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June 13, 1997

FEDERAL EXPRESS

Ms. Blanca Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Betty Easley Building, Room 110
Tallahassee, Florida 32399-0850RE: Application for Rate Increase in Duval,
Nassau, and St. Johns Counties by United Water
Florida Inc., Docket No. 960451-WS

Dear Ms. Bayo:

In connection with the above-referenced matter, please find enclosed an original and seven (7) copies of the Motion for Reconsideration of Order No. PSC-97-0618-FOF-WS. Also please find enclosed a double sided high density diskette, WordPerfect for Windows 6.1, containing the Motion for Reconsideration.

Please file the original of the Motion for Reconsideration and distribute the copies in accordance with your usual procedures.

If you have any questions or comments regarding this matter, please do not hesitate to call.

Sincerely yours,

James L. Ade

ACK _____
AFA 2
APP _____
CAF _____
CMU _____
CTR _____
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LEG 2
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OPC _____
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DOCUMENT NUMBER-DATE

06031 JUN 16 97

FPSC RECORDS/REPORTING

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application for Rate Increase)
in Duval, Nassau, and St. Johns)
Counties by United Water Florida)
Inc.)

DOCKET NO. : 960451-WS

Date Submitted for
Filing: June 13, 1997

MOTION FOR RECONSIDERATION OF
ORDER NO. PSC-97-0618-FOF-WS

United Water Florida Inc. ("United Water Florida"), pursuant to Rule 25-22.060, Florida Administrative Code ("FAC"), by and through the undersigned attorneys, hereby files this motion for reconsideration of certain portions of Order No. PSC-97-0618-FOF-WS, Final Order Approving Rates and Charges ("Order"), and states as follows:

1. The purpose of a motion for reconsideration is "merely to bring to the attention of the [Commission]...some point which it overlooked or failed to consider when it rendered its order in the first instance." Diamond Cab Co. of Miami vs. King, 146 So.2d. 889, 891 (Fla. 1962).

2. The Commission has overlooked or failed to consider certain points relating to Acquisition Adjustment Amortization, Other Postretirement Employee Benefits ("OPEBs"), Investment Tax Credit ("ITC"), and the Parent Debt Adjustment.

Acquisition Adjustment Amortization

3. In determining that United Water Florida should have been amortizing acquisition adjustments from the dates the acquisition adjustments were authorized, the Commission reduced United Water Florida's rate base by over half a million dollars (\$623,485). The writeoff will result in a \$623,485 reduction in United Water

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Florida's reported earnings. The Commission has overlooked or failed to consider the following:

- a. The Commission has not established a generic amortization period or rate for acquisition adjustments of United Water Florida.
- b. The Commission does not have a rule establishing a generic amortization period or rate for acquisition adjustments.
- c. The Commission's rules prohibited United Water Florida from amortizing the acquisition adjustments until the Commission acted.
- d. A requirement that the acquisition adjustments be amortized from the date of approval violates the matching principal.

4. The basis for the Commission's decision requiring the amortization of acquisition adjustments to begin on the date the acquisitions were approved is its belief that "an amortization period of 20 years (5%) has been in effect since the utility's last general rate filing" and that "the Commission should not change [this established] amortization period." Order, p. 27-28.

5. However, in making its decision, the Commission mischaracterized Witness McGuire's testimony and overlooked what he actually said. Witness McGuire did not "admit... that an amortization period of 20 years (5%) has been in effect since the utility's last general rate filing. (Tr. 869)." Order, p. 27. Witness McGuire responded to a question on the amortization period for a specific acquisition adjustment. He did not admit that the Commission had established an amortization period for all of United

Water Florida's acquisition adjustments, including its future acquisition adjustments.

Staff Attorney

Q. Do you know what amortization period the Company used to amortize this Southern Utilities Company acquisition adjustment in the Company's last rate case?

McGuire

A. Again, subject to check -- that was about 20 years ago I believe -- I believe they gave us 20 years, if I'm not mistaken.

Tr. 869 (emphasis added).

This answer is consistent with Witness McGuire's testimony and United Water Florida's position that:

[t]his is the first general rate case the Company has filed since these properties [i.e., the acquisition adjustments at issue in this case--not the Southern Utilities Company acquisition adjustment] were acquired. As a result the Company does not have an approved amortization period from the Commission, and in this proceeding, is requesting that the Commission approve a twenty-year amortization period. Tr. 847.

6. The Order overlooks the point that the record contains no evidence that the Commission has ever authorized United Water Florida to amortize the acquisition adjustments or ever established a generic amortization period or rate for United Water Florida's acquisition adjustments. In United Water Florida's last rate case, the Commission did not establish a generic amortization period or rate. Instead, the Commission referred to acquisition adjustments as "[a]n acquisition adjustment was approved by this Commission in a prior rate proceeding. (Commission Order No. 6575)." Order No. 10531, p. 4, Docket 810071-WS(Cr). Furthermore, the order referred

to in Order No. 10531 (i.e., Order No. 6575) does not establish an amortization period or rate. The twenty year amortization period for the acquisition adjustment in Order No. 6575 (i.e., the Southern Utilities Acquisition Adjustment) is calculated by dividing the total amounts to be amortized set forth in Order No. 6575 by one-half of the two year adjustment shown on one of the schedules to Order No. 10531. See Exhibit 23, p. 8-9. However, in neither order did the Commission order United Water Florida to use a 20 year period or 5 percent rate of amortization for future acquisition adjustments. The orders are silent on this point. If the Commission intended to establish a specific amortization period or rate for all future acquisition adjustments of United Water Florida, then it would have said so in the orders. Furthermore, none of the transfer orders directed United Water Florida to begin amortizing the acquisition adjustments or provided a date for the commencement of such amortization. In addition, the transfer orders did not suggest any period for or any rate of amortization.

7. The Order does not refer to any rule which establishes a specific period or a specific rate for the amortization of acquisition adjustments. The Order overlooks the point that the only rule providing guidance in the area is Rule 25-30.115, FAC, which requires water and wastewater utilities to maintain their accounts and records in conformity with the 1984 NARUC Uniform System of Accounts ("USOA"). The 1984 NARUC USOA provides in the instruction to Account No. 114, Utility Plant Acquisition Adjustments, in part, as follows:

C. The amounts recorded in this account with respect to each property acquisition shall be amortized, or otherwise disposed of, as the Commission may approve or direct. (Emphasis added)

There is no evidence in the record which indicates that the Commission approved or directed any amortization of the six acquisition adjustments prior to this rate case. Moreover, there is no evidence in the record which indicates that the Commission established a time period or rate for the amortization of any of the six acquisition adjustments. The evidence regarding amortization of acquisition adjustments is that United Water Florida had not amortized the six acquisition adjustments prior to this rate case.

8. In addition, the Commission fails to consider that the NARUC instruction mentioned above indicates that a utility company should not look to the past as the Order would require. The focus is on the individual property acquisition - "each property acquisition shall be amortized, or otherwise disposed of, as the Commission may approve or direct." The NARUC instruction obviously does not intend that the Commission's action on one acquisition adjustment established in a rate case twenty years ago should also (i) establish whether acquisition adjustments arising in several future transfers of utility systems should be amortized and, (ii) if the acquisition adjustments are to be amortized, establish the amortization period and rate for the future acquisition adjustments.

9. As set forth above, Commission action was required before United Water Florida could begin amortizing the six acquisition adjustments. United Water Florida was prohibited from commencing amortization without the Commission's approval. Prior to this rate case, the Commission had not given such approval and United Water Florida did not commence amortization. United Water Florida, consistent with the NARUC instruction, has requested Commission approval. United Water Florida should not be penalized for following NARUC instructions and Commission rules, especially when the penalty is so large (\$623,485).

10. The Order also relies on NARUC USOA in its decision on the amortization of acquisition adjustments:

[t]he NARUC USOA states, in the definition of amortization, that amortization is the gradual extinguishment of the asset over the period during which it is anticipated the benefit will be realized. This would be the date that the Commission approved the acquisition of the system and its related acquisition adjustment. Order, p. 27.

The Order takes the position that the acquisition adjustment should be amortized from the date of the order approving the transfer and the acquisition adjustment. Even the witnesses for Public Counsel were not so extreme. Public Counsel's witnesses had the amortization period begin from the date that the acquisition adjustments were recorded on the books. Tr. 645; Order, p. 26-27. There is no evidence in the record to support the Commission's position. The Order would deem that United Water Florida was "benefitted" by the acquisition adjustment before the time to protest the order had expired, before the closing of the

transaction occurred (i.e., before United Water Florida owned the system), before the acquisition adjustment was booked, and before the final orders needed prior to closing were issued (e.g., a second order establishing rates and rate base or resolving a protest to the proposed agency action). For example, under the approach required by the Order, the Commission would have required United Water Florida to begin amortizing the acquisition adjustment in Ponte Vedra starting on December 22, 1993. However, Order No. PSC-93-1819-FOF was protested. Order No. PSC-95-0502-WS, issued on April 24, 1995, resolved the protest but reduced the acquisition adjustment by half. The Order's position would have resulted in sixteen months of amortization of an acquisition adjustment before the final acquisition adjustment amount was even determined, which was only half of the amount set forth in Order PSC-93-1819-FOF-WS.

11. While the Order and all parties agree that the acquisition adjustments should be amortized, there was no guarantee that the Commission would use a 20 year period. Even Public Counsel's witnesses admitted that the Commission might establish a different amortization period than 20 years (i.e., "if the Commission determined that a longer [than 20 year] amortization period is appropriate for the acquisitions...." Tr. 646.)

12. With respect to the Order's discussion concerning the definition of amortization, the Commission has overlooked or failed to consider when United Water Florida will be benefitted by the acquisition adjustment. According to NARUC, 'Amortization' means:

the gradual extinguishment of an amount in an account by distributing such amount over a

fixed period, over the life of the asset or liability to which it applies, or over the period during which it is anticipated the benefit will be realized. NARUC USOA, p. 9, Definitions.

The Commission makes the unsupported statement that "[t]his would be the date that the Commission approved the acquisition of the system and its related acquisition adjustment." Order, p. 27.

13. However, United Water Florida has yet to benefit from the acquisition adjustment. As shown in the Order (p.26-28, 96-97, 100-101, and 103), acquisition adjustments and their amortization have the following benefits: (i) acquisition adjustments increase the rate base upon which a utility company is allowed to earn a return, and (ii) the amortization of acquisition adjustments increases the revenue requirement for a utility company. However, United Water Florida's rates prior to this rate case were not established with the higher rate base resulting from the acquisition adjustment or the higher revenue requirement because of the amortization of the six acquisition adjustments. Because United Water Florida properly withheld amortization pending Commission approval, it has not enjoyed any related benefits as of yet, but the Commission's Order will eliminate \$623,485 of United Water Florida's investment and deny United Water Florida the opportunity to recover that amount through expenses.

14. In order for United Water Florida to receive the benefits of the acquisition adjustments from the dates of the orders of the approvals of the transfers of utility systems, as indicated by the Order, United Water Florida would be required to file a general

rate case prior to each transfer application and arrange for the timing of the final order, tariff sheet approval, and noticing to occur on the same day of the order approving transfer, but the Commission would have needed to incorporate the acquisition adjustment and amortization into the rate increase before the Commission had issued its order on the transfer.

15. United Water Florida has not benefitted from the acquisition adjustments as of yet. The failure to correlate the benefits of acquisition adjustments to a future amortization period will violate the matching principle. Such benefits will occur following this rate case and in the future with the collection of rates which are based, in part, on such acquisition adjustments and amortization of the acquisition adjustments, and the use of the amortization to offset revenues for tax purposes. Accordingly, the amortization period should start with the beginning of the test year. The Order would deny United Water Florida the benefit of \$623,485 in rate base and \$623,485 in future amortization of acquisition adjustments despite United Water Florida's following of NARUC instructions and Commission rules.

16. The purpose of the Commission's policy on acquisition adjustments has been to create an incentive for larger utility companies to acquire small, troubled utility companies. Order No. 25729, issued February 17, 1992, Docket No. 891309-WS. The Commission's action denies United Water Florida the benefit of a substantial portion of the acquisition adjustments. This action is

contrary to the policy and eliminates the incentive for a larger utility company to acquire smaller utility companies.

17. Therefore, the Commission should reconsider the starting point for the amortization of acquisition adjustments, provide that the amortization period shall be from January 1, 1997, through December 31, 2016, not require an increase in accumulated amortization of acquisition adjustment for the test year, and adjust rates accordingly.

Other Postretirement Employee Benefits

18. In its decision on OPEB expenses and reduction to rate base, the Commission has overlooked or failed to consider the purpose of Rule 25-14.012, FAC, and also has failed to consider the information in Exhibit No. 15 other than the annual unfunded expense amounts for 1995, 1996, and 1997, and the OPEB expenses amount for 1997 (i.e., the Commission overlooked the payments and expenses in 1995 and 1996).

19. As shown in the Order, OPEB annual expenses are included in the revenue requirement, and, therefore a utility company will recover the annual expenses in rates. Order, p. 29-30, 55-56.

20. Companies are not required to fully fund the OPEB annual expenses and this results in unfunded liability. Citizens of the State of Florida v. Public Service Commission, 15 FALR 1776, 1783, Case No. 92-5717RP (hereinafter "Rule Approval Decision"), a copy of which is attached hereto as Exhibit A; Exhibit No. 15; and Rule 25-14.012, FAC.

21. Because some utility companies collect rates which cover the annual OPEB expenses, but do not completely fund the annual OPEB liability, the Commission was faced with the possibility of utility companies collecting rates from customers without funding the expenses the same year. Rule Approval Decision, 15 FALR at 1782 ("[t]hese expenses do not represent actual cash outlays"). The delay in the expense payment would allow the utility companies the free use of funds equal to the accumulated unfunded liability ("an additional source of cash"). Id. Accordingly, the Commission adopted Rule 25-14.012, FAC.

22. Rule 25-14.012(3), FAC, provides, in part, as follows:

[e]ach utility's unfunded accumulated post retirement benefit obligation shall be treated as a reduction to rate base in rate proceedings.

"The utility rate payers pay the cost of the OPEBs and other expenses in their utility rates." Rule Approval Decision, 15 FALR at 1782. When properly applied, the rule acts to reduce rate base by removing the funds which the utility company has received from its customers but has not paid in expenses (i.e., the unfunded liability). This is similar to the way deferred taxes or deferred investment tax credits can be used to offset rate base. (e.g., "NOTE:--The net balance of deferred investment tax credits...would be either deducted from rate base or included in capital structure at zero cost." Uniform System of Accounts for Class A Water Utilities ("USOA"), 1984, NARUC, Accounting Instructions, p. 41); Tr. 864-865. Under the rate base reduction approach, the utility company's possession of a cost free funding source is offset by the

reduction in rate base. As noted in the order upholding the rule:

[u]nder the ... rule, the utilities are not required to fund the accumulated post-retirement benefit obligation, which is an expense, with an internal or external account. Just as depreciation expenses result in a write-down of the value of the depreciated asset, so that the utility earns a rate of return only on the depreciated asset value, any unfunded accumulated post-retirement benefit expense allowed by the Commission reduces the utility's rate base so no return is earned on that amount. This can be done as a reduction to the utility's working capital, by treating any portion of the accumulated post-retirement benefit obligation which has been allowed but not actually funded by the utility as a current liability. Rule Approval Decision, 15 FALR at 1783 (emphasis added).

The 1995 and 1996 post-retirement benefit expenses were not allowed by the Commission in the Order or any previous order. Therefore, United Water Florida's rate base should not be reduced by any unfunded liability related to those expenses. "A utility recovers accrued OPEB expenses through rates only when the Commission takes action to change rates, and that action always takes place in the context of a rate case which is subject to a Section 120.57(1) evidentiary hearing." Id.

23. The Commission has mechanically employed the rule in this proceeding and reduced United Water Florida's rate base, however, the Commission has overlooked the purpose of the rule: to offset a utility company's possession of a cost free funding source. This is United Water Florida's first rate case in which it has OPEBs. Order, p. 29, 55, and 56; Tr. 848. Therefore, United Water Florida does not have a cost free funding source because it has not collected rates from customers which include the recovery of OPEB

expenses. United Water Florida has not collected funds for 1995 and 1996 OPEB expenses, funded or unfunded. On the contrary, United Water Florida commenced funding in 1995 without recovery of the expenses. This was done to reduce future liability. The Order mechanically removes rate base to account for a cost free funding source that does not exist. Even Public Counsel did not seek to reduce rate base for the 1995 and 1996 unfunded liability of OPEB expenses--Public Counsel's brief only sought a reduction for the projected 1997 test year unfunded OPEB expense (\$426,764).

24. The inappropriateness of mechanically following the rule without regard to its purpose easily can be seen by comparing the OPEB expense amount with the reduction in rate base. United Water Florida has not previously received any cost free funding for OPEBs. The Order provides that United Water Florida would recover \$524,825 for 1997 OPEB expenses. Order, p. 56. The cost free funding (i.e., the unfunded liability of the 1997 OPEB expenses) in 1997 is \$435,844 ($\$524,825 - \$88,981 = \$435,844$). Accordingly, one would anticipate a corresponding reduction of \$435,844 in 1997 to rate base to offset the cost free funding received by United Water Florida. However, the Order removes not only the cost free funding (\$435,844), but an additional \$717,156. This removal is more than twice the approved 1997 OPEB expenses ($\$1,153,000 + \$524,825 = 2.2$).

25. The Commission's rules require United Water Florida to maintain its books and records pursuant to the Uniform System of Accounts established by NARUC. Rule 25-30.115, FAC. The

Commission has voted to require utility companies to comply with the 1996 edition of the NARUC USOA. Docket No. 970522-WS (vote scheduled for 6/10/97). One of the improvements which utility companies will be required to utilize is the accounting for Regulatory Assets and Liabilities: Account 186.3-Regulatory Assets, Account 253.1-Regulatory Liabilities, Account 407.4-Amortization of Regulatory Assets, and Account 407.5-Amortization of Regulatory Liabilities. Uniform System of Accounts for Class A Water Utilities 1996 NARUC, page 49, Instruction 38.

26. United Water Florida proposed that the Commission amortize the OPEB annual expenses and associated unfunded liability over a fifteen year period, increasing expenses and reducing rate base proportionately. This approach is consistent with the requirements for the creation and amortization of regulatory assets and liabilities. The approach is also consistent with the intent of the rule. United Water Florida has provided the necessary information to the Commission to allow the Commission to establish the regulatory asset for the 1995 and 1996 OPEB expenses and the regulatory liability of the unfunded liability for 1995 and 1996 OPEB expenses and provide for their amortization. The proposed fifteen (15) year period for amortization is within the FAS 106 approved range. Decision Approval Rule, 15 FALR at 1784. "The amortization period may be anywhere from one to twenty years for a particular utility, but cannot be slower than the recognition of the obligation on a pay-as-you-go or cash basis." Id.

27. The amortization procedure put forth by United Water Florida is more consistent with the intent of Rule 25-14.012, FAC, than the Order's mechanical offset. The amortization procedure also is consistent with FAS 106's approach in amortizing the liability for OPEB expenses for the period prior to the adoption of FAS 106. Decision Approval Rule, 15 FALR at 1784-1785. United Water Florida's proposal would increase annual expenses to be recovered in rates while also proportionally reducing rate base for the associated cost free funding (i.e., the portion of the unfunded liability). For example, the percentage of unfunded liability of the 1995 and 1996 OPEB expenses is 77.167%, ($[\$351,512 + \$365,644] + [\$449,126 + \$480,141] = 77.167\%$). United Water Florida proposed an increase in expenses to recover \$61,957 in amortization of the 1995 and 1996 OPEB expenses ($[\$449,121 + \$480,241] + 15 = \$61,957$) with a corresponding reduction of \$47,810 to its rate base ($\$61,957 \times 77.167\% = \$47,810$; $(\$351,512 + \$365,644) + 15 = \$47,810$). This proposal would result in the proper reduction in rate base to offset the associated cost free funding with the appropriate amortization.

28. The Commission should not overlook or fail to consider the intent of the rule. At a minimum, the Commission should not reduce rate base by the unfunded liability of OPEBs in 1995 and 1996, years in which United Water Florida did not receive the cost free funding. In its consideration of the intent of the rule, the Commission should establish a regulatory asset for 1995 and 1996 OPEB annual expense, a regulatory liability for the 1995 and 1996

unfunded OPEB liability, and amortize them over a reasonable period such as five (5) years (Rule 25-30.433(8), FAC) or fifteen years.

29. The Commission has overlooked or failed to consider the purpose of the rule. The Commission should reconsider its decision on OPEBs, create a regulatory asset for the 1995 and 1996 OPEB expenses, create a regulatory liability for the unfunded liability for 1995 and 1996 OPEB expenses, establish a 15 year amortization period, increase OPEB expenses, and reduce the rate base proportionally, and adjust rates.

Investment Tax Credit

30. The Commission's decision on the cost rate for ITC overlooks several points, including the fact that there is absolutely no evidence in the record to support the establishment of a zero cost rate. Even the Staff's own witness used a cost rate of 10.03 percent. Tr. 902. Public Counsel's witness used a cost rate of 10.04 percent. Order, p. 36.

31. The Order lists the portions of the record relating to the appropriate cost rate for the ITCs to be included in United Water Florida's capital structure. Such information included the analysis of Investment Tax Credits required by Schedule C-7 of the MFRs. In Schedule C-7, United Water Florida provided the following:

- a. An analysis of accumulated tax credits generated and amortized on an annual basis beginning with the test year in the last rate case to the end of the current test year.
- b. The company accounting policy on Investment Tax and Other Credits. Exhibit 4.

The only requirement in Exhibit C-7 that United Water Florida could not satisfy was the provision of a copy of the election made under Section 46(f), Internal Revenue Code. United Water Florida stated that it would be provided at a later date. The Commission advised United Water Florida that it had satisfied the minimum filing requirements on September 3, 1996. Order, p. 5.

32. The Order questions the evidence presented in the case on ITC. United Water Florida provided information required by the MFRs, and provided testimony, exhibits, and an affidavit requested by the Staff. The only document which United Water Florida was requested to provide, but did not, was a copy of an election form by United Water Florida's corporate parent. United Water Florida made diligent efforts to obtain a copy of the election form. Tr. 872; Exhibit 51. The Commission has failed to consider that the election form sought by the Staff is twenty-five years old and difficult to find. However, Staff witness Buckley did not find the lack of an election form to be an exception in his audit report. Nor did it prevent him from determining the cost rate for ITC.

33. The Commission also failed to consider that in United Water Florida's last general rate case, which was subsequent to the 1972 election, the Commission determined that United Water Florida's ITC cost rate was 12.81 percent - not zero percent. Order No. 10531, p. 8. The Order failed to consider that the Commission determined that United Water Florida was entitled to a return upon its ITC in its last general rate case and that no

evidence has been presented to show that the Commission should now deny United Water Florida any return on its ITC.

34. During the hearing, United Water Florida offered to provide an affidavit on the ITC election. Witness McGuire stated:

Quite frankly, we have not been able to locate our election. However, we have looked through all of our consolidated tax returns, and all of the information provided indicates they were operating under IRS Option 2, 46-F2, I believe. I have no reason to believe that we have not made the election. IRS would be back on our backs if, in fact, we were not in conformance with that treatment. So although we cannot find the original election, I certainly believe that's the way we're filing it. I'd be happy to sign an affidavit or have our tax manager to sign an affidavit to that effect if that would help. Tr. 872.

The Staff requested that United Water Florida provide such an affidavit. Id. The affidavit addressed the following:

- a. After diligent effort, the Company was unable to locate the original election.
- b. United Water Florida, as a participant, in 1972 elected Option 2 under Section 46(f)(2), Internal Revenue Code.
- c. In the most recent audit by the IRS, which was the 1990 return, no deficiency was cited by the IRS in connection with the treatment of ITC.
- d. If an election had not been made by the Company, the IRS would have disallowed the ITC claimed.

Exhibit 51.

35. The affidavit was prepared and executed on February 7, 1997, and filed on February 10, 1997. Although the affidavit was required to be filed before the transcripts were available to confirm the items to be addressed in the affidavit, the affidavit

addressed each of the points mentioned by Witness McGuire. The Commission has criticized the affidavit, overlooking that the affidavit satisfied the subject matter discussed during the hearing. United Water Florida was not requested to address the effect, if any, of the change in ownership since 1972 nor was United Water Florida requested to provide the 1990 IRS audit.

36. United Water Florida provided testimony that it made the necessary election in 1972. United Water Florida provided the affidavit requested by Staff. The undisputed evidence is that United Water Florida is entitled to use a cost rate greater than zero for its ITCs.

37. Therefore, the Commission should reconsider its decision on ITC, include United Water Florida's unamortized ITC in rate base at a cost of 9.99%, use an above the line ITC amortization amount of \$35,040 for the test year, and adjust rates accordingly.

Parent Debt Adjustment

38. Rule 25-14.004(2), FAC, provides as follows:

[w]here the regulated utility is a subsidiary of tiered parents, the adjusted income tax effect of the debt of all parents invested in the equity of the subsidiary utility shall reduce the income tax expense of the utility.

39. The Commission has overlooked the point that there is no evidence that any debt of United Water Resources Inc. ("United Water Resources") is invested in the equity of United Water Florida.

[T]here is no debt flowing from United Waterworks parents, United Waterworks Resources (sic), to either the equity of

United Waterworks, Incorporated or that of United Water Florida's equity. Tr. 853.

In no way does any debt from UWR ever get down to the equity of United Waterworks nor ever does it get down to the equity of United Water Florida. Tr. 874.

There is a complete absence of evidence to show that the funds invested in United Waterworks as equity came from other than internally generated source of funds of United Water Resources or from other than the equity funds of United Water Resources. Therefore, any assumption that this is a case of tiered parents addressed by Rule 25-14.004, FAC, is not supported by the record.

40. The Order states that the total parent debt adjustment is \$108,392 and provides an allocation of \$38,546 for water and \$69,816 for wastewater. Order, p. 78, 103. However, the Order does not set forth a calculation of such amounts or provide a sufficient explanation of how such amounts were determined. Thus, there is insufficient evidence to support the \$108,392 adjustment.

41. The Commission has failed to consider that the factual situation in this case is not the type of situation to be covered by Rule 25-14.004, FAC.

42. The Commission overlooks the policy behind the rule and the effect of the rebuttable presumption in the rule. As discussed by the Florida Supreme Court in General Telephone Company of Florida v. Florida Public Service Commission, 446 So.2d 1063, 1069 (Fla. 1984):

[i]n the normal course of a parent-subsidary relationship, the parent issues debt in order to acquire capital to support the operations of its subsidiaries. The capital is

transferred to the subsidiary in exchange for stock in the subsidiary. As a practical matter, the equity of the subsidiary is thus directly supported by the debt of the parent. The debt of the parent used to support the subsidiary generates interest expense for the parent, which in turn is tax deductible. Although the capital is passed on through to the subsidiary, there is no corresponding pass-through of interest expense because the parent passes on the capital to acquire an ownership interest in the subsidiary as opposed to a creditor's interest. Therefore, the nature of the acquired capital changes from debt to equity at the point the capital passes from parent to subsidiary.

If the parent and subsidiary had chosen to maintain their separate tax identities, the distinction between the capital acquired through debt by the parent and through equity by the subsidiary would have been valid. By filing a consolidated return, however, the entities have removed the separation between parent and subsidiary for tax purposes. No longer is it realistic to treat transactions between parent and subsidiary as transactions between separate entities. Parent and subsidiary are now components of the consolidated entity and the debt issued by the parent component supports the capital structure of the subsidiary component. The pragmatic result is that the consolidated entity has issued debt to support its overall capital structure and the interest paid on the debt goes toward reducing the tax liability of the consolidated entity, therefore benefiting each component member. The adjustment implemented by the rule in question merely allocates to the subsidiary component the interest expense deduction generated by the proportion of the consolidated debt that is used to support the subsidiary component's capital structure.

However, the rule also provides that this approach can be rebutted. As noted by the Florida Supreme Court in General Telephone:

The rule provides for a rebuttable presumption that the parent's investment in the subsidiary utility was composed of the same debt-equity

ratio as the parent's overall capital structure, and when this presumption bears true the adjustment provided by the rule will result in the correct income tax expense allocation to the utility. When the presumption is rebutted, the utility will be able to have the actual debt-equity ratio of the parent's investment determined on an individual basis by competent and substantial evidence. Once the ratio is determined, the adjustment will be calculated accordingly and once again the adjusted income tax expense will represent the actual cost incurred by the utility. Id. (Emphasis added)

43. The Commission has failed to consider that United Water Florida has rebutted the presumption and shown that the only debt associated with United Water Florida's capital is United Waterworks' debt, and, therefore, no parent debt adjustment should be made.

44. Furthermore, the Commission has failed to consider that imposing the additional interest because of United Water Resources' capital structure is inconsistent with the Commission's use of United Waterworks' capital structure to determine United Water Florida's capital structure and cost of capital (e.g., "[w]e agree with witness McGuire that the cost of long-term debt for UWF should be based upon the long-term debt of its parent, UWW."). Accordingly, the appropriate parent debt adjustment was made by using United Waterworks' corporate structure and cost of capital.

45. The Commission should reconsider the parent debt adjustment, make no parent debt adjustment, and adjust rates accordingly.

WHEREFORE, United Water Florida requests that the Commission grant this Motion for Reconsideration of Order No. PSC-97-0618-FOF-WS and grant the request made in this motion.

Dated this 13th day of June, 1997.

Respectfully submitted,

MARTIN, ADE, BIRCHFIELD &
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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that the original and seven copies of the Motion for Reconsideration of Order No. PSC-97-0618-FOF-WS, has been furnished by Federal Express this 13th day of June, 1997, to Blanca Bayo, Director, Division of Records and Reporting, Florida Public Service Commission, 2450 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, and a copy of the foregoing has been furnished to Rosanne G. Capeless, Attorney for the Staff of the Florida Public Service Commission, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, and to Harold McLean, Esquire, Office of Public Counsel, c/o The Florida Legislature, 111 W. Madison Street, Room 812, Tallahassee, Florida 32399-1400, by U.S. Mail, this 13th day of June, 1997.

James L. Ade
Attorney

¹² Section 440.02(19), Florida Statutes, defines "permanent impairment," as that term is used in Chapter 440, Florida Statutes, as "any anatomic or functional abnormality or loss, existing after the date of maximum medical improvement, which results from the injury." A similar definition is found in the guide.

¹³ Section 440.15(3)(b)1., Florida Statutes, provides that "[e]ach worker who suffers a permanent impairment, which permanent impairment is determined pursuant to the schedule adopted in accordance with subparagraph (a)3., is not based solely on subjective complaints, and results in one or more work-related physical restrictions which are directly attributable to the injury, may be entitled to wage-loss benefits under this subsection, provided that such permanent impairment results in a work-related physical restriction which affects such employee's ability to perform the activities of his usual or other appropriate employment."

STATE OF FLORIDA
DIVISION OF ADMINISTRATIVE HEARINGS

THE CITIZENS OF THE
STATE OF FLORIDA,

Petitioner,

vs.

PUBLIC SERVICE COMMISSION,

Respondent.

CASE NO. 92-5717RP

FINAL ORDER

This matter was heard by William R. Dorsey, Jr., the Hearing Officer designated by the Division of Administrative Hearings, on November 9, 1992, in Tallahassee, Florida.

APPEARANCES

For Petitioner:

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Tallahassee, Florida 32399-1400

For Respondent:

Marsha E. Rule, Esquire
Division of Legal Services

EXHIBIT A

Florida Public Service Commission
101 East Gaines Street
Tallahassee, Florida 32399-0863

STATEMENT OF THE ISSUE

The issue is whether proposed rule 25-14.031 of the Public Service Commission constitutes an invalid exercise of delegated legislative authority.

PRELIMINARY STATEMENT

The Florida Public Service Commission filed notice in the September 3, 1992 edition of the Florida Administrative Weekly of its intention to adopt proposed rule 25-14.012, which would govern the manner in which regulated utilities must account for employees' post-retirement benefits other than pensions. It did so under its statutory authority to set rates which allow regulated utilities sufficient revenue to recover prudently incurred costs of providing utility service, and a fair rate of return on the utilities' rate base.

Among the costs of providing utility service are personnel costs, which include not only current payroll, but future benefits such as pension benefits, and other post-employment benefits (OPEBs). Until the publication of the proposed rule, the Commission has handled treatment of the cost for OPEBs on a case-by-case basis in individual rate cases.

The rule proposed by the Commission defines post-retirement benefits other than pensions by adopting the definition of those benefits found in Statement of Financial Accounting Standards No. 106 of the Financial Accounting Standards Board (FAS 106 or Standard 106), and requires all utilities to use the definition of those benefits and to account for their costs in the manner set out in FAS 106. The rule also prescribes the accounting treatment for unfunded accumulated post-retirement benefit obligations. The rule prohibits a utility from including that unfunded liability in its rate base.

Through the Office of the Public Counsel, the Citizens of the State of Florida (Citizens) filed a request for determination of the invalidity of the proposed rule on September 23, 1992, arguing that proposed rule 25-14.012 is an invalid exercise of delegated legislative authority for three reasons. Citizens contend: (1) through the rule the Commission abdicates its statutory regulatory duty to set fair, just, compensable and nondiscriminatory rates to the Financial Accounting Standards Board, which is a private, nongovernmental entity; (2) the Commission has not adopted FAS 106 as of a certain date, and thus attempts to incorporate by reference future amendments to this standard promulgated by the Financial Accounting Standards Board, and (3) the rule lacks adequate standards to guide the Commission in its rate-making decisions, thereby vesting unbridled discretion in the Commission and permitting arbitrary and capricious action.

The Commission filed a Motion To Dismiss, which was denied in an Order dated October 7, 1992; on that same date, a Notice of Hearing was entered setting the final hearing for November 9, 1992.

Citizens moved to amend their petition on October 8, 1992 and the Commission objected in a response filed on October 14, 1992. Citizens were granted leave to amend their petition on October 15, 1992. The hearing went forward on the amended petition. At the

hearing, Citizens withdrew their challenge to the economic impact statement which the Commission had prepared to accompany the proposed rule (Tr. 103). Citizens presented the testimony of Victoria Montanaro and offered exhibit 1 into evidence, which was received. The Commission called Deborah K. Flannagan as a witness, and its exhibits 1 through 5 were received in evidence. Both Ms. Montanaro and Ms. Flannagan are certified public accountants and both were accepted as expert witnesses in regulatory matters and in the application and interpretation of FAS 106. A transcript of hearing was filed on November 20, 1992. At the request of the parties, they were granted until January 15, 1993 in which to file proposed final orders. Rulings on each proposed findings of fact has been made either directly in this Final Order or in the accompanying Appendix.

FINDINGS OF FACT

Background

1. The Public Service Commission (Commission) proposed rule 25-14.102, Florida Administrative Code, governing accounting for other post-retirement benefits (OPEBs), by publication in the Florida Administrative Weekly. The Citizens of the State of Florida (Citizens) filed a timely challenge to that proposed rule, and they have standing to bring the challenge.
2. The proposed rule applies to utilities regulated by the Commission under Chapters 364, 366 and 367, Florida Statutes (1991), which include telecommunications companies, investor-owned electric and gas utilities, and water and wastewater utilities. No specific statute requires that a regulated utility use the accrual accounting method for OPEBs.
3. Section (1) of the proposed rule defines post-retirement benefits other than pensions, and prescribes the sole acceptable method for measuring and recognizing the employer's accumulated post-retirement benefit obligation.¹ Under Section (2), utilities must

¹The text of the proposed rule is as follows:

25-14.012 Accounting for Post-Retirement Benefits Other Than Pensions.

- (1) "Post-Retirement benefits other than pensions" shall mean all forms of benefits, other than retirement income, provided by an employer to retirees, as defined by the Financial Accounting Standards Board in its Statement of Financial Accounting Standards No. 106 (Employers Accounting for Post-Retirement Benefits Other Than Pensions, December 1990). Those benefits may be defined in terms of specified benefits, such as health care, tuition assistance, or legal services, that are provided to retirees as the need for those benefits arises, or they may be defined in terms of monetary amounts that become payable on the

account for the cost of such benefits in the manner required by Statement of Financial Accounting Standards No. 106, entitled "Employers Accounting For Post-Retirement Benefits Other Than Pensions" published by the Financial Accounting Standards Board in December 1990, and they are prohibited from using deferral accounting under Statement of Financial Accounting Standards No. 71 (Accounting for the Effects of Certain Types of Regulation) for these benefits unless the utility obtains prior approval from the Commission. Section (3) specifies that unfunded accumulated post-retirement benefit obligations will be treated as a reduction to rate base in Commission rate proceedings. This means a utility is not entitled to earn a return on an amount equal to the accumulated post-retirement benefit obligation recognized on its financial statement which the utility has not actually funded. This can be done by treating the unfunded obligation as a reduction to the utility's working capital by adding it to current liabilities. Section (3) also makes explicit that if the Commission disallows a specific OPEB expense, the cost of that disallowed expense does not reduce the utility's rate base.

The Board and Its Standards

4. The Financial Accounting Standards Board is the authoritative body which promulgates standards of financial accounting for the accounting profession. It was organized in 1972 as the successor to the Accounting Principles Board. The Board derives its authority through Rule 203 of the Code of Professional Ethics of the American Institute of Certified Public Accountants. Its pronouncements are an important source of what are known as "generally accepted accounting principles." These principles are concerned with both measurement and disclosure. Measurement principles determine the timing and amounts of items which enter the accounting cycle and have an impact on financial statements. They are

occurrence of a specified event, such as life insurance benefits.

(2) Each utility that offers post-retirement benefits other than pensions shall account for the costs of such benefits in the manner required by Statement of Financial Accounting Standards No. 106. Deferral accounting under Statement of Financial Accounting No. 71 (Accounting for the Effects of Certain Types of Regulation, December 1982) shall not be used to account for the costs of post-retirement benefits other than pensions without prior Commission approval.

(3) Each utility's unfunded accumulated post-retirement benefit obligation shall be treated as a reduction to rate base in rate proceedings. The amount that reduces rate base is limited to that portion of the liability associated with the cost allowance for post-retirement benefits other than pensions.

quantitative standards which require numerically precise answers to problems and activities which may be subject to substantial uncertainty. Disclosure principles deal with factors which may not be numerical. They compliment measurement standards by explaining the standards and giving other information on accounting policies, contingencies and uncertainties which are essential ingredients in the analytical process of accounting. Generally accepted accounting principles thus include the measurement of economic activity, the time when such measurements are made and recorded, disclosures surrounding these activities, and the preparation and presentation of summarized economic activities found in financial statements. Complicated business activities often give rise to complex accounting principles. The Board has issued 110 Statements on Financial Accounting Standards to date, issued Interpretations and Technical Bulletins, and devoted substantial time and resources to development of a Conceptual Framework for Financial Accounting.

5. Once adopted by the Financial Accounting Standards Board, the text of numbered financial accounting standards are not amended. If, for some reason, the Board wished to change the accounting treatment required by a Financial Accounting Standard, a new standard bearing a new number would be adopted. Under current practice of the Financial Accounting Standard Board, the Commission's adoption of FAS 106 is not an attempt to currently adopt future changes to FAS 106, for there will be none. Moreover, the language of section (1) of the proposed rule adopts the Standard as promulgated in December 1990.

6. Standard 106, which the proposed rule would adopt, is not solely applicable to utilities, but is part of generally accepted accounting principles applicable to all business enterprises. Standard 106 sets measurement and disclosure standards for the manner in which post-retirement benefits other than pensions are treated in external financial statements. Standard 106 itself consists of 38 pages of black letter text, and is supplemented with appendices which include a comparison of accounting for other post-employment benefits with accounting for pensions; illustrations; background information concerning considerations which were the basis for the conclusions reached in Standard 106 which are an integral part of the Standard; and a glossary (Commission composite Exhibit 1, at tab 2). The Standard treats OPEBs as a form of deferred compensation and requires accrual accounting. Expected post-retirement costs are to be attributed to the period when an employee renders services. The Standard prescribes a uniform methodology for measuring and recognizing the employer's accumulated post-retirement benefit obligation.

7. The Standard applies to all post-retirement benefits, and benefits payable to disabled workers. The benefits encompassed include tuition assistance, legal services, day care, housing subsidies, and other benefits. The most significant one is post-retirement health care. Benefits most often depend on a formula established by the employer, using factors such as years of service, or compensation before retirement. These benefits may be available to current employees, former employees, beneficiaries (such as spouses) and to persons dependent on the retiree. The Standard focuses on the substantive benefit plan—the one employees understand based on past practice or by the employer's communication of intended plan changes. This is usually the same as the employer's current benefit plan, but if the written plan and practice differ, practice controls.

8. Using the substantive benefit plan, the Standard attempts to account for the exchange between employers who provide OPEBs and employees whose services are provided at least in part to obtain these OPEBs. Standard 106 requires that the employer's liability be

fully accrued when the employee is fully eligible for all expected benefits, even if the employee continues to work, since the employee has already provided the service which has earned the benefits. The costs are attributed in equal amounts (unless the plan text loads a disproportionate share of benefits in early years of employment) over the period from initial employment until the employee attains full eligibility for all benefits.

9. The basic tenet of FAS 106 is that while it requires the use of some variables that are difficult to measure, recognition and measurement of the overall liability of the employer to provide OPEBs is best done through accrual accounting. The use of estimates is superior to implying, by failure to accrue, that no cost or obligation exists prior to the actual cash payment of benefits to retirees.

10. The Financial Accounting Standards Board began work on accounting for OPEBs in 1979, as part of an ongoing project on accounting for pensions. By 1984, the Board decided to separate out accounting for OPEBs as a separate project. In April 1987, the Board issued, as an interim measure, its Technical Bulletin No. 87-1, Accounting For A Change In Method of Accounting For Certain Post-Retirement Benefits. Standard 106 amends another, older source of generally accepted accounting principles, Opinion 12 of the Accounting Principles Board of the American Institute of Certified Public Accountants, a predecessor to the Financial Accounting Standards Board. The amendment is effective for fiscal years beginning after March 15, 1991. Portions of Standard 106, which are wholly new and not an amendment to APB 12, are effective for fiscal years beginning after December 15, 1992. Standard 106 shares with other accounting standards a salient characteristic of pension accounting—delayed recognition. Changes are not made immediately, but are recognized in a gradual and systematic way. This is why there is a transition obligation in Standard 106. The employer's accumulated post-retirement benefit obligation for benefits attributable to the period before Standard 106 became effective is recognized on a delayed basis. The recognition period used must result in recognition of the accumulated obligation at least as rapidly as it would be recognized on a "pay-as-you-go" or cash basis. Until a utility actually recognizes a portion of its accumulated post-retirement benefit obligation, that portion of the obligation plays no part in setting the utility's rates.

11. The Standard requires the use of some assumptions, i.e., the estimates about the occurrence of future events, such as plan continuity. Continuity of the substantive plan for OPEBs is presumed in the absence of evidence to the contrary. Actuarial assumptions are also required, such as retirement age, salary progression in pay-related benefit plans, the probability of payment based on employee turnover, mortality and dependency status. When discount rates are used in present value calculations required by the Standard, they are to be based on current interest rates, as of the measurement date, for high quality fixed income investments with similar face amounts and maturities at which the post-retirement benefit obligations could be settled. Present value factors for health care benefits require consideration of cost trend rates, medicare reimbursement rates and per capita claims cost by age.

12. Standard 106 requires companies to recognize and account for the cost of OPEBs during the time period in which employees earn those benefits. Companies have generally recognized the expense of OPEBs on their financial statements only as those benefits were paid out to retired employees rather than accruing a liability for those future payments as they were earned by employees (the "accrual method"). The pay-as-you-go method was acceptable when OPEB expenses were small, but those expenses are now so significant that the Financial

Accounting Standards Board has determined that the pay-as-you-go method of accounting distorts financial statements and is inappropriate.

13. The utility rate payers pay the cost of OPEBs and other expenses in their utility rates. Recognition of OPEB expenses under the pay-as-you-go method causes current utility rate payers to fund benefits paid to retired utility employees. After the transition period, the implementation of accrual accounting for OPEBs will match employees' OPEB expenses solely with the group of rate payers who actually benefit from service from those employees.

14. The accrual accounting method also contributes to containment of health care costs, since utilities must currently measure the value of the benefits promised in the future and also book a liability for those future health care costs attributable to all employees, not just retired employees.

Other Accrual Requirements of the Commission

15. The Commission already requires utilities to use accrual accounting for other significant expenses. Utilities accrue depreciation expenses after their initial cash outlay for plant so that the cost of construction is paid over the useful life of the plant by rate payers who receive service from that plant, rather than from rate payers who happened to be using the system during the period in which the plant was constructed and the construction cost incurred. These expenses do not represent actual cash outlays. As is typical of depreciation, these non-cash expenses are not matched with deposits in internal or external accounts to provide a fund out of which to build new plants as current plants are retired. Rather, depreciation expenses recovered in utility rates become an additional source of cash, which is matched by a corresponding decrease in the value of plant on which a utility earns a rate of return.

16. Utilities accrue nuclear decommissioning expenses before those expenses actually become current cash outlays. Through this method, rate payers who have received the benefit of power produced at a nuclear plant pay an estimated portion of the eventual dismantlement cost of the plant in each of the years during which the plant is actually in service. Unlike depreciation, the Commission requires that these expenses be funded currently, because the cost of closure of nuclear plants will be large--perhaps hundreds of millions of dollars in a one-year period. It could be difficult or impossible for a utility to raise such amounts in the capital markets at the time they are needed.

17. Requiring accrual accounting treatment for OPEB expenses is consistent with existing Commission policy for the treatment of these other large expenses.

Commission Policy Development

18. Before this rule was proposed, the Commission was developing a policy on proper accounting for OPEB expenses in utility rate hearings conducted under Section 120.57, Florida Statutes. In rate cases for Centel and Gulf Power Corporation, the Commission required the use of accrual accounting for OPEBs. In the latest rate cases for Florida Power Corporation, Final Order PSC-92-1197-FOF-EI entered October 22, 1992, the Commission ordered the utility to adopt accrual accounting for OPEB expenses under FAS 106 (Commission Exhibit 2 at 67, paragraph Z). In the latest rate case for United Telephone Company of Florida, Final Order PSC-92-0708-FOF-TL, the Commission also ordered that utility to adopt accrual

accounting for OPEBs under FAS 106 (Commission Exhibit 3 at 34, paragraph VII.C.1.)

19. In none of these cases did the Commission take the position that the use of accrual accounting under FAS 106 automatically required Commission approval of all expenses shown by the utilities as OPEB expenses in their rate filings with the Commission.

20. The proposed rule instructs utilities how to prepare their accounting information for Commission review. The rule's text does not require the Commission to allow recovery of all costs presented for review in each rate case. A utility recovers accrued OPEB expenses through rates only when the Commission takes action to change rates, and that action always takes place in the context of a rate case which is subject to a Section 120.57(1) evidentiary hearing.

21. In a rate case, the Commission will review the utility's accrual for OPEB expenses, and has the authority to disallow any expense which the Commission finds imprudently incurred, unreasonable in amount, or not related to providing utility service. Adoption of FAS 106 does not limit the Commission's ability to adjust expenses claimed by utilities. The Commission has recognized in the Economic Impact Statement for the proposed rule that intervenors can challenge a utility's actuarial assumptions, discount rates, benefit levels, cost containment efforts, or other accruals in rate hearings (Commission Composite Exhibit 1, tab 3, EIS at page 5).

22. The proposed rule represents a policy decision made by the Commission, which is consistent with the conclusion reached by the Financial Accounting Standards Board, that accrual accounting under FAS 106 is the most appropriate method to account for OPEB expenses.

Impermissible Assumptions?

23. Citizens object that the rule provides vague guidance to utilities about what should be included in the calculation of OPEB expenses, but sets no specific formula for expense calculations so that two companies would apply a formula and arrive at the same result if they were providing similar benefits. Under FAS 106 the utilities must make estimates and assumptions, and the manner in which they are used can affect the final benefit cost used in rate setting.

24. Under the proposed rule, the utilities are not required to fund the accumulated post-retirement benefit obligation, which is an expense, with an internal or external account. Just as depreciation expenses result in a write-down of the value of the depreciated asset, so that the utility earns a rate of return only on the depreciated asset value, any unfunded accumulated post-retirement benefit expense allowed by the Commission reduces the utility's rate base so no return is earned on that amount. This can be done as a reduction to the utility's working capital, by treating any portion of the accumulated post-retirement benefit obligation which has been allowed but not actually funded by the utility as a current liability. For some utilities, such as water and sewer utilities, the regulatory accounting derives working capital in an unusual way--i.e., by computing one eighth of the operation and maintenance expense rather than subtracting current liabilities from current assets (Tr. 118). For these utilities, the reduction to rate base will have to be accomplished in some other way. If a specific OPEB expense for retirees is disallowed by the Commission (e.g., dental coverage for retirees) the utility does not recover that expense in its rate base. Concomitantly, the disallowed expense

does not become a reduction to rate base [Tr. 151, proposed rule section (3)].

1. The Substantive Benefit Plan

25. The first assumption a utility must make concerns the substantive content of the future benefit plan. Standard 106 requires a utility to assume that its current written benefit plan will be the plan in effect throughout the time used to calculate benefits for employees who will retire in the future. The utility may deviate from this written plan if it has communicated to its employees that their post-retirement benefits will be something other than what is found in its current plan. Standard 106 requires the utility to decide whether it has communicated something other than its current plan to its employees and if so, what that plan is. The substantive plan must be disclosed in the utility's filings with the Commission [Standard 106, paragraph 74(a)]. The witness for the Citizens has reviewed benefit plans for nine utilities, and found that although they are quite detailed, all contain language which permits the utility to modify, amend, withdraw, or terminate benefits. This does not invalidate the proposed rule. Assumptions must necessarily be made today about benefits payable in the future. The Commission retains the authority to review the explicit assumptions the utility makes about the future content of its benefit plans when evaluating a utility's current OPEB expense. The disclosure requirement will draw attention to the utility's choices, which the Commission can review. Significant matters which must be disclosed include any changes in cost-sharing provisions between the utility and retirees in the form of co-payments or deductibles, changes in monetary benefits, changes in employees covered or types of benefits provided, or the utility's funding policy for its allowed OPEB expenses.

2. Transition obligation and amortization period

26. Standard 106 also permits utilities to make assumptions and requires disclosures about their transition obligation and amortization period. The transition obligation is one of six cost components that a utility may include in the calculation of post-employment benefits under FAS 106. The transition obligation attempts to quantify and recognize the employer's liability for benefits that employees accrued or earned before accruals for OPEB expenses became mandatory. It attempts to recognize prior period costs, and to include those costs on the utilities' financial statements. The amortization period for the transition obligation is not a set number of years, FAS 106 allows the utilities a range of choices. Prior period costs can be immediately recognized in the first year FAS 106 is effective, or amortized over the average service life of employees, or over some set number of years. The amortization period may be anywhere from one to twenty years for a particular utility, but cannot be slower than the recognition of the obligation on a pay-as-you-go or cash basis. The shorter the amortization period, the higher the annual cost that will be recognized currently. Rate payers in those years covered by the amortization period will pay for a portion of the prior period costs in each of those years. Thus, if a ten-year period is used, the rate payers for the next ten years will be charged currently for benefits to be paid in the future to employees, which benefits were earned before the accrual method of accounting for OPEBs was required by FAS 106, in addition to accruals for current employees. Standard 106, paragraph 74 (b) includes required disclosures about amortization of unrecognized transition obligations.

3. Attribution Period

27. The Standard also requires the utilities to compute an attribution period, which measures the timing of an employee's eligibility for benefits, and attributes the benefit earned by the employee to that period. For example, if the utility's substantive plan promises employees that they will receive OPEB benefits once they reach the age of 55 if they also have five years of service with the utility, then the utility must accrue the full liability associated with the total cost of that employee's OPEBs by the time the employee reaches age 55 and has five years of service, even though the employee may continue to work beyond that time. Standard 106 does not require the utility's substantive plan to contain any specific attribution period. This permits utilities with otherwise similar circumstances but different substantive plans to have an attribution period of "55 years old with 10 years of service" while another may select a period of "55 years old and five years of service." Because the second utility promises the employees benefits in a shorter period of time, the annual cost, which is recovered from the rate payers, will be greater under FAS 106 for the second utility than for the first. The terms of the substantive plan control because it is the best evidence of the exchange transaction between employer and employee.

4. Marital and Dependent Status

28. The Standard also directs the utility to develop an explicit assumption about its employees' marital status and number of covered dependents on retirement. This is important because substantive plan provisions which entitle a spouse or dependents to health care or other welfare benefits substantially increase the employer's cost and obligation for post-retirement benefits. Utilities historically have used differing assumptions about these matters. These factors can be determined based on the actual experience of each utility, and may vary from utility to utility.

5. Discount Rate

29. A discount rate is applied to a company's calculated future post-retirement benefit liability in order to discount that amount back to a present value. The liability for OPEB expenses for the period prior to the adoption of FAS 106 is amortized. In other words, the discount rate is used to calculate a present value of the utility's transition obligation. The selection of a discount rate is initially left to the utility. The discount rates used by business enterprises have varied. Since a difference in the discount rate selected could result in approximately a 10% difference in the utilities' annual expense for OPEBs, two different utilities, in similar circumstances and with similar customer bases in geographic proximity to one another could use different discount rates, and generate different expenses for similar OPEBs. Discount rates are, however, to be chosen based on the interest rates paid, as of the measurement date, on high grade investment securities that have cash flows matching the timing and amount of benefit payments due to employees. The variability should be minor from utility to utility if the measurement dates involved are similar and the timing and amounts of benefits due are similar. The weighted-average of assumed discount rates used to measure the accumulated post-retirement benefit obligation must be disclosed. Standard 106, paragraph

74(e).

6. Future Medical Expenses

30. Standard 106 requires utilities to measure expected post-retirement benefit obligations for health care benefits by making explicit assumptions about the timing and amount of these benefits payable to plan participants in the future. Recent medical claims costs in the geographic area are useful in making estimates of assumed per capita claims cost by age from the earliest date benefits could be due to a participant through the longest life expectancy of participants. Utilities must also calculate their best estimate of the projected medical inflation trend far into the future. The FAS 106 does not require or even suggest a specific time frame that the utilities' estimated trend rate is to encompass. There are a number of indices currently used to evaluate medical inflation which could be used, such as the National Hospital Input Price Index, or a utility could develop a Florida hospital input price index. Some indices show medical inflation trend rates as high as 21%, others are as low as 13%. The effect of a 1% change in the medical inflation trend can result in a change of 15% to 19% in the utilities current expense level, to be charged to current rate payers. Over time it should be possible to use claims cost data specific to each utility, based on (1) current medical care utilization and delivery patterns, (2) evidence of the health status of covered employees, and (3) the location of employees, to project costs specifically for the Florida markets where retirees reside. More art than science is inherent in factoring in assumptions about changes in health care utilization patterns based on technological advances. This is the stock-in-trade of consulting actuaries, and such estimates can be made. These estimates are more easily evaluated because a sensitivity analysis of the effect of a 1% increase in assumed health care cost trend rates on the accumulated post-retirement benefit obligation for health benefits, and on the aggregate of the service and interest cost components of net periodic post-retirement health care benefit costs are required to be presented by the utility. Standard 106, paragraph 74(f).

31. The short answer to the problem of variability arising from the use of permissible assumptions under FAS 106, is that the rule is not invalid because acceptable choices are not etched in stone. All choices available under FAS 106 are subject to review by the Commission. Important ones must be highlighted by disclosures and, in some cases, sensitivity analyses. Unreasonable assumptions could be rejected by the Commission, even though the rule does not state this *in haec verba* as to each of the estimates or assumptions available to utilities under the proposed rule. The simplest example would be the utilities' selection of a discount rate. The Commission has modified the discount rate selected by a utility in the past. If the rate selected is unreasonable, based on the market interest rate being paid on high quality fixed income investments as of the measurement date, the Commission could disallow the utilities' assumption, and use instead another rate which the Commission determined from evidence more closely reflected the market rate for analogous investment vehicles providing necessary cash flows for expected benefit payouts. The text of FAS 106 requires the utility to use the assumption that "individually represents the best estimate of a particular future event, to measure the expected post-retirement benefit obligation." FAS 106, paragraph 29. The utility is not free to make whatever assumption it believes will result in the highest charge to its customers. The test is whether the assumption made reflects the utility's "best estimate of the plan's future experience solely with respect to that assumption" (FAS 106, Glossary, definition

of Explicit Assumptions, at page 197, Commission Composite Exhibit 1, tab 2 [emphasis added]). The Commission retains authority to question experience, which is a fact specific inquiry into the circumstances of each utility, its employee cohort and its substantive plan. The Commission has authority in the text of FAS 106 to make a searching inquiry into each explicit assumption to insure that the best estimate, given the utility's unique circumstances, has been used. If not, the Commission can disallow the expense the assumption generates.

CONCLUSIONS OF LAW

32. The Division of Administrative Hearings has jurisdiction over this matter. Section 120.54(4), Florida Statutes (1991). The Citizens have standing to bring this proceeding. Section 350.0611(5), Florida Statutes (1991).

33. The notice published by the Commission for the proposed rule on accounting for OPEB expenses list Sections 364.01, 366.05 and 367.011, Florida Statutes (1991), as the authority for adopting the proposed rule, and Sections 364.17, 366.04 and 367.121, Florida Statutes (1991), as the laws implemented by the proposed rule.

34. Section 364.01, Florida Statutes, grants the Commission exclusive jurisdiction and broad authority over telecommunication companies. Section 364.17, Florida Statutes (1991), allows the Commission to specify accounting methodologies to be used by telecommunication companies.

35. Section 366.05(1), Florida Statutes (1991), gives the Commission authority over investor-owned electric and gas utilities and grants it the authority to prescribe rules "reasonably necessary and appropriate for the administration and enforcement of this Chapter." The law implemented, Section 366.04, grants the Commission the authority to "prescribe uniform systems and classifications of accounts." Section 366.04(2)(a), Florida Statutes (1991).

36. Section 367.011(2), Florida Statutes (1991), grants the Commission broad jurisdiction over water and wastewater utilities. Like its power over electric and gas utilities, the Commission has statutory authority under Section 367.121(1)(b), Florida Statutes (1991), to adopt rules to establish "a uniform system and classification of all accounts for all utilities." The Commission has the authority to adopt the type of rule at issue here.

37. One of the Citizens' arguments is that the courts have invalidated the Legislature's attempt to adopt statutes which would incorporate by reference future legislative or administrative actions by entities outside of Florida. Department of Legal Affairs v. Rogers, 329 So.2d 257, 267 (Fla. 1976). This is not, however, a case where the Commission has delegated to the Financial Accounting Standards Board the Commission's authority to regulate utility rates through the incorporation of future amendments to FAS 106. The text of the Administrative Procedure Act makes that impossible. The rule at issue does not republish the text of FAS 106, but incorporates it by reference. According to Section 120.54(8):

"[A] rule may incorporate material by reference but only as such material exists on the date the rule is adopted. For purposes of such rule, changes in such material shall have no effect with respect to the rule unless the rule is amended to incorporate such material as changed"

38. The Department of State implements this requirement of the rulemaking procedure with Rule 1S-1.005, Florida Administrative Code, with this language:

(1) Any . . . standard . . . or similar material may be published by reference in a rule subject to the following conditions:

(a) The material shall be generally available to affected persons.

(b) The material shall be published by a governmental agency or a generally recognized professional organization.

(2) The agency publishing material by reference shall file with the Department of State a correct and complete copy of the referenced material with an attached certification page which shall state a description of the referenced material and specify the rule to which the referenced material relates.

(3) Any amendments to material published by reference must be promulgated under the rulemaking provisions of Section 120.54, Florida Statutes, in order for the amended portions to be validly incorporated.

See also, England and Levinson, Florida Administrative Practice Manual, Section 9.26(c), (d), (1993). Moreover, section (1) of the proposed rule identifies FAS 106 by its December 1990 adoption date, clearly incorporating by reference the Standard as originally promulgated by the Financial Accounting Standards Board.

39. Once the Commission files the text of its rule, including FAS 106, with the Department of State, that copy is the only version of the FAS 106 adopted through Section 120.54 rulemaking. Future amendments must be separately adopted. There has been no showing here that the Commission intends to violate Section 120.54(8), and will refuse to file with the Secretary of State the copy of FAS 106 which is part of the rulemaking record (Commission Composite Exhibit 1, tab 2).

40. The statutory authority to incorporate material by reference, with the gloss provided by the Department of State that the material must be something published by a generally recognized professional organization, is an indication that adoption of standards such as the one at issue is contemplated in the rulemaking process.

41. As shown in Finding 5, it is not the practice of the Financial Accounting Standards Board to amend Standards after they are adopted. Changes are made through the adoption of a new Standard, which the Commission would then have to adopt by reference if it chose to do so.

42. It is difficult to understand the Citizens' argument that through adoption of FAS

106 the Commission has abdicated its regulatory function to the Financial Accounting Standards Board. Since 1979, the Board has been dealing with the appropriate accounting treatment for OPEBs. This led to the promulgation of FASB Technical Bulletin No. 87-1, Accounting for a Change in Method of Accounting for Certain Post-Retirement Benefits, which ultimately was rescinded with the recent adoption of FAS 106. A substantial amount of thought obviously has gone into FAS 106. It is hardly surprising that the Commission also would be concerned with accounting for retirement expenses, other than pensions, of retired utility workers. Health care costs have made these expenses more significant over time. The investor-owned gas and electrical utilities regulated by the Commission must conform to the requirements of FAS 106 in external financial statements prepared for their investors, since FAS 106 has become part of generally accepted accounting principles through the adoption of the Standard. The Commission has the statutory authority to require regulated utilities to keep their accounts in a manner prescribed by Commission, and has determined that it wishes to adopt this Standard. It is not blindly adopting an unknown Standard. After review of the text of FAS 106, and adoption of the Standard in at least four individual rate cases, the Commission has determined that FAS 106 represents the appropriate way to treat OPEB expenses for regulatory purposes, as well as for financial reporting purposes. This action of moving from incipient policy, where principles are adopted in individual cases, to adoption of policy through rulemaking is what Section 120.535, Florida Statutes (1991), requires.

43. What led the Financial Accounting Standards Board to adopt FAS 106 as the uniform method for accounting for OPEBs applies with equal force to the work of the Commission:

The Board believes that understandability, comparability, and usefulness of financial information are improved by narrowing the use of alternative accounting methods that do not reflect different facts and circumstances. The Board has been unable to identify circumstances that would make it appropriate for different employers to use fundamentally different accounting methods or measurement techniques for similar post-retirement benefit plans or for a single employer to use fundamentally different methods or measurement techniques for different plans. As a result, a single method is prescribed for measuring and recognizing an employer's accumulated post-retirement benefit obligation. (Commission Composite Exhibit 1, tab 2, Statement of Financial Accounting Standards No. 106, Summary [unnumbered page])

44. The Citizens next urge that the rule is fatally flawed because FAS 106 permits utilities to make assumptions about factors to be used in computing the utility's accumulated post-retirement benefit obligations such as the substantive plan's text, discount rates, salary progressions in pay related plans, and present value factors for health care benefits, such as medical costs trends. They argue that this latitude runs afoul of Section 120.52(8)(d), Florida Statutes (1991), by failing to establish adequate standards for agency decisions, or vesting

unbridled discretion in the agency.

45. Standard 106 does require the use of assumptions, but they are "explicit assumptions" (FAS 106, paragraph 29). An explicit assumption is a defined term. It is an estimate of the occurrence of future events affecting post-retirement benefit costs, such as employee turnover, retirement age, mortality, dependency status, per capita claims costs by age, health care cost trends, levels of Medicare and other health care providers' reimbursements, and discount rates reflecting the time value of money. All these matters are capable of estimation. This explicit assumption approach requires that each significant assumption used reflect the utility's best estimate of the plan's future experience solely with respect to that assumption (FAS 106, paragraph 30 and Appendix E, Glossary, at pages 194 and 197). This test for evaluating assumptions found in paragraphs 29 through 33 of Standard 106 is sufficiently detailed so that the Commission can review in a rate case the underlying rationale offered by the utility in its minimum filing requirements for any estimate or assumption. The utility will be faced with the duty in each case to show why each assumption "represents the best estimate of a particular future event," (FAS 106, paragraph 29).

46. These are examples of matters which cannot be realistically made more specific by rule. Section 120.535, Florida Statutes (1991), recognizes that there are situations where rulemaking is impracticable, where particular questions at issue are of such narrow scope that more specific resolution of the matter is impracticable outside of an adjudication to determine the substantial interest of a party, based on individual circumstances. Section 120.535(1)(b)2., Florida Statutes (1991). The factors which FAS 106 requires a utility to make "explicate assumptions" about are ones which are so fact specific that, as a practical matter, a range of choices must be made available to the utility. How the utility deals with those factors is, however, subject to review by the Commission in the context of a substantial interest adjudication under Section 120.57(1), Florida Statutes, that is, in a rate case, in which the utility bears the burden of persuasion.

SUMMARY

The Commission does not abdicate its duty to set fair, just, compensable and nondiscriminatory rates by adopting FAS 106. It has not attempted to incorporate future, unknown amendments to that Standard in its rule. The explicit assumption approach required by the rule is sufficiently rigorous that it sets adequate standards for Commission decisions in rulemaking cases, and does not permit arbitrary action.

ORDER

It is ORDERED that the challenge to proposed rule 25-14.012 of the Public Service Commission filed by the Citizens of the State of Florida through the Office of Public Counsel be dismissed.

DONE AND ORDERED in Tallahassee, Leon County, Florida, this 26th day of March 1993.

WILLIAM R. DORSEY, JR.
Hearing Officer

Division of Administrative Hearings
The DeSoto Building
1230 Apalachee Parkway
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(904) 488-9675

STATE OF FLORIDA
DEPARTMENT OF BANKING AND FINANCE
DIVISION OF FINANCE

FINANCIAL FUNDING MORTGAGE
CORPORATION,

Petitioner,

Administrative Proceeding
No.: 2474-F-5/92

vs.

DOAH Case No. 92-3339

DEPARTMENT OF BANKING AND FINANCE,

Respondent.

FINAL ORDER AND NOTICE OF RIGHTS

This matter has come before the undersigned as head of the Department of Banking and Finance, Division of Securities and Investor Protection ("Department"), for the entry of a Final Order in this proceeding. On January 21, 1993, a hearing officer from the Division of Administrative Hearings submitted his Recommended Order in this proceeding, a copy of which is attached hereto as Exhibit "A". On or about February 5, 1993, the Petitioner, Financial Funding Mortgage Corporation ("Petitioner") filed its Exceptions to the Recommended Order, a copy of which is attached hereto as Exhibit "B". On or about February 5, 1993, the Department filed Respondent's Exceptions to Recommended Order, a copy of which is attached hereto as Exhibit "C".

This matter arose when the Department, by letter dated April 24, 1992, advised the Petitioner that its application for licensure as a mortgage brokerage business was denied on grounds more particularly stated in this letter.

The Department timely received the Petitioner's Petition for Formal Proceedings. By letter dated June 1, 1992, the matter was transferred to the Division of Administrative Hearings ("DOAH") for the assignment of a hearing officer to conduct an administrative hearing. Thereafter, the parties responded on June 12, 1992, to the Initial Order entered by DOAH. By Notice of Hearing dated June 22, 1992, Hearing Officer Larry J. Sartin set the case for hearing in Miami on October 29, 1992. The location of the hearing was subsequently moved to