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STEVE CRISAFULLI
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August 18, 2016

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

Re: Docket 130105 -- Application for certificates to provide water and wastewater service in Hendry and Collier Counties, by Consolidated Services of Hendry & Collier, LLC.

Dear Ms. Stauffer:

The Office of Public Counsel is monitoring the certificate docket for Consolidated Services of Hendry & Collier, LLC. ("Utility", or "Company"). Attached are several issues that OPC has prepared to identify concerns we have with the utility filing. We are bringing these to staff's attention to aid staff in its review of the rates and to allow staff sufficient time to review our concerns and ask for additional information or documentation 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

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OPC Issues and Concerns
Consolidated Services of Hendry & Collier, LLC
Docket 130105-WS

Consolidated Services of Hendry & Collier, LLC submitted its application for certificate with supporting information and documentation required to complete the establishment of utility rates on July 19, 2016. We have reviewed the application and attached exhibits. The application includes a “form” 99-year land lease between the utility and Consolidated Citrus Limited Partnership, which is a related party, as identified in Paragraph 5 of the application. This lease includes an increase in the annual rent every three years that is to be “negotiated.” In addition, the lease includes royalty payments based on the water extracted from the wells at a rate that will also be renegotiated every three years. While this docket does not establish expense levels to be included in rates, we are concerned about the rent and royalty expenses that are not based on actual historical costs. Therefore, to the extent that any staff recommendation or Commission order may approve initial rates, we request that the Commission avoid implicitly approving the escalation clauses in the lease, as well as the royalty payments.

Rent Expense

The utility has provided a “form” lease that does not include a specific amount for the proposed annual rent expense. Nor do the revenue requirement Schedules attached as Exhibit G appear to include a specifically identified amount. The utility has not provided any calculations to identify that the lease costs are based on the original cost of the land when first devoted to utility service, such as the specific amount of land required, the value of each parcel of land, or the basis used to determine the value of the land when devoted to public service.

Commission precedent requires an analysis based on original cost. In Commission Order No. PSC-00-0917-SC-WS, the Commission stated the following:

By their very nature, related party transactions require closer scrutiny. Although a transaction between related parties is not per se unreasonable, it is the utility's burden to prove that its costs are reasonable. Florida Power Corp. v. Cresse, 413 So.2d at 1191. In GTE Florida, Inc. v. Deason, 642 So.2d 545 (Fla. 1994), the court established that when affiliate transactions occur, that does not mean that unfair or excessive profits are being generated, without more evidence to contrary. The standard established to evaluate affiliate transactions is whether those transactions exceed the going market rate or are otherwise inherently unfair.

We have addressed the valuation of land purchased from related parties in numerous cases [citations omitted].¹ In the instant case, the major distinction from these prior cases is that the subject land was not purchased; rather the utility obtained control of this land through a 99-year lease. However, the decisions in these prior cases are applicable in order to determine the appropriate value of land to allow as a capital lease.

¹Citing, Order No. 7020, issued November 1975, in Docket No. 750128-WS; Order No. 17366, issued April 6, 1987, in Docket No. 850031-WS; Order No. 17532, issued on May 8, 1987, in Docket No. 850941-WS; Order No. PSC-93-0301-FOF-WS, issued February 25, 1993, in Docket No. 911188-WS; Order No. PSC-98-1579-FOF-WS, issued November 25, 1998, in Docket No. 980441-WS; and Order No. PSC-98-1585-FOF-WU, issued November 25, 1998, in Docket No. 980445-WU.

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Florida is an original cost jurisdiction. Pursuant to Rule 25-30.115, Florida Administrative Code, we adhere to the National Association of Regulatory Utility Commissioners' Uniform System of Accounts (USOA) in recording land when first dedicated to public use. Accounting Definition 9 for Class C Water Utilities states that utility plant is be [sic] recorded at original cost when first devoted to public service.

In re: Emergency petition by D.R. Horton Custom Homes, Inc., et al., Order No. PSC-00-0917-SC-WS, pp. 5-6, issued May 9, 2000, in Docket Nos. 981609-WS and 980992-WS (emphasis added).

If instead of owning the land, a utility has a 99-year lease for the land, the Commission has a history of limiting the lease expense to recovery of the annual rate of return, based on the utility's current capital structure, times the original cost of the land when **placed in service**. See, Application for staff-assisted rate case in Volusia County by Tymber Creek Utilities, Incorporated, Order No. PSC-11-0345-PAA-WS, p. 14, issued August 16, 2011, in Docket No. 100359-WS (stating, "[c]onsistent with our practice, the appropriate rent amount shall be determined by multiplying the annual rate of return, based on the Utility's current capital structure, by the original cost of the land in service").²

This requirement to limit the lease expense, as outlined above, also prohibits any increases for inflation or other future adjustments. Pursuant to Commission practice, only the original cost of the land is allowed as a factor in the analysis.

The Commission has previously outlined the process for evaluating real estate transactions between related parties as follows:

... it is the utility's burden to establish the original cost of the land when first devoted to public service. In order to make a determination regarding the appropriate treatment of the land, it is necessary to review 1) when the property was dedicated to public use, and 2) what the appropriate cost was at the time of the dedication.

² Id., citing, Order No. PSC-07-0668-PAA-WS, issued August 20, 2007, in Docket No. 060747-WS, In re: Application for staff-assisted rate case in Highlands County by Mink Associates II, LLC d/b/a Crystal Lake Club Utilities; Order No. PSC-04-1264-PAA-SU, issued December 21, 2004, in Docket No. 040300-SU, In re: Application for staff-assisted rate case in Volusia County by Tymber Creek Utilities; Order No. PSC-02-1168-PAA-WS, issued August 26, 2002 in Docket No. 010869-WS; Application for staff-assisted rate case in Marion County by East Marion Sanitary Systems, Inc.; Order No. PSC-00-2054-PAA-WS, issued October 27, 2000, in Docket No. 990939-WS, Application for rate increase in Martin County by Indiantown Company, Inc.; Order No. PSC-00-0807-PAA-WU, issued April 25, 2000, in Docket No. 991290-WU, Application for staff-assisted rate case in Lake County by Brendenwood Water System; and Order No. PSC-96-0663-FOF-WS, issued May 13, 1996, in Docket No. 950336-WS, In re: Application for rate increase in Charlotte County by Rotonda West Utility Corporation.

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In re: Application for rate increase in Charlotte County by Rotonda West Utility Corporation, Order No. PSC-96-0663-FOF-WS, p. 9, issued May 13, 1996, in Docket No. 950336-WS.

While this is not a full rate case where costs are fully vetted and determined, we believe that the issue regarding the proper valuation of land should be addressed in a manner to put the utility on notice of the legal and accounting requirements. In the instant case, the utility's "form" lease does not include a specific amount for the proposed annual rent expense. Nor do the revenue requirement Schedules attached as Exhibit G appear to include a specifically identified amount. The utility has not provided any of the requisite calculations to identify that the lease costs are based on the original cost of the land when first devoted to utility service, such as the specific amount of land required, the value of each parcel of land, or the basis used to determine the value of the land when devoted to public service.

Royalty Expense

The "form" lease provided by the utility also includes a \$.10 royalty per gallon for all water withdrawn over 4,000,000 gallons of water per year. The utility has not provided any calculations to identify that these costs are based on the original cost of the land when first devoted to utility service. The Commission appears to have only addressed the issue of royalty fees in a fully vetted rate case for two utilities - Florida Cities Water Company and Aloha Utilities, Inc.

As cited above, the Commission has stated that Florida is an original cost jurisdiction. In the Florida Cities Water Company cases, the Commission said in each of four orders that, where a royalty is not cost based, it should be disallowed.³ In PSC Order No. 8586, the Commission specifically stated:

[t]his Commission is ever mindful of its duty to protect the public from incestuous corporate relationships that benefit only the corporation. . . This Commission is of the opinion that it must remain ever mindful of the actual cost to the utility required to provide service to its customers. Based upon the foregoing evidence, we find the royalty agreement to be a substantial departure from that cost principle as required by this Commission. We further find insufficient evidence to support the reasonableness of the royalty charge. We shall therefore disallow this charge in determining the revenue requirement.

³ See, Order No. 16768, issued October 24, 1986, in Docket No. 851007-WU, In re: Application of Florida Cities Water Company for increased water rates to its customers in Lee County, Florida; Order No. 12855, issued January 9, 1984, in Docket No. 820232-WS, In re: Application of Florida Cities Water Company for an increase in its rates to its customers in Lee County, Florida; Order No. 10033, issued May 28, 1981, in Docket No. 800323-WS, In re: Application of Florida Cities Water Company for authority to increase its rates and charges in Lee County, Florida; and Order No. 8586, issued December 5, 1978, in Docket No. 770988-WS, In re: Application of Florida Cities Water Company for authority to increase its rates and charges to customers in Lee County, Florida.

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In re: Application of Florida Cities Water Company for authority to increase its rates and charges to customers in Lee County, Florida, Order No. 8586, issued December 5, 1978, in Docket No. 770988-WS; 1978 Fla. PUC LEXIS 42, *10-11.

In a case where the Commission found a royalty expense to be “reasonable” and thus allowed the expense, the reasonableness of the expense was based on the Commission’s determination of the **original cost value** of the land and its related earnings, taxes, and other expenses spread over the expected gallons to be pumped each year.⁴ This also does not allow any increases to be recovered through additional gallons pumped, CPI increases, or other future increases. The royalty was simply another method to recover only the related earnings, taxes, and other expenses based on the original cost of the land. Even with this determination, the Commission did not allow both a lease expense and a royalty expense. Additionally, the royalty expense was only based on a cost basis for the land.

In the Aloha Utilities, Inc. case, the Commission reiterated that it is the utility's burden to prove that its costs are reasonable and that this burden is even greater when the transaction is between related parties. See, In re: Investigation of rates of Aloha Utilities, Inc. in Pasco County for possible overearnings for the Aloha Gardens water and wastewater systems and the Seven Springs water system, Order No. PSC-01-1374-PAA-WS, issued June 27, 2001 in Docket No. 000737-WS.

Based on the documents filed by Consolidated Services in this case, the utility will be leasing the land on which the wells will be located, the Utility will own the plant and equipment used to withdraw the water, the Utility will pay the expenses to withdraw the water, and the Utility will pay all the taxes on the land leased.⁵ The utility has not provided any evidence that the royalty expense is based on any actual costs; therefore, the royalty expense should not be allowed. While this is not a full rate case where costs are fully vetted and determined, this issue should be addressed in a manner to put the utility on notice of the Commission’s precedent and requirements related to royalty and rent expenses.

There is no evidence that the water that the affiliate is selling to the utility has a cost by itself. This being the case, there is no basis upon which the Commission can approve the cost component of the royalty as it is not a reasonably based method of apportioning the cost of the land over a defined period of time. To the extent the royalty is not reasonably related to the cost of the land, the affiliate would be in the business of selling water without a certificate.

⁴ See, Order No. PSC-96-0859-FOF-WU, pp. 14-16, issued July 2, 1996, in Docket No. 951029-WU, In re: Investigation into rates and charges of Florida Cities Water Company - Lee County Division for potential overearnings in Lee County.

⁵ See, Document No. 05335-16 filed in Docket No. 130105-WS, Exhibits D and E.