

State of Florida



# Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

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

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**DATE:** October 15, 2009  
**TO:** Office of Commission Clerk (Cole)  
**FROM:** Division of Economic Regulation (Fletcher, Bulecza-Banks, Daniel, Linn, Maurey, Mouring, Redemann, Salnova) Office of the General Counsel (Brubaker, Williams)  
**RE:** Docket No. 090182-SU – Application for increase in wastewater rates in Pasco County by Ni Florida, LLC.

**AGENDA:** 10/27/09 – 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:** Edgar

**CRITICAL DATES:** 60-Day Suspension Date Waived to 10/27/09

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\090182.RCM.DOC

### Case Background

Ni Florida, LLC (Ni Florida or Utility) is a Class A utility serving approximately 2,589 residential, 145 commercial, and one industrial customer. The Utility provides wastewater collection service to its customers and purchases wastewater treatment service from Pasco County pursuant to a Bulk Wastewater Treatment Agreement. The majority of Ni Florida's service territory is located in an area designated as a flood plain area, which is unsuitable for the use of septic tanks and drain fields. The Utility is in the South Florida Water Management

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District and is not in a water use caution area. Wastewater rate base was last established for this Utility in 2007.<sup>1</sup>

On July 21, 2009, Ni Florida filed an Application for Rate Increase at issue in the instant docket. The Utility had deficiencies in the Minimum Filing Requirements (MFRs). Those deficiencies have been reconciled. 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 historical year ending December 31, 2008.

Ni Florida requested interim rates designed to generate annual wastewater revenues of \$1,837,081. This represents a revenue increase on an annual basis of \$366,244 (24.90 percent). The Utility requested final rates designed to generate annual wastewater revenues of \$1,873,806. This represents a revenue increase of \$402,969 (27.40 percent).

The original 60-day statutory deadline for the Commission to suspend the Utility's requested final rates is October 6, 2009. However, by letter dated August 25, 2009, the Utility agreed to extend the statutory time frame through October 27, 2009. This recommendation addresses the suspension of Ni Florida'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.).

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<sup>1</sup> See Order Nos. PSC-08-0226-FOF-SU, issued April 7, 2008, in Docket No. 070740-SU, In re: Joint application for approval of transfer of Hudson Utilities, Inc.'s wastewater system and Certificate No. 104-S, in Pasco County, to Ni Florida, LLC, and PSC-09-0017-PAA-SU, issued January 5, 2009, in Docket No. 070740-SU, In re: Joint application for approval of transfer of Hudson Utilities, Inc.'s wastewater system and Certificate No. 104-S, in Pasco County, to Ni Florida, LLC.

### **Discussion of Issues**

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

**Recommendation:** Yes. Ni Florida's proposed final wastewater rates should be suspended. (Mouring, Linn)

**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 considered the information filed in support of the rate application and the proposed final rates. Staff recommends further investigation of this information, including on-site investigations by staff accountants and engineers. Based on the foregoing, staff recommends suspension of 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:

	<u>Adjusted Test Year Revenues</u>	<u>\$ Increase</u>	<u>Revenue Requirement</u>	<u>% Increase</u>
Wastewater	\$1,470,837	\$345,103	\$1,815,940	23.46%

(Mouring, Linn, Redemann)

**Staff Analysis:** Ni Florida has filed rate base, cost of capital, and operating statements to support its requested interim 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 Ni Florida's interim request, as well as Order No. PSC-09-0017-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 is shown on Schedule No. 1. The capital structure is shown on Schedule No. 2. The operating income schedule for wastewater is labeled as Schedule No. 3-A, and the operating income adjustments are shown on Schedule No. 3-B.

#### RATE BASE

On MFR Schedule A-17, the Utility reflected year-end balances to calculate its working capital allowance of \$9,088. Rule 25-30.433(4), Florida Administrative Code (F.A.C.), states that the method to be used by the Commission to calculate rate base and cost of capital shall be a 13-month average for Class A utilities. Based on staff's calculation, the Utility's working capital is negative. A negative working capital is not typical of a "normal" utility or the expected future condition of the utility. In prior Commission decisions, the Commission has used a zero working capital allowance in lieu of the negative amount.<sup>2</sup> Based on the above analysis, staff recommends an interim working capital allowance of zero.

Based on the above adjustment, staff recommends that rate base for interim purposes is \$2,351,327 for wastewater.

#### COST OF CAPITAL

In its interim request, Ni Florida requested an overall cost of capital of 9.53 percent. However, the Utility's requested overall cost of capital is based on the ending balances of their capital accounts and not the 13-month average balances. Consistent with Rule 25-30.433(4),

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<sup>2</sup> See Order Nos. PSC-97-0076-FOF-WS, issued January 27, 1997, in Docket No. 961364-WS, In re: Investigation of rates of Lindrick Service Corporation in Pasco County for possible overearnings, and PSC-96-1338-FOF-WS, issued November 7, 1996, in Docket No. 951056-WS, In re: Application for rate increase in Flagler County by Palm Coast Utility Corporation.

F.A.C., staff has adjusted the ending balances to reflect the 13-month average balances. Also, consistent with prior Commission decisions, staff has not carried over the outstanding debt nor the Return on Equity (ROE) of the Utility's prior owner because neither survives the transfer of the Utility.<sup>3</sup> Based on the above, staff recommends that the interim weighted average cost of capital is 8.70 percent. This represents an eighty-three basis point reduction to the overall cost of capital requested by Ni Florida.

#### NET OPERATING INCOME

Based on an analysis of the MFRs and Order No. PSC-09-0017-PAA-SU from the Utility's last rate proceeding, staff believes that no adjustments are necessary. Staff recommends that the appropriate test year operating loss, before any revenue increase, is \$124,920 for wastewater.

#### REVENUE REQUIREMENT

Based on the above adjustments, staff recommends a revenue requirement of \$1,815,940 for wastewater. This represents an interim increase in annual revenues of \$345,103 (or 23.46 percent) for wastewater. This will allow the Utility the opportunity to recover its wastewater operating expenses and earn a 8.70 percent return on its wastewater rate base.

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<sup>3</sup> See Order Nos. PSC-09-0385-FOF-WS, issued May 29, 2009, in Docket No. 080121-WS, In re: Application for increase in water and wastewater rates in Alachua, Brevard, DeSoto, Highlands, Lake, Lee, Marion, Orange, Palm Beach, Pasco, Polk, Putnam, Seminole, Sumter, Volusia, and Washington Counties by Aqua Utilities Florida, Inc., and PSC-06-0925-PCO-WS, issued November 6, 2006, in Docket No. 060246-WS, In re: Application for increase in water and wastewater rates in Polk County by Gold Coast Utility Corp.

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

**Recommendation:** The wastewater service rates for Ni Florida in effect as of December 31, 2008, should be increased by 24.00 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), 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. (Mouring, Linn)

**Staff Analysis:** Staff recommends that interim wastewater service rates for Ni Florida be designed to allow the Utility the opportunity to generate annual operating revenues of \$1,470,837 for wastewater operations. Before removal of miscellaneous revenues, this would result in increases of \$345,103 or 23.46 percent for wastewater. 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	\$1,470,837
2 Less: Miscellaneous Revenues	<u>32,986</u>
3 Test Year Revenues from Service Rates	\$1,437,851
4 Revenue Increase	<u>\$345,103</u>
5 % Service Rate Increase (Line 4/Line 3)	<u>24.00%</u>

Ni Florida incorrectly applied an increase of approximately 23.71 percent to its present residential and general service rates to calculate its requested interim Base Facility Charge (BFC) and gallonage rates. As stated earlier, staff is recommending an across-the-board increase of 24.00 percent to the Utility's present base facility and gallonage charges. As such, the utility understated its requested wastewater interim BFC charge. Approving interim rates greater than those requested by the Utility, due to an erroneous application of the across-the-board rate increase in the MFRs, is consistent with a prior Commission order.<sup>4</sup>

The interim rate increase of 24.00 percent for wastewater should be applied as an across-the-board increase to the service rates in effect as of December 31, 2008. 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.

<sup>4</sup> See Order No. PSC-06-0925-PCO-WS, issued November 6, 2006, in Docket No. 060246-WS, In re: Application for increase in water and wastewater rates in Polk County by Gold Coast Utility Corp.

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The Utility's 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:** The Utility should be required to open an escrow account or file a surety bond or letter of credit to guarantee any potential refund of revenues collected under interim conditions. If the security provided is an escrow account, the Utility should deposit \$28,759 into the escrow account each month. Otherwise, the surety bond or letter of credit should be in the amount of \$201,457. 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. (Mouring, Linn, Salnova)

**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 \$345,103 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 \$201,457. 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.

The criteria for a corporate undertaking include sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. Since Ni Florida recently acquired Hudson Utility, staff used Ni Florida's PSC Annual Report for 2008 and Hudson Utility, Inc's. Annual Reports for 2006 and 2007 to calculate these ratios. Ni Florida has improved equity ownership and liquidity to sufficient levels in 2008. However, the average of these measures over the most recent three-year period are not within acceptable parameters. Ni Florida reports insufficient interest coverage, deficient average equity ratio, and net losses over the review period. Net losses have steadily increased and have averaged over \$129,000 per year. For these reasons, staff believes Ni Florida does not have the financial capability to support a corporate undertaking in the amount of \$201,457. Based on this analysis, staff recommends that Ni Florida be required to secure a surety bond, letter of credit, or escrow agreement to guarantee any potential refunds of wastewater revenues.

If the security provided is an escrow account, said account should be established between the Utility and an independent financial institution pursuant to a written escrow agreement. The Commission should be a party to the written escrow agreement and a signatory to the escrow account. The written escrow agreement should state the following: that the account is established at the direction of this Commission for the purpose set forth above; that no withdrawals of funds shall occur without the prior approval of the Commission through the Commission Clerk, of Office of Commission Clerk; the account shall be interest bearing; information concerning that escrow account shall be available from the institution to the Commission or its representative at all times; the amount of revenue subject to refund shall be deposited in the escrow account within seven days of receipt; and, pursuant to Cosentino v. Elson, 263 So. 2d 253 (Fla 3d DCA 1972), escrow accounts are not subject to garnishments.

The Utility should deposit \$28,759 into the escrow account each month for possible refund. The escrow agreement should also state that if a refund to the customers is required, all



interest earned on the escrow account shall be distributed to the customers and, if a refund to the customers is not required, the interest earned on the escrow account shall revert to the Utility.

If the security provided is a surety bond or a letter of credit, said instrument should be in the amount of \$201,457. If the Utility chooses a surety bond as security, the surety bond should state that it will be released or terminated only upon subsequent order of the Commission. If the Utility chooses to provide a letter of credit as security, the letter of credit should state that it is irrevocable for the period it is in effect and that it will be in effect until a final Commission order is rendered releasing the funds to the Utility or requiring a refund.

Regardless of the type of security provided, the utility should keep an accurate and detailed account of all monies it receives. 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.

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

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**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. (Williams, Mouring, Linn)

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

Ni Florida, LLC. Schedule of Wastewater Rate Base Test Year Ended 12/31/08			Schedule No. 1-A Docket No. 090182-SU		
Description	Test Year Per Utility	Utility Adjust- ments	Adjusted Test Year Per Utility	Staff Adjust- ments	Staff Adjusted Test Year
Plant in Service	\$7,560,838	(\$8,551)	\$7,552,287	\$0	\$7,552,287
2 Land and Land Rights	9,513	0	9,513	0	9,513
3 Non-used and Useful Components	0	0	0	0	0
4 Construction Work In Progress	315	(315)	0	0	0
5 Accumulated Depreciation	(3,003,678)	22,404	(2,981,274)	0	(2,981,274)
6 CIAC	(3,496,849)	(1)	(3,496,850)	0	(3,496,850)
7 Amortization of CIAC	1,235,992	31,659	1,267,651	0	1,267,651
8 Acquisition Adjustments	3,620,491	(3,620,491)	0	0	0
9 Working Capital Allowance	<u>0</u>	<u>9,088</u>	<u>9,088</u>	<u>(9,088)</u>	<u>0</u>
10 <b>Rate Base</b>	<u>\$5,926,622</u>	<u>(\$3,566,207)</u>	<u>\$2,360,415</u>	<u>(\$9,088)</u>	<u>\$2,351,327</u>

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<b>Ni Florida, LLC.</b>		<b>Schedule No. 1-B</b>	
<b>Adjustments to Rate Base</b>		<b>Docket No. 090182-SU</b>	
<b>Test Year Ended 12/31/08</b>			
<b>Explanation</b>		<b>Water</b>	<b>Wastewater</b>
<u>Working Capital Allowance</u>			
To set working capital allowance to zero.		<u>N/A</u>	<u>(\$9,088)</u>

Ni Florida, LLC.  
 Capital Structure-13 Month Average  
 Test Year Ended 12/31/08

Schedule No. 2  
 Docket No. 090182-SU

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	\$233,931	\$0	\$233,931	(\$137,426)	\$96,505	4.09%	8.50%	0.35%	
2 Short-term Debt	0	0	0	0	0	0.00%	0.00%	0.00%	
3 Preferred Stock	0	0	0	0	0	0.00%	0.00%	0.00%	
4 Common Equity	5,477,556	0	5,477,556	(3,217,862)	2,259,694	95.73%	9.58%	9.17%	
5 Customer Deposits	10,219	0	10,219	(6,003)	4,216	0.18%	6.00%	0.01%	
6 Deferred Income Taxes	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0.00%</u>	0.00%	<u>0.00%</u>	
10 <b>Total Capital</b>	<u>\$5,721,706</u>	<u>\$0</u>	<u>\$5,721,706</u>	<u>(\$3,361,291)</u>	<u>\$2,360,415</u>	<u>100.00%</u>		<u>9.53%</u>	
<b>Per Staff</b>									
11 Long-term Debt	\$233,931	(\$93,468)	\$140,463	(\$24,311)	\$116,152	4.94%	8.50%	0.42%	
12 Short-term Debt	0	0	0	0	0	0.00%	0.00%	0.06%	
13 Preferred Stock	0	0	0	0	0	0.00%	0.00%	0.00%	
14 Common Equity	5,477,556	(2,783,820)	2,693,736	(466,235)	2,227,501	94.73%	8.72%	8.26%	
15 Customer Deposits	10,219	(2,545)	7,674	0	7,674	0.33%	6.00%	0.02%	
16 Deferred Income Taxes	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0.00%</u>	0.00%	<u>0.00%</u>	
20 <b>Total Capital</b>	<u>\$5,721,706</u>	<u>(\$2,879,833)</u>	<u>\$2,841,873</u>	<u>(\$490,546)</u>	<u>\$2,351,327</u>	<u>100.00%</u>		<u>8.70%</u>	
						<b>LOW</b>	<b>HIGH</b>		
RETURN ON EQUITY						<u>8.72%</u>	<u>10.72%</u>		
OVERALL RATE OF RETURN						<u>8.70%</u>	<u>10.60%</u>		

Ni Florida, LLC. Statement of Wastewater Operations Test Year Ended 12/31/08						Schedule No. 3-A Docket No. 090182-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 <b>Operating Revenues:</b>	<u>\$1,470,837</u>	<u>\$366,244</u>	<u>\$1,837,081</u>	<u>(\$366,244)</u>	<u>\$1,470,837</u>	<u>\$345,103</u> 23.46%	<u>\$1,815,940</u>
<b>Operating Expenses</b>							
2 Operation & Maintenance	\$1,302,104	\$34,294	\$1,336,398	\$0	\$1,336,398	\$0	\$1,336,398
3 Depreciation	123,059	0	123,059	0	123,059	0	123,059
4 Amortization	0	0	0	0	0	0	0
5 Taxes Other Than Income	136,300	16,481	152,781	(16,481)	136,300	15,530	151,830
6 Income Taxes	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
7 <b>Total Operating Expense</b>	<u>\$1,561,463</u>	<u>\$50,775</u>	<u>\$1,612,238</u>	<u>(\$16,481)</u>	<u>\$1,595,757</u>	<u>\$15,530</u>	<u>\$1,611,287</u>
8 <b>Operating Income</b>	<u>(\$90,626)</u>	<u>\$315,469</u>	<u>\$224,843</u>	<u>(\$349,763)</u>	<u>(\$124,920)</u>	<u>\$329,573</u>	<u>\$204,653</u>
9 <b>Rate Base</b>	<u>\$5,926,622</u>		<u>\$2,360,415</u>		<u>\$2,351,327</u>		<u>\$2,351,327</u>
10 <b>Rate of Return</b>	<u>(1.53%)</u>		<u>9.53%</u>		<u>(5.31%)</u>		<u>8.70%</u>

Ni Florida, LLC.  
Adjustment to Operating Statement  
Test Year Ended 12/31/08

Schedule No. 3-B  
Docket No. 090182-SU

Explanation	Water	Wastewater
<u>Operating Revenues</u> Remove requested final revenue increase.	<u>N/A</u>	<u>(\$366,244)</u>
<u>Taxes Other Than Income</u> RAFs on revenue adjustments above.	<u>N/A</u>	<u>(\$16,481)</u>

<b>Ni Florida, LLC. Wastewater Monthly Service Rates Test Year Ended 12/31/08</b>		<b>Schedule No. 4 Docket No. 090182-SU</b>		
	<b>Test Year Rates on 12/31/08</b>	<b>Utility Requested Interim</b>	<b>Utility Requested Final</b>	<b>Staff Recommended Interim</b>
<b><u>Residential</u></b>				
All Meter Sizes:	\$15.72	\$19.45	\$19.89	\$19.49
Gallage Charge Per 1,000 Gallons (10,000 gallon cap)	\$5.17	\$6.41	\$6.54	\$6.41
<b><u>General/Multi-Residential Service</u></b>				
Base Facility Charge by Meter Size:				
5/8" x 3/4"	\$15.72	\$19.45	\$19.89	\$19.49
Full 3/4"	\$23.56	\$29.14	\$29.80	\$29.21
1"	\$39.26	\$48.58	\$49.67	\$48.68
1-1/2"	\$78.51	\$97.13	\$99.32	\$97.35
2"	\$125.63	\$155.42	\$158.92	\$155.78
3"	\$251.25	\$310.85	\$317.84	\$311.55
4"	\$392.56	\$485.67	\$496.61	\$486.78
6"	\$785.16	\$971.38	\$993.26	\$973.61
8"	\$1,256.24	\$1,554.18	\$1,589.20	\$1,557.75
10"	\$1,805.86	\$2,234.17	\$2,284.49	\$2,239.29
General Service - Gallage Charge, per 1,000 Gallons	\$6.17	\$7.66	\$7.81	\$7.65
Bulk Flow Meter Service - Gallage Charge, per 1,000 Gallons	\$6.45	\$8.00	\$8.16	\$8.00
<b><u>Typical Residential Bills 5/8" x 3/4" Meter</u></b>				
3,000 Gallons	\$31.23	\$38.68	\$39.51	\$38.72
5,000 Gallons	\$41.57	\$51.50	\$52.59	\$51.54
10,000 Gallons	\$67.42	\$83.55	\$85.29	\$83.59