

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: February 20, 2020

TO: Office of Commission Clerk (Teitzman)

FROM: Division of Accounting and Finance (Wilson, T. Brown)
Division of Economics (Hudson, Sibley) *SH*
Division of Engineering (Doehling, M. Watts) *MI*
Office of the General Counsel (Dziechciarz) *FRAD*

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RE: Docket No. 20190116-SU – Application for staff-assisted rate case in Brevard County, and request for interim rate increase by Merritt Island Utility Company.

AGENDA: 03/03/20 – Regular Agenda – Proposed Agency Action – Except for Issue Nos. 10, 11, and 12 – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Clark

CRITICAL DATES: 10/15/20 (15-Month Effective Date (SARC))

SPECIAL INSTRUCTIONS: None

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Case Background

Merritt Island Utility Company, Inc. (Merritt Island or Utility) is a Class C wastewater system serving approximately 141 residential customers and 1 general service bulk customer in Brevard County. Water service is provided by the City of Cocoa. According to the Utility's 2018 Annual Report, total gross revenues were \$65,442 and total operating expenses were \$73,250, resulting in a net operating loss of \$7,808.

Mobile Home Investors, Inc. was initially granted a certificate to operate a wastewater system in existence in 1974.¹ The wastewater system was subsequently transferred several times.² The most recent transfer to Merritt Island was approved in 2017.³ During the pendency of the transfer docket, it was discovered that the Utility was serving customers outside of its certificated territory. Consequently, Merritt Island filed an application with the Commission to amend its certificate to add territory in Brevard County, which was approved in Order No. PSC-2018-0243-FOF-SU.⁴

Rate base was last established for the Utility in a 2008 staff-assisted rate case (SARC).⁵ In addition, net book value for transfer purposes was updated to reflect balances as of December 22, 2016, when the system was transferred to Merritt Island. The Utility's test year rates became effective on June 13, 2018, following approval of a 2018 price index rate adjustment.

On May 16, 2019, Merritt Island filed an application for a SARC. The Utility requested the 12-month period ended March 31, 2019, as the test year for purposes of both interim and final rates. The Commission approved a 5.38 percent interim increase in Order No. PSC-2019-0309-PCO-SU.⁶ A customer meeting was held in Merritt Island, Florida on November 4, 2019.

¹Order No. 6365, issued December 2, 1974, in Docket No. 730391-S, *In re: Application of Mobile Home Investors, Inc., for a certificate to operate an existing sewer utility in Brevard County, Florida.*

²Order No. 7296, issued June 28, 1976, in Docket No. 750664-S, *In re: Application of Mobile Home Investors, Inc., and Colony Park Utilities, Inc. for approval of the transfer of assets and Certificate No.137-S from the former to the latter. (Section 367.071, Florida Statutes);* Order No. PSC-03-0320-FOF-SU, issued March 6, 2003, in Docket No. 020930-SU, *In re: Application for transfer of majority organizational control of Colony Park Utilities, Inc. holder of Certificate No. 137-S in Brevard County, from Robert Warren, Lenore Warren, William Warren, and Carol Kendall to Eileen Rogow, Arthur Rogow, and Philip Young;* Order No. PSC-07-0420-FOF-SU, issued May 14, 2007, in Docket No. 060636-SU, *In re: Application for transfer of majority organizational control of Colony Park Utilities, Inc., holder of Certificate No. 137-S in Brevard County from Eileen Rogow to Michael Abramowitz;* Order No. PSC-14-0673-PAA-SU, issued December 5, 2014, in Docket No. 120285-SU, *In re: Application to transfer wastewater facilities and Certificate No. 137-S in Brevard County from Colony Park Utilities, Inc. to Colony Park Development Utilities, LLC.*

³Order No. PSC-2017-0366-PAA-SU, issued September 27, 2017, in Docket No. 20170018-SU, *In re: Application to transfer wastewater system and Certificate No. 137-S in Brevard County from Colony Park Development Utilities, LLC to Merritt Island Utility Company, Inc.*

⁴Order No. PSC-2018-0243-FOF-SU, issued May 10, 2018, in Docket No. 20170142-SU, *In re: Application for amendment of Certificate No. 137-S for extension of wastewater service territory in Brevard County, by Merritt Island Utility Company, Inc.*

⁵Order No. PSC-08-0760-PAA-SU, issued November 17, 2008, in Docket No. 080104-SU, *In re: Application for staff-assisted rate case in Brevard County by Colony Park Utilities, Inc.*

⁶Order No. PSC-2019-0309-PCO-SU, issued July 29, 2019, in Docket No. 20190116-SU, *In re: Application for staff-assisted rate case in Brevard County, and request for interim rate increase by Merritt Island Utility Company.*

Docket No. 20190116-SU

Date: February 20, 2020

The Commission has jurisdiction in this case pursuant to Sections 367.011, 367.081, 367.0812, 367.0814, and 367.121, Florida Statutes (F.S.)

Discussion of Issues

Issue 1: Is the quality of service provided by Merritt Island satisfactory?

Recommendation: Yes. Merritt Island has been responsive to its customer complaints; therefore, staff recommends that the quality of service be considered satisfactory. (Doehling, M. Watts)

Staff Analysis: Pursuant to Rule 25-30.433(1), Florida Administrative Code (F.A.C.), the Commission, in every rate case, shall make a determination of the quality of service provided by the utility by evaluating the quality of the utility's product (water) and the utility's attempt to address customer satisfaction (water and wastewater). As a wastewater only utility, this evaluation was limited to the utility's attempt to address customer satisfaction. The Rule further states that the most recent chemical analyses, outstanding citations, violations, and consent orders on file with the Florida Department of Environmental Protection (DEP) and the county health department, along with any DEP and county health department officials' testimony concerning quality of service shall be considered. In addition, any customer testimony, comments, or complaints shall also be considered.

The Utility's Attempt to Address Customer Satisfaction

On November 4, 2019, a customer meeting was held at the Merritt Island Public Library to receive customer comments concerning quality of service. No customers attended the meeting. A review of the Commission's complaint tracking system revealed two customer complaints against the Utility during the previous five-year period. Both complaints were filed by the same customer, and both concerned the condition of a road and issues with the collection system. The Utility has not received any customer complaints aside from the two previously discussed. No complaints were received by the DEP.

In response to the first complaint dated June 6, 2017, the Utility had an employee evaluate the situation, apply a patch to the road, and explain to the customer what further repairs may be needed. The customer raised the same concern approximately 11 months after the initial complaint. The Utility responded to the customer, and explained that it is continuing to evaluate a long-term solution to the issue. Merritt Island did note that it examined the patch and determined it to be stable. Merritt Island is aware that under this road, along with a few other streets, the wastewater collection mains will eventually need to be replaced. However, the Utility does not plan to begin construction at this time.

Conclusion

Merritt Island has been responsive to its customer complaints; therefore, staff recommends that the quality of service be considered satisfactory.

Issue 2: Are the infrastructure and operating conditions of Merritt Island's wastewater system in compliance with DEP regulations?

Recommendation: Merritt Island's wastewater system is not currently in compliance with the DEP, but the Utility is working to address the issues noted by the DEP. (M. Watts)

Staff Analysis: Rule 25-30.225(2), F.A.C., requires each wastewater utility to maintain and operate its plant and facilities by employing qualified operators in accordance with the rules of the DEP. Rule 25-30.433(2), F.A.C., requires consideration of whether the infrastructure and operating conditions of the plant and facilities are in compliance with Rule 25-30.225, F.A.C. In making this determination, the Commission must consider testimony of the DEP and county health department officials, compliance evaluation inspections, citations, violations, and consent orders issued to the utility, customer testimony, comments, and complaints, and utility testimony and responses to the aforementioned items.

Wastewater System Operating Condition

Merritt Island's wastewater treatment plant (WWTP) is a 0.070 million gallon per day (MGD) annual average daily flow (AADF) extended aeration domestic WWTP consisting of aeration, secondary clarification, chlorination, and aerobic digestion of biosolids. Since acquiring the wastewater treatment system, the Utility has made several improvements to bring the system into compliance with the DEP requirements. In response to a November 14, 2019 warning letter issued by the DEP, Merritt Island is working to address vegetation growth in the three rapid infiltration basins (RIB). Merritt Island met with DEP personnel on January 9, 2020, to address the matter. The Utility discussed the improvements to the WWTP that it has made, the improvements currently underway, and the planned improvements to the plant. To date, the Utility has:

1. Removed four truckloads of grit, sand, old piping, and debris from aeration bays.
2. Installed all new fine bubble diffusers.
3. Installed a new bar screen and headworks piping.
4. Installed two new blowers and air header.
5. Installed a new panel box, controls, conduit and outlet plugs.
6. Cleaned out two of the three RIBs.

The third RIB is still drying out from the area's rainy season. When dry, the vegetation and sludge will be removed. During its meeting with the DEP, the Utility discussed entering into a Consent Order in which the Utility would propose additional improvements to the plant in lieu of a direct fine. The Utility is otherwise in compliance with the DEP requirements.

Conclusion

Merritt Island's wastewater system is not currently in compliance with the DEP, but the Utility is working to address the issues noted by the DEP.

Issue 3: What are the used and useful (U&U) percentages for the Utility's wastewater treatment plant (WWTP) and collection system?

Recommendation: Staff recommends that the WWTP and collection system be considered 100 percent U&U. Also, staff recommends that a 5 percent adjustment to purchased power and chemical expenses be made for excessive infiltration and inflow (I&I). (M. Watts)

Staff Analysis: Pursuant to Rule 25-30.432, F.A.C., the U&U percentage of a WWTP is based on the plant flows, growth allowance, I&I and the plant permitted capacity. Other factors, such as whether the service area is built out and whether the plant flows have decreased due to conservation may also be considered. The DEP permitted capacity is currently at 70,000 gallons per day (gpd) based on the annual average daily flow. The collection system is composed of clay and polyvinyl chloride pipes, and two lift stations.

WWTP and Collection System U&U

The Utility indicated in its application that it has 141 mobile home connections in its service area, with no vacant lots. The Utility has one bulk customer that serves 120 equivalent residential connections. During the previous SARC, staff conducted a field inspection and confirmed that the service area is built out.⁷ In that same rate case, the Commission found the WWTP and collection system to be 100 percent U&U. Since that time there have been no changes to the collection system and there are no plans for expansion. Because the service area is built out and there are no plans for expansion, staff recommends that the WWTP and collection system should be considered 100 percent U&U.

Infiltration and Inflow

Rule 25-30.432, F.A.C., provides that in determining the amount of U&U plant, the Commission will consider I&I. Staff calculates the allowable infiltration based on system parameters, and calculates the allowable inflow based on water sold to customers. The sum of these amounts is the allowable I&I. Staff next calculates the estimated amount of wastewater returned from customers. The estimated return is determined by summing 80 percent of the water sold to residential customers with 90 percent of the water sold to non-residential customers. Adding the estimated return to the allowable I&I yields the maximum amount of wastewater that should be treated by the wastewater system without incurring adjustments to operating expenses. If this amount exceeds the actual amount treated, no adjustment is made. If it is less than the gallons treated, then the difference is the excessive amount of I&I.

For the first seven months of the test year, the amount of wastewater was not accurately measured because of an inoperable flow meter. The situation was rectified by November 1, 2018, leaving staff with five months, November 2018 through March 2019, of valid wastewater treatment data. Therefore, staff chose the period November 2018 through October 2019 to perform its I&I evaluation. To do this, staff obtained water sold data from the audit work papers for the period November 2018 through March 2019, and from the City of Cocoa for the period April 2019 through October 2019. Staff obtained the amount of wastewater treated for the same period from the Discharge Monitoring Reports submitted to the DEP by the Utility.

⁷Order No. PSC-08-0760-PAA-SU, issued November 17, 2008, in Docket No. 080104-SU, *In re: Application for staff-assisted rate case in Brevard County by Colony Park Utilities, Inc.*

Using the pipe lengths of the Utility's collection system, the infiltration allowance is calculated to be 2,314,847 gallons per year. Ten percent of the total gallons sold to customers is allowed for inflow, which totals 1,245,600 gallons. The sum of these amounts is the total allowable I&I which is 3,359,487 gallons per year. The amount calculated for estimated return is 10,446,400 gallons per year. The estimated I&I is calculated by subtracting the total allowable I&I from the amount of wastewater actually treated during the 12-month period being evaluated, which is 4,321,500 gallons. The actual amount exceeds the allowable amount with an excess I&I of 962,013 gallons and, therefore, there is 5 percent excessive I&I. As such, staff recommends that a 5 percent adjustment to purchased power and chemical expenses be made for excessive I&I.

Conclusion

Staff recommends that Merritt Island's WWTP and collection system should be considered 100 percent U&U. Also, staff recommends that a 5 percent adjustment to purchased power and chemical expenses be made for excessive I&I.

Issue 4: Should the Commission approve a year-end rate base for Merritt Island Utility Company, Inc., and if so, what is the appropriate year-end wastewater test year rate base?

Recommendation: Yes. The Commission should approve a year-end rate base for Merritt Island. The appropriate year-end test year rate base is \$150,423. (Wilson, T. Brown, Doehling, M. Watts)

Staff Analysis: The appropriate components of a Utility's rate base include utility plant in service, contributions-in-aid-of-construction (CIAC), accumulated depreciation, amortization of CIAC, and working capital. The Utility's rates and charges were approved in a 2008 SARC.⁸ The rates were subsequently amended through two price index increases. This utility has historically operated at a loss. The Utility requested the test year ended March 31, 2019, for the instant case. Commission audit staff determined that the Utility's books and records are in compliance with the National Association of Regulatory Utility Commissioners' Uniform System of Accounts (NARUC USOA). A summary of each component of rate base and staff's recommended adjustments are discussed below.

Year-End Rate Base

In its application, the Utility requested a year-end rate base for its wastewater system in order to have an opportunity to recover its allowed rate of return on the significant capital improvements that were made after the acquisition. These improvements represent a significant portion of the wastewater plant in service. In the transfer order, the Commission approved a net book value for wastewater plant in service of \$166,766.⁹ During the requested test year, Merritt Island made more than \$95,000 of plant investments. If an average rate base is used, the Utility will not be afforded the opportunity to recover its allowed rate of return on the new investment and will be put in the position of needing to request a subsequent SARC at a later date.

The Commission has the authority to apply a year-end rate base, but should only apply a year-end rate base in extraordinary circumstances.¹⁰ Staff believes extraordinary circumstances exist in the instant case. Subsequent to the acquisition, the Utility made significant improvements to the wastewater system, which were required by the DEP. The year-end rate base will provide the Utility with an opportunity to recover the investment made to improve service quality and to provide for compensatory rates for this Utility in this rate case. The Commission has previously authorized the use of a year-end rate base in other cases involving significant test year improvements.¹¹ Therefore, staff recommends that the Commission approve a year-end rate base for Merritt Island.

⁸Order No. PSC-08-0760-PAA-SU, issued November 17, 2008, in Docket No. 080104-SU, *In re: Application for staff-assisted rate case in Brevard County by Colony Park Utility, Inc.*

⁹Order No. PSC-2017-0366-PAA-SU, issued September 27, 2017, in Docket No. 20170018-SU, *In re: Application to transfer wastewater system and Certificate No. 137-S in Brevard County from Colony Park Development Utilities, LLC to Merritt Island Utility Company, Inc.*

¹⁰*See, Citizens of Florida v. Hawkins*, (Fla.1978). 356 So. 2d 254.

¹¹Order No. PSC-98-0763-FOF-SU, issued June 3, 1998, in Docket No. 971182-SU, *In re: Application for staff-assisted rate case in Marion County by BFF Corp.*; Order No. PSC-00-1774-PAA-WU, issued September 27, 2000, in Docket No. 991627-WU, *In re: Application for rate increase in Polk County by Park Water Company Inc.*; Order No. PSC-01-0323-PAA-WU, issued February 5, 2001, in Docket No. 000580-WU, *In re: Application for staff-*

Utility Plant in Service (UPIS)

The Utility recorded a test year UPIS balance of \$266,370. In addition to numerous plant additions that have been made by the Utility since the transfer, Merritt Island also requested pro forma consideration of an emergency pump replacement and the installation of piping to divert effluent between its rapid infiltration basins (RIB). Based on support documentation, the pump replacement was included as part of test year plant. As such, staff did not include the pump replacement in its pro forma plant calculations to avoid inclusion of duplicative costs.

As discussed in Issue 2, the Utility is currently working with the DEP to address vegetation growth in its three rapid RIBs. Two of the three RIBs have been cleared of vegetation. The third RIB has dense growth that needs to be cleared.¹² Prior to bringing in the heavy equipment required to clear the vegetation, the soil in the RIB must first be dried out. Therefore, new piping was installed to divert flows from this RIB to the other two, and is included in the Utility's pro forma request. As this work is being done pursuant to a warning letter issued by the DEP, staff believes this pro forma request is prudent. As such, staff increased UPIS by \$5,813 to reflect the pro forma piping. There were no retirements associated with the piping since it did not previously exist at the ponds. Staff also made corresponding adjustments to accumulated depreciation (discussed below), while depreciation expense and taxes other than income adjustments for taxes related to pro forma plant are discussed in Issue 7. Consistent with Commission practice, no averaging adjustments are applied to pro forma additions. Therefore, staff recommends that the appropriate UPIS balance is \$272,183 (\$266,370 + \$5,813).

Land & Land Rights

The Utility recorded a test year land balance of \$30,479. The Commission approved a land balance of \$30,479 in the Utility's 2017 transfer docket.¹³ There have been no additions to land since the transfer; therefore, no adjustments are necessary. Staff recommends a land and land rights balance of \$30,479.

Used & Useful

As discussed in Issue 3, Merritt Island's WWTP and collection system are considered 100 percent U&U. Therefore, no U&U adjustments are necessary.

Accumulated Depreciation

Merritt Island recorded a test year accumulated depreciation balance of \$161,473. Staff decreased accumulated depreciation by \$460 to reflect appropriate test year depreciation

assisted rate case in Polk County by Keen Sales, Rentals and Utilities, Inc. (Alturas Water Works); and Order No. PSC-02-1449-PAA-WS, issued October 21, 2002, in Docket No. 011451-WS, In re: Investigation of water and wastewater rates for possible overearnings by Plantation Bay Utility Co. in Volusia County; Order No. PSC-2017-0428-PAA-WS, issued November 7, 2017, in Docket No. 20160195-WS, In re: Application for staff-assisted rate case in Lake County by Lakeside Waterworks, Inc., and Order No. PSC-2018-0553-PAA-WS, issued November 19, 2018, in Docket No. 20180021-WU, In re: Application for staff-assisted rate case in Highlands County by Country Walk Utilities, Inc.

¹²The vegetation clearing costs are discussed in Issue 7. Two of the ponds have been completed, and one is being considered as part of pro forma O&M. All three projects will be amortized over a five-year period.

¹³Order No. PSC-2017-0366-PAA-SU, issued September 27, 2017, in Docket No. 20170018-SU, *In re: Application to transfer wastewater system and Certificate No. 137-S in Brevard County from Colony Park Development Utilities, LLC to Merritt Island Utility Company, Inc.*, p.6.

balances pursuant to Rule 25-30.140, F.A.C. In addition, staff recommends an adjustment associated with the pro forma plant project discussed above. Staff's adjustment to accumulated depreciation for pro forma plant results in an increase of \$182. Staff's adjustments to this account result in a decrease of \$278 (\$460 - \$182). Therefore, staff recommends an accumulated depreciation balance of \$161,195 (\$161,473 - \$278).

Contributions in Aid of Construction (CIAC)

The Utility recorded a test year CIAC balance of \$23,500. Based on staff's review, no adjustment is necessary. Based on Order No. PSC-2017-0366-PAA-SU, CIAC is fully amortized. Therefore, staff recommends that the appropriate balance is \$23,500.¹⁴

Accumulated Amortization of CIAC

The Utility recorded a test year accumulated amortization of CIAC balance of \$23,500. Based on staff's review, no adjustment is necessary since CIAC is fully amortized. Therefore, staff recommends that the appropriate balance is \$23,500.

Acquisition Adjustment and Accumulated Amortization of Acquisition Adjustment

The Utility recorded test year balances of \$175 and \$40 for an acquisition adjustment and the associated accumulated amortization, respectively. An acquisition adjustment results when the purchase price differs from the original cost of the assets (net book value) adjusted to the time of the acquisition. Pursuant to Rule 25-30.0371(3), F.A.C., the Commission determined in Docket No. 20170018-SU that a negative acquisition adjustment of \$175 shall be recognized for ratemaking purposes.¹⁵ Based on the Commission's decision in that docket, the negative acquisition adjustment shall be amortized over a seven-year period from the date of issuance of the Commission order approving the transfer of assets. Therefore, staff recommends appropriate balances of \$175 and \$40 for an acquisition adjustment and the associated accumulated amortization, respectively.

Working Capital Allowance

Working capital is defined as the short-term investor-supplied funds that are necessary to meet operating expenses. Consistent with Rule 25-30.433(3), F.A.C., staff used the one-eighth of the operation and maintenance (O&M) expense formula approach for calculating the working capital allowance. Section 367.081(9), F.S., prohibits a utility from earning a return on the unamortized balance of rate case expense. As such, staff removed the rate case expense balance of \$512 for this calculation, resulting in an adjusted O&M expense balance of \$72,729 (\$73,241 - \$512). Applying this formula approach to the adjusted O&M expense balance, staff recommends a working capital allowance of \$9,091 ($\$72,729 \div 8$).

Rate Base Summary

Based on the forgoing, staff recommends that the appropriate year-end test year rate base is \$150,423. Rate base is shown on Schedule No. 1-A. The related adjustments are shown on Schedule No. 1-B.

¹⁴Order No. PSC-2017-0366-PAA-SU, issued September 27, 2017, in Docket No. 20170018-SU, *In re: Application to transfer wastewater system and Certificate No. 137-S in Brevard County from Colony Park Development Utilities, LLC to Merritt Island Utility Company, Inc.*

¹⁵*Id.*

Issue 5: What is the appropriate rate of return on equity and overall rate of return for Merritt Island?

Recommendation: The appropriate return on equity (ROE) is 7.85 percent with a range of 6.85 percent to 8.85 percent. The appropriate overall rate of return is 7.85 percent. (Wilson, T. Brown)

Staff Analysis: Merritt Island's capital structure consists of \$150,000 in common equity. The Utility has no customer deposits. Audit staff determined that no test year adjustments were necessary. The Utility's capital structure has been reconciled with staff's recommended rate base. The appropriate ROE is 7.85 percent based upon the Commission-approved leverage formula currently in effect.¹⁶ Staff recommends an ROE of 7.85 percent, with a range of 6.85 percent to 8.85 percent, and an overall rate of return of 7.85 percent. The ROE and overall rate of return are shown on Schedule No. 2

¹⁶Order No. PSC-2019-0267-PAA-WS, issued July 1, 2019, in Docket No. 20190006-WS, *In re: Water and wastewater industry annual reestablishment of authorized range of return on common equity for water and wastewater utilities pursuant to Section 367.081(4)(f), F.S.*

Issue 6: What are the appropriate test year revenues for Merritt Island?

Recommendation: The appropriate test year revenues are \$65,658. (Sibley)

Staff Analysis: Merritt Island recorded in its general ledger \$66,595 in test year revenues, which consists of \$66,595 in service revenues and no miscellaneous revenues. The City of Cocoa provides the billing and collection of the monthly wastewater charges for Merritt Island. The City of Cocoa submits the monthly collections to Merritt Island no later than the 15th of the following month.

The Utility had a rate increase subsequent to the test year as a result of a price index adjustment. In order to determine the appropriate test year service revenues, staff applied the number of billing determinants by the rates in effect as of June 9, 2019. As a result, staff determined that service revenues should be \$65,658, which is a \$937 (\$66,595-\$65,658) decrease to test year service revenues. This adjustment to service revenues is due to a timing difference between the billing register provided by the City of Cocoa and the general ledger maintained by Merritt Island. Staff has no adjustment to miscellaneous revenues. Staff recommends that the appropriate test year revenues are \$65,658.

Issue 7: What is the appropriate amount of operating expenses for Merritt Island?

Recommendation: The appropriate amount of operating expense for Merritt Island is \$87,417. (Wilson, T. Brown, Doehling, M. Watts)

Staff Analysis: Merritt Island recorded operating expense of \$80,736 for the test year ended March 31, 2019. The test year operation & maintenance (O&M) expenses have been reviewed, including invoices, canceled checks, and other supporting documentation. Staff has made a few adjustments to the Utility's operating expenses as summarized below.

Operation & Maintenance Expense

Salaries and Wages – Officers (703)

The Utility recorded salaries and wages – officers expense of \$5,000 in the test year to reflect the president's monthly salary of \$417. According to the Utility's 2018 Annual Report, Merritt Island's officers also include an accounting manager who does not receive a salary included in this amount. In addition, the Utility indicated in audit work papers that the president only receives compensation through distribution of retained earnings if there are any net operating profits from operations that are not used for continuing operations or capital improvements. As such, staff recommends salaries and wages - officers expense for the test year of \$5,000.

Sludge Removal Expense (711)

The Utility recorded sludge removal expense of \$4,000 in the test year. Supporting documentation confirming the sludge removal expense was provided. Staff made no adjustments to sludge removal expense. Therefore, staff recommends sludge removal expense for the test year of \$4,000.

Purchased Power (715)

The Utility recorded purchased power expense of \$5,764 in the test year. Supporting documentation confirming the purchased power expense was provided. As discussed in Issue 3, staff recommends an I&I adjustment of 5 percent. Therefore, we decreased this account by \$288 ($\$5,764 \times .05 = \288) to reflect a 5 percent excessive I&I adjustment. Therefore, staff recommends purchased power expense for the test year of \$5,476 ($\$5,764 - \288).

Chemicals Expense (718)

The Utility recorded chemicals expense of \$2,425 in the test year. Supporting documentation confirming the chemicals expense was provided. As discussed in Issue 3, staff recommends an I&I adjustment of 5 percent. Therefore, we decreased this account by \$121 ($\$2,425 \times .05 = \121) to reflect a 5 percent excessive I&I adjustment. Therefore, staff recommends chemicals expense for the test year of \$2,304 ($\$2,425 - \121).

Contractual Services – Engineering (731)

The Utility recorded contractual services – engineering expense of \$1,200. Supporting documentation confirming the expense was related to engineering work associated with the permit transfer was provided. As such, staff believes that the one-time expense should be amortized over five years, or \$240 ($\$1,200 \div 5$ years) per year. Staff removed \$960 ($\240×4) from this account to reflect the expense being amortized over a five-year period, and included only one year's amortization in the test year.

The Utility incurred two non-recurring expense items during the test year that were not included in O&M expenses. The first expense was a non-recurring expense of \$6,221 for engineering work on service territory maps and legal description for the Utility's new service area, which were required as part of the Utility's certificate amendment in Docket No. 20170142-SU.¹⁷ The expense was incurred in July 2018. Staff believes the expense should be included in O&M and amortized over five years, or \$1,244 ($\$6,221 \div 5$) per year. The second expense, for DEP required pond clearing, is discussed in "Miscellaneous Expense" below. Therefore, staff recommends contractual services - engineering expense for the test year of \$1,484 ($\$1,200 - \$960 + \$1,244$).

Contractual Services – Accounting (732)

The Utility recorded contractual services – accounting expense of \$400. Supporting documentation confirming the accounting expense was used for preparing and filing the corporate tax preparation was provided. Staff made no adjustments to accounting expense. Therefore, staff recommends contractual services - accounting expense for the test year of \$400.

Contractual Services – Legal (733)

The Utility recorded contractual services – legal expense of \$366 in the test year. Supporting documentation confirming the legal expense was provided. Staff made no adjustments to this account. As such, staff recommends contractual services – legal expense for the test year of \$366.

Contractual Services - Other Expense (736)

During the test year, the Utility recorded contractual services - other expense of \$46,123. Merritt Island receives all of its operational and administrative services under a contract with an affiliated company, U.S. Water Services Corporation (USWSC or U.S. Water). Pursuant to the contract, Merritt Island employed the services of USWSC to perform various functions: administrative management, operations, maintenance, and billing/collection for the Utility. These include management and financial oversight, wastewater system operations, and maintenance. The USWSC contract dated October 1, 2017, was originally in the amount of \$45,277. According to the Utility, this contract amount has increased to \$47,211 as a result of annual index increases over time.¹⁸ This represents a known and measurable increase of \$1,088 ($\$47,211 - \$46,123$) over the amount included in the test year.

On August 9, 2019, Merritt Island submitted documentation containing additional information related to its outside contractual services agreement with USWSC.¹⁹ According to Merritt Island, USWSC currently operates in 60 of Florida's 67 counties, providing service to over 1,000 utility systems, and services to over 1,000,000 customers daily. USWSC's president and majority shareholder has been in the water and wastewater utility management and operations industry for over 30 years. Merritt Island contracts with USWSC for the following services:

1. Wastewater Operations

¹⁷Docket No. 20170142-SU, *In re: Application for amendment of Certificate No. 137-S for extension of wastewater service territory in Brevard County, by Merritt Island Utility Company, Inc.*

¹⁸Document No. 07318-2019, filed August 9, 2019, p. 5.

¹⁹Document No. 07318-2019.

2. System Maintenance and Repairs
3. Regulatory Affairs
4. Testing
5. Accounting
6. Personnel
7. Office Space and Equipment

According to Merritt Island, each of the service contracts that USWSC enters into with a utility “are different and are priced differently depending on numerous factors.”²⁰ These factors include the number of employees needed and the number of hours required per system for successful operation. Additional considerations include whether USWSC provides sludge hauling, chemicals, power, offices, vehicles, etc., or if these items are provided by the utility.

Staff notes that similar relationships currently exist for three other regulated utilities in Marion County; Tradewinds Utilities, Inc. (Tradewinds), C.F.A.T. H2O, Inc. (CFAT), and BFF Corp. (BFF). All have contractual service agreements with MIRA International, Inc. (MIRA). Their respective agreements cover similar services to those included in the agreement between Merritt Island and USWSC. In addition to a relationship established by their contractual service agreements, the same individuals own the three utilities listed above and MIRA. As such, the relationship is similar to that of Merritt Island and USWSC.

As detailed in Table 7-1 below, based on the three most recent Annual Reports, BFF had average operation and maintenance (O&M) expense of \$617.86 per Equivalent Residential Connection (ERC), CFAT had average O&M expense of \$426.77 per ERC, and Tradewinds had average O&M expense of \$501.24 per ERC.

Table 7-1
Comparable Wastewater O&M Expense Per ERC

Annual Report Year	BFF (112 ERCs)	CFAT (227 ERCs)	Tradewinds²¹ (368 ERCs)
2016	\$533.13	\$404.88	\$479.71
2017	\$694.34	\$401.54	\$512.87
2018	<u>\$626.09</u>	<u>\$473.89</u>	<u>\$511.14</u>
3-Year Average	<u>\$617.86</u>	<u>\$426.77</u>	<u>\$501.24</u>

Source: BFF, CFAT, and Tradewinds 2016-2018 Annual Reports; and staff calculations.

Under staff’s proposed revenue requirement, Merritt Island’s O&M expense is \$280.62 per ERC. This proposed expense is 54.58 percent less than BFF, 34.25 percent less than CFAT, and 44.01 percent less than Tradewinds.

Additional support offered by Merritt Island included the “2016 American Water Works Association Benchmarking Performance Indicators for Water and Wastewater” (AWWA Benchmark) and an independent third-party contract and benchmarking review commissioned by the Florida Governmental Utility Authority (FGUA), which was issued in 2013. According to the

²⁰Document No. 07318-2019, p. 6.

²¹Tradewinds is a Class B utility.

AWWA Benchmark, the median O&M expense per account of the 8 wastewater companies surveyed is \$367.91, including customer service costs. This figure is 31.11 percent higher than the O&M expense per ERC (\$280.62) staff is recommending for Merritt Island.

The contract and benchmarking review commissioned by FGUA was undertaken to review charges by USWSC in comparison to similar water and wastewater utilities throughout the United States. The FGUA study concluded that the USWSC costs on a per account basis fell within the top quartile (lower cost) of other utilities.²² While the Utility has represented that there was a flaw in the data presented in the 2013 study, staff's greater concern is the age of some of the underlying data, which can be tied to AWWA's 2011 Benchmarking Performance Indicators. As such, staff believes that the 2016 Benchmarking Performance Indicators are a more appropriate reference point.

In its filing, Merritt Island asserted that if it was required to establish a stand-alone utility with personnel for maintenance, customer service, accounting, regulatory compliance, etc., then the cost would exceed that of the current USWSC contract. As the Utility noted in its supplemental filing, O&M expenses would be incurred regardless of the size of the customer base. In regard to the appropriateness of utility contracts with affiliated companies, the Utility cited *GTE v. Deason*, 642 So. 2d 545 (Fla. 1994), in which the Florida Supreme Court stated:

The mere fact that a utility is doing business with an affiliate does not mean that unfair or excess profits are being generated, without more. Charles F. Phillips, Jr. *The Regulation of Public Utilities* 254-255 (1988). We believe the standard must be whether the transactions exceed the going market rate or otherwise inherently unfair . . . [i]f the answer is "no," then the PSC may not reject the utility's position.

Staff compared Merritt Island to three "sister" wastewater utilities that had rate cases approved in the last five years by calculating a three-year average O&M expense per ERC using information contained in each utility's 2016, 2017, and 2018 Annual Reports. Staff then compared Merritt Island to five non-U.S. Water affiliated wastewater utilities using the same criteria.²³ Based on that criteria, the average O&M expense per ERC of the sister utilities was \$359.45. The average O&M expense per ERC for the non-U.S. Water wastewater utilities was \$314.15. Merritt Island's O&M expense is \$280.62 per ERC under staff's recommended revenue requirement. Table 7-2 reflects the average O&M expense per ERC for Merritt Island, and the average O&M expense per ERC for the U.S. Water sister utilities and non-U.S. Water utilities.

Table 7-2
Wastewater O&M Expense Per ERC

Utility	O&M Exp./ERC
U.S. Water Sister Utilities (3-Yr. Avg.)	\$359.45
Non-U.S. Water Utilities (3-Yr. Avg.)	\$314.15
Merritt Island (Staff Recommended)	\$280.62

Source: 2016-2018 Annual Reports and staff calculations.

²²Document No. 07318-2019, p. 35.

²³Staff did not include West Lakeland Wastewater, LLC since three years of annual reports were not available.

Based on staff's review, Merritt Island's proposed expense is 21.93 percent less than that of the sister utilities, and 10.67 percent less than that of the non-U.S. Water utilities.

Staff notes that the Commission has previously approved similar USWSC agreements and related costs in prior cases involving nine of Merritt Island's sister utilities during eleven rate case proceedings.²⁴ Two sister utilities, LP Waterworks, Inc. and Lakeside Waterworks, Inc., each had two SARCs in which this Commission reviewed and approved expenses related to USWSC management services contracts. In addition to this SARC, two additional sister utilities with similar contracts have SARCs pending at this time,²⁵ and a third has a file and suspend rate case pending.²⁶

Staff also believes that USWSC and its employees bring considerable management and operational experience and expertise at a comparably reasonable cost. As a result, staff believes that Merritt Island's customers are realizing operational and cost benefits that might not be realized if the Utility operated on a stand-alone basis. Staff notes that the Utility, through its contract with USWSC, has made significant plant improvements that should result in improved quality of service.

Based on the discussion above, staff believes Merritt Island's contractual services agreement with USWSC appears reasonable when compared to other utilities with similar agreements. The agreement also appears reasonable when compared to O&M expenses of industry peers as reflected in the AWWA Benchmark. Staff believes that Merritt Island's USWSC contract is appropriate, the adjusted cost is reasonable, and should be included in the Utility's proposed rates because it is known, measurable, and already in effect. Therefore, staff's recommendation for contractual services - other expense for the test year is \$47,211.

²⁴Order No. PSC-14-0413-PAA-WS, issued August 14, 2014, in Docket No. 130153-WS, *In re: Application for staff-assisted rate case in Highlands County, by L.P. Utilities Corporation c/o LP Waterworks, Inc.*; Order No. PSC-15-0013-PAA-WS, issued January 2, 2015, in Docket No. 130194-WS, *In re: Application for staff-assisted rate case in Lake County by Lakeside Waterworks, Inc.*; Order No. PSC-15-0282-PAA-WS, issued July 8, 2015, in Docket No. 140158-WS, *In re: Application for increase in water/wastewater rates in Highlands County by HC Waterworks, Inc.*; Order No. PSC-15-0329-PAA-WU, issued August 14, 2015, in Docket No. 140186-WU, *In re: Application for staff-assisted rate case in Brevard County by Brevard Waterworks, Inc.*; Order No. PSC-15-0335-PAA-WS, issued August 20, 2015, in Docket No. 140147-WS, *In re: Application for staff-assisted rate case in Sumter County by Jumper Creek Utility Company.*; Order No. PSC-16-0256-PAA-WU, issued June 30, 2016, in Docket No. 150199-WU, *In re: Application for staff-assisted rate case in Lake County by Raintree Waterworks, Inc.*; Order No. PSC-16-0305-PAA-WU, issued July 28, 2016, in Docket No. 150236-WU, *In re: Application for staff-assisted rate case in Lake County, by Lake Idlewild Utility Company.*; Order No. PSC-2017-0334-PAA-WS, issued August 23, 2017, in Docket No. 20160222-WS, *In re: Application for staff-assisted rate case in Highlands County by LP Waterworks, Inc.*; Order No. PSC-2017-0428-PAA-WS, issued November 7, 2017, in Docket No. 20160195-WS, *In re: Application for staff-assisted rate case in Lake County by Lakeside Waterworks, Inc.*; Order No. PSC-2018-0552-PAA-WU, issued November 19, 2018, in Docket No. 20180022-WU, *In re: Application for staff-assisted rate case in Lake County by Pine Harbour Waterworks, Inc.*; and Order No. PSC-2018-0553-PAA-WU, issued November 19, 2018, in Docket No. 20180021-WU, *In re: Application for staff-assisted rate case in Highlands County by Country Walk Utilities, Inc.*

²⁵Docket No. 20190114-WU, *In re: Application for staff-assisted rate case in Alachua County, and request for interim rate increase by Gator Waterworks, Inc.*; and Docket No. 20190125-WS, *In re: Application for staff-assisted rate case in Sumter County by The Woods Utility Company.*

²⁶Docket No. 20190166-WS, *In re: Application for increase in water rates in Highlands County by HC Waterworks, Inc.*

Insurance Expense (755)

The Utility recorded insurance expense of \$1,528 in the test year. Staff decreased this amount by \$204 based on supporting documentation provided by Merritt Island. Therefore, staff recommends insurance expense for the test year of \$1,324 (\$1,528 - \$204).

Regulatory Commission Expense (765)

The Utility did not record any regulatory commission expense in this account. Rule 25-30.433(9), F.A.C., requires that non-recurring expenses be amortized over a five-year period unless a shorter or longer period of time can be justified. Accordingly, staff increased this account by \$150 ($\$750 \div 5$) to reflect the five-year amortization of the 2017 certificate transfer application filing fee.²⁷

Regarding the instant case, the Utility is required by Rule 25-22.0407, F.A.C., to provide notices of the customer meeting and notices of final rates in this case to its customers. For noticing, staff estimated \$312 for postage expense, \$142 for printing expense, and \$28 for envelopes. This results in \$482 ($\$312 + \$142 + \28) for the noticing requirement. The Utility paid a \$1,000 rate case filing fee. The Utility requested travel and lodging expense of \$250 to attend the customer meeting and \$250 to attend the Commission Conference. Staff increased the Utility's customer meeting travel expense by \$183 to reflect mileage and actual lodging cost for two Utility employees to attend. This results in travel expense of \$433 ($\$250 + \183) for the customer meeting. Staff also reduced the cost of travel to attend the Commission Conference in order to reflect the actual cost of lodging for one employee and appropriate mileage.²⁸ Staff believes that the travel for the Commission Conference should be shared with Gator Waterworks, Inc. and The Woods Utility Company. The utilities are sister utilities of Merritt Island which have SARCs scheduled for the same Commission Conference. As such, staff believes it is appropriate to split travel costs to the Commission Conference equally between the three utilities, or \$130 ($\$389 \div 3$) per utility. This results in a reduction of \$120 ($\$130 - \250) for Merritt Island's travel expense to the Commission Conference. As such, staff recommends travel expense of \$563 ($\$433 + \130). Staff notes that the Commission previously approved rate case related travel expenses ranging from \$413 to \$1,570 in the nine most recent dockets for Merritt Island's sister utilities. Based on staff's review, the requested travel expense appears reasonable.

Based on the discussion above, staff recommends total rate case expense of \$2,046 ($\$482 + \$1,000 + \563), which amortized over four years is \$512. Staff's total adjustment to this account is an increase of \$662 ($\$150 + \512). As such, staff's recommendation for regulatory commission expense is \$662.

Miscellaneous Expense (775)

The Utility recorded miscellaneous expense of \$3,595. This account consists of billing fees, services performed on road repairs, transfer and permit fees, and Annual Report fees. Staff increased this account by \$46, to correct City of Cocoa billing charges which were originally recorded incorrectly. The Utility also requested that staff consider an increase in the monthly charges that Merritt Island incurs for the billing and collection of account receivables by City of

²⁷Docket No. 20170018-SU, *In re: Application to transfer wastewater system and Certificate No. 137-S in Brevard County from Colony Park Development Utilities, LLC to Merritt Island Utility Company, Inc.*

²⁸Document No. 00605-2020, filed January 28, 2020.

Cocoa. According to support documentation, the 1.79 percent increase went into effect on October 1, 2019.²⁹ Staff believes it is appropriate to include the increase, which equates to \$88 on a yearly basis, in the current proceeding because it is known, measurable, and already in effect.

The road repairs were related to pothole repairs resulting from a cracked sewer line on LaFitte Court. The repair totaled \$943, and was a one-time occurrence. The appropriate annual amortization amount and adjustment is shown in Table 7-3.

In addition, staff believes that several adjustments need to be made to several other transfer related expenses. The \$562 expense related to the legal ad for the certificate transfer, as well as a \$100 expense for a DEP fee related to the wastewater permit transfer, should be amortized over a five-year period because they are one-time occurrences. The appropriate annual amortization amounts and adjustments are shown in Table 7-3.

A second non-recurring expense item was incurred during the test year that was not included in O&M expenses. This \$7,800 expense was incurred in February 2019 for DEP-required pond cleaning for two of the Utility's three RIBs. The Utility classified the expense as Amortization Expense – Other, but staff believes the amount should be included in O&M expense and amortized over five years. The Utility also indicated that an additional \$5,050 will be needed to remove vegetation from the remaining RIB.³⁰ The RIB clearing is a DEP requirement as well. The amount should be amortized over five years. The appropriate annual amortization amounts for pond cleaning are shown in Table 7-3.

**Table 7-3
 Amortization of Misc. Expenses**

Description	Invoiced Amount	Annual Amortization*	Staff Adjustment
<u>Included in TY Misc. Expense:</u>			
Pothole Repair	\$943	\$189	(\$754)
Cert. Transfer Legal Ad	562	112	(450)
DEP Permit Transfer Fee	<u>100</u>	<u>20</u>	<u>(80)</u>
Total	<u>\$1,605</u>	<u>\$321</u>	<u>(\$1,284)</u>
<u>New Misc. Expense:</u>			
Completed RIB Clearing	\$7,800	\$1,560	\$1,560
Pro Forma RIB Clearing	<u>5,050</u>	<u>1,010</u>	<u>1,010</u>
Total	<u>\$12,850</u>	<u>\$2,570</u>	<u>\$2,570</u>
*Per Rule 25-30.433(9), F.A.C.			

Source: Audit Report, Utility filings, and staff calculations.

²⁹Document No. 04960-2019, filed on June 17, 2019.

³⁰Document No. 05392-2019, filed on July 9, 2019.

Based on the information above, staff is recommending an increase of \$1,420 (\$46 + \$88 - \$1,284 + \$2,570) to miscellaneous expense. As such, staff recommends miscellaneous expense of \$5,015 (\$3,595 + \$1,420).

Operation & Maintenance Expense Summary

Based on the above adjustments, staff recommends that O&M expense be increased by \$2,840, resulting in total O&M expense of \$73,241. Staff's recommended adjustments to O&M expense are shown on Schedule No. 3-C.

Depreciation Expense (Net of Amortization of CIAC)

Merritt Island recorded depreciation expense of \$6,274 during the test year. Staff calculated depreciation expense using the prescribed rates set forth in Rule 25-30.140, F.A.C., and determined test year depreciation expense to be \$7,000, resulting in an increase to this account of \$722. Staff also increased this account by \$182 to reflect the incremental increase in depreciation expense for the pro forma plant item previously discussed in Issue 4. Staff's total adjustment to depreciation expense is an increase of \$904 (\$722 + \$182). In addition, staff notes that CIAC is fully amortized and there is no amortization of CIAC. Therefore, staff recommends depreciation expense of \$7,178 (\$6,274 + \$904).

Amortization Expense – Other

The Utility recorded test year amortization expense – other of \$1,064 which included expenses for engineering services related to service territory maps and DEP-required pond cleaning during the test year. Staff believes that both items should be included in the Utility's O&M expense based on Commission practice. The engineering expense should be reclassified to contractual services – engineering (Account No. 731) and the pond clearing reclassified to miscellaneous expense (Account No. 775). Both expenses should be amortized over a five-year period. These adjustments were discussed in O&M expenses elsewhere in this issue. As such, staff decreased this account by \$1,089.

The Utility recorded amortization of an acquisition adjustment of negative \$25. In Docket No. 20170018-SU, the Commission determined that a negative acquisition adjustment of \$175 shall be recognized for ratemaking purposes.³¹ Based on the Commission's decision in that docket, the negative acquisition adjustment shall be amortized over a seven-year period from the date of issuance of the Commission order approving the transfer of assets. As such, the annual amortization of the negative acquisition adjustment is correctly reflected as negative \$25 (\$1,064 - \$1,089).

Taxes Other Than Income (TOTI)

Merritt Island recorded a TOTI balance of \$2,997 during the test year. Staff decreased the Regulatory Assessment Fees (RAFs) by \$106 to reflect the adjusted test year revenues. Staff increased this account by \$75 to reflect the incremental increase in property taxes associated with the pro forma project discussed in Issue 4. The Utility also requested consideration of pro forma

³¹Order No. PSC-2017-0366-PAA-SU, issued September 27, 2017, in Docket No. 20170018-SU, *In re: Application to transfer wastewater system and Certificate No. 137-S in Brevard County from Colony Park Development Utilities, LLC to Merritt Island Utility Company, Inc.*

taxes of \$2,652.³² Prior to this year, Merritt Island had no property taxes due. Staff increased tax expense by \$2,546 to reflect the appropriate amount of property tax going forward, based on the on the Utility's current Brevard County tax notice less a four percent discount for early payment.³³ This results in a net increase of \$2,515 (-\$106 + \$75 + \$2,546).

In addition, as discussed in Issue 8, revenues have been increased by \$33,567 to reflect the change in revenue required to cover expenses and allow the recommended operating margin. As a result, TOTI should be increased by \$1,511 to reflect RAFs of 4.5 percent on the change in revenues. Therefore, staff recommends TOTI of \$7,023.

Income Tax

The Utility is a Subchapter S Corporation and therefore did not record any income tax expense for the test year. Staff recommends no adjustment to income tax expense.

Operating Expenses Summary

The application of staff's recommended adjustments to Merritt Island's test year operating expenses results in operating expenses of \$87,417. Operating expenses are shown on Schedule No. 3-A. The related adjustments are shown on Schedule No. 3-B

³²Document No. 08301-2019, filed on August 21, 2019.

³³Document No. 00817-2020, filed on February 6, 2020.

Issue 8: What is the appropriate revenue requirement for Merritt Island?

Recommendation: The appropriate revenue requirement is \$99,225 resulting in an annual increase of \$33,567 (51.12 percent). (Wilson, T. Brown)

Staff Analysis: Merritt Island should be allowed an annual increase of \$33,567 (51.12 percent). This should allow the Utility the opportunity to recover its expenses and earn an 7.85 percent return on its investment. The calculations are shown in Table 8-1:

**Table 8-1
Revenue Requirement**

Adjusted Rate Base	\$150,423
Rate of Return (%)	x 7.85%
Return on Rate Base	\$11,808
Adjusted O&M Expense	73,241
Depreciation Expense (Net)	7,153
Taxes Other Than Income	7,023
Revenue Requirement	\$99,225
Less Adjusted Test Year Revenues	65,658
Annual Increase	<u>\$33,567</u>
Percent Increase	<u>51.12%</u>

Issue 9: What are the appropriate rate structure and rates for Merritt Island's wastewater system?

Recommendation: The recommended rate structure and monthly wastewater rates are shown on Schedule No. 4. The Utility should file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. The approved rates should be effective for service rendered on or after the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1), F.A.C. In addition, the approved rates should not be implemented until staff has approved the proposed customer notice and the notice has been received by the customers. The Utility should provide proof of the date notice was given within 10 days of the date of this notice. (Sibley)

Staff Analysis: Merritt Island is located in Brevard County. The Utility provides wastewater service to approximately 141 residential customers and one general service bulk customer. The general service customer is a mobile home park classified as a bulk customer. Currently, the residential wastewater rate structure consists of a uniform base facility charge (BFC) for all meter sizes and a gallonage charge with a 6,000 gallon cap per month. General service customers are billed a BFC by meter size and a gallonage charge that is 1.2 times higher than the residential gallonage charge. The bulk service customer is billed a BFC based on the number of ERCs behind the meter and a gallonage charge with a 6,000 gallon cap per connection.

Staff performed an analysis of the Utility's billing data to evaluate various BFC cost recovery percentages and gallonage caps for the residential customers. The goal of the evaluation was to select the rate design parameters that: (1) produce the recommended revenue requirement; (2) equitably distribute cost recovery among the Utility's customers; and (3) implement a gallonage cap that considers approximately the amount of water that may return to the wastewater system.

Consistent with Commission practice, staff allocated 50 percent of the wastewater revenue to the BFC due to the capital intensive nature of wastewater plants. In addition, it is also Commission practice to set the wastewater cap at approximately 80 percent of residential water gallons sold. The wastewater gallonage cap recognizes that not all water is returned to the wastewater system. Based on staff's review of the billing analysis, 87 percent of the gallons are captured at the 6,000 gallon consumption level. For this reason, staff recommends that the gallonage cap for residential customers remain at 6,000 gallons. Staff also recommends that the general service gallonage charge be 1.2 times greater than the residential gallonage charge, which is consistent with Commission practice. The bulk service customer's rate structure should remain a BFC based on the number of ERCs behind the meter and a gallonage charge with a 6,000 gallon cap per ERC.

Based on the above, the recommended monthly wastewater rates, as shown on Schedule No. 4, are reasonable and should be approved. The Utility should file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. The approved rates should be effective for service rendered on or after the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1), F.A.C. The approved rates should not be implemented until staff has approved the proposed customer notice and the notice has been received by customers. The Utility should provide proof of the date notice was given within 10 days of the date of the notice.

Issue 10: What is the appropriate amount by which rates should be reduced four years after the published effective date to reflect the removal of the amortized rate case expense?

Recommendation: The rates should be reduced as shown on Schedule No. 4, to remove rate case expense grossed-up for RAFs and amortized over a four-year period. The decrease in rates should become effective immediately following the expiration of the rate case expense recovery period, pursuant to Section 367.081(8), F.S. Merritt Island should be required to file revised tariffs and a proposed customer notice setting forth the lower rates and the reason for the reduction no later than one month prior to the actual date of the required rate reduction. If the Utility files this reduction in conjunction with a price index or pass-through rate adjustment, separate data should be filed for the price index and/or pass-through increase or decrease and the reduction in the rates due to the amortized rate case expense. (Procedural Agency Action) (Sibley, Wilson, T. Brown)

Staff Analysis: Section 367.081(8), F.S., requires that the rates be reduced immediately following the expiration of the recovery period by the amount of the rate case expense previously included in rates. The reduction will reflect the removal of revenue associated with the amortization of rate case expense and the gross-up for RAFs. The total reduction is \$536.

Staff recommends that the rates should be reduced as shown on Schedule No. 4, to remove rate case expense grossed-up for RAFs and amortized over a four-year period. The decrease in rates should become effective immediately following the expiration of the rate case expense recovery period, pursuant to Section 367.081(8), F.S. Merritt Island should be required to file revised tariffs and a proposed customer notice setting forth the lower rates and the reason for the reduction no later than one month prior to the actual date of the required rate reduction. If the Utility files this reduction in conjunction with a price index or pass-through rate adjustment, separate data should be filed for the price index and/or pass-through increase or decrease and the reduction in the rates due to the amortized rate case expense published effective date to reflect the removal of the amortized rate case expense.

Issue 11: Should the recommended rates be approved for Merritt Island on a temporary basis, subject to refund, in the event of a protest filed by a party other than the Utility?

Recommendation: Yes. Pursuant to Section 367.0814(7), F.S., the recommended rates should be approved for the Utility on a temporary basis, subject to refund with interest, in the event of a protest filed by a party other than the Utility. Merritt Island should file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. The approved rates should be effective for service rendered on or after the stamped approval date on the tariff sheet, pursuant to Rule 25-30.475(1), F.A.C. In addition, the temporary rates should not be implemented until staff has approved the proposed notice, and the notice has been received by the customers. Prior to implementation of any temporary rates, the Utility should provide appropriate security. If the recommended rates are approved on a temporary basis, the rates collected by the Utility should be subject to the refund provisions discussed below in the staff analysis. In addition, after the increased rates are in effect, pursuant to Rule 25-30.360(6), F.A.C., the Utility should file reports with the Commission's Office of Commission Clerk no later than the 20th of each month indicating the monthly and total amount of money subject to refund at the end of the preceding month. The report filed should also indicate the status of the security being used to guarantee repayment of any potential refund. (Procedural Agency Action) (Wilson)

Staff Analysis: This recommendation proposes an increase in rates. A timely protest might delay what may be a justified rate increase resulting in an unrecoverable loss of revenue to the Utility. Therefore, pursuant to Section 367.0814(7), F.S., in the event of a protest filed by a party other than the Utility, staff recommends that the recommended rates be approved as temporary rates. The Utility should file revised tariff sheets and a proposed customer notice to reflect the Commission-approved rates. The approved rates should be effective for service rendered on or after the stamped approval date on the tariff sheet, pursuant to Rule 25-30.475(1), F.A.C. In addition, the temporary rates should not be implemented until staff has approved the proposed notice, and the notice has been received by the customers. The recommended rates collected by the Utility should be subject to the refund provisions discussed below.

The Utility should be authorized to collect the temporary rates upon staff's approval of an appropriate security for the potential refund and the proposed customer notice. Security should be in the form of a bond or letter of credit in the amount of \$22,619. Alternatively, the Utility could establish an escrow agreement with an independent financial institution.

If the Utility chooses a bond as security, the bond should contain wording to the effect that it will be terminated only under the following conditions:

1. The Commission approves the rate increase; or,
2. If the Commission denies the increase, the Utility shall refund the amount collected that is attributable to the increase.

If the Utility chooses a letter of credit as a security, it should contain the following conditions:

1. The letter of credit is irrevocable for the period it is in effect.
2. The letter of credit will be in effect until a final Commission order is rendered, either approving or denying the rate increase.

If security is provided through an escrow agreement, the following conditions should be part of the agreement:

1. The Commission Clerk, or his or her designee, must be a signatory to the escrow agreement.
2. No monies in the escrow account may be withdrawn by the Utility without the prior written authorization of the Commission Clerk, or his or her designee.
3. The escrow account shall be an interest bearing account.
4. If a refund to the customers is required, all interest earned by the escrow account shall be distributed to the customers.
5. If a refund to the customers is not required, the interest earned by the escrow account shall revert to the Utility.
6. All information on the escrow account shall be available from the holder of the escrow account to a Commission representative at all times.
7. The amount of revenue subject to refund shall be deposited in the escrow account within seven days of receipt.
8. This escrow account is established by the direction of the Florida Public Service Commission for the purpose(s) set forth in its order requiring such account. Pursuant to *Cosentino v. Elson*, 263 So. 2d 253 (Fla. 3d DCA 1972), escrow accounts are not subject to garnishments.
9. The account must specify by whom and on whose behalf such monies were paid.

In no instance should the maintenance and administrative costs associated with the refund be borne by the customers. These costs are the responsibility of, and should be borne by, the Utility. Irrespective of the form of security chosen by the Utility, an account of all monies received as a result of the rate increase should be maintained by the Utility. If a refund is ultimately required, it should be paid with interest calculated pursuant to Rule 25-30.360(4), F.A.C.

The Utility should maintain a record of the amount of the bond, and the amount of revenues that are subject to refund. In addition, after the increased rates are in effect, pursuant to Rule 25-30.360(6), F.A.C., the Utility should file reports with the Commission Clerk's office no later than the 20th of every month indicating the monthly and total amount of money subject to refund at the end of the preceding month. The report filed should also indicate the status of the security being used to guarantee repayment of any potential refund.

Issue 12: Should Merritt Island be required to notify the Commission, in writing, that it has adjusted its books in accordance with the Commission's decision?

Recommendation: Yes. Merritt Island should be required to notify the Commission, in writing, that it has adjusted its books in accordance with the Commission's decision. Merritt Island should submit a letter within 90 days of the final order in this docket, confirming that the adjustments to all applicable National Association of Regulatory Commissioners (NARUC) Uniform System of Accounts (USOA) primary accounts have been made to the Utility's books and records. In the event the Utility needs additional time to complete the adjustments, notice providing good cause should be filed not less than seven days prior to the deadline. Staff should be given administrative authority to grant such an extension for up to 60 days. (Procedural Agency Action) (Wilson)

Staff Analysis: Merritt Island should be required to notify the Commission, in writing, that it has adjusted its books in accordance with the Commission's decision. Merritt Island should submit a letter within 90 days of the final order in this docket, confirming that the adjustments to all the applicable NARUC USOA primary accounts have been made to the Utility's books and records. In the event the Utility needs additional time to complete the adjustments, notice providing good cause should be filed not less than seven days prior to the deadline. Staff should be given administrative authority to grant such an extension for up to 60 days.

Issue 13: Should this docket be closed?

Recommendation: No. If no person whose substantial interests are affected by the proposed agency action files a protest within 21 days of the issuance of the proposed agency action order, a consummating order should be issued. The docket should remain open for staff's verification that the revised tariff sheets and customer notice have been filed by the Utility and approved by staff. Once these actions are complete, this docket should be closed administratively. (Dziechciarz)

Staff Analysis: If no person whose substantial interests are affected by the proposed agency action files a protest within 21 days of the issuance of the proposed agency action order, a consummating order should be issued. The docket should remain open for staff's verification that the revised tariff sheets and customer notice have been filed by the Utility and approved by staff. Once these actions are complete, this docket should be closed administratively.

MERRITT ISLAND UTILITY COMPANY, INC.		SCHEDULE NO. 1-A	
TEST YEAR ENDED 3/31/2019		DOCKET NO. 20190116-SU	
SCHEDULE OF WASTEWATER RATE BASE			
DESCRIPTION	BALANCE PER UTILITY	STAFF ADJUSTMENTS TO UTIL. BAL.	BALANCE PER STAFF
UTILITY PLANT IN SERVICE	\$266,370	\$5,813	\$272,183
LAND & LAND RIGHTS	30,479	0	30,479
NON-USED AND USEFUL COMPONENTS	0	0	0
ACCUMULATED DEPRECIATION	(161,473)	278	(161,195)
CIAC	(23,500)	0	(23,500)
AMORTIZATION OF CIAC	23,500	0	23,500
ACQUISITION ADJUSTMENT (AA)	(175)	0	(175)
AMORTIZATION OF AA	40	0	40
WORKING CAPITAL ALLOWANCE	<u>0</u>	<u>9,091</u>	<u>9,091</u>
WASTEWATER RATE BASE	<u>\$135,241</u>	<u>\$15,182</u>	<u>\$150,423</u>

MERRITT ISLAND UTILITY COMPANY, INC.	SCHEDULE NO. 1-B
TEST YEAR ENDED 3/31/2019	DOCKET NO. 20190116-SU
ADJUSTMENTS TO RATE BASE	PAGE 1 OF 1
	<u>WASTEWATER</u>
<u>UTILITY PLANT IN SERVICE</u>	
To reflect pro forma plant addition (No retirement).	<u>\$5,813</u>
<u>ACCUMULATED DEPRECIATION</u>	
1. To reflect accumulated depreciation per Rule 25-30.140, F.A.C.	\$460
2. To reflect pro forma plant depreciation.	<u>(182)</u>
Total	<u>\$278</u>
<u>WORKING CAPITAL ALLOWANCE</u>	
To reflect 1/8 of test year O&M expenses.	<u>\$9,091</u>

MERRITT ISLAND UTILITY COMPANY, INC.							SCHEDULE NO. 2		
TEST YEAR ENDED 3/31/2019							DOCKET NO. 20190116-SU		
SCHEDULE OF CAPITAL STRUCTURE (YEAR END)									
CAPITAL COMPONENT	PER UTILITY	SPECIFIC ADJUSTMENTS	TEST YEAR BALANCE PER STAFF	ADJUSTMENTS TO RECONCILE TO RATE BASE	RECONCILED CAPITAL STRUCTURE PER STAFF	PERCENT OF TOTAL	COST	WEIGHTED COST	
1. COMMON STOCK	\$0	\$0	\$0						
2. RETAINED EARNINGS	0	0	0						
3. OTHER PAID IN CAPITAL	150,000	0	150,000						
4. OTHER COMMON EQUITY	<u>0</u>	<u>0</u>	<u>0</u>						
TOTAL COMMON EQUITY	\$150,000	\$0	\$150,000	\$423	\$150,423	100.00%	7.85%	7.85%	
5. LONG-TERM DEBT	\$0	\$0	\$0	\$0	0	0.00%	0.00%	0.00%	
6. SHORT-TERM DEBT	0	0	0	<u>0</u>	0	0.00%	0.00%	0.00%	
7. PREFERRED STOCK	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>	
TOTAL DEBT	\$0	\$0	\$0	\$0	\$0	0.00%	0.00%	0.00%	
8. CUSTOMER DEPOSITS	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0.00%</u>	2.00%	<u>0.00%</u>	
9. TOTAL	<u>\$150,000</u>	<u>\$0</u>	<u>\$150,000</u>	<u>\$423</u>	<u>\$150,423</u>	<u>100.00%</u>		<u>7.85%</u>	
RANGE OF REASONABLENESS						LOW	HIGH		
RETURN ON EQUITY						<u>6.85%</u>	<u>8.85%</u>		
OVERALL RATE OF RETURN						<u>6.85%</u>	<u>8.85%</u>		

MERRITT ISLAND UTILITY COMPANY, INC.			SCHEDULE NO. 3-A		
TEST YEAR ENDED 3/31/2019			DOCKET NO. 20190116-SU		
SCHEDULE OF WASTEWATER OPERATING INCOME					
	TEST YEAR PER UTILITY	STAFF ADJUSTMENTS	STAFF ADJUSTED TEST YEAR	ADJUST. FOR INCREASE	REVENUE REQUIREMENT
1. OPERATING REVENUES	<u>\$66,595</u>	<u>(\$937)</u>	<u>\$65,658</u>	<u>\$33,567</u> 51.12%	<u>\$99,225</u>
OPERATING EXPENSES:					
2. OPERATION & MAINTENANCE	\$70,401	\$2,840	\$73,241	\$0	\$73,241
3. DEPRECIATION	6,274	904	7,178	0	7,178
4. AMORTIZATION - OTHER	1,064	(1,089)	(25)	0	(25)
5. TAXES OTHER THAN INCOME	2,997	2,515	5,512	1,511	7,023
6. INCOME TAXES	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
7. TOTAL OPERATING EXPENSES	<u>\$80,736</u>	<u>\$4,233</u>	<u>\$84,969</u>	<u>\$2,448</u>	<u>\$87,417</u>
8. OPERATING INCOME/(LOSS)	<u>(\$14,141)</u>		<u>(\$19,311)</u>		<u>\$11,808</u>
9. WASTEWATER RATE BASE	<u>\$135,241</u>		<u>\$150,423</u>		<u>\$150,423</u>
10. RATE OF RETURN	<u>(10.46%)</u>		<u>(12.84%)</u>		<u>7.85%</u>

MERRITT ISLAND UTILITY COMPANY, INC.		SCHEDULE NO. 3-B
TEST YEAR ENDED 3/31/2019		DOCKET NO. 20190116-SU
ADJUSTMENTS TO OPERATING INCOME		Page 1 of 2
		<u>WASTEWATER</u>
OPERATING REVENUES		
	To reflect the appropriate test year services revenues.	(<u>\$937</u>)
OPERATION AND MAINTENANCE EXPENSES		
1.	Purchased Power (715) To reflect 5 percent excessive I&I adjustment.	(<u>\$288</u>)
2.	Chemicals (718) To reflect 5 percent excessive I&I adjustment.	(<u>\$121</u>)
3.	Contractual Services – Engineering (731)	
	a. To reflect appropriate 5-year amortization of permit transfer work.	(\$960)
	b. To reflect appropriate 5-year amortization of service territory maps.	<u>1,244</u>
	Subtotal	<u>\$284</u>
4.	Contractual Services – Other (736) To reflect the new US Water contract amount.	<u>\$1,088</u>
5.	Insurance Expenses (755) To reflect actual insurance expense.	(<u>\$204</u>)
6.	Regulator Commission Expense (765)	
	a. To reflect 5-year amortization of filing fee from transfer docket ($\$750 \div 5$).	\$150
	b. Allowance for rate case expense amortized over 4 years ($\$2,046 \div 4$).	<u>512</u>
	Subtotal	<u>\$662</u>
7.	Miscellaneous Expense (775)	
	a. To reflect appropriate test year billing fees.	\$46
	b. To reflect pro forma adjustment to billing fees.	88
	c. To reflect expense that should be amortized over 5 years.	(1,284)
	d. To reflect appropriate amortization of FDEP-required pond clearing.	<u>2,570</u>
	Subtotal	<u>\$1,420</u>
TOTAL OPERATION & MAINTENANCE ADJUSTMENTS		<u>\$2,840</u>
DEPRECIATION EXPENSE		
1.	To reflect appropriate test year depreciation expense.	\$722
2.	To reflect pro forma plant addition.	<u>182</u>
	Total	<u>\$904</u>

MERRITT ISLAND UTILTY COMPANY, INC.		SCHEDULE NO. 3-B
TEST YEAR ENDED 3/31/2019		DOCKET NO. 20190116-SU
ADJUSTMENTS TO OPERATING INCOME		Page 2 of 2
		<u>WASTEWATER</u>
AMORTIZATION - OTHER		
To reflect reclassification to O&M expense.		(<u>\$1,089</u>)
TAXES OTHER THAN INCOME		
1. To reflect appropriate test year RAFs.		(\$106)
2. To reflect property taxes associated with pro forma plant addition.		75
3. To reflect pro forma Brevard County tax increase.		<u>2,546</u>
Total		<u>\$2,515</u>
INCOME TAX		<u>\$0</u>

MERRITT ISLAND UTILITY COMPANY, INC.		SCHEDULE NO. 3-C	
TEST YEAR ENDED 3/31/2019		DOCKET NO. 20190116-SU	
ANALYSIS OF WASTEWATER OPERATION AND MAINTENANCE EXPENSE			
	TOTAL PER UTILITY	STAFF ADJUST- MENT	TOTAL PER STAFF
(703) SALARIES AND WAGES - OFFICERS	\$5,000	\$0	\$5,000
(711) SLUDGE REMOVAL	4,000	0	4,000
(715) PURCHASED POWER	5,764	(288)	5,476
(718) CHEMICALS	2,425	(121)	2,304
(731) CONTRACTUAL SERVICES - ENGINEERING	1,200	284	1,484
(732) CONTRACTUAL SERVICES - ACCOUNTING	400	0	400
(733) CONTRACTUAL SERVICES - LEGAL	366	0	366
(736) CONTRACTUAL SERVICES - OTHER	46,123	1,088	47,211
(755) INSURANCE EXPENSE	1,528	(204)	1,324
(765) REGULATORY COMMISSION EXPENSE	0	662	662
(775) MISCELLANEOUS EXPENSE	<u>3,595</u>	<u>1,420</u>	<u>5,015</u>
	<u>\$70,401</u>	<u>\$2,840</u>	<u>\$73,241</u>

MERRITT ISLAND UTILITY COMPANY, INC.		SCHEDULE NO. 4		
TEST YEAR ENDED MARCH 31, 2019		DOCKET NO. 20190116-SU		
MONTHLY WASTEWATER RATES				
	PRIOR RATES	COMMISSION APPROVED INTERIM RATES	STAFF RECOMMENDED RATES	4 YEAR RATE REDUCTION
<u>Residential and General Service</u>				
Base Facility Charge by Meter Size				
5/8"X3/4"	\$11.15	\$11.50	\$16.17	\$0.09
3/4"	\$16.73	\$17.25	\$24.26	\$0.13
1"	\$27.88	\$28.75	\$40.43	\$0.22
1-1/2"	\$55.75	\$57.50	\$80.85	\$0.44
2"	\$89.20	\$92.00	\$129.36	\$0.70
3"	\$178.40	\$184.00	\$258.72	\$1.40
4"	\$278.75	\$287.50	\$404.25	\$2.18
6"	\$557.50	\$575.00	\$808.50	\$4.37
Charge per 1,000 gallons - Residential				
All Meter Sizes	\$2.97	\$3.07	\$4.69	\$0.03
6,000 gallon cap				
Charge per 1,000 gallons - General Service				
	\$3.57	\$3.68	\$5.63	\$0.03
<u>Bulk Service</u>				
Base Facility Charge - All Meter Sizes (120 ERCs)	\$1,338.00	\$1,380.00	\$1,940.40	\$10.48
Charge per 1,000 gallons - Bulk Service	\$3.57	\$3.68	\$5.63	\$0.03
720,000 gallon cap				
<u>Typical Residential 5/8" x 3/4" Meter Bill Comparison</u>				
3,000 Gallons	\$20.06	\$20.71	\$30.24	
6,000 Gallons	\$28.97	\$29.92	\$44.31	
10,000 Gallons	\$28.97	\$29.92	\$44.31	