

State of Florida



Public Service Commission

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

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

DATE: March 15, 2007

TO: Commission Clerk (Cole)

FROM: Division of Economic Regulation (Fletcher, Daniel, Edwards, Johnson, Kyle, Massoudi, Maurey, Redemann, Rendell, Revell, Rieger, Springer, Walden)
Office of the General Counsel (Gervasi, Fleming, Jaeger)

RE: Docket No. 060368-WS – Application for increase in water and wastewater rates in Alachua, Brevard, Highlands, Lake, Lee, Marion, Orange, Palm Beach, Pasco, Polk, Putnam, Seminole, Sumter, Volusia, and Washington Counties by Aqua Utilities Florida, Inc.

AGENDA: 03/27/07 – Regular Agenda – Decision on Interim Rates – Participation is at the discretion of the Commission

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Carter

CRITICAL DATES: 03/27/07 (60-Day Interim Date)

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\060368.RCM.DOC

Case Background

Aqua Utilities Florida, Inc. (AUF or utility) is a wholly-owned subsidiary of Aqua America, Inc. AUF provides water and wastewater service in eighty service areas (56 water and 24 wastewater systems) in 15 counties pursuant to certificates issued by the Commission. As a result of a recent corporate reorganization, AUF became the sole shareholder of the eighty Florida Commission-regulated water and wastewater systems that are the subject of this rate case application. In 2005, the utility recorded total company operating revenues of \$5,057,386 and \$2,754,640 for water and wastewater, respectively. AUF reported net operating losses for 2005

of \$540,773 for water and \$552,776 for wastewater. In 2005, AUF had 16,717 and 6,302 respective water and wastewater customers for the total company.

With the exception of the utility's Village Water and Rosalie Oaks water and wastewater systems in Polk County, the Commission has established rate base for AUF's water and wastewater systems. On April 20, 2004, Florida Water Services Corporation (FWSC) entered into an asset purchase agreement with AUF. The actual closing took place on June 30, 2004, with the parties acknowledging that the sale was subject to Commission approval. On August 24, 2004, FWSC and AUF filed a joint application for transfer of FWSC's land, facilities, and certificates to AUF. By Order No. PSC-05-1242-PAA-WS, issued December 20, 2005, the Commission approved that transfer.¹ The following tables reflect the respective orders by which the Commission established rate base for AUF's other water and wastewater systems.

System	Commission Order No.	Issuance Date
JASMINE LAKES	PSC-93-1675-FOF-WS ²	November 18, 1993
ARREDONDO ESTATES/FARMS	PSC-96-0728-FOF-WS ³	May 30, 1996
RAVENSWOOD	PSC-96-1409-FOF-WU ⁴	November 20, 1996
THE WOODS	PSC-97-0312-FOF-WS ⁵	March 24, 1997
HAINES CREEK	PSC-97-0375-FOF-WU ⁶	April 7, 1997
LAKE OSBORNE ESTATES	PSC-97-1149-FOF-WU ⁷	September 30, 1997
SOUTH SEAS	PSC-99-1910-PAA-SU ⁸	September 27, 1999
OCALA OAKS	PSC-99-1925-PAA-WU ⁹	September 28, 1999

¹ In Dockets Nos. 040951-WS, In re: Joint application for approval of sale Florida Water Services Corporation's land, facilities, and certificates in Brevard, Highlands, Lake, Orange, Pasco, Polk, Putnam, a portion of Seminole, Volusia, and Washington counties to Aqua Utilities Florida, Inc.; and 040952-WS, In re: Joint application for approval of sale Florida Water Services Corporation's land, facilities, and certificates for Chuluota systems in Seminole County to Aqua Utilities Florida, Inc.

² In Docket No. 920148-WS, In re: Application for a rate increase in Pasco County by Jasmine Lakes Utilities Corporation.

³ In Docket No. 951234-WS, In re: Application of Arredondo Utility Corporation, Inc. for a staff-assisted rate case in Alachua County.

⁴ In Docket No. 960716-WU, In re: Application for transfer of Certificate No. 123-W in Lake County from Theodore S. Jansen d/b/a Ravenswood Water System to Crystal River Utilities, Inc.

⁵ In Docket No. 960643-WS, In re: Application for transfer of Certificates Nos. 507-W and 441-S in Sumter County from Sumter Water Company, Inc. to Crystal River Utilities, Inc.

⁶ In Docket No. 960793-WU, In re: Application for transfer of Certificate No. 130-W in Lake County from Haines Creek Mobile Homesites Waterworks to Crystal River Utilities, Inc.

⁷ In Docket No. 961535-WU, In re: Application for transfer of Certificate No. 53-W in Palm Beach County from Lake Osborne Utilities Company, Inc. to Crystal River Utilities, Inc.

⁸ In Docket No. 982017-SU, In re: Application for authority to transfer facilities of South Seas Utility Company and Certificate No. 268-S in Lee County to AquaSource Utility, Inc.

⁹ In Dockets. Nos. 981030-WU, In re: Application for transfer of portion of Certificate No. 380-W in Marion County from A.P. Utilities, Inc. to Ocala Oaks Utilities, Inc., holder of Certificate No. 346-W, and amendment of certificates; and 981029-WU, In re: Application by Ocala Oaks Utilities, Inc. for limited proceeding to impose current water rates, charges, classifications, rules, regulations, and service availability policies on Hawks Point and 49th Street Village customers that are currently served by A.P. Utilities, Inc. in Marion County.

System	Commission Order No.	Issuance Date
J. SWIDERSKI - 48 ESTATES	PSC-99-2115-PAA-WS ¹⁰	October 25, 1999
J. SWIDERSKI - KINGS COVE	PSC-99-2115-PAA-WS	October 25, 1999
J. SWIDERSKI - SUMMIT CHASE	PSC-99-2115-PAA-WS	October 25, 1999
LAKE JOSEPHINE	PSC-00-1389-PAA-WU ¹¹	July 31, 2000
SEBRING LAKES	PSC-02-0651-PAA-WU ¹²	May 13, 2002

On September 25, 2006, Aqua America, Inc.'s six regulated Florida subsidiaries filed a joint application for acknowledgement of corporate reorganization and approval of name change. The purpose of the reorganization was to consolidate and segregate all Aqua America, Inc.'s Commission-regulated water and wastewater assets in Florida under the ownership and name of its Florida corporation, Aqua Utilities Florida, Inc. By Order No. PSC-06-0973-FOF-WS, issued November 22, 2006,¹³ the Commission approved Aqua's corporate reorganization and request for name change, effective the date of the order.

On December 1, 2006, AUF filed an application for approval of interim and final water and wastewater rate increases, pursuant to Sections 367.081 and 367.082, Florida Statutes (F.S.). The utility also requested an increase in service availability charges and an allowance for funds prudently invested. On January 3, 2007, the Commission staff determined that AUF's Minimum Filing Requirements (MFRs) had several deficiencies. From January 19, 2007 through February 21, 2007, AUF had submitted several responses to correct its MFR deficiencies. On February 27, 2007, the Commission staff determined that AUF still had some engineering MFR deficiencies. The deadline to correct those deficiencies is March 26, 2007. To date, the official date of filing has not been established.

The intervention of the Office of Public Counsel was acknowledged by Order No. PSC-07-0084-PCO-WS, issued January 30, 2007, in this docket.

The utility's application for increased final water and wastewater rates is based on the projected twelve-month period ending December 31, 2007. In its filing, the utility states that the

¹⁰ In Docket No. 981779-WS, In re: Application for authority to transfer facilities of J. Swiderski Utilities, Inc. and Certificates Nos. 371-S and 441-W in Lake County to AquaSource Utility, Inc.

¹¹ In Docket No. 991001-WU, In re: Application for transfer of facilities and Certificate No. 424-W in Highlands County from Lake Josephine Water to AquaSource Utility, Inc.

¹² In Docket No. 011401-WU, In re: Application for authority to transfer facilities of Heartland Utilities, Inc., holder of Certificate No. 420-W in highlands county, to AquaSource Utility, Inc., holder of Certificate No. 424-W, and for cancellation of Certificate No. 420-W.

¹³ In Docket No. 060643-WS, In re: Joint application for acknowledgement of corporate reorganization and request for approval of name change on Certificate 268-S in Lee County from AquaSource Utility, Inc. d/b/a Aqua Utilities Florida, Inc.; Certificates 479-S and 549-W in Alachua County from Arrendondo Utility Company, Inc. d/b/a Aqua Utilities, Inc.; Certificates 053-W, 441-S, and 507-W in Palm Beach and Sumter Counties from Crystal River Utilities, Inc. d/b/a Aqua Utilities Florida, Inc.; and Certificate 346-W in Marion County from Ocala Oaks Utilities, Inc. d/b/a Aqua Utilities Florida, Inc.; for cancellation of Certificates 424-W, 371-S, 441-W, 503-S, and 585-W in Highlands, Lake, and Polk Counties held AquaSource Utility, Inc. d/b/a Aqua Utilities Florida, Inc.; Certificates 123-W, 510-S, and 594-W in Lake and Polk Counties held by Crystal River Utilities, Inc. d/b/a Aqua Utilities Florida, Inc.; and Certificates 083-S and 110-W in Pasco County held by Jasmine Lakes Utilities Corporation d/b/a Aqua Utilities Florida, Inc.; and for amendment of Certificates 422-W, 120-S, 106-W, 154-S, 209-w, 506-S, and 587-W in Highlands, Lake, Pasco, and Polk Counties held by Aqua Utilities Florida, Inc.

rate increase is necessary because the utility did not earn a fair and reasonable rate of return on its investment. AUF's requested final rate increase would result in additional operating revenues of \$7,298,294 for the utility's combined water and wastewater operations.

The utility's interim request was based on a historical test year ending December 31, 2005. The utility-requested interim rates would produce additional revenues of \$1,998,242 for water operations and \$1,403,563 for wastewater operations.

The original 60-day statutory deadline for the Commission to suspend the utility's requested final rates was February 1, 2007. However, by letter dated February 6, 2007, the utility agreed to extend the statutory time frame by which the Commission is required to address AUF's interim rate request. This recommendation addresses the suspension of the utility's requested final rates and AUF's requested interim rates. The Commission has jurisdiction pursuant to Sections 367.081 and 367.082, F.S.

Discussion of Issues

Issue 1: Should the utility's proposed final water and wastewater rates be suspended?

Recommendation: Yes. The utility's proposed final water and wastewater rates should be suspended. (Fletcher)

Staff Analysis: Section 367.081(6), F.S., provides that the rates proposed by the utility shall become effective within sixty days after filing unless the Commission votes to withhold consent of implementation of the requested rates. Further, the above referenced statute permits the proposed final rates to go into effect, under bond, escrow or corporate undertaking, eight months after filing unless final action has been taken by the Commission.

Staff has reviewed the filing and has considered the proposed rates, the revenues thereby generated, and the information filed in support of the rate application. Staff believes that it is reasonable and necessary to require further amplification and explanation regarding this data, and to require production of additional and/or corroborative data. This further examination will include on-site investigations by staff accountants and engineers. Based on the foregoing, staff recommends that it is appropriate to suspend the utility's proposed final rate increase.

Issue 2: Should any interim revenue increase be approved?

Recommendation: Yes. The appropriate interim revenue requirements are as shown in Attachment A. (Fletcher, Maurey, Rieger, Springer)

Staff Analysis: AUF requested interim rates designed to generate additional revenues of \$1,998,242 for water operations and \$1,403,563 for wastewater operations. The combined increase in water and wastewater operations of \$3,401,805 results in total combined water and wastewater revenues on an interim basis of \$11,167,777.

In its filing, AUF has requested separate interim overall cost of capital rates for each water and wastewater system based on their respective rate bases. As discussed more fully below, staff believes a consolidated capital structure is necessary for interim purposes. There are ten systems that reflect revenue decreases. Pursuant to the provisions of the interim statute, an interim decrease should be calculated using the maximum return on equity (ROE) limit, and an interim increase should be calculated using the minimum ROE limit. Thus, the consolidated capital structure under the maximum ROE limit should be applied to the ten systems with a revenue decrease, and the consolidated capital structure under the minimum ROE limit should be applied to the remaining systems.

Staff has attached accounting schedules to illustrate the recommended rate base and test year operating income amounts on a per system basis. The two capital structure schedules are numbered 1-A (minimum ROE limit) and 1-B (maximum ROE limit). The water and/or wastewater rate base schedules are numbered 2-A and 2-B. The respective water and/or wastewater net operating income statements are reflected on Schedules 3-A and 3-B. Schedule 3-C reflects adjustments to net operating income.

Typically, Schedule 2-C reflects adjustments to rate base. As the Welaka/Saratoga Harbour water system is the only system for which staff made adjustments to rate base, this is the only system for which Schedule 2-C has been included.

Schedule 3-C reflects self-explanatory adjustments to remove the requested revenue increase or decrease and associated regulatory assessment fees and to reflect the fall-out income taxes provision adjustment resulting from staff's recommended capital structure. The utility's Welaka/Saratoga Harbour water system is the only system that has additional adjustments to depreciation expense and property taxes related to its non-used and useful plant.

Pursuant to Section 367.082(5)(b)1., F.S., the achieved rate of return for interim purposes must be calculated by applying adjustments consistent with those used in the utility's most recent rate proceeding and annualizing any rate changes. Staff has reviewed the utility's interim request, as well as past Commission orders in which the Commission last established rate bases for the respective water and wastewater systems. Based on its review, staff has made adjustments which are discussed below.

RATE BASE

Staff reviewed the utility's interim used and useful calculation on a per system basis. For those plants that have had previous rate proceedings, staff verified whether adjustments were made consistent with those prior methodologies. Staff determined that AUF erred in its used and useful calculation for the Welaka/Saratoga Harbour water system.

In MFR Schedule F-5, for Welaka/Saratoga Harbour, the utility requested that water wells be considered 100% used and useful because this system has a single well. Staff believes this statement is incorrect. The system map and sanitary survey reports, provided by the utility, indicate there are two water treatment plants with one well each in this interconnected system. Combined at 186 gallons per minute (gpm), the well capacities for the Welaka and Saratoga Harbour water treatment plants are rated at 76 gpm and 110 gpm respectively.

For interim purposes, staff believes that the largest well should be removed for firm reliable capacity considerations. The remaining well capacity should be used. The demand of 32.57 gpm reflected in Schedule F-5, is divided by the 76 gpm well capacity to reflect a 42.9% used and useful for wells. Therefore, staff recommends that the water wells portion of the Welaka/Saratoga Harbour water treatment plant used and useful calculations be considered 42.9% used and useful.

Staff recalculated the utility's used and useful amount based on the above. As such, staff recommends that net used and useful plant be reduced by \$11,362. Corresponding adjustments should be made to reduce depreciation expense by \$596, and property tax expense by \$289. Based on the above adjustments, staff recommends that the utility's interim rate base should be \$120,158 for the Welaka/Saratoga Harbour water system.

COST OF CAPITAL

In its MFRs, AUF proposed an overall cost of capital of 7.40% based on a 13-month average capital structure as of December 31, 2005. The MFRs showed no debt in the historical test year. Investor sources of capital from AUF were allocated on a proxy debt-to-equity ratio of 40% debt and 60% equity. The MFRs contained actual balances of accumulated deferred income taxes and customer deposits for each individual system.

In its interim request, AUF used a 9.12% return on equity (ROE), which is the minimum of the range of the Commission's current leverage formula approved in Order No. PSC-06-0476-PAA-WS.¹⁴ Section 367.082(5)(b)3., Florida Statutes, states that in calculating an interim increase, the minimum of the range of the last authorized ROE shall be used. However, the ROE authorized in the last rate case should not be used in this instance because the ROE does not survive a transfer.¹⁵ As approved in Order No. PSC-06-0973-FOF-WS, "Through these mergers

¹⁴ Order No. PSC-06-0476-PAA-WS, issued June 5, 2006, in Docket No. 060006-WS, In Re: Water and Wastewater Industry Annual Reestablishment of Authorized Range of Return on Common Equity for Water and Wastewater Utilities Pursuant to Section 367.081(4)(f), Florida Statutes.

¹⁵ See PSC-01-2094-FOF-SU, issued October 22, 2001, in Docket No. 011190-SU, In re: Investigation of possible overearnings by Tierra Verde Utilities, Inc. in Pinellas County, p.3.

and transfers, all Commission-regulated water and wastewater assets in Florida owned by Aqua America have now been consolidated and segregated under its Florida subsidiary corporation, Aqua Utilities FL, as was the intent of the reorganization.” AUF is a wholly-owned subsidiary of its parent company, Aqua America, Inc. (Aqua). Therefore, staff recommends that the current leverage formula be used to determine the ROE for AUF.

Staff reviewed the requested interim capital structure for each individual system. For interim purposes, staff recommends that the system specific capital structures be supplanted by an Aqua system-wide capital structure. Staff specifically identified the deferred tax and customer deposit balances at the individual utility level and aggregated the balances to derive an AUF system-wide total for these two classes of capital. The residual amount of capital was allocated over investor sources on a pro rata basis consistent with the ratios of investor capital maintained at the Aqua level (approximately 53% debt and 47% equity). The utility’s capital structure was then reconciled with staff’s recommended rate base.

For the systems that AUF requested an interim increase, staff used the 9.12% ROE that AUF included in its filing. For the systems that are in line for an interim decrease, the convention is to use the ROE at the top of the range. Typically, this return is 100 basis points above the midpoint or 200 basis points above the floor. For purposes of an interim decrease, staff used an ROE of 11.12% which is 200 basis points above the ROE proposed by the utility for purposes of determining an interim increase. In both cases, staff used the 13-month average cost rates for Aqua as of December 31, 2005 for long-term and short-term debt of 5.81% and 3.73%, respectively. Based on the capital structure and cost rates discussed above, staff’s recommended weighted average cost of capital for purposes of an interim increase is 6.69%. For purposes of an interim decrease, staff’s recommended weighted average cost of capital is 7.51%. Schedules 1-A and 1-B detail staff’s recommendation.

NET OPERATING INCOME

Other than to adjust for the requested revenue increases or decreases and associated regulatory assessment fees, the fall-out income taxes provision adjustments, and the specific non-used and useful depreciation expense and property tax adjustments for the Welaka/Saratoga Harbour water system, staff has not made any other adjustments to operating income.

REVENUE REQUIREMENT

Staff has recommended revenue requirements consistent with the calculations required by the interim statute and Commission practice. For those plants that appear to be underearning, the revenue requirements were determined using the minimum ROE limit. Consistent with the interim statute, for those plants that appear to be overearning, staff used the maximum ROE limit. Based upon recovery of actual operating expenses for the year ended December 31, 2005, and the consolidated cost of capital on an average rate base, staff recommends that the appropriate combined interim revenue requirements are \$6,862,524 and \$4,039,091, respectively for the utility’s water and wastewater systems. This results in interim increase in annual revenues of \$1,851,705 for the water systems and \$1,283,938 for the wastewater systems. Attachment A reflects the interim revenue requirements for each system.

Issue 3: What are the appropriate interim water and wastewater rates?

Recommendation: The appropriate interim rates are shown on Schedules No. 4-A and 4-B for water and wastewater, respectively. The approved rates should be effective for service rendered as of the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1)(a), F.A.C., provided customers have received notice. The rates should not be implemented until staff verifies that the tariff sheets are consistent with the Commission decision, the proposed customer notice is adequate, and the required security has been filed. The utility should provide proof of the date notice was given within 10 days after the date of notice. (Fletcher, Rendell)

Staff Analysis: AUF filed its application for a file and suspend rate case for its water and wastewater systems, pursuant to Section 367.081, F.S. The file and suspend law “was designed to provide accelerated [rate] relief without sacrificing the protections inherent in the overall regulatory scheme.” See Florida Power Corporation v. Hawkins, 367 So. 2d 1011, 1013 (Fla. 1979). Interim rates, which are one aspect of this scheme, were designed “to make a utility whole during the pendency of the proceeding without the interjection of any opinion testimony.” See Citizens v. Public Service Commission, 435 So. 2d 784, 786 (Fla. 1983). Thus, the provision of interim rates is an efficient, prima facie means by which a utility can obtain immediate financial relief. See Citizens v. Mayo, 333 So. 2d 1, 5 (Fla. 1976). In the formal hearing for this docket, all parties and staff will have the opportunity to address the utility’s rates and rate structure.

Staff recommends that interim water and wastewater service rates for AUF be designed to allow the utility the opportunity to generate annual operating revenues reflected on Attachment A. In its interim request, the utility provided a separate revenue requirement calculation for each of its systems. To determine the respective interim rate increase or decrease, AUF divided the respective revenue increase or decrease by the adjusted test year revenues, net of miscellaneous service revenues. Staff believes this methodology is appropriate for the systems that were not formerly Florida Water Service Corporation (FWSC) systems. Staff’s calculations of the rate increase or decrease for the non-FWSC former systems are reflected in Attachment B.

In the last rate case for FWSC, formerly Southern States Utilities, Inc., the Commission approved a capband rate structure.¹⁶ That order was appealed. In Southern States Utilities, Inc. v. Florida Public Service Commission, 714 So. 2d 1046 (Fla. 1st DCA 1998), the First District Court of Appeal affirmed the capband rate structure. This rate structure represented a step toward uniform rates. Generally, rates were calculated by setting caps for certain systems and spreading the overage to the remaining service areas that were not capped within each band. Because the former FWSC systems have a capband rate structure, the calculation of the rate increase should be based on the aggregated revenues for these systems.

¹⁶ See Order No. PSC-96-1320-FOF-WS, issued October 30, 1996, in Docket No. 950495-WS, In re: Application for rate increase and increase in service availability charges by Southern States Utilities, Inc. for Orange-Osceola Utilities, Inc. in Osceola County, and In Bradford, Brevard, Charlotte, Citrus, Clay, Collier, Duval, Highlands, Lake, Lee, Marion, Martin, Nassau, Orange, Osceola, Pasco, Putnam, Seminole, St. Johns, St. Lucie, Volusia, and Washington Counties.

For the former FWSC water systems, staff believes the appropriate method to calculate the across-the-board rate increase is to divide the aggregate revenue increase by the aggregate adjusted test year revenues, net of miscellaneous service revenues. Staff believes this same method should be applied to the former FWSC wastewater systems. Using this methodology, staff calculated the across-the-board rate increase for the former FWSC systems to be 34.70% for water and 42.52% for wastewater. The calculation of the water and wastewater rate increases are reflected on Attachment C.

AUF applied its percentage rate increase or decrease to the utility's current rates. The current rates reflect a rate change occurring after December 31, 2005. Because the interim request is based on a historical test year ending December 31, 2005, the respective interim rate increase or decrease should be applied as an across-the-board increase or decrease to the service rates in effect as of December 31, 2005.

The approved rates should be effective for service rendered as of the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1), F.A.C., provided customers have received notice. The rates should not be implemented until staff verifies that the tariff sheets are consistent with the Commission decision, the proposed customer notice is adequate, and the required security has been filed. The utility should provide proof of the date notice was given within 10 days after the date of notice.

The utility's test year, proposed interim and final rates, and staff's recommended interim rates are shown on Schedules No. 4-A and 4-B for water and wastewater, respectively.

Issue 4: What is the appropriate security to guarantee the interim increase?

Recommendation: A corporate undertaking is acceptable contingent upon receipt of the written guarantee of the parent company, Aqua America, Inc. (Aqua), and written confirmation of Aqua's attestation that it does not have any outstanding guarantees on behalf of Aqua-owned utilities in other states. Aqua should be required to file a corporate undertaking on behalf of its subsidiaries to guarantee any potential refunds of revenues collected under interim conditions. Aqua's total guarantee should be an amount of \$2,671,026. Pursuant to Rule 25-30.360(6), F.A.C., the utility should provide a report by the 20th of each month indicating the monthly and total revenue collected subject to refund. Should a refund be required, the refund should be with interest and undertaken in accordance with Rule 25-30.360, F.A.C. (Fletcher, Springer)

Staff Analysis: Pursuant to Section 367.082, F.S., revenues collected under interim rates shall be placed under bond, escrow, letter of credit, or corporate undertaking subject to refund with interest at a rate ordered by the Commission. As recommended in Issue 2, the total annual interim increase is \$3,135,643. In accordance with Rule 25-30.360, F.A.C., staff has calculated the potential refund of revenues and interest collected, under interim conditions to be \$2,671,026. This amount is based on an estimated 10 months of revenue being collected from staff's recommended interim rates shown on Schedules No. 4-A and 4-B for water and wastewater, respectively.

The criteria for a corporate undertaking include sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. Staff reviewed the financial statements of AUF's parent, Aqua America, Inc. (Aqua), to determine if Aqua can support a corporate undertaking on behalf of its subsidiaries. Aqua's 2003, 2004 and 2005 financial statements were used to determine the financial condition of the Utility. Aqua has experienced a decline in liquidity during 2005 compared to prior years. However, Aqua's average equity ratio over the three year period has been stable at 47% which is sufficient in this instance based on Aqua's overall financial condition. In addition, Aqua has experienced a strong and improving interest coverage ratio. Finally, net income has been on average twenty five times greater than the requested cumulative corporate undertaking amount. Aqua's financial performance has demonstrated adequate levels of profitability, interest coverage, and equity capitalization to offset the decline in liquidity. Staff believes Aqua has adequate resources to support a corporate undertaking in the amount requested. Based on this analysis, staff recommends that a cumulative corporate undertaking of \$2,671,026 is acceptable contingent upon receipt of the written guarantee of Aqua and written confirmation that Aqua does not have any outstanding guarantees on behalf of Aqua-owned utilities in other states.

This brief financial analysis is only appropriate for deciding if the utility can support a corporate undertaking in the amount proposed and should not be considered a finding regarding staff's position on other issues in this proceeding.

Pursuant to Rule 25-30.360(6), F.A.C., the utility shall provide a report by the 20th day of each month indicating the monthly and total revenue collected subject to refund. Should a refund be required, the refund should be with interest and undertaken in accordance with Rule 25-30.360, F.A.C.

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In no instance should maintenance and administrative costs associated with any refund be borne by the customers. The costs are the responsibility of, and should be borne by, the utility.

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Date: March 15, 2007

Issue 5: Should this docket be closed?

Recommendation: No. The docket should remain open pending the Commission's final action on the utility's requested rate increase. (Gervasi, Fleming, Jaeger)

Staff Analysis: The docket should remain open pending the Commission's final action on the utility's requested rate increase.