

State of Florida



Public Service Commission

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-M-E-M-O-R-A-N-D-U-M-

DATE: August 19, 2010

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Deason, Cicchetti, Davis, Fletcher, Maurey)
Office of the General Counsel (Crawford) *SC MC CD BF ALM*

RE: Docket No. 100149-WU – Application for increase in water rates in Lee County by Ni Florida, LLC. *JC*

AGENDA: 08/31/10 – 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: Brisé

CRITICAL DATES: 08/31/10 (60-Day Suspension Date)

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\100149.RCM.DOC *(M)*

Case Background

Ni Florida, LLC (Ni Florida or Utility) is a Class A utility providing water service to approximately 745 customers in Lee County. Water rates were last established for this Utility in 1992.¹ Rate Base was last established in 2009.²

¹ See Order No. PSC-92-0807-FOF-WS, issued August 11, 1992, in Docket No. 910560-WS, In re: Application for Approval of rate increase in Lee County by Tamiami Village Utility, Inc.

² See Order No. PSC-09-0260-PAA-WU, issued April 27, 2009, in Docket No. 080183-WU, In re: Joint application for approval of transfer of Tamiami Village Utility, Inc's water system and Certificate No. 388-W in Lee County to Ni Florida, LLC.

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Docket No. 100149-WU
Date: August 19, 2010

On June 22, 2010, Ni Florida filed its application for a rate increase at issue in the instant docket. The Utility's application did not meet the minimum filing requirements (MFRs). By letter dated July 22, 2010, Ni Florida was notified that the MFRs were deficient. Ni Florida corrected the deficiencies through information submitted on July 28, 2010. The Utility requested that the application be processed using the Proposed Agency Action (PAA) procedure and requested interim rates. The test year established for interim and final rates is the 13-month average period ended December 31, 2009.

Ni Florida requested an interim revenue increase of \$159,475 (or 72.44 percent). The Utility requested a final revenue increase of \$191,525 (or 87.0 percent).

The original 60-day statutory deadline for the Commission to suspend Ni Florida's requested final rates was August 23, 2010. However, by letter dated June 23, 2010, Ni Florida agreed to extend the statutory time frame through August 31, 2010. This recommendation addresses the suspension of Ni Florida'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 water rates be suspended?

Recommendation: Yes. Ni Florida's proposed final water rates should be suspended. (Deason)

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 from the official date of filing if: (1) the Commission has not acted upon the requested rate increase; or (2) if 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 further investigation of this information, including on-site investigations by staff accountants and engineers, is warranted. Based on the foregoing, staff recommends that the Utility's proposed final rate increase be suspended.

Issue 2: Should any interim revenue increase be approved?

Recommendation: Yes, Ni Florida should be authorized to collect annual water revenues as indicated below:

	<u>Adjusted Test Year Revenues</u>	<u>\$ Increase</u>	<u>Revenue Requirement</u>	<u>% Increase</u>
Water	\$220,716	\$117,668	\$338,385	53.31%

(Deason)

Staff Analysis: Ni Florida has filed rate base, cost of capital, and operating statements to support its requested interim increase in water rates. Pursuant to Section 367.082(1), F.S., in order to establish a prima facie entitlement for interim relief, the Utility shall demonstrate that it is earning outside the range of reasonableness on its rate of return. Pursuant to Section 367.081(2)(a), F.S., in a proceeding for an interim increase in rates, the Commission shall authorize, within 60 days of the filing for such relief, the collection of rates sufficient to earn the minimum of the range of rate of return. Based on the Utility's filing and the recommended adjustments below, staff believes that the Utility has demonstrated its prima facie entitlement in accordance with Section 367.082(1), F.S.

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 Ni Florida's interim request, as well as Order No. PSC-09-0260-PAA-WU, in which the Commission last established 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. Rate base is labeled as Schedule No. 1-A, with adjustments shown on Schedule No. 1-B. Capital structure is labeled as Schedule No. 2. Operating income is labeled as Schedule No. 3-A, with adjustments shown on Schedule No. 3-B.

RATE BASE

Ni Florida included adjustments to increase water plant by \$173,478 for the replacement of meters, meter boxes and lids, and updated piping. Pursuant to Section 367.082(5)(b)1, F.S., the only adjustments that should be made to the interim test year are those consistent with the most recent individual rate proceeding or adjustments to annualize rate changes occurring during the interim test year. Staff believes the Utility's proposed adjustments are pro forma in nature because they are beyond the interim test year. As such, staff recommends that Ni Florida's pro forma plant adjustments above be removed from the interim rate base calculation. Therefore, staff recommends that Ni Florida's interim water rate base should be \$82,740.

COST OF CAPITAL

For purposes of its interim request, Ni Florida used a return on equity (ROE) of 9.24 percent and an overall cost of capital of 7.06 percent.³ Pursuant to Section 367.082(2)(a), F.S., the appropriate ROE for purposes of determining an interim rate increase is the minimum of the Utility's currently authorized ROE range. Ni Florida's authorized ROE was set at 11.22 percent in its last rate case.⁴ However, Ni Florida was transferred in April 2009.⁵ The ROE does not survive a transfer.⁶ The Utility has an equity ratio of 100 percent as a percentage of investor sources of capital. Pursuant to Sections 367.081(4)(f) and 367.082(5)(b)3, F.S., staff used the Commission's current leverage formula to determine the appropriate ROE for purposes of this docket. Based on the current Commission leverage formula⁷ and an equity ratio of 100 percent, the indicated ROE is 8.82 percent. With a range of plus or minus 100 basis points, the appropriate ROE for purposes of determining interim rates is 7.82 percent and the resulting overall cost of capital is 7.71 percent.⁸

NET OPERATING INCOME

Based on its review, staff recommends an adjustment to operating revenues. Staff has increased operating revenues by \$570 to reflect the appropriate amount of annualized revenues.

Additionally, staff recommends an adjustment to operating expenses. Ni Florida included adjustments to increase water expenses by \$12,984 for contract operators, uncollectible accounts, bad debt expense, and purchased water. Pursuant to Section 367.082(5)(b)1, F.S., the only adjustments that should be made to the interim test year are those consistent with the most recent individual rate proceeding or adjustments to annualize rate changes occurring during the interim test year. Staff believes the Utility's proposed adjustments are pro forma in nature because they are beyond the interim test year. As such, staff recommends that Ni Florida's pro forma expense adjustments be removed from the interim net operating income calculation.

Based on the above, staff recommends that the appropriate test year operating loss, before any revenue increase, is \$105,991.

³ The Utility's interim filing contained an error in the calculation of the requested overall cost of capital for interim purposes. Based upon the Utility's capital structure for the period ended December 31, 2009, by operation of math the overall cost of capital should have been 9.22 percent, not the 7.06 percent reflected in its filing.

⁴ See Order No PSC-92-0807-FOF-WS.

⁵ See Order No. PSC-09-0260-PAA-WU.

⁶ See Order Nos. PSC-07-0325- FOF-WS, issued April 16, 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., PSC-06-0925-PCO-WS, issued November 6, 2006, in Docket No. 060246-WS, In re: Application for increase in water and wastewater rates in Polk County by Gold Coast Utility Corp., PSC-06-0675-PCO-SU, issued August 7, 2006, in Docket No. 060255-SU, In re: Application for increase in wastewater rates in Pinellas County by Tierra Verde Utilities, Inc.

⁷ See Order Nos. PSC-10-0401-PAA-WS, issued June 18, 2010, and PSC-10-0446-CO-WS, issued July 13, 2010, in Docket No. 100006-WS, In re: Water and wastewater industry annual reestablishment of authorized range of return on common equity for water and wastewater utilities pursuant to Section 367.081(4)(f), F.S.

⁸ The 7.71 percent return represents a one hundred fifty-one basis point reduction of the Utility's corrected overall cost of capital of 9.22 percent.

REVENUE REQUIREMENT

Based on the above adjustments, staff recommends a revenue requirement of \$338,385. This represents an interim increase in annual revenues of \$117,668 (or 53.31 percent). This increase will allow the Utility the opportunity to recover its operating expenses and earn a 7.71 percent return on its rate base.

Issue 3: What are the appropriate interim water rates?

Recommendation: The water service rates for Ni Florida in effect as of December 31, 2009, should be increased by 53.55 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 has been filed. The Utility should provide proof of the date notice was given within 10 days after the date of notice. (Deason)

Staff Analysis: Staff recommends that interim water service rates for Ni Florida be designed to allow the Utility the opportunity to generate annual operating revenues of \$338,385. Before removal of miscellaneous revenues, this would result in an increase of \$117,668 or 53.31 percent. To determine the appropriate percentage increase to apply to the service rates, miscellaneous service revenues should be removed from the test year revenues. The calculation is as follows:

	<u>Water</u>
1 Total Test Year Revenues	\$220,716
2 Less: Miscellaneous Revenues	<u>995</u>
3 Test Year Revenues from Service Rates	\$219,721
4 Revenue Increase	\$117,668
5 % Service Rate Increase (Line 4/Line3)	<u>53.55%</u>

The interim rate increase of 53.55 percent should be applied as an across-the-board increase to the service rates in effect as of December 31, 2009. 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's 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 Schedule No. 4.

Issue 4: What is the appropriate security to guarantee the interim increase?

Recommendation: The Utility should be required to open an escrow account or file a surety bond or letter of credit to guarantee any potential refund of revenues collected under interim conditions. If the security provided is an escrow account, the Utility should deposit \$9,807 into the escrow account each month. Otherwise, the surety bond or letter of credit should be in the amount of \$68,710. 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 in accordance with Rule 25-30.360, F.A.C. (Deason, Davis)

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 \$117,668. 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 \$68,710. 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 Schedules No. 4.

The criteria for a corporate undertaking include sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. Since Ni Florida recently acquired Hudson Utility, staff used Ni Florida's PSC Annual Report for 2008 and 2009 and Hudson Utility, Inc's. Annual Report for 2007 to calculate these ratios. Ni Florida has improved equity ownership and liquidity to sufficient levels in 2009. However, the average of these measures over the most recent three-year period are not within acceptable parameters. Ni Florida reports insufficient interest coverage and net losses over the review period. Net losses have steadily increased and have averaged over \$261,000 per year. For these reasons, staff believes Ni Florida does not have the financial capability to support a corporate undertaking in the amount of \$68,710. Based on this analysis, staff recommends that Ni Florida be required to secure a surety bond, letter of credit, or escrow agreement to guarantee any potential refund of water revenues.

If the security provided is an escrow account, said account should be established between the Utility and an independent financial institution pursuant to a written escrow agreement. The Commission should be a party to the written escrow agreement and a signatory to the escrow account. The written escrow agreement should state the following: that the account is established at the direction of the Commission for the purpose set forth above; that no withdrawals of funds shall occur without the prior approval of the Commission through the Office of Commission Clerk; the account shall be interest bearing; information concerning that escrow account shall be available from the institution to the Commission or its representative at all times; the amount of revenue subject to refund shall be deposited in the escrow account within seven days of receipt; and, pursuant to Cosentino v. Elson, 263 So. 2d 253 (Fla 3d DCA 1972), escrow accounts are not subject to garnishments.

The Utility should deposit \$9,807 into the escrow account each month. The escrow agreement should also state that if a refund to the customers is required, all interest earned on the

escrow account should be distributed to the customers, and if a refund to the customers is not required, the interest earned on the escrow account should revert to the Utility.

If the security provided is a surety bond or a letter of credit, said instrument should be in the amount of \$68,710. If the Utility chooses a surety bond as security, the surety bond should state that it will be released or terminated only upon subsequent order of the Commission. If the Utility chooses to provide a letter of credit as security, the letter of credit should state that it is irrevocable for the period it is in effect and that it will be in effect until a final Commission order is rendered releasing the funds to the Utility or requiring a refund.

Regardless of the type of security provided, the Utility should keep an accurate and detailed account of all monies it receives. Pursuant to Rule 25-30.360(6), F.A.C., the Utility shall 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. Such costs are the responsibility of, and should be borne by, the Utility.

Docket No. 100149-WU
Date: August 19, 2010

Issue 5: Should the docket be closed?

Recommendation: No. The docket should remain open pending the Commission's PAA decision on the Utility's requested rate increase. (Crawford, Deason)

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

Ni Florida, LLC Schedule of Water Rate Base Test Year Ended 12/31/09			Schedule No. 1-A Docket No. 100149-WU		
Description	Test Year Per Utility	Utility Adjust- ments	Adjusted Test Year Per Utility	Staff Adjust- ments	Staff Adjusted Test Year
1 Plant in Service	\$292,084	\$173,478	\$465,562	(\$173,478)	\$292,084
2 Land and Land Rights	0	0	0	0	0
3 Non-used and Useful Components	0	0	0	0	0
4 Accumulated Depreciation	(203,862)	0	(203,862)	0	(203,862)
5 CIAC	(110,779)	0	(110,779)	0	(110,779)
6 Amortization of CIAC	105,297	0	105,297	0	105,297
7 Acquisition Adjustment	713,630	(713,630)	0	0	0
8 Working Capital Allowance	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
9 Rate Base	<u>\$796,370</u>	<u>(\$540,152)</u>	<u>\$256,218</u>	<u>(\$173,478)</u>	<u>\$82,740</u>

Ni Florida, LLC Adjustments to Rate Base Test Year Ended 12/31/09	Schedule No. 1-B Docket No. 100149-WU
Explanation	Water
<u>Plant In Service</u> To remove pro forma plant items.	<u>(\$173,478)</u>

Ni Florida, LLC Capital Structure - 13-Month Average Test Year Ended 12/31/09						Schedule No. 2 Docket No. 100149-WU			
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	\$0	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%	
2 Short-term Debt	0	0	0	0	0	0.00%	0.00%	0.00%	
3 Preferred Stock	0	0	0	0	0	0.00%	0.00%	0.00%	
4 Common Equity	713,563	0	713,563	(459,007)	254,556	76.07%	9.24%	7.03%	
5 Customer Deposits	4,660	0	4,660	(2,998)	1,662	0.50%	6.00%	0.03%	
6 Tax Credits-Zero Cost	0	0	0	0	0	0.00%	0.00%	0.00%	
7 Deferred Income Taxes	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0.00%</u>	0.00%	<u>0.00%</u>	
8 Total Capital	<u>\$718,223</u>	<u>\$0</u>	<u>\$718,223</u>	<u>(\$462,005)</u>	<u>\$256,218</u>	<u>100.00%</u>		<u>7.06%</u>	
Per Staff									
9 Long-term Debt	\$0	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%	
10 Short-term Debt	0	0	0	0	0	0.00%	0.00%	0.00%	
11 Preferred Stock	0	0	0	0	0	0.00%	0.00%	0.00%	
12 Common Equity	713,563	0	713,563	(\$635,483)	78,080	94.37%	7.82%	7.38%	
13 Customer Deposits	4,660	0	4,660	0	4,660	5.63%	6.00%	0.34%	
14 Tax Credits-Zero Cost	0	0	0	0	0	0.00%	0.00%	0.00%	
15 Deferred Income Taxes	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0.00%</u>	0.00%	<u>0.00%</u>	
16 Total Capital	<u>\$718,223</u>	<u>\$0</u>	<u>\$718,223</u>	<u>(\$635,483)</u>	<u>\$82,740</u>	<u>100.00%</u>		<u>7.71%</u>	
						LOW	HIGH		
RETURN ON EQUITY						<u>7.82%</u>	<u>9.82%</u>		
OVERALL RATE OF RETURN						<u>7.71%</u>	<u>9.60%</u>		

Ni Florida, LLC Statement of Water Operations Test Year Ended 12/31/09						Schedule No. 3-A Docket No. 100149-WU	
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>\$220,146</u>	<u>\$159,475</u>	<u>\$379,621</u>	<u>(\$158,905)</u>	<u>\$220,716</u>	<u>\$117,668</u> 53.31%	<u>\$338,385</u>
Operating Expenses							
2 Operation & Maintenance	\$314,908	\$12,984	\$327,892	(\$12,984)	\$314,908	\$0	\$314,908
3 Depreciation	1,911	10,200	12,111	(10,200)	1,911	0	1,911
4 Amortization	0	0	0	0	0	0	0
5 Taxes Other Than Income	9,863	7,176	17,039	(7,151)	9,888	5,295	15,183
6 Income Taxes	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
7 Total Operating Expense	<u>\$326,682</u>	<u>\$30,360</u>	<u>\$357,042</u>	<u>(\$30,335)</u>	<u>\$326,707</u>	<u>\$5,295</u>	<u>\$332,002</u>
8 Operating Income	<u>(\$106,536)</u>	<u>\$129,115</u>	<u>\$22,579</u>	<u>(\$128,570)</u>	<u>(\$105,991)</u>	<u>\$112,373</u>	<u>\$6,382</u>
9 Rate Base	<u>\$796,370</u>		<u>\$256,218</u>		<u>\$82,740</u>		<u>\$82,740</u>
10 Rate of Return	<u>(13.38%)</u>		<u>8.81%</u>		<u>(128.10%)</u>		<u>7.71%</u>

Ni Florida, LLC Adjustments to Operating Income Test Year Ended 12/31/09	Schedule No. 3-B Docket No. 100149-WU
Explanation	Water
<u>Operating Revenues</u>	
Remove requested final revenue increase.	(\$159,475)
To reflect the appropriate annualized revenue adjustment.	<u>570</u>
Total	<u>(\$158,905)</u>
<u>Operation and Maintenance Expense</u>	
To remove pro forma contract operator.	(\$7,100)
To remove pro forma uncollectable accounts.	(2,650)
To remove pro forma purchased water.	(443)
To remove pro forma bad debt expense.	<u>(2,791)</u>
Total	<u>(\$12,984)</u>
<u>Depreciation Expense</u>	
To remove pro forma depreciation expense.	<u>(\$10,200)</u>
<u>Taxes Other Than Income</u>	
RAFs on revenue adjustments above.	<u>(\$7,151)</u>

Ni Florida, LLC		Schedule No. 4		
Water Monthly Service Rates		Docket No. 100149-WU		
Test Year Ended 12/31/09				
	Present Rates	Utility Requested Interim	Utility Requested Final	Staff Recomm. Interim
<u>Residential Service</u>				
All meter sizes	\$13.61	\$23.93	\$25.39	\$20.90
<u>Gallage Charge, per 1,000 Gallons</u>				
RS-Gallage Charge	\$3.36	\$5.50	\$6.27	\$5.16
<u>General Service</u>				
Base Facility Charge by Meter Size:				
5/8" x 3/4"	\$11.13	\$19.57	\$20.76	\$17.09
1"	\$27.89	\$49.03	\$52.02	\$42.83
1-1/2"	\$55.76	\$98.02	\$104.01	\$85.62
2"	\$89.21	\$156.82	\$166.40	\$136.98
3"	195.18	\$343.11	\$364.07	\$299.71
4"	\$278.82	\$490.14	\$520.08	\$428.14
<u>Gallage Charge, per 1,000 Gallons</u>				
GS-Gallage Charge	\$3.36	\$5.91	-	\$5.16
<u>General Service</u>				
Base Facility Charge by Meter Size:				
3"	\$1,425.53	\$2,505.97	\$2,659.04	\$2,188.95
<u>Gallage Charge, per 1,000 Gallons</u>				
GS-Gallage Charge	\$3.54	\$6.22	\$6.60	\$5.44
<u>Typical Residential Bills 5/8" x 3/4" Meter</u>				
3,000 Gallons	\$23.69	\$40.43	\$44.20	\$36.38
5,000 Gallons	\$30.41	\$51.43	\$56.74	\$46.70
10,000 Gallons	\$47.21	\$78.93	\$88.09	\$72.49