

State of Florida



Bane _____
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Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

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

DATE: August 26, 2004

TO: Director, Division of the Commission Clerk & Administrative Services (Bayó)

FROM: Office of the General Counsel (Gervasi)
Division of Economic Regulation (Clapp, Redemann)

RE: Docket No. 981079-SU – Application for amendment of Certificate No. 104-S to extend service territory in Pasco County by Hudson Utilities, Inc., and request for limited proceeding.

AGENDA: 09/07/04 – Regular Agenda – Interested Persons May Participate

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\GCL\WP\981079.RCM.DOC

Case Background

Hudson Utilities, Inc. (Hudson or utility) is a Class B utility serving approximately 2,300 residential and 115 commercial customers. The utility provides wastewater collection service to its customers and purchases wastewater treatment service from Pasco County (County) pursuant to a Bulk Wastewater Treatment Agreement. The majority of Hudson's service territory is located in an area federally designated as a flood plain area, which is unsuitable for the efficient use of septic tanks and drain fields. The County comprehensive land use plan requires that coastal areas, including Hudson's service territory, shall be provided with sanitary sewer collection and treatment systems. The Environmental Administrator for the Pasco County Health Department advises that the Health Department favors the abandonment of septic tanks and the connection to central wastewater service when it is available.

On August 26, 1998, Hudson filed an application for amendment of Certificate No. 104-S to extend its service area. The application included a request to serve a portion of territory

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known as the Signal Cove subdivision, which was being served by the County, as well as a request to serve an area comprising approximately four to five square miles of unserved territory. Part of that unserved territory is called Sea Pines. The Sea Pines area is adjacent to the Sea Pines, Sea Pines (Ironwood), and Viva Villas subdivisions, which are served by the County. Docket No. 981079-SU was opened to process the application.

By Order No. PSC-99-1916-PAA-SU, issued September 27, 1999, which was made final and effective by Order No. PSC-99-2082-CO-SU, issued on October 21, 1999, the Commission approved Hudson's application to amend its certificate, including the transfer of the Signal Cove territory from the County to Hudson, and the amendment to include the formerly unserved Sea Pines area. By that order, Hudson was required to file proof of the transfer of the Signal Cove territory within three months. An Addendum Agreement for Bulk Wastewater Services for the Signal Cove Subdivision by and between Hudson and the County dated April 28, 1998, provided for the transfer of the Signal Cove territory when Hudson connected its force main to the County's wastewater collection system. Since that time, Hudson requested and the Commission granted five extensions of time for Hudson to file proof of the transfer of the Signal Cove territory from the County to Hudson.¹

On March 19, 2002, Hudson filed an application for an increase of service availability charges to increase its system capacity charge from \$1,000 to \$2,400, in order to recover the costs of extending its collection lines to serve the Signal Cove territory and additional areas north of Signal Cove.² By Order No. PSC-02-1626-PAA-SU, issued November 25, 2002, in Dockets Nos. 981079-SU, 020253-SU³, and 020254-SU, the Commission approved Hudson's application for increased service availability charges, which action became final by Order No. PSC-02-1818-CO-SU, issued December 20, 2002. The Commission ordered the utility to complete construction to the Signal Cove area by June 30, 2003, and to submit quarterly progress reports in Docket No. 020254-SU. Finally, the Commission ordered Hudson to file, in Docket No. 981079-SU, proof of the transfer of territory from the County to Hudson by June 30, 2003. The Commission put the utility on notice that failure to meet the June 30, 2003, deadline would result in the immediate initiation of show cause proceedings.

By Order No. PSC-03-0889-PCO-SU, upon finding that Hudson had apparently secured the financing necessary to complete the Signal Cove project, the Commission declined to initiate show cause proceedings and granted Hudson's fifth and last request for extension of time to file proof of the transfer of territory, with the clarification that any potential additional extensions of

¹ See Orders Nos. PSC-00-0212-FOF-SU, issued February 2, 2000; PSC-00-1512-PCO-SU, issued August 21, 2000; PSC-01-1993-PCO-SU, issued October 8, 2001; PSC-02-1166-PCO-SU, issued August 26, 2002; and PSC-03-0889-PCO-SU, issued August 4, 2003.

² OPC filed a notice and an amended notice of intervention in Docket No. 981079-SU, which was acknowledged by Order No. PSC-02-0966-PCO-SU, issued July 16, 2002.

³ Docket No. 020253-SU was opened to process a Petition filed by OPC to initiate show cause proceedings against Hudson for failure to provide wastewater service to the Signal Cove area within a reasonable time. By Order No. PSC-02-1626-PAA-SU, the Commission denied the Petition upon noting that the Commission had found Hudson's requests for extension of time to be reasonable and had granted them, and the docket was closed.

time would be available to accommodate unavoidable construction delays due to *force majeure* only.

On April 21, 2004, Hudson filed a Notice of Completion of Signal Cove Service Territory and Proof of the Transfer of Territory from Pasco County to Hudson Utilities, Inc. (Notice). By Order No. PSC-04-0708-PCO-SU, issued July 20, 2004, the Commission acknowledged the Notice and closed Docket No. 020254-SU (the service availability docket).

Also by Order No. PSC-04-0708-PCO-SU, the Commission kept the instant docket open to process a Citizens' Motion to Initiate a Show Cause Proceeding Against Hudson Utilities, Inc. (Motion), filed by OPC on May 25, 2004. In the Motion, OPC alleges that Hudson has failed to serve its customers residing in the Sea Pines community within a reasonable time. The Commission ordered Hudson to provide information relative to the Motion within 30 days, and directed that the Motion would be addressed as soon as plausible thereafter. Hudson timely filed its Response in Opposition to OPC's Motion on August 19, 2004. This recommendation addresses the Motion and Response. The Commission has jurisdiction pursuant to Sections 367.161 and 376.111, Florida Statutes.

Discussion of Issues

Issue 1: Should OPC's Motion to Initiate a Show Cause Proceeding Against Hudson Utilities, Inc., for failure to serve the Sea Pines area within a reasonable time be granted?

Recommendation: Yes, the Motion should be granted. Hudson should be required to show cause, in writing within 21 days, as to why it should not be fined in the amount of \$1,500 for failure to serve the Sea Pines area within a reasonable time, in apparent violation of Section 367.111(1), Florida Statutes. The order to show cause should incorporate the conditions stated below in the staff analysis. Moreover, Hudson should be required to file monthly progress reports, starting 30 days from the issuance date of the Order arising from this recommendation, to update the Commission on the status of the construction to Sea Pines, and to include: the status of the construction bids and whether a contractor has been employed to begin construction; the estimated construction costs; the estimated dates to begin and to complete construction; the estimated timeline under which construction activities will occur; whether the final right-of-way permit has been approved; whether funding of the construction has been approved by Hudson's lenders; and the status of Hudson's ongoing negotiations with the County for the transfer of the Sea Pines area to the County. (GERVASI, CLAPP, REDEMANN)

Staff Analysis:

Motion

OPC states that to serve Sea Pines, Hudson must construct a collection system including lift stations and force mains to connect the Sea Pines area with its other collection mains that transport wastewater to the County's treatment plant. In its amendment application, Hudson

represented that it had the financial and technical ability to provide this service. The Commission approved Hudson's amendment application to include the addition of the subject Sea Pines area by Order No. PSC-99-1916-PAA-SU, issued September 27, 1999. In the over 4-1/2 years since Hudson's amendment application was approved, the utility has failed to even begin constructing any collection system to serve the area.

Attached to the Motion as Exhibit A is a letter dated May 7, 2004, from counsel for Hudson to OPC, stating that construction to Sea Pines has been delayed due to recent dramatic increases in construction costs stemming from increases in oil prices, and that Hudson must run feasibility tests to satisfy the three lenders involved and gain their approval to go forward with the construction. OPC also states that many Sea Pines customers have requested service from Hudson to no avail. Hudson's failure to provide the service continues to cause severe health and environmental problems to the area. Attached to the Motion as Exhibit B are two letters sent to Representative Fiorentino's office complaining about Hudson's failure to provide service to Sea Pines.

Further, OPC states that Hudson originally assured the Commission that it could provide service to the expanded area without impacting its monthly rates or service availability charges. However, on March 19, 2002, Hudson sought permission to increase its service availability charges from \$1,000 to \$2,400 per equivalent residential connection or \$13.87 per gallon for all non-residential connections. By Order No. PSC-02-1626-SU, issued November 25, 2002, the Commission granted Hudson this substantial increase in its service availability charges. By that same Order, the Commission expressly acknowledged Hudson's assurance that it would begin constructing the Sea Pines collection system on or before August 2003, and that the project was projected to be completed by January 2004. OPC and the Commission were assured that the financing for the Sea Pines collection system was in place and that construction would begin immediately after the completion of the Signal Cove project. However, Hudson's May 7, 2004 letter (Exhibit A to the Motion) is confirmation that Hudson no longer has a binding commitment from its lenders to finance the construction of the Sea Pines project.

In light of the foregoing, OPC requests that the Commission initiate a show cause proceeding against Hudson for failure to provide service to Sea Pines within a reasonable time, impose penalties upon Hudson pursuant to Section 367.161, Florida Statutes, and provide such other relief that the Commission deems necessary to cause Hudson to serve the Sea Pines area as quickly as possible.

Response

Hudson states that it is, and at all times has been, diligently attempting to provide wastewater service to its Sea Pines area. Hudson has extended the terms of its bulk wastewater agreement with the County through February 5, 2025, in order to accommodate expected population growth in the area. OPC's Motion should be denied because Hudson is not, and has never been in violation of Section 367.161, Florida Statutes, as Hudson has never knowingly refused to comply with, or willfully violated any provision of Chapter 367 or any lawful rule or order of the Commission.

Hudson further states that due to economic constraints and other circumstances beyond Hudson's control, Hudson had to complete construction to Signal Cove prior to commencing construction at Sea Pines. Hudson timely fulfilled its commitment to service the Signal Cove territory. However, the construction company that Hudson utilized to construct service to Signal Cove advised Hudson that it may not be able to construct the infrastructure necessary to service Sea Pines. Since the May 7, 2004 letter to OPC (Exhibit A to the Motion), Hudson learned that its contractor is unable to complete construction to Sea Pines at a cost that would render the construction feasible to Hudson's lenders and customers. Immediately thereafter, Hudson commenced a competitive bid process with five other construction contractors. So far, one bid has been received and two others are expected to be received by August 24, 2004. The other two construction companies failed to submit bids as they could not commence working on the project in a timely fashion. Once Hudson receives the final bids, they will be submitted to Hudson's lenders for a feasibility study. If the lenders approve a bid, construction of Sea Pines will commence as soon as practicable. Hudson notes that it is unable to determine at this time whether damage caused by Hurricane Charley to areas close to Hudson will impact the timing of the Sea Pines construction.

Finally, Hudson recognizes that it may not be able to ultimately secure the financing necessary to build out Sea Pines. Therefore, on July 15, 2004, Hudson met with the County Administrator, Representative Fiorentino, OPC, and others, to discuss the feasibility of the County purchasing part or all of Hudson and/or providing service to some customers within Hudson's current certificated territory, including Sea Pines. Hudson is waiting to hear from the County regarding potentially transferring territory to the County and a possible offer to purchase some or all of Hudson's assets.

Other Relevant Filings

On June 30, 2004, staff filed copies of two letters provided by Representative Fiorentino, one from the West Pasco Habitat for Humanity (Habitat) and the other from the Sea Pines Civic Association (Association). The Habitat letter, dated June 25, 2004, requests that Representative Fiorentino advise the Commission of a home built by Habitat on Sea Pines Drive. The house is placed in such a way that it will not be possible to put in a septic system. When Habitat applied for its permits, it was told that the sewers would be installed in the first part of 2004. Now it hears that Hudson is trying delay the in-service date for putting sewers on Sea Pines Drive. According to Habitat, it will be heartbreaking for Habitat to finish the home in the Fall and not be able to let the family move in because there is not a sewer to connect to.

The letter from the Association, dated June 27, 2004, states that the Association has 200 plus homes on five streets that are on septic systems and need to be put on a sewer system at once because many of the septic systems are failing. Two of the streets are on canals on the Gulf of Mexico and the rest connect to the water by way of ditches. Hudson agreed to put in the sewers for \$1,000 per lot, then two years later asked for an increase to \$2,400, which was granted by the Commission, with work to start in the Fall of 2003 and to be completed in the early Spring of 2004. Now Hudson claims they are having trouble getting financing from the bank. The Association has houses being built on Sea Pines Drive, Hatteras, and Mako that are counting on the sewers.

On July 30, 2004, Hudson filed its response to staff's First Data Requests dated June 25, 2004. In that response, Hudson advised that the final right-of-way permit to provide service to Sea Pines was submitted in December 2003 and has not yet been approved by the new County engineer. Mr. Doug Bramlett, Assistant County Administrator, advised staff by telephone on August 25, 2004, that Hudson submitted its application for its final right-of-way permit on February 6, 2004, and that the County met with Hudson concerning the permit application requirements on May 5, 2004. During that meeting, the County advised Hudson of what further information the County needs to process the permit application. Hudson has not, to date, submitted the requested information to the County.

Analysis and Recommendation

Section 367.111(1), Florida Statutes, requires that

[e]ach utility shall provide service to the area described in its certificate of authorization within a reasonable time. If the [C]ommission finds that any utility has failed to provide service to any person reasonably entitled thereto, or finds that extension of service to any such person could be accomplished only at an unreasonable cost and that addition of the deleted area to that of another utility company is economical and feasible, it may amend the certificate of authorization to delete the area not served or not properly served by the utility, or it may rescind the certificate of authorization. If utility service has not been provided to any part of the area which a utility is authorized to serve, whether or not there has been a demand for such service, within 5 years after the date of authorization for service to such part, such authorization may be reviewed and amended or revoked by the [C]ommission.

Section 367.161, Florida Statutes, authorizes the Commission to assess a penalty of not more than \$5,000 per day for each offense, if a utility is found to have knowingly refused to comply with, or to have willfully violated any Commission rule, order, or provision of Chapter 367, Florida Statutes. Each day that such refusal or violation continues constitutes a separate offense.

Utilities are charged with the knowledge of the Commission's orders, rules, and statutes. Additionally, "it is a common maxim, familiar to all minds that 'ignorance of the law' will not excuse any person, either civilly or criminally." Barlow v. United States, 32 U.S. 404, 411 (1833). Thus, any intentional act, such as failure to provide service within a reasonable time, would meet the standard for a "willful violation." In Order No. 24306, issued April 1, 1991, in Docket No. 890216-TL titled In Re: Investigation Into The Proper Application of Rule 25-14.003, Florida Administrative Code, Relating To Tax Savings Refund for 1988 and 1989 For GTE Florida, Inc., having found that the company had not intended to violate the rule, the Commission nevertheless found it appropriate to order it to show cause why it should not be fined, stating that "'willful' implies an intent to do an act, and this is distinct from an intent to violate a statute or rule." Id. at 6.

The construction loan which Hudson received on June 17, 2003, was intended to allow sufficient funding to construct the Signal Cove (Phase I) and Sea Pines (Phase III) areas.⁴ By Order No. PSC-02-1626-PAA-SU, at p. 14, the Commission noted that Phase II of Hudson's construction project, consisting of construction of additional collection lines in other portions of Hudson's territory, was projected to begin in approximately August, 2003, and to be completed by January, 2004. Construction to Phase III, Sea Pines, was projected to be completed prior to beginning construction of Phase II. Therefore, construction to Sea Pines was projected to be completed by August of 2003. It is now one year later, and construction to Sea Pines has not yet begun. Nor will the construction loan that Hudson received to complete construction to Signal Cove and Sea Pines be sufficient to finance the necessary construction in order for Hudson to provide service to Sea Pines.⁵

Hudson advises that the current estimate of construction costs is approximately 20%-25% higher than the estimates prepared in 2002. Hudson will be in a better position to know the exact comparison when it receives and tabulates the construction bids. Hudson does not know at this time when construction to Sea Pines will begin or when construction will be completed. It involves receiving the construction bids for the area and processing through the lenders as to the feasibility of funding.

The construction company that Hudson employed to construct service to Signal Cove and to Sea Pines is affiliated with Hudson. That company completed construction to Signal Cove, but did not commence construction to Sea Pines. In response to a question posed by a Commissioner at the June 29, 2004, agenda conference, Hudson advised that it has not sued its affiliate for its apparent breach of contract with Hudson.⁶ Moreover, Hudson did not solicit bids from other construction companies to construct service to Sea Pines until May of this year. It appears to staff that if Hudson had done so sooner, it may have been able to construct service to Signal Cove and to Sea Pines simultaneously, and may have thus been able to finance both projects with the construction loan that was to have financed both projects. It also appears from staff's conversation with the County that Hudson could have been more proactive in securing its final right-of-way permit in order to commence construction to Sea Pines.

It appears that Hudson is in violation of Section 367.111(1), Florida Statutes, for failure to provide service to Sea Pines within a reasonable time. Staff recommends that Hudson be required to show cause, in writing within 21 days, why it should not be fined in the amount of \$1,500 for failure to provide service to Sea Pines within a reasonable time, in apparent violation of Section 367.111(1), Florida Statutes. In arriving at the fine amount, staff notes that Hudson's 2003 gross operating revenues are \$1,367,735. A fine in the amount of \$1,500 equates to approximately 0.11% of its gross operating revenues, which sends a strong message to Hudson that the delay is unacceptable without having the effect of lessening Hudson's chances of

⁴ See Attachment A, which contains the terms of the construction loan and term sheet, filed by Hudson in this docket on June 23, 2003.

⁵ Staff is currently performing an audit of Hudson's plant and CIAC additions for 2002 forward.

⁶ The prudence of Hudson's decision not to seek to enforce this contract would be an issue for any future proceeding in which Hudson requests recovery of the increased costs of construction or financing for the project.

obtaining the approval of its lenders to go forward with the construction, thereby potentially causing even further delay.

Staff notes that it has been very nearly five years since the Commission amended Hudson's certificate to include the Sea Pines area. Section 367.111(1) authorizes the Commission to review, amend, or revoke the authorization of this area if service has not been provided within five years after the date of authorization. Staff is not recommending that the Commission initiate deletion proceedings at this time because Hudson has voluntarily begun negotiating with the County for the sale of all or a portion of its system. Mr. Bramlett has advised staff that the County has performed a preliminary evaluation of Hudson's facilities and that the County Board has approved for the County to undertake a full due diligence study of Hudson's facilities. Due diligence studies ordinarily take three to four months to complete. The County expects that the study of Hudson's system should be completed by the end of this year and that it will enter into negotiations with Hudson for the purchase of the system by the end of the year. Deletion or revocation proceedings may very well become the next course of action for Hudson. Once the information is available from the County as to whether it is economical and feasible for the County to provide the service, Hudson may voluntarily file an application for deletion of territory.

In the meantime, staff recommends that Hudson file monthly progress reports, starting 30 days from the issuance date of the Order arising from this recommendation, to update the Commission on the status of the construction to Sea Pines, and to include: the status of the construction bids and whether a contractor has been employed to begin construction; the estimated construction costs; the estimated dates to begin and to complete construction; the estimated timeline under which construction activities will occur; whether the final right-of-way permit has been approved; whether funding of the construction has been approved by Hudson's lenders; and the status of Hudson's ongoing negotiations with the County for the transfer of the Sea Pines area to the County.

Staff recommends that the show cause order incorporate the following conditions: Hudson's response to the show cause order must contain specific allegations of fact and law. Should Hudson file a timely written response that raises material questions of fact and makes a request for a hearing pursuant to Sections 120.569 and 120.57(1), Florida Statutes, a further proceeding will be scheduled before a final determination of this matter is made. If a protest is also filed and a request for a formal hearing is made on other issues in this docket, the issues will be addressed in a single hearing to be scheduled in this docket. A failure to file a timely written response to the show cause order shall constitute an admission of the facts herein alleged and a waiver of the right to a hearing on this issue. In the event that Hudson fails to file a timely response to the show cause order, the fine is deemed assessed with no further action required by the Commission. If the utility responds timely but does not request a hearing, a recommendation will be presented to the Commission regarding the disposition of the show cause order. If the utility responds to the show cause by remitting the fine, the show cause matter shall be considered resolved.

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Issue 2: Should this docket be closed?

Recommendation: No, this docket should remain open in order to monitor Hudson's progress in providing service to the Sea Pines area and for final disposition of the show cause order. (GERVASI)

Staff Analysis: This docket should remain open in order to monitor Hudson's progress in providing service to the Sea Pines area and for final disposition of the show cause order.