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LAW OFFICES

MESSER, VICKERS, CAPARELLO, FRENCH, MADSEN & LEWIS

A PROFESSIONAL ASSOCIATION

SUITE 1040, BAYPORT PLAZA
6200 COURTNEY CAMPBELL CAUSEWAY
TAMPA, FLORIDA 33607
TELEPHONE (813) 281-8711
TELECOPIER (813) 282-0050

SUITE 701, FIRST FLORIDA BANK BUILDING
215 SOUTH MONROE STREET
POST OFFICE BOX 1876
TALLAHASSEE, FLORIDA 32302-1876
TELEPHONE (904) 222-0720
TELECOPIER (904) 224-4359

SUITE 900
2000 PALM BEACH LAKES BOULEVARD
WEST PALM BEACH, FLORIDA 33409
TELEPHONE (407) 640-0820
TELECOPIER (407) 640-8202

REPLY TO: Tallahassee

October 29, 1990

Mr. Steve Tribble, Director
Division of Records and Reporting
Florida Public Service Commission
101 East Gaines Street
Tallahassee, Florida 32399-0850

HAND DELIVERY

Re: Docket No. ~~860184-PU~~ 900876-WS

Dear Mr. Tribble:

Enclosed for filing are an original and fifteen copies of Palm Coast Utility Corporation's Petition for Continuation of CIAC Tax Gross-Up. Please date stamp the extra copy of this letter enclosed to indicate this filing and return the copy to me.

Thank you for your assistance in the processing of this filing, and please call if there are any questions or further requirements.

Sincerely,

Laura Gilmore

Laura Gilmore
For the Firm

LG:sb\tribble.ltr

Enclosures

cc: Mr. Robert L. Kelly
All Parties of Record

RECEIVED & FILED

IB

FPSC-BUREAU OF RECORDS

DOCUMENT NUMBER-DATE
09735 OCT 29 1990
FPSC-RECORDS/REPORTING

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Request by FLORIDA WATERWORKS ASSOCIATION for investigation of proposed repeal of Section 118(b), Internal Revenue Code [Contributions-in-aid-of-construction]	)))))	DOCKET NO. 860184-PU Filed: October 29, 1990

PALM COAST UTILITY CORPORATION'S PETITION FOR CONTINUATION OF CIAC TAX GROSS-UP

Palm Coast Utility Corporation ("PCUC"), pursuant to Florida Administrative Code Rule 25-22.036 and Commission Order No. 23541, requests of the Florida Public Service Commission ("Commission") permission to continue a gross-up of contributions-in-aid-of-construction ("CIAC") pursuant to the terms of the attached water and wastewater tariff pages. In support of this Petition, PCUC states:

1. The complete name and address of the Petitioner is:

   Palm Coast Utility Corporation
   2 Utility Drive
   Palm Coast, Florida 32137

2. All notices, pleadings, orders, and other documents should be provided to the individuals listed below:

Mr. Robert Kelly Vice President & Controller Palm Coast Utility Corp. 2 Utility Drive Palm Coast, FL 32137	Floyd R. Self, Esq. Laura Gilmore, Esq. Messer, Vickers, Caparello, French, Madsen & Lewis, P.A. Post Office Box 1876 Tallahassee, FL 32302-1876

3. PCUC is a Class A water and wastewater utility providing service to the public in Flagler County.

4. PCUC first commenced a gross-up of CIAC for tax purposes utilizing the net present value method pursuant to the terms of Commission Order No. 17598, issued May 26, 1987, as later amended by Order No. 17598-A issued June 3, 1987. PCUC continues to be the only utility utilizing the net present value gross-up approach.

5. Commission Order No. 23541 requires that any utility collecting the gross-up must petition the Commission and obtain approval of the utility's proposed plan. On October 16, 1990 PCUC filed for clarification or reconsideration of Order No. 23541, inter alia, to permit consideration of ratepayer impact in any proceeding evaluating a request to gross-up, to establish that cash flow cannot be a minimum criteria, and to utilize a projected cash flow statement.

6. Pursuant to the terms of Order No. 23541 and PCUC's pending Motion for Clarification or Reconsideration, PCUC has prepared Attachment A to this Petition. Attachment A provides the following information:

a. Demonstration of actual tax liability.

b. Projected cash flow statement.

c. Statement of interest coverage.

d. Statement regarding the unavailability of alternative financing.

e. General justification for gross-up treatment.

f. Justification for use of the net present value method of CIAC gross-up.

g. General information regarding the impact on ratepayers if the gross-up is denied.[1]

7. Also attached to this Petition are the company's proposed water and wastewater tariffs which are designated as Attachment B. PCUC is requesting approval of these tariff pages to implement the CIAC gross-up requested by this Petition.

WHEREFORE, Palm Coast Utility Corporation respectfully requests that it be permitted to continue to gross-up CIAC pursuant to the terms of this Petition as implemented by the attached tariff pages.

Respectfully submitted,

FLOYD R. SELF, ESQ.
BRUCE W. RENARD, ESQ.
LAURA GILMORE, ESQ.
MESSER, VICKERS, CAPARELLO,
FRENCH, MADSEN & LEWIS, P.A.
215 South Monroe Street
Suite 701
Post Office Box 1876
Tallahassee, Florida 32302-1876
(904)222-0720

BY:__________________________
FLOYD R. SELF, ESQ.

Counsel for
Palm Coast Utility Corporation

:sb\palmcoas.cia

[1]PCUC believes it is improper to require existing customers to absorb this impact which is directly associated with growth.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of Palm Coast Utility Corporation's Petition for Continuation of CIAC Tax Gross-Up in Docket No. 860184-PU has been sent by U.S. Mail and/or Hand Delivery (*) on October 29, 1990 to the following parties of record:

Robert J. Pierson, Esq.*
Division of Legal Services
Florida Public Service Commission
101 E. Gaines Street
Tallahassee, FL 32301

Ms. Marsha Willis*
Division of Water & Sewer
Florida Public Service Commission
101 E. Gaines Street
Tallahassee, FL 32301

Ms. Beth Salak*
Division of Audit & Finance
Florida Public Service Commission
101 E. Gaines Street
Tallahassee, FL 32301

Jack Shreve, Esq.
Office of Public Counsel
Room 812 Claude Pepper Building
111 West Madison Street
Tallahassee, FL 32399-1400

Sanford A. Minkoff, Esq.
Minkoff and McDaniel, P.A.
275 E. Alfred Street
Tavares, FL 32778-3239

Patrick K. Wiggins, Esq.
Wiggins & Villacorta
P. O. Drawer 1657
Tallahassee, FL 32302

B. Kenneth Gatlin, Esq.
Gatlin, Woods, Carlson & Cowdery
1709-D Mahan Drive
Tallahassee, FL 32308

Robert M. C. Rose, Esq.
F. Marshall Deterding, Esq.
Rose, Sundstrom and Bentley
2548 Blairstone Pines Drive
Tallahassee, FL 32301

BY: ______________________

ARTHUR ANDERSEN & CO.

133 PEACHTREE STREET, N.E.
ATLANTA, GEORGIA 30303
(404) 658-1776

October 23, 1990

Mr. Robert Kelly
Vice President and Comptroller
Palm Coast Utilities Corporation
Two Utility Drive
Palm Coast, Florida 32137

Dear Mr. Kelly:

This letter is written in response to your request that we review and document certain matters associated with Palm Coast Utility Corporation's ("PCUC") petition filed in response to Florida Public Service Commission ("FPSC") Order No. 23541 in Docket No. 860184-PU for continued authority to gross up contributions-in-aid-of-construction ("CIAC") for income taxes using the net present value ("NPV") method. This letter is solely for use by PCUC in petitioning the FPSC for continued authority to gross up CIAC using the NPV method and is not to be used, referred to, or distributed for any other purpose or to any other party.

As you are aware, I am a partner in Arthur Andersen & Co., a firm of independent public accountants, at 133 Peachtree Street, N.E., in Atlanta, Georgia. I am currently a partner in the utilities and telecommunications practice of the Atlanta office of Arthur Andersen & Co. I have previously presented testimony in Docket No. 860184-PU, under which Order No. 23541 was issued.

In this letter, I will discuss certain facts and circumstances of PCUC, as management has presented them to me, and the application and relevance of these facts and circumstances to management's decision to request continued authority to gross up CIAC within the guidelines discussed in Order No. 23541 and the considerations I identified in my earlier testimony related to this docket. The information provided to me has not been audited although we have performed certain limited testing of PCUC's forecasting system discussed later in this letter.

Order No. 23541 states that "the need for gross-up should be determined on a case-by-case basis, based upon the facts and circumstances peculiar to each utility." The important factors which must be considered in making the decision to gross up include:

1. Fairness of the charge to the customer, the contributor, and the utility.

2. Effect of the decision on long-run customer revenue requirements.

3. Rate stability.

4. Assignment of costs to cost causes, including cost of new growth policies.

5. The utility's cash flow and availability of alternative financing sources.

6. Competitive pressures, including potential bypass issues.

Following is a brief discussion of each of these considerations as they relate to PCUC and the information you have provided me.

Fairness of the Charge

Fairness is, of course, a subjective determination. In the case of CIAC tax funding, the fairness to the customer, the contributor, and the utility must be considered. You have stated that in your opinion, the NPV gross-up is the most fair method in the case of PCUC, as it achieves what you believe to be the best balance of the interest of all three parties (the customer, the contributor, and PCUC) affected by the decision.

I understand you have selected the NPV method because you believe it to be a fair method of collecting the cost of taxes attributable to CIAC. As I stated in my testimony in Docket No. 860184-PU, the NPV gross-up method is a fair method to the three parties affected by the CIAC transaction (the customer, the contributor, and PCUC). As a revenue-neutral method, NPV gross-up is fair to the customers. Since only the carrying costs associated with the taxes on CIAC are collected from the contributor, NPV is fair to the contributor. As I testified in the Docket No. 860184-PU hearing, the carrying cost of financing the taxes on CIAC are the true economic costs since the taxes are recouped through future tax depreciation benefits. PCUC is made whole on the carrying costs of financing the CIAC taxes, and the financing of those taxes is not an unreasonable burden on PCUC; therefore, the NPV gross-up is fair to PCUC. In the case of PCUC, the relative importance of CIAC to the customer and the Company is magnified, since, based upon data you have supplied to me, PCUC collects more CIAC than any other FPSC-regulated water and wastewater utility which grosses up (Exhibit I).

Customer Revenue Requirements and Rate Stability

As was discussed by me and other witnesses during the hearing related to Docket 860184-PU, the NPV gross-up method of funding CIAC taxes is revenue neutral, and the no gross-up method creates a future customer revenue requirement. The issue then is the higher customer revenue requirements in the no gross-up environment compared to what they will be if PCUC continues its present policy of NPV gross-up. Due to the relative importance of CIAC to PCUC, if PCUC were not allowed to gross up, customer revenue requirements will be cumulatively $921,000 higher over the next five years. This is graphically illustrated by Exhibit II. This represents an increase in customer revenue requirements of 3.4% per ERC in 1995. You have stated that PCUC believes that not grossing up results in imposing on existing customers' costs associated with new growth, and I concur with your analysis. PCUC management does not wish to impose these costs on existing customers.

As Exhibit II illustrates, this revenue requirement continues to increase over time, as more and more new growth occurs. This will have the effect of leading to higher rates and less rate stability.

Assignment of Costs

You have stated that PCUC believes, and I concur, that the tax costs of CIAC should be assigned consistent with the CIAC itself. As previously discussed, the NPV method assigns the true economic costs of CIAC taxes to the contributor, giving the contributor the benefit of the future tax depreciation benefits.

Cash Flow and Financing

Order No. 23541 requests certain information concerning cash flow and financing. Specifically, the order requests demonstration of an actual tax liability, a demonstration that sources of funds are not available at a reasonable cost, a cash flow statement, and a statement of interest coverage. Under my supervision, we have prepared two schedules which present this information based on amounts projected by PCUC for the years 1991 through 1995. The source of this data and the related notes is PCUC's projected financial data for the years 1991 through 1995. The first schedule (Exhibit III) projects the data assuming PCUC is able to utilize the NPV gross-up method to fund CIAC taxes. The second schedule (Exhibit IV) projects the data assuming PCUC is not able to utilize NPV gross-up and uses the no gross-up method.

We have performed limited testing procedures related to PCUC's forecasting system from which the data in Exhibit III and Exhibit IV was obtained. The scope of our work was not designed to enable us to issue a report under the reporting standards as established by the American Institution of Certified

Public Accountants ("AICPA") for review of forecasts and projections. As you are aware, the scope of testing which would be required in order to allow us to comply with the AICPA standards and issue an examination report covering projected data derived from PCUC's forecasting system is extensive, and you and I decided that such a level of testing would not be cost-effective within the requirements of this docket. Accordingly, we have not issued any form of report related to PCUC's forecasting system.

Both Exhibit III (NPV gross-up) and Exhibit IV (no gross-up) reflect a tax liability for PCUC in each of the years 1991 through 1995. PCUC, therefore, is projected to satisfy the order's minimum requirement that utilities grossing up CIAC actually have a tax liability.

Following the determination of tax liability, a projected summarized cash flow statement is presented. Sources of cash (excluding debt) are net cash flow from operations and CIAC. Uses of cash (excluding debt) are capital additions, CIAC placed in trust, and prepaid taxes and other.

The net difference between sources and uses is borrowings or repayments of debt. PCUC's current debt facility consists of a long-term revolving line of credit, and this type of facility is assumed to continue through 1995.

Interest Coverage

The impact of PCUC's extensive capital program is also evident in the times-interest-earned ("TIE") ratio. If not allowed to gross up through 1993, PCUC's TIE ratio would significantly remain below the FPSC's prescribed threshold of 2.00 (Exhibit IV). Only after the forecasted rate increase in late 1993 does the TIE rise slightly above 2.00 in 1994 and 1995. If allowed to gross up CIAC (Exhibit III), the gross-up funds collected significantly reduce required debt financing, resulting in an improvement in the TIE ratio. Although the TIE ratio remains below 2.00 in 1991 and even lower in 1992, the ratio is stronger than under the no gross-up projection. This also demonstrates that if allowed to gross up CIAC, PCUC's debt borrowings do not exceed currently available facilities until 1995, when the TIE ratio will be significantly above 2.00.

As I discussed in my testimony in this docket, use of a TIE ratio test is only one measure of a company's overall financial health. However, it does provide an indication of a company's ability to service its debt. As can be seen in Exhibits III and IV, if PCUC is not allowed to gross up CIAC for taxes, its debt borrowings are significantly increased and its TIE ratio is significantly reduced. PCUC is projecting a TIE ratio below 2.00 even if allowed to gross up CIAC, with the projected TIE ratio significantly deteriorating if gross-up is not allowed. This indicator supports PCUC's decision to gross-up.

For purposes of comparsion to Exhibits III and IV, a copy of PCUC's audited financial statements are included as Exhibit V.

Alternative Financing

Under both the NPV gross-up and no gross-up cases, the effect of PCUC's high level of capital additions in 1991 is evident, resulting in significant additional debt requirements. PCUC management has anticipated this financing requirement and maintained total debt facilities of $12 million. However, under the no gross-up case, PCUC's available debt facilities would be exceeded in 1995 by almost $5 million due entirely to the requirement to finance taxes on CIAC. You have stated to me that sources of financing to pay these CIAC related taxes have not been obtained.

You have stated that a majority of PCUC's CIAC is received from individuals, not developers. Therefore, you have not considered developer financing to be a viable borrowing source for funds to pay CIAC taxes. In addition, I agree with you that the record-keeping requirements related to numerous homeowner loans would be onerous. Even if debt financing from developers or homeowners were obtained, the customer rate effects of the no gross-up method would still apply.

Based upon the above projections and analysis, I understand that PCUC management believes that continued authority to gross up CIAC is critical to the financial health of the company. Based upon my review of these same projections, I agree that CIAC gross-up funds represent an important and material source of funds during the projected period, and that PCUC's overall financial health would be harmed if CIAC gross-up is not allowed, and the corresponding required rate increases to cover the carrying costs of financing the CIAC taxes are not granted.

Competitive Pressures

You have stated to me that the issue of competitive pressures was considered in the development of PCUC's conclusion that it needs to gross up, but it was not a significant factor in making that determination.

Summary

After having considered and evaluated the previously described facts and circumstances of PCUC, and in view of the current service availability policies in Florida, I concur with your position that a NPV gross-up of CIAC is needed for PCUC, and I believe your position is well supported and consistent with the guidelines described in Order No. 23541. I understand your selection of the NPV gross-up over a full gross-up is based on management's position that the NPV method more appropriately balances the interests of all parties, particularly the contributors, and I concur with this position. Again, my conclusions are based upon the particular facts and circumstances of PCUC as described herein, and do not represent a general endorsement by me of the need for all utilities to gross up or the preferability in all cases of one gross-up method over another.

Very truly yours,

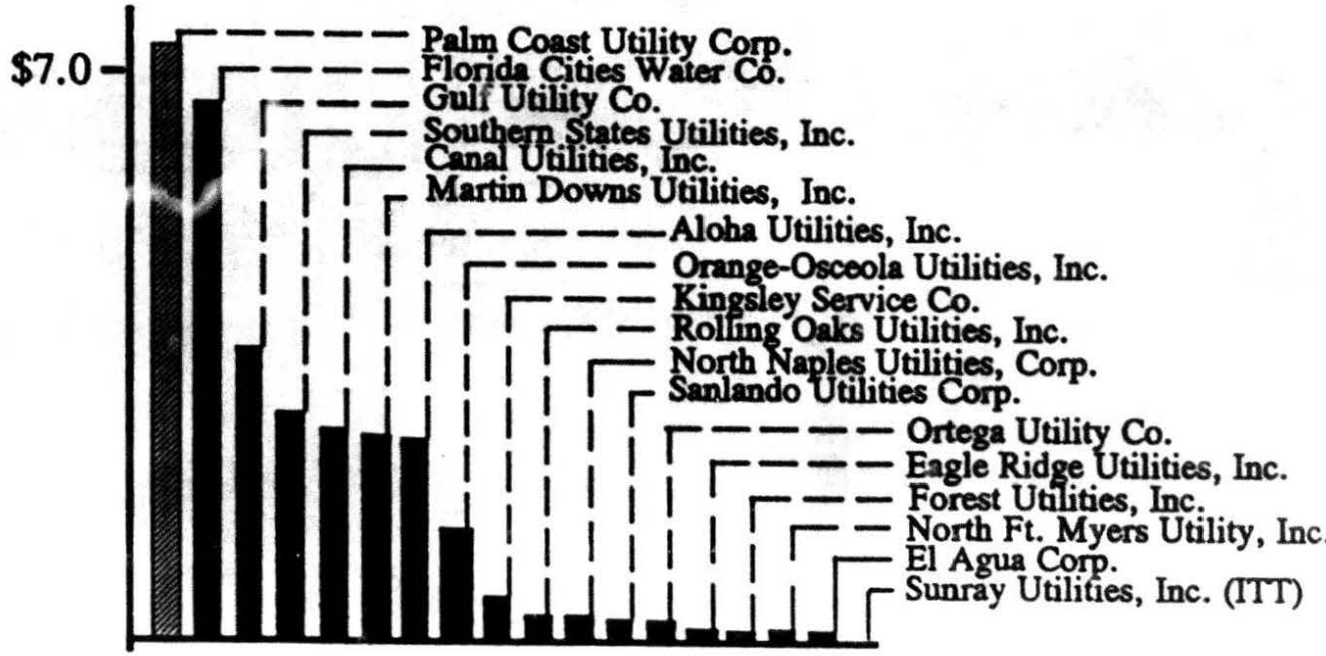
ARTHUR ANDERSEN & CO.

By Thomas L. Elliott III

Thomas L. Elliott III

PALM COAST UTILITY CORPORATION

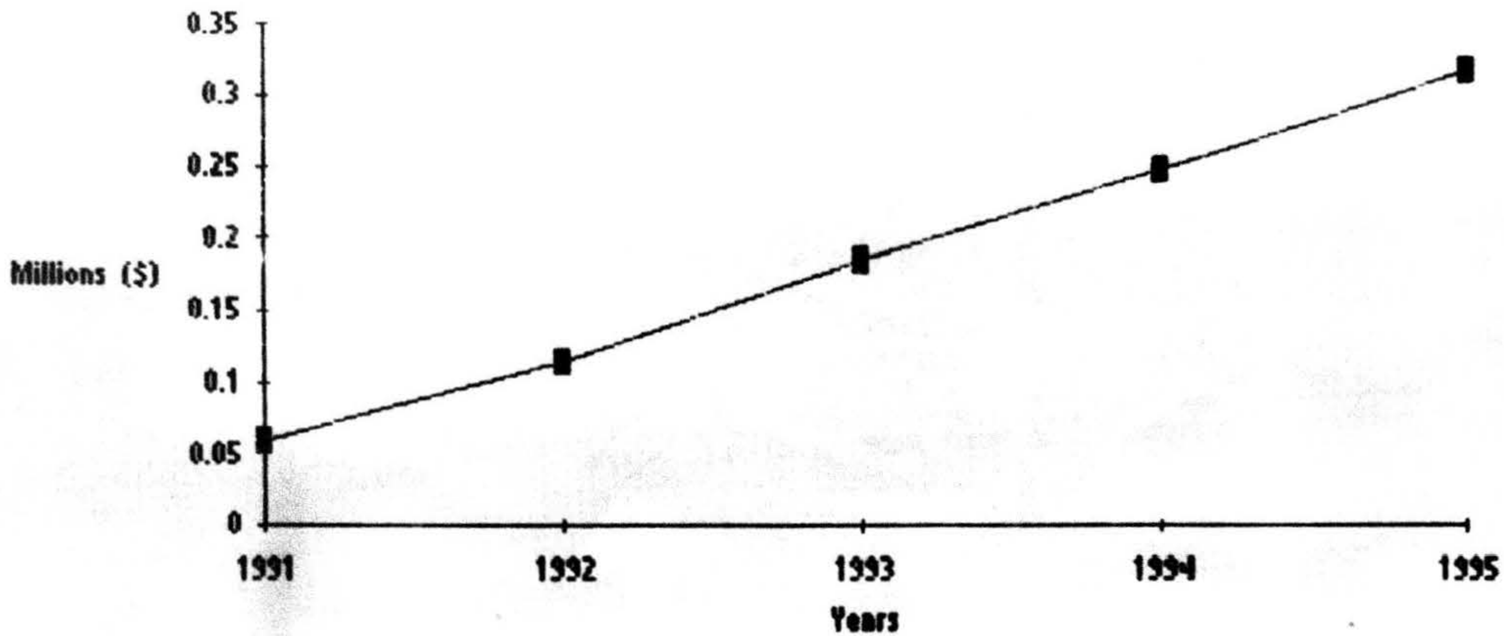
1989 TAXABLE INCOME FROM CIAC AND GROSS-UP AMOUNTS



The above data was derived by the Company from the applicable Annual Reports and CIAC Reports for 1989, as filed with the FPSC.

PALM COAST UTILITY CORPORATION

DIFFERENCE IN CUSTOMER REVENUE REQUIREMENTS: NO GROSS-UP OVER NPV GROSS-UP



SOURCE: The above graph was developed from PCUC projected financial data for the years 1991 through 1995.

PALM COAST UTILITY CORPORATION

PROJECTED SELECTED FINANCIAL DATA

ASSUMING NET PRESENT VALUE GROSS-UP OF CONTRIBUTIONS-IN-AID-OF-CONSTRUCTION

(In Thousands, Except Ratios)

	Projected Year Ended December 31				
	1991	1992	1993	1994	1995
CURRENT TAX LIABILITY:					
Pretax book income	$ 1,217	443	$ 1,353	$ 2,422	$ 2,922
Contributions subject to gross-up	3,147	3,366	4,318	3,115	4,302
Other contributions	1,962	2,056	2,120	2,143	2,109
Gross-up contributions	1,013	1,084	1,391	1,003	1,385
Other timing differences, net	(1,684)	(1,889)	(2,247)	(2,752)	(3,477)
TAXABLE INCOME	$ 5,655	$ 5,060	$ 6,935	$ 5,931	$ 7,241
INCOME TAXES AT 37.63% (ROUNDED)	$ 2,128	$ 1,904	$ 2,610	$ 2,232	$ 2,725
SUMMARIZED CASH FLOW STATEMENT:					
Sources (excluding debt):					
Gross-up contributions	$ 1,013	$ 1,084	$ 1,391	$ 1,003	$ 1,385
Net cash flow from operations	1,733	1,286	1,783	2,479	2,904
Contributions received	5,109	5,422	6,438	5,258	6,411
Total receipts	7,855	7,792	9,612	8,740	10,700
Uses (excluding debt):					
Capital additions	(12,743)	(3,608)	(5,661)	(8,308)	(11,029)
Contributions placed in trust	(815)	(832)	(851)	(857)	(838)
Prepaid taxes and other	(1,209)	(1,693)	(1,794)	(966)	(1,289)
Total uses	(14,767)	(6,133)	(8,306)	(10,131)	(13,156)
(BORROWINGS) REPAYMENTS OF DEBT	$(6,912)	$ 1,659	$ 1,306	$(1,391)	$(2,456)
YEAR-END DEBT BALANCE	$11,934	$10,295	$ 9,020	$10,440	$12,935
INTEREST COVERAGE:					
Pretax book income	$ 1,217	$ 443	$ 1,353	$ 2,422	$ 2,922
Less AFUDC	(308)	(51)	(39)	(141)	(353)
	909	392	1,314	2,281	2,569
Add debt interest	1,016	1,334	1,159	1,168	1,402
EARNINGS BEFORE INTEREST AND TAXES	$ 1,925	$ 1,726	$ 2,473	$ 3,449	$ 3,971
DEBT INTEREST	$ 1,016	$ 1,334	$ 1,159	$ 1,168	$ 1,402
"TIMES INTEREST EARNED" RATIO	1.90	1.29	2.13	2.95	2.83

The above selected data were derived from projections developed by the Company. See accompanying summary of significant projection assumptions.

PALM COAST UTILITY CORPORATION

SUMMARY OF SIGNIFICANT PROJECTION ASSUMPTIONS

YEARS ENDED DECEMBER 31, 1991 THROUGH 1995

NET PRESENT VALUE GROSS-UP

This projected selected financial data represents, to the best of management's knowledge and belief, the company's projected results for the selected data presented during the projection period, assuming gross-up of contributions-in-aid-of-construction ("CIAC") for income taxes using the net present value gross-up method ("NPV gross-up"). Accordingly, the projected data reflects management's judgment as of October 23, 1990, the date of this projected data, of the expected conditions and its expected course of action if CIAC were grossed up for income taxes. The projected data is designed to provide information to the Florida Public Service Commission ("FPSC") as required under Order No. 23541. Accordingly, this projected data should not be used for any other purpose. The assumptions disclosed herein are those that management believes are significant to the projected data; however, management has not yet received authorization of the FPSC to gross up CIAC for income taxes during the projection period. There will usually be differences between projected and actual results because events and circumstances frequently do not occur as expected, and those differences may be material.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies, except for the accounting treatment for the effects of not grossing up CIAC for income taxes, are the same as those disclosed in the company's financial statements for the year ended December 31, 1989. Those financial statements should be read for additional information (see Exhibit V).

The accounting treatment for the effects of not grossing up CIAC for income taxes are the same as those required by the FPSC in Order No. 23541, except that prepaid deferred income taxes resulting from CIAC are treated as a component of rate base. On October 16, 1990, the Company filed a motion requesting the FPSC to reconsider the capital structure normalization provisions of the order.

2. INCOME TAXES

Income taxes are computed at the statutory rates in effect at October 23, 1990.

3. CUSTOMER RATES

For 1991 and 1992, customer rates are forecast using rates currently in effect plus an annual operating and maintenance indexing factor of approximately 2%. Usage is forecast based on management's estimates of future customer usage as follows:

- Usage per residential customer is constant at 139 gallons per ERC per day.

- New customer growth is forecast based on forecasts provided by the Company's affiliate, ITT Community Development Corporation.

The projections assume a rate case in 1993 resulting in a rate increase of 13% for water taking effect as an interim increase in September 1993. This would result in fully compensatory rates for water service. No increase is projected for sewer rates.

Usage, customer growth, and the annual operating and maintenance indexing factor are expected to continue the trends from 1991 and 1992, as discussed above with rates from the 1993 rate case rates as a base.

4. OPERATING AND MAINTENANCE EXPENSES

Operating and maintenance expenses are forecast to increase as warranted by the demands of customer growth to provide safe and adequate services. Inflation is expected to increase costs at 5% per year.

5. GUARANTEED REVENUES

Guaranteed revenues are in effect through June 1991, the date the underlying agreement, as amended, terminates.

6. USED AND USEFUL PERCENTAGES

Used and useful percentages of cost of service and rate base are forecast consistent with the methodology used in Order No. 22843, the Company's most recent rate order.

7. CAPITAL ADDITIONS

Capital expenditures for additional water and wastewater treatment capacity are forecast to provide approximately a six-month lead time in excess treatment capacity. Capital additions in 1991 include construction of the first two-million-gallon-per-day phase of a water treatment facility and appurtenances totaling approximately $7 million.

Expenditures for system strengthening and/or main extensions to serve additional general service requirements are forecasted based on demands placed upon the water and sewer system as brought about by customer growth.

8. LONG-TERM DEBT

Long-term debt consists of a revolving long-term facility with interest based on projected LIBOR rates.

9. CONTRIBUTIONS

Contributions not subject to gross-up include prepaid sewer CIAC placed in trust and prepaid water CIAC which relate to amounts collected prior to the time homesite purchasers connect to the water and sewer system by the Company's affiliate, ITT Community Development Corporation.

CIAC gross-up is computed in accordance with the net present value gross-up method as specified in FPSC Order No. 23541.

PALM COAST UTILITY CORPORATION

PROJECTED SELECTED FINANCIAL DATA

ASSUMING NO GROSS-UP OF CONTRIBUTIONS-IN-AID-OF-CONSTRUCTION

(In Thousands, Except Ratios)

	Projected Year Ended December 31				
	1991	1992	1993	1994	1995
CURRENT TAX LIABILITY:					
Pretax book income	$ 1,171	$ 284	$ 1,094	$ 2,108	$ 2,483
Contributions received	5,109	5,422	6,438	5,258	6,411
Other timing differences, net	(1,762)	(1,948)	(2,299)	(2,734)	(3,465)
TAXABLE INCOME	$ 4,518	$ 3,758	$ 5,233	$ 4,632	$ 5,429
INCOME TAXES AT 37.63% (ROUNDED)	$ 1,700	$ 1,414	$ 1,969	$ 1,742	$ 2,043
SUMMARIZED CASH FLOW STATEMENT:					
Sources (excluding debt):					
Net cash flow from operations	$ 1,675	$ 1,183	$ 1,638	$ 2,348	$ 2,711
Contributions received	5,109	5,422	6,438	5,258	6,411
Total receipts	6,784	6,605	8,076	7,606	9,122
Uses (excluding debt):					
Capital additions	(12,743)	(3,608)	(5,661)	(8,308)	(11,029)
Contributions placed in trust	(815)	(832)	(851)	(857)	(838)
Prepaid taxes and other	(755)	(1,217)	(1,195)	(557)	(715)
Total uses	(14,313)	(5,657)	(7,707)	(9,722)	(12,582)
(BORROWINGS) REPAYMENTS OF DEBT	$(7,529)	$ 948	$ 369	$(2,116)	$(3,460)
YEAR-END DEBT BALANCE	$12,553	$11,628	$11,294	$13,448	$16,955
INTEREST COVERAGE:					
Pretax book income	$ 1,171	$ 284	$ 1,094	$ 2,108	$ 2,483
Less AFUDC	(308)	(51)	(39)	(141)	(353)
	863	233	1,055	1,967	2,130
Add debt interest	1,053	1,451	1,375	1,485	1,824
AVAILABLE EARNINGS	$ 1,916	$ 1,684	$ 2,430	$ 3,452	$ 3,954
DEBT INTEREST	$ 1,053	$ 1,451	$ 1,375	$ 1,485	$ 1,824
TIMES INTEREST EARNED RATIO	1.82	1.16	1.77	2.32	2.17

The above selected data were derived from projections developed by the Company. See accompanying summary of significant projection assumptions.

PALM COAST UTILITY CORPORATION

SUMMARY OF SIGNIFICANT PROJECTION ASSUMPTIONS

YEARS ENDED DECEMBER 31, 1991 THROUGH 1995

NO GROSS-UP

This projected selected financial data represents, to the best of management's knowledge and belief, the company's projected results for the selected data presented during the projection period, assuming no gross-up of contributions-in-aid-of-construction ("CIAC") for income taxes. Accordingly, the projected data reflects management's judgment as of October 23, 1990, the date of this projected data, of the expected conditions and its expected course of action if CIAC were not grossed up for income taxes. The projected data is designed to provide information to the Florida Public Service Commission ("FPSC") as required under Order No. 23541. Accordingly, this projected data should not be used for any other purpose. The assumptions disclosed herein are those that management believes are significant to the projected data; however, management has not decided or been required not to gross up CIAC for income taxes. There will usually be differences between projected and actual results because events and circumstances frequently do not occur as expected, and those differences may be material.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies, except for the accounting treatment for the effects of not grossing up CIAC for income taxes, are the same as those disclosed in the company's financial statements for the year ended December 31, 1989. Those financial statements should be read for additional information (see Exhibit V).

The accounting treatment for the effects of not grossing up CIAC for income taxes are the same as those required by the FPSC in Order No. 23541, except that prepaid deferred income taxes resulting from CIAC are treated as a component of rate base. On October 16, 1990, the Company filed a motion requesting the FPSC to reconsider the capital structure normalization provisions of the order.

2. INCOME TAXES

Income taxes are computed at the statutory rates in effect at October 23, 1990.

3. CUSTOMER RATES

For 1991 and 1992, customer rates are forecast using rates currently in effect plus an annual operating and maintenance indexing factor approximating 2%. Usage is forecast based on management's estimates of future customer usage as follows:

- Usage per residential customer is constant at 139 gallons per ERC per day.
- New customer growth is forecast based on forecasts provided by the Company's affiliate, ITT Community Development Corporation.

The projections assume a rate case in 1993 resulting in a rate increases of 15% for water taking effect as an interim increase in September 1993 and a final increase in 1994. The effect of not grossing up CIAC for income taxes results in 2% of the above water rate increase. This would result in fully compensatory rates for water service. No increase is projected for sewer rates.

Usage, customer growth, and the annual operating and maintenance indexing factor are expected to continue the trends from 1991 and 1992, as discussed above with the 1993 rate case rates as a base.

4. OPERATING AND MAINTENANCE EXPENSES

Operating and maintenance expenses are forecast to increase as warranted by the demands of customer growth to provide safe and adequate service. Inflation is expected to increase costs at 5% per year.

5. GUARANTEED REVENUES

Guaranteed revenues are in effect through June 1991, the date the underlying agreement, as amended, terminates.

6. USED AND USEFUL PERCENTAGES

Used and useful percentages of cost of service and rate base are forecast consistent with the methodology used in Order No. 22843, the Company's most recent rate order.

7. CAPITAL ADDITIONS

Capital expenditures for additional water and wastewater treatment capacity are forecast to provide approximately a six-month lead time in excess treatment capacity. Capital additions in 1991 include construction of the first two-million-gallon-per-day phase of a water treatment facility and appurtenances totaling approximately $7 million.

Expenditures for system strengthening and/or main extensions to serve additional general service requirements are forecasted based as demands placed upon the water and sewer system as brought about by customer growth.

8. LONG-TERM DEBT

Long-term debt consists of a revolving long-term facility with interest based on projected LIBOR rates.

ARTHUR ANDERSEN & CO.

PALM COAST UTILITY CORPORATION

FINANCIAL STATEMENTS AS OF DECEMBER 31, 1989 AND 1988

TOGETHER WITH

AUDITORS' REPORT

ARTHUR ANDERSEN & CO

ATLANTA, GEORGIA

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors of
Palm Coast Utility Corporation:

We have audited the accompanying balance sheets of PALM COAST UTILITY CORPORATION (a Florida corporation and a wholly owned subsidiary of ITT Corporation) as of December 31, 1989 and 1988 and the related statements of operations and accumulated deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Palm Coast Utility Corporation as of December 31, 1989 and 1988 and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

As more fully discussed in Note 8 to the financial statements, the Florida Public Service Commission is reconsidering the amounts of deferred repair costs and completion costs that will be recognized for rate-making purposes. At December 31, 1989, unamortized deferred repair costs were carried at $151,797, and net completion costs were carried at $1,189,858. Realization of these carrying amounts is dependent upon recognition for rate-making purposes; however, the outcome of the Commission's reconsideration is uncertain. Accordingly, no provision for loss, if any, relating to these deferred repair costs and completion costs has been made in the accompanying financial statements.

Arthur Andersen & Co.

January 23, 1990

ASSETS	1989	1988
UTILITY PLANT, at original cost (Notes 1 and 8):		
Water and sewer plant	$91,263,927	$88,825,038
Less accumulated depreciation	(21,229,621)	(19,032,361)
	70,034,306	69,792,677
Construction work in progress	1,673,971	419,432
Net utility plant	71,708,277	70,212,109
CURRENT ASSETS:		
Cash	299,842	197,830
Customer accounts receivable, less allowance for doubtful accounts of $7,532 and $4,000 in 1989 and 1988, respectively	264,053	231,788
Materials and supplies, at average cost	198,723	186,019
Cash and short-term investments held in escrow (Note 4)	953,567	375,666
Other	149,013	151,771
	1,865,198	1,143,074
CASH AND SHORT-TERM INVESTMENTS HELD IN TRUST (Note 3)	5,313,085	4,415,659
DEFERRED CHARGES, net of amortization:		
Deferred repair costs (Note 8)	151,797	153,149
Deferred income taxes	5,008,448	4,092,280
Other deferred charges	377,246	251,819
	5,537,491	4,497,248
	$84,424,051	$80,268,090

CAPITALIZATION AND LIABILITIES	1989	1988
CAPITALIZATION:		
Stockholder's equity:		
Common stock, $1.00 par value, 500 shares authorized and outstanding	$ 500	$ 500
Other paid-in capital	26,736,448	26,736,448
Accumulated deficit	(4,593,428)	(5,343,147)
	22,143,520	21,393,801
Long-term debt (Note 5)	4,000,000	5,000,000
Total capitalization	26,143,520	26,393,801
CURRENT LIABILITIES:		
Accounts payable	765,648	706,171
Payables due to affiliated companies (Notes 1 and 2)	37,077	231,835
Contract retentions	78,459	20,283
Customer deposits	303,187	275,069
Accrued interest	463,709	408,609
	1,648,080	1,641,967
DEFERRED CREDITS:		
Unamortized investment tax credits (Note 1)	2,860,874	2,960,008
Advances for construction	2,887,196	2,201,118
	5,748,070	5,161,126
CONTRIBUTIONS IN AID OF CONSTRUCTION (Note 1):		
Water and sewer CIAC	59,605,584	54,499,125
Less accumulated amortization	(8,721,203)	(7,427,929)
	50,884,381	47,071,196
COMMITMENTS AND CONTINGENCIES (Notes 6, 7, and 8)		
	$84,424,051	$80,268,090

The accompanying notes are an integral part of these balance sheets.

PALM COAST UTILITY CORPORATION

STATEMENTS OF OPERATIONS AND ACCUMULATED DEFICIT

FOR THE YEARS ENDED DECEMBER 31, 1989 AND 1988

	1989	1988
OPERATING REVENUES:		
Water and sewer service revenues (Notes 1, 7, and 8)	$ 4,421,799	$ 3,894,665
OPERATING EXPENSES	4,423,157	3,886,906
Operating income (loss)	(1,358)	7,759
OTHER INCOME (Notes 2 and 10)	1,170,501	1,130,988
INCOME BEFORE INTEREST INCOME AND ALLOCATION OF INCOME TAXES	1,169,143	1,138,747
INTEREST EXPENSE (INCOME) (Notes 1, 2, 3, 4, and 11)	(392,814)	(366,838)
INCOME BEFORE ALLOCATION OF CONSOLIDATED INCOME TAXES	1,561,957	1,505,585
ALLOCATION OF INCOME TAX (PROVISION) BENEFIT (Note 1)	(812,238)	(880,202)
NET INCOME	749,719	625,383
ACCUMULATED DEFICIT, beginning of year	(5,343,147)	(5,968,530)
ACCUMULATED DEFICIT, end of year	$(4,593,428)	$(5,343,147)

The accompanying notes are an integral part of these statements.

PALM COAST UTILITY CORPORATION

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 1989 AND 1988

	1989	1988
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 749,719	$ 625,383
Adjustments to reconcile net income per books to net cash:		
Depreciation and amortization	1,254,230	1,152,000
Change in customer accounts receivable, net	(32,265)	(104,214)
Change in materials and supplies	(12,704)	(14,874)
Change in accounts payable	59,477	378,815
Change in payables due to affiliated companies	(194,758)	(2,509,658)
Change in other working capital items, net	85,713	18,692
Change in deferred income taxes, net	(2,611,999)	(3,066,471)
Other noninvesting or financing, net	(380,271)	(34,412)
Total adjustments	(1,832,577)	(4,180,122)
Net cash used in operating activities	(1,082,858)	(3,554,739)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to net utility plant	(3,830,020)	(3,229,611)
Retirements	136,592	69,994
Retirements charged to accumulated depreciation	(136,592)	(69,994)
Recoveries of net losses on retirements	-	75
Cash placed in trust	(1,483,691)	(1,744,020)
Contributed taxes deposited in escrow	(1,319,432)	(732,160)
Contributed taxes withdrawn from escrow	799,970	878,782
Taxes withdrawn from CIAC trust	586,265	1,429,711
Net cash flows used in investing activities	(5,246,908)	(3,397,227)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long-term debt	1,000,000	1,000,000
Reductions of long-term debt	(2,000,000)	(1,000,000)
Proceeds from short-term debt	4,275,000	3,000,000
Reductions of short-term debt	(4,275,000)	(3,000,000)
Contributions in aid of construction	3,623,247	2,462,924
Advances for construction	686,078	1,387,926
Prepaid CIAC to be placed in trust	1,483,212	1,744,499
Contributed taxes	1,639,241	1,378,391
Net cash flows provided by financing activities	6,431,778	6,973,740
NET INCREASE IN CASH	102,012	21,778
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	197,830	176,052
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 299,842	$ 197,830
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the year:		
Interest	$ 482,202	$ 504,798
Income taxes	$3,106,000	$2,816,582

The accompanying notes are an integral part of these statements.

PALM COAST UTILITY CORPORATION

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1989 AND 1988

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

Palm Coast Utility Corporation (the "Company") is a wholly owned subsidiary of ITT Corporation ("ITT"). The Company provides water and sewer services to Palm Coast, Florida, a community being developed by its affiliate, ITT-Community Development Corporation ("ITT-CDC"). The Company is subject to regulation by the Florida Public Service Commission ("FPSC") (see Note 8).

Water and Sewer Service Revenues

Revenues are included in income for water and sewer services when billed.

Utility Plant, Depreciation, and Maintenance

Utility plant is stated at original cost and includes applicable general and administrative costs; payroll-related costs; and an allowance for funds used during construction.

Depreciation is provided using the straight-line method over the estimated useful lives of the assets. Depreciation expense approximates 2.7% of the average original cost of depreciable property.

Maintenance and repairs are charged to operations as incurred.

Income Tax Matters

For federal and state income tax purposes, the accounts of the Company are included in the consolidated returns of its parent, ITT. Consolidated federal income taxes are allocated to the Company based on its respective contribution to consolidated federal taxable income. State income tax expense is computed on a separate-company basis. Income taxes paid to ITT under this agreement totaled $3,106,000 and $6,423,975 in 1989 and 1988, respectively.

Investment tax credits are deferred and amortized over the estimated useful lives of the related assets after they are placed in service. Such amortization is included as a credit to other interest income in the accompanying statements of operations and accumulated deficit (see Note 10).

Deferred income taxes result from the following items:

- The recognition as taxable income of those amounts of contributions in aid of construction collected after December 31, 1986 in accordance with the Tax Reform Act of 1986. As authorized by the FPSC, the Company has increased its contributions in aid of construction ("CIAC") rates to collect the estimated carrying costs associated with the revised tax treatment of CIAC. At December 31, 1989 and 1988, contributed tax amounts of $3,492,689 and $2,135,714 are netted against deferred income taxes in the accompanying balance sheets.

- The recognition as taxable income of those amounts of CIAC collected prior to 1987 which the Company did not expend within two years of receipt.

- The use of accelerated depreciation and deducting interest expense for tax purposes (which is capitalized for financial reporting purposes).

The provision for income taxes for the years ending December 31, 1989 and 1988 is comprised of the following amounts:

	1989	1988
Current	$(3,092,828)	$(3,900,358)
Deferred	2,280,590	3,020,156
	$ (812,238)	$ (880,202)

Following is a reconciliation of the federal statutory rate to the Company's effective tax rates:

	1989	1988
Federal statutory rate	34.0%	34.0%
Allowance for equity funds used during construction	.6	1.5
Amortization of deferred investment tax credits	(2.2)	(2.3)
State income tax, net of federal benefit	19.6	25.2
Effective tax rate	52.0%	58.4%

State income taxes exceeded the 5.5% statutory rate due mainly to state income taxes currently payable of approximately $398,000 and $506,000 in 1989 and 1988, respectively, related to contributions in aid of construction as discussed above. The Company was unable to record a deferred charge for state income taxes due to the lack of a carryback provision under Florida tax laws. Contributed state income taxes collected from customers and ITT-CDC of $239,723 and $229,820 in 1989 and 1988, respectively, are included in other income.

Allowance for Funds Used During Construction

The allowance for funds used during construction ("AFUDC") represents the estimated debt and equity costs of capital funds which are applicable to construction work in progress.

Contributions in Aid of Construction

CIAC are amortized at a rate of 2.5% annually. Amortization of CIAC amounted to approximately $1,293,000 and $1,187,000 in 1989 and 1988, respectively, and is applied as a credit to depreciation in the accompanying statements of operations and accumulated deficit.

Pension Costs

All eligible salaried employees participate in the ITT Retirement Plan for Salaried Employees (the "Plan"). Total expenses under the Plan for the Company were approximately $64,000 in 1989 and $42,000 in 1988. Actuarial computations are made for the Plan as a whole. Accordingly, actuarial values of benefit obligations, plan assets at fair market value, and assumed rates of return are not available for subsidiary companies. The pension expense allocation is determined by the actuary.

Interest Expense

Interest expense consists primarily of interest on the Company's credit agreement with Manufacturers Hanover Trust Company (Note 5). Other charges include interest on customer deposits and short-term debt. Interest expense, net of amounts capitalized, approximated $504,000 and $532,000 in 1989 and 1988, respectively.

Statements of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents consist only of unrestricted cash on hand.

2. TRANSACTIONS WITH RELATED PARTIES

Reimbursed Expenses

The Company reimburses ITT-CDC for direct expenses incurred on behalf of the Company for data processing, payroll, engineering, and other miscellaneous services.

Charges to Developer, Including Interest

Under a ten-year agreement effective June 1980, the Company charges a fee to ITT-CDC for the availability of water and sewer services to unoccupied lots. Under the same agreement, the Company is also reimbursed for certain interest charges related to the cost of borrowed funds. The fees and interest charges are designed to reimburse the Company for its costs related to such unoccupied lots, including depreciation, operation and maintenance expenses, and interest expense, net of allowance for funds used during construction. Management intends to evaluate and discuss the continuation of such fees with ITT-CDC on a year-to-year basis upon expiration of the current agreement.

3. CASH AND SHORT-TERM INVESTMENTS HELD IN TRUST

On May 28, 1986, the Company established a trust as a depository for sewer CIAC received after December 31, 1985 from ITT-CDC homesite purchasers. The principal purpose of the trust is to ensure that such CIAC are available to the Company as required when future customers connect to the Company's sewer system. Disbursement of the principal by the trustee is limited to the purposes defined in the trust agreement and is allowable only upon written authorization from company representatives as outlined in the agreement.

The trust is administered by Barnett Banks Trust Company N.A. The trust investments in 1989 and 1988 consisted of cash, short-term treasury notes, and certificates of deposit earning an average annual interest rate of 8% and 7% in 1989 and 1988, respectively. Interest earned on these funds was approximately $374,000 and $296,000 in 1989 and 1988, respectively.

4. CASH AND SHORT-TERM INVESTMENTS HELD IN ESCROW

On May 5, 1987, the FPSC allowed the Company to begin collecting the tax impact on CIAC collected after December 31, 1986 (see Note 1). Tax impact amounts are deposited into an escrow account to ensure that tax impact charges are available to the Company for payment to state and federal revenue agencies as required.

The escrow account is administered by Barnett Banks Trust Company, N.A. The escrow investments in 1989 and 1988 consisted of cash, short-term treasury notes, and certificates of deposit earning an average annual interest rate of 8% in 1989 and 6% in 1988. Interest earned on these funds was approximately $41,000 and $26,000 in 1989 and 1988, respectively.

5. LONG-TERM DEBT

The Company has an $11,000,000 credit agreement with Manufacturers Hanover Trust Company which converts to a three-year loan effective December 31, 1992. The final maturity date of the loan is December 31, 1995. Outstanding borrowings under this agreement were $4,000,000 and $5,000,000 at December 31, 1989 and 1988, respectively. At the election of the Company, the outstanding principal amount of the loan bears interest at either (1) the commercial lending rate of Manufacturers Hanover Trust Company or (2) the London Interbank Offered Rate plus 1/2% per annum. A commitment fee of .35% per annum is charged on the unused portion of the commitment.

6. LINE OF CREDIT

On May 31, 1989, the Company renewed through May 31, 1990 a $1,000,000 line of credit with Barnett Bank of Volusia County at an interest rate equal to the bank's prime rate. The Company had no borrowings outstanding under this line at December 31, 1989 and 1988. The unused portion of this line of credit is subject to a commitment fee of 1/2% per annum.

7. OPERATING REVENUES

Sources of operating revenues were as follows:

	1989	1988
Residential	$3,082,917	$2,621,067
Commercial	392,193	365,001
Irrigation	550,385	527,958
Other	396,304	380,639
	$4,421,799	$3,894,665

8. RATE MATTERS

On January 4, 1988, the FPSC granted the Company a rate increase of approximately 28% for water and 20% for sewer. The new rates were effective for meter readings on or after January 14, 1988.

On February 2, 1988, the FPSC initiated an investigation of the "financial records and tax treatment of the investment in the water and sewer assets of the utility." Also to be investigated were the Company's practices in the collection of guaranteed revenue. The Office of Public Counsel intervened in the docket.

On May 19, 1989, the Company filed with the FPSC an Application for Interim and Permanent Rate Increase to increase revenues by approximately $1,186,000 annually. On July 18, 1989, the FPSC granted the Company an interim rate increase of approximately 9% for water. There was no interim rate increase for sewer. The interim rates were effective for meter readings on or after August 18, 1989. Revenues collected under corporate undertaking subject to refund with interest related to the interim rates (included in water and sewer revenues in the accompanying financial statements) approximated $110,000 for the year ended December 31, 1989.

On August 28, 1989, the FPSC subsumed the investigation docket into the rate case docket. The FPSC is currently scheduled to issue an order in the rate case docket on April 9, 1990.

In the Company's current rate case and in the earlier investigation docket now joined to the current rate case, a number of issues have been raised by the FPSC staff and the Office of Public Counsel, including a reconsideration of the amounts of deferred repair costs and completion costs, which will be recognized for rate-making purposes. In the investigation docket, the FPSC did not make a final determination on this repair and completion issue. It is now an issue in the current rate case, and the FPSC is evaluating whether such costs were prudently incurred. The Company is continuing to vigorously contest arguments that these amounts should be disallowed. On November 15, 1989, the Company filed rebuttal testimony with the FPSC expressing the position that the costs in question were prudently incurred and properly accounted for as had been approved by the FPSC.

At December 31, 1989, unamortized deferred repair costs were carried at $151,797, and net completion costs, included in net utility plant, were carried at $1,189,858. Realization of these carrying amounts is dependent on recognition for rate-making purposes. A disallowance by the FPSC of any or all of these amounts could result in a charge to earnings equal to the amount of the disallowance. Management cannot determine the outcome of this issue at this time, and accordingly, no provision for any loss relating to these deferred repair costs and completion costs has been made in the accompanying financial statements.

The Company has also filed rebuttal testimony with the FPSC relating to the other issues raised in the case, including the amount of prepaid deferred income taxes which will be recognized for rate-making purposes. Although the Company's exact exposure to loss from these other issues cannot be determined at this time, in management's opinion, based upon the facts and testimony related to this docket to date, a material adverse impact on either the financial position or results of operations of the Company from these other issues is not probable.

9. OPERATING EXPENSES

Operating expense items were as follows:

	1989	1988
Operating and administration	$2,562,488	$2,200,651
Maintenance	216,725	189,155
Depreciation and amortization	1,254,230	1,164,679
Taxes, other than income taxes	389,714	332,421
	$4,423,157	$3,886,906

10. OTHER INCOME

Other income items were as follows:

	1989	1988
Contributed state income taxes	$ 239,723	$ 229,820
Charges to developer, other than interest	780,528	788,231
Allowance for equity funds used during construction	51,116	13,803
Amortization of investment tax credits	99,134	99,134
	$1,170,501	$1,130,988

11. NET INTEREST INCOME

Interest expense (income) items were as follows:

	1989	1988
Interest on long-term debt	$ 436,846	$ 463,097
Other interest income, net	(287,467)	(237,123)
Allowance for debt funds used during construction	(9,021)	(2,436)
Interest charges to developer	(533,172)	(590,376)
	$(392,814)	$(366,838)

Other interest income is net of interest earned on escrow accounts (Note 3).

PALM COAST UTILITY CORPORATION

TAX IMPACT OF CIAC

15.0 Prior to the Congressional Tax Reform Act of 1986, Section 118(b) of the Internal Revenue Code provided for the exclusion of certain types of Contributions In Aid Of Construction (CIAC) from the taxable income of a corporate utility. Such amounts were, therefore, tax exempt.

However, pursuant to the Congressional Tax Reform Act of 1986, Section 118(b) was amended to reclassify CIAC (both cash and property) as a taxable source of revenue, effective January 1, 1987. The net result of this action is that a utility which is a corporation must now pay income tax on the CIAC it collects.

Since the amount of this additional tax liability is directly attributable to the contributors (developers, builders, etc.) of the CIAC, the utility is authorized to collect this amount from those contributors.

Therefore, in accordance with Order No. 23541 issued on October 1, 1990 in Docket No. 860184-PU, this Commission adopted and approved specific guidelines for a utility to administer in the calculation, collection, and reporting of CIAC tax liabilities as follows:

1) Palm Coast Utility Corporation will collect from developers and others who convey cash and/or property to a utility as CIAC, an amount equal to the tax impact of the CIAC.

2) The tax impact amount to be collected shall be determined using the following formula:

Tax Impact=(CTR/(1-CTR))*((C+CP+CL)-((((C+CP)/TL)*(1-(1+ROR)
-tl))/ROR)*(CTRi/CTR))

EFFECTIVE DATE:

Docket No. 860184-PU
Attachment B

Roy W. Likins, President

PALM COAST UTILITY CORPORATION
Sewer Division

CTR = Applicable marginal rate of federal and state corporate income tax
CTR = ST+FT(1-ST)
ST = applicable marginal rate of state corporate income tax
FT = applicable marginal rate of federal income tax

C = dollar amount of charges paid to a utility as Contributions In Aid of Construction which must be included in taxable income of the utility, and which had been excluded from taxable income pursuant of section 118(b) of the Internal Revenue Code

CP = dollar amount of depreciable property conveyed to utility which must be included in taxable income of the utility and which had been excluded from taxable income pursuant to section 118(b) of the Internal Revenue Code

CL = dollar amount of land conveyed to utility which must be included in taxable income of the utility and which had been excluded from taxable income pursuant to Section 118(b) of the Internal Revenue Code

TL = tax life for contributed property

CTRi = tax rate expected to be in effect when the depreciation is taken on the tax return

-tl = negative exponent of the tax life of the contributed asset

ROR = rate of return of 9.21%

3. Consistent with the terms of an Agreement dated February 11, 1987 between ITT Community Development Corporation (ICDC) and the Utility, both being wholly owned subsidiaries of ITT Corporation, tax impact amounts received by the Utility from ICDC that are specifically related to ICDC projects shall not be required to be deposited as received into an escrow account. However, CIAC tax impact funds received from anyone other than ITT Community Development Corporation shall be deposited into an escrow account.

PALM COAST UTILITY CORPORATION

TAX IMPACT OF CIAC

16.0 Prior to the Congressional Tax Reform Act of 1986, Section 118(b) of the Internal Revenue Code provided for the exclusion of certain types of Contributions In Aid Of Construction (CIAC) from the taxable income of a corporate utility. Such amounts were, therefore, tax exempt.

However, pursuant to the Congressional Tax Reform Act of 1986, Section 118(b) was amended to reclassify CIAC (both cash and property) as a taxable source of revenue, effective January 1, 1987. The net result of this action is that a utility which is a corporation must now pay income tax on the CIAC it collects.

Since the amount of this additional tax liability is directly attributable to the contributors (developers, builders, etc.) of the CIAC, the utility is authorized to collect this amount from those contributors.

Therefore, in accordance with Order No. 23541 issued on October 1, 1990 in Docket No. 860184-PU, this Commission adopted and approved specific guidelines for a utility to administer in the calculation, collection, and reporting of CIAC tax liabilities as follows:

1) Palm Coast Utility Corporation will collect from developers and others who convey cash and/or property to a utility as CIAC, an amount equal to the tax impact of the CIAC.

2) The tax impact amount to be collected shall be determined using the following formula:

Tax Impact=(CTR/(1-CTR))*((C+CP+CL)-((((C+CP)/TL)*(1-(1+ROR)
-tl))/ROR)*(CTRi/CTR))

EFFECTIVE DATE:

Roy W. Likins, President

PALM COAST UTILITY CORPORATION
Water Division

CTR = Applicable marginal rate of federal and state corporate income tax
CTR = ST+FT(1-ST)
ST = applicable marginal rate of state corporate income tax
FT = applicable marginal rate of federal income tax

C = dollar amount of charges paid to a utility as Contributions In Aid of Construction which must be included in taxable income of the utility, and which had been excluded from taxable income pursuant of section 118(b) of the Internal Revenue Code

CP = dollar amount of depreciable property conveyed to utility which must be included in taxable income of the utility and which had been excluded from taxable income pursuant to section 118(b) of the Internal Revenue Code

CL = dollar amount of land conveyed to utility which must be included in taxable income of the utility and which had been excluded from taxable income pursuant to Section 118(b) of the Internal Revenue Code

TL = tax life for contributed property

CTRi = tax rate expected to be in effect when the depreciation is taken on the tax return

-tl = negative exponent of the tax life of the contributed asset

ROR = rate of return of 9.21%

3. Consistent with the terms of an Agreement dated February 11, 1987 between ITT Community Development Corporation (ICDC) and the Utility, both being wholly owned subsidiaries of ITT Corporation, tax impact amounts received by the Utility from ICDC that are specifically related to ICDC projects shall not be required to be deposited as received into an escrow account. However, CIAC tax impact funds received from anyone other than ITT Community Development Corporation shall be deposited into an escrow account.

7

Palm Coast Utility Corporation

A Subsidiary of ITT Corporation

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DEC - 0 1990

FPSC-RECORDS / REPORTING

November 30, 1990

Ms. Kay Flynn
Division of Records and Reporting
Florida Public Service Commission
101 E. Gaines Street
Tallahassee, FL 32399

Dear Ms. Flynn:

As we discussed this morning, the "Report of New Dockets Opened" for the week of 10/29/90 shows Docket No. 900876-WS being opened for Palm Coast Utility. The description indicated Palm Coast is in Palm Beach County. This is not correct. Palm Coast is in Flagler County.

Please change the Commission's records to show Palm Coast Utility as being in Flagler County.

Thank you.

Sincerely yours,

Brian Bilinski
Assistant Controller

correction made
kf

BB/lad

2 Utility Drive, Palm Coast, FL 32137-7392 (904) 445-3311