

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:** September 16, 2010

**TO:** Office of Commission Clerk (Cole)

**FROM:** Office of the General Counsel (A. Williams) *ARW JC Cole*  
Division of Economic Regulation (J. Williams, Daniel) *JW*

**RE:** Docket No. 100318-WS – Petition for order to show cause against Service Management Systems, Inc. in Brevard County for failure to properly operate and manage water and wastewater system.

**AGENDA:** 09/28/10 – Regular Agenda – Motion to Dismiss – Oral Argument Not Requested; Participation is at the Commission’s Discretion

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICER:** Skop

**CRITICAL DATES:** None

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\GCL\WP\100318.RCM.DOC

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### Case Background

Service Management Systems, Inc. (SMS or utility) is a Class B utility that provides water, wastewater, and non-potable irrigation services to approximately 370 customers in Brevard County. The utility’s 2008 annual report shows combined water and wastewater revenues of \$379,622, and a net operating loss of \$75,994. The utility has been providing service to customers in Brevard County since 1984. In 1989, the Commission granted the utility original Certificate Nos. 517-W and 450-S.<sup>1</sup> A name change and a series of majority control

<sup>1</sup> Order No. 22075, issued October 19, 1989, in Docket No. 880595-WS, In re: Objections by Service Management Systems, Inc. for water and sewer certificates in Brevard County.

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transfers by Aquarina Developments, Inc. led to the certificates being transferred to SMS under IRD Osprey, LLC d/b/a Aquarina Utilities in 2003.<sup>2</sup>

On January 8, 2009, Oak Lodge Utility, LLC (Oak Lodge) filed an application for transfer of majority organizational control of SMS from IRD Osprey, LLC to Oak Lodge.<sup>3</sup> By an Objection to Application for Transfer of Majority Organizational Control dated February 13, 2009, Compass Bank (Bank) advised staff that SMS had an outstanding loan that was in default and that on October 6, 2008, the Bank had filed a foreclosure action against SMS, Compass Bank v. Service Management Systems, Inc. et al., Case No. 05-2008-CA-61639, in the Circuit Court for Brevard County, Florida. On February 3, 2010, the Eighteenth Judicial Circuit issued an Order Appointing Receiver of SMS and named Mr. Dennis Basile as receiver, which the Commission acknowledged by Order No. PSC-10-0329-FOF-WS.<sup>4</sup>

Oak Lodge withdrew its application for transfer of majority organization control on February 10, 2010, and the docket was closed on March 5, 2010. On April 15, 2010, FL-Service Management, LLC (the LLC) acquired ownership of SMS by virtue of being the high bidder at the foreclosure sale. Consequently, the LLC owns, and has retained an operator to operate, the water and wastewater treatment utility facilities in Brevard County, Florida that were previously owned by SMS. Docket 100094-WS remains open pending the sale of the utility by the Bank to a permanent owner.

On June 7, 2010, Aquarina Utility Association, Inc. (the Association) filed a Petition for Order to Show Cause Against SMS in Brevard County for Failure to Properly Operate and Manage Water and Wastewater System (Petition). The Association is a Florida non-profit corporation consisting of customers served by the utility's water and wastewater facilities in Brevard County. In its Petition, the Association requests that the Commission enter an order directing the LLC to "show cause why the rates being charged to customers should not be reduced due to the hazardous condition of the plant facilities which threaten the public health and safety as well as the environment."<sup>5</sup>

The Association asserts that the Florida Department of Environmental Protection (FDEP) advised SMS, by letter dated January 13, 2010, that its wastewater system required several modifications and repairs in order to "achieve compliance" and that the wastewater system remains non-compliant. The Association alleged other "safety hazards" at the utility's facilities, including a broken clarifier arm, a gap in the catwalk, a hose and sprinkler lying across the catwalk in lieu of proper aeration, a one-inch pipe lying across the catwalk, and an un-registered, un-permitted oil storage tank that has never been inspected for proper operation. The Association asserts in its Petition that the utility "cannot be expected to operate in compliance

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<sup>2</sup> Order No. PSC-03-0787-FOF-WS, issued July 2, 2003, in Docket No. 020091-WS, In re: Application for transfer of majority organizational control of Service Management Systems, Inc., holder of Certificates Nos. 517-W and 450-S in Brevard County, from Petrus Group, L.P. to IRD Osprey, LLC d/b/a Aquarina Utilities.

<sup>3</sup> Docket No. 090019-WS, In re: Application for transfer of majority organizational control of Service Management Systems, Inc., holder of water Certificate No. 517-W and wastewater Certificate 450-S, in Brevard County, from IRD Osprey, LLC to Oak Lodge Utility, LLC.

<sup>4</sup> Issued May 24, 2010, in Docket No. 100094-WS, In re: Notice of appointment of receiver for Service Management Systems, Inc. in Brevard County pursuant to Circuit Court foreclosure proceeding.

<sup>5</sup> Petition at 1.

with applicable laws, rules and standards for an extended period of time in the current condition of the facilities.”<sup>6</sup> Accordingly, the Association submits that if the Commission does not require the LLC to take immediate affirmative action to correct the alleged hazards at the utility’s facilities, its member customers will be subject to continuous health, safety and environmental risks.

On June 30, 2010, staff sent a data request to the utility to inquire into those issues identified by the Association, including environmental compliance and the current status of facility repairs and improvements. In its July 30, 2010 response, the utility outlined the ongoing steps it is taking to make the necessary repairs and improvements and stated that while repairs are being made, all applicable requirements are being met. Staff also contacted the FDEP about the status of the required repairs and the overall environmental compliance status of the utility. The FDEP verified through the utility’s monthly Discharge Monitoring Reports that all effluent standards and operational requirements are being met while repairs are being made. FDEP acknowledges that the plant is not currently operating as designed. However, the FDEP is allowing the utility time to bring the facility into compliance because it recognizes the financial and ownership issues the utility is facing.

The LLC filed a Motion to Dismiss the Association’s Petition on June 28, 2010. The Association responded to the LLC’s Motion to Dismiss on July 8, 2010 (Response in Opposition). Neither party filed a request for oral argument as provided for in Rule 25-22.0022, Florida Administrative Code (F.A.C.), which states that “[o]ral argument must be sought by separate written request filed concurrently with the motion on which argument is requested.” Pursuant to Rule 25-22.0022, F.A.C., the parties’ failure to timely file such a written request shall constitute a waiver of oral argument. However, pursuant to Rule 25-22.0022(7)(b), F.A.C., participation is at the Commission’s discretion.

For the reasons described below, the Commission should grant the LLC’s Motion to Dismiss, without prejudice. The Commission has jurisdiction pursuant to Chapter 367, Florida Statutes (F.S.).

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<sup>6</sup> Petition at 3.

### **Discussion of Issues**

**Issue 1:** Should the Commission grant FL-Service Management, LLC's (the LLC) Motion to Dismiss Aquarina Utility Association, Inc.'s (the Association) Petition for Order to Show Cause Against Service Management Systems, Inc. in Brevard County for Failure to Properly Operate and Manage Water and Wastewater System?

**Recommendation:** Yes. Staff recommends that the Commission grant the LLC's Motion to Dismiss the Association's Petition without prejudice. The Petition fails to state a cause of action upon which the Commission can grant relief. (A. Williams)

### **Staff Analysis:**

#### **Standard of Review**

A motion to dismiss challenges the legal sufficiency of the facts alleged in a petition to state a cause of action. Meyers v. City of Jacksonville, 754 So. 2d 198, 202 (Fla. 1st DCA 2000). The standard to be applied in disposing of a motion to dismiss is whether, with all the allegations in the petition assumed to be true, the petition states a cause of action upon which relief can be granted. Id. When making this determination, only the petition and documents incorporated therein can be reviewed, and all reasonable inferences drawn from the petition must be made in favor of the petitioner. Varnes v. Dawkins, 624 So. 2d 349, 350 (Fla. 1st DCA 1993); Flye v. Jeffords, 106 So. 2d 229 (Fla. 1st DA 1958), overruled on other grounds, 153 So. 2d 759, 765 (Fla. 1st DCA 1963); and Rule 1.130, Florida Rules of Civil Procedure (F.R.C.P.).

#### **The LLC's Motion to Dismiss**

The LLC timely filed a Motion to Dismiss the Association's Petition. In its Motion, the LCC requests that the Commission dismiss the petition for failure to state an appropriate cause of action or, alternatively, address the concerns identified in the Association's petition pursuant to the Commission's informal complaint resolution procedures set forth in Rules 25-22.032 and 25-30.355, F.A.C.

The LLC argues that the Association's attempt to use the Commission's show cause procedures is inappropriate because the purpose of a show cause proceeding is to address specific instances where a utility knowingly refuses to comply with, or willfully violates, Commission orders, rules or statutes and to bring a utility into compliance. According to the LLC, the Association has not, and cannot, identify any specific orders, rules, or statutes with which the LLC has refused to comply or is alleged to have violated.

The LLC also contends that all of the concerns identified in the Petition are subject to the primary regulatory control of the Florida Department of Environmental Protection (FDEP) and other relevant local building and safety code authorities (Local Enforcement Authorities), rather than the Commission. The LLC asserts that the Commission should defer to the FDEP and Local Enforcement Authorities, who can enforce their regulations with respect to the quality of drinking water or the effluent that the wastewater plant produces if they prove to be outside of established standards.

The LLC states that the concerns raised in the FDEP letter relate to back-up components that will not become an issue unless and until the primary component fails. With respect to the clarifier arm, the LLC asserts that it is in the process of making needed repairs, and that its ongoing repair efforts have not adversely affected the utility's ability to comply with relevant wastewater and water quality standards. The LLC also addresses the "safety hazards" identified by the Association, namely the gap in the catwalk, the hose and sprinkler lying across the catwalk "in lieu of proper aeration," and the one-inch pipe lying across the catwalk. According to the LLC, these conditions do not indicate anything improper. Instead, they are normal conditions of a working plant in the process of making repairs.<sup>7</sup>

Regarding its alternative request, the LLC states that the informal complaint procedures set forth in Rules 25-22.032 and 25-30.355, F.A.C., which are designed to resolve disputes between regulated companies and their customers effectively and cost-efficiently, are appropriate in this case because the LLC is diligently working to repair the utility's facilities, and an ancillary administrative proceeding would divert crucial financial resources from the utility's ongoing improvement efforts.

#### The Association's Response

In its Response, the Association cites Sections 367.0822, 367.081(2)(a)(1), and 367.121(d), F.S., to support its Petition. Section 367.0822, F.S., provides that the Commission may conduct limited proceedings to consider any matter within its jurisdiction, including any matter the resolution of which requires a utility to adjust its rates. Section 367.081(2)(a)(1), F.S., states that the Commission shall, upon request, fix rates which are just, reasonable, compensatory and not unfairly discriminatory. Section 367.121(d), F.S., gives the Commission power to require repairs and improvements to any facility if such repairs and improvements are reasonably necessary to provide adequate and proper service, or any prescribed quality of service.

In further support of its Petition, the Association asserts that the utility's customers should not be required to continue to pay previously established rates for "substandard utility operation."<sup>8</sup> Accordingly, the Association states that it seeks to bring the utility's deficiencies formally before the Commission so that the Commission will take the steps necessary to require the LLC to remedy the existing conditions at the utility's facilities.

#### Analysis

Upon review of the Petition, staff believes that the Association has failed to state a cause of action upon which the Commission can grant relief. The Commission should dismiss the Petition, without prejudice, for the reasons provided below.

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<sup>7</sup> For example, the LLC states: "There may have been a board missing [in the catwalk] because employees were working on a component. The hose and sprinkler laying across was being used as an additional means, in lieu of the clarifying arm, to disperse solids in the tank, not in lieu of proper aeration." Motion to Dismiss at 5, fn.3.

<sup>8</sup> Response at 3.

Show Cause

The Commission has jurisdiction to review conduct that is alleged to violate Chapter 367, F.S., or any lawful rule or order of the Commission. Section 367.161(2), F.S., provides that if any utility knowingly refuses to comply with, or willfully violates, any provision of Chapter 367, F.S., or any lawful rule or order of the Commission, the utility shall incur a penalty for each offense. Each day that the refusal or violation continues constitutes a separate offense, and a penalty of not more than \$5,000 shall be imposed for each offense. The purpose of the Commission's show cause procedure is to bring the utility into compliance.<sup>9</sup> The Commission can also require the utility to show cause why its return on equity should not be reduced pursuant to Section 367.111(2), F.S., but only where there is an apparent violation of the statute.<sup>10</sup> In other words, the Commission must be able to identify a statutory section, rule, or agency order that has been violated, as well as the facts or conduct relied upon to establish the violation.<sup>11</sup>

Staff believes that the Association's attempt to invoke the Commission's show cause procedure is inappropriate in this case. Upon circumstances brought forth by a utility's customers or other parties, staff may recommend that a show cause proceeding is warranted and should be initiated. However, the decision to invoke the Commission's show cause procedure is ultimately the Commission's. The Association has failed to identify any statutory section, rule, or order of the Commission that the utility has violated, nor has it identified facts to support any such violation. The Association states that the utility's wastewater system needs modification and repair in order to "achieve compliance" with the FDEP and that there are several "safety hazards" at the utility's facilities, including a broken clarifier arm, a gap in the catwalk, a hose and sprinkler lying across the catwalk in lieu of proper aeration, a one-inch pipe lying across the catwalk, and an un-registered, un-permitted oil storage tank that has never been inspected for proper operation. Assuming that all of these allegations are true, and viewing all reasonable inferences in favor of the Association, it has not alleged facts sufficient to make a prima facie showing that the utility is willfully violating or refusing to comply with any rule, statute or order of the Commission. Furthermore, the Association has not cited to any FDEP or county health department notices of violation or consent orders. Accordingly, staff recommends that a

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<sup>9</sup> See Section 367.161, F.S.; Order No. PSC-00-1675-PAA-WS, issued September 19, 2000, in Docket No. 991984-WS, In re: Application for transfer of Certificate Nos. 277-W and 223-S in Seminole County from Alafaya Palm Valley Associates, Ltd. to CWS Communities LP d/b/a Palm Valley at 5; Order No. PSC-00-1389-PAA-WU, issued July 31, 2000, in Docket No. 991001-WU, In re: Application for transfer of facilities and Certificate No. 424-W in Highlands County from Lake Josephine Water to AquaSource Utility, Inc. at 4; Order No. PSC-98-1594-FOF-GU, issued December 1, 1998, in Docket No. 981039-GU, In re: Request for authorization, pursuant to Rule 25-7.015, F.A.C., to keep records out of state, by City Gas Company of Florida at 3.

<sup>10</sup> See Order No. PSC-05-0204-SC-WU, issued February 22, 2005, in Docket No. 050018-WU, In re: Initiation of deletion proceedings against Aloha Utilities, Inc. for failure to provide sufficient water service consistent with the reasonable and proper operation of the utility system in the public interest, in violation of Section 367.111(2), Florida Statutes at 4 (requiring utility to show cause why certain territories should not be deleted from its certificate and why it should not be fined for apparent violation of Section 367.111(2), F.S.). For the reasons discussed below, staff believes the Association has failed to make a prima facie showing that the utility is violating or failing to comply with Section 367.111(2), F.S., or any other statute governing quality of service.

<sup>11</sup> Id. See also Order No. PSC-97-0854-FOF-SU, issued July 16, 1997, in Docket No. 961220-SU, In re: Application for staff-assisted rate case in Citrus County by RHV Utility, Inc. (requiring utility to show cause why it should not be fined for failing to comply with Section 367.111(2), F.S., by not providing satisfactory service which meets the standards promulgated by the FDEP).

proceeding requiring the utility to show cause why its rates should not be reduced is inappropriate and should not be initiated.

#### Rate Reduction for Poor Quality of Service

The Association's Petition, though styled as a petition requesting that the Commission order the LLC to show cause why it should not be penalized for failure to properly operate and manage its systems, could reasonably be construed as a complaint regarding the utility's quality of service and a request that rates be decreased due to poor service quality. Considering the Petition in a light most favorable to the Association, staff believes it is appropriate to treat the Petition as such.

The Commission has jurisdiction over the quality of service provided by a public utility pursuant to Section 367.011(2), F.S. Each utility is required to provide safe, efficient, and sufficient service,<sup>12</sup> and there are several avenues of relief where a utility's service quality falls below statutory standards. Section 367.111(2), F.S., for example, provides that if the Commission finds a utility has "failed to provide its customers with water or wastewater service that meets the standards promulgated by the [FDEP] or the water management districts," the Commission may reduce the utility's return on equity until the standards are met. Under that provision, the relevant inquiry is whether there are facts to show that the utility has violated this statutory standard such that it is in the public interest for this Commission to reduce the utility's return on equity. Similarly, Section 367.121(d), F.S., states that the Commission can require repairs and improvements to any utility facility if "necessary to provide adequate and proper service, or . . . any prescribed quality of service." The Commission also has general ratemaking authority under Section 367.121(d), F.S., to fix fair and reasonable rates when it finds that rates must be adjusted in order to comply with statute. To state a cause of action under any of these statutes, a complainant must allege that the utility's quality of service is poor or falls below statutory standards.

According to the Association, the rates the utility is charging to customers should be reduced due to the condition of and the utility's failure to properly operate and manage its water and wastewater systems. The Association claims that according to a January 13, 2010 letter from the FDEP, the utility's wastewater system requires several modifications and repairs in order to achieve compliance. In its Petition, the Association refers to "obvious violations of applicable laws, rules and standards" and "obvious deficiencies," and contends that its member customers will be subject to "continuous health, safety and environmental risks" due to conditions at the utility's facilities (e.g., a broken clarifier arm and a gap in the catwalk). Finally, the Petition states that the utility "cannot be expected to operate in compliance with applicable laws, rules and standards *for an extended period of time* in the current condition of the facilities."<sup>13</sup>

Staff believes that the Association has failed to make substantive allegations that there is a service quality problem which would warrant a reduction to the utility's rates or return on equity. The Association does not make specific factual allegations that the standards prescribed

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<sup>12</sup> Section 367.111(2), F.S.

<sup>13</sup> Petition at 3. Emphasis added.

by the Commission or promulgated by the FDEP are not being met or that the utility is not providing adequate service, nor does it specifically identify any "violations" or "deficiencies." As noted above, the Association has failed to cite to any FDEP or county health department notices of violation or consent orders. The Association's conclusory assertions are unsupported by sufficient factual allegations. In fact, the Association's own assertion that the utility cannot be expected to operate in compliance "for an extended period of time" undermines its requested relief. This statement implies that the utility is currently operating in compliance, which indicates that the Association's concerns, and thus its Petition, are premature at this time. Staff believes that the Association has failed to demonstrate a cause of action for reducing the utility's rates or its authorized return on equity for poor service quality, and that the Commission should dismiss the Petition on that ground. Accordingly, staff does not address the LLC's alternative request that the Association be required to use the informal complaint procedures set forth in Rules 25-22.032 and 25-30.355, F.A.C., should the Commission deny its Motion to Dismiss.

Staff notes that Section 120.569(2)(c), F.S., provides that dismissal of a petition shall, at least once, be without prejudice to petitions filing a timely amended petition curing the defect, unless it conclusively appears from the face of the petition that the defect cannot be cured. In this instance, staff does not believe that the Petition conclusively demonstrates that the defect cannot be cured. The Association could conceivably remedy its failure to state a cause of action if it can specifically allege that the utility's service to customers falls below standards prescribed by the Commission or promulgated by the FDEP or water management districts. Accordingly, staff recommends that the Commission grant the LLC's Motion to Dismiss without prejudice, thus giving the Association the opportunity to file an amended petition.



Docket No. 100318-WS  
Date: September 16, 2010

**Issue 2:** Should this docket be closed?

**Recommendation:** Yes. If the Commission approves staff's recommendation, the docket should be closed after time for an appeal has run. If the Commission denies staff's recommendation, the docket should remain open. (A. Williams)

**Staff Analysis:** If the Commission approves staff's recommendation, the docket should be closed after time for an appeal has run. If the Commission denies staff's recommendation, the docket should remain open.