

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Request for continuation)
of gross-up of contributions-in-)
aid-of-construction (CIAC) in)
Osceola and Polk Counties by)
POINCIANA UTILITIES, INC.)

DOCKET NO. 900991-WS
ORDER NO. 25174
ISSUED: 10/08/91

The following Commissioners participated in the disposition of this matter:

THOMAS M. BEARD, Chairman
SUSAN F. CLARK
J. TERRY DEASON
BETTY EASLEY
MICHAEL McK. WILSON

NOTICE OF PROPOSED AGENCY ACTION

ORDER APPROVING CONTINUED GROSS-UP OF
CONTRIBUTIONS-IN-AID-OF-CONSTRUCTION

BY THE COMMISSION:

NOTICE IS HEREBY GIVEN by the Florida Public Service Commission that the action discussed herein is preliminary in nature and will become final unless a person whose interests are substantially affected files a petition for formal proceedings pursuant to Rule 25-22.029, Florida Administrative Code.

CASE BACKGROUND

In Order No. 23541, issued October 1, 1990, we determined that any water and wastewater utility currently collecting the gross-up on contributions-in-aid-of-construction (CIAC) must file a petition for continued authority to gross-up. On December 18, 1990, Poinciana Utilities, Inc., (Poinciana or utility) filed a petition requesting approval to continue to collect the gross-up.

Poinciana is a wholly-owned subsidiary of Avatar Utilities, Inc., and provides water and wastewater service to developments in adjacent areas in Osceola and Polk Counties.

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09955 OCT -8 1991

FPSC-RECORDS/REPORTING

NEED TO CONTINUE GROSS-UP

In accordance with Order No. 23541, Poinciana has provided the Commission with a demonstration of actual tax liability, a cash flow statement, a statement of interest coverage indicating a times interest earned (TIE) ratio of no more than 2x, a statement that it does not have an alternative source of financing available at a reasonable rate, a statement justifying the gross-up, a statement of the gross-up method selected, and proposed tariffs.

Demonstration of Actual Tax Liability

Our review of the financial information filed by Poinciana indicates that Poinciana will incur an actual above-the-line tax liability as a result of its collection of CIAC. The utility is currently in a net earnings position after years of operating losses. For the twelve month period ended October 31, 1990, the utility's records show \$1,108,000 in taxable income, including income from CIAC, and a \$417,000 actual above-the-line tax liability. Based on the utility's projected operating results for the twelve month period ending December 31, 1991, the utility will have, excluding CIAC, \$221,000 in taxable income and a \$83,000 associated tax liability. When CIAC is included, taxable income will be \$3,176,000 and the associated tax liability will be \$1,195,000--a \$1,112,000 increase in tax liability due to the taxability of CIAC. We conclude that Poinciana has satisfied the requirement that utilities which gross-up CIAC have an above-the-line tax liability.

Cash Flow

The utility submitted a cash flow statement for the twelve month period ended October, 1990, and a projected cash flow statement for the twelve month period ending December, 1991. The cash flow statements should show whether liquid funds are available to pay taxes on CIAC. Poinciana claims that it does not have adequate cash flow to pay income taxes on CIAC and construction advances because it has a limited customer base with a high value of plant-in-service.

Poinciana's cash flow statements show a net cash deficit for both periods. Cash receipts for the October, 1990, period are \$1,923,000, and projected receipts for the December, 1991, period are \$4,205,000. Poinciana's primary source for cash is advances-

in-aid-of-construction from Avatar Properties, a related developer company. Poinciana states that since it does not have the financial resources to construct utility systems, its basic program is to have the developer finance the cost through contributions or advances-for-construction. For the October, 1990, period, Poinciana received \$1,662,000 in advances from the developer, 86.43% of Poinciana's total funds received; and for the December, 1991, period, Poinciana expects to receive \$3,891,000 from the developer, 92.53% of total funds received. For the October, 1990, period, Poinciana spent \$2,712,000, and for the December, 1991, period, it will spend \$6,153,000 primarily for construction and refunding advances. Developer advances are repaid with contributions from future customers. For the October, 1990, period, the net cash deficit, excluding payment of taxes, is \$789,000; for the December 1991, period, the net cash deficit, excluding taxes, will be \$1,948,000. When the payment of taxes is considered, the net cash deficit is \$1,206,000 for the October, 1990, period and will be \$3,143,000 for the December, 1991, period.

The tax liability on Poinciana's CIAC income exceeds the sources of funds generated from operations; therefore, we may conclude that although operations provide a limited source of capital, adequate sources of funds are not available from operations to fully fund the taxes on CIAC. Since the utility reports a net cash deficit for the periods ended October, 1990, and December, 1991, liquid funds are not available to fund taxes on CIAC.

Interest Coverage

The times interest earned (TIE) ratio indicates the number of times a utility is able to cover interest payments on its debt. The TIE ratio indicates an entity's ability to service its debt, the relative protection of the entity's bondholders, and the entity's ability to go into the financial market to borrow money or issue stock at a reasonable rate. In Order No. 23541, we established a benchmark TIE ratio of 2x as an indicator of a utility's ability to cover its interest payment and thus its ability to borrow.

Based on the data it submitted, Poinciana does not meet this benchmark. For the October, 1990, period, the TIE ratio is 1.75; for the December, 1991, period, the TIE ratio is projected to be 1.47.

Alternative Financing

Poinciana claims that there are no other sources of financing available for it to pay taxes on CIAC. As stated above, Poinciana states that it does not have the financial resources to construct utility systems and that its basic program is to have the developer finance construction through contributions or advances.

Since the utility has a TIE ratio below 2x, has a net cash deficit, and a deficit in retained earnings, the utility may not be able to borrow money in the financial markets at a reasonable cost. It appears that the utility does not have financing available as an alternative to grossing-up the taxes on CIAC.

Justification for Gross-up

The utility claims it does not have adequate cash flow to pay income taxes on CIAC and construction advances on its own. For the year 1991, Poinciana's projected cash forecast shows approximately \$2,000,000 in cash advances from affiliates to fund construction plus \$474,000 to pay interest on debt. In addition, Poinciana projects a \$900,000 tax liability on contributions and construction advances from customers and affiliates. Cash projections for 1992 show similar cash funding requirements to cover required cash disbursements. Poinciana believes it needs to continue grossing-up and collecting income taxes on CIAC and construction advances to meet its cash outflow requirements.

In consideration of Poinciana's actual above-the-line tax liability resulting from its collection of CIAC, its net cash flow deficit, and its low TIE ratio, we agree that there is justification for Poinciana to be allowed to continue to gross-up CIAC.

Gross-up Method Selected And Proposed Tariffs

Poinciana requested to be allowed to continue using the full gross-up method rather than implementing the net present value method because of its weak cash position. According to Poinciana, the full gross-up method will provide the cash flow it needs to fund CIAC taxes. Accordingly, Poinciana submitted proposed tariffs for its continuation of the full gross-up method as requested in its filing.

Other Considerations

Poinciana's 1990 annual report indicates that its achieved overall rate of return was 4.97% for the water system and 2.57% for the wastewater system. Neither return is compensatory in light of the 11.58% overall return authorized in Order No. 22166, issued November 9, 1989. By that Order, the utility's return on equity was established at 13.95%, with a range of plus or minus one percent. Currently, the utility is earning well below the low end of the range of reasonableness. For 1990, the utility's achieved return on equity was (8.84%) for the water system and (8.57%) for the wastewater system. We do not believe that it is in the best interest of either the utility or the ratepayers to increase a net operating income deficiency by not allowing a gross-up.

Therefore, in consideration of the foregoing, we find that Poinciana has demonstrated a continued need to collect the full gross-up. Its request to continue collecting the gross-up is, therefore, approved. The proposed tariffs submitted by Poinciana shall become effective upon the expiration of the protest period, if no timely protests are received.

Orders No. 16971 and 23541 prescribed the proper record keeping and the proper accounting and regulatory treatments for the gross-up. The CIAC collections allowed herein shall be made in accordance with those Orders, and all matters discussed in the body of those Orders are expressly incorporated herein by reference.

In consideration of the foregoing it is

ORDERED by the Florida Public Service Commission that approval is granted for Poinciana Utilities, Inc., to continue collecting the gross-up on CIAC. It is further

ORDERED that all of the provisions of this Order, are issued as proposed agency action and shall become final, unless an appropriate petition in the form provided by Rule 25-22.029, Florida Administrative Code, is received by the Director of the Division of Records and Reporting at his office at 101 East Gaines Street, Tallahassee, Florida 32399-0870, by the date set forth in the Notice of Further Proceedings. It is further

ORDERED that the tariffs shall be effective upon the expiration of the protest period. It is further

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ORDERED that in the event no timely protest is received, this docket shall be closed.

By ORDER of the Florida Public Service Commission, this 8th day of OCTOBER, 1991.



STEVE TRIBBLE, Director
Division of Records and Reporting

(S E A L)

MJF

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

The action proposed herein is preliminary in nature and will not become effective or final, except as provided by Rule 25-22.029, Florida Administrative Code. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, as provided by Rule 25-22.029(4), Florida Administrative Code, in the form provided by Rule 25-22.036(7)(a) and (f), Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting at his office at 101 East Gaines Street, Tallahassee, Florida 32399-0870, by the close of business on 10/29/91.

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

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

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

M E M O R A N D U M

October 8, 1991

TO: DIVISION OF RECORDS AND REPORTING
FROM: DIVISION OF LEGAL SERVICES (FEIL) *MJL (usd)*
RE: DOCKET NO. 900991-WS - REQUEST FOR
CONTINUATION OF GROSS-UP OF CONTRIBUTIONS-IN-
AID-OF-CONSTRUCTION (CIAC) IN OSCEOLA AND POLK
COUNTIES BY POINCIANA UTILITIES, INC.

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Attached is a Notice of Proposed Agency Action Order Approving Continued Gross-up of Contributions-in-Aid-of-Construction to be issued in the above-referenced docket.

MJF/slc

*Protests
due 10/29/91*

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