

Public Service
Commission

Docket #

DOCKET NO. 950000

W.S.
HEARING TRANSCRIPT DATED: 8-30-95

BEGINNING DOC. #08682-95 VOL. # I

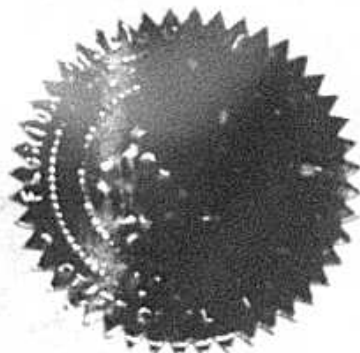
ENDING DOC. # _____ VOL. # _____

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

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In the Matter of
Workshop on Gross-Up of
Contributions in Aid of
Construction.

: DOCKET NO. UNDOCKETED
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PROCEEDINGS: WORKSHOP

DATE: Wednesday, August 30, 1995

TIME: Commenced at 9:30 a.m.
Concluded at 3:40 p.m.

PLACE: The Betty Easley Conference Center
Hearing Room 152
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: SYDNEY C. SILVA, CSR, RPR
ROWENA NASH HACKNEY
Official Commission Reporters

DOCUMENT NUMBER-DATE

08682 SEP-68



Public Service Commission

State of Florida

-M-E-M-O-R-A-N-D-U-M-

DATE: September 7, 1995
TO: Blanco Bayó, Director, Records and Reporting
FROM: Joy Kelly, Chief, Bureau of Reporting
RE: UNDOCKETED WORKSHOP HELD 8-30-95

IN RE: WORKSHOP ON GROSS-UP OF CONTRIBUTIONS IN AID OF
CONSTRUCTION.

DOCUMENT NOS. 08682-95, 9-6-95

The transcript for the above-described hearing has been completed and is forwarded for placement in the docket file, including attachments.

Please note that Staff distribution of this transcript was made to:

LEGAL, AFAD and WAW, SOLD

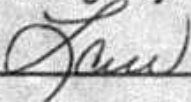
The following exhibits are being filed with this transcript:

NONE

The following exhibits have not been furnished to the Bureau of Reporting to date and do not accompany this transcript:

NONE

Acknowledged by:



JK/pc

1 IN ATTENDANCE:

2 LILA JABER, RALPH JAEGER, BILL LOWE, CONNIE
3 McCASKILL, ANN CAUSSEAU, BETH SALAK and JACKIE GILCHRIST,
4 Florida Public Service Commission.

5 B. KENNETH GATLIN, Palm Coast Utility, Florida
6 Cities Water Company, Poinciana Utilities.

7 F. MARSHALL DETERDING and BOB NIXON, Florida
8 Waterworks Association, Hydratech, Clay, JJ's Mobile Homes,
9 Rolling Oaks, Eagle Ridge, Forest, Aloha, Little Sumpter,
10 North Fort Myers, Parkland.

11 MICHAEL E. MURPHY, Florida Cities Water
12 Company/Poinciana Utilities, Avatar Utilities, Inc.

13 BRIAN BILINSKI, Palm Coast Utility.

14 GEORGE MacFARLANE, Regulatory Consultants, Inc.

15 PAUL H. FREEMAN, Southwest Florida Capital
16 Corporation.

17 PETER R. COMEAU, U.S. Home Corporation.

18 RON NUNES, Parkland Utilities, Inc.

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P R O C E E D I N G S

(Workshop convened at 9:30 a.m.)

MR. LOWE: Good morning. We're here for the CIAC gross-up workshop. For your information, there are some continuing education sign-up sheets if you are interested in continuing education for CPAs and there are extra copies of the notice with the questions that we have prepared and sent out to everybody on the front table also.

At this time, Lila will read the notice.

MS. JABER: This time and place has been designated for a Staff workshop on the gross-up of CIAC, contributions in aid of construction.

MR. LOWE: I guess I'll introduce myself. My name is Bill Lowe, I'm the Assistant Director of the Division of Water and Wastewater. Sitting beside me is Lila Jaber; she's the Bureau Chief of the legal services for Water and Wastewater. Connie McCaskill, Ann Causseaux, Beth Salak, all sitting at the front table. We have Ralph Jaeger and Jackie Gilchrist.

We are here today to get comments, suggestions, anything to fix this mess of a gross-up we've got. We have some 20-something companies that are presently grossing up CIAC. We've got open years on a number of them back into almost the mid '80s. They have become a nightmare. It is difficult, the filings are difficult for the companies,

1 they're difficult for us to process.

2 Our objective is to somehow or another simplify the
3 process. That's what we are here for today. We want to hear
4 from you all as to what we can do to simplify this process.

5 We've got some ideas that we will, if they are
6 workable, we'll use them. Hopefully you all have some other
7 ideas that maybe we can incorporate and we'll all go away
8 happy.

9 With that, that's about the opening comments we
10 have. We're interested in what you have to say. We prepared
11 this list of questions that at some point in the game we'd
12 like to go through and hear what you have to say about the
13 questions; but we're interested in what you have to say about
14 the present CIAC gross-up and the methodologies, anything you
15 want to talk about, and what we can do to fix the problem.

16 Mr. Gatlin, would you like?

17 MR. GATLIN: Yes. I think it's important that today
18 you hear from the people who are actually in the business and
19 have to deal with this. I can make some general statements,
20 but Mike Murphy from Florida Cities and Poinciana is here;
21 Mike Murphy is here from Palm Coast, and Florida Cities and
22 Poinciana and Brian Bilinski is here from Palm Coast. They
23 both have information they would like to offer to you.

24 And we would certainly want to fit in our comments
25 relative to what Marty Deterding might have on behalf of the

1 people he's appearing for today. Marty, whatever is your
2 pleasure, we'll go over, let you make the statements first or
3 whatever is appropriate.

4 MR. DETERDING: I'm here on behalf of the several
5 companies who gross-up individually and also on behalf of the
6 Waterworks Association. We have some information prepared by
7 Bob Nixon of Cronin, Jackson, Nixon and Wilson; and I believe
8 Bob has copies of that. It is basically a response to most of
9 the items raised in the Staff's list of issues. I believe Bob
10 has left off those items where it is either a nonissue, one
11 that I believe everybody agrees on or believes everybody
12 agrees on, or that he believes is not controversial in any
13 case. And I believe Bob has several copies of that.

14 We have also, Bob and I have also, reviewed the
15 information prepared by Florida Cities and Poinciana and
16 concur pretty much in the way that is done, as well, those
17 comments offered there.

18 Bob's memo is from the perspective of what we
19 believe Order 23541 and the previous findings that led up to
20 23541 were intending; and I believe the Florida
21 Cities/Poinciana memo is more from the perspective of
22 generally where we should really go from here as opposed to
23 what is currently in our opinion required under those orders.

24 So while Bob and I have our own documents, I believe
25 we have agreed that we concur with the conclusions reached in

1 the Florida Cities/Poinciana memo as well.

2 I guess we can bring those items up one-by-one as we
3 go through the individual issues in the notice.

4 MR. GATLIN: Excuse me. Palm Coast and Poinciana
5 each have a document which has the questions and the answers
6 on it. I don't know what your preference is, to let us give
7 you these or to go down and see what each position is on each
8 question, or exactly how you want to?

9 MR. LOWE: If someone, the way we tried to structure
10 this was if someone wanted to make a presentation, we would
11 allow them to make a presentation. If there's somebody that's
12 got travel plans that needs to catch an airplane or something,
13 we would take them first or what have you and let them get in
14 what they said. That would suit me just fine.

15 But if you want to jump right to the questions, this
16 is going to be very informal, folks. I have no desire to make
17 this very formal at all. So whatever you all's preference is,
18 if somebody has travel plans, let me know -- travel
19 problems --

20 MR. GATLIN: Why don't we start with Florida
21 Cities/Poinciana in view of Marty's comments about that
22 position and maybe we could key off from there if you want to.

23 MR. LOWE: Sounds good to me, Mr. Gatlin. And,
24 Mr. Gatlin, if we could go ahead and get the copier of
25 whatever you all are going to hand out? And Mr. Deterding, if

1 you have copies?

2 If there's anyone that's out there in the audience
3 that has a comments at any time, I welcome you to interject it
4 at any time you want to, but you'll need to come up and talk
5 to the microphone because we do have a court reporter who is
6 recording for us today.

7 MR. MURPHY: For the record, my name is Michael E.
8 Murphy. I'm Vice President and Chief Financial Officer for
9 Florida Cities Water Company, Poinciana Utilities, as well as
10 Avatar Utilities, Inc., Sarasota, Florida.

11 I have presented to you I guess each and every
12 question has been answered to some extent, as Mr. Deterding
13 has said. I think our perspective at Florida Cities and
14 Poinciana was to ask the Commission Staff and the Commission
15 to look into this whole issue again.

16 My involvement in the utility area only goes back
17 about a year and three months, so there's a lot more
18 experience sitting in front of me and behind me and to my
19 side. But it certainly confuses me, even after 17 years in
20 combined public accounting or real estate issues.

21 My basic focus is and the points I would like to
22 make is, one, I think that as discussed in some of the
23 previous orders, that each utility does have its -- it should
24 make the decision. I think that's a key component of that. I
25 believe the Commission has recognized that in the past.

1 I think it's important that when the utilities
2 select their methods that they have a chance to determine
3 those. And I guess one of the points I would like to bring
4 out is I think that possibly the requirements for gross-up,
5 full gross-up, may be too restrictive.

6 It seems to me that this issue of CIAC tax was
7 brought on by nobody here in this room, whether it be a
8 developer or a customer, but rather was brought out by the
9 Internal Revenue Code or the Congress of America. I think
10 it's an area where we have to be very careful when we weigh I
11 guess the benefits and the effects on everybody.

12 I think the utility is certainly involved, the
13 customers, the developers, all of those people need to be
14 weighed out. This is something that we realize. But this
15 issue of CIAC causing a tax to me is kind of a stand-alone
16 issue. You know, this is one that was brought up in one of
17 the major previous orders of 1990 and was rejected by the
18 Commission. And I would hope that they might turn toward that
19 and look at that again this time around.

20 To me, CIAC is kind of a stand-alone issue. There's
21 nothing that CIAC does that causes -- it causes a tax in and
22 of itself. And some of the concepts that have spun off of
23 that the Commission has now recognized has a stand-alone
24 nature. I think they recognize issues I think that cause
25 discrimination amongst contributors and I think impair the

1 ability of the utilities.

2 I would say, as to discrimination amongst the
3 contributors, if certain circumstances -- and I think Marty's,
4 Mr. Nixon's position, shows it quite well -- is that one of
5 the issues we're struggling with is subsequent years
6 depreciation. That subsequent years depreciation under full
7 gross would suddenly tend to have a different tax paid by
8 each, by different contributors in different years. It seems
9 to me that this is an issue that ought to be simple enough
10 that if you have \$100,000 in cash, for example, or give
11 \$100,000 of contribute! property, that the developer pays the
12 gross-up tax on it if that's the method the utility chooses to
13 use and that's the end of it.

14 When we get into issues, one of the first things I
15 guess that happened in all this is somehow the developers now
16 get the first year depreciation returned on full gross-up.

17 That concept, I can't understand it. I don't see
18 the logic in it. I guess if I was a developer I would
19 certainly argue that. If they're going to give me the first
20 year's depreciation, I think I ought to be entitled to every
21 year's depreciation. So there's a gap of logic.

22 I'm certain the Commissioners and the Staff have
23 more knowledge how that was arrived at. I'm a little bit at a
24 loss at that. That doesn't make a lot of logic to me.

25 So, in effect, a contributor can get a different tax

1 rate. A contributor can get a different tax rate if, for
2 example, one year my revenue requirements weren't as good as
3 they were in my past year. For example, if there's a
4 conservation effort in my district, or if there is a heavy
5 rain, my normal revenues come down. My "above-the-line," in
6 quotes, I might have an above-the-line cost. In that case,
7 then the contributor in that year effectively would not pay
8 any tax. This formula would say, "You have no tax liability,
9 therefore, no tax."

10 I think that causes a great discrimination. I just
11 don't see the logic in treating a party one year differently
12 as opposed to next year when receiving contributions.

13 Another issue I think that spins off of this is the
14 confusion over net operating losses of the utility. And the
15 concept was raised that whether these are above or below the
16 line. I guess I would have to say that in that context the
17 net operating losses of the utility are below the line. These
18 are losses from prior years and they have nothing to do with
19 the CIAC contributor.

20 Now true in effect, as some of the orders have
21 indicated, the tax calculated in that year for a utility in
22 totality for a total company basis might have a lower, but
23 they utilized the NOL and therefore might have a lower tax.
24 But to me that net operating loss belongs to the utility
25 shareholders. Something created that loss in the past; and by

1 virtue of applying the CIAC income against that, you deny the
2 utility owners their chance to earn that back.

3 And that argument was brought out in the 1990 order;
4 it was rejected by the Commission, and I still don't see the
5 logic of that. You know, if I give \$100, if I lose \$100 today
6 and I have CIAC comes in a tax at \$100, I have lost that
7 opportunity. Because I think the way the Commission has ruled
8 on this, they say that any benefit of CIAC should go back to
9 the ratepayers.

10 So if we are given that -- if we give the CIAC back
11 to the ratepayers in the form of the tax benefit of
12 depreciation on CIAC, certainly the utility itself I don't
13 believe gets any benefit to it. So just using NOLs I think
14 would benefit one contributor in one year.

15 It seems like this has caused a situation where the
16 CIAC tax kind of bounces up and down, as you were. I may be
17 the lucky developer that comes in and hits the year of the big
18 jackpot year. The company didn't do very well, it might have
19 an above-the-line loss, it might have NOLs, and I get away
20 without having to pay the tax.

21 The next year, another developer comes in and puts a
22 contribution in -- or a homeowner -- and the NOL has been
23 utilized, things have turned around for the utility and they
24 have a much better bottom line and suddenly I have to pay a
25 tax on the CIAC.

1 So I think all those issues kind of cloud the issue
2 and I think give us some of the problems that the Staff and
3 the Commission are searching for right now. There are just
4 too many things that I guess I could call it a quagmire in
5 some respects and I'm sure you sound like you recognize it,
6 too. But, I mean, that's the sum concept of where I think
7 CIAC is from a standpoint of.

8 Let me summarize, it's a utility decision, okay? In
9 regards to it's a utility decision, I think some of the
10 requirements that the Commission has levied upon the utility
11 to meet may make it too difficult to try to meet those
12 requirements.

13 MS. SALAK: Can you be specific on which ones you
14 think?

15 MR. MURPHY: I think any of them from a general
16 standpoint. I think it's utility management. If you start
17 looking at each one of the requirements, I think there are
18 seven listed in that order, I think they all kind of relate
19 together. I think that should be a practice of the utility.

20 Obviously, one of the big ones is the competition
21 issue. The utility might decide they don't want to gross up
22 because of the competition. They may want to have extension
23 fees or capacity fees and pick it up. But I think that's a
24 decision for the utility to make in that regards and I think
25 it becomes a little bit arbitrary in some respects.

1 Maybe I can address each one of the seven at another
2 point in time. As I indicated, I have only about a year and
3 three months experience in utilities, so don't grill me too
4 hard on cross examination.

5 I think we should try to simplify this whole area.
6 I really think CIAC is a stand-alone issue. We collect the
7 tax that we gross up, we keep it unless there's a change in
8 the tax law or some event like that. Theoretically, if you
9 collected it based on the proper rate, if you were applying
10 the proper rate in the future you wouldn't give it back.

11 Remember, that CIAC goes back to the ratepayer in
12 the form of lower rates. And maybe that's a windfall to the
13 ratepayer. Maybe you can sit up there and say, "Well, we're
14 going to," I guess I hate to use the phrase, "do the right
15 thing." But when we do the right thing, who are we doing it
16 for?

17 Certainly, I guess I want to do the right thing for
18 the ratepayer first. And I firmly believe in my heart, being
19 in the development side about eight years, that when the
20 developer makes a profit, he's made a profit.

21 Now, I would admit if I was on the other side of the
22 issue here, I would argue up and down, wouldn't I want to have
23 more money in my pocket as a developer? Darned tooting I
24 would. But the same thing, I would like FPL to give me a
25 rebate on my power rates; or I would like my carpenter to

1 charge me less rates; or I would like the government to cut
2 its tax rate on my business. Those are all things that I
3 would like to see as a developer if I was a developer to
4 improve my cash flow.

5 But once I have committed to that development, sold
6 that lot, sold that home or sold that commercial site, I have
7 a profit. Now, my profit could have been higher because of
8 many different things or lower because of many different
9 things, but it is kind of out of my hands at that point in
10 time. Essentially, then the person who has bought that
11 property, commercial tract, industrial tract or homeowner, now
12 they're kind of there in my place and I have kind of passed
13 that along to them.

14 I certainly wouldn't argue that the CIAC belongs to
15 the ratepayer. I wouldn't want to make that argument. But in
16 a sense, some of that accrued benefit does go to them. I
17 think the method of full gross-up will pass back the tax
18 depreciation that we the utilities receive from the
19 government, from the IRS, and I think the ratepayer then gets
20 a lower rate.

21 Why shouldn't he get a lower rate? He's had to pay
22 a higher, maybe a higher premium for that lot because of the
23 CIAC tax. So I guess that's kind of where I'm coming from and
24 where Florida Cities and Poinciana is coming from.

25 Let's open this issue up and maybe free our minds of

1 some of the things that we have decided in the past. You
2 know, this has a ten-year history, we're coming up on ten full
3 years. I'm not saying that all the items are wrong.
4 Certainly, things can be improved on; but if we're going to
5 look at it, let's just kind of look at it and bring it out.

6 That's the way we went with our paper, let's think
7 of it in a new frame; let's just free our minds, as it were,
8 and then see if we can't move forward from here.

9 MR. LOWE: That is my intention, Mr. Murphy. That's
10 why all of the questions are there. We tried to open up every
11 issue there was. I want us to have an open mind and I want us
12 to take something to the Commission that will work, regardless
13 of past decisions.

14 Now, there's a court case or two out there that we
15 can't undo, I don't think; but other than that, I have a
16 completely totally open mind. I want something that works
17 because it is not working now.

18 MR. MURPHY: Thank you, sir.

19 MS. CAUSSEAU: Mr. Murphy, do you have a copy that
20 has Pages 4 and 5 that we can get copied?

21 MR. MURPHY: Oops. I apologize. That's the secret
22 stuff. (Laughter)

23 MS. CAUSSEAU: That's what we thought. We thought
24 it was the good stuff.

25 MR. LOWE: I interrupted you, Mr. Murphy, are you

1 finished with your comments?

2 MR. MURPHY: Yes, I think I've rambled enough at
3 this point in time.

4 MR. LOWE: No, you did a very good job.

5 Mr. Gatlin, you then want to go to Mr. Nixon next?

6 MR. GATLIN: Yes.

7 MR. DETERDING: I want to touch on a couple of
8 things before you do that.

9 MR. LOWE: Okay.

10 MR. DETERDING: Mr. Murphy mentions -- and I believe
11 it's something that I have seen throughout the comments I have
12 seen from members of the industry, including a letter from
13 Mr. Ron Nunes at Parkland, who is currently in the process of
14 requesting approval of gross-up authority -- and that is that
15 there is a tax impact of the collection of CIAC.

16 Mr. Murphy notes it should be treated standing
17 alone, the CIAC tax impact; and that's because regardless of
18 whether this year there's an operating loss carryforward, or a
19 carryback two years from now, or a current operating loss
20 because of some circumstance, there's a tax impact of that.
21 You may be able to offset it by some other tax benefit you
22 have, but there is a tax impact of collection of CIAC. And
23 what I believe Mr. Murphy's memo proposes is that we recognize
24 that.

25 If we recognize that fact, we can simplify his

1 process a great deal because you can eliminate a lot of this
2 reporting back and calculation of refunds. Because there is a
3 tax impact; and if there is a tax impact, there are no refunds
4 to it. So, in light of that, that's just up one point.

5 Another point I wanted to make is the question of
6 the authority to grant gross-up -- to utilize gross-up. I
7 made this point when we were discussing Canal a while back and
8 I got the impression from the Staff that they disagreed with
9 me, and that was that it was intended to be liberally granted.

10 Admittedly, with the advent of Order No. 23541,
11 there were some restrictions placed on it. As you will
12 recall, originally in 1986 with Order 16971, all you had to do
13 was file a tariff. The Commission then over the next four
14 years or three-and-a-half years started thinking that, "Well,
15 maybe we ought to provide some tests whether you need
16 gross-up."

17 And I think Mr. Murphy's memo addresses that point,
18 that the Commission ought to be considering that as the way to
19 go, especially if the company desires to do it that way in
20 order to keep from impacting the customer.

21 But even with the issuance of Order 23541, I still
22 believe that gross-up authority was fairly liberally granted.
23 And I think the restrictions have grown ever tighter since
24 then. That's of great concern to me, especially in light of
25 the fact that I believe the person who is going to ultimately

1 suffer from that is the general body of ratepayers. Because
2 if you agree there is a tax impact from CIAC, either the
3 shareholders are going to eat it if you deny gross-up
4 authority where it is requested or the customers are going to
5 eat it -- one or the other and quite possibly and probably
6 both.

7 So those are the two comments I just wanted to offer
8 in light of what Michael has had to say.

9 MS. SALAK: Marty, what makes you think we've got --
10 is it you think Staff has gotten so that we are interpreting
11 it so that it is tighter?

12 MR. DETERDING: Yes. Yes.

13 MS. SALAK: And which case are you referring to?

14 MR. DETERDING: Well, I mean, every case I have been
15 involved in in the last couple of years related to a request
16 for gross-up authority I think the restrictions have grown
17 ever tighter. And I think the same is true with the
18 calculation of the refund, the level of inquiry and analysis
19 has grown substantially.

20 MR. NIXON: I think what we are seeing in that
21 regard is an attempt or a request at the time a company
22 applies for authority to gross up to look at every conceivable
23 number on an above- and below-the-line basis, including
24 carrybacks that may go back ten years, projections of income
25 out into the future on an above- and below-the-line basis.

1 I know all the applications we filed shortly after
2 the issuance of Order 23541 we simply demonstrated that there
3 was an above-the-line, the likelihood of an above-the-line
4 tax; and that this likelihood would later be proved out when
5 the company filed its annual reports with the PSC regarding
6 disposition of gross-up.

7 So I have seen a tightening of the requirements, an
8 attempt to so analyze a company's past operations, present and
9 future, to make sure that with absolute certainty they think
10 there's going to be a tax liability and, if not, the tendency
11 is to deny the company's request to gross up.

12 MR. GATLIN: My observation is that the Commission
13 has approved a gross-up formula to go in a company's tariff
14 and the company collects it, collects gross-up of the tax
15 thereon pursuant to that approved tariff sheet, particularly
16 on full gross-up.

17 And then when it comes time to file the reports and
18 the refund consideration, it seems every case further refines
19 or puts in another element that is a surprise to everybody so
20 that the full gross-up when the refund is considered is not
21 considered on the basis of a full gross-up but closing the gap
22 between that and a net present value gross-up. So the
23 application is the net present value consideration applied to
24 the full gross-up collection.

25 And it seems to me if the Commission has approved a

1 full gross-up formula for a utility and the utilities used
2 that and complied with the tariff and all that, I don't know
3 why all this NOLs and depreciation has to be involved in it.
4 Because it is not a full gross-up if you do all that.

5 MR. LOWE: Mr. Gatlin, I think we're both -- I was
6 going to say "both sides," but we're really not supposed to be
7 a side, but in some cases we tend to be guilty of chipping
8 away in both directions.

9 MR. GATLIN: I understand.

10 MR. LOWE: You all file different things with
11 different adjustments on them per the individual company and
12 then we look at things from another perspective. So I think
13 both sides are guilty --

14 MR. GATLIN: Yes, sure. I wasn't accusing anybody
15 of anything, I was telling you what my observation was as to
16 how it had developed.

17 MR. LOWE: And I agree with you wholeheartedly. As
18 you remember, when this mess started when they changed the tax
19 law, the Commission in an attempt to be fair to the utilities
20 so that they didn't lose any money put the authority to
21 gross-up in almost as an emergency type item subject to
22 refund.

23 MR. GATLIN: Right.

24 MR. LOWE: Which is totally different than what the
25 Commission does with most things: If you want rates, you come

1 in and prove you need rates; and then you go away and you file
2 an annual report; nothing is subject to refund. If we find
3 that you are overearning, we go through an overearning process
4 and it's prospective in nature. We're not holding all this
5 money subject to going back to somebody.

6 A major difference in how this is done and how we
7 set rates -- how we set the original portion of the CIAC
8 charge.

9 MR. GATLIN: Yeah. All I'm pointing out -- and I
10 think Mike referred to it. This started in 1986, the
11 Commission's order came out in December of '86 and the first
12 gross-ups went into effect on January 1, 1987. But that's
13 been a long time ago. There's been an order out considering
14 it since then from the Commission where they set up these
15 criteria.

16 And I think that one of the evolutions should have
17 been or should be surely at this point is to resolve, "Okay,
18 utility, you can collect it," you know, it's just like any
19 other charge. It's sort of like your service availability
20 charges, it's sort of part of that. There's a tariff sheet on
21 it just like there is a service availability charge.

22 MR. LOWE: And I tend to agree with you. In fact I
23 think it just ought to be a part of the CIAC charge itself,
24 the service availability charge.

25 MS. JABER: Can I ask Mr. Murphy a couple of

1 questions on Pages 4 and 5? Actually, they're both on 5.

2 In response to the Commission allowing
3 project-specific gross-up, you said no. What is your
4 rationale for that?

5 MR. MURPHY: I apologize here. I think the copy
6 that I got here is a draft copy.

7 MS. JABER: Okay.

8 MR. LOWE: Why don't we go on to Mr. Nixon and come
9 back to that?

10 MR. MURPHY: I can give you the answer. Should the
11 Commission allow? I just think no. I think I thought through
12 this as a possibility of maybe on a project-by-project basis
13 but I came to the conclusion, I guess I kind of slept on it,
14 that we had a discriminatory type action it really would be.
15 When I first read this --

16 MS. JABER: In the sense that you would treat all
17 developers the same, they all --

18 MR. MURPHY: And I said to myself, "Well, what if
19 somebody comes in, what if I have a no gross-up or what if I
20 make my decision myself as the utility and somebody comes in
21 with a huge project? And as a normal rule I have maybe some
22 de minimis type CIAC taxes. I suddenly have a large tax,
23 maybe I ought to collect that from them because of the impact
24 on the utility?"

25 But then I said, "Yes, I think it could be on a

1 project-by-project basis." But then I came to the conclusion
2 that no, I think we need to be as consistent as possible in
3 these areas. And I said that would be, I think,
4 discriminatory, because obviously one developer might say,
5 "Why this and why not that?"

6 MS. JABER: All right. And the second question --

7 MR. DETERDING: I just want to make one point on
8 that. If you mean by "project" a new development or a new
9 phase of a development versus another phase or another
10 development within a new territory, I agree wholeheartedly.

11 The bottom line is we would love to have that
12 option, but it won't work. You and us would be involved in
13 litigation with so many developers who are screaming
14 discrimination, it will never work. If you mean
15 system-by-system, maybe that's an alternative; but
16 project-by-project in terms of different developments within
17 one system, it just couldn't work.

18 MR. LOWE: Marty, I think that when I originally
19 thought about that particular question that I was looking for
20 the smaller companies that somebody is trying to make somebody
21 tie together and pick up a new project. You've got an
22 existing utility sitting there, everything is working fine,
23 and now you have another utility that's in trouble financially
24 and the physical plant is in trouble, everything, quality of
25 service is bad, now we're going to tie the two together; who

1 pays the CIAC tax?

2 MR. DETERDING: You make a good point. I think I
3 faced that in one circumstance and we bought it.

4 MR. LOWE: Yeah.

5 MR. DETERDING: We put ourselves on the line in that
6 if we got what is considered a bargain purchase we may be
7 sticking our neck out with the IRS. But that is the choice we
8 made. We stuck our neck out but we got a troubled system off
9 the line through a purchase as opposed to that. And
10 admittedly that is a risk.

11 MR. LOWE: I j'ust don't want to eliminate any
12 possibilities of us being able to fix a troubled system.

13 MR. DETERDING: Certainly in that kind of situation
14 it's an alternative to certainly be considered. It's just I'm
15 afraid there's no such, just like CIAC tax, I'm not sure
16 there's a, quote, "solution."

17 MR. LOWE: I'm not either, but I wanted that thrown
18 out anyway.

19 MS. JABER: The second question I have, Mr. Murphy,
20 was on the notion of giving Staff administrative authority to
21 reduce the amount of gross-up. You said no?

22 MR. GATLIN: Page 6?

23 MS. JABER: It's 5 on mine.

24 MR. MURPHY: In what context I guess would the
25 question come from, is why I had to say no.

1 MS. JABER: Okay. I think we were coming from the
2 proposition that if the utility had one method approved and
3 was permitted to change the next year, should Staff have
4 administrative authority to deal with those situations and
5 reduce the amount of gross-up collected if need be?

6 MS. CAUSSEUX: In other words, if you were going
7 from full gross-up -- if you had requested to go from full
8 gross-up to net present value, could we just do that
9 administratively as opposed to going back through the whole
10 process before the Commissioners?

11 Not us deciding to reduce your amount, but you
12 requesting it and then avoiding the full process.

13 MR. MURPHY: Let me change my answer. Yes.

14 MR. DETERDING: Would that include a request to go
15 from net present value to full?

16 MS. SALAK: No.

17 MS. CAUSSEUX: No.

18 MS. JABER: No. I still think the Commission would
19 have to vote to that. But that's why it was important for me
20 to clarify, because this was a way we viewed it as
21 streamlining the process and making it a bit simpler.

22 MR. DETERDING: I guess what you are saying is if
23 you demonstrated an entitlement under the current criteria to
24 full, you certainly can demonstrate one as to --

25 MS. JABER: Exactly.

1 MS. CAUSSEAU: Mr. Murphy, we must have very
2 inartfully worded our question on Page 2 at the top, B, should
3 it be permissive or required? What we were thinking was if
4 gross-up was a good idea -- and I think you have indicated
5 that it is -- should all utilities be required to gross up as
6 opposed to should some be allowed to and others not? Should
7 we just simply say, "It's a good idea, gross up"?

8 MR. MURPHY: I think permissive and it's a good idea
9 management decision type would be my response on it. I was a
10 little confused on the term "permissive or required," I think
11 "permissive" would be my response. I'm sure other people
12 would like to speak to responses to "required" and probably
13 can talk to it more intelligently. I think it is really a
14 management decision and almost it is utility-by-utility as the
15 case warrants.

16 MR. DETERDING: I think the circumstances are so
17 different with regard to each utility that, despite the fact
18 that I think most of us here believe that generally the
19 utility needs a utility who is getting a substantial amount of
20 CIAC probably ought to gross up to avoid an impact on the
21 ratepayers, there are circumstances and quite a few of them
22 out there where all sorts of variables may affect that
23 decision, including the question of whether or not you're
24 going to stagnate your growth. And that may have a larger
25 impact on your customers than deciding to pay the tax on

1 CIAC -- which I think is part of the reason why some companies
2 have chosen not to.

3 MR. LOWE: We've had comments from a number of
4 companies about the effects of competition, too, fighting for
5 the same customers.

6 MR. DETERDING: Absolutely.

7 MR. MURPHY: If I may add to that? When you first
8 talked about changing to full gross-up, obviously Florida
9 Cities Water Company has no gross-up. We're starting to maybe
10 reconsider that.

11 I think one of the points is why you hadn't gone
12 back and asked. I guess we considered the seven points, it
13 may be hard for us to meet those seven tasks or some
14 combination of them. But I know -- I would suspect at one
15 point in time in Florida Cities that some of the service areas
16 competition would be a concern for us. We do need to expand
17 and increase the size of our system, which ultimately benefits
18 our ratepayers.

19 But as we've seen recently, when we're up against
20 municipals, municipals have tended to increase their impact
21 fees so great in the past few years that my fee now without
22 the CIAC tax actually may be less than --

23 MR. DETERDING: With the CIAC.

24 MR. MURPHY: -- with the CIAC tax. So I'm probably
25 at a competitive advantage to the municipals, even. ...and I

1 think it depends on as an area grows -- I mean, obviously, as
2 areas fill in, the lower impact fees or lower connection fees
3 without a CIAC tax would be the areas that would connect
4 first. But as those areas fill in, I think the whole measure
5 changes and it needs to be kind of looked at again. It's a
6 dynamic situation.

7 MR. LOWE: Mr. Nixon, why don't we go to you if you
8 are ready.

9 MR. NIXON: Someone mentioned that we're going on
10 ten years discussing and then debating this issue, and that's
11 right. And Marty and I and Ken and some others here have been
12 in this battle and went through the big hearing, which, as I
13 recall, was a three- or a four-day hearing up here that led to
14 the issuance of Order 23541.

15 I'm not sure how productive our workshop will be
16 today unless we can focus in more specifically on what we
17 think is broken. I guess with the actual implementation and
18 the practice of the items that were decided in Order 23541.

19 For instance, I think after a lot of debate that we
20 decided in that order that the gross-up would be to cover the
21 tax effect on the CIAC and not just the actual tax paid. That
22 was decided.

23 Should the Commission continue to allow utilities to
24 gross up CIAC? That was an issue in the time. The Commission
25 decided yes, but we want to review your situation through an

1 application; and the Commission in that order established
2 certain criteria which I think the industry has lived with.

3 Certainly, the number of companies grossing up
4 living under those criterias to get the authority in the first
5 place has not increased dramatically. In fact, I think the
6 number of companies grossing up has gone down from maybe 40,
7 38 to 40 back at the time of 23451 now down to about 22 or 23.

8 So this whole issue is not an issue which impacts a
9 great number of companies in relationship to the total number
10 that you regulate.

11 MR. LOWE: Mr. Nixon, let me interrupt you right
12 there. Would the process itself intimidate some people, like
13 some companies?

14 MR. DETERDING: Yes.

15 MR. LOWE: In other words, if we streamlined it, we
16 might be able to get more of the companies grossing up.

17 MR. NIXON: Well, it would. But to be fair, I think
18 if you look at the tax situation of the vast majority of
19 companies you regulate, a lot of them are not taxable
20 entities, the smaller ones are partnerships or Sub S
21 corporations or sole proprietorships.

22 The larger A and B companies that are
23 developer-affiliated, many of them file consolidated tax
24 returns. And if the developer entity is the only bu'lder or
25 seller of lots, it doesn't really make sense for them to gross

1 up because they are just transferring money from one entity to
2 the other. I mean, on an overall basis, there's no tax. So I
3 think for that reason you're down to those companies that are
4 really pure utilities.

5 So I guess I would like some input from you to what
6 extent do you think we ought to try to amend what was in
7 23541? I think -- and I'm certainly not arguing for the
8 status quo, but I think what's broken with 23541 is this
9 notion of allocating above-the-line operating losses or
10 operating losses to above or below the line, which has led to
11 most of the problems. We didn't really have this problem the
12 first couple of years because Staff by and large liberally
13 looked at the information filed by the utility; and if it
14 seemed reasonable, they okayed it and the refunds were made
15 within a year after the report was filed.

16 I think the comments of Florida Cities are wise.
17 Back at the time of 23541, that was the Waterworks
18 Association's position on NOLs, that none of the NOLs belonged
19 to the ratepayer or the developer, that they're property, they
20 have value, the stockholders or the owner of the company paid
21 for those NOLs and they were his, and that they shouldn't be
22 used to the benefit of a contributor, a developer that comes
23 in.

24 And 23541 I think clearly established that the
25 developer, builder, seller of lots, whatever, he recovers that

1 money through the sales price of his home, both the CIAC and
2 the gross-up, and that the issue be decided was who gets the
3 benefit of depreciation? That was decided to go back to the
4 ratepayers.

5 I think, looking back, the decision that was made in
6 that order to require some allocation of the losses to above
7 and below the line to use to benefit the developer probably
8 was a poor decision because no one could have foreseen at that
9 time how complicated the calculations to achieve above- and
10 below-the-line numbers would become.

11 So I ask my question again: What is your intent
12 today? What is it you want to fix? One easy answer would be
13 just to forget about this above- and below-the-line
14 allocations.

15 MR. LOWE: Mr. Nixon, are you suggesting then that
16 NOLs as opposed to allocating them, you're suggesting we not
17 consider them at all, right?

18 MR. NIXON: Right.

19 MR. LOWE: Okay. We agree.

20 MR. NIXON: But, see, I need to know and I think
21 everybody here needs to know, are you willing to change or be
22 flexible on that position? Because what came out of 23541 was
23 a halfway victory. We argued for all that the NOLs not affect
24 the computation. Order No. 23541 said, Well, we'll go part
25 way with the industry and let you only use above-the-line NOLs

1 for the contributor's benefit. All the rest of them are
2 property of the stockholders.

3 So if we are willing to go back and readdress that
4 finding, I think this thing could be simplified greatly.

5 MR. LOWE: I have a very open mind on it. As to
6 whether I have three or more Commissioners who have an open
7 mind on it, I don't know. That's the only way I can answer
8 that.

9 We are here to make -- we're here to listen and see
10 what you all can convince us of. And I want us to present
11 something to the Commission that the Commission would accept
12 and will do that will simplify the process. Because I don't
13 know whether they will buy off on the NOLs or not. I can tell
14 you right now you have at least two Commissioners that will
15 never do that.

16 MS. MCCASKILL: One concern I had coming in is what
17 is our intent of this gross-up? Is it to tax the effect of
18 the CIAC at the time it is collected? If so, in my opinion
19 from dealing with it so far, what we intend for CIAC to do,
20 for the gross-up to do, will affect how we are calculating all
21 of this stuff.

22 If we are saying it's the tax effect of the CIAC
23 when it is received, then, from what I can see, we may just be
24 doing a lot of unnecessary work going above and below the
25 line. I don't think you have to do that to come up with a tax

1 effect.

2 MR. MURPHY: Absolutely --

3 MS. McCASKILL: So, you know, that's why I would
4 like us to clear up what do we intend for the gross-up to do?

5 MR. MURPHY: Just let me make the point that I think
6 we're right here. Our point is that I think CIAC is a
7 stand-alone issue. I think, even above and below the line,
8 that's a complicating factor; but when you take it in the
9 context of day-to-day business, it even meshes inside of that.

10 As I indicated earlier, I think you could have a bad
11 year, you could have a loss. It's not an NOL, it's a current
12 year loss. That current year loss then effectively -- which
13 will become and NOL in the future -- it goes to the current
14 year contributor. So I'm going to pull it even further out of
15 the above- and below-the-line to say I think CIAC is a
16 stand-alone issue. I think it's just like any other expense
17 and it gets passed along to somebody. And the "somebody" we
18 recommend if you use full gross-up would obviously be the
19 developer.

20 MR. DETERDING: To the extent you do this
21 above-the-line and below-the-line analysis, that
22 above-the-line loss or tax benefit in my mind has to be by
23 definition one of two things: it's either got to be one
24 generated by a shareholder funding a loss or it's got to be
25 one that a customer is somehow funding through the recognition

1 of accelerated depreciation, or some other item that is
2 technically going to in the long -- is related to the general
3 body of the ratepayers.

4 If you give it back to a contributor, you have taken
5 it from somebody. You've taken a tax benefit away from either
6 the shareholders that belongs to the shareholders or one that
7 belongs to the general body of ratepayers. I think that's our
8 perspective of all of us in the industry is that's not right
9 and that, therefore, this analysis, while it was the halfway
10 point that we all came to an agreement with in 23541, we don't
11 think it's right. And we think the person who's probably at
12 least the person you are most concerned about, the general
13 body of ratepayers, are going to get hurt by that.

14 MR. NIXON: I know under the method of accounting --
15 and I have attached an exhibit to show how the accounting
16 works, at least the way we have figured it out -- that there
17 is a, there is clearly a substantial benefit that goes to the
18 ratepayers each year in the books and records of the company.
19 These benefits either keep a company from coming in and
20 increasing rates or, if they come into a rate case, I think,
21 over time, substantially will reduce the amount of the rate
22 increase that a company may need.

23 When we look at this from that standpoint, that
24 makes simplifying this above- and below-the-line business to
25 give money back to a developer kind of a moot proposition. I

1 mean, why? Why are we going through this to benefit the
2 developer who has already collected or received the gross-up
3 and the amount of the CIACs paid to the utility from the
4 customer in the first place in the sales price of his home?
5 Plus he's received a tax benefit because he's taken a
6 deduction on his return for the cost of his lots sales, which
7 includes these items.

8 MR. LOWE: I tend to agree with you on that one,
9 Mr. Nixon. I mean, I don't see the customer ever getting the
10 benefit -- the ultimate customer ever getting the benefit.
11 The developer gets the benefit and therein I have a problem.

12 MR. NIXON: Absolutely. I mean, I think the Staff's
13 concern about the companies collecting gross-up and maybe
14 through NOLs and so forth and actually not paying a tax was
15 that, "Gee, the utility is all of a sudden getting a big
16 infusion of cash and it's a windfall to the utility." But
17 that's not the case. (Pause)

18 I was through.

19 MR. LOWE: Okay, I got confused, we were talking.

20 MR. NIXON: The only other thing I would like to
21 mention, I see this as the key issue and this is why you are
22 experiencing such complications. All of my gross-up clients,
23 and I think I have about 14 or 15 out of the total that gross
24 up, have refund reports going back to 1990 sitting some place
25 here at the Commission. And the holdup is not that we haven't

1 furnished reams and reams and reams of information concerning
2 above- and below-the-line and what we think it is, it is just
3 that it has become so complicated in trying to determine what
4 is above the line and what is below the line that I don't
5 think anybody wants to just make a decision.

6 MR. DETERDING: You could ask a million questions on
7 any one of them and the process has gotten, as all of you well
8 recognize, the process has kind of gotten out of hand. It's
9 gotten so that you start to question, if this is the process,
10 you start to question whether or not we can continue to gross
11 up.

12 MS. McCASKILL: That's one of the reasons we're here
13 today.

14 MR. DETERDING: I understand.

15 MS. McCASKILL: Should we really have to be doing
16 all this we are doing? We need to determine what we intend
17 for a gross-up to do and then what is the best way to do it?

18 MR. DETERDING: In light of that -- and just keep in
19 mind that, of course, affects the little guy the most; and the
20 guy who is collecting \$10,000 in gross-up, the process
21 suddenly makes the whole deal absurd. I realize that's why
22 we're here.

23 MS. SALAK: Say we decide that NOLs we're not going
24 to look at them any more. Do you believe -- well, legs'ly and
25 just otherwise, should we -- that we can do that on a

1 prospective basis for new filings only or do you think all the
2 ones you have pending since 1990 we can apply those rules to?

3 MR. NIXON: I would think all of them.

4 MS. SALAK: I don't know legally if we can do that.
5 I just don't know. We have an order out there and that order
6 was governing all these reports that we have filed with us.
7 It supposedly set out the rules of the game. Can we go back
8 and process those reports with a new set of rules?

9 MR. NIXON: If you can't, my suggestion is for those
10 reports that have already been filed where an attempt -- or
11 not just an attempt, an above- and below-the-line analysis was
12 made, but look at what the companies have filed and interpret
13 it liberally.

14 MR. GATLIN: I think that's part of the problem is
15 what are those rules? There seems to be a lot of disagreement
16 as to what those rules are. I think if the Commission were to
17 readopt a policy regarding this, I think you certainly would
18 want to try to do the extent at all possible would be to
19 interpret those rules and those past orders consistent with
20 what the Commission's policy is announced to be.

21 MS. CAUSSEAU: So you are saying basically it would
22 be a clarification of the prior orders as opposed to a change
23 in policy?

24 MR. GATLIN: I think it could be described as that
25 process.

1 MR. DETERDING: At least to some extent the things
2 we're talking about. Because I think we have gotten into a
3 situation where above-the-line and below-the-line may be a
4 morass that you just cannot solve as currently analyzed.

5 MR. GATLIN: That's what the Commission has been
6 doing is evolving this policy. Nearly every order has been
7 saying, in effect, "Well, we're going to clear this question
8 up from the last order in how it is to be applied." I think
9 this would be, if the Commission takes any more action, it
10 would be to make clear what its policy is.

11 MS. JABER: I kind of see it as being both. It has
12 the potential of being both. I think that the outcome of this
13 could be that we would be clarifying our policy but I also see
14 a change --

15 MR. DETERDING: I agree.

16 MR. GATLIN: Sure.

17 MS. JABER: -- happening. So I think it could be
18 both.

19 As to the retroactive application, for lack of a
20 better word, with the NOLs, I think we have to look into that.
21 But consistently, the Commission has always gone forward with
22 a change of policy, it's just one of those things we need to
23 add to our list looking into.

24 MR. DETERDING: As to the above-the-line and
25 below-the-line type analysis, though, I think that that's one

1 of the keys holding up the existing gross-up matters. And
2 some of this stuff can be in effect a clarification. Because,
3 as I say, I'm not sure extending it out to the end of
4 everything you can look at in an above-the-line and
5 below-the-line analysis is really possible and I kind of think
6 to some degree that's where we have been heading. And as to
7 that issue, I think that it could be considered clarification
8 of existing policy.

9 MR. NIXON: I guess the last thing I wanted to touch
10 on in the handout I have, if the decision is made -- and after
11 what I have heard today, you'd probably get a fight on it -- I
12 think everyone here would fight to go to a nonrecognition of
13 the NOLs because of all the problems. But if in spite of all
14 this you think a policy could be created to analyze above- and
15 below-the-line current year losses and NOLs to continue what's
16 been done, that's basically the gist of the information that's
17 in the handout by issue. I have ignored all those issues that
18 I think were previously decided in 23541. So whatever issues
19 you don't see on my summary are those that I think have
20 already been decided.

21 MR. DETERDING: As I mentioned, that's the way we
22 framed our response was in light of what we felt had been
23 decided in previous orders. And Bob and I agree with what
24 Florida Cities and Poinciana have done in light of just
25 reevaluating the whole thing, and we agree wholeheartedly with

1 what they have done.

2 MR. LOWE: Because our intent is to do both -- at
3 least my intent is to do both -- is to fix the problem with
4 the existing cases and to do something different in the future
5 to stop that problem from ever arising again.

6 MR. NIXON: One thing that might help you with the
7 Commissioners, and that's to look at these journal entries
8 that I have attached that we're required -- or 23451 requires
9 us to create an account called "Contributed Taxes" as a
10 subaccount of CIAC. And the way we account for it, that
11 contributed tax account is net of the tax-on-tax effect and
12 net of any refunds made to contributors. So what that
13 represents is all of the tax money received from contributors
14 or customers on CIAC.

15 Now, that account will not self-amortize. There's
16 no mechanism in the books to make it amortize. It's just like
17 CIAC, so you to amortize it over some life. And if that
18 account was amortized over the useful life of the plant assets
19 as an above-the-line basis, the Commissioners would be able to
20 see a direct benefit every year coming through on the annual
21 reports, an above-the-line amortization of that contributed
22 tax account. Just like amortization of CIAC. And for several
23 companies I represent, that would be a big number, a real big
24 number.

25 MR. LOWE: Let me throw something back at you I

1 mentioned earlier.

2 What would be wrong if you had to go through all the
3 hoops up front to get a service availability charge that
4 included a provision for income taxes that's not subject to
5 refund; you made a filing with the annual report either that
6 year or the year thereafter; and that we looked to see
7 whether, through that filing, whether or not you were paying
8 the taxes or not? Would that be a workable solution?

9 MR. NIXON: When you say, "Look to see if you are
10 paying the taxes again," you ignored --

11 MR. LOWE: No, no, no. I mean with those issues
12 resolved, too, is what I meant. I mean, we may or may not
13 ever come to resolution between the industry and the
14 Commission on those issues. I can't guarantee that particular
15 portion of it, that we can convince five Commissioners --
16 excuse me, three or more Commissioners that NOLs ought not to
17 be considered or that first year depreciation ought not to be
18 considered. We may be able to convince them of that, I don't
19 know. But that's not part of --

20 MR. NIXON: But if you can show them where a
21 customer is receiving a substantial benefit in revenue coming
22 back to them every year --

23 MR. LOWE: We may be able to -- (Simultaneous
24 conversation) -- I'm not ruling that out. That's not the
25 portion that I'm talking about. I'm talking about so we don't

1 have this filing every year, we don't have all this money
2 subject to refund. You have it as a portion of your CIAC
3 charge. Just like in rates, you have an income tax provision
4 that's built into the rates.

5 MR. DETERDING: I think what Bob is saying, maybe
6 it's just semantics, but the concern was the last comment
7 about whether you are paying a tax. And there's quite a lot
8 of circumstances where you are not paying a tax but you are
9 giving up a tax benefit that either belongs to the shareholder
10 or to the ratepayer that you would be giving up in order to
11 avoid that tax.

12 But assuming all that is taken into consideration,
13 as far as just doing something up front to analyze it and
14 throw it into the service availability as opposed to this
15 separate accounting and so forth, I mean, if it could work
16 out, that would be fine, except you have a lot of companies
17 out there that you would be putting through an awfully major
18 process to get that. If you are talking about complying with
19 the rule on service availability to get there, that's a pretty
20 major process.

21 MS. JABER: More major than this?

22 MR. DETERDING: Yes. Maybe not more major than ten
23 years of this, (Laughter) but more major than one, for sure.

24 MR. LOWE: What I meant by paying the tax, I didn't
25 articulate what I meant to say real well.

1 You would have resolved all of those issues up
2 front, whether NOLs were to be considered or not, it would
3 have been in whatever the amount that was grossed up, the
4 calculation of whatever your tariffed rate for service
5 availability was. All we would be doing was looking to see
6 whether or not you were still -- that those facts still held
7 true.

8 I didn't really mean the tax paid, because I know
9 that's a part of our major problem here. But I would be
10 looking at whether the circumstances were still the same as
11 they were when you filed and had the approved tariff. Just
12 verifying that the circumstances were the same.

13 MR. NIXON: Let me ask you this, Bill. Would you
14 envision that for ratemaking purposes, say you collect one
15 amount which includes the tax? And say your total CIAC on the
16 books would be much higher than it is now by the amount of the
17 tax effect. Would you consider under your proposal using all
18 that CIAC balance, which includes the tax --

19 MR. LOWE: No.

20 MR. NIXON: -- to reduce rate base, or still record
21 it separately on the books even though you are collecting it
22 as one charge? Because I think that for accounting purposes
23 and to comply with FASB 109 because of the nature of the
24 timing differences that the accountants would have to separate
25 that out every year in coming up with their journal entries to

1 book deferred tax assets and liabilities.

2 MR. DETERDING: I don't think Bill is talking about
3 a change so much in where it falls. Because if you start
4 throwing it into CIAC, you just turn the whole world topsy
5 turvy and you put it right back into rates by doing that.
6 But --

7 MR. LOWE: Not if you account for it correctly.

8 MR. DETERDING: Well, I'm saying if you throw it
9 into CIAC, you do. If you are calling that CIAC, then you are
10 reducing the overall service availability charge if you are
11 going to comply with the rule, 25.35 -- well, you have a rule
12 limiting CIAC to 75% to a plant.

13 MR. LOWE: I might be very willing to revisit the
14 rule.

15 MR. DETERDING: I'm just saying as far as the
16 treatment of the tax collected, the gross-up, for regulatory
17 "above the line" purposes it should not be treated as CIAC.
18 Maybe it is part of your service availability charge and in
19 the process as such that it gets approved as part of your
20 service availability charge; and as far as continued reporting
21 to the Commission on that, it is somewhat similar to service
22 availability charge. But as far as the accounting for it in
23 the ratemaking scheme, it's got to be treated separately. I
24 think it does.

25 MR. MURPHY: I guess I tend to disagree. I hate to

1 disagree. But I think as I pointed out, this is one of your
2 last questions, I think you say, "Should the gross-up CIAC for
3 cash contributions," if you are talking about cash
4 contribution, maybe we ought to extend this to cash and
5 property contributions, "be a component of the total service
6 availability charge, thus eliminating separate gross-up
7 totals?"

8 I say yes. Gross-up is a component of total service
9 availability like any other cost. To me, that tax is no
10 different than that big old piece of pipe that's in the
11 ground. It just happens to be there. And it should be
12 recovered in the same manner. So I mean I believe that. How
13 you would get there and get over a few of these problems, I
14 think Mr. Nixon and we would point out is one thing.

15 I mean, you know, when you start saying -- to me it
16 would be as simple as adding 60% to the cost. If it's \$1,000
17 to the property or \$1,000 cash, you pay me \$1,600, we're
18 clear, you give me \$1,600; I put \$1,600 in CIAC and then it
19 would obviously work its way back to the ratemaking process to
20 the general ratepayers as well -- I mean as well as any CIAC
21 would.

22 But that's it. We don't concern ourselves with
23 escrowing that money and giving it away to somebody, there's
24 no refund. The only change would be probably if the tax rate
25 changes.

1 MR. LOWE: We're going to take about a five- or
2 ten-minute break. The court reporter needs a break.

3 (Brief recess.)

4 MS. SALAK: Bob, are you done with your comments?

5 MR. NIXON: I think so.

6 MS. SALAK: Are you ready to make your comments?

7 State your name for the report reporter.

8 MR. COMEAU: Hi. My name is Pete Comeau, I'm the
9 Land Development Manager for U.S. Home Corporation.

10 Number one, I want to thank you for the opportunity
11 to be able to participate in these proceedings and this
12 workshop. Unfortunately, we didn't receive the comments to
13 the questions until the 28th and now is the 30th; so to
14 actually prepare a formal response, we didn't have time.

15 Second, that my fellow developers at the Florida
16 Association of Developers would like to have an opportunity to
17 respond, not only to your questions but the issues that have
18 been brought up today, so we would have an opportunity to
19 review prior to going to formal hearing.

20 MS. SALAK: Just two comments on that. One, we'll
21 be more than happy to take comments after the workshop today.
22 But, in addition, we're having a Commission workshop in front
23 of the Commissioners on October 5; so for everybody to know,
24 we are having it. that was in the closing statements; but
25 just to let you know. So you'll have another opportunity.

1 MR. COMEAU: I appreciate that, thanks.

2 Overall, I have to say as a developer I'm quite
3 appalled at the comments I am hearing in this room today. I
4 hear comments reference to the customer and also for the
5 utility where the developer is ignored. And in general, the
6 developer's position -- at least mine with U.S. Home -- is
7 that we're not a moot point in these proceedings, and that
8 regard to our profit and our fair share of contribution should
9 be considered.

10 And more importantly, our customers, our growth and
11 our prosperity are directly linked to a lot of the private
12 utilities' growth and prosperity. And just to sit there and
13 ignore it, the comments of Bill in reference that the only
14 upset's with the developer's profitability and they're going
15 forward with that, the developer's position should be ignored,
16 concerns me.

17 That's the image that I receive, not only from these
18 comments but also in the first year depreciation ignoring
19 considerations the normal overall gross-up considerations, you
20 know, should pass on -- that does hurt us as developers. Just
21 passing on those costs to our consumers is not a moot point.
22 Most importantly is that as the developing communities, the
23 competition is quite fierce. And as we're going from our
24 community with one utility to the next, we're passing on these
25 costs. You know, a couple thousand dollars can mean a sale.

1 So this passing on these costs should not be
2 ignored; our position should not be ignored; our opportunity
3 to respond should not also be ignored. The developers, at
4 least U.S. Home's position, we're down mainly from Tampa south
5 and I'm mainly talking about with Gulf Utilities and our
6 position down -- like I have one development in Country Creek.
7 I have never seen the actual savings being passed on to our
8 consumers ever.

9 We get letters from our consumers complaining about
10 the high utilities rates and I just don't see this as a
11 reality. And since, like I say, I don't have an opportunity
12 to review all your questions and respond, I do need to get
13 back south and we have other reservations. So I just wanted
14 to let you know that we appreciate the opportunity. We hope
15 to get all the minutes and the other questions and comments
16 that are generated from this to be sent to me -- I actually
17 gave it to one of your colleagues -- and at a future date
18 respond.

19 Mainly, I just wanted to make sure we got on the
20 record that we do want to respond. We are concerned about the
21 tone and the intent of this session and hope that it will be
22 beneficial to all parties involved and not just a utility and
23 this fictitious savings to the consumer.

24 MS. SALAK: Just a comment. I was going to say on
25 Staff's part there is certainly no intent to leave you out.

1 We are just exploring ideas, streamlining. It is a process
2 that has become very burdensome from the Commission's
3 perspective and we're looking for new ideas and a new
4 perspective. Certainly, we welcome all your comments.

5 Actually, our workshop is on October 5th. The
6 Commissioners -- we would like to see them before the
7 workshop. Part of the reason we're having the Staff workshop
8 today is to get ideas, be able to incorporate them. Staff
9 will be doing a presentation on that day informing the
10 Commissioners of what we have done in all the orders so far
11 and giving them a case background before we start discussing
12 if we should even change anything, if we should change
13 anything in the future or not.

14 MR. COMEAU: What's Staff's deadline for preparing
15 their packet for the Commission's workshop so we would have an
16 opportunity to have our comments incorporated?

17 MS. SALAK: We would probably like to get it done at
18 least the week before the workshop. So if you gave it to us
19 two weeks before that -- I don't have a calendar?

20 MR. JAEGER: September 30 is a Saturday, that's all
21 I have.

22 MS. SALAK: We'd probably have our package put
23 together by the 29th. So if we could have what you have by
24 the 22nd that gives us a week, probably about the most time.

25 MR. DETERDING: I'm sorry, what was it? you have a

1 date for what?

2 MS. SALAK: There's a Commission workshop set up on
3 October 5.

4 MR. DETERDING: And you're supposed to have
5 something to them in advance of that?

6 MS. SALAK: We don't have to; but if we have
7 something put together, we'd probably have it done a week
8 before that.

9 MR. DETERDING: Kind of a package of comments from
10 everybody who is interested, as well as the Staff?

11 MS. SALAK: Probably we're putting together a
12 presentation that Staff is going to give, and we'd like to
13 have that. And in that we wanted today's workshop so we could
14 hear comments from the industry and developers and everyone
15 else and see if we wanted to incorporate that into the
16 package.

17 The format that day will be similar to today but
18 Staff will be also doing a presentation up front. Which is a
19 little different because Staff usually doesn't do
20 presentations at workshops. But there was a request that we
21 delve into some of the history, so we're going to do that.

22 MR. COMEAU: Including a summary of comments from
23 these proceedings and those received will be presented by
24 Staff? Or are we going to be responsible to show up and
25 reiterate any and all comments we may have?

1 MS. SALAK: If you have comments you specifically
2 want passed out to the Commissioners, if you get them to us a
3 week ahead of time we'll put a packet together of everyone's
4 comments that wants them supplied and we'll bind them and copy
5 them and make sure they are given to the Commissioners at the
6 workshop.

7 MR. COMEAU: I'd like to be able to put together a
8 response per question and also a two-paged summary of the
9 highlight issues that we are concerned about and also
10 recommended action for resolution of some of these problems.

11 Back to you.

12 MS. SALAK: I think we could do that, I mean, open
13 that up to everybody if they wanted to do that. Then we could
14 put together a package and give them to the Commissioners
15 verbatim what you say.

16 MS. CAUSSEAU: We did something similar last year
17 with the rate of return on equity workshop. We requested that
18 if anybody had comments they would be provided ahead of time
19 so that we could make adequate copies. Some people provided
20 them ahead of time, an individual copy and then we made
21 copies, and some people provided a number of copies and they
22 were distributed.

23 But the Commissioners do like to have the
24 opportunity up front to read and digest and then ask questions
25 specifically about your comments rather than just putting them

1 cold at the workshop and having to respond to them there.

2 MR. COMEAU: Excellent. Thank you for that
3 feedback. On that note, I do have to be leaving, thank you
4 for your time.

5 MS. SALAK: Do you have any comments?

6 MR. FREEMAN: My name is Paul Freeman with Southwest
7 Florida Capital Corporation. What I wanted to do is make a
8 few comments on some of the things that I have heard today
9 that I do not agree with, some of the things that I actually
10 do agree with and would like to see.

11 From the tenor of the conversation and the only
12 thing, other than Pete and I, the only people here are those
13 regulated. So from our standpoint, this would be like a, you
14 know, tax committee meeting at Congress and the only
15 presenters are the taxpayers, they're all going to want
16 different rates. We will give the other side.

17 But from a simplicity standpoint, from a filing
18 standpoint, from a complications standpoint, from an escrow
19 standpoint, and all of the other items that seem to be
20 bothering the Waterworks Association and the utilities, we
21 don't have a problem with eliminating or getting rid of those.

22 We only want fairness, number one.

23 Number two, we would like to see the three bodies of
24 parties that have an interest in this treated with some
25 equality. One is the utility company, which I believe the

1 Commission has looked at and has great concerns for their
2 position. Number two is the ratepayers, who are our
3 customers; and the Commission also has great concern for
4 ratepayers. Number three is the development community, the
5 land owners and the builders. And we have not seen that
6 concern or the balancing coming down and people looking at our
7 position and saying, "Yeah, let's try and be fair to all three
8 groups." That's what we would like to see.

9 From a focus standpoint and a history standpoint,
10 the orders that are there -- which we don't happen to agree
11 with and we like them probably as little as they like them --
12 started when the the tax was put into effect in 1986,
13 effective 1987. But if we go back and rerecall, which I have
14 not seen addressed here yet, every utility that's here had a
15 rate at the time. They were taking CIAC. What was done was
16 CIAC was a single focus issue and the position was, "We should
17 be able to do full gross-up, let's charge the developer at the
18 cost of contributing the property because we now have to pay
19 tax."

20 It had no effect on the ratepayer and everything
21 that went through was no effect on the ratepayer. So when you
22 have full gross-up, the full burden of the tax is on the
23 developer but any benefit does not go back to the developer.
24 The only benefit the developer gets is first year's
25 depreciation because that's part of the tax rate.

1 There were various methods that had gone through and
2 various reporting that has been required or has come to be
3 required; there's been tons of testimony; and every time
4 anything has been done you always come back to net present
5 value is the true cost. If the utility gets net present
6 value, they are whole, the ratepayer is whole and the
7 developer is paying the actual cost of contribution.

8 And if a utility charged net present value -- and I
9 do not believe any of the 26 down from 44 are at net present
10 value -- if the utility charged net present value, we don't
11 think there should be any reporting or any looking at it.
12 That's the true cost, that's it. Their net losses are their
13 net losses and that's the cost of doing business. And if
14 we're in a utility's area, that's a private utility that wants
15 to charge gross-up and that's what they charge. We think
16 that's fair. At least my company does.

17 What we have a problem with with the full gross-up,
18 number one, we're charging the first year's costs to put
19 everything on the books. So that has no effect to the utility
20 and no effect to the customer in the first year.

21 Starting in the second year, there's depreciation.
22 And when we look at pre 1986 versus current conditions or post
23 1987, the depreciation on the property contributed is going
24 somewhere.

25 Now, the reason Mr. Comeau is here is because his

1 company, which is thousands of times larger than our company,
2 wound up buying a project in Gulf Utility's service area,
3 which charges full CIAC. They were never here before because
4 they are mostly on municipal or they have a project on Florida
5 Cities and they don't charge them. So he came in, number one,
6 they are objecting to the cost most of which they didn't pay
7 because they took over a project; but, number two, because his
8 customers are coming in and complaining.

9 My customers are complaining that they are paying
10 the highest rates in Lee County and yet we are paying full
11 CIAC add-on and everybody is telling us that our customers are
12 getting the full benefit of this. He's not seeing it, I'm not
13 seeing it, and if you want to bring the ratepayers in, they're
14 not seeing it.

15 What happens is that in all of these formula, the
16 lines that were not depreciated before we pay the tax on,
17 those lines are depreciated theoretically between above- and
18 below-the-line adjustments, they reduce the rate base.

19 The cash contributions which used to pay for plant
20 and pre 1986 -- which, as I understand it, I am not an
21 accountant, Mr. Nixon can tell me exactly how it was accounted
22 for -- but I understand there was a corresponding amortization
23 charge for the cash received against the plant.

24 What I do know, having experience in the tax field,
25 is that if I put on a plant and it's \$10 million and I

1 collected pre 1986 the tax, that would reduce my basis somehow
2 and it would reduce my depreciation somehow as I collected my
3 nontaxable CIAC. That does not go to the customer, that stays
4 with the utility. And it is paid for by the developer. And
5 we really don't believe that should happen.

6 Now, what we would -- and there's tons of different
7 solutions. And nobody wants to see, you know, we don't want
8 to see 12 different alternatives, just like they don't want to
9 see 12 different alternatives. We would like to see something
10 simple, something that they can make a determination on, and
11 something that's fair.

12 By the same token, we would not have a problem if a
13 utility that charged full add-on CIAC no longer had their
14 monopoly in the area. Because what you do with them is tell
15 us, "If you've got land in a certain area and you want to
16 develop it, this is your utility. You must hook to them, you
17 must charge them. If your competitor down the block has a
18 different utility, you can't do that." That's no longer done
19 in telephone, it's no longer done in cable, it isn't done
20 anywhere else in the regulatory scheme.

21 We don't have a problem maintaining the same system
22 if it is fair. If it is not, let us get the county to run a
23 line. We'll pay for that line. Let a company that isn't
24 charging CIAC run a line if they will service us. Give us an
25 opportunity to be competitive.

1 If the utilities were in here and their chemicals to
2 treat their plants were determined on a monopoly basis, and
3 you told them what chemical company they would buy from, and
4 each individual chemical company had a different charge, and
5 then you told them to compete on a rate base, they would be in
6 here telling you they're not passing on their costs, that the
7 one that's paying the extra charge is paying more than
8 somebody else.

9 And that's our case. When my salespeople and when
10 Mr. Comeau's salespeople in his project in this Gulf Utilities
11 area go around and look at where people want to buy homes,
12 they look at our area, they look at areas that are on Florida
13 cities, they look at projects that are on Lee County
14 utilities. And nobody comes in and says, "Gee, your CIAC does
15 something to the toilet or to the water that comes out of the
16 spigot and, magic, you're going to pay an extra \$3,000 or
17 \$3,500 more for your house." It doesn't happen.

18 It comes out of our gross profit margin. If in fact
19 we have enough gross profit margin, we stay in business. If
20 someone doesn't have enough gross profit margin, they don't
21 stay in business. But we have to be competitive from one
22 project to the next and one utility to the next.

23 If my plumber is not competitive, I hire a plumber.
24 If my electrician is not competitive, I hire an electrician.
25 If you take your car into a gas station and their price is not

1 competitive, you drive down the street and you buy gas
2 someplace else. We can't do that in this utility business.

3 Now, if you give us the right to do that, maybe we
4 could overlook an awful lot of things. But if we don't have
5 the right to do that, then we don't think that we should be
6 paying any more than the actual cost of what it costs to give
7 that asset to the utility. And after nine years, they've got
8 enough depreciation on their books and received enough
9 contributions that they're not going to be short going to net
10 present value.

11 If they then need full gross-up, then we think they
12 probably should go through the whole process. But if there's
13 some way of measuring the absolute cost in taking the PSC
14 Staff out of it and streamlining the process from your
15 standpoint and streamlining the process from the utility's
16 standpoint, we would have no objection and we would welcome
17 it.

18 I thank you for your comments. Like Mr. Comeau
19 said, I didn't realize we should file something; we probably
20 will file something with this company and this Association. I
21 thank you very much for your time.

22 MS. SALAK: Just one question. To summarize what
23 you said: Basically, if we went to net present value you
24 would be happy?

25 MR. FREEMAN: If you went to net present value, we

1 would be happy. Florida Cities has a service availability
2 charge. We would be happy, we would be thrilled with that.
3 Anything that reflects either the cost, or the cost of holding
4 on to the line, or the cost of receiving the line and not
5 having -- one of the problems the utilities have raised in the
6 past, and it is a problem, is if I do a project and we put 100
7 lots on line and we don't build the houses and give them the
8 customers, they not only paid the tax on the line but they are
9 not getting any revenue as a result of that and it's a
10 problem.

11 And Florida Cities in our area has a service
12 availability charge. The longer you have those lines before
13 people hook up to them, the more you wind up paying. We have
14 no problem with that because it is fair.

15 MS. SALAK: Thank you.

16 MR. BILINSKI: My name is Brian Bilinski, and I'm
17 Assistant Controller for Palm Coast Utility Corporation.

18 I believe you also got a handout from Mr. Gatlin
19 regarding our responses to the workshop questions. I just
20 wanted to clarify two things. One, the gentleman said there
21 were no utilities using the net present value method for
22 gross-up; we are I believe the sole utility using net present
23 value.

24 MR. FREEMAN: We applaud you for that because we
25 think that's fair.

1 MR. BILINSKI: I won't comment on your comment.

2 (Laughter)

3 So our responses to your questions were framed not
4 only from that perspective but also from the perspective of
5 working within the orders that the Commission has already
6 approved and not starting from square one, such as Florida
7 Cities has done.

8 I would like to buttress the comments that have been
9 made here today that there is a tax effect of CIAC regardless
10 of any other financial activity and that, as such, peripheral
11 items such as NOL should be disregarded as not generated by
12 the contributor so that they should not go back to the
13 contributor as a benefit.

14 I believe that if Staff can answer Ms. McCaskill's
15 question as to what the intent of the gross-up is supposed to
16 be that it would go a long way toward resolving your problem
17 and our problem.

18 MS. SALAK: What do you believe that it should be,
19 the intent of the gross-up?

20 MR. BILINSKI: The intent of the gross-up is to
21 recover the tax effect of the CIAC so that the contributor
22 bears the cost that he generated and it does not affect the
23 ratepayers.

24 That's it.

25 MS. SALAK: Did you have some comments?

1 MR. NUNES: Yes. My name is Ron Nunes, N-U-N-E-S,
2 I'm the Vice President and Manager of the Parkland Utilities,
3 a small utility in Broward.

4 I have a letter here, I don't know if I can
5 distribute that to you. I'm somewhat new to this issue.

6 I received, obviously, a notice of the workshop; and
7 not used to being in a workshop, I'm not sure what we need to
8 do or present. So I put together some comments which I
9 thought was somewhat of a common sense look at what we were
10 dealing with. I was surprised to hear some similar situations
11 come out from other utilities.

12 First off, one thing I don't say in here that I
13 would like to say is we don't want to charge gross-up. I
14 think many utilities will agree with that. This is something
15 that has been placed upon us by the IRS. I think every one of
16 us -- I didn't bring those letters -- have supported every
17 effort to repeal the taxability of the CIAC.

18 But I have put together somewhat of a oversimplified
19 effect of operations and impacting the receipt of CIAC. And
20 the bottom line is that over time it will be the ratepayers
21 that have to come up with the cash to pay for the tax under
22 the way it is currently being operated. That was my greatest
23 concern in looking at this whole issue is making sure that the
24 effect of the tax is paid by the people that now are burdening
25 the utility and the ratepayers with that tax.

1 MR. DETERDING: If we could give it to Congress, I
2 think we would. (Laughter)

3 And, Mr. Freeman, all due respect, and also to
4 Mr. Comeau, when we say that you all are causing the tax,
5 we're not suggesting it is your fault. Because we have worked
6 together in trying to -- we've all worked together, the
7 Commission has worked, I've worked, many members of the
8 Association have worked in trying with the Florida Home
9 Builders and the national association to try and get this
10 thing repealed. And I worked with people at the Florida Home
11 Builders last year in putting out a letter campaign through
12 that organization to try and do so.

13 So when we say that, we don't mean any offense to
14 you. From our perspective, the cause of the tax is when we
15 receive the contribution and that gets back to you and your
16 people.

17 MS. McCASKILL: Beth, let me ask a question. I've
18 heard several people say that the purpose of the gross-up
19 should be to recover the tax effect of the CIAC -- yeah, the
20 tax effect of the CIAC. What I'm thinking then, does full
21 gross-up do that or does net present value?

22 Because I'm thinking, I know in a year you collect
23 it, there's the tax effect. But also that CIAC is
24 depreciated; and in subsequent years, there's a tax effect.
25 So it appears that the net present value method to me is the

1 only method that really recovers the tax effect. With
2 anything else, you're getting a little more.

3 MR. DETERDING: Well, I'll leave that for the most
4 part to some of the accountants. But my perspective on that
5 is, first of all, net present value assumes that the cost to
6 the contributor is the cost of receiving that -- the cost, the
7 return of any tax benefit related to the receipt of that CIAC
8 should go to the contributor. And I think there have been
9 findings both in relation to 23541, and most recently in the
10 Gulf case that went up on appeal, that that was not true; that
11 those benefits ought to accrue to the general body of
12 ratepayers, not only for the sake of simplicity of accounting,
13 which was one the issues raised when we got into 23541, but
14 also because of the fact that supposedly -- or the finding of
15 this Commission was that the developer pass those costs on to
16 the home purchaser.

17 And I know that Mr. Freeman disagrees with that
18 conclusion, but that was a basis for the conclusion reached
19 and, therefore, to my mind, offsets that argument for net
20 present value to a certain extent. So I'll leave it to Bob or
21 one of these fellows.

22 MR. MURPHY: I just would make a comment that I
23 don't believe -- obviously, the net present value has, you
24 know, obviously, a merit for the developer and I can
25 understand that. I think we have got to consider, though, to

1 the fact that to the utility, that means a much higher
2 negative cash flow in that first year.

3 I mean, albeit well that you receive some sort of
4 depreciation benefit over the next 30 years or thereabouts;
5 today is what I'm worried about and I'm worried about my
6 financial viability today. I mean, and if it's a sizable
7 contribution, that means that you have to go out and find the
8 sources for that funds. And, also, when you add in the net
9 present value, there is an impact to the ratepayer.

10 Now, I won't say that I am the accounting guru for
11 net present value. Maybe we could ask Brian. But certainly
12 from the standpoint that I have to fund that tax liability, my
13 ratepayers have to help me fund that.

14 I have an investment in taxes, therefore, I get a
15 return on my investment in taxes. So the ratepayers do pay
16 something. Now, they don't pay as much as they would pay
17 maybe under no gross-up and in which they pay the most, but
18 certainly they don't pay as little as they do under full
19 gross-up. Theoretically, under full gross-up, the ratepayer,
20 I guess, pays no more and actually the developer I would
21 probably say, gets the benefit. And I would have to echo
22 Mr. Deterding's comments with regards to where does that
23 benefit lie.

24 But don't be -- I don't want you to be confused, and
25 it's a hard issue, the net present value, that it's the -- it

1 is not the great balancing act. It probably moves one way or
2 the other. But certainly the utility has a cash flow problem,
3 and the ratepayers, in turn, then have higher rates because of
4 that.

5 MS. McCASKILL: Okay. And I'm trying to think this
6 through, and there's probably a lot I'm missing. I'm going to
7 have to talk to my tax people.

8 But I guess what I'm saying then, it's not just then
9 a matter of the tax effect, but there's a cash flow situation
10 involved, too. If a utility pays the taxes, it has its
11 investment in the taxes and somebody is incurring some cost
12 somewhere. So how do you get to the middle ground where you
13 actually do recover the tax effect of the CIAC, and that's it?
14 And I don't know that full gross-up does that. And then I
15 don't know that net present value does that, if we are talking
16 about just the tax effect of it.

17 MR. DETERDING: Well, again, as you mentioned, if
18 you've got net present value, then the utility has got a
19 significant investment in that tax that the ratepayers are
20 going to have to pay for while they have got that outstanding
21 investment. It turns around with each -- as time goes by.
22 But if you are adding on more customers, you are always going
23 to have something with the customers, in effect, paying for
24 that additional investment that the utility makes now.

25 As I said, over time it will turn around as to each

1 individual contribution and each individual gross-up; but if
2 you're continuing to grow, it's always going to be there.
3 There's always going to be some balance in that account
4 investment in tax by the utility under the net present value
5 method.

6 And I think, as far as I know, and I'm certainly
7 open to other ideas, but as far as the tax, the full tax
8 impact of, and only the tax impact of, CIAC being passed on,
9 that is what full gross-up does.

10 MR. FREEMAN: Excuse me. We would like to disagree
11 with that a little bit. Number one -- and you've had
12 testimony including the fellow from Arthur Andersen back in
13 1990 -- net present value does take into account the rate of
14 return the utility would get, because you've got a discount
15 rate in order to get to net present value. Net present value
16 takes the total cost, reduces it by the assumed benefits of
17 the depreciation discounted at a percentage rate, which
18 normally is their rate of return. So the utility, in that
19 number that they charge, recoups that over the period of
20 years. That is by definition "net present value."

21 What happens is, in the first year -- and we're no
22 longer in the first year, we are in the ninth year -- but in
23 the first year, there is an investment because the tax rate
24 that they pay is more than what is received. Okay? That's
25 the difference. It does not affect the ratepayer. And your

1 account -- if you go back to the transcripts, your accountant
2 testimony from their experts, not our experts, state that; and
3 the ratepayer ultimately does not bear a burden.

4 Now, does it cost the utility more money in front?
5 Yes. Is the ratepayer absorbing it? No. Is it really in the
6 rate? No.

7 What happens, though, if they want to get to true
8 fair, and if everybody wants to sit there and say, "Well, I
9 pass it on to my ratepayer," because I don't know what I pass
10 on to my homeowner, because my homeowner doesn't buy two miles
11 of line each time I sell a home.

12 But if you want to say that he does, then what needs
13 to be done is every person, that as they get a new connection,
14 then they get that depreciation over the years. But what
15 happens is when you give it to the general body of ratepayers,
16 who is not the homeowner that paid for that CIAC, or you give
17 it to the utility, or you give it to a combination of the two,
18 what you are doing is you are taking the developer or the home
19 builder, putting them in a disadvantageous, competitive
20 position and saying it's okay in the name of simplicity, or
21 it's okay in the name of -- well, we'll save it to somebody
22 else.

23 And what I think we are seeing, at least what
24 Mr. Comeau is seeing, is that his ratepayers are not saving
25 anything. They are paying more than competitive rates. And

1 if I have a utility and I come in here and I've got a rate
2 case, I don't come in and give you what everybody in the
3 county is charging and say this should be my rate; everybody
4 should be the same thing because it's the same water.

5 I mean, I don't know that anyone cares whether their
6 water comes from Gulf or Florida Cities or Palm Coast or
7 anywhere else as long as it's the same quality, and it's got
8 to be because there are state health standards. But
9 everybody's rates are different.

10 The industry, as much as we are working with Marty
11 and I agree with him, we would like to see it gone, too; but
12 it's not gone. And I'm not trying to put my hand in their
13 pocket, but I just get this feeling that everybody's trying to
14 put their hands in my pocket because they are not held to a
15 competitive standard. And if they were, they would be in here
16 yelling and shouting that they are paying CIAC and their
17 competitor is not. Or they are paying an excess tax on
18 something and their competitor's not.

19 And you've seen that in the phone business. I mean,
20 people are sitting there: "Well, my long distance bill is
21 more than so and so," and it almost got to no regulation. So
22 now the market goes and finds a competitive level.

23 What we are saying is if you want to protect them,
24 and that's what they want and that's what you want to do and
25 give them, then our position is: If you do that, that's okay;

1 let us be competitive, though. Let us go out and find
2 somebody else. Otherwise, I go with Connie. I mean the --
3 and I will hope that for the October 5th hearing you actually
4 do consult with some independent CPAs or go back to the Arthur
5 Andersen fellow that testified before and go on net present
6 value. And I don't see Palm Coast going broke on net present
7 value, so I'm sure that's in their calculation. And I don't
8 think they have any greater problems than anyone else.

9 MR. BILINSKI: Going broke? No. Having a
10 significant cash impact in the first year that the taxes are
11 paid? Absolutely.

12 MR. FREEMAN: Okay. But you didn't collect full
13 CIAC for nine years. If you collected full CIAC for nine
14 years, in the tenth year would you have a big negative impact?
15 You'd have nine years of built up depreciation.

16 MR. BILINSKI: Yes, there is --

17 MR. FREEMAN: You've got assets on the book for nine
18 years.

19 MR. BILINSKI: There is the depreciation benefit
20 that does turn around over time, but it could be -- it's
21 essentially 20 years as you go through your tax calculations.

22 MR. FREEMAN: Right. It's 20 years for full
23 depreciation. But if you've got nine years, you've built up.
24 You've got "X" dollars Year One. If you have the same amount
25 contributed for each year, by the tenth year you've got ten

1 times that on your books. You're in a tenth-year depreciation
2 of the first asset, the ninth year on the second --

3 MR. BILINSKI: Right.

4 MR. FREEMAN: The eighth year --

5 MR. BILINSKI: Absolutely.

6 MR. FREEMAN: And if you are getting one year's
7 contributions in Year 10 or Year 11, there's no way that you
8 don't have more benefit from that depreciation throw off than
9 your negative cost in the tenth year.

10 MR. BILINSKI: That assumes that we only collect
11 CIAC in Year One, and then there's no activity going forward.
12 We are continually in a cash flow.

13 MR. FREEMAN: But they have got nine years of full
14 CIAC; you don't. But they do. They have nine years of full
15 CIAC. Florida Cities doesn't. I mean, I'd almost be happy if
16 Florida Cities goes to full gross-up if we've still got to pay
17 it because that will then raise my competitor's prices \$3,500.

18 MR. MURPHY: Maybe to add to that point with regard
19 to cash flow, I think maybe -- and like I say, I proclaim to
20 be no technical guru; I don't think he does either. On
21 present value, I think you can read the same thing that I read
22 here. And I would assume that if he's -- and I've got two
23 accounting degrees; and if he can understand this better than
24 I can, so be it, maybe we need to have Arthur Andersen come in
25 to explain present value to me. It sounds good on paper.

1 I'll be honest; I don't understand it.

2 But with regards to the cash flow, I think what the
3 proposal is would be -- is that let's assume that present
4 value is the method, okay? What you'd have to supplement
5 that, though, is with cash flow. Okay? Now, I guess what the
6 development community might propose is to have a funding
7 mechanism, in essence, to loan that money to the utility for
8 that period of time, and that may be a ten-year period of
9 time.

10 MR. FREEMAN: We have done that. That's been turned
11 down.

12 MR. MURPHY: Well, and then I say, that's the
13 problem, and you go. The difference is we are still out the
14 cash. We've got to go out and find where the cash flow comes
15 from.

16 MS. SALAK: I'm sorry. The way I understand your
17 statement is that you think that there's not a cash flow
18 problem because the detriment of the CIAC, having to pay tax
19 on it, is offset because you have the deductibility of the
20 depreciation.

21 MR. FREEMAN: No, no, no.

22 MS. SALAK: No.

23 MR. FREEMAN: I want to give you what I hope are
24 intellectually honest answers because I have an accounting
25 degree, too, as well as a law degree and a master's in tax,

1 so --

2 And I'm not sure I understand the net -- I've done
3 net present value calculations, but what happens with net
4 present value is in Year One, if we are in 1987 and this was
5 the first year that something was being done, if I contributed
6 \$1,000, theoretically, the utility, if they were in a maximum
7 tax bracket, would have about \$600 of tax. On a net present
8 value method, my contribution would be about \$380. So they
9 would be off a couple hundred dollars. Built in that \$380,
10 though, is the tax on it plus a return on that negative cash
11 flow. So that's what you get into on the net present value.

12 Now, where we are today -- at least in the utility
13 that we do business with -- I think most of the utilities that
14 are collecting full gross-up is -- you are not in 1987. By
15 the time you do anything, you are in 1996. So now there's
16 nine years of full gross-up that they've collected with nine
17 years of accumulated assets they've received contributions on.
18 So unless you've got in 1996 a company that just got into the
19 utility business in 1996, they've got all that depreciation
20 benefit on those assets that they've depreciated for nine
21 years and will continue to depreciate that would offset the
22 net present value; and it really would not negatively impact
23 anyone at this point. So that's our position.

24 Now if you had somebody that came in and said, "Gee,
25 I just started a utility; we started today. This is our first

1 year. Is there a negative impact?" Yeah, there would be a
2 negative impact.

3 MS. McCASKILL: Let me ask a question that might
4 sound like it doesn't make any sense, but I'm really trying to
5 understand what happens with gross-up. Let's say, I know
6 because there is a cash flow problem with some utilities that
7 necessitates full gross-up. Let's just pretend there is no
8 cash flow problem; you have plenty of money. Then would you
9 want to gross-up and why and under what method?

10 MR. DETERDING: Give me the source of that "plenty
11 of money," and then I can answer it. Because it assumes that
12 you either got it from a parent or you've got a line of credit
13 or you've got a banker who's willing to loan it to you. The
14 latter two I seriously doubt would be true. It's going to
15 impact your ability to borrow for needed improvements to
16 plant. All these things were brought out, I think, in the
17 discussion both in 23541 and in Gulf, that there's a lot of
18 detrimental impact of a net present value method. And even if
19 you assume you can find some source for those funds, that cash
20 flow problem, it has got a lot of other repercussions, I
21 believe.

22 And, again, I'll leave it to the guys who have dealt
23 with this issue from an accounting standpoint to tell you that
24 more specifically, but that's my perspective or understanding
25 of it.

1 MS. SALAK: Somebody want to help Marty out?

2 (Laughter)

3 MR. FREEMAN: I just want to say one thing. We
4 don't want to argue what's what. What I suggested was that if
5 net present value is charged, which over the long run places
6 the actual cost burden on the contributor, does not impact the
7 utility negatively over the long run on the asset nor the
8 ratepayer, that we have no problem with regulation.

9 The one thing I'm hearing here is that, "Well, we
10 would like to just make a management decision on full gross-up
11 and, yeah, maybe it will negatively impact my cash flow."
12 Maybe it will do this and maybe it'll do that. And that's
13 great, but then they are saying, "But we don't want a rate
14 case."

15 And I don't believe that they can go in and just
16 make management decisions on rates and that you let them do
17 that. So I don't think that getting out of the paperwork and
18 out of the supervision and out of the -- or get into the
19 streamlining should be done in an area where there is a
20 benefit going to someone, we don't know what it is and it's
21 being hidden in the books. And I think somebody needs to look
22 at that.

23 If someone that comes up, I mean, like, Palm Coast,
24 if they are at net present value, do I think you should
25 administratively allow them to charge it? Yes. Do I think

1 that you should look at their escrows and look at their NOLs
2 and do anything else? No. If they wanted to go to full
3 gross-up, do I think you should? Yes, because that is like a
4 rate case. And I think that's what the order said.

5 As much as I disagree with it, it basically said,
6 "Hey, if you are going to charge this full thing, there's
7 benefits going someplace. And we regulate your rate of return
8 and we look at your rate of return so that we make sure you
9 are not overcharging somebody or getting benefits and not
10 passing them on, and you need to do that. And I just don't
11 see the streamlining going with the full gross-up.

12 MR. NIXON: I would just comment that I think what's
13 lost sight of here is most of the -- I'd say all but maybe one
14 or two at the most of the 22 companies that are now grossing
15 up, are in terrible financial shape.

16 I've heard all this talk about a lot of extra cash
17 floating around; there's no such thing. I challenge you to go
18 look at the annual reports of those 22 companies. Most of
19 them have debt in excess of rate base, very small amounts of
20 equity in them. Many of them are in the process of trying to
21 borrow funds to meet DER requirements and expand their plants
22 and to minimize the impact of coming up with the cash not only
23 in one year and saying, "Well, if this thing plays out over 30
24 years," yet there is a zero impact, and the company should
25 theoretically have plenty of cash flow. That's not how it

1 works in the real world. The companies are collecting CIAC
2 and paying a tax each and every year, and the companies are in
3 a cash flow bind.

4 MS. McCASKILL: I guess what I was trying to get an
5 answer to or get at, again, like I say, suppose cash flow
6 wasn't a problem, then what would be the fair method?

7 I know paying the taxes will cost somebody. But
8 what would be the method that would be fair to the utility,
9 fair to the ratepayers, fair to the developer? Say, for
10 instance, that cash flow wasn't a problem; you didn't have to
11 have the full gross-up. I understand for a lot of utilities
12 you have to have the full gross-up. You don't have that cash
13 in the year that those taxes are due.

14 MR. NIXON: I'm not sure how to answer your question
15 because apparently the only utility in Florida with sufficient
16 cash flow to utilize net present value gross-up is Palm Coast.
17 The others don't.

18 Hypothetically, if there is a company out there that
19 has this excess cash sitting there and you require them
20 somehow to pay the tax in the interest of fairness to the
21 developer, then that utility has to earn a rate of return on
22 that investment in taxes. And I think we are arguing points
23 that we've testified to ad infinitum in that 23451 hearing.

24 The most cost-effective approach for the ratepayer
25 is the full gross-up because he ultimately gets the benefit of

1 that. And if the utility pays it, then ultimately the
2 ratepayer pays that tax impact. And to me, it doesn't seem
3 fair, especially after the ratepayer has already paid that
4 once through the purchase of his home.

5 Now, Mr. Freeman may not make as much profit as he
6 would like to make on a sale, because I recognize there are
7 competitive situations. But I think the presumption has to be
8 that any time a guy stays in business as a developer and sells
9 a unit, he is recovering those costs.

10 MS. McCASKILL: Okay. I believe what I'm hearing
11 then is that so far it's a full gross-up. It's not just a
12 matter of collecting the tax effect of that CIAC, but for a
13 lot of our utilities, it is a cash flow issue.

14 MR. NIXON: Absolutely.

15 MS. CAUSSEAU: Please don't forget in any of your
16 comments today or that you prepare for the Commissioner
17 workshop that Bill indicated, everything is open to
18 reexamination. Everything. Even the premise that the
19 depreciation benefit goes back to the ratepayer; everything is
20 open.

21 MR. FREEMAN: The only comment I would like to make
22 with respect to what Mr. Nixon said, that is, I don't know the
23 financial -- I mean he would know the financial condition of
24 the 26 or 22 of the 26 companies that are getting full
25 gross-up. And I know Palm Coast gets a net present value so

1 they must be financially stable.

2 Southern States, which I think is larger than either
3 of the two of them, doesn't charge any gross-up. So it's not
4 like the companies that are charging gross-up are in a
5 terrible financial state. Some companies have elected not to
6 for various reasons. And I'm not telling them how to do it or
7 how not to do it. All we want to do is pay whatever our net
8 cost is to be on line, and that's fine.

9 But I will say -- and this is a point that I'm going
10 to hopefully address for the last time. But as much as we
11 make less money on our house because we pass on our cost, we
12 are in a competitive environment. And I challenge my utility
13 to run their business the way I run my business, and that is
14 to go out and find out the rates of everybody else in Lee
15 County and charge those rates. Because then they're in my
16 business, and there, nobody is looking at whether they pass on
17 their costs or not. We are not in a cost pass-on business.
18 And that differentiates a private business from a regulated
19 business.

20 I have got to go set my pricing and what I deliver
21 based on what my competitors do. And if I'm noncompetitive, I
22 go out of business; they don't. But if they do, then I think
23 this comes out in a wash; and we aren't here. But that's not
24 the case.

25 And I think that's the thing that everybody loses

1 sight of. It's like, well, yet a developer passes everything
2 on and the customer is ultimately paying it. Well, who's
3 paying for what they are not passing on? They don't have to
4 be efficient, because the homeowner that I sell to pays their
5 rates. And they are not happy because there are other
6 utilities that charge lower rates. And if my customer could
7 pick their utility like they could pick a builder, it's
8 different.

9 So we need to be competitive, and it is important
10 for us. And it's important because we need to move our units.
11 And we don't just put that money in our bottom line because it
12 affects our pricing. It affects it now, and it has always
13 affected it, so --

14 MS. McCASKILL: One more question because we were
15 talking about cash flow and tax effect. What I see happen in
16 a lot of cases is that while the utility collects gross-up of
17 the bottom line -- you know, above the line we may calculate
18 an above-the-line tax liability about the bottom line of the
19 tax return -- the utility pays no taxes. So I guess am I
20 understanding your position to be, though, but you should get
21 the tax effect because you would have either had to use up
22 some losses you would have had earlier, earlier than you
23 otherwise would have if you did not have the CIAC, and that is
24 why you say the tax effect; because its effect is the
25 deductions you would have had that would have generated a loss

1 if it had not been for the CIAC?

2 MR. NIXON: That's right. We are viewing the tax on
3 CIAC as an isolated stand-alone item of income and the related
4 tax. The other items on the return that cause maybe a loss
5 for tax purposes are not related to the CIAC. The
6 stockholders are funding those other losses.

7 MR. DETERDING: Or the ratepayer, in some
8 circumstances. And if you give those back, the benefit of
9 those, to the developer, we're saying it's an improper
10 matching of who generated this tax benefit versus who is going
11 to be given that benefit; and it's inappropriate.

12 MR. NIXON: And I think the only thing on the return
13 that, you know, does relate to the CIAC is the depreciation.
14 And under the wisdom of 23541, realizing that it may be -- the
15 whole thing -- concept may be changed, that depreciation, the
16 tax benefits of that depreciation are through the accounting
17 methods, those journal entries that I've given you, ultimately
18 end up working to the benefit of the ratepayer. So
19 depreciation could cause the company not to pay any tax. I
20 doubt if that one single item on the return is responsible for
21 all of the tax loss, but it does have an impact. But under
22 the system of accounting that is in use, the benefits of that
23 loss can go back to the ratepayer.

24 MR. MURPHY: Just to point out, too, that we are not
25 only talking about NOL carryforwards, net loss carryforwards,

1 but also current year operating losses have the same impact.

2 MR. NIXON: Right, right.

3 MR. MURPHY: I mean, above the line could be a loss.
4 And if you apply your gross-up in that situation, the
5 developer would receive the benefit in that case. So it's not
6 only just NOLs that bring forward, but it's also losses
7 generated in the current year for whatever reason they may be.
8 They may be depreciation, or they may be the fact that it was
9 rainy. And contrary to his comments, we do lose money as a
10 utility sometimes. So that's why I made that point.

11 MR. DETERDING: One thing I also want to mention is
12 the recurring comment from Mr. Freeman that the utilities,
13 that their customers are not seeing this benefit. Well, we as
14 an industry have never suggested that they should not. The
15 way we have proposed and the way I understand 23541 was
16 designed under the circumstances and whatever method you come
17 up in the future, to the extent that there is a tax
18 depreciation benefit, that I believe the set of entries that
19 were devised are intended to accumulate that benefit and to
20 consider it as, as I understand it, zero cost capital in the
21 analysis of an appropriate rate of return.

22 So I think whether they are seeing that benefit and
23 a company coming in and saying, "Hey, we need a rate reduction
24 because we have this big zero cost capital item," or just
25 hearing nothing from the utility because they don't have a

1 need for a rate increase because they have got zero cost
2 capital, they are getting that benefit to the extent that
3 company doesn't need to seek a rate increase; just as much as
4 if the company came in and said, "We need a rate reduction."
5 So I think they are getting that benefit.

6 I think all the accounting was devised in order to
7 make sure that that benefit was to the extent applicable to
8 those depreciation benefits was -- does accrue to the general
9 body of ratepayers.

10 MR. MURPHY: Yeah, I think we may be -- we're
11 confusing maybe a couple of issues: service availability and
12 CIAC. And, obviously, I think, as you recognize, they go
13 together. But the fact that, for example, if Gulf Utility
14 charges \$100 a month and Florida Cities in Lee County only
15 charges \$80 a month, it's not the CIAC or lack of CIAC
16 gross-up that accounts for that difference. As the Commission
17 and Staff would know, there are any number of reasons;
18 thousands, I guess, there could be.

19 So from the standpoint of -- you hear it all the
20 time from ratepayers saying, "My rates are too high." And
21 there are many reasons for those rates being too high. But as
22 Mr. Deterding has said here, we, hopefully, when we do our
23 accounting and we do our ratemaking, we do give this benefit
24 back if we do a full gross-up. If we do a no gross-up, we
25 then increase our rates to our taxpayers -- our ratepayers,

1 I'm sorry.

2 MR. DETERDING: And I guess Mr. Freeman's comment
3 about the financial position of all these companies -- I think
4 what Mr. Nixon was referring to as to these companies not
5 being in the greatest financial position and cash flow
6 position to be able to fund these things -- I think that is
7 more of an industry situation. And as well run as I'm sure
8 Palm Coast is, we all recognize the reason why they are able
9 to find funding in this is because the investment that ITT
10 Community Development Corporation makes in the taxes for Palm
11 Coast are minuscule compared to their resources. And I don't
12 think most of us have that kind of resource available.

13 MS. SALAK: Any other general comments anyone would
14 like to make?

15 MR. MacFARLANE: Can I --

16 MS. SALAK: Sure, Mr. MacFarlane.

17 MR. MacFARLANE: I know everybody wants to get out
18 of here.

19 MS. SALAK: Well, we still have all the questions to
20 go through, so don't worry. (Laughter)

21 MR. MacFARLANE: So I need to wait to have lunch.

22 For the record, my name is George MacFarlane with
23 the firm of Regulatory Consultants.

24 Let me try something real quick, and I want to ask a
25 question because, quite frankly, tax gross-up has become a

1 service availability charge. That's where you find it in the
2 tariff. It is a contributor-driven charge.

3 And what we really have today is what I consider
4 interim SAC or service availability charges that are subject
5 to refund year by year. We collect it; somebody looks at it,
6 and then decides whether we have to give it back. I mean, in
7 effect, that's what's happening. The problem has become
8 ratemaking general. The benefits Mr. Freeman's looking for,
9 we won't see -- may not see -- until some previous period of
10 time. And in every situation every year, every utility
11 changes -- things change within a utility. I have got a
12 little utility that just got hit with a million dollars of
13 contributor lines and never grossed-up before that. Now they
14 are facing a serious problem. And beside that, they are in
15 receivership so they are facing a dual problem.

16 The point being that, unfortunately, the process of
17 approval is slow. And that's nothing against the Commission.
18 It's just, you know, under the current process, things have to
19 be approved.

20 I'm suggesting two things. I'm suggesting, first,
21 that the formula method, if you will -- I don't really care if
22 you call it a net present value, the formula method, or
23 whatever, the full gross-up method, which is continued forth
24 as part of the service availability charge. Because I have
25 clients that from a cash standpoint will collect a cash

1 service availability charge and is willing to pay the tax out
2 of the cash service availability charge. But they are not
3 willing and cannot afford to pay the tax on contributed
4 property, because there's no cash that comes with it. I mean,
5 their cash balance isn't large enough to do that.

6 So the formula would allow that possibility for the
7 utility to decide what maybe its average tax effect may be.
8 I'm not talking about always in the marginal brackets. I
9 mean, admittedly, it has begun in the marginal brackets
10 because they are concerned year by year what that tax effect
11 is going to be.

12 But hear my words carefully. Right now that money
13 is being placed in an escrow account. I'm not suggesting that
14 we discontinue that practice. What I am suggesting we
15 discontinue is trying to true it up year by year.

16 I'm suggesting the money stays in there year by year
17 to give the utility a determination, for example, if it wants
18 to gross-up at a 25% rate or a 20% rate or an 18% rate, which
19 would give effect to a net present value approach, it gets
20 that rate approved by the Commission; it charges that rate to
21 everyone within that year, or from then on out, until it
22 changes it again. And that could be handled on an
23 administrative basis. But my point is the money stays in the
24 escrow account to pay taxes associated with contributed
25 property.

1 On a service availability approach, what happens is
2 that is a SAC charge. It is a CIAC. It will be recorded as a
3 CIAC. The taxes paid will be debited to the deferred tax
4 account.

5 The next issue becomes in the issue of the NOL
6 carryforwards. As long as the money is there in the account,
7 somebody could come back and make claim against that cash,
8 that they should be able to remove it because it got there as
9 a result of an NOL carryforward that was never generated by
10 the contributor. And I'm the first to admit that. I mean,
11 I'm just like Bob. Most of my clients are small and have
12 generated NOLs a long time before 1986.

13 But what I'm suggesting is, the real problem we've
14 got here is the refund situation. I mean, it is really
15 complex. And if it is a service availability charge, it goes
16 into CIAC.

17 If you pay taxes on CIAC, property or cash, it goes
18 in as a debit that ultimately will end up in rate base, which
19 will be handled in the next rate case. If there is any type
20 of benefit from the depreciation of that property to go back
21 to the general body of ratepayers, it will also be handled in
22 that rate case.

23 So what we have got, though, is we started -- and
24 admittedly started in 1986 -- and that formula that we are
25 using today, at least the initial one in '86, came from

1 Sarasota County. Kenneth Gatlin, myself, and Peter Martin,
2 and a few other people put it in front of the Board of County
3 Commissioners in Sarasota County to begin with. And everybody
4 is always concerned that the utility will walk away with a
5 pocketful of cash. And so we thought that the only way to get
6 this thing to work was to promise back a refund. And the
7 truth is, that one provision is probably the provision that
8 has caused us the biggest, single problem from the Staff's
9 viewpoint, from the utilities' standpoint besides that.

10 Truing up what is on a tax return is probably one of
11 the most difficult decisions and is more driven by a person's
12 opinion than maybe by fact, if that makes sense. I mean, you
13 have to do a used and useful calculation by year. You have to
14 determine if you have disallowed expenses for rate case
15 expense. Well, fine, we get to keep that one. But how about
16 if we have disallowed salaries and management fees that are
17 continuing to be charged at a level lower than -- I mean, at a
18 level higher than what was allowed in rate case? What do we
19 do about interim years? What do we do about inflation rates?

20 You know 2% -- or indexing requirements. I mean,
21 everything builds into in and around the tax rate, and it's
22 just too complicated.

23 So I'm suggesting we go back to the idea to handle
24 it like a service availability charge, give the utility an
25 opportunity to gross-up and at what level, at what percent it

1 feels like grossing up. I mean, if the tax rate is going to
2 39%, then gross-up at 39%. There is a certain burden that
3 comes with that. And the money stays in the escrow account.
4 And if you want to remove it -- the money stays in the escrow
5 account, except to the extent that paid directly for federal
6 taxes. Okay?

7 But if you want to remove it for any other reason,
8 such as you believe you have a benefit that has been used up
9 as a result, then you have got to come to this Commission and
10 prove that you've had a benefit that's been used up and allow
11 the Commissioners to make a decision of whether they will or
12 will not allow you to remove it. What happens next?

13 In Sarasota County we have created situations where,
14 unfortunately, they have a different opinion of service
15 availability charges than you do. They believe that you're
16 supposed to collect 100% back. Everything you put in the
17 ground, you've got to collect back 100% of. They do not have
18 a minimum and maximum level CIAC. We've tried and have lost
19 that. They believe they can take you over for nothing, so
20 that's another situation.

21 But the point is they have created a situation where
22 in some cases we have overcollected CIAC, which is mandated to
23 go into an escrow account to be used on improvements on the
24 property. So you start to fund through some processes a
25 couple of different things.

1 First off, the taxes are going to get -- they vary
2 year by year. Everybody admits that. The benefits will run
3 back to the ratepayer. Ratemaking principles are not precise.
4 And we look at rate base, expenses, taxes, depreciation,
5 income tax expense in a rate case and the benefit from all
6 that property, be it cash or property contributed, will be
7 looked at during a rate case proceeding.

8 So I'm suggesting -- and if we start to exceed
9 service availability, then I get a letter from someone else
10 that says, "By the way, your service availability is now at
11 76%. Explain to us why, that you are starting to exceed the
12 limit."

13 This thing would work the same way. And as long as
14 there are deferred debits in there as part of the cost of rate
15 base, and as far as the credit sitting as SAC charges, that's
16 part of the calculation that would be -- that will have to be
17 made for service availability charges.

18 I'm not suggesting we determine each service
19 availability charge with it included. I'm saying it's just
20 another component. A service availability charge has \$100 for
21 meter installation fees. You charge all kinds of different
22 service availability charges under your service availability
23 policy. This would simply be another charge that someone
24 would have to come forth with. And if somebody decides that
25 zero, they don't want to gross-up in the formula, the formula

1 is zero. That's what I'm suggesting.

2 MS. CAUSSEAU: Do you think that the refund
3 procedure that we follow now is more complex than a rate case?

4 MR. MacFARLANE: Yes, because -- one of the reasons
5 why is in a rate case you are dealing with a much shorter
6 period of time. And you know what I'm saying? I mean, when
7 we deal with an eight-month situation, it's very compact.
8 Here we are dealing with things going back to 1990 and before.
9 Year by year -- and we are not dealing with amended tax
10 returns. Amended rate cases, so to speak, are being handled
11 within the rates cases. Do you know what I'm saying? All
12 those are effects that come about at some future date past
13 when you made the initial determination. We have to deal with
14 that for CIAC. You don't deal with that under a rate case.
15 So I consider it to be much more complex than in a rate case.

16 MR. DETERDIN: I think the issues involved are more
17 complex. And just to add to what George has said, you are
18 trying to mix book and tax; and that can be mind-boggling. I
19 think that's what hits us the worst in this whole gross-up
20 thing is you are looking at book for one purpose and tax for
21 another, and then you are trying to blend the two in this
22 process. And that's, I think, one of the main things that
23 makes it so complex, as well as blending years to a certain
24 extent.

25 MS. CAUSSEAU: I think we started out just looking

1 at tax.

2 MR. MacFARLANE: Right, we did.

3 MS. CAUSSEAU: You paid tax; you kept it. You
4 didn't pay tax; you didn't keep it. And that certainly was
5 simple.

6 MR. DETERDING: That wasn't my impression how it
7 started out.

8 MS. CAUSSEAU: I think you mean back before 23541
9 you paid tax. Okay, you didn't, too bad.

10 MR. DETERDING: Well, I interpreted 16971 in a
11 different way than you did then, because I don't think that
12 was the intent. And if it was, it is, in effect, a
13 confiscation of property, so I'm glad we are not at that
14 point.

15 As to George's, and to a certain extent Bill's,
16 suggestion that we treat it as a service availability charge,
17 I think from an approval and further analysis reporting and
18 Commission review of the charge, that is a good idea. I think
19 from suggesting that it become part of CIAC and that you book
20 that as CIAC, it's going to throw the provisions of the rule
21 dealing with the maximum 75% out of kilter because it's going
22 to result in the tax taking up part of that total.

23 If you then book to an asset, your investment in tax
24 is an offset. There's going to be major timing differences
25 there. I think we also then get into the same issues of above

1 and below the line in that process that we get into in this
2 one.

3 So I honestly believe it's not going to make a whole
4 heck of a lot of difference in the issues or the frequency we
5 have to address them if we do it that way. And that is just
6 my perspective on that without -- today was the first time I
7 really tried to think through that.

8 MS. SALAK: I want to follow up with
9 Mr. MacFarlane's idea about the escrow account, keeping it
10 forever and going --

11 Were you talking about, when you said, "Pay taxes
12 out of it," are you talking about actual taxes where cash
13 actually goes out? That's the only thing you can take out of
14 it?

15 MR. MacFARLANE: That's correct.

16 MS. SALAK: Okay. And then anything else would be a
17 petition before the Commission?

18 MR. MacFARLANE: That's correct. If you believe
19 that you have had a benefit that has been impacted in some way
20 or another, then you can come before the Commission and ask
21 for it to be removed.

22 MR. DETERDING: And, again, I think that the result
23 of that is you'll be doing that every year with above- and
24 below-the-line analysis and that won't resolve the basic
25 problems that we have with the reporting. Because most of the

1 companies that I know of do have some impact from that above-
2 and below-the-line analysis that would have to be considered.
3 If you've got a nonuseful plant, by definition you do, and you
4 want to get the money out to the extent that it is rightfully
5 yours from giving up the tax benefit related to that item.

6 MS. SALAK: We have a choice; we can go on and start
7 the questions now or break for lunch. Connie's decided.

8 MR. DETERDING: Moved. Did I hear a second?

9 MS. SALAK: Well, the second question is: We are a
10 long ways out here, John, did you bring your lunch? No? So
11 we need to break for at least an hour?

12 MR. JAEGER: Like 1:30 or 1:45? What do you want?

13 MS. SALAK: How about 1:45, get a little extra time.

14 (Thereupon, lunch recess was taken at 12:20 p.m.)

15 - - - - -

16 (Reconvened at 1:50 p.m.)

17 (Due to mechanical difficulties, the record
18 continues at this point.)

19 MR. MURPHY: I think my comments, which tax act it
20 becomes, short stands on -- and the whole thing and short
21 history that compared to these other people, and not having
22 been here in 1990, I think this thing is in some respects.
23 But, you know, I guess, is meter fees, is that just a
24 superfluous or a diminimus type of amount that nobody really
25 wants to get involved with?

1 MR. NIXON: Generally. Relatively, yeah. It's
2 always been taxable.

3 MR. DETERDING: Relatively, and it's always been
4 taxable.

5 MR. MURPHY: It's always been taxable but it is a
6 CIAC?

7 MR. DETERDING: Yes.

8 MR. MURPHY: I think the diminimus rule or
9 immateriality may be something we'd want to consider here so
10 my comment is, whatever tax act it is, I think, and
11 irregardless of whatever tax act, I think maybe the
12 materiality of the subject is important.

13 MS. SALAK: Okay. I think No. 3 is where it starts
14 to get a little more controversial on how we interpret things.
15 It says, "Is there an actual tax liability due to the
16 collection of CIAC?" And 3a says, How should we define above
17 and below the line?

18 And your comments say, As on the same basis as we do
19 for ratemaking purposes.

20 MR. MURPHY: Essentially, yeah. Well, my first
21 question is, the first part of that question is, yes. I mean,
22 I really think that the transaction results in a taxable event
23 to the utility, on a stand-alone basis. And I think it's
24 important to understand that there can be a loss from any
25 number of issues that I don't think should affect the gross-up

1 refund, as it were. And that's really what our argument is,
2 the refund is.

3 MR. NIXON: Again, this was argued before the last
4 big hearing. And I think all parties agree there is always a
5 tax liability. The question is how is that tax liability
6 settled? Is it settled through the use of current year
7 operating losses or loss carryforwards or cash from the
8 utilities or cash from the contributor causing the tax?

9 MR. DETERDING: Because CIAC is treated as income,
10 it, by definition, has a tax impact whether you settle that
11 with a loss or whatever, is the question.

12 MS. SALAK: All right. And as far as the question
13 about how to define above and below --

14 MR. DETERDING: Well, that we can spend three months
15 on that. Bob had some comments.

16 MR. NIXON: In my comment -- and they're in the
17 written portion of my presentation -- but if we're left with
18 this above and below the line, if we don't have a change of --
19 I think that the tax return should be looked at on the same
20 basis that you would look at it in a cost of service
21 proceeding to determine what the taxable operating income in a
22 rate case would be and use that number as your above-the-line
23 income or loss.

24 I think to illustrate this, if you had a company
25 that was in for a rate case and was entitled to an income tax

1 expense in the cost of service, you would calculate a pretax
2 income on which you would base your calculation of the income
3 tax to include in cost of service. And what if at the same
4 moment the company came in and had been grossing up and you
5 were considering a refund of gross-up, wouldn't you be forced
6 to look at that tax return and come to the conclusion that the
7 above-the-line taxable income, or if there was a loss, would
8 be the same in the cost of service proceeding as it would for
9 your refund calculations? And I think it would.

10 MS. MCCASKILL: Going back to something Bob said
11 regarding if there is an actual tax liability, then it seems
12 to me the issue here is not necessarily whether you actually
13 pay out any taxes in dollars. The fact is this CIAC has a tax
14 consequence and what you all have said, you should be able to
15 recover that. And the question is are we going to allow you
16 to recover it from the developer, or how are we going to allow
17 you to recover that.

18 MR. DETERDING: Right. That's correct.

19 MR. NIXON: That's correct.

20 MS. SALAK: All right. Should the liability be
21 measured on a total company basis or on an above-the-line
22 basis if you had to do it again?

23 MR. NIXON: Well, if we had to do it again, and
24 we're stuck with this above and below the line, it would be on
25 an above-the-line basis.

1 MS. SALAK: And not a total company basis.

2 MR. NIXON: Right.

3 MS. SALAK: Why is that?

4 MR. MURPHY: I think I can add a comment to that. I
5 think there's a number of items that come below the line when
6 it's happening to our company. It's a significant
7 below-the-line expense, which we will not be passing along to
8 our ratepayers. And I'd certainly want that to stay below the
9 line because that is an expense that my shareholder is
10 burdened with. So I wouldn't want to try to come into a
11 situation where I'm saying part of that is above the line or
12 below the line. That type of item is always a below the line
13 type expense.

14 And like Bob said, these are typically expenses that
15 in ratemaking we make a distinction are -- you know, we make a
16 distinction between above and below the line. And I think
17 where we blur that above-the-line and below-the-line concept
18 is maybe when we've tried to make a theoretical concept of,
19 maybe, NOLs, for example, I think that's one point. Part of
20 it is above-the-line and part of it is below the line.

21 I think it's difficult to be able to say what's
22 above and below the line. I mean, you can use the used and
23 useful percentages or any number of formulae that you can come
24 up with, but I think that's what kind of derails that
25 whole concept. Those items, to me, are below the line. I

1 mean, the NOL essentially -- maybe I can be proven wrong --
2 isn't above the line in ratemaking purposes.

3 Bob, do you have any other comments to add onto
4 that?

5 MR. NIXON: And just -- and this is going back to
6 23541. That decision, I think, was a compromise between
7 giving the utility the position advocated by Florida Cities,
8 which we agree with and still think should be the position of
9 the Commission because it would greatly simplify this. But
10 given the fact that the Commissioners may not want to take
11 that step and still believe that current year operating losses
12 or loss carryforwards should go through this allocation
13 process to give some portion of those losses back to the
14 contributor as a benefit, then, I think, we'd all decided that
15 the measurement of that loss and the benefit from that loss
16 would be on a regulated basis, which is why at the outset I
17 said I thought the above-the-line taxable income would be
18 computed in the same manner you would do it in a cost of
19 service proceeding.

20 Anything that would be disallowed in determining the
21 revenue requirement in a cost of service proceeding would, by
22 definition, be a below-the-line item. And it doesn't make any
23 sense to me that those kinds of items, if they are disallowed
24 for ratemaking and are not being recovered by a utility in
25 their monthly service rates, why in the world those losses

1 would then be used to benefit a contributor.

2 MR. DETERDING: Or anybody else.

3 MR. NIXON: Right, or anybody else.

4 MS. McCASKILL: Would there be any difference -- you
5 know, I've heard -- I think it was Mr. Murphy or someone was
6 saying, just take the CIAC, multiply it by the tax rate or
7 whatever, that's the gross-up. Would there be any difference
8 in doing that and then just looking at total cost saying this
9 is what it was before CIAC. And this is what it was without
10 CIAC. Would there be any difference in those results? Is
11 that essentially the same thing?

12 MR. MURPHY: Yeah. Yeah, there would be a lot of
13 difference because the total company would bring in all these
14 below-the-line items and possibly NOL carryforwards or
15 possibly ITC carryforwards. And it also might reflect, and I
16 keep driving this home, is that you might have a current year
17 loss -- okay -- which is an above-the-line current year loss;
18 but that current year loss, in and of itself would then, when
19 compared with the CIAC contribution, lay nullify the CIAC tax.
20 So the utility has lost the benefit of the current year loss.

21 MR. DETERDING: And a developer in Year One where
22 it's a very dry year and you're selling a lot of water may
23 have to pay full gross-up and the utility keep it. But if you
24 go through this analysis, above-/and below-the-line type
25 stuff, and this yearly accounting, you may have -- the next

1 year have a big loss; and then Developer 2 pays the same
2 contribution, and he gets a substantial refund. So those
3 factors come into play in making it somewhat kind of
4 discriminatory, I guess, as well.

5 MR. NIXON: You know, if we could just find a way to
6 satisfy the Commissioners that all these benefits of
7 depreciation were being preserved for or going to the
8 ratepayers and totally do away with refunds back to the
9 developer, we could sure simplify this process.

10 MR. DETERDING: What has been suggested -- and, you
11 know, right now, supposedly, the way it's organized is through
12 normalization and recognition of that deferred tax as a
13 cost-free item of capital; and then as it starts to actually
14 reverse, then that reduces.

15 Bob has suggested, I think, I don't know whether
16 someone else has as well, as an alternative to that, just an
17 amortization of the same amount each year to be recognized in
18 rate setting as opposed to that just following whatever
19 happens with the tax picture each year.

20 And that would certainly -- just from hearing that,
21 it seems to me like an awful good way to simplify the whole
22 process. The amount would be pretty apparent, the amount of
23 the benefit flowing back, and be easy to calculate and easy to
24 track. And then all this reporting stuff would go out the
25 window, it seems like.

1 MS. CAUSSEAU: Well, aren't you going to have a
2 different mix of contributions every year so that the amount,
3 the life over which you can amortize it is going to change
4 every year so you can have that to flow back?

5 MR. DETERDING: You mean mix as far as quantity?

6 MS. CAUSSEAU: Lives.

7 MR. NIXON: You could do it on a composite basis or
8 just, you know, the way we do intangible assets, 40 years, or
9 just pick a number that you are comfortable with.

10 MR. DETERDING: Well, the nature of contributions,
11 if it's a cash contribution, you just have to assume it
12 relates to certain assets in general. If it's a property
13 contribution, 99% of the time it's one of those things that
14 has got a 40- to 50-year life or something under the
15 guidelines. It's lines and related materials.

16 And for the most part, the mix is about the same;
17 for every so many feet of sewer line you have to have a lift
18 station, or something like that. So, generally, as far as the
19 lives of the assets received in a property contribution, they
20 are pretty much the same.

21 I mean, I'm not saying they are exactly the same.
22 There are certainly circumstances if somebody has got a
23 pressurized system, there's probably going to be a variability
24 in there that's much different than a gravity system. But for
25 the normal case, I think it's pretty much -- the property

1 contributions are generally the same type of assets as far as
2 the life, depreciable life.

3 MR. NIXON: So you could come up with something
4 that's fair.

5 MS. SALAK: The next question has to do with if we
6 stay with the above-the-line basis, How should the information
7 on the actual tax return be allocated to above-the-line
8 operations? That's 2C -- let's see. That's 2C, 3C.

9 MR. NIXON: Well, I said the revenues, the
10 above-the-line revenues, would be those revenues that are
11 recognized as on an above-the-line basis.

12 For a rate case proceeding, you'd have, for
13 instance, your monthly service rates, miscellaneous service
14 revenues, those kinds of things that are normally viewed as
15 above-the-line revenues. Items like APPI, guaranteed revenues
16 for those companies that still have them, meter fees, interest
17 income, things like that would be below-the-line revenues.

18 MS. SALAK: And what do you think should happen to
19 amended returns? Or should or how should those be recognized?

20 MR. NIXON: I don't think the amended return would
21 have any affect because the calculation of a refund on above-
22 and below-the-line basis -- usually the amended return is a
23 recognition for a later year's loss which is carried back,
24 unless there's been some error made on the return.

25 And so I don't see where that would affect the

1 calculation of any refund in a previous year or for a refund
2 that had already been made. I just don't see there would be
3 any impact on it.

4 MR. MURPHY: My questions were somewhat sarcastic, I
5 guess, in comment, but it really is. If there is a refund,
6 then the Commission would probably say give that money back.
7 But if I have an overpayment I have to make in our payment to
8 the government, would the Commission say, "You should go out
9 to the developer and ask him for more money"? I don't think
10 so, so I don't think they should have any affect.

11 And I want to get back to that previous point I keep
12 wanting to hit home that, true, above-the-line/below-the-line
13 should be on a ratemaking stand basis, which was what Bob
14 says, but I think anything other than a stand-alone gets us
15 into too many theoretical concepts. And, again, I think
16 ignores -- I want to keep saying that if we have a loss in the
17 current year, that loss in the current year is a loss in the
18 current year. And when you net that CIAC against it, you've
19 lost that loss. So you may have an above-the-line loss and
20 that still goes to net against CIAC. And that benefit thing
21 goes back in a full gross-up back to the developer.

22 MR. NIXON: Right, in the current year calculation.
23 That was my point, that the existence of any above-the-line
24 losses and so forth are recognized in the calculation that
25 give rise to the refund to the contributor. So, therefore, a

1 subsequent amended return to carry that above-the-line loss
2 back to a previous year should have absolutely no affect.

3 MS. McCASKILL: Bob, you mentioned that meter fees
4 would be below the line. There is some opinion that the meter
5 fees should be above the line. Your rationale for meter fees
6 being below the line is because they're not revenues in the
7 ratemaking process or because they were previously taxable.
8 What I get regarding an opinion that the meter fees should be
9 above the line is that those meters are used and useful so
10 those revenues should follow where the meters would be.

11 (Simultaneous conversation.)

12 MR. NIXON: Well, again, you know, that's where we
13 start getting into these theoretical arguments. I just think
14 to be consistent with my position that the above-the-line
15 income computation should be consistent with the Commission's
16 established ratemaking policy, let's follow that established
17 policy.

18 Meter fees are not included as part of the revenue
19 requirement, nor is a tax on the those meter fees generally
20 allowed in the tax provision included in cost of service. So
21 just to be consistent and to establish some principles for
22 doing the above and below the line, I would tend to think it
23 should go below the line.

24 MS. CAUSSEUX: Would it surprise you terribly that
25 if you're not doing the tax on that, we don't have a problem

1 with your doing it?

2 MR. DETERDING: It wouldn't surprise me because,
3 theoretically, I think you're right. You ought to request to
4 get a tax provision, but I have yet to ever see a rate case
5 where they gave a tax provision on meter-fee revenue. I
6 haven't seen one. Certainly not in any of the cases I've been
7 involved in.

8 MS. CAUSSEAU: Well, I would imagine in the Staff
9 assisted they just use you all's calculation, and I suspect
10 they use you all's calculation in anything else. But, I mean,
11 theoretically, you ought to have a piece of the current
12 liability allocated to above-the-line operations and then some
13 real deferred taxes out there instead of some calculated
14 number, and you might recover it because you've got an
15 investment in it.

16 MR. NIXON: Well, I mean, from a practical
17 standpoint other than consistency with my position, I'd be
18 glad to include those meter fees above the line because they
19 increase --

20 MS. McCASKILL: Right.

21 MR. NIXON: -- the above-the-line income or at least
22 reduce the loss. So I'm just trying -- in my position, I'm
23 just trying to be consistent.

24 MS. McCASKILL: Right. And I guess I'm concerned
25 with what is appropriate and what is consistent, too. Like I

1 know you want to do that, but I want to know really what
2 should be done.

3 MR. NIXON: Well, again, in my opinion, what should
4 be done -- because I'm trying to make my calculation of
5 above-the-line taxable income as close to what it would be if
6 we were in a rate case or a cost of service proceeding, and I
7 would put it below the line.

8 MS. SALAK: The next criteria is cash flow. So do
9 you think we should be considering whether or not you have the
10 cash flow to pay your taxes or not, and whether or not that
11 cash flow can come from your parent or an affiliate?

12 MR. NIXON: Well, I think --

13 MS. SALAK: Let me get your answer so I can -- the
14 answer is no.

15 Go ahead.

16 MR. NIXON: I think it's appropriate to look at. I
17 mean, that's what you decided before; and I don't think the
18 industry had any particular problem with that. That's one of
19 the criteria, to demonstrate that you need to gross-up.
20 Whether that's appropriate going forward if you revise this
21 whole thing, I don't know. But I tend to think cash flow is
22 fairly important. And even to a company that has good cash
23 flow, if they use that cash to pay tax, they're somehow
24 affecting their ability to borrow funds; or they are not being
25 able to use those funds in some other manner.

1 MR. DETERDING: If your sources are limited or the
2 amount that you are able to get from whatever sources are
3 limited, then as you use those sources to pay for tax, you are
4 going to diminish your ability to borrow those monies or
5 increase the rate at which you can borrow or acquire those
6 monies for expansion and upgrade and meeting DEP requirements
7 and so forth.

8 And as to the related party, I definitely believe
9 you should not be looking at whether or not a related party
10 can fund taxes. If that related party wants to volunteer,
11 that's fine; but I certainly don't think it should be a
12 prerequisite to a determination of ability or authority to
13 gross-up.

14 MS. McCASKILL: If we went on the premise that the
15 CIAC has a tax effect and the utility should be allowed to
16 recover that from somebody, then does cash flow really matter?
17 It wouldn't matter because you'll be getting your gross-up
18 anyway.

19 MR. DETERDING: None of these matter. None of those
20 matter. When you get into that, when you go on that premise,
21 none of these things matter; and it simplifies it a lot.

22 MS. SALAK: Mike, did you have something to say?

23 MR. MURPHY: Agree.

24 MS. SALAK: Agree.

25 "E," the utility's ability to go into the financial

1 markets, you touched on that briefly, Marty. How should we
2 measure it, and should your willingness to go to the
3 financials, should that be -- magic marker -- should that be
4 considered?

5 MR. NIXON: I don't know of any utilities that could
6 go into the market and obtain a loan to pay income tax
7 expenses. What you are talking about would be an unsecured
8 line of credit, and I would be willing to bet there are no
9 more than four or five utilities in the state that can do
10 that. And, certainly, even with that, they would want a
11 personal guaranty from the stockholders. Or if there is an
12 affiliated company, a guaranty from the affiliated company.

13 It's just I've never understood this question. We
14 dealt with it before in 23451.

15 MS. SALAK: Right.

16 MR. NIXON: And we had a lot of people testify, a
17 banker and some others with a lot of years of utility
18 experience. And this is just something that doesn't occur in
19 the real world out there.

20 MR. DETERDING: I think it came to light in this,
21 and the last time the leverage formula came up -- that I don't
22 know of any water and sewer utilities in this state who have
23 obtained debt financing on a stand-alone basis. So on a
24 stand-alone basis, which, I think, is all this Commission
25 should be looking at, there's no way they're going to get

1 somebody to loan them money to pay taxes, not any significant
2 amounts anyway, not for that purpose.

3 MS. SALAK: So you think we shouldn't bother with
4 the interest coverage ratios or the alternative methods of
5 financing?

6 MR. DETERDING: Well, if you believe it to the
7 extent you utilize these sources of funds to pay a tax, that
8 you are diminishing your ability to obtain funds for other
9 purposes, which I think is pretty easily proven or at least
10 through testimony was proven in that last hearing, you
11 shouldn't.

12 MR. NIXON: And as far as I know, every one of the
13 22 companies has proven that their interest coverage ratio is
14 under that benchmark of two in order to get approval of the
15 authority. And I'm not familiar with any companies that have
16 that kind of coverage right now.

17 MS. SALAK: Connie, do you know offhand if we've had
18 any; there have been over two?

19 MS. McCASKILL: To my knowledge, we haven't had
20 anybody who's over two, at least not that I recall.

21 MS. SALAK: We can check on that.

22 And the alternative methods of financing, should we
23 be looking to see if you are trying new and inventive ways?

24 MR. MURPHY: You got something?

25 MR. DETERDING: Loans from the developer was

1 mentioned, and I think litigated in Gulf; but that creates its
2 own tax consequences if it's anything other than a market
3 rate, so --

4 MS. SALAK: True.

5 MR. DETERDING: And I don't know what other sources
6 there are other than that one as an alternative.

7 MR. NIXON: One thing that we've tried with a couple
8 of my clients is to get around the taxation of CIAC is to have
9 the utility actually buy the lines. You know, this approach
10 does not make sense for some companies. Some companies it
11 might.

12 And for those where it does, I mean, it's an
13 alternative where the utility buys the lines from a developer
14 at the minimum federal rate on the note, and the repayments
15 made over the life of the lines. But I can see a lot of
16 practical problems that may develop.

17 MR. DETERDING: Well, it has a rate impact for one.

18 MR. NIXON: Down the road. I mean, that's why
19 they've used it as a sort of a vehicle to build rate base,
20 plus avoid taking a contribution and requiring a gross-up.

21 But as Marty said, there's always two sides.
22 Someone is going to pay for this; it's either going to be the
23 utility and its ratepayers or the developer.

24 MS. McCASKILL: Right now, I can't precisely
25 remember Florida Cities' method, but would that fit -- most of

1 the clients that you represent, do you think that would be
2 viable for them?

3 I think they have one where somehow it's related to
4 service availability. It appears they're collecting the
5 carrying charge of those taxes or something like that. I
6 don't remember exactly right now.

7 MR. MURPHY: I think the developer referred to, I
8 think, Florida Cities Water Companies or -- which were called
9 guaranteed revenues.

10 MR. NIXON: AFPI or something like that.

11 MR. MURPHY: AFPI and guaranteed revenues. I mean,
12 obviously, Florida Cities has a no gross-up policy. There
13 were some particular circumstances where we have, you know, a
14 plant in place that has some use and useful problems --
15 nonused and useful problems. I should say. And I believe
16 that's where those fees kind of originated from is that the
17 developer has to start paying on them now. But the amount
18 that they run through those service agreements is
19 significantly less than, obviously, the cash flow.

20 Essentially, those guaranteed arrangements,
21 guaranteed service agreements allow for just the carrying
22 charges as it were, your rate of return on those lines that
23 you are carrying out there on a monthly basis. So it's a very
24 small part of it. It almost kind of even goes into the net
25 present value type of computation. It weaves in there a

1 little ways. It's some way to get something from the
2 developer, and you are not getting all of it. But I guess in
3 the scheme of things, the period of time is such that you get
4 very little back as opposed to the real impact.

5 MR. NIXON: But it wouldn't begin to cover the tax
6 on the --

7 MR. MURPHY: It wouldn't begin to cover -- it's not
8 meant to even begin to cover.

9 MR. NIXON: Right, I know.

10 MR. MURPHY: It's meant to begin to cover --

11 MR. DETERDING: It's meant for specific other
12 things, right.

13 MR. MURPHY: -- just the carrying charge essentially
14 on the tax and the investment, so --

15 It's an alternative, but I don't know what impact
16 that would have on each individual utility.

17 MS. SALAK: Marty, you look like you were going to
18 say something, you are not?

19 MR. DETERDING: (Shaking head.)

20 MS. SALAK: Okay. "F" is sort of a broad question.
21 It says: What is the effect on existing utility earnings and
22 customer rates if the utility does not collect gross-up?

23 MR. MURPHY: The long-term effect is his increased
24 rates to all customers, an increased cost of capital, and a
25 weakening of the balance sheet, an investment in taxes versus

1 capital, and an overall reduction in the utility's viability.

2 MS. SALAK: You mean you don't gross-up, right?

3 (Laughter)

4 MR. MURPHY: And we don't gross-up. Poinciana
5 Utility does gross-up and would have to in that situation.
6 But, obviously, at Florida Cities, we don't gross-up. They
7 don't gross-up at Southern States Utilities. It just means
8 higher rates.

9 MR. DETERDING: I mean, again, all other things
10 being equal, there are circumstances where you may be able to
11 sell -- you know, management has made that decision in some of
12 these cases, I assume, based upon a belief that the other
13 factors offset the detriment of gross-up.

14 From a pure all-other-things-being-equal standpoint,
15 though, that flat statement by Mike is right. I mean, it has
16 the effect of increasing rates, increasing cost of capital,
17 weakening the balance sheet, et cetera, et cetera.

18 MR. NIXON: I think your large national water
19 companies, some of which are publicly traded, we've had
20 trouble in -- you know the Waterworks Association is part of
21 the National Association of Water Companies, and we've had
22 trouble in the last few years getting them interested in
23 continuing to fight the battle to get repeal. Because some of
24 the larger ones, you know, look at the tax on CIAC as a chance
25 to make an investment to build the rate bases, to be able to

1 maintain or get rate increases in the future. They are not
2 impacted by it as much as, you know, some of these. Most of
3 the companies in Florida are so small in comparison. Even the
4 big large A's are very small compared to some of these larger
5 companies. But its been a problem with the association trying
6 to keep up interest at a national level, to keep going to
7 congress and lobbying and doing all this other stuff to try to
8 get the law repealed.

9 MR. DETERDING: We had the executive director of the
10 national association come to one of our meetings a year ago,
11 and tell us that many of the members nationally had found ways
12 to cope with it, be it through gross-up or otherwise. But I
13 think because -- and that is because I think they don't have
14 the kind of growth that the utilities do in Florida,
15 especially if you're a relatively new utility. There's plenty
16 of utilities -- Bob and I met with one yesterday -- that
17 increased its customer base by 25% last year and expects to do
18 it by 20 next year and 17 the year after, and so forth. In
19 other words, they are adding a tremendous number of customers
20 and a tremendous amount of CIAC.

21 In any case, the executive director expressed to us
22 that they had pretty much given up on the fight; and as soon
23 as he got that out of his mouth, he received a bashing from
24 the membership, basically, saying if the national association
25 gives up on the repeal of the tax of CIAC, they are going to

1 find that the Florida members are going to give up on the
2 national association. And as a matter of fact, he even got
3 letters after the fact from several members, including, as I
4 recall, Palm Coast, saying basically that is the issue you
5 don't give up on as far as we're concerned. We need to
6 continue to fight this battle.

7 So, I mean, just as an aside, we've got a great deal
8 of interest and are still trying to do something about it.

9 MS. SALAK: As far as your association -- we've done
10 some research into what other states are doing as far as
11 gross-up, and we have some responses. But has it been -- has
12 anybody related any experiences to you on their gross-up in
13 another state and how it's working there?

14 MR. DETERDING: To be honest with you, not
15 personally, no. Actually Kenneth may have more and some of
16 the guys from Florida Cities and Palm Coast may have more
17 contact with people outside the state than I do. But --

18 MS. SALAK: Do you have a source where you could
19 find out?

20 MR. DETERDING: I don't think it's gotten into the
21 detail that this Commission has gotten into in analyzing it in
22 most states. I think it's been a simpler process, probably
23 just because they don't have as much growth, to be honest with
24 you, and it's not as big an issue.

25 MS. SALAK: They don't have what?

1 MR. DETERDING: Not as much growth.

2 MS. SALAK: Oh.

3 MR. DETERDING: And, therefore, not as big an issue.
4 I mean, certainly those companies in the northeast, and just
5 in northeast Florida as an example -- I mean, Jax Suburban is
6 a large company, and it was large before the taxation of CIAC
7 came along. If it adds 300 customers a year, that's very
8 immaterial in relation to what it may be for most of the
9 companies who are grossing up now who have substantial growth
10 going on each year. That magnified is what you get with these
11 companies, I think, in places like Connecticut and New York.
12 They don't have the kind of yearly growth in relation to their
13 current size and growth in CIAC that the Florida companies
14 see. I don't know that, but that's what I perceive.

15 MS. SALAX: Would you have any way or any access to
16 what they are doing in other states and the methodologies and
17 anything like that, three years extension?

18 MR. DETERDING: I don't per se. The national
19 association magazine kind of reports to us on a regular basis
20 about what's going on with the attempts to reverse the
21 legislation on a quarterly basis or whatever, but I don't
22 think we'd get any information on that source. Maybe Kenneth
23 knows some source.

24 MR. GATLIN: There's a bill now in congress that the
25 association is trying to get the repeal of the tax ability of

1 CIAC on the bill. And they have quite a number of sponsors
2 for the amendment. And it's really the first real opportunity
3 that has come up in several years, but there still doesn't
4 seem to be much optimism as to whether it would ever get
5 passed or not.

6 MS. CAUSSEAUX: We had heard from our neighbor
7 sources that that bill would be added in committee if
8 anywhere.

9 MR. GATLIN: Right, that it would be?

10 MS. CAUSSEAUX: If anywhere.

11 MR. GATLIN: Yes. That's right.

12 MS. CAUSSEAUX: That it will not get in either of
13 the senate or house bills.

14 MR. GATLIN: Right.

15 MS. CAUSSEAUX: That it would be added at conference
16 if anywhere.

17 MR. GATLIN: That's the only place that they think
18 it will. And the Treasury Department has signed off on it.
19 They said it's fine, the amendment.

20 MS. CAUSSEAUX: Our understanding is that they have
21 not taken a position this year as yet; that they will take
22 that position if the bill begins to move and only then. They
23 signed off in years past.

24 MR. DETERDING: I think Beth's question was more,
25 though, what's the experience in the state regulatory scene.

1 And, as I said, I don't know. I don't have any idea or any
2 sources from which I could get it. I guess I could ask the
3 people at NAWC, but I have a feeling they wouldn't really know
4 that well either because they certainly didn't know what ours
5 was when they walked into our meeting and suggested they were
6 going to give up the fight. (Laughter)

7 MR. MURPHY: When Avatar Utilities had the midwest,
8 we were a larger company. We obviously had other states,
9 midwestern states mostly, and it wasn't -- CIAC was not a
10 significant issue in Missouri or Indiana, Michigan, Ohio for
11 the simple reason of growth. If you don't have a lot of
12 growth going on, it really doesn't concern you. But I can
13 certainly contact people that we still have contacts in those
14 states and will report back to you about my findings.

15 MS. SALAK: If you wouldn't mind, I'd appreciate
16 that.

17 MR. MURPHY: Yeah. But it probably would be midwest
18 states which aren't experiencing as much growth, but we'll see
19 what they say.

20 MS. CAUSSEAU: Thank you. Are the levels of CIAC
21 collected in the other states at that same level that Florida
22 collects?

23 MR. MURPHY: I guess would the question be or would
24 the answer be obviously an advanced wastewater treatment plant
25 costs maybe the same in the midwest as it does in Florida?

1 MS. CAUSSEAU: Well, we could, like what, somewhere
2 between 25% and 75%?

3 MR. MURPHY: Oh, I see what you're saying.

4 MS. CAUSSEAU: What percents do they collect? Is
5 that something that makes it coupled with growth part of the
6 problem here?

7 MR. MURPHY: I couldn't answer that question now,
8 but I can ask that same question when I do some research on
9 this matter.

10 MS. CAUSSEAU: Thanks.

11 MR. DETERDING: I mean, I don't have really any
12 expense to say anything, but I would think that the level of
13 water treatment in Florida is generally higher than he's going
14 to find in the midwest, so at least water treatment facilities
15 will probably be a little more expensive. I don't know about
16 the rest of it.

17 And that's just one factor. As you say, the level
18 they collect or authorize to collect is one factor.

19 MS. CAUSSEAU: Right.

20 MR. MURPHY: And the cost behind it are another
21 factor, so --

22 MS. SALAK: Well, anybody you could contact in a
23 high growth state that could help out. I mean, if their
24 gross-up capabilities are going smoothly and you get positive
25 feedback --

1 MR. NIXON: I know I tried to do some research on
2 that for the hearing in 23541. And, basically, what I ran
3 into is at that time not many companies had totally nailed
4 down their position on it. Some had; some said if you collect
5 gross-up, we let the companies collect the tax whether they
6 are -- you know, no matter what form of tax entity they are.
7 Others, I think, were present value approvals only.

8 But I constantly was reminded by a couple of the
9 people at some of the commissions I contacted to ask Bill
10 Lowe, because Bill and Marshall had worked on the revision of
11 the Uniform System of Accounts. And probably, you know, their
12 contacts through NARUC and so forth would be the best place
13 for you to get a wide --

14 MS. SALAX: Well, we did do a survey. I mean, we
15 have done a survey; and we do the results of the surveys,
16 which we'll share with you on that workshop on the 5th.

17 No, actually we have them upstairs. I just didn't
18 think to bring them. We have done that. We have summarized
19 them.

20 I was just wondering if you've gotten -- not all the
21 states had responded, so I was wondering if we had any
22 additional information we could glean.

23 Susan, do we have any extra copies of that?

24 If anybody's interested we can make you copies today
25 if you're interested in it.

1 VI is sort of a question that asks if there are any
2 criteria that you would like to see eliminated, which ones and
3 why.

4 MR. NIXON: Well, it goes back to exactly what we
5 intend to accomplish here.

6 MS. SALAK: We want to simplify it. We want to make
7 it still fair, but we want to simplify the process. And,
8 prospectively, we can do anything. I think there's still a
9 question about what we can do with the past years that we
10 already have. But, prospectively, we are just revisiting the
11 issue to see if we've learned additional information since
12 that order came out in 1990 or we've learned from our
13 experiences or, you know, if you've tried it, for example.

14 If you've tried alternative methods of financing and
15 there just aren't any out there, I mean, which seems to be
16 what you're saying, is this something we should be dropping
17 from our criteria?

18 MR. DETERDING: Well, I guess as far as that item is
19 concerned, nobody seems to know of any. If all we need to do
20 is state that we don't know of any, then it doesn't present
21 any big problem.

22 The things that I'm more concerned with is the
23 suggestion of whether or not you have an actual tax liability
24 to the IRS. And that gets back into all the points we raised
25 when we discussed that specific item. I don't think that

1 should be a criteria because that ignores the question, the
2 fact that CIAC does create a tax by its collection. So that's
3 the primary one, but I think we went through on each of these
4 and gave you our kind of input, unless somebody has some
5 additional on that.

6 MS. SALAK: Mike? No, you just agree? Okay.

7 So "D" would be how frequently should a utility
8 prove its entitlement to gross-up? I believe in the old order
9 it said you prove it and then if circumstances change you come
10 and tell us.

11 MR. MURPHY: It works.

12 MS. SALAK: It works.

13 MR. DETERDING: And I think that's generally still
14 true from our perspective, yeah.

15 MS. SALAK: Okay.

16 MR. DETERDING: I mean, if you see circumstances
17 changing in our particular circumstances with regard to the
18 annual report or whatever, then I'm sure you'll let us know
19 that you think something may have changed. But I'm not so
20 sure, again, given our perspective on it, how -- they would
21 have to change awfully dramatically for there to be a change
22 in our perspective of the appropriateness of ARISA.

23 MR. MURPHY: As long as it's a stand-alone type
24 basis, and as long as it's a taxable entity, short of a change
25 in tax rates, there's not really any reason to make a change,

1 I wouldn't think.

2 MS. MCCASKILL: If for some reason circumstances
3 changed and you determined you didn't need to gross-up, then
4 do you believe that we should cancel those tariffs and then
5 when the circumstances change again you come back, or should
6 you have to go through the whole process again, or those
7 tariffs should not be cancelled, or what?

8 MR. DETERDING: Well, again, I generally think that
9 there are companies out there -- and I've seen several of
10 them -- that may go along for several years and have no need
11 for gross-up. And they may have no need for it either because
12 they don't have any CIAC; or under the current scenario, maybe
13 they have no above-the-line income that would offset it or
14 something like that. But then something will come along and,
15 in fact, I think just from a general perspective, the
16 Commission ought to be reviewing those things after you've
17 grossed up because that's the way in which you protect the
18 customer from getting popped by an event that causes a
19 substantial tax liability.

20 I mean, The Parklands case is an example. They've
21 gone along for years with no need to gross-up, and all of a
22 sudden they know they've got two years of heavy contributions
23 and have applied for gross-up. They had gross-up, I think,
24 years and years ago and dropped it when the requirement came
25 in after 23541 to justify. And at the time they saw no need.

1 And then suddenly they had this new development come in, which
2 is like the last development within their existing service
3 territory, and suddenly they do need it.

4 But I do think there are circumstances where a
5 company can sit -- can have activity that requires gross-up,
6 go two or three or four years without it, or even one and then
7 need it again. I just think the presumption should be that
8 gross-up is appropriate if the company decides that it's
9 appropriate and that you review those things in hindsight
10 after the collection and refund.

11 If a company is doing that continually and has no
12 need for gross-up, then they'll drop it. They don't want to
13 do the work that's involved in the current situation in
14 dealing with it if they don't need it.

15 MS. SALAK: Well, let me ask this of Mike. If we
16 dropped the criteria, would your company come in and ask for
17 gross-up?

18 MR. MURPHY: No response.

19 MS. SALAK: Smart man. (Laughter)

20 MS. CAUSSEAU: Marty, you are talking about if they
21 don't have it and they need it. But what if they had it.
22 What if they'd been granted authority and they have a tariff
23 on their books and they are expected to charge those tariffs
24 but they discover that for some reason they are in a
25 tremendous competitive pressure and they can't afford to

1 charge that and they cancel it. Then if that changed, such as
2 he was mentioning where the municipality or whatever, the
3 surrounding utilities' rates went up to such an extent that
4 they were no longer in that bind and needed it; Connie's
5 question was: Okay. The tariff's been cancelled for whatever
6 reason, because otherwise you'd have to charge it. Now,
7 should they go through the same steps, or should there be some
8 provision for sort of a suspended tariff, if you will, and
9 then the authority would just be automatically or
10 administratively or whatever granted.

11 MR. DETERDING: Well, I mean, I understand. If
12 that's the point, probably so. I mean, that would envision
13 the fact that they've already demonstrated that it's
14 appropriate for them, and they just chose for some reason to
15 forego it for a while. And, certainly, I can see those
16 circumstances.

17 MS. CAUSSEAU: I mean, if we are trying to simplify
18 it, it looked to us like we wouldn't want to go through the
19 whole thing again when you just had a sort of a quirk or a
20 bump that -- you know.

21 MR. DETERDING: Right.

22 MS. McCASKILL: Right. And I'm just trying to
23 determine, you know if you have a tariff, you have to abide by
24 that tariff. You may decide, well, for now and maybe a couple
25 of years, we really don't need to gross-up. So, you know, my

1 question is: So should we be looking at cancelling the tariff
2 or maybe like a temporary suspension, so you won't have to
3 come back and go through the whole situation again.

4 MR. DETERDING: Right. I mean, that makes sense if
5 what you're doing is talking about somebody who's been
6 authorized and then for a while doesn't need it. I would
7 agree with that.

8 MS. SALAK: And question VIII hits a point that was
9 mentioned earlier that if we should be asking for historic
10 data, projected data, or a combination of historic projected,
11 and what kind of data we should be asking for and how many
12 years' worth we should ask for.

13 You were talking about where you keep asking for
14 more and more information. How much is too much and how much
15 is too little and what kind should it be?

16 MR. MURPHY: I sure like my answer. I mean, if CIAC
17 is taxable on a stand-alone basis, the present quagmire -- and
18 I don't mean to use that term derogatorily, but as well as the
19 many theoretical questions, which this is one of the most
20 theoretical -- has it resolved itself? I don't know. I
21 couldn't even begin to answer, historical, projected. I just
22 don't know.

23 Bob's got an answer for that one, right?

24 MR. DETERDING: I mean, I think he agrees
25 wholeheartedly with that. The question is what under

1 current --

2 MR. NIXON: I agree, but, you know, if not that many
3 changes are made --

4 I would tend to think that the year with the last --
5 the most current year in which a tax return was filed would be
6 the basis for looking at the company's demonstration of a tax
7 liability. And, of course, with that would be if a company
8 expects to collect contributions in the coming year, there
9 would be some projection of what they see as the additional
10 contributions coming on line that would affect that last tax
11 return that was filed.

12 I see no need to go back and -- you know, four or
13 five years -- and try to -- at the time of asking permission
14 to gross-up, try to sort out all the above-the-line and
15 below-the-line issues related to the carryforwards or the
16 current year above-the-line loss. But to get approval to
17 gross-up, let's just have the company present, you know, the
18 most current year, tax year, and maybe a projection of how
19 that's going to change with the expected CIAC it's going to
20 receive and what the tax impact of that is expected to be.
21 And if it looks like there's even a remote possibility that
22 the company is going to have a liability, which it will, go
23 ahead and approve it. And if you stick with this above- and
24 below-the-line, we sort that out later.

25 MR. DETERDING: The point is that it's worse to say,

1 "We're going to deny you gross-up because we don't think
2 you've quite proven to us for sure that you are going to have
3 tax liability." It's much worse to do that from the ratepayer
4 or the company's perspective than it is to say, "Okay, you
5 grossed up and you really didn't need it refunded." Because
6 the purpose of the gross-up is to protect the ratepayers and
7 also to an extent to protect this company from the extreme
8 cash flow demands that may result. And so to take all that
9 analysis up front and try and project it and say, you know,
10 here's what we think might happen based on our projections and
11 these detailed analyses, I think you are putting the
12 presumption in the wrong light, is my point.

13 I think you should presume that if a company
14 requests gross-up that they need it and not be so tough on
15 granting it. And then, if when they report the next year or
16 the next two years you figure out that was wrong, then maybe
17 you need to readdress it. But the point is it shouldn't be so
18 strict in getting the authority. And until recently, I don't
19 think it was.

20 MS. SALAK: There's only been one case denied,
21 right?

22 MR. DETERDING: Well, I know of one denied and one
23 proposed to be denied. And I'm not familiar with the one that
24 was denied, but I am familiar with the one that's proposed to
25 be denied, and it's a circumstance that I can't understand.

1 The developers agreed to gross-up; the utility wants gross-up;
2 and the Commission is proposing to deny it; and that just
3 doesn't make sense to me, especially since what I'm saying is
4 that there is a potential for a substantial impact on both the
5 utility and its ratepayers.

6 Let's don't try and project everything out and make
7 sure absolutely positively they might have a tax liability.
8 Let's look at it after it's done and see if they did. Because
9 what we are trying to do is protect those from those evils of
10 something that's going to impact the ratepayers or the cash
11 flow of the utility company. And especially where you have
12 got a situation where the developer has already agreed to it,
13 and then we'll look at in the refund process.

14 MR. NIXON: I mean, if we stick with this above- and
15 below-the-line analysis, I mean it's tough enough doing it
16 when you have a historic tax return that's been filed, much
17 less the viability of projecting two, three, or four years
18 ahead and prior to granting gross-up approval trying to second
19 guess or look into your crystal ball and see whether the
20 company is going to actually have a tax liability.

21 MS. McCASKILL: And I guess that's why it is so
22 important to determine what you would do, how you would
23 utilize NOLs if you look at them at all because we could have
24 a situation -- yeah, we have denied one utility, and there's a
25 proposal to deny another one. You may be faced with a

1 situation where when you look at the utility's tax return, I
2 mean they have a lot of NOLs and it appears that even within
3 the near future they won't actually have a tax liability,
4 although there'll be a tax consequence of a CIAC or a tax
5 effect. So it is important to determine if it should be, you
6 know, looking at NOLs.

7 MR. DETERDING: And, again, I'm saying it's a lot
8 more accurate and puts the proper emphasis on protecting the
9 ratepayers and the company from the tax consequence of CIAC to
10 go ahead and grant it on a fairly simplified criteria and then
11 review it after the fact. And, again, especially where there
12 is an agreement that gross-up is appropriate between the party
13 paying it and the party collecting it.

14 MR. NIXON: I think it gets back to these two
15 notions of what we're dealing with. Are we dealing with the
16 CIAC and the tax on a stand-alone basis, and is there always a
17 tax liability regardless of whether there's an immediate tax
18 payable?

19 And, of course, I think everybody on this side of
20 the room believes that there's always a tax liability.
21 Sometimes there is not an immediate payable because of the
22 existence of these either current year operating losses or
23 loss carryforwards. But there is a liability and somehow it
24 is settled. And the choice is who pays for that.

25 I mean, I would assume, even if a company's got NOLs

1 and they use them to satisfy a liability, that under the
2 current ratemaking procedures, the next time a company in that
3 position would come in for a rate case, that the tax benefits
4 that were used to pay the tax on that CIAC will get rate base
5 treatment.

6 MS. CAUSSEAU: I'm sorry, say that again? I spaced
7 out.

8 MR. NIXON: If a company has either a current year
9 operating loss or a loss carryforward and they don't gross-up
10 and they use that loss or loss carryforward to satisfy the tax
11 liability on the CIAC they collect, that in a rate proceeding,
12 the tax benefit that was used to satisfy the tax would get
13 recognition in the rate base.

14 MS. CAUSSEAU: I'd have to work through that; I'm
15 not so sure. You say there's always a liability; there's
16 always an effect. But, ultimately, there is rarely ever, on a
17 long-going basis, a liability or an effect because of the
18 depreciation. You pay it here; you collect it there. It's
19 over time. But, ultimately, the only thing out there other
20 than cash flow, isn't it really the carrying cost in the
21 period of time over which it returns?

22 MR. NIXON: Well, theoretically, you may be right;
23 but depending on the financial position of a company, those
24 tax benefits which are coming back may not mean anything.
25 They may not be able to ever realize them.

1 MS. CAUSSEAU: If they're not realizable --

2 MR. MURPHY: Wouldn't it apply, though, to an
3 above-line-only type of concept? I mean, that's kind of the
4 present value thought at it, that these things do go out over
5 time, they come back. But if you started absorbing NOLs, I
6 think that changes that whole focus. I don't think that
7 that's a true statement then, because if you use an NOL today,
8 it's not out there tomorrow to be used.

9 MS. CAUSSEAU: But I wasn't talking about NOLs. I
10 was talking about the depreciation on that contributed asset.

11 MR. MURPHY: Agreed. Okay.

12 MS. SALAK: The next section was the method of your
13 gross-up, whether it's net present value or full gross-up or
14 some other method. I think several of you have expressed an
15 opinion on that today or at least -- well, let me let you
16 express your opinion again, because I would hate to -- I know
17 Mr. Freeman wants net present value.

18 Mike, what would you suggest? What did you suggest?

19 MR. MURPHY: I suggested no gross-up, full gross-up,
20 or net present value. I think it's up to the utility
21 management. You know, the present value method sounds good in
22 theory. I think there's some issues that aside from my
23 ignorance in that matter, that should be considered.

24 When you set that, you have to decide that the
25 income tax rate is going to be "X" for the next 20 years, that

1 your cost of debt or cost of equity or rate of return is "y"
2 for the next 20 years; and there may be other factors, too.
3 Anytime any one of those changes, then that dollar today has
4 been changed effectively.

5 I think the full gross-up, obviously, takes care of
6 that problem. You give me all your money now, and I don't
7 have to worry about those considerations in the future. Full
8 gross-up I think has the most impact on the ratepayers.

9 I think I very much feel that it is -- they've
10 paid -- I don't want to say they've paid for the CIAC. No,
11 no, no, don't ever let me say that. But they are the ones
12 that should be deriving that benefit. We, the utility, do
13 not -- contrary to what that gentleman said -- we aren't
14 socking away this money for the future. And we attempt to,
15 hopefully, through the correct accounting and rate setting,
16 pass that benefit along to the customer.

17 So if Brian wants to do present value, that's fine.
18 I think that's his decision to be made.

19 MS. SALAK: Anybody else have any thoughts on that?

20 MR. DETERDING: Just the same, generally. That it
21 should be a decision of the utility management based on the
22 specific circumstances they find themselves in, and there's so
23 many different circumstances that any one may be appropriate
24 for any given entity.

25 MS. SALAK: Okay. What do you think of George's

1 idea about the average rate, the average amounts methodology?

2 MR. DETERDING: What's that?

3 MS. SALAK: Mr. MacFarlane brought up an idea
4 earlier about using an average amount, didn't you, George?

5 MR. MURPHY: I think George was concerned with the
6 marginal rate --

7 MS. SALAK: Right.

8 MR. MURPHY: -- the marginal tax rate.

9 MS. SALAK: What did you think of that idea?

10 MR. MURPHY: I think it has merit. I think that's a
11 technical refinement to the issue. Obviously, if not
12 everybody's at 35%, we wouldn't want to deal with 35% and --
13 I'd have to study that some more.

14 I mean, I wouldn't come out and say that is fair
15 because George has just presented that, maybe -- I would have
16 to consider what the tax rate would be and then following
17 years and really think about that, if it goes up and down and
18 does it go to the advantage of it.

19 MS. SALAK: Did you want to say something?

20 MR. MacFARLANE: No. But -- I guess yes.

21 I think my point was you are going to get ahead of
22 the curve no matter what. I mean, I'm not suggesting that we
23 put any utility to an average basis or an average amount
24 behind the cash flow curve. I think that's the first
25 question.

1 The first criteria, we deal every day with cash
2 flow. The bank wants to get paid first. The employees want
3 to get paid. But it sure seems to me if you start using the
4 concept that there could be cash year-to-year that your tax
5 rate may change and it may change for a number of reasons
6 including the IRS may change it for you.

7 That if you start building an account that allows
8 you to pay those taxes that as a manager you may choose to
9 start reducing the amount of the gross-ups that you have been
10 collecting so as to spread the effect over time. Does that
11 make sense to you?

12 I mean, things start happening, there's benefits
13 flowing back. They're coming back on the tax return. So if
14 you are in a competitive market, my point is it allows the
15 utility management to make that decision, instead of the
16 Staff. As soon as the refunds leave, I have no problem with
17 the Staff making decisions over it; but they do so for us on
18 more than one occasion. But that's what I really want.

19 It's got to be driven by the -- the only person that
20 I have ever met that can run the utility is typically the
21 utility manager, some don't do it well but that's my request.
22 They're the ones that do it every day. If they want to start
23 to come to you and ask for that right -- and, again, the idea
24 about the formula if you don't want to gross up, inform the
25 Staff that your percentage of tax liability that you are

1 looking for to gross up is zero. You have to look at the
2 formula and the formula is you won't get a gross-up.

3 The point is the formula works well. The net
4 present value basically would disappear, because if you choose
5 a 15% or 16% rate or 20% rate, the same thing would happen.
6 So it really gives the benefit back to the utility manager to
7 make that decision.

8 MS. SALAK: It's been requested that we take a
9 break. We're going to take a 15-minute break. When we come
10 back, we'll focus on your comments you have for each section
11 as opposed to going through every question, if that's all
12 right with everyone else. I would really like to get to the
13 alternatives and the new ideas and the new concepts and where
14 we should be going.

15 (Brief recess.)

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17 MR. GATLIN: May I make a suggestion?

18 MS. SALAK: Sure.

19 MR. GATLIN: The utilities and the Association filed
20 specific answers to each one of these questions in this notice
21 that we thought pretty well answered them from our position
22 and each of us emphasized the points that we were particularly
23 interested in this morning. Would it be permissible do you
24 suppose, since Staff has now heard this and has these answers,
25 if there's a particular one that the Staff is interested in

1 let's just go to it and talk about that? Otherwise, I think
2 we HAVE answered them about the best we can do.

3 MS. SALAK: That's great. Connie, Ralph? Anyone?

4 MS. McCASKILL: I don't have a problem with that.
5 My only concern also is that after we really get a chance to
6 sit down and read the responses we may want to do some
7 follow-up.

8 MR. GATLIN: You can call us.

9 MS. SALAK: The one thing I really wanted to talk
10 about were alternatives to our current methodology. On a
11 prospective basis, if you had any -- I'm sorry, I just haven't
12 had time to read these meanwhile -- but any alternatives you
13 have. And if you don't have them today, if you could
14 emphasize to prepare in that area for the Commission workshop.

15 MR. DETERDING: Alternatives to gross-up?

16 MS. SALAK: Yes. Alternatives to gross-up or
17 alternatives to our current method or alternatives -- you
18 know, Bill's idea about the service availability, those kind
19 of new creative ideas that we could do and some methodology
20 that perhaps maybe we don't want to call it gross-up but --

21 MR. DETERDING: Yeah.

22 MR. GATLIN: VIII?

23 MR. DETERDING: I think the thing we discussed that
24 I mentioned a little while ago that Bob brought up to my
25 attention was, basically, rather than -- I guess it's rather

1 than the normalization back based upon the actual tax
2 consequences or tax timing of those consequences to allow
3 gross-up, a company who chooses to gross up does it as part of
4 their charge; there's no yearly review or proposed refunds;
5 and then the amortization of the tax benefits is shown on a
6 regular yearly amount based upon some established life for
7 that intangible asset. That way the customers are getting the
8 benefit, the tax benefits.

9 It's shown in a flat amount each year based upon the
10 amount that the contributions in gross-up receive, and it
11 simplifies it a great deal as far as the reporting and
12 tracking and the collection and so forth. And that's just
13 that general proposition seems to me to make an awful lot of
14 sense. It would greatly simplify and it would be easier for
15 you all to track.

16 MS. McCASKI L: Then I guess to me what you are
17 saying, you are presuming that we are saying the purpose of
18 the gross-up is the tax effect of the CIAC?

19 MR. DETERDING: That is correct. It presumes that;
20 and it also presumes, as I believe we've stated and the
21 Commission found in 23541 and in the Gulf case, that the
22 developer really doesn't -- the contributor does not generate
23 the things that would possibly offset the tax effect of CIAC.

24 I mean, surely there's a depreciation benefit; but
25 if you assume that the developer writes off his costs, et

1 cetera, et cetera, the things that were found in those two
2 cases, then that benefit should flow back to the general body
3 of ratepayers. And with the smaller companies, which I would
4 say the majority of those grossing up are Class Bs; if not,
5 all but one or two.

6 The current system -- and I realize we all recognize
7 that it is not working well -- but the current system makes
8 the cost a substantial portion of the amount that's being
9 collected. So that seems like a method that would allow you
10 all to track the benefits and would allow us to go through the
11 process.

12 And again, I think it's very important that the
13 presumption be that gross-up, if management proposes gross-up
14 as being in the best interests of that company and its
15 ratepayers, that that be given some presumption of
16 correctness. I think we've got more and more away from that
17 as time has gone by.

18 And I think that the analysis, the in-depth analysis
19 that Bob was talking about that gets into the projections, is
20 not only extremely difficult to do and likely inaccurate, but
21 it ignores what I perceive to be the basic purpose, which is
22 to make sure that the customers are not impacted, and,
23 instead, an after-the-fact reporting back is a better method
24 to handle that.

25 MS. McCASKILL: I guess what I'm not clear on -- and

1 perhaps it's in some of your responses, I haven't had a chance
2 to look at it. Can you in a simple way what I still have not
3 been able to grasp is 23541 said the ratepayers would get the
4 benefit of the depreciation and I'm still not sure I see how
5 that happens.

6 MR. DETERDING: Well, it happens currently under the
7 current methodology, I think Bob's analysis shows the entries
8 and so forth through the normalization process. The current
9 accounting and entries result in the accumulation of zero cost
10 deferred tax items that is considered zero cost capital in the
11 capital structure. As time goes by, that's growing and these
12 companies are grossing up, and it's growing to quite a
13 material amount in many of the companies.

14 That is how they are receiving, they are receiving
15 it through a reduced cost of capital, just like customer
16 deposit -- not customer deposit, but just like other ITCs and
17 those sorts of things, the Commission has a component in cost
18 of capital and in the capital structure of the utility that is
19 growing pretty quickly in some of these companies at zero
20 cost; therefore, the cost of capital of the utility is
21 declining as it collects more gross-up and through that
22 mechanism, that normalization, that the customers are
23 receiving the benefits either through no need for a rate
24 increase where one would otherwise be necessary or in a
25 reduced amount of a rate increase when a company comes up for

1 rates. And their capital cost of capital could conceivably be
2 down at 5% or 6% instead of 13% because of that zero cost,
3 weighting that zero cost of capital.

4 MS. McCASKILL: I want to make sure I'm clear on
5 this. Okay, so when a utility files its annual reports and we
6 look at those annual reports and we calculate the capital
7 structure and everything to see what rate of return the
8 utilities are earning, that amount you're talking about is
9 there to be put in the capital structure?

10 MR. DETERDING: It should be. It should show up in
11 the annual report as a deferred tax item that would be
12 included in that capital structure.

13 MR. NIXON: I think, Connie, if you have a chance to
14 look over Exhibit C, which is attached to that package I
15 handed out, that exhibit gives you the entries for the first
16 two years with the assumption that \$100,000 of depreciable
17 CIAC was received.

18 MS. McCASKILL: Okay. The reason I'm really
19 concerned, because there had been some argument that unless
20 the utility actually comes in for a rate case then the
21 customers don't get the benefit. But as long as that amount
22 is there, then when we look at you to determine your earnings
23 year after year, then that affects really whether you need to
24 come in for a rate case or whether we say you need one. So
25 the fact that it's there, you don't have to come in for a rate

1 case, then perhaps they are receiving that benefit.

2 MR. NIXON: Yes.

3 MR. DETERDING: That's correct. And to the extent
4 that a company is doing indexes every year, this will bring
5 down that rate of return each and every year. Probably if the
6 company is in a gross situation their cost of capital has
7 dropped a little bit every year as they collect more gross-up.

8 Therefore, even conceivably and quite conceivably
9 the first place it will show up is the company will file for
10 an index, their overall cost of capital will be lower than
11 that; after you review these things two years later on the
12 indexes to see if somebody is overearning, they will exceed
13 that lower cost of capital and then be required to refund
14 part of the index. That's the way I perceive that is most
15 likely to happen.

16 Or probably just as likely, one of these companies
17 will have a rate case and you'll throw that into zero cost of
18 capital and say your rate of return is 8%, next time they come
19 in it may be 5% if they continue to grow.

20 That's the way it was intended to work under 23541
21 and in think that's what I think Bob's entries have the effect
22 of doing.

23 MR. NIXON: What you will see, Connie, in the annual
24 reports is on the assets side of the balance sheet for a
25 company that grosses up you'll see a deferred tax asset. On

1 the liability side of the balance sheet, you'll see an account
2 called "Contributed Taxes," which has the actual amount of tax
3 on CIAC that the company has received and retained and not
4 refunded back, plus you'll see an account called "Deferred Tax
5 Liability."

6 Now, that deferred tax liability balance is the tax
7 effect of the depreciation timing differences. And that is
8 the account that would go into the capital structure at zero
9 cost.

10 You're never going to get a perfect match. But for
11 a company that grosses up, the deferred tax asset would be
12 cancelled out by the contributed tax account. Because if you
13 are grossing up, you can't put that deferred tax asset into
14 your rate base and earn on it, because you are grossing up,
15 somebody else is paying for that. So that's where you would
16 look for that deferred tax liability.

17 The suggestion that I had made earlier is that a
18 simpler way, in lieu of trying to calculate the effect on cost
19 of capital each year of that deferred tax liability, might be
20 instead to look at the contributed tax balance and amortize
21 that, say, over 40 years or 35 years and require the companies
22 to show that as above-the-line income on the annual report and
23 label it "Amortization of Contributed Taxes."

24 I think the Commission can require the company to
25 give the benefit back either through the amortization of the

1 contributed taxes or through zero cost of capital, but not
2 both. One or the other. Because there would be a doubling of
3 a benefit going back to the ratepayers.

4 MR. DETERDING: The latter method is one I was
5 mentioning. It's just amortizing it so you have a flat amount
6 or a flat amount per dollar of gross-up.

7 MR. NIXON: And that would flow right into your
8 reported operating income each year on your annual report and
9 then into your rate of return on rate base on Page F5, I think
10 it is, of the annual report. So you would have a real quick
11 way to track to make sure that companies that are using full
12 gross-up are --

13 MR. DETERDING: Flowing it back.

14 MR. NIXON: -- flowing it back and giving that
15 benefit to the ratepayer.

16 MR. DETERDING: And it's a simplified way over the
17 cost of capital which you have to pull out and then wait and
18 then put it into the capital structure.

19 MR. NIXON: I have come up with the journal entries
20 in this illustrated example simply because 23451 required the
21 establishment of that contributed tax account.

22 You could do a system of accounting that you
23 wouldn't have that contributed tax account; but once you
24 establish that thing, you have to amortize it somehow. So
25 that's why we are coming up with two different numbers that

1 could be used to benefit the ratepayer, either the
2 amortization of the contributed tax or zero cost of capital.

3 And you can call me after you have studied this over
4 and I'll try to answer your questions.

5 MS. MCCASKILL: Okay.

6 MS. SALAK: Any other comments anybody would like to
7 make? Well, in that case, again we're going to have the
8 workshop October 5, Commissioner workshop. If I -- how about
9 if I rephrase?

10 If you have something in addition to what you
11 already submitted today that you want included in a package to
12 be printed up, how is that, so that they can have those also,
13 then get it to us by September 22nd so that we can look at it,
14 review it and get all our thoughts together by we'll probably
15 aim for about the 29th, which will be just about a week before
16 the workshop, for us to get our thoughts together. So we'll
17 see you October 5.

18 MR. GATLIN: Did you have that information that you
19 had from other states?

20 MS. SALAK: We do have that, we can get you copies
21 of that. Sure thing. What we have is a summary of them.
22 Then if you want any more detail you can ask for that. If you
23 want CPE from today you should return the sheets and sign the
24 roll over there and we'll get these forms back to you in the
25 mail. I think that's all our housekeeping.

1 MR. DETERDING: If anybody needs some of Bob
2 Nixon's, there's about five copies right here.

3 MS. SALAK: I did want to mention to you just a
4 slight problem with the recording of the session today and so
5 there will be about an eight-minute gap right after lunch
6 where we have erased the tapes. (Laughter)

7 MR. GATLIN: The Nixon tapes?

8 MS. SALAK: No, where we were having the trouble.
9 So when you read the transcript, it will say there was a
10 malfunction.

11 (Thereupon, the workshop concluded at 3:40 p.m.)

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1 STATE OF FLORIDA)
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3 COUNTY OF LEON)

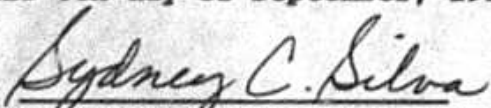
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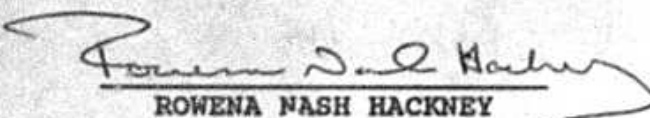
4 We, SYDNEY C. SILVA, CSR, RPR, and ROWENA NASH
5 HACKNEY, Official Commission Reporters.

6 DO HEREBY CERTIFY that the undocketed workshop was
7 heard by the Staff of the Florida Public Service Commission at
8 the time and place herein stated; it is further.

9 CERTIFIED that we stenographically reported the said
10 proceedings; that the same has been transcribed under our
11 direct supervision; and that this transcript, consisting of
12 146 pages, constitutes a true transcription of our notes of
13 said proceedings.

14 DATED this 6th day of September, 1995.

15 
16 SYDNEY C. SILVA, CSR, RPR
17 Official Commission Reporter

18 
19 ROWENA NASH HACKNEY
20 Official Commission Reporter