

**FLORIDA PUBLIC SERVICE COMMISSION**

**Fletcher Building  
101 East Gaines Street  
Tallahassee, Florida 32399-0850**

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

**August 29, 1991**

**TO : DIRECTOR, DIVISION OF RECORDS AND REPORTING**

**FROM : DIVISION OF WATER AND SEWER (MCASKILL) *Boape***  
**DIVISION OF LEGAL SERVICES (BEDALL) *Bedall***  
**DIVISION OF AUDIT & FINANCIAL ANALYSIS (HICKS, SALAK) *Hicks***

**RE : UTILITY: TRADEWINDS UTILITIES, INC.**  
**DOCKET NO.: 900840-WS**  
**COUNTY: MARION**  
**CASE: PETITION FOR CONTINUATION OF GROSS-UP OF**  
**CONTRIBUTIONS-IN-AID-OF-CONSTRUCTION (CIAC)**

**AGENDA: SEPTEMBER 10, 1991 - PROPOSED AGENCY ACTION - PARTIES MAY PARTICIPATE**

**CRITICAL DATES: NONE**

**SPECIAL INSTRUCTIONS: NONE**

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DOCUMENT NUMBER-DATE

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FPSC-RECORDS/REPORTING

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**CASE BACKGROUND**

By Order No. 16971, issued December 18, 1986, the Commission granted approval for water and wastewater utilities to amend their service availability policies to meet the tax impact on Contributions-in-aid-of-Construction (CIAC) resulting from the amendment of Section 118(b) of the Internal Revenue Code. Order No. 23541, issued October 1, 1990, 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. Orders No. 16971 and 23541 also prescribed the accounting and regulatory treatments for the gross-up and required refunds of certain gross-up amounts collected. On October 22, 1990, pursuant to Order No. 23541, Tradewinds Utilities, Inc. filed for authority to continue grossing-up CIAC. The information as filed did not meet the minimum filing requirements of Order No. 23541, and additional information was requested from the utility. The additional information was received from the utility on February 18, 1991.

Tradewinds Utilities, Inc. is a Class C water and wastewater utility providing service to the public in Marion County. As of December 31, 1990, the utility served 366 water customers and 257 wastewater customers. The utility had gross operating revenues of \$59,401 for the water system and \$64,755 for the wastewater system. Net operating income was a loss of \$4,656 and \$3,334 for the water and wastewater systems, respectively.

**DISCUSSION OF ISSUES**

**ISSUE 1:** Should Tradewinds Utilities, Inc. be allowed to continue to gross-up Contributions-in-aid-of-Construction (CIAC) utilizing the full gross-up method?

**RECOMMENDATION:** Yes, the Commission should allow the utility to continue to gross-up CIAC using the full gross-up method. The collections of the CIAC gross-up should be made in accordance with the provisions of Orders No. 16971 and 23541. The tariffs should be approved as filed and become effective at the expiration of the protest period, if no timely protests are received. (MCCASKILL, HICKS, SALAK)

**STAFF ANALYSIS:** Order No. 23541 required that all utilities, that wished to collect the gross-up, file a petition for approval of the gross-up with this Commission. The Order stated that each utility demonstrate that a tax liability exists and that alternate sources of funds are not available at a reasonable cost. Utilities were required to file the following information to demonstrate the need to gross-up: Demonstration of Actual Tax Liability, Cash Flow Statements (except for Class C Utilities), Statement of Interest Coverage, Statement of Alternative Financing, Justification for Gross-up, Gross-up Method Selected and Proposed Tariffs. On October 22, 1990, Tradewinds Utilities, Inc. filed information which it believed demonstrated its need to continue the full gross-up method as previously approved. We have completed our review of the information filed, and our findings are as discussed below:

**DEMONSTRATION OF ACTUAL TAX LIABILITY:** Our review of the financial statements filed by the utility indicates that Tradewinds Utilities, Inc. will incur an actual above-the-line tax liability as a result of its collection of CIAC. Prior to CIAC becoming taxable, the utility sustained minimal above-the-line net operating losses for the water and wastewater systems. Additional information submitted by the utility indicates that in 1991 alone, the utility will collect approximately \$189,096 of CIAC from a developer in connection with putting the Pearl Britian Plaza water and wastewater system on line. Without the gross-up, the federal and state taxes associated with the collection of this CIAC will be approximately \$59,225. With the gross-up, the total CIAC and tax impact fee to be collected from the developer would be \$270,607. Of this amount, federal and state taxes would be approximately \$81,511. Based on the information filed, it appears that the utility will have an actual above-the-line tax liability associated with the collection of CIAC.

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**STATEMENT OF INTEREST COVERAGE:** The times interest earned (TIE) ratio indicates the number of times a utility is able to cover its interest. The ratio is an indicator of the relative protection of the bondholders. It is also indicative of the utility's ability to go into the financial market to borrow money or issue stock at a reasonable rate. Order No. 23541 established a TIE ratio of 2x as a benchmark.

As of December 31, 1990, the utility had total long-term debt of \$205,327. The TIE ratio was calculated to be .72x, which is less than the benchmark established by Order No. 23541. This TIE ratio indicates that the utility does not have adequate interest coverage. Further, it should be noted that the utility has a deficit of \$52,885 in retained earnings. This factor coupled with the utility's low TIE ratio may be indicative of the utility's inability to go into the financial market to borrow money at a reasonable cost.

**STATEMENT OF ALTERNATIVE FINANCING:** The utility stated that its weak financial position would make it difficult to obtain alternative financing. It stated that as seen by the TIE ratio, the stockholders have been in a continuing posture of having to subsidize the utility until such time as the customer base could grow to a sufficient size as to not require constant funding. Staff believes that because the utility does not have adequate interest coverage, has a deficit in retained earnings and has a debt to equity ratio of 2.98%, the utility's ability to go into the financial market to borrow money may be impaired and the utility may not be able to obtain alternative financing at a reasonable rate.

**JUSTIFICATION FOR THE GROSS-UP:** Tradewinds is a Class C utility with gross operating revenues of \$59,401 for the water system and \$64,755 for the wastewater system. For 1991 alone, the taxes associated with the \$189,096 of contributed plant and gross-up has been calculated to be \$81,511. Based on the total gross operating revenues of \$124,156 generated in 1990, it appears that the utility will not be able to generate enough revenues through its current rates and customer base to cover its operating expenses and the taxes of \$59,225 associated with CIAC. Further, the utility asserts that its weak financial position would make it difficult to obtain alternative financing. This assertion appears to be supported by the utility's TIE ratio, debt to equity ratio and a general review of the utility's balance sheet. 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 finance the taxes either through its existing rates or alternative financing. Therefore, there appears

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to be justification for this utility to continue to gross-up CIAC.

**GROSS-UP METHOD SELECTED:** The utility has elected to use the full gross-up method. The utility stated that due to the small size of the utility and the complicated record keeping associated with the Net Present Value method, it does not believe that it would be cost effective for the utility to use this method; therefore, it does not believe that the Net Present Value method would necessarily assist or satisfy its situation.

**PROPOSED TARIFFS:** In accordance with Order No. 23541, the utility has submitted proposed tariffs for the full gross-up as requested in its filing. Staff recommends that the tariffs be approved as filed and become effective upon the expiration of the protest period.

As a result of the above analysis, staff recommends that Tradewinds Utilities, Inc. be allowed to continue to gross-up CIAC. Further, Orders No. 16971 and 23541 prescribed the accounting and regulatory treatments and record keeping for the gross-up, and required refunds of certain gross-up amounts collected. Staff recommends that the CIAC collections be made in accordance with those Orders and that all matters discussed in the body of those Orders are expressly incorporated herein by reference.

**ISSUE 2:** Should the docket be closed?

**RECOMMENDATION:** Yes, the docket should be closed upon expiration of the protest period, if no protests are received. (MCCASKILL)

**STAFF ANALYSIS:** Upon the expiration of the protest period, if no protests have been received, the docket may be closed.