

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Response to Commission  
order to show cause by Mad  
Hatter Utility, Inc. in Pasco  
County.

DOCKET NO. 961418-SU  
ORDER NO. PSC-97-0681-FOF-SU  
ISSUED: June 11, 1997

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

NOTICE OF PROPOSED AGENCY ACTION  
ORDER APPROVING SETTLEMENT PROPOSAL OF  
MAD HATTER UTILITY, INC.

AND

ORDER RESOLVING SHOW CAUSE PROCEEDING

BY THE COMMISSION:

NOTICE is hereby given by the Florida Public Service Commission that the action discussed herein approving Mad Hatter Utility, Inc.'s offer of settlement and requiring no refund is preliminary in nature and will become final unless a person whose interests are substantially affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

BACKGROUND

Section 367.081(4)(b), Florida Statutes, provides that the approved rates of any utility which receives all or any portion of its utility service from a governmental authority or from a water or wastewater utility regulated by the Commission and which redistributes that service to its utility customers shall be automatically increased or decreased without hearing, upon verified notice to the Commission 45 days prior to its implementation of the

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FPSO-REGISTRATION REPORTING

increase or decrease that the rates charged by the governmental authority or other utility have changed.

On December 12, 1995, after a public hearing, the Pasco County Board of County Commissioners approved a rate change for all customers encompassing the period of January 1, 1996 through September 30, 1999. As a result of this rate change, the rates for all bulk water and/or wastewater customers were decreased effective January 1, 1996. On December 20, 1995, the Commission staff received from Pasco County copies of the notices it sent to utilities regulated by the Florida Public Service Commission (PSC), advising the utilities of the bulk water and/or wastewater rate change. There are nine PSC regulated utilities which purchase water and/or wastewater from Pasco County. According to the notice, Pasco County extended the January 1, 1996 effective date until April 1, 1996 in order to allow the utilities sufficient time to contact the Commission and/or incorporate the new charges into its rate structure.

The bulk water and/or wastewater rate change approved by Pasco County qualifies for a pass-through rate adjustment for PSC regulated utilities pursuant to Section 367.081(4)(b), Florida Statutes. Section 367.081(4)(e), Florida Statutes, provides that a utility may not adjust its rates under this subsection more than two times in any 12 month period. Therefore, on March 29, 1996, staff sent letters to the nine affected utilities regarding the Pasco County rate change advising them that because Pasco County approved two rate changes in 1996, the utilities had the option of using the pass-through statute to adjust their rates accordingly. Specifically, staff informed the utilities that one of the rate changes could be filed as a pass-through in conjunction with an index and the other pass-through adjustment could be filed separately to be effective for October 1, 1996.

Only three of the nine (Utilities Inc. of Florida, Betmar Utilities, Inc. and Jasmine Lakes Utilities Corporation) filed for a pass-through rate reduction. Another utility, Virginia City Utilities, Inc. (Virginia City) had a staff assisted rate case in Docket No. 960625-WU, through which the county's decreased rates were incorporated. By Order No. PSC-96-1226-FOF-WS, issued September 27, 1996, in Docket No. 960878-WS, the remaining five utilities, Hudson Utilities, Inc., d/b/a, Hudson Bay Company (Hudson); Forest Hills Utilities, Inc. (Forest Hills); Mad Hatter Utilities, Inc. (MHU or Utility); Aloha Utilities, Inc. (Aloha); and Southern States Utilities, Inc. (SSU) were ordered to show

cause in writing why their rates should not be adjusted, effective April 1, 1996, to reflect the reduction in purchased water and/or wastewater costs to bulk water and/or wastewater customers in Pasco County. Order No. PSC-96-1226-FOF-WS also required the utilities to file the information required by Rule 25-30.425(1)(a) through (f), Florida Administrative Code, along with a calculation of the rate reduction. By Order No. PSC-97-0458-FOF-SU, issued April 22, 1997, in Docket No. 961417-SU, we ordered that no refund was appropriate for Hudson Utilities, Inc. Further, by Order No. PSC-97-0457-FOF-WU, issued April 22, 1997, in Docket No. 961428-SU, we ordered that no reduction in rates was required for Forest Hills. However, to date, no decision has been made in the cases of MHU, Aloha, and SSU.

On October 17, 1996, MHU filed its response to the show cause order. In its response, MHU requested a waiver of that provision of the Order requiring it to file the information required by Rule 25-30.425(1)(a) through (f), Florida Administrative Code, along with a calculation of the rate reduction. In addition, to the extent that we propose to retroactively apply any reduction based upon the reduced purchased costs, MHU requested a hearing on the questions of the appropriate level of any prospective rate reduction and overearnings and on the legality and appropriateness and amount of any retroactive rate reduction.

At the April 1, 1997 agenda conference, after much discussion, we deferred this item to allow our staff time to review the settlement proposal offered by the utility in its October 17, 1996 response to the show cause order. On April 18, 1997, the utility provided a revised settlement proposal which included a calculation of the actual 1996 cost savings from April 1, 1996 through December 31, 1996 and the annualized cost savings to the utility, resulting from the reduced cost of purchased wastewater treatment.

MHU is a Class B utility serving approximately 1,890 water and 1,804 wastewater customers in Pasco County. MHU owns and operates water and wastewater systems in three separate communities: Linda Lakes, Foxwood and Turtle Lakes. According to the utility's 1995 annual report, gross annual operating revenues were \$442,014 and \$856,686 for the water and wastewater systems, respectively. The utility reported net operating revenue of \$37,123 for the water system and \$4,092 for the wastewater system. The utility's 1996 annual report reflected gross annual operating revenues of \$468,225 and \$876,750 for the water and wastewater systems, respectively.

Net operating income was reported as \$42,359 for water and \$60,486 for wastewater.

REQUEST FOR WAIVER

In its written response to the show cause order, MHU contends that the second ordering paragraph of Order No. PSC-96-1226-FOF-WS, which requires each utility to file the information required by Rule 25-30.425(1)(a) through (f), Florida Administrative Code, along with a calculation of the rate reduction, is contrary to our decision at agenda and the filing of that information prior to a determination of what, if any, rate reduction is appropriate is premature and a waste of the utility's time, resources, and consulting fees. Further, the utility requests a waiver of that provision of the Order until such time as a determination is made as to the amount, if any, of a rate reduction for the utility's systems. However, because we were able to obtain the necessary and pertinent information from other independent sources, we find that this issue is now moot, and a decision regarding the utility's request for a waiver is no longer required.

MHU'S OFFER OF SETTLEMENT

MHU owns and operates water and wastewater systems in three separate communities: Linda Lakes, Foxwood and Turtle Lakes. The utility does not purchase water from Pasco County. However, MHU's Foxwood and Turtle Lakes systems purchase wastewater treatment from Pasco County. MHU's Linda Lakes system does not purchase any wastewater treatment from Pasco County. As stated earlier, on October 17, 1996, MHU filed its response to Order No. PSC-96-1226-FOF-WS, which required MHU to show cause in writing why its rates should not be adjusted to reflect the reduction in purchased water and/or wastewater costs to bulk water and/or wastewater customers in Pasco County.

The utility asserts in its response that it disagrees with the proposition that this Commission has the statutory authority to require a decrease in rates of a regulated utility based upon a decrease in the cost of bulk service received from a governmental provider. The utility further asserts that it does not believe this Commission may reduce rates under Section 367.081(4)(b), Florida Statutes, or any other statutory section without first determining that overearnings exist.

We believe, however, that this Commission is vested with the authority to order a reduction in rates when the utility fails to initiate a decrease pursuant to Section 367.081(4)(b), Florida Statutes. We further believe that it is appropriate for this Commission to require pass-through decreases in the event that the utility meets or exceeds the minimum of its authorized range of return on equity to reflect the reduction in purchased water and/or wastewater costs to bulk water and/or wastewater customers in Pasco County. This is consistent with our decisions in the cases of Hudson Utilities, Inc., Docket No. 961417-SU, Order No. PSC-97-0458-FOF-SU and Forest Hills Utilities, Inc., Docket No. 961428-SU, Order No. PSC-97-0457-FOF-WU, both issued April 22, 1997.

In its response, MHU failed to file the information required by Rule 25-30.425(1)(a) through (f), Florida Administrative Code, pursuant to Order No. PSC-96-1226-FOF-WS. Instead, MHU provided the same legal arguments it raised at the September 3, 1996 agenda conference. In addition, the utility provided a narrative assessment of each system, proposing to reduce its rates for the Foxwood and Turtle Lakes wastewater systems, on a prospective basis, for the entire amount of the reduction in purchased wastewater treatment.

In its response to Order No. PSC-96-1226-FOF-WS, the utility presented the following arguments: Because MHU purchases the majority of its wastewater treatment from Pasco County and because the reduction in purchased wastewater treatment cost will have a material impact on the utility's operations, the utility does concede that this reduction in cost may result in an achieved rate of return for 1996 which exceeds the utility's last authorized rate of return. Some portion of this reduced cost will only cause the utility's achieved rate of return on a prospective basis to approach or equate to its authorized rate of return. However, rather than incur the substantial costs of responding to further inquiries and of litigation, the utility is willing on a prospective basis to reduce rates for the entire amount of the reduction in purchased wastewater treatment for its Foxwood and Turtle Lakes Systems, the only systems which purchase wastewater treatment from Pasco County. In addition, the utility stated that if we accept the prospective proposal by MHU to pass-through the reduction in purchased wastewater treatment, based upon the difference in the rate applied in 1995 and that effective October 1, 1996, MHU will immediately file the information necessary to effectuate that pass-through in wastewater charges.

In the absence of the utility filing the information required by Rule 25-30.425(1)(a) through (f), Florida Administrative Code, we used the information contained in the utility's 1995 annual report to calculate the rate reduction. Using the most recent purchases from Pasco County for the twelve month period ended December 31, 1995, we calculated the decreased cost in purchased wastewater treatment.

In its April 18, 1997 revised settlement proposal, the utility updated its October 17, 1996 proposed offer of settlement, based upon actual information for 1996. The utility provided actual 1996 purchases of wastewater treatment from Pasco County and a calculation of the actual 1996 cost savings from April 1, 1996 to December 31, 1996 and the annualized cost savings resulting from the reduced cost to the utility of the purchased wastewater treatment. The information showed that the utility purchased 120,979,000 gallons of wastewater treatment from Pasco County in 1996. On April 1, 1996, Pasco County's bulk wastewater rate was reduced from \$3.11 to \$2.20 per thousand gallons. On October 1, 1996, the rate was increased from \$2.20 to \$2.23. The utility calculated a reduction in cost of \$106,462 by multiplying the total thousands of gallons purchased (120,979) by \$.88, the difference in the old purchased wastewater treatment rate and the new rate (\$3.11 - \$2.23). This amount was then adjusted for regulatory assessment fees at 4.5%, resulting in a total cost savings of \$111,479.

However, based on the utility's 1996 annual report, the utility's net income was \$60,486, resulting in an achieved rate of return of 26.09%. As a result, the utility calculated an overearnings for 1996 of \$35,494. The utility stated that because only approximately one-third of the cost savings will result in overearnings to the utility, an adjustment to the original settlement proposal of October 17, 1996 was necessary to avoid pushing the utility into a substantial loss position. The utility, therefore, proposes to reduce rates for the Foxwood and Turtle Lakes wastewater systems by a total of \$70,000. The utility stated that this offer would not only cover any refund which would be appropriate under an earnings test for 1996, but also would include the prospective reduction. Further, the utility states that the customers would receive twice the prospective rate reduction to which they are entitled and would receive that reduction on an unlimited prospective basis.

As stated previously, we believe that a utility's rates should be reduced to reflect a reduction in purchased water and/or wastewater costs in the event that the utility meets or exceeds the minimum of its authorized range of return on equity. By Order No. PSC-93-0295-FOF-WS, issued February 24, 1993, in Docket No. 910637-WS, we authorized MHU a 12.44% return on equity, with a range of reasonableness between 11.44% to 13.44%. Further, MHU's rate of return was set at 10.78%, with a range of 10.71% to 10.85%. Based on a review of the 1995 annual report and other documents on file, we calculated an achieved rate of return of 1.56% for the wastewater system and a negative return on equity of 2.14% prior to any decrease in purchased wastewater treatment costs. Because the utility did not meet or exceed the minimum of its authorized range of return on equity, no reduction would be required.

However, as previously stated, the utility indicated that approximately one-third of the costs savings would result in overearnings to the utility in 1996. Therefore, to avoid costly litigation and the substantial cost entailed in any potential refund, the utility proposes to reduce its rates by \$70,000 or \$.52 per thousand gallons (\$70,000/133,625) on a prospective basis.

We have reviewed the information provided by the utility in its April 18, 1997 settlement proposal, and we have also reviewed the utility's 1996 annual report. Based on the 1996 annual report, the utility's achieved rate of return was 26.09%, and the allowed rate of return based on the utility's current capital structure is 8.97%. Therefore, the utility is in an overearnings position for 1996. The utility's current capital structure consists of 94.78% debt and 5.22% customer deposits. The utility has a deficit in its retained earnings; as such, the allowed rate of return calculation for 1996 does not include an equity component. As a result, we calculate that the utility's allowed net operating income should be \$20,796, instead of \$24,992 as reflected in the utility's proposed settlement proposal of April 18, 1997. As a result, we have calculated the amount of overearnings for 1996 to be \$39,690 (\$60,486 - \$20,796), instead of \$35,494 as calculated by the utility. However, for purposes of this proceeding, we find that the utility's proposed reduction of \$70,000 on a prospective basis is a reasonable offer of settlement to cover any proposed refund which would be appropriate under an earnings test for 1996 as a result of the purchased wastewater decrease and the prospective rate reduction. We, therefore, approve the utility's settlement proposal to reduce the rates for the Foxwood and Turtle Lakes

wastewater systems by \$70,000 or \$.52 per thousand gallons of wastewater treated, on a prospective basis.

In addition to adjusting its wastewater rates, the utility shall file revised tariff sheets along with a proposed customer notice reflecting the appropriate rates and the reason for the reduction. The rates shall be effective for service rendered as of the stamped approval date on the tariff sheets provided the customers have received notice. The tariff sheets shall be approved upon staff's verification that the tariffs are consistent with our decision and that the customer notice is adequate. The utility shall provide proof of the date notice was given within 10 days after the date of the notice.

If the effective date of the new rates falls within a regular billing cycle, the initial bills at the new rates may be prorated. The old charge shall be prorated based on the number of days in the billing cycle before the effective date of the new rates. The new charge shall be prorated based on the number of days in the billing cycle on or after the effective date of the new rates. In no event shall the rates be effective for service rendered prior to the stamped approval date.

#### REFUND

As previously stated, the utility did not meet or exceed the minimum of the range of its last authorized rate of return on equity; therefore, we find that no reduction in rates would be required as a result of the pass-through decrease, and no refund is appropriate.

#### CLOSING OF DOCKET

Upon expiration of the protest period, if a timely protest is not received from a substantially affected person, this docket shall be closed.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the offer of settlement of Mad Hatter Utility, Inc. to reduce the rates for the Foxwood and Turtle Lakes wastewater systems on a prospective basis by \$70,000 or \$.52 per thousand gallons of wastewater treated is hereby approved. It is further

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ORDERED that the rate decrease approved herein shall be effective for service rendered on or after the stamped approval date of the revised tariff sheets. It is further

ORDERED that, prior to implementation of the rate decrease approved herein, Mad Hatter Utility, Inc. shall submit a proposed customer notice explaining the decreased rates and the reasons therefor. It is further

ORDERED that, prior to the implementation of the rate decrease approved herein, Mad Hatter Utility, Inc. shall submit and have approved revised tariff sheets. The revised tariff sheets will be approved upon staff's verification that they are consistent with this Commission's decision and that the proposed customer notice is adequate. It is further

ORDERED that each of the findings made in the body of this Order is hereby approved in every respect. It is further

ORDERED that the provisions of this Order, issued as proposed agency action, shall become final and effective unless an appropriate petition, in the form provided by Rule 25-22.036, Florida Administrative Code, is received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings or Judicial Review" attached hereto. It is further

ORDERED that in the event this Order becomes final, this Docket shall be closed.

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By ORDER of the Florida Public Service Commission, this 11th  
day of June, 1997.

  
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BLANCA S. BAYÓ, Director  
Division of Records and Reporting

( S E A L )

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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.

Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

The action proposed herein approving Mad Hatter Utility, Inc.'s offer of settlement and requiring no refund is preliminary in nature and will not become effective or final, except as provided by Rule 25-22.029, Florida Administrative Code. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, as provided by Rule 25-22.029(4), Florida Administrative Code, in the form provided by Rule 25-22.036(7)(a) and (f), Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on July 2, 1997.

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In the absence of such a petition, this order shall become effective on the day subsequent to the above date as provided by Rule 25-22.029(6), Florida Administrative Code.

Any objection or protest filed in this docket before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

If this order becomes final and effective on the date described above, any party substantially affected may request judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or by the First District Court of Appeal in the case of a water or wastewater utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days of the effective date of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.