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Public Service Commission
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TALLAHASSEE, FLORIDA 32399-0850

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

DATE: February 5, 2004
TO: Director, Division of the Commission Clerk & Administrative Services (Bayó)
FROM: Division of Economic Regulation (Greene, Floyd, Joyce, Merchant, Walden)
Division of Auditing & Safety (Vandiver)
Office of the General Counsel (Jaeger)
RE: Docket No. 020567-WS – Investigation of possible overearnings by Lake Groves Utilities, Inc. in Lake County.

AGENDA: 02/17/04 – Regular Agenda – Interested Persons May Participate

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\020567.RCM.DOC

Case Background

Lake Groves Utilities, Inc. (Lake Groves or utility) was a Class B utility providing water and wastewater service to approximately 2,248 water and 2,088 wastewater customers in Lake County. According to its 2001 annual report, the utility's operating revenue was \$750,622 for water and \$520,309 for wastewater, and the net operating income was \$324,624 for water and \$265,888 for wastewater. The utility is located in a Severe Water Shortage Area as designated by the St. Johns River Water Management District (SJRWMD).

Lake Groves was issued an original certificate pursuant to Order No. 24283, issued March 25, 1991, in Docket No. 900957-WS, In Re: Application for Water and Sewer Certificates in Lake County by Lake Groves Utilities, Inc. The initial rates and charges of the utility were set in Order No. 24283.

DOCUMENT NUMBER-DATE

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FPSC-COMMISSION CLERK

Docket No. 020567-WS

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By Order No. PSC-99-0164-FOF-WS, issued January 26, 1999, in Docket No. 980958-WS, In Re: Application for Transfer of Majority Organizational Control of Lake Groves Utilities, Inc. in Lake County to Utilities, Inc., the Commission approved the transfer to Utilities, Inc. (UI). In that order, the Commission ordered UI to adopt and use the rates, classification, and regulations of Lake Groves.

Based on staff's review of the utility's 2001 Annual Report, Lake Groves achieved a 35.19% overall rate of return on its water rate base, which equated to a 76.26% return on equity (ROE). For wastewater, Lake Groves had an achieved 8.37% overall rate of return, or an 11.54% ROE. Based on this analysis, the Commission initiated an investigation into potential water overearnings of Lake Groves. See Order No. PSC-02-1011-PCO-WS, issued July 26, 2002, in this current docket.

On July 11, 2002, the utility filed an application to request approval of a name change and acknowledgement the corporate merger of Lake Groves with Lake Utility Services, Inc. (LUSI). By Order No. PSC-02-1658-FOF-WS, issued November 26, 2002, in Docket No. 020695-WS, In Re: Application for name change on Certificate No. 465-S in Lake County from Lake Groves Utilities, Inc. to Lake Utility Services, Inc., the Commission approved the merger and LUSI is the name of the surviving subsidiary. The surviving entity remains under the control of UI.

Based on the 2002 Annual Report, which includes the combined operations of both utilities, LUSI provides service to approximately 6,071 water and 2,192 wastewater customers. According to its 2002 annual report, the utility's operating revenue was \$1,627,914 for water and \$569,028 for wastewater. The net operating income for 2002 was \$319,371 and \$150,020 for water and wastewater, respectively.

Given the merger and material plant improvements that the utility communicated was occurring in 2002, staff requested an audit of the combined entity for the year ended December 31, 2002. Based on an analysis of the audit, staff does not believe that the utility exceeded a fair return on its investment and, accordingly, recommends that this investigation should be closed.

The Commission has jurisdiction pursuant to Sections 367.081, 367.082 and 367.121, Florida Statutes.

Discussion of Issues

Issue 1: In determining whether the Lake Groves water system exceeded a fair return on its investment, should the Commission update the test year and consider the total earnings of the newly merged entity of LUSI?

Recommendation: Yes. The test year ended December 31, 2002, is appropriate given the material additions to water plant and to reflect the merger of Lake Groves into LUSI in 2002. Staff's investigation of the calendar year 2002 indicates that the water system for the combined entity is earning a return within the overall range of the required rate of return, using the current leverage formula. Accordingly, staff recommends that the investigation should be closed and the corporate undertaking guaranteeing the revenue held subject to refund should be released. (GREENE, MERCHANT)

Staff Analysis: Pursuant to Order No. PSC-02-1011-PCO-WS, the Commission initiated a full investigation of Lake Groves' water system earnings and held \$397,548 of revenues subject to refund pending the conclusion of the investigation. The Commission also determined that the test year for the investigation would be the year ended December 31, 2001. The Commission's decision to hold water revenues subject to refund was made at the Agenda Conference on July 9, 2002, two days prior to the utility's filing for approval of the merger of Lake Groves and LUSI.

Upon the Commission's decision to open an investigation into the earnings, the utility informed staff of their pending interconnection of the LUSI and Lake Groves water systems. The utility also addressed the plan to interconnect many of the smaller water systems that made up LUSI. Concurrently, staff became aware that the SJRWMD was carefully monitoring both systems' water withdrawal levels and that the Lake Groves consumptive use permit was coming up for renewal. Given the above circumstances and the major changes occurring, staff believed it was appropriate to review the combined earnings of the two water systems for 2002. Staff believes that the 2002 test year was more representative for rate setting purposes and this analysis is consistent with the method used in choosing a test year for a file and suspend rate case. As such, staff requested an audit for the 2002 test year.

Staff notes that both water systems have very low rates, particularly the gallonage charges, as follows:

	Base Facility Charge 5/8"x3/4" <u>Meter Size</u>	Gallonage Charge, Per <u>1,000 gallons</u>
Lake Groves	\$12.18	\$1.21
LUSI	\$5.97	\$0.69

A review of the audit and discovery received from the utility for the calendar year 2002 shows that the water system for the combined entity earned a 9.35% return, which is within the

overall range of the required rate of return (8.81% to 9.58%). Staff's analysis also shows that the wastewater system earned a 2.40% overall rate of return for 2002. For informational purposes, the total company overall rate of return for both water and wastewater is 6.66%. In our analysis, staff used the midpoint of the current leverage formula in effect pursuant to Order No. PSC-03-0707-PAA-WS, issued June 13, 2003, in Docket No. 030006-WS, In Re: Water and wastewater industry annual reestablishment of authorized range of return on common equity for water and wastewater utilities pursuant to Section 367.081(4)(f), Florida Statutes.

Staff has had recent conversations with the SJRWMD regarding the Lake Groves consumptive use permit status. SJRWMD has indicated to staff that it is considering conservation rate structure requirements and programs, as well as wastewater reuse requirements for Lake Groves. Once the permit renewal process is finalized by the SJRWMD, the utility will need to consider its options and address whether a rate case or rate restructuring docket is appropriate at that time.

Based on the above, it does not appear that the utility has exceeded a fair return on its investment based on the 2002 test year. Accordingly, staff recommends that the investigation docket should be closed and the corporate undertaking guaranteeing the revenue held subject to refund should be released to the utility.

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Issue 2: Should this docket be closed?

Recommendation: Yes, if the Commission approves staff's recommendation in Issue 1, there are no further actions to be taken, and this docket should be closed. (JAEGER)

Staff Analysis: If the Commission approves staff's recommendation in Issue 1, there are no further actions to be taken, and this docket should be closed.