

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: April 24, 2008

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Bulecza-Banks, Fletcher, Kyle, Maurey)
Office of the General Counsel (Jaeger, Young)

RE: Docket No. 080024-WS – Application for limited proceeding rate increase in Sumter County by Continental Utility, Inc.
County: Sumter

CRAA *BS* *JOL* *ALM* *192*

AGENDA: 05/06/08 – Regular Agenda – All Issues Proposed Agency Action Except Issue 3 – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Argenziano

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\080024.RCM.DOC

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Case Background

Continental Utility, Inc. (Continental or utility) is a Class B water and wastewater utility located in Sumter County serving approximately 800 individual residential customers and approximately 100 customers in a master-metered condominium building. Continental is wholly owned by Continental Country Club Residents Organization (CCCRO), whose members constitute the utility's customer base. The utility's 2006 annual report reflects wastewater operating revenues of \$228,845 and wastewater operating income of \$31,774.

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The utility's last rate proceeding was in Docket No. 910093-WS, which culminated in Proposed Agency Action Order No. 25347, dated November 14, 1991.¹ Subsequently, two amendatory orders were entered, 25347-A and 25347-B, on January 8, 1992 and February 12, 1992, respectively. Continental's wastewater rates were last adjusted on February 14, 1997, as a result of a Price Index Application.

On January 7, 2008, the utility filed its application for a limited proceeding pursuant to Section 367.0822, Florida Statutes (F.S.). The utility has filed for a limited proceeding in order to recover the costs of rehabilitating seven wastewater lift stations. Staff has determined that the utility met the filing requirements of Rule 25-30.445, Florida Administrative Code (F.A.C.), and established an official filing date of January 7, 2008. The Commission has jurisdiction pursuant to Section 367.0822, F.S.

¹ In re: Request for rate increase in Sumter County by Continental Utility, Inc.

Discussion of Issues

Issue 1: What is the appropriate increase in revenues for this utility?

Recommendation: The appropriate increase in wastewater revenues should be \$46,332, or 20.25%. (Kyle)

Staff Analysis: In January, 2007 the utility commissioned an engineering evaluation of its seven lift stations to recommend necessary repairs to rehabilitate the system. An inspection and evaluation was performed and completed by Booth, Ern, Straughan & Hiott, Inc. (BESH) and summarized in their report dated February 2007, a copy of which was included in the utility's filing. On June 7, 2007, a contract with Utility Technicians, Inc. was signed for rehabilitation of all seven lift stations at a cost of \$354,452. The total project was completed by the end of 2007. A copy of the contract and the scope of work performed at each lift station was included in Continental's filing. In response to a staff data request, the utility provided evidence that it solicited bids for the rehabilitation project, and that the bid submitted by Utility Technicians, Inc. was the lowest of the three bids received.

In its application, Continental states that financing of the project was accomplished by means of a loan from CCCRO at a rate of Prime Rate plus 1%. In response to a staff data request, the utility stated that it does not have the ability to obtain financing in its own name because its assets are encumbered by a mortgage to Wachovia Bank and a refinancing of that mortgage would have incurred termination expenses approaching \$200,000. Further, the Wachovia mortgage also encumbers the assets of CCCRO and a related party. The utility asserts that funding the improvements through a loan from CCCRO is the most cost effective means available to the customers to allow recovery of the rehabilitation costs.

A customer meeting was held near the utility's service area on March 13, 2008. There were no objections to the proposed rate increases. Several customers expressed concerns about what they believed was an inequitable "bulk rate" billing arrangement with Sandalwood Condominium. The utility's responses to staff inquiries indicate that the condominium is billed in accordance with Continental's approved General Service tariff. Staff responded directly to the concerned customers and explained its findings.

In its application, the utility proposed to recover the costs of the rehabilitation project through an annual wastewater rate increase of \$48,229, or 21.08% of the wastewater revenues reported in its 2006 Annual Report. This increase was calculated using a methodology which began by applying a rate of return of 8.27% to the net increase in rate base resulting from the project over the rate base shown in the utility's 2006 Annual Report to arrive at a requested increase in operating income. The utility then added the increase in operating expenses resulting from the project and grossed the total up for the effect of the regulatory assessment fees to arrive at the requested increase in revenues. Staff believes that the utility's methodology is a reasonable approach, but has made adjustments to the calculation of the rate of return as described later in this recommendation. The utility's calculations and staff's recommended adjustments are reflected in the following table:

	Utility Request	Staff Recommendation
Increase in new utility plant	\$354,452	\$354,452
Retirement of utility plant	<u>-125,619</u>	<u>-125,619</u>
	<u>228,833</u>	<u>228,833</u>
Accumulated Depreciation:		
Depreciation on new plant	-18,894	-18,894
Adjust depreciation for retirement	<u>125,619</u>	<u>125,619</u>
	<u>106,725</u>	<u>106,725</u>
Total increase in rate base	\$335,558	\$335,558
Rate of return	<u>8.27%</u>	<u>7.73%</u>
Increase in operating income	<u>27,751</u>	<u>25,939</u>
Increase in operating expenses:		
Depreciation expense on new plant additions	18,894	18,894
Depreciation expense on plant retired	<u>-5,025</u>	<u>-5,025</u>
Net increase in depreciation expense	13,870	13,870
Increase in property taxes	4,439	4,439
Total increase in operating expenses	<u>18,308</u>	<u>18,308</u>
Total increase in operating income and expenses	46,059	44,247
Divide by factor for Regulatory Assessment Fees	<u>0.955</u>	<u>0.955</u>
Total increase in revenue required	<u>\$48,229</u>	<u>\$46,332</u>

Continental provided schedules to support the amounts shown in its requested revenue increase. Staff reviewed these schedules and believes that they are reasonable, with the exception of the utility's calculation of rate of return. In its application, the utility stated that its return on equity was 12.07%. In response to a staff data request, the utility stated that there was an apparent typographical error in its submitted schedule, and that the correct amount should be 12.01%, using the current leverage formula. Staff notes that the current leverage formula

imposes a cap of 11.40% for mid-point cost of equity for utilities with an equity ratio of less than 40%. Staff calculated Continental's equity ratio as 17.75%. Accordingly, staff believes that the appropriate cost of equity for Continental in this proceeding is 11.40%. Further, Continental used a cost rate of 8.75% for the loan from CCCRO. This is described as prime rate plus 1%. Staff notes that the prime rate as of October 1, 2007, was 7.75%. In a data request, staff asked the utility to provide a copy of a written loan agreement between the utility and CCCRO if such agreement existed. The utility's response indicated that there was no written agreement. Staff's research indicates that the prime rate as of April 2008 is 5.25%. In the absence of a written agreement specifying repayment terms, staff believes that it is appropriate to calculate the rate of return for this proceeding using an interest rate which is expected to reflect economic conditions at the time the requested increase in rates takes effect. Accordingly, staff has calculated its recommended rate of return using an interest rate of 6.25% (5.25% + 1.00%) for the CCCRO loan. Taking into consideration the above adjustments, staff recommends that the appropriate rate of return for calculation of the revenue increase is 7.73%.

In summary, staff recommends that the appropriate increase in wastewater revenues in this proceeding should be \$46,332, or 20.25% of the wastewater revenue reported in the utility's 2006 Annual Report.

Issue 2: What are the appropriate wastewater rates for Continental Utility, Inc.?

Recommendation: The recommended rates should be designed to allow the utility the opportunity to generate additional revenues of \$46,332 for wastewater service. This results in a wastewater increase of \$3.55 per month, or approximately 20.25%, for the average residential customer. The utility should be required to file revised tariff sheets and a proposed customer notice to reflect the appropriate rates. The approved rates should be effective for service rendered on or after the stamped approval date of the tariff, pursuant to Rule 25-30.475(1), F.A.C., provided the notice has been approved by staff. Within 10 days of the date the order is final, the utility should be required to provide notice of the tariff changes to all customers. The utility should provide proof the customers have received notice within 10 days after the date that the notice was sent. (Kyle)

Staff Analysis: The recommended rates requested by the utility are designed to allow the utility the opportunity to generate additional revenues of \$46,332 for wastewater service. This results in a wastewater increase of \$3.55 per month, or approximately 20.25%, for the average residential customer. The recommended rates are shown on Schedule 1.

The utility should be required to file revised tariff sheets and a proposed customer notice to reflect the appropriate rates. The approved rates should be effective for service rendered on or after the stamped approval date of the tariff, pursuant to Rule 25-30.475(1), F.A.C., provided the notice has been approved by staff. Within 10 days of the date the order is final, the utility should be required to provide notice of the tariff changes to all customers. The utility should provide proof the customers have received notice within 10 days after the date that the notice was sent.

Issue 3: Should the recommended rates be approved for the utility on a temporary basis, subject to refund, in the event of a protest filed by a substantially affected person?

Recommendation: Yes. The recommended rates should be approved for the utility on a temporary basis, subject to refund, in the event of a protest filed by a substantially affected person. Prior to implementation of any temporary rates, the utility should provide appropriate security. If the recommended rates are approved on a temporary basis, the rates collected by the utility should be subject to the refund provisions discussed below in the staff analysis. In addition, after the increased rates are in effect, pursuant to Rule 25-30.360(6), F.A.C., the utility should file reports with the Commission's Division of Economic Regulation no later than the 20th of each month indicating the monthly and total amount of money subject to refund at the end of the preceding month. The report filed should also indicate the status of the security being used to guarantee repayment of any potential refund. (Kyle)

Staff Analysis: This recommendation proposes an increase in wastewater rates. A timely protest might delay what may be a justified rate increase resulting in an unrecoverable loss of revenue to the utility.

Therefore, in the event of a protest filed by a substantially affected person, staff recommends that the recommended rates be approved as temporary rates. The recommended rates collected by the utility should be subject to the refund provisions discussed below.

The utility should be authorized to collect the temporary rates upon staff's approval of appropriate security for the potential refund and the proposed customer notice. Security should be in the form of a bond or letter of credit in the amount of \$31,430. Alternatively, the utility could establish an escrow agreement with an independent financial institution.

If the utility chooses a bond as security, the bond should contain wording to the effect that it will be terminated only under the following conditions:

- 1) The Commission approves the rate increase; or
- 2) If the Commission denies the increase, the utility shall refund the amount collected that is attributable to the increase.

If the utility chooses a letter of credit as a security, it should contain the following conditions:

- 1) The letter of credit is irrevocable for the period it is in effect; and
- 2) The letter of credit will be in effect until a final Commission order is rendered, either approving or denying the rate increase.

If security is provided through an escrow agreement, the following conditions should be part of the agreement:

- 1) No refunds in the escrow account may be withdrawn by the utility without the express approval of the Commission;

- 2) The escrow account shall be an interest bearing account;
- 3) If a refund to the customers is required, all interest earned by the escrow account shall be distributed to the customers;
- 4) If a refund to the customers is not required, the interest earned by the escrow account shall revert to the utility;
- 5) All information on the escrow account shall be available from the holder of the escrow account to a Commission representative at all times;
- 6) The amount of revenue subject to refund shall be deposited in the escrow account within seven days of receipt;
- 7) This escrow account is established by the direction of the Florida Public Service Commission for the purpose(s) set forth in its order requiring such account. Pursuant to Cosentino v. Elson, 263 So. 2d 253 (Fla. 3d DCA 1972), escrow accounts are not subject to garnishments; and
- 8) The Commission Clerk must be a signatory to the escrow agreement.
- 9) The account must specify by whom and on whose behalf such monies were paid.

In no instance should the maintenance and administrative costs associated with the refund be borne by the customers. These costs are the responsibility of, and should be borne by, the utility. Irrespective of the form of security chosen by the utility, an account of all monies received as a result of the rate increase should be maintained by the utility. If a refund is ultimately required, it should be paid with interest calculated pursuant to Rule 25-30.360(4), F.A.C.

The utility should maintain a record of the amount of the bond, and the amount of revenues that are subject to refund. In addition, after the increased rates are in effect, pursuant to Rule 25-30.360(6), F.A.C., the utility should file reports with the Commission's Division of Economic Regulation no later than the 20th of each month indicating the monthly and total amount of money subject to refund at the end of the preceding month. The report filed should also indicate the status of the security being used to guarantee repayment of any potential refund.

Docket No. 080024-WS

Date: April 24, 2008

Issue 4: Should this docket be closed?

Recommendation: If a protest is not received from a substantially affected person within 21 days of issuance of the Proposed Agency Action Order, a Consummating Order will be issued. If a Consummating Order is issued, the docket should be closed upon its issuance and upon staff's approval of the revised tariff sheets. (Jaeger)

Staff Analysis: If a protest is not received from a substantially affected person within 21 days of issuance of the Proposed Agency Action Order, a Consummating Order will be issued. If a Consummating Order is issued, the docket should be closed upon its issuance and upon staff's approval of the revised tariff sheets.

Continental Utility, Inc.
 Schedule of Present and Recommended Rates

Schedule 1

	<u>Present Rates</u>	<u>Recommended Increase</u>	<u>Recommended Rates</u>
<u>Residential</u>			
<u>Base Facility Charges</u>			
5/8" x 3/4"	\$8.06	\$1.63	\$9.69
Gallonage Charge-per 1,000 gallons (Maximum 6,000 gallons)	\$2.44	\$0.49	\$2.93
<u>General Service</u>			
<u>Base Facility Charges</u>			
5/8" x 3/4"	\$8.06	\$1.63	\$9.69
1"	\$20.15	\$4.08	\$24.23
1 1/2"	\$40.29	\$8.16	\$48.45
2"	\$64.48	\$13.06	\$77.54
3"	\$128.95	\$26.11	\$155.06
4"	\$201.48	\$40.80	\$242.28
6"	\$402.94	\$81.60	\$484.54
Gallonage Charge-per 1,000 gallons	\$2.92	\$0.59	\$3.51

Typical Residential Bills, 5/8" x 3/4" Meter Customers

	<u>Rates Prior to Filing</u>	<u>Staff Recommended Rates</u>
3,000 Gallons	\$15.38	\$18.48
5,000 Gallons	\$20.26	\$24.34
6,000 or more Gallons	\$22.70	\$27.27

(Wastewater Gallonage Cap – 6,000 Gallons)