

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition to Gross-Up ) DOCKET NO. 920433-WU  
Contributions-in-Aid-of- ) ORDER NO. PSC-93-0238-FOF-WS  
Construction (CIAC) by EAST ) ISSUED: 02/15/93  
CENTRAL FLORIDA SERVICES, INC.)  
in Brevard, Orange and Osceola )  
Counties. )  
\_\_\_\_\_ )

The following Commissioners participated in the disposition of this matter:

J. TERRY DEASON, Chairman  
THOMAS M. BEARD  
SUSAN F. CLARK  
JULIA L. JOHNSON  
LUIS J. LAUREDO

ORDER APPROVING TARIFF

BY THE COMMISSION:

CASE BACKGROUND

By Order No. 16971, issued December 18, 1986, this Commission granted approval for water and wastewater utilities to amend their service availability policies to collect the tax impact on contributions-in-aid-of-construction (CIAC) resulting from the amendment of Section 118(b) of the Internal Revenue Code. By Order No. 23541, issued October 1, 1990, we ordered utilities currently grossing-up CIAC to file a petition for continued authority to gross-up and also ordered that no utility may gross-up CIAC without first obtaining the approval of this Commission. Further, in Orders Nos. 16971 and 23541, we prescribed the accounting and regulatory treatment for CIAC gross-up collections and the calculation of and manner for refunds of same.

By Order No. PSC-92-0104-FOF-WU, issued March 27, 1992, in Docket No. 910114-WU, we granted East Central Florida Services, Inc., (ECFS or utility) water certificate no. 537-W and approved service availability charges and service availability policies, whereby ECFS would receive substantial CIAC. The City of Cocoa filed a timely notice of appeal to that Order, and the appeal is still pending. By Order No. PSC-92-0955-FOF-WU, issued September 9, 1992, we lifted the stay which was instituted automatically when the City appealed by virtue of Rule 9.310(b)(2) of the Rules of Appellate Procedure. The City sought review of our Order lifting the stay, but the First District Court of Appeal denied the City's request to review our lifting the stay.

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ESCALATED TO THE COMMISSION

On May 12, 1992, pursuant to Order No. 23541, ECFS filed for initial authority to gross-up CIAC. In Order No. PSC-92-0958-FOF-WU, issued September 9, 1992, we elected not to withhold consent to ECFS's gross-up tariffs, thereby allowing ECFS to collect the gross-up on a temporary basis, subject to refund, pending further investigation and final evaluation of ECFS's request. By letter dated October 23, 1992, we inquired into several aspects of ECFS's filing. ECFS's responses which we make reference to herein were received on December 8, 1992.

ECFS is a class "C" water utility which currently provides potable and agricultural water in Brevard, Orange and Osceola Counties. Because ECFS is a new utility, it has no annual report on file with this Commission. According to ECFS's petition for gross-up authority, revenue for 1992 was projected to be \$153,216 and operating income was projected to be \$16,443.

#### TARIFF APPROVAL - FULL GROSS-UP METHOD

In its petition, ECFS asserts that its request is necessary because of its status as a newly-certificated utility. ECFS explains that although it commenced operations in May 1992, with many existing customers and with facilities in place, it expects to enter into future service agreements to provide potable and bulk raw water service which will result in its receiving substantial amounts of taxable CIAC. As a predicate to connecting such future customers, the utility states that it will need to construct costly facilities, financed through borrowing. Prior to receipt of taxable CIAC, ECFS anticipates having a regulatory above-the-line taxable income from utility operations. Unless it has gross-up authority throughout this period, ECFS states, it will incur a substantial tax liability with no apparent source for the funding of such liability.

In Order No. 23541, we stated that, to qualify for gross-up authority, each utility must demonstrate that it has an above-the-line tax liability and that alternate sources of funds are not available at a reasonable cost. We required that utilities file the following information to demonstrate the need to gross-up: a demonstration of actual tax liability, a cash flow statement (except for class "C" utilities), a statement of interest coverage, a statement of alternative financing, a justification for gross-up, a selection of gross-up method, and proposed tariffs. We have completed our review of the information ECFS filed, and our findings, categorized by filing requirement, are discussed below.

### Demonstration of Actual Tax Liability

ECFS is a new utility, so current financial operational data is not available. Because of the delay caused by the presence of the stay and its subsequent lifting, ECFS states it is just now preparing to provide service to customers as contemplated in the Commission's Order granting the certificate. ECFS explains that, among other problems, it has had some difficulty in getting the Water Management Districts to approve the requested transfers of the consumptive use permits held by the Corporation of the President of the Church of Jesus Christ of the Latter Day Saints, the parent of Magnolia Management Corporation (Magnolia), ECFS's parent.

The projected financial statements filed indicate that ECFS will incur an actual above-the-line tax liability for both its potable water and agricultural water services exclusive of any collection of CIAC. As shown on Schedule No. 1 of Order No. PSC-92-0104-FOF-WU, the amount of CIAC associated with a single raw water facility could be as much as \$1,071,429. It appears, then, that the utility will have an actual above-the-line tax liability prior to its collection of CIAC and any taxable CIAC received would result in a tax liability which the existing rates would not allow the utility to pay.

### Cash Flow Statement

A cash flow statement shows whether liquid funds are available to pay taxes on CIAC. ECFS, a class "C" utility, was not required to file a cash flow statement. However, the information filed indicates ECFS anticipates above-the-line income in its first year of operation. The \$153,216 of 1992 projected revenue does not appear sufficient to cover operating expenses and taxes associated with possible taxable CIAC collections.

### Statement of Interest Coverage

The times-interest-earned (TIE) ratio indicates the number of times a utility will be able to cover its interest obligations. The ratio is an indicator of the relative protection for bondholders and is indicative of the utility'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 TIE ratio of 2x as a benchmark for evaluating the need to gross-up.

In Order No. PSC-92-0104-FOF-WU, we projected ECFS's capital structure to be 60% debt with a cost rate of 10%. Projected total debt was \$420,738. Based upon the projected operating statements and capital structure, ECFS's TIE ratio is 2.22x. Thus, expected coverage on current debt from existing rates is slightly higher than the minimum guideline we established. However, we are mindful that with the addition of new customers or developments, the utility will be required to incur substantial additional borrowing, which will reduce the TIE ratio significantly. Such a reduction will render the ratio lower than the minimum standards and inadequate for the purpose of supporting an ability to fund the taxes on CIAC through additional borrowing. Therefore, we do not consider ECFS's current TIE ratio dispositive.

#### Statement of Alternative Financing

ECFS, as stated above, is a subsidiary of Magnolia. Order No. PSC-92-0104-FOF-WU, indicates that Magnolia would provide ECFS funding and financial support as needed. Further, on page 19 of the Order, we noted that it appears the utility and its parent are "fully capable of providing the needed capital and operating funds to ensure a viable utility operation for the present time and into the future."

ECFS anticipates no start up period during which it will find itself in a loss position for income tax purposes. However, according to ECFS, borrowing to pay income taxes, assuming such loans are available, would almost certainly jeopardize its ability to obtain financing for the facilities it will need to construct to serve future customers. The gross-up would provide funds to the utility to pay the income tax on CIAC at zero cost.

ECFS made no mention of Magnolia in the initial gross-up application. We requested information as to the extent of Magnolia's financial support and whether that support will include the payment of income taxes on donated property or cash CIAC. The utility responded as follows:

When Magnolia and in turn its parent made the commitment to provide financial funding, payment of taxes on CIAC was not envisioned. The utility and its parent company do not perceive funding of such tax impacts as "needed capital and operating funds to ensure viable utility operation for the present time and into the future." Instead, this would be a subsidization of the CIAC by the general body of ratepayers, and would increase rates to all ratepayers as a result of the additional investment

required. The rates as established in the certificate case would be inadequate to recognize the additional investment required by imposing the tax impact obligation for funding upon the Utility and its parent company. While the parent company stands ready, willing, and able to fund all needs for capital of ECFS, that commitment was not intended to cover taxes on CIAC.

We believe that any additional borrowings by ECFS for purposes other than construction, if available, would erode ECFS's capital structure and could result in operating losses due to additional interest expense. Because the utility is in development stage and must rely upon its parent for financial support, the utility's ability to go into the financial market to borrow money to pay taxes on CIAC would be impaired, and the utility would not be able to obtain alternative financing at a reasonable rate.

#### Justification for the Gross-Up

As explained above, it appears the utility will incur an above-the-line taxable income in its initial year of operation and expects to receive significant amounts of taxable CIAC in the future. ECFS's earnings will not be sufficient to pay income taxes in excess of taxes on above-the-line operations. All available financial resources will be needed to fund anticipated plant construction. Interest coverage will not be adequate under existing rates to cover interest on any additional debt.

Assuming total 1992 gross operating revenue is as projected, \$153,216, we do not think that the utility will be able to generate enough revenues with its current rates and customer base to pay for its operating expenses and taxes associated with CIAC and, at the same time, service its existing debt. It appears that the utility will incur an above-the-line tax liability associated with the collection of CIAC and that it will not be able to generate the funds to pay taxes either through its existing rates or through alternative financing. Therefore, we conclude that there is justification for this utility to gross-up CIAC.

#### Gross-Up Method Selected

The utility has elected to use the full gross-up method because it is cost effective and relatively simple to administer, compared with the present value method. We have no objection to ECFS selected method.



Proposed Tariffs

The utility submitted proposed tariffs for the full gross-up requested in its filing. We approve the tariffs as filed.

The collections of the CIAC gross-up shall be made in accordance with the provisions of Orders No. 16971 and 23541. Orders No. 16971 and 23541 prescribe the accounting and regulatory treatment of and record keeping requirements for the gross-up and established criteria and method for refunds of certain gross-up amounts collected. ECFS's CIAC collections shall be made in accordance with those Orders. All matters discussed in the body of those Orders are expressly incorporated herein by reference.

EFFECTIVE DATE

The tariffs are approved as filed and will be effective on the stamped approval date. The tariffs will be approved after the protest period expires.

Persons substantially affected by this tariff have the right to a hearing prior to final approval. Therefore, substantially affected persons shall have 21 days from the date of this Order to request a hearing.

Based on the foregoing, it is, therefore,

ORDERED by the Florida Public Service Commission that the tariffs for CIAC gross-up collections filed by East Central Florida Services, Inc., are hereby approved as filed. It is further

ORDERED that the aforementioned tariffs will be effective on their stamped approval date, and the tariffs will be stamped approved upon the expiration of the protest period. It is further


ORDERED that collections of and accounting for the CIAC gross-up shall be made in accordance with the provisions of Orders Nos. 16971 and 23541. It is further

ORDERED that substantially affected persons shall have 21 days from the date of this Order to request a hearing. It is further

ORDERED that upon expiration of the protest period, if no protest has been received, the docket may be closed.

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DOCKET NO. 920433-WU  
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By ORDER of the Florida Public Service Commission this 15th  
day of February, 1993.

  
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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 Commission's decision on this tariff is interim in nature and may become final, unless a person whose substantial interests are affected by the action proposed files a petition for a formal proceeding, as provided by Rule 25-22.036(4), Florida Administrative Code, in the form provided by Rule 25-22.036(7)(a)(d) and (e), 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 March 8, 1993.

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 wastewater utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days of the date this Order becomes final, 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.