

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Disposition of CIAC
gross-up funds collected by
North Fort Myers Utility, Inc.
in Lee County.

DOCKET NO. 971179-SU
ORDER NO. PSC-99-1068-PAA-SU
ISSUED: May 25, 1999

The following Commissioners participated in the disposition of this matter:

JOE GARCIA, Chairman
J. TERRY DEASON
SUSAN F. CLARK
JULIA L. JOHNSON
E. LEON JACOBS, JR.

ORDER TO SHOW CAUSE
AND

NOTICE OF PROPOSED AGENCY ACTION ORDER GRANTING VARIANCE,
ACCEPTING SETTLEMENT OFFER TO OFFSET FIFTY PERCENT OF APPROPRIATE
LEGAL FEES AND ACCOUNTING COSTS, REQUIRING REFUNDS OF
CONTRIBUTIONS IN AID OF CONSTRUCTION GROSS-UP FOR FISCAL YEARS
1994 AND 1995, AND REJECTING SETTLEMENT OFFER TO FOREGO PRICE
INDEXES FOR THREE YEARS AND REQUIRING REFUNDS AND A REDUCTION IN
RATES FOR THE IMPROPERLY IMPLEMENTED PRICE INDEXES FOR THE YEARS
1995, 1996, AND 1997

BY THE COMMISSION:

NOTICE is hereby given by the Florida Public Service Commission that the action discussed herein, except for the show cause portion, 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

North Fort Myers Utility, Inc. (NFMU or utility) is a Class A wastewater utility providing service to approximately 5,360 customers in Lee County. According to its 1997 annual report, the utility reported gross operating revenues of \$1,958,553 and net operating income of \$446,362.

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FPSC-RECORDS/REPORTING

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As a result of the repeal of Section 118(b) of the Internal Revenue Code, effective January 1, 1987, contributions-in-aid-of-construction (CIAC) became gross income and were depreciable for federal tax purposes. Therefore, by Order No. 16971, issued December 18, 1986, we 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 December 18, 1986 and October 1, 1990, respectively, 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 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.

However, the Small Business Job Protection Act of 1996 (The Act), which became law on August 20, 1996, provided for the non-taxability of CIAC collected by water and wastewater utilities effective retroactively for amounts received after June 12, 1996. However, as established in Order No. PSC-96-0686-FOF-WS, we directed that all pending CIAC gross-up refund cases would continue to be processed pursuant to Orders Nos. 16971 and 23541.

Further, because CIAC was no longer taxable, in Docket No. 960965-WS, by Order No. PSC-96-1180-FOF-WS, issued September 20, 1996, we revoked the authority of utilities to collect gross-up of CIAC and canceled the respective tariffs unless, within 30 days of the issuance of the order, affected utilities requested a variance. Although NFMU did not request a variance, it explained in a letter dated January 10, 1997, that it did not believe that the continued collection of the installment payments constituted a variance, but merely a payment of a debt over a period of time.

NFMU provides wastewater service to several subdivisions (Forest Park, Lake Arrowhead, Carriage Village, Tamiami Village, and Lazy Days) formerly receiving service through package plants. In each case, under the authority granted in its tariff, NFMU allowed each customer to either pay the plant capacity charge and applicable gross-up at the time of connection onto the utility's central wastewater system or pay by installment payments over a seven-year period for the total amount owed. This installment

arrangement was undertaken and authorized for the convenience of the customers who could not or chose not to pay their plant capacity fees and gross-up at the time of connection.

Although the Act provided for the non-taxability of CIAC collected by water and wastewater utilities for amounts received after June 12, 1996, several of the contractual agreements between the customers and the utility continue to be outstanding and require payments after June 12, 1996. As a result, on November 18, 1996, our staff received a call from the Office of Public Counsel (OPC), advising them that several customers had contacted OPC regarding the status of the customer's obligation to continue paying the gross-up amount of the installment payment to NFMU.

From March 17, 1997, through March 25, 1997, our staff received approximately seventeen letters and numerous telephone calls from customers of NFMU, wanting to know why NFMU continued to collect gross-up from its customers when the Commission had canceled the utility's authority to collect gross-up. Our staff advised the customers that the utility could continue to collect gross-up if it had not collected all of the gross-up it was entitled to receive from those customers who were paying by installment. Further, our staff assured the customers that this matter would be investigated thoroughly and a recommendation to the Commission would be made accordingly. On November 12, 1997, OPC filed its Notice of Intervention in this docket and by Order No. PSC-97-1474-PCO-SU, we acknowledged OPC's intervention.

Our staff initially filed its recommendation on October 23, 1997. In that recommendation, our staff treated the installment contracts as "income" in the year the contracts were entered into. However, our staff then realized that the utility was not treating the installment payments received after June 12, 1996, as taxable income on its tax return, and that this might give the utility CIAC gross-up on CIAC which may not have been taxable income. Therefore, the gross-up refund calculations appearing in staff's recommendation of October 23, 1997, were revised to remove the installment contracts as being taxable income and the utility was advised accordingly. As a result, consideration of the October 23, 1997 recommendation was deferred from the November 4, 1997, agenda conference.

By letter dated November 14, 1997, our staff submitted revised refund calculations to the utility. In response to this letter,

the utility advised staff that it would be filing amended tax returns to reflect as taxable income, the CIAC and gross-up due from customers paying by installment.

On December 12, 1997, the utility filed a certified copy of the amended tax returns with this Commission along with a copy of the return receipt from the Internal Revenue Service (IRS). This again caused our staff to revise their recommendation.

On December 3, 1998, our staff filed a recommendation to address the utility's request for a variance from Order No. PSC-96-1180-FOF-WS, to address the disposition of gross-up funds collected by the utility in 1994, 1995, and 1996, including the concerns of Mr. Pete Longjohn, President of Tamiami Village Homeowners Association, and the concerns expressed in the letters and telephone calls received from customers of NFMU, to address the utility's request that 50 percent of its legal and accounting costs be offset against the refund amounts, and to address the utility's informal Settlement Offer that had been filed on October 2, 1998, and OPC's response to the utility's informal Settlement Offer.

However, after briefly discussing the December 3, 1998 recommendation, we again deferred taking any action. Finally, on May 4, 1999, we considered our staff's recommendation dated April 22, 1999. The purpose of this Order is to address the same issues referenced above. Also, in this Order, we address whether the utility should be made to show cause why it should not be fined for continuing to collect CIAC gross-up without obtaining a variance from Order No. PSC-96-1180-FOF-WS; for filing inaccurate annual reports; and for implementing price index rate increases based on inaccurate operating costs. Further, this Order addresses whether the utility should be ordered to refund a portion of the revenues received from the improper implementation of the 1995, 1996, and 1997 price indexes and whether the utility should be ordered to reduce its rates to reflect the improper price index rate adjustments.

SHOW CAUSE

We have identified three areas where the utility has apparently violated the Florida Statutes, or lawful rules or orders of this Commission. These apparent violations are summarized as follows: 1. failure to timely request a variance from Order No. PSC-96-1180-FOF-WS for the continued collection of CIAC gross-up;

2. failure to file correct annual reports; and 3. implementation of price-index rate increases based on inaccurate operating costs.

Section 367.161(1), Florida Statutes, authorizes this Commission to assess a penalty of not more than \$5,000 for each offense, if a utility is found to have knowingly refused to comply with, or to have willfully violated any provision of Chapter 367, Florida Statutes, or any lawful rule or order of the Commission. Pursuant to Section 367.021(12), Florida Statutes, utilities are charged with the knowledge of the Commission's rules and statutes. In Order No. 24306, issued April 1, 1991, in Docket No. 890216-TL titled In Re: Investigation Into The Proper Application of Rule 25-14.003, F.A.C., Relating To Tax Savings Refund for 1988 and 1989 For GTE Florida, Inc. (hereinafter GTE Florida) we, having found that the company had not intended to violate the rule, nevertheless found it appropriate to order it to show cause why it should not be fined, stating that "'willful' implies an intent to do an act, and this is distinct from an intent to violate a statute or rule." Id. at 6. Additionally, "[i]t is a common maxim, familiar to all minds that 'ignorance of the law' will not excuse any person, either civilly or criminally." Barlow v. United States, 32 U.S. 404, 411 (1833). Thus, any intentional act, such as the utility's failure to comply with Order No. PSC-96-1180-FOF-WS, implementation of an inaccurate price index, or filing of an inaccurate annual report, would meet the standard for a "willful violation." We have analyzed each of the three apparent violations using the above-noted criteria.

1. Failure To Request A Variance From Order No. PSC-96-1180-FOF-WS

As stated in the case background, NFMU did not timely request a variance for its continued collection of CIAC gross-up. The utility argues that it is no longer CIAC gross-up, but merely collection of a debt that is being collected over time. However, we find that the installment payments still constitute CIAC gross-up and were subject to cancellation pursuant to Order No. PSC-96-1180-FOF-WS, and refund pursuant to the provisions of Orders Nos. 16971 and 23541. Therefore, the utility should have requested a variance pursuant to Order No. PSC-96-1180-FOF-WS.

That Order canceled CIAC gross-up authority within 30 days of the date of the Order for all utilities unless the utility applied for a variance within 30 days of the date of the Order. By letter dated February 28, 1997, the utility, while arguing that a variance

was not required, requested that it be granted a variance if the Commission deemed that one was required.

The utility, having failed to timely request and obtain a variance, appears to have violated Order No. PSC-96-1180-FOF-WS by continuing to collect CIAC gross-up 30 days after the issuance of that Order. Thus, its act was "willful" in the sense intended by Section 367.161, Florida Statutes. However, we believe that the utility legitimately thought it did not need a variance, and, that there was some confusion as to whether its approved tariffs providing for installment payments required a waiver from Order No. PSC-96-1180-FOF-WS. Although regulated utilities are charged with complying with lawful Orders of this Commission, based on the confusion, we do not believe that the apparent violation of the Order, rises in these circumstances to the level which warrants the initiation of a show cause proceeding. Therefore, NFMU shall not be made to show cause for its apparent failure to comply with Order No. PSC-96-1180-FOF-WS.

2. Failure To File Accurate Annual Reports

Also, in a letter dated June 11, 1998, the utility contended initially that \$437,968 and \$374,019 of operating and maintenance (O&M) expenses shown in the utility's 1994 and 1995 annual reports should be reclassified as below-the-line expenses for gross-up purposes. Therefore, the utility appears to admit that it filed an inaccurate annual report and, on February 15, 1999, the utility filed revised sheets for its annual reports for 1994-1997, accordingly. The annual report pages indicated that an additional \$296,841 of expenses were reclassified below-the-line for 1996 and \$297,092 was reclassified to below-the-line for 1997.

Although the reclassification of expenses does not cause the utility to exceed the range of its authorized return on equity, we note that the utility, through price indexing, has received the benefit of these expenses being classified above-the-line. Further, pursuant to Section 367.081(4)(c), Florida Statutes, the utility has submitted an affirmation under oath as to the accuracy of the figures and calculations upon which the change in rates was based. This affidavit appears to have also been in error.

Section 367.121(1)(d), Florida Statutes, authorizes the Commission to require regular financial reports as it deems necessary. Pursuant to Rule 25-30.110(4), Florida Administrative

Code, a utility must file an annual report on the appropriate form. Further, Rule 25-30.110(5)(d), Florida Administrative Code, provides that the chief executive officer and chief financial officer shall certify as follows:

Whether the financial statements and related schedules fairly present the financial condition and results of operations for the period presented and whether other information and statements presented as to the business affairs of the respondent are true, correct, and complete for the period which they represent.

If a utility files an incorrect annual report, pursuant to Rule 25-30.110(9), Florida Administrative Code, the report is considered delinquent and subject to the same penalty as set forth in Rules 25-30.110(7)(a) and (b), Florida Administrative Code. Rule 25-30.110(11), Florida Administrative Code, states that the penalties that may be assessed against the utility for failure to file an annual report in compliance with Rule 25-30.110, Florida Administrative Code, shall be separate and distinct from penalties that may be imposed for other violations of the requirements of the Commission. Implicit in our power to require the reports set forth in Section 367.121(1)(c), Florida Statutes, is that these reports be accurate.

The revisions made in this particular case were made only after the utility had first implemented three price indexes with the expenses above the line, but then determined that it could reduce its CIAC gross-up liability and retain the maximum amount of CIAC gross-up funds received by placing those expenses below the line. At the December 15, 1998 Agenda Conference, the utility's consultant stated that it was just not cost effective to go into a detailed analysis of what should be above or below-the-line. An error of \$437,968, \$374,019, \$296,841 and \$279,072 of O&M expenses shown in the utility's 1994, 1995, 1996 and 1997 annual reports, respectively, is not insignificant.

The provisions for a penalty for an inaccurate and delinquent annual report are set forth in Rules 25-30.110(7) and (9), Florida Administrative Code. However, we do not believe that we should impose a penalty in this case.

We are seriously troubled by what appears to be a manipulation by the utility of the CIAC gross-up disposition procedures in an

attempt to maximize the amount of CIAC gross-up collections retained. The manipulation has occurred through revisions to its annual reports in this case. We are further troubled by the inference made at a past agenda conference that the effort necessary to prepare the most accurate annual report was not initially made. However, we are concerned in another regard as to the wisdom of invoking the penalties set forth in Rule 25-30.110(7) and (9), Florida Administrative Code. This Commission has had a long standing practice to encourage corrections and revisions to annual reports when inaccuracies are discovered, and we have never invoked this provision when revisions have been filed. To do so may discourage, and perhaps eliminate, the correction and revision of the information contained in annual reports. Thus, we believe it is more appropriate to require the refund with interest of the inappropriately implemented price indexes and a concomitant reduction in rates. Therefore, we decline to initiate a show cause proceeding for the utility having filed incorrect annual reports, since the revisions were ultimately made.

3. Erroneous Implementation Of Price Indexes

The utility filed for and implemented price index rate increases for the years 1995, 1996 and 1997. These index increases were based on the incorrect annual reports filed for those years as noted above. The result was that the increases received from indexing were higher than they would have been had the utility filed the correct annual reports initially. In a later section of this Order, we have recalculated the price index rate increases for the affected years based on the revised annual reports. Based on these recalculations, we are ordering that refunds be made with interest for the amounts over collected and that rates be reduced accordingly. This will result in some administrative burden for the utility. However, we do not believe that this is a sufficient deterrent to the filing of improper rate increases.

Therefore, NFMU is ordered to show cause, in writing, within 21 days, why it should not be fined \$5,000 for each apparent offense pursuant to Section 367.161, Florida Statutes, for its having improperly implemented three price indexes for the respective years of 1995, 1996 and 1997 based on inaccurate operating costs stated in its annual reports in apparent violation of Section 367.081(4), Florida Statutes. NFMU's response shall address all issues raised in this show cause order. NFMU's response to the show cause order must contain specific allegations

of fact and law. Should NFMU file a timely written response that raises material questions of fact and makes a request for a hearing pursuant to Section 120.57(1), Florida Statutes, a further proceeding will be scheduled before a final determination of this matter is made. A failure to file a timely written response to the show cause order shall constitute an admission of the facts herein alleged and a waiver of the right to a hearing.

In the event that NFMU fails to file a timely response to the show cause order, the maximum fine is deemed assessed with no further action required by the Commission. In that event, if NFMU fails to respond to reasonable collection efforts by Commission staff, the collection of the fine shall be referred to the Department of Banking and Finance's Office of the Comptroller for further collection efforts. Reasonable collection efforts shall consist of two certified letters requesting payment. The referral to the Comptroller's office would be based on the conclusion that further collection efforts by this Commission would not be cost effective.

If the utility responds timely but does not request a hearing, we will consider the final disposition of the show cause order at a subsequent time. If the utility responds to the show cause by remitting the penalties, the show cause matter shall be considered resolved.

We further strongly admonish the utility to provide the most accurate information possible in future annual reports and price index rate increase applications. Also, the utility should be aware of Section 837.06, Florida Statutes, which provides that false information intentionally provided to a public servant is a second degree misdemeanor.

REQUEST FOR VARIANCE

Order No. PSC-96-1180-FOF-WS, revoked the authority of utilities to collect gross-up of CIAC and required the cancellation of the respective tariffs unless, within 30 days of the issuance of the order, affected utilities requested a variance. In its letter of January 10, 1997, the utility explains why its request for a variance was not filed in a timely manner. The utility explains that it was not aware that the Commission considered the installment contracts as somehow requiring a variance from

Commission Order No. PSC-96-1180-FOF-WS. The utility goes on to say that it has always taken the position that the installment contract arrangement which is authorized pursuant to the provisions of the utility's tariff (other than the gross-up provisions) simply was allowing the customers to pay a debt for service availability charges and gross-up fees over an extended period of time, and, that it is not now and has never been considered by the utility to be continued collection of gross-up.

In its letter of February 28, 1997, the utility reiterates that the debt owing originally represented CIAC and gross-up, and, for those customers who chose to pay the amount owing over time, it became simply an installment debt authorized by tariff from the date that those individuals became customers of NFMU and agreed to make the installment payments. By that same letter, the utility, while arguing that a variance was not required, requested that it be granted a variance if the Commission concluded that one was required.

As mentioned previously, the utility charges its mobile home customers a service availability charge of \$462, and in accordance with its tariff, the utility allows customers residing in Forest Park, Lake Arrowhead, Carriage Village, Lazy Days Village, and Tamiami Village the option of paying system capacity charges in monthly installments over a seven-year period at 10 percent interest. By letter dated January 10, 1997, the utility indicated that the gross-up tax due from the customers residing in these parks is \$278. A request for a variance is necessary because in the absence of a variance, the authority of NFMU to collect gross-up of CIAC is revoked and the respective tariffs are canceled. Upon revocation, a portion of the installment payment constitutes CIAC gross-up which is no longer authorized and is not in its tariff.

The utility looks on the payments as installment loan payments, not as payments of gross-up. Nonetheless, the utility's collection of the payments as installment loan payments does not alter the fact that a portion of the payment collected from the customers paying by installment is CIAC gross-up. Although the utility has not technically timely requested a variance, there appears to have been a valid question as to whether the utility had to apply for a variance. Therefore, we believe that the utility's failure to timely request a variance is excusable. See, Rothblatt v. Department of Health and Rehabilitative Services, 520 So. 2d 644

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(Fla. 4th DCA 1988), and Hamilton County Board of County Commissioners v. Department of Environmental Protection, 587 So. 2d 1378 (Fla. 1st DCA 1991)

Based on the above, NFMU shall be allowed to collect from the customers, the gross-up portion of the installment payment that it was entitled to receive prior to the change in the tax law. Therefore, the request by NFMU for a variance from Order No. PSC-96-1180-FOF-WS is granted, and NFMU's tariffs for gross-up authority shall not be canceled. The utility shall file revised tariff sheets to allow for the continued collection of gross-up taxes on CIAC that is paid in installments from customers that entered into the installment contracts prior to June 12, 1996. Once the utility has collected the entire amount of taxes on the CIAC installment agreements it is entitled to receive, the utility shall submit canceled tariff sheets to the Commission.

REFUND REQUIREMENT FOR CIAC GROSS-UP

In compliance with Orders Nos. 16971 and 23541, NFMU filed its 1994 and 1995 annual CIAC reports regarding its collection of gross-up for fiscal years 1994 and 1995, respectively. However, as stated in the background, the utility did not initially treat the installment payments received after June 12, 1996 as taxable income. After having this brought to its attention, the utility determined that the full amount of the installment contract was taxable. Therefore, the utility amended its tax returns, and on December 12, 1997, the utility filed a certified copy of the amended tax returns with this Commission along with a copy of the return receipt from the IRS. The amended tax returns showed that the utility reported as taxable income the total amount due under the installment contracts.

By letter dated February 20, 1998, our staff sent the revised refund calculations, based on the utility's amended tax returns and revised CIAC gross-up reports and schedules, to the utility. On March 20, 1998, the utility filed its response. In its letter of March 20, 1998, the utility indicated that it did not agree with our staff's above-the-line allocation of: 1. operating and maintenance expenses; 2. the legal expenses relating primarily to the litigation over an agreement with a consulting firm for its assistance in refinancing the company's industrial development revenue bonds; and 3. amortization expense for retired plant.

At the request of the utility, our staff met with the utility and OPC on May 19, 1998, to further discuss the adjustments referenced in staff's letter of February 20, 1998. Subsequently, the utility submitted additional information on June 11, 1998. In its letter of June 11, 1998, the utility contends that \$437,968 and \$374,019 of O&M expenses shown in the utility's 1994 and 1995 annual reports should be reclassified as below-the-line expenses for gross-up purposes.

After reviewing the additional information, our staff informed the utility that if the expenses were reclassified below the line for gross-up purposes, then those same expenses should receive the same treatment for index purposes. Therefore, our staff informed the utility that it should refund that portion of the 1995, 1996, and 1997 price indexes related to the reclassification of expenses.

Settlement Offer To Dispose of CIAC Gross-up Funds and Correct
Improper Implementation of Price Indexes and Dispose of CIAC
Gross-up Funds

On October 2, 1998, the utility filed an informal settlement agreement for staff's consideration. The utility proposed to:

1. Treat, solely for the purposes of gross-up, certain expenses as below-the-line which were originally reported on the utility's annual reports as above-the-line expenses.
2. To the extent the utility is required to refund overpayments of gross-up funds to those who paid by installment, the utility is willing to apply those refunds as credits including interest at the installment contract rate.
3. To forego the implementation of indexing expenses for the years 1997, 1998, and 1999. According to the utility's calculations, the utility will forego revenues of \$118,183, by not implementing indexes for the years 1998-2000.
4. The utility will not seek to recover the additional gross-up costs which it has incurred since February, 1998.

On October 21, 1998, OPC filed a response to the utility's informal settlement agreement. In summary, OPC stated, that the Commission should reject the settlement offer proposed by the utility because the offer is fraught with errors and is wholly inconsistent with sound ratemaking practices and principles. OPC stated that the settlement should be rejected because of the following reasons:

1. The expenses in question cannot be considered reasonable for rate purposes, but not for CIAC gross-up purposes.
2. NFMU's calculation of the gross-up amounts owed to customers is severely understated. OPC disagrees with the expenses which have been suggested by the utility as being below-the-line for purposes of determining taxable income. If the utility's position is accepted, the Commission must immediately open an investigation into the earnings of this utility. If the expenses the utility claims are non-utility and more appropriately recorded below-the-line, OPC believes the utility's achieved return on rate base to be substantially in excess of any reasonable authorized rate of return on equity.
3. The Commission should reject the utility's suggestion that for those customers paying by installment, any refund of CIAC gross-up monies should be treated as a credit to monies owed under the contract.
4. The utility's offer to forego rate indexing increases for the years 1997, 1998, and 1999 should be rejected, because the expenses in question should be recorded above-the line, nullifying the need for any refunds or rate reductions.
5. OPC urges the Commission to reach a quick and final resolution of these gross-up monies owed to NFMU's customers.

The utility has requested that its informal offer of settlement be considered as a formal offer of settlement. However,

on February 15, 1999, the utility filed revised annual reports for 1994-1997. Therefore, we no longer need to consider whether the expenses need to be considered above-the-line for one purpose and below-the-line for another purpose. The second part of the settlement offer concerning correction of the price indexes shall be considered under the section of the Order concerning the Refund of Portion of 1995, 1996, and 1997 Price Indexes.

Even with the revisions of the annual reports, our calculations show that the utility has not exceeded the range of its authorized return on equity. Finally, the utility shall be allowed to collect from the customers, the gross-up portion of the installment payment that it was entitled to receive prior to the change in the tax law. The amounts collected would be subject to refund pursuant to the provisions of Orders Nos. 16971 and 23541.

As stated above, the utility revised its 1994 and 1995 annual reports to remove \$438,272 and \$374,019 of O&M expenses that were originally reported as above-the-line expenses. Based on these changes, we have 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 method adopted in Order No. PSC-92-0961-FOF-WS.

The calculations, taken from the information provided by the utility in its revised gross-up reports and revised annual reports for fiscal years 1994 and 1995, respectively, are reflected on Schedule No. 1. Also, the utility, as a settlement offer, has requested that it be allowed to offset 50 percent of the legal and accounting costs incurred in processing the CIAC gross-up refunds. A discussion of this settlement offer and a summary of each year's refund calculation follows.

Settlement Offer to Allow Fifty Percent of Legal and Accounting
Fees as an Offset

The utility provided documentation requesting legal and accounting fees of \$19,389.52 for fiscal year 1994 and \$21,496.52 for fiscal year 1995, for a total of \$40,886.04. However, these costs included the cost incurred to file the amended tax returns. The filing of tax returns is a normal cost of operations, and should not be passed directly to the contributors of the gross-up. Therefore, we have removed those costs.

We have considered on several occasions, the question of whether an offset should be allowed pursuant to the orders governing CIAC gross-up. In Dockets Nos. 961076-WS and 970275-WS, by Orders Nos. PSC-97-0657-AS-WS and PSC-97-0816-FOF-WS, respectively, we accepted the utilities' settlement proposals that 50 percent of the legal and accounting costs be offset against the refund amount. In general, the utility argues that the legal and accounting costs should be deducted from the amount of the contributors' refund, as the contributors are the cost-causers and as such, those costs should be recovered from the cost-causers.

Although Orders Nos. 16971 and 23541 did not provide for or contemplate an offset as requested by the utility, we recognize in this case that acceptance of the utility's request may avoid the substantial cost associated with a hearing, which may in fact exceed the amount of the legal and accounting costs to be recovered. We further note that the actual costs associated with implementing the refunds have not been included in these calculations and will be absorbed by the utility. Moreover, the utility's request is a reasonable "middle ground". Therefore, while not adopting the utility's position, we find it appropriate to grant NFMU's request that it be allowed to offset 50 percent of the legal and accounting fees against the refund amounts.

Based upon our review, we have determined that \$34,298 of the legal and accounting fees submitted by the utility are the legitimate costs for preparing the required reports, calculating the tax effect and the proposed refunds -- with \$16,096 of these expenses being incurred in fiscal year 1994 and \$18,202 incurred in fiscal year 1995. When reduced by fifty percent, these amounts are \$8,048 and \$9,101, respectively. Because the revised CIAC gross-up reports and schedules were filed to satisfy regulatory requirements, we find that it is appropriate that the costs incurred should be shared equally between the utility and the contributors of the gross-up. Therefore, the required refund shall be reduced by \$8,048 for fiscal year 1994 and by \$9,101 for fiscal year 1995.

Fiscal Year 1994

Requesting that we offset the refund by 50 percent of the legal and accounting costs, the utility proposes a refund of \$73,367, for fiscal year 1994 (year ended May 31, 1995). We

calculate that a refund of \$74,239 is appropriate for fiscal year 1994.

On February 15, 1999, the utility revised its 1994 annual report to remove \$438,272 of O&M expenses that were originally reported as above-the-line expenses. Also, the utility allocated depreciation in the amount of \$268,395, below-the-line. We have adjusted this amount by \$22,120 to reflect first year's depreciation, above-the line. Based on the adjustments above, taxable income for the utility is calculated to be \$809,618 for fiscal year 1994.

The utility's revised 1994 CIAC report reveals that the utility received taxable CIAC of \$619,015 for fiscal year 1994, and deducting \$22,120 for the first year's depreciation, results in net taxable CIAC of \$596,895. The utility's revised 1994 CIAC report also indicates that the utility was operating at a loss before the inclusion of CIAC in income. Order No. 23541 requires that CIAC income be netted against the above-the-line losses; therefore, not all of the CIAC collected would create a tax liability. When CIAC in the amount of \$596,895 is netted against the calculated loss of \$144,170, the amount of taxable CIAC resulting in a tax liability is \$452,725. Using the 37.63 percent combined marginal federal and state tax rates as provided in the revised 1994 CIAC Report, we calculate net income taxes of \$170,360. When this amount is multiplied by the expansion factor for gross-up taxes, the amount of gross-up required to pay the tax effect on the CIAC is calculated to be \$273,144. However, the utility collected \$355,431 of gross-up monies. Therefore, before any offset for legal and accounting fees is considered, the refund would be \$82,287. However, we have previously accepted utilities' offers to allow 50 percent of the appropriate legal and accounting costs as an offset against any calculated refund, and, as set out above, have chosen to do so in this case. The utility has shown that it had \$16,096 in appropriate legal and accounting fees for the 1994 fiscal year. Therefore, the refund is reduced by \$8,048, and the net refund for fiscal year 1994 is calculated to be \$74,239.

Fiscal Year 1995

Again, requesting that we offset the refund by 50 percent of the legal and accounting costs, the utility proposes a refund of

\$51,131, for fiscal year 1995 (ended May 31, 1996). We calculate that a refund of \$51,999 is appropriate for fiscal year 1995.

On February 15, 1999, the utility revised its 1995 annual report to remove \$374,019 of O&M expenses, that were originally reported as above-the-line expenses. Also, the utility allocated depreciation in the amount of \$326,800, below-the-line. Adjusting this amount by \$25,196 to reflect first year's depreciation, above-the-line, we calculate taxable income for the utility to be \$1,830,114 for fiscal year 1995.

The utility's revised 1995 CIAC report reveals that the utility received taxable CIAC of \$1,434,249 for fiscal year 1995, and deducting \$25,196 for the first year's depreciation and \$477,842 for CIAC associated with the purchase of existing systems not grossed up, we calculate net taxable CIAC to be \$931,211. The utility's revised 1995 CIAC report also indicates that the utility was operating at a loss before the inclusion of CIAC in income. 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. When CIAC in the amount of \$931,211 is netted against the calculated loss of \$127,339, the amount of taxable CIAC resulting in a tax liability is \$803,872. Using the 37.63 percent combined marginal federal and state tax rates as provided in the revised 1995 CIAC Report, we calculate net income taxes to be \$302,497. When this amount is multiplied by the expansion factor for gross-up taxes, the amount of gross-up required to pay the tax effect on the CIAC is calculated to be \$485,004. The utility collected \$546,104 of gross-up monies. Therefore, before any offset for legal and accounting fees is considered, the refund would be \$61,100.

However, we have previously accepted utilities' offers to allow 50 percent of the appropriate legal and accounting costs as an offset against any calculated refund. In this case, the utility has shown that it had \$18,202 appropriate legal and accounting fees for the 1995 fiscal year. Therefore, the refund is reduced by \$9,101, and the net refund for fiscal year 1995 is calculated to be \$51,999.

Fiscal Year 1996

By correspondence dated February 20, 1998, our staff advised NFMU that the disposition of gross-up collected for fiscal year

1996 (ended May 31, 1997) would be addressed in this docket and requested the utility to file its tax return and CIAC Gross-up report for 1996. The utility responded by letter dated June 24, 1998, stating that during the period of June 1 through June 12, 1996, it collected service availability and the related gross-up charges totaling \$2,753.82 from five contributors. On October 1, 1996, refunds in the amount of \$2,753.82 were made to the five contributors and the utility submitted canceled checks as proof that the refunds were made. Since the refunds to the five contributors have been made, there was no need for the utility to file a tax return for fiscal year 1996 and filing a 1996 CIAC Gross-up Report was not necessary.

Procedures for the Refund

For those contributors who have paid the full amount of the gross-up, the utility shall make a cash refund based on the contributors' pro rata share of the \$74,239 and \$51,999 overcharged amounts. The utility shall also refund interest accrued for the respective refunds from May 31, 1995, and May 31, 1996, to the date of the refund.

For those contributors who are paying by installment, the contributor may or may not have paid the full amount of gross-up the utility is entitled to collect. Therefore, for those contributors who are paying by installment, but have not paid the full amount of gross-up that the utility is entitled to collect for fiscal years 1994 and 1995, the utility shall reduce (credit) the principal amount due on their installment contracts by their pro rata share of the gross-up overcharge for 1994 and 1995, and collect the reduced amount of gross-up from the contributor. Further, for those contributors who are paying by installment, and have paid the full amount of the gross-up that the utility is entitled to collect for fiscal years 1994 and 1995, the utility shall make a cash refund of any excess gross-up and associated interest payments, and discontinue gross-up collections from those contributors. In addition, the utility shall also refund interest accrued on the excess gross-up and associated interest payments, at the escrow rate, from May 31, 1995, and May 31, 1996, to the date of refund.

The utility proposes, and we agree that each of these customers would be notified that the principal amount owing under their installment contract would be reduced by their pro rata share

of the refund amount. The utility has indicated that it is willing to make the appropriate calculations for the customer depending upon the year of the installment contract and notify the customers in accordance with that revision. This is a reasonable approach because the customers would get full benefit of the lower amount of gross-up owed, and the utility would not be required to make refunds to customers before payments are received from those customers.

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 canceled checks, credits applied to the 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.

REFUND OF PORTION OF 1995, 1996, AND 1997 PRICE INDEXES AND
REDUCTION OF RATES

NFMU implemented three price indexes as follows: a 1995 price index, effective August 5, 1995, which increased rates by 2.04 percent; a 1996 price index, effective August 13, 1996, which increased rates by 2.17 percent; and a 1997 price index, effective August 19, 1997, which increased rates by 1.53 percent. The utility did not file a price index for 1998. In a settlement proposal, the utility has offered to forego implementing price indexes for 1998-2000 as an alternative to refunding the over collections of the 1995, 1996, and 1997 indexes and reducing rates.

The utility estimates that it will forego \$118,183 in revenues by not implementing price indexes for 1998-2000. However, the utility's calculation does not include a deduction for excess revenues it has collected to date, but is not entitled to collect as a result of expenses being overstated in 1994-1997. According to our calculations, as of April 19, 1999, the utility would actually forego revenues of approximately \$48,324 (\$118,183 - \$69,859) by not implementing price indexes for 1998-2000. Also, the utility argued that it should not be required to refund the 1995-1997 price indexes because it did not exceed the range of its authorized return on equity during those years. Nonetheless, the utility's O&M expenses were overstated in 1994-1997 and, as a result, the utility implemented a higher rate increase than it was

entitled to. As further justification for rejecting the utility's offer, we note that unforeseen circumstances could force the utility to file for a rate case, and the offer of not implementing price indexes for 1998-2000 could be partially negated. Therefore, we reject the utility's offer to forego rate indexing increases for the years 1998-2000, and the utility shall refund that portion of the 1995-1997 price indexes related to the reclassification of expenses and reduce its rates accordingly.

On February 15, 1999, the utility revised its 1994, 1995 and 1996 annual reports to remove \$438,272, \$374,019, and \$296,841 of O&M expenses that were originally reported as above-the-line expenses. We have recalculated the 1995, 1996, and 1997 price indexes based on the expenses reported in the revised 1994, 1995 and 1996 annual reports. On an annual basis, revenues should be reduced by \$8,949, for 1995, \$9,751 for 1996, and \$6,621 for 1997 and the price index increases should have been only 1.31 percent, 1.52 percent, and 1.15 percent for 1995, 1996, and 1997, respectively.

As of April 19, 1999, NFMU shall refund a total of \$69,859 plus interest. The refunds shall be made with interest, as required by Rule 25-30.360(4), Florida Administrative Code. The utility shall submit the proper refund reports pursuant to Rule 25-30.360(7), Florida Administrative Code, within 90 days of the effective date of the Order. The refund shall be made to customers of record as of the date of the Order pursuant to Rule 25-30.360(3), Florida Administrative Code. The utility shall treat any unclaimed refunds as CIAC pursuant to Rule 25-30.360(8), Florida Administrative Code. Further, the utility shall lower its rates to reflect the appropriate price index rates shown below. A schedule of the utility's existing and the approved rates follows:

WASTEWATER

Monthly Rates

--Residential--	<u>Existing</u>	<u>Approved</u>
BASE FACILITY CHARGE	<u>Rates</u>	<u>Rates</u>
All Meter Sizes	\$ 10.98	\$ 10.79
GALLONAGE CHARGE per 1,000 gallons (Maximum 10,000 gallons)	\$ 3.98	\$ 3.91
--General Service--	<u>Existing</u>	<u>Approved</u>
BASE FACILITY CHARGE	<u>Rates</u>	<u>Rates</u>
<u>Meter Size</u>		
5/8 x 3/4"	\$ 10.81	\$ 10.62
1"	26.99	26.52
1 1/2"	53.98	53.06
2'	86.36	84.89
3"	172.70	169.74
4"	269.83	265.21
6"	539.78	530.52
GALLONAGE CHARGE per 1,000 gallons	\$ 3.98	\$ 3.91
--Multi-Residential--	<u>Existing</u>	<u>Approved</u>
BASE FACILITY CHARGE	<u>Rates</u>	<u>Rates</u>
PER UNIT	\$ 9.90	\$ 9.72
GALLONAGE CHARGE per 1,000 gallons	\$ 3.98	\$ 3.91

CLOSING OF DOCKET

Upon expiration of the PAA protest period, the docket shall remain open pending verification of the CIAC gross-up refunds and 1995, 1996, and 1997 price index refunds. Regardless of how North Fort Myers Utility, Inc., responds to the show cause portion of the Order, this docket shall remain open pending the processing of the

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refunds of the improperly implemented price indexes and the over collected CIAC gross-up funds. If the utility remits the penalties for its improper implementation of the 1995, 1996, and 1997 price indexes, and makes the refunds for the improperly implemented price indexes and over collection of CIAC gross-up, and there are no unclaimed refunds, the docket shall be closed. If the utility responds to the show cause order and requests a hearing, or there is a timely protest by a substantially affected person of the proposed agency action portion of this Order, this docket shall remain open for final disposition.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the settlement offer of North Fort Myers Utility, Inc., to offset the appropriate legal and accounting fees against the over collection of any contributions-in-aid-of-construction gross-up funds is hereby approved. It is further

ORDERED that, other than the portion of the Order to Show Cause, the provisions of this Order, issued as proposed agency action, shall become final and effective upon the issuance of a consummating order unless an appropriate petition, in the form provided by Rule 25-22.036, Florida Administrative Code, is received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings or Judicial Review" attached hereto. It is further

ORDERED that the request of North Fort Myers Utility, Inc., for a variance from Order No. PSC-96-1180-FOF-WS is granted and the tariffs for gross-up authority shall not be canceled. It is further

ORDERED that within 30 days of the date of the Order, North Fort Myers Utility, Inc., shall file revised tariff sheets to allow for the continued collection of gross-up on contributions-in-aid-of-construction paid in installments from customers that entered into installment contracts prior to June 12, 1996. It is further

ORDERED that once North Fort Myers Utility, Inc., has collected the entire amount of gross-up that it is entitled to receive from customers paying by installment, then it shall submit canceled tariff sheets to the Commission. It is further

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ORDERED that the schedule attached to this Order is incorporated into and made a part of this Order. It is further

ORDERED that pursuant to the settlement offer, as modified in the body of this Order, North Fort Myers Utility, Inc., shall refund excess gross-up of contributions-in-aid-of-construction in the amount of \$74,239 for fiscal year 1994 (ended May 31, 1995), and \$51,999 for fiscal year 1995 (ended May 31, 1996). It is further

ORDERED that no further refund is required for fiscal year 1996. It is further

ORDERED that the refunds shall be carried out as set forth in the body of this Order. It is further

ORDERED that North Fort Myers Utility, Inc., shall refund accrued interest from May 31, 1995 and May 31, 1996, through the date of refund, for gross-up of contributions-in-aid-of-construction collected in excess of the tax liability. It is further

ORDERED that, pursuant to Orders Nos. 16971 and 23541, all refund amounts shall be refunded on a pro rata basis to those persons who contributed the funds. It is further

ORDERED that the refunds required herein shall be completed within six months of the effective date of this Order, and that North Fort Myers Utility, Inc., shall submit copies of canceled checks, credits applied to monthly bills or other evidence verifying that the refunds have been made within 30 days of completion of the refund. It is further

ORDERED that within 30 days of completion of the refund, North Fort Myers Utility, Inc., shall provide a list of unclaimed refunds detailing the contributor and the amount, and an explanation of the efforts made to make the refunds. It is further

ORDERED by the Florida Public Service Commission that North Fort Myers Utility, Inc., shall show cause, in writing, within 21 days why a fine in the total amount of \$15,000 should not be imposed for the utility having improperly implemented three price indexes in apparent violation of Section 367.081(4), Florida Statutes. It is further

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ORDERED that any response to this Order to Show Cause must contain specific allegations of fact and law. It is further

ORDERED that any response to this Order to Show Cause be filed with the Director of the Division of Records and Reporting within 21 days of this Order. It is further

ORDERED that in the event that North Fort Myers Utility, Inc., files a written response which raises material questions of fact and requests a hearing pursuant to Section 120.57, Florida Statutes, further proceedings will be scheduled before final determination is made. It is further

ORDERED that if North Fort Myers Utility, Inc., fails to file a timely response to this Order to Show Cause, such failure shall constitute an admission of the facts alleged in the body of this Order and a waiver of any right to a hearing. It is further

ORDERED that if North Fort Myers Utility, Inc., fails to respond within 21 days of the issuance of this Order, the fine of \$15,000 shall be imposed without further action of this Commission. It is further

ORDERED that if reasonable collection efforts are unsuccessful, the collection of the fine shall be deemed uncollectible and shall be referred to the Department of Banking and Finance's Office of the Comptroller. It is further

ORDERED that if North Fort Myers Utility, Inc., responds to this Order to Show Cause by remitting the \$15,000, the show cause proceeding will be considered to be resolved. It is further

ORDERED that any payment shall be forwarded to the Comptroller's office for deposit in the State General Revenue Fund. It is further

ORDERED that North Fort Myers Utility, in addition to the show cause proceeding, shall be strongly admonished to file the most accurate information possible in future annual reports and price index applications. It is further

ORDERED that the settlement offer of North Fort Myers Utility, Inc., to forego price indexes for the years 1998-2000, and that it neither be required to refund any of the improperly collected price index revenues nor reduce its rates is rejected. It is further

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ORDERED that North Fort Myers Utility, Inc., shall refund, with interest, the portion of the revenues received as a result of the improper implementation of the price indexes for the years 1995, 1996, and 1997. It is further

ORDERED that the amount, before assessment of interest, is approximately \$69,859, as of April 19, 1999. It is further

ORDERED that the refunds shall be made with interest as required by Rule 25-30.360(4), Florida Administrative Code, within 90 days of the effective date of the Order. It is further

ORDERED that North Fort Myers Utility, Inc., shall submit the proper refund reports pursuant to Rule 25-30.360(7), Florida Administrative Code. It is further

ORDERED that the refund shall be made to customers of record as of the date of the Order pursuant to Rule 25-30.360(3), Florida Administrative Code. It is further

ORDERED that North Fort Myers Utility, Inc., shall treat any unclaimed refunds as contributions in aid of construction pursuant to Rule 25-30.360(8), Florida Administrative Code. It is further

ORDERED that North Fort Myers Utility, Inc., shall reduce its rates to reflect the appropriate price index rates as shown in the body of this Order. It is further

ORDERED that the docket shall be closed upon the PAA portion of the Order becoming final and after our staff's verification that over collected contributions-in-aid-of-construction gross-up funds and the improperly implemented price indexes have been properly refunded, and the reduction in rates and the show cause process have been completed.

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By ORDER of the Florida Public Service Commission this 25th
day of May, 1999.

BLANCA S. BAYÓ, Director
Division of Records and Reporting

By: Kay Flynn
Kay Flynn, Chief
Bureau of Records

(S E A L)

RRJ

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), 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.

As identified in the body of this order, our actions, except for the show cause portion of this order, are preliminary in nature. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, in the form provided by Rule 28-106.201, Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting, at 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on June 15, 1999. If such a petition is filed, mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing. In the absence of such a petition, this order shall become effective upon the issuance of a consummating order.

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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.

The show cause portion of this order is preliminary, procedural or intermediate in nature. Any person whose substantial interests are affected by this show cause order may file a response within 21 days of issuance of the show cause order as set forth herein. This response 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 June 15, 1999.

Failure to respond within the time set forth above shall constitute an admission of all facts and a waiver of the right to a hearing and a default pursuant to Rule 28-106.111(4), Florida Administrative Code. Such default shall be effective on the day subsequent to the above date.

If an adversely affected person fails to respond to this order within the time prescribed above, that party may request judicial review by the Florida Supreme Court in the case of any 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.

COMMISSION CALCULATED GROSS-UP

North Fort Myers Utility		1994	1995
SOURCE: (Line references are from Amended CIAC Reports)			
		-	-
1	Form 1120, Line 30 (Line 15) \$	809,618	\$ 1,830,114
2	Less CIAC (Line 7)	(619,015)	(1,434,249)
3	Less Gross-up collected (Line 19)	(355,431)	(546,104)
4	Add First Year's Depr on CIAC (Line 8)	22,120	25,196
5	Add/Less Other Effects (Lines 20 & 21)	(1,462)	(2,296)
6		-	-
7	Adjusted Income Before CIAC and Gross-up \$	(144,170)	\$ (127,339)
8			
9	Taxable CIAC (Line 7) \$	619,015	\$ 1,434,249
10	Less first years Depr. (Line 8)	(22,120)	(25,196)
		---	---
11	Adjusted Income After CIAC \$	452,725	\$ 1,281,714
12	Less CIAC associated with purchase of existing systems not grossed-up		(477,842)
13	Less: NOL Carry Forward	0	0
14		-	-
15	Net Taxable CIAC \$	452,725	\$ 803,872
16	Combined Marginal state & federal tax rates	37.63%	37.63%
17		-	-
18	Net Income tax on CIAC \$	170,360	\$ 302,497
19	Less ITC Realized	0	0
20		-	-
21	Net Income Tax \$	170,360	\$ 302,497
22	Expansion Factor for gross-up taxes	1.6033349	1.6033349
23		-	-
24	Gross-up Required to pay tax effect \$	273,144	\$ 485,004
25	Less CIAC Gross-up collected (Line 19)	(355,431)	(546,104)
26		-	-
27	(OVER) OR UNDER COLLECTION \$	(82,287)	\$ (61,100)
28		=	=
29	TOTAL YEARLY REFUND \$	(82,287)	\$ (61,100)
30		=	=
31	OFFSET OF LEGAL AND ACCOUNTING FEES \$	8,048	\$ 9,101
32		-	-
33	REFUND (excluding interest) \$	(74,239)	\$ (51,999)