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STEVE CRISAFULLI
Speaker of the House of Representatives

August 6, 2015

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

Re: Docket 150102 -- Application for increase in wastewater rates in Charlotte County by Utilities, Inc. of Sandalhaven

Dear Ms. Stauffer:

Attached is a list of issues that the Office of Public Counsel has prepared to identify concerns we have with the MFRs filed in this case. This is a preliminary letter and we will file a follow-up letter after we review the staff audits and the utility responses to staff data requests. 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 (Archer, Buys, Cicchetti)
Division of Economics (Bruce, Daniel, Hudson)
Division of Engineering (King, Lewis, Watts)
Office of the General Counsel (Brownless)
Office of Auditing and Performance Analysis (Deamer)
Utilities, Inc. of Sandalhaven (Flynn)
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RATE BASE

Utility Plant In Service (UPIS)

1. Schedule A-4 shows the annual additions, retirements, and adjustments to Plant in service since the last PSC rate case. Line 26 is labeled 2012 Additions, but there is a negative amount of $341,741. How did the utility have negative additions in 2012?

Retirement of Wastewater Plant

2. Schedule A-3 of the MFRs includes adjustments for the retirement, decommissioning, and abandonment of the wastewater treatment plant (WWTP). The schedule below summarizes the utility's proposed adjustments to UPIS and accumulated depreciation. We have several questions and concerns regarding the utility's proposed adjustments.

Schedule A-3			
		UPIS	**A/D**
354.4	Structures & Improvements	(623,976)	350,998
355.4	Power Generation Equipment Treatment Plant	(170)	79
375.6	Reuse Transmission & Distribution System	(3,164)	403
380.4	Treatment & Disposal Equipment	(404,329)	433,289
381.4	Plant Sewers	(28,342)	2,104
380.5	Treatment & Disposal Equipment Reuse Treatment Plant	(1,110)	379
		(1,061,091)	787,252

   a. We believe that staff should carefully review the plant balances. Schedule A-6 in Docket No. 060285-SU indicates a December 31, 2005 balance for these accounts of $141,723. Now the utility is reporting $1,061,091.
      i. Did the utility make substantial investments in plant additions, even when it was planning to retire the plant?
      ii. Did the utility make adjusting entries to move plant to these accounts?
         1. If so, where did these adjustments come from?
         2. When were these adjustments made?
         3. What was the purpose of the adjustments?
   b. Why is there is more accumulated depreciation retired for Account 380.4 than plant?

Pro Forma Plant

3. Schedule A-3 (Page 1, Lines 28 and 29) of the MFRs includes an adjustment for "engineering services, permitting and construction costs to relocate existing sewer due to Charlotte County road, sidewalk and storm water improvements in the Placida Road right-of-way."

a. There is no related retirement made with this adjustment. However, our review of the information filed in Volume III indicates that there will be associated retirements. Page 344 of the .pdf version of the MFRs (Document No. 0335-15) addresses these retirements. Item 3 in the discussion of the project indicates certain collection system assets that are likely to be retired as part of this project (sections of 4" and 6" PVC and HDPE force main, 4" and 6" gate valves and associated fittings). These retirements were not reflected in the adjustments to rate base and depreciation expense. We believe that an adjustments should be made to reflect these retirements.

Non-Used and Useful Plant

4. In Docket No. 060285-SU, the Commission established Phase I and Phase II rates[1]. The Phase II rates were calculated to include the full value of the costs to connect to Englewood Water District (EWD), including connection fees, force mains, and lift stations. Due to the significant growth expected, the rates further included Accumulated Depreciation, CIAC, and Accumulated Amortization expected at 80% build-out. This was a fair match of costs necessary to provide service to customers. However, the WWTP was never retired and Phase II rates were never implemented. We believe that the current case should consider the same factors in determining a fair calculation of costs to be borne by the current rate payers. Several factors should be considered in determining the net investment to include in rate base:
   a. Was the utility prudent in reserving 300,000 gpd in capacity from EWD?
   b. How much of the reserved capacity is serving current customers?
   c. How much growth is anticipated in the next five years?
   d. Why shouldn't a used and useful adjustment be applied to the connection charges and related plant additions that will benefit future customers?
   e. Should CIAC, accumulated depreciation, and accumulated amortization be projected to the expected levels at 80% build-out?
   f. The service availability charges were set in the last case to recover approximately 75% of the connection charges and plant additions spread over the estimated 1,382 of future ERCs. Why should current customers pay for 100% of the plant costs through rate base when the service availability charges were set to recover a significant portion of these costs? Won't this result in some level of double recovery by allowing the plant to be recovered through rates as well as service availability charges?
   g. Without a used and useful adjustment or imputation of CIAC, wouldn't the future collection of $2,000,000 in CIAC put the utility in an overearning position? As the higher level of service availability charges are collected, rate base is reduced, but rates are set on the higher rate base level.

[1] Order No. PSC-07-0865-PAA-SU, issued October 29, 2007, in Docket No. 060285-SU, in re: Application for increase in wastewater rates in Charlotte County by Utilities, Inc. of Sandalhaven.

Contributions In Aid Of Construction (CIAC)

We reviewed Schedules A-11 and A-12 and compared these schedules to the same schedules in Docket No. 060285-SU. Our review indicates several areas we believe should be investigated further.

5. In Docket No. 060285-SU, Schedule A-12 shows a CIAC year-end balance for the historic test year 2005 of $2,293,750. The Schedule also shows the entire balance as “Line/Main Extension Fees.” In the current docket, Schedule A-12 indicates a year-end balance of $3,276,640. However, this amount is split as shown in the chart below.

Account	Description	Test Year 12/31/14
3550	Line/Main Extension Fees - Force Mains	76,270
3555	Contributed Lines - Gravity Mains	336,394
	Contributed - Other	
3500	Struct - Pumping Plant	340,846
3505	Struct - Treatment Plant	628,734
3560	Special Coll Struct Manholes	97,788
3565	Services to Customers	62,033
3600	Lagoons	185
3605	Treatment Equipment	62,927
	Other	
3705	Sewer Taps	1,593,575
3715	Sewer Res Cap Fee	77,890
	TOTAL	3,276,640

Schedule A-12 does not indicate any amounts that resemble the $2,293,750 that was included in the last rate case as Line/Main Extension Fees. Schedule A-11 reflects annual changes to CIAC. The schedule shows only additions but no adjustments or retirements. We believe that the utility should explain why the prior balances have been changed and provide supporting documentation for these changes. We disagree that any cash contributions should be reallocated to plant-designated accounts. We remind the Commission and the utility that the utility agreed to the following in a stipulation and settlement agreement with the Office of Public Counsel which was accepted by Commission order:

> Utilities, Inc. agrees that when cash CIAC has been received from main extension fees, plant capacity charges or meter installation charges, those amounts will be recorded in accounts that specifically identify the source of the cash contribution and will not be allocated to plant-designated accounts.
>
> For those systems where cash CIAC has been inadvertently allocated to plant-designated accounts, all cash CIAC shall be moved

> back to the appropriate cash CIAC accounts. No adjustments shall be made to recalculate the amortization of CIAC; however all amortization balances for cash CIAC shall also be moved from plant-designated accounts to the appropriate cash CIAC amortization accounts. These adjustments shall be made by Utilities, Inc. no later than June 30, 2014. [2]

We believe the Commission should determine if the utility is in violation of this order.

6. Schedules A-3 and A-12 show an adjustment to reclassify $974,922 from Sewer Tap Fees to Plant Capacity Fees. There is no indication how these amounts were originally collected and what the utility's basis was for making this adjustment. Considering the significant size of this adjustment, we believe that the utility should be required to fully support the source of these fees, why they were reclassified, and how the utility determined the amount to reclassify.

7. Schedule A-3 of the MFRs includes adjustments for the retirement, decommissioning, and abandonment of the WWTP. The schedule below summarizes the utility's proposed adjustments to CIAC and accumulated amortization. We have several questions and concerns regarding the utility's proposed adjustments.

Schedule A-3			
		CIAC	**A/A**
	Organization		5,996
	Structure - Treatment Plant	628,734	(869,345)
	Lagoons	185	(103)
	Treatment Equipment	62,927	(40,230)
	Tap Fees	618,653	(167,679)
		1,310,499	(1,071,361)

a. The summary shows an adjustment to retire $691,846 ($628,734 + $185 + $62,927) related to the retirement of the WWTP. Considering that these amounts were not identified as specifically related to the WWTP in the last docket, we question how the utility determined that this adjustment is reasonable. As stated above, we question why CIAC has been moved to the WWTP accounts.
    i. If the utility indicates that these represent donated plant, why is there Lagoons in CIAC but no plant recorded in the UPIS account for Lagoons? And why is the amount for Structure – Treatment Plant $628,734 for CIAC but only $623,976 for UPIS? (The adjustment to

[2] Order No. PSC-14-0044-FOF-WS, issued January 22, 2014, in Docket No. 120161-WS, in re: Analysis of Utilities, Inc.'s financial accounting and customer service computer system, page 8.

accumulated amortization and accumulated depreciation is even more out of line.)

b. The utility adjustment also includes an adjustment to retire tap fees of $618,653 related to the retirement of the WWTP. We also believe that the utility should justify how it identified this amount for tap fees related to the WWTP retirement.

c. As the above schedule indicates, the utility's proposed adjustment is to retire $1,310,499 from CIAC. However, the total proposed adjustment to UPIS is only for $1,061,091. Even if some CIAC is found to be plant specific, how can the total be greater than the amounts recorded to UPIS?

d. Why does this adjustment include a Debit to Accumulated Amortization of $5,996 for "CIAC – Organization"? How do you have accumulated amortization in this account? Especially, when there is no corresponding balance in CIAC?

    i. What do organization costs have to do with the retirement of the WWTP?

CAPITAL STRUCTURE

Accumulated Deferred Income Taxes (ADIT)

Our review of Schedule C-6 indicates several areas we believe should be investigated further.

8. Schedule C-6 includes 3 pages that detail the annual activity for fourteen ADIT accounts (7 for state taxes and 7 for federal taxes.) The ADIT related to depreciation expense (federal) includes activity related to depreciation for 2005 - 2014. However, the other thirteen accounts do not indicate any activity for 2014. We believe the utility should provide 2014 activity for all of the other 13 accounts. We agree that some accounts may not include activity every year. But we believe that accounts such as deferred maintenance, state depreciation, and rate case expense should reflect increases and amortization every year.

9. Schedule C-6, pages 2 and 3 include schedules showing the annual activity for the state and federal ADIT related to depreciation expense. Generally, depreciation creates deferred income taxes (DIT) as the utility can accelerate depreciation for tax purposes which creates a lower tax expense than under the Commission revenue requirement calculation. This results in a credit ADIT. The ADIT balance will increase as plant is built and decrease as regulatory depreciation catches up to the accelerated depreciation. Therefore, we would expect a summary of changes to these accounts to show gradual debits to reflect the "catching-up" of regulatory depreciation to tax depreciation. However, on Page 3 of schedule C-6, there are three large debits to the federal DIT account in 2012, 2013, and 2014. These three debits total $313,123. If there are significant increases in the deferred tax related to Depreciation, there should be a corresponding increase in plant accounts. We do not believe that these schedules indicate this relationship. We believe that these three amounts should be investigated and the utility should fully explain why this account includes these unusual amounts and provide work papers to support the ADIT balances.

10. Schedule C-6, page 2 includes a schedule showing the annual activity for the state and federal ADIT related to “Tap Fees Post 2000”. These schedules show a debit beginning balance of $211,987 for federal ADIT and $36,288 for state ADIT. These amounts were not reflected in Schedule C in the last Commission rate case. However, Commission Order No. PSC-07-0865-PAA-SU indicated that the audited utility balances for ADIT included these amounts. The same Commission order extensively addressed the issue of whether these debit balances should be included for ratemaking purposes.

    We agree with the decision in the Commission order but have a few additional comments. **First**, the Commission should not even consider including these amounts until the utility proves it paid taxes on the Tap Fees. In the last case, the Commission asked the utility to provide a copy of the tax returns to support or verify that the taxes were in fact paid on the plant capacity charges from 2001 to the present. As the prior order stated, the utility only provided the state returns but it is the federal returns that contain the necessary detail to verify if the utility paid taxes on the plant capacity charges.

    Second, if the utility is paying taxes on its tap fees, a debit DIT is created when a tap fee is received and the taxes paid. However, as the CIAC is amortized for book purposes, a credit should be recorded and gradually grow to offset the recorded debit. However, Schedule C-6 does not show any credits to this account. The utility should also explain how these debit deferred taxes originated, when they will reverse, and why there is no annual amortization on this account.

    Third, we would note that the last Commission order references the IRS Treasury Regulation (IRS Reg.) regarding the taxation of CIAC but omits one phrase that may be critical in any analysis in this account. The order discusses that the CIAC must be set within 8½ months from the in-service date. However, the IRS Reg states:

    > (b) with respect to the cost of the facility unless, no later than 8½ months after **<u>the close of the taxable year</u>** in which the facility was placed in service, there is an agreement, binding under local law, that the utility is to receive the amount as reimbursement for the cost of acquiring or constructing the facility. (Emphasis added)

    Therefore, as the Commission evaluates whether the tap fees create a DIT, we believe it is critical to determine 1) the in-service date for the plant related to the tap fees, 2) the end of the tax year when this occurred, 3) the date the plant capacity fee was established, and if the tap fees are not taxable, whether it is prudent for the utility to pay taxes on these fees.

11. The utility included a debit ADIT amount associated with a net operating loss (NOL) of $137,165 for federal taxes and $19,665 for state taxes. We believe that

these amounts should be removed from the ADIT calculation in this case. The Commission has set rates in the past based on allowable expenses and return on investment. ADITs have been established based on timing differences between book and tax accounting. If an NOL occurs due to factors outside the prior ratemaking decisions, the utility should not create a debit DIT to be recovered through rates in the future. If the Commission develops rates including a debit ADIT for NOL, it would result in retroactive ratemaking as it would be based on factors in the past that were not previously allowed in setting rates. The IRS has issued a Private Letter Ruling that confirms that such an approach does not violate the normalization requirements[3]. The Commission has previously stated that these amounts should not be included as part of the ADIT determination. In the last rate case for Labrador Utilities, Inc. the Commission stated that

> for the purpose of setting rates, the debit amount associated with the NOL shall not be included in the ADIT balance unless the NOL is included in the calculation of the per book income tax expense. Because the Utility did not include the NOL in its income tax expense, the debit amount . . . . shall be removed from the Utility's net credit ADIT balance[4].

12. Pursuant to Order No. PSC-14-0044-FOF-WS, issued January 22, 2014, Utilities, Inc. agreed as part of its stipulation in Issue 6 that for rate cases, it would make adjustments to its capital structure as necessary to reflect the proper amount of deferred income taxes on pro forma plant additions. Sandalhaven should explain where in its MFRs it has reflected the adjustments to reflect the ADITs on the pro forma adjustments and provide all supporting documentation. If the utility has not made any adjustments, it should provide the necessary adjustments and work papers to show what ADIT amounts would be necessary to comply with the Commission approved settlement regarding this issue.

13. If the utility has not made any adjustments to ADITs for the pro forma plant, we believe that staff should consider what action should be taken against the utility for failing to follow a settlement approved by Commission Order[5]. This is not the first case where the utility has failed to comply with the Settlement. The Sanlando rate case was filed July 1, 2014, well after the Settlement and the Commission order made an adjustment to ADIT for the pro forma plant[6]. In addition, the Labrador rate case was filed September 16, 2014, also well after the Settlement and the Commission order made an adjustment to ADIT for the pro forma plant[7]. We

[3] Internal Revenue Service, Private Letter Ruling Number 201418024, issued May 2, 2014.
[4] Order No. PSC-15-0208-PAA-WS, issued May 26, 2015, in Docket No. 140135-WS, In re: Application for increase in water and wastewater rates in Pasco County by Labrador Utilities, Inc., pages 14-15.
[5] Order No. PSC-14-0044-FOF-WS, op. cit., page 9.
[6] Order No. PSC-15-0233-PAA-WS, issued June 3, 2015, in Docket No. 140060-WS, In re: Application for increase in water and wastewater rates in Seminole County by Sanlando Utilities Corporation, pages 17-18.
[7] Order No. PSC-15-0208-PAA-WS, op. cit., page 15.

believe that the Commission should show cause the utility why it should not be fined for failure to follow a Commission Order.

NET OPERATING INCOME

Revenues

14. Comparing Schedule E-2 of the MFRs to Table 22 of the Charlotte County Consultant's report indicates a significant drop in consumption by general service customers. There was only a 2% drop in bills, but a 52% drop in consumption. We believe that this should be investigated to determine if the loss in customers were for particularly large customers, or if this was an across the board reduction in consumption due to continually increasing rates.

Salaries and Wages-Employees

15. Schedule B-6 indicates an adjusted Salaries and Wages – Employees expense of $131,692. The same expense in the Charlotte County rate case was $103,510 for a 2010 test year. Based on these numbers, the utility is asking for a compounded increase of over 6% a year. We believe that salaries should be carefully reviewed to consider the cost savings that the utility should experience when it retires the WWTP. Volume III of the MFRs (page 276 of the .pdf document) indicates five Sandalhaven field employees. According to the filing, one full-time position is a lead wastewater operator. Another wastewater operator is allocated about 80% to Sandalhaven, and a third wastewater operator is allocated about 30% to Sandalhaven. The utility should fully explain why it needs the equivalent of two full time operators when the WWTP will be retired. We believe that salary expense should be decreasing when the plant is retired as there will be a significant drop in the work required.

Excessive Inflow and Infiltration (I&I)

16. The utility calculated that it had no excessive inflow or infiltration on Schedule F-6. In its interim recommendation, staff calculated that the utility experienced excessive inflow and infiltration of 20.16% in the test year. We mostly agree with staff's adjusted calculation. However, we believe that the calculation for the estimated inflow should be 10% of the billed water (not 10% of the wastewater treated - as shown in the utility calculation). We have reviewed prior Commission orders and found that the Commission has used 10% of the billed water in prior calculations[8]. The utility notes on schedule F-6 that "looking forward, we believe that there will be no excess I&I." However, based on our calculation, as well as staff's calculation, there was excessive I&I in the test year. Therefore, the utility incurred additional costs to process the additional gallons. We believe that staff should verify the gallons used by the utility to project expenses (purchased sewage treatment, purchased power, chemicals, and sludge removal expense) and that

[8] Order No. PSC-11-0015-PAA-WS, issued January 5, 2011, in Docket No. 090531-WS, In re: Application for staff-assisted rate case in Highlands County by Lake Placid Utilities, Inc., page 7; Order No. PSC-07-0082-PAA-SU, issued January 29, 2007, in Docket No. 060255-SU, In re: Application for increase in wastewater rates in Pinellas County by Tierra Verde Utilities, Inc., page 3; and Order No. PSC-05-0624-PAA-WS, issued June 7, 2005, in Docket No. 040450-WS, In re: Application for rate increase in Martin County by Indiantown Company, Inc., page 11.

expenses should not include any of the excessive infiltration and inflow gallons when setting expense levels.

Contractual Services - Engineering

17. Schedule B-6 indicates a test year expense for Contractual Services – Engineering of $1,132. Schedule B-9 indicates this expense is for Effluent Disposal Evaluation by Excel Engineering Consultants. We believe that this appears to be a non-recurring cost that may be part of the decommissioning of the WWTP and should be removed from the test year O&M expenses.

Contractual Services – Testing

18. Schedule B-9 indicates an expense of $3,626 for Contractual Services – Testing (Account 735) paid to Sanders Laboratories, Inc. However, the O&M schedules do not reflect a charge to this account. We believe that the utility should indicate what account this was charged to in the test year and whether it will be an expense on a going forward basis after the WWTP is retired.

Contractual Services – Other

19. Schedule B-6 indicates a test year expense for Contractual Services – Other of $21,950. Schedule B-9 lists various charges to Contractual Services – Other as shown in the chart below. Eighty percent of the total account is lumped together under “Various” consultants. We believe that there should be further information provided regarding the $17,666.

Computer Maintenance	3,299
Internet Services	527
Employ Finder Fees	11
Payroll Services	408
Temp Employ - Clerical	82
Other Outside Services	17,666
MFR Adjustment	(44)
Total	21,949

Amortization of Rate Case Expense

20. Schedules B-6 and B-10 indicate that the MFRs include amortization of the prior rate case expense in an amount of $3,115 per month. (This is based on the amortization of the total approved rate case expense of $149,535.) Table 1 in the Hearing Officer’s Recommended Order indicates the amounts that the rates should be reduced after four years. This date should be in the fall of 2016 and now that the Florida Public Service Commission has regulatory authority for Charlotte County water and wastewater utilities, staff should monitor and ensure that this reduction is implemented.

Miscellaneous Expense

21. Lines 7 and 8 of Schedule B-11 list two projects totaling $326,940 for abandoned projects relating to a deep well injection project and a wastewater treatment plant expansion. These projects were included in the last Commission order and an amortization expense was allowed in rates to recover the costs over a 15 year period. The schedule also indicates the in-service date of 12/31/12 for these projects. We disagree with the utility's in-service date. The last order began the amortization period when the order was issued in October 2007.[9] We believe that the projects should be considered amortized over 15 years beginning in 2007 and that the amortization expense included in Miscellaneous Expense should be reduced from $65,388 to $21,796.

Amortization Expense

22. Schedules B-2 and B-3 include an amortization expense of $10,412 for the amortization of the "net loss related to the decommissioning of the WWTP". As expressed above we have some concerns with the calculation of the retirement. However, we believe that the utility should fully support its calculation of the amortization period. Using the numbers included in the MFRs to retire the plant, results in a loss of $34,701 (see chart below). Given this loss, an amortization of $10,412 allows for an amortization period of 3.33 years. We believe that this is unreasonable. Commission rule 25-30.433(9), F.A.C. prescribes the methodology for calculating an amortization period based on the net depreciation expense and a return on the net invested plant. Considering that the utility is attempting to retire more CIAC than plant, this creates a negative depreciation expense. We believe that this is another reason that staff should carefully review the utility's retirement entry. Without any depreciation expense to consider, the 9.60% rate of return applied to the net loss results in an annual amortization of $3,331 (for an amortization period of 10.42 years). Therefore, we believe that if staff determines that a net loss is appropriate, we believe that the annual amortization expense should be limited to $3,331.

	Debit	**Credit**
UPIS		1,061,091
Acc Depr.	787,252	
CIAC	1,310,499	
Acc Amort.		1,071,361
Loss	34,701	

[9] Order No. PSC-07-0865-PAA-SU, op. cit., pages 12-14.