

State of Florida



Public Service Commission

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-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 (Merta, Rendell, Springer) SM *ALM*
Office of the General Counsel (Brown) *MCB*

RE: Docket No. 060255-SU – Application for increase in wastewater rates in Pinellas County by Tierra Verde 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\060255.RCM.DOC

Case Background

Tierra Verde Utilities, Inc. (Tierra Verde or utility) is a Class B utility providing wastewater service to approximately 2,411 customers in Pinellas County. The utility is a wholly-owned subsidiary of Utilities, Inc. (UI). Wastewater rates were last established for Tierra Verde in its 1985 rate proceeding.¹ On June 30, 1992, UI purchased the assets of Seagull Utility Company (Seagull) and transferred them to a separate wholly-owned subsidiary (Tierra Verde).² In the transfer proceeding, the utility's rate base was established. Further, in a 2001 earnings

¹ See Order No. 16781, issued October 27, 1986, in Docket No. 850883-SU, In Re: Application of Seagull Utility Company for increased sewer rates to its customers in Pinellas County, Florida.

² See Order No. PSC-93-0364-FOF-SU, issued March 9, 1993, in Docket No. 920716-SU, In Re: Application For Transfer of Certificate No. 58-S from Seagull Utility Company to Tierra Verde Utilities, Inc. in Pinellas County

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investigation, the Commission approved a settlement agreement ordering refunds; however, rates were not changed.³

On May 15, 2006, Tierra Verde filed its Application for Rate Increase at issue in the instant docket. The utility requested that the application be processed using the Proposed Agency Action (PAA) procedure and requested interim rates. The utility had deficiencies in the Minimum Filing Requirements (MFRs). The deficiencies will not be corrected until after the statutory 60-day timeframe to suspend the requested interim rates, therefore the official filing date has not been established. The test year established for interim and final rates is the historical twelve-month period ended December 31, 2005.

Tierra Verde requested interim rates designed to generate annual wastewater revenues of \$728,171, an increase of \$109,767 or 17.75%. The utility requested final rates designed to generate wastewater revenues of \$825,139, an increase of \$206,735 or 33.44%.

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 time by which the Commission is required to authorize interim rates. This recommendation addresses the suspension of Tierra Verde'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.).

³ See Order No. PSC-02-0778-PAA-SU, issued June 10, 2002, in Docket No. 011190-SU, In re: Investigation of possible overearnings by Tierre Verde Utilities, Inc. in Pinellas County.

Discussion of Issues

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

Recommendation: Yes. Tierra Verde's proposed final wastewater rates should be suspended. (Merta)

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 an interim revenue increase be approved?

Recommendation: Yes. The utility should be authorized to collect annual wastewater revenues as indicated below: (Merta)

	<u>Adjusted Test Year Revenues</u>	<u>\$ Increase</u>	<u>Revenue Requirement</u>	<u>% Increase</u>
Wastewater	\$618,404	\$109,767	\$728,171	17.75%

Staff Analysis: The utility 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 reviewed the utility's interim request, as well as Order No. PSC-93-0364-FOF-SU, in which the Commission last established rate base, and Order No. 16781, in which the Commission last established rates. Staff's recommended adjustments are discussed below. Attached are accounting schedules to illustrate staff's recommended rate base, capital structure, and test year operating income amounts. The rate base schedule is labeled as No. 1-A. The capital structure schedule is No. 2, and the operating income schedule is labeled as No. 3-A, with adjustments shown on No. 3-B. Schedule 4 reflects the monthly service rates.

RATE BASE

Based on an analysis of the MFRs and on Order Nos. PSC-93-0364-FOF-SU and 16781 from the utility's last rate proceeding, staff recommends that no adjustments are necessary to the utility's rate base. Staff's recommended interim rate base should be \$835,421.

COST OF CAPITAL

In its MFRs, the utility used a simple average capital structure, which consisted of allocated investor sources of capital from UI and Tierra Verde's actual accumulated deferred income taxes. In its interim request, Tierra Verde used an 11.05% return on equity (ROE).

In Order No. PSC-02-0778-PAA-SU, the issue of lowering Tierra Verde's ROE was tabled, pending a decision in Docket No. 011189-WS.⁴ Order No. PSC-02-1452-FOF-WS, issued October 21, 2002, closed that docket due to the fact that there were other pending dockets before the Commission involving those utilities, and the docket would be unnecessarily duplicative. Of the utilities involved in the investigation into ROE, the Commission determined an ROE only for Alafaya Utilities, Inc.⁵ Tierra Verde's ROE was last established at 13.03% by

⁴ In re: Investigation into the authorized return on equity of Alafaya Utilities, Inc. in Seminole County; Lake Groves Utilities, Inc. in Lake County; Miles Grant Water and Sewer Company in Martin County; and Utilities, Inc. of Longwood in Seminole County.

⁵ See Order No. PSC-04-0363-PAA-SU, issued April 5, 2004, in Docket No. 02408-SU, In re: Application for rate increase in Seminole County by Alafaya Utilities, Inc.

Order No. 16781. However, the authorized ROE for Seagull in Order No. 16781 should not be used because the ROE does not survive a transfer.⁶ Therefore, staff believes that the current leverage formula should be used to determine ROE for Tierra Verde and the minimum of the range should be used pursuant to Section 367.082(5)(b)3., F.S.

The utility's capital structure was reconciled with staff's recommended rate base. Using the leverage formula approved by Order No. PSC-06-0476-PAA-WS, issued June 5, 2006,⁷ the return on equity is 11.53% with a range of 10.53% - 12.53%. Using the 10.53% minimum of the range, staff recommends an interim weighted average cost of capital of 7.11%.

NET OPERATING INCOME

Based on its review, staff is recommending two adjustments to operating expenses.

Taxes Other Than Income

On MFR B-15, the utility included \$27,436 for regulatory assessment fees (RAFs) on historical per books revenues of \$606,834. Using the .045 RAF rate, pursuant to Section 367.145, F.S., and Rule 25-30.120, Florida Administrative Code (F.A.C.), staff calculated RAFs of \$27,308. As such, the utility's historical per book RAFs are overstated and should be decreased by \$128.

Income Tax

In its filing, the utility made adjustments of \$6,760 to reflect the income tax effect of operating and expense adjustments and of \$28,377 to reflect the income tax effect of the requested interim revenue increase. The utility failed to make an adjustment to remove the negative income tax balance shown in the "per books" column of MFR Schedule B-2 (interim). Staff has made an adjustment of \$56,675 to eliminate this negative balance; however, for the reason stated in the next section, this adjustment had no impact on staff's recommended interim revenue increase.

Based on the above, staff recommends that the appropriate interim test year operating income, before any revenue increase, for wastewater is a loss of \$30,242.

REVENUE REQUIREMENT

The utility requested a revenue requirement of \$728,171. Staff's recommended adjustments generate a revenue requirement higher than requested by the utility. In such circumstances, it has been Commission practice to limit the revenue requirement to the level

⁶See PSC-01-2094-FOF-SU, issued October 22, 2001, in Docket No. 011190-SU, In re: Investigation of possible overearnings by Tierra Verde Utilities, Inc. in Pinellas County, p. 3.

⁷Docket No. 060006-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), F.S.

requested.⁸ In addition, the interim revenue requirement is based on amounts that will be tried up in the determination of final rates. Based on the above, staff recommends a revenue requirement of \$728,171 for wastewater. This represents an interim increase in annual revenues of \$109,767, or 17.75%. This will allow the utility the opportunity to recover its operating expenses and earn a 4.21% return on its rate base.

⁸ See Order No. PSC-05-0287-PAA-SU, issued March 17, 2005, in Docket No. 040972-SU, In re: Application for rate increase in Pinellas County by Ranch Mobile WWTP, Inc. and Order No. PSC-95-0191-FOF-WS, issued February 9, 1995, in Docket No. 940917-WS, In Re: Application for rate increase for increased water and wastewater rates in Seminole, Orange, and Pasco Counties by Utilities, Inc. of Florida.

Issue 3: What are the appropriate interim wastewater rates?

Recommendation: The wastewater service rates for Tierra Verde in effect as of December 31, 2005, should be increased by 17.75% 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. 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. (Merta)

Staff Analysis: Staff recommends that interim wastewater service rates for Tierra Verde be designed to allow the utility the opportunity to generate annual operating revenues of \$728,171 for wastewater operations. This reflects an increase of \$109,767 for wastewater, or 17.75%, before removal of miscellaneous revenues. 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	\$618,404
2 Less: Miscellaneous Revenues	<u>0</u>
3 Test Year Revenues from Service Rates	\$618,404
4 Revenue Increase	<u>\$109,767</u>
5 % Service Rate Increase (Line 4/Line3)	<u>17.75%</u>

The interim rate increase of 17.75% 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. 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 wastewater rates, and staff's recommended interim wastewater 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 \$64,969 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. (Merta, 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 \$109,767 for wastewater. 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 \$64,969. 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.

Tierra Verde 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 \$64,969 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. 060255-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. 060255-SU

Date: July 6, 2006

Issue 5: Should this docket be closed?

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

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

Tierra Verde Utilities, Inc. Schedule of Wastewater Rate Base Test Year Ended 12/31/05			Schedule No. 1-A Docket No. 060255-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	\$3,271,506	\$0	\$3,271,506	\$0	\$3,271,506
2 Land and Land Rights	\$0	\$0	0	0	0
3 Non-used and Useful Components	\$0	\$0	0	0	0
4 Accumulated Depreciation	(\$1,746,670)	\$0	(1,746,670)	0	(1,746,670)
5 CIAC	(\$1,683,577)	\$0	(1,683,577)	0	(1,683,577)
6 Amortization of CIAC	\$918,751	\$0	918,751	0	918,751
7 CWIP	\$63,296	(\$63,296)	0	0	0
8 Acquisition Adjustments	\$351,207	(\$351,207)	0	0	0
9 Accum. Amort.of Acq. Adjs.	(\$81,247)	\$81,247	0	0	0
10 Working Capital	<u>0</u>	<u>75,411</u>	<u>75,411</u>	<u>0</u>	<u>75,411</u>
11 Rate Base	<u>\$1,093,266</u>	<u>(\$257,845)</u>	<u>\$835,421</u>	<u>\$0</u>	<u>\$835,421</u>

Tierra Verde Utilities, Inc.
 Capital Structure-Simple Average
 Test Year Ended 12/31/05

Schedule No. 2
 Docket No. 060255-SU
 Interim

Description	Total Capital	Specific Adjustments	Subtotal Adjusted Capital	Prorata Adjustments	Capital Reconciled to Rate Base	Ratio	Cost Rate	Weighted Cost
Long-term Debt	\$124,044,203	\$0	\$124,044,203	\$123,637,449	\$406,754	48.69%	6.65%	3.24%
Short-term Debt	11,347,000	0	\$11,347,000	-11,309,790	\$37,210	4.45%	2.64%	0.12%
Preferred Stock	0	0	\$0	0	\$0	0.00%	0.00%	0.00%
Common Equity	90,787,422	0	\$90,787,422	-90,489,715	\$297,707	35.64%	11.05%	3.94%
Customer Deposits	0	0	\$0	0	\$0	0.00%	6.00%	0.00%
Deferred Income Taxes	<u>93,749</u>	<u>0</u>	<u>\$93,749</u>	<u>0</u>	<u>\$93,749</u>	<u>11.22%</u>	<u>0.00%</u>	<u>0.00%</u>
Total Capital	<u>\$226,272,374</u>	<u>\$0</u>	<u>\$226,272,374</u>	<u>\$225,436,954</u>	<u>\$835,420</u>	<u>100.00%</u>		<u>7.29%</u>
Long-term Debt	\$124,044,203	\$0	\$124,044,203	\$123,637,444	\$406,759	48.69%	6.65%	3.24%
Short-term Debt	11,347,000	0	\$11,347,000	-\$11,309,792	37,208	4.45%	2.64%	0.12%
Preferred Stock	0	0	\$0	\$0	0	0.00%	0.00%	0.00%
Common Equity	90,787,422	0	\$90,787,422	-\$90,489,717	297,705	35.64%	10.53%	3.75%
Customer Deposits	0	0	\$0	\$0	0	0.00%	6.00%	0.00%
Deferred Income Taxes	<u>93,749</u>	<u>0</u>	<u>\$93,749</u>	<u>\$0</u>	<u>93,749</u>	<u>11.22%</u>	<u>0.00%</u>	<u>0.00%</u>
Total Capital	<u>\$226,272,374</u>	<u>\$0</u>	<u>\$226,272,374</u>	<u>\$225,436,953</u>	<u>\$835,421</u>	<u>100.00%</u>		<u>7.11%</u>
						<u>LOW</u>	<u>HIGH</u>	
						<u>10.53%</u>	<u>12.53%</u>	
						<u>7.11%</u>	<u>7.82%</u>	
								RETURN ON EQUITY
								OVERALL RATE OF RETURN

**Tierra Verde Utilities, Inc.
 Statement of Wastewater Operations
 Test Year Ended 12/31/05**

**Schedule No. 3-A
 Docket No. 060255-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 Operating Revenues:	<u>\$606,834</u>	<u>\$121,337</u>	<u>\$728,171</u>	<u>-\$109,767</u>	<u>\$618,404</u>	<u>\$109,767</u>	<u>\$728,171</u>
						17.75%	
Operating Expenses							
2 Operation & Maintenance	\$603,289	\$0	\$603,289	\$0	\$603,289		\$603,289
3 Depreciation	46,547	0	46,547	0	46,547		46,547
4 Amortization	0	0	0	0	0		0
5 Taxes Other Than Income	33,576	5,332	38,908	-4,939	33,969	4,940	38,908
6 Income Taxes	<u>-56,675</u>	<u>35,137</u>	<u>-21,538</u>	<u>43,054</u>	<u>-35,159</u>	<u>39,447</u>	<u>4,288</u>
7 Total Operating Expense	<u>626,737</u>	<u>40,469</u>	<u>667,206</u>	<u>38,115</u>	<u>648,646</u>	<u>44,386</u>	<u>693,032</u>
8 Operating Income	<u>-\$19,903</u>	<u>\$80,868</u>	<u>\$60,965</u>	<u>-\$147,882</u>	<u>-\$30,242</u>	<u>\$65,381</u>	<u>\$35,139</u>
9 Rate Base	<u>\$1,093,266</u>		<u>\$835,421</u>		<u>\$835,421</u>		<u>\$835,421</u>
10 Rate of Return	<u>-1.82%</u>		<u>7.30%</u>		<u>-3.62%</u>		<u>4.21%</u>

**Tierra Verde Utilities, Inc.
 Adjustment to Operating Income
 Test Year Ended 12/31/05**

**Schedule No. 3-B
 Docket No. 060255-SU
 Interim**

Explanation	Wastewater
<u>Operating Revenues</u>	
1 Remove requested final revenue increase	(\$109,767)
2	\$0
3	\$0
4	<u>\$0</u>
Total	<u>(\$109,767)</u>
<u>Operation and Maintenance Expense</u>	
1	\$0
2	\$0
3	\$0
4	\$0
5 Total	<u>\$0</u>
<u>Depreciation Expense - Net</u>	
1	\$0
2	\$0
3	\$0
4	\$0
Total	<u>\$0</u>
<u>Amotization-Other Expense</u>	
	<u>\$0</u>
<u>Taxes Other Than Income</u>	
1 RAFs on revenue adjustments above	(\$4,811)
2 To reflect the appropriate historical test year RAFs	(\$128)
3	\$0
4	<u>\$0</u>
Total	<u>(\$4,939)</u>
<u>Income Taxes</u>	
1 To adjust to test year income tax expense	(\$13,621)
2 To eliminate negative income tax expense	\$56,675
Total	<u>\$43,054</u>

Tierra Verde Utilities, Inc. Wastewater Bimonthly Service Rates Test Year Ended 12/31/05		SCHEDULE NO. 4 Docket No. 060255-SU Interim		
	Rates Prior to Filing	Utility Requested Interim	Utility Requested Final	Staff Recomm. Interim
<u>Residential</u>				
Flat Rate All Meter Sizes:	\$66.42	\$78.21	\$88.62	\$78.21
Gallonge Charge - Per				
1,000				
gallons (10,000 gallon cap)	\$0.00	\$0.00	\$0.00	\$0.00
<u>General Service</u>				
Base Facility Charge by Meter Size:				
5/8" x 3/4"	\$33.43	\$39.36	\$44.61	\$39.36
1"	\$83.59	\$98.43	\$111.53	\$98.43
1-1/2"	\$167.15	\$196.82	\$223.03	\$196.82
2"	\$267.45	\$314.92	\$356.86	\$314.92
3"	\$534.88	\$590.40	\$669.15	\$629.82
4"	\$835.74	\$984.08	\$1,115.13	\$984.08
6"	\$1,671.47	\$1,968.16	\$2,230.25	\$1,968.16
8"	\$0.00	\$0.00	\$0.00	\$0.00
Gallonge Charge, per 1,000 Gallons	\$1.80	\$2.12	\$2.40	\$2.12
<u>Typical Residential Bills 5/8" x 3/4" Meter</u>				
3,000 Gallons	\$66.42	\$78.21	\$88.62	\$78.21
5,000 Gallons	\$66.42	\$78.21	\$88.62	\$78.21
10,000 Gallons	\$66.42	\$78.21	\$88.62	\$78.21
(Wastewater Gallonge Cap - 10,000 Gallons)				