

State of Florida



Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

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COMMISSION CLERK

DATE: November 7, 2002

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

FROM: DIVISION OF ECONOMIC REGULATION (BOUTWELL, MERCHANT
RIEGER, DRAPER)
OFFICE OF THE GENERAL COUNSEL (JAEGER)

Handwritten initials and signatures: PAK, DM, ALM, CB, M, J, N, W

RE: DOCKET NO. 020344-SU - APPLICATION FOR RATE INCREASE IN
MONROE COUNTY BY KEY HAVEN UTILITY CORPORATION.
COUNTY: MONROE

AGENDA: 11/19/02 - REGULAR AGENDA - DECISION ON INTERIM RATES -
PARTICIPATION IS LIMITED TO COMMISSION AND STAFF

CRITICAL DATES: 60-DAY SUSPENSION DATE: 11/25/02

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\WP\020344.RCM

CASE BACKGROUND

Key Haven Utility Corporation (Key Haven or utility) is a Class B wastewater utility providing service to approximately 419 residential customers in Monroe County, Florida. In its 2001 Annual Report, the utility reported operating revenues of \$237,181 and net operating income of \$1,258.

The utility's last rate case, in Docket No. 940299-SU, was based on the test year ended December 31, 1993. By Order No. PSC-94-1557-S-SU, issued December 13, 1994, the Commission approved a stipulation between the utility and the Office of Public Counsel (OPC). By that order, the previously authorized flat rates were increased, return on equity was established with a midpoint of 10.93%, and rate base was set at \$719,139. The utility received a price index increase in 2001 that was effective December 31, 2001.

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12238 NOV-78

FPSC-COMMISSION CLERK

On August 14, 2002, the utility filed for approval of permanent and interim rate increases pursuant to Sections 367.081 and 367.082, Florida Statutes. However, the information submitted did not satisfy the minimum filing requirements (MFRs) for a general rate increase. Subsequently, on September 26, 2002, the utility satisfied the MFRs and this date was designated as the official filing date, pursuant to Section 367.083, Florida Statutes. The utility requested that the Commission process this case under the proposed agency action (PAA) procedure.

The test year for interim and final purposes is the historical test year ended December 31, 2001. Key Haven has requested interim revenues of \$296,484, which represents an increase of \$55,377 or 22.97%. The requested final revenues are \$330,623, representing an increase of \$89,516 or 37.13%.

The sixty-day statutory deadline for the Commission to suspend the utility's requested final rates is November 25, 2002. This recommendation addresses the suspension of Key Haven's final rates and staff's recommended interim rate increase.

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

DISCUSSION OF ISSUES

ISSUE 1: Should the utility's proposed final wastewater rates be suspended?

RECOMMENDATION: Yes. Key Haven's proposed final wastewater rates should be suspended. The docket should remain open pending the Commission's final action on the utility's requested rate increase. (BOUTWELL)

STAFF ANALYSIS: Section 367.081(6), Florida Statutes, provides that the rates proposed by the utility shall become effective within sixty days after filing unless the Commission votes to withhold consent to implementation of the requested rates. Further, Section 367.081(8), Florida Statutes, permits the proposed rates to go into effect, (secured and subject to refund) at the expiration of five months if: (1) the Commission has not acted upon the requested rate increase; or (2) if the Commission's PAA action is protested by a party other than the utility.

Staff has reviewed the filing and has considered the proposed rates, the revenues thereby generated, and the information filed in support of the rate application. Staff recommends that it is reasonable and necessary to require further amplification and explanation regarding this data, and to require production of additional and/or corroborative data. This further examination will include on-site investigations by staff accountants and engineers. Based on the foregoing, staff recommends that it is appropriate to suspend the utility's proposed rate increase.

The docket should remain open pending the Commission's final action on the utility's requested rate increase.

ISSUE 2: Should an interim revenue increase be approved?

RECOMMENDATION: Yes. On an interim basis, the utility should be authorized to collect annual wastewater revenues as indicated below: (BOUTWELL)

	<u>Revenues</u>	<u>\$ Increase</u>	<u>% Increase</u>
Wastewater	\$296,454	\$55,347	22.96%

STAFF ANALYSIS: As stated in its MFRs, Key Haven requests interim rates designed to generate annual revenues of \$296,484. This represents a wastewater revenue increase of \$55,377 or 22.97%. The utility has filed rate base, cost of capital, and operating statements to support its requested wastewater increase.

Staff has reviewed the utility's interim request, as well as the prior rate proceeding orders, and our analyses are discussed below. We have attached accounting schedules to illustrate staff's recommended rate base, capital structure, and test year operating income amounts. The rate base schedule is attached as No. 1, the capital structure schedule is No. 2, and the operating income schedule is No. 3.

RATE BASE

The utility has filed a simple average rate base for the calendar year ended December 31, 2001. Working capital has been calculated using the formula approach, which is consistent with Key Haven's last rate case. The utility's only adjustment to working capital was a \$3,107 reduction, which resulted from the removal of a \$24,858 non-recurring charge from operation and maintenance (O&M) expenses.

In Key Haven's last rate case, the Commission approved the stipulation that the wastewater treatment plant and collection systems were 100% used and useful. In this case, the utility has also reflected its plant as 100% used and useful. While reported on its rate base schedule as non-used and useful, Key Haven reduced plant to reflect the removal of the original wastewater treatment plant that is being held off-line as a stand-by. Staff has reviewed the filed rate base, believes it is reasonable, and as such, propose no additional adjustments. Schedule No. 1 details staff's recommended rate base.

COST OF CAPITAL

In its MFRs, Key Haven used a simple average capital structure and made pro rata adjustments to reconcile the capital structure to rate base. The utility used a cost rate of 8.54% for long-term debt. Also, in accordance with the interim statute, Key Haven used a return on equity (ROE) of 9.93%, the lower end of the range of the last authorized ROE, to calculate its overall rate of return. Staff has reviewed the utility's cost of capital and we believe that based on the above, no adjustments are necessary. The utility's calculated overall cost of capital of 8.95% should be approved for interim purposes. Schedule No. 2 illustrates staff's recommended cost of capital.

NET OPERATING INCOME

Operating Revenues

Section 367.082(5)(b)1., Florida Statutes, states that the achieved rate of return is calculated by applying appropriate adjustments and annualizing any rate changes that occurred during the interim test year. On December 31, 2001, the utility implemented a price index increase, and consistent with the interim statute, Key Haven annualized its revenues associated with this price index. Adjusted test year operating revenues are \$241,107, which includes an increase of \$3,926 due to the price index. Staff has reviewed this adjustment and recommends no further adjustments to test year revenue.

Operating Expenses

The utility has adjusted O&M expenses, depreciation, and amortization for the calendar test year ended December 31, 2001. As noted earlier, the utility amortized \$24,858 in non-recurring major line maintenance costs over four years. This resulted in a decrease to O&M expenses of \$19,886, and an amortized charge of \$4,972 in the test year. Key Haven also reduced depreciation expense by \$7,997 to reflect the removal of a stand-by wastewater plant from rate base. Based on staff's review, these adjustments appear to be reasonable. As such, staff recommends that no additional adjustments are necessary.

Net Operating Income

Based on these adjustments, staff recommends that the appropriate test year operating income, before any increase, is \$32,849. Schedule No. 3 illustrates staff's recommended net operating income.

REVENUE REQUIREMENT

Staff has calculated the interim revenue requirements using the actual operating expenses for the year ended December 31, 2001, as adjusted by the utility and an 8.95% overall rate of return on a simple average test year rate base. As a result, staff's recommended interim revenue requirement is \$296,454 as shown on attached Schedule No. 3. This represents an interim increase in annual wastewater revenues of \$55,347 or 22.96%. Therefore, staff recommends the Commission approve interim rates which will allow the utility to generate \$55,347 in additional annual wastewater revenue as set forth in Issue 3.

ISSUE 3: What are the appropriate interim wastewater rates for Key Haven Utility Corporation?

RECOMMENDATION: The service rates for Key Haven in effect as of December 31, 2001, should be increased by 23.00% to generate the recommended revenue increase for the interim period. The approved rates should be effective for service rendered on or after the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1), Florida Administrative Code, provided the customers have received notice. Also, the rates should not be implemented until the required security has been filed. The utility should provide proof to staff of the date notice was given within 10 days after the date of notice. (BOUTWELL)

STAFF ANALYSIS: Staff recommends that interim flat rates for Key Haven's wastewater system be designed to allow the utility the opportunity to generate additional annual operating revenues of \$55,347, or an increase of 22.96%. To determine the appropriate increase to apply to the service rates, miscellaneous service and other revenues should be removed from the test year revenues. The calculation is as follows:

1 Total Test Year Revenues	\$241,107
2 Less: Miscellaneous & Other Revenues	<u>(420)</u>
3 Test Year Revenues from Service Rates	<u>\$240,687</u>
4 Revenue Increase	<u>\$55,347</u>
5 % Service Rate Increase (Line 4/Line 3)	<u>23.00%</u>

This rate increase of 23.00% should be applied as an across the board increase to flat service rates in effect as of December 31, 2001.

For final rates, the utility has requested to switch from a flat rate to a consumption-based rate structure. The utility is now able to obtain customer water use data from the Florida Aqueduct Authority.

The interim rates should be implemented for service rendered on or after the stamped approval date on the tariff sheets, provided customers have received notice. The revised tariff sheets will be approved upon staff's verification that the tariff sheets

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are consistent with the Commission's decision, that the proposed notice to the customers is adequate, and that the required security discussed in Issue 4 has been filed. The utility should provide proof to staff of the date notice was given within 10 days after the date of notice.

The utility's current, proposed interim and final, and staff's recommended interim rates, are shown on Schedule No. 4.

ISSUE 4: What is the appropriate security to guarantee the interim increase?

RECOMMENDATION: The utility should be required to file a bond, secure a letter of credit, or open an escrow account to guarantee any potential refunds of wastewater revenues collected under interim conditions. If the utility chooses to open an escrow account, it should deposit 23.00% of interim wastewater revenues collected each month. The letter of credit or surety bond should be in the amount of \$37,115. Pursuant to Rule 25-30.360(6), Florida Administrative Code, the utility shall provide a report by the 20th of each month indicating the monthly and total revenue collected subject to refund. Should a refund be required, the refund should be with interest and undertaken in accordance with Rule 25-30.360, Florida Administrative Code. (BOUTWELL, D. DRAPER)

STAFF ANALYSIS: Pursuant to Section 367.082, Florida Statutes, revenues collected under interim rates shall be placed under bond, escrow, letter of credit, or corporate undertaking subject to refund with interest at a rate ordered by the Commission. In accordance with Rule 25-30.360, Florida Administrative Code, the amount of a potential refund in this case has been calculated to be \$37,115. This amount is based on an estimated eight months of revenue being collected from staff's recommended interim rates over the previously authorized rates shown on Schedule 4, with interest.

Staff has analyzed the utility's financial condition to determine what type of security is appropriate for Key Haven's interim rates. The criterion for a corporate undertaking includes sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. The 1999, 2000 and 2001 annual reports of Key Haven were used to determine the financial condition of the Company. The utility reports minimal liquidity for 2001 and shows a declining equity ratio for the three-year period. In addition, over the three-year period, net income has been negative and the utility has reported minimal interest coverage. Based upon this analysis, staff recommends that Key Haven cannot support a corporate undertaking in the amount of \$37,115.

Considering the above analysis, staff recommends that the utility provide a letter of credit, bond, or escrow agreement to guarantee the funds collected, subject to refund. Irrespective of the type of security provided, the utility should keep an accurate

account of all monies it receives. Also, pursuant to Rule 25-30.360(6), Florida Administrative Code, the utility should provide a report by the 20th of each month indicating the monthly and total revenue collected, subject to refund. Should a refund be required, the refund should be with interest and undertaken in accordance with Rule 25-30.360, Florida Administrative Code.

If the security provided is a bond or a letter of credit, said instrument should be in the amount of \$37,115. If the utility chooses a bond as security, the bond should state that it will be released or should terminate only upon subsequent order of the Commission. If the utility chooses to provide a letter of credit as security, the letter of credit should state that it is irrevocable for the period it is in effect and that it will be in effect until a final Commission order is rendered releasing the funds to the utility or requiring a refund.

If the security provided is an escrow account, said account should be established between the utility and an independent financial institution pursuant to a written escrow agreement. The Commission should be a party to the written escrow agreement and a signatory to the escrow account. The written escrow agreement should state the following: That the account is established at the direction of this Commission for the purpose set forth above, and that no withdrawals of funds should occur without the prior approval of the Commission through the Director of the Commission Clerk and Administrative Services. That the account should be interest bearing, and information concerning the escrow account should be available from the institution to the Commission or its representative at all times. And finally that, pursuant to Cosentino v. Elson, 263 So. 2d 253 (Fla. 3d. DCA 1972), escrow accounts are not subject to garnishments.

The utility should deposit 23.00% of interim revenues collected each month into the escrow account each month to secure for possible refund. The escrow agreement should also state the following: that if a refund to the customers is required, all interest earned on the escrow account shall be distributed to the customers; and if a refund to the customers is not required, the interest earned on the escrow account shall revert to the utility.

In no instance should maintenance and administrative costs associated with any refund be borne by the customers. The costs are the responsibility of, and should be borne by, the utility.

KEY HAVEN UTILITY CORPORATION SCHEDULE OF WASTEWATER RATE BASE TEST YEAR ENDED 12/31/2001			SCHEDULE NO. 1 DOCKET 020344-WS		
DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUST- MENTS	ADJUSTED TEST YEAR PER UTILITY	STAFF ADJUST- MENTS	STAFF ADJUSTED TEST YEAR
1 UTILITY PLANT IN SERVICE	\$1,668,919	\$0	\$1,668,919	\$0	\$1,668,919
2 LAND	\$5,666	\$0	\$5,666	\$0	\$5,666
3 NON-USED & USEFUL COMPONENTS (*)	(\$47,757)	\$0	(\$47,757)	\$0	(\$47,757)
4 ACCUMULATED DEPRECIATION	(\$617,860)	\$0	(\$617,860)	\$0	(\$617,860)
5 CIAC	(\$308,379)	\$0	(\$308,379)	\$0	(\$308,379)
6 AMORTIZATION OF CIAC	\$237,482	\$0	\$237,482	\$0	\$237,482
7 WORKING CAPITAL ALLOWANCE	<u>\$22,974</u>	<u>(\$3,107)</u>	<u>\$19,867</u>	<u>\$0</u>	<u>\$19,867</u>
RATE BASE	<u>\$961,045</u>	<u>(\$3,107)</u>	<u>\$957,938</u>	<u>\$0</u>	<u>\$957,938</u>

* This adjustment reflects non-utility plant retired in 1991, but still carried on books.

**KEY HAVEN UTILITY CORPORATION
CAPITAL STRUCTURE - SIMPLE AVERAGE
TEST YEAR ENDED 12/31/2001**

**SCHEDULE NO. 2
DOCKET 020344-WS**

DESCRIPTION	TOTAL CAPITAL	SPECIFIC ADJUSTMENTS (EXPLAIN)	PRO RATA ADJUSTMENTS	CAPITAL RECONCILED TO RATE BASE	RATIO	COST RATE	WEIGHTED COST	
PER UTILITY								
1 LONG TERM DEBT	\$739,608	\$0	(\$62,058)	\$677,550	70.73%	8.54%	6.04%	
2 SHORT-TERM DEBT	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%	
3 PREFERRED STOCK	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%	
4 COMMON EQUITY	\$306,030	\$0	(\$25,642)	\$280,388	29.27%	9.93%	2.91%	
5 CUSTOMER DEPOSITS	\$0	\$0	\$0	\$0	0.00%	6.00%	0.00%	
6 DEFERRED INCOME TAXES	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%	
7 TOTAL CAPITAL	<u>\$1,045,638</u>	<u>\$0</u>	<u>(\$87,700)</u>	<u>\$957,938</u>	<u>100.00%</u>		<u>8.95%</u>	
PER STAFF								
8 LONG TERM DEBT	\$739,608	\$0	(\$62,033)	\$677,575	70.73%	8.54%	6.04%	
9 SHORT-TERM DEBT	\$0	\$0	\$-0	\$0	0.00%	0.00%	0.00%	
10 PREFERRED STOCK	\$0	\$0	\$-0	\$0	0.00%	0.00%	0.00%	
11 COMMON EQUITY	\$306,030	\$0	(\$25,667)	\$280,363	29.27%	9.93%	2.91%	
12 CUSTOMER DEPOSITS	\$0	\$0	\$-0	\$0	0.00%	6.00%	0.00%	
13 DEFERRED INCOME TAXES	\$0	\$0	\$-0	\$0	0.00%	0.00%	0.00%	
14 TOTAL CAPITAL	<u>\$1,045,638</u>	<u>\$0</u>	<u>(\$87,700)</u>	<u>\$957,938</u>	<u>100.00%</u>		<u>8.95%</u>	
					LOW	HIGH		
RETURN ON EQUITY					<u>9.93%</u>	<u>11.93%</u>		
OVERALL RATE OF RETURN					<u>8.95%</u>	<u>9.53%</u>		

KEY HAVEN UTILITY CORPORATION STATEMENT OF WASTEWATER OPERATIONS TEST YEAR ENDED 12/31/2001				SCHEDULE NO. 3 DOCKET 020344-WS			
DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUST- MENTS	ADJUSTED TEST YEAR PER UTILITY	STAFF ADJUST- MENTS (1)	STAFF ADJUSTED TEST YEAR	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	<u>\$237,181</u>	<u>\$59,303</u>	<u>\$296,484</u>	<u>(\$55,377)</u>	<u>\$241,107</u>	<u>\$55,347</u> 22.96%	<u>\$296,454</u>
OPERATING EXPENSES							
2 OPERATION & MAINTENANCE	\$183,795	(\$24,858)	\$158,937	\$0	\$158,937		\$158,937
3 DEPRECIATION	\$38,462	(\$7,997)	\$30,465	\$0	\$30,465		\$30,465
4 AMORTIZATION	\$0	\$4,972	\$4,972	\$0	\$4,972		\$4,972
5 TAXES OTHER THAN INCOME	\$13,707	\$2,669	\$16,376	(\$2,492)	\$13,884	\$2,491	\$16,375
6 INCOME TAXES	\$0	\$0	\$0	\$0	\$0	\$0	\$0
7 TOTAL OPERATING EXPENSES	<u>\$235,964</u>	<u>(\$25,214)</u>	<u>\$210,750</u>	<u>(\$2,492)</u>	<u>\$208,258</u>	<u>\$2,491</u>	<u>\$210,749</u>
8 OPERATING INCOME	<u>\$1,217</u>	<u>\$84,517</u>	<u>\$85,734</u>	<u>(\$52,885)</u>	<u>\$32,849</u>	<u>\$52,856</u>	<u>\$85,705</u>
9 RATE BASE	<u>\$961,045</u>		<u>\$957,938</u>		<u>\$957,938</u>		<u>\$957,938</u>
10 RATE OF RETURN	<u>0.13%</u>		<u>8.95%</u>		<u>3.43%</u>		<u>8.95%</u>

(1) Reflects removal of requested revenue increase and associated RAF's.

KEY HAVEN UTILITY CORPORATION WASTEWATER MONTHLY SERVICE RATES TEST YEAR ENDED 12/31/2001		SCHEDULE NO. 4 DOCKET 020344-WS		
	Utility Requested Interim	Rates Prior to Filing	Utility Requested Final	Staff Recomm. Interim
<u>Residential</u>				
Flat Rate Charge: All Meter Sizes:	\$59.11	\$48.07		\$59.11
Base Facility Charge: All meter sizes			\$26.96	
Gallonage Charge, per 1,000 Gallons			\$6.34	
<u>General Service</u>				
Flat Rate Charge: All Meter Sizes:	\$59.11	\$48.07		\$59.11
Base Facility Charge: All meter sizes				
5/8" x 3/4"			\$26.96	
1"			\$67.40	
1-1/2"			\$134.80	
2"			\$215.68	
3"			\$431.36	
4"			\$674.00	
6"			\$1,348.00	
			\$2,156.00	
Gallonage Charge, per 1,000 Gallons			\$7.45	
Note: The utility has requested to switch from a flat rate structure, to a consumption-based rate structure for final rates.				