

State of Florida



# Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

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COMMISSION  
CLERK

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

**DATE:** July 6, 2006

**TO:** Director, Division of the Commission Clerk & Administrative Services (Bayó)

**FROM:** Division of Economic Regulation (Fletcher, Rendell, Springer) *DBS* *ma*  
Office of the General Counsel (Jaeger) *ALM*

**RE:** Docket No. 060256-SU – Application for increase in wastewater rates in Seminole County by Alafaya Utilities, Inc.

**AGENDA:** 07/18/06 – Regular Agenda – Decision on Suspension of Rates and on Interim Rates – Participation is at the Discretion of the Commission

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICER:** Arriaga

**CRITICAL DATES:** 07/18/06 (60-Day Suspension Date)

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\060256.RCM.DOC

### Case Background

Alafaya Utilities, Inc. (Alafaya or utility) is a Class A utility providing wastewater service to approximately 8,482 customers in Seminole County. Water service is provided in the area by the City of Oviedo. Wastewater rates were last established for this utility in its 2002 rate proceeding.<sup>1</sup>

On May 15, 2006, Alafaya filed the Application for Rate Increase at issue in the instant docket. The utility had a few deficiencies in the Minimum Filing Requirements (MFRs). As of

<sup>1</sup>See Order No. PSC-04-0363-PAA-WS, issued April 5, 2004, in Docket No. 020408-SU, In re: Application for rate increase in Seminole County by Alafaya Utilities, Inc. That Order was consummated by Order No. PSC-04-0435-CO-SU, issued April 28, 2004.

the filing of this recommendation, those deficiencies remain outstanding. The utility requested that the application be processed using the Proposed Agency Action (PAA) procedure and requested interim rates. The test year established for interim and final rates is the 13-month average period ending December 31, 2005.

Alafaya requested interim rates designed to generate annual revenues of \$3,475,879. This represents a revenue increase on an annual basis of \$617,794 (21.62%) for wastewater. The utility requested final rates designed to generate annual revenues of \$4,195,278. This represents a revenue increase of \$1,337,192 (46.79%).

The original 60-day statutory deadline for the Commission to suspend the utility's requested final rates was July 14, 2006. However, by letter dated June 5, 2006, the utility agreed to extend the statutory time frame by which the Commission is required to address Alafaya's interim rate request. This recommendation addresses the suspension of Alafaya's requested final rates and the utility's requested interim rates. The Commission has jurisdiction pursuant to Sections 367.081 and 367.082, Florida Statutes (F.S.).

**Discussion of Issues**

**Issue 1:** Should the utility's proposed final wastewater rates be suspended?

**Recommendation:** Yes. Alafaya's proposed final water and wastewater rates should be suspended. (Fletcher)

**Staff Analysis:** Section 367.081(6), F.S., provides that the Commission may, for good cause, withhold consent to the implementation of the requested rates by a vote to that effect within 60 days after the date the rate request is filed. Further, Section 367.081(8), F.S., permits the proposed rates to go into effect (secured and subject to refund) at the expiration of five months if: (1) the Commission has not acted upon the requested rate increase; or (2) if the Commission's PAA action is protested by a party other than the utility.

Staff has reviewed the filing and has considered the information filed in support of the rate application and the proposed final rates. Staff recommends that it is necessary to require further investigation of this information, including on-site investigations by staff accountants and engineers. Based on the foregoing, staff recommends that it is appropriate to suspend the utility's proposed rate increase.

**Issue 2:** Should any interim revenue increase be approved?

**Recommendation:** Yes, the utility should be authorized to collect annual wastewater revenues as indicated below: (Fletcher)

	<u>Adjusted Test Year Revenues</u>	<u>\$ Increase</u>	<u>Revenue Requirement</u>	<u>% Increase</u>
Wastewater	\$2,858,086	\$539,070	\$3,397,156	18.86%

**Staff Analysis:** The utility has filed rate base, cost of capital, and operating statements to support its requested wastewater increase. Pursuant to Section 367.082(5)(b)1, F.S., the achieved rate of return for interim purposes must be calculated by applying adjustments consistent with those used in the utility’s most recent rate proceeding and annualizing any rate changes. Staff has reviewed the utility’s interim request, as well as Order No. PSC-04-0363-PAA-SU, in which the Commission last established rate base. Staff’s recommended adjustments are discussed below. Staff has attached accounting schedules to illustrate staff’s recommended rate base, capital structure, and test year operating income amounts. The rate base schedule is labeled as Nos. 1-A, with the adjustment schedule on 1-B. The capital structure schedule is No. 2, and the operating income schedule is labeled as No. 3-A, with the adjustments shown on No. 3-B.

RATE BASE

Based on an analysis of the MFRs and Order No. PSC-04-0363-PAA-SU from the utility’s last rate proceeding, staff believes that one adjustment is necessary to the utility’s rate base. Rule 25-30.433(2), Florida Administrative Code (F.A.C.), states that Class A utilities shall calculate its working capital allowance using the balance sheet approach. On MFR Schedule A-17, Alafaya reflected a 13-month average balance of \$311,419 for “Accounts and Notes Receivable, Less provision for Uncollectible Accounts.” However, on MFR Schedule A-18, the utility reflected a 13-month average balance of \$311,419 for accounts receivable and \$1,414 for allowance for bad debts. As such, Alafaya did not offset its allowance for bad debts against its accounts receivable in the working capital allowance. Therefore, staff recommends that Alafaya’s working capital allowance should be reduced by \$1,414, and its interim wastewater rate base should be \$6,047,665.

COST OF CAPITAL

On MFR Schedule D-2, Alafaya reflected a 13-month average balance of \$1,264 for accumulated deferred income taxes (ADITs). This amount was derived by a negative 2004 year-end balance of \$10,600 and a positive 2005 year-end balance of \$143,632. However, according to MFR Schedule A-19, the utility reflected a 13-month average ADITs balance of \$20,833. On MFR Schedules A-19 and C-6, the utility reflected a positive 2004 year-end of \$10,600 for ADITs. Thus, Alafaya understated its ADITs in the capital structure because of an apparent typographical error for the 2004 year-end ADITs balance. Therefore, staff recommends that the utility’s 13-month average ADITs balance should be increased by \$19,569 (\$20,833 less 1,264).

In its interim request, Alafaya used a 10.47% return on equity (ROE) which is the minimum of the range of its last authorized ROE. Based on the above, staff recommends that the interim weighted average cost of capital is 8.10%.

#### NET OPERATING INCOME

Based on its review, staff is recommending two adjustments to operating expenses. First, on MFR Schedule B-15, Alafaya reflected historical per book regulatory assessment fees (RAFs) of \$114,373. Using the 4.50% RAF rate pursuant to Section 367.145, F.S., and Rule 25-30.120, F.A.C., staff calculated RAFs of \$125,151. As such, the utility's historical per book RAFs are understated and should be increased by \$10,778.

Second, on MFR Schedule A-2, the utility made an adjustment to reflect non-used and useful plant. However, Alafaya did not make any corresponding non-used and useful adjustments to depreciation expense and property tax expense. Rule 25-30.433(5), F.A.C., states that non-used and useful adjustments shall be applied to the applicable depreciation expense and property tax expense. Section 367.082(5)(b)1, F.S., states that the achieved rate of return is calculated by applying adjustments consistent with the utility's last rate proceeding. By Order No. PSC-04-0363-PAA-SU, p. 49, the Commission made adjustments to remove depreciation expense and property tax expense associated with non-used and useful plant in Alafaya's last rate case. Therefore, staff recommends that depreciation expense and property tax expense should be reduced by \$12,205 and \$2,193, respectively.

Based on the above, staff recommends that the appropriate test year operating income, before any revenue increase, is \$168,903.

#### REVENUE REQUIREMENT

Based on the above adjustments, staff recommends revenue requirements of \$3,397,156 which represents interim increase in annual revenues of \$539,070 (or 18.86%). This will allow the utility the opportunity to recover its wastewater operating expenses and earn a 8.10% return on its wastewater rate base.

**Issue 3:** What are the appropriate interim wastewater rates?

**Recommendation:** The wastewater service rates for Alafaya in effect as of December 31, 2005, should be increased by 18.92% to generate the recommended revenue increase for the interim period. The approved rates should be effective for service rendered as of the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1)(a), F.A.C., provided customers have received notice. The rates should not be implemented until staff verifies that the tariff sheets are consistent with the Commission decision, the proposed customer notice is adequate, and the required security has been filed. The utility should provide proof of the date notice was given within 10 days after the date of notice. (Fletcher)

**Staff Analysis:** Staff recommends that interim wastewater service rates for Alafaya be designed to allow the utility the opportunity to generate annual operating revenues of \$3,397,156 for wastewater operations. Before removal of miscellaneous revenues, this would result in an increase of \$539,070 or 18.86%. To determine the appropriate percentage increase to apply to the service rates, miscellaneous service revenues should be removed from the test year revenues. The calculation is as follows:

	<u>Wastewater</u>
1 Total Test Year Revenues	\$2,858,086
2 Less: Miscellaneous Revenues	<u>8,963</u>
3 Test Year Revenues from Service Rates	\$2,849,123
4 Revenue Increase	<u>\$539,070</u>
5 % Service Rate Increase (Line 4/Line3)	<u>18.92%</u>

The interim rate increase of 18.92% for wastewater should be applied as an across-the-board increase to the service rates in effect as of December 31, 2005. The approved rates should be effective for service rendered as of the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1), F.A.C., provided customers have received notice. The rates should not be implemented until staff verifies that the tariff sheets are consistent with the Commission decision, the proposed customer notice is adequate, and the required security has been filed. The utility should provide proof of the date notice was given within 10 days after the date of notice.

The utility's test year, proposed interim and final rates, and staff's recommended interim rates are shown on Schedule No. 4.

**Issue 4:** What is the appropriate security to guarantee the interim increase?

**Recommendation:** A corporate undertaking is acceptable contingent upon receipt of the written guarantee of the parent company, Utilities, Inc. (UI), and written confirmation of UI's continued attestation that it does not have any outstanding guarantees on behalf of UI-owned utilities in other states. UI should be required to file a corporate undertaking on behalf of its subsidiaries to guarantee any potential refunds of revenues collected under interim conditions. UI's total guarantee should be a cumulative amount of \$718,575, which includes an amount of \$319,065 subject to refund in this docket. Pursuant to Rule 25-30.360(6), F.A.C., the utility should provide a report by the 20th of each month indicating the monthly and total revenue collected subject to refund. Should a refund be required, the refund should be with interest and undertaken in accordance with Rule 25-30.360, F.A.C. (Fletcher, Springer)

**Staff Analysis:** Pursuant to Section 367.082, F.S., revenues collected under interim rates shall be placed under bond, escrow, letter of credit, or corporate undertaking subject to refund with interest at a rate ordered by the Commission. As recommended in Issue 2, the total annual interim increase is \$539,070. In accordance with Rule 25-30.360, F.A.C., staff has calculated the potential refund of revenues and interest collected, under interim conditions to be \$319,065. This amount is based on an estimated seven months of revenue being collected from staff's recommended interim rates over the utility's current authorized rates shown on Schedule No. 4.

Alafaya is a wholly-owned subsidiary of UI, which provides all investor capital to its subsidiaries. UI has requested a corporate undertaking to secure any interim increases granted in Dockets Nos. 060254-SU, 060255-SU, 060256-SU, 060257-WS, 060258-WS, 060260-WS, 060261-WS, and 060262-WS. As such, staff reviewed the financial statements of the parent company. As a result of staff's interim recommendations in all of the above dockets, the total requested cumulative corporate undertaking amount is \$718,575, which includes \$319,065 subject to refund for this docket.

The criteria for a corporate undertaking includes sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. Staff has reviewed UI's financial statements from 2003 to 2005 to determine the financial condition of the parent company. Staff's analysis shows that UI has experienced a significant decline in liquidity and interest coverage during 2005 compared to prior years. However, UI's average equity ratio over the three-year period has been 40%. Additionally, net income has been on average six times greater than the requested cumulative corporate undertaking amount. UI's financial performance has demonstrated adequate levels of both profitability and equity capitalization to offset the recent decline in liquidity and interest coverage. Based upon this analysis, staff recommends that a cumulative corporate undertaking of \$718,575 is acceptable contingent upon the receipt of the written guarantee of UI and written confirmation that UI does not have any outstanding guarantees on behalf of UI-owned utilities in other states.

Pursuant to Rule 25-30.360(6), F.A.C., 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 should be with interest and undertaken in accordance with Rule 25-30.360, F.A.C.

Docket No. 060256-SU

Date: July 6, 2006

In no instance should maintenance and administrative costs associated with any refund be borne by the customers. The costs are the responsibility of, and should be borne by, the utility.



Docket No. 060256-SU

Date: July 6, 2006

**Issue 5:** Should the docket be closed?

**Recommendation:** No. The docket should remain open pending the Commission's final action on the utility's requested rate increase. (Fletcher, Jaeger)

**Staff Analysis:** The docket should remain open pending the Commission's final action on the utility's requested rate increase.

Alafaya Utilities, Inc. Schedule of Wastewater Rate Base Test Year Ended 12/31/05				Schedule No. 1-A Docket No. 060256-SU Interim	
Description	Test Year Per Utility	Utility Adjust- ments	Adjusted Test Year Per Utility	Staff Adjust- ments	Staff Adjusted Test Year
1 Plant in Service	\$21,402,133	\$0	\$21,402,133	\$0	\$21,402,133
2 Land and Land Rights	60,843	0	60,843	0	60,843
3 Non-used and Useful Components	0	(75,568)	(75,568)	0	(75,568)
4 Accumulated Depreciation	(6,497,520)	0	(6,497,520)	0	(6,497,520)
5 CIAC	(13,634,102)	0	(13,634,102)	0	(13,634,102)
6 Amortization of CIAC	4,483,331	0	4,483,331	0	4,483,331
7 CWIP	356,711	(356,711)	0	0	0
8 Working Capital Allowance	<u>0</u>	<u>309,962</u>	<u>309,962</u>	<u>(1,414)</u>	<u>308,548</u>
9 <b>Rate Base</b>	<u>\$6,171,396</u>	<u>(\$122,317)</u>	<u>\$6,049,079</u>	<u>(\$1,414)</u>	<u>\$6,047,665</u>

Docket No. 060256-SU

Date: July 6, 2006

Alafaya Utilities, Inc. Adjustments to Rate Base Test Year Ended 12/31/05	Schedule No. 1-B Docket No. 060256-SU Interim
Explanation	Wastewater
<u>Working Capital</u> To offset account receivables with bad debt allowance.	<u>(\$1,414)</u>

Alafaya Utilities, Inc. Capital Structure-Simple Average Test Year Ended 12/31/05							Schedule No. 2 Docket No. 060256-SU Interim		
Description	Total Capital	Specific Adjustments	Subtotal Adjusted Capital	Prorata Adjustments	Capital Reconciled to Rate Base	Ratio	Cost Rate	Weighted Cost	
<b>Per Utility</b>									
1 Long-term Debt	\$133,025,102	\$0	\$133,025,102	(\$129,585,817)	\$3,439,285	56.86%	6.65%	3.78%	
2 Short-term Debt	4,522,923	0	4,522,923	(4,405,961)	116,962	1.93%	6.62%	0.13%	
3 Preferred Stock	0	0	0	0	0	0.00%	0.00%	0.00%	
4 Common Equity	91,510,699	0	91,510,699	(89,144,803)	2,365,896	39.11%	10.47%	4.09%	
5 Customer Deposits	125,672	0	125,672	0	125,672	2.08%	6.00%	0.12%	
6 Deferred Income Taxes	<u>1,264</u>	<u>0</u>	<u>1,264</u>	<u>0</u>	<u>1,264</u>	<u>0.02%</u>	0.00%	<u>0.00%</u>	
7 <b>Total Capital</b>	<u>\$229,185,660</u>	<u>\$0</u>	<u>\$229,185,660</u>	<u>(\$223,136,581)</u>	<u>\$6,049,079</u>	<u>100.00%</u>		<u>8.13%</u>	
<b>Per Staff</b>									
8 Long-term Debt	\$133,025,102	\$0	\$133,025,102	(\$129,598,023)	\$3,427,079	56.67%	6.65%	3.77%	
9 Short-term Debt	4,522,923	0	4,522,923	(4,406,401)	116,522	1.93%	6.62%	0.13%	
10 Preferred Stock	0	0	0	0	0	0.00%	0.00%	0.00%	
11 Common Equity	91,510,699	0	91,510,699	(89,153,141)	2,357,558	38.98%	10.47%	4.08%	
12 Customer Deposits	125,672	0	125,672	0	125,672	2.08%	6.00%	0.12%	
13 Deferred Income Taxes	<u>1,264</u>	<u>19,569</u>	<u>20,833</u>	<u>0</u>	<u>20,833</u>	<u>0.34%</u>	0.00%	<u>0.00%</u>	
14 <b>Total Capital</b>	<u>\$229,185,660</u>	<u>\$19,569</u>	<u>\$229,205,229</u>	<u>(\$223,157,564)</u>	<u>\$6,047,665</u>	<u>100.00%</u>		<u>8.10%</u>	
						<b>LOW</b>	<b>HIGH</b>		
RETURN ON EQUITY						<u>10.47%</u>	<u>12.47%</u>		
OVERALL RATE OF RETURN						<u>8.10%</u>	<u>8.88%</u>		

Alafaya Utilities, Inc. Statement of Wastewater Operations Test Year Ended 12/31/05						Schedule No. 3-A Docket No. 060256-SU Interim	
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 <b>Operating Revenues:</b>	<u>\$2,781,124</u>	<u>\$694,756</u>	<u>\$3,475,880</u>	<u>(\$617,794)</u>	<u>\$2,858,086</u>	<u>\$539,070</u> 18.86%	<u>\$3,397,156</u>
<b>Operating Expenses</b>							
2 Operation & Maintenance	\$2,013,286	-\$8,500	\$2,004,786	\$0	\$2,004,786		\$2,004,786
3 Depreciation	295,596	0	295,596	(12,205)	283,391		283,391
4 Amortization	0	0	0	0	0		0
5 Taxes Other Than Income	437,478	38,320	475,798	(29,994)	445,804	24,258	470,062
6 Income Taxes	<u>45,626</u>	<u>162,405</u>	<u>208,031</u>	<u>(252,830)</u>	<u>(44,799)</u>	<u>193,724</u>	<u>148,925</u>
7 <b>Total Operating Expense</b>	<u>2,791,986</u>	<u>192,225</u>	<u>2,984,211</u>	<u>(295,028)</u>	<u>2,689,183</u>	<u>217,982</u>	<u>2,907,164</u>
8 <b>Operating Income</b>	<u>(\$10,862)</u>	<u>\$502,531</u>	<u>\$491,669</u>	<u>(\$322,766)</u>	<u>\$168,903</u>	<u>\$321,088</u>	<u>\$489,991</u>
9 <b>Rate Base</b>	<u>\$6,171,396</u>		<u>\$6,049,079</u>		<u>\$6,047,665</u>		<u>\$6,047,665</u>
10 <b>Rate of Return</b>	<u>(0.18%)</u>		<u>8.13%</u>		<u>2.79%</u>		<u>8.10%</u>

Alafaya Utilities, Inc. Adjustment to Operating Income Test Year Ended 12/31/05		Schedule No. 3-B Docket No. 060256-SU Interim
Explanation	Wastewater	
<u>Operating Revenues</u>		
Remove requested interim revenue increase.		<u>(\$617,794)</u>
<u>Depreciation Expense - Net</u>		
To remove net depreciation for non-U&U plant.		<u>(\$12,205)</u>
<u>Taxes Other Than Income</u>		
1 RAFs on revenue adjustments above.		(\$38,579)
2 To reflect appropriate historical RAFs.		10,778
3 To remove property taxes for non-U&U plant.		<u>(2,193)</u>
Total		<u>(\$29,994)</u>
<u>Income Taxes</u>		
To adjust to test year income tax expense.		<u>(\$252,830)</u>

<b>Alafaya Utilities, Inc.</b>		<b>SCHEDULE NO. 4</b>		
<b>Wastewater Monthly Service Rates</b>		<b>Docket No. 060256-SU</b>		
<b>Test Year Ended 12/31/05</b>		<b>Interim</b>		
	<b>Rates Prior to Filing</b>	<b>Utility Requested Interim</b>	<b>Utility Requested Final</b>	<b>Staff Recomm. Interim</b>
<b><u>Residential</u></b>				
Base Facility Charge All Meter Sizes:	\$16.69	\$20.30	\$24.50	\$19.85
Gallonge Charge - Per 1,000 gallons (10,000 gallon cap)	\$2.23	\$2.71	\$3.27	\$2.65
<b><u>General Service</u></b>				
Base Facility Charge by Meter Size:				
5/8" x 3/4"	\$16.69	\$20.30	\$24.50	\$19.85
1"	\$41.73	\$50.75	\$61.25	\$49.63
1-1/2"	\$83.48	\$101.52	\$122.54	\$99.27
2"	\$133.56	\$162.43	\$196.05	\$158.83
3"	\$267.13	\$324.87	\$392.11	\$317.67
4"	\$417.38	\$507.60	\$612.66	\$496.35
Gallonge Charge, per 1,000 Gallons	\$2.60	\$3.22	\$8.48	\$3.09
<b><u>Reuse Irrigation Service</u></b>				
Residential Flat Rate	\$6.93	\$8.43	\$10.17	\$8.24
Residential Availability Fee	\$5.78	\$7.03	\$8.48	\$6.87
General Service Gallonge Charge	\$0.29	\$0.35	\$0.43	\$0.34
<b><u>Typical Residential Bills 5/8" x 3/4" Meter</u></b>				
3,000 Gallons	\$24.49	\$29.96	\$49.94	\$27.80
5,000 Gallons	\$29.69	\$36.40	\$66.90	\$33.10
10,000 Gallons	\$42.69	\$52.50	\$109.30	\$46.35
(Wastewater Gallonge Cap - 10,000 Gallons)				