

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Request by FLORIDA WATERWORKS)	DOCKET NO. 860184-PU
ASSOCIATION for investigation of)	
proposed repeal of Section 118(b),)	ORDER NO. 22859
Internal Revenue Code (Contributions-)	
in-aid-of-construction))	ISSUED: 4-26-90
)	

Pursuant to notice, a prehearing conference was held on April 20, 1990, before Chairman Michael McK. Wilson, as Prehearing Officer, in Tallahassee, Florida.

APPEARANCES: B. KENNETH GATLIN, Esquire, Gatlin, Woods, Carlson & Cowdery, 1709-D Mahan Drive, Tallahassee, Florida 32308
On behalf of the Florida Waterworks Association

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On behalf of Aloha Utilities, Inc., Canal Utilities, Inc., Clay Utility Company, Eagle Ridge Utilities, Inc., El Agua Corporation, and Martin Downs Utilities, Inc.

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On behalf of Alafaya Utilities, Inc., Aloha Utilities, Inc., Canal Utilities, Inc., Clay Utility Company, Eagle Ridge Utilities, Inc., El Agua Utilities, Inc., Kingsley Service Company, Lehigh Utilities, Inc., Martin Downs Utilities, Inc., Neighborhood Utilities, Inc., North Fort Myers Utility, Inc., Rolling Oaks Utilities, Inc., Royal Utility Company, Inc., and Southside Utilities, Inc.

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On behalf of the Florida Home Builders Association and Southwest Florida Capital Corporation

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PSC-RECORDS/REPORTING

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 2

APPEARANCES: ROBERT J. PIERSON, Esquire, Florida Public
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On behalf of the Commission Staff

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Counsel to the Commission

PREHEARING ORDER

I. Case Background

By Order No. 16971, issued December 18, 1986, this Commission authorized corporate water and wastewater utilities to elect to "gross-up" contributions-in-aid-of- construction (CIAC) in order to offset the tax impact of an amendment to Section 118(b), Internal Revenue Code, under the Tax Reform Act of 1986. To date, forty-four water and/or wastewater utilities have elected to implement the gross-up.

By Order No. 21266, issued May 22, 1989, this Commission proposed to establish guidelines to control the collection of the gross-up. On or about June 12, 1989, Alafaya Utilities, Inc., Aloha Utilities, Inc., Canal Utilities, Inc., Clay Utility Company, Eagle Ridge Utilities, Inc., El Agua Utilities, Inc., Kingsley Service Company, Lehigh Utilities, Inc., Martin Downs Utilities, Inc., Neighborhood Utilities, Inc., North Fort Myers Utility, Inc., Rolling Oaks Utilities, Inc., Royal Utility Company, Inc., and Southside Utilities, Inc. (21266 Petitioners) protested Order No. 21266.

On June 13, 1989, Florida Home Development Corporation (FHDC) filed a petition on Order No. 21266; however, its petition was untimely. Accordingly, FHDC's petition was treated as a petition to intervene. By Order No. 21921, issued September 19, 1989, FHDC was granted status as an intervenor in these proceedings.

By Order No. 21436, issued June 26, 1989, we proposed to require a number of utilities to refund amounts of the gross-up collected or to make adjustments to their depreciation reserves. On or about July 17, 1989, Aloha Utilities, Inc.,

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 3

Canal Utilities, Inc., Clay Utility Company, Eagle Ridge Utilities, Inc., El Agua Utilities, Inc., and Martin Downs Utilities, Inc. (21436 Petitioners) protested Order No. 21436.

As a result of the petitioners' protests, this case is set for an administrative hearing on April 27, 1990.

II. Prefiled Testimony and Exhibits

Testimony of all witnesses to be sponsored by the parties and the Staff of this Commission (Staff) has been prefiled. All testimony which has been prefiled in this case will be inserted into the record as though read after the witness has taken the stand and affirmed the correctness of the testimony and associated exhibits. All testimony remains subject to appropriate objections. Each witness will have the opportunity to orally summarize his or her testimony at the time he or she takes the stand. Upon insertion of a witness' testimony, exhibits appended thereto may be marked for identification. After all parties and Staff have had the opportunity to object and cross-examine, the exhibit may be moved into the record. All other exhibits may be similarly identified and entered into the record at the appropriate time during the hearing.

Witnesses are reminded that, on cross-examination, responses to questions calling for a simple yes or no answer shall be so answered first, after which the witness may explain his or her answer.

III. Order of Witnesses

<u>Witness</u>	<u>Appearing for</u>	<u>Issues</u>
<u>Direct</u>		
James H. Anderson, CPA	21436 Petitioners	6 - 9
Jim L. Bowen, CPA	21436 Petitioners	6 - 9
Robert H. Jackson, CPA	21436 Petitioners	6-9, 17
Charles R. Wintz, CPA	21436 Petitioners	6 - 9
F.M. Deterding, Esquire	21436 Petitioners	6-9, 17, 18, 28

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 4

<u>Witness</u>	<u>Appearing for</u>	<u>Issues</u>
Thomas L. Elliott, III	FWWA	1, 3, 10
J. Peter Martin	21266 Petitioners	1, 3, 11-18, 23
W. Larry O'Steen	21266 Petitioners	11, 12, 14, 15, 23
Robert C. Nixon	21266 Petitioners	1-5, 9, 11-18, 20-27
Ann P. Causseaux	Staff	1 - 9

Rebuttal

Thomas L. Elliott, III	21436 Petitioners	1-9, 17 (policy), 18, 23, 28
Robert C. Nixon	21266 Petitioners	1-5, 9, 11-18, 20-27
Thomas L. Elliott, III	FWWA	1, 3, 10
Ann P. Causseaux	Staff	1 - 9

IV. Basic Positions

FWWA: The guidelines set forth in Order No 21266 are too restrictive and narrow to allow for reasonable and prudent regulation of Florida's water and wastewater utilities pertaining to the issue of funding income taxes on CIAC. These guidelines regarding this issue should be broadened to permit treatments which more properly balance the interests of water and wastewater utilities and the utilities' customers given the economic and other circumstances faced by the members of this industry.

21266 PETITIONERS: The Commission's proposed changes to the gross-up authority, as outlined in Order No. 21266, are contrary to the Commission's past policy with regard to the imposition of costs upon the "cost-causers," will result in increased rates to customers to pay for growth, and is

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 5

discriminatory. The stated or implied assumptions which form the basis for the change in gross-up policy, as enumerated by Order No. 21266, are contrary to fact.

21436 PETITIONERS: The income tax benefits or obligations which result from a transaction are a direct result of and a part of that transaction. The regulatory treatment of the tax benefit or obligation should be consistent with the regulatory treatment of the transaction which gave rise to the tax consequence. Order No. 21436 requires a utility to, in effect, follow a no gross-up policy with regard to funding income taxes on CIAC when the utility is in a net operating loss (NOL) or investment tax credit (ITC) carryforward position, or for some other reason does not currently pay, in cash, income taxes on CIAC. This no gross-up requirement is inappropriate because: under no circumstances could have created the NOL or ITC carryforward; the transfer of NOL or ITC benefits to the contributor will result in a windfall to the contributor and increased future revenue requirements; NOLs and ITCs are economic assets and the Commission should not treat these assets any differently than other assets, and; the principles set forth in Order No. 21436 may have discriminatory effects.

FHDC: FHDC supports the approach of Order No. 21266 which allows the gross-up under limited circumstances. However, FHDC believes that Order No. 21266 should be modified in four specific ways. First, the financial ability of the utility to meet the tax liability resulting from its collection of CIAC should be based upon the utility's revenue requirement, not merely its cash flow. Second, the utility should be required to show in its request for authority to gross-up that the gross-up is the most cost-effective alternative for handling the tax liability. Third, the utility should be required to show in its request that persons whose interests may be substantially affected by the gross-up have been given notice of the request. Fourth, the utility should be required to repay to the party paying the gross-up the tax savings obtained in subsequent years.

FHBA: FHBA supports the approach of Order No. 21266 which allows the gross-up under limited circumstances. However, FHBA believes that Order No. 21266 should be modified in four specific ways. First, the financial ability of the utility to meet the tax liability resulting from its collection of CIAC should be based upon the utility's revenue requirement, not

ORDER NO. 22859
 DOCKET NO. 860184-PU
 PAGE 6

merely its cash flow. Second, the utility should be required to show in its request for authority to gross-up that the gross-up is the most cost-effective alternative for handling the tax liability. Third, the utility should be required to show in its request that persons whose interests may be substantially affected by the gross-up have been given notice of the request. Fourth, the utility should be required to repay to the party paying the gross-up the tax savings obtained in subsequent years.

STAFF: The tax expense associated with the receipt of CIAC is a cost of doing business like any other cost of doing business. No gross-up should be allowed except in cases where special need has been demonstrated through a financial test and a showing that alternative financing is not available at a reasonable cost. The normal calculation of the utility's taxable income and tax liability will consume any available net operating tax losses and investment tax credits. Any net tax liability due to CIAC is the amount that may be offset by a CIAC gross-up. Accounting for the tax effect of the CIAC should be normalization. When there is a gross-up, the tax-on-tax effect should be treated as an expense of the period.

V. Issues and Positions

Issues of Staff

1. ISSUE: Should a gross-up be allowed for the tax effect of CIAC?

POSITIONS

FWWA: Yes, at the option of the utility. (Elliott)

21266 PETITIONERS: Yes, at the option of the utility. (Martin, Nixon)

21436 PETITIONERS: Yes. (Elliott)

SFCC/FHBA: A gross-up should be allowed when need has been established on a case-by-case basis. To obtain the gross-up, the utility must show that without allowing for gross-up the function, operation, expansion and financial ability of the utility will be impaired.

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 7

STAFF: A gross-up should be allowed when need has been proven on a case-by-case basis. Alternatively, a full gross-up should be required without exception. (Causseaux)

2. ISSUE: How should the gross-up be calculated?

POSITIONS:

FWWA: Full gross-up or present value at option of utility.

21266 PETITIONERS: Options should be left open to management to demonstrate the appropriateness of the full gross-up, net present value gross-up, or other method that management deems appropriate for a given utility. Full gross-up would, however, be the norm. (Nixon)

21436 PETITIONERS: Yes. (Elliott)

SFCC/FHBA: Unless it can be shown that the utility's ability to operate will be impaired, the gross-up, if any, should not be greater than the net present value difference involving the timing of tax benefits. Only the smallest taxpaying companies should get a full gross-up, and then only after a showing that actual tax is being paid.

In any case where gross-up is allowed, governmental bodies should be exempted, and the depreciation benefits should be returned to the customer paying the gross-up. This latter repayment, to be equitable, must be based only on actual tax savings to a utility if the gross-up is based on actual tax increase. If a gross-up is based on potential tax liability, then the repayment should use the same standard.

STAFF: The calculation should result in collection of the full gross-up.

3. ISSUE: How is need for a gross-up to be determined?

POSITIONS

FWWA: At option of utility. (Elliott)

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 8

21266 PETITIONERS: The need for gross-up should be left solely to the determination by management, who is in the best position to determine such need. Current Commission procedures for review of gross-up authority fully protect contributors. Any current year losses or prior year losses which provide the utility with an off-set to the tax resulting from CIAC, would not be a criteria upon which the gross-up authority is approved or disapproved. (Martin and Nixon)

21436 PETITIONERS: As reflected in Petitioners' basic position. (Elliott)

SFCC/FHBA: At a minimum, a utility's request for authority to gross-up should demonstrate that:

- a. there exists an actual tax liability resulting from its collection of CIAC;
- b. based upon need, it is financially unable to meet the tax liability resulting from its collection of the CIAC;
- c. the gross-up is the most cost-effective alternative for handling the tax liability;
- d. persons whose interests may be substantially affected by the gross-up have been given notice of the utility's request to implement the gross-up, and
- e. the utility has made provisions to repay to the party paying the gross-up the tax savings that will be obtained in subsequent years.

STAFF: Need should be determined by use of a financial integrity test and a showing that alternate financing was not available at a reasonable cost. (Causseaux)

4. ISSUE: What is the appropriate accounting and ratemaking treatment when there is no gross-up?

POSITIONS

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 9

FWWA: Investment in taxes should go in rate base without any used and useful adjustments.

21266 PETITIONERS: The appropriate accounting and rate making treatment is to normalize the full tax impact of CIAC by recognizing a deferred debit, which must be considered in rate setting, and ultimately paid for by the general body of rate payers. The deferred debit arising from such investment in tax should be recognized as an investment in rate setting separately, regardless of whether the formula approach or balance sheet approach to working capital is utilized in rate setting. (Nixon)

21436 PETITIONERS: U.S. Income Tax normalization accounting should be followed. (Elliott)

SFCC/FHBA: No position at this time.

STAFF: Normalization accounting should be followed. The used and useful utility investment in taxes should earn a return. (Causseaux)

5. ISSUE: What is the appropriate accounting and ratemaking treatment when there is a gross-up?

POSITIONS

FWWA: It should have no effect on the rates.

21266 PETITIONERS: Normalization of the full gross-up amount is the simplest, least cumbersome accounting and rate making treatment, and should be utilized. (Nixon)

21436 PETITIONERS: U.S. Tax Normalization. (Elliott)

SFCC/FHBA: There are different types of gross-up. If net present value gross-up is utilized, then there should be no effect on ratemaking accounting books. If full gross-up is utilized then a liability account for depreciation return to the contributor should be created, and tax books should become public record and part of the ratemaking process.

For accounting and tax purposes it should be noted that depreciation benefits are only allowable on the value of contributed property and not for cash gross-up amounts.

ORDER NO. 22859
 DOCKET NO. 860184-PU
 PAGE 10

STAFF: The tax-on-tax effect should be treated as an expense of the period. Normalization accounting should be followed for the remainder of the gross-up. (Causseaux)

6. ISSUE: Should the taxable income from CIAC and the gross-up be offset by net operating tax losses?

POSITIONS

FWWA: No.

21266 PETITIONERS: No position.

21436 PETITIONERS: No. (Anderson, Bowen, Deterding, Elliott, Jackson, Wintz)

SFCC/FHBA: Yes.

STAFF: Yes, taxable income from CIAC and the gross-up should be offset by net operating tax losses. Regulation should recognize that offset. (Causseaux)

7. ISSUE: Should the tax liability from CIAC and the gross-up be offset by investment tax credits?

POSITIONS

FWWA: No.

21266 PETITIONERS: No position.

21436 PETITIONERS: No. (Anderson, Bowen, Deterding, Elliott, Jackson, Wintz)

SFCC/FHBA: Yes.

STAFF: Yes, the tax liability from CIAC and the gross-up should be offset by investment tax credits. Regulation should recognize that offset. (Causseaux)

8. ISSUE: Does use of the net operating tax losses and investment tax credits as offsets violate the normalization provisions of Sections 46, 167, or 168 of the Internal Revenue Code or the underlying Regulations?

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 11

POSITIONS

FWWA: No position.

21266 PETITIONERS: No position.

21436 PETITIONERS: No. Not if the cost of the benefit is not paid for by ratepayers in accordance with tax normalization requirements. (Anderson, Bowen, Deterding, Elliott, Jackson, Wintz)

SFCC/FHBA: No.

STAFF: No. (Causseaux)

9. ISSUE: Should the gross-up be refunded in total or in part, with interest, if a utility incurred a tax liability less than the gross-up collected during a given tax year?

POSITIONS

FWWA: No.

21266 PETITIONERS: No position, except with regard to interest calculation. Any refunds necessitated as a result of what is ultimately determined to be "excessive" gross-up received by the utility, should be based upon the interest rate earned in the escrow account. Since the utility does not have full use of these monies, use of the interest calculations contained in Commission Rule 25-30.360 are inappropriate. (Nixon)

21436 PETITIONERS: No. (Anderson, Bowen, Deterding, Elliott, Jackson, Wintz)

SFCC/FHBA: Yes, although interest on any amount refunded need not be paid.

STAFF: Yes. (Causseaux)

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 12

Issues of 21266 Petitioners

10. ISSUE: Should the policy adopted by the Commission by Order 16971 be in effect so that water and wastewater utilities are allowed to amend their service availability policies in order to meet the tax impact of their collections of CIAC resulting from the amendment of Section 118(b), Internal Revenue Code.

POSITIONS

FWWA: Yes. (Elliott)

21266 PETITIONERS: The policy adopted by the Commission in Order No. 16971, is to allow the water and sewer utilities subject to the Commission's jurisdiction to amend their service availability policies to meet the tax impact of CIAC at management's discretion. This policy should be in effect currently, and should continue in the future.

21436 PETITIONERS: No position.

SFCC/FHBA: No position at this time.

STAFF: No.

11. ISSUE: Was Commission Order No. 16971 issued solely for the purpose of alleviating cash flow problems related to the gross-up of CIAC?

POSITIONS

FWWA: No.

21266 PETITIONERS: No, while cash flow difficulties were, and are a major concern related to taxation of CIAC, many other considerations, including the inappropriateness of requiring system rate payers to pay for the cost related to growth; increased risk through a utility assuming financial interest in the success of a development; increased cost of debt and decreased availability of debt financing; regular and continuing requirements for increased rates, and as such frequent rate cases; and the inability of a utility to ever achieve its authorized rate of return because of

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 13

regulatory lag and continual recurring required investment in tax, also play key roles in the determination that discretionary gross-up of CIAC was an appropriate course for the Commission and the industry. (Martin, O'Steen, and Nixon)

21436 PETITIONERS: No position.

SFCC/FHBA: No position at this time.

STAFF: The order speaks for itself.

12. ISSUE: In situations where a utility is not authorized to gross-up CIAC for the related tax impact under the criteria proposed in Order No. 21266, will the utility be able to obtain debt financing for such tax liability, and what difficulties will be encountered in obtaining such financing, if available?

POSITIONS

FWWA: Agree with Order No. 21266.

21266 PETITIONERS: Debt financing will likely be unavailable for these recurring cash needs to pay tax on CIAC. To the extent it is available, it will likely be at substantial increased cost, of shorter duration, and with more restrictive terms than available for capital improvement needs. (Martin, O'Steen, Nixon)

21436 PETITIONERS: No position.

SFCC/FHBA: Yes. First, the criteria set forth in Order No. 21266 set cash flow as a standard for need. Debt financing and an ability to expand are a function of cash flow. Second, long term cash flow is obtained from the utilization of the depreciation benefits from CIAC property. This cash flow source will be evaluated by lenders in determining "coverage" for lender requirements. It is important to note that the primary focus of a lender is "cash flow" available to cover debt service, the concept found in Order No. 21266.

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 14

STAFF: This issue can only be answered on a case-by-case basis. If debt is unavailable, not readily available, or available only at an unreasonable cost, the gross-up would be allowed under Order No. 21266.

13. ISSUE: Is the demonstration of need for gross-up authority proposed in Order No. 21266 to be a one-time demonstration, or a continuing and periodic requirement?

POSITIONS

FWWA: Apparently not.

21266 PETITIONERS: While Order No. 21266 does not speak to this point, indications at the Agenda Conference were that an annual demonstration of need may be required. Such a requirement would not only be costly, but would result in high fluctuations in service availability charges, and could have a severe impact on the ability of a utility to obtain financing through the use of bonds or other long-term debt. (Martin, Nixon)

21436 PETITIONERS: No position.

SFCC/FHBA: A continuing and periodic requirement. However, once granted, gross-up should continue until either the utility or a customer requests a change. If gross-up is not granted for one year, the utility may reapply in a future year.

STAFF: No position at this time.

14. ISSUE: In situations where a utility is authorized under the proposed criteria in Order No. 21266 to gross-up CIAC for the related tax impact, how will the frequency of the required demonstration of continuing need for that gross-up authority impact the utility's ability to borrow funds for needed capital improvements?

POSITIONS

FWWA: Agree with Order No. 21266.

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 15

21266 PETITIONERS: Yes, if such demonstration of need is required on an annual basis, it could have a severe impact on the ability of a utility to borrow funds for needed physical assets. (Martin, O'Steen, Nixon)

21436 PETITIONERS: No position.

SFCC/FHBA: There will be no impact. If granted, a later charge will be based upon the utility's ability to meet needs and coverage requirements for lenders. Further, for each year assets are placed on the utility's books, depreciation to offset future cash requirements is created.

STAFF: No position at this time.

15. ISSUE: If situations where a utility is not authorized to gross-up under the criteria established in Order No. 21266, will its ability to obtain financing for needed capital additions be impacted by its other borrowings, or capital needed to invest in taxes related to the receipt of CIAC?

POSITIONS

FWWA: Yes.

21266 PETITIONERS: Yes, financing of taxes related to CIAC can place the members of an already highly leveraged industry into even higher leveraging to pay for taxes on CIAC. This will most likely result in restrictions upon the utility's ability to obtain needed financing for the addition of necessary capital improvements. (Martin, O'Steen, Nixon)

21436 PETITIONERS: No position.

SFCC/FHBA: No. Criteria should not be established which requires borrowing from institutional sources to fund CIAC tax. However, on information and belief only 37 of 700 companies use the gross-up procedure, and these companies may be collecting significantly more money in contributions than is required for tax funding, and without having to account for the extra revenue.

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 16

STAFF: This can only be answered on a case-by-case basis. Adverse impacts would be a consideration in determining need.

16. ISSUE: Are there any valid methods reasonably available for avoidance of taxation on CIAC by regulated utilities?

POSITIONS

FWWA: No.

21266 PETITIONERS: There are no legally available methods for avoidance of taxation on receipt of CIAC based upon the IRS position taken in Internal Revenue Bulletin No. 87-82, dated December 3, 1987. (Martin, Nixon)

21436 PETITIONERS: No position.

SFCC/FHBA: No. However there are many methods available to reduce the amount of tax below that which is required by full CIAC gross-up.

STAFF: Staff does not preclude the existence of methods to avoid taxation of CIAC.

17. ISSUE: If taxation on receipt of CIAC is unavoidable, (factual question) from whom can the utility collect these funds and (policy question) who should bear this responsibility?

POSITIONS

FWWA: Should be at the option of the utility.

21266 PETITIONERS: Tax on the receipt of CIAC must be paid for by either the utility's general body of rate payers, or by contributors. If the contributors are not charged for this cost, the general body of rate payers, by necessity, will pay these costs. Contributors of CIAC should be responsible for payment of the taxes related to that CIAC in situations where the payment of such taxes by the utility will have a material effect on its ability to earn its authorized rate of return or on rates of customers.

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 17

Any circumstances, including competitive pressures or immateriality of the payment of taxes, may result in gross-up of CIAC not being necessary. Because the particular circumstances of each utility are different, the decision should be left to the utility management to assess these factors and determine the appropriateness of gross-up in the particular circumstances. (Martin, Nixon)

21436 PETITIONERS: (Fact question) No position. (Policy question) Contributors. (Deterding, Elliott, Jackson)

SFCC/FHBA: If income to the utility generates income taxes, the utility (i.e., the general body of ratepayers) should bear the responsibility for paying those taxes, irrespective of the source of the income. To do otherwise is to misidentify the CIAC contributor as the incremental cost-causer. However, if the utility demonstrates the need to gross-up the CIAC to handle the tax effects (as contemplated in Order No. 21266 and as addressed by SFCC/FHBA in its basic position and in response to Issue 3) the utility should look for a method of generating the tax that does not trigger the highest marginal rate. One way to do this is to borrow the money from the developer. In any event, whoever bears the responsibility for the tax on the CIAC should also derive the benefits of the tax treatment of the CIAC (e.g. - depreciation). Developers should not be subsidized by shareholders or ratepayers, but handling the tax due on CIAC should not create a windfall for the shareholders or ratepayers at the expense of the developer.

STAFF: If taxes have not been avoided, the utility can collect the funds from the contributor, the general body of ratepayers, or invest in the taxes itself. The utility is ultimately responsible for the costs incurred in operations.

18. ISSUE: In situations where a utility is authorized to gross-up contributions for the related tax impact, does this properly assign the cost of taxation on CIAC to the cost-causer?

POSITIONS

FWWA: No position.

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 18

21266 PETITIONERS: Allowing gross-up of CIAC does properly assign the cost of taxation on CIAC to the cost-causer. Where gross-up is not authorized, the effect is to assign this cost of tax related to new customers to the general body of rate payers. (Martin, Nixon)

21436 PETITIONERS: Yes. Agree with 21266 Petitioners. (Elliott, Deterding)

SFCC/FHBA: No. There will be no income tax on CIAC unless the total income for the utility during the fiscal year exceeds the total expenses. In other words, unless there is profit there will not be tax. Treating the contributor of the CIAC as the sole cause of that incremental taxable income is to misidentify him as the cost causer.

STAFF: No position at this time.

19. ISSUE: Under what circumstances will the cost related to tax on CIAC have a material impact on the rates, and the frequency of need to file for rate relief, for those utilities who choose not to implement, or are denied authority to implement the gross-up authority?

POSITIONS

FWWA: No position.

21266 PETITIONERS: In those circumstances where a utility has a material amount of growth, and therefore a material amount of contributions, the impact on revenue requirements and rates of a utility who, for whatever reason, does not gross-up contributions for the related tax impact, will be material. Therefore, this investment in tax will require frequent, if not yearly, need for increased rate applications for such company, and the costs of those applications will have to be passed on to the general body of rate payers as well.

21436 PETITIONERS: No position.

SFCC/FHBA: Unknown. In fact, whether failure to gross-up has a material adverse effect on the general body of ratepayers can only be determined on a case by case basis.

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 19

One may infer from the fact that few utilities have had the need to gross-up, that in most situations failure to allow the gross-up does not have a material adverse impact on the utility. Therefore, it is appropriate that the utility be required to demonstrate the need to gross-up and that this required demonstration be periodic.

Nevertheless, one can predict a material adverse impact under circumstances where large contributions are made to taxpaying utilities. This impact, however, will only be for a short time. If tax cost (on a net basis) becomes an element in ratemaking, then depreciation benefits will later offset these charges. After a few years, in almost all circumstances, income on CIAC property contributions will be offset by depreciation on contributed property.

STAFF: This issue is more properly addressed on a case-by-case basis. "Materiality" varies from utility to utility.

20. ISSUE: Will a utility with regular and material growth in its system ever be able to achieve its authorized rate of return if it is not authorized the authority to gross-up CIAC?

POSITIONS

FWWA: No position.

21266 PETITIONERS: No. Because of regulatory lag, and the continuing yearly requirement for additional investment in taxes under such circumstances, such a utility will never be able to achieve its authorized rate of return because almost immediately after rate setting, additional contributions, and therefore additional investment in tax, will be required. (Nixon)

21436 PETITIONERS: No position.

SFCC/FHBA: Yes. First, although a utility may have regular and material growth, it is rare that material assets in large quantities are contributed on an every year basis. This results because once lines are built, there is fill-in use for the lines over subsequent years. However,

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 20

only a handful of utilities could possibly experience this problem. Thus, once again, a case by case analysis is the best approach to handling predicted problems for utilities that need gross-up.

Second, as CIAC property is contributed depreciation benefits are generated. The cost of contributions in Year 2 is offset by depreciation of property contributed in Years 1 and 2. Income from contributions in Year 6 is offset by depreciation on property contributed in Years 1 through 6. Each year the cost decreases. For example, if a utility had equal contributions every year, by Year 7, 40 percent of the income would offset, and with income decreasing each year, the utility would reach a crossover point where depreciation will exceed contribution income. To reiterate, however, it is unlikely that a utility will receive extended high percentage contributions over a ten to twenty year period.

STAFF: This issue is more properly addressed on a case-by-case basis. "Materiality" varies from utility to utility.

21. ISSUE: Who should receive the depreciation benefits of the allowance of tax depreciation on CIAC?

POSITIONS

FWWA: Ratepayer.

21266 PETITIONERS: Despite some allegations in both the testimony of Ms. Causseaux and in the comments made at the Agenda Conference which led to the entry of Order No. 21266, regulated water and sewer utilities recognize that in keeping with general Commission policy, depreciation benefits accruing to the utility on CIAC will be passed on to rate payers. In the alternative the Commission may be able to devise an appropriate method for return of those benefits to contributors if such a method can be devised which is not overly burdensome on the utility's recordkeeping functions. (Nixon)

21436 PETITIONERS: No position.

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 21

SFCC/FHBA: If no gross-up the utility should receive tax benefits. If full gross-up the party paying the tax should receive the benefit. However, with partial gross-up the method adopted will vary and the party equitably entitled to the tax benefits, or the extent to which the contributor is entitled to tax benefits will vary.

STAFF: No position at this time.

22. ISSUE: Are there any circumstances under which it is feasible to attempt to provide those benefits, as received, to the contributor of the related CIAC? If so, under what circumstances?

POSITIONS

FWWA: No position.

21266 PETITIONERS: Providing those benefits of depreciation on CIAC to the contributor of CIAC may be possible if strictly limited. Any attempt to provide each contributor with a pro rata share of those depreciation benefits would result in unmanageable additional bookkeeping tasks. (Nixon)

21436 PETITIONERS: No position.

SFCC/FHBA: Any contributor of significant CIAC who pays a substantial tax as a result, should receive the tax benefits as the utility receives the.

Yes. If there is a full gross-up on an assumed tax rate, regardless of the actual tax paid, the contributor should receive the depreciation benefit based upon the maximum tax rate for that year, on the assumption that the utility paid in that rate. This approach will standardize all assumptions. If there is a de minimis customer and gross-up is charged without tax benefits being repaid, then the benefit not refunded should go to ratepayers, based upon the same assumptions.

STAFF: No position at this time.

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 22

23. ISSUE: When a utility does not gross-up CIAC and pays the taxes on that CIAC, should that tax payment be considered an investment of that utility, be included in rate base without any used and useful adjustment, and should the utility be able to earn a return on the full investment?

POSITIONS

FWWA: Yes.

21266 PETITIONERS: Yes, the Commission must recognize the investment in taxes related to this contributed property, regardless of whether that property is being utilized to provide service to the maximum number of customers since the alternative is to require an investment in that property, without compensation. This troublesome conclusion is one of the main reasons why a continuation of an optional gross-up authority at management's discretions is necessary. (Martin, O'Steen, Nixon)

21436 PETITIONERS: The utility should receive a return on its investment regardless of whether the investment is in cash or tax assets. (Elliott)

SFCC/FHBA: Perhaps. If the tax actually paid is included as an element of investment, then depreciation benefits to the extent of the tax paid should reduce the investment or otherwise be included in rate base calculations.

STAFF: The tax payment should be considered an investment with used and useful adjustments made. For the sake of simplicity, the used and useful portion should be included in rate base.

24. ISSUE: Is there any factual basis for the assertion that the costs of increased CIAC and tax impact charges donated by developers are ultimately borne by the home buyer?

POSITIONS

FWWA: No position.

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 23

21266 PETITIONERS: No. Generally speaking, the cost to developers for utility services cannot be expected to be passed on dollar for dollar to the home buyer, since prices for the developer's product are controlled by market conditions, not by direct cost. (Nixon)

21436 PETITIONERS: No position.

SFCC/FHBA: No. Further, even if costs can be passed on to a home buyer there is no reason for a home buyer or the developers to overpay because of an unnecessarily high tax rate.

STAFF: It is the developer who determines what costs are included in the price of his homes.

25. ISSUE: Is there a factual basis for the assertion that cash CIAC is typically collected from individual customers?

POSITIONS

FWWA: No position.

21266 PETITIONERS: No. In fact, in the great majority of cases, cash CIAC is collected from developers. (Nixon)

21436 PETITIONERS: No position.

SFCC/FHBA: No. Cash CIAC is collected from customers. These customers may be individuals, may be developers, may be municipalities, and may be school boards, hospitals, etc.

STAFF: CIAC is collected from developers and individuals. The circumstances of the individual utility would be a determining factor.

26. ISSUE: What is the effect on a utility of the suggestion that cash CIAC can be utilized to meet the tax liability related to the receipt of such CIAC?

POSITIONS

FWWA: No position.

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 24

21266 PETITIONERS: That cash CIAC should theoretically be utilized to retire the debt or other capital which initially funded the plant now funded by CIAC. Ultimately, a policy to use that cash for payment of taxes would result in a debt substantially exceeding rate base, and therefore a very unstable and risky capital structure for the regulated utility. (Nixon)

21436 PETITIONERS: No position.

SFCC/FHBA: No position at this time.

STAFF: If cash CIAC is used to pay taxes, that amount of cash will not be available for the intended use.

27. ISSUE: What is the factual basis for the assertion that gross-up of CIAC places private utilities at a competitive disadvantage with governmentally owned systems, or that the utilization of the gross-up authority has resulted in greater use of septic tanks by developers?

POSITIONS

FWWA: No position.

21266 PETITIONERS: There is no factual basis for any such assertion. In fact, a polling of those utilities who have chosen to gross-up found that none were aware of any situation in which developers had chosen governmentally owned systems over private utilities as a result of the gross-up, and in fact, private utilities' service availability charges with gross-up are quite often lower than those for local governments. Restrictions on the use of septic tanks by developers, and their cost, often makes this alternative more expensive than gross-up. a poll of those companies who have chosen to utilize the authority to gross-up found that none were aware of any situation in which a developer has chosen to use septic tanks because of the cost of paying the gross-up to a utility. (Nixon)

21436 PETITIONERS: No position.

SFCC/FHBA: Gross-up, if utilized could put a utility in a competitive disadvantage. SFCC presently has a portion of its project outside of a private utility franchise area,

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 25

and with full CIAC gross-up, will bring the County utility to that site. Further, SFCC knows of actual projects utilizing septic tanks because of the CIAC gross-up cost.

STAFF: Statements in the petition of Jacksonville Suburban Utilities Corporation.

Issues of 21436 Petitioners

28. ISSUE: Is the requirement of Order No. 21436 that Petitioners "refund" funds as set forth in Order No. 21436 to contributors of taxes on CIAC in accordance with Section 367.101, Florida Statutes, just and reasonable?

POSITIONS

FWWA: No position.

21266 PETITIONERS: No position.

21436 PETITIONERS: No. (Elliott, Deterding)

SFCC/FHBA: Yes.

STAFF: Yes.

29. ISSUE: Does Order No. 21436 confiscate Petitioners' property without just or fair compensation, and in violation of Petitioners' right to due process?

POSITIONS

FWWA: No position.

21266 PETITIONERS: No position.

21436 PETITIONERS: Yes. (Legal position)

SFCC/FHBA: No.

STAFF: No.

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 26

30. ISSUE: The first sentence on page 2 of Order No. 21436 states as follows:

We believe that the correct interpretation of the refund requirements is that utilities should refund all contributed taxes in excess of taxes actually paid as result of their collection of CIAC.

Is this sentence a statement of Florida Public Service Commission policy?

POSITIONS

FWWA: No position.

21266 PETITIONERS: No position.

21436 PETITIONERS: Yes. (Legal position)

SFCC/FHBA: No position at this time.

STAFF: This Order speaks for itself; however, it has been protested and has no further force or effect.

31. ISSUE: The third sentence on page 2 of Order No. 21436 states as follows:

Our interpretation will have the effect of transferring the benefits of operating loss carryforwards, less the first year's tax depreciation, to those who contributed taxes on CIAC, rather than preserving them for the future benefit of the rate payers.

Is the above-quoted sentence a statement of Florida Public Service Commission policy?

POSITIONS

FWWA: No position.

21266 PETITIONERS: No position.

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 27

21436 PETITIONERS: Yes. (Legal position)

SFCC/FHBA: No position at this time.

STAFF: The Order speaks for itself; however, it has been protested and has no further force or effect.

32. ISSUE: If implemented, would transferring the benefits of net operating loss carryforwards, less the first year's depreciation, to those who have contributed taxes on CIAC be an action pursuant to Section 367.101, Florida Statutes?

POSITIONS

FWWA: No position.

21266 PETITIONERS: No position.

21436 PETITIONERS: Yes. (Legal position)

SFCC/FHBA: No position at this time.

STAFF: In part.

VI. Proposed Stipulations

At the prehearing conference, the parties and Staff stipulated to the following:

- Chapter 367, Florida Statutes (1989), is the law applicable to this proceeding.

VII. Exhibits

<u>Witness</u>	<u>Proffered By</u>	<u>I.D. No.</u>	<u>Description</u>
<u>Direct</u>			
Elliott	FWWA	TLE-1	FWWA Plant Investment funding chart
Elliott	FWWA	TLE-2	FWWA no gross-up of CIAC

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 28

<u>Witness</u>	<u>Proffered By</u>	<u>I.D. No.</u>	<u>Description</u>
Elliott	FWWA	TLE-3	FWWA full gross-up of CIAC
Elliott	FWWA	TLE-4	FWWA net present value gross-up of CIAC
Elliott	FWWA	TLE-5	FWWA comparison of no gross-up, full gross-up, and net present value gross-up methods
Elliott	FWWA	TLE-6	FPSC survey of CIAC gross-up methods utilized
Nixon	21266 Petitioners	RCN-1	Select Data from utilities currently grossing-up
Nixon	21266 Petitioners	RCN-2	Projected cost to customers if gross-up is disallowed
Anderson	21436 Petitioners	JHA-1	Tax returns of Martin Downs Utilities
Bowen	21436 Petitioners	JLB-1	Tax returns of Canal Utilities
Jackson	21436 Petitioners	CHJ-1	Tax returns of Aloha Utilities, Clay Utility Co. & Eagle Ridge Utilities
Wintz	21436 Petitioners	CRW-1	Tax returns of El Agua Corporation
Causseaux	Staff	APC-1 (Ex. A)	Formula to gross-up net contributed depreciable plant
Causseaux	Staff	APC-2 (Ex. B)	Formula to gross-up present value method for contributed depreciable property, cash, land

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 29

<u>Witness</u>	<u>Proffered By</u>	<u>I.D. No.</u>	<u>Description</u>
Causseaux	Staff	APC-3 (Ex. C)	Formula to gross-up contributed land
Causseaux	Staff	APC-4 (Ex. D)	Illustration of flow-through accounting
Causseaux	Staff	APC-5 (Ex. E)	Illustration of effect of full gross-up
Causseaux	Staff	APC-6 (Ex. F)	Illustration of full gross-up with normalization
Causseaux	Staff	APC-7 (Ex. G)	Illustration of no gross-up with normalization
<u>Rebuttal</u>			
Elliott	FWWA	TLE-7	No gross-up balance sheets and data sheets
Elliott	FWWA	TLE-8	Full gross-up balance sheets and data sheets
Elliott	FWWA	TLE-9	Net present value gross-up balance sheets and data sheets
Causseaux	Staff	APC-8	IRS Private Letter Ruling No. 8326081
Causseaux	Staff	APC-9	IRS Private Letter Ruling No. 8414013
Causseaux	Staff	APC-10	IRS Private Letter Ruling No. 8438029
Causseaux	Staff	APC-11	Possible solutions to cash flow problems

In addition to the above, Staff will use IRS Notice 87-82, select portions of petitioners' annual CIAC gross-up reports and, for a Class A petitioners', Schedules Nos. F-1(a) and (b),

ORDER NO. 22859
DOCKET NO. 860184-PU
PAGE 30

F-2(a) and (b), F-3(a)-(c), F-4, F-7, F-9, F-15, F-17, F-20, F-22(a)-(c) and F-23 from their annual reports, and for Class B and C petitioners, the comparable pages from their annual reports, for the purpose of cross examination.

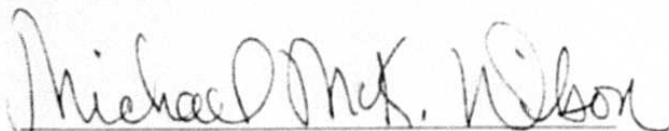
VIII. Rulings of Prehearing Officer

At the prehearing Conference, a motion was made to substitute Southwest Florida Capital Corporation for Florida Home Development Corporation. In addition, the petition by Florida Home Builders Association to intervene in these proceedings was considered. The motion and petition were both granted.

Based upon the foregoing, it is

ORDERED by Chairman Michael McK. Wilson, as Prehearing Officer, that this Order shall govern the conduct of these proceedings unless modified by the Commission.

By ORDER of Chairman Michael McK. Wilson, as Prehearing Officer, this 26th day of APRIL, 1990.


MICHAEL McK. WILSON, Chairman
and Prehearing Officer

(S E A L)

RJP