

State of Florida



Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0858

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

RECORDS AND REPORTING

APR 8 11:13

DATE: APRIL 8, 1999

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYÓ)

FROM: DIVISION OF WATER AND WASTEWATER (GILCHRIST)
DIVISION OF AUDITING AND FINANCIAL ANALYSIS (CAUSSEAUX)
DIVISION OF LEGAL SERVICES (JAEGER)

RE: DOCKET NO. 971179-SU - DISPOSITION OF CIAC GROSS-UP FUNDS
COLLECTED BY NORTH FORT MYERS UTILITY, INC. IN LEE COUNTY.
COUNTY: LEE

AGENDA: APRIL 20, 1999 - REGULAR AGENDA - PROPOSED AGENCY ACTION
(EXCEPT FOR ISSUE NO. 1) - INTERESTED PERSONS MAY
PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\LEG\WP\971179D.RCM

CASE BACKGROUND

North Fort Myers Utility, Inc. (NFMU or utility) is a Class A wastewater utility providing service to approximately 5,360 customers in Lee County. According to its 1997 annual report, the utility reported gross operating revenues of \$1,958,553 and net operating income of \$446,362.

As a result of the repeal of Section 118(b) of the Internal Revenue Code, effective January 1, 1987, contributions-in-aid-of-construction (CIAC) became gross income and were depreciable for federal tax purposes. Therefore, by Order No. 16971, issued December 18, 1986, the Commission authorized corporate utilities to collect the gross-up on CIAC in order to meet the tax impact resulting from the inclusion of CIAC as gross income.

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Order No. 16971 and Order No. 23541, issued December 18, 1986 and October 1, 1990, respectively, require that utilities annually file information which would be used to determine the actual state and federal income tax liability directly attributable to the CIAC. The information would also determine whether refunds of gross-up would be appropriate. These orders also required that all gross-up collections for a tax year, which are in excess of a utility's actual tax liability for the same year, should be refunded on a pro rata basis to those persons who contributed the taxes.

However, the Small Business Job Protection Act of 1996 (The Act), which became law on August 20, 1996, provided for the non-taxability of CIAC collected by water and wastewater utilities effective retroactively for amounts received after June 12, 1996. As a result, Docket No. 960965-WS, Order No. PSC-96-1180-FOF-WS, issued September 20, 1996, revoked the authority of utilities to collect gross-up of CIAC and canceled the respective tariffs unless, within 30 days of the issuance of the order, affected utilities requested a variance. Although NFMU did not request a variance, it explained in a letter dated January 10, 1997, that it did not believe that the continued collection of the installment payments constituted a variance, but merely a payment of a debt over a period of time. Since there was no longer a need to review the Commission's policy on the gross-up of CIAC, Order No. PSC-96-1253-FOF-WS, issued October 8, 1996, closed Docket No. 960397-WS. However, as established in Order No. PSC-96-0686-FOF-WS, all pending CIAC gross-up refund cases are being processed pursuant to Orders Nos. 16971 and 23541.

NFMU provides wastewater service to several subdivisions (Forest Park, Lake Arrowhead, Carriage Village, Tamiami Village, and Lazy Days) formerly receiving service through package plants. In each case, under the authority granted in its tariff, NFMU allowed each customer to either pay the plant capacity charge and applicable gross-up at the time of connection onto the utility's central wastewater system or pay by installment payments over a seven-year period for the total amount owed. This installment arrangement was undertaken and authorized for the convenience of the customers who could not or chose not to pay their plant capacity fees and gross-up at the time of connection.

Although the Act provided for the non-taxability of CIAC collected by water and wastewater utilities for amounts received after June 12, 1996, several of the contractual agreements between the customers and the utility continue to be outstanding and

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require payments after June 12, 1996. As a result, on November 18, 1996, staff received a call from the Office of Public Counsel (OPC), advising staff that several customers had contacted OPC regarding the status of the customer's obligation to continue paying the gross-up amount of the installment payment to NFMU.

From March 17, 1997, through March 25, 1997, staff received approximately seventeen letters and numerous telephone calls from customers of NFMU, wanting to know why NFMU continued to collect gross-up from its customers when the Commission had canceled the utility's authority to collect gross-up. Staff advised the customers that the utility could continue to collect gross-up if it had not collected all of the gross-up it was entitled to receive from those customers who were paying by installment. Further, staff assured the customers that this matter would be investigated thoroughly and a recommendation to the Commission would be made accordingly. On November 12, 1997, OPC filed its Notice of Intervention in this docket and by Order No. PSC-97-1474-PCO-SU, the Commission acknowledged OPC's intervention.

Subsequent to filing its recommendation on October 23, 1997, staff realized that since, the utility was not treating the installment payments received after June 12, 1996, as taxable income on its tax return, staff's treating the installment contracts as "income" in the year the contracts were entered into, would have given the utility gross-up on CIAC which may not have been taxable income. Therefore, the gross-up refund calculations appearing in staff's recommendation of October 23, 1997, were revised to remove the installment contracts as being taxable income and the utility was advised accordingly. As a result, staff's recommendation of October 23, 1997, was deferred from the November 4, 1997, Agenda Conference. By letter dated November 14, 1997, revised refund calculations were submitted to the utility. In response to staff's letter, the utility advised staff that it would be filing amended tax returns to reflect as taxable income, the CIAC and gross-up due from customers paying by installment.

On December 12, 1997, the utility filed a certified copy of the amended tax returns with this Commission along with a copy of the return receipt from the Internal Revenue Service (IRS). Staff's recommendation has been revised accordingly.

On December 3, 1998, staff filed a recommendation to address the utility's request for a variance from Order No. PSC-96-1180-FOF-WS, to address the disposition of gross-up funds collected by

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the utility in 1994, 1995, and 1996, including the concerns of Mr. Pete Longjohn, President of Tamiami Village Homeowners Association, and the concerns expressed in the letters and telephone calls received from customers of NFMU, to address the utility's request that 50% of its legal and accounting costs be offset against the refund amounts, and to address the utility's informal Settlement Offer that was filed on October 2, 1998, and OPC's response, which was filed on October 21, 1998, to the informal Settlement Offer filed by the utility. Staff's recommendation of December 3, 1998, was deferred from the December 16, 1998, Agenda Conference.

The purpose of this recommendation is to address the same issues referenced above. Also, in this recommendation staff addresses whether the utility should be fined for continuing to collect CIAC gross-up without obtaining a waiver from Order No. PSC-96-1180-FOF-WS; for filing inaccurate annual reports; and for implementing price index rate increases based on inaccurate operating costs. Finally, this recommendation addresses whether the utility should be ordered to refund a portion of the revenues received from the implementation of the 1995, 1996, and 1997 price indexes and whether the utility should be ordered to reduce its rates to reflect the 1.15% price index rate adjustment calculated by staff.

DISCUSSION OF ISSUES

ISSUE 1: Should the Commission order North Fort Myers Utility, Inc., to show cause, in writing within twenty-one days, why it should not be fined an amount up to \$5,000 for each offense for: 1) its apparent failure to timely request a variance for the continued collection of CIAC gross-up as required by Order No. PSC-96-1180-FOF-WS; 2) its apparent failure to file accurate annual reports for the years 1994, 1995, 1996, and 1997, in compliance with Rule 25-30.110(9), Florida Administrative Code; and 3) its apparent implementation of price-index rate increases based on inaccurate operating costs in violation of Section 367.081(4)(c), Florida Statutes?

RECOMMENDATION: A show cause proceeding should not be initiated for the utility's failure to timely request a variance from Order No. PSC-96-1180-FOF-WS. Although the utility has filed inaccurate annual reports for the years 1994, 1995, 1996, and 1997, in apparent violation of Rule 25-30.110, Florida Administrative Code, it should not be made to show cause in writing within 21 days why it should not remit the applicable delinquent penalties as set forth in Rule 25-30.110(7), Florida Administrative Code, through the date of the correction which was February 15, 1999. Consistent with its recommendation in Issue 3 staff believes that refunding over collected amounts with interest serves as sufficient remediation for the incorrect Price Index rate increases and revised annual reports. Staff recommends that the Commission take no further action for the utility having implemented price index rate increases based on inaccurate operating costs in apparent violation of Section 367.081(4), Florida Statutes. Finally, the Commission should strongly admonish the utility to file the most accurate information possible in future annual reports and Price Index applications. (JAEGER, GILCHRIST)

STAFF ANALYSIS: As stated in the issue, staff lists three separate areas regarding whether the utility should be made to show cause why it should not be fined or penalized for apparent violations of Section 367.081(4)(c), Florida Statutes, or lawful rules or orders of the Commission. These apparent violations are summarized as follows: 1. failure to timely request a variance for the continued collection of CIAC gross-up; 2. failure to file correct annual reports; and 3. implementation of price-index rate increases based on inaccurate operating costs.

Section 367.161(1), Florida Statutes, authorizes the Commission to assess a penalty of not more than \$5,000 for each offense, if a utility is found to have knowingly refused to comply with, or to have willfully violated any provision of Chapter 367, Florida Statutes, or any lawful rule or order of the Commission. Pursuant to Section 367.021(12), Florida Statutes, utilities are charged with the knowledge of the Commission's rules and statutes. In Order No. 24306, issued April 1, 1991, in Docket No. 890216-TL titled In Re: Investigation Into The Proper Application of Rule 25-14.003, F.A.C., Relating To Tax Savings Refund for 1988 and 1989 For GTE Florida, Inc. (hereinafter GTE Florida) the Commission, having found that the company had not intended to violate the rule, nevertheless found it appropriate to order it to show cause why it should not be fined, stating that "'willful' implies an intent to do an act, and this is distinct from an intent to violate a statute or rule." Id. at 6. Additionally, "[i]t is a common maxim, familiar to all minds that 'ignorance of the law' will not excuse any person, either civilly or criminally." Barlow v. United States, 32 U.S. 404, 411 (1833). Thus, any intentional act, such as the utility's failure to comply with Order No. PSC-96-1180-FOF-WS, implementation of an inaccurate price index, or filing of an inaccurate annual report, would meet the standard for a "willful violation." Staff has analyzed each of the three apparent violations using the above-noted criteria.

1. Failure To Request A Variance From Order No. PSC-96-1180-FOF-WS

As stated in the case background, NFMU did not timely request a variance for its continued collection of CIAC gross-up. The utility argues that it is no longer CIAC gross-up, but merely collection of a debt that is being collected over time. Nevertheless, staff believes that its collection still constitutes CIAC gross-up and was subject to cancellation pursuant to Order No. PSC-96-1180-FOF-WS, and refund pursuant to the provisions of Orders Nos. 16971 and 23541. Therefore, staff believes that the utility should have requested a variance pursuant to Order No. PSC-96-1180-FOF-WS.

That Order canceled CIAC gross-up authority within 30 days of the date of the Order for all utilities unless the utility applied for a variance within 30 days of the date of the Order. To the extent that the Commission deems that a variance is required, the utility by letter dated February 28, 1997, has requested that it be granted a variance.

The utility, having failed to timely request and obtain a variance, appears to have violated Order No. PSC-96-1180-FOF-WS by continuing to collect CIAC gross-up 30 days after the issuance of that Order. Thus, its act was "willful" in the sense intended by Section 367.161, Florida Statutes.

While the utility's failure to timely seek and obtain a variance from Order No. PSC-96-1180-FOF-WS could be said to be willful, staff believes that the utility legitimately thought it did not need a variance, and, that there was some confusion as to whether its approved tariffs providing for installment payments required a waiver from Order No. PSC-96-1180-FOF-WS. Although regulated utilities are charged with complying with lawful Orders of this Commission, based on the confusion, staff does not believe that the apparent violation of the Order, rises in these circumstances to the level which warrants the initiation of a show cause proceeding. Therefore, staff recommends that the Commission not order NFMU to show cause for failing to comply with Order No. PSC-96-1180-FOF-WS.

2. Failure To File Accurate Annual Reports

Also, in a letter dated June 11, 1998, the utility contends that \$437,968 and \$374,019 of operating and maintenance (O&M) expenses shown in the utility's 1994 and 1995 annual reports should be reclassified as below-the-line expenses for gross-up purposes. Therefore, the utility appears to admit that it filed an inaccurate annual report and on February 15, 1999, the utility filed revised sheets for its annual reports for 1994-1997, accordingly. The annual report pages indicated that an additional \$296,841 of expenses were reclassified below-the-line for 1996 and \$297,092 was reclassified to below-the-line for 1997.

Although the reclassification of expenses does not cause the utility to exceed the range of its authorized return on equity, staff notes that the utility, through price indexing, has received the benefit of these expenses being classified above-the-line. Further, pursuant to Section 367.081(4)(c), Florida Statutes, the utility has submitted an affirmation under oath as to the accuracy of the figures and calculations upon which the change in rates was based. This affidavit appears to have also been in error.

Section 367.121(1)(d), Florida Statutes, authorizes the Commission to require regular financial reports as it deems necessary. Pursuant to Rule 25-30.110(4), Florida Administrative

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Code, a utility must file an annual report on the appropriate form. Further, Rule 25-30.110(5)(d), Florida Administrative Code, provides that the chief executive officer and chief financial officer shall certify as follows:

Whether the financial statements and related schedules fairly present the financial condition and results of operations for the period presented and whether other information and statements presented as to the business affairs of the respondent are true, correct, and complete for the period which they represent.

If a utility files an incorrect annual report, pursuant to Rule 25-30.110(9), Florida Administrative Code, the report is considered delinquent and subject to the same penalty as set forth in Rules 25-30.110(7)(a) and (b), Florida Administrative Code. Rule 25-30.110(11), Florida Administrative Code, states that the penalties that may be assessed against the utility for failure to file an annual report in compliance with Rule 25-30.110, Florida Administrative Code, shall be separate and distinct from penalties that may be imposed for other violations of the requirements of the Commission. Staff believes that implicit in the Commission's power to require reports set forth in Section 367.121(1)(c), Florida Statutes, is that these reports be accurate.

The revisions made in this particular case were made only after the utility had first implemented three price indexes with the expenses above the line, but then determined that it could reduce its CIAC gross-up liability and retain the maximum amount of CIAC gross-up funds received by placing those expenses below the line. At the December 15, 1998 Agenda Conference, the utility's consultant stated that it was just not cost effective to go into a detailed analysis of what should be above or below-the-line. An error of \$437,968, \$374,019, \$296,841 and \$279,072 of operating and maintenance (O&M) expenses shown in the utility's 1994, 1995, 1996 and 1997 annual reports is not insignificant.

The provisions for a penalty for an inaccurate and delinquent annual report are set forth in Rules 25-30.110(7) and (9), Florida Administrative Code. Staff's calculation of the penalty based on the revised filing date of February 15, 1999 is as follows: The utility is subject to a penalty of \$34,650 for its delinquent 1994 annual report (1,386 days x \$25); a penalty of \$25,525 for its delinquent 1995 annual report (1,021 days x \$25); a penalty of \$16,400 for its delinquent 1996 annual report (656 days x \$25) and

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a penalty of \$7,275 for its delinquent 1997 annual report (291 days x \$25).

Staff is seriously troubled by what appears to be a manipulation by the utility of the CIAC gross-up disposition procedures in an attempt to maximize the amount of CIAC gross-up collections retained. The manipulation has occurred through revisions to its annual reports in this case. We are further troubled by the inference made at a past agenda conference that the effort necessary to prepare the most accurate annual report was not initially made. However, staff is concerned in another regard as to the wisdom of invoking the penalties set forth in Rule 25-30.110(7) and (9), Florida Administrative Code. It has been the staff's long standing practice to encourage corrections and revisions to annual reports when inaccuracies are discovered and it has never invoked this provision when revisions have been filed. To do so would certainly discourage, and perhaps eliminate all together, the correction and revision of the information contained in annual reports. Therefore, staff is seeking other remedies (see Issue 3) in this case and cannot recommend show causing the utility for incorrect annual reports in this case.

3. Erroneous Implementation Of Price Indexes

Finally, the utility filed for and implemented Price Index rate increases for the years 1995, 1996 and 1997. These index increases were based on the incorrect annual reports filed for those years as noted above. The result was that the increases received from indexing were higher than they would have been had the utility filed the correct annual reports initially. Staff recommends in Issue 3 that the index rate increases for the affected years be recalculated based on the revised annual reports and that refunds be made with interest for the amounts over collected. This will result in some administrative burden for the utility. Staff believes that should the Commission approve staff's recommendation in Issue 3, that administrative burden should serve as a sufficient punitive measure and no further show cause action would be necessary. In addition, the Commission should strongly admonish the utility to provide the most accurate information possible in future annual reports and Price Index rate increase applications. Staff would also direct the utility to Section 837.05, Florida Statutes, which provides that false information intentionally provided to a public servant is a second degree misdemeanor. Should the Commission not agree with staff's

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recommendation in Issue 3 the utility should be subject to a Show Cause action for implementing erroneous price indexes.

Conclusion

Based on all the above, staff believes that no show cause proceeding is warranted for the utility's apparent violation of Order No. PSC-96-1180-FOF-WS. Although the utility has filed inaccurate annual reports for the years 1994, 1995, 1996, and 1997, in apparent violation of Rule 25-30.110, Florida Administrative Code, it should not be made to show cause in writing within 21 days why it should not remit the applicable delinquent penalties as set forth in Rule 25-30.110(7), Florida Administrative Code, through the date of the correction which was February 15, 1999. Consistent with its recommendation in Issue 3 staff believes that refunding over collected amounts with interest serves as sufficient remediation for the incorrect Price Index rate increases and revised annual reports. Staff recommends that the Commission take no further action for the utility having implemented price index rate increases based on inaccurate operating costs in apparent violation of Section 367.081(4), Florida Statutes. Finally, the Commission should strongly admonish the utility to file the most accurate information possible in future annual reports and Price Index applications. (JAEGER, GILCHRIST)

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ISSUE 2: Should North Ft. Myers Utility, Inc., be required to refund excess gross-up collections for fiscal year 1994(ended May 31, 1995), fiscal year 1995(ended May 31, 1996), and fiscal year 1996 (ended May 31, 1997)?

RECOMMENDATION: Based on past stipulations, staff recommends that the Commission accept NFMU's request that it be allowed to offset 50% of the legal and accounting fees incurred in processing the refund of CIAC gross-up over collections. If the Commission approves staff's recommendation, the over collection of \$82,287 should be reduced by the offset of \$8,048, for a refund of \$74,239 for fiscal year 1994 (ended May 31, 1995). For fiscal year 1995 (ended May 31, 1996) the over collection of \$61,100 should be reduced by the offset of \$9,101, for a refund of \$51,999. For those contributors who have paid the full amount of the gross-up, the utility should make a cash refund based on the contributors' pro rata share of the \$74,239 and \$51,999 overcharged amounts. The utility should also refund interest accrued from May 31, 1995, and May 31, 1996, to the date of the refund.

For those contributors who are paying by installment, one of two situations may exist: (1) the contributor may not have paid the full amount of gross-up the utility is entitled to collect or (2) the contributor may have paid the full amount of the gross-up the utility is entitled to collect. Therefore, for those contributors who are paying by installment, but have not paid the full amount of gross-up that the utility is entitled to collect for fiscal years 1994 and 1995, the utility should reduce (credit) the principal amount due on their installment contracts by the contributors' pro rata share of the gross-up overcharge for 1994 and 1995, and collect the reduced amount of gross-up from the contributor. Further, for those contributors who are paying by installment, and have paid the full amount of the gross-up that the utility is entitled to collect for fiscal years 1994 and 1995, the utility should make a cash refund of any excess gross-up and associated interest payments, and discontinue gross-up collections from those contributors. In addition, the utility should also refund interest accrued on the excess gross-up and associated interest payments, at the escrow rate, from May 31, 1995, and May 31, 1996, to the date of refund.

The refunds should be completed within 6 months of the effective date of the order. Within 30 days from the date of the refund, the utility should submit copies of canceled checks,

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credits applied to the monthly bills or other evidence that verifies that the utility has made the refunds. Within 30 days from the date of the refund, the utility should also provide a list of unclaimed refunds detailing contributor and amount, and an explanation of the efforts made to make the refunds. Further, on October 1, 1996, the utility refunded \$2,753.82 it collected for the period of June 1 through June 12, 1996, and no refund is recommended for the fiscal year 1996 (ended May 31, 1997). (GILCHRIST, CAUSSEAU)

STAFF ANALYSIS: In compliance with Orders Nos. 16971 and 23541, NFMU filed its 1994 and 1995 annual CIAC reports regarding its collection of gross-up for fiscal years 1994 and 1995, respectively. On October 23, 1997, staff filed a recommendation addressing the disposition of CIAC gross-up collected by the utility. Subsequent to filing its recommendation on October 23, 1997, staff realized that since the utility was not treating the installment payments received after June 12, 1996, as taxable income on its tax return, staff's treating the installment contracts as "income" in the year the contracts were entered into, would have given the utility gross-up on CIAC which may not have been taxable income. Therefore, the gross-up refund calculations appearing in staff's recommendation of October 23, 1997, were revised to remove the installment contracts as being taxable income.

By letter dated November 14, 1997, revised refund calculations were submitted to the utility. In response to staff's letter, the utility advised staff that it would be filing amended tax returns to reflect as taxable income the CIAC and gross-up due from the customers paying by installment. On December 12, 1997, the utility filed a certified copy of the amended tax returns with this Commission along with a copy of the return receipt from the Internal Revenue Service (IRS). The amended tax returns showed that the utility reported as taxable income the total amount due under the installment contracts.

By letter dated February 20, 1998, revised refund calculations based on the utility's amended tax returns, and revised CIAC gross-up reports and schedules were sent to the utility. On March 20, 1998, the utility filed its response to staff's letter of February 20, 1998. In its letter of March 20, 1998, the utility indicated that it does not agree with staff's above-the-line allocation of operating and maintenance expenses, with staff's above-the-line

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allocation of the legal expenses relating primarily to the litigation over an agreement with a consulting firm for its assistance in refinancing the company's industrial development revenue bonds, and with staff's above-the-line allocation of amortization expense for retired plant.

At the request of the utility, staff met informally with the utility and OPC on May 19, 1998 to further discuss the adjustments referenced in staff's letter of February 20, 1998 and to resolve as many differences as possible prior to the agenda conference. Based on the discussions held on May 19, 1998, the utility submitted additional information on June 11, 1998, that staff has been asked to consider. In its letter of June 11, 1998, the utility contends that \$437,968 and \$374,019 of operating and maintenance (O&M) expenses shown in the utility's 1994 and 1995 annual reports should be reclassified as below-the-line expenses for gross-up purposes. After reviewing the additional information, staff informed the utility that staff believed that if the expenses were reclassified below the line for gross-up purposes, they should receive the same treatment for index purposes. Therefore staff informed the utility that it believed the utility should refund that portion of the 1995, 1996, and 1997 index related to the reclassification of expenses.

On October 2, 1998, the utility filed an informal settlement agreement for staff to consider. The utility proposed to:

1. Treat, solely for the purposes of gross-up, certain expenses as below-the-line which were originally reported on the utility's annual reports as above-the-line expenses.
2. To the extent the utility is required to refund overpayments of gross-up funds to those who paid by installment, the utility is willing to apply those refunds as credits including interest at the installment contract rate.
3. To forego the implementation of indexing expenses for the years 1997, 1998, and 1999. According to the utility's calculations, the utility will forego revenues of \$118,183, by not implementing indexes for the years 1998-2000.

4. The utility will not seek to recover the additional gross-up costs which it has incurred since February, 1998.

On October 21, 1998, OPC filed a response to the utility's informal settlement agreement. In summary, OPC stated, that the Commission should reject the settlement offer proposed by the utility because the offer is fraught with errors and is wholly inconsistent with sound ratemaking practices and principles. OPC stated that the settlement should be rejected because of the following reasons:

1. The expenses in question cannot be considered reasonable for rate purposes, but not for CIAC gross-up purposes.
2. NFMU's calculation of the gross-up amounts owed to customers is severely understated. OPC disagrees with the expenses which have been suggested by the utility as being below-the-line for purposes of determining taxable income. If the utility's position is accepted, the Commission must immediately open an investigation into the earnings of this utility. If the expenses the utility claims are nonutility and more appropriately recorded below-the-line, OPC believes the utility's achieved return on rate base to be substantially in excess of any reasonable authorized rate of return on equity.
3. The Commission should reject the utility's suggestion that for those customers paying by installment, any refund of CIAC gross-up monies should be treated as a credit to monies owed under the contract.
4. The utility's offer to forego rate indexing increases for the years 1997, 1998, and 1999 should be rejected, because the expenses in question should be recorded above-the line, nullifying the need for any refunds or rate reductions.

5. OPC urges the Commission to reach a quick and final resolution of these gross-up monies owed to NFMU's customers.

On February 15, 1999, the utility filed revised annual reports for 1994-1997. Therefore, OPC's arguments presented in statements 1 and 2 are now moot as a result of the utility revising its 1994-1997 annual reports. The utility's calculations of refunds are no longer understated and although the expenses that were originally reported above-the-line have now been allocated below-the-line, the utility has not exceeded the range of its authorized return on equity. Also, staff believes the utility should be allowed to collect from the customers, the gross-up portion of the installment payment that it was entitled to receive prior to the change in the tax law.

The utility argues that it should not be required to refund the 1995-1997 price indexes because it did not exceed the range of its authorized return on equity during those years. However, the utility's O&M expenses were overstated in 1994-1997 and, as a result, the utility received a higher rate increase than it was entitled to. Therefore, the utility's offer to forego rate indexing increases for the years 1998-2000 should be rejected, and, as recommended in Issue 3, the utility should be ordered to refund a portion of the revenues received as a result of the price indexes that were implemented in 1995, 1996, and 1997.

As stated above, the utility revised its 1994 and 1995 annual reports to remove \$438,272 and \$374,018 of O&M expenses that were originally reported as above-the-line expenses. Staff's proposed refund calculations for 1994 and 1995 have been revised accordingly.

Staff calculated the gross-up required to pay the tax liability resulting from the collection of taxable CIAC by grossing-up the net taxable CIAC amount, in accordance with the method adopted in Order No. PSC-92-0961-FOF-WS.

ANNUAL GROSS-UP REFUND AMOUNTS

Based upon the foregoing, staff calculated the amount of refund per year which is appropriate. The calculations, taken from the information provided by the utility in its revised gross-up reports and revised annual reports for fiscal years 1994 and 1995,

respectively, are reflected on Schedule No. 1. A summary of each year's refund calculation follows.

1994

If the Commission votes to offset the refund by 50% of the legal and accounting costs, the utility proposes a refund of \$73,367, for fiscal year 1994 (ended May 31, 1995). Staff believes a refund of \$74,239 is appropriate for fiscal year 1994(ended May 31, 1995).

On February 15, 1999, the utility revised its 1994 annual report to remove \$438,272 of O&M expenses that were originally reported as above-the-line expenses. Also, the utility allocated depreciation in the amount of \$268,395, below-the-line. Staff adjusted this amount by \$22,120 to reflect first year's depreciation, above-the line. Based on the adjustments above, taxable income for the utility is calculated to be \$809,618 for fiscal year 1994 (ended May 31, 1995).

The utility's revised 1994 CIAC report reveals that the utility received taxable CIAC of \$619,015 for fiscal year 1994(ended May 31, 1995); and staff deducted \$22,120 for the first year's depreciation, resulting in net taxable CIAC of \$596,895. The utility's revised 1994 CIAC report also indicates that the utility was operating at a loss before the inclusion of CIAC in income. Order No. 23541 requires that CIAC income be netted against the above-the-line loss; therefore, not all of the CIAC collected would create a tax liability. When CIAC in the amount of \$596,895 is netted against staff's calculated loss of \$144,170, the amount of taxable CIAC resulting in a tax liability is \$452,725. Staff used the 37.63% combined marginal federal and state tax rates as provided in the revised 1994 CIAC Report to calculate net income taxes of \$170,360. When this amount is multiplied by the expansion factor for gross-up taxes, the amount of gross-up required to pay the tax effect on the CIAC is calculated to be \$273,144. The utility collected \$355,431 of gross-up monies. Therefore, staff calculates a refund of \$82,287. If the Commission votes to offset the refund by 50% (\$8,048) of the legal and accounting costs, the net refund is calculated to be \$74,239.

1995

If the Commission votes to offset the refund by 50% of the legal and accounting costs, the utility proposes a refund of \$51,131, for fiscal year 1995(ended May 31, 1996). Staff believes a refund of \$51,999, is appropriate for fiscal year 1995(ended May 31, 1996).

On February 15, 1999, the utility revised its 1995 annual report to remove \$374,018 of O&M expenses, that were originally reported as above-the-line expenses. Also, the utility allocated depreciation in the amount of \$326,800, below-the-line. Staff adjusted this amount by \$25,196 to reflect first year's depreciation, above-the line. Based on the adjustments above, taxable income for the utility is calculated to be \$1,830,114 for fiscal year 1995 (ended May 31, 1996).

The utility's revised 1995 CIAC report reveals that the utility received taxable CIAC of \$1,434,249 for fiscal year 1995 (ended May 31, 1996); and staff deducted \$25,196 for the first year's depreciation and \$477,842 for CIAC associated with the purchase of existing systems not grossed up, resulting in net taxable CIAC of \$931,211. The utility's revised 1995 CIAC report also indicates that the utility was operating at a loss before the inclusion of CIAC in income. Order No. 23541 requires that CIAC income be netted against the above-the-line loss; therefore, not all of the CIAC collected would create a tax liability. When CIAC in the amount of \$931,211 is netted against staff's calculated loss of \$127,339, the amount of taxable CIAC resulting in a tax liability is \$803,872. Staff used the 37.63% combined marginal federal and state tax rates as provided in the revised 1995 CIAC Report to calculate net income taxes of \$302,497. When this amount is multiplied by the expansion factor for gross-up taxes, the amount of gross-up required to pay the tax effect on the CIAC is calculated to be \$485,004. The utility collected \$546,104 of gross-up monies. Therefore, staff calculates a refund of \$61,100. If the Commission votes to offset the refund with 50% (\$9,101) of the legal and accounting costs, the net refund is calculated to be \$51,999.

1996

By correspondence dated February 20, 1998, staff advised NFMU that the disposition of gross-up collected for 1996 (ended May 31, 1997) would be addressed in this docket and requested the utility to file its tax return and CIAC Gross-up report for 1996. In response to staff's request, by letter dated June 24, 1998, the utility advised staff that during the period of June 1 through June 12, 1996, it collected service availability and the related gross-up charges totaling \$2,753.82 from five contributors. On October 1, 1996, refunds in the amount of \$2,753.82 were made to the five contributors and the utility submitted canceled checks as proof that the refunds were made. Since the refunds to the five contributors have been made, staff agrees with the company that filing a tax return for 1996 (ended May 31, 1997) and filing a 1996 CIAC Gross-up Report will not be necessary.

The utility provided documentation requesting legal and accounting fees of \$19,389.52 for fiscal year 1994 and \$21,496.52 for fiscal year 1995, for a total of \$40,886.04. Staff reviewed these costs and believes the cost incurred to file the amended tax returns should be disallowed. Staff believes that filing tax returns is a normal cost of operations, therefore, this cost should not be passed directly to the contributors of the gross-up.

Based upon its review, staff has determined that \$34,298 of the legal and accounting fees submitted by the utility are the legitimate costs for preparing the required reports, calculating the tax effect and the proposed refunds, \$16,096 of these expenses were incurred in fiscal year 1994 and \$18,202 of the expenses were incurred in fiscal year 1995. Fifty percent (50%) of these amounts are \$8,048 and \$9,101, respectively. Staff believes only one-half (½) of the cost of filing the revised CIAC gross-up reports and schedules should be allowed because the contributors of the gross-up did not have any control over the utility's decision to file amended tax returns; however, because the revised CIAC gross-up reports and schedules were filed to satisfy regulatory requirements, staff believes the cost incurred should be shared equally between the utility and the contributors of the gross-up. Therefore, for fiscal year 1994 (ended May 31, 1995), staff recommends that \$8,048 of legal and accounting fees be used to offset the proposed refund amount of \$82,287 and for fiscal year 1995 (ended May 31, 1996), \$9,101 of legal and accounting fees should be used to offset the proposed refund amount of \$61,100. As a result, staff recommends refunds of \$74,239 and \$51,999 for

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fiscal years 1994 and 1995 (ended May 31, 1995 and 1996, respectively).

Staff notes that the Commission has considered on several occasions, the question of whether an offset should be allowed pursuant to the orders governing CIAC gross-up. In Docket Nos. 961076-WS, and 970275-WS, by Order Nos. PSC-97-0657-AS-WS and PSC-97-0816-FOF-WS, respectively, the Commission accepted the utility's settlement proposals that 50% of the legal and accounting costs be offset against the refund amount. In general, the utility argues that the legal and accounting costs should be deducted from the amount of the contributors' refund, as the contributors are the cost-causers and as such, those costs should be recovered from the cost-causers.

Staff believes that Orders Nos. 16971 and 23541 did not provide for or contemplate an offset as requested by the utility. Therefore, staff does not believe that a reduction in the amount of refund a contributor is entitled to receive as a result of his overpayment of gross-up taxes is appropriate. Staff acknowledges that those costs were incurred to satisfy regulatory requirements; however, staff does not believe that the contributors should be held responsible for the legal and accounting costs incurred to determine whether they are entitled to a refund. Staff views those costs as a necessary cost of doing business. Finally, staff believes that this situation is similar to when a utility files for an increase in service availability charges. The costs of processing the utility's service availability case is borne by the general body of ratepayers, although the charges are set for future customers, only.

However, as in the other cases referenced herein, staff recognizes in this case that acceptance of the utility's request may avoid the substantial cost associated with a hearing, which may in fact exceed the amount of the legal and accounting cost to be recovered. Staff further notes that the actual costs associated with implementing the refunds have not been included in these calculations and will be absorbed by the utility. Moreover, staff believes the utility's request is a reasonable "middle ground". Therefore, staff recommends that while not adopting the utility's position, the Commission grant NFMU's request that it be allowed to offset 50% of the legal and accounting fees against the refund amounts.

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As previously stated, staff believes that for fiscal years 1994 and 1995, \$17,149 of the legal and accounting expenses incurred by the utility are appropriate. Therefore, for fiscal year 1994(ended May 31, 1995), staff recommends that \$8,048 of legal and accounting fees be used to offset the proposed refund amount of \$82,287. For fiscal year 1995 (ended May 31, 1996), staff recommends that \$9,101 of legal and accounting fees be used to offset the proposed refund amount of \$61,100. As a result, refunds of \$74,239 and \$51,999 are being proposed for fiscal years 1994 and 1995(ended May 31, 1995 and 1996, respectively). For those contributors who have paid the full amount of the gross-up, the utility should make a cash refund based on the contributors' pro rata share of the \$74,239 and \$51,999 overcharged amounts. The utility should also refund interest accrued from May 31, 1995, and May 31, 1996, to the date of the refund.

For those contributors who are paying by installment, one of two situations may exist: (1) the contributor may not have paid the full amount of gross-up the utility is entitled to collect or (2) the contributor may have paid the full amount of the gross-up the utility is entitled to collect. Therefore, for those contributors who are paying by installment, but have not paid the full amount of gross-up that the utility is entitled to collect for fiscal years 1994 and 1995, the utility should reduce (credit) the principal amount due on their installment contracts by their pro rata share of the gross-up overcharge for 1994 and 1995, and collect the reduced amount of gross-up from the contributor. Further, for those contributors who are paying by installment, and have paid the full amount of the gross-up that the utility is entitled to collect for fiscal years 1994 and 1995, the utility should make a cash refund of any excess gross-up and associated interest payments, and discontinue gross-up collections from those contributors. In addition, the utility should also refund interest accrued on the excess gross-up and associated interest payments, at the escrow rate, from May 31, 1995, and May 31, 1996, to the date of refund.

The utility proposes, and staff agrees that each of these customers would be notified that the principal amount owing under their installment contract would be reduced by their pro rata share of the refund amount. The utility has indicated that it is willing to make the appropriate calculations for the customer depending upon the year of the installment contract and notify the customers in accordance with that revision. Staff believes this is a reasonable approach because the customers would get full benefit of

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the lower amount of gross-up owed, and the utility would not be required to make refunds to customers before payments are received from those customers.

The refunds should be completed within 6 months of the effective date of the order. Within 30 days from the date of the refund, the utility should submit copies of canceled checks, credits applied to the monthly bills or other evidence that verifies that the utility has made the refunds. Within 30 days from the date of the refund, the utility should also provide a list of unclaimed refunds detailing contributor and amount, and an explanation of the efforts made to make the refunds.

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ISSUE 3: Should North Ft. Myers Utility, Inc., be ordered to refund a portion of the revenues it received as a result of the price indexes that were implemented in 1995, 1996, and 1997?

RECOMMENDATION: Yes. The Commission should reject the utility's settlement offer to forgo indexes for the next three years and a portion of the revenues received as a result of implementing the 1995-1997, price indexes should be refunded with interest. The combined refund for 1995, 1996, and 1997 is approximately \$52,970 before assessment of interest. The refunds should be made with interest as required by Rule 25-30.360 (4), Florida Administrative Code, within 90 days of the effective date of the order. The utility should be required to submit the proper refund reports pursuant to Rule 25-30.360 (7), Florida Administrative Code. The refund should be made to customers of record as of the date of the Order pursuant to Rule 25-30.360(3), Florida Administrative Code. The utility should treat any unclaimed refunds as CIAC pursuant to Rule 25-30.360(8), Florida Administrative Code. Further, the utility should be ordered to lower its rates to reflect the 1.15% price index rate adjustment calculated by staff. (GILCHRIST)

STAFF ANALYSIS: NFMU was granted a 1995 price index, effective November 5, 1995, which increased rates by 2.04%, the utility was granted a 1996 price index, effective November 5, 1996, which increased rates by 2.17%, and the utility was granted a 1997 price index, effective August 19, 1997, which increased rates by 1.53%. The utility did not file a price index for 1998. As discussed in Issue 2, the utility argued that it should not be required to refund the 1995-1997 price indexes because it did not exceed the range of its authorized return on equity during those years. Nonetheless, the utility's O&M expenses were overstated in 1994-1997 and, as a result, the utility received a higher rate increase than it was entitled to. Therefore, the utility's offer to forego rate indexing increases for the years 1998-2000 should be rejected and the utility should be ordered to refund that portion of the 1995-1997 index related to the reclassification of expenses.

On February 15, 1999, the utility revised its 1994, 1995 and 1996 annual reports to remove \$438,272, \$374,018, and \$296,841 of O&M expenses that were originally reported as above-the-line expenses. Staff recalculated the 1995, 1996, and 1997 price indexes based on the expenses reported in the revised 1994, 1995 and 1996 annual reports. On an annual basis, revenues should be reduced by \$8,949, for 1995, \$9,751 for 1996, and \$6,621 for 1997 and the

price index increases are 1.31%, 1.52%, and 1.15% for 1995, 1996, and 1997, respectively. As a result, NFMU should be ordered to refund a total of \$52,970 plus interest. The refunds should be made with interest, as required by Rule 25-30.360(4), Florida Administrative Code. The utility should be required to submit the proper refund reports pursuant to Rule 25-30.360 (7), Florida Administrative Code, within 90 days of the effective date of the Order. The refund should be made to customers of record as of the date of the Order pursuant to Rule 25-30.360(3), Florida Administrative Code. The utility should treat any unclaimed refunds as CIAC pursuant to Rule 25-30.360(8), Florida Administrative Code. Further, the utility should be ordered to lower its rates to reflect the 1.15% price index rate adjustment calculated by staff. A schedule of the utility's existing and staff's proposed rates follows:

WASTEWATER

Monthly Rates

--Residential--	Existing	Staff's
BASE FACILITY CHARGE	<u>Rates</u>	<u>Proposed</u>
		<u>Rates</u>
All Meter Sizes	\$ 10.98	\$ 10.79
GALLONAGE CHARGE		
per 1,000 gallons	\$ 3.98	\$ 3.91
(Maximum 10,000 gallons)		
--General Service--	Existing	Staff's
BASE FACILITY CHARGE	<u>Rates</u>	<u>Proposed</u>
<u>Meter Size</u>		<u>Rates</u>
5/8 x 3/4"	\$ 10.81	\$ 10.62
1"	26.99	26.52
1 1/2"	53.98	53.06
2'	86.36	84.89
3"	172.70	169.74
4"	269.83	265.21
6"	539.78	530.52
GALLONAGE CHARGE	\$ 3.98	\$ 3.91
per 1,000 gallons		

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--Multi-Residential-- BASE FACILITY CHARGE	Existing <u>Rates</u>	Staff's Proposed <u>Rates</u>
PER UNIT	\$ 9.90	\$ 9.72
GALLONAGE CHARGE per 1,000 gallons	\$ 3.98	\$ 3.91

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ISSUE 4: Should the docket be closed?

RECOMMENDATION: No. Upon expiration of the protest period, the docket should remain open pending verification of the CIAC gross-up and 1995, 1996, and 1997 price index refunds. Regardless of how North Fort Myers Utility, Inc., responds to the show cause portion of the Order, this docket should remain open pending the processing of the refunds of the improperly implemented price indexes and the over collected CIAC gross-up funds. If the utility remits the penalties for its failure to timely file accurate annual reports for the years 1994-1997, and makes the refunds for the improperly implemented price indexes and over collection of CIAC gross-up, and there are no unclaimed refunds, staff should have administrative authority to close the docket. If the utility fails to timely respond to the portion of the show cause order relating to the timely filing of accurate annual reports, the penalties set forth in the show cause order shall be liens on the real and personal property of the utility, enforceable by the Commission as statutory liens under Chapter 85, and Section 55.10, Florida Statutes, respectively. If the utility responds to the show cause order and requests a hearing, or there is a timely protest by a substantially affected person of the proposed agency action portion of this Order, this docket should remain open for final disposition. (JAEGER)

STAFF ANALYSIS: The docket should remain open. Upon expiration of the protest period, the docket should remain open pending verification of the CIAC gross-up and 1995 and 1996 price index refunds. Regardless of how North Fort Myers Utility, Inc., responds to the show cause portion of the Order, this docket should remain open pending the processing of the refunds of the improperly implemented price indexes and the over collected CIAC gross-up funds. If the utility remits the penalties for its failure to timely file accurate annual reports for the years 1994-1997, and makes the refunds for the improperly implemented price indexes and over collection of CIAC gross-up, and there are no unclaimed refunds, staff should be given administrative authority to close the docket. If the utility fails to timely respond to the portion of the show cause order relating to the timely filing of accurate annual reports, the penalties set forth in the show cause order shall be liens on the real and personal property of the utility, enforceable by the Commission as statutory liens under Chapter 85, and Section 55.10, Florida Statutes, respectively. If the utility responds to the show cause order and requests a hearing, or there is a timely protest by a substantially affected person of the proposed agency action portion of this Order, this docket should remain open for final disposition.

STAFF CALCULATED GROSS-UP REFUND

North Fort Myers Utility

SOURCE: (Line references are from Amended CIAC Reports)

	1994		1995
	-----		-----
1 Form 1120, Line 30 (Line 15)	\$ 809,618	\$	1,830,114
2 Less CIAC (Line 7)	(619,015)		(1,434,249)
3 Less Gross-up collected (Line 19)	(355,431)		(546,104)
4 Add First Year's Depr on CIAC (Line 8)	22,120		25,196
5 Add/Less Other Effects (Lines 20 & 21)	(1,462)		(2,296)
6	-----		-----
7 Adjusted Income Before CIAC and Gross-up	\$ (144,170)	\$	(127,339)
8			
9 Taxable CIAC (Line 7)	\$ 619,015	\$	1,434,249
10 Less first years depr. (Line 8)	(22,120)		(25,196)
	-----		-----
11 Adjusted Income After CIAC	\$ 452,725	\$	1,281,714
12 Less CIAC associated with purchase of existing systems not grossed-up			(477,842)
13 Less: NOL Carry Forward	0		0
14	-----		-----
15 Net Taxable CIAC	\$ 452,725	\$	803,872
16 Combined Marginal state & federal tax rates	37.63%		37.63%
17	-----		-----
18 Net Income tax on CIAC	\$ 170,360	\$	302,497
19 Less ITC Realized	0		0
20	-----		-----
21 Net Income Tax	\$ 170,360	\$	302,497
22 Expansion Factor for gross-up taxes	1.6033349		1.6033349
23	-----		-----
24 Gross-up Required to pay tax effect	\$ 273,144	\$	485,004
25 Less CIAC Gross-up collected (Line 19)	(355,431)		(546,104)
26	-----		-----
27 (OVER) OR UNDER COLLECTION	\$ (82,287)	\$	(61,100)
28	=====		=====
29 TOTAL YEARLY REFUND	\$ (82,287)	\$	(61,100)
30	=====		=====
31 OFFSET OF LEGAL AND ACCOUNTING FEE	\$ 8,048	\$	9,101
32	-----		-----
33 PROPOSED REFUND (excluding interest)	\$ (74,239)	\$	(51,999)
	=====		=====