

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: November 19, 2013

TO: Office of Commission Clerk (Stauffer)

FROM: Division of Engineering (Lee) *CKL PV BS TJS*
Division of Accounting and Finance (Fletcher, Kelly, Norris) *AMP/CCS*
Division of Economics (Thompson) *SAH PA*
Office of the General Counsel (Gilcher) *ALM*

RE: Docket No. 130212-WS – Application for increase in water/wastewater rates in Polk County by Cypress Lakes Utilities, Inc.

AGENDA: 12/03/13 – 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: 12/02/13 (60-Day Suspension Date)

SPECIAL INSTRUCTIONS: None

Case Background

Cypress Lakes Utilities (Utility) is a Class B utility providing service to 1,264 water and 1,161 wastewater customers in Polk County. Water and wastewater rates were last established for this utility in 2010.

On September 30, 2013, Cypress Lakes Utilities filed its application for a rate increase at issue in the instant docket. The Utility's application has met the minimum filing requirements and the test year established for interim and final rates is the simple average period ended December 31, 2012.

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Cypress Lakes Utilities requested interim rate relief of \$85,052 (26.80 percent) for its water system only. The Utility requested final revenue increases of \$100,603 (31.71 percent) for water and \$26,350 (3.95 percent) for wastewater.

This recommendation addresses the suspension of Cypress Lakes' 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 water and wastewater rates be suspended?

Recommendation: Yes. The Utility's proposed final water and wastewater rates should be suspended. (Lee)

Staff Analysis: Section 367.081(6), F.S., provides that the Commission may, for good cause, withhold consent to the implementation of requested rates within 60 days after the date the rate request is filed. Further, Section 367.081, F.S., permits the proposed rates to go into effect (secured and subject to refund) at the expiration of five months from the official date of filing 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 believes that it is necessary to require further investigation of this information, including on-site investigations by staff accountants and engineers. To date, staff has initiated an audit of the Utility's books and records, as well as an audit of Utilities, Inc. (UI, Parent, or Company), the Utility's parent, to examine allocated investment and operating expenses. Staff sent its first data request on November 12, 2013. The Utility's response is due on December 12, 2013. Further, staff believes additional requests will be necessary to process this case. Based on the foregoing, staff recommends suspension of the Utility's proposed final rate increases.

Issue 2: Should any interim revenue increases be approved?

Recommendation: Yes, Cypress Lakes should be authorized to collect annual water revenues as indicated below:

	<u>Adjusted Test Year Revenues</u>	<u>\$ Increase</u>	<u>Revenue Requirement</u>	<u>% Increase</u>
Water	\$317,304	\$85,052	\$402,356	26.80%

(Kelly, Norris)

Staff Analysis: On September 30, 2013, Cypress Lakes filed its rate base, cost of capital, and operating statements to support its requested interim increase in water rates. The Utility did not request an interim increase for its wastewater operations. Pursuant to Section 367.082(1), F.S., in order to establish a prima facie entitlement for interim relief, the utility shall demonstrate that it is earning outside the range of reasonableness on its rate of return. Pursuant to Section 367.081(2)(a), F.S., in a proceeding for an interim increase in rates, the Commission shall authorize, within 60 days of the filing for such relief, the collection of rates sufficient to earn the minimum of the range of rate of return. Based on the Utility's filing and the recommended adjustments below, staff believes that Cypress Lakes has demonstrated a prima facie entitlement in accordance with Section 367.082(1), F.S.

Pursuant to Section 367.082(5)(b)1, F.S., the achieved rate of return for interim purposes must be calculated by applying appropriate adjustments consistent with those made in a utility's most recent rate proceeding. Staff reviewed the Utility's interim request, Order No. PSC-07-0199-PAA-WS (the last rate case in which the Commission established water and wastewater rates), issued March 5, 2007 in Docket No. 060257-WS, and Order No. PSC-10-0682-PAA-WS (the limited proceeding in which the Commission last established water and wastewater rates), issued November 15, 2010, in Docket No. 090349-WS. Staff's recommended adjustments are discussed below. Staff has attached accounting schedules to illustrate the recommended rate base, capital structure, and test year operating income amounts. Rate base is labeled as Schedule No. 1 and capital structure is labeled as Schedule No. 2. Operating income for water is labeled as Schedule No. 3-A, with the adjustments shown on Schedule No. 3-B.

RATE BASE

Pursuant to Rule 25-30.433(2), Florida Administrative Code (F.A.C.), working capital for class B utilities shall be calculated using the formula method which is one-eighth of operation and maintenance (O&M) expense. Based on staff's recommended adjustments to water O&M expense discussed below, staff reduced working capital by \$6. Thus, staff recommends an interim working capital allowance of \$27,225 and a total rate base of \$715,894. Rate base is shown on Schedule No. 1.

COST OF CAPITAL

Cypress Lakes utilized the Commission's 2013 leverage formula for its requested return on equity (ROE) of 10.22 percent. Pursuant to Section 367.082(5)(b)3., F.S., the Utility should have used the last authorized ROE from its last rate case. In the last rate case, the Commission established an ROE of 11.45 percent with a range of plus or minus 100 basis points.

Pursuant to Section 367.082(2)(a), F.S., in a proceeding for an interim increase in rates, the Commission shall authorize, within 60 days of the filing for such relief, the collection of rates sufficient to earn the minimum of the range of rate of return calculated in accordance with Section 367.082(5)(b)2, F.S. When the lower authorized ROE limit of 10.45 percent is used, it results in a rate increase for water.

Based on the above and using the minimum ROE of 10.45 percent, staff calculated an interim weighted average cost of capital of 8.37 percent. This calculation is shown on Schedule No. 2.

NET OPERATING INCOME

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 adjustments made in the Utility's most recent rate proceeding and annualized for any rate changes. To obtain the appropriate amount of interim test year operating revenues, staff removed the requested interim revenue increase of \$85,052 for water. Based on staff's review, adjustments are necessary for interim purposes.

First, Cypress Lakes included an adjustment to increase the expense for Salaries and Wages by \$1,529 for water related to the annualization of salaries. Staff believes the Utility's proposed adjustment for annualizing salaries is pro forma because it is outside the interim test year. As such, staff recommends that this adjustment be reversed for purposes of calculating the interim net operating income, thus decreasing Salaries and Wages expense by \$1,529.

Second, the Utility reduced the expense for Pension and Benefits by \$1,327 for water related to the annualization of benefits. Staff believes the Utility's proposed adjustment for annualizing benefits is pro forma because it is outside the interim test year. As such, staff recommends that this adjustment be removed from the interim net operating income calculation, thus increasing Pensions and Benefits expense by \$1,327.

Third, in its MFRs, the Utility included annual amortization of rate case expense of \$10,077 for water. In its last rate proceeding, the Commission approved annual amortization of rate case expense of \$10,226 for water. As such, consistent with the Utility's last rate case, staff recommends that O&M expense be increased by \$149. Operating Income is shown on Schedule No. 3-A and the recommended adjustments are shown on Schedule No. 3-B.

REVENUE REQUIREMENT

To calculate the interim revenue requirement, staff incorporated the above net operating income adjustments to the Utility's proposed interim request and applied an 8.37 percent overall rate of return. However, this resulted in a revenue requirement for the water system that is greater than the level requested by the Utility. Commission practice is to limit the recommended interim revenue requirement to the amount requested.¹ Staff believes the appropriate interim revenue requirement should be \$402,356 for water. This represents an interim increase in revenues of \$85,052 (or 26.80 percent). This increase will allow the Utility the opportunity to recover its operating expenses and earn an 8.35 percent return on its water rate base.

¹ See Order Nos. PSC-10-0707-FOF-WS, issued November 29, 2010, in Docket No. 100330-WS, In re: Application for increase in water/wastewater rates in Alachua, Brevard, DeSoto, Hardee, Highlands, Lake, Lee, Marion, Orange, Palm Beach, Pasco, Polk, Putnam, Seminole, Sumter, Volusia, and Washington Counties by Aqua Utilities Florida, 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-96-1187-FOF-WU, issued September 23, 1996, in Docket No. 960444-WU, In re: Application for rate increase and for increase in service availability charges in Lake County by Lake Utility Services, Inc.

Issue 3: What are the appropriate interim water rates?

Recommendation: The existing service rates for Cypress Lakes should be increased by 27.1 percent to generate the recommended revenue increase for the interim period. The rates, as shown on Schedule No. 4, should be effective for service rendered on or after the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1), F.A.C. The Utility should file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. In addition, the approved rates should not be implemented until the required security has been filed, staff has approved the proposed customer notice and the notice has been received by the customers. The Utility should provide proof of the date notice was given within ten days of the date of the notice. (Thompson)

Staff Analysis: Staff recommends that interim service rates for Cypress Lakes be increased by 27.1 percent to allow the Utility the opportunity to generate annual operating revenues of \$402,356. Before removal of miscellaneous revenues, this would result in an increase of \$85,052 or 26.8 percent for water. To determine the appropriate increase to apply to the service rates, miscellaneous revenues should be removed from the test year revenues. The calculation is as follows:

Table 3-1

	<u>Water</u>
1 Total Test Year Revenues	\$317,304
2 Less: Miscellaneous Revenues	<u>\$3,437</u>
3 Test Year Revenues from Service Rates	\$313,867
4 Revenue Increase	<u>\$85,052</u>
5 % Service Rate Increase (Line 4/Line 3)	27.1%

The interim rate increase of 27.1 percent for water should be applied as an across-the-board increase to the existing rates. The approved rates should be effective for service rendered on or after the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1), F.A.C. The Utility should file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. In addition, the approved rates should not be implemented until the required security has been filed, staff has approved the proposed customer notice, and the notice has been received by the customers. The Utility should provide proof of the date notice was given within ten days of the date of the notice.

Issue 4: What is the appropriate security to guarantee the interim increase?

Recommendation: A cumulative corporate undertaking is acceptable contingent upon receipt of the written guarantee of the parent company, UI and written confirmation that the cumulative outstanding guarantees on behalf of UI-owned utilities in other states will not exceed \$1.2 million (inclusive of all Florida utilities). UI should be required to file a corporate undertaking on behalf of its subsidiaries to guarantee any potential refunds of revenues collected under interim conditions. UI's total guarantee should be a cumulative amount of \$125,191, which includes an amount of \$49,622 subject to refund in this docket. Pursuant to Rule 25-30.360(6), F.A.C., the Utility should provide a report by the 20th of each month indicating the monthly and total revenue collected subject to refund. Should a refund be required, the refund should be with interest and in accordance with Rule 25-30.360, F.A.C. (Kelly, Norris, Springer)

Staff Analysis: Pursuant to Section 367.082, F.S., revenues collected under interim rates shall be placed under bond, escrow, letter of credit, or corporate undertaking subject to refund with interest at a rate ordered by the Commission. Cypress Lakes has requested an annual interim revenue increase of \$85,052 for water only. As recommended in Issue 2, the annual interim increase for water is \$85,052. In accordance with Rule 25-30.360, F.A.C., staff calculated the potential refund of revenues and interest collected under interim conditions to be \$49,622. This amount is based on an estimated seven months of revenue being collected under the recommended interim rates shown on Schedule No. 4.

Cypress Lakes is a wholly-owned subsidiary of UI, which provides all investor capital to its subsidiaries. Based on the amount subject to refund for the Utility, the incremental increase in UI's corporate undertaking is \$49,622. The current cumulative corporate undertaking amount outstanding for other UI systems is \$75,569.² The new request will bring the cumulative amount outstanding to \$125,191.

The criteria for a corporate undertaking include sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. Staff reviewed UI's 2010, 2011, and 2012 financial statements to determine if the Company can support a corporate undertaking on behalf of its subsidiary. UI reported negative working capital in 2012. However, in all other time periods, the Company achieved sufficient liquidity and interest coverage ratios. In addition, UI reported adequate ownership equity over the three-year review period. UI also reported net income in excess of \$5 million a year in all periods.

Staff believes UI has adequate resources to support a corporate undertaking in the amount requested. Based on this analysis, staff recommends that a cumulative corporate undertaking of \$125,191 is acceptable contingent upon receipt of the written guarantee of UI and written confirmation that the cumulative outstanding guarantees on behalf of UI-owned utilities in other states will not exceed \$1.2 million (inclusive of all Florida utilities).

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

² By Order No. PSC-13-0332-PCO-WS, the Commission approved annual interim revenue increase of \$106,123 for water and \$23,389 for wastewater for Utilities, Inc. of Florida, which is also a wholly-owned subsidiary of UI. Specifically, the Commission approved a corporate undertaking of \$75,569 to secure the interim rate increase granted.

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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.

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Issue 5: Should this docket be closed?

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

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

Cypress Lakes Utilities, Inc. Schedule of Water Rate Base Test Year Ended 12/31/2012			Schedule No. 1 Docket No. 130212-WS		
Description	Test Year Per Utility	Utility Adjust- ments	Adjusted Test Year Per Utility	Staff Adjust- ments	Staff Adjusted Test Year
1 Plant in Service	\$1,738,817	(\$23,430)	\$1,715,387	\$0	\$1,715,387
2 Land and Land Rights	1,365	0	1,365	0	1,365
3 Non-used and Useful Components	0	0	0	0	0
4 Accumulated Depreciation	(870,888)	37,154	(833,734)	0	(833,734)
5 CIAC	(347,273)	0	(347,273)	0	(347,273)
6 Amortization of CIAC	140,254	12,670	152,924	0	152,924
7 Working Capital Allowance	<u>26,891</u>	<u>340</u>	<u>27,231</u>	<u>(6)</u>	<u>27,225</u>
8 Rate Base	<u>\$689,166</u>	<u>\$26,734</u>	<u>\$715,900</u>	<u>(\$6)</u>	<u>\$715,894</u>

Cypress Lakes Utilities, Inc.
Capital Structure-Simple Average
Test Year Ended 12/31/2012

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	(\$178,709,833)	\$1,290,167	48.30%	6.64%	3.21%	
2 Short-term Debt	250,000	0	250,000	(248,208)	1,792	0.07%	0.00%	0.00%	
3 Preferred Stock	0	0	0	0	0	0.00%	0.00%	0.00%	
4 Common Equity	175,327,223	0	175,327,223	(174,070,548)	1,256,675	49.78%	10.22%	5.09%	
5 Customer Deposits	13,366	0	13,366	0	13,366	0.51%	3.00%	0.02%	
6 Deferred Income Taxes	34,531	0	34,531	0	34,531	1.33%	0.00%	0.00%	
7 Total Capital	<u>\$355,625,120</u>	<u>\$0</u>	<u>\$355,625,120</u>	<u>(\$353,028,589)</u>	<u>\$2,596,531</u>	<u>100.00%</u>		<u>8.32%</u>	
Per Staff									
8 Long-term Debt	\$180,000,000	\$0	\$180,000,000	(\$178,709,836)	\$1,290,164	49.69%	6.64%	3.30%	
9 Short-term Debt	250,000	0	250,000	(248,208)	1,792	0.07%	0.00%	0.00%	
10 Preferred Stock	0	0	0	0	0	0.00%	0.00%	0.00%	
11 Common Equity	175,327,223	0	175,327,223	(174,070,551)	1,256,672	48.40%	10.45%	5.06%	
12 Customer Deposits	13,366	0	13,366	0	13,366	0.51%	3.00%	0.02%	
13 Deferred Income Taxes	34,531	0	34,531	0	34,531	1.33%	0.00%	0.00%	
14 Total Capital	<u>\$355,625,120</u>	<u>\$0</u>	<u>\$355,625,120</u>	<u>(\$353,067,368)</u>	<u>\$2,596,525</u>	<u>100.00%</u>		<u>8.37%</u>	
						LOW	HIGH		
RETURN ON EQUITY						<u>10.45%</u>	<u>12.45%</u>		
OVERALL RATE OF RETURN						<u>8.37%</u>	<u>9.34%</u>		

Cypress Lakes Utilities, Inc. Statement of Water Operations Test Year Ended 12/31/2012						Schedule No. 3-A Docket No. 130212-WS	
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>\$317,304</u>	<u>\$85,052</u>	<u>\$402,356</u>	<u>(\$85,052)</u>	<u>\$317,304</u>	<u>\$85,052</u> 26.80%	<u>\$402,356</u>
Operating Expenses							
2 Operation & Maintenance	\$215,132	\$2,724	\$217,856	(\$53)	\$217,803		\$217,803
3 Depreciation	61,810	(3,846)	57,964	0	57,964		57,964
4 Amortization	0	0	0	0	0		0
5 Taxes Other Than Income	50,038	(4,694)	45,344	(4,106)	41,238	3,827	45,065
6 Income Taxes	<u>22,510</u>	<u>(882)</u>	<u>21,628</u>	<u>(30,445)</u>	<u>(8,817)</u>	<u>30,565</u>	<u>21,748</u>
7 Total Operating Expense	<u>349,490</u>	<u>(6,698)</u>	<u>342,792</u>	<u>(34,604)</u>	<u>308,188</u>	<u>34,392</u>	<u>342,580</u>
8 Operating Income	<u>(\$32,186)</u>	<u>\$91,750</u>	<u>\$59,564</u>	<u>(\$50,448)</u>	<u>\$9,116</u>	<u>\$50,660</u>	<u>\$59,776</u>
9 Rate Base	<u>\$689,166</u>		<u>\$715,900</u>		<u>\$715,894</u>		<u>\$715,894</u>
10 Rate of Return	<u>(4.67%)</u>		<u>8.32%</u>		<u>1.27%</u>		<u>8.35%</u>

Cypress Lakes Utilities, Inc.		Schedule No. 3-B
Adjustment to Operating Income		Docket No. 130212-
Test Year Ended 12/31/2012		WS
Explanation	Water	
<u>Operating Revenues</u>		
Remove requested Interim revenue increase.	(\$85,052)	
<u>Operation and Maintenance Expense</u>		
1 To remove annualized Salaries adjustments.	(\$1,529)	
2 To remove annualized Pension and Benefits adjustments.	1,327	
3 Appropriate RCE for limited proceeding.	<u>149</u>	
Total	<u>(\$53)</u>	
<u>Taxes Other Than Income</u>		
1 RAFs on revenue adjustments above.	(\$3,827)	
2 To reflect removal of pro forma expenses.	<u>(279)</u>	
Total	<u>(\$4,106)</u>	

CYPRESS LAKES UTILITIES, INC.
TEST YEAR ENDED DECEMBER 31, 2012
MONTHLY WATER RATES

SCHEDULE NO. 4
DOCKET NO. 130212-WS
INTERIM

	CURRENT RATES	UTILITY REQUESTED INTERIM	UTILITY REQUESTED FINAL	STAFF RECOMMEN DED INTERIM
<u>Residential and General Service</u>				
Base Facility Charge by Meter Size:				
5/8"X3/4"	\$5.99	\$7.68	\$7.98	\$7.61
1"	\$14.97	\$19.20	\$19.95	\$19.03
1-1/2"	\$29.96	\$38.43	\$39.94	\$38.08
2"	\$47.92	\$61.47	\$63.88	\$60.91
3"	\$95.83	\$122.92	\$127.74	\$121.80
4"	\$149.75	\$192.09	\$199.61	\$190.33
6"	\$299.48	\$384.15	\$399.20	\$380.64
Charge per 1,000 Gallons - Residential				
0-6,000 Gallons	\$4.12	\$5.28	\$5.49	\$5.24
6,001 - 12,000 Gallons	\$6.18	\$7.93	\$8.24	\$7.85
Over 12,000 Gallons	\$8.24	\$10.57	\$10.98	\$10.47
Charge per 1,000 Gallons - General Service	\$4.37	\$5.61	\$5.83	\$5.55
<u>Typical Residential 5/8" x 3/4" Meter Bill Comparison</u>				
3,000 Gallons	\$18.35	\$23.52	\$24.45	\$23.33
5,000 Gallons	\$26.59	\$34.08	\$35.43	\$33.81
10,000 Gallons	\$55.43	\$71.08	\$73.88	\$70.45