

State of Florida



Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

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

DATE: October 20, 2005

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

FROM: Division of Economic Regulation (Kyle, Edwards, Lingo, Slemkewicz, Willis)
Office of the General Counsel (Vining)

RE: Docket No. 000694-WU – Petition by Water Management Services, Inc. for limited proceeding to increase water rates in Franklin County.
County: Franklin

AGENDA: 11/01/05 – Regular Agenda – Proposed Agency Action Except for Issue 7 – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Edgar

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\000694.RCM.DOC

Case Background

Water Management Services, Inc. (WMSI or utility) is a Class A water utility providing service to approximately 1,776 water customers in Franklin County. For the year ended December 31, 2004, the utility reported in its annual report operating revenues of \$1,419,587, and utility operating income of \$269,290. The utility's water rates were last established in a rate case by Order No. PSC-94-1383-FOF-WU, issued November 14, 1994, in Docket No. 940109-WU, In re: Petition for interim and permanent rate increase in Franklin County by St. George Island Utility Company, Ltd.

On June 6, 2000, WMSI filed an application, pursuant to Section 367.0822, Florida Statutes, for a limited proceeding to increase its water rates to recover the cost of building a new water transmission main to connect its wells on the mainland to its service territory on St. George Island. In its petition, the utility stated that it was notified by the Florida Department of Transportation (DOT) that the existing bridge to St. George Island, to which WMSI's water main is attached, was to be demolished and replaced by a new bridge with an expected in-service date of March 2003. Upon completion of the new bridge, WMSI would have to make alternative arrangements to provide service to its certificated service area. The utility's petition set forth its plan to construct a new main to be attached to the new bridge, along with ancillary modifications to its system, and requested an increase in its rates to provide funding for the proposed construction.

A customer meeting was held at the Franklin County Courthouse in Apalachicola on September 12, 2000, in order to allow the utility's customers the opportunity to comment on WMSI's petition. More than 100 customers attended, and 13 customers made statements. In general, the speakers believed that the projected cost of the project was excessive and that the utility should have planned for this contingency in such a way as to avoid such a large rate increase. There was also great concern over the utility's ability to provide fire protection.

WMSI originally requested that the Commission approve two tiers of temporary increases, to be approved concurrently, described as Phase 1 and Phase 2, in its initial consideration of this matter. Phase 1 would cover preliminary costs and Phase 2 would cover estimated total costs of the project. The utility then proposed a true-up, described as Phase 3, which would set final rates after the project was complete and all costs were verified.

By Order No. PSC-00-2227-PAA-WU, issued November 21, 2000 (consummated by Order No. PSC-00-2405-CO-WU, issued December 14, 2000), the Commission found that construction of the new water transmission main was justified, and that the prudent costs to be incurred by WMSI for this project should be recovered through a three phase mechanism. Further, the Commission found that replacement of the existing 8-inch main with a 12-inch water main was prudent, and that the used and useful percentage for the new main should be 100 percent. The Commission also approved the prudence of constructing a new line from Well No. 1 to Well No. 4 in connection with the replacement project. In addition, the Commission approved a Phase 1 increase and deferred consideration of a temporary Phase 2 increase until the utility filed more complete and detailed cost information. The approved Phase 1 increase was 11.3 percent, or an annual revenue increase of \$82,707.

On May 14, 2003, WMSI filed a Supplemental Petition for Limited Proceeding (supplemental petition), requesting revised rates for the Phase 2 rate increase. In its supplemental petition, the utility stated that numerous changes had occurred since the filing of the original petition. First, the projected bridge in-service date was changed from March 2003 to October 2003. Second, the estimated capital cost of the new transmission main and the other approved work on the mainland had decreased. Third, WMSI had obtained financial support from the State Revolving Fund (SRF) loan program administered by the Department of Environmental Protection (DEP). Finally, an eminent domain case filed by WMSI in an attempt to receive compensation from DOT for the old main was unsuccessful.

Since the net effect of the above mentioned changes substantially reduced the total project cost, WMSI requested the inclusion of fire flow protection improvement measures in its supplemental petition for limited proceeding. The utility stated that fire flow protection is an issue of great importance to the utility's customers, as communicated at the customer meeting. The overall rate increase requested in the supplemental petition was designed to generate annual Phase 2 revenue of \$568,657 above the expected revenue from the previously approved Phase 1 rates, or an additional increase of 50.2 percent.

By Order No. PSC-03-1005-PAA-WU (Phase 2 PAA order), issued September 8, 2003, the Commission approved a Phase 2 revenue requirement of \$490,959, or an increase of 42.1 percent in base facility and gallonage charges. The Commission also approved the utility's request to include the cost of improved fireflow protection in this proceeding, and established a depreciable life of 35 years for the portion of WMSI's transmission main attached to the new bridge.

The Office of Public Counsel (OPC) and the utility both filed Petitions on Proposed Agency Action. OPC objected to that portion of the utility's plan which called for removing the existing 150,000 gallon elevated water storage tank and replacing it with a new 200,000 gallon tank. WMSI stated that its petition was in response to its understanding that OPC was also filing a protest. WMSI's petition addressed the rate case expense that would be incurred as a result of a formal hearing. On May 28, 2004, WMSI and OPC filed a Joint Motion Requesting Commission Approval of Settlement Agreement to address both parties' protests. The substance of the settlement agreement was that, in lieu of replacing the storage tank, the utility would complete the looping of the water mains that serve the service territory from Bob Sikes Cut to the state park. By Order No. PSC-04-0791-AS-WU, issued August 12, 2004 (Settlement Agreement Order), the Commission approved the settlement agreement.

On October 14, 2004, the utility filed its Petition for Approval of Phase 3 Final Rates (the final petition). On June 9, 2005, staff filed a recommendation to address the requested final rates. This recommendation was deferred at the utility's request. Subsequently, additional meetings and discussions took place between staff, WMSI and OPC, and additional written comments were filed by WMSI and OPC. As a result, this recommendation completely replaces the recommendation filed on June 9, 2005. The Commission has jurisdiction pursuant to Sections 367.081 and 367.121, Florida Statutes.

Discussion of Issues

Issue 1: What is the appropriate final revenue requirement for this limited proceeding?

Recommendation: The appropriate final revenue requirement for this limited proceeding is \$1,368,807. (Kyle, Edwards)

Staff Analysis: In its final petition, WMSI requested final water rates which, by its calculation, would generate annual revenues of \$1,387,480. The utility's request for final rates was based upon a formula which included factors for the total expenditures for the supply main and fire flow improvements. These expenses included the interest rate applicable to construction financing, depreciation and property taxes on the new construction, rate case expense for the limited proceeding, increased property insurance costs, the expense of annual audits required by the lender, amortization of the residual value of the retired supply main, and regulatory assessment fees (RAF) associated with the increased revenue. The utility's calculation is summarized as follows:

Table 1 - WMSI Revenue Calculation

Total Cost of Project	\$6,156,536
One-half Year Depreciation	<u>-\$96,116</u>
Net Cost	<u>\$6,060,420</u>
Average Depreciation on Total Cost at 3.13%	\$192,233
Interest on Net Cost at 3.48%	\$211,622
Personal Property Tax on Net Cost at 1.14%	\$69,089
Rate Case Expense	\$18,511
Increased Property Insurance Cost	\$8,253
Cost of Annual Audit	\$12,000
Amortization of Retired Property	<u>\$14,631</u>
Subtotal	\$526,339
Gross-up for RAF at 4.5%	<u>\$24,801</u>
Total Additional Revenue	\$551,140
Additional Revenue From Phase 2 Rates	<u>\$486,259</u>
Excess of Additional Revenue Over Phase 2 Revenue	\$64,881
Expected Total Revenue at Phase 2 Rates	<u>\$1,322,599</u>
Required Final Revenue Requirement	<u>\$1,387,480</u>

WMSI's calculation methodology is similar to the approach approved by the Commission in the Phase 2 PAA Order. Staff has reviewed the information submitted by the utility in support of its calculation and believes that the methodology is still reasonable, with adjustments as discussed below. The utility attached three schedules to the final petition providing details of its calculations. WMSI also responded to several formal and informal requests from staff for additional data. As ordered by the Commission in the Phase 2 PAA Order, staff conducted an audit of the expenditures claimed by the utility in the final petition. On May 4, 2005, OPC submitted a letter expressing seven specific concerns about the utility's filing. On May 9, 2005, WMSI submitted a letter responding to OPC's concerns. Staff will first address six of the specific areas of concern addressed in OPC's letter, then provide additional analysis and adjustments. The other area of concern included in OPC's letter will be addressed in staff's analysis of the utility's proposal for a true-up in Issue 2.

Improvements to Office Building

OPC's first concern was that the final petition included costs associated with improvements to its office building on the island in the amount of \$287,231. OPC believes that these costs are outside of the scope of the limited proceeding, that they have not been mentioned by the Commission in any previous orders in this docket, and that these costs have not been verified and reviewed for prudence by the staff audit.

WMSI responded that the improvements were included in the fire protection improvements approved by the Commission in the Phase 2 PAA Order. Although described as "island office improvements" in the final petition, the \$287,231 represents an expenditure included in "other plant improvements" in the Supplemental Petition. WMSI stated that all of the high service pumps, the electrical equipment, and the generator are located in the office building structure. The utility explained that the building required substantial renovation in order to accommodate the operational requirements of the service improvements which are the subject of this proceeding, to improve safety and working conditions for WMSI employees, and to improve the appearance of the building.

The staff audit report, issued March 16, 2005, did not contain any exceptions with respect to the expenditures which are the subject of this limited proceeding. On May 9, 2005, the staff engineer made a physical inspection of the utility's water facilities. In his report dated May 16, 2005, the staff engineer stated that he had reviewed the structural improvements to the utility's plant and the fire flow protection system. The improvements observed included a new electrical room, a new generator and generator room, a new chlorination room, a new spare parts room, and a new roof for the expanded building. The engineer's report indicated that all of the improvements appear to be prudent and within the scope of this limited proceeding, with the possible exception of a second floor area created by the roof expansion. This area includes glass French doors, large windows, decking and vinyl siding. The utility stated that the area could be used for storage; however, staff's observation was that it was not currently being used and construction had not been completed.

In response to staff's request, WMSI provided a detailed breakdown of the costs of the building improvements. The cost of the decking and other improvements which were questioned by the engineer was \$37,310. The utility reiterated its belief that all of the first floor

improvements were integral to the implementation of the improvements which are the subject of this limited proceeding. Staff agrees with this assessment, but believes that the second floor improvements go beyond what the Commission approved in the Phase 2 PAA Order. Therefore, staff recommends that \$37,310 be removed from the total cost used in the utility's calculation.

Staff also recommends that the cost of the second floor be removed from the "net cost" component of the utility's calculation. Staff has calculated one-half year depreciation for the second floor to be \$605 (this did not materially change the composite depreciation rate). Accordingly, staff's recommended adjustment to "net cost" is a reduction of \$36,705.

Depreciation Expense For Retired Supply Main

In its May 4, 2005 letter, OPC observes that the utility does not appear to have made any adjustment to remove depreciation expense for the retired supply main in its calculations. In its response, the utility agrees with this assertion, and states that the depreciation expense included in the final petition includes only the expense related to the new construction.

Staff believes that the rationale of the utility's calculation of additional revenue required is, appropriately, the net increase in costs incurred for the replacement of the supply main and for the fire flow improvements. Therefore, staff believes that it is appropriate to net the depreciation for assets which are being replaced and are no longer in service with the depreciation expense for the new construction.

Staff notes that, in Schedule 2, page 2 of 3, of the final petition, WMSI assigned a 32 year life to the largest single component of the retired assets (\$298,469 placed in service in 1985). Rule 25-30.140(2)(a), Florida Administrative Code, prescribes a 35 year life for supply mains recorded in NARUC Account 309 for Class A and B utilities. In response to a staff request, the utility stated that WMSI was a Class C utility in 1985, and had used the prescribed 32 year life prescribed for Class C utilities. Staff believes that, because the utility is now subject to the Class A and B guidelines, it is appropriate to use a 35 year life for purposes of this calculation, because the approved revenue adjustment will relate to future periods. The utility calculated the annual depreciation of the retired assets as \$9,791, but did not include that amount as an offset to the depreciation expense for the new construction. Using a 35 year life for all of the retired assets, staff calculates the annual depreciation as \$8,992. Staff recommends that the utility's formula be adjusted to subtract that amount from the calculated depreciation on the new construction.

Depreciable Life for New Supply Main

In its final petition, the utility requests that the Commission approve a 30 year life for the portion of the new supply main which is attached to the bridge and exposed to air and salt spray. In the Phase 2 Supplemental Petition, the utility had described this main as a transmission main, for which the guideline depreciation rate would be 40 years. The utility requested a reduced depreciable life, and the Commission approved a 5-year reduction from the guideline rate. In the final petition, the utility points out that the asset in question is actually a supply main, for which the guideline life is 35 years. WMSI states that the characterization of the main as a transmission main was a clerical error, which staff did not notice in its analysis of the Supplemental Petition.

The utility states that the same factors which were considered by the Commission in approving a 5-year reduction in the life of the exposed portion of the main are still relevant, and requests approval of a 30 year life for the exposed supply main and a 35 year life for the buried portion of the main.

In its May 4, 2005 letter, OPC states that “the utility changed the Commission approved depreciation rate for the water main now called a supply main from 35 to 30 years.” OPC believes that this is an untimely motion for reconsideration of a final order, that the Commission fully considered the issue during the Phase 2 proceeding, and that a 35 year life is reasonable and should be used.

In its response to OPC’s letter, WMSI states that it is only asking the Commission to recognize that there was an error in nomenclature, and to apply its previously approved adjustment for adverse environmental conditions to the correct category. The utility cites to Sunshine Utilities v. Public Service Commission, 577 So. 2d 663 (Fla. 1st DCA 1991), in which the Court upheld a Commission order that properly corrected a rate base computation in a prior Commission order issued five years earlier that required the utility to make refunds, holding that the Commission “has the authority to determine whether there are mistakes of this character in its prior orders and has a duty to correct such errors.” Id. at 665.

Staff, after reviewing the above case and considering the parties’ arguments, believes that the utility’s request should be approved. The final phase of this proceeding was always intended to consider all of the relevant facts in setting final rates. The main in question is clearly a supply main, properly assigned to NARUC Account 309, for which the guideline life is 35 years. Staff believes that the rationale employed by the Commission in approving a 5-year reduction for the exposed portion of the main is still appropriate, and that the Commission has the authority to approve this correction.

Amortization of Retired Supply Main

WMSI included in its final petition a provision for amortization of the undepreciated portion of the supply main which was replaced. The calculation of the requested amortization amount of \$14,631 was provided in Schedule 2, page 2 of 3. In its May 4, 2005 letter, OPC notes that this factor was not included in the Phase 2 proceeding. OPC also expressed concern with the calculation of the amortization, the source of the figures used in Schedule 2, and the depreciation lives used.

In its response to OPC’s letter, the utility correctly points out that the amortization could not have been included in the prior phases of this proceeding, because the date of the retirement would not have been known at that time. Further, WMSI states that the calculation was performed in accordance with Rule 25-30.443(9), Florida Administrative Code, and that the source of the figures was the company books, which were subject to audit by staff.

In response to staff questions about the calculation of the amortization amount, the utility stated that none of the retired property was contributed, and that the assets were not salvaged because the cost of preparing them for salvage would have exceeded the amount which might have been received. As noted in the previous discussion of depreciation expense for the retired

main, the utility used a 32 year life for the portion of the retired assets placed in service in 1985. Staff believes that the appropriate life for purposes of this calculation is 35 years, because WMSI is now a Class A utility. Staff also questioned the discrepancy between the retirement date of December 31, 2003, used in WMSI's calculation, and the fact that the retirement was included in the utility's 2004 Annual Report. The utility responded that the actual date that the retirement was recorded in its books was February 27, 2004. WMSI provided an updated calculation of an amortization amount of \$14,298, using a 35 year life for all of the assets and February 27, 2004, as the retirement date.

Staff has reviewed the supplemental data provided by WMSI, and believes that the revised calculation is in accordance with Rule 25-30.443(9), Florida Administrative Code. Accordingly, staff recommends that the calculation of revenue requirement for final rates should include amortization of undepreciated prudently retired plant in the amount of \$14,298.

Incremental Property Insurance

In its May 4, 2005 letter, OPC questions whether the utility has provided support for the amount of the increase in property insurance cost. Further, OPC notes that the insured cost of the old main as stated on Schedule 2, page 3 of 3 (\$113,000) differs from the total cost of the retired assets shown on Schedule 2, page 2 of 3 (\$314,709).

In its response to OPC's letter, WMSI states that the information provided in the final petition was taken from a summary of present and subsequent premiums provided by the utility's insurance agent, and that the information was available to the staff auditor, who made no comment in the audit report. In response to staff's request for additional information, the utility provided copies of actual Common Policy Declarations and Notices of Acceptance detailing the property covered and the applicable premiums, as well as documentation of payment of the premiums. The utility also provided a copy of the original memorandum which was the basis for the amount of increased insurance cost included in the final petition. WMSI stated that it is not known why the insured value of the old main was less than the cost reflected on the books; however, the utility noted (and the documents provided supported) that the amount of the premium on the old assets was \$147, as reflected on Schedule 2, page 3 of 3.

Staff has reviewed the information provided and the utility's explanation, and staff believes that WMSI's requested amount, \$8,253, should be included as incremental insurance cost in the calculation of the revenue requirement for final rates.

Used and Useful Analysis of Transmission and Distribution Mains

In its May 4, 2005 letter, OPC asks whether staff has considered the "used and usefulness of additional island water distribution mains added to WMSI's system, since the Commission's last order in this limited proceeding." In a follow-up memorandum, OPC stated its belief that "a used and useful analysis should be performed on all water distribution pipes installed on the island since the 'first' Commission Order was issued in this Limited Proceeding, not the 'last' Commission Order issued in this proceeding. This analysis should be performed on all of the additions to the WMSI's island transmission and distribution mains since the inception of this limited proceeding."

WMSI's response stated that, in the Phase 2 PAA Order, the Commission found the utility's proposal for fire flow improvements including 17,700 feet of 6 inch and 8 inch mains, a new 200,000 gallon elevated storage tank, high speed service pumping, an emergency generator and other plant improvements to be prudent. Further, the utility noted that the settlement agreement resolving the protests of the Phase 2 PAA Order called for using the money originally approved for the new storage tank to be spent instead to complete the looping of the water mains. In the final petition, WMSI stated that a total of approximately 35,000 feet of 6 inch and 8 inch distribution lines were installed pursuant to the Phase 2 PAA Order and the settlement agreement. The utility's response to OPC's letter and memorandum noted that the Commission accepted the settlement agreement, and by inference, approved the prudence of all of the new mains. WMSI explained that the lines were not installed for the sole purpose of providing potable water to individual lots, because this was already being done by existing lines. The utility reiterated its belief that the new lines, "roughly half of which have been designed and installed at the request and agreement of OPC, are used and useful in the provision of the enhanced fire protection service and capacity."

Staff agrees with the utility's assertion that the prudence of the installation of the transmission and distribution lines included in the final petition was established by the Phase 2 PAA Order and the subsequent settlement agreement. Pursuant to their review of the utility's expenditures related to this limited proceeding, the staff auditors did not state any exceptions to WMSI's final listing and categorization of plant additions as stated in Schedule 2, page 1 of 3. Accordingly, staff believes that no used and useful adjustment should be made with respect to the transmission and distribution mains included in the final petition.

Rate Case Expense

In its final petition, WMSI included a request for recovery of the cost of pursuing this limited proceeding. In Schedule 2, page 3 of 3, the utility provided details of actual and projected expenses totaling \$74,043, of which the utility is including 25 percent (\$18,511) in its calculation of additional revenue requirement. In response to staff's request, WMSI provided copies of invoices in support of the amounts claimed. Staff has reviewed the data submitted and believes that the utility's request is reasonable, with one exception. The utility included \$2,100 in legal fees from Nicholas Yonclas, P.A. for "legal representation regarding water tower." Staff's review of the invoices provided by the utility indicates that this representation relates to the protests of the Phase 2 PAA Order and the resulting negotiated settlement agreement. In the Settlement Agreement Order, the Commission ruled that "both Petitions shall be deemed to be resolved, with both parties bearing their own expenses associated with this proceeding (OPC on behalf of the customers and the shareholders of the company on behalf of WMSI)." As a result of this agreement, staff believes that the legal fees for the representation by Nicholas Yonclas, P.A. should not be included in the cost of expense of pursuing this limited proceeding. Accordingly, staff recommends a reduction in the amount of \$525 (25 percent of \$2,100) to the utility's calculated expense of pursuing the proceeding.

Summary of Revenue Requirement Calculation

In Schedule 1, page 2 of 3, of the final petition, WMSI provided details of billing units and consumption for the year ended June 30, 2004, along with a calculation of the revenue

expected to be generated by those billing determinants at the rates approved in Phase 2 of this proceeding. The expected total revenue calculated by the utility was \$1,322,599, which included \$486,259 of revenue resulting from the excess of the approved Phase 2 rates over the rates in effect prior to the filing of this limited proceeding. As noted above, the utility calculated a final additional revenue requirement of \$551,140, or an increase of \$64,881 over the additional revenue provided by the Phase 2 rates. WMSI's total final revenue requirement request was \$1,387,480, an increase of 4.9 percent over the total Phase 2 revenue estimate of \$1,322,599.

The billing determinants provided in Schedule 1, page 2 of 3, reflected total consumption of 175,747,000 gallons; however, in its response to a staff data request, the utility provided a revised total of 178,638,000 gallons along with some changes in billing categories. Using the utility's revised figure, staff recalculated the excess of revenue from Phase 2 rates over pre-filing rates as \$489,584. As shown in Table 2, staff's recommended adjustments to WMSI's calculation of total final additional revenue requirement reduced that amount from \$551,140 to \$537,163. The excess of this amount over staff's recalculated additional revenue provided from Phase 2 rates is \$47,579. Adding this amount to the utility's estimated total Phase 2 revenue (\$1,322,599) results in a tentative final revenue requirement of \$1,370,178.

As discussed in Issue 5, staff has recommended a repression adjustment of 2.2 percent. To calculate the impact of this adjustment on the revenue requirement in rate cases, staff normally makes an adjustment to reduce purchased power and chemicals included in the Operation and Maintenance (O & M) expenses that are part of a utility's filing. In this proceeding, the utility has not filed a detailed description of its O & M expenses; however, the staff audit included an examination of WMSI's O & M expenses for the year ended June 30, 2004. The total amount of purchased power and chemicals, per the staff audit report, was \$59,867. For the purpose of calculating the revenue requirement repression adjustment, staff multiplied this amount by 2.2 percent, then applied a 4.5 percent RAF expansion factor, resulting in an adjustment of \$1,371. Accordingly, staff's recommended final revenue requirement for this proceeding is \$1,368,807. Staff's recommended adjustments are summarized in Table 2, below.

Table 2 – Staff Revenue Calculation

	Per Utility	Staff Recommended Adjustments	Staff Adjusted
Total Depreciable Cost of Project	\$6,136,385	-\$37,310	\$6,099,075
Land	\$20,151	\$0	\$20,151
One-half Year Depreciation	<u>-\$96,116</u>	<u>\$605</u>	<u>-\$95,511</u>
Net Cost	<u>\$6,060,420</u>	<u>-\$36,705</u>	<u>\$6,023,715</u>
Average Depreciation on Total Cost at 3.13%	\$192,233	-\$1,210	\$191,023
Interest on Net Cost at 3.48%	\$211,622	-\$1,929	\$209,693
Personal Property Tax on Net Cost at 1.14%	\$69,089	-\$359	\$68,730
Rate case Expense	\$18,511	-\$525	\$17,986
Increased Property Insurance Cost	\$8,253	\$0	\$8,253
Cost of Annual Audit	\$12,000	\$0	\$12,000
Amortization of Retired Property	\$14,631	-\$333	\$14,298
Depreciation on Retired Property	\$0	<u>-\$8,992</u>	<u>-\$8,992</u>
Subtotal	\$526,339	-\$13,348	\$512,991
Gross-up for RAF at 4.5%	<u>\$24,801</u>	<u>-\$629</u>	<u>\$24,172</u>
Total Additional Revenue	\$551,140	-\$13,977	\$537,163
Additional Revenue From Phase 2 Rates	<u>\$486,259</u>	<u>\$3,325</u>	<u>\$489,584</u>
Excess of Additional Revenue Over Phase 2 Revenue	\$64,881	-\$17,302	\$47,579
Expected Total Revenue at Phase 2 Rates	<u>\$1,322,599</u>	<u>\$0</u>	<u>\$1,322,599</u>
Tentative Required Final Revenue Requirement	\$1,387,480	-\$17,302	\$1,370,178
Repression Adjustment	<u>\$0</u>	<u>-\$1,371</u>	<u>-\$1,371</u>
Required Final Revenue Requirement	<u>\$1,387,480</u>	<u>-\$18,673</u>	<u>\$1,368,807</u>

Issue 2: What true-up mechanism, if any, should be approved to adjust for differences between revenues collected and recoverable expenses incurred from the inception of this limited proceeding through the test year?

Recommendation: WMSI's final rates should be decreased by 10.0 percent during the first twelve months that final rates approved in this proceeding are in effect in order to return to ratepayers revenues collected during Phase 1 and Phase 2 of this proceeding in excess of the actual incremental costs incurred by the utility. (Kyle)

Staff Analysis: In its final petition, WMSI requested that it be allowed to collect a surcharge of \$72,957 from ratepayers during the first twelve months that final rates are in effect. The utility stated that the Phase 2 rate increase went into effect in September 2003, on the assumption that all of the constructed plant would go into service in the first half of 2004. The utility stated that, in fact, some of the new construction was placed in service as early as January 2001, and that the calculation of depreciation accrual should begin at the actual in-service date. The utility also noted that it was required to fund a one-time reserve payment of \$209,785 in 2003 in conjunction with the construction loan from DEP.

The utility's original petition proposed that "to the extent that the additional revenues produced by the Phase I and Phase II rates either over- or under-recover the actual additional revenue requirement associated with the project during those time periods, the Phase III rates would be subject, for the first twelve months they are in effect, to a credit or surcharge in the amount necessary to effect a true-up." In the Phase 2 PAA Order, the Commission held that the approved Phase 2 rates were "held subject to over-collection with interest pending the final decision in this docket."

Schedule 4 of the utility's final petition provides detail of interest, depreciation and rate case expense incurred from the inception of this limited proceeding through June 30, 2004, including the timing of the expenses. These amounts, along with the reserve payment, are compared with a calculation of the cumulative total revenue collected as a result of the Phase 1 and Phase 2 rate increases. WMSI concludes that the revenue required to fund the expenses is greater than the revenue collected by \$72,957.

In its May 4, 2005 letter, OPC notes that the cost of funding the DEP loan reserve was not included in the Phase 1 or Phase 2 revenue requirements, and states that it does not believe that this cost should be included in determining whether a refund or surcharge is appropriate. In its response to OPC's letter, WMSI states that the reserve payment was addressed in the Supplemental Petition, and that it is an appropriate consideration for true-up because it was a cash expense incurred during the period in question. Further, the utility argues that "if the projected interest to be earned on the required cash reserve over twenty years is being included as part of WMSI's operating revenue, then it is only fair and appropriate to include the interest cost to WMSI for the cash required to fund this reserve for the twenty year period."

Staff notes that the issue of the loan reserve payment was considered by the Commission in Phase 2 of this proceeding. In the Phase 2 PAA Order, the Commission stated that:

We also computed the annual revenue increase projected at the approved Phase 2 rates, less property taxes, as \$415,977 (\$490,959 - \$74,982). We compared this amount with the total of the utility's first two payments on the SRF loan (\$419,608, per Exhibit A of the supplemental petition). We believe that the additional revenue to be received from Phase 2 rates is sufficient to meet the utility's needs, in view of the fact that the accrued property taxes will not be payable until November 2004.

Staff notes that, in the final petition, WMSI's calculation of additional Phase 2 revenues collected was \$486,259. As stated in the preceding issue, staff recalculated this amount as \$489,584, based on revised billing determinants. A comparison of this amount with the approved Phase 2 revenue requirement of \$490,959 would indicate that the utility did not experience an unexpected shortfall of revenue from Phase 2 rates.

In Schedule 3, page 2 of 2, of the final petition, the utility calculates the effective interest rate of the DEP loan as 3.32 percent. In Schedule 3, page 1 of 2, this amount is then used in a calculation of an overall weighted interest rate of 3.48 percent for financing the construction which is the subject of this limited proceeding. Staff notes that the calculation on Schedule 3, page 2 of 2, includes a factor for amortization of the loan reserve. This is consistent with the effective interest rate calculation approved by the Commission in the Phase 2 PAA Order. In a letter dated July 8, 2005, WMSI proposes to omit the reserve payment from the interest rate calculation, but to include it in the true-up. The utility states that this would result in a weighted interest rate of 3.37 percent, and an under-collection of \$62,471. The utility further states that omitting the loan reserve payment from the true-up calculation would result in a severe cash flow shortfall for WMSI during the true-up period. In a letter dated July 29, 2005, OPC expressed its opposition to the utility's new proposal. In addition, OPC noted that the reserve payment would eventually be returned to WMSI at the end of the loan period. After considering the parties' arguments, and the data provided, staff does not believe that it is appropriate to include the reserve as a separate cost for purposes of calculating a true-up, while at the same time including the amortization of the reserve in the calculation of the effective interest rate used in calculating the final revenue requirement. Accordingly, staff recommends that the reserve payment of \$209,785 not be included in the true-up calculation.

The utility's true-up calculation in Schedule 4 reflected a "total revenue requirement through 6/30/04" of \$727,091, including the loan reserve payment. WMSI calculated a "cumulative total collected at phased rates" of \$654,134. Staff has reviewed the utility's calculations and believes that they are reasonable, with the exception of the loan reserve payment. Subtracting the loan reserve payment from the utility's total revenue requirement reduces that amount to \$517,306, which would result in an over-collection of \$136,828. As a test of reasonableness, staff reviewed the earnings and cost of capital reported in the utility's annual reports for the years 2000 through 2003. WMSI has no positive equity; therefore, the cost of capital consists of debt and customer deposits. After adjusting the cost rate on customer deposits to the Commission standard 6 percent for each year, staff compared the utility's reported rate of return with its reported cost of capital for each year, and noted that, for all of the years except 2001, the utility was earning slightly more than 1 percent below its cost of capital. Staff calculated the additional revenue (grossed up for RAF) which would have been required to

bring the utility's earnings within one percent of its reported cost of capital for each year. Staff's analysis is summarized in the Table 3.

Table 3

Year	Adjusted Cost of Capital	One Percent Below Cost of Capital	Rate of Return	Required Revenue Increase (Decrease)
2000	10.23%	9.23%	8.02%	\$8,331
2001	8.86%	7.86%	7.92%	(\$459)
2002	5.07%	4.07%	3.40%	\$4,179
2003	3.94%	2.94%	2.59%	\$20,813
		Total		\$32,864

Staff considered offsetting the total net under earnings reflected in the utility's annual reports against staff's previously calculated over-collection of \$136,828, resulting in a net over-collection of \$103,964. However, as noted by OPC in its letter dated July 29, 2005, the annual reports have not been audited. Further, the utility's annual report for 2004 reflected a small over-earning posture. Staff believes that there is not sufficient support in the annual reports to offset apparent net under-earnings against the calculated over-collection. Although no specific true-up mechanism has been approved by the Commission in the first two phases of this proceeding, staff believes that it is reasonable to return the over-collection to current customers by means of a credit over the first twelve months during which the final rates are in effect. The over-collection represents 10.0 percent of staff's recommended final revenue requirement of \$1,368,807. Accordingly, staff recommends that the final rates approved in this proceeding be reduced by 10.0 percent for the first twelve months that the rates are in effect. These reduced rates are shown in Schedule 1 of this recommendation.

Issue 3: What are the appropriate test year billing determinants before repression?

Recommendation: The appropriate test year billing determinants before repression are 24,441 equivalent residential connections (ERCs) and 176,017,000 gallons (176,017 kgals). (Lingo)

Staff Analysis: According to the utility's final petition, the utility reported test year billing determinants of 23,367 ERCs and 175,747 kgals. The utility's requested ERCs was based on its statement that effective November 2004, metering at the State Park would change, eliminating numerous smaller meters and replacing them with a 6" turbine meter; however, as of June 2005, one year after the end of the test period, this change has not yet occurred.

Staff believes it is inappropriate to set rates on the ERCs contained in the utility's filing. Staff's calculated test period ERCs are based on a compilation of the utility's monthly reports which have been filed in compliance with a prior Commission Order. (See Order No. PSC-00-2227-PAA-WU, issued November 21, 2000 in Docket No. 000694-WU, In Re: Petition by Water Management Services, Inc. for limited proceeding to increase water rates in Franklin County, p. 14.) In addition, staff used residential billing analysis data, including the reclassification of 180 bills from the residential to the nonresidential class, which was provided by the utility in response to a staff data request. Staff found apparent consumption discrepancies between the utility's filing, billing analysis data, and the consumption that results from a compilation of the above-referenced monthly reports. Staff's recommended resulting billing determinants as filed in its June 9, 2005 recommendation were 24,465 ERCs and 178,637 kgals.

As discussed previously, staff received a letter from the utility dated July 8, 2005, in which the utility addressed specific areas of disagreement with staff's June 9, 2005 recommendation. One area of disagreement was that, according to the utility, staff erred in using raw, unadjusted kgals for rate setting which did not include any adjustments to account for leaks or meter reading errors. When this was discussed with the utility in a meeting between the parties on July 18, 2005, the utility realized that it had not filed revised monthly consumption reports to reflect the corrected consumption information. On August 3, 2005, the utility provided staff an itemization of its monthly test year consumption adjustments totaling 2,620 kgals. Based on this information, staff has revised its recommended number of kgals for rate setting purposes to 176,017 kgals. In addition, staff recalculated ERCs, and recommends that the appropriate figure is 24,441 ERCs.

Based on the foregoing, the appropriate test year billing determinants before repression are 24,441 equivalent residential connections (ERCs) and 176,017 kgals. Staff's analysis of the appropriate test year billing determinants is contained on Attachment A.

Issue 4: What is the appropriate rate structure for this utility?

Recommendation: The appropriate rate structure for this utility is a three-tier inclining-block rate structure. The appropriate usage blocks should be set for monthly usage of: 1) 0 – 8 kgals; 2) 8.001 – 15 kgals; and 3) for usage in excess of 15 kgals. The appropriate rate factors are 1.0, 1.25 and 1.5, respectively, while the appropriate base facility charge cost recovery percentage should be set at 40%. (Lingo)

Staff Analysis: The utility's current rate structure is the traditional base facility charge (BFC) / uniform gallonage charge rate structure. Under this usage-sensitive rate structure, customers are charged a monthly BFC of \$33.06, plus \$3.13 for each 1,000 gallons (kgal) used during the month. The utility's current rates were approved as a result of its Phase 2 filing in this case.

At the customer meetings held on September 12, 2000, during Phase One of this proceeding, several customers mentioned their preference for a rate structure with a greater emphasis placed on usage in order to reflect the different consumption habits of permanent residents versus renters. However, because the utility's Phase One increase in the instant docket was treated as an emergency, and because staff did not have sufficient customer usage data at that time, the Commission approved a continuation of the utility's BFC / uniform gallonage charge rate structure, but ordered that the utility's current rate structure be examined in Phase Three of this case. (See Order No. PSC-00-2227-PAA-WU at pp. 13-14.) In staff's June 9, 2005 recommendation, staff recommended that the appropriate rate structure for this utility was a three-tier inclining block rate structure, with usage blocks of 1) 0 – 8 kgals; 2) 8.001 – 15 kgals; and 3) for usage in excess of 15 kgals. The recommended rate factors were 1.0, 1.25 and 1.5, respectively, while the appropriate base facility charge cost recovery percentage was set at 40%. Staff's recommended rate structure was in part to comply with the multi-tier inclining block rate structure conditions of the utility's Consumptive Use Permit issued by the Northwest Florida Water Management District. This is discussed further in Attachment B.

After staff filed its June 9, 2005 recommendation in this case, the utility requested that the item be deferred to the July 19, 2005 agenda to allow the utility an opportunity to meet with staff to address certain concerns in the aforementioned recommendation. The meeting, held on July 18, 2005, led to several subsequent staff data requests. The discussion supporting staff's initial recommendation on this issue, subjects of subsequent correspondence and meetings between the utility and staff, as well as staff's subsequent rate structure analysis and recommendation, are contained in Attachment B.

Based on the foregoing and the discussion contained in Attachments B and C, staff again recommends that the appropriate rate structure for this utility is a three-tier inclining-block rate structure. The appropriate usage blocks should be set for monthly usage of: 1) 0 – 8 kgals; 2) 8.001 – 15 kgals; and 3) for usage in excess of 15 kgals. The appropriate rate factors are 1.0, 1.25 and 1.5, respectively, while the appropriate base facility charge cost recovery percentage should be set at 40%.

Issue 5: Is a repression adjustment appropriate in this case, and, if so, what is the appropriate adjustment to make for this utility?

Recommendation: Yes, a repression adjustment is appropriate. Residential consumption should be reduced by 2.5%, resulting in a consumption reduction of approximately 3,813.9 kgals. The resulting total water consumption for rate setting is 172,202.8 kgals, which represents a 2.2% reduction in overall consumption. In order to monitor the effects of both the changes in revenue and rate structure, the utility should continue filing the monthly reports that were ordered in Order No. PSC-00-2227-PAA-WS. These reports should be continued for a period of two years, beginning the first billing period after the approved rates go into effect. To the extent the utility makes adjustments to consumption in any month during the reporting period, the utility should be ordered to file a revised monthly report for that month within 30 days after all adjustments to that month have been closed. (Lingo)

Staff Analysis: Staff, in its June 9, 2005 recommendation, recommended a residential repression adjustment of 3,913.6 kgals, representing 2.2% of total water consumption. The repression adjustment in that recommendation was based on staff's recommended billing determinants and rate structure at that time. As discussed in Issue 4, staff has not changed its recommended rate structure from its June 9, 2005 recommendation. However, because staff has changed its recommended number of gallons for rate setting purposes as discussed in Issue 3, the repression analysis for the current recommendation had to be revisited.

Absent direct, comparable data from our database of utilities receiving price increases and decreases, staff utilized the proportional equation approach to calculate the recommended repression adjustment, which is consistent with Commission practice. (See Order No. PSC-01-2385-PAA-WU, issued December 10, 2001, in Docket No. 010403-WU, In Re: Application for staff-assisted rate case in Highlands County by Holmes Utilities, Inc., p. 22; Order No. PSC-02-1168-PAA-WS, issued August 26, 2002, in Docket No. 010869-WS, In Re: Application for staff-assisted rate case in Marion County by East Marion Sanitary Systems, Inc., p. 40.) Staff's recommended rate structure results in pre-repression price decreases below 10 kgal and nominal price increases from 10 kgal to 15 kgal; therefore, no repression adjustment is warranted for consumption less than 15 kgal.

The average, pre-repression monthly consumption for those customers using greater than 15 kgal is approximately 32.6 kgal. This level of consumption corresponds to a pre-repression price increase of approximately 41.62%. Staff has found that, for utilities receiving a water system only increase, a price increase of 33.33% leads to a 6.98% reduction in consumption. These relationships may be used to solve for the anticipated consumption reduction as follows:

$$\frac{33.33\% \text{ water-only increase}}{-6.98\% \text{ consumption reduction}} = \frac{41.62\% \text{ pre-repression price increase}}{X\% \text{ anticipated consumption reduction}}$$

$$X\% = \text{Repression} = -8.72\%$$

Residential kgals > 15 kgal	43,761.000
x Repression percent	-8.72%
= Residential kgals repressed	-3,813.922

Residential kgals repressed	-3,813.9
/ Total overall kgals	176,016.7
= Overall repression	-2.2%
Residential kgals after repr	146,704.078 kgals
+ General Service kgals	25,498.700 kgals
= Total kgals for rate setting	172,202.778 kgals

Based on the foregoing, a repression adjustment is appropriate. Residential consumption should be reduced by 2.5%, resulting in a consumption reduction of approximately 3,813.9 kgals. The resulting total water consumption for rate setting is 172,202.8 kgals, which represents a 2.2% reduction in overall consumption. In order to monitor the effects of both the changes in revenue and rate structure, the utility should continue filing the monthly reports that were required by Order No. PSC-00-2227-PAA-WS. These reports should be continued for a period of two years, beginning the first billing period after the approved rates go into effect. To the extent the utility makes adjustments to consumption in any month during the reporting period, the utility should be ordered to file a revised monthly report for that month within 30 days after all adjustments to that month have been closed.

Issue 6: What are the appropriate rates for this utility?

Recommendation: The appropriate water monthly rates are shown on Schedule No. 1. Excluding miscellaneous service revenues, the recommended water rates are designed to produce revenues of \$1,368,807. The utility should file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-30.475(1), Florida Administrative Code. In addition, the rates should not be implemented until staff has approved the proposed customer notice. The utility should provide proof of the date the notice was given no less than 10 days after the date of the notice. (Lingo, Kyle)

Staff Analysis: As discussed earlier, the water revenues to be recovered through rates are \$1,368,807. As discussed in Issue 3, staff recommends that the appropriate billing determinants before repression are 24,441 ERCs and 176,017 kgals. As discussed in Issue 4 and in Attachment B, staff recommends that the appropriate rate structure is a three-tier inclining block rate structure, with usage blocks of: 1) 0 – 8 kgals; 2) 8.001 – 15 kgals; and 3) usage in excess of 15 kgals, with a BFC cost recovery percentage of 40%. The recommended usage block rate factors are 1.0, 1.25 and 1.5, respectively. As discussed in Issue 5, staff recommends that the appropriate repression adjustment is 3,813.9 kgals. Therefore, the resulting monthly rates are shown in Schedule No. 1.

Staff's recommended increase in revenue requirement is \$46,208 (approximately 3.5% over Phase 2 rates, and approximately 64.7% over pre-filing rates). Approximately 40% (or \$552,062) of the revenue requirement is recovered through ERCs, while approximately 60% (or \$816,761) represents revenue recovery through the consumption charges.

The utility should file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-40.475(1), Florida Administrative Code. The rates should not be implemented until staff has approved the proposed customer notice. The utility should provide proof of the date notice was given no less than 10 days after the date of the notice.

As discussed in Attachment B of Issue 4, the utility has a seasonal customer base, and, in the utility's 1994 rate case, the Commission approved a rate design more heavily weighted to the BFC to increase cash flow during the utility's off-season. However, as also discussed in Issue 4, staff's recommended BFC in the instant case represents an approximate 32% reduction from the current BFC. Staff prepared a cost recovery analysis in order to determine whether the fixed revenue stream generated from staff's final recommended rates would cover the utility's requested 58% cost recovery from monthly base facility charges. This analysis, contained in page 1 of Attachment C, demonstrates that, based on staff's final recommended rates, the utility's fixed revenue stream each month generates approximately \$22,500 (or 34%) in excess of the requested fixed recovery amount. As discussed in Issue 2, staff is recommending a credit of 10.0 percent to be reflected as reduced rates for a period of one year. A similar analysis,

contained in page 2 of Attachment C, demonstrates that, with the reduced rates for one year, the utility continues to recover in excess of its requested fixed recovery by approximately 21%.

In the utility's July 8, 2005 letter to staff, the utility stated that staff's fixed cost recovery /fixed revenue stream analysis was flawed. The utility stated that "Under the current rate structure, the BFC accounts for 58% of revenues and staff has apparently assumed that the BFC includes all fixed costs. It does not and never has. Fixed monthly costs are those recurring costs that the utility faces each month, regardless of output; i.e., even if only the minimum quantity of water is produced." (p. 4)

In ratemaking, the terms "revenue requirements" and "cost of service" are synonymous. If the utility has requested that 58% of the revenue requirement be generated from fixed charges, then it may also be said that the utility has requested that 58% of the costs be covered by fixed charges (i.e., through a fixed revenue stream). The purpose of fixed charges is to generate a fixed, stable revenue stream to cover fixed charges, and certainly the BFC represents an important component in any utility's fixed revenue stream. However, the minimum quantity of gallons sold each month represents the other component of any utility's fixed revenue stream. The purpose of Attachment C is to demonstrate that, based on the utility's request that 58% of the revenue requirement be recovered from fixed charges (a fixed revenue stream), staff's final rate structure and rates would more than meet the utility's 58% request.

In the alternative, WMSI prepared a different fixed cost recovery analysis, which is shown in part [A] of page 1 of Attachment D. The utility's analysis has determined that its annual fixed costs are approximately \$1.25 million (representing greater than 90% of staff's recommended revenue requirement). The associated monthly fixed costs is \$104,284, which, when compared to staff's fixed costs (revenue requirement) to recover of \$66,159 from Attachment C, leaves the utility at a deficit of approximately \$38,000 per month according to its analysis.

Staff believes the utility's analysis is flawed, mainly because it included principal and interest on debt in its calculation. Neither revenue requirement nor the corresponding rates are calculated taking debt principal into consideration. In ratemaking, typically depreciation expense is used as payment toward debt principal, and the interest (rate) is captured in the utility's capital structure. Interest expense represents a below-the-line item not to be recovered in rates. Part [B] of Attachment D (pages 1 and 2) restates the utility's analysis by adjusting insurance payments, principal and interest on debt and including taxes other than income (which was left out of the utility's analysis). The result is that the fixed revenue stream generated by staff's recommended rate structure and rates, both with and without the 10% credit, generate revenues in excess of the monthly fixed costs from the analysis submitted by the utility, adjusted by staff.

Based on the foregoing, the appropriate water monthly rates are shown on Schedule No. 1. Excluding miscellaneous service revenues, the recommended water rates are designed to produce revenues of \$1,368,807. The utility should file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets

Docket No. 000694-WU

Date: October 20, 2005

pursuant to Rule 25-30.475(1), Florida Administrative Code. In addition, the rates should not be implemented until staff has approved the proposed customer notice. The utility should provide proof of the date the notice was given no less than 10 days after the date of the notice.

Issue 7: What is the appropriate amount by which water rates should be reduced four years after the established effective date to reflect the removal of amortized rate case expense, as required by Section 367.0816, Florida Statutes?

Recommendation: The water rates should be reduced as shown on Schedule No. 1 to remove \$17,986 in rate case expense amortization, grossed-up for regulatory assessment fees. The decrease in rates should become effective immediately following the expiration of the four-year rate case expense recovery period, pursuant to Section 367.0816, Florida Statutes. The utility should be required to file revised tariffs and a proposed customer notice setting forth the lower rates and the reason for the reduction no later than one month prior to the actual date of the required rate reduction. (Kyle)

Staff Analysis: Section 367.0816, Florida Statutes, requires that the rates be reduced immediately following the expiration of the four-year period by the amount of the rate case expense previously included in the rates. The reduction will reflect the removal of revenues associated with the amortization of rate case expense in the amount of \$17,986, grossed-up for regulatory assessment fees to \$18,834. The decreased revenues will result in the rate reduction recommended by staff on Schedule No. 1.

The utility should be required to file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. The approved rates should be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-40.475(1), Florida Administrative Code. The rates should not be implemented until staff has approved the proposed customer notice and the notice has been received by the customers. The utility should provide proof of the date notice was given no less than 10 days after the date of the notice.

If the utility files this reduction in conjunction with a price index or pass-through rate adjustment, separate data shall be filed for the price index and pass-through increase or decrease, and for the reduction in the rates due to the amortized rate case expense.

Docket No. 000694-WU

Date: October 20, 2005

Issue 8: Should this docket be closed?

Recommendation: If no person whose substantial interests are affected by the proposed agency action files a protest within 21 days of the issuance of the order, this docket should be closed upon the issuance of a consummating order. (Vining)

Staff Analysis: If no person whose substantial interests are affected by the proposed agency action files a protest within 21 days of the issuance of the order, this docket should be closed upon the issuance of a consummating order.

**COMPARISON OF STAFF v. UTILITY-FILED BILLING
 DETERMINANTS FOR RATESETTING**

ERCs

<u>Customers</u>	<u>ERCs Before Reclassification</u>	<u>Adjustments / Reclassification</u>	<u>Rate setting ERCs After Reclassification</u>	<u>ERCs Per Utility Filing</u>	<u>Staff ERCs Greater Than Utility's Filing</u>
Residential 5/8"	19,800		19,800	19,578	222
Residential 1"	970	(180)	790	958	(168)
Total Residential	20,770	(180)	20,590	20,536	55
All Other ERCs	3,695	180	3,851	2,831	1,020
TOTALS			24,441	23,367	1,074

CONSUMPTION (000)

<u>Customers</u>	<u>Consump Before Reclassification</u>	<u>Adjustments / Reclassification</u>	<u>Rate setting Consump After Reclassification</u>	<u>Per Utility Filing</u>	<u>Staff Consump Greater Than Utility's Filing</u>
Residential 5/8"	149,076		149,076	146,198	
Residential 1"	5,767	(1,705)	4,062	5,755	
Total Residential	154,843	(1,705)	153,138	151,953	1,185
All Other Custs	23,794	1,705	25,499	23,794	1,705
Subtotals			178,637	175,747	2,890
Leaks / Bills Adjust		(2,620)			(2,620)
TOTAL			176,017	175,747	270

Sources: Water Management Services, Inc. (Utility), monthly reports filed in compliance with Order No. PSC-00-2227-PAA-WU; Utility Filing, Schedule 1; response to staff's first data request, item no. 1; response to staff's fourth data request, item no. 3; workpaper obtained from the utility during staff's site visit on July 28, 2005.

DETERMINATION OF APPROPRIATE RATE STRUCTURE

**CURRENT RATES
AND HISTORY OF
CURRENT RATE
STRUCTURE:**

- (1) The utility's current rate structure is the traditional base facility charge (BFC) / uniform gallonage charge rate structure. Under this usage-sensitive rate structure, customers are charged a monthly BFC of \$33.06, plus \$3.13 for each 1,000 gallons (kgal) used during the month. The utility's current rates were approved as a result of its Phase 2 filing in this case.
- (2) The most recent time the utility's rates were adjusted as a result of a rate case was in Docket No. 940109-WU. In that case, the utility proposed a rate design more heavily weighted towards the BFC in order to increase cash flow to cover fixed expenses during the off-season. The Commission approved the utility's request. (See Order No. PSC-94-1383-FOF-WU, issued November 14, 1994, in Docket No. 940109-WU, In Re: Petition for interim and permanent rate increase in Franklin County by St. George Island Utility Company, Ltd., p. 64.)
- (3) At the customer meetings held on September 12, 2000 during Phase One of this proceeding, several customers mentioned their preference for a rate structure with a greater emphasis placed on usage in order to reflect the different consumption habits of permanent residents versus renters. However, because the utility's Phase One increase in the instant docket was treated as an emergency, and because staff did not have sufficient customer usage data at that time, the Commission approved a continuation of the utility's BFC / uniform gallonage charge rate structure, but ordered that the utility's current rate structure be examined in Phase Three of this case. (See Order No. PSC-00-2227-PAA-WU, issued November 21, 2000, in Docket No. 000694-WU, In Re: Petition by Water Management Services, Inc. for limited proceeding to increase water rates in Franklin County, pp. 13-14.)

**PRIOR ORDERS
AND PRACTICES
WITH THE WATER
MANAGEMENT
DISTRICTS:**

- (4) The Commission has a Memorandum of Understanding (MOU) with the five Water Management Districts (WMDs or Districts). A guideline of the five Districts is to set the base facility charges such that they recover no more than 40% of the revenues to be generated from monthly service. (See Order No. PSC-02-0593-FOF-WS, issued April 30, 2002, in Docket No. 010503-WU, In Re: Application for increase in water rates for Seven Springs system in Pasco County by Aloha Utilities, Inc., p. 81; Order No. PSC-03-1440-FOF-WS, issued December 22, 2003, in Docket No. 020071-WS, In Re: Application for rate increase in Marion, Orange, Pasco, Pinellas and Seminole Counties by Utilities, Inc. of Florida, p. 144.) This is also a practice of the Commission. (See Order No. PSC-94-1452-FOF-WU, issued November 28, 1994, in Docket No. 940475-WU, In Re: Application for rate increase in Martin County by Hobe Sound Water Company, p. 12; Order No. PSC-01-0327-PAA-WU, issued January 6, 2001, in Docket No. 000295-WU, In Re: Application for increase in water rates in Highlands County by Placid Lakes Utilities, Inc., pp. 23, 28; Order No. PSC-00-2500-PAA-WS, issued December 26, 2000, in Docket No. 000327-WS, In Re: Application for staff-assisted rate case in Putnam County by Buffalo Bluff Utilities, Inc., p. 27; Order No. PSC-02-0593-FOF-WS, issued April 30, 2002, in Docket No. 010503-WU, In Re: Application for increase in water rates for Seven Springs system in Pasco County by Aloha Utilities, Inc., pp. 81-82.)

DETERMINATION OF APPROPRIATE RATE STRUCTURE (cont.)

**PRIOR ORDERS
AND PRACTICES
WITH THE WATER
MANAGEMENT
DISTRICTS (cont):**

- (5) The BFC / uniform gallonage charge rate structure had been the Commission's rate structure of choice because it is designed to provide for the equitable sharing by the rate payers of both the fixed and variable costs of providing service. (See Order No. PSC-00-2227-PAA-WU, issued November 21, 2000, in Docket No. 000694-WU, In Re: Petition by Water Management Services, Inc. for limited proceeding to increase water rates in Franklin County, p. 13.) However, over the past several years, based in large part on requests made by the WMDs, the Commission has been implementing the inclining-block rate structure as its rate structure of choice. (See Order No. PSC-03-0647-PAA-WS, issued May 28, 2003, in Docket No. 020407-WS, In Re: Application for rate increase in Polk County by Cypress Lakes Utilities, Inc., p. 31; Order No. PSC-00-0248-PAA-WU, issued February 7, 2000, in Docket No. 990535-WU, In Re: Request for approval of increase in water rates in Nassau County by Florida Public Utilities Company (Fernandina Beach System), p. 37; Order No. PSC-01-0327-PAA-WU, issued February 6, 2001, in Docket No. 000295-WU, In Re: Application for increase in water rates in Highlands County by Placid Lakes Utilities, Inc., p. 25; Order No. PSC-02-0593-FOF-WS, issued April 30, 2002, in Docket No. 010503-WU, In Re: Application for increase in water rates for Seven Springs system in Pasco County by Aloha Utilities, Inc., pp. 80-81; Order No. PSC-03-1440-FOF-WS, issued December 22, 2003, in Docket No. 020071-WS, In Re: Application for rate increase in Marion, Orange, Pasco, Pinellas and Seminole Counties by Utilities, Inc. of Florida, pp. 184, 208.)
- (6) Although the utility's current rate structure is considered usage sensitive because customers are charged for all water used, the WMDs do not consider this rate structure to be a conservation-oriented rate structure. (South Florida Water Management District, Section 2.6.1, District's Basis for Review; Northwest Florida Water Management District, Permit No. 20040013, p. 5.)

**SPECIFIC
CONCERNS OF
THE NORTHWEST
FLORIDA WATER
MANAGEMENT
DISTRICT:**

- (7) The utility is located in the Northwest Florida Water Management District (NFWFMD) in an area of special concern. The utility's current Consumptive Use Permit (CUP) was issued on March 25, 2004. Its previous CUP had expired due to the utility's failure to timely submit a request for renewal of water use. Additionally, WMSI failed to comply with its pumping limits and a number of the specific conditions of the expired permit. (Northwest Florida Water Management District, Staff Report to Governing Board (District Staff Report), February 13, 2004, p. 1.)
- (8) According to the above-referenced District Staff Report issued to the Governing Board before the current CUP was renewed, one of the permit conditions that WMSI failed to comply with was consistently reporting its progress in implementing water conservation and efficiency measures. (Ibid.)

DETERMINATION OF APPROPRIATE RATE STRUCTURE (cont.)

SPECIFIC CONCERNS OF THE NORTHWEST FLORIDA WATER MANAGEMENT DISTRICT (cont.):

- (9) WMSI's cumulative drawdown, coupled with water quality data that may indicate an increasing trend in chloride concentrations, indicate a future potential for adverse impacts from WMSI's withdrawals. (Ibid., p. 2.) The current permit expires on April 1, 2006. The current permit duration is two years rather than five years so that the District may closely monitor WMSI's compliance with its permit. (Ibid.)
- (10) A specific permit condition of the utility's current CUP is that WMSI, by July 31, 2005, implement "action towards the adoption of a rate structure that promotes water efficiency and conservation (e.g., a multi-step inverted block rate structure)." (Northwest Florida Water Management District Individual Water Use Permit No. 20040013, issued to Water Management Services, Inc. on March 25, 2004, p. 5.)

UTILITY'S REQUESTED PHASE THREE RATES AND RATE STRUCTURE:

- (11) The utility requested a continuation of its BFC / uniform gallonage charge. The requested BFC was increased from \$33.06 to \$34.68, representing an increase of 4.9%. The gallonage charge was increased from \$3.13 to \$3.28, or 4.8%. Application of the utility's requested BFC and gallonage charges result in 58% of the requested revenue requirement being recovered through the BFC and the remaining 42% through the gallonage charges. (Water Management Services, Inc., Phase Three Petition, Schedule 1, p. 2)

THEORY BEHIND INCLINING BLOCK RATE STRUCTURES:

- (12) The goal of the inclining block rate structure is to reduce average demand. Under this rate structure, it is anticipated that demand in the higher usage blocks will be more elastic (responsive to price) than demand in the first usage block.
- (13) There are several factors to consider when designing inclining block rates, including, but not limited to, selection of the appropriate: a) BFC cost recovery percentage and the required conservation adjustment; b) usage blocks; and c) usage block rate factors.

BFC COST RECOVERY, USAGE BLOCKS AND RATE FACTORS:

- (14) Approximately 64% of the utility's bills and 41% of the corresponding kgals are captured at 5 kgal or less. The majority of consumption at or below 5 kgal is considered highly nondiscretionary, essential consumption. Therefore, an important rate design goal is to minimize, to the extent possible, the price increases at 5 kgal or less. (See Order No. PSC-94-1452-FOF-WU, issued November 28, 1994, in Docket No. 940475-WU, In Re: Application for rate increase in Martin County by Hobe Sound Water Company, p. 12; Order No. PSC-02-0593-FOF-WS, issued April 30, 2002, in Docket No. 010503-WU, In Re: Application for increase in water rates for Seven Springs system in Pasco County by Aloha Utilities, Inc., p. 83; Order No. PSC-03-1440-FOF-WS, issued December 22, 2003, in Docket No. 020071-WS, In Re: Application for rate increase in Marion, Orange, Pasco, Pinellas and Seminole Counties by Utilities, Inc. of Florida, pp. 143-144.)

DETERMINATION OF APPROPRIATE RATE STRUCTURE (cont.)

- BFC COST RECOVERY, USAGE BLOCKS AND RATE FACTORS (cont.):**
- (15) Based upon staff’s site evaluation of the utility’s service area, there is a great size disparity among residential customers’ homes. There is a greater percentage of nondiscretionary consumption in smaller homes than in the much larger homes.
 - (16) It is important to quantify the consumption disparity in order to appropriately target high-end users while rewarding those customers who usage is mainly nondiscretionary. Therefore, a consumption analysis, detailing relationships between the percentage of bills and the related percentage of kgals captured at given consumption levels, is detailed in Table 4 below.

TABLE 4

(a)	IF THE FOLLOWING PERCENTAGE OF BILLS AND KGALS ARE CAPTURED AT THESE LEVELS:		THEN THE REMAINING PERCENTAGE OF BILLS ACCOUNT FOR THE REMAINING PERCENTAGE OF KGALS USED:	
	(b)	(c)	(d) = 100% - (b)	(e) = 100% - (c)
<u>Consump:</u>	<u>% Bills</u>	<u>% Kgals</u>	<u>% Bills</u>	<u>% Kgals</u>
8 kgals	75%	53%	25%	47%
10 kgals	80%	59%	20%	41%
15 kgals	88%	70%	12%	30%
20 kgals	92%	77%	8%	23%

- (17) As shown in columns (b) and (c) of Table 4, approximately 80% of the utility’s bills and 59% of the corresponding kgals are captured at consumption of 10 kgal or less, 88% of the bills and 70% of the kgals are captured at consumption of 15 kgal or less, and 92% of the bills and 77% of the kgals are captured at consumption of 20 kgal or less.
- (18) As shown in columns (e) and (d) on Table 4, 41% of the water is used by only 20% of the bills at usage levels of 10 kgal or greater. Similarly, 30% of the water is used by only 12% of the bills at usage levels of 15 kgal or greater, and 23% of the water is used by only 8% of the bills at usage of 20 kgal or greater. These figures represent a consumption disparity at usage levels greater than 8 kgal.
- (19) Staff performed a detailed analysis of the utility’s billing data in order to select the usage blocks for evaluation of the recommended rate structure. Based on this analysis, plus the information contained in Table 4 above, staff selected both a three-tiered and a two-tiered set of usage blocks for consideration: The three-tiered usage blocks are for monthly usage of : a) 0 – 8 kgal; b) 8 – 15 kgal; and c) in excess of 15 kgal. The two-tiered usage blocks considered are for monthly usage of: a) 0 – 10 kgal and b) in excess of 10 kgal.

DETERMINATION OF APPROPRIATE RATE STRUCTURE (cont.)

BFC COST RECOVERY, USAGE BLOCKS AND RATE FACTORS (cont.): (20) Staff used comparable usage block rate factors in its analysis of the propriety of a three-tiered vs. a two-tiered inclining block rate structure for the utility, which means that the same rate factors are used to price the last block of each rate structure. Our analysis is contained in Table 5 below.

TABLE 5

PRE-REPRESSION PERCENTAGE PRICE INCREASES AT DIFFERENT USAGE BLOCKS (UB) AND RATE FACTORS (RF)										
Line No.		RATES USING CONSERVATION ADJUSTMENT = 23%, BFC = 40% Monthly Usage (Kgals)								
		0	3	5	8	15	20	30	50	100
	Using RFs of:	Kgals	Kgals	Kgals	Kgals	Kgals	Kgals	Kgals	Kgals	Kgals
1	UB =0-8 / 8-15 / 15+									
2	1.0 / 1.25 / 1.5	-31.7%	-19.6%	-14.2%	-8.2%	8.6%	21.0%	36.5%	52.2%	66.6%
3	1.0 / 1.25 / 1.75	-31.7%	-21.3%	-16.6%	-11.4%	3.8%	19.8%	41.1%	60.5%	79.2%
4	1.0 / 1.25 / 2.0	-31.7%	-22.8%	-18.7%	-14.3%	-0.6%	18.7%	43.0%	67.5%	90.0%
5	1.0 / 1.5 / 2.0	-31.7%	-23.5%	-19.7%	-15.7%	4.5%	21.9%	43.9%	66.0%	86.3%
6	1.0 / 1.5 / 2.25	-31.7%	-24.7%	-21.5%	-18.0%	0.6%	21.0%	46.6%	72.5%	96.2%
7	1.0 / 1.5 / 2.5	-31.7%	-25.7%	-23.0%	-20.1%	-2.9%	20.2%	49.2%	78.6%	105.4%
8	UB = 0-10 / 10+									
9	1.0 / 1.5	-31.7%	-19.9%	-14.6%	-8.8%	-0.5%	13.0%	30.0%	47.2%	63.0%
10	1.0 / 1.75	-31.7%	-22.0%	-17.7%	-12.9%	-6.1%	10.5%	31.5%	52.7%	72.1%
11	1.0 / 2.0	-31.7%	-23.8%	-20.3%	-16.4%	-10.8%	8.6%	33.0%	57.6%	80.3%
12	1.0 / 2.25	-31.7%	-25.4%	-22.5%	-19.4%	-15.0%	6.8%	34.1%	61.8%	87.1%
13	1.0 / 2.5	-31.7%	-26.8%	-24.6%	-22.2%	-18.7%	5.0%	34.8%	64.9%	92.6%
14	NOTE: Staff also tried a conservation adjustment of 44%, which resulted in a BFC cost recovery percentage of 30%. However, this would have reduced the current BFC by approximately 50%. Staff believes a BFC reduction of that magnitude is too great at this time. Therefore, staff eliminated the BFC =30% option from consideration.									

(21) As shown in the 0 kgals column of Table 5, setting the BFC to 40% would reduce the current BFC by approximately 32%. This represents a significant reduction in the current BFC. Therefore, in instances in which the recommended BFC represents a significant reduction from the current BFC, staff believes that properly evaluating the utility's fixed vs. variable cost recovery (fixed vs. variable revenue streams) is also important. This analysis is included in Attachment C of Issue 6, addressing the appropriate recommended rates for WMSI. Based upon the results of the analysis in Attachment C, staff believes that reducing the BFC to 40% does not harm the utility.

DETERMINATION OF APPROPRIATE RATE STRUCTURE (cont.)

BFC COST RECOVERY, USAGE BLOCKS AND RATE FACTORS (cont.):

- (22) As shown in Table 5 on the previous page, in the columns labeled 3 Kgals, 5 Kgals and 8 Kgals, the three-tiered inclining block rate structure with rate factors of 1.0, 1.25 and 1.5 (see Line No. 2 in Table 5) minimize the percentage price decreases at those levels of consumption. Furthermore, this rate structure represented on Line 2 of Table 5 results in the greatest percentage price increases at 15 kgals of consumption.
- (23) As shown in Table 5 under the columns labeled 30 Kgals, 50 Kgals and 100 Kgals, the three-tiered rate structure with rate factors of 1.0, 1.5 and 2.5 (see Line No. 7 in Table 5) produced the greatest price signals regarding water conservation. However, these rate factors result in price **decreases** up to 15 kgals of pre-repression consumption, a level approximately five times the average consumption for those customers whose monthly usage typically falls between 0 – 8 kgal. Staff therefore eliminated the rate factors of 1.0, 1.5 and 2.5, plus those other rate structures found in Lines 3 through 6, from consideration.
- (24) As shown in Lines 8 through 13 of Table 5, the less aggressive two-tier inclining block rate structure produced neither the smallest price decreases nor the greatest price increases at any level of consumption. Therefore, these rate structures were also eliminated from consideration.

RECOMMENDED RATE STRUCTURE FILED JUNE 9, 2005:

Based on the foregoing, staff recommends that the appropriate rate structure is the three-tiered inclining block rate structure with usage blocks for monthly consumption at: 1) 0-8 kgal; 2) 8.001-15 kgal; and 3) for usage in excess of 15 kgal. A BFC cost recovery percentage of 40%, coupled with rate factors of 1.0, 1.25 and 1.5 (see Line No. 2 of Table 5) best captures the balance between revenue stability and conservation pricing. Furthermore, it addresses the customers' preference for a rate structure with a greater emphasis placed on usage, and satisfies the rate structure requirement that the NFWMD has placed on the utility.

EVENTS SUBSEQUENT TO STAFF'S REC FILED JUNE 9, 2005:

- (25) On July 8, 2005, staff received a letter, plus several attachments, from Mr. Kenneth Hoffman, counsel for the utility. In the letter, Mr. Hoffman made numerous points regarding staff's initial rate structure recommendation. A summary of those rate structure concerns follows.
 - (a) The utility's most serious concern is staff's recommended reduction of the BFC cost recovery percentage from 58% to 40%.
 - (b) Staff's fixed cost recovery analysis in Attachment C is "well intentioned, but flawed." The total recommended revenues do not even cover the principal and interest payments on the DEP loan.
 - (c) Staff has apparently assumed that the current BFC of 58% covers all fixed costs. It does not and it never has.
 - (d) The Commission should exercise sound judgment before deferring to the WMD's goal of setting BFC revenue at 40%. The WMD's goal is water conservation, while the PSC's obligation is much broader.

DETERMINATION OF APPROPRIATE RATE STRUCTURE (cont.)

**EVENTS
SUBSEQUENT TO
STAFF'S REC
FILED JUNE 9, 2005
(cont.):**

- (25) (e) WMSI is a 100% debt company, which leaves little room for error in revenue collection.
- (f) Changing to a tiered rate structure places revenues in jeopardy because “. . . the repression analysis is theoretical and not based on this utility’s circumstances. It does not recognize that there has been repression in blocks lower than the final block,; it does not recognize that there will be greater than average repression for users of 100,000 gallons per month or more. . . . It also does not recognize the potential for the permanent loss of revenues from those who may opt to replace purchased water for irrigation with shallow wells. . . .”
- (g) An inclining block rate structure places the utility at risk because of the seasonal nature of the consumption.
- (h) The number of gallons used by staff for rate setting was incorrect because it did not include gallonage adjustments made by the utility.
- (i) The utility proposed retaining the BFC of 58%, while implementing a three-tier inclining block rate structure with the same usage blocks and rate factors as recommended by staff, in part because it provides revenue stability for the utility and still sends strong price signals to the very large users.
- (j) One of the attachments to the July 8, 2005 letter was from Hartman Consulting & Design (HCD or Hartman), who prepared price elasticity analyses based on staff’s initial recommendation filed on June 9, 2005, plus different rate design alternatives submitted by Hartman. HCD believes that staff’s June 9, 2005 rate structure could result in revenue requirement shortfalls between \$20,600 and \$42,600.
- (k) HCD’s analysis discussed in (j) above was based on several assumptions which increased the overall repression percentage.
- HCD assumed that Phase One rates were in effect for at least five months of the analysis period, resulting in significant pre-repression price increases in usage blocks less than 15 kgal. This was the basis for HCD’s conclusion that staff’s June 9, 2005 rate structure could result in a revenue shortfall of approximately \$20,600.
 - Based on engineering design criteria and typical capacity ranges based on American Water Works Association (AWWA) standards, HCD believed it was reasonable to “discount” flows greater than 100 kgal per month by 50%, resulting in HCD decreasing the flows in staff’s recommended third usage block (usage in excess of 15 kgal) by 50%. This “discounting” of flows, in conjunction with the assumption that Phase One rates had been in effect for at least five months of the analysis period, formed the basis for HCD’s conclusion that staff’s June 9, 2005 rate structure could result in a revenue shortfall of up to \$42,600.

DETERMINATION OF APPROPRIATE RATE STRUCTURE (cont.)

**EVENTS
SUBSEQUENT TO
STAFF'S REC
FILED JUNE 9, 2005
(cont.):**

- (26) An informal meeting between OPC, utility representatives and staff was held on July 18, 2005. In that meeting, the utility reiterated its concerns with staff's recommended rate structure. Utility representatives had several other rate structure concerns.
 - (a) The utility's primary concern is the recommended reduction of the BFC.
 - (b) Since the Commission did not order a rate structure change, the utility specifically asked staff on several occasions to "stand down" from any change in rate structure, because it undermines the utility's desire to keep this proceeding as a PAA, especially in light of the damage to the island caused by Hurricane Dennis.
- (27) On August 31, 2005, staff received a letter from the utility, with an attached schedule comparing the water sold figures from January through June, plus August, of 2004 to the comparable months of 2005. The letter said in part that the water sold during the seven month period of 2005 was approximately 10,657 kgals less than the comparable 2004 period. "This shows that our trend is not necessarily up, which is especially important if we are going (sic) to a block rate structure . . ."

**STAFF'S ANALYSIS
OF EVENTS
SUBSEQUENT TO
FILING ITS REC
ON JUNE 9, 2005:**

- (28) In response to the utility's contention in (25) (h) above that staff used the incorrect number of kgals for rate setting, staff agrees that the unadjusted number of kgals were used. However, staff was unaware of any adjustments because the utility had not filed revised monthly consumption reports to reflect the corrected consumption information. As discussed in Issue 3, staff has revised its recommended kgals for rate setting (before repression) to reflect the adjustments made to kgals during the test year. These adjustments have an immaterial effect on the figures represented in Tables 4 and 5 above.
- (29) In response to the utility's concerns raised in (25) (a), (d), (e) and (g) above, staff recognizes the Commission has broad obligations, and that care should be taken when designing the BFC cost recovery percentage. Staff's recognition of the utility's concerns is the purpose of Attachment C regarding cost recovery. The seasonal nature of the utility's water sales was recognized in Attachment C by using only the minimum number of kgals sold each month in Attachment C's revenue recovery analysis.
- (30) In response to (25) (c) above, staff did not assume that the current BFC of 58% covers all fixed costs. Rather, staff assumed that its recommended rate structure would recover at least 58% of the utility's annual costs through a fixed revenue stream. Staff has revised the title of Attachment C plus some of the line item entries on Attachment C in an effort to be more clear. The analysis on Attachment C did not change, nor did the conclusions drawn by staff.

DETERMINATION OF APPROPRIATE RATE STRUCTURE (cont.)

**STAFF'S ANALYSIS
OF EVENTS
SUBSEQUENT TO
FILING ITS REC
ON JUNE 9, 2005
(cont.):**

- (31) In response to (25) (f) above, staff disagrees with the utility's assertion that staff's repression analysis ". . . is theoretical and not based on this utility's circumstances." The repression calculations in this case are based on this utility's average consumption and corresponding price changes within each recommended usage block. Usage greater than 100 kgal per month is included in the third usage block and staff's recommended repression is calculated accordingly.
- (32) In response to (25) (j) and (k) above, HCD inappropriately prorated Phase One rates during the analysis period. Although Phase One rates were in effect for two months during the test year, Phase Two rates have been in effect for slightly more than the past two years. Short-run price elasticity evaluations are based on price changes and behavior over the most recent one-year period. In addition, the customers' price responses resulting from going from Phase One to Phase Two rates are already reflected in the billing units. Therefore, consideration of the effects of changing from Phase One to Phase Three rates is inappropriate.

Furthermore, HCD's "discounting" 50% of consumption greater than 100 kgal per month for customers on 5/8" x 3/4" is not based on a price elasticity analysis, but instead was based on engineering **theory** and AWWA standards for usage associated with that meter size. However, the **reality** for the utility is that greater than 50 bills had consumption of greater than or equal to 100 kgal per month. Therefore, to discount these flows is baseless given the actual circumstances.

Based on the foregoing, HCD's conclusion that staff's June 9, 2005 rate structure could result in revenue requirement shortfalls between \$20,600 and \$42,600 is based on flawed analysis and should be disregarded.

- (33) In response to (25) (i) above, staff has prepared a comparison of final, post-repression price increases based on staff's recommended rate structure of a three-tier inclining block rate structure with usage blocks for monthly consumption of: 1) 0-8 kgal; 2) 8.001 – 15 kgal; and 3) for usage in excess of 15 kgal. The usage block rate factors are 1.0, 1.25 and 1.5, respectively. The only difference between the rate structures will be that one is based on staff's recommended BFC cost recovery of 40%, while the other will be based on the utility's requested BFC cost recovery of 58%. The results are shown in Table 6 on the following page.

DETERMINATION OF APPROPRIATE RATE STRUCTURE (cont.)

TABLE 6

PERCENTAGE PRICE INCREASES AT IDENTICAL USAGE BLOCKS (UB) AND RATE FACTORS (RF) BUT DIFFERENT BFC COST RECOVERY PERCENTAGES										
Line No.		RATES USING BFC = 40%								
		Monthly Usage (Kgals)								
	UB =0-8 / 8-15 / 15+	0	3	5	8	15	20	30	50	100
	Using RFs of:	Kgals	Kgals	Kgals	Kgals	Kgals	Kgals	Kgals	Kgals	Kgals
1										
2	1.0 / 1.25 / 1.5	-31.7%	-18.4%	-12.4%	-5.8%	12.4%	25.6%	42.1%	58.8%	74.1%
RATES USING BFC = 58%										
Monthly Usage (Kgals)										
	UB =0-8 / 8-15 / 15+	0	3	5	8	15	20	30	50	100
	Using RFs of:	Kgals	Kgals	Kgals	Kgals	Kgals	Kgals	Kgals	Kgals	Kgals
3										
4	1.0 / 1.25 / 1.5	-1.9%	-3.9%	-4.9%	-5.9%	-1.2%	4.4%	11.5%	18.7%	25.3%

STAFF’S ANALYSIS OF EVENTS SUBSEQUENT TO FILING ITS REC ON JUNE 9, 2005 (cont.):

- (34) As shown in Table 6 above, the utility’s contention that implementing staff’s recommended rate structure, but changing the BFC cost recovery percentage to 58% will still send strong price signals to the very large users, is incorrect. The utility’s proposed rate structure creates price decreases for all monthly consumption in the first two usage blocks, while staff’s recommended rate structure has price decreases for monthly consumption in the first usage block only (Table 6 above). The utility’s overall price increase for average usage in the third usage block (where the greatest amount of discretionary consumption occurs) is only 11.5%, while staff’s comparable percentage increase is 42.1%, or approximately 3.6 times greater than the utility’s increase in the third block.
- (35) Section 373.227 (1), Florida Statutes, states in part: “The Legislature recognizes that the proper conservation of water is an important means of achieving the economical and efficient utilization of water necessary, in part, to constitute a reasonable-beneficial use. The overall water conservation goal of the state is to prevent and reduce wasteful, uneconomical, impractical, or unreasonable use of water resources.” Staff’s three-tier inclining block rate structure as described in both (34) and Table 6 above achieves greater conservation than the utility’s proposed three-tier structure because more of the revenue requirement is recovered in the gallonage charges in staff’s plan (60%) than in the utility’s plan (42%).

DETERMINATION OF APPROPRIATE RATE STRUCTURE (cont.)

**STAFF'S ANALYSIS
OF EVENTS
SUBSEQUENT TO
FILING ITS REC
ON JUNE 9, 2005
(cont.):**

- (36) The Commission is a signatory to the Joint Statement of Commitment for the Development and Implementation of a Statewide Comprehensive Water Conservation Program (JSOC), in conjunction with other agencies including all five Water Management Districts, the Florida Department of Environmental Protection, the Florida Rural Water Association, the Florida Water Environment Association and the Florida section of the AWWA. The JSOC was signed by all parties by February 2004.
- (37) Staff believes that its rate structure as filed in the June 9, 2005 recommendation is more in keeping with the intent of the JSOC, the NFWFMD CUP requirements and the legislative intent than the utility's proposed rate structure.

**RECOMMENDED
RATE STRUCTURE
FILED OCTOBER
20, 2005:**

Based on the foregoing, staff continues to recommend that the three-tiered inclining block rate structure recommended in its June 9, 2005 recommendation best captures the balance between revenue stability and conservation pricing. Furthermore, it addresses the customers' preference for a rate structure with a greater emphasis placed on usage, and satisfies the rate structure requirement that the NFWFMD has placed on the utility.

COST RECOVERY ANALYSIS: FIXED

- (A) **Assumptions:**
1. The utility's revenue requirement is \$1,368,807.
 2. Approximately 58% of the utility's revenues represent fixed recovery of the utility's costs. This is consistent with the fixed vs. variable cost recovery that is represented in WMSI's Phase Three filing on Schedule 1, p. 2.
 3. The utility's fixed monthly revenue stream should be used to cover its fixed cost recovery.
 4. The revenues generated from the minimum number of gallons sold each month represent part of the utility's monthly fixed revenue stream. The month in which the fewest gallons are sold by WMSI occurs in February of each year. Therefore, the number of February gallons sold represents the minimum gallons the utility can expect to sell each month, and should be included as part of the cost recovery analysis from fixed revenue streams.

(B) **Analysis:**

	Annual Revenue Requirement	(\$1,368,807)	
x	Requested Percentage of Fixed Recovery	58%	
=	Annual Fixed Recovery	(\$793,908)	
/	Months in a Year	12	
=	Monthly Fixed Recovery		(\$66,160)
	<u>Recovery from Staff's Recom BFC Revenues:</u>		
	Annual Residential BFC Revenues	\$465,130	
less	Divided by 12 Months = Monthly RS BFC Revs		\$38,761
	Annual Nonresidential BFC Revenues	\$86,995	
less	Divided by 12 Months = Monthly NonRS Revs		\$7,250
=	Remaining Monthly Fixed Recovery from Sales of Kgals		(\$20,149)
	<u>Recovery From Minimum Monthly Kgals Sold Each Month:</u>		
	Minimum Monthly Kgals Sold (occurs in Feb)	9,429.158	
	X 65% Min Kgals Sold @ Block 1 Rate	\$24,638	
	X 20% Min Kgals Sold @ Block 2 Rate	\$9,476	
	X 15% Min Kgals Sold @ Block 3 Rate	\$8,529	
less	Minimum Monthly Kgal Revenues		\$42,643
=	Surplus (Remaining) Monthly Fixed Recovery	Amount	\$22,494
		Percent	34%

COST RECOVERY ANALYSIS: FIXED

- (A) **Assumptions:**
1. The utility's revenue requirement is \$1,368,807 **(excl credit)**.
 2. Approximately 58% of the utility's revenues represent fixed recovery of the utility's costs. This is consistent with the fixed vs. variable cost recovery that is represented in WMSI's Phase Three filing on Schedule 1, p. 2.
 3. The utility's fixed monthly revenue stream should be used to cover its fixed cost recovery.
 4. The revenues generated from the minimum number of gallons sold each month represent part of the utility's monthly fixed revenue stream. The month in which the fewest gallons are sold by WMSI occurs in February of each year. Therefore, the number of February gallons sold represents the minimum gallons the utility can expect to sell each month, and should be included as part of the cost recovery analysis from fixed revenue streams. **This analysis reflects post-credit rates.**

(B) **Analysis:**

	Annual Revenue Requirement (excl credit)	(\$1,368,807)	
x	Requested Percentage of Fixed Recovery	58%	
=	Annual Fixed Recovery	(\$793,908)	
/	Months in a Year	12	
=	Monthly Fixed Recovery		(\$66,160)
	<u>Recovery from Staff's Rec BFC Revs (incl credit):</u>		
	Annual Residential BFC Revenues	\$418,617	
less	Divided by 12 Months = Monthly RS BFC Revs		\$34,885
	Annual Nonresidential BFC Revenues	\$78,295	
less	Divided by 12 Months = Monthly NonRS Revs		\$6,525
=	Remaining Monthly Fixed Recovery from Sales of Kgals		(\$24,750)
	<u>Recovery From Minimum Monthly Kgals Sold Each Month (incl credit):</u>		
	Minimum Monthly Kgals Sold (occurs in Feb)	9,429.158	
	X 65% Min Kgals Sold @ Block 1 Rate	\$22,175	
	X 20% Min Kgals Sold @ Block 2 Rate	\$8,529	
	X 15% Min Kgals Sold @ Block 3 Rate	\$7,676	
less	Minimum Monthly Kgal Revenues		\$38,379
=	Surplus (Remaining) Monthly Fixed Recovery	Amount	\$13,629
		Percent	21%

Sources: Water Management Services, Inc. (Utility), monthly reports filed in compliance with Order No. PSC-00-2227-PAA-WU; Utility's Filing, Schedule 1; Utility's response to staff's fourth data request, item 3; Table 2; Schedule 1.

[A] UTILITY'S FIXED COST RECOVERY ANALYSIS

Line No.	(a) Item	(b) Annually	(c) Monthly	(d) FC Recov Per Staff	(e) Surplus (Deficit)
1	Salaries and Benefits	\$394,685	\$32,890		
2	Electric and Chemical (min mo.)	37,480	3,123		
3	Testing	2,303	192		
4	Transportation Exp (mostly gas)	34,219	2,852		
5	Insurance Payments	52,723	4,394		
6	Telephone Bills	12,991	1,083		
7	Employee Uniforms	3,567	297		
8	Electric for Offices	2,893	241		
9	Principal and Interest on Debt	710,552	59,213		
		\$1,251,413	\$104,284	\$66,159	(\$38,125)

[B] STAFF'S RESTATEMENT OF UTILITY'S FIXED COST RECOVERY ANALYSIS

Line No.	(a) Item	(b) Annually	(c) Monthly	(d) FC Recov Per Staff	(e) Surplus (Deficit)
1	Salaries and Benefits	\$394,685	\$32,890		
2	Electric and Chemical (min mo.)	37,480	3,123		
3	Testing	2,303	192		
4	Transportation Exp (mostly gas)	34,219	2,852		
5 (1)	Insurance Payments	47,297	3,941		
6	Telephone Bills	12,991	1,083		
7	Employee Uniforms	3,567	297		
8	Electric for Offices	2,893	241		
9 (2)	Depreciation Expense (net)	240,564	20,047		
10 (3)	Taxes Other Than Income	112,397	9,366		
		\$888,396	\$74,033	\$88,654	\$14,621 19.7%

- (1) Consistent with Staff Audit Exception no. 1, staff removed \$5,426 from annual Insurance Expense.
- (2) "Principal and interest on debt" inappropriate to include for rate setting. Depreciation expense (net of CIAC) was used as a substitute.
- (3) Although not included in the utility's analysis, staff believes another component of fixed costs includes certain Portions of taxes other than income (TOFIT). **To be conservative, staff included ALL of the utility's TOFIT in this analysis.**

[A] UTILITY'S FIXED COST RECOVERY ANALYSIS

Line No.	(a) Item	(b) Annually	(c) Monthly	(d) FC Recov Per Staff	(e) Surplus (Deficit)
1	Salaries and Benefits	\$394,685	\$32,890		
2	Electric and Chemical (min mo.)	37,480	3,123		
3	Testing	2,303	192		
4	Transportation Exp (mostly gas)	34,219	2,852		
5	Insurance Payments	52,723	4,394		
6	Telephone Bills	12,991	1,083		
7	Employee Uniforms	3,567	297		
8	Electric for Offices	2,893	241		
9	Principal and Interest on Debt	710,552	59,213		
		\$1,251,413	\$104,284	\$66,159	(\$38,125)

[B] STAFF'S RESTATEMENT OF UTILITY'S FIXED COST RECOVERY ANALYSIS AND BASED ON RATES AFTER 10% CREDIT

Line No.	(a) Item	(b) Annually	(c) Monthly	(d) FC Recov Per Staff	(e) Surplus (Deficit)
1	Salaries and Benefits	\$394,685	\$32,890		
2	Electric and Chemical (min mo.)	37,480	3,123		
3	Testing	2,303	192		
4	Transportation Exp (mostly gas)	34,219	2,852		
5 (1)	Insurance Payments	47,297	3,941		
6	Telephone Bills	12,991	1,083		
7	Employee Uniforms	3,567	297		
8	Electric for Offices	2,893	241		
9 (2)	Depreciation Expense (net)	240,564	20,047		
10 (3)	Taxes Other Than Income	112,397	9,366		
		\$888,396	\$74,033	\$79,778	\$5,755 7.8%

- (1) Consistent with Staff Audit Exception no. 1, staff removed \$5,426 from annual Insurance Expense.
- (2) "Principal and interest on debt" inappropriate to include for rate setting. Depreciation expense (net of CIAC) was used as a substitute.
- (3) Although not included in the utility's analysis, staff believes another component of fixed costs includes certain Portions of taxes other than income (TOFIT). **To be conservative, staff included ALL of the utility's TOFIT in this analysis.**

Sources: Water Management Services, Inc., 2004 Annual Report, letter from Ken Hoffman dated July 8, 2005; Attachment C, Schedule 1.

Schedule No. 1**Water Management Services, Inc.
Water Monthly Service Rates**

	<u>Rates Prior to Filing</u>	<u>Commission Approved Phase 2</u>	<u>Utility Requested Final</u>	<u>Staff Recomm. Final</u>	<u>12-month True-Up Rates</u>	<u>4-year Rate Reduction</u>
<u>Residential and General Service</u>						
Base Facility Charge by Meter Size:						
5/8" x 3/4"	\$20.90	\$33.06	\$34.68	\$22.59	\$20.33	\$0.31
3/4"	N/A	N/A	N/A	\$33.89	\$30.50	\$0.47
1"	\$52.25	\$82.66	\$86.71	\$56.48	\$50.83	\$0.78
1 1/2"	\$104.51	\$165.34	\$173.45	\$112.95	\$101.65	\$1.55
2"	\$167.20	\$264.52	\$277.50	\$180.72	\$162.64	\$2.49
3" Compound	\$334.40	\$529.03	\$554.98	\$338.85	\$304.95	\$4.66
3" Turbine	\$365.77	\$578.67	\$607.06	\$395.33	\$355.78	\$5.44
4" Compound	\$522.52	\$826.50	\$867.04	\$564.75	\$508.25	\$7.77
4" Turbine	\$627.02	\$991.98	\$1,040.64	\$677.70	\$609.90	\$9.32
6" Compound	\$1,045.03	\$1,653.00	\$1,734.09	\$1,129.50	\$1,016.50	\$15.54
6" Turbine	\$1,306.30	\$2,066.64	\$2,168.02	\$1,411.88	\$1,270.63	\$19.43
8" Compound	\$1,672.05	\$2,644.80	\$2,774.40	\$1,807.20	\$1,626.40	\$24.87
8" Turbine	\$1,881.06	\$2,975.40	\$3,121.20	\$2,033.10	\$1,829.70	\$27.97
10" Compound	\$2,403.58	\$3,801.90	\$3,988.20	\$2,597.85	\$2,337.95	\$35.74
10" Turbine	\$3,030.59	\$4,793.70	\$5,028.60	\$3,275.55	\$2,947.85	\$45.07
12" Compound	\$4,493.65	\$6,281.40	\$7,456.20	\$4,856.85	\$4,370.95	\$66.83
Gallage Charge, per 1,000 gallons						
Current and Requested, Residential	\$1.98	\$3.13	\$3.28	N/A	N/A	N/A
Residential						
0 - 8 kgal	N/A	N/A	N/A	\$4.02	\$3.62	\$0.06
8 - 15 kgal	N/A	N/A	N/A	\$5.03	\$4.53	\$0.07
Over 15 kgal	N/A	N/A	N/A	\$6.03	\$5.43	\$0.08
General Service	\$1.98	\$3.13	\$3.28	\$4.74	\$4.27	\$0.07
<u>Typical Residential Bills 5/8" x 3/4" Meter</u>						
3,000 Gallons	\$26.84	\$42.45	\$44.52	\$34.65	\$31.19	
8,000 Gallons	\$30.80	\$48.71	\$51.08	\$54.75	\$49.29	
10,000 Gallons	\$40.70	\$64.36	\$67.48	\$64.81	\$58.35	
17,000 Gallons	\$54.56	\$86.27	\$90.44	\$102.02	\$91.86	