

Dorothy Menasco

100426-WS

From: Trina Collins [TCollins@RSBattorneys.com]
Sent: Friday, May 06, 2011 11:17 AM
To: Filings@psc.state.fl.us
Cc: smlubertozzi@uiwater.com; jrstover@uiwater.com; keweeks@uiwater.com; rjdurham@uiwater.com; pcflynn@uiwater.com; jdwilliams@uiwater.com; frankdenjup@att.net; dswain@milianswain.com; Dale Buys; Reilly.steve@leg.state.fl.us; Martin Friedman; Christian W. Marcelli; Trina Collins
Subject: Filing in Docket No. 100426-WS; Application for increase in water and wastewater rates in Lake County by Lake Utility Services, Inc.

Importance: High**Attachments:** PSC Clerk 17 (Response to WSC Audit Report 11-004-4-2).ltr.pdf

- a. Martin S. Friedman, Esq.
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- b. Docket No. 100426-WS; Lake Utility Services, Inc.'s Application for increase in water and wastewater rates in Lake County, Florida - Filing the response of Lake Utility Services, Inc. to Staff's Audit Report filed on March 22, 2011.
- c. Lake Utility Services, Inc.
- d. 5 Pages.
- e. Letter to Commission Clerk and attachments - 5 pages.

DOCUMENT NUMBER-DATE

03164 MAY-6 =

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5/6/2011

LAW OFFICES
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Please Respond to the Lake Mary Office

May 6, 2011

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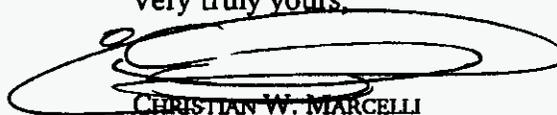
Re: Docket No. 100426-WS; Application for increase in water and wastewater rates in
Lake County by Lake Utility Services, Inc.
Our File No.: 30057.194

Dear Ms. Cole:

Enclosed for filing in the above-referenced docket is the response of Lake Utility Services, Inc. (the "Company" or "LUSI") to Audit Staff's report filed on March 22, 2011 in connection with audit control no. 11-004-4-2.

Should you or the Staff have any questions regarding this filing, please do not hesitate to give me a call.

Very truly yours,



CHRISTIAN W. MARCELLI

For the Firm

Enclosures

cc: Steven M. Lubertozi, Executive Dir. of Regulatory Accounting & Affairs (w/enclosures) (via e-mail)
John Stover, Vice President and Secretary (w/enclosures) (via e-mail)
Kirsten Weeks, Manager of Regulatory Accounting (w/enclosures) (via e-mail)
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**LAKE UTILITY SERVICES, INC. – AFFILIATED TRANSACTIONS
DOCKET NO. 100426-WS
RESPONSES TO AUDIT REPORT (Control No. 11-004-4-2)**

Audit Finding No. 1 – Expenses Recorded as Plant

The Company does not object to audit finding no. 1.

Audit Finding No. 2 – Ordered Adjustments for Project Phoenix Not Booked

The Company disagrees with audit finding no. 2 and argues for the full balance of Project Phoenix to be included at the headquarters level, with the appropriate 4.51% allocated to LUSI. It is incorrect to reduce the Phoenix balance for sold companies, as none of the Phoenix system was sold in conjunction with the divested companies. The total Phoenix balance is currently in service and benefiting current ratepayers and it is arbitrary and inappropriate to reduce the balance. Doing so guarantees that the Company will earn a subpar return on a Commission-approved investment, and the adjustment is contrary to established ratemaking principles.

The question is also raised that if the Company were to acquire customers, would the Commission allow the Company to increase its Project Phoenix balance? We are certain that such practice would not be allowed. However, the same arbitrary practice is occurring by reducing the Phoenix balance due to divestment. The Company cannot arbitrarily reduce the book value of an asset due to divestment of customers.

In addition, reducing the Phoenix balance creates an improper gain on sale situation in the amount of \$1,652,234 because it effectively “sells off” this amount of Phoenix with the sold companies. None of the Phoenix assets were included in any of the sales and the Staff’s position resulted in “stranded” assets on which the Utility will never recover. In Order No. PSC-03-1440-FOF-WS, pg. 129, in Docket No. 020071-WS, the Commission expressly states “it is clear that the courts have found that the rates paid by customers are only for the service received during a given period of time and that the rates paid by customers do not vest ratepayers with any ownership rights to property used to render service. Another compelling factor raised by witness Gower is that the customers pay rates based on original cost rather than on replacement values. We find that these are strong arguments to assign the gains to the shareholders.”

Audit Staff cited to Order No. PSC-10-0407-PAA-SU in audit finding no. 2. This Order does not apply to future filings such as the current filing. The Company believes the Commission will not make a similar adjustment in the present case because it would be in violation of Section 367.0813, Florida Statutes.

In Order No. PSC-10-0407-PAA-SU, the Commission approved a ledger balance for Phoenix of \$21,617,487. Pursuant to practice, the Commission then allocated that amount to the subsidiaries of Utilities, Inc. as of that date. However, the Commission reduced the allocable amount by the amount previously allocated to three divested systems: Miles Grant Water & Sewer Company, Utilities, Inc. of Hutchinson Island, and Wedgefield Utilities, Inc. (the “Divested Subsidiaries”). The Commission used the gains received by the shareholders on those sales to reduce the rate base of the remaining systems in violation of Section 367.0813, Florida Statutes.

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Order No. PSC-10-0407-PAA-SU states, “the amounts allocated to the divested subsidiaries were recovered by the shareholders through the sale of those systems.” This is prohibited by Section 387.0813, Florida Statutes, which states that “gains ... from a purchase ... of a utility’s assets which results in the loss of customers served by such assets and the associated future revenue streams shall be borne by the shareholders of the Utility.” Instead of the gain on sale being borne by the shareholders, the Commission’s Order No. PSC-10-0407-PAA-SU uses those gains for the benefit of the non-divested subsidiaries.

Even if the Commission believes it was not in error to capture shareholder gains for the benefit of the remaining systems, the Commission erred by alleging that the shareholders had recovered the Phoenix amounts previously allocated. The purchase and sale agreements for the divested subsidiaries clearly state that accounting and billing systems were excluded assets.¹ Shareholders do not recover the amounts allocated for the accounting and billing system when that accounting and billing system was expressly not a part of the sale. As a result, the gains captured for the benefit of the non-divested systems were not related to Project Phoenix.

Based on these facts, it is inappropriate and illegal to reduce the Project Phoenix balance. The Phoenix balance should remain as is in the filing, and no adjustments are required.

Audit Finding No. 3 – Depreciation Life of Project Phoenix

The Company disagrees with audit finding no. 3. The depreciation life established for Project Phoenix in the previous LUSI rate case, Docket No. 070693-WS, was less than ten years. To change this depreciation life would be a stark contrast to the Commission’s prior ruling on this issue with respect to LUSI, and would result in an unsettling inconsistency between successive rate cases. Staff has not stated its basis for changing Phoenix to a ten year life and rejecting the Commission’s determination in Order No. PSC-09-0101-PAA-WS. An eight year life has already been established in the previous docket and is the life used for all other computer software booked to the same account as Phoenix.

Audit Finding No. 4 – Prepaid – Other Expenses

The Company does not object to audit finding no. 4.

Audit Finding No. 5 – Short-Term Debt Cost Rate

The Company does not object to audit finding no. 5.

Audit Finding No. 6 – Salary Increase and 401K Contribution

A full salary analysis was done for the filing. That salary analysis included increases of 3.5%. Salary increases were granted on April 1, 2011. The “bucket amount” for salary increases were 3%. A second analysis should be performed as of current to annualize salaries for current employees after the April 1st salary increase. The Company will provide this analysis to Staff after the first pay period for increases is paid and recorded. This will allow Staff to have the most current salary information to date. However, for estimation purposes, a 3% increase using

¹ The purchase and sale agreements can be found at: Document ID No. 03890-09, filed April 27, 2009 in Docket No. 090232-WS and Document ID No. 09321-09, filed September 9, 2009 in Docket No. 090442-WS.

the same employees as of August 2010 has the following effect on salaries, payroll taxes, and benefits:

	Per Estimated 3%	Per Filing at 3.5%
Total Salaries	\$939,187	\$943,746
Total Payroll Taxes	\$78,163	\$78,477
Total Benefits	\$231,506	\$231,825

Audit Finding No. 7 – Salaries – Capitalized Time Charged to Plant

The Company agrees with this concept in theory, but would propose a different adjustment. First, the formula calculating pro forma capitalized time for the filing contained an error, because it only pulled annualized salaries and left out the increase planned for 2011. The Company’s proposed adjustment pulls both the annualized salary and the increase for 2011 (using 3%, since that is what the “increase bucket” was for 2011). Using these amounts, we come up with a debit adjustment to salaries charged to plant in the amount of \$36,974. See the document entitled AF 7 for support. Second, Staff’s finding is showing that only one water plant account had a project with capitalized time, therefore the Company believes that the entire water portion should go to that project accounts, and that the wastewater portion should be allocated between the three wastewater project accounts.

Effect on the general ledger – Water UPIS should be credited for \$27,800.66. Water A/D should be debited for \$1,390.03 and water depreciation expense should be credited for \$1,390.03. Wastewater UPIS should be credited for \$9,173.22. Wastewater A/D should be debited for \$454.94. Wastewater depreciation expense should be credited for \$454.94.

Effect on the filing – Water UPIS should be credited for \$25,662.15. Water A/D should be debited for \$695.02 and water depreciation expense should be credited for \$1,390.03. Wastewater UPIS should be credited for \$8,467.59. Wastewater A/D should be debited for \$227.47. Wastewater depreciation expense should be credited for \$454.94.

Audit Finding No. 8 – Prepaid Insurance - Other

The Company does not object to audit finding no. 8.

Audit Finding No. 9 – Removal of Operating Expenses

The Company does not object to audit finding no. 9.

LAKE UTILITY SERVICES, INC.
 AFFILIATE TRANSACTIONS AUDIT, DOCKET NO. 100426-WS
 RESPONSE TO AUDIT FINDING NO. 7
 SALARIES - CAPITALIZED TIME CHARGED TO PLANT

AF 7

(1)	Total Per Book Salaries	per TB	\$901,457		
(2)	Per Book Salaries for Captive Employees	per TB	<u>754,122</u>		
(3)	Percentage of Operator to Total	line (1) / line (2)	<u>84.77%</u>		
(4)	Per Book Salaries for Captive Employees	per TB	\$764,122		
(5)	Per Book Payroll Taxes for Captive Employees	per TB * line (4)	62,524		
(6)	Per Book Payroll Benefits for Captive Employees	per TB * line (4)	<u>173,243</u>		
(7)		sum, lines (4) thru (6)	<u>\$1,000,586</u>		
(8)	Per Book Capitalized Time	per TB	(\$176,709)		
(9)	Per Book Total Payroll for Captive Employees	line (7)	<u>1,000,586</u>		
(10)	Percentage of Total Payroll to Captive	line (8) / line (9) * -1	<u>17.66%</u>		
(11)	Pro Forma Captive Employee Payroll	per w/p a	\$791,227		
(12)	Percentage of Total Payroll to Captive	line (10)	<u>17.66%</u>		
(13)	Pro Forma Capitalized Time	line (11) * line (12)	<u>(\$139,735)</u>		
(14)	Per Book Capitalized Time	line 8	(176,709)		
(15)	Difference	line (14) - line (13)	<u>36,974</u>		
				Water	Wastewater
				<u>27,800.66</u>	<u>9,173.22</u>

Notes:

Captive employees include employees that are booked to JDE accounts 6120, 6135, 6140, 6150, and 6155.

Water:											
UPIIS Obj Acct	UPIIS Amount	% to Total	Reduction Amount	Years in Service	Dep Rate	A/D Obj Acct	A/D Amount	Dep Exp Obj Acct	Dep Exp Amount		
1095	111,804.00	100.00%	(27,800.66)	1	5.00%	1890	1,390.03	6500	(1,390.03)		
	<u>111,804.00</u>	<u>100.00%</u>	<u>(27,800.66)</u>				<u>1,390.03</u>		<u>(1,390.03)</u>		

Wastewater:											
UPIIS Obj Acct	UPIIS Amount	% to Total	Reduction Amount	Years in Service	Dep Rate	A/D Obj Acct	A/D Amount	Dep Exp Obj Acct	Dep Exp Amount		
1400	2,420,443.00	26.41%	(2,423.01)	1	5.56%	2160	134.61	6765	(134.61)		
1405	5,051,947.00	55.13%	(5,057.30)	1	5.56%	2165	280.96	6770	(280.96)		
1540	1,691,117.00	18.45%	(1,692.91)	1	2.33%	2285	39.37	6890	(39.37)		
	<u>9,163,507.00</u>	<u>100.00%</u>	<u>(9,173.22)</u>				<u>454.94</u>		<u>(454.94)</u>		

13-Month Average Adjustments

Water:															
Date in Service	Reduction Amount	Jun-09	Jul-09	Aug-09	Sep-09	Oct-09	Nov-09	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	13-Month Average
Jul-09	(25,562.15)	-	115.84	231.67	347.51	463.34	579.18	695.02	810.85	926.69	1,042.52	1,158.36	1,274.20	1,390.03	<u>695.02</u>
	<u>(25,562.15)</u>														

Wastewater															
Date in Service	Reduction Amount	Jun-09	Jul-09	Aug-09	Sep-09	Oct-09	Nov-09	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	13-Month Average
Jul-09	(2,236.62)	-	11.22	22.44	33.65	44.87	56.09	67.31	78.52	89.74	100.96	112.18	123.39	134.61	67.31
Jul-09	(4,668.28)	-	23.41	46.83	70.24	93.65	117.07	140.48	163.89	187.31	210.72	234.13	257.55	280.96	140.48
Jul-09	(1,562.69)	-	3.28	6.56	9.84	13.12	16.40	19.68	22.97	26.25	29.53	32.81	36.09	39.37	19.68
	<u>(8,467.59)</u>														<u>227.47</u>