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MEMORANDUM

March 12, 1998

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

FROM : DIVISION OF WATER AND WASTEWATER (JOHNSON)  
DIVISION OF LEGAL SERVICES (JAEGER)

RE : DOCKET NO.: 980182-WS DISPOSITION OF CONTRIBUTION-IN-AID-OF-CONSTRUCTION GROSS-UP FUNDS COLLECTED BY PALM COAST UTILITY CORPORATION  
COUNTY: FLAGLER

AGENDA : MARCH 24, 1998 - REGULAR AGENDA - PROPOSED AGENCY ACTION  
- INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\WAW\WP\980182-WS.RCM

CASE BACKGROUND

As a result of the repeal of Section 118(b) of the Internal Revenue Code (I.R.C.), contributions-in-aid-of-construction (CIAC) became gross income and were depreciable for federal tax purposes. In 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.

Orders Nos. 16971, issued December 18, 1986, and 23541, issued October 1, 1990, 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 require 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.

In Order No. 23541, the Commission required any water and wastewater utility already collecting the gross-up on CIAC and wishing to continue, to file a petition for approval with the Commission on or before October 29, 1990. On November 30, 1992, Palm Coast Utility Corporation (PCUC or utility) timely filed a petition requesting approval to continue to collect the gross-up on

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its CIAC. The information as filed met the filing requirements of Order No. 23541. By Order No. 25141, issued September 30, 1991, the Commission approved the utility's request to continue gross-up of CIAC using the net present value method.

On September 9, 1992, this Commission issued Proposed Agency Action Order No. PSC-92-0961-FOF-WS, which clarified the provisions of Orders Nos. 16971 and 23541 for the calculation of refunds of gross-up of CIAC. On October 12, 1994, Order No. PSC-94-1265-FOF-WS revised the full gross-up formula. No protests were filed, and the Order 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, staff was directed to continue processing CIAC gross-up and refund cases pursuant to Orders Nos. 16971 and 23541; however, staff was also directed to make a recommendation to the Commission concerning whether the Commission's policy regarding the collection and refund of CIAC should be changed upon staff's completion of its review of the proposals and comments offered by the workshop participants. In addition, staff was directed to consider ways to simplify the process and determine whether there were viable alternatives to the gross-up.

However, on August 1, 1996, The Small Business Job Protection Act of 1996 (The Act) passed Congress and was signed into law by President Clinton 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. Since there was no longer a need to review the Commission's policy to determine any changes; on October 8, 1996, Order No. PSC-96-1253-FOF-WS was issued closing 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 Order Nos. 16971 and 23541.

As previously stated, by Order No. PSC-96-1180-FOF-WS, issued September 20, 1996 in Docket No. 960965, the Commission voted to revoke the authority of utilities to collect gross-up of CIAC. Pursuant to this order, on October 16, 1996, PCUC filed an Application for Variance to collect the gross-up taxes for prepaid CIAC that was collected from January 1, 1987 through June 12, 1996.

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By Order No. PSC-97-0188-POF-WS, issued February 18, 1997, PCUC's Application for Variance was dismissed for lack of jurisdiction due to Flagler County's rescision of Commission jurisdiction effective August 5, 1996.

On March 3, 1997, the utility filed a Motion for Reconsideration or, Alternatively, Clarification of that order and a Request for Oral Argument. According to the utility, Section 367.171(5), Florida Statutes, states that all cases pending before the Commission or on appeal from an order of the Commission as of the jurisdictional transfer date remain within the jurisdiction of the Commission until disposed of by the Commission. The utility stated that if the Commission had the jurisdiction to dispose of gross-up collected by the utility during 1992 through 1994, and to cancel its authority to collect CIAC after the effective date of the jurisdictional transfer date, then the Commission continued to have jurisdiction to consider the utility's request for variance. Conversely, the utility argued that if the Commission did not have jurisdiction after the jurisdictional transfer date to consider its variance request, then it had no jurisdiction to cancel the utility's prospective gross-up authority.

PCUC, therefore, requested that the Commission either exercise jurisdiction over the request for variance, or alternatively, clarify Order No. PSC-97-0188-POF-WS to state that the Commission lacked jurisdiction to cancel the utility's gross-up authority. Order No. PSC-97-0601-POF-WU issued May 27, 1997, denied PCUC's request for oral argument, and denied its motion for reconsideration, or, alternatively, clarification. However, the Commission, on its own motion, corrected Order No. PSC-97-1180-POF-WS, to remove PCUC from the list of utilities whose gross-up authority was revoked by that order.

Although Flagler County rescinded Commission jurisdiction effective August 5, 1996, Order No. 25141, which approved the utility's request to continue the gross-up of CIAC, provides that all CIAC collections are to be made in accordance with Orders Nos. 16971 and 23541, and all matters discussed in those orders were expressly incorporated therein. Order No. 23541 states that "all gross-up amounts in excess of a utility's actual tax liability resulting from its collection of CIAC should be refunded on a pro rata basis to those persons who contributed the taxes." Since the collection of gross-up of CIAC was made subject to refund by the order, the Commission retains jurisdiction of the matter regarding the determination of refunds. The purpose of this recommendation is to address the disposition of refunds for 1996.

PCUC, Inc. is a Class A utility which is a wholly-owned subsidiary of the ITT Corporation. The utility provides water and

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wastewater service to the community of Palm Coast and part of Flagler county known as the Hammock. As of December 31, 1996, the utility served 16,205 water and 11,170 wastewater customers. Gross operating revenues were reported as \$7,328,311 for the water system and \$3,700,965 for the wastewater system. Net operating income was reported as \$1,354,129 for water and \$1,791,825 for wastewater.

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DISCUSSION OF ISSUES

ISSUE 1: Should PCUC be required to refund excess gross-up collections plus accrued interest for the year 1996?

RECOMMENDATION: No, the utility required more gross-up than was collected in 1996; therefore, no refund is necessary.  
(JOHNSON)

STAFF ANALYSIS: In compliance with Orders Nos. 16971 and 23541, PCUC filed its 1996 annual CIAC report regarding its collection of gross-up. On February 9, 1998, the utility submitted their preliminary refund calculation numbers to the staff. Staff's review of the CIAC report and supporting documentation reveal that the utility did not collect sufficient gross-up tax to satisfy their tax liability obligation.

ANNUAL GROSS-UP REFUND AMOUNTS

Based upon the foregoing, staff has calculated the amount of refund which is appropriate. The calculations are based on the information provided by the utility in its gross-up reports. A summary of the refund calculation is as follows.

1996

The utility proposes that no refund is appropriate. Staff agrees that a refund of gross-up collections for 1996 is not appropriate.

The 1996 CIAC report indicates the utility was in a taxable position on an above-the-line basis prior to the inclusion of taxable CIAC in income. Therefore, all taxable CIAC received would be taxed. The CIAC report indicates a total of \$946,082 of taxable CIAC was received. The tax liability is \$364,951 on the taxable CIAC of \$946,082. However, gross-up was collected on only \$729,732 of this amount because \$216,350 of the CIAC collected was prepaid. The utility collects the gross-up on prepaid CIAC when the customer actually connects to the system. The CIAC report also indicates that \$244,747 of gross-up collections were received on the \$729,732 of taxable CIAC.

PCUC uses the net present value gross-up method. Therefore, staff has 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 net present value method adopted in Order No. 23541. In accordance with the net present value formula staff has used the utility's last authorized

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rate of return of 9.21% as approved in Order No. 22843, Docket No. 890277-WS, issued April 23, 1990. As a result, the authorized gross-up percentage is 32.2%. Staff calculated that the utility should have collected \$244,747 of gross-up for 1996. Hence, no refund is required.

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ISSUE 2: Should the docket be closed?

RECOMMENDATION: Yes. Upon expiration of the protest period, if a timely protest is not filed by a substantially affected person, this docket should be closed. (JAEGER)

STAFF ANALYSIS: Upon expiration of the protest period, if a timely protest is not filed by a substantially affected person, processing of this docket is complete and the docket should be closed.