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Sent: Tuesday, July 31, 2012 4:11 PM
To: Filings@psc.state.fl.us
Cc: Office of Commissioner Brisé; Office Of Commissioner Edgar; Office Of Commissioner Graham; Office of Commissioner Balbis; Office of Commissioner Brown; Todd Brown; Mark Cicchetti; Bart Fletcher; Andrew Maurey; Ralph Jaeger; Martha Barrera; Marty Friedman; Gene Brown; Ann Cole
Subject: E-filing (Dkt. No. 110200-WU)
Attachments: Letter to Ann Cole.dated 7-31-12.docx.pdf

Electronic Filing

a. Person responsible for this electronic filing:

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b. Docket No. 110200-WU

In re: Application for increase in water rates in Franklin County by Water Management Services, Inc.

c. Document being filed on behalf of Office of Public Counsel

d. There are a total of 9 pages.

e. The document attached for electronic filing is a letter to Ann Cole,
Director, Office of Commission Clerk.
(See attached file: Letter to Ann Cole.dated 7-31-12.docx.pdf)

Thank you for your attention and cooperation to this request.

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FILED

DOCUMENT NUMBER-DATE

05149 JUL 31 2012

FPSC-COMMISSION CLERK

7/31/2012

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*Speaker of the
House of Representatives*



July 31, 2012

Ann Cole, Director
Office of Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

**Re: Docket 110200-WU, Application for increase in water rates in Franklin County by
Water Management Services, Inc.**

Dear Ms. Cole:

The Office of Public Counsel has reviewed staff's proposed agency action (PAA) recommendation for Water Management Services, Inc. (WMSI). OPC agrees with many aspects of staff's recommendation and disagrees with others. OPC supports staff's customer protections built into Issue 5 and Issue 15. However given the long history of WMSI's interaction with this Commission, OPC believes that more needs to be done to adequately address the underlying issues that have caused the utility's financial difficulties. These self-inflicted financial difficulties impact the continued viability of the utility as a going concern and primarily involve issues relating to and stemming from the managerial imprudence related to the utility's cash flow management.

This letter is an attempt to highlight a few of OPC's concerns with the utility and the recommendation. Below OPC sets forth a few of the major questions and concerns which OPC believes must be addressed and appropriately disposed of at this juncture in the PAA process. This letter is meant to help facilitate a thoughtful discussion of OPC's concerns and allow an opportunity for the utility and/or staff to respond. To this end, we are sharing these concerns in advance of the Commission's consideration of staff's PAA recommendation.

Thank you in advance for your review and consideration.

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Respectfully Submitted,



Erik Saylor
Associate Public Counsel

CC: **Chairman Ronald A. Brisé's Suite (via email)**
Commissioner Lisa Polak Edgar's Suite (via email)
Commissioner Art Graham's Suite (via email)
Commissioner Eduardo E. Balbis's Suite (via email)
Commissioner Julie I. Brown's Suite (via email)

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Office of General Counsel (Jaeger, Barrera via email)

Martin S. Friedman, Esq. (via email)

Mr. Gene D. Brown (via email)

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Issue 5: Should adjustments be made to the Utility's pro forma plant additions and associated expenses?

Requested pro forma plant

OPC is concerned with the scope of the utility's requested plant additions, especially since the pro forma requested by the utility has increased by over \$1 million since the last rate case which was decided less than 18 months ago. There is a discussion of two new plant additions in this rate case, but there is no discussion of what caused the substantial increased cost over the last rate case (whether the substantial increase in cost was attributable to these new items or the original pro forma request), or whether the substantial increase in cost for plant additions is reasonable. OPC disputes the utility's request for more than \$400,000 in additional land to build the new ground water storage tank and whether the proposed cost of that land is reasonable given the current state of the economy.

Les Thomas attached three bids to his testimony in support of the requested plant additions. Does the Commission have an established process by which the staff evaluates and determines that a utility's pro forma plant bids were appropriate or that the costs contained therein reasonable? The low bid was submitted by Ben Withers, Inc. However, it did not contain his licensing credentials unlike the other two bids. Has it been determined whether Ben Withers, Inc. is licensed to perform the work upon which he submitted his low bid? Did the staff determine whether there is any relation to Barbara Withers, WMSI's accountant, and, if so, whether there is a conflict of interest?

Post-in-service pro forma review

Staff auditors confirmed that WMSI's president has transferred more than \$1.2 million of utility cash out of the utility to himself and other non-utility entities, costing the utility more than \$930,000 in extra interest on the DEP loan. Staff is recommending a finding of managerial imprudence related to those transfers which have impaired the utility's ability to meet its financial and operating responsibilities. In light of these two facts, OPC is concerned whether WMSI can be entrusted to appropriately spend the \$3.3 million being recommended for approval.

OPC agrees that Phase II rates should not be implemented until after the additions are placed into commercial service. However, other than reviewing "final invoices and cancelled checks" after the plant is placed into service, what steps are being recommended to ensure that nearly \$3.3 million is appropriately and prudently spent? Will there be a review of the final expenditures to determine that the moneys were reasonably and prudently expended especially in light of this utility's past history of transferring cash out of the utility?

OPC believes that pre-approving Phase II rates may be a license for the utility and its contractor to spend up to the amount preapproved. There is no incentive to do otherwise. By pre-approving the pro forma amount, where is the incentive for the utility to cut costs and save money? The recommendation appears to be a blank check for spending up to \$3.3 million so long as the utility provides "final invoices and cancelled checks."

Phased in Rates

From a ratemaking perspective, OPC is concerned with the Phase II rate increase being recommended.¹ OPC appreciates what the staff is recommending and some of the customer protections built in to its recommendation on this issue. Given the precarious financial position of this utility, OPC understands that the promise of a Phase II rate increase is something a lender may be willing to lend against, assuming there is even adequate cash flow from future a Phase II rate increase to make the debt service payments on the new loan. Once Phase II rates are implemented, rate base will increase from approximately \$3.7 million to approximately \$7.1 million and long-term debt from approximately \$7.7 million to approximately \$11.6 million. However, there is a bigger question here. Even with Phase I or Phase II rates, can this utility service its current or future debt obligations?

Pro forma plant financing

The utility has stated that it is seeking a USDA-backed loan with a new lender in the amount of \$6.6 million to finance the new pro forma additions totaling \$3.3 million and to retire a \$2.7 million loan with Centennial bank. The recommendation does not indicate whether staff independently verified the statements made by the utility related to financing the requested additions. On May 25, 2012, WMSI submitted an application for a loan with Fidelity Bank; however, many things appear to be omitted from that application, such as Mr. Gene Brown's personal tax returns and other key financial documents that banks commonly require when considering a loan application. Has staff independently verified that the bank loan application has been submitted to and accepted by Fidelity Bank? Did the utility provide a copy of the canceled check for the bank loan application fee, which we understand for Fidelity Bank is usually 1% of the requested total loan amount, \$66,000 on a \$6.6 million loan?

On July 9, 2012, WMSI submitted follow-up statements concerning the Fidelity Bank application, stating that the loan application is "pending." Has that pending status been verified with Fidelity Bank? Did the utility provide documentation or a letter from the Bank that the application is "on hold", or that the bank will in fact entertain WMSI's financing proposal? Further, the July 9, 2012 letter implied that DEP and the Bank would have to reach some inter-creditor agreement as it relates to utility assets. Did staff independently verify these statements with the Bank or DEP? Has it been ascertained whether DEP will in fact subordinate its loan to another lender? Can DEP under Florida Statutes subordinate its loan or reach an inter-creditor agreement as described in the July 9, 2012 letter? Many questions remain concerning this financing arrangement.

¹ Authorizing a Phased-in-Rate process for a Class A utility may not be appropriate. Past cases where staff has recommended a Phased-in-Rate process have been in Staff Assisted Rate Cases (SARC's), not in rate cases for Class A or B utilities. A utility that qualifies for a SARC usually needs a higher level of help and "handholding" from staff due to its small size and it may suffer from cash flow issues. A Class A utility is usually more sophisticated and should not need such help.

Issue 7: What is the appropriate amount of unamortized rate case expense?

Rate case expense from last rate case

In the last rate case, WMSI was authorized approximately \$230,000 in rate case expense. Approximately \$146,000 of this amount was approved for WMSI to pay its attorneys for legal services. In March 2012, OPC sent discovery to ascertain whether WMSI had paid its legal fees for the last rate case. In April, WMSI provided documents showing that it had not made any payments to its attorneys since November 2010, which was before the conclusion of its last rate case. OPC brought this to the Commission's attention. In a statement by WMSI filed on May 30, 2012, WMSI said it did not dispute any of the charges for legal services from the last rate case and had entered into an agreement to make installment payments. OPC understands that WMSI started making \$1,000 monthly payments to its prior attorneys in April 2012 after OPC asked for proof of payment. OPC notes that it will take almost 10 years at \$1,000 per month to repay the last law firm. OPC is concerned whether the utility will continue making those \$1,000 payments following the conclusion of this rate case.

In light of these facts, why is it appropriate to allow any unamortized rate case expense to remain when the utility has previously demonstrated an unwillingness to pay its legal services from the last rate case notwithstanding the current repayment plan? Customer rates currently include money to pay those prior legal services. Should the Commission reduce current rates to reflect the actual payments being made by WMSI to its former attorneys, i.e., match the \$1,000 monthly payments? Should customers be refunded the monies already paid in rate case expense that were not used by WMSI for the purpose for which it was requested? Should the Commission discontinue authorizing rate case expense from the last rate case because as demonstrated by earlier actions the utility may likely discontinue making payments following the conclusion of this rate case?

Issue 15: Have the Utility's cash advances to WMSI's President and associated companies in the amount of \$1.2 million, represented by Account 123, affected the Utility's ability to meet its financial and operating responsibilities? If so, what action, if any, should the Commission take?

Funds transferred to WMSI President

In the last rate case, the Commission ordered a cash flow audit of the utility to determine whether the activity in Account 123 impaired the utility's ability to meet its financial and operating responsibilities. Account 123 relates to *Investment in Associated Companies* as defined by NARUC.² According to Staff's most recent updated cash flow audit, dated March 2, 2012, Exhibit 3: Comparative Cash Receipts and Disbursements, Non-Utility Activity, *Cash Receipts*, it shows that Gene D. Brown personally contributed \$948,135 of cash to the utility. Under *Cash Disbursements*, and it shows that Gene D. Brown personally received \$2,560,664 in cash from the utility. That leaves a net amount of \$1,612,529 that the WMSI President

² The NARUC USOA for Class A Water Utilities defines the account as: "This account shall include the book cost of investments in securities issued or assumed by associated companies and investment advances to such companies, including interest accrued thereon when such interest is not subject to current settlement. Include also the offsetting entry to the recording of amortization of discount or premium on interest bearing investments."

personally received in cash from Account 123. Can an individual receive cash from or through Account 123, a NARUC account designated for Investment in Associated Companies?

Additional remedies to rectify current and prevent future cash flow problems

OPC agrees with audit staff's cash flow analysis that more than \$1.2 million net flowed out of the utility to WMSI's President and associated companies. OPC agrees with staff's finding that the President's actions have impaired the utility's ability to meet its financial and operating responsibilities and constitutes managerial imprudence. OPC agrees with staff's recommended remedy of reducing the President's salary and benefits by approximately \$44,000 as it relates to the more than \$930,000 in excess interest on the DEP loan that WMSI is now obligated to pay because it did not timely pay its debt and had to renegotiate.

Staff's recommendation correctly analyzes the cause of the utility's cash flow ills and properly finds managerial imprudence; however, staff treats only one symptom and does not propose a long-time cure. The recommendation does not address what steps the Commission could take to ensure WMSI does not transfer even more cash out of the utility to WMSI's president and/or associated companies after the conclusion of this rate case, further impairing the utility's financial position. It does not address how to repatriate the \$1.2 million back into the utility from the president and/or associated companies or address the need to impute interest which should be accruing on the \$1.2 million since 2004.

OPC recommends that the Commission take further steps to protect the customers and the financial viability of the utility, by addressing the \$1.2 million transferred from the utility and to prevent those cash transfers from happening in the future. OPC urges the Commission to consider implementing one or more of the following options. Under each option, the investments in associated companies should be treated as long-term loans to those associated companies and not accounts receivable. As such, these loans should include the calculation of interest on the \$1.2 million starting in 2004, based upon the IRS interest rate tables for long-term intercompany loans, *available at* <http://www.irs.gov/app/picklist/list/federalRates.html>. Additionally, the Commission should take affirmative action to ensure that absolutely no additional utility money goes personally to Mr. Brown or is transferred out of the utility until the \$1.2 million plus interest is repatriated to the utility.

Option (1) -- The Commission could order an accounting and/or valuation of Brown Management Group (BMG) which the utility purportedly owns 100% of that stock. If it is worth more than \$1.2 million as alleged by WMSI's President, the Commission could order the liquidation of BMG's assets and require the utility to pay off as much debt as possible with the proceeds. Liquidating BMG will strengthen the financial integrity of WMSI by reducing the level of excessive utility debt. In the past, the Commission has ordered the utility to purchase assets, such as the elevated storage tank to maintain its quality of service. See Order No. 23258, issued July 27, 1990, in Docket No. 871177-WU. In this instance, the Commission could order the utility to liquidate BMG in order to pay down a significant portion of its long-term debt. Alternatively, condition any Phase I rate increase on the proof of BMG's liquidation and paying down of long-term utility debt.

Option (2) -- The Commission could take the interest accrued on the \$1.2 million since 2004 and impute as income to the utility and reduce rates. The associated companies should not benefit from interest free loans. This would at least allow the interest portion that should accrue on these loans to be repatriated to the utility and to the benefit of the customers.

Option (3) -- The Commission could direct WMSI to record a regulatory liability in the amount of \$1.2 million plus accrued interest, and require amortization of that amount over a reasonable period of time (5 years; 10 years; etc), and reduce rates equal to the annual amortization. Whether designated as a regulatory liability or another more appropriate account, it could be imputed against rates, and that imputation made permanent until the money with interest is repaid to the utility. Either alternative should be implemented in a fashion to ensure that \$1.2 million plus interest will be repaid to the utility should Mr. Brown sell the utility to another company regulated by the Commission.

Option (4) -- According to the last rate case order, the Commission has the authority to reduce the president's salary for managerial imprudence. (at 55). Therefore, in addition to the steps taken to reduce the President's salary for the excess DEP loan interest, the Commission could reduce the President's salary and benefits to zero.³ The remainder of the President's salary plus benefits could be used to reduce customer rates by the amount of the president's remaining salary to eventually repatriate the \$1.2 million plus interest taken out of the utility by the President and/or associated companies.

Option (5) -- The Commission could take the entire \$1.2 million plus interest and reduce rate base by that amount. This would provide some benefit to customers should Mr. Brown sell the utility to another company regulated by the Commission.

In the public interest

Section 367.011, Florida Statutes, states: "The regulation of utilities is declared to be in the public interest, and this law is an exercise of the police power of the state *for the protection of the public health, safety, and welfare. . .*" (emphasis added). Whether the Commission orders one of OPC's suggested options or some other ratemaking option to return the \$1.2 million and shore up the financial integrity of this utility, OPC believes that this issue must be confronted now as opposed to later. An example should be provided to other utilities in this state that this Commission will not sit idly by and let a utility run itself into financial ruin affecting the health, safety, and welfare of its customers through managerial imprudence.

Issue 24: Should the Utility be authorized to revise certain service availability charges, and, if so, what are the appropriate charges?

The current combined service availability charge (SAC) is \$1,620. The utility requested a service availability charge that was over \$10,000. Commission staff appropriately rejected the utility's request and determined that the requested amount is excessive and highly speculative

³ This reduction should attach to any and all salary, benefits, and expenses paid to Mr. Gene D. Brown from the utility whether his title is President, director, etc.

with the potential to stunt future growth. However, staff is recommending a combined service availability charge of \$5,310 which is triple the current SAC, without any discussion of whether that level has the potential to stunt future growth.

According to the staff recommendation, the recommended SAC is based on *future plant in service* instead of current plant in service. The amount of recommended SAC is premature since it simply assumes that the utility will add nearly \$3.3 million in requested pro forma plant described in Issue 5. It is speculative at this time whether WMSI can secure the financing necessary for this additional plant given the managerial imprudence of the utility by its President and the current cash flow issues. Further, if the Utility is not allowed to implement Phase II rates until after all pro forma items have been completed, placed in commercial service, and copies of the final invoices and cancelled checks have been provided, then the utility should not be allowed to implement the staff recommended SAC charge at this time. Recommending an increase in service availability charges on proposed plant additions does not appear to be consistent with the ratemaking treatment accorded to the proposed plant in Issue 5.

In addition, given the staff audit finding that the utility President transferred more \$1.2 million out of the utility and the recommended finding of managerial imprudence, how can the utility be entrusted to properly utilize the current service availability charge for utility purposes, let alone the recommended SAC amount which is three times greater? At a minimum, the Commission should defer allowing the recommended SAC amount until after all the pro forma items are placed in commercial service and the final costs verified. In addition, the Commission should order that the current SAC amounts received should be placed in a commercial escrow account. Moreover, if the Commission approves the recommended increased service availability charge, then that amount should be escrowed. The escrowed SAC should be earmarked for reducing utility debt after being recorded as contributions in aid of construction (CIAC).

Miscellaneous other issues

Ordering Escrow Accounts

On several occasions, the Commission has previously required commercial escrow accounts for this utility, starting in 1989, specifically ordering the utility to escrow service availability charges. See Order No. 21122, issued April 24, 1989, in Docket No. 871177-WU.⁴ A second escrow account was approved for the purposes of collecting monies for the construction of the elevated storage tank. See Order No. 22779, issued April 4, 1990, in Docket No. 871177-WU.⁵ A third escrow account was approved to escrow CIAC payments. See Order No. 23258, issued July 27, 1990; and Order No. 23649, issued October 22, 1990, in Docket No. 871177-WU.⁶ In 1994, the utility was again ordered to escrow service availability charges until the utility's next rate case. See Order No. PSC-94-1383-FOF-WU, issued November 14, 1994, in Docket No. 940109-WU. However, the escrow requirement was discontinued. In 2000, the Commission found the utility to be "diligent" and "... responsibly carry[ed] out the requirements related to the establishment of the escrow account and the process prescribed for

⁴ 89 FPSC 4:381, 1989 WL 1639952 (Fla.P.S.C.), at 15-16.

⁵ 90 FPSC 4:55, 1990 WL 10549521 (Fla.P.S.C.), at 1-2.

⁶ 90 FPSC 7:429, 1990 WL 10548574 (Fla.P.S.C.), at 1-2; 90 FPSC 10:499, 1990 WL 10548904 (Fla.P.S.C.) at 5.

disbursing funds from the escrow account. . . ” and released the utility from the requirement to escrow those funds. See Order No. 00-2227-PAA-WU, issued November 21, 2000, in Docket No. 000694-WU; Docket No. 940109-WU.⁷ In the past, the utility has demonstrated a need for escrow accounts as it relates to quality of service. The question is, has the utility once again demonstrated a need for escrow accounts as it relates to its cash flow management?

Based on the actions of the utility over the last 10 years and the findings in staff’s recommendation as it relates to the utility President’s management of this utility’s cash flow, WMSI has demonstrated no justification for entrusting it with unrestricted access to cash. If anything, the utility continues to demonstrate a need for more stringent cash restrictions, including but not limited to, additional escrow accounts and continued oversight by this Commission.⁸ Moreover, it is in the public interest to ensure that the financial actions of this utility do not eventually endanger the health, safety, and welfare of the customers.

Thus, the Commission should require commercial escrow accounts for a number of different recommended expenditures to ensure money collected for one expense does not end up being advanced to WMSI’s President or his associated companies for nonutility purposes. OPC would recommend escrow accounts for the DEP debt service, Centennial Bank debt service, the current and future service availability charges, bridge main maintenance and tank maintenance contracts, the President’s salary (to ensure compliance with the staff’s recommendation), and the remainder of his salary to repay the \$1.2 million the President transferred out of the utility. The Commission should utilize the escrow account procedures it used in the past with WMSI and require a co-signature by a Commission staff person designated to ensure that these expenses are timely and properly paid.

RAF payments

Twice in the last year, the utility has been unable to make its regularly scheduled biannual regulatory assessment fee (RAF) payment. See Docket Nos. 110237-WU and 120031-WU. That amount due on each occasion was approximately \$30,000. Both times the utility claimed cash flow issues and requested a payment plan from the Commission which was granted. According to the March 12, 2012 updated staff cash flow audit, OPC understands that approximately \$40,000 in cash was advanced from the utility to associated companies in Account 123. *But for* this cash advance, the utility would have been able to make at least one of these two missed RAF payments. OPC wonders whether any additional cash has been advanced through Account 123 and whether the utility will be able to pay its next RAF payment which should be due shortly.

⁷ 2000 WL 1911381 (Fla.P.S.C.) at 2.

⁸ As noted in the order from the last rate case, as a general rule, the Commission does not attempt to “micro-manage” a utility’s operations. However, there is always an exception to a general rule, and this utility demonstrates a need for such an exception.