

MEMORANDUM

November 18, 1996

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**RECEIVED**  
10-21-96

TO: DIVISION OF RECORDS AND REPORTING  
FROM: DIVISION OF LEGAL SERVICES (CYRUS-WILLIAMS) *DCW*  
RE: DOCKET NO. 961076-WS - Disposition of gross-up funds collected by Hydratech Utilities, Inc. in Martin County

*1352-FOF*

Attached is an Order FINDING NO REFUND REQUIRED FOR 1991 THROUGH 1993 AND FINDING REFUND REQUIRED FOR 1994, with attachment, to be issued in the above-referenced docket. (Number of pages in Order - 9)

DCW/dp

Attachment

cc: Division of Water and Wastewater (Gilchrist)

I: 961076OR.DCW

*[Faint circular stamp]*

*Attachment Not on-Line*

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Disposition of gross-up ) DOCKET NO. 961076-WS  
funds collected by Hydratech ) ORDER NO. PSC-96-1352-FOF-WS  
Utilities, Inc. in Martin County ) ISSUED: November 18, 1996  
\_\_\_\_\_ )

The following Commissioners participated in the disposition of this matter:

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

NOTICE OF PROPOSED AGENCY ACTION  
ORDER FINDING NO REFUND REQUIRED FOR 1991 THROUGH 1993 AND  
FINDING REFUND REQUIRED FOR 1994

BY THE COMMISSION:

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

BACKGROUND

As a result of the repeal of Section 118(b) of the Internal Revenue Code, 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 and 23541, issued October 1, 1990, require that utilities annually file information 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 also required 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.

DOCUMENT NUMBER DATE

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FPSC-REGGROS/REPORTING

Hydratech Utilities, Inc. (Hydratech or utility) is a Class A water and wastewater utility providing service to approximately 5,169 water and 4,389 wastewater customers in Martin County. According to its 1995 annual report, the utility reported gross operating revenues of \$1,210,078 and \$963,550 for water and wastewater, respectively, and net operating income of \$119,558 for water and a net operating loss of \$14,873 for wastewater. Hydratech filed for authority to gross-up on May 22, 1991. By Order No. 25515, issued December 20, 1991, Hydratech was granted authority to gross-up CIAC using the full gross-up formula.

On September 9, 1992, this Commission issued Proposed Agency Action Order No. PSC-92-0961-FOF-WS, which clarified the provision of Orders Nos. 16971 and 23541 for the calculation of refunds of gross-up of CIAC. On September 14, 1992, Order No. PSC-92-0961A-FOF-WS was issued, which included Attachment A, reflecting the generic calculation form. On October 12, 1994, Order No. PSC-94-1265-FOF-WS, was issued, revising the full gross-up formula.

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, Commission staff was directed to continue processing CIAC gross-up and refund cases pursuant to Order Nos. 16971 and 23541; however, the 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 the staff's completion of its review of the proposals and comments offered by the workshop participants. In addition, the 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 the President 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, 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. Docket No. 960397-WS was also closed on October 8, 1996. As established in Order No. PSC-0686-FOF-WS, all pending CIAC gross-up refund cases are being processed pursuant to Orders Nos. 16971 and 23541. This order, therefore, addresses the disposition

of funds collected by the utility in excess of its tax liability, resulting from the gross-up of CIAC from 1991 through 1994.

REFUND CALCULATIONS FOR YEARS 1991 THROUGH 1994

In compliance with Orders Nos. 16971 and 23541, Hydratech filed annual CIAC gross-up reports for 1991 through 1994. Our calculations, taken from these reports, are reflected on Schedule No. 1, which is attached hereto and by reference incorporated herein. Gross-up calculations are in accordance with the method adopted in Order No. PSC-92-0961-FOF-WS. A summary of each year's calculations follows.

1991

The utility's 1991 CIAC report indicates that the utility was in an above-the-line taxable position before the inclusion of taxable CIAC and gross-up. Therefore, all taxable CIAC received during the year would be taxed, net of the first year's depreciation.

Although the CIAC report indicates a total of \$492,450 in taxable CIAC was received, the utility did not make a deduction for first year's depreciation. According to the utility, none of the CIAC received in 1991 was used for plant additions or debt service, therefore, no adjustment for first year's depreciation should be made. However, to the extent that cash CIAC is used and useful, there is always first year's depreciation, since the cash either pays for a prior investment made by the utility or it provides for new plant in the year it is received by the utility. Based on the foregoing, the utility's first year's depreciation has been included in the calculation of the net taxable amount of CIAC.

The annual CIAC reports filed by the utility details the amount of depreciation per year. The utility received taxable CIAC of \$492,450, and \$7,436 was deducted for the first year's depreciation. The combined marginal federal and state tax rate of 37.63% was used to calculate the tax effect, as provided in the utility's 1991 CIAC Report. This rate applied to the net amount of \$485,014 results in the tax effect of \$292,626. Since the utility collected only \$26,788 of gross-up monies, significantly less than the amount required to pay the tax impact of CIAC collected, no refund is necessary.

1992

The utility's 1992 CIAC report indicates that the utility was in an above-the-line taxable position before the inclusion of

taxable CIAC and gross-up. Therefore, as stated previously, all taxable CIAC received during the year would be taxed, net of the first year's depreciation.

In a letter dated July 23, 1996, however, the utility stated that it disagrees with the Commission's classification of \$138,627 of legal expense as an above-the-line expense. In its filing, the utility classified this amount as a below-the-line expense. The utility explains that the legal fees should be classified below-the-line because they were related to efforts to sell the utility and efforts to obtain refinancing through a Private Placement Bond Issue.

However, when we reviewed the utility's annual report, the entire amount of legal fees were considered to be utility related and used and useful. Thus, for annual report review purposes, these legal fees were included and considered when determining the utility's net income and earned rate of return. In addition, the full amount of these legal fees were included in the calculation of the utility's 1993 price index rate increase. Therefore, for purposes of calculating the CIAC gross-up refund, the legal fees shall be given the same above-the-line treatment they were given in the utility's annual report review and price index application.

Also, although the utility's annual report shows legal fees to be \$148,627, classification of the above-the-line legal expense must be limited to \$138,627, the amount stated on the utility's tax return. Therefore, legal fees in the amount of \$138,627 shall be included as an above-the-line expense in calculating the utility's taxable income.

The utility's 1992 CIAC report indicates that a total of \$205,868 in taxable CIAC was received, and \$11,439 was deducted for the first year's depreciation. The reported 37.63% combined marginal federal and state tax rate applied to the net \$229,008 results in the tax effect of \$117,306. Since the utility collected only \$91,555 of gross-up monies, less than the amount required to pay the tax impact of CIAC collected, no refund is necessary.

#### 1993

The utility's 1993 CIAC report indicates that the utility was in an above-the-line taxable position before the inclusion of taxable CIAC and gross-up. Therefore, all taxable CIAC received during the year would be taxed, net of the first year's depreciation.

The utility's 1993 CIAC report indicates that a total of \$23,040 in taxable CIAC was received, with \$876 being deducted for the first year's depreciation. The reported 37.63% combined marginal federal and state tax rate applied to the net \$22,164 results in the tax effect of \$13,372. The utility collected \$13,712 in gross-up monies; therefore, a \$340 refund is appropriate.

In its July 23, 1996 letter, the utility states that a refund for 1993 is not appropriate because \$11,799, the incurred cost of filing and processing the gross-up reports for 1993, should be deducted from the \$340 refund amount. However, the contributors shall not be held responsible for the legal and accounting costs incurred to determine whether they are entitled to a refund. Although these are costs incurred to satisfy regulatory requirements, a reduction to the contributors' refund amount is not the appropriate place to seek recovery of these fees. The utility may seek recovery of these expenses in a rate case proceeding.

The utility has indicated that the gross-up was collected from 31 different contributors, making the amount of refund less than \$11 per contributor. Since the anticipated cost of making the refund would more than likely exceed the amount of the refund, the utility shall credit CIAC for the \$340 of excess gross-up collections, in lieu of refund.

According to the utility's 1995 annual report, the utility is 47.96% contributed for the water system and 67.04% contributed for the wastewater system. Of the \$340 to be credited to CIAC, \$170 shall be allocated to water and \$170 shall be allocated to wastewater, based on the ratio of water service availability charges to wastewater service availability charges in the utility's approved tariff.

#### 1994

The utility's 1994 CIAC report indicates that the utility had an above-the-line loss before the inclusion of taxable CIAC and gross-up. Order No. 23541 requires that CIAC income be netted against the above-the-line loss; therefore, not all of the CIAC collected would create a tax liability.

The utility's CIAC report indicates a total of \$179,860 in taxable CIAC was received, with \$9,406 being deducted for the first year's depreciation, resulting in CIAC of \$170,454. When this amount is netted against the above-the-line loss of \$29,401, the amount of taxable CIAC resulting in a tax liability is \$141,053, instead of \$166,490 as calculated by the utility. Applying the

37.63% combined marginal federal and state tax rate, as provided in the 1994 CIAC Report, results in the tax effect of \$85,102. The utility collected \$106,602 of gross-up monies; therefore, a refund of \$21,500 is appropriate.

In its letter of July 23, 1996, the utility proposes that a refund of \$6,709 is appropriate because it believes that \$14,791 of legal expense, the incurred costs of filing and processing the gross-up reports for 1994, should be deducted from the refund amount of \$21,500. As previously explained, however, legal and accounting fees shall not be deducted from the refund amount. Therefore, for 1994, the utility shall refund \$21,500, plus accrued interest through the date of refund, for gross-up collected in excess of the above-the-line tax liability.

According to Orders Nos. 16971 and 23541, all amounts shall be refunded on a pro rata basis to those persons who contributed the taxes. The refunds shall be completed within 6 months of the effective date of the order. Within 30 days from the date of the refund, the utility shall submit copies of cancelled checks, credits applied to monthly bills, or other evidence that verifies that the utility has made the refunds. Within 30 days from the date of the refund, the utility shall also provide a list of unclaimed refunds detailing contributor and amount, and an explanation of the efforts made to make the refunds.

#### CLOSING OF DOCKET

Upon the expiration of the protest period, this docket shall remain open pending the verification of refunds. This docket shall be closed administratively upon verification that the refunds have been completed.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the provisions of this order are issued as proposed agency action and shall become final, unless an appropriate petition in the form provided by Rule 25-22.029, Florida Administrative Code, is received by the Director of the Division of Records and Reporting at his office at 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the date set forth in the Notice of Further Proceedings below. It is further

ORDERED that Hydratech Utilities, Inc. is not required to refund any gross-up of contributions-in-aid-of-construction collected in 1991 and 1992. It is further

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ORDERED that Hydratech Utilities, Inc. shall credit contributions-in-aid-of-construction in the amount of \$340 for excess gross-up collections in 1993, in lieu of refund. It is further

ORDERED that Hydratech Utilities, Inc. shall refund \$21,500, plus accrued interest through the date of refund, for gross-up collected in excess of the tax liability in 1994. It is further

ORDERED that all refund amounts shall be refunded on a pro rata basis to those persons who contributed the taxes. The refunds shall be completed within six (6) months of the effective date of this order. Within thirty (30) days from the date of the refund, Hydratech Utilities, Inc. shall submit copies of cancelled checks, credits applied to monthly bills or other evidence that verifies that the utility has made the refunds. Within thirty (30) days from the date of the refund, Hydratech Utilities, Inc. shall also provide a list of unclaimed refunds detailing contributor and amount, and an explanation of the efforts made to make the refunds. It is further

ORDERED that upon expiration of the protest period, this docket shall remain open pending the verification of refunds. This docket shall be closed administratively upon verification that the refunds have been completed.

By ORDER of the Florida Public Service Commission, this 18th day of November, 1996.



BLANCA S. BAYÓ, Director  
Division of Records and Reporting

( S E A L )

DCW

Commissioner Deason dissented on the issue of whether the utility should be allowed to offset the administrative costs of filing and processing the 1993 and 1994 gross-up of CIAC reports against the actual amount to be refunded.



NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

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

The action proposed herein is preliminary in nature and will not become effective or final, except as provided by Rule 25-22.029, Florida Administrative Code. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, as provided by Rule 25-22.029(4), Florida Administrative Code, in the form provided by Rule 25-22.036(7)(a) and (f), Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on December 9, 1996.

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

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

If this order becomes final and effective on the date described above, any party substantially affected may request judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or by the First District Court of Appeal in the case of a water or wastewater utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days of the effective date of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.

SCHEDULE NO. 1

COMMISSION CALCULATED GROSS-UP REFUND

Hydratech Utilities, Inc.

SOURCE: (Line references are from CIAC Reports)

	1991	1992	1993	1994
1 Form 1120, Line 30 (Line 15)	\$ 655,577	\$ 321,637	\$ 166,816	248,344
2 Less CIAC (Line 7)	(492,450)	(205,868)	(28,040)	(179,860)
3 Less Gross-up Collected (Line 10)	(26,788)	(91,555)	(18,712)	(106,602)
4 Add First Year's Depr on CIAC (Line 8)	7,436	11,439	876	9,406
5 Add/Less Other Effects (Lines 20 & 21)	(461)	(1,074)	(168)	(689)
6				
7 Adjusted Income Before CIAC and Gross-up	\$ 143,814	\$ 34,579	\$ 180,772	(29,401)
8				
9 Taxable CIAC (Line 7)	\$ 492,450	\$ 205,868	\$ 28,040	179,860
10 Less first years depr. (Line 4)	\$ (7,436)	\$ (11,439)	\$ (876)	(9,406)
11				
12 Adjusted Income After CIAC	\$ 628,328	\$ 229,008	\$ 152,936	141,053
13 Less: NOL Carry Forward	\$ 0	\$ 0	\$ 0	0
14				
15 Net Taxable CIAC	\$ 485,014	\$ 194,429	\$ 22,164	141,053
16 Combined Marginal state & federal tax rates	37.63%	37.63%	37.63%	37.63%
17				
18 Net Income tax on CIAC	\$ 182,511	\$ 73,164	\$ 8,340	53,078
19 Less ITC Realized	0	0	0	0
20				
21 Net Income Tax	\$ 182,511	\$ 73,164	\$ 8,340	53,078
22 Expansion Factor for gross-up taxes	1.6033349	1.6033349	1.6033349	1.6033349
23				
24 Gross-up Required to pay tax effect	\$ 292,626	\$ 117,306	\$ 13,872	85,102
25 Less CIAC Gross-up collected (Line 19)	(26,788)	(91,555)	(13,712)	(106,602)
26				
27 (OVER) OR UNDER COLLECTION	\$ 265,838	\$ 25,751	\$ (340)	(21,500)
28				
29				
30 TOTAL YEARLY REFUND	\$ 0	\$ 0	\$ (340)	(21,500)
31				
32				
33 PROPOSED REFUND (excluding interest)	(21,840)			
34				