic disinfection feed system with sensor/control. Staff recommends that the cost to install this automated disinfection system be included as a pro forma plant, and the utility be given four months from the date of the Consummating Order to install the system.

Concerning the complaint of low water pressure, staff discussed the issue at the meeting by informing the customers that the minimum requirement pursuant to Rule 62-550.518(4), Florida Administrative Code, for water pressure is 20 psi. The county health office is the office of primacy in this matter, and the low pressure complaint was reported to the Polk County Department of Health the next day. They did not have any record of low pressure complaints for this utility, but stated that should a customer call their office, they would investigate the matter completely. Staff later passed the word to Mr. Dosser that the health department would investigate the low pressure complaint as soon as someone registered a complaint in their office. Upon this writing, no such complaint has been received.

The concerns over contractors paying their fair share and the draw-down effect from the two wells at the plant site are believed to be minor issues. At every opportunity, staff explained to the customers that the installation of individual meters would insure they would only pay their fair share. The contractors building houses in the subdivision may be using a lot of water, however, the utility alternates the use of the two wells. This insures that any draw-down cone created by the extraction of raw water from the water table will have a chance to recover before the other well is placed into use. Both wells are considered deep wells. The smaller (4 inch) well was drilled to a depth of 280 feet with the casing set at 105 feet, and the static water level recorded at 58 feet. Other wells in the area are considered to be at a sufficient distance away to not have an influence on the dynamics of the wells serving McLeod Gardens. It is believed that the installation of meters will resolve both of these concerns.

Staff asked the utility why they did not return customer phone calls left on the answering machine. The utility answered that they either called the operator or a contract service company to go and correct the complaint. At that point, they considered the issue resolved. Staff has discussed the appropriate response with the utility management, and the utility has assured staff that in the future they will respond directly to the customer and inform them what was being done to resolve their complaint. The utility tends to respond well to regulatory authority, and it is believed that they will be responsible in this matter as well.

Staff believes that the utility has shown ample good faith effort in their attempt to address customer concerns. It is recommended that the utility's quality of service be considered satisfactory; however, the utility should be required to install the automatic chlorination system within four months of the Consummating Order.

ISSUE 2: Should the Commission approve a projected test year for the utility?

RECOMMENDATION: Yes, the Commission should approve a projected test year for the utility to better match expenses with customer growth on a going forward basis. A projected test year ending December 31, 2003, should be approved. (FITCH)

STAFF ANALYSIS: For audit purposes staff selected a historic test year ending December 31, 2001. Because the utility is growing at an exceptionally high rate (13 connections a year or 22%), staff believes that rates based on historical data alone will be significantly different than rates based on current or even future conditions. Staff believes that a projected test year (ending December 31, 2003) is appropriate in this case and will better match increasing revenues with recommended expenses on a going forward basis.

This is consistent with Order No. 15725, issued February 21, 1986, in Docket No. 840315-WS, In re: Application of Martin Downs Utilities, Inc. For an increase in water and wastewater rates to its customers in Martin County, Florida, in which the Commission found the following:

> The test year is an analytical device used in rate making proceedings to compute current levels of investment and income in order to determine the amount of revenue that will be required to assure a company a fair return on its investment. Test year data must be adjusted to properly reflect conditions in the future period for which rates are being fixed. Based upon historical data we anticipate Martin Downs will continue to experience rapid growth of demand for its services.

Therefore, the Commission found a projected test year was appropriate for Martin Downs.

Staff believes that using a projected test period in cases of extremely high growth will keep the utility from overearning in the short run and will promote rate stability. The Commission has approved a projected test year for high growth in Order No. PSC-01-1246-PAA-WS, issued June 4, 2001, in Docket No. 001382-WS.

Because of the above factors, staff recommends that a projected test year rate base is appropriate, in this case, to better match expenses with customer base on a going forward basis. Staff recommends that a projected test year ending December 31, 2003, should be approved.

USED AND USEFUL

ISSUE 3: What portions of McLeod Gardens, are used and useful?

RECOMMENDATION: The water treatment plant at McLeod Gardens, should be considered 100% used and useful. The water distribution system should be 100% used and useful. (T. DAVIS)

STAFF ANALYSIS:

Water Treatment Plant

The water treatment plant is a closed system that fully relies on the total pumping capacity of 495 gpm to meet instantaneous customer demands on the system. Well number one is equipped with a 25 horsepower submersible pump, and has a rated capacity of 425 gpm. Well number two is equipped with a 5 horsepower submersible pump that has a rated capacity of 70 gpm. To properly evaluate a closed system plant, the highest capacity well is removed from the calculation which reduces the reliable capacity to 70 gpm. The hydropneumatic tank is considered to be a pressure equalization chamber and serves little as a storage facility. Current customer demands (for calculation purposes) are more appropriately determined by the minimum design criteria of 1.1 gpm in accordance with General Waterworks Design Criteria which is compared to the number of customer connections. This standard is backed by the American Water Works Association (AWWA), and is recommended to be met by the lowest capacity well. Based upon design criteria, the reliable capacity of this plant is calculated to be 70 gpm which serves an average anticipated customer demand of 91 gpm.

Customer growth has been steady over the last five years. The anticipated growth rate is calculated to be 13 customers per year by regression analysis. Using a projected test year for the used and useful calculation, it is anticipated that the average number of customers in 2003 will be 77 ERCs. The anticipated growth rate of 13 customers per year exceeds the 5% per year statutory limit staff must use in calculating the five year growth period as prescribed by Section 367.081(2)(a)2(b), Florida Statutes. The 5% growth in ERCs used to calculate customer growth is 3 ERCs per year which yields an estimated 36 gpm for the five year growth capacity. From the flow analysis, there does not appear to be an excessive unaccounted for water problem. By the formula, the water plant is calculated to be 100% used and useful. Therefore, in accordance

with the calculation sheet (Attachment "A", Sheet 1 of 2), it is recommended that the used and useful for the water treatment plant should be 100%.

Water Distribution System

The water distribution system has the potential of serving 93 customers (estimated to be 93 ERCs). The average number of customers anticipated during the projected test year is 77 customers (estimated to be 77 ERCs). Using the statutory cap of 5% per year for the five year growth period (3 ERCs), the future growth is calculated to be 15 ERCs. By the formula approach, staff calculates the distribution system to be 100% used and useful (See Attachment "A", Page 2 of 2). It is recommended that the water distribution system be considered 100% used and useful.

ISSUE 4: What is the appropriate projected average test year rate base for the utility?

RECOMMENDATION: The appropriate projected average test year rate base for this utility is $68,792. The utility should be required to complete the installation of the automatic chlorination system within four months of the Consummating Order. (FITCH, DAVIS)

STAFF ANALYSIS: Rate base has not been established by the Commission for this utility. Staff was able to find cost documentation for UPIS with the exception of three items of plant. For those items, staff relied on an original cost study.

Staff has selected a projected average test year ending December 31, 2003. Rate base components have been calculated using the original cost study and staff's audit and engineering report for a plant balance through December 31, 2003. A discussion of each component of rate base follows:

Utility Plant in Service (UPIS): The utility recorded UPIS of $80,118 for the test year. The utility had three items of plant that were not recorded on the books and for which no cost documentation was available. Staff has determined the original cost of these items as follows:

Acct. No.	Description	Original Cost
304	Pumphouse	$2,250
307	Well Drilling and Casing	$4,251
311	Vertical Turbine Pump	$2,678
		$9,179

Therefore, staff has increased UPIS by $9,179 to reflect the plant items not recorded on the utility's books.

The utility serves a subdivision being developed by its parent company (developer). According to Audit Exception No. 5, the utility is recording the cost of the distribution system as development cost; the cost is recorded as the developer's lot inventory. The inventory account is expensed as "cost of sales" as lots are sold. The cost of the distribution system should have been recorded on the utility's books with a corresponding

adjustment to CIAC. Therefore, staff has increased UPIS by $97,126 (Acct. No. 331 $64,725, Acct. No. 333 $22,143 and Acct. No. 335 $10,258) to include the portion of the distribution system not recorded by the utility. Because the utility is recovering the cost of the distribution system through lots sold, a corresponding adjustment should be made to CIAC to recognize the contributed lines.

According to Audit Exception No. 4, the utility recorded $1,885 associated with meters and meter installation in an expense account (Account No. 636 Contractual Services-Other). The cost of purchasing and installing a meter should be capitalized. Therefore, staff has increased Account No. 334 by $1,885 to reclassify and capitalize the cost of meters expensed by the utility from Account No. 636.

In 2000, the utility replaced the vertical turbine pump discussed above with a 25-horsepower submersible pump. Since the vertical pump was replaced, it should have been retired from UPIS by the utility. Therefore, staff has decreased Account No. 311 by $2,678 to reflect the retirement of the vertical pump.

The utility has provided staff with cost documentation associated with meters and meter installation of $115 per meter. Staff has increased Account No. 334 by $2,990 ($115 x 13 connections x 2 years) to reflect the meters associated with the projected customers. Staff has decreased UPIS by $748 to reflect an averaging adjustment. In Issue No. 1, staff is recommending that the utility install an automatic chlorination system that will reduce the fluctuations in chlorine and hydrogen sulfide levels which concerned several customers. The utility has provided staff with estimates for the chlorination equipment of $7,375, which includes installation cost. Therefore, staff has increased Account No. 320 by $7,375 to include the automatic chlorination system.

Staff's net adjustment to UPIS is an increase of $115,129. Staff recommends UPIS of $195,247.

Land: The utility did not record an amount in this account for the test year. According to Audit Exception No. 3, the developer bought a total of 70 acres for $245,000 in 1991 to develop as single family home sites. The auditor determined that the utility occupies approximately 2 acres of this land. Therefore, staff has

increased this account by $7,000 ($245,000 ÷ 70 acres x 2 acres) to reflect the original cost of the land associated with utility use.

Non-used and Useful Plant: Staff has determined the used and useful percentages for each plant account. The water treatment plant is 100% used and useful and the water distribution system is 100% used and useful. Because both the treatment plant and water distribution system are considered 100% used and useful, a non-used and useful adjustment has not been made.

Contribution in Aid of Construction (CIAC): The utility recorded $15,650 in this account during the test year. As discussed above, the cost of the distribution system is expensed through the "cost of sales." This means that the utility has recovered its investment of the distribution system through lot sales and should not continue to earn a return on that investment. Therefore, an adjustment should be made to CIAC to remove the cost of the distribution system from rate base.

Staff has increased this account by $1,955 to reflect the contributed portion of the collection system recorded by the utility. As discussed above, because the utility recovered the collection system through the "cost of sales," the utility did not record a majority of the distribution system on its books. Staff has made an adjustment above to include the unrecorded distribution system in rate base. Therefore, staff has made a corresponding adjustment to increase this account by $97,126 to reflect the contributed portion of the collection system not recorded by the utility.

Staff has increased this account by $8,645 to reflect CIAC for the projected test years. Projected CIAC was determined by taking the projected number of customers times the utility's current service availability charges and staff's recommended service availability charges anticipated to be in effect during the projected period. Staff has decreased this account by $2,535 to reflect an averaging adjustment. Staff's adjustments result in CIAC of $120,841.

Accumulated Depreciation: The utility recorded $14,239 for accumulated depreciation on its books during the historic test year. Staff has calculated accumulated depreciation using the prescribed rates in Rule 25-30.140, Florida Administrative Code. Staff's calculated accumulated depreciation on December 31, 2001,

is $17,179. Staff has decreased this account by $2,678 to reflect the retirement above and has increased this account by $5,618 to reflect staff's calculated depreciation of $17,179 ($14,239 - $2,678 + 5,618).

Staff has increased this account by $13,628 to reflect accumulated depreciation for the projected test years. Staff has decreased this account by $3,333 to reflect an averaging adjustment. Staff's adjustments result in accumulated depreciation of $27,474.

Amortization of CIAC: The utility recorded $421 for amortization of CIAC. Staff has calculated year end amortization using composite depreciation rates. Staff's calculated year-end amortization of CIAC is $7,020. This account has been increased by $6,599 ($7,020 - $421) to reflect staff's calculated amortization of CIAC.

Staff has increased this account by $7,072 to reflect CIAC amortization for the projected test years. Staff has decreased this account by $1,828 to reflect an averaging adjustment. Staff's adjustments result in amortization of CIAC of $12,264.

Working Capital Allowance: Working capital is defined as the investor-supplied funds necessary to meet operating expenses or going-concern requirements of the utility. Consistent with Rule 25-30.433, Florida Administrative Code, staff recommends that the one-eighth of operation and maintenance (O&M) expense formula approach be used for calculating working capital allowance. Applying that formula, staff recommends a working capital allowance of $2,596 (based on O&M of $20,770). Working capital has been increased by $2,596 to reflect one-eighth of staff's recommended O&M expenses.

Rate Base Summary: Based on the foregoing, staff recommends that the appropriate projected teat year rate base is $68,792 for water.

Rate base is shown on Schedule No. 1-A. Related adjustments are shown on Schedule No. 1-B.

COST OF CAPITAL

ISSUE 5: What is the appropriate rate of return on equity and the appropriate overall rate of return for this utility?

RECOMMENDATION: The appropriate return on equity is 10.41% with a range of 9.41% - 11.41%. The appropriate overall rate of return is 9.98%. (FITCH)

STAFF ANALYSIS: The utility's capital structure consists of common stock of $37,500, retained earnings of $37,134, paid in capital of $298,210, and long term debt of $114,000. The utility's long term debt consists of two loans of $67,500 and $46,500 with an interest cost of 8.75% and 8.30% respectively.

Using the current leverage formula approved by Order No. PSC-02-0898-PAA-WS, issued July 5, 2002, in Docket No. 020006-WS, the appropriate rate of return on equity is 10.41%. Staff has determined the total weighted average cost of capital to be 9.98%.

The utility's capital structure has been reconciled with staff's recommended rate base. Staff recommends a return on equity of 10.41% with a range of 9.41% - 11.41% and an overall rate of return of 9.98%.

The return on equity and overall rate of return are shown on Schedule No. 2.

NET OPERATING INCOME

ISSUE 6: What are the appropriate test year revenues?

RECOMMENDATION: The appropriate test year revenues for the utility are $17,224. (FITCH)

STAFF ANALYSIS: The utility recorded revenues, for the 12-month period ended December 31, 2001, of $11,982 ($11,222 for service revenues and $760 for other revenues). Included in the utility's test year revenues was $60 associated with revenues collected for non-sufficient funds. Staff has recommended in Issue No. 7 that the expense associated with receiving non-sufficient fund checks from customers be removed from O&M. Therefore, the revenues associated with the non-sufficient funds should be removed as well. Staff has decreased this account by $60 to remove the non-sufficient funds revenue.

The utility's tariff authorizes a $18 flat rate for residential customers. Staff has recalculated service revenues based on the billing analysis and the authorized rate. Staff has increased this account by $460 to annualize historic test year billing. In Issue No. 2, staff has recommended a projected test year ending December 31, 2003. Staff has increased this account by $4,842 to account for total service revenues that would be collected based on average projected test year customers.

Based upon the foregoing, staff recommends that the test year revenues are $17,224. Test year revenues are shown on Schedule No. 3-A. The related adjustments are shown on Schedule No. 3-B.

ISSUE 7: What is the appropriate amount of operating expense?

RECOMMENDATION: The appropriate amount of operating expense for this utility is $26,276. (FITCH)

STAFF ANALYSIS: The utility recorded operations and maintenance (O&M) expenses of $19,642 during the test year. The utility provided the auditor with access to all invoices, canceled checks and other utility records to verify its O&M and taxes other than income expense for the 12-month period ended December 31, 2001. Using the documents provided by the utility, staff has determined the appropriate operating expenses for the test year and a breakdown of expenses by account class. The utility did not use the NARUC USOA account numbers; however, the utility did use similar accounts and staff has allocated those expenses to the appropriate NARUC accounts.

Operations and Maintenance Expenses (O&M)

Purchased Power-(615) - The utility recorded $1,891 in this account during the test year. Staff has increased this account by $838 to reflect the increase in power associated with the projected increase in gallons consumed. Staff has decreased this account by $1,365 to reflect a repression adjustment. Staff recommends purchased power expense of $1,365.

Chemicals-(615) - The utility recorded $1,708 in this account during the test year. Staff has increased this account by $757 to reflect the increase in chemicals associated with the projected increase in gallons consumed. Staff has decreased this account by $1,233 to reflect a repression adjustment. Staff recommends chemicals expense of $1,233.

Contracted Services-Billing-(630) - The utility did not record an amount in this account during the test year. Although the utility currently has a flat rate structure, staff is recommending a base facility gallonage charge rate structure in Issue No. 9. Therefore, the utility will need someone to read the meters. The utility has requested $75 per month for meter reading. Traditionally the Commission has approved meter reading expense between $0.30 and $1.00 per meter. The utility's requested amount results in approximately $0.90 per meter. Staff believes that this amount is reasonable and has increased this account by $900 ($75 x 12 months) to reflect annual meter reading expense.

Contractual Services-Testing-(635) - The utility recorded $1,328 in this account during the test year. Each utility must adhere to specific testing conditions prescribed within its operating permit. These testing requirements are tailored to each utility as required by Chapters 62-550 and 551, Florida Administrative Code, which are enforced by the DEP. The tests and the frequency at which those tests must be repeated for this utility are:

WATER DEP REQUIRED TESTING

Test	Frequency	Annual Amount
Microbiological	Monthly	$480
Primary Inorganics	3 Years	$77
Secondary Inorganics	3 Years	$77
Asbestos	9 Years	$35
Volatile Organics	Yearly	$658
Pesticides & PCB	3 Years	$292
Nitrates & Nitrites	Yearly	$40
Radionuclides I	3 Years	$32
Radionuclides II	3 Years	$250
Unregulated Organics I	qty 1st yr/ 9 yrs.	$275
Unregulated Organics II	3 Years	$110
Unregulated Organics III	3 Years	$83
Lead & Copper	Biannual	$320
Total		$2,729

Staff has increased this account by $1,401 ($2,729 - $1,328) to reflect the DEP required testing.

Contractual Services Other-(636) - The utility recorded $10,647 in this account during the test year. The utility has a contracted operator at $250 a month, two contracted bookkeepers at $150 a month, and contracted management at $250 a month. Staff believes that these amounts are reasonable for a utility of this size.

Staff has increased this account by $250 to annualize the above contracts.

The utility believes that the cost associated with the bookkeeping will increase to $650 per month once billing for metered consumption begins. Staff agrees that accounting for metered bills is more complex than flat rate bills; however, staff believes that a monthly increase of $500 to account for 83 customer bills is unreasonable. Currently the utility is billing customers a flat rate, and since staff is allowing an amount for a meter reader, the only accounting difference will be multiplying the gallonage rate times the gallons provided by the meter reader and adding that amount to the base facility charge. Staff believes that the difference in time associated with calculating a flat rate bill and calculating a base facility gallonage charge bill is immaterial. The increased cost associated with the new rate structure is reflected in staff's recommended meter reader.

According to Audit Exception No. 4, the utility recorded $1,885 in this account for meters and meter installations during the test year. Meters and meter installations should be capitalized rather than expensed. Therefore, staff has decreased this account by $1,885 to reclassify and capitalize meters to Account No. 311.

The utility did not record an amount for grounds keeping during the test year. The utility has submitted a bid for $65 a month for grounds keeping. Staff believes this amount is reasonable and has increased this account by $780 ($65 x 12 months) to reflect grounds keeping expense.

Staff's net adjustment to this account is a decrease of $855. Staff's recommended Contractual Services-Other expense is $9,792.

Transportation Expense - (650) - The utility did not record an amount in this account during the historic test year. The utility personnel uses their personal vehicles to meet with regulatory personnel, run errands, pick up supplies, meet with contracted companies on special projects, and perform minor repairs and upkeep at the plants. Staff has estimated that the utility personnel travels approximately 200 miles per month performing these functions. Staff has increased this account by $696 for transportation expense (200 miles a month x 12 months x $0.29 a mile).

Regulatory Commission Expense-(655) - The utility did not record an amount in this account during the test year. The utility paid a $200 rate case filing fee pursuant to Rule 25-30.020, Florida Administrative Code. Staff has increased this account by $50 ($200/4 years) to reflect rate case expense amortized over four years.

Miscellaneous Expense-(675/775) - The utility recorded $62 in this account during the test year. This amount reflects expense associated with non-sufficient funds and penalties for over drawing an account. Staff believes that customers should not be responsible for the cost associated with the utility over drawing an account. Further, the utility can recover the cost associated with non-sufficient funds paid to the utility from the individual who wrote the bad check under Section 68.065, Florida Statutes. Therefore, staff has decreased this account by $62 to remove the expense associated with non-sufficient funds and penalties for over drawing an account.

Operation and Maintenance Expense (O&M Summary) - The total O&M adjustment is an increase of $1,128. Staff's recommended O&M expense is $20,770 for water. O&M expenses are shown on Schedule 3-B.

Depreciation Expense - The utility did not record depreciation expense for the test year. Depreciation expense has been calculated using the prescribed rates in Rule 25-30.140, Florida Administrative Code. Staff's calculated depreciation is $7,692; therefore, staff has increased this account by $7,692 to reflect staff calculated depreciation expense. Staff has calculated test year amortization of CIAC, using composite rates, of $4,050; therefore, staff has decreased this account by $4,050 to reflect staff calculated amortization of CIAC. CIAC has a negative impact on depreciation expense. Staff's calculated net depreciation expense is $3,642.

Taxes Other Than Income - The utility recorded taxes other than income of $372. According to Audit Exception No. 7, the utility did not record RAFs for the test year. Staff has increased this account by $775 to include RAFs based on annualized revenues.

Income Tax - McLeod Gardens is a Sub-chapter S corporation; therefore, consistent with Rule 25-30.433(7), Florida

Administrative Code, an allowance for income taxes has not been made.

Operating Revenues - Revenues have been increased by $15,917 to reflect the increase in revenue required to cover expenses and allow the recommended return on investment.

Taxes Other Than Income - This expense has been increased by $716 to reflect RAFs of 4.5% on the increase in revenues.

Operating Expenses Summary - The application of staff's recommended adjustments to the audited test year operating expenses results in staff's calculated operating expenses of $26,276.

Operating expenses are shown on Schedule No. 3-A. The related adjustments are shown on Schedule No. 3-B.

REVENUE REQUIREMENT
ISSUE 8: What is the appropriate revenue requirement?

RECOMMENDATION: The appropriate revenue requirement is $33,141 for water. (FITCH)

STAFF ANALYSIS: The utility should be allowed an annual increase of $15,917 (92.41%). This will allow the utility the opportunity to recover its expenses and earn a 9.98% return on its investment. The calculations are as follows:

	Water
Adjusted Rate Base	$68,792
Rate of Return	x .0998
Return on Investment	$6,865
Adjusted O & M Expense	$20,770
Depreciation Expense (Net)	$3,642
Taxes Other Than Income	$1,863
Revenue Requirement	$33,141
Adjusted Test Year Revenues	$17,224
Percent Increase/(Decrease)	92.41%

Revenue requirement is shown on Schedules No. 3-A.

ISSUE 9: Is a continuation of the utility's current flat rate structure for its water system appropriate in this case, and, if not, what is the appropriate rate structure?

RECOMMENDATION: No, a continuation of the utility's current flat rate structure for its water system is not appropriate in this case. The water system rate structure should be changed to a traditional base facility charge (BFC)/gallonage charge rate structure. The cost recovery allocated to the BFC should be 30%. (LINGO)

STAFF ANALYSIS: The utility's current water system rate structure consists of a monthly flat rate of $18.00. This rate structure is nonusage sensitive and discourages conservation at all levels of consumption. The Commission's preferred rate structure has been the traditional BFC/gallonage charge rate structure, because it is designed to provide for the equitable sharing by the rate payers of both the fixed and variable costs of providing service. This rate structure is also considered usage-sensitive because customers are charged for all water consumed. Therefore, customers are able to reduce their total bill by reducing their water consumption. Over the past few years, however, due to water supply concerns and requirements imposed on utilities by the Water Management Districts, the more conservation-oriented inclining-block rate structure has become the Commission's rate structure of choice.

Rule 25-30.255(1), Florida Administrative Code, requires that each utility measure water sold on the basis of metered volume sales unless the Commission approves a flat rate service arrangement for that utility. The utility's current flat rates were approved when it was granted an original water certificate in Docket No. 001381-WU. See Order No. PSC-01-2317-PAA-WU, issued on November 27, 2001. As discussed in Issue No. 4, all customers are now metered. Therefore, staff recommends that the current flat rate structure be discontinued in favor of a usage-sensitive rate structure, not only to conform to the requirements of the Commission's prior Order, but to be consistent with Commission policy and with the overall statewide goal of eliminating conservation-discouraging water rate structures.

Although meters have been installed for all customers, the utility's current flat rate structure does not require, nor has the utility been taking, meter readings of its customers. The absence of metered consumption data precludes implementation of an

inclining-block rate structure at this time. Therefore, staff recommends that the traditional BFC/gallonage charge be implemented.

In lieu of metered consumption data, staff used data obtained from the DEP Monthly Operating Reports (MORs) during the test year to estimate customers' average monthly consumption of approximately 18,900 gallons (18.9 kgal). Based on an average of 2.5 persons per household, the average gallons per day per capita (gpdc) use is 252 gallons (18,900 gallons / 2.5 persons / 30 days).

McLeod Gardens is located in the Southwest Florida Water Management District (SWFWMD or District) within the Southern Water Use Caution Area (SWUCA). The gallons per day per capita (gpdc) target usage rate for utilities located in the SWUCA is 150 gpdc, and is listed as a general condition on the utility's Water Use Permit (WUP). The customers' gpdc of 252 gallons is substantially greater (approximately 68%) than the District's 150 gpdc target.

Although implementation of an inclining-block rate structure is not appropriate at this time, one method of making rates more conservation-oriented is by implementing a conservation adjustment, whereby more of the revenue recovery is shifted to the gallonage charge. Based on staff's initial assessment of fixed versus variable allocation of revenue requirement recovery, the utility would recover 41% ($14,394) in the BFC and the remaining 59% ($20,801) in the gallonage charge. This revenue recovery allocation is just outside the rate design guidelines of the SWFWMD which state that no more than 40% of the total cost recovery be allocated to the BFC.

Staff believes that additional costs should be shifted from the BFC to the gallonage charge in order to accomplish several rate design goals. BFC cost recovery percentages of 35% (requiring a pre-repression conservation adjustment of 15%) and 30% (requiring a pre-repression conservation adjustment of 27%) were analyzed. The results of this pre-repression analysis, including making no adjustment, are shown in the following table:

PRE-REPRESSION PRICE INCREASES AT VARIOUS CONSERVATION ADJUSTMENTS (CA) AND BFC COST RECOVERY PERCENTAGES			
	CA and BFC Cost Recovery Percentages		
Monthly Consumption	CA = 0% BFC = 41%	CA = 15% BFC = 35%	CA = 27% BFC = 30%
0 kgal	-12.9%	-25.9%	-36.4%
1 kgal	-6.2%	-18.6%	-28.5%
2 kgal	0.4%	-11.3%	-20.6%
3 kgal	7.1%	-3.9%	-12.7%
5 kgal	20.4%	10.7%	3.1%
9 kgal	47.1%	40.1%	34.6%
10 kgal	53.8%	47.4%	42.5%
15 kgal	87.1%	84.1%	81.9%
20 kgal	120.4%	120.7%	121.4%
25 kgal	153.8%	157.4%	160.8%

As shown above, the BFC cost recovery percentage of 30% accomplishes the following rate design goals: 1) it minimizes the price increases for lesser, nondiscretionary monthly consumption of 5 kgal or less; and 2) it maximizes price increases at levels of consumption greater than the current monthly average.

Therefore, staff recommends that a continuation of the utility's current flat rate structure for its water system is not appropriate in this case. The water system rate structure should be changed to a traditional BFC/gallonage charge rate structure. The cost recovery allocated to the BFC should be 30%.

ISSUE 10: Is an adjustment to reflect repression of consumption due to the rate structure and price changes appropriate in this case, and, if so, what is the appropriate repression adjustment?

RECOMMENDATION: Yes, a repression adjustment of 8,668 kgal is appropriate in this case. In order to monitor the effects of both the changes in rate structure and the recommended revenue change, the utility should be ordered to prepare monthly reports detailing the number of bills rendered, the consumption billed and the revenue billed. These reports should be provided, by customer class and meter size, on a quarterly basis for a period of two years, beginning with the first billing period after the approved rates go into effect. (LINGO)

STAFF ANALYSIS: Based on information contained in our database of utilities receiving rate increases and decreases, there were four water utilities that converted from a flat rate structure to a traditional BFC/gallonage charge rate structure. The specific consumption reductions were 60%, 60%, 50% and 44%, respectively. Two utilities were removed from consideration because they received substantial concomitant wastewater increases, which, we believe, placed upward pressure on the levels of water consumption reduction levels. This leaves two utilities in the sample: one of the remaining utilities experienced a 60% consumption reduction, while the other utility's corresponding consumption reduction was 44%.

Staff notes that the average monthly consumption for McLeod Gardens' customers is approximately 18.885 kgal, which, we believe, represents a substantial amount of discretionary usage, making a high magnitude of repression likely. Furthermore, the magnitude of the revenue requirement increase (92.41%) indicates that the current rates are far from compensatory. We believe that, due to the rate shock to be experienced by the customers, the anticipated consumption reductions will in fact be substantial. Therefore, based on our professional judgement, Staff recommends a 50% repression adjustment be made to residential consumption; the resulting recommended reduction in consumption is 8,668 kgal.

In order to monitor the effects of both the changes in rate structure and the recommended revenue change, the utility should be ordered to prepare monthly reports detailing the number of bills rendered, the consumption billed and the revenue billed. These reports should be provided, by customer class and meter size, on a

quarterly basis for a period of two years, beginning with the first billing period after the approved rates go into effect.

ISSUE 11: What are the appropriate monthly rates for service?

RECOMMENDATION: The appropriate monthly rates should be designed to produce revenues of $32,441, excluding miscellaneous service charge revenues. The utility should file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-30.475(1), Florida Administrative Code. The rates should not be implemented until staff has approved the proposed customer notice, and the notice has been received by the customers. The utility should provide proof of the date notice was given no less than 10 days after the date of the notice. Staff should be given administrative authority to approve the revised tariff sheets upon staff's verification that the tariffs are consistent with the Commission's decision. (LINGO, FITCH)

STAFF ANALYSIS: As discussed in Issue No. 8, the appropriate revenue requirement is $33,141. The utility had other revenues totaling $700 during the test year. Other revenues should be used to reduce the revenue requirement recovered through rates. Therefore, staff has designed rates to produce revenues of $32,441 ($33,141 - $700). As discussed in Issue No. 9, staff recommends that the water system rate structure be changed to a traditional BFC/gallonage charge rate structure with a BFC cost recovery percentage of 30%. As discussed in Issue No. 10, staff recommends that the appropriate repression adjustment is 8,668 kgal. Therefore, the resulting monthly rates for service are those shown below.

MONTHLY RATES - WATER
RESIDENTIAL AND GENERAL SERVICE
BASE FACILITY CHARGE

METER SIZES	EXISTING RATES	RECOMMENDED RATES
Flat Rate	$18.00	N/A
5/8" x 3/4"	N/A	$10.51
3/4"	N/A	$15.76
1"	N/A	$26.26
1 ½"	N/A	$52.53
2"	N/A	$84.05
3"	N/A	$168.10
4"	N/A	$262.65
6"	N/A	$525.30
GALLONAGE CHARGE		
Per 1,000 gallons	Flat Rate	$2.63

Staff's recommended increase in revenue requirements is $15,917 or approximately 92.41%. The rates approved for the utility should be designed to produce revenues of $32,441.

Approximately 30% ($9,644) of the service revenues are recovered through the recommended base facility charge. The fixed costs are recovered through the BFC based on the number of factored ERCs. The remaining 70% ($22,797) of the service revenues represents revenues collected through the consumption charge based on the number of gallons. The following is a comparison of bills at 3,000, 5,000, and 10,000 gallons:

GALLONS	EXISTING RATE	RECOMMENDED RATE
3,000	$18.00	$18.40
5,000	$18.00	$23.66
10,000	$18.00	$36.81

The utility should file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-30.475(1), Florida Administrative Code. The rates should not be implemented until staff has approved the proposed customer notice, and the notice has been received by the customers. The utility should provide proof of the date notice was given no less than 10 days after the date of the notice. Staff should be given administrative authority to approve the revised tariff sheets upon staff's verification that the tariffs are consistent with the Commission's decision.

ISSUE 12: What is the appropriate amount by which rates should be reduced four years after the established effective date to reflect the removal of the amortized rate case expense as required by Section 367.0816, Florida Statutes?

RECOMMENDATION: The water rates should be reduced as shown on Schedule 4, to remove rate case expense grossed-up for regulatory assessment fees and amortized over a four-year period. The decrease in rates should become effective immediately following the expiration of the four year rate case expense recovery period, pursuant to Section 367.0816, Florida Statutes. The utility should be required to file revised tariffs and a proposed customer notice setting forth the lower rates and the reason for the reduction no later than one month prior to the actual date of the required rate reduction. If the utility files this reduction in conjunction with a price index or pass-through rate adjustment, separate data should be filed for the price index and/or pass-through increase or decrease and the reduction in the rates due to the amortized rate case expense. Staff should be given administrative authority to approve the revised tariff sheets upon staff's verification that the tariffs are consistent with the Commission's decision. (FITCH)

STAFF ANALYSIS: Section 367.0816, Florida Statutes, requires that the rates be reduced immediately following the expiration of the four year period by the amount of the rate case expense previously included in the rates. The reduction will reflect the removal of revenues associated with the amortization of rate case expense and the gross-up for regulatory assessment fees which is $52 annually. Using the utility's current revenues, expenses, capital structure and customer base, the reduction in revenues will result in the rate decreases as shown on Schedule No. 4.

The utility should be required to file revised tariff sheets no later than one month prior to the actual date of the required rate reduction. The utility also should be required to file a proposed customer notice setting forth the lower rates and the reason for the reduction. If the utility files this reduction in conjunction with a price index or pass-through rate adjustment, separate data should be filed for the price index and/or pass-through increase or decrease and the reduction in the rates due to the amortized rate case expense. Staff should be given administrative authority to approve the revised tariff sheets upon staff's verification that the tariffs are consistent with the Commission's decision.

ISSUE 13: What are the appropriate customer deposits for this utility?

RECOMMENDATION: The appropriate customer deposits should be the recommended charges as specified in the staff analysis. The utility should file revised tariff sheets, which are consistent with the Commission's vote. Staff should be given administrative authority to approve the revised tariff sheets upon staff's verification that the tariffs are consistent with the Commission's decision. If revised tariff sheets are filed and approved, the customer deposits should become effective for connections made on or after the stamped approval date of the revised tariff sheets, if no protest is filed. (FITCH)

STAFF ANALYSIS: Rule 25-30.311, Florida Administrative Code, provides guidelines for collecting, administering and refunding customer deposits. It also authorizes customer deposits to be calculated using an average monthly bill for a two-month period. The utility's existing tariff does not authorize the utility to collect a customer deposit. Staff has calculated customer deposits using the recommended rates and an average monthly bill for a two-month period. A schedule of the utility's existing and staff's recommended deposits follows:

Water Customer Deposits

Residential and General Service

Meter Size	Existing Deposit	Recommended Deposit
5/8" x 3/4"	N/A	$70.00
All over 5/8" x 3/4"	N/A	2 x average bill

The utility should file revised tariff sheets, which are consistent with the Commission's vote. Staff should be given administrative authority to approve the revised tariff sheets upon staff's verification that the tariffs are consistent with the Commission's decision. If revised tariff sheets are filed and approved, the customer deposits should become effective for connections made on or after the stamped approval date of the revised tariff sheets, if no protest is filed.

ISSUE 14: Should the utility's service availability charges be revised?

RECOMMENDATION: Yes, the utility's current tap in fee of $275 should be discontinued and a plant capacity charge of $275 should be approved. The utility should also be authorized to collect a meter installation fee of $115. The utility should file revised tariff sheets which are consistent with the Commission's vote within thirty days of the Consummating Order. Staff should be given administrative authority to approve the revised tariff sheets upon staff's verification that the tariffs are consistent with the Commission's decision. If revised tariff sheets are filed and approved, the service availability charges should become effective for connections made on or after the stamped approval date of the revised tariff sheets, if no protest is filed. (FITCH)

STAFF ANALYSIS: The utility's existing tariff authorizes a tap in fee of $275. As discussed in Issue No. 4, the utility's distribution system is contributed through the cost of sales. A tap in fee is usually designed to recover the cost of the line from the main to the meter (also referred to as services). Since services are contributed through the cost of lot sales, the tap in fee should be discontinued.

The utility has collected the $275 tap in fee for all its existing customers. Staff believes that these previous fees should be considered plant capacity charges (charges designed to defray the cost of the treatment plant associated with customer growth). Staff is recommending that the utility be allowed a plant capacity charge of $275. This is consistent with previous CIAC collections by the utility and this charge will not cause the utility to exceed the contributions levels outlined in Rule 25-30.580, Florida Administrative Code.

As discussed earlier, staff is recommending that the utility's rate structure be changed to bill based on consumption. The utility has installed meters on all existing customers and will install meters on all future customers. The utility currently does not have a meter installation fee. A meter installation fee will help defray the cost associated with customer growth since new customers will be paying for additional meters rather than the general body of rate payers. Staff is recommending a meter installation fee of $115. Based on the utility's cost documentation, this fee will cover the cost of the meter, meter

box, labor, and other miscellaneous supplies necessary to install a meter.

Staff recommends that the utility's current tap in fee of $275 be discontinued and a plant capacity charge of $275 should be approved. Further, staff is recommending that a meter installation fee of $115 should be approved. If revised tariff sheets are filed and approved, the service availability charges should become effective for connections made on or after the stamped approval date of the revised tariff sheets, if no protest is filed. Staff should be given administrative authority to approve the revised tariff sheets upon staff's verification that the tariffs are consistent with the Commission's decision.

ISSUE 15: Should the recommended rates be approved for the utility on a temporary basis, subject to refund, in the event of a protest filed by a party other than the utility?

RECOMMENDATION: Yes. Pursuant to Section 367.0814(7), Florida Statutes, the recommended rates should be approved for the utility on a temporary basis, subject to refund, in the event of a protest filed by a party other than the utility. Prior to implementation of any temporary rates, the utility should provide appropriate security. If the recommended rates are approved on a temporary basis, the rates collected by the utility should be subject to the refund provisions discussed below in the staff analysis. In addition, after the increased rates are in effect, pursuant to Rule 25-30.360(6), Florida Administrative Code, the utility should file reports with the Commission's Division of Economic Regulation no later than the 20th of each month indicating the monthly and total amount of money subject to refund at the end of the preceding month. The report filed should also indicate the status of the security being used to guarantee repayment of any potential refund. (VINING, FITCH)

STAFF ANALYSIS: This recommendation proposes an increase in water rates. A timely protest might delay what may be a justified rate increase resulting in an unrecoverable loss of revenue to the utility. Therefore, pursuant to Section 367.0814(7), Florida Statutes, in the event of a protest filed by a party other than the utility, staff recommends that the recommended rates be approved as temporary rates. The recommended rates collected by the utility should be subject to the refund provisions discussed below.

The utility should be authorized to collect the temporary rates upon staff's approval of appropriate security for the potential refund and the proposed customer notice. Security should be in the form of a bond or letter of credit in the amount of $10,745. Alternatively, the utility could establish an escrow agreement with an independent financial institution.

If the utility chooses a bond as security, the bond should contain wording to the effect that it will be terminated only under the following conditions:

1) The Commission approves the rate increase; or

2) If the Commission denies the increase, the utility shall refund the amount collected that is attributable to the increase.

If the utility chooses a letter of credit as a security, it should contain the following conditions:

1) The letter of credit is irrevocable for the period it is in effect.

2) The letter of credit will be in effect until a final Commission order is rendered, either approving or denying the rate increase.

If security is provided through an escrow agreement, the following conditions should be part of the agreement:

1) No refunds in the escrow account may be withdrawn by the utility without the express approval of the Commission.

2) The escrow account shall be an interest bearing account.

3) If a refund to the customers is required, all interest earned by the escrow account shall be distributed to the customers.

4) If a refund to the customers is not required, the interest earned by the escrow account shall revert to the utility.

5) All information on the escrow account shall be available from the holder of the escrow account to a Commission representative at all times.

6) The amount of revenue subject to refund shall be deposited in the escrow account within seven days of receipt.

7) This escrow account is established by the direction of the Florida Public Service Commission for the purpose(s) set forth in its

order requiring such account. Pursuant to Cosentino v. Elson, 263 So. 2d 253 (Fla. 3d DCA 1972), escrow accounts are not subject to garnishments.

8) The Director of Commission Clerk and Administrative Services must be a signatory to the escrow agreement.

This account must specify by whom and on whose behalf such monies were paid.

In no instance should the maintenance and administrative costs associated with the refund be borne by the customers. These costs are the responsibility of, and should be borne by, the utility. Irrespective of the form of security chosen by the utility, an account of all monies received as result of the rate increase should be maintained by the utility. If a refund is ultimately required, it should be paid with interest calculated pursuant to Rule 25-30.360(4), Florida Administrative Code.

The utility should maintain a record of the amount of the bond, and the amount of revenues that are subject to refund. In addition, after the increased rates are in effect, pursuant to Rule 25-30.360(6), Florida Administrative Code, the utility should file reports with the Commission Division of Economic Regulation no later than the 20th of each month indicating the monthly and total amount of money subject to refund at the end of the preceding month. The report filed should also indicate the status of the security being used to guarantee repayment of any potential refund.

ISSUE 16: Should this docket be closed?

RECOMMENDATION: No. If no timely protest is received upon expiration of the protest period, the PAA Order will become final upon the issuance of a Consummating Order. However, this docket should remain open for an additional five months from the date of the Consummating Order, to allow staff time to verify the installation of an automatic chlorination system as described in Issue Nos. 1 and 4. Once staff has verified that this work has been completed, the docket should be closed administratively. (FITCH, VINING)

STAFF ANALYSIS: Staff has recommended that the utility complete the installation of an automatic chlorination system as described in Issue Nos. 1 and 4. If no timely protest is received upon expiration of the protest period, the PAA Order will become final upon the issuance of a Consummating Order. However, this docket should remain open for an additional five months from the date of the Consummating Order, to allow staff time to verify the installation of an automatic chlorination system. Once staff has verified that the work has been completed, the docket should be closed administratively.

WATER TREATMENT PLANT - USED AND USEFUL DATA

Docket No. 011677-WU - Tevalo, Inc. d/b/a McLeod Gardens

1)	**Reliable Capacity of Plant**	70	gallons per minute
2)	**Maximum Daily Flow** (83 cust X 1.1 gpm X 2)	183	gallons per minute
3)	**Average Daily Flow** (83 cust X 1.1 gpm)	91	gallons per minute
4)	**Fire Flow Capacity**	N/A	gallons per minute

a) Required Fire Flow: 500 gallons per minute for 4 hours (State if utility is not providing required fire flow)

5)	**Growth**	36	gallons per minute

a) Test year Customers in ERCs:

Begin	70
End	83
Average	77

b) Customer Growth in ERCs based on 5% of the customer base. 3 ERCs

c) Statutory Growth Period 5 Years

(b)x(c)x [2\(a)] = 36 gallons per minute for growth

6)	**Excessive Unaccounted for Water**	N/A	gallons per minute
	a) Total Unaccounted for Water	N/A	gallons per minute
	Percent of Average Daily Flow		
	b) Reasonable Amount	9	gallons per minute
	(10% of average Daily Flow)		
	c) Excessive Amount	N/A	gallons per day

USED AND USEFUL FORMULA

[(2)+(4)+(5)-(6)]/(1) = **100% Used and Useful**

WATER DISTRIBUTION SYSTEM - USED AND USEFUL DATA

Docket No. 011677-WU - Tevalo, Inc. d/b/a McLeod Gardens

1)	**Capacity of System** (Number of Potential Customers, ERCs or Lots Without Expansion)	93	ERCs
2)	**Test year connections**		
	a) Beginning of Test Year	70	ERCs
	b) End of Test Year	83	ERCs
	c) Average Test Year	77	ERCs
3)	**Growth**	15	ERCs
	a) customer growth in ERCs based on 5% of the customer base	3	ERCs
	b) Statutory Growth Period	5	Years

(a)x(b) = 15 connections allowed for growth

USED AND USEFUL FORMULA

[(2)+(3)]/(1) = **100% Used and Useful**

TEVALO, INC. d/b/a McLEOD GARDENS WATER COMPANY
TEST YEAR ENDING 12/31/03 SCHEDULE NO. 1-A
SCHEDULE OF WATER RATE BASE DOCKET NO. 011677-WU

DESCRIPTION	BALANCE PER UTILITY	STAFF ADJUST. TO UTIL. BAL.	BALANCE PER STAFF
1. UTILITY PLANT IN SERVICE	$80,118	$115,129	$195,247
2. LAND & LAND RIGHTS	0	$7,000	$7,000
3. NON-USED AND USEFUL COMPONENTS	0	$0	$0
4. CIAC	(15,650)	($105,191)	($120,841)
5. ACCUMULATED DEPRECIATION	(14,239)	($13,235)	($27,474)
6. AMORTIZATION OF CIAC	421	$11,843	$12,264
7. WORKING CAPITAL ALLOWANCE	0	$2,596	$2,596
8. WATER RATE BASE	$50,650	$18,142	$68,792

TEVALO, INC. d/b/a McLEOD GARDENS WATER COMPANY — SCHEDULE NO. 1-B
TEST YEAR ENDING 12/31/03 — DOCKET NO. 011677-WU
ADJUSTMENTS TO RATE BASE

	WATER
UTILITY PLANT IN SERVICE	
1. Original Cost for plant with no documentation	$9,179
2. Lines Contributed but not recorded on utility's books	97,126
3. Reclassify meters from expense accounts	1,885
4. Retire old pump	(2,678)
5. Projected Meters	2,990
6. Chlorinating System	7,375
7. Averaging Adjustment	(748)
Total	$115,129
LAND AND LAND RIGHTS	
1. Per Audit	$7,000
CIAC	
1. Unrecorded CIAC	($1,955)
2. Contributed lines unrecorded	(97,126)
3. Projected CIAC	(8,645)
4. Averaging Adjustment	2,535
Total	($105,191)
ACCUMULATED DEPRECIATION	
1. Retirement (pump)	$2,678
2. To reflect test year depreciation calculated per 25-30.140 FAC.	(5,618)
3. Projected Accumulated Depreciation	(13,628)
4. Averaging Adjustment	3,333
Total	($13,235)
AMORTIZATION OF CIAC	
1. To reflect accumulated amortization per 25-30.140 FAC.	$6,599
2. Projected Amortization	7,072
3. Averaging Adjustment	(1,828)
Total	$11,843
WORKING CAPITAL ALLOWANCE	
1. To reflect 1/8 of test year O & M expenses.	$2,596

TEVALO, INC. d/b/a McLEOD GARDENS WATER COMPANY
TEST YEAR ENDING 12/31/03
SCHEDULE OF CAPITAL STRUCTURE

SCHEDULE NO. 2
DOCKET NO. 011677-WU

	CAPITAL COMPONENT	PER UTILITY	SPECIFIC ADJUST-MENTS	BALANCE BEFORE PRO RATA ADJUSTMENTS	PRO RATA ADJUST-MENTS	BALANCE PER STAFF	PERCENT OF TOTAL	COST	WEIGHTED COST
1.	COMMON STOCK	$37,500	$0	$37,500					
2.	RETAINED EARNINGS	37,134	0	$37,134					
3.	PAID IN CAPITAL	298,210	0	$298,210					
4.	OTHER COMMON EQUITY	0	0	$0					
5.	TOTAL COMMON EQUITY	$372,844	$0	372,844	(320,160)	52,684	76.58%	10.41%	7.97%
6.	LONG TERM DEBT		0	0	0	0	0.00%	0.00%	0.00%
	Colonial Bank	67,500	0	67,500	(57,962)	9,538	13.86%	8.75%	1.21%
	Citrus Highlands	46,500	0	46,500	(39,929)	6,571	9.55%	8.30%	0.79%
	TOTAL LONG TERM DEBT	114,000	0	114,000	(97,892)	16,108	23.42%		
7.	CUSTOMER DEPOSITS	0	0	0	0	0	0.00%	6.00%	0.00%
8.	TOTAL	$486,844	$0	$486,844	($418,052)	$68,792	100.00%		9.98%

RANGE OF REASONABLENESS	LOW	HIGH
RETURN ON EQUITY	9.41%	11.41%
OVERALL RATE OF RETURN	9.21%	10.74%

TEVALO, INC. d/b/a McLEOD GARDENS WATER COMPANY
TEST YEAR ENDING 12/31/03
SCHEDULE OF WATER OPERATING INCOME

SCHEDULE NO. 3-A
DOCKET NO. 011677-WU

	TEST YEAR PER UTILITY	STAFF ADJ. PER UTILITY	STAFF ADJUSTED TEST YEAR	ADJUST. FOR INCREASE	REVENUE REQUIREMENT
1. OPERATING REVENUES	$11,982	$5,242	$17,224	$15,917 92.41%	$33,141
OPERATING EXPENSES:					
2. OPERATION & MAINTENANCE	19,642	1,128	20,770	0	20,770
3. DEPRECIATION (NET)	0	3,642	3,642	0	3,642
4. AMORTIZATION	0	0	0	0	0
5. TAXES OTHER THAN INCOME	372	775	1,147	716	1,863
6. INCOME TAXES	0	0	0	0	0
7. TOTAL OPERATING EXPENSES	$20,014	$5,545	$25,559	$716	$26,276
8. OPERATING INCOME/(LOSS)	($8,032)		($8,335)		$6,865
9. WATER RATE BASE	$50,650		$68,792		$68,792
10. RATE OF RETURN	-15.86%		-12.12%		9.98%

TEVALO, INC. d/b/a McLEOD GARDENS WATER COMPANY — SCHEDULE NO. 3-B
TEST YEAR ENDING 12/31/03 — DOCKET NO. 011677-WU
ADJUSTMENTS TO OPERATING INCOME

	WATER
OPERATING REVENUES	
1. Annualize Revenues per customer billing data	$460
2. Remove insufficient fund revenue	($60)
3. Projected Revenues	4,842
Total	$5,242
OPERATION AND MAINTENANCE EXPENSES	
1. Purchased Power (615)	
a. Projected power use	$838
b. Repression Adjustment	(1,365)
Sub Total	($526)
2. Chemicals (615)	
a. Projected chemical use	$757
b. Repression Adjustment	(1,233)
Sub Total	($475)
3. Contractual Services - Billing (630)	
a. Meter reader $75 a month	$900
4. Contractual Services - Testing (635)	
a. Reflect DEP required testing	$1,401
5. Contractual Services - Other (636)	
a. Annualize Contractual expenses	$250
b. Reclassify meter installation	(1,885)
c. Grounds keeping	780
Sub Total	($855)
6. Transportation Expense (650)	
a. Include allowance per engineer	$696
7. Regulatory Commission Expense (665)	
a. Amortize Filing fee over 4 years	$50
8. Miscellaneous Expense (675)	
a. Remove NSF Fees from bank	($62)
TOTAL OPERATION & MAINTENANCE ADJUSTMENTS	$1,128
DEPRECIATION EXPENSE	
1. To reflect test year depreciation calculated per 25-30.140, F.A.C.	$7,692
2. Test year amortization of CIAC.	(4,050)
Total	$3,642
TAXES OTHER THAN INCOME	
1. To include regulatory assessment fees on test year revenue.	$775

TEVALO, INC. d/b/a McLEOD GARDENS WATER COMPANY — SCHEDULE NO. 3-C
TEST YEAR ENDING 12/31/03 — DOCKET NO. 011677-WU
ANALYSIS OF WATER OPERATION AND MAINTENANCE EXPENSE

	TOTAL PER UTILITY	STAFF PER ADJUST.		TOTAL PER STAFF
(601) SALARIES AND WAGES - EMPLOYEES	0	0		0
(603) SALARIES AND WAGES - OFFICERS	0	0		0
(604) EMPLOYEE PENSION & BENEFITS	0	0		0
(610) PURCHASED WATER	0	0		0
(615) PURCHASED POWER	1,891	(526)	[1]	1,365
(616) FUEL FOR POWER PRODUCTION	0	0		0
(618) CHEMICALS	1,708	(475)	[2]	1,233
(620) MATERIALS AND SUPPLIES	316	0		316
(630) CONTRACTUAL SERVICES - BILLING	0	900	[3]	900
(631) CONTRACTUAL SERVICES - PROFESSIONAL	1,553	0		1,553
(635) CONTRACTUAL SERVICES - TESTING	1,328	1,401	[4]	2,729
(636) CONTRACTUAL SERVICES - OTHER	10,647	(855)	[5]	9,792
(640) RENTS	954	0		954
(650) TRANSPORTATION EXPENSE	0	696	[6]	696
(655) INSURANCE EXPENSE	1,183	0		1,183
(665) REGULATORY COMMISSION EXPENSE	0	50	[7]	50
(670) BAD DEBT EXPENSE	0	0		0
(675) MISCELLANEOUS EXPENSES	62	(62)	[8]	0
	19,642	1,128		20,770

RECOMMENDED RATE REDUCTION SCHEDULE

TEVALO, INC. d/b/a McLEOD GARDENS WATER COMPANY — **SCHEDULE NO. 4**
TEST YEAR ENDING 12/31/03 — **DOCKET NO. 011677-WU**

CALCULATION OF RATE REDUCTION AMOUNT
AFTER RECOVERY OF RATE CASE EXPENSE AMORTIZATION PERIOD OF FOUR YEARS

MONTHLY WATER RATES

		MONTHLY RECOMMENDED RATES	MONTHLY RATE REDUCTION
RESIDENTIAL AND GENERAL SERVICE BASE FACILITY CHARGE:			
Meter Size:			
5/8"x 3/4"	$	10.51	0.02
3/4"		15.76	0.02
1"		26.26	0.04
1-1/2"		52.53	0.08
2"		84.05	0.13
3"		168.10	0.27
4"		262.65	0.41
6"		525.30	0.83
GALLONAGE CHARGE PER 1,000 GALLONS	$	2.63	0.00