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Public Service Commission

December 8, 2003

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COMMISSION
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F. Marshall Deterding
Rose, Sundstrom & Bentley, LLP
2548 Blairstone Pines Drive
Tallahassee, FL 32301

Re: Investigation into 2002 Earnings of Residential Water Systems, Inc. of Marion County;
Docket No. 030423-WU

Dear Marty:

Attached is staff's response to your November 18, 2003 letter. This response is being offered in an attempt to work with the utility in reaching an equitable resolution to staff's investigation. If you have any questions, please call me at 413-6934 or Sam Merta at 413-642.

The opinions in this response are those of staff and do not bind the Commission's decision on any future matter in this case.

Sincerely,

Troy Rendell
Public Utilities Supervisor

TR:sm
Enclosure

- AUS
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cc: Robert C. Nixon, C.P.A.
Wayne Schiefelbein, Esquire
Charles deMenzes
Office of General Counsel (Jaeger)
Division of Commission Clerk and Administrative services (030423-WU)

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RESPONSE TO NOVEMBER 18, 2003 LETTER FROM M. DETERDING

COVER LETTER

3. The utility recorded \$172,514 in service revenues through October 31, 2003. The utility annualized this amount and projected \$207,017 for annual 2003 service revenues. The utility did not include \$6,239 in annualized other revenues. Staff projected \$219,357 in revenues for 2003 (\$211,322 service revenues + 8,035 other revenues). Staff will use the utility's projected revenues for 2003. Staff will update 2003 revenues to actual before the recommendation is filed.

ADJUSTMENTS TO RATE BASE

UTILITY PLANT IN SERVICE

1. Staff may include \$59,000 in Acct 304 in 2004 for the building. In its final recommendation, staff will include the requirement that this pro forma item be completed by December 31, 2004.

2. Staff may include \$69,847 (\$99,100 - 29,253 = \$69,847) in meters & services in 2004. In its final recommendation, staff will include the requirement that this pro forma item be completed by December 31, 2004. The contract was for \$120,000 (WP 16-16 p. 4); per WP 16-16 p. 4, \$20,900 was completed in 2002, therefore \$99,100 remains for 2003; however, of the \$20,900, the auditor documented only \$18,836 (WP 16 p. 1). In 2002, per WP 20-5 p. 1, \$6,340 of the \$18,836 was CIAC. Per Response to Data Request (RDR) 39 & 40, as of 10/8/03, \$29,253 of the \$99,100 was completed. In 2003, per RDR 52 c, \$2,275 of the \$29,253 was CIAC.

Of the \$69,847 not yet completed, how much will be CIAC?

3. \$4,920 was included in the 1997 Annual Report in Account 339, Other Plant & Miscellaneous Equipment. Staff may include this item in 1990.

4. \$3,084 was included in the 1997 Annual Report in Account 340, Office Furniture & Equipment. This item is fully depreciated. Staff may include this item in 1987.

5. Staff agrees and this would result in the retirement of

\$1,537 (\$6,397 - \$4,860 CIAC) in Account 334, Meters, in 2002.

6. Staff does not agree with this adjustment. Staff believes this adjustment is a double counting of Number 1. The distribution upgrade includes meter replacement. Therefore, the \$32,623 is included in the \$99,100. See WP 16-16, pages 4 & 15.

7. Staff does not agree with the removal of the averaging adjustment. Staff is using a projected 2003 average test year to calculate earnings.

8. Staff agrees that the update of the cost of fire flow upgrades to actual in 2003 is appropriate. The additional cost of \$1,818 is recorded in Account 311 (\$1,000 is CIAC per RDR 53)

CONTRIBUTIONS IN AID OF CONSTRUCTION

1. Staff does not agree with this adjustment. Per the auditor (WP 16-9 p. 4) the utility recorded \$4,930 in plant and \$7,750 in CIAC (WP 20-2 p6). The amounts should have been the same for plant and CIAC. The auditor took the conservative approach and recorded \$4,860 (the amount the utility documented) in plant and CIAC. This item is being retired.

2. Staff agrees that the CIAC related to meters \$4,860 in 2002 should be retired.

3. Staff does not agree with the removal of the averaging adjustment. Staff is using a projected 2003 average test year to calculate earnings.

4. Staff agrees that an additional \$1,000 in pumping equipment CIAC in 2003 should be allowed.

ACCUMULATED DEPRECIATION

1. If the \$4,920 Other Plant is included, \$3,075 should be recorded as accumulated depreciation per the 2002 Annual Report.

2. According to the 2002 Annual Report, the \$3,084 office furniture is fully depreciated. Therefore, \$3,084 should be recorded as accumulated depreciation.

3. Staff agrees with this adjustment and this would result in retirement of \$1,537 (\$6,397 - \$4,860 CIAC) in Account 334, Meters, in 2002.

4. Staff believes that the half year convention should be used and will calculate its own accumulated depreciation on the pro forma items.

5. Staff does not agree with the removal of the averaging adjustment. Staff is using a projected 2003 average test year to calculate earnings.

AMORTIZATION OF CIAC

1. Staff agrees that the CIAC related to meters \$4,860 in 2002 should be retired.

2. Staff believes that the half year convention should be used and will calculate its own amortization of the pro forma items.

3. Staff does not agree with this adjustment. The utility supported only \$4,860 in plant, therefore staff will use \$4,860 for the related CIAC and will calculate the appropriate amortization. This item is being retired.

4. Staff does not agree with the removal of the averaging adjustment. Staff is using a projected 2003 average test year to calculate earnings.

ADJUSTMENTS TO OPERATING INCOME

A. O&M Expense

1. The utility identified \$5,967 as the cost of health insurance and reduced this amount by \$399 to remove the deductible amount for a total of \$5,568. Included in staff's \$120,644 O&M expense is \$4,168 for health insurance. The utility should have reduced its adjustment by staff's \$4,168 and increased O&M by only \$1,400 for this item.

Staff's calculation is as follows: \$4,785 (reclassified from account 655) + 1,324 (recorded in account 604) - \$399 = \$5,710 = total cost of insurance. Staff allocated this amount among the utilities based on the number of hours the vice president works for each entity ($5,710 \times .73 = 4,168$). See RDR 2. The \$4,168 was indexed for 2003 and 2004.

B. Depreciation Expense

1. Staff will calculate depreciation and amortization expense

based on its adjusted plant and CIAC.

C. Taxes Other Than Income

1. Staff will calculate RAFs based on its revenue requirement.

D. Operating Revenue

1. Staff will calculate the decrease in revenue to achieve the appropriate rate of return.

RECONCILIATION OF CAPITAL TO RATE BASE

Long Term Debt

Staff may consider updating the Bobcat & Kubota, the Wachovia Bank and State of Florida loan balances in 2003 and 2004 if the utility provides proof of the 2003 balances.

Common Equity

In 2003, if the utility provides proof, staff may consider including the \$84,065 loan pay off as Paid in Capital plus \$26,978 (29,253 - 2,275 CIAC) for the distribution system upgrades. Staff may also consider including \$69,847 plus \$59,000 as Paid in Capital in 2004 for the remaining distribution system upgrades and the building.

The utility must provide documentation to confirm the pay off of the Wachovia loan and the current loan balances.

Retained Earnings

Staff does not agree with this adjustment. Per the Finance Section, we do not know how the utility will invest its earnings.

Customer Deposits

Staff will update the amount of customer deposits based on the projected number of new customers for 2003 and 2004.

CJNW RECALCULATION - DETAIL OF EXPENSES 2003 TEST YEAR

(604) Pensions & Benefits - Staff does not agree with this adjustment. Staff will not include life insurance on the president because the stock purchase agreement requires that the seller be beneficiary and therefore there is no benefit to ratepayers (WP 45 p.3). Staff included \$4,223 in 2003 in this account for the vice president's health insurance.

(615) Purchased Power - Staff does not agree with this adjustment. Staff reduced this account in 2002 for unaccounted for water. Staff did not make an unaccounted for water adjustment in 2003 or 2004. Staff included \$6,107 in 2003.

(618) Chemicals - Staff does not agree with this adjustment. Staff reduced this account in 2002 for unaccounted for water. Staff did not make an unaccounted for water adjustment in 2003 or 2004. Staff included \$652 in 2003.

(631) Contract Services - Professional - Staff agrees that an additional \$1,500 for additional accounting services is appropriate and should be included. If the utility can provide more detail on the what the legal services are for and a breakdown of the added expense, staff may consider adding the \$2,000 in legal expense or staff may amortize it over 5 years.

Please provide additional detail and a breakdown of the legal expenses requested.

(675) Miscellaneous - Staff does not agree with the addition of \$3,000 in bank charges and payroll service charges. Per the Audit Report at page 14, the \$1,740 recorded in the utility's trial balance in Account 675002, identified as bank charges, was interest expense. In addition, this was verified by the auditor in an e-mail.

Provide documentation for the \$2,509 claimed for 2003. In 2003, in what account are these charges being recorded?

Depreciation - Staff will calculate depreciation based on its rate base.

Taxes Other Than Income - Staff will calculate the RAF based on its recommendation on revenues. Staff agrees and this would result in an increase to property tax

of \$996 to recommend \$3,260 in 2003.

Staff agrees and this would result in the decrease of real estate tax by \$108 to recommend \$305 in 2003.

The utility did not include FUTA and SUTA taxes in its calculation of payroll taxes. Therefore, staff may include \$6,627 for payroll taxes.