

ANDY GARDINER  
President of the Senate



J.R. Kelly  
Public Counsel

STATE OF FLORIDA  
OFFICE OF PUBLIC COUNSEL

c/o THE FLORIDA LEGISLATURE  
111 WEST MADISON ST.  
ROOM 812  
TALLAHASSEE, FLORIDA 32399-1400  
1-800-342-0222

EMAIL: OPC\_WEBSITE@LEG.STATE.FL.US  
WWW.FLORIDAOPC.GOV



February 2, 2016

Carlotta S. Stauffer, Director  
Office of Commission Clerk  
Florida Public Service Commission  
2540 Shumard Oak Blvd.  
Tallahassee, FL 32399-0850

Re: Docket 150269 -- Application for limited proceeding water rate increase in Marion, Pasco, and Seminole Counties, by Utilities, Inc. of Florida

Dear Ms. Stauffer:

Attached is a list of issues that the Office of Public Counsel has prepared to identify concerns we have with the information included in the limited proceeding filed in this docket. We are submitting this letter in an effort to be up front with our concerns and allow the staff and utility sufficient time to review our concerns and ask for any additional information that might be needed. If you should have any questions, please feel free to call or e-mail me.

Respectfully submitted,

*s/ Denise N. Vandiver*

Denise N. Vandiver  
Legislative Analyst

c: Division of Accounting & Finance (Mouring, Slemkewicz, Fletcher)      Utilities, Inc. of Florida  
Division of Economics (Hudson)      John Hoy  
Division of Engineering (King, Mtenga)      Friedman Law Firm  
Office of the General Counsel (Janjic, Barrera)      Martin S. Friedman  
  
Office of Public Counsel (Saylor)

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Overall, OPC believes staff should carefully review the utility's calculations. Our preliminary review indicates that it may be possible that the utility has incorrectly calculated the Regulatory Assessment Fee (RAF) and Income Tax expense impact of any increases. In some places, the individual adjustment is grossed up, and in other places, the final request appears to be grossed up. As such, RAFs and income tax expense may be double-counted, leading to double recovery.

In addition, the utility includes test year adjustments to reflect annualized revenues and the RAF associated. However, the utility should show these adjustments in a separate column so that the limited proceeding increase reflects only those items and the related gross up for RAF and income taxes.

Listed below are specific questions or concerns we have with the four requests.

**PASCO COUNTY PHASE I**

**Schedule 3**

1. The utility calculates income tax expense on Lines 17 – 19 on the total return required for its estimated rate base increase. The utility did not adjust to remove the interest portion of the total return.
2. Line 14 of the calculation on this schedule includes \$1,843 for increases in taxes other than income. However, on the referenced Schedule 10, this number is \$625 for property taxes and \$1,218 for RAF. However, RAF should not be included at this point but at the end of the calculation to gross up all the changes.

**Schedules 4 and 5**

3. The utility indicates its adjusted earned rate of return using the net operating income (NOI) from Schedule 5 which is based on the 2014 Annual Report. The purpose of Schedule 4 appears to be to reflect that the requested increase in this proceeding will not result in earnings exceeding the authorized rate of return. However, the NOI calculation on Schedule 5 includes net depreciation expense of \$376,488, which is more than double the amount included in the last rate case. This does not correspond to the fact that there is virtually no change in the total plant balance.

**Schedule 5**

4. The utility includes a revenue adjustment for "lost revenues" due to several large irrigation customers leaving the system. However, there is no correlating adjustments made to expenses to reflect less operation and maintenance expense for these customers and their usage. At a minimum, purchased power and chemical expense should be reduced for the lower amount of treated water. Also, there should be a reduction to rate base to retire the meters.
5. Line 25 indicates an increase for property taxes of \$2,469. However, the referenced schedule only indicates an increase of \$625 for property taxes.

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Schedule 6

6. The utility includes capitalized salary expense for “Summertree Water Quality Improvements”. The amounts included are \$9,807.69 for 2014 and \$2,759.99 for 2015. OPC is concerned that salaries were included in the test year and any capitalization of salaries may result in double recovery of the expense.

Schedule 10

7. The utility calculates the impact on property taxes based on the requested changes to the rate base. However, the utility adds utility plant in service to accumulated depreciation instead of subtracting the accumulated depreciation.

Schedule 11

8. The utility’s calculation of cost of capital excludes Customer Deposits, Deferred Income Taxes, and Investment Tax Credits. Commission Rule 25-30.445(4)(e), Florida Administrative Code addresses the requirements for a limited proceeding. The rule requires the following be included in the cost of capital calculation:

(e) A calculation of the weighted average cost of capital shall be provided for the most recent 12-month period, using the mid-point of the range of the last authorized rate of return on equity, the current embedded cost of fixed-rate capital, the actual cost of short-term debt, the actual cost of variable-cost debt, **and the actual cost of other sources of capital which were used in the last individual rate proceeding of the utility.** If the utility does not have an authorized rate of return on equity, the utility shall use the current leverage formula pursuant to Section 367.081(4)(f), F.S. (emphasis added)

Schedule 12

9. The utility includes a total of \$36,000 in rate case expense for this limited proceeding. We believe that this appears high for the limited nature of the filing. We recognize that staff closely reviews rate case expense and only brings this up to identify our concern.

Schedule 15

10. This schedule appears to include the monthly bills for the irrigation customers that have left the system. Our review indicates that for each account, the utility has included two February bills, resulting in 13 monthly bills included in the calculations. We believe that the “lost revenues” calculation should be reduced by 1,703,430 gallons and \$8,806.76. We note that staff has already requested corrected information from the utility.

Schedule 16

11. We believe that this calculation of the amount of the Lost Revenue is flawed.

- a. First, staff should remove the duplicate February bills that the utility included in its calculation.

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- b. Second, the schedule compares the 2014 bills and consumption to the 2011 revenues plus an amount for a 2015 price index. However, it does not reflect the four-year reduction to rates for rate case expense made in 2014.
- c. It also appears that the calculation is not attempting to adjust revenues for the specific irrigation customers that dropped off the system but for all reductions in 2014 consumption over the 2011 consumption used in the rate case. *We do not believe that this is an appropriate use of a limited proceeding.* Each year may have higher or lower consumption based on many factors such as weather patterns, customer consumption patterns, and economic trends. These changes should not be included in a limited proceeding as they may change from year to year. The revenue requirement philosophy is to design rates to allow a utility the opportunity to earn a reasonable rate of return. If a limited proceeding is used to adjust rates to **guarantee** a certain revenue level, it changes the entire ratemaking philosophy and does not encourage utilities to prudently manage the system.

**PASCO COUNTY PHASE II**

We believe that a decision on Phase II rates is premature as the decision to interconnect depends upon the outcome of the customers' decision whether to authorize the utility to interconnect with Pasco County Water System. Additionally, a decision on Phase II rates should be deferred until after the proposed interconnection is placed into service and operational. Any rates established at this time are speculative and may not match the utility's operation and maintenance expenses that it incurs. OPC has also identified a number of concerns with the proposed Phase II rates as proposed by the utility.

**Schedule 2**

- 12. The annualized revenue on Line 2 is the adjusted revenue from the 2011 test year plus the 2015 price index. As discussed previously, it does not include the four-year rate reduction for rate case expense, nor does it appropriately reflect the revenues to be used in the limited proceeding.

**Schedule 3**

- 13. The utility calculates income tax expense on Lines 17 – 19 on the total return required for its estimated rate base increase. The utility did not adjust to remove the interest portion of the total return.

**Schedules 4 and 5**

- 14. The utility indicates its adjusted earned rate of return using the net operating income (NOI) from Schedule 5 which is based on the 2014 Annual Report. The purpose of Schedule 4 appears to be to reflect that the requested increase in this proceeding will not result in earnings exceeding the authorized rate of return. However, the NOI calculation on Schedule 5 begins with net depreciation expense of \$376,488, which is more than double the amount included in the last rate case but does not correspond to the fact that there is virtually no change in the total plant balance.

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Schedule 5

15. We have concerns with the calculation methodology used by the utility in the piecemeal calculations used. For example, this schedule shows a net increase of \$45,865 to Net Operating Income (NOI) on Line 11. However, the utility is reflecting a net **DECREASE** to rate base. The change to NOI should be equivalent to the change in rate base times the cost of capital. Therefore, the schedule should reflect a decrease in NOI.

Schedule 7

16. The Depreciation Expense in Column (c) does not appear to add up to the total reflected. The total appears to exclude the \$804 for amortization of CIAC-Water Treatment Equipment.

Schedule 10

17. This schedule is referenced on Schedule 3 as supporting the taxes other than income adjustment of \$9,943. However, schedule 10 is missing from the filing. We note that staff has already requested this schedule.

Schedule 11

18. The utility's calculation of cost of capital excludes Customer Deposits, Deferred Income Taxes, and Investment Tax Credits. Commission Rule 25-30.445(4)(e), Florida Administrative Code addresses the requirements for a limited proceeding. The rule requires the following be included in the cost of capital calculation:

(e) A calculation of the weighted average cost of capital shall be provided for the most recent 12-month period, using the mid-point of the range of the last authorized rate of return on equity, the current embedded cost of fixed-rate capital, the actual cost of short-term debt, the actual cost of variable-cost debt, **and the actual cost of other sources of capital which were used in the last individual rate proceeding of the utility.** If the utility does not have an authorized rate of return on equity, the utility shall use the current leverage formula pursuant to Section 367.081(4)(f), F.S. (emphasis added)

Schedule 14

19. This schedule uses \$42,391 for the reduction to O&M Expenses, but Schedule 17 reflects \$46,245, which is an annualized amount. We believe that the annualized amount of \$46,245 should be used in this calculation.

Schedule 17

20. This schedule reflects the reduction to Operation and Maintenance expenses (O&M) related to the retirement of the four wells. We believe that the utility should reflect a reduction to salaries and wages (as well as a related reduction to employee benefits, transportation expense, and payroll taxes) for the reduced labor required for the Summertree system. The test year appears to include approximately 4.23 FTE for the operation and maintenance of the Summertree and Orangewood system. We believe

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the retirement of four wells should impact these expenses as there will be less testing, monitoring, maintenance, flushing, and other plant operation activities.

Schedule 18

21. This schedule reflects the amounts retired from the specific plant accounts. In order to determine the net book value of the assets, the utility calculates the accumulated depreciation based on a date it appears to indicate as the installation date. However, of the 37 individual accounts, only four accounts indicate a date before the year 2000. In Docket No. 090462-WS, the Commission order stated that all “the UIF systems were built sometime from the 1950s through the 1970s”. Therefore, we believe that the utility has significantly overstated the net book value of the retired assets. We believe that the schedule should reflect that most of the assets are fully depreciated.
22. This schedule also does not reflect any offsets for salvage value. In Order No. PSC-14-0025-PAA-WS, the Commission included pro forma plant for a new Hydro Tank at Well 13 in the Summertree system. Because this is a new tank, we believe that the utility will be able to use it for another system or sell it to another utility. We believe that the utility should also identify any other items that may have salvage value and these amounts should be included as an offset to the limited proceeding calculations.

Schedule 19

23. This schedule calculates the additional cost to the utility to purchase water from Pasco County. We would point out that there is not a signed agreement between the utility and Pasco County at this time, so the rate is only based on the rates posted on the website for bulk customers. We note that staff has requested evidence of the actual rate.
24. This schedule starts the calculation with test year consumption (and as mentioned in Phase I is based on 13 months of lost revenues instead of 12 months) and allows an additional 10% for flushing and an additional 10% for other uses. We believe that 20% additional usage is high and an adjustment should be considered.

**MARION COUNTY**

Schedule 3

25. The utility calculates income tax expense on Lines 17 – 19 on the total return required for its estimated rate base increase. The utility did not adjust to remove the interest portion of the total return.

Schedules 4 and 5

26. Schedule 4 reflects the replacement costs of the service lines but does not reflect any reductions for the retirement of the old service lines. Also Schedule 5 does not reflect any depreciation expense savings for the retired plant.

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Schedule 5

27. This schedule does not reflect any cost savings due to the new service lines. The utility included additional information in the filing which states:

The utility's field staff had made repairs to enough service lines over the previous few years to determine that water lost through leaks and pipe failures was significant. . . . Additionally, a majority of the water taps made on the water mains were done using inferior methods and materials that would fail without warning and require emergency repairs in order to reestablish service. The new service lines and tapping saddles will provide long-term service life and minimize the likelihood of service interruptions.

We believe that the utility should include the costs savings that will result from less water lost (such as chemicals and purchased power) and less emergency repairs (such as salaries, materials and supplies, and outside services).

28. Line 17 on this schedule indicates an increase in property taxes of \$10,341 as referenced on Schedule 10. However, Schedule 10 references an increase in Property Tax of 5,170. OPC believes that the property tax should be even lower as the utility did not reflect any plant retirements in the amounts used to calculate the property tax for the Marion County system.

29. Footnote 2 on this schedule references adjustments made to depreciation expense. OPC is unable to reconcile these numbers to the schedules and we believe that the utility should provide additional explanation regarding these adjustments.

Schedule 6

30. The utility includes \$18,248.25 for capitalized salary expense for the Marion County replacement of 135 water service lines in the Golden Hills service area. OPC is concerned that salaries were included in the last test year and any capitalization of salaries may result in double recovery of the expense.

Schedule 11

31. The utility's calculation of cost of capital excludes Customer Deposits, Deferred Income Taxes, and Investment Tax Credits. Commission Rule 25-30.445(4)(e), Florida Administrative Code addresses the requirements for a limited proceeding. The rule requires the following be included in the cost of capital calculation:

(e) A calculation of the weighted average cost of capital shall be provided for the most recent 12-month period, using the mid-point of the range of the last authorized rate of return on equity, the current embedded cost of fixed-rate capital, the actual cost of short-term debt, the actual cost of variable-cost debt, **and the actual cost of other sources of capital which were used in the last individual rate proceeding of the utility.** If the utility does not have an authorized rate

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of return on equity, the utility shall use the current leverage formula pursuant to Section 367.081(4)(f), F.S. (emphasis added)

Schedule 12

32. The utility includes a total of \$36,000 in rate case expense for this limited proceeding. We believe that this appears high for the limited nature of the filing. We recognize that staff closely reviews rate case expense and only brings this up to identify our concern.

**SEMINOLE COUNTY**

Schedule 3

33. The utility calculates income tax expense on Lines 17 – 19 on the total return required for its estimated rate base increase. The utility did not adjust to remove the interest portion of the total return.

Schedule 5

34. We have concerns with the calculation methodology used by the utility in the piecemeal calculations used. For example, this schedule shows a net increase of \$24,248 to Net Operating Income (NOI) on Line 11. However, the proposed increase to rate base for Seminole County is only \$97,132 as shown on Schedule 4, Line 10. The increase to NOI should be no more than the cost of capital times the increase to rate base.

Schedule 11

35. The utility's calculation of cost of capital excludes Customer Deposits, Deferred Income Taxes, and Investment Tax Credits. Commission Rule 25-30.445(4)(e), Florida Administrative Code addresses the requirements for a limited proceeding. The rule requires the following be included in the cost of capital calculation:

(e) A calculation of the weighted average cost of capital shall be provided for the most recent 12-month period, using the mid-point of the range of the last authorized rate of return on equity, the current embedded cost of fixed-rate capital, the actual cost of short-term debt, the actual cost of variable-cost debt, **and the actual cost of other sources of capital which were used in the last individual rate proceeding of the utility.** If the utility does not have an authorized rate of return on equity, the utility shall use the current leverage formula pursuant to Section 367.081(4)(f), F.S. (emphasis added)

Schedule 12

36. The utility includes a total of \$36,000 in rate case expense for this limited proceeding. We believe that this appears high for the limited nature of the filing. We recognize that staff closely reviews rate case expense and only brings this up to identify our concern.