

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition to Gross-Up ) DOCKET NO. 921218-SU  
Contributions-in-Aid-of- ) ORDER NO. PSC-93-0962-FOF-SU  
Construction (CIAC) in Pasco ) ISSUED: June 28, 1993  
County for the Related Tax )  
Impact by HUDSON UTILITIES, INC. )  
d/b/a HUDSON BAY COMPANY. )  
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The following Commissioners participated in the disposition of this matter:

J. TERRY DEASON, Chairman  
SUSAN F. CLARK  
JULIA L. JOHNSON

ORDER APPROVING AUTHORITY TO GROSS-UP  
CONTRIBUTIONS-IN-AID-OF-CONSTRUCTION

BY THE COMMISSION:

BACKGROUND

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

On November 30, 1992, pursuant to Order No. 23541, Hudson Utilities, Inc. (Hudson or utility) filed a request for authority to gross-up CIAC. By Order No. PSC-93-0206-FOF-SU, issued February 9, 1993, the Commission allowed the utility's proposed tariff to become effective by operation of law on an interim basis, subject to refund, after January 30, 1993.

Hudson is a Class C wastewater utility providing service to the public in Pasco County. As of December 31, 1991, Hudson served 469 wastewater customers. The utility had gross operating revenues of \$329,258 for the wastewater system and reported a net operating income of \$34,622 for the wastewater system.

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OFFICE RECORDS, TALLAHASSEE

APPROVAL OF AUTHORITY TO GROSS-UP CIAC

Order No. 23541 states that each utility must demonstrate that an above-the-line tax liability exists and that alternate sources of funds are not available at a reasonable cost. Utilities are required to file the following information to demonstrate the need to gross-up: Demonstration of Actual Tax Liability, Cash Flow Statements (except for Class C Utilities), Statement of Interest Coverage, Statement of Alternative Financing, Justification for Gross-up, Gross-up Method Selected and Proposed Tariffs.

Demonstration of Actual Tax Liability

Our review of the financial statements filed by Hudson indicates that it will incur an actual above-the-line tax liability prior to its collection of taxable CIAC. The utility projects collecting taxable CIAC in the future of approximately \$1,157,562. Based upon the filing, it appears that the utility will continue to have an actual above-the-line tax liability associated with the collection of CIAC.

Cash Flow Statement

The purpose of our review of the cash flow statements is to determine whether liquid funds are available to pay taxes on CIAC. Our review of the cash flow statements filed by the utility indicates that funds are not available to pay the taxes associated with CIAC. Generally, net cash is provided by operating activities. For 1991 and the nine months ending September, 1992, funds were used for capital improvements and debt service. The result of capital improvements activities on cash flow resulted in a deficit of cash for financing and investing activities, even with the inclusion of CIAC collections. The net change in cash was negative for the nine months ended September, 1992, and cash increased for 1991. In consideration of the foregoing, it appears that funds are not available for payment of taxes.

Statement of Interest Coverage

The times interest earned (TIE) ratio indicates the number of times a utility is able to cover its interest. The ratio is an indicator of the relative protection for the bondholders. It is also indicative of the utility's ability to go into the financial market to borrow money or issue stock at a reasonable rate. Order No. 23541 established a TIE ratio of 2x as a benchmark.

As of December 31, 1991, the utility had long-term debt of \$480,010. The TIE ratio calculated is 1.01x for the nine months ended September, 1992 and 1.412x for 1991, which are less than the benchmark established by Order No. 23541. This TIE ratio indicates that the utility does not have adequate interest coverage. From the annual report it appears the jurisdictional, above-the-line TIE ratio is 10.05x. It should be noted that the utility has a deficit in retained earnings of \$404,294, according to the annual report. This factor coupled with the utility's low TIE ratio may be indicative of the utility's inability to go into the financial market to borrow money. Additionally, the utility is earning a negative return of 2.5% for wastewater. These rates are not compensatory in view of the 12.73% overall rate of return authorized in the utility's last staff assisted rate case in Docket No. 900293-SU, by Order No. 23810, issued November 27, 1990. When these factors are considered, it does not appear that it is in the interest of either the utility or the ratepayers to increase a NOI deficiency.

#### Statement of Alternative Financing

The utility stated that additional unsecured, third-party loans are not available, at any cost to fund the additional tax burden related to CIAC, due to the proposed bond covenants. Proceeds from the bonds to pay operation expenses, such as income taxes are prohibited. The bond indenture does not contain any language which would prohibit the utility from securing subordinate debt for operating purposes. All of the utility's financial resources have been utilized in order to issue approximately \$3.934 million in taxable bonds to finance construction of extension of the collection system.

The utility states that although subordinated debt could be issued for operating purposes, it is highly unlikely that a subordinate lender could be found, given the current financial circumstances. Additional borrowings, even if available, would further erode the utility's capital structure and add to operating losses via additional interest expenses. In conclusion, the utility's ability to go into the financial market to borrow money may be impaired and the utility may not be able to obtain alternative financing at a reasonable rate because the utility has inadequate interest coverage, negative retained earnings, and a negative equity ratio.

#### Justification for the Gross-up

Hudson's service area includes the unincorporated Town of Hudson and surrounding areas. Most of the new connections will come from existing homes. There is a strong demand for central sewage collection services in the area. The utility indicates that expansion of the collection system and resulting customer additions will result in the receipt of taxable CIAC which will create a substantial tax liability. During the period 1992 through 1995, the utility anticipates the addition of some 2,457 new wastewater customers who will be paying the currently approved system capacity charges of \$1,000 per equivalent residential connection (ERC). The utility states that unless gross-up is effective prior to the collection of this CIAC, the utility will incur a substantial tax liability with no apparent source for funding of the tax liability.

Based on the total gross operating revenue generated in 1991, \$329,258, it appears that the utility will not be able to generate enough revenues through its current rates and customer base to cover its operating expenses, the taxes associated with CIAC, and service debt. The utility continues to accumulate operating losses. It appears that the utility will incur an above-the-line tax liability associated with the collection of CIAC and that it will not be able to generate the funds to finance the taxes either through its existing rates or alternative financing. Therefore, we find there is justification for this utility to gross-up CIAC and we, hereby, authorize Hudson to utilize the full gross-up method.

#### Gross-up Method Selected

The utility stated that it selected the full gross-up method because of the ease in administration and implementation. Also, the utility states it does not have the financial resources to fund the up-front investment required by the present value gross-up method.

#### Proposed Tariffs

In accordance with Order No. 23541, the utility has submitted proposed tariffs for the full gross-up as requested in its filing.

Upon consideration of the foregoing, we find that the utility's request to gross-up its CIAC is reasonable and it is therefore, approved. Further, Orders No. 16971 and 23541 prescribed the accounting and regulatory treatments and record

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keeping for the gross-up, and required refunds of certain gross-up amounts collected. The CIAC collections shall be made in accordance with those Orders and all matters discussed in the body of those Orders are expressly incorporated herein by reference. The tariffs shall be approved as filed and will become effective upon expiration of the protest period. Upon expiration of the protest period, if no protests have been received, this docket may be closed. In the event a protest is received, the utility may continue to collect the gross-up, on an interim basis, subject to refund.

Based on the foregoing, it is, therefore

ORDERED by the Florida Public Service Commission that the request of Hudson Utilities, Inc., for authority to gross-up-contributions-in-aid-of-construction is hereby approved. It is further

ORDERED that the collections of the CIAC gross-up shall be made in accordance with the provisions of Orders No. 16971 and 23541, which by reference are incorporated herein. It is further

ORDERED that the tariffs shall be approved as filed and shall become effective on the stamped approval date. It is further

ORDERED that this docket shall be closed upon expiration of the protest period if no timely protests are received. However, if a protest is filed, the utility may continue to collect the gross-up, on an interim basis, subject to refund.

By ORDER of the Florida Public Service Commission this 28th day of June, 1993.

  
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STEVE TRIBBLE, Director  
Division of Records and Reporting

( S E A L )

LAJ

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

The Commission's decision on this tariff is interim in nature and will become final, unless a person whose substantial interests are affected by the action proposed files a petition for a formal proceeding, as provided by Rule 25-22.036(4), Florida Administrative Code, in the form provided by Rule 25-22.036(7)(a)(d) and (e), Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting at his office at 101 East Gaines Street, Tallahassee, Florida 32399-0870, by the close of business on July 19, 1993.

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

Any objection or protest filed in this docket before the issuance date of this Order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

If this Order becomes final on the date described above, any party adversely affected may request judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or by the First District Court of Appeal in the case of a water or wastewater utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days of the date this Order becomes final, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.