State of Florida

Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

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

DATE: APRIL 24, 2003

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

FROM: DIVISION OF ECONOMIC REGULATION (JOYCE, GREENE, REVELL, G. EDWARDS, MERCHANT, HUDSON, LINGO, FITCH)
OFFICE OF THE GENERAL COUNSEL (HARRIS, ECHTERNACHT)
DIVISION OF AUDITING AND SAFETY (VANDIVER)

RE: DOCKET NO. 020407-WS - APPLICATION FOR RATE INCREASE IN POLK COUNTY BY CYPRESS LAKES UTILITIES, INC.

AGENDA: 05/06/03 - REGULAR AGENDA - PROPOSED AGENCY ACTION EXCEPT ISSUES 26 AND 27 - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: 5-MONTH EFFECTIVE DATE: 05/6/03 - Extended (PAA RATE CASE)

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\GCL\WP\020407.RCM

TABLE OF CONTENTS

OTHER

ACCOUNTING AND RATE SCHEDULES

CASE BACKGROUND

Cypress Lakes Utilities, Inc. (Cypress Lakes, CLU or the utility) is a Class B water and wastewater utility in Polk County. As of December 31, 2001, Cypress Lakes provided service to 1133 water and 1097 wastewater customers. Cypress Lakes is a wholly-owned subsidiary of Utilities, Inc. (UI) and is a sister company to Utilities, Inc. of Florida (UIF). Water Services Corp. (WSC) is an affiliated service company, which provides common services to all UI subsidiaries.

In 1998, the Commission approved the transfer of certificates from Cypress Lakes Associates, Ltd. to Cypress Lakes Utilities, Inc. by Order No. PSC-98-0993-FOF-WS, issued July 20, 1998, in Docket No. 971220-WS. In that same docket, by Order No. PSC-00-0264-FOF-WS, issued February 8, 2000, the Commission established rate base as of December 31, 1997, and declined to include a negative acquisition adjustment related to the transfer.

On September 30, 2002, the utility filed for approval of final 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 November 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 has requested that the Commission process this case under the Proposed Agency Action (PAA) procedure. By letter dated March 12, 2003, CLU requested an extension of the 5-month statutory deadline until May 6, 2003.

The test year for interim and final purposes is the historical teat year ended December 31, 2001. In its MFRS, the utility reported operating revenues of $114,552 and a net operating loss of $48,384 in its water operations. The utility reported operating revenues of $234,778 and a net operating income of $3,276 in its wastewater operations. By Order No. PSC-03-0196-PCO-WS, issued February 10, 2003, the Commission granted interim revenues for Cypress Lakes of $255,196 and $339,167 for water and wastewater, respectively. This represents an interim increase of $140,644, or 122.78% for water and $104,389, or 44.46% for wastewater. The utility has requested final water revenues of $275,490 and wastewater revenues of $361,255. This represents an increase of

$160,939 (140.49%) for water and $126,477 (53.87%) for wastewater.

As part of the PAA process, staff held a customer meeting on January 22, 2003, in Lakeland, Florida, which approximately 650 customers attended.

This recommendation addresses the appropriate revenue requirement, rates and charges for CLU. The Commission has jurisdiction pursuant to Sections 367.081 and 367.082, Florida Statutes.

DISCUSSION OF ISSUES

QUALITY OF SERVICE

ISSUE 1: Is the quality of service provided by Cypress Lakes satisfactory?

RECOMMENDATION: Yes. The quality of service should be considered satisfactory. (G. EDWARDS, MERCHANT)

STAFF ANALYSIS: Pursuant to Rule 25-30.433(1), Florida Administrative Code (F.A.C.), in every water and wastewater rate case, the Commission shall determine the overall quality of service provided by a utility by evaluating three separate components of water operations. The components are (1) the quality of the utility's product; (2) the operating conditions of the utility's plant and facilities; and, (3) the utility's attempt to address customers' satisfaction. The Rule further states that sanitary surveys, outstanding citations, violations, and consent orders on file with the Department of Environmental Protection (DEP) and the County Health Department over the preceding three-year period shall be considered, along with input from the DEP and health department officials and consideration of customer comments or complaints. Staff's analysis addresses each of these three components.

Cypress Lakes provides both water and wastewater service in Polk County and is located in Lakeland, Florida. The customer base consists of single-family residential (SFR) and general service customers.

The water and wastewater treatment plants are located inside of the Cypress Lakes community. The water treatment facility is monitored by the Polk County Health Department. The water treatment plant contains two wells, two hydropneumatic tanks, a utility building, and transmission lines. The water treatment process consists of pumping, chlorine disinfection, and distribution, with no storage capability.

The wastewater treatment plant is an extended-aeration domestic wastewater treatment facility, with activated sludge. The DEP permitted capacity for the wastewater plant is 175,000 gallons per day on an annual average daily flow (AADF) basis. The wastewater treatment plant processes the incoming waste, the activated sludge is removed and the effluent is routed to the

reclaimed water processing system. The treated wastewater effluent is then transported, via a distribution line, to a holding pond to be used by the two golf courses inside the Cypress Lakes community. The wastewater collection system consists of collection mains and lift stations that are located throughout the service area.

Staff has reviewed the system maps, chemical analyses and use, monthly operation reports (MORs), the DEP and SWFWMD permits, the water sanitary survey, the wastewater compliance inspection reports, field employees records, vehicles, and customer complaint logs maintained by the utility. Staff also researched whether any customer complaints were filed with the Commission related to this utility. Staff conducted a field inspection of the water and wastewater facilities and spoke with DEP and the Health Department officials regarding the quality of those facilities.

Quality of Product

Staff has reviewed the records of the utility, DEP and the health department. The information contained in those records indicates that the quality of both the water produced and wastewater treated meet environmental regulatory standards. Further, DEP and health department staff indicate that the finished products of both plants meet regulatory standards. Therefore, staff believes that the quality of the finished products for the water and wastewater plants is satisfactory.

Operating Condition of the Water and Wastewater Facilities

Staff conducted a field inspection of the water and wastewater treatment, water distribution, wastewater collection, and reclaimed water systems. Based on staff's investigation, the Cypress Lakes' plants appear to be in compliance with the Department of Health and DEP rules and regulations. In addition, the inspectors of both plants indicated that the plants were in compliance with each agency's rules. Based on the above, staff recommends that the operating condition of the utility's facilities be considered satisfactory.

Customer Satisfaction

On January 22, 2003, staff conducted a customer meeting in Lakeland, Florida, at the Cypress Lakes Clubhouse. There were approximately 650 customers that attended the meeting and fourteen

customers spoke. Staff also held an informal meeting earlier that same day with the members of the Cypress Lakes Homeowners Association (HOA) and representatives of the Office of Public Counsel (OPC). During the customer meeting, residents expressed numerous concerns, the majority of which dealt with the level of the rate increase.

Mr. Holzschuh, the president of the HOA, expressed concern about the timeliness of receiving the notice for the January 22, 2003, customer meeting. Mr. Holzschuh also gave staff several letters of concern from the homeowners. He stated that the HOA understood that the utility should not operate at a loss; however, the HOA believed that the customers are captive, and must rely on the government to protect them.

He further stated that the HOA is requesting that the Commission limit the proposed rate increase to a reasonable amount and postpone the Commission's decision on interim rates. Mr. Holzschuh questioned the reasonableness of the 2001 test year. He believed that 2001 was a poor choice because it was a wet year and the amount of usage was low during that year. In addition, he stated that the number of customers listed in the MFRs was incorrect, and that revenues did not reflect the true income. He also questioned the operating cost. The HOA believed that the customers should not be required to pay for the wastewater treatment plant expansion. In addition, he questioned the utility's ability to properly manage its business. Mr. Holzschuh asked the question, "what is a fair rate of return?"

When staff met with the board members of the HOA prior to the customer meeting, staff explained the interim statute requirements and that the utility's customer meeting notice was sent in the time frame prescribed by rule. In response to Mr. Holzschuh's question regarding the appropriate test year, staff's analysis reflects that the test year did not have excessive customer growth or any other material anomalies that would make the 2001 test year not representative. Regarding the question about the number of customers, staff pursued this issue through discovery and we believe that the utility satisfactorily corrected the numbers reflected in its MFRs so that the number of customers, bills and gallons are all consistent. Staff also explained the Commission's procedures for determining a fair rate of return. The issue of rate of return is discussed in Issue 12.

Customers questioned how rates are developed, how wastewater rates depend on water consumption, whether customers are charged for wastewater for their irrigation systems, whether the utility has planned for reuse, and if the utility uses non-potable water for irrigation. Further questions dealt with what level of capital reserves the utility has and is there a requirement for utilities to be audited each year. Customers also questioned if there is a cap on the number of times that a utility can request an increase in rates. Staff notes that water and wastewater rate structure is discussed in further detail in Issues 20 and 21, respectively. Regarding capital reserve levels, the Commission rules do not prescribe specific levels, but staff notes that depreciation and contributions in aid of construction (CIAC) are means by which utilities are provided with reserves. Staff also notes that there is no maximum number of times that a utility can request rate relief, but if a utility files an imprudent rate application, then it risks losing recovery of all rate case expense. Historically, staff has not seen a pattern of abuse by utilities filing for rate cases. Staff does note that index and pass-through rate increases have a statutory limit of not more than two increases during a calendar year.

Other customers expressed concerns regarding the name of the company that sends out bills for the utility's services. The customers stated that they were billed by Cypress Lakes Associates, Ltd. (the owner of the park) and not Cypress Lakes Utilities, Inc. Staff sent a data request regarding this issue. By letter dated March 3, 2003, the utility stated that it had corrected the error and now the name of Cypress Lakes Utilities, Inc. is listed on each customer's bill.

Another customer stated the she had inquired of the utility what the cost would be to add a separate irrigation meter. She stated that the utility quoted her that the cost would be $2,000. At the customer meeting, staff informed her that the amount appeared to be high. Staff notes that the utility's tariff calls for a meter installation charge of $125 and that the customer would be responsible for another monthly base facility charge. In addition to these costs, the customer would also incur personal plumbing expenses associated with reconnecting their sprinkler system to a new meter. Given all of the variables that could exist for a residential sprinkler system, staff is unable to estimate this outside plumbing cost.

Another customer indicated that there were multi-residential customers listed on the rate sheet of the MFRs; however, the residents of Cypress Lakes are single homes. In addition, he stated that the wastewater flows listed in the MFRs for the test year were highest in June; however, half of the residents are up north during this period. He also wanted to know why there were no revenues stated from the gulf course. He was further upset about an 11% level of unaccounted for water and he questioned the level of rate case expenses. Staff agrees that there are no multi-residential customers and that this is corrected in the attached rate schedules. Regarding the level of test year wastewater flow, staff sent a data request to the utility asking it to explain the abnormal wastewater flow levels during the summer months. As discussed in Issue 7, the utility notified staff that the wastewater flows reported in the MFRs were overstated and they sent in corrected flow levels. Staff has addressed the level of unaccounted for water in Issue 6, rate case expense in Issue 17, and reuse in Issue 25.

At the January 23, 2003, customer meeting, no customers complained about the quality of wastewater service. However, on February 4, 2003, the Commission received numerous letters objecting to the increase in rates. Nine of the letters were water quality related (odor, taste, low pressure and interruptions).

At the time of staff's field inspection, there were no complaints reflected in the DEP or Health Department files. Staff notes that have been no complaints filed with the Commission for the years 1999 through 2002. The Commission did, however, receive two complaints in 2003 related to a water outage which occurred on January 24, 2003. The utility stated that the problem was caused by a hard freeze which damaged a pressure switch controlling the operation of the wells. The utility promptly corrected the problem and restored the water supply within three hours of the water outage on the morning of the hard freeze.

There were also 35 complaints listed in the utility's complaint logs in the MFRs. The majority of these complaints focused on the following concerns: bad odor and taste in the water (23), the color of the water (1), air in the water lines (2), low water pressure (3), service interruptions (4), and miscellaneous (2). According to the utility's records, the complaints were addressed in the following manner:

- The utility responded within 24 hours to the complaints of odor, taste, air in the lines, and color of water by flushing the lines.

- The customer that complained of low water pressure had a faulty check valve on the customer side of the meter that interfered with the customer's water pressure.

- The utility installed a new back-up generator to address water service interruptions the caused by power failures at well #1.

All 35 complaints filed in the MFRs were water quality related and the utility's records indicate that the response time was less than 24 hours. Staff has reviewed the customer complaint logs and staff believes that the utility has promptly and satisfactory addressed each complaint. Based on the above, staff believes that the utility is satisfactorily attempting to address customer concerns.

Summary

Based on staff's review of the water and wastewater treatment, distribution, collection, and reclaimed water systems, it appears that all systems are operating properly and are in compliance with DEP and Health Department standards. In addition, staff believes that the utility is actively attempting to address the concerns of the customers. Therefore, staff recommends that the quality of service provided by Cypress Lakes be considered satisfactory.

RATE BASE

ISSUE 2: Should adjustments be made to organization and franchise costs?

RECOMMENDATION: Yes. Cypress Lakes' organization and franchise costs should be reduced by $80,551 for water and $28,321 for wastewater, respectively, to reclassify them as below the line acquisition costs. Corresponding adjustments are also necessary to decrease accumulated depreciation and depreciation expense as follows: (JOYCE)

	Water	Wastewater
Organization Costs	($80,551)	($10,115)
Franchise Fees	$0	($18,206)
Accumulated Depreciation	($4,863)	($1,714)
Depreciation Expense	($2,030)	($795)
Land	$0	$2,610

STAFF ANALYSIS: Pursuant to Order No. PSC-98-0993-FOF-WS, issued July 20, 1998, the Commission approved the transfer of the facilities of Cypress Lakes Associates, Ltd., to Cypress Lakes Utilities, Inc. The purchase price of the utility was $820,000 and the Commission established rate base was $617,609 for water and $921,439 for wastewater as December 31, 1997. The Commission declined to include a negative acquisition adjustment related to the transfer.

Subsequent to the Commission's approval of the transfer, Cypress Lakes recorded additional organization costs of $90,666. The organization costs recorded were $80,551 for water and $10,115 for wastewater. Pursuant to Audit Exception No. 1, these costs included legal and consulting fees paid by the utility to purchase and secure the transfer certificates of Cypress Lakes. Also, pursuant to Audit Exception No. 1, the auditors recommended that $2,610 of the $10,115 in wastewater organization costs should have been recorded in Land and Land Rights, pursuant to Order No. PSC-98-0993-FOF-WS.

Further, subsequent to the Commission's approval of the transfer, the utility recorded additional franchise fees of $18,206 for wastewater. According to Audit Exception No. 1, these costs also represented legal and consulting fees paid by the utility to purchase and secure the transfer of Cypress Lakes.

Per the National Association of Regulatory Utility Commissioners (NARUC) Uniform System of Accounts (USOA), the organization account shall include all fees paid to federal or state governments for the privilege of incorporation and expenditures incident to organizing the corporation, partnership or other enterprises and putting it into readiness to do business.

In addition, the USOA states that the Utility Plant Acquisition Adjustment account includes the difference between the cost to the purchasing utility of plant acquired and the original cost of the property acquired less accumulated depreciation, accumulated amortization, and contributions in aid of construction (CIAC) at the time of purchase. Staff interprets the term "cost of acquisition" to include any consideration paid, plus any other costs incurred related to or given for the purchase of the assets.

Staff believes the expenses discussed above should not be recorded as organization costs and franchise fees for these reasons: First, the expenses are acquisition costs and inappropriately treated as organization costs and franchise fees. Second, the expenses should be borne by the stockholders of Cypress Lakes' parent company because the purchase of Cypress Lakes was not the ratepayers' decision, nor has Cypress Lakes demonstrated how the customers have benefitted from this transaction. Because these expenses are directly associated with the change of ownership, they should be recorded as acquisition costs.

The Commission has previously disallowed acquisition costs recorded on a utility's books as organization costs. See, Order No. PSC-93-1713-FOF-SU, issued November 30, 1993, in Docket No. 921293. Also see, Order No. PSC-98-0524-PAA-SU, issued April 16, 1998, in Docket No. 971065. Thus, staff recommends removing the additional balances of $80,551 and $28,321 for water and wastewater, respectively. Corresponding adjustments should also be made to decrease accumulated depreciation and depreciation as follows:

	Water	Wastewater
Organization Costs	($80,551)	($10,115)
Franchise Fees	$0	($18,206)
Accumulated Depreciation	($4,863)	($1,714)
Depreciation Expense	($2,030)	($795)
Land	$0	$2,610

ISSUE 3: Should adjustments be made to utility plant in service to remove unapproved Allowance for Funds Used During Construction (AFUDC) accruals, unsupported plant, and plant never placed in service?

RECOMMENDATION: Yes, average water and wastewater utility plant in service should be reduced by $6,413 and $29,586, respectively. Average accumulated depreciation should be reduced by $724 and $595, respectively; and depreciation expense should be reduced by $392 and $1,506, respectively. (REVELL)

STAFF ANALYSIS: In Audit Exception No. 1, the staff auditors recommended three categories of adjustments. These categories are detailed below. The utility does not contest these adjustments.

Allowance for Funds Used During Construction (AFUDC)

AFUDC is an accounting entry designed to permit a utility recovery of the cost associated with financing eligible construction activities over the depreciable life of the related asset. AFUDC is capitalized in lieu of interest and recognizes that the overall capital structure provides funding for construction projects, not just debt financing. Rule 25-30.116, F.A.C., specifies the requirements necessary to capitalize AFUDC and the methodology used to determine the AFUDC rate. Subsection (5) of that rule states that "[n]o utility may charge or change its AFUDC rate without Commission approval." While the Commission has granted permission to accrue AFUDC for other Florida subsidiaries of Utilities, Inc., Cypress Lakes has not requested, nor received, an approved AFUDC rate.

The staff auditors stated that Cypress Lakes capitalized $58,052 of AFUDC for the calender years of 2000-2001. In 2000, Cypress Lakes accrued $794 in water Account 311, Pumping Equipment, and $2,345 in wastewater Account 380, Treatment and Disposal Equipment. In 2001, the utility accrued $54,913 in wastewater Account 380. Staff believes these amounts should be removed from plant. Since the Commission is setting rates using an average rate base, only one-half of the amount for 2001 in Account 380, or $27,457, should be removed from test year average plant.

Overall, staff recommends that $794 in capitalized AFUDC in Account 311 be removed from average water plant and $29,802 be removed from average wastewater plant. Water accumulated

depreciation and depreciation expense, should each be reduced by $40. Wastewater accumulated depreciation should be reduced by $894 and depreciation expense should be reduced by $1,657.

Unsupported Plant

The auditors also recommended reducing water Account 340, Office Furniture and Equipment, and Account 343, Tools, Shop & Garage Equipment, by $303 and $5,316, respectively, for which there was no supporting documentation. The utility stated that it could not locate any supporting documentation for the $303 and given the small amount it would not dispute the reduction. The average accumulated depreciation for this item should be reduced by $20 and depreciation expense should be reduced by $20.

In its response to the audit, the utility produced an invoice for the $5,316 originally included in water Account 343. Staff examined the invoice which is sufficient to support a wastewater plant addition. Thus, staff recommends that this item be allowed, but reclassified from water to wastewater. As such, water plant should be reduced by $5,316. Additionally, average accumulated depreciation should be reduced by $665. Also, depreciation expense should be reduced by $332. Corresponding adjustments to wastewater should also be made to increase plant Account 380 by $5,316 and average accumulated depreciation by $443. Wastewater depreciation expense should be increased by $296.

In a further adjustment, the auditors recommended reducing wastewater Account 380 by $2,600 for plant for which there was no documentation. The utility agreed with this adjustment. Thus, staff recommends that wastewater plant be reduced by $2,600, with corresponding reductions to average accumulated depreciation of $145. Wastewater depreciation expense should be reduced by $145.

Plant Never Placed in Service

The auditors recommended that $2,500 of plant recorded in wastewater Account 380 as plant held for future use be removed. This amount represents the cost of three water tanks that were stored at the wastewater plant site for future expansion. The utility stated that the tanks were never placed in service and were disposed of several years ago. The utility did not depreciate the tanks; as a result, no adjustment to accumulated depreciation or depreciation is necessary.

Summary

Based on the above adjustments, staff recommends total average water plant be reduced by $6,413, with a corresponding reduction to average accumulated depreciation of $724, and a reduction of depreciation expense of $392. Staff also recommends that total average wastewater plant be reduced by $29,586, with a corresponding reduction to average accumulated depreciation of $595, and a reduction to depreciation expense of $1,506.

ISSUE 4: Should adjustments be made to plant for common rate base allocations from UIF and WSC?

RECOMMENDATION: Yes, Cypress Lakes' common plant allocation from UIF should be decreased by $17,187 for water and increased by $16,539 for wastewater. Corresponding adjustments should be made to reduce accumulated depreciation by $3,978 for water and increase by $3,298 for wastewater. Depreciation expense should be reduced by $256 and $247 for water and wastewater, respectively. Also, adjustments should be made to increase WSC's rate base allocation by $9,481 and $10,018 for water and wastewater, respectively. (GREENE)

STAFF ANALYSIS: Utilities, Inc. of Florida (UIF) is a sister company of Cypress Lakes, both of which are subsidiaries of Utilities Inc. (UI). UIF allocates a portion of its common plant and accumulated depreciation to each Florida subsidiary. In addition, WSC, the service corporation for UI, allocates common costs, including billing costs to all of its subsidiary utilities, including Cypress Lakes. UI allocates these common costs to its water and wastewater operations based on a calculated customer equivalent percentage that equates all UI customers in terms of single family residential units.

UIF Common Plant Allocations

In Audit Exception No. 2 of the Cypress Lakes audit, the staff auditors noted that several items in the common plant allocations were either mis-stated or not recorded in the MFRs. First, the auditors reviewed the allocations from UIF and found that CLU's common plant and accumulated depreciation amounts for its water operations were overstated. According to the auditors, the utility reflected the total 2001 Cypress Lakes allocation from UIF as $32,819 and $7,095 for common plant and accumulated depreciation, respectively. The staff auditors stated that the UIF common allocations should be reduced for water and wastewater combined by $648 for plant and $680 for accumulated depreciation. In addition, the auditors stated that the utility failed to record any of the UIF common plant cost in its water operations.

Staff has reviewed the auditor's adjustments and believes that they should be approved. The resulting correcting entries are as follows:

Common Plant Allocations - UIF	Per Utility	Staff Adjustments	Per Staff
Water	$32,819	($17,187)	15,632
Wastewater	$0	$16,539	$16,539
Total	$32,819	($648)	$32,171

COMMON ACCUMULATED DEPRECIATION - UIF	Per Utility	Staff Adjustments	Per Staff
Water	($7,095)	$3,978	($3,117)
Wastewater	$0	($3,298)	($3,298)
Total	($7,095)	$680	($6,415)

Corresponding adjustments are also necessary to decrease depreciation expense by $256 for water and $247 for wastewater for UIF common plant allocations.

Also, Audit Exception 2 addressed the WSC allocation to CLU. According to the UI 2001 Allocation Manual, CLU was allocated $18,547 or approximately 0.81 percent of WSC's net rate base of $2,300,646. Cypress Lakes did not record any amount for WSC common rate base in its MFRs.

WSC Common Rate Base Allocations

In Audit Exception No. 1 of the WSC affiliate transactions audit, staff auditors found two problems. First, the utility was unable to locate any invoices for the computer equipment reflected on WSC's books. Second, the utility did not post several equipment transfers or retirements to the ledgers. In order to support its balance of computers, the utility provided an inventory dated August 14, 2002, but that document did not provide copies of supporting invoices. Staff auditors recommended that WSC plant should be reduced for invoices not located, and the associated accumulated depreciation. Further, the auditors recommend that computer equipment and accumulated depreciation should reflect a zero balance as of December 31, 2001, based on the above audit findings. The auditors recommended that Cypress Lakes' WSC common plant should be $9,334 and 9,875 for water and wastewater, respectively.

In its response dated March 25, 2003, the utility disagreed with the auditors adjustment to remove all computers from WSC's inventory. The utility stated that it located two of the five invoices addressed in the WSC affiliate transaction audit. Cypress Lakes stated that the remaining three invoices were not included in the computer inventory list and are irrelevant to its calculation of computer assets and accumulated depreciation. Further, the utility believes that minicomputers and its associated accumulated depreciation for Cypress Lakes should be increased in total by $566 and $275, respectively or a net of $291. Staff has reviewed the invoices submitted and staff believes that the utility's inventory list has been supported. Based on the above audit exception and utility response, the allocation to WSC common plant should be increased by $147 and $143. Thus, staff recommends that WSC's common plant should be increased by $9,481 and $10,018 for water and wastewater, respectively.

Based on the above, staff believes that the auditor's findings are appropriate, as adjusted, and we recommend that Cypress Lakes' common plant allocation from UIF should be $15,632 and $16,539 for water and wastewater, respectively. This reflects an adjustment of a decrease of $17,187 for water and an increase of $16,539 for wastewater. UIF common accumulated depreciation should be decreased by $3,978 and increased by $3298 for wastewater. Depreciation expense should be decreased by $256 and $247 for water and wastewater, respectively. Also, adjustments should be made to increase rate base for the WSC common rate base allocation by $9,481 and $10,018 for water and wastewater, respectively.

ISSUE 5: What is the appropriate used and useful percentage for the water treatment plant?

RECOMMENDATION: The water treatment plant should be considered 100% used and useful. (MERCHANT)

STAFF ANALYSIS: In its MFRs, the utility reflected that the used and useful percentage for the water treatment plant was in excess of 100%. The utility stated that the system consists of simple chlorination and that the only storage is in hydropneumatic tanks and there is no high service pumping. Thus, the utility stated that all demands must be met by well pumping capacity, and used and useful was calculated on instantaneous demand. The utility stated that its instantaneous demand was 1,114 gallons per minute (gpm).

The utility has two wells with a total capacity of 1,500 gpm. By taking the largest 770 gpm well out of service, the utility reflected a firm reliable capacity of 730 gpm, which is the capacity of the smaller well. The utility's calculation of firm reliable capacity by removing the largest well is consistent with Commission practice. See, Order No. PSC-96-1320-FOF-WS (at 58), issued October 30, 1996, in Docket No. 950495-WS. The utility also has a 500 gpm fire flow requirement and it calculated a 5-year growth margin, but these two items were not included in the calculation since the utility's instantaneous demand factor was in excess of 100% used and useful.

For small water systems that do not have storage capacity, the demand for the water system has to be supplied by the well capacity alone. The utility has to provide sufficient capacity to meet its maximum day, as well as its peak hour demands. Most smaller water utilities measure water gallons pumped on a daily basis, not on a per-minute or even per-hour basis. Daily measurements generate average demand and will not reflect what the peak demand is at a given minute or hour on that day. In determining the demand to use for used and useful purposes, the Commission uses a gallons per minute (gpm), as opposed to a gallons per day (gpd), basis for those water systems without storage. Without actual measurements for the peak hour or minute demand, some type of estimation is appropriate in order to recognize the utility's demand requirements based on the number of customers during the test year.

While staff agrees that the water system is 100% used and useful, we disagree with the utility's method to determine the

water customer demand factor. The utility's instantaneous demand estimate was based on a 1965 publication by Joseph S. Ameen, entitled *Community Water Systems Source Book*. This publication provides water system design criteria based on a sliding scale of per-connection usage. The publication states that initial instantaneous flows are high with small customer bases and taper off with larger customers bases. Based on this methodology, utility estimates its instantaneous demand for Cypress Lakes' 1,082 customers is estimated at 1,114 gpm.

Staff notes that instantaneous demand to determine the amount of customer demand on a system without water storage is not commonly used. While maximum day and peak hour demand calculations are common in engineering design manuals for building water systems, the publication referenced by the utility is 38 years old, and is not commonly used today. Staff believes that this document does not necessarily reflect current water usage patterns by the utility's customers or the trend toward water conservation.

The Commission has recognized peaking factors of 2.0 applied to the maximum day demand to determine peak hour demands to calculated used and useful water plant without storage. Further, the maximum day should be a day exclusive of any abnormal events such as fire flows and line breaks. See PSC-96-1320-FOF-WS. In its MFRs, the utility stated that the maximum day demand was 331,000 gpd. Thus, two times the maximum day is 662,000 gpd, or 460 gpm (662,000 gpd /1,440 minutes/day.)

Adding a fire flow allowance of 500 gpm to the 460 gpm peak demand equals 960 gpm, before a growth allowance. Since the firm reliable capacity of the system is 750 gpm, staff recommends that the water system should be considered 100% used and useful.

ISSUE 6: What is the level of unaccounted for water, is any portion excessive, and, if so, should any adjustments be made?

RECOMMENDATION: The test year unaccounted for water level is 11.27%, of which 1.72% is excessive. No adjustment is necessary to the used and useful calculation because the plant is 100% used and useful before consideration of growth. However, purchased power and chemical expenses should be reduced by $124 and $47, respectively. (G. EDWARDS)

STAFF ANALYSIS: It is the Commission's practice to allow 10% of the total water treated as an acceptable level of unaccounted for water for a reasonable amount of non-revenue producing water caused by stuck meters, line flushing, etc. (See Order No. PSC-00-0248-PAA-WU, issued February 7, 2000, in Docket No. 990535-WU, and Order No. PSC-00-2005-PAA-WU, issued June 7, 2000, in Docket No. 000331-WU). In its revised MFRs, the utility reported 64,894,000 gallons of water treated during the test year and 8,728,000 gallons of water were unaccounted, or 11.27%. Since Cypress Lakes recorded a total of 11.72% of unaccounted for water, staff recommends, in accordance with Commission practice, that 1.72% be considered excessive. Accordingly, adjustments should be made to remove 1.72% of direct expenses associated with water treatment. Staff recommends that purchased power expenses should be reduced by $124 and chemicals by $47.

ISSUE 7: What is the used and useful percentage for the utility's wastewater treatment plant?

RECOMMENDATION: The wastewater treatment plant should be considered 71.66% used and useful. This results in a net non-used and useful plant balance of $200,004 and a reduction to the utility's rate base of $68,411. A corresponding adjustment should also be made to reduce depreciation expense by $1,490 for non-used and useful plant. (G. EDWARDS, MERCHANT)

STAFF ANALYSIS: In its MFRS, the utility calculated the used and useful percentage of the wastewater treatment plant by taking the sum of the annual average daily flows (AADF) of 112,392 gpd and an allowance of 31,265 gpd for growth. It then divided that total by the plant's DEP permitted capacity of 175,000 gpd measured in AADF. The result was 82.09%. The utility did not make any adjustments for inflow and infiltration (I&I) in its calculations.

In calculating its growth allowance, the utility used the total gallons of water sold to single family residential (SFR) customers to estimate the wastewater customer growth on a total company basis for the years 1997-2001. It then used linear regression to project 5 years of growth beyond the test year. This resulted in a total wastewater growth allowance of 298 ERCs or 59.5 ERCs per year for 5 years. The utility calculated the 105 gpd consumption per ERC by taking the test year AADF of 112,392 gallons divided by average customers of 1,063. Thus, the utility's growth allowance was 31,265 gpd/ERC growth (59.55 ERCs/year x 5 years x 105 gpd/ERC).

Based on inaccuracies in the MFRs and questions asked by the Cypress Lakes Homeowners Association, staff requested that the utility explain why wastewater gallons exceeded water treated in May and June 2001. The customers asserted that this time frame normally has the lowest number of customers present in the neighborhood but the utility's MFR reflected those two months as the peak for the test year wastewater consumption levels. In addition, the customers as well as staff questioned why the number of customers dropped dramatically (50 SFR) from January to February in the test year.

In its response dated February 28, 2003, the utility stated that wastewater flows reported in the MFRs in May and June, 2001, were overstated by a considerable amount. The utility explained

that the effluent flow meter at the wastewater treatment plant was out of service between early May and late June because of an electrical transducer failure. Also, during that time frame, the utility completed improvements to the wastewater treatment plant, which were followed by the filling of empty aeration tanks and clarifiers. The utility stated that both of these factors reduced the effluent volume by approximately 0.200 million gallons. The utility re-estimated the flows through the plant to be 3.1 and 3.0 million gallons for May and June, 2001, respectively.

Along with its response, the utility revised its wastewater treatment plant flows from 112,392 gpd to 101,885 gpd AADF. The utility also reduced its growth allowance from 31,265 to 30,066 gpd. These changes resulted in a revised result of 75.40% used and useful.

Staff has reviewed the utility's revised calculation and we believe that two adjustments are necessary to the growth calculation. First, staff disagrees with the utility's method of calculating historical wastewater customer growth. In its MFRs, the utility is required to calculate the growth rate of all wastewater customers based on the annual average consumption per SFR customer. Then each years' total gallons sold are divided by the SFR annual average to arrive at total wastewater customer growth. In its calculations, the utility did not use wastewater SFR billed consumption, which is capped at 8,000 gallons each month and instead used total water gallons sold to SFR customers. The utility stated that it used the total SFR water gallons sold because it did not maintain records in years prior to the test year to separate the gallons sold above the cap.

Staff believes that using total SFR water consumption instead of the capped gallons is inappropriate because it inflates the growth rate of wastewater ERCs. Water consumption for SFR customers is generally much higher than wastewater consumption, thus supporting the rationale behind a wastewater cap. Since we do not have the data to measure total company historical growth, staff believes it is appropriate, in this case, to use actual historical SFR customers to measure wastewater customer growth. Staff believes that since the utility failed to maintain this data, this more conservative method should be used because the utility's method overstates the actual growth incurred. Using linear regression, staff has calculated a growth rate of 49 SFR customers

per year. Staff notes that the number of water and wastewater SFR customers is equal.

Staff's second adjustment to the utility's growth calculation relates to the amount of consumption per ERC used. In its revised growth calculation, the utility used the same 105 gpd/ERC as filed in its MFRs and failed to recalculate the average growth per ERC based on the corrected wastewater flows. Staff recalculated the test year consumption by dividing the revised test year flows of 101,885 gpd by 1,063, the average number of wastewater customers. This results in a consumption factor of 96 gpd/ERC.

After applying the adjustments above, staff recommends that the wastewater treatment plant should be 71.66% used and useful. Staff took the 101,885 gpd plus a growth margin of 23,520 gpd and divided this by the 175,000 gpd capacity of the plant. Staff's growth factor was calculated by taking 49 ERCs/year times 5 years times consumption of 96 gpd/ERC.

Staff has reviewed the utility's MFRs and staff's analysis does not reflect excessive infiltration and inflow (I&I). As such, staff does not believe that I&I is an issue in this case.

Based on the above, staff recommends that the wastewater treatment plant be considered 71.66% used and useful. This results in a net non-used and useful plant balance of $200,004. As such, the utility's requested non-used and useful amount of $131,593 should be reduced by $68,411. A corresponding adjustment should also be made to reduce depreciation expense by $1,490 for non-used and useful plant.

WASTEWATER TREATMENT PLANT - USED AND USEFUL DATA

1)	Permitted Capacity of Plant (on Annual Average Daily Flow basis)	175,000	gallons per day (gpd)
2)	Annual Average Daily Flow	101,885	gpd
3)	Growth		
	A) Average Test Year ERCS:	1,060	ERCs
	B) Annual Customer Growth	49	ERCs
	C) Statutory Growth Period	5	Years
	Growth Margin (3A x 3B x 3C)	23,520	gpd

[(2)+(3)-(4)]/(1) = **71.66%** Used and Useful

ISSUE 8: What are the used and useful percentages for the utility's wastewater collection and water distribution systems?

RECOMMENDATION: The wastewater collection and water distribution systems should be considered 100% used and useful. (G. EDWARDS)

STAFF ANALYSIS: In its filing, the utility calculated the used and useful percentage for the collection and distribution systems to be 100%. The utility stated that all residential wastewater customers are water customers; therefore, only one calculation was necessary for the distribution and collection systems. The utility's calculation took the average number of the test year residential connections of 1,058 and a growth margin of 276 (55 ERCs x 5 years), for a sum of 1,334 connections. Since the present number of lots which have service available is 1,200, the result is 100% used and useful (1,334/1,200 connections).

Staff has reviewed the utility's calculation and while we agree with the conclusion, we disagree with the growth component included in the calculation. In Issue 7, staff has recommended that the annual growth rate in ERCs should be 49, not 55 as originally requested by the utility. This equates to a total of 245 instead of the 276 ERCs requested by the utility. Regardless, including either of these amounts still results in a 100% used and useful for the distribution and collections systems.

ISSUE 9: Should adjustments be made to the contributions in aid of construction (CIAC) and accumulated amortization of CIAC accounts?

RECOMMENDATION: Yes, water CIAC balances should be increased by $18,100 related to unrecorded 1998-2000 additions to water CIAC. Further, accumulated amortization of CIAC should be increased by $3,364 and $2,604 for water and wastewater, respectively, to reflect the proper accruals and amortization rates. Corresponding adjustments should be made to reduce water and wastewater CIAC amortization expense by $1,153 and $2,315, respectively. Additionally, the utility should be required to calculate its accumulated amortization of CIAC accruals by specific account as required by Rule 25-30.140(8), F.A.C. (REVELL)

STAFF ANALYSIS: In Audit Exception No. 3, the utility's water and wastewater CIAC balances were last established as of December 31, 1997, by Order No. PSC-98-0993-FOF-WS, issued July 20, 1998, in Docket No. 971220-WS. For purposes of the current rate case, the field audit covered rate base additions for the 1998 through 2001 calender year. The auditors determined that the utility did not record any additions to water CIAC for 1998 or 1999 and failed to record CIAC for five ERCs in 2000. As a result, the water CIAC balance was found to be understated by $18,100.

The staff auditors also stated that the utility used the composite plant amortization method to record its accruals to CIAC for the years 1999 through 2001, instead of calculating amortization by specific account. Pursuant to Rule 25-30.140(8)(a), Florida Administrative Code, "adequate records to account for CIAC must be maintained by the utility". The Rule further states that:

> The CIAC plant shall then be amortized either by account, function or bottom line depending on availability of supporting information. The amortization rate shall be that of the appropriate account or function where supporting documentation is available to identify the account or function of the related CIAC plant. Otherwise, the composite plant amortization rate shall be used.

The staff auditors recommended that because the utility has the responsibility to maintain its CIAC records by account, it should calculate its amortization rates on that same basis. Thus,

the auditors reflected year-end balances of accumulated amortization of CIAC of $41,854 and $84,937, respectively. Based on the utility's adjusted average balance in its MFRs, accumulated amortization of CIAC should be increased by $3,364 and $2,604 for water and wastewater, respectively. Also, the auditors stated that the utility should be required to reduce CIAC amortization expense by $1,153 and $2,315, respectively. The utility stated in its response to the audit that it did not contest this exception.

Staff believes that the auditors' adjustments are appropriate and should be made. Accordingly, water CIAC should be increased by $18,100 for unrecorded 1998-2000 additions to water CIAC. Further, accumulated amortization of CIAC should be increased by $3,364 and $2,604 for water and wastewater, respectively, to reflect the proper accruals and amortization rates. Corresponding adjustments should be made to reduce water and wastewater CIAC amortization expense by $1,153 and $2,315, respectively. The utility should also be required to calculate its accumulated amortization of CIAC accruals by specific account, as required by Rule 25-30.140(8), F.A.C.

ISSUE 10: What is the appropriate working capital allowance?

RECOMMENDATION: The appropriate amount of working capital is $10,701 for water and $17,915 for wastewater based on the formula method. (JOYCE)

STAFF ANALYSIS: Rule 25-30.433(2), F.A.C., requires that Class B utilities use the formula method, or one-eighth of operation and maintenance (O&M) expenses, to calculate the working capital allowance. The utility has properly filed its allowance for working capital using the formula method. Staff has recommended several adjustments to the utility's balance of O&M expenses. Due to the adjustments recommended in other issues, staff recommends that working capital of $10,701 and $17,915 should be approved for water and wastewater, respectively. This reflects a decrease of $2,103 to the utility's requested working capital allowance of $12,804 for water and a decrease of $3,353 from the utility's requested of $21,268 for wastewater.

ISSUE 11: What is the appropriate rate base?

RECOMMENDATION: The appropriate water rate base for the test year ending December 31, 2001 is $730,290. The appropriate wastewater rate base for the period ending December 31, 2001 is $897,212. (REVELL)

STAFF ANALYSIS: Staff has calculated Cypress Lakes' water and wastewater rate base using the utility's MFRs with adjustments as recommended in the proceeding issues, as $730,290 and $897,212, respectively.

COST OF CAPITAL

ISSUE 12: Are any adjustments necessary to CLU's capital structure and what is the appropriate weighted cost of capital including the proper components, amounts and cost rates associated with the capital structure for the test year ending December 31, 2001?

RECOMMENDATION: Yes, adjustments should be made to use the correct debt rates and to include Cypress Lakes' balance of accumulated deferred income taxes at a zero cost rate. The resulting overall cost of capital should be 9.23%, with a range of 8.78% to 9.68%. The return on equity (ROE) should be 10.93%, with a range of 9.93% to 11.93%. (GREENE)

STAFF ANALYSIS: In its MFRs, the utility used the debt and equity ratios of its parent, UI, to prorate Cypress Lakes' share of the parent's capital. The utility then included the actual balance of Cypress Lakes' customer deposits. Cypress Lakes did not include investment tax credits or deferred income taxes in its cost of capital calculation. The utility's requested overall cost of capital is 9.21%, and its return on equity is 10.93% per Order No. PSC-01-2514-FOF-WS.

In the staff audit of UI's affiliate transactions for the year ended December 31, 2001, the staff auditors recommended that the debt rates used by the utility in its MFRs were incorrect. Staff has reflected the correct debt rates in staff's recommended cost of capital. The auditors also stated that several components, including accumulated deferred income taxes were omitted from the various capital structures of the subsidiaries. Based on staff's review of supporting documentation provided by the utility, the only missing component for Cypress Lakes was the balance of deferred income taxes. The appropriate average balance of accumulated deferred income taxes related to Cypress Lakes agrees with those amounts included in the income tax section of the MFRs. Thus, staff recommends that deferred income taxes should be increased by $9,806.

Staff used the current leverage formula approved by Order No. PSC-02-0898-PAA-WS, issued July 5, 2000, in Docket No. 020006-WS to calculate the ROE. The 2002 leverage formula decision from that order was consummated by Order No. PSC-02-1252-CO-WS, issued September, 11, 2002. Using an equity ratio of 45.48%, the utility's ROE is 10.93%, with a range of 9.93% to 11.93%.

Schedule No. 2 shows the components, amounts and cost rates associated with the capital structure for the test year. Staff recommends approval of an overall cost of capital of 9.23%, with a range of 8.78% to 9.68%. The return on equity (ROE) should be 10.93%, with a range of 9.93% to 11.93%.

ISSUE 13: Should an AFUDC rate be approved, and if so, what is the appropriate annual rate, monthly discounted rate, and the effective date for Cypress Lakes?

RECOMMENDATION: Yes, since the utility does not currently have an authorized AFUDC rate, the Commission, on its own motion, should establish such a rate. The utility should be authorized to implement an AFUDC rate of 9.23%, on an annual basis, with a monthly discounted rate of 0.768680%. These charges should be effective for projects as of January 1, 2002. (REVELL)

STAFF ANALYSIS: As indicated in Issue 3, Cypress Lakes does not currently have an approved AFUDC rate, nor did it request approval of such a rate in this proceeding. Rule 25-30.116(5), F.A.C., states that no utility may charge or change its AFUDC rate without prior Commission approval. However, Rule 25-30.116(7), F.A.C., states that the Commission, on its own motion, may initiate a proceeding to revise a utility's AFUDC rate. Since staff is recommending a current cost of capital in this proceeding, staff believes that the Commission should authorize a prospective AFUDC rate for Cypress Lakes to allow the utility to charge AFUDC in the future if the need arises. The incremental cost of approving an AFUDC rate in this docket is very minimal compared to the cost of a separate future filing for approval of an AFUDC rate.

Staff has recommended that the cost of capital be established as 9.23%. Consistent with Rules 25-30.116(2) and (3), F.A.C., the annual AFUDC rate should also be 9.23%, with a monthly discounted rate of 0.768680%. Further, Rule 25-30.116(5), F.A.C., states that the AFUDC rate should be effective the month following the end of the period used to establish the rate. Since the test year ended December 31, 2001, was used to determine the cost of capital, the AFUDC rate should be effective January 1, 2002. Schedule 2 reflects staff's recommended cost of capital and resulting annual AFUDC rate.

NET OPERATING INCOME

ISSUE 14: Should adjustments be made to operation and maintenance (O&M) expense to remove incorrect beginning and ending year accruals, unsupported expense additions, and improperly recorded expenses?

RECOMMENDATION: Yes. O&M expenses should be reduced by a total of $1,029 for water and $1,922 for wastewater. (JOYCE)

STAFF ANALYSIS: Per Audit Exception No. 6, the utility's test year water and wastewater O&M expenses are overstated by $1,029 and $1,922, respectively. The audit staff analysis of the utility's O&M expense accounts identified that several adjustments were necessary. The auditors stated that the utility could not provide adequate supporting documentation for expense additions and improperly recorded expenses associated with other Florida affiliated utilities on their books.

According to the auditors, the utility could not provide adequate supporting documentation for chemicals and materials and supplies. As such, chemicals should be reduced by $141 for water and $266 for wastewater. Materials and Supplies should be reduced by $87 for water and $573 for wastewater.

The auditors also stated that the utility improperly recorded on Cypress Lakes' books expenses associated with one of its other Florida affiliated utilities. As such, materials and supplies should be reduced by $308 for wastewater. Additionally, contractual services-legal should be reduced by $800 for water and $775 for wastewater.

The utility does not contest any adjustments in this audit exception. Accordingly, staff believes that the adjustments above should be made to the utility's operation and maintenance expense because the utility could not provide adequate supporting documentation for expense additions and improperly recorded expenses associated with other Florida affiliated utilities on its books. Thus, O&M expenses should be reduced by $1,029 and $1,922 for water and wastewater, respectively.

ISSUE 15: Should an adjustment be made to the O&M expense allocation from WSC?

RECOMMENDATION: Yes, O&M expenses should be reduced by $1,426 for water and $1,381 for wastewater. (GREENE)

STAFF ANALYSIS: UI, the parent, through its subsidiary WSC, allocates common costs, including billing costs to all of its subsidiary utilities, including Cypress Lakes. Cypress Lakes' allocated share of common O&M expenses was $23,853. Cypress Lakes allocated its share between water and wastewater operations based on customer equivalents. The customer equivalent ratios for water and wastewater are 50.81 percent and 49.19 percent, respectively.

Per Audit Exception No. 7, the auditors believe the Cypress Lakes allocated WSC water and wastewater O&M expenses are overstated by $1,523 and $1,475, respectively, based on its customer ratio allocation. In addition, the auditors recommended that several expense items should be removed because the utility did not provide support or incorrectly charged expenses to Cypress Lakes.

In its response to the Cypress Lakes audit, the utility disputed only one of the several adjustments recommended by the auditors. This issue related to the auditor's removal of finder's fees. According to Audit Exception No. 1 in the WSC affiliate transactions audit, staff auditors stated that the company provided finder's fees for informing the company about systems that can be purchased. The auditor's believe that these costs should be charged to the acquisition costs of the system being purchased and should be removed from expenses.

In the utility's response dated March 25, 2003, Cypress Lakes stated that the auditors were mistaken that this account related to system acquisition costs. Instead these costs relate to key-employee finder's fees and the utility provided documentation to support the employee finder's fees account. In its support, the utility states that the $21,615 recorded as an expense in 2001 is comprised of amortized amounts from 1999, 2000, and 2001 additions. Also, the utility notes that all expenses are related to WSC employees and should be allocated to UI subsidiaries.

Staff has reviewed the utility's response and believes that the employee finder's fees are reasonable and should be included.

Cypress Lakes' allocated share of these costs is $191, or $97 for water and $94 for wastewater. Therefore, staff recommends that O&M expense should be reduced by $1,426 and $1,381 for water and wastewater, respectively.

ISSUE 16: Should adjustments be made to salaries and pensions and benefit expense to include the proper level of allocated expenses?

RECOMMENDATION: Yes, the utility should reduce water and wastewater salary-related expenses as follows: (REVELL)

	Water	Wastewater
Salary Expense	($3,478)	($3,368)
Pension & Benefits	($11,699)	$11,328)
Payroll Taxes	($4,008)	($3,881)

STAFF ANALYSIS: In its filing, the utility made adjustments to its O&M expense balances for the 12-month period ending December 31, 2001, to annualize salaries and related costs to current pay levels. The adjustments are reflected below.

Account	Water	Wastewater	Total
Salaries	($983)	($952)	($1,935)
Pensions & Benefits	$6,671	$6,459	$13,130
Payroll Expense	$3,640	$3,524	$7,164

In Audit Exception No. 8, the auditors stated that the utility incorrectly computed the salary expense adjustment because the utility failed to include $6,846 of historical WSC salary expenses in its calculation. The auditors also stated that the utility incorrectly computed the pensions and benefits expense adjustment because the utility understated the historical operator and WSC pension and benefits expense by $23,027. In its response to the audit, the utility stated that it does not contest these adjustments.

These recommended adjustments are totals for both water and wastewater, and are allocated based on the percentage of customers compared to the total. Water customers represent 50.81% of the total water and wastewater customers, and wastewater customers represent the remaining 49.19%. As a result of this allocation, the auditors recommended that 50.81%, or $3,478, of the recommended adjustment of $6,846 be allocated to water and the remaining 49.19%, or $3,368, be allocated to wastewater. The auditors recommended that $11,699 of the overstated $23,027 in

operator and WSC pension benefits be allocated to water and the remainder, $11,328, be allocated to wastewater.

Additionally, there is a corresponding reduction to the associated payroll expense. The utility's filing included a total payroll tax expense increase of $7,164, of which $3,640 was allocated to water and $3,524 to wastewater. The auditors stated that the utility's payroll tax adjustments were overstated by $7,889 because the utility failed to include historical operator and WSC payroll taxes in its calculations.

Thus, the auditors recommended that the utility's water and wastewater payroll tax expense should be reduced by $4,008 and $3,881, respectively. This will properly record the reductions in annual payroll tax expense projected by the utility for the 12-month period ending December 31, 2001. The utility also stated in its response to the audit that it did not contest this adjustment.

Thus, staff recommends that salary expense be reduced by $3,478 and $3,368; pensions and benefits expense be reduced by $11,699 and $11,328; and the related payroll tax expense be reduced by $4,008 and $3,881, for water and wastewater operations, respectively.

ISSUE 17: What is the appropriate amount of rate case expense?

RECOMMENDATION: The appropriate rate case expense for this docket is $56,943. This expense is to be recovered over four years for an annual expense of $14,236. Since the utility erroneously amortized its rate case expense over 8 instead of 4 years, staff recommends that the test year amortization be increased by $3,312 and $3,205, for water and wastewater, respectively. (JOYCE)

STAFF ANALYSIS: The utility included a $123,500 estimate in the MFRs for current rate case expense. Staff requested an update of the actual rate case expense incurred, with supporting documentation, as well as the estimated amount to complete the case. The utility submitted a revised estimated rate case expense through completion of the PAA process of $68,940. The components of the estimated rate case expense are as follows:

	Mfr Estimated	Actual	Additional Estimated	Total
Filing Fee	$5,500	$5,500	$0	$5,500
Legal Fees	50,000	8,188	7,850	16,038
Consultant Fees	45,000	21,420	5,830	27,250
WSC In-house Fees	11,000	4,634	3,518	8,152
Miscellaneous Expense	12,000	4,860	7,140	12,000
Total Rate Case Expense	$123,500	$44,486	$24,454	$68,940

Pursuant to Section 367.081(7), Florida Statutes, the Commission shall determine the reasonableness of rate case expenses and shall disallow all rate case expenses determined to be unreasonable. Staff has examined the requested actual expenses, supporting documentation, and estimated expenses as listed above for the current rate case. Staff believes that the revised estimate is reasonable with three exceptions, as discussed below.

The first adjustment relates to costs incurred to correct deficiencies in the MFR filing. As reflected in its response to staff's data request, the utility's consultant and attorney incurred $1,900 and $180 respectively, related to correcting the MFRs. The Commission has previously disallowed rate case expense associated with correcting MFR deficiencies because of duplicate filing costs. See Order No. PSC-01-0326-FOF-SU, issued February 6, 2001, in Docket No. 991643-SU. Accordingly, staff recommends that

$2,080 be removed as duplicative and unreasonable rate case expense.

Staff's second adjustment relates to costs incurred to correct errors in the MFRs. As reflected in its response to staff's data request, the utility's consultant estimated that he would spend 40 hours to respond to staff data requests and the attorney estimated 32 hours. As discussed in Issue 8, staff asked the utility to explain several discrepancies in its MFRs. Several of the utility's responses corrected original data included in the MFRs. Since the utility was not able to give actual costs for correcting these errors, staff has estimated that the consultant spent 16 hours on these corrections and the attorney spent 4 hours. Based on their hourly rates, staff recommends that rate case expense be reduced by $1,600 and $900, respectively, for the consultant and attorney to correct MFR errors. Also, the utility estimated a total of 79 hours of estimated time to complete the case with no breakout of the hours by work performed. Staff estimated that the three WSC employees spent ten hours each for correcting MFR errors. This reduction amounts to a total of $1,100. Accordingly, staff recommends that $3,600 be removed for correction of MFR errors.

Staff's last adjustment related to miscellaneous expenses incurred. Of the miscellaneous expenses, travel expenses requested amounted to $7,067. Of the travel expenses, $1,784 related to the reimbursement of travel expenses incurred by the Commission staff auditors when performing an audit of the utility's out of state records. An additional $5,283 was for estimated travel expenses for WSC employees, Utilities, Inc. employees, the attorneys and the consultant. Staff recommends removing $4,533 of the estimated cost to travel for lack of support and has included $750 for one utility officer to travel to Florida. Thus, staff recommends removing $6,317 from miscellaneous expenses.

Staff does not believe the estimated travel expenses are reasonable for several reasons. One, the travel cost appears excessive for one trip to Tallahassee and there are no breakdowns of the estimated travel costs to allow staff to test for reasonableness. In addition, staff does not believe that travel costs are required since estimated costs are already included for the utility's consultant to prepare for and attend the agenda conference.

Staff recommends that the appropriate total rate case expense is $56,943. A breakdown of the allowance of rate case expense is as follows:

	MFR Estimated	Utility Revised Actual & Estimated	Staff Adjustments	Total
Filing Fee	$5,500	$5,500	$0	$5,500
Legal Fees	50,000	16,038	(1,080)	14,958
Consultant Fees	45,000	27,250	(3,500)	23,750
WSC In-house Fees	11,000	8,152	(1,100)	7,052
Miscellaneous Expense	12,000	12,000	(6,317)	5,683
Total Rate Case Expense	$123,500	$68,940	($11,997)	$56,943
Annual Amortization	$30,875		($16,639)	$14,236

The recommended allowable rate case expense is to be amortized over four years, pursuant to Section 367.0816, Florida Statutes, at $14,236 per year. Based on the data provided by the utility and the staff recommended adjustments mentioned above, staff recommends that the rate case expense should be reduced by $16,639. This is the difference between the $14,236 recommended by staff and the $30,875 included as expenses on MFR Schedule B-10. Staff's recommended annual amortization expense to include in rates should be $7,235 for water and $7,001 for wastewater.

In its MFRs, the utility requested total rate case expense of $123,500, which amortized over four years would be $30,875. Using the utility's allocation methodology, it should have requested $15,691 for water and $15,184 for wastewater. Instead the utility divided the annual amortization amount by four again and reflected only $3,923 and $3,796 for water and wastewater, respectively. In order to reflect the correct test year amortization, staff recommends that the utility's test year expenses should be increased by $3,312 and $3,205, for water and wastewater, respectively.

ISSUE 18: What is the test year water and wastewater operating income before any revenue increase?

RECOMMENDATION: Based on the adjustments discussed in previous issues, staff recommends that the test year water operating income before any provision for increased revenues should be ($5,844). The test year wastewater operating income before any provision for increased revenues should be $35,464. (REVELL)

STAFF ANALYSIS: As shown on attached Schedules 3-A and 3-B, after applying staff's adjustments, the test net operating income before any revenue increase for water is ($5,844) and $35,464 for water and wastewater, respectively. Staff's adjustments to operating income are listed on Schedule 3-C.

ISSUE 19: What is the appropriate revenue requirement?

RECOMMENDATION: The following revenue requirement should be approved. (REVELL)

	Test Year Revenues	$ Increase	Revenue Requirement	% Increase
Water	$114,551	$122,955	$237,506	107.34%
Wastewater	$234,778	$79,463	$314,241	33.85%

STAFF ANALYSIS: Cypress Lakes requested final rates designed to generate annual revenues of $275,490 and $361,255 for water and wastewater respectively. These revenues exceed test year revenues by $160,939 (140.50%), and $126,477 (53.87%) for water and wastewater, respectively.

Based upon staff's recommendations concerning the underlying rate base, cost of capital, and operating income issues, we recommend approval of rates that are designed to generate a water revenue requirement of $237,506, and a wastewater revenue requirement of $314,241. These revenues exceed staff's adjusted test year revenues by $122,955, or 107.34%, for water, and $79,463, or 33.85%, for wastewater. These increases are shown on attached Schedules 3-A and 3-B. These increases will allow the utility the opportunity to recover its expenses and earn an 9.23% return on its investment in water and wastewater rate base.

RATES AND RATE STRUCTURE

ISSUE 20: Is a continuation of the utility's current inclining-block rate structure for its residential water system customers appropriate in this case?

RECOMMENDATION: Yes, a continuation of the utility's current inclining-block rate structure for its residential water system customers is appropriate. Staff recommends no change to the usage blocks or usage block rate factors. No conservation adjustment is recommended. (HUDSON)

STAFF ANALYSIS: The utility's current water system rate structure for its residential customers consists of a base facility charge (BFC) and a three-tiered inclining-block rate structure. The BFC is $3.82 per month, plus a charge of $.82 per one thousand gallons (kgal) sold for usage between 0 - 6 kgal, $1.23 per kgal for usage between 6.001 - 12 kgal, and $1.64 per kgal for usage over 12 kgal gallons. The usage block rate factors are 1.00, 1.50 and 2.00, respectively. This rate structure was in place when the utility was issued a grandfather certificate by the Commission by Order No. PSC-97-0569-FOF-WS in Docket No. 961334-WS, on May 20, 1997. The utility is located in the Southwest Florida Water Management District, but not within a water use caution area.

Conservation Adjustment

A conservation adjustment moves more of the revenue recovery from the BFC to the gallonage charge. This is an important rate design tool because it results in a higher gallonage charge, thereby making that charge more conservation-oriented. The utility's proposed rates allocate 48% of the revenue recovery allocation to the BFC or fixed charges and 52% to the gallonage charge or variable charges. These cost recovery allocation percentages are outside the guidelines of the Southwest Florida Water Management District (District). The District's guidelines state that no more than 40% of a water utility's cost recovery should come from the BFC. This is Commission practice as well.

The principles of going concern and revenue stability should be considered in conjunction with any adjustment to a utility's revenue recovery allocation. Absent any rate design adjustment, staff's preliminary revenue recovery allocation results in 37% of the revenues recovered through the BFC, with the remaining 63% of revenues recovered through the gallonage charge. Although a

conservation adjustment may increase revenue instability, the Commission's concerns in this regard are often mitigated by such factors as: 1) the percentage of bills and gallons recovered in the first block (in the case of an inclining-block rate structure); 2) a low seasonality of the utility's customer base; or 3) the average consumption per customer. Based upon staff's analysis, at least 70% of the utility's bills and gallons are accounted for in the 0 - 6 kgal usage block, which typically lessens revenue stability concerns when shifting more of the cost recovery burden to the gallonage charge. However, due to the high seasonality of the utility's customer base coupled with the low average consumption per customer, staff does not believe sufficient mitigating factors exist in this case to make a conservation adjustment.

Based on the utility's billing analysis, approximately 18% of the utility's bills and 20% of the gallons are captured at 1 kgal or less. At 2 kgal or less, the utility has accounted for approximately 30% of its bills and 40% of its gallons. These percentages indicate that the utility has a high level of seasonality. The greater the degree of seasonality, the more exposed the utility becomes for meeting its minimum cash requirements during each month of the year. Based on the foregoing, staff does not believe a conservation adjustment to recover less than 37% of the revenues through the BFC is appropriate in this case.

Rate Structure

As discussed previously, the utility's current rate structure consists of a BFC with a three-tiered inclining-block rate structure. In light of the drought conditions and water shortages throughout the state, the Commission, at the request of the various Water Management Districts (WMDs), has been implementing, whenever possible, inclining-block rate structures as the rate structure of choice. The goal of this rate structure is to reduce average demand. Under an inclining-block rate structure, it is anticipated that demand in the higher usage block(s) will be more elastic than demand in the first block. Water users with low monthly usage will benefit because the gallonage charge is slightly lower than the true cost of service, while water users with high monthly use will pay increasingly higher rates because the gallonage charge(s) increase in subsequent usage blocks. Thus, the high water users have a greater incentive to conserve.

When a utility has a high degree of seasonality, it is important to pay extra attention to maintaining the utility's revenue stability and revenue sufficiency. This means that the percentage price increases at low levels of consumption (or non-discretionary use) should be greater than the corresponding increases if seasonality was not a concern. Furthermore, when designing rates for a utility with high seasonality and low average consumption, a balance needs to be met between revenue stability versus the price signals to high end users. As discussed above, staff recommends a conservation adjustment of 0%, with a corresponding BFC cost recovery of 37%. Staff analyzed the percentage price increases, based on the utility's current usage blocks, at various usage block rate factors. The results of this analysis are shown in the following table:

PRE-REPRESSION PRICE INCREASES AT VARIOUS USAGE BLOCK RATE FACTORS WITH CONSERVATION ADJUSTMENT OF 0% AND BFC=37%

	USAGE BLOCK RATE FACTORS			
Monthly Consumption	**1/1.5/2**	**1/1.5/3**	**1/1.75/3**	**1/2/3**
0 kgal	65.4%	65.4%	65.4%	65.4%
3 kgal	99.0%	95.7%	93.3%	90.4%
5 kgal	109.8%	105.4%	102.3%	98.5%
8 kgal	121.9%	116.3%	121.0%	124.3%
13 kgal	132.8%	137.3%	148.6%	157.9%
20 kgal	140.0%	187.0%	190.3%	191.6%

As shown above, the usage block rate factors of 1/1.5/2 strikes a balance between revenue stability and price signals to high end users by maximizing the price increases for nondiscretionary consumption to increase revenue stability and sufficiency while sending increasingly greater price increases at levels of consumption greater than the overall average consumption of approximately 5 kgal.

Based on the foregoing, staff recommends that a continuation of the utility's current inclining-block rate structure for its residential water system customers is appropriate. Staff

recommends no change to the usage blocks or usage block rate factors. No conservation adjustment is recommended.

ISSUE 21: What is the appropriate general service gallonage charge?

RECOMMENDATION: The general service gallonage charge should be the uniform gallonage charge calculated as if that charge were applicable to all customers. (HUDSON)

STAFF ANALYSIS: As discussed in Issue 20, the utility currently has a three-tiered inclining block rate structure. The utility currently charges its general service customers the same gallonage charge as the residential customers in the first usage block. The rate in the first usage block is designed to be slightly less than the true cost of service. Therefore, applying the first usage block rate to all general service gallons results in residential customers subsidizing the general service customers.

The inclining block rate structure is designed to penalize and target discretionary use in an effort to promote conservation. Residential customers' usage typically includes some level of discretionary use whereas the usage of a general service customer is typically considered part of the cost of doing business which is usually passed on to its customers. Often, these customers are the residential customers in the same service area. By applying an inclining block rate structure to general service customers, it creates a double burden on residential customers without any penalty to the general service customer.

The traditional BFC rate structure with a uniform gallonage charge has been the Commission's rate structure of choice for the general service class. The uniform gallonage charge would be calculated by dividing the total revenues to be recovered through the gallonage charge by the total of both residential and general service gallons. This should be the same methodology used to the determine the general service gallonage charge in this case. With this methodology, the general service customers would pay their fair share of the cost of service.

Therefore, staff is recommending that the general service gallonage charge should be the uniform gallonage calculated as if that charge were applicable to all customers.

ISSUE 22: Are adjustments to reflect repression of residential consumption appropriate in this case, and, if so, what are the appropriate adjustments?

RECOMMENDATION: Yes, repression adjustments of 9,196.3 kgal to residential water consumption and 7,357.0 kgal to residential wastewater consumption are appropriate. In order to monitor the effects of the recommended revenue changes, 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 increased rates go into effect. (LINGO)

STAFF ANALYSIS: Typically, staff's repression analysis involves an examination of our database of utilities receiving rate increases and decreases. We look for utilities with comparable parameters to the utility being examined, and ultimately base our recommended repression adjustment on the past behavior of these like utilities. These parameters include, but are not limited to, utilities with similar: 1) rate structure changes; 2) average monthly consumption; 3) average monthly price; and 4) percentage price increases. However, on an overall basis, an examination of our database revealed no sufficiently similar utilities upon which staff could base a recommended repression adjustment. Therefore, staff has extrapolated from available information to develop our recommended repression adjustment.

Staff has found that for utilities that did not experience a rate structure change, a price increase of approximately 31% (in cases which involve both the utility's water and wastewater systems) has led to a corresponding 7% reduction in consumption (demand or consumption repression). We have used this overall price/repression relationship as a starting point in cases where there are no comparable utilities in the database. That analysis in this case would yield the following proportional relationship:

$$\frac{\text{31\% price increase}}{\text{7\% consumption reduction}} = \frac{\text{Pre-repression avg price incr of 108.0\%}}{\text{X\% consumption reduction}}$$

Solving for X, the anticipated consumption reduction would be approximately 24.4%. However, based on overall historical usage patterns, staff does not believe 24.4% is an appropriate recommended repression adjustment in this case. As discussed in the preceding issue, Cypress Lakes' average monthly water

consumption per residential customer is 4.6 kgal, with approximately 83% of Cypress Lakes' bills representing average monthly consumption of 3.1 kgal. Staff does not believe this consumption level is sufficient to sustain a 24.4% reduction. In fact, a 24.4% consumption reduction to these bills would result in average monthly consumption dropping to a low 2.3 kgal per month.

In the alternative, staff analyzed the potential repression effects in three average monthly usage groups: 1) usage at 6 kgal or less; 2) usage between 6.001 kgal and 12 kgal; and 3) usage above 12 kgal. An analysis of the anticipated repression in each of these three usage groups follows.

0 - 6 kgal per Month

This usage block captures approximately 77% of all bills and 83% of billed consumption. As discussed above, staff does not believe that the average monthly consumption in this usage block of 3.1 kgal is sufficient to sustain a 24.4% reduction in consumption. However, based upon a visual inspection of the service area, staff believes that some repression will occur in this block.

An analysis of the utility's test year billing data indicates that almost 30% of the bills and 40% of consumption are captured at 2 kgal. These figures represent a high degree of seasonality (in which customers are gone for some portion of the year), combined with one-person households using bare subsistence consumption of slightly greater than 50 gallons per day. Staff does not believe it is possible to reduce consumption in this group.

The remaining customers using between 3 kgal and 6 kgal exhibit average monthly consumption of approximately 4.2 kgal. For these customers, staff calculated an average anticipated pre-repression price increase of 106.3%. Staff assumed a proportional price/repression relationship, yielding the following:

$$\frac{\text{Avg 31\% price increase}}{\text{7\% consumption reduction}} = \frac{\text{New avg price increase of 106.3\%}}{\text{X\% consumption reduction}}$$

Solving for X, the anticipated consumption reduction would be approximately 24% for monthly usage between 3 kgal and 6 kgal. Based on the housing types and landscaping requirements of the service area, staff believed it is possible for these customers to sustain a 24% reduction in consumption, which would reduce average monthly consumption in the 3 kgal to 6 kgal range to 3.2 kgal.

This proposed adjustment represents a corresponding overall anticipated reduction in the entire 0 - 6 kgal block of 13.1%.

6.001 kgal - 12 kgal per Month

Staff's analysis of Cypress Lakes' customers using 6.001 kgal to 12 kgal per month revealed average monthly residential consumption of 8.4 kgal. Staff identified four utilities from our database which exhibited similar prior price and prior consumption characteristics. However, the average price increase for the four utilities' was 16.7% - a very poor and unrepresentative match to the anticipated price increase for Cypress Lakes' customers in this block of 123.2%. Therefore, staff applied the following proportional relationship:

$$\frac{\text{Avg 31\% price increase}}{\text{7\% consumption reduction}} = \frac{\text{New avg price increase of 123.2\%}}{\text{X\% consumption reduction}}$$

Solving for X, the anticipated consumption reduction would be approximately 27.8% for monthly usage between 6.001 kgal and 12 kgal, which would reduce average monthly consumption to 6.1 kgal. Again, based on the housing types and landscaping requirements of the service area, staff believes it is possible for these customers to sustain this level of consumption reduction.

12+ kgal per Month

An examination of our database revealed no sufficiently similar utilities upon which staff could base a recommended repression adjustment for monthly usage levels above 12 kgal. Absent any comparable utilities, and in consideration of the factors and discussion above, staff used the proportional relationship methodology to estimate repression.

For customers whose usage was billed at 12 kgal or greater, the average monthly consumption was 19.0 kgal, with an anticipated pre-repression average price increase of 139.4%. The proportional price/repression relationship yielded the following:

$$\frac{\text{Avg 31\% price increase}}{\text{7\% consumption reduction}} = \frac{\text{New avg price increase of 139.4\%}}{\text{X\% consumption reduction}}$$

Solving for X, the anticipated consumption reduction would be approximately 31.5% for monthly usage above 12 kgal. We believe it is possible for these customers to sustain a 31.5% reduction in

consumption, which would decrease average consumption in this usage block to 13.0 kgal.

Summary

The above-referenced repression adjustments results in an overall water repression adjustment of 15.8%, with an anticipated 9,196.3 kgal reduction in water consumption and a corresponding 7,357.0 kgal reduction in wastewater consumption. In order to monitor the effects of the recommended revenue changes, 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 increased rates go into effect.

ISSUE 23: What are the appropriate water and wastewater rates?

RECOMMENDATION: The appropriate monthly rates are shown on Schedules 4-A and 4-B. Staff's recommended rates are designed to produce water and wastewater revenues of $234,677 and $314,241, respectively, 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 after the notice is 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. (REVELL)

STAFF ANALYSIS: As discussed in Issue 19, the appropriate revenue requirements are $237,506, and $314,241 for water and wastewater, respectively. After excluding water miscellaneous service charges of $2,829, the revenues to be recovered through rates are $234,677 and $314,241 for water and wastewater, respectively.

Cypress Lakes' current wastewater rate structure is a base facility charge and gallonage charge with an 8,000 gallon cap on residential customers. The utility's current rate structure does not contain a differential in the gallonage charge between residential and general service. This rate differential is designed to recognize that approximately 80% of a residential customer's water usage will not return to the wastewater system. Whereas, approximately 96% of multi-family and general service water usage is returned. This wastewater gallonage rate differential is employed by the Commission in wastewater rate settings and is widely recognized as an industry standard. The utility stated in response to a staff interrogatory that it proposed the same gallonage charge for residential and general service customers for simplicity, and that it continued the existing general service/residential relationship. Based on the above, staff believes that the gallonage rate differential should be used in this case, consistent with Commission practice.

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 25-40.475(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.

A comparison of the utility's original and requested rates, the Commission approved interim rates and staff's recommended PAA rates are shown on Schedules 4-A and 4-B.

ISSUE 24: In determining whether any portion of the interim increase granted should be refunded, how should the refund be calculated, and what is the amount of the refund, if any?

RECOMMENDATION: The proper refund amount should be calculated by using the same data used to establish final rates, excluding rate case expense. This revised revenue requirement for the interim collection period should be compared to the amount of interim revenues granted. Based on this calculation, the utility should be required to refund 9.36% of water and 7.03% of wastewater revenues collected under interim rates. The refund should be made with interest in accordance with Rule 25-30.360(4), Florida Administrative Code. The utility should treat any unclaimed refunds as CIAC pursuant to Rule 25-30.360(8), Florida Administrative Code. (REVELL)

STAFF ANALYSIS: By Order No. PSC-03-0196-PCO-WS, issued on February 10, 2003, the Commission authorized the collection of interim wastewater rates, subject to refund, pursuant to Section 367.082, Florida Statutes. The approved interim revenue requirements are shown below:

	Revenue Requirement	Revenue Increase	Percentage Increase
Water	$255,196	$140,644	122.78%
Wastewater	$339,167	$104,389	44.46%

According to Section 367.082, Florida Statutes, any refund should be calculated to reduce the rate of return of the utility during the pendency of the proceeding to the same level within the range of the newly authorized rate of return. Adjustments made in the rate case test period that do not relate to the period interim rates are in effect should be removed. An attrition allowance or rate case expense are examples of adjustments, which are recovered only after final rates are established.

In this proceeding, the test period for establishment of interim and final rates is the twelve month period ended December 31, 2001. Cypress Lakes' approved interim rates did not include any provisions for pro forma or projected operating expenses or plant. The interim increase was designed to allow recovery of actual interest costs, and the floor of the last authorized range for equity earnings.

To establish the proper refund amount, staff has calculated a revised interim revenue requirement utilizing the same data used to establish final rates. Rate case expense and the repression adjustments were excluded because those items are prospective in nature and did not occur during the interim collection period.

Using the principles discussed above, staff has calculated the interim revenue requirement for the interim collection period to be $231,563 for water and $315,327 for wastewater. The water and wastewater revenue levels are less than the interim revenues which were granted in Order No. PSC-03-0196-PCO-WS. Therefore, staff recommends a refund of 9.36% of interim rates for water and 7.03% for wastewater.

The refunds should be made with interest in accordance with Rule 25-30.360(4), F.A.C. The utility should be required to submit proper refund reports pursuant to Rule 25-30.360(7), F.A.C. The utility should treat any unclaimed refunds as CIAC pursuant to Rule 25-30.360(8), F.A.C.

ISSUE 25: Should the utility be required to file a tariff for reuse service, and if so, what is the appropriate reuse rate?

RECOMMENDATION: Yes, the utility should be required to file a tariff for reuse service. The appropriate reuse rate is a rate of $0, for the Cypress Lakes Golf Course (golf course). The utility should file revised tariff sheets which are consistent with the Commission's vote within one month of the Commission's final vote. The revised tariff sheets should be approved upon staff's verification that the tariffs are consistent with the Commission's decision. 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. (FITCH)

STAFF ANALYSIS: On April 23, 1996, Cypress Lakes Associates, Ltd. and the golf course owner entered a Declaration of Covenants, Conditions, Restrictions, and Easement Agreement. This agreement contained the rights of the utility to dispose of its effluent to the golf course. The effluent disposal to the golf course is considered a reuse service and the utility has not charged the Golf course for this service.

The golf course is currently the utility's only reuse customer. According to responses to staff's data request, the golf course is able to meet the utility's effluent disposal needs and the utility has no plans to expand its reuse service to residential customers in the near future. The Golf course is not a related party to the utility.

Generally, reuse rates cannot be determined in the same fashion as other water and wastewater rates set by the Commission. Reuse rates based on rate base and revenue requirements would typically be so high that it would be impractical to use reuse at all based on the revenue needed to supply the service. When staff considers recommending reuse rates, staff must consider the type of customer being served and balance the disposal needs of the utility with the consumption needs of the customer. In this case the only reuse customer is the golf course and the utility does not plan on expanding its reuse service to residential customers in the near future.

The next factor looked at was the disposal needs of the utility and customer. In cases where a utility has excess reuse capacity, rates typically would be set lower to encourage customers to use reuse at a level sufficient to meet the utility's disposal

needs. In cases where a utility's reuse capacity is unable to meet demand, rates would be set higher or rate structure would be changed in order to promote conservation. In this case, the golf course is able to meet the needs of the utility's disposal and currently is the utility's only disposal option.

The rational behind setting reuse rates is rapidly changing. Initially, reuse rates were set very low or at a rate of $0 to encourage acceptance and use. As reuse becomes more widely accepted and demand rises, utilities are considering charging or increasing existing rates to balance demand. In this case, it is clear that the utility views the golf course as a disposal site rather than a reuse customer. Having a reliable disposal site is obviously a benefit of the utility; however, the current rate of zero implies that there is no benefit to the golf course. Staff believes that there are some benefits to the golf course including the avoided cost of the golf course providing its own irrigation supply and benefits associated with obtaining future consumptive use permits.

Although staff believes that the golf course does benefit from reuse service, staff does not believe that setting a rate above zero is appropriate at this time. Because the golf course is the utility's only disposal option, staff is concerned that imposing a reuse rate on the golf course may cause the golf course to no longer accept reuse or reduce its reuse consumption. This could cause disposal problems for the utility and could lead to increased expenses for alternative disposal options. However, staff believes that the utility should be encouraged to begin negotiating with the golf course regarding charging for this service in the future. The utility should also request a charge for reuse service in its next rate proceeding.

Section 367.091(3), Florida Statutes, specifies that each utility's rates, charges, and customer service policies must be contained in a tariff approved by and on file with the Commission. Section 367.091(4), Florida Statutes, specifies that a utility may only impose and collect those rates and charges approved by the Commission for the particular class of service involved. Although the utility is charging a rate of $0 for reuse, reuse is a class of service provided by the utility and the utility should have a tariffed rate on file with the Commission even if that rate is $0.

Based on the above, staff believes that the utility should be required to file a tariff for reuse service and that the

appropriate reuse rate is a rate of $0 for the golf course. The utility should file revised tariff sheets which are consistent with the Commission's vote within one month of the Commission's final vote. The revised tariff sheets should be approved upon staff's verification that the tariffs are consistent with the Commission's decision. 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), F.A.C.

ISSUE 26: 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 rates should be reduced as shown on Schedule 4 to remove $7,576 for water and $7,331 for wastewater rate case expense, grossed-up for regulatory assessment fees, which is being 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. (REVELL)

STAFF ANALYSIS: Section 367.0816, Florida Statutes, requires rates to be reduced immediately following the expiration of the four-year amortization 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 $7,576 and $7,331 for water and wastewater, respectively. The decreased revenues will result in the rate reduction recommended by staff on Schedule 4.

The utility should be required to 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 25-40.475(1), F.A.C. 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.

If the utility files this reduction in conjunction with a price index or pass-through rate adjustment, separate data shall be filed for the price index and/ or pass-through increase or decrease, and for the reduction in the rates due to the amortized rate case expense.

ISSUE 27: Should the utility be required to show cause, in writing within 21 days, why it should not be fined $3,000 for its apparent violation of Rule 25-30.115, Florida Administrative Code, and Order Nos. PSC-00-1528-PAA-WU, issued August 23, 2000, and PSC-00-2388-AS-WU, issued December 31,2000, for its failure to maintain its books and records in conformance with the National Association of Regulatory Utility Commissioners (NARUC) Uniform System of Accounts (USOA)?

RECOMMENDATION: Yes. the utility should be required to show cause, in writing within 21 days, why it should not be fined $3,000 for its apparent violation of Rule 25-30.115, Florida Administrative Code, for its failure to maintain its books and records in conformance with the NARUC USOA. The order to show cause should incorporate the conditions stated below in the staff analysis.

(HARRIS, JOYCE, MERCHANT, VANDIVER)

STAFF ANALYSIS: In Audit Exception No. 12, the auditors stated that the utility's books and records continue to not be in substantial compliance with the NARUC USOA, and that the utility has not complied with Order Nos. PSC-00-1528-PAA-WU, issued August 23, 2000, and PSC-00-2388-AS-WU, issued December 31, 2000.

Rule 25-30.115, Florida Administrative Code, requires all water and wastewater utilities to maintain their accounts and records in conformance with the 1996 NARUC USOA. Accounting Instruction 2.A. of the NARUC USOA for Class B utilities states:

> Each utility shall keep its books of account, and all other books, records, and memoranda which support the entries in such books of account so as to be able to furnish readily full information as to any item included in any account. Each entry shall be supported by such detailed information as will permit a ready identification, analysis, and verification of all facts relevant thereto. (emphasis added)

Further, Accounting Instruction 3.D. of the NARUC USOA for Class B utilities states:

> The numbers prefixed to account titles are solely for convenience of reference and are not a part of the titles. Each utility may adopt such scheme of account

> numbers as it deems appropriate; provided, however, that it shall keep readily available a list of the account numbers and subdivisions of accounts which it uses and a reconciliation of such numbers and subdivisions with the account numbers and titles provided herein. Further, the records must be kept to permit classification or summarization of each accounting period according to the prescribed accounts. (emphasis added)
>
> Rule 25-30.450, F.A.C., states:
>
> In each instance, the utility must be able to support any schedule submitted, as well as any adjustments or allocations relied on by the utility. The work sheets, etc., supporting the schedules and data submitted must be organized in a systematic and rational manner so as to enable Commission personnel to verify the schedules in an expedient manner and minimum amount of time. The supporting work sheets, etc., shall list all reference sources necessary to enable Commission personnel to track to original source of entry into the financial and accounting system and, in addition, verify amounts to the appropriate schedules. (emphasis added)

Utilities, Inc. and its Florida subsidiaries have been cited in prior Commission Orders for failure to comply with one or both of the above-mentioned rules. See Orders Nos. PSC-95-0574-FOF-WS, issued May 9, 1995, in Docket No. 940917-WS, Utilities, Inc. of Florida; PSC-97-0531-FOF-WU, issued May 9, 1997, in Docket No. 960444-WU, Lake Utility Services, Inc.; PSC-96-0910-FOF-WS, issued July 15, 1996, in Docket No. 951027-WS, Lake Placid Utilities, Inc.; PSC-98-0524-FOF-SU, issued April 16, 1998, in Docket No. 971065-SU, Mid-County Services, Inc.; and PSC-00-1528-PAA-WU (Wedgefield Order) issued August 23, 2000, in Docket No. 991437-WS, Wedgefield Utilities, Inc.

In Order No. PSC-97-0531-FOF-WU, issued May 9, 1997, in Docket No. 960444-WU, the Commission placed the utility on notice that all of its Florida utilities owned or purchased in the future that are under our jurisdiction shall come into compliance or maintain their books and records in compliance with our rules and the NARUC Uniform Systems of Accounts. The Commission gave the utility a time certain for compliance with all of its Florida regulated utilities.

In the Wedgefield Order, the Commission stated that many of the problems the auditors encountered dealt with the utility's complex utility accounting system that must be converted to the NARUC-required format for each rate proceeding. The Commission found that this clearly was a violation of the requirements to keep the information readily available. In that case, the audit staff had to request the utility to reconcile numerous accounts because the account balances did not tie to the utility's general ledger. Despite the state of the utility's books and records in that case, the auditors were able to perform the audit. However, the condition of the books and records resulted in significant excess time in the field and a corresponding delay in completing the audit report.

Further, in the Wedgefield Order, the Commission found that the errors identified by the auditors constituted an apparent violation of Rule 25-30.115, F.A.C., "Uniform System of Accounts for Water and Wastewater Utilities" as well as an apparent violation of the Commission's mandate in Order No. PSC-97-0531-FOF-WU, which required that all jurisdictional subsidiaries of Utilities, Inc. be brought into compliance with this rule. The Commission, thus, ordered the utility to show cause why it should not be fined $3,000 for its apparent violation of Rule 25-30.115, F.A.C., and Order No. PSC-97-0531-FOF-WU for its failure to maintain its books and records in conformance with the NARUC USOA.

On September 13, 2000, the utility filed a response to the show cause order. The utility requested that the Commission waive the $3,000 fine and allow the utility to work with staff to resolve any discrepancies remaining after the 1998 modifications of its accounting system. Further, the utility asked the Commission to direct staff to perform a compliance audit of the books and records as of January 31, 2001.

By Order No. PSC-00-2388-AS-WU, issued December 31, 2000, the Commission accepted the utility's offer of settlement and permanently suspended the $3,000 fine. The utility was ordered to correct any remaining areas of noncompliance with the NARUC USOA by January 31, 2001. Further, the utility and its parent were ordered to file, in future proceedings before this Commission, MFRs which begin with utility book balances, and show all adjustments to book balances after the "per book" column in the MFRs. Additionally, the utility was ordered to file with its MFRs, a statement which affirms that the MFRs begin with actual book balances.

In the current docket, based on Audit Exception No. 12, the auditors stated that the utility's books and records continue to not be in substantial compliance with the NARUC USOA, and that the utility has not complied with Order Nos. PSC-00-1528-PAA-WU, issued August 23, 2000, and PSC-00-2388-AS-WU, issued December 31, 2000.

First, the auditors state that in Exception No. 1 of the Compliance Investigation, mentioned above, the utility was not in substantial compliance with the stipulated agreement approved in Order No. PSC-00-2388-AS-WU. The audit staff determined that the utility's response indicated that no change had been made to the accounting system to comply with the Commission Order.

Second, the auditors state that the utility's MFRs in this case do not comply with the filing requirements for future rate proceedings of the parent's Florida operations as stated in Order No. PSC-00-2388-AS-WS. Rate Base Schedules 1-A, Column (2) Balance per Books, which should be the balance in the utility's general ledger, begins with balances that the utility reports in its 2001 Annual Report. Further in Column (3), entitled Utility Adjustments, which should show all utility adjustments to its general ledger balance, is in most cases, the adjustment required to make the utility's general ledgers agree to its 2001 Annual Report and MFR filing.

Further, the auditors state that Order PSC-000-1528-PAA-WU specifically addressed the utility's noncompliance with NARUC Accounting Instruction 2. A. and Rule 25-30.450, F.A.C., concerning supporting documentation for the utility's books and records, schedules, and data that it files in rate proceedings. The utility continually lacked supporting documentation that should have been readily available to adequately determine the reasonableness of the utility's methodologies in calculating its customer equivalents (CE) percentages which are used to allocate common costs. For example, the auditors requested supporting documentation for the utility's allocation methodology three different times and was given two additional schedules that did not reconcile to the filing.

Finally, the auditors stated that the structure of the utility's accounting system continues to require significant amounts of the audit staff time to reconcile its MFR filing to its books and records. Because of the numerous accounts involved and the allocation methodologies applied, the staff auditors had to

spend extraordinary amounts of time in order to reconcile and test the reasonableness of the amounts and the allocation percentages.

In its response to the Cypress Lake's audit, the utility stated that it does not agree with this audit exception. The utility stated that it is not aware of any specific corrections required by staff of the PSC and if staff is aware of and specific differences that need to be corrected, the utility will work with staff pursuant with Commission's Order to correct these differences. The utility requests that any of the alleged differences that staff believes still exist be communicated in writing.

Section 367.161, Florida Statutes, authorizes the Commission to assess a penalty of not more than $5,000 for each offense, if a utility is found to have knowingly refused to comply with, or have willfully violated any Commission rule, order, or provision of Chapter 367, Florida Statutes. In failing to maintain its books and records in conformance with the USOA, the utility's act was "willful" within the meaning and intent of Section 367.161, Florida Statutes. In Order No. 24306, issued April 1, 1991, in Docket No. 890216-TL, titled In Re: Investigation Into The Proper Application of Rule 25-14.003, Florida Administrative Code, Relating To Tax Savings Refund For 1988 and 1989 For GTE Florida, Inc., the Commission having found that the company had not intended to violate the rule, nevertheless found it appropriate to order it to show cause why it should not be fined, stating that "[i]n our view, 'willful' implies an intent to do an act, and this is distinct from an intent to violate a statute or rule." Id. at 6. Additionally, "[i]t is a common maxim, familiar to all minds that 'ignorance of the law' will not excuse any person, either civilly or criminally." Barlow v. United States, 32 U.S. 404, 411 (1833).

The utility's failure to keep its books and records in conformance with the NARUC USOA is an apparent violation of Rule 25-30.115, Florida Administrative Code, and Order No. PSC-00-2388-AS-WU. Therefore, staff believes that a show cause proceeding is warranted at this time. Staff recommends that the Commission order the utility to show cause, in writing within 21 days, why it should not be fined $3,000 for its apparent violation of Rule 25-30.115, F.A.C., and Order No. PSC-00-2388-AS-WU.

Staff further recommends that the show cause order incorporate the following conditions: The utility's response to the show cause order must contain specific allegations of fact and law. Should

the utility file a timely written response that raises material questions of fact and makes a request for a hearing pursuant to Section 120.57(1), Florida Statutes, at which time further proceedings will be scheduled on this matter before a final determination is made. A failure to file a timely written response to the show cause order shall constitute an admission of the facts herein alleged and a waiver of the right to a hearing. In the event the utility fails to file a timely response to the show cause order, the penalty is deemed assessed with no further action required by the Commission. Reasonable collection efforts shall consist of two certified letters requesting payment. If the utility fails to respond to reasonable collection efforts by Commission staff, the collection of penalties should be referred to the Department of Financial Services for further collection efforts. The referral to the Department of Financial Services would be based on the conclusion that further collection efforts by this Commission would not be cost effective. If, however, the utility responds to the show cause by remitting the fine imposed by this Commission, no further action is required. Any collection of the fines imposed shall be deposited in the State General Revenue Fund pursuant to Section 367.161, Florida Statutes.

ISSUE 28: Should this docket be closed?

RECOMMENDATION: No. If no person whose substantial interests are affected by the PAA issues files a protest within twenty-one days of the issuance of the order, a consummating order will be issued. This docket should remain open pending completion of these matters: staff's verification that the revised tariff sheets and customer notice have been filed by the utility and approved by staff, the refund has been completed and verified by staff, and the disposition of the show cause recommendation in Issue 27. Once the tariff and refund actions are complete, the corporate undertaking may be released. When the PAA issues are final, the tariff and notice actions are complete, and the show cause has been resolved, this docket may be closed administratively. (GREENE, ECHTERNACHT, HARRIS)

STAFF ANALYSIS: If no person whose substantial interests are affected by the PAA issues files a protest within twenty-one days of the issuance of the order, a consummating order will be issued. This docket should remain open pending completion of these matters: staff's verification that the revised tariff sheets and customer notice have been filed by the utility and approved by staff, the refund has been completed and verified by staff, and the disposition of the show cause recommendation in Issue 27. Once the tariff and refund actions are complete, the corporate undertaking may be released. When the PAA issues are final, the tariff and notice actions are complete, and the show cause has been resolved, this docket may be closed administratively.

CYPRESS LAKES UTILITIES, INC.
SCHEDULE OF WATER RATE BASE
TEST YEAR ENDED 12/31/01

SCHEDULE NO. 1-A
DOCKET NO. 020407-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	$1,329,461	$0	$1,329,461	($94,670)	$1,234,791
2	UTILITY LAND AND LAND RIGHTS	$509	$0	$509	$0	$509
3	NON-USED & USEFUL COMPONENTS	$0	$0	$0	$0	$0
4	CWIP	$0	$0	$0	$0	$0
5	ACCUMULATED DEPRECIATION	($288,550)	$0	($288,550)	($161)	($288,711)
6	CIAC	($246,499)	$0	($246,499)	($18,100)	($264,599)
7	ACCUM. AMORTIZATION OF CIAC	$28,574	$5,565	$34,139	$3,364	$37,503
8	ACQUISITION ADJUSTMENTS	($267,107)	$267,107	$0	$0	$0
9	WORKING CAPITAL ALLOWANCE	$0	$12,804	$12,804	($2,006)	$10,798
	RATE BASE	$556,388	$285,476	$841,864	($111,574)	$730,290

CYPRESS LAKES UTILITIES, INC.
SCHEDULE OF WASTEWATER RATE BASE
TEST YEAR ENDED 12/31/01

SCHEDULE NO. 1-B
DOCKET NO. 020407-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	$2,252,159	$0	$2,252,159	($31,350)	$2,220,810
2	UTILITY LAND AND LAND RIGHTS	$0	$0	$0	$2,610	$2,610
3	NON-USED & USEFUL COMPONENTS	$0	($131,593)	($131,593)	($68,411)	($200,004)
4	CWIP	$160,381	($160,381)	$0	$0	$0
5	ACCUMULATED DEPRECIATION	($502,877)	$0	($502,877)	($4,417)	($507,294)
6	CIAC	($711,034)	$0	($711,034)	$0	($711,034)
7	ACCUM. AMORTIZATION OF CIAC	$58,598	$12,509	$71,107	$2,604	$73,711
8	ACQUISITION ADJUSTMENTS	($400,032)	$400,032	$0	$0	$0
9	WORKING CAPITAL ALLOWANCE	$0	$21,268	$21,268	($2,854)	$18,414
	RATE BASE	$857,195	$141,835	$999,030	($101,818)	$897,212

CYPRESS LAKES UTILITIES, INC.
ADJUSTMENTS TO RATE BASE
TEST YEAR ENDED 12/31/01

SCHED. NO. 1-C
DOCKET NO. 020407-WS

EXPLANATION	WATER	WASTEWATER
PLANT IN SERVICE		
1 Remove acquisition costs	($80,551)	($28,321)
2 Remove AFUDC and misc. plant adjustments	($6,413)	($29,586)
3 Adjust for UIF common rate base allocations	($17,187)	$16,539
4 Include WSC allocated rate base, net of depreciation	$9,481	$10,018
Total	($94,670)	($31,350)
LAND		
Reclassify land from organization costs	$0	$2,610
NON-USED AND USEFUL		
To reflect net non-used and useful adjustment	$0	(68,411)
ACCUMULATED DEPRECIATION		
1 Remove acquisition costs	($4,863)	($1,714)
2 Remove AFUDC and misc. plant adjustments	$724	$595
3 Adjust for UIF common rate base allocations	$3,978	($3,298)
Total	($161)	($4,417)
CIAC		
To reflect proper balance of CIAC	($18,100)	$0
ACCUM. AMORT. OF CIAC		
To reflect proper balance of CIAC & reserve balances	$3,364	$2,604
WORKING CAPITAL		
To reflect adjusted working capital using formula approach.	($2,006)	($2,854)

CYPRESS LAKES UTILITIES, INC.
CAPITAL STRUCTURE SIMPLE AVERAGE
TEST YEAR ENDED 12/31/01

SCHEDULE NO. 2
DOCKET NO. 020407-WS

	DESCRIPTION	TOTAL CAPITAL	SPECIFIC ADJUST-MENTS (Note 1)	SUBTOTAL CAPITAL	PRO RATA ADJUST-MENTS	CAPITAL RECONCILED TO RATE BASE	RATIO	COST RATE	WTD. COST
PER UTILITY									
1	LONG-TERM DEBT	$72,051,803	$0	$72,051,803	($71,230,357)	$821,446	44.62%	8.81%	3.93%
2	SHORT-TERM DEBT	$15,659,000	$0	$15,659,000	($15,480,552)	$178,448	9.69%	2.54%	0.25%
3	PREFERRED STOCK	$0	$0	$0	$0	$0	0.00%	0.00%	0.00%
4	COMMON EQUITY	$73,169,033	$0	$73,169,033	($72,334,933)	$834,100	45.31%	11.07%	5.02%
5	CUSTOMER DEPOSITS	$6,900	$0	$6,900	$0	$6,900	0.37%	6.00%	0.02%
6	DEFERRED INCOME TAXES	$0	$0	$0	$0	$0	0.00%	0.00%	0.00%
7	DEFERRED ITC'S-ZERO COST	$0	$0	$0	$0	$0	0.00%	0.00%	0.00%
8	**TOTAL CAPITAL**	$160,886,736	$0	$160,886,736	($159,045,842)	$1,840,894	100.00%		9.22%
PER STAFF									
9	LONG-TERM DEBT	$72,051,803	$0	$72,051,803	($71,330,390)	$721,413	44.33%	8.71%	3.86%
10	SHORT-TERM DEBT	$15,659,000	$0	$15,659,000	($15,502,216)	$156,784	9.63%	4.38%	0.42%
11	PREFERRED STOCK	$0	$0	$0	$0	$0	0.00%	0.00%	0.00%
12	COMMON EQUITY	$73,169,033	$0	$73,169,033	($72,436,434)	$732,599	45.01%	10.93%	4.92%
13	CUSTOMER DEPOSITS	$6,900	$0	$6,900	$0	$6,900	0.42%	6.00%	0.03%
14	DEFERRED INCOME TAXES	$0	$9,806	$9,806	$0	$9,806	0.60%	0.00%	0.00%
15	DEFERRED ITC'S-ZERO COST	$0	$0	$0	$0	$0	0.00%	0.00%	0.00%
16	**TOTAL CAPITAL**	$160,886,736	$9,806	$160,896,542	($159,269,040)	$1,627,502	100.00%		9.23%

Note 1. Reflect CLU specific deferred income taxes

	LOW	HIGH
RETURN ON EQUITY	9.93%	11.93%
OVERALL RATE OF RETURN	8.78%	9.68%

CYPRESS LAKES UTILITIES, INC.
STATEMENT OF WATER OPERATIONS
TEST YEAR ENDED 12/31/01

SCHEDULE NO. 3-A
DOCKET NO. 020407-WS

	DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUST-MENTS	ADJUSTED TEST YEAR PER UTILITY	STAFF ADJUST-MENTS	STAFF ADJUSTED TEST YEAR	REVENUE INCREASE	REVENUE REQUIREMENT
1	**OPERATING REVENUES**	$110,204	$165,286 140.50%	$275,490	($160,939)	$114,551	$122,955 107.34%	$237,506
	OPERATING EXPENSES:							
2	OPERATION &MAINTENANCE	$93,356	$9,074	$102,430	($16,050)	$86,380		$86,380
3	DEPRECIATION	$43,325	$0	$43,325	($3,831)	$39,494		$39,494
4	AMORTIZATION	$0	$0	$0	$0	$0		$0
5	TAXES OTHER THAN INCOME	$17,268	$11,012	$28,280	($11,250)	$17,030	$5,533	$22,563
6	INCOME TAXES	($28,449)	$52,368	$23,919	($46,427)	($22,508)	$44,186	$21,677
7	**TOTAL OPERATING EXPENSES**	$125,500	$72,454	$197,954	($77,559)	$120,395	$49,719	$170,114
8	**OPERATING INCOME**	($15,296)	$92,832	$77,536	($83,380)	($5,844)	$73,236	$67,392
9	**RATE BASE**	$556,388		$841,864		$730,290		$730,290
10	**RATE OF RETURN**	-2.75%		9.21%		-0.80%		9.23%

CYPRESS LAKES UTILITIES, INC.
STATEMENT OF WASTEWATER OPERATIONS
TEST YEAR ENDED 12/31/01

SCHEDULE NO. 3-B
DOCKET NO. 020407-WS

	DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUST-MENTS	ADJUSTED TEST YEAR PER UTILITY	STAFF ADJUST-MENTS	STAFF ADJUSTED TEST YEAR	REVENUE INCREASE	REVENUE REQUIREMENT
1	OPERATING REVENUES	$229,432	$131,823 53.87%	$361,255	($126,477)	$234,778	$79,463 33.85%	$314,241
	OPERATING EXPENSES							
2	OPERATION & MAINTENANCE	$161,412	$8,735	$170,147	($22,832)	$147,315		$147,315
3	DEPRECIATION	$35,990	($3,293)	$32,697	($6,353)	$26,344		$26,344
4	AMORTIZATION	$0	$0	$0	$0	$0		$0
5	TAXES OTHER THAN INCOME	$29,745	$7,989	$37,734	($10,155)	$27,579	$3,576	$31,154
6	INCOME TAXES	$780	$27,886	$28,666	($30,590)	($1,924)	$28,556	$26,632
7	TOTAL OPERATING EXPENSES	$227,927	$41,317	$269,244	($69,930)	$199,314	$32,132	$231,446
8	OPERATING INCOME	$1,505	$90,506	$92,011	($56,547)	$35,464	$47,331	$82,795
9	RATE BASE	$857,195		$999,030		$897,212		$897,212
10	RATE OF RETURN	0.18%		9.21%		3.95%		9.23%

CYPRESS LAKES UTILITIES, INC. SCHED. NO. 3-C
ADJUSTMENTS TO OPERATING INCOME DOCKET NO. 020407-WS
TEST YEAR ENDED 12/31/01

EXPLANATION	WATER	WASTEWATER
OPERATING REVENUES		
Remove requested final revenue increase	($160,939)	($126,477)
OPERATION & MAINTENANCE EXPENSE		
1 Excess unaccounted for water	($170)	$0
2 Overstated O&M expenses	(1,029)	(1,922)
3 Overstated common allocated expenses	(1,426)	(1,381)
4 Overstated salaries	(3,478)	(3,368)
5 Overstated pensions & benefits	(11,699)	(11,328)
6 Rate case expense	3,312	$3,205
7 Repression adjustment	(1,560)	(8,038)
Total	($16,050)	($22,832)
DEPRECIATION EXPENSE-NET		
1 Remove acquisition costs	($2,030)	($795)
2 Remove AFUDC and misc. plant adjustments	(392)	(1,506)
3 Adjust for UIF common rate base allocations	(256)	(247)
4 To adjust for non-used and useful plant	0	(1,490)
5 To reflect proper balance of CIAC	(1,153)	(2,315)
Total	($3,831)	($6,353)
TAXES OTHER THAN INCOME		
1 RAFs on revenue adjustments above	($7,242)	($5,691)
2 Non-used and useful property taxes	0	($583)
3 Payroll taxes on salary adjustment	(4,008)	(3,881)
Total	($11,250)	($10,155)
INCOME TAXES		
To adjust to test year income tax expense	($46,427)	($30,590)

CYPRESS LAKES UTILITIES, INC.
WATER MONTHLY SERVICE RATES
TEST YEAR ENDED 12/31/01

SCHEDULE NO. 4-A
DOCKET 020407-WS

	Rates Prior to Filing	Commission Approved Interim	Utility Requested Final	Staff Recomm. Final	4-Year Rate Reduction
Residential					
Base Facility Charge:					
5/8" x 3/4" meter	$3.82	$8.63	$9.19	$6.32	$0.20
Gallonage Charge, per 1,000 Gallons					
0-6,000 gallons	$0.82	$1.85	$1.97	$2.41	$0.08
6,001-12,000 gallons	$1.23	$2.78	$2.96	$3.62	$0.12
over 12,000 gallons	$1.64	$3.70	$3.94	$4.82	$0.15
General Service & Irrigation					
Base Facility Charge: By Meter Size					
5/8" x 3/4"	$3.82	$8.63	$9.19	$6.32	$0.20
1"	$9.55	$21.57	$22.98	$15.80	$0.50
1-1/2"	$19.10	$43.14	$45.95	$31.60	$1.01
2"	$30.56	$69.03	$73.52	$50.56	$1.61
3"	$57.30	$129.43	$137.85	$101.12	$3.23
4"	$95.50	$215.72	$229.75	$158.00	$5.04
6"	$191.00	$431.44	$459.50	$316.00	$10.08
Gallonage Charge, per 1,000 Gallons	$0.82	$1.85	$1.97	$2.63	$0.08
Typical Residential Bills					
5/8" x 3/4" Meter Size					
3,000 Gallons	$6.28	$14.18	$15.10	$13.55	
4,000 Gallons	$7.10	$16.03	$17.07	$15.96	
5,000 Gallons	$7.92	$17.88	$19.04	$18.37	
10,000 Gallons	$13.66	$30.85	$32.85	$35.26	

CYPRESS LAKES UTILITIES, INC.
WASTEWATER MONTHLY SERVICE RATES
TEST YEAR ENDED 12/31/01

SCHEDULE NO. 4-B
DOCKET 020407-WS

	Rates Prior to Filing	Commission Approved Interim	Utility Requested Final	Staff Recomm. Final	4-Year Rate Reduction
Residential					
Base Facility Charge:					
All meter sizes	9.52	13.75	14.65	$13.79	$0.32
Gallonage Charge - Per 1,000 gallons (8,000 gallon cap)	2.02	2.92	$3.11	$2.80	$0.07
General Service					
Base Facility Charge:					
Meter Size:					
5/8" x 3/4"	9.52	13.75	14.65	$13.79	$0.32
1"	23.81	34.4	36.63	$34.48	$0.80
1-1/2"	47.62	68.79	73.25	$68.97	$1.61
2"	76.19	110.07	117.2	$110.35	$2.57
3"	142.85	206.37	219.75	$220.69	$5.15
4"	238.09	343.95	366.25	$344.83	$8.04
6"	476.17	687.89	732.5	$689.66	$16.09
Gallonage Charge, per 1,000 Gallons	2.02	2.92	3.11	$3.36	$0.08
	Typical Residential Bills				
5/8" x 3/4" meter					
3,000 Gallons	$15.58	$22.51	$23.98	$22.20	
5,000 Gallons	$19.62	$28.35	$30.20	$27.81	
8,000 Gallons Residential Max	$25.68	$37.11	$39.53	$36.22	