

State of 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-

DATE: December 4, 2008

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Johnson)
Office of the General Counsel (Klancke) *OK P. O. Con*
CRK JSB (M) TGT

RE: Docket No. 070740-SU – Joint application for approval of transfer of Hudson Utilities, Inc.'s wastewater system and Certificate No. 104-S, in Pasco County, to Ni Florida, LLC.

AGENDA: 12/16/08 – Regular Agenda – Proposed Agency Action Except for Issue 3 – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Argenziano

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\070740.RCM.DOC

Case Background

Hudson Utilities, Inc. (Hudson or utility) is a Class A utility serving approximately 2,575 residential and 145 commercial customers. The utility provides wastewater collection service to its customers and purchases wastewater treatment service from Pasco County (County) pursuant to a Bulk Wastewater Treatment Agreement. The majority of Hudson's service territory is located in an area designated as a flood plain area, which is unsuitable for the use of septic tanks and drain fields. The utility is in the South Florida Water Management District and is not in a water use caution area. The utility's 2007 annual report shows total operating revenue of

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\$1,459,125 and net operating income of \$210,601 for the system. The utility was granted Certificate No. 104-S in 1973.¹

On December 27, 2007, Hudson and Ni Florida filed a joint application for transfer of Hudson's wastewater facilities and certificate to Ni Florida. On April 7, 2008, the Commission issued Order No. PSC-08-0226-FOF-SU, approving the transfer of Hudson Utilities, Inc.'s wastewater system and Certificate No. 104-S, in Pasco County to Ni Florida, LLC. Since rate base was established over seventeen years ago, it was decided that rate base should be updated with the change in ownership.² An audit was conducted to establish rate base as of December 31, 2007.

This recommendation establishes rate base as of December 31, 2007, for the transfer application of the wastewater facilities and Certificate No. 104-S from Hudson to Ni Florida. The Commission has jurisdiction to consider this matter pursuant to Section 367.071, Florida Statutes.

¹ Wastewater certificate issued pursuant to Order No. 5781, issued June 19, 1973, in Docket No. C-72696-S, In Re: Application of Allyn Water Supply, Inc., for certificates to operate its existing water and sewer system in Pasco County.

² Rate base was last established by the Commission in Order No. 23810, issued November 27, 1990, in Docket No. 900293-SU, In Re: Application for a Staff-Assisted Rate Case in Pasco County by Hudson Utilities, Inc.

Discussion of Issues

Issue 1: What is rate base for Hudson's wastewater facilities as of December 31, 2007?

Recommendation: The appropriate rate base, which reflects the net book value for transfer purposes, is \$2,417,932 for the Hudson system as of December 31, 2007. Within 60 days of the date of the final order, Ni Florida should be required to provide a statement that the utility's books have been updated to reflect the Commission-approved rate base adjustments and balances. In addition, the Commission approved rate base adjustments should be reflected in the utility's 2008 annual report. (Johnson)

Staff Analysis: Rate base was last set for the utility in Order No. 23810, as of December 31, 1990. The last audit of rate base was through June 30, 2004, in Docket No. 981079-SU.³ However, the utility did not apply the adjustments from the audit in Docket No. 981079-SU to the company's books and records. Staff began with the last audit of rate base and verified plant additions and retirements in order to establish rate base as of December 31, 2007.

Utility Plant in Service (UPIS): The Hudson rate base balance as of December 31, 2007, included total depreciable UPIS of \$7,560,838. The UPIS costs include the facilities for structures and improvements, force and collection mains, services, receiving wells, flow measuring devices, pumping equipment, miscellaneous equipment, transportation equipment and tools and other garage equipment.

According to the audit, the utility replaced four pumps and did not retire the old pumps. Consistent with Commission practice, when a utility is unable to provide original cost records for a retirement, then 75 percent of the replacement cost is a reasonable estimate of original cost.⁴ Therefore, staff made an adjustment to retire the pumps at 75 percent of the cost of the new pumps. Staff recommends that UPIS should be adjusted to decrease UPIS by \$8,551 to reflect the retired pumps. Staff's recommended UPIS balance is \$7,552,287 for the wastewater system as of December 31, 2007.

Land & Land Rights: Hudson recorded \$9,513 for wastewater land in Account No 353. The National Association of Regulatory Utility Commissioners (NARUC) Uniform System of Accounts (USOA) states that the cost of land should be recorded at its original cost when first dedicated to utility service. According to the prior owner, the utility does not own any land. The land on which the wastewater system is located was obtained by easements. The recorded

³ An audit report was completed on Hudson's plant and CIAC for the period of January 1, 2002 through June 30, 2004 for internal Commission use and a copy was mailed to the utility, in Docket No. 981079-SU, In Re: Application for amendment of Certificate No. 104-S to extend service territory in Pasco County by Hudson Utilities, Inc., and request for limited proceeding.

⁴ The Commission found, where original cost is not available for retirements, that 75 percent of replacement cost was a reasonable estimate for the cost of the retirement. This practice of determining plant costs is consistent with Order No. PSC-03-1250-PAA-WU, issued November 6, 2003, in Docket No. 030250-WU, In Re: Application for a staff-assisted rate case in Pasco County by Floralino Properties, Inc. and in Order No. PSC-01-1574-PAA-WS, issued July 30, 2001, in Docket No. 000584-WS, In Re: Application for a staff-assisted rate case in Martin County by Laniger Enterprises of America, Inc.

\$9,513 for land is the cost to obtain the easements. Staff recommends a land and land rights balance of \$9,513 for the system as of December 31, 2007.

Contributions-in-aid-of-Construction (CIAC): The Utility recorded a CIAC balance of \$3,495,558 for the system as of December 31, 2007. Staff has reviewed the utility's CIAC balance and it appears to be reasonable. Therefore, staff is in agreement with the utility and recommends that a CIAC balance of \$3,495,558 be included in rate base.

Accumulated Depreciation: The utility recorded a balance for accumulated depreciation of \$2,886,826 for wastewater as of December 31, 2007. The utility should adjust this account by \$9,855 to remove the depreciation associated with several retired plant items. The utility did not apply the prescribed rates set in Rule 25-30.140, Florida Administrative Code. Staff has calculated accumulated depreciation using the prescribed rates and determined that an adjustment of \$16,528 is needed to correct the account balance. In addition, an adjustment to increase the account balance by (\$10,038) was not recorded from a prior audit in Docket No. 981079-SU. As a result, staff has decreased this account by the net amount of \$16,345 to reflect the correct depreciation balance. These adjustments result in an accumulated depreciation balance of \$2,870,481 for the system as of December 31, 2007.

Accumulated Amortization-CIAC: The utility recorded a balance for accumulated amortization of \$1,186,714 as of December 31, 2007. The company used a three percent amortization rate to calculate accumulated amortization. The NARUC USOA, for a Class A wastewater system, provides that a group or overall composite rate may be used for contributed balances that cannot be directly related to a plant's assets. Staff used a yearly composite depreciation rate to determine the accumulated amortization balance. The composite rate is based on the guideline average service lives in Rule 25-30.140, Florida Administrative Code. Therefore, staff has increased this account by \$35,457. The adjustment results in an accumulated amortization balance of \$1,222,171 for the system as of December 31, 2007.

Conclusion: Based on the forgoing, staff recommends that the appropriate rate base is \$2,417,932 for the system as of December 31, 2007. Rate base is shown on Schedule No. 1-A and staff's adjustments are shown on Schedule 1-B. Staff notes that rate base for transfer purposes do not include the normal ratemaking adjustments for working capital or used and useful. Staff recommends that, within 60 days of the date of the final order, Ni Florida should be required to provide a statement that the utility's books have been updated to reflect the Commission approved rate base adjustments and balances. In addition, the Commission-approved rate base adjustments should be reflected in the utility's 2008 annual report.

Issue 2: Should an acquisition adjustment be approved?

Recommendation: No. An acquisition adjustment should not be included in the calculation of rate base for transfer purposes. (Johnson)

Staff Analysis: An acquisition adjustment results when the purchase price differs from the original cost of the assets adjusted to the time of the acquisition. The calculation of an acquisition adjustment is shown below:

Purchase Price	\$5,600,000
Rate Base	<u>\$2,417,932</u>
Positive Acquisition Adjustment	\$3,182,068

Pursuant to Rule 25-30.0371, Florida Administrative Code, a positive acquisition adjustment shall not be included in rate base absent proof of extraordinary circumstances. The buyer has neither requested an acquisition adjustment nor identified any extraordinary circumstances. Therefore, staff recommends that an acquisition adjustment should not be included in the calculation of rate base for transfer purposes.

Issue 3: Should this docket be closed?

Recommendation: No. If no protest to the proposed agency action issues is filed by a substantially affected person within 21 days of the date of the order, a consummating order should be issued. However, the docket should remain open pending receipt of the confirmation statement that the utility's books have been adjusted to reflect the Commission approved rate base adjustments. Upon receipt of the statement, the docket should be administratively closed. (Klancke)

Staff Analysis: If no protest to the proposed agency action issues is filed by a substantially affected person within 21 days of the date of the order, a consummating order should be issued. However, the docket should remain open pending receipt of the confirmation statement that the utility's books have been adjusted to reflect the Commission approved rate base adjustments. Upon receipt of the statement, the docket should be administratively closed.

HUDSON UTILITIES, LLC
SCHEDULE OF WASTEWATER RATE BASE
AS OF DECEMBER 31, 2007

<u>DESCRIPTION</u>	<u>BALANCE PER UTILITY BOOKS</u>	<u>STAFF'S ADJUSTMENTS</u>		<u>BALANCE PER STAFF</u>
Utility Plant in Service	\$7,560,838	(\$8,551)	A	\$7,552,287
Land	9,513	0		9,513
Contributions in Aid of Construction (CIAC)	(3,495,558)	0		(3,495,558)
Accumulated Depreciation	(2,886,826)	16,345	B	(2,870,481)
Amortization of CIAC	<u>1,186,714</u>	<u>35,457</u>	C	<u>1,222,171</u>
WASTEWATER RATE BASE	<u>\$2,374,681</u>	<u>\$43,251</u>		<u>\$2,417,932</u>

HUDSON UTILITIES, LLC
 SCHEDULE OF WASTEWATER RATE BASE ADJUSTMENTS

<u>EXPLANATION</u>	<u>STAFF RECOMMENDED ADJUSTMENT</u>
A Utility Plant In Service	
1. To record UPIS retirements	(8,551)
Total Utility Plant In Service adjustment	(\$8,551)
B Accumulated Depreciation	
1. To adjust for retired plant	\$ 9,855
2. To reflect the correct deprecation rates	16,528
3. To reflect prior PSC audit adjustment	(10,038)
Total Accumulated Depreciation adjustment	\$16,345
C Accumulated Amortization of CIAC	
1. To increase amortization to reflect composite rate	\$35,457
Total Accumulated Amortization of CIAC adjustment	\$35,457
Total Adjustments	<u>\$43,251</u>

HUDSON UTILITIES, LLC		SCHEDULE NO. 1-B	
STAFF RECOMMENDED DECEMBER 31, 2007 BALANCE			
ACCT NO.	ACCOUNT NAME	WASTEWATER	ACCUMULATED
		PLANT BALANCE	DEPRECIATION BALANCE
351	Organization	\$6,247	\$6,247
353	Land and Land Rights	9,513	0
354	Structures and Improvements	2,195	1,562
360	Collection Sewers-Force	995,236	582,640
361	Collection Sewers-Gravity	3,692,850	937,648
362	Special Collecting Structure	411,793	108,881
363	Services to customers	991,349	266,716
364	Flow Measuring Devices	157,854	157,854
370	Receiving Wells	550,916	263,733
371	Pumping Equipment	540,546	343,008
389	Other Plant and Miscellaneous Equipment	6,298	6,298
390	Office Furniture and Equipment	36,751	35,641
391	Transportation Equipment	146,609	146,609
393	Tools, Shop and Garage Equipment	10,829	10,829
398	Other Tangible Plant	<u>2,814</u>	<u>2,814</u>
Total Wastewater Plant		\$7,561,800	\$2,870,481