

State of Florida



Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

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

DATE: October 16, 2008

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Crawford, Bulecza-Banks, Fletcher, ^{AC} ^{CO} ^{BO} ¹⁸²
Livingston, Redemann) ^{AK} ¹⁰
Office of the General Counsel (Bennett) ^{BO} ^{SO}

RE: Docket No. 080247-SU – Application for increase in wastewater rates in Lee County by Utilities, Inc. of Eagle Ridge. ^{ALM}

AGENDA: 10/28/08 – 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: Argenziano

CRITICAL DATES: 60-Day Suspension Date Waived to 10/28/08

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\080247.RCM.DOC

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Case Background

Eagle Ridge Utilities, Inc. (Eagle Ridge or Utility) is a Class B utility providing wastewater service to approximately 869 customers in Lee County. Water service is provided in the area by Lee County. Wastewater rates were last established for this Utility in its 2003 rate proceeding.¹

On August 22, 2008, Eagle Ridge filed an Application for Rate Increase at issue in the instant docket. The Utility had a few deficiencies in the Minimum Filing Requirements (MFRs).

¹ See Order No. PSC-04-1107-PAA-SU, issued November 8, 2004, in Docket No. 030445-SU, In re: Application for rate increase in Lee County by Utilities, Inc. of Eagle Ridge.

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As of 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 simple average period ending December 31, 2007.

Eagle Ridge requested interim rates designed to generate annual revenues of \$1,041,747. This represents a revenue increase on an annual basis of \$246,392 (30.98 percent). The Utility requested final rates designed to generate annual revenues of \$1,109,542. This represents a revenue increase of \$332,525 (42.80 percent).

The original 60-day statutory deadline for the Commission to suspend the Utility's requested final rates is October 21, 2008. However, by letter dated September 8, 2008, the Utility agreed to extend the statutory time frame through October 28, 2008. This recommendation addresses the suspension of Eagle Ridge'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. Eagle Ridge's proposed final water and wastewater rates should be suspended. (Crawford)

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 further investigation of this information, including on-site investigations by staff accountants and engineers is needed. Based on the foregoing, staff recommends suspension of 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:

	<u>Adjusted Test Year Revenues</u>	<u>\$ Increase</u>	<u>Revenue Requirement</u>	<u>% Increase</u>
Wastewater	\$795,355	\$246,392	\$1,041,747	30.98%

(Crawford)

Staff Analysis: Eagle Ridge 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 Eagle Ridge's interim request, as well as Order No. PSC-04-1107-PAA-SU, in which the Commission last established rate base for Eagle Ridge. 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 shown in schedule No. 1. The capital structure schedule is shown in schedule No. 2, and the operating income schedule is in schedule No. 3-A, with the operating income adjustments shown in schedule No. 3-B.

RATE BASE

Based on an analysis of the MFRs and Order No. PSC-04-1107-PAA-SU from the Utility's last rate proceeding, staff recommends no adjustments.

COST OF CAPITAL

In its interim request, the Utility requested an overall cost of capital of 8.06 percent. Eagle Ridge used an 11.70 percent return on equity (ROE), which is the minimum of the range using the Commission's 2007 leverage formula.² However, pursuant to Order No. PSC-04-1107-PAA-SU, pp.7-8, Eagle Ridge's last authorized return on equity is 11.21 percent with a range of 10.21 percent to 12.21 percent. Consistent with the interim statute, the 10.21 percent minimum ROE authorized in the Utility's last rate case should be used for interim purposes. Based on the above, staff recommends an interim weighted average cost of capital of 7.48 percent.

NET OPERATING INCOME

In its filing, Eagle Ridge reflected no provision for income taxes. Based on staff's recalculation, the Utility's provision of income taxes should be negative \$32,688. Based on the

² See Order No. PSC-07-0472-PAA-WS, issued June 1, 2007, in Docket No. 070006-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.S.

above, staff recommends that the appropriate test year operating income, before any revenue increase, is \$28,741.

REVENUE REQUIREMENT

In its filing, the Utility reflected \$40,585 for its provision of income taxes based on its interim revenue increase. However, based on staff's recalculation, Eagle Ridge's provision of income taxes were significantly understated. This understatement of income taxes was greater than the revenue requirement impact of staff's recommended 58 basis points reduction of the Utility's requested overall cost of capital (8.06 percent less 7.48 percent).

Eagle Ridge requested a revenue requirement of \$1,041,747. 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 requested.³ Based on the above, staff recommends a revenue requirement of \$1,041,747 for wastewater. This represents an interim increase in annual revenues of \$246,392, or 31.30 percent. This will allow Eagle Ridge the opportunity to recover its operating expenses and earn a 7.42 percent return on its rate base.

³ See Order Nos. PSC-06-0675-PCO-SU, issued August 7, 2006, in Docket No. 060255-SU, In re: Application for increase in wastewater rates in Pinellas County by Tierra Verde Utilities, Inc.; 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 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 Eagle Ridge in effect as of December 31, 2007, should be increased by 31.01 percent 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), Florida Administrative Code (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. (Crawford)

Staff Analysis: Staff recommends that interim wastewater service rates for Eagle Ridge be designed to allow the Utility the opportunity to generate annual operating revenues of \$1,041,747 for wastewater operations. Before removal of miscellaneous revenues, this would result in an increase of \$246,392, or 30.98 percent. 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	\$795,355
2 Less: Miscellaneous Revenues	<u>870</u>
3 Test Year Revenues from Service Rates	\$794,485
4 Revenue Increase	<u>\$246,392</u>
5 % Service Rate Increase (Line 4/Line 3)	<u>31.01%</u>

The interim rate increase of 31.01 percent for wastewater should be applied as an across-the-board increase to the service rates in effect as of December 31, 2007. 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. Eagle Ridge 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 equal to the outstanding amount of \$528,209 plus the amount approved by the Commission in this docket and Docket Nos. 080248-SU, 080249-WS, and 080250-SU. 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. (Crawford, Livingston)

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 \$246,392. 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 \$145,289. 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.

Eagle Ridge 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 Docket Nos. 080248-SU, 080249-WS, and 080250-SU. The Commission's consideration of interim for those dockets is also being decided at the October 28, 2008, agenda conference. The recommended cumulative corporate undertaking amount for those dockets is \$201,755. At present, UI has a corporate undertaking for Miles Grant Water & Sewer Company (Miles Grant) and Lake Utility Services, Inc. (LUSI), for combined corporate undertaking of \$528,209.⁴ 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 and the previously approved corporate undertaking amount for Miles Grant and LUSI, the total requested cumulative corporate undertaking amount is \$875,253, which includes \$145,289, subject to refund for this docket. However, in case the recommended incremental amounts for the above four dockets are not approved by the Commission, staff recommends that UI's total guarantee should be equal to the outstanding amount of \$528,209 plus the amount approved by the Commission in this docket and Docket Nos. 080248-SU, 080249-WS, and 080250-SU.

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 2005 to 2007 to determine the financial condition of the parent company. UI's relative level of liquidity has decreased compared to 2006. The Utility has also

⁴ See Order Nos. PSC-08-0338-PCS-WS, issued May 27, 2008 in Docket No. 070695-WS, In re: Application for rate increase in water and wastewater in Martin County, by Miles Grant Water & Sewer Company; and PSC-08-0308-PCO-WS, issued May 12, 2008 in Docket No. 070693-WS, In re: Application for rate increase in water and wastewater Lake County by Lake Utility Services, Inc.

experienced a decline in interest coverage ratio and relative level of net income over the three year review period. However, UI's equity ratio has increased to 44.48 percent in 2007 from 40 percent in 2006. In addition, net income has been on average three times greater than the requested interim undertaking amount. UI's financial performance has demonstrated adequate levels of both equity capitalization and profitability on an absolute basis to offset the decline in interest coverage and profitability on a relative basis. Based upon this analysis, staff recommends that a cumulative corporate undertaking of \$875,253 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 should 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.

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. 080247-SU
Date: October 16, 2008

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. (Crawford, Bennett)

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

Utilities, Inc. of Eagle Ridge Schedule of Wastewater Rate Base Test Year Ended 12/31/07			Schedule No. 1 Docket No. 080247-SU			
Description	Test Year Per Utility	Utility Adjust- ments	Adjusted Test Year Per Utility	Staff Adjust- ments	Staff Adjusted Test Year	
1 Plant in Service	\$6,267,052	(\$47,709)	\$6,219,343	\$0	\$6,219,343	
2 Land and Land Rights	39,579	0	39,579	0	39,579	
3 Non-used and Useful Components	0	(303,511)	(303,511)	0	(303,511)	
4 Accumulated Depreciation	(2,626,722)	45,012	(2,581,710)	0	(2,581,710)	
5 CIAC	(3,556,830)	0	(3,556,830)	0	(3,556,830)	
6 Amortization of CIAC	2,469,069	0	2,469,069	0	2,469,069	
7 CWIP	97,371	(97,371)	0	0	0	
8 Acquisition Adjustment	266,765	(266,765)	0	0	0	
9 Working Capital Allowance	<u>0</u>	<u>80,104</u>	<u>80,104</u>	<u>(0)</u>	<u>80,104</u>	
10 Rate Base	<u>\$2,956,284</u>	<u>(\$670,344)</u>	<u>\$2,285,940</u>	<u>\$0</u>	<u>\$2,285,940</u>	

Utilities, Inc. of Eagle Ridge
 Capital Structure-Simple Average
 Test Year Ended 12/31/07

Schedule No. 2
 Docket No. 080247-SU

Description	Total Capital	Specific Adjustments	Subtotal Adjusted Capital	Prorata Adjustments	Capital Reconciled to Rate Base	Ratio	Cost Rate	Weighted Cost
Per Utility								
1 Long-term Debt	\$180,000,000	\$0	\$180,000,000	(\$178,810,370)	\$1,189,630	50.28%	6.65%	3.34%
2 Short-term Debt	7,750,000	0	7,750,000	(7,698,775)	51,225	2.17%	2.44%	0.05%
3 Preferred Stock	0	0	0	0	0	0.00%	0.00%	0.00%
4 Common Equity	139,282,132	0	139,282,132	(138,361,596)	920,536	38.91%	11.70%	4.55%
5 Customer Deposits	42,656	0	42,656	0	42,656	1.80%	6.00%	0.11%
6 Deferred Income Taxes	<u>161,998</u>	<u>0</u>	<u>161,998</u>	<u>0</u>	<u>161,998</u>	<u>6.85%</u>	0.00%	<u>0.00%</u>
7 Total Capital	<u>\$327,236,786</u>	<u>\$0</u>	<u>\$327,236,786</u>	<u>(\$324,870,741)</u>	<u>\$2,366,045</u>	<u>100.00%</u>		<u>8.06%</u>
Per Staff								
8 Long-term Debt	\$180,000,000	\$0	\$180,000,000	(\$178,810,361)	\$1,189,639	50.28%	6.65%	3.34%
9 Short-term Debt	7,750,000	0	7,750,000	(7,698,779)	51,221	2.16%	2.44%	0.05%
10 Preferred Stock	0	0	0	0	0	0.00%	0.00%	0.00%
11 Common Equity	139,282,132	0	139,282,132	(138,361,602)	920,530	38.91%	10.21%	3.97%
12 Customer Deposits	42,656	0	42,656	0	42,656	1.80%	6.00%	0.11%
13 Deferred Income Taxes	<u>161,998</u>	<u>0</u>	<u>161,998</u>	<u>0</u>	<u>161,998</u>	<u>6.85%</u>	0.00%	<u>0.00%</u>
14 Total Capital	<u>\$327,236,786</u>	<u>\$0</u>	<u>\$327,236,786</u>	<u>(\$324,870,742)</u>	<u>\$2,366,044</u>	<u>100.00%</u>		<u>7.48%</u>
						LOW	HIGH	
					RETURN ON EQUITY	<u>10.21%</u>	<u>12.21%</u>	
					OVERALL RATE OF RETURN	<u>7.48%</u>	<u>8.25%</u>	

**Utilities, Inc. of Eagle Ridge
Statement of Wastewater Operations
Test Year Ended 12/31/07**

**Schedule No. 3-A
Docket No. 080247-SU**

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>\$787,117</u>	<u>\$254,630</u>	<u>\$1,041,747</u>	<u>(\$246,392)</u>	<u>\$795,355</u>	<u>\$246,392</u> 30.98%	<u>\$1,041,747</u>
Operating Expenses							
2 Operation & Maintenance	\$678,384	(\$37,554)	\$640,830	\$0	\$640,830		\$640,830
3 Depreciation	95,366	(1,313)	94,053	0	94,053		94,053
4 Amortization	0	0	0	0	0		0
5 Taxes Other Than Income	65,599	9,908	75,507	(11,088)	64,419	11,088	75,507
6 Income Taxes	<u>(53,924)</u>	<u>94,509</u>	<u>40,585</u>	<u>(73,273)</u>	<u>(32,688)</u>	<u>88,545</u>	<u>55,857</u>
7 Total Operating Expense	<u>\$785,425</u>	<u>\$65,550</u>	<u>\$850,975</u>	<u>(\$84,361)</u>	<u>\$766,614</u>	<u>\$99,633</u>	<u>\$866,247</u>
8 Operating Income	<u>\$1,692</u>	<u>\$189,080</u>	<u>\$190,772</u>	<u>(\$162,031)</u>	<u>\$28,741</u>	<u>\$146,759</u>	<u>\$175,500</u>
9 Rate Base	<u>\$2,956,284</u>		<u>\$2,366,044</u>		<u>\$2,366,044</u>		<u>\$2,366,044</u>
10 Rate of Return	<u>0.06%</u>		<u>8.06%</u>		<u>1.21%</u>		<u>7.42%</u>

**Utilities, Inc. of Eagle Ridge
Adjustment to Operating Income
Test Year Ended 12/31/07**

**Schedule 3-B
Docket No. 080247-SU**

Explanation	Wastewater
<u>Operating Revenues</u>	
Remove requested interim revenue increase	<u>(\$246,392)</u>
<u>Taxes Other Than Income</u>	
RAFs on revenue adjustments above	<u>(\$11,088)</u>

**Utilities, Inc. of Eagle Ridge
Wastewater Monthly Service Rates
Test Year Ended 12/31/07**

**SCHEDULE NO. 4
Docket No. 080247-SU**

	Test Year Rates on 12/31/2007	Utility Requested Interim	Utility Requested Final	Staff Recommended Interim
<u>Residential</u>				
Base Facility Charge All Meter Sizes:	\$16.91	\$22.15	\$24.15	\$22.15
Gallonge Charge - Per 1,000 gallons (10,000 gallon cap)	\$3.44	\$4.51	\$4.91	\$4.51
Cross Creek Flat Rate	\$18.42	\$24.13	\$26.31	\$24.13
<u>General Service</u>				
Base Facility Charge by Meter Size:				
5/8" x 3/4"	\$16.91	\$22.15	\$24.15	\$22.15
1"	\$42.29	\$55.41	\$60.41	\$55.41
1-1/2"	\$84.57	\$110.80	\$120.80	\$110.80
2"	\$135.31	\$177.27	\$193.28	\$177.27
3"	\$270.63	\$354.56	\$386.58	\$354.56
4"	\$422.86	\$554.00	\$604.03	\$554.00
6"	\$845.71	\$1,107.99	\$1,208.04	\$1,107.99
Gallonge Charge, per 1,000 Gallons	\$4.12	\$5.40	\$5.89	\$5.40
<u>Typical Residential Bills 5/8" x 3/4" Meter</u>				
3,000 Gallons	\$27.23	\$35.68	\$38.88	\$35.68
5,000 Gallons	\$34.11	\$44.70	\$48.70	\$44.70
10,000 Gallons	\$51.31	\$67.25	\$73.25	\$67.25
(Wastewater Gallonge Cap - 10,000 Gallons)				