

FLORIDA PUBLIC SERVICE COMMISSION
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M E M O R A N D U M

January 23, 1997

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

FROM : DIVISION OF WATER AND WASTEWATER (JOHNSON) *CAH*
DIVISION OF AUDITING AND FINANCIAL ANALYSIS (CAUSSEAGX) *APC*
DIVISION OF LEGAL SERVICES (CYRUS-WILLIAMS) *SW*

RE : DOCKET NO.: 961277-WS DISPOSITION OF CONTRIBUTION-IN-AID-OF-CONSTRUCTION GROSS-UP FUNDS COLLECTED BY PALM COAST UTILITY CORPORATION
COUNTY: FLAGLER

AGENDA : FEBRUARY 4, 1997 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\WAW\WP\961277-WS.RCM

CASE BACKGROUND

As a result of the repeal of Section 118(b) of the Internal Revenue Code (I.R.C.), contributions-in-aid-of-construction (CIAC) became gross income and were depreciable for federal tax purposes. In Order No. 16971, issued December 18, 1986, the Commission authorized corporate utilities to collect the gross-up on CIAC in order to meet the tax impact resulting from the inclusion of CIAC as gross income.

Orders Nos. 16971, issued December 18, 1986, and 23541, issued October 1, 1990, require that utilities annually file information which would be used to determine the actual state and federal income tax liability directly attributable to the CIAC. The information would also determine whether refunds of gross-up would be appropriate. These orders require that all gross-up collections for a tax year, which are in excess of a utility's actual tax liability for the same year, should be refunded on a pro rata basis to those persons who contributed the taxes.

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

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

On September 9, 1992, this Commission issued Proposed Agency Action Order No. PSC-92-0961-FOF-WS, which clarified the provision of Orders Nos. 16971 and 23541 for the calculation of refunds of gross-up of CIAC. On October 12, 1994, Order No. PSC-94-1265-FOF-WS revised the full gross-up formula. No protests were filed, and the Order became final.

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

However, on August 1, 1996, The Small Business Job Protection Act of 1996 (The Act) passed Congress and was signed into law by President Clinton on August 20, 1996. The Act provided for the non-taxability of CIAC collected by water and wastewater utilities effective retroactively for amounts received after June 12, 1996. As a result, on September 20, 1996, in Docket No. 960965-WS, Order No. PSC-96-1180-FOF-WS was issued to revoke the authority of utilities to collect gross-up of CIAC and to cancel the respective tariffs unless, within 30 days of the issuance of the order, affected utilities requested a variance. Since there was no longer a need to review the Commission's policy to determine any changes; on October 8, 1996, Order No. PSC-96-1253-FOF-WS was issued closing Docket No. 960397-WS. However, as established in Order No. PSC 96-0686-FOF-WS, all pending CIAC gross-up refund cases are being processed pursuant to Order Nos. 16971 and 23541. The purpose of this recommendation is to address the disposition of refunds for the years 1992 through 1994.

Flagler County rescinded Commission jurisdiction effective August 5, 1996. However, Order No. 25141, which approved the utility's request to continue the gross-up of CIAC, provides that all CIAC collections are to be made in accordance with Orders Nos.

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16971 and 23541, and all matters discussed in those orders were expressly incorporated therein. Order No. 23541 states that "all gross-up amounts in excess of a utility's actual tax liability resulting from its collection of CIAC should be refunded on a pro rata basis to those persons who contributed the taxes." Since the collection of gross-up of CIAC was made subject to refund by the order, the Commission retains jurisdiction of the matter regarding the determination of refunds.

Palm Coast Utility Corporation, Inc. (PCUC or Utility) is a Class A utility which is a wholly-owned subsidiary of the ITT Corporation. The utility provides water and wastewater service to the community of Palm Coast and part of Flagler county known as the Hammock. As of December 31, 1995, the Utility served 15,290 water and 10,436 wastewater customers. Gross operating revenues were reported as \$6,424,127 for the water system and \$3,217,123 for the wastewater system. Net operating income was reported as \$877,227 for water and \$527,170 for wastewater.

DISCUSSION OF ISSUES

ISSUE 1: Should PCUC be required to refund excess gross-up collections plus accrued interest for the years 1992 through 1994?

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

STAFF ANALYSIS: In compliance with Orders Nos. 16971 and 23541, PCUC filed its 1992 through 1994 annual CIAC reports regarding its collection of gross-up for each year. By letter dated November 22, 1996, staff submitted their preliminary refund calculation numbers to the utility. The Utility responded on November 30, 1996, that they agreed with staff's preliminary calculations.

PCUC uses the net present value gross-up method. Staff has calculated the gross-up required to pay the tax liability resulting from the collection of taxable CIAC by grossing-up the net taxable CIAC amount, in accordance with the net present value method adopted in Order No. 23541. The authorized rate of return is 9.21% as approved in Order No. 22843, Docket No. 890277-WS, issued April 23, 1990. Therefore, the authorized gross-up percentage is 32.2%.

ANNUAL GROSS-UP REFUND AMOUNTS

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

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1992

The utility proposes that no refund is appropriate.

Staff agrees that a refund of gross-up collections for 1992 is not appropriate. The 1992 CIAC report indicates the utility was in a taxable position on an above-the-line basis prior to the inclusion of taxable CIAC in income. Therefore, all taxable CIAC received would be taxed. The CIAC report indicates a total of \$2,383,771 of taxable CIAC was received. However, gross-up was collected on only \$972,005 of this amount because \$1,411,766 of the CIAC collected was prepaid. The utility collects the gross-up on prepaid CIAC when the customer actually connects to the system. The CIAC report also indicates that \$313,180 of gross-up collections were received on the \$972,005 of taxable CIAC. Staff calculated that the utility should have collected \$313,180 of gross-up for 1992. Therefore, no refund is required.

1993

The utility proposes that no refund is appropriate.

Staff agrees that a refund of gross-up collections for 1993 is not appropriate. The 1993 CIAC report indicates the utility was in a taxable position on an above-the-line basis prior to the inclusion of taxable CIAC in income. Therefore, all taxable CIAC received would be taxed. The CIAC report indicates a total of \$2,257,507 of taxable CIAC was received. However, gross-up was collected on only \$1,120,282 of this amount because \$1,137,225 of the CIAC collected was prepaid. The utility collects the gross-up on prepaid CIAC when the customer actually connects to the system. The CIAC report also indicates that \$360,955 of gross-up collections were received on the \$1,120,282 of taxable CIAC. Staff calculated that the utility should have collected \$360,955 of gross-up for 1993. Therefore, no refund is required.

1994

The utility proposes that no refund is appropriate.

Staff agrees that a refund of gross-up collections for 1994 is not appropriate. The 1994 CIAC report indicates the utility was in a taxable position on an above-the-line basis prior to the inclusion of taxable CIAC in income. Therefore, all taxable CIAC received would be taxed. The CIAC report indicates a total of \$2,393,825 of taxable CIAC was received. However, gross-up was collected on only \$1,394,103 of this amount because \$999,722 of the CIAC collected was prepaid. The utility collects the gross-up on prepaid CIAC when the customer actually connects to the system.

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The CIAC report also indicates that \$467,582 of gross-up collections were received on the \$1,394,103 of taxable CIAC. Staff calculated that the utility should have collected \$467,582 of gross-up for 1994. Therefore, no refund is required.

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ISSUE 2: Should the docket be closed?

RECOMMENDATION: Yes. (CYRUS-WILLIAMS)

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