ANDY GARDINER
President of the Senate

J.R. Kelly
Public Counsel

STATE OF FLORIDA
OFFICE OF PUBLIC COUNSEL

C/O THE FLORIDA LEGISLATURE
111 WEST MADISON ST.
ROOM 812
TALLAHASSEE, FLORIDA 32399-1400
1-800-342-0222

EMAIL: OPC_WEBSITE@LEG.STATE.FL.US
WWW.FLORIDAOPC.GOV

STEVE CRISAFULLI
Speaker of the House of Representatives

5/21/15

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

Re: Docket 140186 -- Application for staff-assisted rate case in Brevard County by Brevard Waterworks, Inc.

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 (Norris, Frank, Monroe, Holmes)
Division of Economics (Thompson, Daniel, Hudson)
Division of Engineering (King, Buys)
Office of the General Counsel (Murphy)
Office of Auditing and Performance Analysis (Deamer)

Brevard Waterworks, Inc.
Gary Deremer / Troy Rendell
4939 Cross Bayou Blvd.
New Port Richey, FL 34652-3434

Office of Public Counsel (Sayler)

OPC Issues and Concerns
Brevard Waterworks, Inc.
Docket 140186-WU

Utility Plant in Service

1. Pursuant to Order No. PSC-14-0326-PAA-WU, issued June 25, 2014, the Commission approved the transfer of the facilities of Aqua's Brevard County Kingswood and Oakwood water systems and Certificate No. 002-W to Brevard Waterworks, Inc. (BWI) and established $61,885 as the net book value of the system as of March 28, 2013. The Commission further declined to include a positive acquisition adjustment in rate base.

   Subsequent to the date of transfer as shown in the Commission's order, BWI recorded organization costs of $2,434.48. Audit WP 16-2 p.1 indicates 5 invoices charged to Account 301.1 Intangible Plant. The five invoices are listed below. The staff report transfers the filing fee for the transfer to operating expenses and amortizes it over 4 years.

4/10/13	Booth & Cook	Legal Fees and Tax Settlement for Utility Purchase	$497.48
6/18/13	Florida Public Service Commission	Filing Fee	$750.00
5/20/14	Hill Ward Henderson	Organizational documents, shareholder agreement, stock subscription agreements for shareholders, draft organization minutes	$276.00
6/10/14	Hill Ward Henderson	Organizational documents and e-mails and draft regarding corporate documentation	$481.00
7/9/14	Hill Ward Henderson	Transmittal letter for organizational resolutions, shareholder agreement and subscription agreement for review and execution, corporate organizational documents	$430.00
		TOTAL	$2,434,48

   Per the National Association of Regulatory Utility Commissioners (NARUC) Uniform System of Accounts (USOA) Plant Account 301 Organization shall include:

   > all fees paid to federal or state governments for the privilege of incorporation and expenditures incident to organizing the corporation, partnership or other enterprise and putting it into readiness to do business.

   In addition, the USOA states that Account 114 Utility Plant Acquisition Adjustments shall include:

   > the difference between (1) the cost to the utility of plant acquired as an operating unit or system by purchase, merger, or otherwise, and (2) the net of amounts distributed to the plant accounts, the accumulated depreciation account and the other appropriate accounts.

We believe that these costs are costs related to the acquisition of the system, and as such, they are not costs related to providing service to the ratepayers. These are costs of the shareholders and should not be included in rate base or in operating expenses.

Commission practice supports making this adjustment. In Docket No. 020407-WS, by Order No. PSC-03-0647-PAA-WS, issued May 28, 2003, the Commission stated

> We interpret the term "cost of acquisition" to include any consideration paid, plus any other costs incurred related to or given for the purchase of the assets. We believe the expenses discussed above should not be recorded as organization costs and franchise fees for the following reasons. First, the expenses are acquisition costs and are inappropriately treated as organization costs and franchise fees. Second, the expenses should be borne by the stockholders of Cypress Lakes' parent company because the purchase of Cypress Lakes was not the ratepayers' decision, nor has Cypress Lakes demonstrated how the customers have benefitted from this transaction. Because these expenses are directly associated with the change of ownership, they should be recorded as acquisition costs.
>
> We have previously disallowed acquisition costs recorded on a utility's books as organization costs. See, Order No. PSC-93-1713-FOF-SU, issued November 30, 1993, in Docket No. 921293. Also see, Order No. PSC-98-0524-PAA-SU, issued April 16, 1998, in Docket No. 971065.

Therefore, we recommend that these costs that total $2,434.48 be removed from ratemaking consideration in this docket.

Pro Forma Plant

2. In response to staff audit request BW-30, the utility also identified post test year plant in the amount of $4,479.92 for an invoice dated November 20, 2014 for two service line repairs. The invoice is from US Water Services Corporation (USWSC) and includes 6 hours for a tradesman @ $57.91 per hour. The USWSC contract provided to the staff auditor does not include Attachment G which lists the hourly rates for services provided by USWSC to BWI. Our review of an Attachment G provided in response to OPC requests in a related docket does not indicate a line item for tradesman. In addition, the invoice provided does not provide additional detail supporting the cost for the material charges. This invoice was also filed in Document No. 00110-15 and the pro forma amount was requested by letter. We do not believe that the utility has documented that this invoice was billed accurately according to the contract. According to *Florida Power Corp. v. Cresse*, 413 So. 2d 1187, 1191 (Fla. 1982), the utility always has the burden of proof to show that is costs are reasonable. If it cannot carry its burden, the costs must be disallowed.

O&M Expenses
Contractual Services-Other

3. The staff report included $41,546 for Contractual Services – Other. This reflects the annual expense for the management services agreement with USWSC. The USWSC contract represents monthly charges of $3,462.15 (or approximately $15 per month for each of the utility's 236 customers). The Office of Public Counsel remains very concerned about this high cost contract and would like to highlight additional concerns we have with this particular USWSC contract:

(1) The owner of USWSC also owns this system, necessitating heightened scrutiny into the reasonableness of all the contractual provisions and the costs contained in the contract;
(2) These USWSC contracts are typically one-size-fits-all contracts, with some modifications for each system. Thus BWI may have contracted for services and administration for which this purchase-water utility has no need;
(3) Unlike other water systems which must incur costs to pump and treat the water and to operate and maintain the pumping and treatment equipment, this utility consists of two small systems that purchase all of their water from Brevard County, so its remaining O&M expenses should be much less;
(4) The cost of the USWSC contract as compared to the cost of the purchased water seems unreasonable. For example, the cost of purchasing water from Brevard County is $83,935; whereas, the USWSC contract amount is $41,546; and
(5) According to *Florida Power Corp. v. Cresse*, 413 So. 2d 1187, 1191 (Fla. 1982), the utility has the burden of proof to show that this USWSC contract is reasonable for this small purchase-water utility.

We do not oppose reasonably priced outside services contracts; however, such contracts must be right-sized, and tailored to meet the needs of the utility. It should not be a one-size-fits-all contract that provides unnecessary services which a purchase-water only utility would not reasonably need. We believe that the utility has not carried its burden of proof to show why it is reasonable for BWI to enter into this contract with an affiliate nor has it shown that all the costs in all the provisions of this contract are reasonable given this a purchase-water only utility. Further, the Commission's tacit approval of other USWSC contracts for other systems owned by Mr. Deremer does not provide any basis to show that BWI has carried its burden of proof in this case. If it cannot carry its burden, then some or all of the costs associated with this USWSC contract must be disallowed.

We have other global issues with USWSC contracts in general, which we discuss in detail below.

Market Value

The utility submitted two letters to the Commission staff in order justify its outside contractual services contract with USWSC. The first is dated December 9, 2014 (DN 06669-14) and the second is dated March 6, 2015 (DN 01305-15). In these letters, the utility attempts to provide several comparisons with other utilities in an attempt to justify the high level of expense associated with the USWSC contract for this utility. While we recognize that it is difficult to create an “apples-to-apples” comparison of other similar outside services contracts to this contract, however, we do not believe that some of the specific rate cases that the utility has referenced are reasonable to use to compare to BWI. In the utility responses, it selectively picks several line-item expenses and attempts to equate these to the total contract cost. We do not believe that this methodology captures the total costs nor compares all the pertinent expenses. Because certain expenses such as Materials and Supplies and Miscellaneous expenses include a variety of costs, including distribution system repair and maintenance, we believe that a more accurate “apples to apples” comparison would best consider total O&M expenses.

In Document No. 01305-15, the utility attempts to compare similar costs approved in Commission Order No. PSC-14-0626-PAA-WS, issued October 29, 2014, for Little Gasparilla Water Utility, Inc. (LGI). However, LGI is a water treatment facility that is converting from a standalone reverse osmosis water system and interconnecting with the county water system via a subaqueous pipeline approximately 3,000 feet in length. The capital investment, plant retirement, and maintenance on the interconnection are not at all comparable to BWI, which has two separate distribution systems. The approved expenses include the imbedded costs for converting from a standalone reverse osmosis water system to an interconnection with the county via a subaqueous pipeline. Since the LGI system is on an island with no bridge to the mainland, LGI has every reason to have higher expenses than BWI which merely purchases water from Brevard County. Moreover, our “apples to apples” review indicates that the average cost of total O&M per customer for LGI is $565 compared to an average cost of total O&M per customer for BWI of $613.

In Document No. 06669-14, the utility attempts to compare the USWSC contract to the expenses incurred by K W Resort Utilities Corp. (KW) and Tradewinds Utilities, Inc. (Tradewinds). We believe that these two utilities are also significantly different from BWI as well as the costs associated with providing service.

First, KW is a wastewater system in an environmentally sensitive area that complies with Advanced Wastewater Treatment Standards and serves over 6 times the number of customers as BWI. It does not supply water to its customers. With that said, the total expenses approved on a per customer basis for KW equate to $681 per customer compared to the $613 per water customer for BWI. We believe that this highlights how unreasonable the BWI costs are such that BWI’s costs are only 10% lower than KW’s cost to operate a wastewater treatment plant on an environmentally sensitive island to advanced wastewater treatment standards.

Second, Tradewinds has a water system which includes a water treatment plant (WTP) composed of three wells, a hypochlorination system for disinfection, two hydropneumatic/flow tanks, and one elevated storage tank. As such, Tradewinds has capital investment, operation, and maintenance expenses for its treatment facilities which BWI does not have. Further, these expenses for BWI would be considered included in the purchased water expense from Brevard County. Moreover, the total water expenses approved on a per customer basis for Tradewinds equate to $241 per water customer, which is significantly less than the BWI cost per customer of $613.

Further, Tradewinds has a wastewater system which includes an extended aeration facility which consists of flow equalization, aeration, secondary clarification, chlorination, and aerobic digestion of residuals. Its treated effluent is sent to a holding pond with a 2.34 acre spray field used for irrigation. With that said, the total wastewater expenses approved on a per customer basis for Tradewinds equate to $606 per wastewater customer, which is almost the same as the BWI water cost per customer of $613, but there is significantly greater treatment demands for a wastewater system which BWI does not have.

There are very few utilities specifically in Brevard County to compare to BWI. But the chart below shows the average O&M cost per customer for these few utilities. The only utility with costs per customer higher than BWI has a reverse osmosis water treatment system which is an expensive method of treatment.

Utility Code	Utility Name	Source for O&M	Water O&M per Customer	Sewer O&M per Customer
WU965	Brevard Waterworks	Current SARC filing	$613.00	N/A
WS949	Aquarina Utilities, Inc.	2014 Annual Report	621.70	452.90
WS172	Northgate Properties, Inc.	2013 Annual Report	230.73	154.45
SU288	Colony Park Utilities, Inc.	PSC-08-0760-PAA-SU	N/A	172.89
SU942	TKCB	PSC-13-0126-PAA-SU	N/A	210.64
WS571	Service Management Systems, Inc.	PSC-03-1342-PAA-WS	520.66	256.45
WS842	Burkim Enterprises, Inc.	PSC-01-2511-PAA-WS	205.17	225.93

Basis for the USWSC Contract Costs

The utility also submitted the confidential USWSC cost model to staff and the Office of Public Counsel which provides a breakdown of the costs that support the contract costs. Our review of these confidential components raises several questions that we believe staff should consider.

In the confidential version of the letter filed with the Commission on March 13, 2015 (DN 01436-15 and 01437-15), we identified several specific issues regarding overtime, fuel and gasoline, and vehicle maintenance embedded in the USWSC contract cost model. First, the utility's confidential USWSC cost model indicates estimates that are in excess of actual costs. These discrepancies may not be material on an individual basis, but for a system as small as BWI, which purchases all of its water, we believe that all costs should be carefully reviewed as to their prudency. Second, BWI justifies some of the excess costs based on a 45 minute commute for the operator and maintenance man to reach the utility. If these commuter costs are significant, we believe the utility should consider hiring someone locally to save money. Third, we also pointed out that the USWSC contract includes a margin/profit on top of the specific expenses that are detailed. The amount of the margin/profit is confidential, but the Commission should determine if the amount is prudent.

This and the other specific issues we identified with the USWSC contract for BWI raise concerns with the amount of excess overhead that is being charged to BWI, a distribution only system that is facing another significant rate increase in a three year period.

Attachment G and Unreasonable 18% Surcharge

In past related cases, we have been provided copies of Attachment G but the Attachment G provided did not reference the utility to which the attachment applies. However, the attachments that we have reviewed in the past include a provision that "materials and reimbursable expenses will be billed at actual cost plus: 18%" and "Operations Supplies provided will be billed at actual cost plus 18%". For example, if USWSC has to replace a battery for a generator, it purchases that battery "off the shelf" and then adds an 18% surcharge (cost plus) to the cost of the battery. The utility has not demonstrated that an 18% surcharge on materials, expenses, and supplies that USWSC (an affiliate) provides is reasonable. We believe the 18% surcharge exceeds the market rate and is inherently unfair, and should be disallowed according to *GTE Fla. v. Deason*, 642 So. 2d 545, 547-48 (Fla. 1994).

Further, we believe that the utility already recovers USWSC overhead costs through the contract with BWI. If USWSC recovers its overhead through the contract and then adds an additional 18% surcharge on materials, expenses, and supplies it provides BWI, we believe this allows a double recovery of these costs which should be disallowed.

$400 Threshold in the USWSC Contract is Unreasonably Low

Under the terms of the USWSC contract, $400 is the threshold amount that determines whether routine repairs or maintenance expenses are covered under the USWSC contract or an added O&M expense charged to the utility. We believe the $400 threshold is unreasonably low considering the high $613 cost per customer for this purchase-water only system. The utility has failed to carry its burden of proof to demonstrate this amount is reasonable under *Florida Power Corp. v. Cresse*, 413 So. 2d 1187, 1191 (Fla. 1982). For ratemaking purposes, the Commission should either disallow these additional costs or increase that threshold to $1,000 for routine repairs or maintenance expenses.

Bad Debt Expense

4. The staff report includes bad debt of $10,042 which equates to 8% of test year revenues. We believe that this expense is too high and should be more carefully reviewed. The purpose of a bad debt expense is to accrue a sufficient level in the allowance for uncollectible accounts to cover the accounts that will be written off throughout the year.

   The staff report adjusts the utility's expense based on its calculation of a two-year average. We are concerned that this is still too high. We have reviewed the bad debt expense granted by the Commission in staff assisted rate cases for the period January 2010 through June 2014. The average bad debt expense as a percentage of revenues was less than one percent (.72%) or $2.33 per customer on an annual basis. This is substantially less than the 8% of revenues in the staff report (or $42 per customer on an annual basis.) We recommend that because the utility has not met its burden to support an 8% bad debt expense, the staff should at a minimum, reduce the bad debt expense to no more than the historic average of .72% of the revenues on an annual basis.

   In the alternative, while we don't know what amounts the staff report uses to calculate bad debt expense, our review of the 2013 Annual Report indicates a bad debt expense for 2013 of $1,855. The utility report of past due amounts for August 31, 2013 showed $5,939. The report as of August 31, 2014 showed $18,161, an increase of $12,222. The average of these two balances is $7,039. If this average was used as a bad debt expense it would equate to about 4% of the recommended revenue requirement. We still believe this is too high, but would be more in line with staff's philosophy.

   We are concerned with the amount of bad debt given the size of the system. We believe that the following questions should be considered to review the reasonableness of the bad debt expense.

   Why is the utility continuing to write off such a significant amount of bad debt? What is the utility doing to reduce this expense? Is the utility requiring deposits from customers? Is the utility cutting off service to eliminate the continued accumulation of uncollectible amounts? Is there a particular reason why the accounts are not paid? Why did this amount increase so dramatically from $5,939 in August 2013 to $18,161 in August 2014? What changed to create this significant increase? What are the uncollectible amounts for the most recent six months?

   We note that Bad Debt Expense is not included in the USWSC contract. However USWSC provides the meter reading, billing, and collecting services. While BWI and USWSC are related entities, unless the bad debt expense allowed is significantly reduced, we believe that there will be no incentive for USWSC to minimize bad debt expense as any losses are not passed through to USWSC. Alternatively, the Commission could reduce the USWSC contract to account for the uncollected bad debt.

Aged Accounts Receivable reports

5. We would also note that the bad debt expense amount appears to consider the Aged Accounts Receivable reports provided by the company. The report dated August 31, 2014 indicates total Accounts Receivable of $32,873.22, which is $1,897 less than the amount reflected as Accounts Receivable on the Trail Balance.