

# HC WATERWORKS, INC.

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January 7, 2020

Office of Commission Clerk  
Public Service Commission  
2540 Shumard Oak Blvd.  
Tallahassee, FL 32399

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**Re: Docket No. 20190166-WU Application for increase in water rates in Highlands County by HC Waterworks, Inc. – Supplemental Response to Staff Second Data Request**

Dear Commission Clerk,

HC Waterworks, Inc. (HCWW) hereby submits its supplemental response to Staff's Second Data Request related to its Outside Contractual Services in response to previous concerns brought forth by the Commission at previous agenda conferences. Several questions were expressed on comparative contracts with affiliated parties.

HCWW contracted with US Water Service Corporation (USWSC) for administrative management, operations, maintenance, and customer service. The President and majority shareholder of HCWW has been in the water and wastewater utility management, operations and maintenance related industry for over thirty (30) years bringing a level of Florida specific expertise that is not typical to private utility ownership within the State. The Vice President of Investor Owned Utilities also has over thirty (30) years experience in regulated utilities provides direct management oversight to HCWW. Further, through its contract with USWSC, HCWW has made significantly plant improvements that have resulted in improved water quality of service. USWSC is the largest service provider of operations, maintenance, customer service and billing in the State of Florida. USWSC provides service in 60 of the 67 counties in Florida providing service to over 1,000 utility systems. Currently, USWSC provides water service to over 1,000,000 customers daily. USWSC has over 400 operational and maintenance employees throughout the State of Florida, and has over 99.95% compliance success record. USWSC also currently has several water and wastewater clients in close proximity to HCWW.

USWSC provides more than 100,000 meter reading services per month and responds to over 25,000 service calls per month. Through USWSC, professional and experienced managerial, financial, technical and operational resources are provided to twenty (20) related investor-owned utilities (IOUs) regulated by the Commission. The majority shareholder and president of HCWW is also the majority shareholder and president of the other related IOUs as well as USWSC. This provides for significant synergies and cost savings to all of the IOUs' customers. This technical and operational skills and knowledge can be used to further improve the operational performance of HCWW.

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**Past Commission Decisions**

HCWW has researched past Commission decisions on similar contractual services and offers the following relative to the existing contract.

A similar relationship exists with several regulated utilities in Marion County. However, these relationships are not exactly like HCWW contract. The following regulated water and wastewater utilities have similar services provided by a related party:

Tradewinds Utilities, Inc.  
Residential Water Systems, Inc.  
C.F.A.T. H2O, Inc.  
BFF Corp

These utilities have Outside Contractual Services with MIRA International, Inc. (MIRA). All of the above regulated utilities, as well as MIRA are owned by the same owners and have affiliated relations. MIRA provides the following services to the regulated utilities:

Billing/Computer Services  
Administrative Services  
Payroll  
Meter Reading  
Insurance  
Office Space  
Materials & Supplies  
Repair & Service Equipment  
Customer Relations  
Customer Services  
Annual PSC Reporting  
Hospitalization Benefits

Testing expenses and operation and maintenance expenses are covered under separate contracts discussed below.

In review of the Annual Reports, as well as past Commission orders on previous rate cases, these utilities also have utility Employee Salaries and Employee Pensions and Benefits. In Order No. PSC-11-0385-PAA-WS, issued September 13, 2011, the Commission approved a rate increase for Tradewinds Utilities, Inc. (Tradewinds). In review of the documentation in the Commission's docket file, the Commission approved Tradewinds' Outside Contractual Services with MIRA, an affiliated company. Specifically, in the Commission's audit – Audit Control No: 10-175-2-1 dated December 17, 2010, the Commission's auditor disclosed the following in Audit Finding 8:

The Utility's filing includes \$100,276 and \$131,475 of charges from MIRA International, Inc. (MIRA), an administrative Service Company, which is a related party. The charges are for employee and officer payroll, payroll tax expenses,

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employee benefits, office space and support for customer billing and collections, general maintenance materials and supplies, and other general administrative support operations as needed for utility operations. The Utility has no employees of its own and all administrative and general maintenance services are provided by MIRA.

The auditor recommended adjustments based on recommended amounts for affiliated charges as follows:

Tradewinds: \$93,228 – water  
\$55,754 – wastewater

Residential: \$146,849 – water

C.F.A.T.: \$34,580 – water  
\$33,666 - wastewater

BFF Corp: \$16,300 – wastewater

In addition, in reviewing Document No. **09572-10** in the docket file of Docket No. 20100127-WS, Tradewinds also has an additional contract for operations with Pro-Tech for \$600/month, or \$7,200 annually. There were also additional expenses for Testing included in the operating expenses. The amount requested by Tradewinds in its MFRs for Pro-Tech was \$4,400 for water and \$5,250 for wastewater. In addition, there was additional testing in the amount of \$3,630 for wastewater for Aqua Pure Water.

In Order No. PSC-11-0385-PAA-WS, the Commission approved Tradewind's Operation & Maintenance Expense with minor adjustments for Pro Forma Salary Increase and Bad Debt Expense. Tradewinds had requested O&M in the amount of \$125,421 for water and \$187,846 for wastewater. The Commission approved O&M in the amount of \$120,654 for water and \$176,895 for wastewater.

Tradewind's MFRs also reflected plant in service amounts for Transportation; Office Furniture and Equipment; and Power Operated Equipment which were included in rate base. These items are included in the contract with U.S. Water Services Corporation with HCWW and are not included separately in plant-in-service.

In another related rate case in Docket No. 200100126-WU for C.F.A.T. H2O, Inc. (CFAT), the Commission approved the utility's request for a rate increase. In reviewing the Commission audit in Audit Control No: 10-274-2-1 dated December 15, 2010, the Commission's auditor disclosed the following in Audit Finding 5:

The Utility's filing includes \$16,718 of charges to water O&M expenses from MIRA International, Inc. (MIRA), an administrative Service Company, which is a related party. The charges are for employee and officer payroll, payroll tax expenses, employee benefits, office space and support for customer billing and

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collections, general maintenance materials and supplies, and other general administrative support operations as needed for utility operations. CFAT has no employees of its own and all administrative and general maintenance services are provided MIRA. (sic)

The auditor recommended that “The Utility’s O&M expense balance should be increased by \$17,862 for the 12-month period ending December 31, 2009.” This would bring the MIRA recoverable amount to \$34,580 for water. In addition, Document No. 09566-10 in the docket file contained an operations contract for Pro-Tech in the amount of \$595 a month or \$7,140 annually. The amount included in the Utility’s MFRs and requested O&M expense for Pro-Tech was \$8,197. These additional amounts were allowed by the Commission, for a total outside services amount of \$49,917 for water.

In Order No. PSC-11-0366-PAA-WU, issued August 31, 2011, the Commission made minor adjustments to CFAT’s O&M expenses primarily for Pro Forma salaries and bad debt expenses. This rate case was only for CFAT’s water utility and did not include its wastewater utility.

In another similar rate case, the Commission approved total outside services for K.W. Resort Utilities Corp in Order No. PSC-09-0057-FOF-WS, issued January 27, 2009. In that rate case, the utility had several Outside Contractual Services with several affiliated parties. The first was for operations services with Keys Environmental, Inc. (KEI), an affiliated party. The utility recorded expenses in the amount \$450,776 for KEI during the test year. The Commission reduced this amount by \$71,053 for an allowed amount of \$379,723. This represented the operations portion of the utility services. However, KEI employees utilized the transportation equipment (vehicles) owned by the utility. In addition, KEI does not provide accounting services or initial customer contacts. These services are provided by Key West Golf Course (KWGC), another affiliate company. The utility paid KWGC an amount of \$8,000 a month or \$96,000 annually. The Commission reduced this amount by \$12,038 for a total allowed amount of \$83,962. Finally, the utility was charged \$60,000 annually for “management” of the utility paid to Green Fairways (an affiliated company). The Commission reduced this amount by \$30,000 and allowed the remaining \$30,000 annually. The total amount of these three contractual services was a total of \$493,683. This is a wastewater only utility providing service to 1,556 customers during the test year. The total amount of the Commission allowed affiliated transactions equates to \$317 per connection. In addition the utility also was allowed \$65,289 in ongoing engineering charges in Contractual Services – Engineering in the approved revenue requirement. It should be noted that the KEI contract provides that the contractor provide the chemicals and sludge hauling in the contract.

It should also be noted, that in the rate cases cited above, the Commission approved rate case expense in its orders. In HCWW’s filing, there is very minimal rate case expense requested.

HCWW contract with U.S. Water Service Corporation (USWSC) include the following services:

- Water Operations
- Wastewater Operations
- Meter Reading

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System Maintenance  
Flushing – distribution system  
Billing / Collection  
Customer Service  
Service Orders  
Regulatory - PSC, WMD, DEP  
Permits – DEP, DOH, WMD, etc.  
Testing – all normal required for water (does not include abnormal testing)  
DMRs, MORs - monthly reporting  
CCRs - annual  
PSC Annual Reports, indexes, rate cases, complaints, etc.  
Accounting - all bookkeeping, record keeping, AR, AP, etc.  
Meter Replacements  
Line break repairs  
Lawn care and maintenance  
Minor repairs and/or replacements – up to \$400  
Locates  
Meter calibrations  
Backflow preventor testing  
Turn Ons/ Turn Offs  
Disconnections  
Re-reads  
Generator Maintenance  
Tank inspections  
Vehicles  
Office (also equipment, tools, phones, etc.)

The USWSC revised contract dated September 1, 2018 was in the amount of \$266,771.45 for water. This equates to \$241.93 per ERC for water. This contract amount has increased by an index increase and the current amount is \$273,067.20 for water, which equates to \$252.84 for water.

Pursuant to the Contract, HCWW employed the services of USWSC in distinct functions; administrative management, operation, maintenance and billing/collection of the utility. This includes (a) Management and Financial Oversight; (b) Water System Operations; (c) Maintenance; and (d) Customer Service. For a listing of serviced provided to HCWW, see USWSC's Scope of Services – Base Contract Service, Section 2, as well as the cost responsibilities on Table 4 of the contract for water.

**WetCon Study**

In 2013, the Florida Governmental Utility Authority (FGUA) hired WetCon Utility and Management Consultants to review charges by USWSC in comparison to similar water and wastewater utilities throughout the United States. The Wetcon study was issued in July 2013. The WetCon study concluded that the USWSC costs on a per account bases fell within the top quartile of other utilities. These were charges to FGUA by USWSC.

Upon further analysis of the WetCon benchmarking study, there was a flaw in their data table. The underlying data for the “South” was obtained from the AWWA 2011 Benchmarking Performance Indicators. Upon further analysis, it was discovered that the costs in WetCon’s table were an average of the two water and wastewater costs. Further, the WetCon Benchmarking report states, “It is virtually impossible to find any two water utilities that are comparable, given their unique treatment systems, customer bases, permit requirements, operational procedures, capital needs and rate structures. This is particularly true when comparing other systems to FGUA, with its’ geographic spread, diverse customer base and broad range of treatment technologies.”

**AWWA Benchmark**

Another reputable study often used in the water and wastewater industry is the American Water Works Association (AWWA) Benchmarking Performance Indicators. Utilizing the 2018 Edition for water and wastewater, below is the actual costs contained in the AWWA 2016 Benchmarking Analysis:

<u>2018 AWWA:</u>	<u>Top</u>	<u>Medium</u>	<u>Bottom</u>
O&M cost per account			
Water - O&M	\$ 300.00	\$ 397.00	\$ 622.00
Customer Service Cost			
Water - per account	<u>\$ 31.33</u>	<u>\$ 44.80</u>	<u>\$ 60.85</u>
Total Cost:			
Water:	<u>\$ 331.33</u>	<u>\$ 441.80</u>	<u>\$ 682.85</u>
 <u>Compared to HCWW:</u>			
Water	<b><u>\$ 252.84</u></b>		

Also, in the 2018 AWWA, there was a further analysis based on company size. When compared to utilities in this study for Population from 0 - 50,000 customers, the contrast is similarly striking. Below are the numbers from the AWWA study:

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Population 0 – 10,000:

O&M cost per customer	<u>Top</u>	<u>Medium</u>	<u>Bottom</u>
Water - O&M	\$ 308.00	\$ 384.00	\$ 649.00
Customer Service Cost			
Water per account	<u>\$ 13.95</u>	<u>\$ 35.62</u>	<u>\$ 81.04</u>
Total Cost per customer:	<u>\$ 321.95</u>	<u>\$ 419.62</u>	<u>\$ 730.04</u>

Both of these independent studies provide third party independent verification that the USWSC operation and maintenance costs are well below the market rate. The “market” comparison is drawn on by both the 2018 AWWA benchmark as well as the Wetzell Benchmarking Report. This market comparison is paramount in providing finality to HCWW’s unrefuted evidence that these costs are well below market, and not above as required by the Florida Supreme Court as discussed below.

Each of the Administrative Management, Operation, Maintenance, and Customer Service contracts that USWC enters into with a party are different and are priced differently depending on numerous factors. This includes the number of utility operation employees needed (Facility Operators and Maintenance Mechanic) and the number of hours required per system for operation. Also whether the contractor provides the cost of the sludge hauling, chemicals, power, offices, vehicles, etc. or if those costs are borne by the owner. Also for the regulated utilities, a portion of the Vice President of IOUs, the Utility Manager and the Accountant are spread over all ERCs of the investor owned utilities. The contractual monthly charges for these utilities include the operations, accounting, and operation management positions. For the “Administrative Services” portion, this is derived at by using all currently owned or purchased investor owned utilities and dividing these amounts by the existing. The Administrative portion of the contract covers the management, accounting and utility oversight, including office space and equipment. These amounts are to cover the monthly operational and administrative expenses for all the investor owned utilities.

The Utility Manager oversees the daily operational items of each regulated utility, as well as the future capital improvement requirements. This individual also interacts with the field employees of the Department of Environmental Protection, local Health Departments, Public Service Commission, and the various Water Management Districts. The Vice President and Utility Manager also interact with the customers of the various regulated utilities. The Accountant performs all accounting and reporting requirements of the regulated utilities. This includes daily transactions in accounts payable, accounts receivable, bookkeeping, financial statements, etc. The Vice President oversees all aspects of each regulated utility and supervises both the Utility

Manager and Accountant. The Vice President also is responsible for all governmental reporting with the various agencies, including the Public Service Commission.

HCWW respectfully submits that the comparison of these non-related contracts, although useful and informational, should not be the sole basis of any disallowance of prudently incurred operating expenses. If HCWW was required to establish a stand-alone utility with personnel for maintenance, customer service, accounting, regulatory compliance, etc. the costs would far exceed the amount in the current USWSC contract. These operation and maintenance expenses would be incurred regardless of the size of the customer base.

It should be noted that the Commission has previously considered this approach at analyzing affiliated transactions of related parties and stated the following in Order No. PSC-12-0102-FOF-WS, issued March 5, 2012:

In evaluating whether and how much affiliate costs should be included in rates, we are aware of the relevant statutes and cases on rates and affiliate transactions. Section 367.081(2)(a)1., F.S., sets forth our responsibility in rate setting, and specifically states:

The commission shall, either upon request or upon its own motion, fix rates which are just, reasonable, compensatory, and not unfairly discriminatory. In every such proceeding, the commission shall consider the value and quality of the service and the cost of providing the service, which shall include, but not be limited to, debt interest; the requirements of the utility for working capital; maintenance, depreciation, tax, and operating expenses incurred in the operation of all property used and useful in the public service; and a fair return on the investment of the utility in property used and useful in the public service. . . .

As reflected in the statute cited above, we are required to set reasonable rates, but we must also set rates that are compensatory. The provisions in the statute require that we consider the cost of providing service, which includes operating expenses incurred in the operation of all property used and useful in the public service, as well as a fair return on the investment of the Utility in property used and useful in the public service. In conducting our analysis of the appropriate operating expenses to be included, we are mindful of two Florida Supreme Court cases. In the case of **Keystone Water Co v. Bevis**, 278 So. 2d 606 (Fla. 1973), the Court held that a utility is entitled to a fair rate of return on property used or useful in public service. In **Keystone**, the Court further found that rates which do not yield a fair rate of return are unjust, unreasonable, and confiscatory and their enforcement deprives a utility of due process.<sup>1</sup> Additionally, in **GTE v. Deason**, 642 So. 2d 545 (Fla. 1994), the Florida Supreme Court laid out the standard of review for affiliate transactions, stating:

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<sup>1</sup> See **Keystone Water Co. v. Bevis**, 278 So. 2d 606, 609 (Fla. 1973).



The mere fact that a utility is doing business with an affiliate does not mean that unfair or excess profits are being generated, without more. Charles F. Phillips, Jr., *The Regulation of Public Utilities* 254-55 (1988). We believe the standard must be whether the transactions exceed the going market rate or are otherwise inherently unfair. . . . If the answer is “no,” then the PSC may not reject the utility’s position.

**GTE v. Deason**, 645 So. 2d at 547-548. We have reviewed the record evidence and applied the holdings in **Keystone v. Bevis** and **GTE v. Deason** as appropriate. (pages 99 – 100)

The Commission, in arriving at its final decision stated:

While we agree with OPC witness Dismukes that AUF’s Market Based Study does not offer a realistic comparison of market based rates, we also agree with AUF witness Szyzgiel that the peer group analysis presented by witness Dismukes does not provide an adequate comparison. We note that in AUF’s 2008 rate case we also disagreed with witness Dismukes’ previous recommendation to use a comparison of Commission-regulated utilities to AUF in evaluating affiliate-provided services. In the Utility’s 2008 rate case, we specifically found “[t]hat the comparison analysis proposed by witness Dismukes does not provide an appropriate basis to warrant an adjustment being made.”<sup>2</sup> As acknowledged by witness Dismukes, there are complexities associated with determining the reasonableness of affiliate transactions. To that point, we find that witness Dismukes’ peer group comparison does not adequately compare the duties, activities, and responsibilities for the Utility’s affiliate-provided services.

The Commission further stated:

Moreover, just because the costs to operate a utility are high, this does not necessarily mean that a utility is operating inefficiently. Other factors may influence the costs to provide service to customers. Therefore, we believe a review of this particular Utility’s history is helpful in understanding the costs associated with providing service.

HCWW also offers that in the alternative, certain utility expenses may be excluded from the contract amount with the mutual understanding that these expenses will still be incurred but recorded in other expense accounts. The amounts of these prudently incurred expenses, such as testing, would also need to be included in overall approved revenue requirement.

### **Previous Commission Decision – USWSC**

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<sup>2</sup> See Order No. PSC-09-0385-FOF-WS, p. 78.

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The Commission has previously reviewed the reasonableness of the USWSC contract in several rate cases of “sister” utilities. Specifically, in Order No. PSC-15-0013-PAA-WS, issued January 2, 2015, the Commission stated:

We understand that the U.S Water contract is a significant operating expense. However, the U.S Water contract is comprehensive in nature, and provides the Utility’s customers with services that prior owners/operators did not. We recognize that such services in rates is the primary reason that the water and wastewater expenses have increased. Upon review, we shall approve contractual services – other expenses of \$38,197 for water and \$35,730 for wastewater.

Again in Order No. PSC-15-0282-PAA-WS, issued July 8, 2015, the Commission stated:

The USWSC provided its costing and allocation model to this Commission and OPC. We reviewed the model and its inputs and allocation procedures and, with the exception of the items for which we made adjustments, found the model to be reasonable.

The Commission continued by stating:

In conclusion, we find that the adjusted cost of the management services contract with USWSC is reasonable. The contract cost is comparable to the cost allowed in Lakeside Waterworks, Inc.’s rate case, Docket No. 130194-WS, and is lower than similar contract costs that have been identified. USWSC and its managers bring considerable management and operator experience and expertise at a comparably reasonable cost. By spreading costs over multiple systems, and adding ERCs to recognize potential future growth, HC Waterworks’ customers are realizing operational and cost benefits that would not be available if the Utility operated on a stand-alone basis. The adjusted total cost of the management services contract of \$194,847 for water and \$57,566 for wastewater is hereby approved.

Finally, in Order No. PSC-16-0305-PAA-WU, issued July 28, 2016, the Commission stated:

Lake Idlewild receives all of its operational and administrative services under a contract with an affiliated company, U.S. Water Services Corporation (USWSC). We previously reviewed and approved expenses related to the USWSC management services contracts for six of Lake Idlewild’s sister utilities.<sup>3</sup> In the

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<sup>3</sup>Order No. PSC-14-0413-PAA-WS, issued August 14, 2014, in Docket No. 130153-WS, *In re: Application for staff-assisted rate case in Highlands County, by L.P. Utilities Corporation c/o LP Waterworks, Inc.*; Order No. PSC-15-0013-PAA-WS, issued January 2, 2015, in Docket No. 130194-WS, *In re: Application for staff-assisted rate case in Lake County by Lakeside Waterworks, Inc.*; Order No. PSC-15-0282-PAA-WS, issued July 8, 2015, in Docket No. 140158-WS, *In re: Application for increase in water/wastewater rates in Highlands County by HC Waterworks, Inc.*; Order No. PSC-15-0329-PAA-WU, issued August 14, 2015, in Docket No. 140186-WU, *In re: Application for staff-assisted rate case in Brevard County by Brevard Waterworks, Inc.*; Order No. PSC-15-0335-PAA-WS, issued August 20, 2015, in Docket No. 140147-WS, *In re: Application for staff-assisted rate case in Sumter County by Jumper Creek Utility Company*. In addition, we approved similar expenses in Docket No. 150199-WU, *In re:*

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four most recent related dockets, we found USWSC's costing and allocation model to be reasonable with the exception of some allocated expenses related to salary overtime, fuel, and vehicle maintenance which were adjusted in those dockets.<sup>4</sup>

The Commission approved the USWSC contract by stating:

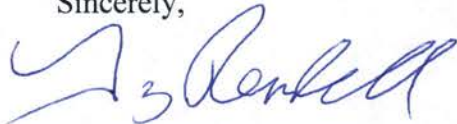
In addition to the cost subsidy resulting from USWSC's cost model, we find that Lake Idlewild is experiencing additional cost savings related to expenses such as chemicals, testing, and miscellaneous expenses that are attributable to economies of scale achieved through operations provided under the USWSC contract.

USWSC and its managers bring considerable management and operator experience and expertise at a comparably reasonable cost. By spreading costs over multiple systems, and adding ERCs to recognize potential future growth, Lake Idlewild's customers are realizing operational and cost benefits that would not be available if the Utility operated on a stand-alone basis. We find that the adjusted cost of the USWSC management services contract is reasonable.

The circumstances for HCWW remain the same as it did in the last rate case approved by the Commission. Thus, this analysis provided should be taken into consideration in this instant case.

If you have any additional questions or concerns, please do not hesitate to contact me at (727) 848-8292, ext. 245.

Sincerely,



Troy Rendell  
Vice President  
Investor Owned Utilities  
*// for HCWW Waterworks, Inc.*

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*Application for staff-assisted rate case in Lake County by Raintree Waterworks, Inc., Order No. PSC-16-0256-PAA-WS, issued June 30, 2016*

<sup>4</sup>Order Nos. PSC-15-0282-PAA-WS, PSC-15-0329-PAA-WU, and PSC-15-0335-PAA-WS. This Commission again found USWSC's costing and allocation model to be reasonable, with the exception of some allocated expenses related to fuel and vehicle maintenance, in Docket No. 150199-WU, *In re: Application for staff-assisted rate case in Lake County by Raintree Waterworks, Inc., Order No. PSC-16-0256-PAA-WS, issued June 30, 2016.*