BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application of PALM COAST UTILITY CORPORATION for rate increase in Flagler County	DOCKET NO. 890277-WS ORDER NO. 23471 ISSUED: 9-12-90

The following Commissioners participated in the disposition of this matter:

THOMAS M. BEARD
BETTY EASLEY

ORDER DENYING MOTION FOR RECONSIDERATION, CROSS MOTION FOR RECONSIDERATION, AND MOTION TO CAPITALIZE REVENUES ASSOCIATED WITH EXTENSION OF EIGHT-MONTH SUSPENSION PERIOD

BY THE COMMISSION:

BACKGROUND

By Order No. 18785, issued February 2, 1988, this Commission began an investigation to consider, among other matters, the investment of Palm Coast Utility Corporation (PCUC) in utility plant assets. Docket No. 871395-WS was opened in order to process the investigation.

On May 19, 1989, during the pendency of the investigative docket, PCUC completed the minimum filing requirements for a general rate increase and that date was established as the official filing date. Docket No. 890277-WS was opened in order to process PCUC's rate application.

Since the issues in the investigation were intrinsic to the issues in the rate case, by Order No. 21794, issued August 28, 1989, this Commission subsumed Docket No. 871395-WS, the investigative docket, into Docket No. 890227-WS, the rate case docket.

A hearing was held on the combined rate case and investigation issues on December 6 through 8, 1989, in Palm Coast, and continued on January 8, 1990, in Tallahassee.

By Order No. 22843, issued April 23, 1990, this Commission established increased rates for water and wastewater service.

On May 8, 1990, PCUC filed a motion for reconsideration and oral argument. On May 15, 1990, the Office of Public Counsel (OPC) filed a response to PCUC's motion, along with its own cross-motion for reconsideration. On May 21, 1990, OPC filed an amended cross-motion for reconsideration.

On June 4, 1990, PCUC filed an amended request for oral argument on its motion for reconsideration. Also on June 4, 1990, PCUC filed a response to OPC's cross-motion for reconsideration, along with a request for oral argument thereon.

On June 15, 1990, OPC filed a response to PCUC's response to OPC's cross-motion for reconsideration. Also on June 15, 1990, OPC filed a response to PCUC's amended request for oral argument on its motion for reconsideration and a response to PCUC's request for oral argument on PCUC's response to OPC's cross-motion for reconsideration.

By Order No. 23327, issued August 8, 1990, the Prehearing Officer denied PCUC's various requests for oral argument. Each of the issues upon which the parties requested reconsideration is discussed separately, below.

In addition to the above, on March 9, 1990, PCUC filed a motion to capitalize the revenues that it had lost by agreeing to a second extension of the eight-month suspension period. OPC filed an objection thereto on March 21, 1990. On March 28, 1990, PCUC filed a response to OPC's objection. On April 6, 1990, OPC filed a response to PCUC's response to OPC's objection. This issue is also discussed separately, below.

REPAIR/COMPLETION PROGRAM

During the early 1970s, a substantial amount of defective utility plant was constructed. Subsequently, PCUC repaired, replaced, and/or completed a significant portion of this plant. Some of the repair/completion expenditures were capitalized while others were assigned to an extraordinary property loss account. The latter portion has been amortized for approximately ten years.

By Order No. 22843, we found that the original, defective plant was imprudently constructed and that, absent such imprudent construction, the repair/completion program would have been unnecessary. We also determined that PCUC's ratepayers should not have to pay a return on both the defectively constructed plant and the costs incurred to repair it. Accordingly, since the repair/completion program was a direct consequence of the imprudent construction of the original plant, we disallowed all of the costs related to the repair/completion program.

In its motion, PCUC contends that our decision was not based on competent substantial evidence. PCUC asserts that the only competent substantial evidence of record with regard to the repair/completion program was disclosed in a staff audit report from its first rate proceeding before this Commission, which was processed under Docket No. 800594-WS, and a detailed schedule from that docket that listed the individual repair charges. PCUC argues that we completely ignored this information and that, as a result, our decision was incorrectly made.

We do not agree. Although Order No. 22843 is not explicit on this point, we utilized the audit report to confirm that the cost of the repair/completion program was $2,519,030, rather than the approximately $3.9 million urged by OPC. However, while the audit report shows that our auditors reviewed contracts and traced expenditures to the general ledger, it did not, and could not, resolve the underlying prudence issue concerning the defective construction or the cost of repairing that work. In fact, the report included a disclaimer to that effect, as follows:

> B. Extraordinary Property Losses - Exhibit "B" consists of a letter to to the Commission requesting permission to reclassify $980,000 of plant to Extraordinary Property Losses and the reasons related to the request. The rest of that Exhibit details the additions ($2,519,030) of which the $980,000 is a part. The "loss" amount was recommended by consultants on the basis of relating to repairs: <u>the consultants' report is available for review but was not reviewed by a Staff field auditor</u>. (Emphasis added)

While the audit report confirmed that PCUC incurred $2,519,030 to repair and/or complete defective work, and that $980,000 of this amount was subsequently reclassified as an extraordinary loss, it yields no support for the prudence of this expenditure. Our decision in that regard was based on certain admissions made by PCUC and ITT Community Development Corporation (ICDC) in a civil proceeding, which matter was fully discussed in Order No. 22843.

We do not believe that PCUC considered the prudence aspect of our decision when it requested reconsideration of this issue. Rather, PCUC's motion merely suggests that the audit of the accounting treatment of the repair/replacement program should be dispositive of the ratemaking treatment to be afforded this expenditure.

Since we did consider the audit in our original decision, we do not believe that that decision is based upon any error or omission of fact or law. PCUC's motion for reconsideration of this issue is, therefore, denied.

EQUITY PENALTY FOR TAX POLICIES

By Order No. 22843, based upon certain tax decisions made by PCUC and its parent, ITT, we also found that there was a pattern on PCUC's part of not taking its customers into account when determining its tax policies. We, therefore, imposed an equity penalty of 50 basis points against PCUC in order to encourage it to consider its customers in future tax decisions.

In its motion for reconsideration, PCUC argues that this Commission "failed to consider that by imposing this penalty the Commission could subject PCUC to a normalization violation of the Internal Revenue Code, and thereby increase cost of service in the long run." With that in mind, we quote the following language from page 48 of Order No. 22843:

> We agree with PCUC that a violation could occur if deferred income taxes are imputed or an indirect adjustment is made to accomplish the same result. Accordingly, we do not believe that such an imputation should be made, but only because a normalization violation might hurt the ratepayers in the long-run.
>
> Notwithstanding the above, we believe that a prudent utility should attempt to provide the best

> possible service at the lowest possible cost. This includes paying the least amount of tax legally possible. Based upon this as well as other issues, we find that there has been a pattern, on PCUC's part, of not taking the cost of service into consideration when determining its tax policies. We believe that it is appropriate to send a signal to PCUC. Accordingly, we find it appropriate to assess an equity penalty of 50 basis points against PCUC for its failure to take the interests of its ratepayers into consideration when determining its tax policies.

As stated above, the equity penalty was assessed "for [PCUC's] failure to take the interests of its ratepayers into consideration when determining its tax policies", not to impute, either directly or indirectly, the effects of accelerated depreciation not being used by PCUC. We do not believe this is a violation of the Internal Revenue Code normalization requirements. Further, the record does not contain a revenue impact amount associated with the adjustment.

Since we did, in fact, consider normalization requirements in our original decision, we do not believe that our decision is based upon any error or omission of fact or law. PCUC's motion for reconsideration of this matter is, therefore, denied.

IMPUTATION OF CONTRIBUTIONS-IN-AID-OF-CONSTRUCTION (CIAC) FOR INCLUSION OF COST OF WATER PLANT IN LOT PRICE

Throughout this proceeding, OPC has argued that evidence would prove that CIAC is understated because the utility's water system was included in the price of a homesite. This purported evidence included speculation about how a subsequently voided tax deduction should be construed; an ambiguous statement regarding a main extension fee extracted from an early report prepared by an outside consultant; one page from an early offering statement that, upon review, seemed to guarantee the availability of water service; and confusing testimony concerning how different terms for payment of water and wastewater fees should be construed.

By Order No. 22843, we rejected OPC's evidence and accepted the expert testimony of Utility Witness Guastella, who reported that PCUC had "accurate detailed records supporting all amounts of CIAC that have been paid by its customers." Utility Witness Guastella also testified that OPC's proposed imputation would violate Rule 25-30.570, Florida Administrative Code, since the utility had submitted competent substantial evidence as to the amount of CIAC. Since PCUC supported its position that all CIAC had been recorded, and OPC's contrary arguments were shown to be insubstantial, we rejected OPC's proposed imputation of CIAC.

In its cross-motion for reconsideration, OPC did not actually request that we reconsider our decision not to impute CIAC; rather, OPC suggested that we reword the reasoning behind our decision. Specifically, OPC requested that we reword our decision to state that:

> Based upon the record and given the requirements of Commission Rule 25-30.570, Florida Administrative Code, and The Deltona Corporation v. William T. Mayo et al., 342 So. 2d 510 (Fla. 1977), relating to the scope of the Commission's jurisdiction and authority, we reject OPC's proposal that we impute additional CIAC to offset the cost of the water transmission and distribution system. (Motion dated May 21, 1990)

In the Deltona case, the Supreme Court reversed this Commission's decision to impute CIAC when the Commission found that the utility's facilities were included in the price of purchased land, based upon oral representations to customers and various advertisements, offering statements, and other materials filed with the Florida Land Sales Board. OPC believes that the Commission should invoke that decision as the reason for not imputing CIAC in this proceeding, in order to remove any potential obstacle if the customers pursue a lawsuit against ICDC for breach of contract. However, OPC also admits that the record in this proceeding did not include many of the contracts, brochures, offering statements, and other correspondence which might convince a Court that the price of land included the cost of providing water service. In fact, our review of the record does not disclose any direct customer testimony concerning recovery of plant costs through purchase

of land. Moreover, there does not appear to be any competent substantial evidence concerning either written or oral representations to homesite purchasers regarding such recovery. Thus, OPC has asked this Commission to invoke the Deltona case when the record for this proceeding does not include the same evidence considered in the Deltona case.

In its response to OPC's cross motion for reconsideration, PCUC argued that this Commission should not reword Order No. 22843, since OPC did not point out any error or omission of fact or law in our original decision. PCUC also argued that OPC's Motion should be denied because the matter of a potential unrelated lawsuit against a nonparty to this docket was not in the record.

In its response to PCUC's response to OPC's cross motion for reconsideration, OPC contended that it merely asked this Commission to clarify its reasons for not imputing CIAC, giving prominence to the Deltona case, so that the customers will not be prevented from pursuing any legal remedies they may have regarding any alleged fraudulent land sales practices or contractual breaches by ICDC.

We believe that our reasons for not imputing CIAC in this docket were clearly explained in Order No. 22843. We do not believe that it would be appropriate to express any opinion on any evidence, which OPC indicates may be considerable, which was not introduced in this docket. Our decision in this case must be based upon the record, not speculation. Accordingly, we hereby reject OPC's cross motion for reconsideration.

CAPITALIZATION OF REVENUES ASSOCIATED WITH EXTENSION OF EIGHT-MONTH SUSPENSION PERIOD

On March 9, 1990, PCUC filed a petition for permission to "capitalize" those revenues that would have been collected, and retained after any refund requirement, if PCUC had implemented its proposed rates on February 13, 1990, when a first extension of the suspension period would have expired. According to PCUC, its agreement to extend the suspension period for an additional 35 days, or until March 20, 1990, caused a substantial loss of revenues, which PCUC proposes to recover through collection of a rate increment that will terminate when recovery is complete. PCUC contends that, while it voluntarily agreed to a second extension until March 20, 1990, it did so

with the understanding that the Commission and OPC would carefully consider its proposal to capitalize the otherwise lost revenues.

PCUC filed its application for increased rates on May 22, 1989, which date was accordingly established as the official filing date for this proceeding. Pursuant to Section 367.081(6), Florida Statutes, this Commission may suspend a utility's proposed rates for good cause, but that suspension of requested rates expires eight months after the filing date. Thereafter, the utility may implement its proposed rates, or any portion thereof, upon notification to the Commission and submission of appropriate security and tariffs, but the increased rates are subject to refund.

By letter dated September 8, 1989, PCUC agreed to a 25-day waiver of the eight-month suspension period, or until February 13, 1990. At that time, the hearings in this case were scheduled for December 6 - 8, 1989. If the hearings had concluded on December 8, 1989, there would have been adequate time for the parties to submit their briefs and for this Commission to render a decision by February 13, 1990. The hearings were not completed by this time, however, and a new date, January 8, 1990, was established to complete the hearing portion of this case. Accordingly, the date scheduled for our decision was revised to March 20, 1990.

During the concluding minutes of the hearing on December 8, 1989, we inquired about PCUC's intended action upon expiration of the suspension period. PCUC responded that, while some further extension was acceptable, PCUC would not agree to an indefinite extension. At the hearing on January 8, 1990, it appeared possible that one or more additional hearing dates might be needed. Accordingly, we inquired again as to whether PCUC intended to implement its proposed rates on or after February 13, 1990. PCUC responded that it had accepted an extension consistent with the January 8, 1990, hearing date and that February 8, 1990, was the revised date for the submission of briefs. We observed, however, that it would be impossible to render a decision by February 13, 1990, since that would leave no time for review of the parties briefs, a recommendation thereon, or the composition of an order. We also informed PCUC that we would not be "offended" if PCUC exercised its statutory right to implement its proposed rates, although such action might be inappropriate if the collection

period was of short duration. PCUC thereupon reported that a further extension, to March 20, 1990, would result in $114,000 in lost revenues, based upon expected usage and PCUC's requested rates. PCUC then requested that it be allowed to "capitalize" this revenue loss. We then asked the parties to consider this proposal and meet with the Prehearing Officer to offer their responses before February 13, 1990. This meeting, however, did not transpire.

On March 9, 1990, PCUC renewed its request to "capitalize" revenues that were lost during the second extension period. PCUC proposed that we subtract the interim rate increase from the approved rate increase (based upon a 35-day period using March of 1988 as a representative month), increase rate base by this amount, and allow it to amortize this "lost" revenue amount over the period for recovery of rate case costs. PCUC further proposed that the lost revenues be recovered through a specifically identified rate increment, that it be subject to any Commission-imposed reporting requirement, and that the rate increment terminate upon full recovery of the lost amounts.

On March 21, 1990, OPC filed a written objection to PCUC's request. OPC argued that approval of the requested rate adjustment would be retroactive ratemaking. OPC also argued that PCUC's statements at the December 8, 1989, hearing indicated a voluntary agreement for an extension which would not be indefinite. OPC also argued that PCUC voluntarily extended the suspension period since OPC did not affirmatively respond to PCUC's proposal to capitalize revenues before the February 13, 1990, expiration date of the initial extension. OPC further suggested that PCUC's unresponsiveness to many discovery requests extended the time for completion of this case.

On March 28, 1990, PCUC filed a response to OPC's objection. In response to OPC's suggestion that the delays were caused by PCUC's unresponsiveness to discovery requests, PCUC suggested that more time was needed because this rate case and an investigative docket were merged at the Commission's direction and because the hearing could not be concluded within three days due to the number of issues and witnesses.

We agree with PCUC that there were an inordinate amount of issues and witnesses for a case of this magnitude. However, we agree with OPC that PCUC's request to capitalize the lost

revenues would constitute retroactive ratemaking. Retroactive ratemaking occurs anytime new rates are applied to prior consumption. Gulf Power Company v. Cresse, 410 So. 2d 492, 493 (Fla. 1982). Here, PCUC is proposing to add a rate increment for service already rendered. Since the proposed increment would violate the proscription against retroactive ratemaking, PCUC's motion to capitalize the revenues lost due to its extension of the eight-month suspension period is hereby denied.

Upon consideration of the foregoing, it is

ORDERED by the Florida Public Service Commission that Palm Coast Utility Corporation's motion for reconsideration is hereby denied, as set forth in the body of this Order. It is further

ORDERED that the Office of Public Counsel's cross-motion for reconsideration is hereby denied, as set forth in the body of this Order. It is further

ORDERED that Palm Coast Utility Corporation's motion to capitalize revenues associated with its second extension of the eight-month suspension period is hereby denied, as set forth in the body of this Order.

By ORDER of the Florida Public Service Commission this 12th day of SEPTEMBER, 1990.

STEVE TRIBBLE, Director
Division of Records and Reporting

(S E A L)

RJP

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.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of any decision not disposing of a motion for reconsideration by filing a motion for reconsideration with the Director, Division of Records and Reporting within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or 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 after the issuance 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.