

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation of possible overearnings by North Peninsula Utilities Corporation in Volusia County.

DOCKET NO. 030601-SU
ORDER NO. PSC-03-1001-PCO-SU
ISSUED: September 5, 2003

The following Commissioners participated in the disposition of this matter:

LILA A. JABER, Chairman
J. TERRY DEASON
BRAULIO L. BAEZ
RUDOLPH "RUDY" BRADLEY
CHARLES M. DAVIDSON

ORDER INITIATING INVESTIGATION INTO RATES AND CHARGES AND
MAKING REVENUES SUBJECT TO REFUND

BY THE COMMISSION:

BACKGROUND

North Peninsula Utilities Corporation (North Peninsula or utility) is a Class C wastewater utility serving approximately 548 customers in Volusia County. According to its 2002 annual report, the utility reported operating revenues of \$187,899 and operating expenses of \$161,307. This resulted in a net operating income of \$26,592.

By Order No. 16184, issued June 4, 1986, in Docket No. 850121-SU, the Commission processed a staff assisted rate case for this utility when the utility was known as Shore Utility Corporation. A transfer docket was opened in 1989 to transfer Shore Utility Corporation to North Peninsula. By Order No. 22345, issued December 27, 1989, in Docket No. 891016-SU, the Commission approved the transfer. Rate base was established during this transfer proceeding for book value of the property being transferred and did not include the normal ratemaking adjustments of working capital calculations and used and useful adjustments.

DOCUMENT NUMBER-DATE

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FPSC-COMMISSION CLERK

In addition to the mentioned docketed activities, the utility has taken advantage of price indexing and pass-through opportunities. North Peninsula received price index rate increases in 1991, 1992, 1993, 1994, 1995, 1996, 1998, 2000, 2001, and 2002. The utility also received pass-through rate increases in 1993, 1994, 1995, 1996, 1998, and 2000.

By Order No. PSC-97-0263-FOF-SU, issued March 11, 1997, in Docket No. 960984-SU, we found the utility to be overearning and ordered a refund (with interest) of index and pass-through increases which contributed to the utility overearning in 1995 and 1996, and also ordered a refund of interim revenues which were held subject to refund. Also, by Order No. PSC-00-1676-PAA-SU, issued September 19, 2000, in Docket No. 000715-SU, we found the utility to be overearning and ordered a refund, with interest, of the 1998 price index and pass-through rate increase.

A review of North Peninsula's 2002 annual report indicated that the utility may have exceeded its authorized rate of return. Based on results of its analysis, we believe it is necessary and appropriate to initiate an audit of the utility's books and records and an investigation into the potential overearning of this utility. We have jurisdiction pursuant to Sections 367.081 and 367.082, Florida Statutes.

INITIATION OF OVEREARNINGS INVESTIGATION

Section 367.082, Florida Statutes, authorizes this Commission to initiate an investigation of a utility's earnings upon a preliminary demonstration that the utility is earning a rate of return which is outside the range of reasonableness. To the extent that the achieved rate of return exceeds the authorized rate of return applied to rate base, we may require revenues to be collected subject to refund during the pendency of the investigation. See, Section 367.082(1) and (5), Florida Statutes.

Our preliminary analysis indicates that during 2002, the utility's wastewater system earned a 15.49% return. Using the utility's 2002 capital structure, the maximum of the range of reasonableness for the rate of return is 7.00%. Therefore, based

on the results of our preliminary analysis, we believe a full investigation of this utility's earnings is appropriate.

ANNUAL WASTEWATER REVENUES TO BE HELD SUBJECT TO REFUND

As mentioned previously, we believe that North Peninsula may be overearning. Pursuant to Section 367.082(5)(b)1., Florida Statutes, the achieved rate of return for setting revenues subject to refund shall be calculated by applying appropriate adjustments consistent with those used in the utility's most recent rate proceeding. The attached schedules illustrate our approved rate base, capital structure, and operating income amounts, which are discussed below.

RATE BASE

Pursuant to Rule 25-30.433(4), Florida Administrative Code, the averaging method used by this Commission to calculate rate base and the cost of capital for a Class C utility is the simple beginning and end-of-year average. The utility's 2002 Annual Report reflects North Peninsula's year-end financial data. Therefore, we have used the simple average of 2001 and 2002 to analyze the utility's wastewater system.

Accumulated Depreciation

The utility recorded an end-of-year accumulated depreciation balances of \$598,231 for 2002 and \$560,530 for 2001. Pursuant to Rule 25-30.433(4), we made an averaging adjustment to decrease accumulated depreciation by \$18,850. As a result, the accumulated depreciation balance is \$579,381.

Accumulated Amortization

The utility recorded a Contribution in Aid of Construction Accumulated Amortization end-of-year balances of \$492,182 for 2002 and \$463,007 for 2001. Pursuant to Rule 25-30.433(4), we made an averaging adjustment to decrease accumulated amortization by \$14,588. The resulting accumulated amortization balance is \$477,594.

Working Capital Allowance

Working Capital is defined as the investor-supplied funds necessary to meet operating expenses or going-concern requirements of the utility. Consistent with Rule 25-30.433(2), Florida Administrative Code, we find that the one-eighth of the O&M expense formula approach shall be used for calculating working capital allowance. Applying that formula, we find that the working capital allowance is \$16,320. This represents one-eighth of the average of 2001 and 2002 O&M expenses of \$127,978 and \$133,143, respectively.

Rate Base Summary

Based on our review, we find that the appropriate test year rate base is \$143,978. Rate base is shown on Schedule No. 1-A, attached to this Order and which are incorporated herein by reference.

COST OF CAPITAL

Consistent with Section 367.082(5)(b), Florida Statutes, the required rate of return shall be calculated using the last authorized rate of return on equity, the current embedded cost of fixed-rate capital and the actual cost of other sources of capital. This section also requires that the return on equity for an interim decrease shall be calculated using the maximum of the range of the utility's last authorized return on equity. In Order No. PSC-00-1676-PAA-SU, issued September 19, 2000, in Docket No. 000715-SU, we found it appropriate to establish a return on equity of 9.94%; however, North Peninsula's current capital structure is 100% debt. Therefore, the overall rate of return is based on the weighted cost of debt.

The utility's capital structure has been reconciled with our approved rate base. We find that the appropriate overall rate of return is 7.00%. Schedule 2, attached to this order, reflects our adjusted rate of return.

OPERATING INCOME

Operating Revenue

On August 1, 2002, the utility implemented a price index rate adjustment. Pursuant to Section 367.082(5)(b)1., Florida Statutes, any rate changes which occurred during the test year must be annualized in order to calculate the achieved rate of return. Therefore, we have annualized revenues using the year-end number of customers and the rates in effect at year end. Based on this calculation, we have decreased revenues by \$4,494.

Taxes Other Than Income

Taxes Other Than Income were decreased by \$202 to reflect Regulatory Assessment Fees (RAFs) on our annualized revenue discussed above. In addition, the adjustments caused a revenue decrease of \$12,797. The revenue decrease generates a reduction in RAFs of \$576.

REVENUE REQUIREMENT

Based on the adjustments, the revenue requirement should be \$170,608, which represents a decrease of \$12,797 or 6.98%. However, pursuant to Section 367.081(4)(d), Florida Statutes, the revenue associated with the price index rate adjustment remains subject to refund 15 months after the filing of the utility's annual report for the year the increase was implemented. As previously stated, North Peninsula implemented its price index increase, an annual increase of \$2,724, on August 1, 2002. The utility filed its 2002 Annual Report on May 3, 2003. Therefore, the revenues generated by the price index are subject to refund through August 3, 2004. Based on our analysis, we find that \$10,073 (\$12,797 - \$2,724) in revenues shall be held subject to refund pending the final determination by this Commission.

The adjustments to revenue, operating expenses, and revenue requirement are attached as Schedule No. 3-A, which are incorporated herein by reference.

APPROPRIATE SECURITY FOR REFUND

Pursuant to Section 367.082, Florida Statutes, when revenues are held subject to refund, the utility is authorized to continue collecting the previously authorized rates. We have found that the amount of potential overearnings on an annual basis is \$12,797. However, \$2,724 of the potential overearnings is a result of a 2002 price index. Pursuant to Section 367.081(4)(d), Florida Statutes, the revenues associated with the price index and pass-through rate adjustments are already subject to refund, and are not required to be protected by a bond or corporate undertaking. Therefore, only \$10,073 in annual wastewater revenues, shall be collected under guarantee, subject to refund with interest. Assuming an 8-month time frame, the potential refund amount is \$6,768.

We have analyzed the financial data of the utility in order to determine whether North Peninsula can support a corporate undertaking of \$6,768. The criteria for a corporate undertaking includes sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. The 2000, 2001, and 2002 annual reports of North Peninsula were used to determine the financial condition of the utility. Our analysis shows that the utility has minimal liquidity and interest coverage. While the utility has shown improvement by posting net income of nearly \$7,000 in 2002, this follows net losses of \$19,000 in 2001, and \$27,000 in 2000. In addition, North Peninsula has a negative equity balance of over \$300,000. Based upon this analysis, we find that the utility cannot support a corporate undertaking in the amount of \$6,768. Therefore, the utility shall provide a letter of credit, bond, or escrow agreement to guarantee the funds collected subject to refund.

If the security provided is an escrow account, the account shall be established between the utility and an independent financial institution pursuant to a written escrow agreement. The Commission shall be a party to the written escrow agreement and a signatory to the escrow account. The written escrow agreement shall state the following:

1. The account is established at the direction of this Commission for the purpose set forth above;
2. No withdrawals of funds shall occur without the prior approval of the Commission through the Director of the Commission Clerk and Administrative Services;
3. The account shall be interest bearing;
4. Information concerning that escrow account shall be available from the institution to the Commission or its representative at all times;
5. The amount of revenue subject to refund shall be deposited in the escrow account within seven days of receipt; and
6. Pursuant to Cosentino v. Elson, 263 So. 2d 253 (Fla 3d DCA 1972), escrow accounts are not subject to garnishments.

The utility shall deposit 3.69%, of wastewater revenues collected, into the escrow account each month to secure for a possible refund. The escrow agreement shall also state the following:

1. If a refund to the customers is required, all interest earned on the escrow account shall be distributed to the customers; and
2. If a refund to the customers is not required, the interest earned on the escrow account shall revert to the utility.

If the security provided is a bond or a letter of credit, said instrument shall be in the amount of \$6,768. If the utility chooses a bond as security, the bond shall state that it will be released or shall terminate only upon subsequent order of the Commission addressing overearnings or requiring a refund. If the utility chooses to provide a letter of credit as security, the letter of credit shall state that it is irrevocable for the period it is in effect and that it will be in effect until a final Commission order is rendered addressing overearnings or requiring a refund.

Irrespective of the type of security provided, the utility shall keep an accurate and detailed account of all monies it receives. Pursuant to Rule 25-30.360(6), Florida Administrative Code, the utility shall provide a report by the 20th day of each month indicating the monthly and total revenue collected subject to refund. Should a refund be required, the refund shall be with interest and undertaken in accordance with Rule 25-30.360, Florida Administrative Code.

In no instance shall maintenance and administrative costs associated with any refund be borne by the customers. These costs are the responsibility of, and shall be borne by, the utility. Finally, the utility shall be on notice that if it does not comply with the requirements stated in this Order, show cause proceedings will be initiated.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that an investigation of the wastewater rates and charges of North Peninsula Utilities Company shall be initiated. It is further

ORDERED that all matters contained in the schedules attached are by reference incorporated herein. It is further

ORDERED that North Peninsula Utilities Company shall provide the Commission with a bond or letter of credit in the amount of \$6,768, or an escrow agreement as set forth in the body of this Order, as a guarantee of funds collected subject to refund. It is further

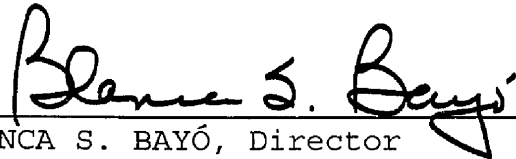
ORDERED that no later than the 20th of each month, North Peninsula shall file monthly reports consistent with the requirements set forth in the body of this Order. Should a refund be required, the refund shall be with interest and undertaken in accordance with Rule 25-30.360, Florida Administrative Code. It is further

ORDER NO. PSC-03-1001-PCO-SU
DOCKET NO. 030601-SU
PAGE 9

ORDERED that North Peninsula Utilities shall be on notice that failure to comply on a timely basis with the requirements of this Order will result in the initiation of a show cause proceeding. It is further

ORDERED that this docket shall remain open.

By ORDER of the Florida Public Service Commission this 5th Day of September, 2003.



BLANCA S. BAYÓ, Director
Division of the Commission Clerk
and Administrative Services

(S E A L)

KEF

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

ORDER NO. PSC-03-1001-PCO-SU
DOCKET NO. 030601-SU
PAGE 10

Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

Any party adversely affected by this order, which is preliminary, procedural or intermediate in nature, may request: (1) reconsideration within 10 days pursuant to Rule 25-22.0376, Florida Administrative Code; or (2) judicial review by the Florida Supreme Court, in the case of an electric, gas or telephone utility, or the First District Court of Appeal, in the case of a water or wastewater utility. A motion for reconsideration shall be filed with the Director, Division of the Commission Clerk and Administrative Services, in the form prescribed by Rule 25-22.060, Florida Administrative Code. Judicial review of a preliminary, procedural or intermediate ruling or order is available if review of the final action will not provide an adequate remedy. Such review may be requested from the appropriate court, as described above, pursuant to Rule 9.100, Florida Rules of Appellate Procedure.

NORTH PENINSULA UTILITIES CORP.		SCHEDULE NO. 1-A	
TEST YEAR ENDING 12/31/02 SCHEDULE OF WASTEWATER RATE BASE		DOCKET NO. 030601-SU	
DESCRIPTION	BALANCE PER UTILITY	COMMISSION ADJUST. TO UTIL. BAL.	BALANCE PER COMMISSION
1. UTILITY PLANT IN SERVICE	\$806,039	\$0	\$806,039
2. LAND & LAND RIGHTS	46,800	\$0	\$46,800
3. NON-USED AND USEFUL COMPONENTS	0	\$0	\$0
4. CIAC	(623,394)	\$0	(\$623,394)
5. ACCUMULATED DEPRECIATION	(598,231)	\$18,850	(\$579,381)
6. AMORTIZATION OF CIAC	492,182	(14,588)	\$477,594
7. WORKING CAPITAL ALLOWANCE	<u>0</u>	<u>\$16,320</u>	<u>\$16,320</u>
8. WASTEWATER RATE BASE	<u>\$123,396</u>	<u>\$20,582</u>	<u>\$143,978</u>

NORTH PENINSULA UTILITIES CORP. TEST YEAR ENDING 12/31/02 SCHEDULE OF CAPITAL STRUCTURE			SCHEDULE NO. 2 DOCKET NO. 030601-SU						
CAPITAL COMPONENT	PER UTILITY	SPECIFIC ADJUSTMENTS	BALANCE BEFORE PRO RATA ADJUSTMENTS	PRO RATA ADJUSTMENTS	BALANCE PER COMMISSION	PERCENT OF TOTAL	COST	WEIGHTED COST	
1. COMMON STOCK	\$100	\$0	\$100						
2. RETAINED EARNINGS	(301,852)	219,941	(\$81,911)						
3. PAID IN CAPITAL	400	0	\$400						
4. OTHER COMMON EQUITY	<u>81,411</u>	<u>0</u>	<u>\$81,411</u>						
5. TOTAL COMMON EQUITY	(\$219,941)	\$219,941	0	0	0	0.00%	9.94%	0.00%	
6. LONG TERM DEBT									
S. Comm. Bank	356,334	0	356,334	(212,356)	143,978	100.00%	7.00%	7.00%	
	0	0	0	0	0	0.00%	0.00%	0.00%	
	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>	
TOTAL LONG TERM DEBT	356,334	0	356,334	(212,356)	143,978	100.00%			
7. CUSTOMER DEPOSITS	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0.00%</u>	6.00%	<u>0.00%</u>	
8. TOTAL	<u>\$136,393</u>	<u>\$0</u>	<u>\$356,334</u>	<u>(\$212,356)</u>	<u>\$143,978</u>	<u>100.00%</u>		<u>7.00%</u>	
RANGE OF REASONABLENESS RETURN ON EQUITY OVERALL RATE OF RETURN						<u>LOW</u> <u>8.94%</u> <u>7.00%</u>	<u>HIGH</u> <u>10.94%</u> <u>7.00%</u>		

NORTH PENINSULA UTILITIES CORP. TEST YEAR ENDING 12/31/02 SCHEDULE OF WASTEWATER OPERATING INCOME			SCHEDULE NO. 3-A DOCKET NO. 030601-SU		
	TEST YEAR PER UTILITY	COMM. ADJ. PER UTILITY	COMMISSION ADJUSTED TEST YEAR	ADJUST. FOR DECREASE	REVENUE REQUIREMENT
1. OPERATING REVENUES	<u>\$187,899</u>	<u>(\$4,494)</u>	<u>\$183,405</u>	<u>(\$12,797)</u> -6.98%	<u>\$170,608</u>
OPERATING EXPENSES:					
2. OPERATION & MAINTENANCE	133,143	0	133,143	0	133,143
3. DEPRECIATION (NET)	8,526	0	8,526	0	8,526
4. AMORTIZATION	0	0	0	0	0
5. TAXES OTHER THAN INCOME	19,638	(202)	19,436	(576)	18,860
6. INCOME TAXES	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
7. TOTAL OPERATING EXPENSES	<u>\$161,307</u>	<u>(\$4,696)</u>	<u>\$161,105</u>	<u>(576)</u>	<u>\$160,529</u>
8. OPERATING INCOME/(LOSS)	<u>\$26,592</u>		<u>\$22,300</u>		<u>\$10,079</u>
9. WASTEWATER RATE BASE	<u>\$123,396</u>		<u>\$143,978</u>		<u>\$143,978</u>
10. RATE OF RETURN	<u>21.55%</u>		<u>15.49%</u>		<u>7.00%</u>