

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition to Gross-Up) DOCKET NO. 920739-WS
Contributions-in-Aid-of-) ORDER NO. PSC-93-0291-FOF-WS
Construction in Lake County by) ISSUED: 02/23/93
LAKE GROVES UTILITIES, INC.)
_____)

The following Commissioners participated in the disposition of this matter:

J. TERRY DEASON, Chairman
THOMAS M. BEARD
SUSAN F. CLARK
JULIA L. JOHNSON
LUIS J. LAUREDO

ORDER APPROVING TARIFF

BY THE COMMISSION:

BACKGROUND

Lake Groves (Lake Groves or utility) is a Class C water and wastewater utility providing service to the public in Lake County. The utility was organized on March 22, 1990. As of December 31, 1991, utility operations had not begun. Because Lake Groves is a new utility it did not have any gross operating revenues in 1991 for the water or wastewater systems. The utility reported a net operating loss of \$4,222 for the water system and a loss of \$6,992 for the wastewater system.

By Order No. 16971, issued December 18, 1986, this Commission granted approval for water and wastewater utilities to amend their service availability policies to meet the tax impact on contributions-in-aid-of-construction (CIAC) resulting from the amendment of Section 118(b) of the Internal Revenue Code. By Order No. 23541, issued October 1, 1990, we ordered utilities currently grossing-up CIAC to file a petition for continued authority to gross-up and also ordered that no utility may gross-up CIAC without first obtaining the approval of this Commission. Further, in Orders Nos. 16971 and 23541, we prescribed the accounting and regulatory treatments for CIAC gross-up collections and the calculation of and manner for refunds of same.

On July 20, 1992, pursuant to Order No. 23541, Lake Groves filed for initial authority to gross-up CIAC. The information as filed did not meet the filing requirements of that Order.

DOCUMENT NUMBER-DATE

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FPSC-RECORDS/REPORTING

In Order No. PSC-92-0962-FOF-WS, issued September 9, 1992, we allowed the utility's proposed tariff to become effective on an interim basis, subject to refund, effective September 19, 1992, pending further review of additional information.

APPROVAL OF AUTHORITY TO GROSS-UP
CONTRIBUTIONS-IN-AID-OF-CONSTRUCTION

In Order No. 23541, we stated that, to qualify for gross-up authority, each utility must demonstrate that it has an above-the-line tax liability and that alternate sources of funds are not available at a reasonable cost. We required that utilities file the following information to demonstrate the need to gross-up: a demonstration of actual tax liability, a cash flow statement (except for Class "C" utilities), a statement of interest coverage, a statement of alternative financing, a justification for gross-up, a selection of gross-up method, and proposed tariffs. We have completed our review of the information Lake Groves filed, and our findings, categorized by filing requirement, are discussed below.

Demonstration of Actual Tax Liability

Our review of the financial statements filed by the utility indicates that Lake Groves will incur an actual above-the-line tax liability as a result of its collection of CIAC. For 1991 the utility operations resulted in an above-the-line loss prior to collection of taxable CIAC. Projections for 1992 indicate the utility will have an above-the-line loss prior to collection of taxable CIAC. However, based upon the information filed, it appears that the utility will continue to have an actual above-the-line tax liability associated with the collection of CIAC.

Cash Flow Statement

A cash flow statement shows whether liquid funds are available to pay taxes on CIAC. Lake Groves, a Class "C" utility, was not required to file a cash flow statement. This utility is in its early stages of development. Our review of the projected revenues to be generated for 1992, indicates that the utility projects only 78 residential customers to be on line by the end of that year. The \$19,246 of 1992 projected revenue does not appear sufficient to cover operating expenses and taxes associated with the possible CIAC property donations of \$1,124,744. Therefore, we do not believe that funds are available for payment of taxes.

Statement of Interest Coverage

The times-interest-earned (TIE) ratio indicates the number of times a utility is able to cover its interest obligations. The ratio is an indicator of the relative protection for the bondholders and is also indicative of the utility's ability to go into the financial market to borrow money or issue stock at a reasonable rate. In Order No. 23541, we established a TIE ratio of 2x as a benchmark. As of December 31, 1991, the utility had long-term debt of \$1,004,964. The TIE ratio was calculated to be a negative .05% for 1990 and negative .14% for 1991. Projected 1992 data indicates a TIE ratio of negative .64%. Thus, each year's TIE ratio is less than the benchmark established by Order No. 23541. This TIE ratio indicates that the utility does not have adequate interest coverage. We do note that the utility is in its early development stage and has a deficit in retained earnings of \$144,950 as of December 31, 1991. This factor coupled with the utility's low TIE ratio may be indicative of the utility's inability to go into the financial market to borrow money. In addition, the utility has generated a loss each year since inception in 1990. The utility's rates were set based on 80% of design capacity, and at this point are not compensatory. When these factors are considered, we find that it is not in the interest of either the utility or the ratepayers to increase a NOI deficiency.

Statement of Alternative Financing

Greater Construction Corporation (Greater) is an affiliated corporation of the utility. The initial capital investment in the utility was supplied by shareholders, who are also the shareholders of Greater. In its filing, the utility asserts that the deficits in administrative and operating expenses, as well as substantial capital expenditures, during the initial period of formation were funded by the utility's shareholders and Greater, and it is anticipated that the utility will have to continue to rely on this financial support during the initial growth years. The utility adds that this subsidization extends not only to the non-used and useful revenue requirement components, but also to the start-up costs associated with the creation of a new utility from its inception and through its growth years. However, the shareholders of the utility and Greater are not willing to extend contributions or guarantees to include payment of taxes related to taxable CIAC collections.

The utility stated that additional unsecured, third-party loans are not available, at any cost, to fund the additional tax burden related to CIAC, on the strength of its own operations without the personal guarantees of its shareholders and the support of its affiliated development company. Additional borrowing, even if available, would further erode the utility's capital structure and add to operating losses via additional interest expenses. We believe that because the utility has inadequate interest coverage, negative retained earnings, and a negative equity ratio, the utility's ability to go into the financial market to borrow money to pay taxes on CIAC may be impaired, and the utility would not be able to obtain alternative financing at a reasonable rate.

Justification for the Gross-up

The utility indicated that it has been in a loss position since its inception in 1990. As of year-end 1991, the utility had no internally generated sources of revenue. Assuming total 1992 gross operating revenue is as projected, \$19,246, we do not believe that the utility will be able to generate enough revenues with its current rates and customer base to cover its operating expenses and taxes associated with CIAC, and, at the same time, service its debt. The company continues to accumulate operating losses. Based on the foregoing, it appears that the utility will incur an above-the-line tax liability associated with the collection of CIAC and that it will not be able to generate the funds to pay taxes either through its existing rates or alternative financing. Therefore, we conclude that there is justification for this utility to gross-up CIAC.

Gross-up Method Selected

The utility has elected to use the full gross-up method because it is cost effective and relative simple to administer, compared with the present value method. We have no objection to Lake Groves' selected method.

Proposed Tariffs

The utility submitted proposed tariffs for the full gross-up requested in its filing.

The collections of the CIAC gross-up shall be made in accordance with the provisions of Orders Nos. 16971 and 23541. Orders Nos. 16971 and 23541 prescribe the accounting and regulatory treatment of and record keeping requirements for the gross-up and established criteria and method of refunds of certain gross-up

ORDER NO. PSC-93-0291-FOF-WS
DOCKET NO. 920739-WS
PAGE 5

amounts collected. Lake Groves' collections shall be made in accordance with those Orders. All matters discussed in the body of those Orders are expressly incorporated herein by reference.

Effective Date

The tariffs are approved as filed and will be effective on the stamped approval date. The tariffs will be approved after the protest period expires.

Persons substantially affected by this tariff have the right to a hearing prior to final approval. Therefore, substantially affected persons shall have 21 days from the date of this Order to request a hearing.

Based on the foregoing, it is, therefore,

ORDERED by the Florida Public Service Commission that the tariffs for CIAC gross-up collections filed by Lake Groves Utilities, Inc. are hereby approved as filed. It is further

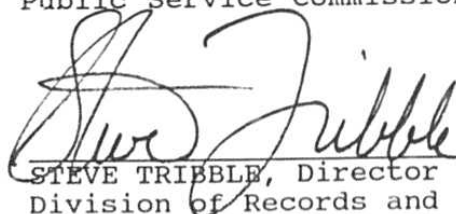
ORDERED that the aforementioned tariffs will be effective on their stamped approval date, and the tariffs will be stamped approved upon the expiration of the protest period. It is further

ORDERED that collections of and accounting for the CIAC gross-up shall be made in accordance with the provisions of Orders Nos. 16971 and 23541. It is further

ORDERED that substantially affected persons shall have 21 days from the date of this Order to request a hearing. It is further

ORDERED that upon expiration of the protest period, if no protests have been received, the docket may be closed.

By ORDER of the Florida Public Service Commission this 23rd day of February, 1993.



STEVE TRIBBLE, Director
Division of Records and Reporting

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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 Commission's decision on this tariff is interim in nature and will become final, unless a person whose substantial interests are affected by the action proposed files a petition for a formal proceeding, as provided by Rule 25-22.036(4), Florida Administrative Code, in the form provided by Rule 25-22.036(7)(a)(d) and (e), Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting at his office at 101 East Gaines Street, Tallahassee, Florida 32399-0870, by the close of business on March 16, 1993.

In the absence of such a petition, this order shall become final on the day subsequent to the above date.

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 on the date described above, any party adversely 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 date this Order becomes final, 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.