FILED AUG 22, 2014
DOCUMENT NO. 04692-14
FPSC - COMMISSION CLERK

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August 22, 2014

Carlotta S. Stauffer, Director
Office of Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Re: Docket No. 130178-SU; Application for staff-assisted rate case in Polk County by Crooked Lake Park Sewerage Company

Dear Ms. Stauffer:

Attached is a list of issues that the Office of Public Counsel has prepared to identify concerns we have with the information included in the staff report that addresses the preliminary review of the requested rate increase. We are submitting this letter in an effort to be up front with our concerns and allow the staff and utility sufficient time to review our concerns and ask for any additional information that might be needed. If you should have any questions, please feel free to call or e-mail me.

Respectfully submitted,

s/ Denise N. Vandiver

Denise N. Vandiver
Legislative Analyst

c: Division of Accounting & Finance (Mouring, Golden, Springer, Prestwood)
Division of Economics (Bruce, Hudson, Daniel)
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5578 Commercial Blvd.
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OPC Issues and Concerns
Crooked Lake Sewerage Company
Docket No. 130178-SU

Quality of Service

1. One of the customers at the Customer Meeting on July 17, 2014 commented that he has had a recurring problem with the sewer line getting clogged. He believes that the sewer lines are undersized. We believe that this is an issue that should be addressed by the Commission.

O&M Expenses

Overhead Charges

2. We reviewed the invoices supporting the expenses in the staff audit and the staff report. Many of the individual expense accounts included invoices where the utility purchased materials or services directly from a vendor. Within these same individual expense accounts include invoices from Garrard Framing and Drywall (GF&D) purchased the item and "sold" it to the utility with an additional 10% surcharge. It appears that this is merely a pass-through function where one company (a related company) buys a product and then sells it to the utility for the original cost plus 10%. We do not believe that the utility should be able to increase its expenses merely by shifting a purchase to GD&F and that ratepayers should not pay additional costs for this arrangement. We note the utility has also purchased products from these same outside vendors without the 10% increase. In addition, the staff report includes the annualized cost of the contract office manager which would seem to duplicate any costs such as this surcharge. Therefore, we believe that the following surcharge amounts should be removed from the expenses.

Garrard Framing and Drywall
Invoices with Surcharge

Account #	Invoice #	Date	Vendor	Amount	10% Surcharge	Vendor Amount
718	37635	1/29/2013	Pinch A Penny	341.32	31.03	310.29
718	37666	1/31/2013	Pinch A Penny	341.32	31.03	310.29
718 Total				682.64	62.06	620.58
720	37628	1/28/2013	Sunniland	34.62	3.15	31.47
720	37637	1/29/2013	Sunniland	508.35	46.22	462.13
720	37719	2/15/2013	Lowes	230.54	20.96	209.58
720 Total				773.51	70.33	703.18
736	1613	11/30/2012	Lowes	717.16	65.20	651.96
736 Total				717.16	65.20	651.96
775	37906	3/15/2013	Postage	9.78	0.89	8.89
775	37627	1/28/2013	Greenway Recycling	341.72	31.07	310.65
775 Total				351.50	31.95	319.55
Grand Total				2,524.81	229.53	2,295.28

Sludge Removal Expense (711)

3. The staff audit reflects Sludge Hauling expense of $2,220. The staff report increased this amount by $5,180 to $7,400 “to reflect the appropriate annual sludge removal expense.” We were unable to see any invoices in the audit work papers or the docket file that would indicate how staff determined this adjustment. We believe staff should explain the adjustment and that any adjustment should be based on invoices and actual experience.

Chemical Expense (718)

4. The staff audit reflects chemical expense to be $3,643. The staff report does not address Chemical Expense but the amount included in Schedule 3-C is $4,253. This appears to include two invoices for chemicals that the auditor disallowed for lack of supporting documentation. The ratepayers should not be required to pay for expenses that the utility is unable to support.

Contractual Services-Professional (731)

5. The staff report adjusted the test year expense of $631 to include accounting expense of $6,606 that was not included in the test year. The total expense recommended includes $55 for copies of tax returns, $575 for Jan – June 2012 Accounting Fees, and $6,650 for an amount invoiced July 2013. This invoice includes $2,500 for PSC and IRS tax returns, $3,500 for 2012 accounting fees, and $650 for Additional accounting, amended PSC, and reworked 2012 1120. We do not believe that it is clear whether the $575 billed in August of 2012 is duplicative of services included in the $3,500 billed in July 2013. We believe the utility should justify whether the $575 should be included in addition to the amount billed in July 2103 (after the test year). Also, we do not believe that the $650 for amended returns is a recurring cost and that it should be removed from test year expenses.

Contractual Services-Testing (735)

6. The staff report indicates that testing expense was $490 for the test year and increases the amount by $1,468 to annualize the three test year expenses to reflect a full year. The utility used at least two plant operators during the test year. We question why the utility only paid these testing charges when the plant operator was Innovative Fluid Solutions. The utility does not appear to have paid these expenses when its current operator began servicing the plant. We recommend that the test year exclude the $1,468 as it appears that the testing expense is included in the operator expense.

Contractual Services-Other

7. The staff report calculated test year expense of $64,416. The chart below summarizes the vendors and amounts included in the report’s total expense.

	Operations	WTWP Maint.	S/Line Maint.	Blower Srv	LS Maint	Total
A D Baynard Plumbing, Inc	-	-	2,783.96	-	-	2,783.96
Innovative Fluid Solutions	-	1,050.00	-	1,836.19	-	2,886.19
Consta Flow	11,700.00	7,258.47	-	337.75	2,160.84	21,457.06
C&W Equipment Repair & Maintenanc	-	-	-	-	2,743.75	2,743.75
Garrard Building Contractors, LLC	-	731.60	-	-	-	731.60
Mainstay Financial Services, LLC	-	322.67	-	-	-	322.67
Brooker Septic Service Inc.	-	-	-	-	3,380.00	3,380.00
Calico, LLC	-	1,990.92	-	-	-	1,990.92
Bern's Septic Tank Co., Inc.	-	-	-	-	450.00	450.00
Webb Concrete, Inc.	-	-	-	-	225.00	225.00
Applied Aquatic Mgt Inc.	-	300.00	-	-	-	300.00
College Park Mobile Home Park Croo	-	-	46.74	-	-	46.74
Annualization of Clerical Position						17,175.60
Annualization of Maintenance Position						9,622.86
Pro Forma amortization of smoke test			300.00			300.00
Staff Report Totals	11,700.00	11,653.66	2,830.70	2,173.94	8,959.59	64,416.35

Our analysis of the charges to this account raises three questions we believe staff should investigate. First, we are concerned whether the annualized salaries for clerical and maintenance employees duplicate any charges that were included in the test year. In particular, will the maintenance employee be used in place of some of the maintenance expenses provided by outside vendors in the chart above?

Second, we believe that the $1,991 paid to Calico, LLC is not a recurring expense and should be removed from expenses or amortized. It appears that this is a significant repair to the building roof and decking and should be capitalized or amortized.

Third, we believe that the remaining $23,627 may be overstated as an on-going maintenance expense. The utility changed ownership during the test year and many of these expenses were incurred after the new owners took over and involve large expenditures such as the replacement of pumps and diffusers in the aeration tanks and repairing a clarifier. We believe that these may be an accumulation of deferred maintenance items that the new owner was forced to address. While we support the improvement of the system, we do not believe that these costs represent an appropriate annual level for setting rates in the future. However, in order for the owner to recover his investment in these activities, we believe that they may be amortized over a four or five year period.

<u>Transportation Expense</u>

8. The staff report included $4,353 for transportation expense. It appears that the staff expense does not remove two adjustments recommended by the staff audit as unsupported by sufficient documentation. These two adjustments are for $1,250 and $2,000 and appear to be for payments made by the former owner on a Chase credit card. They do not appear to be supported by documents that indicate what was

purchased for these amounts and therefore these amounts should be removed from transportation expense.

Bad Debt Expense

9. The staff report reviewed the test year expense of $22,710 for bad debt expense. The test year expense was to record amounts written off at the end of 2012 following the sale of the utility. Staff reviewed the Utility's customer accounts receivable balance for the 3-year period of 2010 through 2012 and found that bad debt expense of $3,734 is a more reasonable estimate of the Utility's average annual uncollectable revenues. Therefore, staff decreased bad debt expense by $18,976 to a test year balance of $3,734. While we agree that a three-year average is a reasonable approach to setting bad debt expense, we believe that the average should be updated to the most recent three-year period. Using the 2013 Annual Report, we calculated a three-year average of $1,095. The chart below shows a comparison of the calculations. We believe that the amount shown in 2010 is an anomaly and should be removed and the most recent average used. Not only does the 2010 amount stand out from the most recent three years, it was under the previous owner and may be another indication of poor management similar to the maintenance issues that had been neglected.

Year		Staff	OPC
2010		(6,793)	
2011		(1,212)	(1,212)
2012		(3,198)	(3,198)
2013			1,126
3-Yr Avg.		**(3,734)**	**(1,095)**

Taxes Other Than Income

10. The utility books reflect test year property taxes of $3,902. The staff report reduced the test year amount by $752 but did not explain the calculation. Our review of the tax bills from the Polk County Tax Collector website indicates that the discounted tax bills for the 2013 year are substantially less than in previous years. We find that the total for 2013 is $1,920. We believe that the test year expense should be reduced by $1,982. The chart below shows the results of our analysis of the tax bills on the county website.

	2012			2013		
Account	Taxable Value	Billed	Discount	Taxable Value	Billed	Discount
353027-000000-013080	495	7.61	7.31	495	7.68	7.37
353027-928300-008300	7,119	126.51	121.45	7,119	128.53	123.39
353027-000000-011050	8,514	130.98	125.74	8,514	132.21	126.92
000000-000020-154324				28,000	543.48	
000000-000032-006827	218,023	3,354.08	3,219.92	111,516	1,731.63	1,662.36
		3,619.18	3,474.41		2,543.53	1,920.05

<u>Operating Ratio</u>

11. The staff report includes the use of an operating ration in setting Phase I rates. In principle, our office does not support the operating ratio. We do not plan to argue the generic issue in this case, but we find some of the specific supporting statements in this case create concern. First, on page 18 in the third full paragraph, staff states

> Historically, when application of the 10 percent margin yielded a result above $10,000, the operating margin was capped at $10,000. However, application of a $10,000 limit to Crooked Lake’s operating margin results in only a $9,664 operating margin, which is insufficient to cover the Utility's interest expense of $10,293 and leaves no cushion for revenue or expense variances.

We find a fallacy in this statement as the interest expense referenced in the staff report is not the interest rate on the debt included in the adjusted capital structure. By using the debt before reconciliation to rate base, staff is in effect requiring the rate payers to pay interest on debt that does not support rate base.

In addition, when the Commission first established the operating ratio, it made the following statement.

> Therefore, we find that during the two year evaluation period, a margin of 10% shall be used unless unique circumstances justify the use of a greater or lesser margin. We also find it is reasonable and prudent to limit the dollar amount of margin until more experience is gained. Therefore, we find it appropriate to cap operating margin at $10,000.[1]

In fact, in a recent case with Utility Corporation of Florida, Inc., the Commission capped the operating ratio at $10,000:

[1] <u>See</u> Order No. PSC-96-0357-FOF-WU, issued March 13, 1996, in Docket No. 950641-WU, <u>In re: Application for staff assisted rate case in Palm Beach County by Lake Osborne Utilities Company, Inc.</u>

> When the criteria were established, we found it was reasonable and prudent to limit the dollar amount of the margin to $10,000. Based on the circumstances for Utility Corporation, an operating margin of $10,000 is achieved with an operating margin ratio of 7.81 percent. Therefore, we approve a 7.81 percent operating margin ratio in the instant case.[2]

While it has been 18 years since the original order establishing an operating ratio, the Commission has not promulgated any rules or orders further refining this provision of the Commission's non-rule policy to cap the operating ratio at $10,000. Further, we have been unable to find an order where the Commission has approved an operating ratio that exceeds the $10,000 cap referenced in the lake Osborne order. Therefore, without sufficient argument why the $10,000 cap should be exceeded, we believe that the operating ratio should be capped at $10,000 in this case.

Our last concern is with the threshold criteria of whether the utility is expected to "become a Class B utility in the foreseeable future". Even though the staff report recognizes that the Phase II rates (which are in the foreseeable future) will push the utility into a Class B status, the recommendation is that Class B status is not reached until there is a 3-year average above the limit so it will be several years before Class B status is reached. Plus, the Operating Ratio is only temporary as Phase II rates will not use the operating Ratio. Once again, without any rule development that defines the terms for an Operating Ratio, we find that the term "foreseeable future" has not been defined and it appears that our definition is different than the staff definition.

[2] See Order No. PSC-12-0410-PAA-SU, issued August 13, 2012, in Docket No. 110165-SU, In re: Application for staff assisted rate case in Highlands County by Utility Corporation of Florida, Inc.