State of Florida

Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

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

DATE: FEBRUARY 6, 2003

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

FROM: DIVISION OF ECONOMIC REGULATION (RIEGER, CLAPP, JONES)
OFFICE OF THE GENERAL COUNSEL (CROSBY, BRUBAKER)

RE: DOCKET NO. 020650-WU - APPLICATION FOR PARTIAL TRANSFER OF FACILITIES IN MARION COUNTY FROM MARION UTILITIES, INC. TO SILVER SPRINGS REGIONAL WATER AND SEWER, INC., A NON-PROFIT CORPORATION, AND FOR AMENDMENT OF CERTIFICATE NO. 347-W.
COUNTY: MARION

AGENDA: FEBRUARY 18, 2003 - REGULAR AGENDA - PROPOSED AGENCY ACTION FOR ISSUE 2 -INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\WP\020650.RCM

CASE BACKGROUND

Marion Utilities, Inc. (Marion or utility) is a Class A utility which provides service in Marion County to approximately 4,724 water and 118 wastewater customers. The utility is located primarily in the St. Johns River Water Management District, all of which is considered a water use caution area. The utility's 2001 annual report shows a combined water and wastewater annual operating revenue of $1,119,363 and a net operating income of $115,889.

The Commission assumed jurisdiction over the privately-owned utilities in Marion County on May 5, 1981. In Order No. 10566, issued February 3, 1982, in Docket No. 820018-W, the utility was granted Certificate No. 347-W. Over the years, there have been

twenty-seven additional territory amendments to the utility's certificate. In addition to this docket, Docket No. 020928-WU is currently open to address adding territory to this utility. An administrative order for that case is presently scheduled to be issued by the Commission by April 25, 2003. The two open dockets address separate issues, and no negative effect resulting from the disposition of either case is expected to affect the other.

Pursuant to Section 367.071, Florida Statutes, on July 5, 2002, the utility applied for a partial transfer of facilities to Silver Springs Regional Water and Sewer, Inc. (Silver Springs), a non-profit corporation, and for an amendment to Water Certificate No. 347-W to delete the service area. The service area, known as Quadvillas Estates/Sugar Hills Quadvillas (QV/SHQ), is a residential area that has 217 customers. As a result of a May 31, 2002, contract for sale of this system for $260,000 to Silver Springs, the utility has dismantled the treatment facility that provided potable water to this area and interconnected the distribution system to Silver Springs' potable water system. This recommendation addresses the proposed transfer, deletion of territory, and potential gain on sale of this system. The Commission has jurisdiction pursuant to Section 367.071, Florida Statutes.

ISSUE 1: Should Marion Utilities, Inc.'s application for partial transfer of facilities in Marion County to Silver Springs Regional Water and Sewer Inc., and for amendment of Certificate No. 347-W be granted?

RECOMMENDATION: Yes, Marion Utilities, Inc.'s application for partial transfer of facilities effective July 31, 2002, and for amendment of Certificate No. 347-W to delete the territory described in Attachment A, should be granted. Marion is responsible for the applicable regulatory assessment fees for the period of January 1, 2002 through July 31, 2002. In addition Marion should include in its 2002 annual report the operations related to this system from January 1, 2002 through July 31, 2002. (RIEGER, CLAPP, JONES)

STAFF ANALYSIS: Pursuant to Section 367.071, Florida Statutes, on July 5, 2002, the utility applied for a partial transfer of facilities to Silver Springs, a non-profit corporation, and for an amendment to Water Certificate No. 347-W to delete the service area. Silver Springs plans to provide both water and wastewater service to the area. The QV/SHQ service area, as described in Attachment A, is a residential area in Marion County that has 217 water customers. Wastewater disposal is presently handled through the use of septic disposal systems. As a result of a May 31, 2002, contract for sale of this system for $260,000 to Silver Springs, effective July 31, 2002, the utility has dismantled the treatment facility that provided potable water to this area and has interconnected the distribution system to Silver Springs' system. The utility's last billing for this system was for service rendered through July 31, 2002.

Pursuant to Chapter 367.071, Florida Statutes, no utility shall transfer its certificate or assets without prior Commission approval. The May 31, 2002, contract for sale did not reference this requirement. Both Marion and Silver Springs have since acknowledged through an addendum to the contract that the sale is contingent upon Commission approval.

As part of the sales agreement, Marion agreed to modify the QV/SHQ distribution system to accommodate Silver Springs system specification requirements. System improvements, including main replacement and extension, installation of fire hydrants, and replacement of meters, total approximately $63,000. In addition to improvements made to the distribution system, it was also necessary

to decommission the water treatment facility. The utility incurred approximately $3,750 in costs to remove well pumps, a hydropneumatic tank, and a generator, and to abandon the wells. The utility indicated that some of the equipment removed from the QV/SHQ facility will be used in its other systems.

Pursuant to Rule 25-30.037(2) (c), (d), (e), (f), Florida Administrative Code, the application contains information on the corporate nature of the buyer. Silver Springs was incorporated on October 2, 1989, as a Florida not-for-profit corporation, which is exempt pursuant to Chapter 367.022(7), Florida Statutes. Everyone who receives service is a member.

The application contains documentation to comply with Rule 25-30.037(2) (g), (h), (i), (l), (p) and (q), Florida Administrative Code, regarding the contract for sale, the financing of purchase, value of the system, condition of system, and ownership of land.

Pursuant to Rule 25-30.037(2) (r), Florida Administrative Code, staff verified that the utility paid RAFs through December 31, 2001, filed all annual reports through 2001, and that no interest, penalties, or refunds are due or outstanding as of December 31, 2001. The partial transfer of this utility's certificate to a nonprofit corporation, Silver Springs Regional Water and Sewer Inc. (Silver Springs), was effective July 31, 2002. The application indicated the applicable regulatory assessment fees for the period of January 1, 2002 through July 31, 2002 are the responsibility of Marion Utilities, Inc. In Exhibit B of the application, the utility indicated that the payment for these 2002 regulatory fees will be remitted with their total company payment, which will be due March 31, 2003. Also, the operations from January 1, 2002 through July 31, 2002 related to this sale should be included in the 2002 annual report.

The application also contained proof of compliance with the noticing provisions set forth in Rule 25-30.030, Florida Administrative Code. The Commission received no objections and the time for filing has passed. The application contained a check in the amount of $750, which is the correct filing fee pursuant to Rule 25-30.020, Florida Administrative Code.

The utility's application is in compliance with the governing statute, Section 367.071, Florida Statutes, and other pertinent statutes and administrative rules concerning applications for

amendment of certificate. Based on the above information, staff recommends that Marion application for partial transfer of facilities, effective July 31, 2002, and for amendment of Certificate No. 347-W to delete the territory described in Attachment A, should be granted. The utility has filed a revised tariff sheet with the proposed deleted area removed. Marion should be responsible for the applicable regulatory assessment fees for the period of January 1, 2002 through July 31, 2002. In addition, Marion should include in its 2002 annual report the operations related to this system from January 1, 2002 through July 31, 2002.

ISSUE 2: Should the Commission open a docket to examine whether Marion's sale of its Quad Villas Estates/Sugar Hill system involves a gain that should be shared with other customers?

RECOMMENDATION: No. The Commission should not open an investigation to further evaluate the gain on sale aspects for the Quadvillas Estates/Sugar Hill Quadvillas system. (CLAPP, RIEGER)

STAFF ANALYSIS: The issue of whether a gain on the sale of a utility system should be shared with the remaining customers has been addressed in a number of Commission dockets. In each case, the Commission evaluated whether the remaining customers had contributed to the utility's recovery of its investment in the system being sold and therefore should share in the gain on sale. See Dockets Nos. 911188-WS, 920199-WS, 950495-WS, 991890-WS, and 001826-WS.

On July 31, 2002, Marion transferred its 217 water customer QV/SHQ system to Silver Springs. The transfer leaves the utility with approximately 4,500 water customers served by over 30 remaining systems. The utility reported the proceeds, book basis of plant, and seller's closing costs and staff estimated the tax relating to the sale.

Sale Proceeds	$259,413
Deductions:	
Book Basis of Plant	34,785
Cost of Improvements Required by Contract	62,986
Seller's Closing Costs	30,164
Pre-Tax Gain	131,478
*Taxes (30%)	39,443
*Net Gain	$92,035

*Staff Estimate

Utility's Position

In response to staff's inquiry, Marion provided its comments as to why the gain on the sale of the system to Silver Springs should not be shared with its remaining customers. According to the utility, the system was purchased in 1981. Rates and rate base were last established for the entire utility by Order No. PSC-95-1193-FOF-WS, issued on September 22, 1995, in Docket No. 950170-WS; however, no rate base was established for individual systems at that time. The water rate base as of June 30, 1994, was $765,344.

With the exception of the 137 customers of the Windgate East system, all of Marion's customers have uniform rates. While the utility's billing procedures accumulate separate revenue numbers for each system, the expenses are recorded on a utility-wide basis. The utility provided an analysis using assumptions about the relationship between expenses, net income, and gross revenues showing that the QV/SHQ system contributed to the utility's net income, and therefore, the remaining customers did not subsidize the QV/SHQ system. The QV/SHQ system is not contiguous to nor interconnected with any of Marion's other water and sewer systems.

The utility further supported its position by stating that it did not achieve its authorized rate of return in 2001. With the sale of the QV/SHQ system, the utility will lose the revenue from those customers as well as the future income stream. The gain on sale will, in part, compensate the shareholders for the loss of future earnings.

The utility believes that its customers do not acquire a proprietary interest in the property, plant and equipment that are used for utility service. The ownership of the property, plant and equipment resides with the shareholders. Likewise, any risk of loss in their investment is borne by the shareholders and not the utility customers. This risk of loss is generally rewarded with compensation for the risk. The gain on sale is this compensation. Therefore, the customers should not share in that gain. Certainly, if the sale resulted in a loss, that loss would not be borne by the remaining customers, but rather the shareholders.

Commission Practice regarding Gain on Sales

Staff's research has identified a number of cases in which the Commission allocated all or a substantial part of the gains on sale

of utility assets to ratepayers; however, all of these cases involved the sale of specific assets, not complete systems including customer bases. Staff also reviewed cases in which the Commission addressed the gains on sale of utility facilities which included customer bases.

In Docket No. 911188-WS, the Commission considered whether the customers of Lehigh Utilities, Inc. (Lehigh) should share in the gain on sale of the St. Augustine Shores (SAS) water and wastewater facilities to St. Johns County as a result of a condemnation. Both SAS and Lehigh had been owned by Southern States Utilities, Inc. (SSU). The Commission decided that sharing the gain was not appropriate in Order No. PSC-93-0301-FOF-WS, issued February 25, 1993, stating:

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

In 1992, shortly after the Lehigh docket was filed, SSU filed an application for a rate increase for several of its systems under the Commission's jurisdiction. In Docket No. 920199-WS, the issue of the gain on sale of SAS was again considered in the context of whether the gain should be shared with the remaining shareholders of SSU. By Order No. PSC-93-0423-FOF-WS, issued March 22, 1993, in that docket, the Commission found the following:

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

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

The issue of the gain on the SAS sale was considered once again in SSU's subsequent rate case, Docket No. 950495-WS, along with several additional gains, including the sale of SSU's Venice Gardens (VGU) system to Sarasota County, also under condemnation. The Office of Public Counsel (OPC) argued that the remaining ratepayers should benefit from the gain because SSU had been found to be a single system and ratepayers had been required to pay a return on used and useful property. Further, OPC argued that the jurisdictional systems were absorbing administrative and general expenses and general plant costs that otherwise would have been paid by the VGU ratepayers. OPC also reiterated its objection to the Commission's decision in Docket No. 920199-WS regarding the SAS gain. SSU rebutted OPC's arguments, stating that the remaining customers did not contribute to SSU's recovery of its investment and did not bear the risk of loss. Further, SSU noted that the sale of VGU involved not only the sale of SSU's assets but also the loss of customers, and that the Commission's policy concerning gains and losses should be consistent with the (then) recently confirmed acquisition adjustment policy.

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

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

> This part of Order No. PSC-93-0423-FOF-WS was affirmed by the First District Court of Appeal in the Citrus County decision.
>
> Although OPC argued that the ratepayers have benefitted from the gains on the sale of property devoted to public service in previous dockets and absorbed a loss on the sale of the Skyline facility, we do not find the circumstances to be the same. Had either the SAS and VGU facilities been regulated by the FPSC at the time of the sale or previously included in a uniform rate structure, the situation would be different. However, we conclude that similar treatment should be afforded based on the previous decision in Docket No. 920199-WS. The record lacks sufficient evidence to support the contrary. Therefore, we shall not allocate either the VGU or SAS gains to the ratepayers.

Pursuant to Order No. 98-0688-FOF-WS, issued May 19, 1998, in Docket No. 971667-WS, the Commission approved the transfer of all of Florida Water Services Corporation's (FWSC) water and wastewater facilities in Orange County to Orange County, with the exception of the Druid Hills water system. Since FWSC charged uniform rates within Orange County and there was a remaining system, the Commission also ordered that a docket be opened to evaluate any gain on sale. On June 15, 1998, the Commission established Docket No. 980744-WS for that purpose. OPC filed a notice of intervention in this docket on June 29, 1998. The docket is set for hearing on August 7, 2003.

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

Most recently, the Commission again addressed the investigation into ratemaking consideration of gain on sale from sales of facilities of Utilities, Inc. of Florida (Utilities, Inc.) to the City of Maitland in Orange County and the City of Altamonte Springs in Seminole County in Order No. PSC-02-0657-PAA-WU, issued on May 14, 2002, in Docket No. 991890-WS. In that investigation, the Commission staff found that this Commission has generally based its decisions on treatment of gains on sale of utility property on the following key factors:

1. Whether the property sold was used and useful in providing utility services;

2. Whether the property was included in uniform rates;

3. Whether a system, including customer base, was sold, as opposed to specific assets;

4. The extent to which ratepayers would have borne the risk, had the sale been at a loss; and

5. Consistency with other Commission practice, such as the calculation of rate base when a facility is purchased for more or less than its net book value.

On June 4, 2002, OPC protested the Commission's decision in Order No. PSC-02-0657-PAA-WU. In the meantime, Utilities, Inc. filed an application for rate increase in Seminole, Orange, Pasco, Marion, and Pinellas Counties and Docket No. 020071-WS was established. OPC filed a notice of intervention in that docket. Order No. PSC-02-1467-PCO-WS, issued October 25, 2002, in Dockets Nos. 991890-WU and 020071-WS, ordered that Docket No. 991890-WU be closed and Docket No. 020071-WS remain open in order to conduct a hearing on the utility's rate case as well as the protest to the gain on sale case. This docket is set for hearing on June 4, 2003.

Applicability of Commission Practice to this Case

The QV/SHQ system sale involved the sale of facilities included in rate base, along with the customer base serviced by these facilities. Based on our review of Commission Orders and the utility's cancelled tariff sheets, all the utility's systems in Marion County, except for the Windgate East system, have been under a uniform rate structure since 1981; however, staff agrees with the

utility that it would be very difficult to determine how much any customer or group of customers contributed to the utility's investment in, or operation of, the facility.

Further, staff believes that the Commission has consistently acknowledged that, where the utility is losing the revenue stream provided by the customer base transferred, it is reasonable for the shareholders to be compensated by receiving the gain on sale of the facility. Further, the Commission has consistently found that paying rates for utility service does not vest ratepayers with an ownership interest in the utility's assets. Accordingly, staff recommends that the Commission should not open an investigation to further evaluate the gain on sale aspects for the QV/SHQ system.

ISSUE 3: Should this docket be closed?

RECOMMENDATION: Yes, if staff's recommendations in Issues 1 and 2 are approved, and no protest is received from a substantially affected person to the proposed agency action issue, a consummating order should be issued and this docket should be closed. (CROSBY, BRUBAKER)

STAFF ANALYSIS: If staff's recommendations in Issues 1 and 2 are approved, and no protest is received from a substantially affected person to the proposed agency action issue, a consummating order should be issued and this docket should be closed.

Attachment A

Marion Utilities Inc.
Amended Water Territory Description
Marion County

Section 1 Township 15 South, Range 22 East

QUADVILLA ESTATES:
The East ½ of the Northeast 1/4 of the Northwest 1/4 of the Northwest 1/4.

SUGAR HILLS QUADVILLAS:
The Northwest 1/4 of the Northwest 1/4 of Section 1, except the East ½ of the Northeast 1/4 of the Northwest 1/4 of the Northwest 1/4 of said Section 1.