

State of Florida



Public Service Commission

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

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DIVISION OF RECORDS AND REPORTING

**DATE:** FEBRUARY 3, 2000

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

**FROM:** DIVISION OF LEGAL SERVICES (FUDGE, GERVASI)  
DIVISION OF WATER AND WASTEWATER (WILLIS, MERCHANT)

**RE:** DOCKET NO. 951056-WS - APPLICATION FOR RATE INCREASE IN  
FLAGLER COUNTY BY PALM COAST UTILITY CORPORATION.

**AGENDA:** 02/15/2000 - REGULAR AGENDA - INTERESTED PERSONS MAY  
PARTICIPATE

**CRITICAL DATES:** NONE

**SPECIAL INSTRUCTIONS:** NONE

**FILE NAME AND LOCATION:** S:\PSC\LEG\WP\951056.RCM

CASE BACKGROUND

Palm Coast Utility Corporation (PCUC) provides water and wastewater service to the public in Flagler County. Palm Coast is located in a critical use area as designated by the St. Johns River Water Management District (SJRWMD). During the twelve months ending December 31, 1994 (the historical test year), the utility recorded operating revenues of \$5,007,702 for water service and \$2,951,217 for wastewater service. During the same period, Palm Coast reported a net operating loss of \$2,247 for water and net operating income of \$281,533 for wastewater.

On December 27, 1995, the utility filed an application for increased rates pursuant to Sections 367.081 and 367.082, Florida Statutes. The utility satisfied the Minimum Filing Requirements (MFRs) for a rate increase on February 12, 1996 and that date was designated as the official filing date pursuant to Section 367.083, Florida Statutes.

DOCUMENT NUMBER-DATE

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FPSC-RECORDS/REPORTING

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By Order No. PSC-96-0493-FOF-WS, issued April 9, 1996, (Interim Order) the Commission approved interim rates for PCUC based upon a historic test year, designed to generate \$5,491,319 in annual water revenues and \$3,432,636 in annual wastewater revenues, subject to refund with interest. This represents a \$483,617 (9.66%) increase over water test year revenues, and a \$481,419 (16.31%) increase over wastewater test year revenues.

A prehearing was held in Tallahassee on June 20, 1996. The hearing was held in Palm Coast on July 1 and 2, 1996 and concluded in Tallahassee on July 19, 1996. The Office of Public Counsel (OPC), Dunes Community Development District, and Flagler County intervened in this docket.

On November 7, 1996, the Commission issued Order No. PSC-96-1338-FOF-WS (Final Order). On November 22, 1996, PCUC filed a timely Motion for Reconsideration (Motion) and a Request for Oral Argument. On December 2, 1996, OPC filed its timely response to PCUC's motion and request. On January 24, 1997, PCUC filed an additional Request for Oral Argument and an Amended Motion for Reconsideration or, Alternatively, Motion to Correct Computational Errors (Amended Motion). On January 31, 1997, OPC filed its response to PCUC's Amended Motion. On February 26, 1997, PCUC filed its Second Amended Motion for Reconsideration or, Alternatively, Amended Motion to Correct Computational Errors. OPC filed its response to this Second Amended Motion on March 3, 1997.

By Order No. PSC-97-0388-FOF-WS, issued on April 7, 1997, (Reconsideration Order) the Commission granted in part and denied in part PCUC's Motion for Reconsideration, denied PCUC's Amended and Second Motions for Reconsideration and denied the requests for oral argument. As a result of this order, PCUC was ordered to refund a percentage of the interim water and wastewater revenues and lower certain water rates and all wastewater rates.

On April 11, 1997, PCUC filed its Motion for Stay Pending Judicial Review. By Order No. PSC-97-0655-FOF-SU, issued June 9, 1997, the Commission granted PCUC's Motion for Stay of Orders Nos. PSC-96-1338-FOF-WS and PSC-97-0388-FOF-WS, which required: PCUC to decrease certain water rates and all wastewater rates charged to customers; refund a percentage of interim revenues; and the filing of additional security.

On August 12, 1997, PCUC appealed the Final Order issued November 7, 1996. On May 10, 1999, the First District Court of Appeal issued its opinion on review of the Final Order. Palm Coast Utility Corporation v. FPSC, 24 Fla. L. Weekly D1182a (Fla 1st DCA

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May 10, 1999). Among other things, the Court reversed and remanded for further proceedings on the issues of fire flow, lot count methodology, annual average daily flow, margin reserve, and imputation of CIAC. The Court remanded these issues to the Commission.

The Commission filed a Motion for Clarification on May 25, 1999, to determine whether further evidentiary proceedings were permissible on remand. The court issued a corrected opinion on October 14, 1999. See Palm Coast Utility Corporation v. State, Pub. Serv. Comm'n, 742 So. 2d 482 (Fla. 1st DCA 1999). In that opinion, the court reversed and remanded for further proceedings, including the introduction of additional evidence on the issue of lot county methodology, fire flow allowance, and annual average daily flow.

On August 5, 1996, the Flagler County Board of County Commissioners (Flagler County or the County) met and adopted Resolution No. 96-62 rescinding Commission jurisdiction in Flagler County effective immediately. Although that resolution was acknowledged in Order No. PSC-96-1391-FOF-WS, issued November 20, 1996, Section 367.171(5) states that "[w]hen a utility becomes subject to regulation by a county, all cases in which the utility is a party then pending before the commission, or in any court by appeal from any order of the commission, shall remain within the jurisdiction of the commission or court until disposed of." Therefore, the Commission still has jurisdiction over Docket No. 951056-WS now before this Commission on remand.

This recommendation addresses only what action the Commission should take on the Court's reversal and remand of the Commission's Final Order on: what methodology should be used in calculating the used and useful percentages for the water distribution and wastewater collection systems; whether to approve a fire flow allowance; and what flows should be used in the numerator of the used and useful equation. Additionally, this recommendation addresses the action the Commission should take on the margin reserve period for the wastewater plant and the correct service availability charge that should be used to impute CIAC on margin reserve.

At the January 18, 2000 Agenda Conference, the Commission ordered PCUC to increase the original appeal bond to the amount of \$1,633,122 to cover the total potential refund.

**DISCUSSION OF ISSUES**

**ISSUE 1:** In light of the decision and mandate of the First District Court of Appeal, what action should the Commission take regarding the Courts reversal and remand of portions of Order No. PSC-96-1338-FOF-WS, issued November 7, 1996?

**RECOMMENDATION:** The Commission should reopen the record for the very limited purpose of taking evidence on what methodology should be used in calculating the used and useful percentages for the water distribution and wastewater collection systems; whether to approve a fire flow allowance; and what flows should be used in the numerator of the used and useful equation. If the Commission does reopen the record to take evidence on these issues, staff believes that the additional issue of rate case expense for reopening the record can be considered at that time. The Commission should not reopen the record on the margin reserve period for the wastewater plant and instead should adopt a three year margin reserve period which was supported by the testimony of staff witness Amaya. Furthermore, the Commission should, in accordance with the Court's mandate, correct the service availability charge used to impute CIAC on margin reserve. (FUDGE, WILLIS, MERCHANT)

**STAFF ANALYSIS:**

**LOT COUNT METHODOLOGY**

In its opinion, the First DCA reversed the portion of Order No. PSC-96-1338-FOF-WS, issued November 7, 1996, in this docket (Final Order), which utilized "the 'lot count' methodology in determining that portion of Palm Coast's water transmission and distribution system and its wastewater gravity mains which are deemed used and useful in the public service." In the Final Order, the Commission acknowledged its departure from a previous policy of using a ratio of ERCs to lots in its used and useful calculation. Final Order at 40. The ratio of ERCs to lots method of calculating used and useful takes into consideration the residential flows with respect to some lots, as well as significantly higher flows with respect to commercial lots. Final Order at 39.

The *lot count methodology* used by the Commission takes the ratio of lots connected to lots served. The Commission stated that

[w]e also believe that the size of the lines is the primary difference between a system which is sized to serve residential only customers and one which will serve

high demand commercial areas. We agree with the conclusions of Mr. Bidy and Ms. Amaya that the fairest way to allocate the cost of the distribution lines is by taking the ratio of lots connected to lots served.

Final Order at 39-40.

Mr. Bidy testified that the "lot count" method allocates the water main costs evenly to all customers, after engineers have properly designed the whole system. (Bidy p. 9). Ms. Amaya testified that

I believe it is appropriate to compare lots connected to lots available, not ERCs connected to lots available. It would be necessary to either convert the number of lots connected to lots available in order to compare "apples to apples."

The court reversed the Commission's use of the "lot count" methodology, holding that the record lacked an adequate basis for the change in methodology; and remanded with directions that the Commission provide explanation with record support, for the change in methodology.<sup>1</sup>

#### FIRE FLOW ALLOWANCE

Palm Coast also appealed the Commission's refusal to continue a fire flow allowance for the wells, even though an allowance for fire flow for the well, water treatment, and storage facility was previously granted. The Commission stated that such an allowance, from an engineering design perspective, was not cost effective. Again, the court held that such a decision was a departure by the Commission of its previous treatment of Palm Coast, which was not justified on the record. Accordingly, the court reversed and remanded for further proceedings, including the introduction of additional evidence, on the issue.

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<sup>1</sup>In Southern States Utils. v. Florida Public Service Comm'n, 714 So.2d 1046, 1056 (Fla. 1st DCA 1998), the Court noted that, "[i]n prior cases, the PSC expressly rejected arguments that the lot count method was appropriate for determining used and useful percentages of investment in distribution and collection systems serving mixed use areas. The court stated that the testimony of Mr. Bidy "affords no support for abandoning prior practice in favor of a change to the lot count method for systems serving mixed use developments." Id. at 1057, n.8.

ANNUAL AVERAGE DAILY FLOW

This Commission has attempted to depart from the peak month average and substitute the lower annual average daily flow to calculate "used and useful" property. See Florida Cities Water Co. v. State, Pub. Serv. Comm'n, 705 So.2d 620 (Fla. 1st DCA 1998); Southern States Utils. v. Florida Pub. Serv. Comm'n, 714 So.2d 1046 (Fla 1st DCA 1998); Palm Coast Utility Corporation v. State, Pub. Serv. Comm'n, 24 Fla. L. Weekly D2269 (Fla. 1st DCA October 14, 1999). Using the AADF represents a departure from published regulatory philosophy<sup>2</sup>, which the court has consistently held must be supported "by expert testimony, documentary opinion, or other evidence appropriate to the nature of the issue involved." Manasota-88, Inc. v. Gardinier, Inc., 481 So.2d 948, 950 (Fla. 1st DCA 1986); see also Florida Cities, 705 So.2d at 625 (finding that disregarding the peak month average and substituting the lower annual average daily flow figures represented a departure from established agency rate-making policy. The court held that "[n]o newly promulgated rule necessitated, authorized, or justified such a policy change." Id. at 625).

The use of AADF, as opposed to a three-month average daily flow, was precipitated because the Department of Environmental Protection (DEP) changed its method of permitting. Originally, the DEP had permitted wastewater treatment plants without designating whether the capacity was based on AADF or ADFMM, or some other flow. Staff generally found that the DEP permit was based upon ADFMM, and used that flow criteria in the numerator.

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<sup>2</sup>See Florida Cities, 705 So.2d at 625, stating that "[t]he use of average daily flow in the maximum month to calculate how much treatment capacity is "used and useful" in a wastewater rate case had been repeatedly articulated as the PSC's policy." See In re Application of Indian River Utils., Inc., 96 F.P.S.C. 2:695 (1996); In re Application of Poinciana Utils., Inc., 94 F.P.S.C. 9:349, 353 (1994) (average daily flow during maximum month used to determine wastewater plant used and useful); In re Application of Gen. Dev. Utils., Inc., 93 F.P.S.C. 7:725, 742-744 (1993) (average day demand of the maximum month used to calculate used and useful); In re Application Florida Cities Water Co. (Golden Gate Division), 92 F.P.S.C. 8:270, 291 (1992) (wastewater plant 100% used and useful since it was operating above rated design capacity during maximum flow periods); In re Application of Florida Cities Water Co. (South Ft. Myers Sys.), 92 F.P.S.C. 4:547, 551-552 (1992).

The DEP permit issued for PCUC's wastewater plant stated the time frame associated with the permitted capacity in terms of AADF. Based on this change, staff recommended, and the Commission approved, the use of AADF in the numerator. Other than the permit itself, there was no evidence as to what flows should be used in the numerator of the used and useful fraction when the permit was issued based on AADF.

The First DCA stated that "[t]he use of annual average daily flow was another departure from the Commission's previous practices." The court stated that "we have previously held that the fact that the Department of Environmental Protection has changed the language used on its permits is an insufficient basis by itself for a departure from the previous methodology employed by the Commission." Accordingly, the court reversed and remanded as required under § 120.68, F.S., which provides:

(7) The court shall remand a case to the agency for further proceedings consistent with the court's decision or set aside agency action, as appropriate, when it finds that:

....

(e) The agency's exercise of discretion was:

....

3. Inconsistent with officially stated agency policy or a prior agency practice, if deviation therefrom is not explained by the agency ....

#### MARGIN RESERVE

In the Order, the Commission allowed a margin reserve period of only eighteen months for the wastewater treatment facility. The court held that basing the margin reserve "only on the time required to construct a treatment facility, without considering the pre-construction period needed for design and permitting, the Commission departed from its prior practice" and without record support. The court went on to hold that "no competent, substantial evidence in the record supports an 18-month margin reserve period." Therefore, the court reversed and remanded "for the determination of the margin reserve allowance for the wastewater treatment plant based upon competent substantial evidence in the record."

The court recognized that there was testimony in the record by staff witness Amaya, and a utility witness, that the margin reserve period should be three years and five years, respectively. Since this is the only testimony in the record, and the court did not permit the Commission the discretion to reopen the record on this issue, the options available to the Commission are to accept either a three year or five year margin reserve period. Staff recommends that the Commission adopt the three years proposed by staff witness Amaya in her testimony. Although new law Chapter 99-319, amending § 367.081, Florida Statutes, would allow a "margin reserve" period of five years or more. However, the law does not apply to this docket, because it became effective after the filing of this docket. Moreover, since PCUC has come under the jurisdiction of Flagler County, PCUC would be unable to file a limited proceeding immediately following the disposition of this docket.

IMPUTATION OF CIAC ON MARGIN RESERVE

In the Final Order, the Commission used the utility's proposed service availability charges to impute CIAC against the margin reserve. However, in a separate docket 21 days after the rate case decision was made, the Commission changed the utility's proposed charge for the wastewater plant capacity charge. Although the Commission believed it could not take notice of this other decision because it was not in the record; the Court stated that "the Commission is certainly capable of taking notice of its own orders." Accordingly, staff believes that the Commission should correct the charge for wastewater to the charge approved in Order No. PSC-96-1430-FOF-WS, issued on November 21, 1996.

REVENUE REQUIREMENT

Staff has recalculated the revenue requirement for the wastewater system to reflect a three-year margin reserve on the wastewater treatment plant and to correct the service availability charge to impute on the margin reserve. Staff's recommended revenue requirement is shown below and is compared to the final amount approved in the reconsideration order.

<b>Wastewater</b>	<u>Reconsid- eration Order</u>	<u>Staff Recomm. on Remand</u>	<u>Difference</u>
Revenue Requirement	\$3,186,512	\$3,241,607	\$55,095
\$ Increase	\$(100,693)	\$(45,598)	\$55,095
% Increase	-3.06%	-1.39%	1.73%



Pending the appeal of the Final and Reconsideration Orders, PCUC continued to collect the interim rates granted by Order No. PSC-96-0493-FOF-WS, issued on April 9, 1996. Since these interim rates are higher than either the final rates or the rates that would be implemented based on staff's revised revenue requirement on remand, no surcharge will be required. Further, there will still be an interim refund for both water and wastewater based on staff's revised revenue requirement. A comparison of the revenue requirement for refund purposes and the interim revenue requirement follows.

	Staff Recommended Revenue Requirement for <u>Refund Purposes</u>	Interim Revenue <u>Requirement</u>	% <u>Refund</u>
<b>Water</b>			
Revenue Requirement	\$5,326,232	\$5,491,319	
\$ Increase/(Decrease)	\$(74,132)	\$483,617	
% Increase/(Decrease)	-1.37%	9.66%	<u>9.66%</u>
<b>Wastewater</b>			
Revenue Requirement	\$3,192,488	\$3,432,636	
\$ Increase/(Decrease)	\$(94,717)	\$481,419	
% Increase/(Decrease)	-2.88%	16.31%	<u>16.31%</u>

Remand of the First DCA

In the corrected opinion issued on September 28, 1999, the court made it clear that on remand the Commission could conduct further proceedings, including the introduction of additional evidence, on the issues of lot count methodology, fire flow allowance, and annual average daily flow.

Therefore, staff believes that the opinion of the First DCA allows for the reopening of the record. Even though this recommendation supports the notion that the record can be reopened for a very limited purpose, it is important to note that the Commission also has the discretion to decide not to reopen the record, while recognizing its ability to do so.

Options Available To The Commission

Staff believes that the Commission should be aware of the two main options available to the Commission: (1) it may decline to reopen the record and adopt the positions advocated PCUC: use a ratio of ERCs to lots available; grant a fire flow allowance for the wells; and use 3MMADF in the numerator of the used and useful equation; or (2) it may reopen the record and have the parties put on testimony on these issues.

Option 1 has the advantage that it would be quicker and would almost certainly be upheld by the First DCA. However, staff believes that it is wrong to calculate used and useful with this mismatch. Also, staff is concerned that in subsequent rate cases, utilities may cite this case as precedent that the correct flows to use in the numerator would be 3MMADF even when evidence to the contrary is presented. Staff does not believe that the Commission should accept 3MMADF in the numerator if it believes that another flow might be correct. Therefore, staff recommends that the Commission reject this option.

Staff believes that the Commission should adopt Option 2. It has the disadvantage that it would take longer to reopen the record and conduct a further evidentiary proceeding. However, it has the advantage of allowing the Commission to consider the evidence regarding the issues in dispute, before deciding on the issues.

Therefore, staff recommends that the Commission reopen the record for the very limited purpose of taking testimony on: calculating the used and useful percentages for the water distribution and wastewater collection systems; whether to grant a fire flow allowance; and what flows should be used in the numerator of the used and useful equation.

If the Commission does reopen the record to take evidence on these issues, staff believes that the additional issue of rate case expense for reopening the record can be considered at that time. Also, it should be noted that the resulting rate bases, operating and maintenance expenses, revenue requirements, rates, and interim refunds are fall out issues dependent upon the resolution of the used and useful issues.

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**ISSUE 2:** Should this docket be closed?

**RECOMMENDATION:** No, the docket should remain open pending final disposition of the remand. (FUDGE)

**STAFF ANALYSIS:** Pending the final disposition of the remand, the docket should remain open.