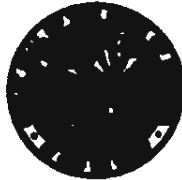


Commissioners:
SUSAN F. CLARK, CHAIRMAN
J. TERRY DEASON
JULIA L. JOHNSON
DIANE K. KIBSLING
JOE GARCIA



DIVISION OF LEGAL SERVICES
NOREEN S. DAVIS
DIRECTOR
(904) 413-6199

Public Service Commission

February 3, 1997

B. Kenneth Gatlin
Gatlin, Schiefelbein & Cowdery
1709-D Mahan Drive
Tallahassee, FL 32308

Re: Docket No. ~~9000000000~~WB. Application for increase in rates and service availability charges in Lee County by Gulf Utility Company.
LATE FILED EXHIBIT FOR KATHY WELCH

Dear Mr. Gatlin:

During Kathy Welch's deposition, she agreed to provide a late filed exhibit consisting of the portion of the Commission's Digest of Regulatory Procedures (DORP) which supported her testimony as to working capital (page 5, lines 14-15).

Attached are the following pages from the Commission's DORP: III-51 through III-57. These pages support in general the methodology for the adjustments to working capital. In particular, subsection (g) on page III-53 addresses interest and dividends receivable.

- ACK _____
- AFA _____
- ADP _____
- CAF _____
- CMU _____
- EDP _____
- ESP _____
- FSR _____
- GIS _____
- INS _____
- INT _____
- ISD _____
- ISG _____
- ISL _____
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- ISO _____
- ISP _____
- ISQ _____
- ISR _____
- ISU _____
- ISV _____
- ISW _____
- ISX _____
- ISY _____
- ISZ _____
- OTH _____

cc: Mr. Steve Reilly, Esquire
Division of Records and Reporting

Sincerely,

Maggi O'Sullivan
Staff Counsel

DOCUMENT NUMBER-DATE

90015 FEB 4 5

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BLVD • TALLAHASSEE, FL 32399-0850

2. Balance sheet approach.

- a. Use of the balance sheet method for calculating a utility's working capital needs was more persuasive than using the 1/8 of operation and maintenance expenses method. Gulfstream Utility Company, Docket No. 800621-WS, Order No. 10337, (10/14/81).
- b. The balance sheet approach for determining the working capital allowance considers the actual amount of taxes accrued. The use of the 20% formula is, therefore, no longer necessary. Gulf Power Company, Order No. 9628, (11/10/80). Tampa Electric Company, Order No. 9599, (10/17/80).
- c. Temporary cash investments should be included in working capital and the related earnings should be included in NOI.

We regard cash management as part of the utility's normal business and thereby have included temporary cash investments in working capital. Gulf Power Company, Docket No. 810136-EU, Order No. 10557, (2/1/82).

- d. Minimum bank balances are included in working capital allowance, and no hypothetical service charges are allowed.

Since the Commission has adopted the use of the balance sheet working capital approach, the inclusion of the hypothetical bank service charges in operating expenses is unnecessary, as minimum bank balances are included in working capital. Gulf Power Company, Docket No. 810136-EU, Order No. 10557, (2/1/82).

- e. Employee loans are a nonutility function and should not be included in working capital.

We have reduced assets by \$500,000 to eliminate loans to employees which is a non-utility function. Gulf Power Company, Docket No. 810136-EU, Order No. 10557, (2/1/82).

- f. Employee Stock Option Plans (ESOP).

- (1) ESOP accounts are considered as cost-free liabilities.

We find that we should now consider ESOP accounts payable as

customer deposits and \$12,000 of current maturities of long-term debt. These items have a cost associated with them and are included in the company's capital structure. Gulf Power Company, Docket No. 810136-EU, Order No. 10557, (2/1/82).

- j. Unamortized gain on sale of corporate headquarters should be recognized as a cost free liability in the test year working capital.

We have determined that the company's gain on the sale of its corporate headquarters should be recognized above the line and amortized over a five year period. The unamortized balance of the gain should be recognized in the test year working capital as a liability. Thus unamortized gain reduces the working capital allowance by \$1,007,000. TECO, Docket No. 820007-EU, Order No. 11307, (11/10/82).

- k. The amount needed to balance represents the difference between the projected amounts for asset and liability accounts and is not to be included in working capital.

Because this amount cannot be identified with specific accounts, we decline to include it in working capital. FP&L, Docket No. 820097-EU, Order No. 11437, (12/22/82).

- l. Reduction of current tax liability due to amended state income tax law requires an adjustment to working capital.

The utility has chosen Option "B" which causes a reallocation of test year expense between current payable and deferred taxes. The reduction to current tax expense reduces the current tax liability. As tax liability is a current liability included in the working capital allowance, an adjustment to working capital should be made to reduce current tax liability by \$269,000 and thus increase the working capital allowance by \$269,000. TECO, Docket No. 820007-EU, Order No. 11307, (11/10/82).

- m. Exclusion of intercompany accounts.

"Since intercompany accounts are within the discretionary power of the affiliate group to discharge, we recommend exclusion of the intercompany accounts in the determination of working capital." Regency Utilities, Inc., Order No. 12008, (6/6/83).

- n. Prepaid EEI dues should not be included in working capital.

- t. When the liability for post retirement benefits is fully funded no adjustment to rate base is needed. See rule 25-14.012 Accounting for Postretirement Benefits Other Than Pensions.

Since SSU has a clear funding plan and since its witness has provided testimony that the FAS 106 liability will not appear in the financial statements, we find that SSU will not have an unfunded liability. Therefore, we have not made a rate base adjustment. To ensure that the obligation will be funded in a manner that qualifies as a plan asset under FAS 106, SSU shall place an amount equal to the monthly FAS 106 expense allowance in an escrow account until it establishes a fund that meets the FAS 106 criteria for such funds. Southern States Utilities, Inc. (Marco Island), Docket No. 920655-WS, Order No. PSC-93-1070-FOF-WS, p. 16 (7/23/93).

3. Formula approach.

Utilities should use the formula approach, which is based on one-eighth of operation and maintenance expenses, to calculate the working capital allowance. This is in accordance with Rule 25-30.437, Florida Administrative Code, which incorporates form PSC/WAS 17, entitled "Financial, Rate and Engineering Minimum Filing Requirements - Class A and B Utilities" by reference.

H. Plant Held For Future Use.

1. Used and useful.

a. Current policy.

- (1) We calculated the used and useful percentages for the water systems by adding the average of five maximum consumption days as peak flow, the required fire flow, and margin reserve, less any excessive unaccounted for water, and then dividing by the combined capacity of the two water plants...

We believe that it is appropriate to consider economies of scale and make an adjustment to the treatment facilities. ...[A]ll of the equipment is minimum sized and prudently designed. Therefore, no adjustment should be made to the treatment facilities of the membrane softening plant and the water plant should be considered 100 percent used and useful... Gulf Utility Company, Docket No.

pending review of the anticipated savings, in the Company's next rate case. Peoples Gas Systems, Inc., Docket No. 891353-GU, Order No. 23858 (12/11/90).

- j. When the total purchase price exceeds the depreciated book cost for the portion of the unit to be purchased, an acquisition adjustment is allowed based on the determination that the purchase was necessary, reasonable and the most cost-effective alternative.

FPL has requested that we approve as a part of the purchase price of \$615,387,000 an acquisition adjustment in the amount of \$111,362,000 which represents the difference between FPL's purchase price and the seller's net original cost of the unit . . . Our view is that the amount in question does not appear to be a ordinary acquisition adjustment. We find the amount in question should be evaluated based on whether the purchase of Scherer is necessary, reasonable, and the most cost-effective alternative. Because we have previously made those findings, we find the amount of \$111,362,000 should be included in rate base on a pro rata basis consistent with the phased purchase of the unit. Florida Power & Light, Docket No. 900796-EI, Order No. 24165 p. 8 (1/26/91).

5. Acquisition adjustment not used to offset prior operating losses.

In Lindrick's last rate case we recognized acquisition adjustments... due to the fact that Lindrick acquired its facilities in 1965 for less than the cost of construction. We do not agree with the utility that these acquisition adjustments should be removed to offset losses during the early years of the utility's operation. We have, therefore, adjusted water rate base... and sewer rate base... to recognize the fact of the negative acquisition adjustments approved... Lindrick Service Corporation, Docket No. 830062-WS, Order No. 12691, (11/16/83).

G. Working Capital.

1. Temporary cash investments will be excluded from working capital and the related earnings should be excluded from NOI.

If the temporary cash investments earn less than the approved rate of return, the rate payers make up the difference; conversely, if the company's return on temporary cash investment exceeds its approved rate of return, the ratepayers benefit. To prevent subsidization of the company by the ratepayers and vice versa, temporary cash investments will be excluded from working capital. Gulf Power Company, Order No. 11498, (1/11/83).

Revised 2/97

2. **Balance sheet approach.**

- a. **Use of the balance sheet method for calculating a utility's working capital needs was more persuasive than using the 1/8 of operation and maintenance expenses method. Gulfstream Utility Company, Docket No. 800621-WS, Order No. 10337, (10/14/81).**
- b. **The balance sheet approach for determining the working capital allowance considers the actual amount of taxes accrued. The use of the 20% formula is, therefore, no longer necessary. Gulf Power Company, Order No. 9628, (11/10/80). Tampa Electric Company, Order No. 9599, (10/17/80).**
- c. **Temporary cash investments should be included in working capital and the related earnings should be included in NOI.**

We regard cash management as part of the utility's normal business and thereby have included temporary cash investments in working capital. Gulf Power Company, Docket No. 810136-EU, Order No. 10557, (2/1/82).

- d. **Minimum bank balances are included in working capital allowance, and no hypothetical service charges are allowed.**

Since the Commission has adopted the use of the balance sheet working capital approach, the inclusion of the hypothetical bank service charges in operating expenses is unnecessary, as minimum bank balances are included in working capital. Gulf Power Company, Docket No. 810136-EU, Order No. 10557, (2/1/82).

- e. **Employee loans are a nonutility function and should not be included in working capital.**

We have reduced assets by \$500,000 to eliminate loans to employees which is a non-utility function. Gulf Power Company, Docket No. 810136-EU, Order No. 10557, (2/1/82).

- f. **Employee Stock Option Plans (ESOP).**

- (1) **ESOP accounts are considered as cost-free liabilities.**

We find that we should now consider ESOP accounts payable as

cost-free liabilities until such time as they are converted to common stock. The accounts payable are the result of an accrual process and the company does not have any identifiable cost that could be applied to the accounts payable. Working capital should be reduced by \$1,501,000 to recognize ESOP accounts payable as cost-free liabilities. TECO, Docket No. 820007-EU, Order No. 11307, (11/10/82).

- (2) Inclusion of ESOP accounts payable in cost-free liabilities is not an impermissible reduction of rate base for the tax credits.

...We find that we should consider ESOP accounts payable as cost-free liabilities until such time as they are converted to common stock... The company raised the possibility of potential conflicts of our treatment of ESOP accounts payable adopted here with the Internal Revenue Code. Certain investment tax credits may be lost to a utility if an impermissible rate base reduction for the credit is required by the regulatory authority... To view the inclusion of this account among payable as increasing current liabilities which, when subtracted from current assets, gives rise to a lower working capital requirement as constituting an impermissible reduction in rate base is simply too speculative. Florida Power Corporation, Order No. 11628, (2/17/83).

- g. Interest and dividends receivable are not included in working capital.

These amounts represent earnings on other assets and should not be included in working capital. Gulf Power Company, Docket No. 810136-EU, Order No. 10557, (2/1/82).

- h. Common dividends declared should not be included in current liabilities when calculating working capital allowance.

In our opinion, common dividends declared represent stockholders' funds until such time as they are actually paid, and as such, they should not be used to reduce working capital. Gulf Power Company, Docket No. 810136-EU, Order No. 10557, (2/1/82).

- i. Liabilities which have associated cost are included in capital structure rather than in working capital.

We have reduced liabilities by \$6,753,000 to remove \$6,741,000 of

customer deposits and \$12,000 of current maturities of long-term debt. These items have a cost associated with them and are included in the company's capital structure. Gulf Power Company, Docket No. 810136-EU, Order No. 10557, (2/1/82).

- j. Unamortized gain on sale of corporate headquarters should be recognized as a cost free liability in the test year working capital.

We have determined that the company's gain on the sale of its corporate headquarters should be recognized above the line and amortized over a five year period. The unamortized balance of the gain should be recognized in the test year working capital as a liability. Thus unamortized gain reduces the working capital allowance by \$1,007,000. TECO, Docket No. 820007-EU, Order No. 11307, (11/10/82).

- k. The amount needed to balance represents the difference between the projected amounts for asset and liability accounts and is not to be included in working capital.

Because this amount cannot be identified with specific accounts, we decline to include it in working capital. FP&L, Docket No. 820097-EU, Order No. 11437, (12/22/82).

- l. Reduction of current tax liability due to amended state income tax law requires an adjustment to working capital.

The utility has chosen Option "B" which causes a reallocation of test year expense between current payable and deferred taxes. The reduction to current tax expense reduces the current tax liability. As tax liability is a current liability included in the working capital allowance, an adjustment to working capital should be made to reduce current tax liability by \$269,000 and thus increase the working capital allowance by \$269,000. TECO, Docket No. 820007-EU, Order No. 11307, (11/10/82).

- m. Exclusion of intercompany accounts.

"Since intercompany accounts are within the discretionary power of the affiliate group to discharge, we recommend exclusion of the intercompany accounts in the determination of working capital." Regency Utilities, Inc., Order No. 12008, (6/6/83).

- n. Prepaid EEI dues should not be included in working capital.

We believe the entire amount should be removed from working capital because this item (prepaid EEI dues) should be expensed rather than capitalized. TECO, Docket No. 930012-EU, Order No. 12663, (11/7/83).

- o. Preoccupancy costs should be excluded from working capital.

The company included the unamortized balance of \$217,000 of the preoccupancy costs of TECO Plaza in its proposed working capital. The costs should have been expensed rather than amortized. Therefore, it will be excluded from working capital. TECO, Docket No. 830012-EU, Order No. 12663, (11/7/83).

- p. Statement of Financial Accounting Standards no. 106 was approved for ratemaking purposes with no funding required. Rate base was reduced by the unfunded liability directly or as a reduction to WCA.

We find that the implementation of FAS No. 106 results in an increase in the liability side of the working capital calculation which causes a reduction to working capital. . . . As discussed above, we have decided to use FAS No. 106 for ratemaking purposes. FPC, Order No. PSC-92-1197-POF-EI, pp. 25 and 38 (10/22/92).

- r. The Commission may disallow a portion or all of the costs of post retirement benefits other than pensions accrued based on SFAS 106.

We find that an independent basis supports the PSC's determination regarding SFAS 106: the uncertainties still associated with the accrual method of accounting for PBOPs in ratemaking. . . . In fact, we believe the PSC would be within its discretion to entirely reject SFAS 106 for ratemaking purposes in light of the doubts surrounding such use. GTE Florida, Inc. v. Deason, 642 So. 2d 545 (Fla. 1994).

- s. When the liability for post retirement benefits is unfunded it is treated as a zero cost source of capital which reduces rate base. See rule 25-14.012 Accounting for Postretirement Benefits Other Than Pensions.

The unfunded liability should be treated as a zero cost source of capital. Based on the fact that the utility has not funded this liability we find it appropriate to reduce its rate base by being consistent with our past decisions. Lehigh Utilities, Inc., Docket No. 911188-WS, Order No. PSC-93-0301-POF-WS, p. 13 (2/25/93).

- t. When the liability for post retirement benefits is fully funded no adjustment to rate base is needed. See rule 25-14.012 Accounting for Postretirement Benefits Other Than Pensions.

Since SSU has a clear funding plan and since its witness has provided testimony that the FAS 106 liability will not appear in the financial statements, we find that SSU will not have an unfunded liability. Therefore, we have not made a rate base adjustment. To ensure that the obligation will be funded in a manner that qualifies as a plan asset under FAS 106, SSU shall place an amount equal to the monthly FAS 106 expense allowance in an escrow account until it establishes a fund that meets the FAS 106 criteria for such funds. Southern States Utilities, Inc. (Marco Island), Docket No. 920655-WS, Order No. PSC-93-1070-FOF-WS, p. 16 (7/23/93).

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Utilities should use the formula approach, which is based on one-eighth of operation and maintenance expenses, to calculate the working capital allowance. This is in accordance with Rule 25-30.437, Florida Administrative Code, which incorporates form PSC/WAS 17, entitled "Financial, Rate and Engineering Minimum Filing Requirements - Class A and B Utilities" by reference.

H. Plant Held For Future Use.

1. Used and useful.

- a. Current policy.

- (1) We calculated the used and useful percentages for the water systems by adding the average of five maximum consumption days as peak flow, the required fire flow, and margin reserve, less any excessive unaccounted for water, and then dividing by the combined capacity of the two water plants...

We believe that it is appropriate to consider economies of scale and make an adjustment to the treatment facilities. ...[A]ll of the equipment is minimum sized and prudently designed. Therefore, no adjustment should be made to the treatment facilities of the membrane softening plant and the water plant should be considered 100 percent used and useful... Gulf Utility Company, Docket No.

900718-WU, Order No. 24735, (7/1/91).

(2) ...Using the five day peak average calculated in MFR Schedule F-3, and the growth percentage of 10.84 from MFR Schedule F-8, the five day peak average is 175,818 GPD... Adding the fire flow of 180,000 GPD found in MFR Schedule F-3 and margin reserve of 16,542 GPD based on yearly growth, and adjusting for excessive unaccounted-for-water of 5,087 GPD, we find that the water treatment plant is 100 percent used and useful. Sailfish Point Utility Corporation, Docket No. 900816-WS, Order No. 25092, (9/23/91).

b. Used and useful allowances made where a larger than necessary plant built to recognize economies of scale. Florida Cities Water Company, Docket No. 830121-S, Order No. 12743, (12/8/83), Order No. 12897, (1/18/84).

2. Margin Reserve.

Imputation of CIAC on the margin reserve included in rate base.

Our determination of used and useful plant includes a margin reserve for anticipated customer growth patterns. This margin reserve represents the number of customer equivalent residential connections (ERC's) expected to be connected during the 18 months following the test year. For the water treatment plant, the number of ERC's included in the margin reserve is 216. The sewage treatment has 204 ERC's included in the margin reserve. We have determined that only the utility's net investment in the margin reserve should be recognized in rate base and that CIAC should be imputed for the additional ERC's. Marion Oaks Utilities, Docket No. 830413-WS, Order No. 13338, (5/25/84).

I. Other

1. Deferred Taxes Not a Reduction From Rate Base.

... the utility reflected deferred taxes as a reduction to rate base. Consistent with the normalization method of accounting approved for this utility, deferred taxes should be included in the capital structure as zero cost. Avatar Utilities, Inc. of Florida, Barefoot Bay Division, Docket No. 820014-WS, Order No. 11487, (1/5/83).

2. Advances for Construction.