

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Investigation of rates) DOCKET NO. 961364-WS
of Lindrick Service Corporation) ORDER NO. PSC-97-0076-FOF-WS
in Pasco County for possible) ISSUED: January 27, 1997
overearnings.)
_____)

The following Commissioners participated in the disposition of this matter:

JULIA L. JOHNSON, Chairman
SUSAN F. CLARK
J. TERRY DEASON
JOE GARCIA
DIANE K. KIESLING

ORDER INITIATING INVESTIGATION INTO RATES AND CHARGES
AND
MAKING REVENUES SUBJECT TO REFUND

BY THE COMMISSION:

BACKGROUND

Lindrick Service Corporation (Lindrick or utility) is a Class B utility providing water and wastewater service for approximately 2,255 water and 2,221 wastewater customers in Pasco County. For the test year ended December 31, 1995, the utility reported water operating revenues of \$583,545 and a net operating loss of \$163,575. Wastewater operating revenues were \$605,249, with a net operating income of \$7,485.

Lindrick's last rate case was finalized on November 16, 1983, in Order No. 12691, Docket No. 830062-WS. In that order, rate base was established and the return on equity was set at 14.38% for both water and wastewater. In Docket No. 860089-SU, the Commission initiated an overearnings investigation and lowered rates for the wastewater system only. Pursuant to Order No. 16142, issued May 23, 1986, the return on equity was lowered to 12.65% for the wastewater system. The Commission approved index and pass-through increases in both March and December of 1995.

The purpose of this docket is to initiate an investigation to address the potential for overearnings of Lindrick and to hold revenues subject to refund.

DOCUMENT FILED DATE

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FPSC-RECORDS/REPORTING

INITIATION OF OVEREARNINGS INVESTIGATION AND PLACING REVENUES
SUBJECT TO REFUND

The utility's 1994 annual report was not filed until June of 1995. Upon review of the annual report, our staff discovered several deficiencies. Therefore, our staff notified the utility of these deficiencies, and the utility responded on September 29, 1995. Based on this response, staff determined that Lindrick appeared to be earning a 45.42% overall rate of return for its wastewater system and initiated an informal investigation into potential overearnings. As a part of this investigation, our staff requested an audit of the utility's books for the test year ended December 31, 1995.

Based upon the staff auditor's suggested adjustments, it appears that the utility is underearning by \$34,584 for its water system and overearning by \$154,668 for its wastewater system. As a result of the audit findings, we shall open this docket for an investigation of potential overearnings. Furthermore, the rate base and return on equity shall be set for both water and wastewater, because several years have elapsed since this utility's last rate case.

Test year wastewater operating revenues as adjusted by staff auditors totaled \$706,130 for the year ended December 31, 1995. Based on the auditor's adjusted rate base and net operating income, we calculate the annual revenue requirement to be \$570,402 for wastewater. Based on our preliminary analysis, the water system is operating at a loss, which is more than offset by the potential overearnings. After our staff has completed its investigation, we will be able to determine if the utility is, in fact, overearning.

We have attached accounting schedules to illustrate the approved water and wastewater rate base (Schedules Nos. 1-A and 1-B), capital structure (Schedule No. 2), and test year operating income amounts (Schedules Nos. 3-A and 3-B). These schedules reflect average test year balances as reflected in the audit, as well as specific audit adjustments.

Because there was no filing on the part of the utility, the amounts in the audit do not necessarily reflect the utility's position. These balances do not include any utility calculations for working capital, income taxes or the overall cost of capital. Based on our calculations set out in detail below, and excluding the amounts already subject to refund pursuant to Section 367.081(4)(d), Florida Statutes, Lindrick shall hold annual revenues of \$119,884 subject to refund. With total annual revenues

being \$706,130, reducing that amount by \$119,884 equates to 16.98% of those revenues being subject to refund.

RATE BASE

Our calculation of the appropriate rate base for wastewater for the purpose of this proceeding is depicted on Schedule No. 1-A. Our adjustments are itemized on Schedule No. 1-B. Those adjustments which are self-explanatory or which are essentially mechanical in nature are reflected on those schedules without further discussion in the body of this Order. The major adjustments are discussed below.

CIAC and Accumulated Depreciation

Section 367.082(5)(b)1, Florida Statutes requires that, in calculating the amount to be held subject to refund, adjustments be made consistent with those made in the utility's last rate proceeding. The staff auditor reviewed the utility's books to determine if all adjustments were made to reflect the adjustments required by Order No. 16142, issued May 23, 1986. The audit report revealed that the utility had failed to book the correct amount of contributions-in-aid-of-construction (CIAC) and also failed to use Commission approved guideline depreciation rates. Consequently, the auditor made adjustments to correct CIAC, accumulated amortization of CIAC, and accumulated depreciation. These adjustments are explained on the rate base adjustment schedule.

Working Capital Allowance

Additionally, the auditor used the balance sheet method to calculate working capital, which is consistent with the treatment used in Lindrick's last wastewater rate proceeding. Based on the staff auditor's calculation, the utility's working capital is negative. A negative working capital is not typical of a "normal" utility or the expected future condition of the utility. In Seacoast Utilities, Inc., Docket No. 820073-WS, Order No. 13317, issued May 21, 1984, we used a zero working capital allowance in lieu of the negative amount. For the purposes of establishing final rates for Lindrick, our staff will investigate why a negative working capital exists. However, for interim purposes, we find it appropriate to reflect a working capital allowance of zero.

Based on the above adjustments, we find that rate base for interim purposes is \$106,985 for wastewater.

COST OF CAPITAL

Our calculation of the appropriate cost of capital for wastewater for the purpose of this proceeding is depicted on Schedule No. 2. Those adjustments which are self-explanatory or which are essentially mechanical in nature are reflected on that schedule without further discussion in the body of this Order.

Pursuant to Order No. 16142, Lindrick's return on equity for its wastewater system was set at 12.65%, with a range of 11.65% to 13.65%. Consistent with Section 367.082(2)(b), Florida Statutes, the appropriate rate of return on equity to determine the amount to be held subject to refund is calculated using the maximum of the range of the last authorized rate of return on equity. Using the high-end for the purpose of holding revenues subject to refund, the overall rate of return for interim purposes is calculated to be 12.11%.

NET OPERATING INCOME

Our calculation of the net operating income for wastewater for the purpose of this proceeding is depicted on Schedule No. 3-A. Our adjustments are itemized on Schedule No. 3-B. Those adjustments which are self-explanatory or which are essentially mechanical in nature are reflected on those schedules without further discussion in the body of this Order. The major adjustments are discussed below.

Due to numerous problems encountered with the utility's books and records, the staff auditors have proposed several adjustments to the utility's operating expenses. These adjustments correct errors, remove undocumented charges, remove non-utility charges, correct out-of-period charges, reclassify costs and disallow charges.

Section 367.082(5)(b)1, Florida Statutes, requires that all adjustments be consistent with those made in the utility's last rate proceeding. In accordance with the above statute, we find that all of the auditor's suggested adjustments are applicable, except the \$21,685 adjustment to disallow the salary and benefits for the Secretary-Treasurer. Since this adjustment was not considered in the last rate proceeding, we do not find it appropriate to make an adjustment for the purpose of holding revenues subject to refund. Therefore, the auditor's figures for wastewater operation and maintenance expenses shall be increased by \$21,685.

In addition the auditor did not include an allowance for income taxes or regulatory assessments fees. Therefore, we have included an allowance for both in the revenue requirement calculation.

REVENUE REQUIREMENT

Based on the above, the wastewater revenue requirement is calculated to be \$570,402 for the interim test year. This represents a decrease of \$135,728 or 19.22%. However, we note that Lindrick had a 1994 index and pass-through increase on March 6, 1995, and a 1995 index and pass-through increase on December 8, 1995. These two adjustments increased annual wastewater revenues by \$6,948, and \$8,896, respectively. Pursuant to Section 367.081(4)(d), Florida Statutes, the revenues associated with these increases are already subject to refund. Accordingly, only the additional \$119,884 (\$135,728 less \$15,844) in wastewater revenues, or 16.98%, shall be held subject to refund pending the final determination of any refund requirement.

SECURITY

Pursuant to Section 367.082, Florida Statutes, when revenues are held subject to refund, the utility is authorized to continue collecting the previously authorized rates. The amount of potential overearnings in the wastewater system is \$135,728 on an annual basis. As mentioned above, \$15,844 of the potential overearnings is a result of two indexes and pass-throughs. Pursuant to Section 367.081(4)(d), Florida Statutes, the indexes and pass-throughs are already subject to refund. Therefore, only \$119,884 in annual revenues shall be collected under guarantee, subject to refund with interest. Assuming a 6-month time frame, the potential refund amount is \$61,575.

Based on our financial analysis of the utility's financial statements, the utility cannot support a corporate undertaking for \$61,575 due to marginal interest coverage and minimal profitability. In addition, the combined net income from the profitable years is less than the amount subject to refund, and the average net income over the last three years is negative. Therefore, the utility shall provide a letter of credit, bond or escrow agreement to guarantee the funds collected subject to refund.

If the security provided is an escrow account, that account shall be established between the utility and an independent financial institution pursuant to a written escrow agreement. The Commission shall be party to the written escrow agreement and a

signatory to the escrow account. The written escrow agreement shall state the following: That the account is established at the direction of this Commission for the purpose set forth above; that no withdrawals of funds shall occur without the prior approval of the Commission through the Director of the Division of Records and Reporting; that the account shall be interest bearing; that information concerning that escrow account shall be available from the institution to the Commission or its representative at all times; and that pursuant to Cosentino v. Elson, 263 So. 2d 253 (Fla. 3d DCA 1972), escrow accounts are not subject to garnishments. The utility shall deposit the funds to be escrowed, \$10,263, into the escrow account each month. If a refund to the customers is required, all interest earned by the escrow account shall be distributed to the customers. If a refund to the customers is not required, the interest earned by the escrow account shall revert to the utility.

If the security provided is a bond or a letter of credit, said instrument shall be in the amount of \$61,575. If the utility chooses a bond as security, the bond shall state that it will be released or shall terminate upon subsequent order of the Commission addressing overearnings or requiring a refund. If the utility chooses to provide a letter of credit as security, the letter of credit shall state that it is irrevocable for the period it is in effect and that it will be in effect until a final Commission order is rendered addressing overearnings or requiring a refund.

Irrespective of the type of security provided, the utility shall keep an accurate and detailed account of all monies it receives. Pursuant to Rule 25-30.360(6), Florida Administrative Code, the utility shall provide a report by the 20th of each month indicating the monthly and total revenue collected subject to refund. Should a refund be required, the refund shall be with interest and undertaken in accordance with Rule 25-30.360, Florida Administrative Code.

In no instance shall maintenance and administrative costs associated with any refund be borne by the customers. The costs are the responsibility of, and shall be borne by, the utility.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that an investigation of the wastewater rates and charges of Lindrick Service Corporation shall be initiated. It is further

ORDERED that all matters contained in the schedules attached hereto are by reference incorporated herein. It is further

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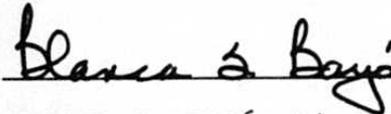
ORDERED that Lindrick Service Corporation shall place \$119,844 (16.98%) annually of its revenues for wastewater service, subject to refund with interest in accordance with Rule 25-30.360, Florida Administrative Code, to the extent set forth in the body of this order. It is further

ORDERED that Lindrick Service Corporation shall provide the Commission with a bond or letter of credit in the amount of \$61,575, or an appropriate escrow agreement as set forth in the body of this Order as a guarantee of any potential refund of wastewater revenues collected subject to refund. It is further

ORDERED that by no later than the twentieth day of each month, the utility shall file a report showing the amount of revenues collected each month and the amount of revenues collected to date relating to the amount subject to refund, pursuant to Rule 25-30.360(6), Florida Administrative Code. It is further

ORDERED that this docket shall remain open.

By ORDER of the Florida Public Service Commission, this 27th day of January, 1997.



BLANCA S. BAYÓ, Director
Division of Records and Reporting

(S E A L)

RRJ

DISSENT

Commissioner J. Terry Deason dissents with opinion:

I respectfully dissent from the decision to ignore the negative portion of working capital when establishing the level of revenues subject to refund. The adjustment is inconsistent with the interim statute, 367.082, Fla. Stat., and is contrary to our internal practices developed to implement the interim statute.

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I have previously expressed a concern about this practice and whether the application of it has lost sight of the original reason for making the adjustment. My understanding of the genesis of the practice was that it was originated in the fact-specific circumstances of a rate case. In Re Application by Seacoast Utilities, Inc., for an increase in the water and sewer rates to its customers in Palm Beach County, Florida, Docket No. 820073, Orders Nos. 12350 and 13317, issued August 10, 1983, and May 21, 1984, respectively. Unfortunately, the practice has evolved into a more or less rote application without regard to whether the underlying circumstances supporting the original instance exist or not. While I have recently expressed concerns about this in the context of rate setting [see, In Re: Application for a rate increase in Flagler County by Palm Coast Utility Corporation, Docket No. 951056-WS, Order No. PSC-96-1338-FOF-WS, issued November 7, 1996], I am even more concerned about the majority's application of this practice in the interim arena.

What concerned me about this issue in the context of interim rates was that the Commission practice has traditionally been to make adjustments to the achieved return based on adjustments made in the most recent rate case. This is strictly in conformance with the interim statute. As it is my understanding that the "zeroing" practice originated in a fact-specific environment, it seemed to me that, absent a rule requiring it, application of the adjustment in the context of placing revenues subject to refund would depend on a determination of the existence of those facts in this case. In this case, it is undisputed that the balance sheet approach was utilized. There never was a need to address the requirement, if any, for a zeroing adjustment. Since there was no adjustment in the last case, there should be none made for interim purposes.

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Any party adversely affected by this order, which is preliminary, procedural or intermediate in nature, may request: (1) reconsideration within 10 days pursuant to Rule 25-22.0376, Florida Administrative Code, if issued by a Prehearing Officer; (2) reconsideration within 15 days pursuant to Rule 25-22.060, Florida Administrative Code, if issued by the Commission; or (3) judicial review by the Florida Supreme Court, in the case of an electric, gas or telephone utility, or the First District Court of Appeal, in the case of a water or wastewater utility. A motion for reconsideration shall be filed with the Director, Division of Records and Reporting, in the form prescribed by Rule 25-22.060, Florida Administrative Code. Judicial review of a preliminary, procedural or intermediate ruling or order is available if review of the final action will not provide an adequate remedy. Such review may be requested from the appropriate court, as described above, pursuant to Rule 9.100, Florida Rules of Appellate Procedure.

LINDRICK UTILITY CORPORATION
 SCHEDULE OF WASTEWATER RATE BASE
 TEST YEAR ENDED 12/31/95

SCHEDULE NO. 1-A
 DOCKET NO. 961364

COMPONENT	BALANCE PER UTILITY 12/31/95	UTILITY ADJUSTMENTS	BALANCE PER UTILITY 12/31/95	COMMISSION ADJUSTMENTS	BALANCE PER COMMISSION 12/31/95
1 UTILITY PLANT IN SERVICE	\$ 2,554,556	0	\$ 2,554,556	0	2,554,556
2 LAND & LAND RIGHTS	19,353	0	19,353	0	19,353
3 NON-USED & USEFUL COMPONENTS	0	0	0	0	0
4 CWIP	0	0	0	0	0
5 ACCUMULATED DEPRECIATION	(1,118,651)	0	(1,118,651)	(232,601)	(1,351,252)
6 CIAC	(2,074,790)	0	(2,074,790)	(108,656)	(2,183,446)
7 AMORTIZATION OF CIAC	796,962	0	796,962	279,888	1,076,850
8 DEBIT DEFERRED INCOME TAXES	(24,901)	0	(24,901)	0	(24,901)
9	15,825	0	15,825	0	15,825
10 ADVANCES FOR CONSTRUCTION	0	0	0	0	0
11 WORKING CAPITAL ALLOWANCE	0	0	0	0	0
12 OTHER	0	0	0	0	0
RATE BASE	\$ 168,354	0	\$ 168,354	(61,369)	106,985

LINDRICK UTILITY CORPORATION
ADJUSTMENTS TO RATE BASE
YEAR ENDED 12/31/95

SCHEDULE NO. 1-B
DOCKET NO. 961364

EXPLANATION	WASTEWATER
ACCUMULATED DEPRECIATION	
To reflect commission approved guideline depreciation rates (Audit Exception #3)	<u>(232,601)</u>
CIAC	
To correct balance (Audit Exception # 2)	<u>(108,656)</u>
ACCUM. AMORT. OF CIAC	
To correct balance (Audit Except #2)	<u>279,888</u>

LINDRICK UTILITY CORPORATION
 CAPITAL STRUCTURE
 TEST YEAR ENDED 12/31/95

SCHEDULE NO. 2
 DOCKET NO. 961364

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DESCRIPTION	TOTAL CAPITAL	SPECIFIC ADJUSTMENTS (EXPLAIN)	PRO RATA ADJUSTMENTS	CAPITAL RECONCILED TO RATE BASE	RATIO	COST RATE	WEIGHTED COST
PER UTILITY 1995 - YEAR-END							
1 LONG TERM DEBT	0	0	0 \$	0	0.00%	0.00%	0.00%
2 SHORT-TERM DEBT	374,323	0	0	374,323	39.55%	9.75%	3.86%
3 PREFERRED STOCK	0	0	0	0	0.00%	0.00%	0.00%
4 COMMON EQUITY	572,070	0	0	572,070	60.45%	10.93%	6.61%
5 CUSTOMER DEPOSITS	0	0	0	0	0.00%	0.00%	0.00%
6 DEFERRED INCOME TAXES	0	0	0	0	0.00%	0.00%	0.00%
7 DEFERRED ITC'S-ZERO COST	0	0	0	0	0.00%	0.00%	0.00%
8 OTHER	0	0	0	0	0.00%	0.00%	0.00%
9 TOTAL CAPITAL	<u>946,393</u>	0	0 \$	<u>946,393</u>	<u>100.00%</u>		<u>10.46%</u>
PER COMMISSION 1995 - 13-MONTH AVERAGE							
10 LONG TERM DEBT	0	0	0 \$	0	0.00%	0.00%	0.00%
11 SHORT-TERM DEBT	374,323	0	(333,254)	41,069	39.55%	9.75%	3.86%
12 PREFERRED STOCK	0	0	0	0	0.00%	0.00%	0.00%
13 COMMON EQUITY	572,070	0	(509,305)	62,765	60.45%	13.65%	8.25%
14 CUSTOMER DEPOSITS	0	0	0	0	0.00%	6.00%	0.00%
15 DEFERRED INCOME TAXES	0	0	0	0	0.00%	0.00%	0.00%
15 DEFERRED ITC'S-ZERO COST	0	0	0	0	0.00%	0.00%	0.00%
16 OTHER	0	0	0	0	0.00%	0.00%	0.00%
17 TOTAL CAPITAL	<u>946,393</u>	0	<u>(842,559) \$</u>	<u>103,834</u>	<u>100.00%</u>		<u>12.11%</u>
RANGE OF REASONABLENESS					LOW	HIGH	
RETURN ON EQUITY					<u>11.65%</u>	<u>13.65%</u>	
OVERALL RATE OF RETURN					<u>10.90%</u>	<u>12.11%</u>	

LINDRICK UTILITY CORPORATION
 STATEMENT OF WASTEWATER OPERATIONS
 TEST YEAR ENDED 12/31/95

SCHEDULE NO. 3-A
 DOCKET NO. 961364

DESCRIPTION	BALANCE PER UTILITY 12/31/95	ADJUSTMENTS	BALANCE PER UTILITY 12/31/95	COMMISSION ADJUSTMENTS	BALANCE PER COMMISSION 12/31/95	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	\$ 606,393	\$ 0	\$ 606,393	99,737	706,130	(140,428)	565,702
OPERATING EXPENSES						-19.89%	
2 OPERATION AND MAINTENANCE	\$ 526,652	\$ 0	\$ 526,652	(76,030)	450,622		450,622
3 DEPRECIATION	57,998	0	57,998	26,072	84,070		84,070
4 AMORTIZATION	(37,650)	0	(37,650)	(513)	(38,163)		(38,163)
5 TAXES OTHER THAN INCOME	56,819	0	56,819	0	56,819	(6,319)	50,500
6 INCOME TAXES	0	0	0	58,452	58,452	(52,732)	5,720
7 TOTAL OPERATING EXPENSES	\$ 603,819	\$ 0	\$ 603,819	7,981	611,800	(59,051)	552,749
8 OPERATING INCOME	\$ 2,574	\$ 0	\$ 2,574	91,756	94,330	(81,377)	12,953
9 RATE BASE	\$ 168,354	\$ 106,985			106,985		106,985
RATE OF RETURN	1.53%	2.41%			88.17%		12.11%

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LINDRICK UTILITY CORPORATION
 ADJUSTMENTS TO OPERATING STATEMENTS
 TEST YEAR ENDED 12/31/95

SCHEDULE NO. 3-B
 DOCKET NO. 961364

EXPLANATION	WASTEWATER
OPERATING REVENUES	
To annualize revenues (Audit Disclosure # 3)	\$ <u>99,737</u>
OPERATION & MAINTENANCE EXPENSE	
1 To adjust unsupported expenses (Audit Disc # 6)	(737)
2 To remove salary for Sec/Tres (AD 9)	(19,656)
3 To remove non-utility related transportation expenses (AD 10)	(8,660)
4 To remove employee benefits for Sec/Tres & non-employee personnel (AD 11)	(12,629)
5 To reclassify purchased power and remove out of period charges (AD 12)	16,761
6 To remove duplicative & non-supported expenses (AD 13)	(12,173)
7 To remove capitalized, undocumented, & duplicative costs (AD 14)	(33,076)
8 To remove duplicative rental expenses (AD 15)	(3,869)
9 To adjust Contract Serv for duplicative, capitalized, and undocumented charges (AD 16)	(19,414)
10 To remove non-utility related insurance expenses (AD 17)	(4,262)
11 To add back salary for Sec-Tres	19,656
12 To add back benefits for Sec-Tres	<u>2,029</u>
Total	\$ <u>(76,030)</u>
DEPRECIATION EXPENSE-NET	
To reflect guideline rates (AE 3)	\$ <u>26,072</u>
AMORTIZATION OF ACQUISITION ADJUSTMENT	
To reflect correct amount (AD 1)	\$ <u>(513)</u>
TAXES OTHER THAN INCOME TAXES	
Regulatory assessment fees on annualized revenues	\$ <u>0</u>
INCOME TAXES	
To adjust to test year income tax expense	\$ <u>58,452</u>
OPERATING REVENUES	
Adjustment to reflect revenue requirement	\$ <u>(140,428)</u>
TAXES OTHER THAN INCOME TAXES	
Regulatory assessment taxes on additional revenues	\$ <u>(6,319)</u>
INCOME TAXES	
Income taxes related to revenue requirement	\$ <u>(52,732)</u>