



Public Service Commission

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

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RECORDS AND REPORTING
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PROCENDD-TRCO

DATE: JANUARY 20, 2000

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYÓ)

FROM: DIVISION OF WATER AND WASTEWATER (B. DAVIS, MERCHANT) *MD*
DIVISION OF LEGAL SERVICES (FUDGE) *GF PS*

RE: DOCKET NO. 991902-SU - COMMERCIAL UTILITIES, DIVISION OF GRACE & COMPANY INC.
COUNTY: DUVAL

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and

AGENDA: 02/01/00 - REGULAR AGENDA - DECISION ON SETTING REVENUES SUBJECT TO REFUND - INTERESTED PERSONS MAY PARTICIPATE ON ISSUE 1 ONLY - PARTICIPATION IS LIMITED TO COMMISSIONERS AND STAFF ON ISSUES 2 - 4

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\WAW\WP\991902I.RCM

CASE BACKGROUND

Commercial Utilities, Division of Grace & Company, Inc., (CU or utility) is a Class B wastewater only facility located in Jacksonville, Florida. The utility serves 35 wastewater general service customers. These customers include hotels, banks, a shopping center, restaurants, and other small businesses. CU was issued Certificates Nos. 219-W and 164-S by Order No. 6704, issued June 4, 1975, in Docket Nos. 74787-W and 74788-S.

Pursuant to the Environmental Protection Board's Rule 3, Section 3.402 F.2.2, the Jacksonville Department of Health, Welfare, and Bio-Environmental Service required CU to connect to a regional wastewater facility. The original deadline for this was March 10, 1992. The actual interconnection took place July 30, 1992.

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PSC-RECORDS/REPORTING

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The utility's last rate proceeding was in Docket No. 910766-WS which resulted in Order No. PSC-93-0233-FOF-WS, issued February 12, 1993. In that order, the Commission transferred \$343,080 in interconnection costs, which were to be accounted for in the Intangible Plant category. The intangible plant was to be amortized over 27 years.

CU's water certificate was canceled through Order No. PSC-97-0094-FOF-WU, issued January 27, 1997, in Docket No. 961268-WU. All water service is now provided by the City of Jacksonville.

Staff review of the utility's 1998 Annual Report indicated that the utility achieved a greater return than what was authorized in Order No. PSC-93-0233-FOF-WS. Staff believes it is necessary and appropriate to initiate an investigation into the potential overearnings of this utility.

DISCUSSION OF ISSUES

ISSUE 1: Should the Commission initiate an overearnings investigation of Commercial Utilities, Division of Grace & Company Inc.?

RECOMMENDATION: Yes, the Commission should initiate an investigation of the composition and level of wastewater rates to determine potential overearnings. (B. DAVIS)

STAFF ANALYSIS: Section 367.082(2)(b), Florida Statutes, authorizes the Commission to initiate an investigation of a utility's earnings upon a preliminary demonstration that the utility is earning a rate of return which is outside the range of reasonableness. To the extent that the achieved rate of return exceeds the required rate of return applied to an average investment rate base or an end-of-period rate base, the Commission may require revenues to be collected subject to refund during the investigation. Section 367.082(2)(b), Florida Statutes.

Staff's preliminary analysis, based on the review of the utility's 1998 Annual Report, indicates that during 1998 the utility's wastewater system earned a 19.43% return. Using the utility's 1998 capital structure from the Annual Report as modified by staff and the return on equity authorized in Order No. PSC-93-0233-FOF-WS, the range of reasonableness for the rate of return is 10.40% to 10.70%. Therefore, staff believes that a full investigation of this utility's earnings for wastewater service is appropriate. The test year for the investigation should be the year ended December 31, 1999.

ISSUE 2: Should any amount of annual wastewater revenue be held subject to refund, and, if so, what is the appropriate amount?

RECOMMENDATION: Yes, the utility should hold annual wastewater revenues of \$53,860 subject to refund. The following amounts are recommended:

1998 Revenue	\$350,194	
Amount Subject to Refund	\$ 53,860	
Percent Subject to Refund	15.38%	(B. DAVIS)

STAFF ANALYSIS: The 1998 Annual Report shows wastewater operating revenues totaling \$350,194 for the year ended December 31, 1998. The corresponding annual wastewater revenue requirement, based on staff's adjusted rate base, capital structure and operating expenses, totals \$296,334. (Schedule No. 3-A)

Using the upper boundary of 11.88% for return on equity, in conjunction with the appropriate cost rates for other components in the utility's capital structure, yields a 10.55% overall cost of capital. (Schedule No. 2) Our preliminary review indicates that the utility is earning a return of 19.35% on the wastewater system. (Schedule No. 3-A)

Section 367.082(5)(b)1., Florida Statutes, requires that adjustments consistent with those made in the last individual rate proceeding shall be made in arriving at the achieved rate of return of the utility. For the purpose of this interim recommendation, the schedules reflect average 1998 balances per the annual report, as well as specific staff adjustments to show accounting for the interconnection costs in accordance with Order No. PSC-93-0233-FOF-WS. This recommendation reflects the appropriate adjustments, the nature and magnitude of which are discussed below.

RATE BASE

Plant in Service

The utility did not book the interconnection costs as intangible plant, but did include \$153,492 in plant in service which represents the unpaid balance of interconnection costs owed to the Jacksonville Electric Authority (JEA), the operator of the regional wastewater treatment plant. The resulting average balance for utility plant in service is \$366,050.

Intangible Plant

Staff has included the entire amount of interconnection costs as Intangible Plant in accordance with Order No. PSC-93-0233-FOF-WS.

Accumulated Amortization of Intangible Plant

Staff has calculated the 1998 balance of accumulated amortization of the intangible plant using the 27-year amortization period from Order No. PSC-93-0233-FOF-WS.

Working Capital

Section 367.082(5)(b)1., Florida Statutes, requires that in calculating interim rates, adjustments be made consistent with those in the utility's last rate proceeding. Consistent with the methodology used in CU's last rate case, staff has calculated the Allowance for Working Capital using the formula method.

Rate base for interim purposes, as adjusted by staff, is \$466,974 for the wastewater system. The rate base is shown on Schedule No. 1-A and the related adjustments are shown on Schedule No. 1-B.

COST OF CAPITAL

Staff has added the estimated 1998 average unpaid balance due to JEA for interconnection of \$217,360 as short term debt at a 12% cost rate, which the utility is paying JEA.

In Order No. PSC-93-0233-FOF-WS, the Commission found it appropriate to establish a return on equity of 10.88% for the utility, with a range of 9.99%-11.88%, to be used in future proceedings. Consistent with Section 367.082(5)(b)3., Florida Statutes, the appropriate return on equity for interim refund purposes is calculated using the maximum of the last authorized range. Using the upper boundary of 11.88% for return on equity, in conjunction with the appropriate cost rates for other components in the utility's capital structure, yields a 10.70% overall cost rate of return for interim purposes.

OPERATING INCOME

Operation and Maintenance Expenses

Staff has removed \$49,446 in payments to JEA for interconnection, which represent payment of debt principle and interest, from Operation and Maintenance expense.

Amortization Expense

Staff has included \$12,694 to show the 1998 amortization of the intangible asset.

Income Taxes

Staff has recalculated income taxes based on the above adjustments.

REVENUE REQUIREMENT FOR THE INTERIM PERIOD

As discussed previously, the wastewater system generated operating revenues of \$350,194. Staff's recommended adjustments result in revenue requirements for the interim test period of \$296,334, using the ceiling of the range of reasonableness as the cost of equity. This represents a decrease of \$53,860, or 15.38% of the 1998 revenue. Since 1998 has already passed, staff recommends an investigation of 1999. If the study of 1999 indicates a rate adjustment, revenue collected in excess of the adjusted rates from February, 2000, should be refunded to the customers.

ISSUE 3: What is the appropriate security to guarantee the amount subject to refund?

RECOMMENDATION: The utility should be required to file a corporate undertaking to guarantee the amount subject to refund. The corporate undertaking should be in the amount of \$45,000. Pursuant to Rule 25-30.360(6), Florida Administrative Code, the utility should be required to provide a report by the 20th of each month indicating the monthly and total revenue collected subject to refund. The utility should be put on notice that failure to comply with these requirements will result in the initiation of a show cause proceeding. (B. DAVIS, DRAPER)

STAFF ANALYSIS: Pursuant to Section 367.082(2)(b), Florida Statutes, when revenues are held subject to refund, the utility is authorized to continue collecting the previously authorized rates. The amount of potential overearnings on an annual basis is \$53,860 for the wastewater system. Assuming a 10-month time frame, the potential refund amount is \$44,833.

Staff in the Division of Auditing and Financial Analysis (AFA) has recommended that CU be allowed a corporate undertaking. The criteria for a corporate undertaking includes sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. The 1996, 1997 and 1998 annual reports of CU were used to determine the financial condition of the utility. CU has shown steady improvement in liquidity and equity capitalization over the three-year period. CU has also shown improvement in interest coverage and profitability for 1998 compared with previous periods. Base upon this analysis, staff recommends that CU can support a corporate undertaking in the amount of \$45,000.

The utility should keep an accurate and detailed account of all monies it receives. Pursuant to Rule 25-30.360(6), Florida Administrative Code, 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, Florida Administrative Code.

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. Finally, the utility should be on notice that if it does not comply with the requirements stated in this recommendation, a show cause proceedings will be initiated.

DOCKET NO. 991902-SU
DATE: JANUARY 20, 2000

ISSUE 4: Should this docket be closed?

RECOMMENDATION: No, this docket should remain open pending staff's investigation of the utility's earnings for 1999 and the results of staff's investigation and analysis into all other outstanding matters. (FUDGE, B. DAVIS)

STAFF ANALYSIS: Based on staff's preliminary analysis, the utility's wastewater system is overearning by \$54,066. Therefore, this docket should remain open pending staff's investigation of the utility's earnings for 1999.

DOCKET NO. 991902-SU
 DATE: JANUARY 20, 2000

COMMERCIAL UTILITIES
 SCHEDULE OF WASTEWATER RATE BASE
 YEAR ENDED 12/31/98

SCHEDULE NO. 1-A
 DOCKET NO. 991902-SU

DESCRIPTION	1998 PER ANNUAL REPORT	UTILITY ADJUST- MENTS	AVERAGE 1998 PER UTILITY	STAFF ADJUST- MENTS	STAFF ADJUSTED 1,998
1 UTILITY PLANT IN SERVICE	\$519,542	\$0	\$519,542	(\$153,492)	\$366,050
2 LAND	\$0	\$0	\$0	\$0	\$0
3 NON-USED & USEFUL COMPONENTS	\$0	\$0	\$0	\$0	\$0
4 ACCUMULATED DEPRECIATION	(\$187,838)	\$9,611	(\$178,228)	\$0	(\$178,228)
5 CIAC	(\$15,440)	\$0	(\$15,440)	\$0	(\$15,440)
6 AMORTIZATION OF CIAC	(\$3,997)	\$7,709	\$3,712	\$0	\$3,712
7 INTANGIBLE PLANT	\$0	\$0	\$0	\$343,080	\$343,080
8 AMORTIZATION OF INTANGIBLE PLT.	\$0	\$0	\$0	(\$82,511)	(\$82,511)
9 WORKING CAPITAL ALLOWANCE	<u>\$30,311</u>	<u>\$0</u>	<u>\$30,311</u>	<u>\$0</u>	<u>\$30,311</u>
RATE BASE	<u>\$342,578</u>	<u>\$17,319</u>	<u>\$359,897</u>	<u>\$107,077</u>	<u>\$466,974</u>

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**COMMERCIAL UTILITIES
ADJUSTMENTS TO RATE BASE
YEAR ENDED 12/31/98**

**SCHEDULE NO. 1-B
DOCKET NO. 991902-SU**

EXPLANATION	WASTEWATER
<u>PLANT IN SERVICE</u>	
To show intangible plant, per Order No. PSC-93-0233-FOF-WS, separately.	<u>(\$153,492)</u>
<u>LAND</u>	<u>\$0</u>
<u>NON-USED AND USEFUL</u>	
To reflect net non-used and useful adjustment	<u>\$0</u>
<u>ACCUMULATED DEPRECIATION</u>	<u>\$0</u>
<u>CIAC</u>	<u>\$0</u>
<u>ACCUMULATED AMORTIZATION OF CIAC</u>	<u>\$0</u>
<u>INTANGIBLE PLANT</u>	
Per Order No. PSC-93-0233-FOF-WS	<u>\$343,080</u>
<u>ACCUMULATED AMORTIZATION OF INTANGIBLE PLANT</u>	
Per Order No. PSC-93-0233-FOF-WS	<u>(\$82,511)</u>
<u>WORKING CAPITAL</u>	<u>\$0</u>

**COMMERCIAL UTILITIES
 AVERAGE CAPITAL STRUCTURE
 YEAR ENDED 12/31/98**

**SCHEDULE NO. 2
 DOCKET NO. 991902-SU**

DESCRIPTION	TOTAL CAPITAL PER ANNUAL REPORT	SPECIFIC ADJUST- MENTS/ AVERAGING	PRO RATA ADJUST- MENTS	CAPITAL RECONCILED TO RATE BASE	RATIO	COST RATE	WEIGHTED COST
PER ANNUAL REPORT 1998							
1 LONG TERM DEBT	\$446,656	(\$5,731)	\$0	\$440,926	79.37%	9.75%	7.74%
2 SHORT-TERM DEBT	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
3 PREFERRED STOCK	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
4 COMMON EQUITY	\$128,471	(\$13,830)	\$0	\$114,642	20.64%	10.88%	2.25%
5 CUSTOMER DEPOSITS	\$0	\$0	\$0	\$0	0.00%	6.00%	0.00%
6 DEFERRED INCOME TAXES	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
7 DEFERRED ITC'S	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>
8 TOTAL CAPITAL	<u>\$575,127</u>	<u>(\$19,560)</u>	<u>\$0</u>	<u>\$555,567</u>	<u>100.00%</u>		<u>9.98%</u>
PER STAFF 1998							
9 LONG TERM DEBT	\$440,926	\$0	(\$174,535)	\$266,391	57.05%	9.75%	5.56%
10 SHORT-TERM DEBT	\$0	\$217,360	(\$86,039)	\$131,321	28.12%	12.00%	3.37%
11 PREFERRED STOCK	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
12 COMMON EQUITY	\$114,642	\$0	(\$45,379)	\$69,262	14.83%	10.88%	1.61%
13 CUSTOMER DEPOSITS	\$0	\$0	\$0	\$0	0.00%	6.00%	0.00%
14 DEFERRED INCOME TAXES	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%
15 DEFERRED ITC'S	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>
16 TOTAL CAPITAL	<u>\$555,567</u>	<u>\$217,360</u>	<u>(\$305,953)</u>	<u>\$466,974</u>	<u>100.00%</u>		<u>10.55%</u>

DOCKET NO. 991902-SU
 DATE: JANUARY 20, 2000

**COMMERCIAL UTILITIES
 STATEMENT OF WASTEWATER OPERATIONS
 YEAR ENDED 12/31/98**

**SCHEDULE NO. 3-A
 DOCKET NO. 991902-SU**

DESCRIPTION	1998 PER ANNUAL REPORT	UTILITY ADJUST- MENTS	ADJUSTED 1998 PER UTILITY	STAFF ADJUST- MENTS	STAFF ADJUSTED 1998	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	<u>\$350,194</u>	<u>\$0</u>	<u>\$350,194</u>	<u>\$0</u>	<u>\$350,194</u>	<u>(\$53,860)</u> -15.38%	<u>\$296,334</u>
OPERATING EXPENSES							
2 OPERATION & MAINTENANCE	<u>\$242,486</u>	<u>\$0</u>	<u>\$242,486</u>	<u>(\$49,446)</u>	<u>\$193,040</u>		<u>\$193,040</u>
3 DEPRECIATION	<u>\$18,650</u>	<u>\$0</u>	<u>\$18,650</u>	<u>\$0</u>	<u>\$18,650</u>		<u>\$18,650</u>
4 AMORTIZATION	<u>\$5,653</u>	<u>\$0</u>	<u>\$5,653</u>	<u>\$12,694</u>	<u>\$18,347</u>		<u>\$18,347</u>
5 TAXES OTHER THAN INCOME	<u>\$16,613</u>	<u>\$0</u>	<u>\$16,613</u>	<u>\$0</u>	<u>\$16,613</u>	<u>(\$2,424)</u>	<u>\$14,189</u>
6 INCOME TAXES	<u>\$6,635</u>	<u>\$0</u>	<u>\$6,635</u>	<u>\$6,162</u>	<u>\$12,797</u>	<u>(\$10,648)</u>	<u>\$2,148</u>
7 TOTAL OPERATING EXPENSES	<u>\$290,037</u>	<u>\$0</u>	<u>\$290,037</u>	<u>(\$30,590)</u>	<u>\$259,447</u>	<u>(\$13,072)</u>	<u>\$246,374</u>
8 OPERATING INCOME	<u>\$60,157</u>	<u>\$0</u>	<u>\$60,157</u>	<u>\$30,590</u>	<u>\$90,747</u>	<u>(\$40,787)</u>	<u>\$49,960</u>
9 RATE BASE	<u>\$342,578</u>		<u>\$359,897</u>		<u>\$466,974</u>		<u>\$466,974</u>
10 RATE OF RETURN	<u>17.56%</u>		<u>16.72%</u>		<u>19.43%</u>		<u>10.70%</u>

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DATE: JANUARY 20, 2000

**COMMERCIAL UTILITIES
ADJUSTMENTS TO OPERATING INCOME
YEAR ENDED 12/31/98**

**SCHEDULE NO. 3-B
DOCKET NO. 991902-SU**

EXPLANATION	WASTEWATER
<u>OPERATING REVENUES</u>	<u>\$0</u>
<u>OPERATION & MAINTENANCE EXPENSE</u>	
Remove payments to JEA for intangible assets	<u>(\$49,446)</u>
<u>DEPRECIATION EXPENSE-NET</u>	<u>\$0</u>
<u>AMORTIZATION EXPENSE</u>	
Per Order No. PSC-93-0233-FOF-WS	<u>\$12,694</u>
<u>TAXES OTHER THAN INCOME</u>	
RAFs on revenue adjustments above	<u>\$0</u>
<u>INCOME TAXES</u>	
To adjust to test year income tax expense	<u>\$6,162</u>