

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: October 16, 2008

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Buys, Bulecza-Banks, Daniel, Fletcher, Livingston, Walden)
Office of the General Counsel (Young)

RE: Docket No. 080248-SU – Application for increase in wastewater rates in Pinellas County by Tierra Verde Utilities, Inc.

AGENDA: 10/28/08 – Regular Agenda – Decision on Suspension of Rates and on Interim Rates – Participation is at the Discretion of the Commission

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Argenziano

CRITICAL DATES: 60-Day Suspension Date Waived Through 10/28/08

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\080248.INTERIM.RCM.DOC

Case Background

Tierra Verde Utilities, Inc. (Tierra Verde or Utility) is a Class B utility providing wastewater service to approximately 1,033 customers in Pinellas County. The Utility is a wholly-owned subsidiary of Utilities, Inc. (UI). Tierra Verde's service area is located entirely on a barrier island at the mouth of Tampa Bay. All the Utility's sewage treatment service is purchased from the City of St. Petersburg. Wastewater rates were last established for Tierra Verde in its 2006 rate proceeding.¹

¹ See Order No. PSC-07-0082-PAA-SU, issued January 29, 2007, in Docket No. 060255-SU, In Re: Application for increase in wastewater rates in Pinellas County by Tierra Verde Utilities, Inc. Consummating Order No. PSC-07-0164-CO-SU, issued February 23, 2007, made Order No. PSC-07-0082-PAA-SU final and effective.

Docket No. 080248-SU

Date: October 16, 2008

On August 27, 2008, Tierra Verde filed its application for approval of final and interim rate increases in the instant docket. The Utility had a few deficiencies in the Minimum Filing Requirements (MFRs). As of the filing of this recommendation, those deficiencies remain outstanding. The Utility requested that the application be processed using the Proposed Agency Action (PAA) procedure. The test year established for interim and final rates is the historical twelve-month period ended December 31, 2007.

Tierra Verde requested interim rates designed to generate annual wastewater revenues of \$923,677, an increase of \$142,978 or 18.31 percent. The Utility requested final rates designed to generate wastewater revenues of \$1,132,684, an increase of \$351,954 or 45.08 percent.

The sixty-day statutory deadline for the Commission to suspend the Utility's requested final rates is October 26, 2008. However, by letter dated September 8, 2008, Tierra Verde agreed to extend the statutory time frame through October 28, 2008. This recommendation addresses the suspension of Tierra Verde's requested final rates and the Utility's requested interim rates. The Commission has jurisdiction pursuant to Sections 367.081 and 367.082, Florida Statutes (F.S.).

Discussion of Issues

Issue 1: Should the Utility's proposed final wastewater rates be suspended?

Recommendation: Yes. Tierra Verde's proposed final wastewater rates should be suspended. (Buys)

Staff Analysis: Section 367.081(6), F.S., provides that the Commission may, for good cause, withhold consent to the implementation of the requested rates within 60 days after the date the rate request is filed. Further, Section 367.081(8), F.S., permits the proposed rates to go into effect (secured and subject to refund) at the expiration of five months if: (1) the Commission has not acted upon the requested rate increase; or (2) the Commission's PAA action is protested by a party other than the Utility.

Staff has reviewed the filing and has considered the information filed in support of the rate application and the proposed final rates. Staff recommends that it is necessary to require further investigation of this information, including on-site investigations by staff accountants and engineers. Based on the foregoing, staff recommends that it is appropriate to suspend the Utility's proposed rate increase.

Issue 2: Should an interim revenue increase be approved?

Recommendation: Yes. On an interim basis, the Utility should be authorized to collect annual wastewater revenues as indicated below:

	<u>Adjusted Test Year Revenues</u>	<u>\$ Increase</u>	<u>Revenue Requirement</u>	<u>% Increase</u>
Wastewater	\$751,404	\$151,806	\$903,210	20.20%

(Buys)

Staff Analysis: In its MFRs, Tierra Verde requested interim rates designed to generate annual revenues of \$923,677. This represents a wastewater revenue increase of \$142,948 (18.31 percent). The Utility has filed rate base, cost of capital, and operating statements to support its requested wastewater increase.

Pursuant to Section 367.082(5)(b)1., F.S., the achieved rate of return for interim purposes must be calculated by applying appropriate adjustments consistent with those made in a utility's most recent rate proceeding. Staff has reviewed Tierra Verde's interim request, as well as prior orders concerning the Utility's rate base. Staff's recommended adjustments are discussed below. Staff has attached accounting schedules to illustrate staff's recommended rate base, capital structure, and test year operating income amounts. The rate base schedule is shown on Schedule No. 1-A, with adjustments shown on Schedule No. 1-B; the capital structure schedule is shown on Schedule No. 2, and the operating income schedule is shown on Schedule No. 3-A, with the adjustments shown on Schedule No. 3-B.

RATE BASE

Tierra Verde filed a simple-average wastewater rate base for the calendar year ended December 31, 2007. The Utility made adjustments to allocated plant, construction work in progress (CWIP), accumulated depreciation, acquisition adjustments, accumulated amortization of acquisition adjustments, and working capital. Staff reviewed the Utility's MFRs and Order No. PSC-07-0082-PAA-SU for consistency with the last rate proceeding. As a result of this review, staff believes that one adjustment to the rate base should be made.

Accumulated Depreciation

In Tierra Verde's last rate proceeding, the Commission decreased the test year average balance in Acct No. 351.1 – Accumulated Depreciation – Organization to zero. In its MFRs, the Utility recorded a test year average balance in Acct No. 351.1 Accumulated Depreciation – Organization, but did not have an average test year balance for the plant Acct No. 351.1 – Organization. See Order No. PSC-07-0082-PAA-SU, p. 6. In the instant case, Tierra Verde made similar entries in its MFR schedules. On MFR Schedule A-10, Line 2, the Utility recorded a test year average balance of \$123,213 for Acct No. 351.1 – Accumulated Depreciation – Organization, but did not record a test year average balance on MFR Schedule A-6, Line 2, for wastewater plant Acct. No. 351.1 - Organization. Therefore, as required by Section 367.082(5), F.S., the same adjustment made in the prior rate case shall be applied in this case for interim

purposes. Accordingly, staff recommends that the Accumulated Depreciation be reduced by \$123,213.

Based on the adjustment above, staff's recommended interim rate base should be \$1,278,623. Schedule No. 1-A details staff's recommended interim rate base, with adjustments reflected on Schedule No. 1-B.

COST OF CAPITAL

In its MFRs, Tierra Verde used a simple-average capital structure consisting of allocated investor sources of capital from UI. The Utility included a zero balance in customer deposits. Staff reviewed Tierra Verde's requested capital structure and believes that the Utility erred in calculating its cost rate for common equity. Section 367.082(5)(b)3., F.S., requires that the minimum of the range of the last authorized rate of return on equity (ROE) be used when calculating the cost of capital for an interim rate increase. In Tierra Verde's last rate case, the midpoint of the authorized ROE was established as 11.45 percent, with a range of 10.45 percent to 12.45 percent. See Order No. PSC-07-0082-PAA-SU, p. 9. Therefore, for interim purposes, staff recommends that the appropriate cost of equity should be 10.45 percent. Accordingly, staff's recommended weighted cost of capital for interim purposes is 7.50 percent. Schedule No. 2 details staff's recommended capital structure.

NET OPERATING INCOME

Operating Revenues

Section 367.082(5)(b)1., F.S., states that the achieved rate of return is calculated by applying adjustments consistent with the Utility's last rate proceeding and annualizing any rate changes occurring during the interim test year. For purposes of the interim application, Tierra Verde chose the test period ended December 31, 2007. The Utility implemented the rates approved in its previous rate case on February 22, 2007. Tierra Verde subsequently implemented a price index and pass through rate increase on April 11, 2007, followed by a price index rate increase on September 19, 2007, and a pass through rate increase on February 21, 2008. The Utility then annualized its revenues for the test year using the rates currently in effect on February 21, 2008. The revenues should be annualized using the rates in effect at the end of the test year. Staff reviewed Tierra Verde's revenues for the test year and recommends that operating revenues be reduced by \$29,325 to reflect the appropriate amount of annualized revenues.

Based on these adjustments, staff recommends that the appropriate test year operating income, before any revenue increase, is \$5,431. Schedule No. 3-A details staff's recommended net operating income, with adjustments reflected on Schedule No. 3-B.

REVENUE REQUIREMENT

The Utility requested an interim revenue requirement of \$923,677. Based on the above, staff recommends an interim revenue requirement of \$903,210. This represents an interim revenue increase of \$151,806, or 20.20 percent. This will allow Tierra Verde the opportunity to recover its operating expenses and earn a 7.50 percent return on its rate base.

Issue 3: What are the appropriate interim wastewater rates?

Recommendation: The wastewater service rates for Tierra Verde in effect as of December 31, 2007, should be increased by 20.22 percent to generate the recommended revenue increase for the interim period. 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. The rates should not be implemented until staff verifies that the tariff sheets are consistent with the Commission's decision, the proposed customer notice is adequate, and the required security discussed in Issue 4 has been filed. The Utility should provide proof of the date notice was given within 10 days after the date of notice. (Buys)

Staff Analysis: Staff recommends that interim wastewater service rates for Tierra Verde be designed to allow the Utility the opportunity to generate annual operating revenues of \$903,210. This reflects an increase of \$151,806, or 20.20 percent, before removal of miscellaneous revenues. To determine the appropriate percentage increase to apply to the service rates, miscellaneous service revenues should be removed from the test year revenues. In its MFRs, Tierra Verde included miscellaneous revenues of \$450. The calculation is as follows:

	<u>Wastewater</u>
1 Total Test Year Revenues	\$751,404
2 Less: Miscellaneous Revenues	<u>450</u>
3 Test Year Revenues from Service Rates	\$750,954
4 Revenue Increase	<u>\$151,806</u>
5 % Service Rate Increase (Line 4/Line3)	<u>20.22%</u>

The interim rate increase of 20.22 percent for wastewater should be applied as an across-the-board increase to the service rates in effect as of December 31, 2007. 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. 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 discussed in Issue 4 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 wastewater rates, and staff's recommended interim wastewater rates are shown on Schedule No. 4.

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, Utilities, Inc. (UI), and written confirmation of UI's continued attestation that it does not have any outstanding guarantees on behalf of UI-owned utilities in other states. UI should be required to file a corporate undertaking on behalf of its subsidiaries to guarantee any potential refunds of revenues collected under interim conditions. UI's total guarantee should be equal to the outstanding amount of \$528,209 plus the amount approved by the Commission in this docket and Docket Nos. 080247-SU, 080249-WS, and 080250-SU. 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. (Buys, Livingston)

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 \$151,806. In accordance with Rule 25-30.360, F.A.C., staff calculated the potential refund of revenues and interest collected under interim conditions to be \$89,515. This amount is based on an estimated seven months of revenue being collected from staff's recommended interim rates over the Utility's current authorized rates shown on Schedule No. 4.

Tierra Verde is a wholly-owned subsidiary of UI, which provides all investor capital to its subsidiaries. UI has requested a corporate undertaking to secure any interim increases granted in Docket Nos. 080247-SU, 080249-WS, and 080250-SU. The Commission's consideration of interim rates for those dockets is also being decided at the October 28, 2008, Agenda Conference. The recommended cumulative corporate undertaking amount for those dockets is \$257,529. At present, UI has a corporate undertaking for Miles Grant Water & Sewer Company (Miles Grant) and Lake Utility Services, Inc. (LUSI), for a combined corporate undertaking of \$528,209.² As such, staff reviewed the financial statements of the parent company. As a result of staff's interim recommendations in all of the above dockets, and the previously-approved corporate undertaking amount for Miles Grant and LUSI, the total requested cumulative corporate undertaking amount is \$875,253, which includes \$89,515, subject to refund for this docket. However, in case the recommended incremental amounts for the above four dockets are not approved by the Commission, staff recommends that UI's total guarantee should be equal to the outstanding amount of \$528,209 plus the amount approved by the Commission in this docket and Docket Nos. 080247-SU, 080249-WS, and 080250-SU.

The criteria for a corporate undertaking includes sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. Staff has reviewed UI's financial statements from 2005 to 2007 to determine the financial condition of the parent company. UI's relative level of liquidity has decreased compared to 2006. The Utility has also experienced a decline in interest coverage ratio and relative level of net income over the three year review period. However, UI's equity ratio has increased to 44.48 percent in 2007 from 40

² See Order Nos. PSC-08-0338-PCS-WS, issued May 27, 2008 in Docket No. 070695-WS, In re: Application for rate increase in water and wastewater in Martin County, by Miles Grant Water & Sewer Company; and PSC-08-0308-PCO-WS, issued May 12, 2008 in Docket No. 070693-WS, In re: Application for rate increase in water and wastewater Lake County by Lake Utility Services, Inc.

Docket No. 080248-SU

Date: October 16, 2008

percent in 2006. In addition net income has been on average three times greater than the requested interim undertaking amount. UI's financial performance has demonstrated adequate levels of both equity capitalization and profitability on an absolute basis to offset the decline in interest coverage and profitability on a relative basis. Based upon this analysis, staff recommends that a cumulative corporate undertaking of \$875,253 is acceptable contingent upon the receipt of the written guarantee of UI and written confirmation that UI does not have any outstanding guarantees on behalf of UI-owned utilities in other states.

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 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.

Docket No. 080248-SU

Date: October 16, 2008

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. (Buys, Young)

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

Tierra Verde Utilities, Inc. Schedule of Wastewater Rate Base Test Year Ended 12/31/07			Schedule No. 1-A Docket No. 080248-SU		
Description	Test Year Per Utility	Utility Adjust- ments	Adjusted Test Year Per Utility	Staff Adjust- ments	Staff Adjusted Test Year
1 Plant in Service	\$3,901,999	\$1,123	3,903,122	0	3,903,122
2 Land and Land Rights	234	0	234	0	234
3 Non-used and Useful Components	0	0	0	0	0
4 Accumulated Depreciation	(2,135,206)	6,887	(2,128,319)	(123,213)	(2,251,532)
5 CIAC	(1,687,658)	0	(1,687,658)	0	(1,687,658)
6 Amortization of CIAC	1,226,192	0	1,226,192	0	1,226,192
7 CWIP	116,722	(116,722)	0	0	0
8 Acquisition Adjustment – Net	269,960	(269,960)	0	0	0
9 Working Capital Allowance	<u>0</u>	<u>88,265</u>	<u>88,265</u>	<u>0</u>	<u>88,265</u>
10 Rate Base	<u>\$1,692,243</u>	<u>(\$290,407)</u>	<u>\$1,401,836</u>	<u>(\$123,213)</u>	<u>\$1,278,623</u>

Docket No. 080248-SU
Date: October 16, 2008

Tierra Verde Utilities, Inc. Adjustments to Rate Base Test Year Ended 12/31/07	Schedule No. 1-B Docket No. 080248-SU
Explanation	Wastewater
<u>Accumulated Depreciation</u> To zero out the balance in Acct No. 351.1 - Organization	<u>(\$123,213)</u>

Tierra Verde Utilities, Inc. Capital Structure-Simple Average Test Year Ended 12/31/07						Schedule No. 2 Docket No. 080248-SU			
Description	Total Capital	Specific Adjustments	Subtotal Adjusted Capital	Prorata Adjustments	Capital Reconciled to Rate Base	Ratio	Cost Rate	Weighted Cost	
Per Utility									
1 Long-term Debt	\$180,000,000	\$0	\$180,000,000	(\$179,291,510)	\$708,490	50.54%	6.65%	3.36%	
2 Short-term Debt	7,750,000	0	7,750,000	(7,719,493)	30,507	2.18%	2.44%	0.05%	
3 Preferred Stock	0	0	0	0	0	0.00%	0.00%	0.00%	
4 Common Equity	139,282,132	0	139,282,132	(138,733,902)	548,230	39.11%	11.70%	4.58%	
5 Customer Deposits	0	0	0	0	0	0.00%	6.00%	0.00%	
6 Deferred Income Taxes	<u>114,609</u>	<u>0</u>	<u>114,609</u>	<u>0</u>	<u>114,609</u>	<u>8.18%</u>	0.00%	<u>0.00%</u>	
10 Total Capital	<u>\$327,146,741</u>	<u>\$0</u>	<u>\$327,146,741</u>	<u>(\$325,744,905)</u>	<u>\$1,401,836</u>	<u>100.00%</u>		<u>7.99%</u>	
Per Staff									
11 Long-term Debt	\$180,000,000	0	\$180,000,000	(\$179,296,486)	\$703,514	50.51%	6.65%	3.36%	
12 Short-term Debt	7,750,000	0	7,750,000	(7,719,710)	30,290	2.17%	2.44%	0.05%	
13 Preferred Stock	0	0	0	0	0	0.00%	0.00%	0.00%	
14 Common Equity	139,282,132	0	139,282,132	(138,737,760)	544,372	39.09%	10.45%	4.08%	
15 Customer Deposits	0	0	0	0	0	0.00%	6.00%	0.00%	
16 Deferred Income Taxes	<u>114,609</u>	<u>0</u>	<u>114,609</u>	<u>0</u>	<u>114,609</u>	<u>8.23%</u>	0.00%	<u>0.00%</u>	
20 Total Capital	<u>\$327,146,741</u>	<u>\$0</u>	<u>\$327,146,741</u>	<u>(\$325,868,117)</u>	<u>\$1,392,785</u>	<u>100.00%</u>		<u>7.50%</u>	
						LOW	HIGH		
RETURN ON EQUITY						<u>10.45%</u>	<u>12.45%</u>		
OVERALL RATE OF RETURN						<u>7.16%</u>	<u>7.94%</u>		

Tierra Verde Utilities, Inc. Statement of Wastewater Operations Test Year Ended 12/31/07						Schedule No. 3-A Docket No. 080248-SU	
Description	Test Year Per Utility	Utility Adjust- ments	Adjusted Test Year Per Utility	Staff Adjust- ments	Staff Adjusted Test Year	Revenue Increase	Revenue Requirement
1 Operating Revenues:	<u>\$690,922</u>	<u>\$232,755</u>	<u>\$923,677</u>	<u>(\$172,273)</u>	<u>\$751,404</u>	<u>\$151,806</u> 20.20%	<u>\$903,210</u>
Operating Expenses							
2 Operation & Maintenance	645,324	60,793	706,117	0	706,117		706,117
3 Depreciation	14,180	10,266	24,446	0	24,446		24,446
4 Amortization	0	0	0	0	0		0
5 Taxes Other Than Income	35,388	10,820	46,208	(7,752)	38,456	6,831	45,287
6 Income Taxes	<u>(43,791)</u>	<u>78,780</u>	<u>34,989</u>	<u>(58,035)</u>	<u>(23,046)</u>	<u>54,554</u>	<u>31,509</u>
7 Total Operating Expense	<u>651,101</u>	<u>160,659</u>	<u>811,760</u>	<u>(65,787)</u>	<u>745,973</u>	<u>61,385</u>	<u>807,359</u>
8 Operating Income	<u>\$39,821</u>	<u>\$72,096</u>	<u>\$111,917</u>	<u>(\$106,486)</u>	<u>\$5,431</u>	<u>\$90,421</u>	<u>\$95,851</u>
9 Rate Base	<u>\$1,692,243</u>		<u>\$1,401,836</u>		<u>\$1,278,623</u>		<u>\$1,278,623</u>
10 Rate of Return	<u>2.35%</u>		<u>7.98%</u>		<u>0.42%</u>		<u>7.50%</u>

Tierra Verde Utilities, Inc. Adjustment to Operating Income Test Year Ended 12/31/07		Schedule 3-B Docket No. 080248-SU
Explanation		Wastewater
<u>Operating Revenues</u>		
1	Remove requested interim revenue increase	(\$142,948)
2	To reflect the appropriate amount of annualized revenues.	<u>(29,325)</u>
	Total	<u>(\$172,273)</u>
<u>Taxes Other Than Income</u>		
	RAFs on revenue adjustments above	<u>(\$7,752)</u>
<u>Income Taxes</u>		
	To adjust to test year income tax expense	<u>(\$58,035)</u>

Tierra Verde Utilities, Inc.		Schedule No. 4			
Wastewater Monthly Service Rates		Docket No. 080248-SU			
Test Year Ended 12/31/07		Test Year	Utility	Utility	Staff
		Rates on	Requested	Requested	Recommended
		12/31/07	Interim	Final	Interim
<u>Residential</u>					
Base Facility Charge For All Meter Sizes:		\$72.29	\$87.82	\$107.69	\$86.90
Gallonge Charge Per 1,000 Gallons (10,000 gallon cap)		\$0	\$0	\$0	\$0
<u>General Service</u>					
Base Facility Charge by Meter Size:					
5/8" x 3/4"		\$46.79	\$57.12	\$70.04	\$56.25
1"		\$116.99	\$142.81	\$175.13	\$140.64
1-1/2"		\$233.96	\$285.50	\$350.22	\$281.26
2"		\$374.34	\$456.96	\$560.36	\$450.01
3"		\$748.67	\$913.92	\$110.71	\$900.01
4"		\$1,169.80	\$1,428.00	\$1,751.12	\$1,406.28
6"		\$2,339.60	\$2,855.99	\$3,502.23	\$2,812.55
8"		\$0.00	\$0.00	\$0.00	\$0.00
Gallonge Charge, per 1,000 Gallons		\$2.30	\$2.80	\$3.44	\$2.76
<u>Typical Residential Bills 5/8" x 3/4" Meter</u>					
3,000 Gallons		\$72.29	\$87.82	\$107.69	\$86.90
5,000 Gallons		\$72.29	\$87.82	\$107.69	\$86.90
10,000 Gallons		\$72.29	\$87.82	\$107.69	\$86.90
(Wastewater Gallonge Cap - 10,000 Gallons)					