

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-**

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**DATE:** July 18, 2008

**TO:** Office of Commission Clerk (Cole)

**FROM:** Division of Economic Regulation (Fletcher, Billingslea, Bruce, Bulecza-Banks, Deason, Hall, Hudson, Kyle, Lingo, Maurey, Mouring, Roberts, Springer, Stallcup, Wright)  
Office of the General Counsel (Jaeger, Fleming, Klancke, Sayler)

**RE:** Docket No. 080121-WS – Application for increase in water and wastewater rates in Alachua, Brevard, DeSoto, Highlands, Lake, Lee, Marion, Orange, Palm Beach, Pasco, Polk, Putnam, Seminole, Sumter, Volusia, and Washington Counties by Aqua Utilities Florida, Inc.

**AGENDA:** 07/29/08 – Regular Agenda – Decision on Interim Rates – Participation is at the discretion of the Commission

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICER:** Edgar

**CRITICAL DATES:** 07/29/08 (60-Day Suspension Date – As Extended by the Utility)

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\080121.RCM.DOC

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### 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-two certificated service areas (57 water and 25 wastewater systems) in 16 counties. As a result of a 2004 corporate reorganization, AUF became the sole shareholder of the eighty-two Florida Commission-regulated water and wastewater systems that are the subject of this rate case application. In

2007, the Utility recorded total regulated operating revenues of \$5,456,559 and \$3,093,735 for water and wastewater, respectively. AUF reported regulated net operating losses for 2007 of (\$304,033) for water and (\$502,259) for wastewater. In 2007, AUF had 16,964 and 6,653 respective water and wastewater customers for its regulated systems.

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.<sup>1</sup> 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 <sup>2</sup>	November 18, 1993
ARREDONDO ESTATES/FARMS	PSC-96-0728-FOF-WS <sup>3</sup>	May 30, 1996
RAVENSWOOD	PSC-96-1409-FOF-WU <sup>4</sup>	November 20, 1996
THE WOODS	PSC-97-0312-FOF-WS <sup>5</sup>	March 24, 1997
HAINES CREEK	PSC-97-0375-FOF-WU <sup>6</sup>	April 7, 1997
LAKE OSBORNE ESTATES	PSC-97-1149-FOF-WU <sup>7</sup>	September 30, 1997
SOUTH SEAS	PSC-99-1910-PAA-SU <sup>8</sup>	September 27, 1999
OCALA OAKS	PSC-99-1925-PAA-WU <sup>9</sup>	September 28, 1999

<sup>1</sup> In Docket 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.

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

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

<sup>4</sup> 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.

<sup>5</sup> 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.

<sup>6</sup> 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.

<sup>7</sup> 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.

<sup>8</sup> 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.

<sup>9</sup> In Docket 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 49<sup>th</sup> 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 <sup>10</sup>	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 <sup>11</sup>	July 31, 2000
SEBRING LAKES	PSC-02-0651-PAA-WU <sup>12</sup>	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,<sup>13</sup> 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. That case was assigned Docket No. 060368-WS. On July 31, 2007, the Office of Public Counsel (OPC) and the Attorney General (AG) filed a Joint Motion to Dismiss the rate case.<sup>14</sup> AUF timely filed its Response in opposition thereto on August 10, 2007. On August 16, 2007, the Commission staff filed a recommendation to grant the Joint Motion to Dismiss for the reasons stated therein and for additional reasons warranting the dismissal of AUF's request for an increase in water and wastewater rates.<sup>15</sup>

<sup>10</sup> 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.

<sup>11</sup> 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.

<sup>12</sup> 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.

<sup>13</sup> 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.

<sup>14</sup> OPC and AG argued that AUF's MFRs regarding its operating expenses were irreparably flawed; that the Utility failed to provide sufficient or timely supporting documentation in response to discovery and audit requests to support its rate request; and failed to fully comply with two orders compelling discovery responses by dates certain.

<sup>15</sup> Staff recommended that, in addition to the reasons set forth in the Joint Motion to Dismiss, AUF's rate case should be dismissed because the MFRs were irreparably flawed with respect to projected plant additions and engineering data; because AUF failed to provide sufficient documentation regarding the historical number of bills rendered or the number of gallons sold during either the 2005 test year or during 2006, its 2005 and 2006 gallons data was irreparably flawed; and AUF failed to support its 2006 and 2007 billing determinants projections.

On August 27, 2007, AUF filed a Notice of Voluntary Dismissal of the rate case without prejudice, including its application for interim and final rates, its request for increased service availability charges, and its request for approval of AFPI charges. On that same date, AUF filed an agreement between AUF, OPC, and the AG (collectively referred to as "Parties") on the proposed resolution and disposition of the issues contained in the staff recommendation. At its August 28, 2007, Agenda Conference, the Commission acknowledged AUF's notice of voluntary dismissal resulting in a return to the rates and charges in effect prior to the implementation of interim rates and in the refund of interim rates with interest. The Commission also approved the Parties' agreement for the Utility's proposed resolution and disposition of the remaining other issues contained in staff's recommendation.<sup>16</sup>

On May 22, 2008, AUF filed an application for approval of interim and final water and wastewater rate increases. By letter dated June 20, 2008, the Commission staff advised AUF that its Minimum Filing Requirements (MFRs) had several deficiencies. The deadline to correct those deficiencies is July 21, 2008. To date, the official date of filing has not been established.

The Utility's application for increased final water and wastewater rates is based on the historical twelve-month period ended December 31, 2007, with requested adjustment for pro forma plant and operating expenses. In its filing, the Utility states that the 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 \$4,518,358 for water and \$3,856,180 for wastewater.

AUF's interim request was based on a historical test year ended December 31, 2007. The Utility-requested interim rates would produce additional revenues of \$2,946,615 for water operations and \$2,983,934 for wastewater operations. For interim rate purposes, AUF is requesting that the interim rate increase be capped at approximately the level of the final rates for the requested consolidated rate structure. For those systems that are capped and for which the Utility would actually collect less in interim rates than it was entitled, AUF requests that the difference over the term of the interim rates be recognized as a regulatory asset to be recovered over a period of two years once final rates are determined. The Utility states that it would neither seek to recover interest on this deferred recovery, nor have this amount included in the calculation of working capital.

On June 10, 2008, Lake Suzy Utility, Inc. d/b/a Aqua Utilities Florida, Inc. (Lake Suzy) filed a Petition for Leave to Intervene in the instant case. On the same day, Lake Suzy and AUF filed a joint application for acknowledgement of a corporate reorganization and approval of name change on Certificate Nos. 599-W and 514-S in Desoto and Charlotte Counties from Lake Suzy to AUF. By Order No. PSC-08-0443-FOF-WS, issued July 10, 2008, the Commission approved Lake Suzy and AUF's joint application for a corporate reorganization and approval of name change on Certificate Nos. 599-W and 514-S in Desoto and Charlotte Counties from Lake

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<sup>16</sup> See Order No. PSC-07-0773-FOF-WS, issued September 24, 2007, in Docket No. 060368-WS, In re: 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.

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Suzy to AUF.<sup>17</sup> Because Lake Suzy is now included in AUF, staff believes that the Petition for Leave to Intervene is moot.

The original 60-day statutory deadline for the Commission to suspend the Utility's requested final rates was July 21, 2008. However, by letter dated June 10, 2008, AUF agreed to extend the statutory time frame by which the Commission is required to suspend the Utility's final requested rates and to address AUF's interim rate request through July 29, 2008. 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, Florida Statutes (F.S.).

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<sup>17</sup> In Docket No. 080311-WS, In re: Joint application for acknowledgement of corporate reorganization and request for approval of name change on Certificate 599-W and 514-S in Desoto and Charlotte Counties from Lake Suzy Utilities, Inc. d/b/a Aqua Utilities Florida, Inc. to Aqua Utilities Florida, Inc.

**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 inspections 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 the Commission's approve the Utility's capped interim rate methodology?

**Recommendation:** Yes. As discussed in the case background, the Utility's has proposed to cap interim rates at approximately the level of the final rates for the requested consolidated rate structure. Delaying full implementation of the interim increase and extending the payment period without interest will benefit some customers and cause no harm to others. Some customers would receive the benefit of having to pay interim rates at a much later date without interest (and over a two-year period) and would not be subjected to what could have been a significantly larger initial interim rate increase. (Fletcher, Jaeger)

**Staff Analysis:** In its application for increased final rates, the Utility is requesting a consolidated rate structure for its 57 water systems and 25 wastewater systems. For interim rate purposes, AUF is requesting that the interim rate increase be capped at approximately the level of the final rates for the requested consolidated rate structure. For those systems that are capped, and for which the Utility would actually collect less in interim rates than it was entitled, AUF requests that the difference over the term of the interim rates be recognized as a regulatory asset to be recovered over a period of two years once final rates are determined. The Utility states that it would neither seek to recover interest on this deferred recovery, nor have this amount included in the calculation of working capital.

A regulatory asset typically involves a cost incurred by a regulated utility that would normally be expensed currently but for an action by the regulator or legislature to defer the cost as an asset to the balance sheet. This allows a utility to amortize the regulatory asset over a period greater than one year. For example, unamortized rate case expense in the water and wastewater industry is a regulatory asset. Normally, the costs of a rate case would be expensed when they are incurred. However, Section 367.0816, F.S., requires that water and wastewater utilities amortize rate case expense over a four year period, thus creating a regulatory asset. The Commission's approval to defer entitled revenues and amortize the recovery of those revenues over a period greater than one year can also create a regulatory asset.

Statement of Financial Accounting Standards 71 allows regulated companies to defer costs and create regulatory assets, provided that it is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes. To create a regulatory asset or liability, a regulated utility must have the approval of its regulator. This concept of deferral accounting allows utilities to defer costs due to events beyond their control and seek recovery through rates at a later time. The alternative would be for a utility to seek a rate case each time it experiences an exogenous event.

Staff believes that this request is reasonable and is consistent with the interim rate statute. In approving interim rates pursuant to Section 367.082, F.S., it has been the Commission's practice to require the Utility's current rate structure at the time of the interim rate request be used in setting interim rates.<sup>18</sup> In setting interim rates, staff would use the current rate structure

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<sup>18</sup> See Order No. PSC-96-1388-FOF-WS, issued November 19, 1996, in Docket No. 960451-WS, In re: Application for a rate increase in Duval, Nassau, and St. Johns Counties by United Water Florida; and Order No. PSC-96-0170-FOF-WS, issued February 6, 1996, in Docket No. 951027-WS, In re: Application for a rate increase in Highlands County by Lake Placid Utilities, Inc.

of each system for the collection of the interim revenues up to the cap. The issue in the final determination of rates would be who would have to pay the regulatory asset (or deferred interim revenues), if it was ultimately determined that the Utility was entitled to those revenues when it first applied for interim rates. If the Commission determines that the deferred interim revenues should be recovered from each individual system, then those customers would be in no worse position than they would have been if they were charged the uncapped interim rates. Moreover, those customers would receive the benefit of having to pay a portion of the uncapped rates at a much later date without interest (and over a two-year period) and would not be subjected to what could have been a significantly larger initial interim rate increase.

As discussed in Issue 4, staff is recommending the respective system interim rates should be the lower of staff's uncapped calculated rates or the Utility's capped rates as shown on Schedules 4-A and 4-B. Attachment A reflects staff's calculation of the total regulatory asset on an annual basis of \$233,858 for water and \$674,128 for wastewater.



**Issue 3:** Should any interim revenue increase be approved?

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

**Staff Analysis:** AUF requested interim rates designed to generate additional revenues of \$2,946,615 for water operations and \$2,978,897 for wastewater operations. The combined increase in water and wastewater operations of \$5,925,512 results in total combined water and wastewater revenues on an interim basis of \$14,934,895.

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 eight 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.

Schedule 3-C reflects adjustments to remove the requested revenue increase or decrease, and the associated regulatory assessment fees and income taxes provision resulting from staff's recommended capital structure. As discussed in greater detail later, staff has made adjustments to remove certain Operation and Maintenance (O&M) expenses which are pro forma in nature.

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

Based on staff's review the Utility's filing and the Commission's prior orders for AUF's respective water and wastewater systems, staff recommends no adjustments are necessary. Staff recommended rate base for each water and wastewater systems are reflected on Schedules 2-A and 2-B, respectively.

### COST OF CAPITAL

In its MFRs, AUF has proposed different overall cost of capital rates for its respective water and wastewater based on a 13-month average capital structure as of December 31, 2007. AUF's investor sources of capital are 37.7 percent long-term debt and 62.3 percent common equity. According to its MFR Schedules D-2, D-7, and C-6, the Utility included the specific amounts of each system's customer deposits and accumulated deferred income taxes (ADITs). AUF derived the long-term debt and common equity amounts for each system by subtracting the specific amounts for customer deposits and ADITs from its respective system rate bases and then prorating, the incremental difference to long-term debt and common equity.

In its interim request, AUF used a 9.25 percent ROE, which is the minimum of the range of the Commission's current leverage formula approved in Order No. PSC-06-0476-PAA-WS.<sup>19</sup> Section 367.082(5)(b)3., F.S., 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.<sup>20</sup> As approved in Order No. PSC-06-0973-FOF-WS, p.5, "Through these mergers 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. 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 AUF 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 AUF level (approximately 37.7 percent debt and 62.3 percent equity). The Utility's capital structure was then reconciled with staff's recommended total rate base for AUF's regulated water and wastewater systems.

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<sup>19</sup> See Order No. PSC-07-0472-PAA-WS, issued June 1, 2007, in Docket No. 070006-WS, In re: Water and Wastewater industry annual establishment of authorized range of return on common equity for water and wastewater utilities pursuant to Section 367.081(4)(f), F.S.

<sup>20</sup> See Order 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.

For the systems that AUF requested an interim increase, staff used the 9.25 percent 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 in accordance with the interim statute. 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 11.25 percent, 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 rate for long-term debt of 5.10 percent. 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 7.46 percent. For purposes of an interim decrease, staff's recommended weighted average cost of capital is 8.66 percent. Schedules 1-A and 1-B detail staff's recommendation.

### NET OPERATING INCOME

Staff has made adjustments to remove the requested revenue increase or decrease, and the associated regulatory assessment fees and income taxes provision resulting from staff's recommended capital structure. In addition, staff believes further adjustments are necessary to the adjusted test year revenues and expenses.

First, staff reviewed the Utility's test year billing determinants contained in MFR Schedules E-2, E-3, and E-14. These billing determinants list the number of bills rendered and number of gallons sold during the test year by customer class for each of the 83 systems. The raw data for these schedules originates in AUF's billing records. MFR Schedule E-2 is an annual summarization of the number of bills and gallons sold by customer class and meter size, and together with the applicable tariffs, are used to calculate test year revenues. MFR Schedule E-3 details the number of annual bills by month and by system. MFR Schedule E-14 shows the number of test year bills for each system rendered in 1,000-gallon increments by customer class and meter size. Because each of these schedules are based upon the same billing records, there should be little, if any, discrepancy between the numbers being reported on these schedules.

In comparing the information contained in these schedules, staff discovered a systematic pattern of variation between the number of water and wastewater residential bills reported on the E-2 and E-14 Schedules, and those reported on the E-3 Schedules. Of the Utility's 83 systems, 80 of them had some form of billing determinant discrepancy, with the vast majority of customer bills being reported on MFR Schedule E-3 being greater than those reported on Schedule E-2. For the Utility's water systems, the total number of bills reported on Schedule E-3 was 5.6 percent greater than those reported on the E-2's, and 5.5 percent greater for the wastewater systems. Again, because each of these schedules should be based upon the same billing records, there should be little, if any, discrepancy between the numbers being reported on these schedules. To calculate our proposed annualized revenues, staff adjusted each system's revenues for the respective percentage difference of residential bills between Schedules E-2 and E-3. With the exception of four water and wastewater systems, the customers for the remaining 53 water systems and 21 wastewater systems will benefit from staff's recommended annualized revenue adjustments because it reduces the respective interim revenue increases and increases the respective interim decreases. Those respective percentage difference in the residential bills are shown on Attachment B.

Moreover, on MFR Schedule B-3, the Utility has made adjustments to normalize its historical interim test year O&M expenses for changes to salary & wages, contractual services – accounting, legal, management fees, other, and miscellaneous expenses. Staff believes these normalized O&M expenses are pro forma in nature. Thus, staff recommends these pro forma O&M expenses be removed for interim purposes.

#### REVENUE REQUIREMENT

Staff has recommended revenue requirements consistent with the calculations required by the interim statute and Commission practice. For those systems that appear to be underearning, the revenue requirements were determined using the minimum ROE limit. Consistent with the interim statute, for those systems that appear to be overearning, staff used the maximum ROE limit. Based upon recovery of actual operating expenses for the year ended December 31, 2007, and the consolidated cost of capital on an average rate base, staff recommends that the appropriate combined interim revenue requirements are \$7,518,110 and \$5,452,463, respectively for the Utility's water and wastewater systems. Attachment A reflects staff's recommended interim revenue requirements for each system.

**Issue 4:** What are the appropriate interim water and wastewater rates?

**Recommendation:** The appropriate respective system interim rates should be the lower of staff's uncapped calculated rates or the Utility's capped rates as 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), Florida Administrative Code (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, Jaeger)

**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 calculated the uncapped interim water and wastewater service rates for AUF based on the 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 uncapped 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 uncapped rate increase or decrease for the non-FWSC former systems are reflected in Attachment C.

In the last rate case for FWSC, formerly Southern States Utilities, Inc., the Commission approved a capband rate structure.<sup>21</sup> 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.

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<sup>21</sup> 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 uncapped 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 33.49 percent for water and 89.72 percent for wastewater. The calculation of the uncapped water and wastewater rate increases are reflected on Attachment D.

Because the interim request is based on a historical test year ending December 31, 2007, 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, 2007. In accordance with staff's recommendation in Issue 2, the respective system interim rates should be the lower of staff's uncapped calculated rates or the Utility's capped rates.

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 5:** What is the appropriate security to guarantee the interim increase?

**Recommendation:** A corporate undertaking is an acceptable security contingent upon receipt of the written guarantee of the parent company, Aqua America, Inc. (Aqua or AAI), and written confirmation that Aqua will not assume outstanding guarantees on behalf of AAI-owned utilities in other states in excess of \$55 million (inclusive of AUF). 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 \$2,480,622. 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. (Springer, Fletcher, Hall)

**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 \$2,946,615. 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 \$2,480,622. 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, to determine if AAI can support a corporate undertaking on behalf of its subsidiary. Aqua's 2007, 2006, and 2005 financial statements were used to determine the financial condition of Aqua. AAI has experienced deficient levels of liquidity during the three-year period of this analysis. However, Aqua's average equity ratio over the three-year period has averaged approximately 47 percent which is sufficient in this instance based on AAI's overall financial condition. In addition, Aqua has experienced a declining but still adequate interest coverage ratio. Finally, net income has steadily increased over the period and has been on average nineteen times greater than the requested cumulative corporate undertaking amount. AAI's financial performance has demonstrated adequate levels of profitability, interest coverage, and equity capitalization to offset the deficient liquidity position. 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 \$2,480,622 is acceptable contingent upon receipt of the written guarantee of AAI and written confirmation that Aqua will not assume outstanding guarantees on behalf of AAI-owned utilities in other states in excess of \$55 million (inclusive of AUF).

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 should provide a report by the 20th day of each month indicating the monthly and total revenue collected subject to refund. Should a

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refund be required, the refund should be with interest and undertaken in accordance with Rule 25-30.360, F.A.C.

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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**Issue 6:** 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. (Fletcher, Jaeger, Fleming, Klancke, Saylor)

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