

State of Florida



# Public Service Commission

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

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COMMISSION  
CLERK

**DATE:** January 22, 2015

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

**FROM:** Division of Economics (Thompson, Hudson) *BT*  
Division of Accounting and Finance (T. Brown, Fletcher, Norris) *BF*  
Office of the General Counsel (Tan) *AT* *ALM* *JWB*

**RE:** Docket No. 140239-WS – Application for staff-assisted rate case in Polk County by Orchid Springs Development Corporation.  
County(ies): Polk

**AGENDA:** 02/03/15 – Regular Agenda – Decision on Interim Rates – Participation is at the Discretion of the Commission

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICER:** Edgar

**CRITICAL DATES:** 02/09/15 (60-Day Suspension Date)

**SPECIAL INSTRUCTIONS:** None

## Case Background

Orchid Springs Development Corporation (Orchid Springs or Utility) is a Class C utility providing service to approximately 510 water and 494 wastewater customers in Polk County. Effective July 7, 1998, Orchid Springs was granted Certificate Nos. 600-W and 516-S.<sup>1</sup> The Utility's rates and charges were last approved in a staff-assisted rate case in 1998.<sup>2</sup> The rates were subsequently reduced to reflect the expiration of rate case expense approved in 1998. The

<sup>1</sup> See Order No. PSC-98-0918-FOF-WS, issued July 7, 1998, in Docket No. 970158-WS, In re: Application for grandfather certificate to operate a water and wastewater utility in Polk County, by Orchid Springs Development Corporation.

<sup>2</sup> See Order No. PSC-98-1579-FOF-WS, issued November 25, 1998, in Docket No. 980441-WS, In re: Application for staff-assisted rate case in Polk County by Orchid Springs Development Corporation.

Docket No. 140239-WS

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Utility has filed numerous index and pass through applications since its last rate case. According to Orchid Springs' 2013 annual report, total gross revenues were \$95,411 for water and \$121,198 for wastewater. Total operating expenses were \$58,426 and \$155,123 for water and wastewater, respectively. This resulted in a net income of \$36,985 for water and a net operating loss of \$33,925 for wastewater.

On December 11, 2014, Orchid Springs filed its application for a staff-assisted rate increase. In its application, the Utility requested a test year ended December 31, 2013, for interim and final rates purposes.

This recommendation addresses the Utility's interim rates. The Commission has jurisdiction pursuant to Sections 367.082 and 367.0814(4), Florida Statutes (F.S.).

**Discussion of Issues**

**Issue 1:** Should an interim revenue increase be approved?

**Recommendation:** Yes, Orchid Springs should be authorized to collect interim revenues as indicated below:

	Adjusted Test Year Revenues	\$ Increase	Revenue Requirement	% Increase
Wastewater	\$121,624	\$19,714	\$141,338	16.21%
Water	\$104,548	\$0	N/A	0%

Revenues are sufficient to cover staff-adjusted O&M expenses for the water system, but not the wastewater system. As such, an interim revenue increase is warranted for the wastewater system, but not the water system. (T. Brown, Norris)

**Staff Analysis:** On December 11, 2014, Orchid Springs filed rate base, cost of capital, and operating statements to support an interim increase in water and wastewater rates. While Orchid Springs provided this financial data, it is not required for a Class C utility seeking interim relief. While the Utility's filing is consistent with an interim request as outlined in Section 367.082, F.S., which pertains to a file and suspend rate case, it is inconsistent with Section 367.0814(4), F.S., which limits the increase to the amount necessary to cover operation and maintenance (O&M) expenses. Section 367.0814(4), F.S., is specific to staff-assisted rate cases.

Section 367.0814(4), F.S., states:

(4) The commission may, upon its own motion, or upon petition from the regulated utility, authorize the collection of interim rates until the effective date of the final order. Such interim rates may be based upon a test period different from the test period used in the request for permanent rate relief. To establish interim relief, there must be a demonstration that the operation and maintenance expenses exceed the revenues of the regulated utility, and interim rates shall not exceed the level necessary to cover operation and maintenance expenses as defined by the Uniform System of Accounts for Class C Water and Wastewater Utilities (1996) of the National Association of Regulatory Utility Commissioners.

Staff has reviewed the Utility's filed O&M expenses in relation to its revenues. Based on the Utility's filing and the adjustments below, staff recommends that Orchid Springs has demonstrated a prima facie entitlement in accordance with Section 367.0814(4), F.S., for the wastewater system, but not for the water system.

**O&M EXPENSES**

Based on staff's review, several adjustments to the Utility's filed O&M expenses are necessary. The water and wastewater O&M expenses filed by the Utility included annual amortization of rate case expense for the instant docket, as well as repression adjustments to decrease the expenses for purchased water/sewer treatment, purchased power, and chemicals.

Rate case expense is a deferred expense, and the final determination of the total expense is outside the interim test year. In addition, it is Commission practice to apply an interim percentage increase across the board to existing rates. Thus, interim rates should not include changes in rate structure, such as repression adjustments.

In addition, the Utility's filed O&M expenses contained an adjustment to reflect the allocation of management salaries included in Contractual Services – Management Expense. Staff contacted the Utility for clarification of this adjustment. The Utility maintained that this adjustment was made to reflect expenses incurred during the interim test year. However, the allocation of this expense as recorded in the Utility's 2013 annual report was significantly less than the amount of the proposed adjustment. Aside from the previously discussed adjustments, all other expense accounts in the Utility's interim filing reconcile with the Utility's 2013 annual report. As such, these adjustments should be removed from O&M expenses for interim purposes.

Based on the above, the net effect of staff's adjustments to O&M expenses is a decrease of \$41,522 for water and \$36,694 for wastewater. Staff's recommended adjustments are summarized in the table below.

Table 1-1

Staff Adjustments to O&M Expenses	Water	Wastewater
1. Remove rate case expense.	(\$695)	(\$1,218)
2. Remove purchased water/sewer treatment repression adjustment.	246	5,697
3. Remove purchased power repression adjustment.	138	195
4. Remove chemicals repression adjustment.	157	0
5. Remove allocation of management salaries adjustment.	<u>\$41,368</u>	<u>\$41,368</u>
Total	<u>\$41,522</u>	<u>\$36,694</u>

REVENUE INCREASE

In order to establish interim rate relief as prescribed by Section 367.0814(4), F.S., staff utilized the Utility's revenues per its filing. For the test year ended December 31, 2013, revenues exceeded staff-adjusted O&M expenses for the water system, but not for the wastewater system. Thus, staff recommends an interim increase for the wastewater system only. The difference between the Utility's revenues and the staff-adjusted O&M expenses for wastewater is \$18,865. This results in an interim increase of \$18,865.

In addition, the interim wastewater increase should be grossed up to include regulatory assessment fees (RAFs). The Commission has previously determined that it would be inappropriate to approve an increase in a utility's rates to cover its operating expenses and deny that same utility the funds to pay RAFs.<sup>3</sup> Furthermore, by approving an interim rate increase that

<sup>3</sup> See Order No. PSC-01-1654-FOF-WS, issued August 13, 2001, in Docket No. 010396-WS, In re: Application for staff-assisted rate case in Brevard County by Burkim Enterprises, Inc.

allows for the payment of RAFs, the Utility will be able to fully cover its O&M expenses. The RAFs associated with the interim increase is calculated to be \$849 (\$18,865 x 4.5%).

In total, Orchid Springs should be allowed an interim wastewater revenue increase of \$19,714 (\$18,865 + \$849) in order to produce revenues sufficient to cover wastewater O&M expenses and RAFs. Thus, staff recommends the appropriate interim revenue requirement should be \$141,338 for wastewater. This is a 16.21 percent increase above the Utility's 2013 wastewater revenues of \$121,624. Table 1-2 illustrates staff's interim increase calculation.

Table 1-2

Determination of Interim Increase		
	Water	Wastewater
1. Utility Adjusted Test Year O&M Expenses	\$96,016	\$177,183
2. Less: Staff's Adjustments	( <u>\$41,522</u> )	( <u>\$36,694</u> )
3. Staff Adjusted Test Year O&M Expenses	\$54,494	\$140,489
4. Less: Utility Test Year Revenues	<u>\$104,548</u>	<u>\$121,624</u>
5. Revenues to Cover O&M Expenses	(\$50,054)	\$18,865
6. Interim Revenue Increase	\$0	\$18,865
7. RAFs on Interim Rate Increase	\$0	\$849
8. Total Interim Revenue Increase (\$)	<u>(\$0)</u>	<u>(\$19,714)</u>
9. Total Interim Revenue Increase (%)	<u>(0%)</u>	<u>(16.21%)</u>

**Issue 2:** What are the appropriate interim wastewater rates?

**Recommendation:** The interim rate increase of 16.21 percent for wastewater should be applied as an across-the-board increase to the existing rates. The rates, as shown on Schedule No. 1, 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 10 days of the date of the notice. (Thompson)

**Staff Analysis:** Staff recommends that interim service rates for Orchid Springs be designed to allow the Utility the opportunity to generate annual operating revenues of \$141,338 for wastewater. Typically, to determine the appropriate increase to apply to the service rates, miscellaneous service revenues are removed from the test year revenues. However, there are no miscellaneous service revenues for wastewater. Therefore, the amount of increase should be \$19,714 (16.21 percent).

The interim rate increase of 16.21 percent for wastewater should be applied as an across-the-board increase to the existing rates. The rates, as shown on Schedule No. 1, 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 10 days of the date of the notice.

**Issue 3:** What is the appropriate security to guarantee the interim increase?

**Recommendation:** The Utility should be required to open an escrow account or secure 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 \$1,643 into the escrow account each month. Otherwise, the surety bond or letter of credit should be in the amount of \$13,146. 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. (Monroe, T. Brown, Holmes)

**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 1, the interim increase for wastewater is \$19,714. 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 \$13,146. This amount is based on an estimated eight months of revenue being collected under the recommended interim rates shown on Schedule No. 1.

The criteria for a corporate undertaking include sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. Staff used Orchid Springs' PSC Annual Reports for 2011, 2012, and 2013 to evaluate these criteria. In all three years, Orchid Springs reported negative working capital and a current asset to liability ratio below one. The average of these measures over the most recent three-year period is not within acceptable parameters. Orchid Springs also reported insufficient interest coverage and a negative equity ratio for all three years and net losses over the last two years. Net losses have steadily increased and have averaged approximately \$8,500 per year in 2012 and 2013. For these reasons, staff believes that Orchid Springs does not have the financial capability to support a corporate undertaking in the amount of \$13,146. Staff recommends Orchid Springs be required to secure a surety bond, letter of credit, or escrow agreement to guarantee any potential refund of wastewater revenues.

If the security provided is an escrow account, said account should be established between the Utility and an independent financial institution or the Division of Treasury for the Florida Department of Financial Services 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: the account is established at the direction of the Commission for the purpose set forth above; no withdrawals of funds shall occur without the prior approval of the Commission through the Commission Clerk, 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.

If the security provided is an escrow account, the Utility should deposit \$1,643 into the escrow account each month. 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 \$13,146. 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 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 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.



**Issue 4:** 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. (Tan)

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

<b>ORCHID SPRINGS DEVELOPMENT CORPORATION</b> <b>TEST YEAR ENDED DECEMBER 31, 2013</b> <b>MONTHLY WASTEWATER RATES</b>		<b>SCHEDULE NO. 1</b> <b>DOCKET NO. 140239-WS</b> <b>INTERIM</b>	
	<b>UTILITY</b> <b>EXISTING</b> <b>RATES</b>	<b>STAFF</b> <b>RECOMMENDED</b> <b>INTERIM</b>	
<b><u>Residential Service</u></b>			
Base Facility Charge - All Meter Sizes	\$14.13	\$16.42	
Charge per 1,000 gallons 10,000 gallon cap	\$3.08	\$3.58	
<b><u>General Service</u></b>			
Base Facility Charge by Meter Size			
5/8" x 3/4"	\$14.13	\$16.42	
3/4"	\$21.24	\$24.63	
1"	\$35.40	\$41.05	
1 1/2"	\$70.78	\$82.10	
2"	\$113.26	\$131.36	
3"	\$226.50	\$262.72	
4"	\$353.90	\$410.50	
6"	\$707.80	\$821.00	
Charge per 1,000 gallons	\$3.72	\$4.32	
<b><u>Typical Residential 5/8" x 3/4" Meter Bill Comparison</u></b>			
3,000 Gallons	\$23.37	\$27.16	
5,000 Gallons	\$29.53	\$34.32	
10,000 Gallons	\$44.93	\$52.22	