

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Application for approval) DOCKET NO. 950831-SU
of contributions-in-aid-of-) ORDER NO. PSC-95-1569-FOF-SU
construction (CIAC) tax gross-up) ISSUED: December 19, 1995
in Charlotte County by)
Sandalhaven Utility, Inc.)
_____)

The following Commissioners participated in the disposition of this matter:

SUSAN F. CLARK, Chairman
J. TERRY DEASON
JOE GARCIA
JULIA L. JOHNSON
DIANE K. KIESLING

NOTICE OF PROPOSED AGENCY ACTION
ORDER APPROVING AUTHORITY TO GROSS-UP
CONTRIBUTIONS-IN-AID-OF-CONSTRUCTION

BY THE COMMISSION:

NOTICE IS HEREBY GIVEN by the Florida Public Service Commission that the action discussed herein is preliminary in nature and will become final unless a person whose interests are substantially affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

BACKGROUND

On December 29, 1994, Sandalhaven Utility, Inc. (Sandalhaven or utility) filed its application for a grandfather certificate pursuant to Section 367.171, Florida Statutes. The grandfather certificate was approved in Order No. PSC-95-0478-FOF-SU, issued April 13, 1995. This order allowed the utility to continue collecting gross-up for contributions-in-aid-of-construction (CIAC) on an interim basis, subject to refund with interest. All gross-up taxes collected by the utility from September 27, 1994 onward were placed in an interest bearing escrow account.

Sandalhaven was previously authorized by the Charlotte County Board of County Commissioners to collect gross-up for CIAC. By Order No. 16971, issued December 18, 1986, the Commission granted approval for water and wastewater utilities to amend their service availability policies to meet the tax impact of CIAC resulting from the amendment of Section 118(b) of the Internal Revenue Code.

DOCUMENT NUMBER-DATE

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FPSC-RECORDS/REPORTING

Order No. 23541, issued October 1, 1990, ordered utilities currently grossing-up CIAC to file a petition for continued authority to gross-up and also ordered that no utility may gross-up CIAC without first obtaining the approval of this Commission. Order Nos. 16971 and 23541 also prescribed the accounting and regulatory treatments for the gross-up and required refunds of certain gross-up amounts collected. On July 17, 1995, pursuant to Order No. 23541, Sandalhaven filed its petition for authority to gross-up CIAC. The information as filed met the filing requirements of Order No. 23541.

The utility was established on June 29, 1983. Sandalhaven is a Class C utility which provides wastewater service to residential, general service, and multi-family customers in Charlotte County. As of December 31, 1994, the utility was serving 588 wastewater customers. In 1994, the utility had annual gross revenues of \$148,446, and a net operating loss of \$993. The utility will serve approximately 2,000 customers when it reaches build-out. The facilities of the utility include one wastewater treatment plant and one wastewater collection system.

APPROVAL OF AUTHORITY TO GROSS-UP
CONTRIBUTIONS-IN-AID-OF CONSTRUCTION

Order No. 23541, issued October 1, 1990, required all utilities that wished to collect CIAC gross-up to file a petition for approval of the gross-up with this Commission. The Order further required each utility to demonstrate that an above-the-line tax liability exists and that alternate sources of funds are not available at a reasonable cost. The Order required utilities to file the following information to demonstrate the need to gross-up: Demonstration of Actual Tax Liability, Cash Flow Statements (except for Class C Utilities), Statement of Interest Coverage, Statement of Alternative Financing, Justification for Gross-up, Gross-up Method Selected and Proposed Tariffs. On July 17, 1995, Sandalhaven filed the information which it believed demonstrated its need to gross-up CIAC using the full gross-up method. We have completed our review of the information filed, and our findings are discussed below:

DEMONSTRATION OF ACTUAL TAX LIABILITY: Our review of the financial statements filed by the utility indicates that Sandalhaven will incur an actual above-the-line tax liability as a result of its collection of CIAC. Based upon the information filed for 1994, the utility incurred an above-the-line loss of \$9,169 prior to its collection of taxable CIAC. The utility had taxable income of \$47,671 after the collection of taxable CIAC. The filing indicates that the utility will continue to have an above-the-line

tax liability associated with the collection of CIAC in 1995. The utility projects to collect \$95,875 in taxable CIAC in 1995.

CASH FLOW STATEMENT: Sandalhaven is a Class C utility, and Order No. 23541 does not require Class C utilities to file a cash flow statement as a part of the petition for gross-up. However, a cash flow statement was submitted for the period ended December 31, 1994. Our review of the cash flow statement the utility filed indicates that funds are not sufficient to pay the taxes associated with CIAC. For the period ended December 31, 1994, the utility had a positive cash flow of \$6,823. The maximum taxes that would be generated by the taxable CIAC in 1994 was approximately \$17,940, and the estimated taxes on the \$95,875 of CIAC projected to be collected in 1995 would be \$36,078. Further, the utility states that the available cash reserves are needed for building additional treatment and disposal facilities to serve its current certificated area. Based on the foregoing, we do not believe funds are available for payment of taxes on CIAC.

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

As of June 30, 1995, the utility had long term debt of \$74,416. The TIE ratio was calculated to be 2.76 as of December 31, 1994. This TIE ratio indicates that the utility does have adequate interest coverage. However, if additional debt is incurred, the utility would need a rate increase in order to handle the additional interest expense. The utility has a net operating loss of \$993, and a negative return of .79% according to the 1994 annual report. This factor, coupled with the utility's present debt ratio of 51%, may be indicative of the utility's inability to go into the financial market to borrow money. Additionally, the utility has never had a rate of return or rate base established by the Commission. These rates are not compensatory in view of the negative .79% rate of return. These rates were established in 1986, when the utility was a subchapter "S" entity. The utility's entity status has changed and it files both state corporate taxes and federal tax returns, effective in 1995. When these factors are considered, we do not believe that it is in the interest of either the utility or the ratepayers to increase a net operating income (NOI) deficiency.

STATEMENT OF ALTERNATIVE FINANCING: The utility stated that additional bank financing is not available under current circumstances. The utility has financed all plant improvements out of its cash reserves in the last few years. The utility has an outstanding long term loan obligation for \$74,416, which is secured by a first mortgage on the assets of Sandalhaven and the personal guaranty of one of its stockholders. The other stockholders do not wish to personally guaranty debt for the utility. Therefore, additional bank financing is not available. The utility stated that it will attempt to borrow money under any payment terms possible in order to meet its income tax liability. However, this type of short term borrowing will further erode the utility's cash flow, capital structure, and add to operating losses via additional interest expenses.

JUSTIFICATION FOR THE GROSS-UP: The utility indicated that it is in a growing area and present plant will soon need to be expanded and modified to allow for both increased capacity and a change in its current means of effluent disposal from on-site retainage to public access irrigation. These modifications will place a large cash demand on the utility, which it will have to meet in order to keep from violating its certificate.

Based on the total gross operating revenues of \$148,446 generated in 1994, it appears that the utility will not be able to generate enough revenues through its current rates and customer base to cover its operating expenses, the taxes other than income and the income tax expense on both its operating income and its CIAC contribution. The utility's current rates were approved in 1986 and have not been modified since. It is projected that the utility will continue to accumulate operating losses above-the-line in 1995. It appears that the utility will incur an above-the-line tax liability associated with the collection of CIAC and that it will not be able to generate the funds to finance the taxes either through its existing rates or alternative financing. Therefore, there appears to be justification for this utility to gross-up CIAC.

GROSS-UP METHOD SELECTED: The utility has elected to use the full gross-up method. This method was selected due to the large amount of CIAC collected and the utility's inability to pay the tax liability associated with the CIAC. The utility cash reserves are being used for plant modifications and current changes in its operating needs. The cash reserves are not sufficient to cover the plant modification, the current changes in its operating needs, and the tax liability associated with the CIAC. The utility stated that it does not have the financial resources to fund the up-front investment required by the present value gross-up method.

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

Upon consideration of the foregoing, we find that the utility's request to gross-up its CIAC using the full gross-up method is reasonable and it is, therefore, approved. Further, Order Nos. 16971 and 23541 prescribed the accounting and regulatory treatments and record keeping for the gross-up, and required refunds of certain gross-up amounts collected. We find it appropriate for the CIAC collections to be made in accordance with those Orders and that all matters discussed in the body of those Orders are expressly incorporated herein by reference. The tariffs shall be approved as filed and will become effective upon expiration of the protest period. Upon expiration of the protest period, if no timely protests have been received from a substantially affected person, this docket shall be closed. If a protest is filed, the utility may continue to collect the gross-up, on an interim basis, subject to refund, pending resolution of the protest.

Based on the foregoing, it is, therefore,

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

ORDERED that the gross-up shall be made in accordance with Orders Nos. 16971 and 23541 and that all matters discussed in the body of those Orders are expressly incorporated herein by reference. It is further

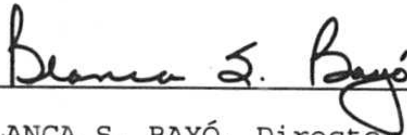
ORDERED that the provisions of this Order are issued as proposed agency action and shall become final unless an appropriate petition in the form provided by Rule 25-22.029, Florida Administrative Code, is received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the date set forth in the Notice of Further Proceedings below. It is further

ORDERED that the tariffs shall be approved as filed and will become effective upon expiration of the protest period. It is further

ORDERED that upon expiration of the protest period, if no timely protests have been received from a substantially affected person, this docket shall be closed.

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By ORDER of the Florida Public Service Commission, this 19th
day of December, 1995.



BLANCA S. BAYÓ, Director
Division of Records and Reporting

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

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

The action proposed herein is preliminary in nature and will not become effective or final, except as provided by Rule 25-22.029, Florida Administrative Code. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, as provided by Rule 25-22.029(4), Florida Administrative Code, in the form provided by Rule 25-22.036(7)(a) and (f), Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on January 9, 1996.

In the absence of such a petition, this order shall become effective on the day subsequent to the above date as provided by Rule 25-22.029(6), Florida Administrative Code.

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

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