friedman & friedman PA
ATTORNEYS AT LAW

March 2, 2016

VIA E-FILE

Carlotta S. Stauffer, Commission Clerk
Office of Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399

RE: Docket No. 150269-WS; Application for limited proceeding water rate increase in Marion, Pasco, and Seminole Counties, by Utilities, Inc. of Florida.
Our File No. 30057.224

Dear Ms. Stauffer:

The following are the responses of Utilities, Inc. of Florida, ("Utility") to the OPC's Issues and Concerns Request dated February 2, 2016:

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.
Response: The Utility agrees that only the equity portion of the weighted average cost of capital should be use for calculating the effects of income tax expense on lines 17-19.

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.
Response: The Utility agrees that the RAF portion should be included 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.
Response: The increase in depreciation expense is mainly due to increased allocations of UIF plant and UIF depreciation expense since the last rate case.

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.
   Response: The lower O&M expenses are accounted for in the revised schedule No. 17 that was submitted in response to PSC staff’s first data request. This schedule uses actual O&M expenses recorded for the year 2015, after the irrigation customers were lost. Further O&M adjustments were then made based upon the expected interconnection with Pasco County.

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.
   Response: Line 25 inadvertently added two cells in Schedule 10. Property Taxes should be $625 on line 25.

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.
   Response: The salaries included in the expenses were net of any capitalized salaries. Therefore, there was no double recovery of salary expenses.

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.
   Response: The accumulated depreciation should be subtracted from UPIS.

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)

   Response: The only sources of capital that would apply are customer deposits ($1,393,000) and deferred income taxes ($51,992,000). Taking these into account would change the weighted cost of capital to 7.02%.

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.

   Response. The $36,000 to which OPC refers is the legal fees portion of rate case expense. The attorney involvement in a rate case, whether a limited proceeding or full rate case does not change much. The real savings is in the accounting fees since there are limited financial MFRs. In a limited proceeding there is still an application to prepare, staff data requests to respond to (although presumably fewer than a full rate case), responses to OPC requests such as this one, customer meeting (in this case two), the Agenda Conference, and implementation of rates matters. This analysis is supported by the fact that since 2010, legal rate case expense has been approved by the Commission in limited proceedings in amounts between $31,150 and $53,971.

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.

    Response: Schedule 15 has already been revised to remove the double bills in February and was provided to PSC Staff as part of responses to Staff’s first data request.

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.
    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.

    Response: a. As stated above, the double bills in February have been eliminated and a revised schedule was provided to PSC Staff as part of responses to Staff’s first data request.

    b. The Utility agrees that the 4-year rate reduction in 2014 should be taken into account.

    c. The Utility disagrees with OPC’s conclusion. The Utility is seeking to get back to its authorized revenues allowed in UIF’s last rate case, which is appropriate for a limited proceeding. The main purpose of showing the lost irrigation customers is to illustrate one example of why UIF is not receiving its authorized revenues from Docket No. 120209-WS. The Utility requesting an increase in rates in order to receive its authorized revenue requirement is consistent with prior Commission decisions. See Docket No. 130155-WU.

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.
Response: The purpose of providing a proposed phase two rate is to provide customers with information to aid in their decision as to whether they would like to have the interconnection or not.

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.
    Response: The Utility agrees that the 4-year rate reduction in 2014 should be taken into account.

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.
    Response: The Utility agrees that only the equity portion of the weighted average cost of capital should be use for calculating the effects of income tax expense on lines 17-19.

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.
    Response: The increase in depreciation expense is mainly due to increased allocations of UIF plant and UIF depreciation expense since the last rate case.

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.
    Response: The increase is reflective of the fact that the Utility's purchased water will increase substantially, $99,101 as stated on Schedule 19. As well as, reflecting the recovery of abandoned wells, see schedule 7. These items more than offset any reduction in Rate Base. Additionally, considerations have to be for depreciation expense, rate case expense, income taxes, TOTI and their effects on annualized revenue.

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.
    Response: That is correct. The Sum formula in the Excel Spreadsheet failed to capture the $804.

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.
    Response: Schedule 10 was provided in response to PSC Staff's first data request.

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)

    Response: The only sources of capital that would apply are customer deposits ($1,393,000) and deferred income taxes ($51,992,000). Taking these into account would change the weighted cost of capital to 7.02%.

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.
    Response: This amount was revised to $48,609.00. See the revised Schedule No. 17 provided in response to PSC Staff's first data request.

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 the retirement of four wells should impact these expenses as there will be less testing, monitoring, maintenance, flushing, and other plant operation activities.
    Response: The abandonment of the Summertree wells is not expected to result in a decrease in manpower due to the fact that the amount of time spent by the certified operators at the Summertree wells, as specified under Chapter 62-699.310 for a Class 5C water system, is less than an hour a day. The same certified operators are responsible for the operation and maintenance of all of the other water and sewer facilities in Summertree and Orangewood systems in Pasco County as well as the water

facilities in Pinellas County, all of which will remain in service. The limited amount of time freed up by one individual after the wells are abandoned will be applied toward preventive and corrective maintenance activities in the service of our customers. Therefore, no reduction in salaries and wages, transportation expense and payroll taxes is expected to occur following the well abandonments.

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.
Response: Although most of the UIF systems were initially developed in the 1950's through the 1970's, much of the Summertree community was developed subsequently. For instance, the Arborwood subdivision was developed in the 1980's and Cross Creek in the 2000's. Under UIF's ownership, some of the assets in place as of the purchase date have been replaced. Depreciation of those assets began once the new assets were placed into service. Therefore, those assets are not yet 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.
Response: The vast majority of the assets located at the Summertree well sites either will be relocated to an Orangewood well site where they will be utilized thereafter or otherwise have no salvage value. To the extent there is an opportunity to use the newly installed hydro tank at Well 13 in the Orangewood system, the tank will be reused in conjunction with the retirement of an old tank that is fully depreciated net of the cost to move and reinstall the tank in its new location.

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.
Response:The Utility provided the actual rate. In the Utility's discussions with Pasco County Utilities regarding the terms of a bulk water agreement, Pasco identified to UIF that the applicable volumetric rate was not negotiable because their rate must be maintained in conformance with their current rate structure that supports Pasco's current indebtedness. The bond covenants are foundational to the volumetric rates established by Pasco. Therefore, the rate posted on Pasco's website is the applicable rate with regard to the provision of bulk water service to the Summertree system.

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.

Response: The 10% flushing volume identified in Phase II reflects a considerable reduction from the historical flushing volume, which reflects the change in the water source from groundwater only to one that is a blend of surface and groundwater sources. Because the County's blended water is expected to have a more stable chlorine demand, its water quality is expected to degrade at a slower rate and thus allow for a sizable reduction in flushing volume on an ongoing basis. However, Pasco's method of disinfection is chloramination, the same as that used by UIF at the Summertree wells. Therefore, it is prudent and reasonable to expect line flushing to occur on an ongoing basis at a rate of 10% of the purchased water. This is consistent with other water systems using chloramination and reflects technical guidance from FDEP staff, Florida Rural Water Association staff, and UIF's experience in operating multiple chloramination disinfection systems.

Beyond the water used for flushing water mains, real and apparent water losses will occur and thus must be taken into account. Losses will occur as a function of line breaks, water meter error, fire flow or other unmetered authorized uses. It is reasonable to project the total annual volume associated with real and apparent losses will amount to 10%.

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.
Response: The Utility agrees that only the equity portion of the weighted average cost of capital should be use for calculating the effects of income tax expense on lines 17-19.

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.
Response: The service lines that were replaced were originally installed in 1975 and were fully depreciated at the time of replacement.

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).

Response: The capital project to replace service lines in a comprehensive manner was initiated in the middle of 2014. The project wrapped up at the end of March 2015 with the majority of the work occurring in 2014. Therefore, no adjustment to annual operating expense is warranted in this instance as the effect of the project on annual expense with respect to chemical expense, purchased power, and repair activities occurred primarily in 2014, which is outside of the Test Year. In addition, this capital project did not address the age and condition of the asbestos cement pipe that is prevalent throughout the water distribution system and continues to age. It is likely that the frequency of repairs to the asbestos cement materials will increase over time and have a material impact on annual repairs expenses.

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.
    Response: The amount of property tax should be $5,170. The formula inadvertently doubled the property tax amount. Additionally, the service lines that were replaced were originally installed in 1975 and were fully depreciated at the time of replacement and thus would not have been included in the Property Appraisers calculation of the property taxes.

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.
    Response: The MFRs for this Limited Proceeding were based on a previous Limited Proceeding involving Cypress Lakes Utilities, Inc. and were as a template for this Limited Proceeding. The adjustments stated in footnote 2 were inadvertently left in when they should have been deleted.

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.
    Response: The salaries included in the expenses were net of any capitalized salaries Therefore, there was no double recovery of salary expenses.

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

<u>Response:</u> The only sources of capital that would apply are customer deposits ($1,393,000) and deferred income taxes ($51,992,000). Taking these into account would change the weighted cost of capital to 7.02%.

<u>Schedule 12</u>

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.
<u>Response.</u> See response to #9 above.

<u>SEMINOLE COUNTY</u>

<u>Schedule 3</u>

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.
<u>Response:</u> The Utility agrees that only the equity portion of the weighted average cost of capital should be use for calculating the effects of income tax expense on lines 17-19

<u>Schedule 5</u>

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.
<u>Response</u>: Considerations have to be for depreciation expense, rate case expense, income taxes, TOTI and their effects on annualized revenue.

<u>Schedule 11</u>

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, <u>**and the actual cost of other sources of capital which were used in the last individual rate proceeding of the utility.**</u> 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)

<u>Response:</u> The only sources of capital that would apply are customer deposits ($1,393,000) and deferred income taxes ($51,992,000). Taking these into account would change the weighted cost of capital to 7.02%.

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.
Response. See response to #9 above.

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

Very truly yours,

Martin S. Friedman

MARTIN S. FRIEDMAN
For the Firm

MSF/
Enclosures

cc: John Hoy (via email, w/o enclosures)
Patrick Flynn (via email, w/o enclosures)
Danijela Janjic, Esquire (via email, w/o enclosures)
Erik Sayler, Esquire (via email, w/o enclosures)