

FLORIDA PUBLIC SERVICE COMMISSION  
Capital Circle Office Center, 2540 Shumard Oak Boulevard  
Tallahassee, Florida 32399-0850

**M E M O R A N D U M**

**AUGUST 22, 1996**

**TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYO)** *ma*

**FROM: DIVISION OF WATER AND WASTEWATER (AUSTIN, B. DAVIS, FUCHS)** *ma*  
**DIVISION OF LEGAL SERVICES (PELLEGRINI)** *ma*

**RE: DOCKET NO. 960011-WS - INDIANTOWN COMPANY, INC. -**  
**INVESTIGATION OF RATES OF INDIANTOWN COMPANY, INC. IN**  
**MARTIN COUNTY FOR POSSIBLE OVERTURNINGS**

**COUNTY: MARTIN**

**AGENDA: 9/03/96 - REGULAR AGENDA - PROPOSED AGENCY ACTION -**  
**INTERESTED PERSONS MAY PARTICIPATE**

**CRITICAL DATES: NONE**

**SPECIAL INSTRUCTIONS: I:\PSC\WAW\WP\960011-2.RCM**

**CASE BACKGROUND**

Indiantown Company, Inc. (Indiantown or utility) is a Class B utility providing water and wastewater service to approximately 1,677 water and 1,585 wastewater customers in Martin County. Based on a desk audit of the 1994 Annual Report for Indiantown, staff began an informal investigation into potential overearnings. Staff requested an audit of the utility's books. Based on the auditor's suggested adjustments, it appeared that the utility was earning an overall rate of return of 75.08% for the water system.

Indiantown's last rate case was finalized on April 27, 1983, in Order No. 11891, Docket No. 810037-WS. In that order, rate base was set and an authorized return on equity of 16.35% was approved. Index and pass-through increases were granted for years 1986 through 1994.

By Order No. PSC-95-1328-FOF-WS, issued November 1, 1995, the Commission authorized 10.43% as the midpoint of Indiantown's Return on Equity (ROE) for all regulatory purposes effective November 1, 1995.

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PSC-RECORDS REPORTING

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By Order No. PSC-96-0169-FOF-WS, issued on February 6, 1996, the Commission initiated an investigation of the water rates and charges and ordered 1996 water service revenues of \$118,066 on an annual basis to be placed subject to refund with interest in accordance with Rule 25-30.360, Florida Administrative Code. It further ordered that Indiantown provide the Commission with a corporate undertaking as a guarantee of any potential refund of water revenues collected under interim conditions, and that by no later than the twentieth day of each month, Indiantown Company, Inc., shall file a report with the Commission showing the amount of revenues collected each month and the amount of revenues collected to date relating to the amount subject to refund.

By PAA Order PSC-96-0657-FOF-WS, the Commission established rate base as of 1994, required a refund of the 1994 Water Price Index Adjustment and reduced rates to remove the 1994 Water Price Index.

This recommendation addresses the 1996 revenue requirement and disposition of the 1996 water service revenues of \$118,066, on an annual basis, collected subject to refund with interest in accordance with Rule 25-30.360, Florida Administrative Code. Staff's review indicates that Indiantown's 1996 projected return on equity will exceed the range of its return on equity authorized by Order No. PSC-95-1328-FOF-WS for the water system, will be well below the authorized range for the wastewater system and will be below the authorized range for the utility as a whole.

**DISCUSSION OF ISSUES**

**ISSUE 1:** Will Indiantown Company earn in excess of its authorized return on equity (ROE) for 1996?

**RECOMMENDATION:** Yes, the Commission should recognize \$27,076 in projected water revenue which exceeds Indiantown's maximum authorized ROE of 10.43%. The wastewater system will earn below its authorized range of ROE by \$118,696. The utility, as a whole, will earn 8.44% on equity which is below its authorized range of ROE. (B. DAVIS)

**STAFF ANALYSIS:** Indiantown filed its projection of 1996 earnings on July 8, 1996. This projection was based on 1995 actual results, January through April, 1996 actual results and the utility's budget for the remainder of 1996. Staff has reviewed the year end projection and has recalculated the rate base as an average. Staff has also reconciled the capital to rate base, which was not included in the projection. The utility included the 1994 calculations for used and useful which staff believes is reasonable. Staff has recalculated income taxes and property taxes based on the utility projection. With these adjustments, Indiantown's revenue above the maximum allowed ROE of 11.43%, as set forth in Order No. PSC-95-1328-FOF-WS, for 1996 is \$27,076 for the water system. The wastewater system is earning \$118,696 below the floor of Indiantown's authorized range. As a whole, the utility is earning 3.22% ROE, which is below the authorized range for ROE.

Staff's analysis of Indiantown's 1994 earnings, as approved in Order PSC-96-0657-FOF-WS, showed the utility's water system earning revenue of \$110,834 above its then maximum authorized ROE of 17.35% and the wastewater system earning within its authorized range. By Order No. PSC-95-1328-FOF-WS the Commission authorized 10.43%, plus or minus 100 basis points, as the ROE for all regulatory purposes effective November 1, 1995, reducing Indiantown's authorized ROE by 592 basis points. In 1995 and 1996, Indiantown made substantial improvements to its water and wastewater facilities. In 1995, a major highway relocation by the Florida Department of Transportation necessitated the relocation of existing water and wastewater lines in downtown Indiantown. A new surge tank was installed at the main wastewater plant, 4" pumps were required for pond drainage and emergency pumping and the Indiantown Marina lift station was repaired, which included extensive replacement of components. In 1996, the utility is improving its water mains by increasing the size of the mains and looping the system to correct a fire flow problem noted by Martin County. The county has also

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directed the utility to add new fire hydrants for better fire protection. This will relieve water pressure complaints as well as reduce leaks by replacing older steel water mains. The utility is also replacing wastewater mains that were damaged and are experiencing infiltration problems. As a result of the increased rate bases due to these improvements, the earned return on both systems has fallen considerably. Since the water improvements occurred in 1996, only the average amounts are included in staff's analysis. Staff projects that 1997 water earnings will be within the authorized range when the full impact of the improvements will be included in rate base.

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INDIANTOWN COMPANY, INC. REVENUE REQUIREMENT TEST YEAR ENDED 12/31/96		
REVENUE REQUIREMENT CALCULATION	WATER	WASTEWATER
Rate Base:		
Utility Projection	\$ 461,913	\$ 904,266
Recommended Adjustments	<u>56,977</u>	<u>163,399</u>
Recommended Rate Base	\$ 518,889	\$ 1,067,665
Minimum Return at 9.43% ROE		5.84%
Maximum Return at 11.43% ROE	<u>6.86%</u>	
Required Net Operating Income	\$ 35,583	\$ 62,336
Achieved Net Operating Income		
Utility Projection	\$ 55,438	\$ (1,691)
Recommended Adjustments	<u>(3,607)</u>	<u>(6,463)</u>
Recommended NOI	\$ <u>51,831</u>	\$ <u>(8,154)</u>
Achieved Return on Equity	<u>16.79%</u>	<u>-3.38%</u>
Achieved NOI Deficiency (Excess)	\$ (16,127)	\$ 70,699
Revenue Expansion Factor	<u>1.67888</u>	<u>1.67888</u>
Revenue Increase (Decrease)	\$ (27,076)	\$ 118,696
Achieved Operating Revenue	<u>466,482</u>	<u>513,266</u>
Revenue Requirement	\$ <u>439,406</u>	\$ <u>631,962</u>
Percent Increase (Decrease)	<u>-5.80%</u>	<u>23.13%</u>

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**ISSUE 2:** What is the appropriate disposition of the water service revenues of \$118,066, on an annual basis, subject to refund with interest in accordance with Rule 25-30.360?

**RECOMMENDATION:** The corporate undertaking should be released and the utility be allowed to retain the revenues. (B. DAVIS)

**STAFF ANALYSIS:** Indiantown Company operates both water and wastewater systems with common management in identical service areas. Of the 1,604 water and 1,519 wastewater customers (1995 count), only 85 customers, 5.3% of the total, are water only. The utility as a whole is earning a 3.22% ROE which is below its authorized range of 9.43% - 11.43%.

Normally the Commission has not netted water and wastewater earnings. For example, in Order No. PSC-96-0501-FOF-WS, issued on April 11, 1996 in Docket No. 960234-WS, the Commission began an investigation of Gulf Utility Company's water rates although the wastewater system was not earning its authorized return. In the Gulf Utility case, the water and wastewater customers were materially different and the Commission found that netting the earnings was not appropriate. However, in Order No. PSC-92-1189-FOF-WS, issued on October 20, 1992, in Docket No. 920361-WS, the Commission did allow the netting of Kingsley Service Company's water and wastewater earnings for interim purposes.

In Order No. PSC-96-0595-FOF-WS, issued on May 7, 1996 in this docket, the utility noted that while its water operations may appear to be overearning, its wastewater operations appear to be underearning. It argued that "the Commission has just as much legal obligation to adjust one inequity as the other." The Commission, however, found that it had fully considered both the potential for overearnings in Indiantown's water operations and the potential for underearnings in its wastewater operations in deciding to order a formal investigation only of the water operations' earnings. See, also, Order No. PSC-96-0595-FOF-WS, issued May 7, 1996, Denying Motion for Reconsideration.

After investigation, the Commission found, in Order No. PSC-96-0657-FOF-WS, issued on May 10, 1996, that as adjusted, Indiantown's 1994 ROE was 50.77% for the water system, which was above its maximum authorized ROE of 17.35%. The revenue in excess of the maximum authorized ROE was \$110,834. As adjusted, Indiantown's 1994 ROE was 17.29% for the wastewater system which was within its authorized range. The Commission found it appropriate that the index adjustment collected in 1994 for the water system, be refunded with interest, finding that the 1994

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price index contributed to overearnings in 1994 for the water system.

For 1996, with the large amount of capital expenditures discussed in Issue 1, the situation has changed. Now the water system is overearning slightly, but the wastewater system is well under its authorized range. The water overearnings situation appears to be temporary and rate adjustment is not indicated based on staff's estimate of 1997 earnings taking into account the full amount of the 1996 plant additions. Rate adjustment for the wastewater system could also be avoided by netting the earnings for 1996. Even though the Commission declined to do so earlier, given these new circumstances, staff recommends that a small amount of netting is appropriate since the water and wastewater systems have a common service area and, for the most part, common customers, contrary to the Gulf case.

Staff believes that all concerned will be best served by allowing the utility to offset the \$118,696 1996 annual wastewater earnings deficit with the small amount, 5.8% of water revenue, of water overearnings, amounting to \$27,076 annually, rather than adjusting the wastewater rates. This would be effectively accomplished by releasing the corporate undertaking and allowing Indiantown to retain the revenue. On the other hand, if the Commission denies staff's recommendation and orders a refund or other disposition of the excess water earnings, the appropriate amount is estimated to be \$24,820 plus \$630 in interest for a total of \$25,450. This amount is based on staff's estimated overearnings for the period February, 1996, when the revenues were ordered subject to refund, to December, 1996 with interest calculated in accordance with Rule 25-30.360(4), Florida Administrative Code.

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**ISSUE 3:** Should this docket be closed?

**RECOMMENDATION:** Yes. This docket should be closed if no person, whose interests are substantially affected by the proposed action, files a protest within the 21 day protest period. (PELLEGRINI, B. DAVIS)

**STAFF ANALYSIS:** Staff recommends that this docket be closed. No further action by the Commission is necessary pertaining to 1996 earnings unless a person whose interests are substantially affected by the proposed action herein files a protest within the 21 day protest period.