

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Disposition of gross-up) DOCKET NO. 961077-SU
funds collected by Eagle Ridge) ORDER NO. PSC-96-1394-FOF-SU
Utilities, Inc. in Lee County.) ISSUED: November 20, 1996
_____)

The following Commissioners participated in the disposition of this matter:

SUSAN F. CLARK, Chairman
J. TERRY DEASON
JOE GARCIA
JULIA L. JOHNSON
DIANE K. KIESLING

NOTICE OF PROPOSED AGENCY ACTION
ORDER REQUIRING REFUNDS

BY THE COMMISSION:

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

BACKGROUND

The repeal of Section 118(b) of the Internal Revenue Code (IRC) resulted in making contributions-in-aid-of-construction (CIAC) gross income, and depreciable, for federal tax purposes. By Order No. 16971, issued December 18, 1986, this Commission authorized corporate utilities to collect a CIAC tax gross-up in order for those utilities to pay the tax liability resulting from their receipt of CIAC.

In Order No. 23541, we determined that any water and wastewater utility already collecting the gross-up on CIAC and wishing to continue collecting the gross-up, had to file a petition for approval with the Commission on or before October 29, 1990. Eagle Ridge Utilities, Inc. (Eagle Ridge or utility), filed for authority to continue to gross-up on December 11, 1990. By Order No. 25436, issued December 4, 1991, Eagle Ridge was granted authority to continue to gross-up using the full gross-up formula.

By Orders Nos. 16971 and 23541, we required utilities which gross-up to file annually the information needed for: (1) a determination of the utility's state and federal income tax

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liability directly attributable to receipt of CIAC for that year; and (2) a determination of whether a refund of gross-up charges collected during that year is appropriate. These orders required that a utility refund on a pro rata basis the gross-up charges collected each year which exceeded the utility's actual above-the-line tax liability attributable to CIAC for the same year.

By Proposed Agency Action (PAA) Order No. PSC-92-0961-FOF-WS, issued September 9, 1992, as amended by Order No. PSC-92-0961A-FOF-WS, issued September 14, 1992, we clarified the refund calculation provisions of Orders Nos. 16971 and 23541. No protest to that PAA Order was filed, and the action taken therein became final.

On March 29, 1996, Docket No. 960397-WS was opened to review the Commission's policy concerning the collection and refund of CIAC gross-up. Workshops were held and comments and proposals were received from the industry and other interested parties. By Order No. PSC-96-0686-FOF-WS, issued May 24, 1996, we directed our staff to continue processing CIAC gross-up and refund cases pursuant to Orders Nos. 16971 and 23541; however, we also directed our staff to make a recommendation to the Commission concerning whether the Commission's policy regarding the collection and refund of CIAC should be changed upon our staff's completion of its review of the proposals and comments offered by the workshop participants.

However, on August 1, 1996, Congress passed The Small Business Job Protection Act of 1996 (The Act) and the President signed The Act on August 20, 1996. The Act 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, on September 20, 1996, in Docket No. 960965-WS, Order No. PSC-96-1180-FOF-WS was issued to revoke the authority of utilities to collect gross-up of CIAC and to cancel the respective tariffs unless, within 30 days of the issuance of the order, affected utilities requested a variance. Based on the above, there was no longer a need to review our policy to determine any changes and on September 16, 1996, we voted to close Docket No. 960397-WS. However, as established in Order No. PSC-0686-FOF-WS, all pending CIAC gross-up refund cases are still being processed pursuant to Orders Nos. 16971 and 23541.

Eagle Ridge is a Class B wastewater utility providing service to 606 customers in Lee County. According to its 1995 annual report, the utility reported operating revenues of \$338,486 and a net operating loss of \$53,052.

REFUND CALCULATIONS FOR YEARS 1993 AND 1994

In compliance with Orders Nos. 16971 and 23541, Eagle Ridge filed its 1993 and 1994 annual CIAC reports regarding its collection of gross-up for each year. By letter dated June 18, 1996, our staff submitted preliminary refund calculation numbers to the utility. By letter dated July 22, 1996, the utility responded that it did not agree with our staff's preliminary calculations.

Specifically, the utility disagreed with staff's classifying the entire amount of its management fees as above-the-line expense. Also, the utility believes that \$16,104, the costs associated with preparing the utility's gross-up reports should be deducted from the refund due to the contributors. We find that the contributor should not be held responsible for the legal and accounting charges incurred by the utility in determining whether he is entitled to a refund. Although these costs are incurred to satisfy regulatory requirements, the request for a reduction to the contributor's refund amount is not the appropriate place to seek recovery of these fees. The utility may seek recovery of these expenses in a rate case proceeding.

We have 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 Orders Nos. PSC-92-0961-FOF-WS and PSC-96-0961A-FOF-WS. Using Eagle Ridge's annual gross-up reports, we have made a refund calculation for each of the years Eagle Ridge collected CIAC and the gross-up, 1993-1994, and we find that refunds are due. Our calculations are reflected on Schedule No. 1, which is attached hereto and by reference incorporated herein. A summary of each year's calculation follows.

1993

The utility proposes that no refund is appropriate for 1993. However, we find that a refund of \$14,589 is appropriate.

In its filing, the utility classified \$30,135 of its management fees as above-the-line expense and \$26,459 as below-the-line expense. We have classified the entire \$56,594 as above-the-line expense. The utility explains that rates for the utility were originally set in 1985, and that we approved only an annual expense of \$7,500 for management and administrative services by Order No. 14133, issued February 27, 1985. Adjusting the \$7,500 figure to reflect customer growth and to reflect the change in the Consumer

Price Index (CPI), the utility calculated an above-the-line management fee of only \$30,135. Also, the utility noted that it had an operating loss of \$62,373 in 1993.

In response to what the utility has stated above, we note that the utility's annual report for 1993 shows management fees to be \$56,594. In reviewing the utility's annual report to determine whether it was overearning, the entire amount of \$56,594 was considered to be utility related and used and useful. For annual report review purposes, this expense was included and considered when determining the utility's net income; therefore, we find that the \$56,594 management fee should be included as an above-the-line expense in calculating the utility's taxable income.

Further, the utility states that it had an operating loss of \$67,593 in 1993. We find that the utility's operating loss should not determine whether the management fees should be classified as an above or below-the-line expense. The utility had the option of filing for a rate case, but chose not to do so.

Based on the above, we have adjusted management fees to reflect \$56,594 as above-the-line expense. This adjustment to management fees changed the utility's reported above-the-line taxable income of \$3,440 to an above-the-line loss of \$23,019. 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. The utility's CIAC report indicates a total of \$158,366 in taxable CIAC was received, with \$5,195 being deducted for the first year's depreciation, resulting in CIAC of \$151,371. When this amount is netted against the above-the-line loss of \$23,019, the amount of taxable CIAC resulting in a tax liability is \$130,152, instead of the \$153,171 as calculated by the utility. Using the 37.63% combined marginal federal and state tax rate as provided in the 1993 CIAC Report, we calculated the tax effect to be \$78,525. The utility collected \$93,114 of gross-up monies; therefore, a refund of \$14,589 is required for 1993.

1994

The utility proposes that no refund is appropriate for 1994. However, we find that a refund of \$5,655 is appropriate.

In its filing, the utility classified \$26,214 of its management fees as above-the-line expense and \$23,786 as below-the-line expense. Based on the same reasoning as stated above, we have classified the entire \$50,000 of management fees as above-the-line expense. This adjustment to management fees changes the utility's reported above-the-line taxable income of \$15,516 to an above-the-

line taxable loss of \$8,019. 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. The utility's CIAC report indicates a total of \$127,684 in taxable CIAC was received, with \$3,407 being deducted for the first year's depreciation, resulting in CIAC of \$124,277. When this amount is netted against the above-the-line-taxable loss of \$8,019, the amount of taxable CIAC resulting in a tax liability is \$116,007, instead of the \$124,277 as calculated by the utility. Using the 37.63% combined marginal federal and state tax rate as provided in the 1994 CIAC Report, we calculated the tax effect to be \$69,990. The utility collected \$75,645 of gross-up monies; therefore, a refund of \$5,655 is required.

The refunds for both the years 1993 and 1994 shall be completed within 6 months of the effective date of the order. Within 30 days from the date of the refund, the utility shall submit copies of canceled checks, credits applied to 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 shall also provide a list of unclaimed refunds detailing the contributor and the amount, and an explanation of the efforts made to make the refunds.

Upon expiration of the protest period, the docket shall remain open pending completion and verification of the refunds. Our staff shall be given administrative authority to close the docket upon verification that the refunds have been made.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that Eagle Ridge Utilities, Inc., shall refund contributions-in-aid-of-construction gross-up funds in the amount of \$14,589 for 1993, and in the amount of \$5,655 for 1994. It is further

ORDERED that the provisions of this Order are issued as proposed agency action and shall become final, unless an appropriate petition in the form provided by Rule 25-22.029, Florida Administrative Code, is received by the Director of the Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings or Judicial Review" below. It is further

ORDERED that all matters contained in the schedule attached hereto are by reference incorporated herein. It is further

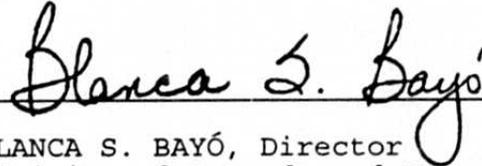
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ORDERED that the refunds required herein must be completed within six months of the date of this Order and that Eagle Ridge Utilities, Inc., shall submit copies of canceled checks, credits applied to monthly bills, or other evidence verifying that the refunds have been made within 30 days of completion of the refund. It is further

ORDERED that within 30 days of completion of the refund, Eagle Ridge Utilities, Inc., shall provide a list of unclaimed refunds detailing the contributor and the amount, and an explanation of the efforts made to make the refunds. It is further

ORDERED that the docket shall be closed upon expiration of the protest period, if no timely protest is filed, and upon our staff's verification that the refunds have been made.

By ORDER of the Florida Public Service Commission, this 20th day of November, 1996.

A handwritten signature in cursive script, reading "Blanca S. Bayó", is written over a horizontal line.

BLANCA S. BAYÓ, Director
Division of Records and Reporting

(S E A L)

RRJ

Commissioner Deason dissented on the issue of allowing the utility to offset the administrative costs of the refunds and the costs of the gross-up reports against the actual amount refunded.

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

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

The action proposed herein is preliminary in nature and will not become effective or final, except as provided by Rule 25-22.029, Florida Administrative Code. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, as provided by Rule 25-22.029(4), Florida Administrative Code, in the form provided by Rule 25-22.036(7)(a) and (f), Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on December 11, 1996.

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

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

If this order becomes final and effective on the date described above, any party substantially 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 effective date of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.

SCHEDULE NO. 1

COMMISSION CALCULATED GROSS-UP REFUND

Eagle Ridge Utilities, Inc.

SOURCE: (Line references are from CIAC Reports)

	1993	1994
	-----	-----
1 Form 1120, Line 30 (Line 15)	\$ 224,074	\$ 192,633
2 Less CIAC (Line 7)	(158,366)	(127,684)
3 Less Gross-up collected (Line 19)	(93,114)	(75,645)
4 Add First Year's Depr on CIAC (Line 8)	5,195	3,407
5 Add/Less Other Effects (Lines 20 & 21)	(808)	(981)
6	-----	-----
7 Adjusted Income Before CIAC and Gross-up	\$ (23,019)	\$ (8,270)
8		
9 Taxable CIAC (Line 7)	\$ 158,366	\$ 127,684
10 Less first years depr. (Line 8)	\$ (5,195)	\$ (3,407)
11	-----	-----
12 Adjusted Income After CIAC	\$ 130,152	\$ 116,007
13 Less: NOL Carry Forward	\$ 0	\$ 0
14	-----	-----
15 Net Taxable CIAC	\$ 130,152	\$ 116,007
16 Combined Marginal state & federal tax rates	37.63%	37.63%
17	-----	-----
18 Net Income tax on CIAC	\$ 48,976	\$ 43,653
19 Less ITC Realized	0	0
20	-----	-----
21 Net Income Tax	\$ 48,976	\$ 43,653
22 Expansion Factor for gross-up taxes	1.6033349	1.6033349
23	-----	-----
24 Gross-up Required to pay tax effect	\$ 78,525	\$ 69,990
25 Less CIAC Gross-up collected (Line 19)	(93,114)	(75,645)
26	-----	-----
27 (OVER) OR UNDER COLLECTION	\$ (14,589)	\$ (5,655)
28	=====	=====
29		
30 TOTAL YEARLY REFUND	\$ (14,589)	\$ (5,655)
31	=====	=====
32		
33 PROPOSED REFUND (excluding interest)	(20,244)	
34	=====	