

HC Waterworks, Inc.

December 9, 2014

Office of Commission Clerk
Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399

Re: Docket No. 140158-WS – Application for increase in water and wastewater rates in Highlands County by HC Waterworks, Inc.

Dear Commission Clerk,

HC Waterworks, Inc. (HCWW) submits additional information on its Outside Contractual Services in response to concerns brought forth by the Commission and the Office of Public Counsel. Several questions were expressed on comparative contracts with affiliated parties. HCWW has researched past Commission decisions on similar contractual services and offers the following relative to the existing contract.

A similar relationship currently exists with several regulated utilities in Marion County. However, these relationships are not exactly like the HCWW contract. The following regulated water and wastewater utilities have similar services provided by a related party:

Tradewinds Utilities, Inc.
Residential Water Systems, Inc.
C.F.A.T. H2O, Inc.
BFF Corp

These utilities have Outside Contractual Services with MIRA International, Inc. (MIRA). All of the above regulated utilities, as well as MIRA are owned by the same owners and have affiliated relations. MIRA provides the following services to the regulated utilities:

Billing/Computer Services
Administrative Services
Payroll
Meter Reading
Insurance
Office Space
Materials & Supplies
Repair & Service Equipment
Customer Relations
Customer Services
Annual PSC Reporting
Hospitalization Benefits

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Testing expenses and operation and maintenance expenses are covered under separate contracts discussed below.

In review of the 2013 Annual Reports, as well as past Commission orders on previous rate cases, these utilities also have utility Employee Salaries and Employee Pensions and Benefits. In Order No. PSC-11-0385-PAA-WS, issued September 13, 2011, the Commission approved a rate increase for Tradewinds Utilities, Inc. (Tradewinds). In review of the documentation in the Commission's docket file, the Commission approved Tradewinds' Outside Contractual Services with MIRA, an affiliated company. Specifically, in the Commission's audit – Audit Control No: 10-175-2-1 dated December 17, 2010, the Commission's auditor disclosed the following in Audit Finding 8:

The Utility's filing includes \$100,276 and \$131,475 of charges from MIRA International, Inc. (MIRA), an administrative Service Company, which is a related party. The charges are for employee and officer payroll, payroll tax expenses, employee benefits, office space and support for customer billing and collections, general maintenance materials and supplies, and other general administrative support operations as needed for utility operations. The Utility has no employees of its own and all administrative and general maintenance services are provided by MIRA.

The auditor recommended adjustments based on recommended amounts for affiliated charges as follows:

Tradewinds:	\$93,228 – water
	\$55,754 – wastewater
Residential:	\$146,849 – water
C.F.A.T.:	\$34,580 – water
	\$33,666 - wastewater
BFF Corp:	\$16,300 – wastewater

In addition, in reviewing Document No. 09572-10 in the docket file of Docket No. 100127-WS, Tradewinds also has an additional contract for operations with Pro-Tech for \$600/month, or \$7,200 annually. There were also additional expenses for Testing included in the operating expenses. The amount requested by Tradewinds in its MFRs for Pro-Tech was \$4,400 for water and \$5,250 for wastewater. In addition, there was additional testing in the amount of \$3,630 for wastewater for Aqua Pure Water.

In the Order No. PSC-11-0385-PAA-WS, the Commission approved Tradewind's Operation & Maintenance Expense with minor adjustments for Pro Forma Salary Increase and Bad Debt Expense. Tradewinds had requested O&M in the amount of \$125,421 for water and \$187,846 for wastewater. The Commission approved O&M in the amount of \$120,654 for water and \$176,895 for wastewater.

Tradewind's MFRs also reflected plant in service amounts for Transportation; Office Furniture and Equipment; and Power Operated Equipment which were included in rate base. These items are included

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in the contract with U.S. Water Services Corporation with HC Waterworks, Inc. and are not included in plant-in-service.

In another related rate case in Docket No. 100126-WU for C.F.A.T. H2O, Inc. (CFAT), the Commission approved the utility's request for a rate increase. In reviewing the Commission audit in Audit Control No: 10-274-2-1 dated December 15, 2010, the Commission's auditor disclosed the following in Audit Finding 5:

The Utility's filing includes \$16,718 of charges to water O&M expenses from MIRA International, Inc. (MIRA), an administrative Service Company, which is a related party. The charges are for employee and officer payroll, payroll tax expenses, employee benefits, office space and support for customer billing and collections, general maintenance materials and supplies, and other general administrative support operations as needed for utility operations. CFAT has no employees of its own and all administrative and general maintenance services are provided MIRA. (sic)

The auditor recommended that "The Utility's O&M expense balance should be increased by \$17,862 for the 12-month period ending December 31, 2009." This would bring the MIRA recoverable amount to \$34,580 for water. In addition, Document No. 09566-10 in the docket file contained an operations contract for Pro-Tech in the amount of \$595 a month or \$7,140 annually. The amount included in the Utility's MFRs and requested O&M expense for Pro-Tech was \$8,197. These additional amounts were allowed by the Commission, for a total outside services amount of \$49,917 for water.

In Order No. PSC-11-0366-PAA-WU, issued August 31, 2011, the Commission made minor adjustments to CFAT's O&M expenses primarily for Pro Forma salaries and bad debt expenses. This rate case was only for CFAT's water utility and did not include its wastewater utility.

In another similar rate case, the Commission approved total outside services for K.W. Resort Utilities Corp in Order No. PSC-09-0057-FOF-WS, issued January 27, 2009. In that rate case, the utility had several Outside Contractual Services with several affiliated parties. The first was for operations services with Keys Environmental, Inc. (KEI), an affiliated party. The utility recorded expenses in the amount \$450,776 for KEI during the test year. The Commission reduced this amount by \$71,053 for an allowed amount of \$379,723. This represented the operations portion of the utility services. However, KEI employees utilizes the transportation equipment (vehicles) owned by the utility. In addition, KEI does not provide accounting services or initial customer contacts. These services are provided by Key West Golf Course (KWGC), another affiliate company. The utility paid KWGC an amount of \$8,000 a month or \$96,000 annually. The Commission reduced this amount by \$12,038 for a total allowed amount of \$83,962. Finally, the utility was charged \$60,000 annually for "management" of the utility paid to Green Fairways (an affiliated company). The Commission reduced this amount by \$30,000 and allowed the remaining \$30,000 annually. The total amount of these three contractual services was a total of \$493,683. This is a wastewater only utility providing service to 1,556 customers during the test year. The total amount of the Commission allowed affiliated transactions equates to \$317 per connection. In addition the utility also was allowed \$65,289 in ongoing engineering charges in Contractual Services – Engineering in the approved revenue requirement. It should be noted that the KEI contract provides that the contractor provide the chemicals and sludge hauling in the contract.

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It should also be noted, that in the rate cases cited above, the Commission approved rate case expense in its orders. In HC Waterworks filing, there is very minimal rate case expense requested.

The HC Waterworks contract with U.S. Water Service Corporation (USWSC) include the following services:

Water Operations – water treatment plant, filtration, etc.

Wastewater Operations

Meter Reading

System Maintenance – water and wastewater

Flushing – distribution system

Lift station maintenance and operation

Billing / Collection

Customer Service

Service Orders

Regulatory - PSC, WMD, DEP

Permits – DEP, DOH, WMD, etc.

Testing – all required for water and wastewater

DMRs, MORs - monthly reporting

CCRs - annual

PSC Annual Reports

Accounting - all bookkeeping, record keeping, AR, AP, etc.

Meter Replacements

Line break repairs

Minor repairs and/or replacements – up to \$400

Locates

Meter calibrations – water and wastewater

Backflow preventor testing

Turn Ons/ Turn Offs

Disconnections

Re-reads

Generator Maintenance

Tank inspections

Vehicles

Office (also equipment, phones, etc.)

Previously, these items were provided by Aqua Utilities Florida, Inc. and its parent company Aqua America, Inc. The previous owner had employees, vehicles, computers, offices, etc. HC does not have any employees, vehicles, computers, office, etc.

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The USWSC contract dated March 29, 2013 is in the amount of \$196,409.82 for water and \$57,679.37 for wastewater. This equates to \$212.66 per customer and \$206.41 per ERC for water and \$194.86 per customer/ERC for wastewater. Pursuant to the Contract HCWW employed the services of USWSC in three distinct functions; the operation, maintenance and billing/collection (OM&BC) of the utility systems. This includes (a) Water System Operations; (b) Wastewater System Operations; (c) Maintenance; and (d) Customer Service. For a listing of serviced provided to HCWW, see USWSC’s Scope of Services – Base Contract Service, Section 2, as well as the cost responsibilities on Table 4 of the contract for both water and wastewater.

The Florida Governmental Utility Authority (FGUA) hired WetCon Utility and Management Consultants in 2013 to review charges by USWSC in comparison to similar water and wastewater utilities throughout the United States. The Wetcon study was issued in July 2013. The WetCon study concluded that the USWSC costs on a per account bases fell within the top quartile of other utilities. These were charges to FGUA by USWSC.

HCWW respectfully submits that the cost per account for HCWW is well below the cost for the FGUA South systems. The cost per water account is \$212.66 annually compared to \$263.58 for South and \$263.51 for West. Similarly the cost per wastewater account is \$194.86 annually compared to \$263.58 for South and \$263.51 for West. For the FGUA systems, if they were water and wastewater the combined cost per ERC would be \$527.16 annually for South and \$527.02 annually for West; this compares favorably to the less combined cost charged to HCWW of \$407.52. When taken in total, the average overall cost for HCWW is \$206.51 which is well below the charges to FGUA. See below:

HCWW	FGUA Benchmarking					
	Annual	Cust.	Cost/acct	-	South	West
Water	\$196,709.82	925.25	\$ 212.66	Customer Service	\$ 50.58	\$ 38.51
Wastewater	\$ 57,679.37	295.75	\$ 194.86	O&M	\$ 213.00	\$ 225.00
Total	\$254,389.19	1,221	\$208.34	Total/acct	\$ 263.58	\$ 263.51

Upon further analysis of the WetCon benchmarking study, there was a flaw in their data table. The underlying data for the “South” was obtained from the AWWA 2011 Benchmarking Performance Indicators. Upon further analysis, it was discovered that the costs in WetCon’s table were an average of the two water and wastewater costs. Below is the actual costs contained in the AWWA 2011 Benchmarking Analysis:

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<u>AWWA:</u>	Top	Medium	Bottom
O&M cost per customer			
Water - O&M	\$233	\$257	\$331
Wastewater O&M	<u>\$259</u>	<u>\$345</u>	<u>\$426</u>
Total O&M	<u>\$492</u>	<u>\$602</u>	<u>\$757</u>
Average	\$246	\$301	\$379
Customer Service Cost	Top	Medium	Bottom
Average	\$36.43	\$41.16	\$52.38
Total Cost:			
Water:	\$269.43	\$298.16	\$383.38
Wastewater:	<u>\$295.43</u>	<u>\$386.16</u>	<u>\$478.38</u>
Total	<u>\$564.86</u>	<u>\$684.32</u>	<u>\$861.76</u>
<u>Compared to HCWW:</u>			
Water	\$212.66		
Wastewater	<u>\$194.86</u>		
Total	<u>\$407.52</u>		
Average	\$208.34		

Also, in the AWWA, there was a further analysis based on company size. When compared to utilities in this study for Population from 0 -10,000 customers, the contrast is much more striking. Below are the numbers from the AWWA study:

Population 0 – 10,000:

O&M cost per customer			
Water - O&M	\$251	\$324	\$ 456
Wastewater O&M	<u>\$399</u>	<u>\$473</u>	<u>\$ 573</u>
Total O&M	<u>\$650</u>	<u>\$797</u>	<u>\$1,029</u>
Customer Service Cost	Top	Medium	Bottom
Average	\$ 66.31	\$ 82.26	\$ 101.19
Total Cost per customer:	\$716.31	\$879.26	\$1,130.19

Further, the WetCon Benchmarking report states, "It is virtually impossible to find any two water utilities that are comparable, given their unique treatment systems, customer bases, permit requirements, operational procedures, capital needs and rate structures. This is particularly true when comparing other systems to FGUA, with its' geographic spread, diverse customer base and broad range of treatment technologies."

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Both of these independent studies provide third party independent verification that the U.S. Water operation and maintenance costs are well below the market rate. The “market” comparison is drawn on by both the AWWA study previously provided to both the Commission and OPC for nation-wide utility companies as well as the Wetzell Benchmarking Report also by a third independent party which was also previously provided to both the Commission and OPC. This market comparison is paramount in providing finality to HCWW’s unrefuted evidence that these costs are well below market, and not above as required by the Florida Supreme Court as discussed below.

Each of the Operation, Maintenance, and Customer Service contract that USWC enters into with a party are different and are priced differently depending on numerous factors. This includes the number of utility operation employees needed (Facility Operators and Maintenance Mechanic) and the number of hours required per system for operation. Also whether the contractor provides the cost of the sludge hauling, chemicals, power, offices, vehicles, etc. or if those costs are borne by the owner. Also for the regulated utilities, the Utility Manager and Accountant are spread over all ERCs of the regulated utilities plus anticipated growth. The contractual monthly charges for these utilities include the operations, accounting, and operation management positions. For the “Administrative Services” portion, this is derived at by using all currently owned or purchased private regulated utilities and dividing these amounts by the existing ERCs and future potential ERCs through growth and potential acquisitions. Thus these costs are lower than actual costs since there is a growth factor built in for potential acquisitions in the future that have not taken place. These amounts are to cover the monthly operational and administrative expenses for all the regulated utilities, both present and future.

Below is a table reflecting the salaries of the operations and maintenance personnel allotted to HCWW.

Operational Expenses for HCWW

Water:

<u>Employee:</u>	<u>Annual Salary</u>	<u>Time/Week</u>	<u>FTE</u>
Operator	\$ 40,082	21.2 hr	.58
Maintenance Mechanic (UT) (UT based on ERCs)	\$ 36,816	17.6 hrs	.44
Total Salary Cost (without benefits, payroll tax, etc.)			\$37,442

Wastewater:

<u>Employee:</u>	<u>Annual Salary</u>	<u>Time/Week</u>	<u>FTE</u>
Operator	\$ 40,082	6 hr	.15
Maintenance Mechanic (UT) (UT based on ERCs)	\$ 36,816	5.6 hrs	.14
Total Salary Cost (excluding benefits, payroll tax, etc.)			\$11,160

The amount of Personnel and Benefits, including taxes and insurance is \$56,626 for water and \$16,888 for wastewater. For the HC water utility, this includes three water treatment plants consisting of eight

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wells and AdEdge treatment systems. These operation and maintenance expenses would be incurred regardless of the size of the customer base.

HCWW respectfully submits that the comparison of these non-related contracts, although useful and informational, should not be the sole basis of any disallowance of prudently incurred operating expenses. If HCWW was required to establish a stand-alone utility with personnel for maintenance, customer service, accounting, regulatory compliance, etc. the costs would far exceed the amount in the current USWSC contract.

It should be noted that the Commission has previously considered this approach at analyzing affiliated transactions of related parties and stated the following in Order No. PSC-12-0102-FOF-WS, issued March 5, 2012:

In evaluating whether and how much affiliate costs should be included in rates, we are aware of the relevant statutes and cases on rates and affiliate transactions. Section 367.081(2)(a)1., F.S., sets forth our responsibility in rate setting, and specifically states:

The commission shall, either upon request or upon its own motion, fix rates which are just, reasonable, compensatory, and not unfairly discriminatory. In every such proceeding, the commission shall consider the value and quality of the service and the cost of providing the service, which shall include, but not be limited to, debt interest; the requirements of the utility for working capital; maintenance, depreciation, tax, and operating expenses incurred in the operation of all property used and useful in the public service; and a fair return on the investment of the utility in property used and useful in the public service. . . .

As reflected in the statute cited above, we are required to set reasonable rates, but we must also set rates that are compensatory. The provisions in the statute require that we consider the cost of providing service, which includes operating expenses incurred in the operation of all property used and useful in the public service, as well as a fair return on the investment of the Utility in property used and useful in the public service. In conducting our analysis of the appropriate operating expenses to be included, we are mindful of two Florida Supreme Court cases. In the case of **Keystone Water Co v. Bevis**, 278 So. 2d 606 (Fla. 1973), the Court held that a utility is entitled to a fair rate of return on property used or useful in public service. In **Keystone**, the Court further found that rates which do not yield a fair rate of return are unjust, unreasonable, and confiscatory and their enforcement deprives a utility of due process.¹ Additionally, in **GTE v. Deason**, 642 So. 2d 545 (Fla. 1994), the Florida Supreme Court laid out the standard of review for affiliate transactions, stating:

The mere fact that a utility is doing business with an affiliate does not mean that unfair or excess profits are being generated, without more. Charles F. Phillips, Jr., *The Regulation of Public Utilities* 254-55 (1988). We believe the

¹ See **Keystone Water Co. v. Bevis**, 278 So. 2d 606, 609 (Fla. 1973).

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standard must be whether the transactions exceed the going market rate or are otherwise inherently unfair. . . . If the answer is “no,” then the PSC may not reject the utility’s position.

GTE v. Deason, 645 So. 2d at 547-548. We have reviewed the record evidence and applied the holdings in **Keystone v. Bevis** and **GTE v. Deason** as appropriate. (pages 99 – 100)

The Commission, in arriving at its final decision stated:

While we agree with OPC witness Dismukes that AUF’s Market Based Study does not offer a realistic comparison of market based rates, we also agree with AUF witness Szygiel that the peer group analysis presented by witness Dismukes does not provide an adequate comparison. We note that in AUF’s 2008 rate case we also disagreed with witness Dismukes’ previous recommendation to use a comparison of Commission-regulated utilities to AUF in evaluating affiliate-provided services. In the Utility’s 2008 rate case, we specifically found “[t]hat the comparison analysis proposed by witness Dismukes does not provide an appropriate basis to warrant an adjustment being made.”² As acknowledged by witness Dismukes, there are complexities associated with determining the reasonableness of affiliate transactions. To that point, we find that witness Dismukes’ peer group comparison does not adequately compare the duties, activities, and responsibilities for the Utility’s affiliate-provided services.

The Commission further stated:

Moreover, just because the costs to operate a utility are high, this does not necessarily mean that a utility is operating inefficiently. Other factors may influence the costs to provide service to customers. Therefore, we believe a review of this particular Utility’s history is helpful in understanding the costs associated with providing service.

HCWW will be providing the USWC cost model used to arrive at the appropriate charges for the contracted services. These costing models will be provided under separate cover letter requesting confidential treatment due to “proprietary confidential business information.” These models are being provided for (a) HC Waterworks, Inc.; (b) Brevard Waterworks, Inc.; (c) Jumper Creek Utilities; and, (d) Lakeside Waterworks, Inc. The additional cost model also used for these four cost models is for the Administrative portion of the contracts which all amount to \$3.23 per ERC per month. The Administrative portion of the contract covers the accounting and utility oversight, including office space and equipment.

The above utilities, including HCWW, offers to meet with both the Commission staff, as well as the OPC staff to review how the models were used to determine the appropriate charges. HCWW also offers that in the alternative certain utility expenses may be excluded from the contract amount with the mutual understanding that these expenses will still be incurred but recorded in other expense accounts. The amounts of these prudently incurred expenses, such as testing, would also need to be included in overall approved revenue requirement.

² See Order No. PSC-09-0385-FOF-WS, p. 78.

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If you have any additional questions or concerns, please do not hesitate to contact me at (727) 848-8292, ext. 245.

Sincerely,

A handwritten signature in black ink, appearing to read "Troy Rendell". The signature is fluid and cursive, with a large initial "T" and "R".

Troy Rendell
Manager of Regulated Utilities
// for HC Waterworks, Inc.

Cc: Office of Public Counsel