

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation into rates
and charges of Florida Cities
Water Company - Lee County
Division (South Ft. Myers
Wastewater System) for potential
overearnings.

DOCKET NO. 970991-SU
ORDER NO. PSC-97-1125-PCO-SU
ISSUED: September 25, 1997

The following Commissioners participated in the disposition of
this matter:

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

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

BY THE COMMISSION:

BACKGROUND

Florida Cities Water Company - Lee County Division (FCWC or utility) is a Class A utility that provides wastewater service for two communities in Ft. Myers, Florida: a northern sector and a southern sector. The South Ft. Myers wastewater system was serving approximately 8,966 equivalent residential connections as of December 31, 1996. For the twelve months ended December 31, 1996, the South Ft. Myers wastewater system reported operating income of \$805,958, inclusive of revenues for the treatment of Lee County wastewater under an amended agreement dated August 28, 1996.

Lee County had approached FCWC regarding treatment and disposal of reclaimed water from its Ft. Myers Beach wastewater treatment plant as a short-term response to an emergency situation which had developed at the plant. Due to inadequate disposal capacity through the reuse of reclaimed water, Lee County's storage ponds overflowed. Lee County then entered into a consent order with the Florida Department of Environmental Protection to address

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ORDER NO. PSC-97-1125-PCO-SU
DOCKET NO. 970991-SU
PAGE 2

the overflow. While Lee County plans to construct a deep well injection system as a permanent solution, FCWC agreed to receive and dispose of the reclaimed water from Lee County as a temporary measure, which should not extend beyond July, 1998.

We considered this agreement in Docket No. 961231-WS. In that docket, FCWC requested that the revenues received by FCWC pursuant to the agreement with Lee County be treated as nonrecurring so that they would not be considered in determining the level of regulated earnings for FCWC. The utility requested that, if the revenue from the agreement caused overearnings, we defer those overearnings to subsequent years.

Subsequently, we issued Order No. PSC-97-0019-FOF-WS on January 6, 1997. That Order authorized FCWC to charge for a new class of service to treat and dispose of reclaimed water from Lee County.

By Order No. PSC-97-0019-FOF-WS, we also found it appropriate to treat the estimated annual revenues of \$122,912 associated with the agreement as nonrecurring. However, we required FCWC to file semiannual earnings reports to allow our staff to monitor the utility's earnings. Additionally, if the revenues associated with the agreement placed FCWC outside its approved rate of return, the matter was to be addressed in a subsequent docket.

INITIATION OF INVESTIGATION INTO POSSIBLE OVEREARNINGS

A review of FCWC's 1996 Annual Report indicates that the utility's wastewater system in South Ft. Myers may be exceeding its last authorized return on equity investment. The increase in revenues due to FCWC's agreement with Lee County has almost certainly caused the overearnings posture of the South Ft. Myers wastewater system.

Our review of FCWC's 1996 Annual Report indicates that FCWC's South Ft. Myers wastewater system was earning a 10.06 percent overall return on rate base at year-end 1996. Our review also indicates an achieved rate of return on equity of approximately 18.08 percent for this period. The maximum authorized return on equity was set at 13.44 percent, by Order No. PSC-93-1288-FOF-SU, issued on September 7, 1993. Based on this analysis, we shall, pursuant to Sections 367.081(4)(d) and 367.082, Florida Statutes, initiate an investigation of the level of wastewater rates to determine potential overearnings.

REVENUES SUBJECT TO REFUND

According to FCWC's 1996 Annual Report, the utility achieved a 10.06 percent overall rate of return for wastewater service in South Ft. Myers. In the utility's last rate proceeding for the South Ft. Myers wastewater system, by Order No. PSC-93-1288-FOF-SU, issued on September 7, 1993, we approved a range of reasonableness for total capital investment from 8.60 to 9.18 percent. Also, that Order approved a range for the rate of return on equity of 11.44 percent to 13.44 percent.

Using the maximum return on equity of 13.44 percent, and appropriate interest rates for other components in the capital structure, a 9.56 percent overall cost of capital is indicated. Additionally, our preliminary review suggests that the utility achieved a 18.08 percent return on equity investment in 1996 with respect to wastewater service in South Ft. Myers.

Section 367.082(5)(b), Florida Statutes, requires that adjustments consistent with those made in the last individual rate proceeding shall be made in arriving at the achieved rate of return of the utility. Additionally, the statute requires the annualization of any rate changes that occurred during the test period. We have made the appropriate adjustments, and our adjustments are outlined in the respective sections below.

We have attached accounting schedules to illustrate our recommendations regarding rate base (Schedules 1-A and 1-B), capital structure (Schedule 2), and test year operating income (Schedules 3-A and 3-B).

Rate Base

Our calculation of the South Ft. Myers wastewater rate base balance is based upon information shown in the utility's 1996 Annual Report. Rule 25-30.433(4), Florida Administrative Code, requires Class A utilities to calculate rate base and cost of capital using a 13-month average. Since month-by-month balances are not contained in the annual report, simple averages were computed using the beginning and ending balances for all rate base components. For interim purposes, working capital was calculated using the formula method (one-eighth of Operations and Maintenance expenses), which is consistent with the method used in FCWC's last wastewater rate proceeding. Based on this methodology, working capital should be \$198,747. Our rate base amount also reflects an allocation of FCWC's total unfunded SFAS 106 Obligation (Post-

Retirement Benefits). Accordingly, the rate base for the South Ft. Myers wastewater system is \$7,883,672.

Cost of Capital

The capital structure for interim refund purposes reflects the utility's outstanding capital balances shown in FCWC's 1996 Annual Report. Simple averages were computed using the beginning and ending balances for each component of the capital structure. In accordance with Section 367.082(2)(b), Florida Statutes, the amount held subject to refund is calculated using the top of the range of the last authorized return on equity investment, or 13.44 percent. Applying the 13.44 percent, and applicable interest rates for other components of the capital structure, the weighted cost of capital for purposes of holding revenues subject to refund is 9.56 percent.

Net Operating Income

On or about June 14, 1996, the utility implemented a price-index adjustment that increased revenues by \$35,096 on an annual basis. In accordance with the interim statute, the full revenue impact of that adjustment has been annualized and is reflected as an increase of \$17,548 to test year revenues.

Also, in accordance with the interim statute, test-year revenues have been increased for the revenues received by FCWC for the treatment of Lee County wastewater, as the charges for this new class of service went into effect July 10, 1996. The basis for this adjustment is the \$151,007 reported by the utility, net of tax, on page 20, Schedule S-1 of the 1996 annual report. We have grossed-up these revenues for the utility's 34 percent federal tax bracket, 5.5 percent state tax rate, and 4.5 percent for regulatory assessment fees, which resulted in a revenue increase of \$253,523, or \$507,045 on an annual basis. Additionally, we have decreased operation and maintenance expenses by \$27,230, which represents our approved rate case expense in the utility's last wastewater rate proceeding. All other components in the statement of wastewater operations were taken from FCWC's 1996 Annual Report.

These adjustments result in a revenue requirement of \$3,512,246 for the interim test period. This represents a decrease of \$316,076 or 8.26 percent from the adjusted test-year balance. Pursuant to Section 367.081(4)(d), Florida Statutes, the annual revenues of \$35,096 associated with the 1996 index adjustment are already subject to refund. Therefore, only an additional \$280,980 (\$316,076 less \$35,096) or 7.34 percent in wastewater revenues

ORDER NO. PSC-97-1125-PCO-SU
DOCKET NO. 970991-SU
PAGE 5

shall be held subject to refund pending our final determination on overearnings.

SECURITY FOR FUNDS HELD SUBJECT TO REFUND

Pursuant to Section 367.082, Florida Statutes, the utility is authorized to continue collecting the previously authorized rates. As determined above, the amount of potential overearnings for the wastewater system is \$316,076 on an annual basis. The utility filed for an index in 1996, which was effective for service rendered after June 14, 1996. According to Section 367.081(4)(d), Florida Statutes, an index is subject to refund for up to fifteen months after the date of filing of the annual report for the year the index was implemented. The utility's 1996 annual report was filed on March 31, 1997, and fifteen months from that date is June 30, 1998. Since that index is already subject to refund, only \$280,980 in annual revenues shall be collected under guarantee, subject to refund with interest. Assuming a 12-month time frame, the potential refund, with interest, is \$296,566.

The Division of Auditing and Financial Analysis has advised that a corporate undertaking signed by FCWC would be sufficient to protect the potential refund. Therefore, FCWC shall file a corporate undertaking in the amount of \$296,566 as guarantee for any potential refund of wastewater revenues collected under the interim conditions.

Further, an accurate and detailed account of all monies received shall be kept by the utility. By no later than the twentieth day of each month, the utility shall file a report showing the amount of revenues collected each month subject to refund. Should a refund be required, the refund shall be with interest and 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. These costs are the responsibility of and shall be borne by the utility.

CLOSING OF DOCKET

Pending determination of whether the utility is overearning, this docket shall remain open.

ORDER NO. PSC-97-1125-PCO-SU
DOCKET NO. 970991-SU
PAGE 6

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that an investigation of the wastewater rates of Florida Cities Water Company - Lee County Division, South Ft. Myers wastewater system, shall be initiated. It is further

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

ORDERED that Florida Cities Water Company - Lee County Division, South Ft. Myers wastewater system, shall place \$280,980 (7.34 percent) 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 Florida Cities Water Company - Lee County Division shall provide the Commission with a corporate undertaking in the amount of \$296,566 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 Florida Cities Water Company - Lee County Division shall keep an accurate and detailed account of all monies 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

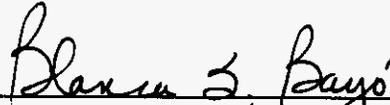
ORDERED that should a refund be required, the refund shall be with interest and undertaken in accordance with Rule 25-30.360, Florida Administrative Code. It is further

ORDERED that no maintenance or administrative costs associated with any refund shall be borne by the customers. It is further

ORDERED that this docket shall remain open.

ORDER NO. PSC-97-1125-PCO-SU
DOCKET NO. 970991-SU
PAGE 7

By ORDER of the Florida Public Service Commission this 25th
day of September, 1997.



BLANCA S. BAYÓ, Director
Division of Records and Reporting

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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.

Any party adversely affected by the Commission's decision to initiate an investigation into overearnings in this matter, which is final action, may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or 2) 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 and/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 after the issuance

ORDER NO. PSC-97-1125-PCO-SU
DOCKET NO. 970991-SU
PAGE 8

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.

For the decision making revenues subject to refund, which is preliminary, procedural, or intermediate in nature, any party adversely affected by this order may do (1) and (2) in the paragraph above. However judicial review of a preliminary, procedural or intermediate ruling or order is available only 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.

FCWC -- SOUTH FT. MYERS WASTEWATER SCHEDULE OF WASTEWATER RATE BASE TEST YEAR ENDED 12/31/96				SCHEDULE NO. 1-A DOCKET NO. 970991-SU	
COMPONENT	AVG. BAL. PER UTILITY ANNUAL RPT.	UTILITY ADJUSTMENTS	UTILITY ADJUSTED TEST YEAR 12/31/96	COMMISSION ADJUSTMENTS	COMMISSION ADJUSTED TEST YEAR 12/31/96
1 UTILITY PLANT IN SERVICE	\$ 27,135,082	0 \$	27,135,082		27,135,082
2 LAND	0	0	0	0	0
3 NON-USED & USEFUL COMPONENTS	(1,843,500)	0	(1,843,500)	0	(1,843,500)
4 CONSTRUCTION WORK IN PROGRESS	0	0	0	0	0
5 ACCUMULATED DEPRECIATION	(8,961,153)	0	(8,961,153)	0	(8,961,153)
6 CIAC	(13,329,612)	0	(13,329,612)	0	(13,329,612)
7 AMORTIZATION OF CIAC	4,734,950	0	4,734,950	0	4,734,950
8 ADVANCES FOR CONSTRUCTION	0	0	0	0	0
9 WORKING CAPITAL ALLOWANCE	202,503	0	202,503	(3,756)	198,747
10 OTHER: ALLOC. OF GENERAL OFFICE	0	0	0	0	0
11 UNFUNDED SFAS 106 OBLIGATION	0	0	0	(50,841)	(50,841)
RATE BASE	\$ 7,938,270	0 \$	7,938,270	(54,597)	7,883,672

ORDER NO. PSC-97-1125-PCO-SU
DOCKET NO. 970991-SU
PAGE 10

FCWC -- SOUTH FT. MYERS WASTEWATER
ADJUSTMENTS TO RATE BASE
TEST YEAR ENDED 12/31/96

SCHEDULE NO. 1-B
DOCKET NO. 970991-SU
PAGE 1 OF 1

EXPLANATION	WASTEWATER
1 <u>UNFUNDED SFAS 106 OBLIGATION</u> Adjustment to allocate a portion of the average bal. to South Ft. Myers system	\$ (50,841)
2 <u>WORKING CAPITAL</u> Adjustment to reflect one-eighth of O&M Expenses	\$ (3,756)

FCWC -- SOUTH FT. MYERS WASTEWATER
 CAPITAL STRUCTURE - WASTEWATER
 TEST YEAR ENDED 12/31/96

SCHEDULE NO. 2
 DOCKET NO. 970991-SU

ORDER NO. PSC-97-1125-PCO-SU
 DOCKET NO. 970991-SU
 PAGE 11

DESCRIPTION	TOTAL CAPITAL	SPECIFIC ADJUSTMENTS (EXPLAIN)	PRO RATA ADJUSTMENTS	CAPITAL RECONCILED TO RATE BASE	RATIO	COST RATE	WEIGHTED COST
PER UTILITY							
1 LONG TERM DEBT	34,214,167	0	(30,224,337) \$	3,989,830	46.03%	7.81%	3.59%
2 SHORT-TERM DEBT	0	0	0	0	0.00%	9.00%	0.00%
3 PREFERRED STOCK	9,000,000	0	(8,019,341)	980,659	11.31%	9.00%	1.02%
4 COMMON EQUITY	23,405,734	0	(20,751,317)	2,654,417	30.62%	12.44%	3.81%
5 CUSTOMER DEPOSITS	831,713	0	(748,961)	82,752	0.95%	6.00%	0.06%
6 DEFERRED ITC'S-ZERO COST	0	0	0	0	0.00%	0.00%	0.00%
7 DEFERRED ITC'S-WTD COST	1,638,381	0	(1,459,958)	178,423	2.06%	9.61%	0.20%
8 DEFERRED INCOME TAXES	2,495,891	0	(1,713,608)	782,283	9.02%	0.00%	0.00%
9 TOTAL CAPITAL	<u>71,585,885</u>	0	<u>(62,917,521) \$</u>	<u>8,668,364</u>	<u>100.00%</u>		<u>8.68%</u>
PER COMMISSION							
10 LONG TERM DEBT	34,214,167	0	(30,446,199) \$	3,767,967	47.79%	7.81%	3.73%
11 SHORT-TERM DEBT	0	0	0	0	0.00%	0.00%	0.00%
12 PREFERRED STOCK	9,000,000	0	(8,008,840)	991,160	12.57%	9.00%	1.13%
13 COMMON EQUITY	23,405,734	0	(20,828,087)	2,577,647	32.70%	13.44%	4.39%
14 CUSTOMER DEPOSITS	831,713	0	(740,117)	91,596	1.16%	6.00%	0.07%
15 DEFERRED ITC'S-ZERO COST	0	0	0	0	0.00%	0.00%	0.00%
15 DEFERRED ITC'S-WTD COST	1,638,381	0	(1,457,948)	180,433	2.29%	9.95%	0.23%
16 DEFERRED INCOME TAXES	2,495,891	0	(2,221,021)	274,870	3.49%	0.00%	0.00%
17 TOTAL CAPITAL	<u>71,585,885</u>	0	<u>(63,702,213) \$</u>	<u>7,883,672</u>	<u>100.00%</u>		<u>9.56%</u>
RANGE OF REASONABLENESS					LOW	HIGH	
AUTHORIZED RETURN ON EQUITY					<u>11.44%</u>	<u>13.44%</u>	
OVERALL RATE OF RETURN					<u>8.90%</u>	<u>9.56%</u>	

FCWC -- SOUTH FT. MYERS WASTEWATER STATEMENT OF WASTEWATER OPERATIONS TEST YEAR ENDED 12/31/96			SCHEDULE NO. 3-A DOCKET NO. 970991-SU				
DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUSTMENTS	UTILITY ADJUSTED TEST YEAR 12/31/96	COMMISSION ADJUSTMENTS	COMMISSION ADJUSTED TEST YEAR 12/31/96	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	3,557,253	0	3,557,253	271,069	3,828,322	(316,076)	3,512,246
OPERATING EXPENSES						-8.26%	
2 OPERATION AND MAINTENANCE	1,617,210	0	1,617,210	(27,230)	1,589,980 \$		1,589,980
3 DEPRECIATION	613,938	0	613,939	0	613,939		613,939
4 AMORTIZATION	0	0	0	0	0		0
5 TAXES OTHER THAN INCOME	319,164	0	319,165	12,198	331,363	(14,223)	317,140
6 INCOME TAXES	226,501	0	226,502	124,907	351,409	(113,587)	237,822
7 TOTAL OPERATING EXPENSES	2,776,814	0	2,776,815	109,875	2,886,691	(127,811)	2,758,881
8 OPERATING INCOME	780,439	0	780,438	161,194	941,631	(188,266)	753,365
9 RATE BASE	7,938,270		7,938,270		7,883,672		7,883,672
RATE OF RETURN	9.83%		9.83%		11.94%		9.56%

FCWC – SOUTH FT. MYERS WASTEWATER
 ADJUSTMENTS TO OPERATING STATEMENT
 TEST YEAR ENDED 12/31/96

SCHEDULE NO. 3-B
 DOCKET NO. 970991-SU
 PAGE 1 OF 1

EXPLANATION	WASTEWATER
1 OPERATING REVENUES	
To adjust for annualized revenues on treatment of Lee County WW, according to S-1, AR	\$ 507,045
To adjust for annualized 6/14/96 index	17,548
To adjust for rev. associated w/Lee Cty. incl. in Misc. Serv. Rev. in AR	(253,524)
	<u>\$ 271,069</u>
2 OPERATION & MAINTENANCE EXPENSES	
To adjust for Commission approved rate case exp. in Docket No. 920808-SU	\$ (27,230)
3 TAXES OTHER THAN INCOME	
Regulatory assessment fees on revenue adjustment	\$ 12,198
Regulatory assessment fees associated with overearnings	\$ (14,223)
4 INCOME TAXES	
Income taxes associated with adjusted test year income	\$ 124,907
Income taxes related to recommended revenue decrease	\$ (113,587)