

FLORIDA PUBLIC SERVICE COMMISSION  
Capital Circle Office Center • 2540 Shumard Oak Boulevard  
Tallahassee, Florida 32399-0850

MEMORANDUM

OCTOBER 17, 1996

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYO)

FROM: DIVISION OF WATER & WASTEWATER (GILCHRIST)  
DIVISION OF LEGAL SERVICES (JAEGER)

RE: DOCKET NO. 961077-SU - DISPOSITION OF GROSS-UP FUNDS  
COLLECTED BY EAGLE RIDGE UTILITIES, INC. -  
COUNTY: LEE

AGENDA: OCTOBER 29, 1996 - REGULAR AGENDA - PROPOSED AGENCY  
ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\WAW\WP\961077.RCM

CASE BACKGROUND

The repeal of Section 118(b) of the Internal Revenue Code (I.R.C.) caused contributions-in-aid-of-construction (CIAC) to be treated as gross income and depreciable for federal tax purposes. In Order No. 16971, issued December 18, 1986, the Commission authorized corporate utilities to collect the gross-up on CIAC in order to meet the tax impact resulting from the inclusion of CIAC as gross income.

Orders Nos. 16971 and 23541, issued December 18, 1986 and October 1, 1990, respectively, require that utilities annually file information which would be used to determine the actual state and federal income tax liability directly attributable to the CIAC, and whether a refund of the gross-up is appropriate for any given year for which gross-up was in effect. These orders also required that all gross-up collections for a tax year which are in excess of a utility's actual tax liability for the same year resulting from its collection of CIAC should be refunded on a pro rata basis to those persons who contributed the taxes.

In Order No. 23541, the Commission determined that any water and wastewater utility already collecting the gross-up on CIAC and wishing to continue collecting the gross-up, had to file a petition for approval with the Commission on or before October 29, 1990. Eagle Ridge Utilities, Inc. (Eagle Ridge or utility), filed for

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authority to continue to gross-up on December 11, 1990. By Order No. 25436, issued December 4, 1991, Eagle Ridge was granted authority to continue to gross-up using the full gross-up formula.

On September 9, 1992, this Commission issued Proposed Agency Action Order No. PSC-92-0961-FOF-WS, which clarified the provision of Orders Nos. 16971 and 23541 for the calculation of refunds of gross-up of CIAC. On September 14, 1992, Order No. PSC-92-0961A-FOF-WS, was issued which included Attachment A which reflects the generic calculation form. No protests were filed, and the Order became final.

On March 29, 1996, Docket No. 960397-WS was opened to review the Commission's policy concerning the collection and refund of CIAC gross-up. Workshops were held and comments and proposals were received from the industry and other interested parties. By Order No. PSC-96-0686-FOF-WS, issued May 24, 1996, staff was directed to continue processing CIAC gross-up and refund cases pursuant to Order Nos. 16971 and 23541; however, staff was also directed to make a recommendation to the Commission concerning whether the Commission's policy regarding the collection and refund of CIAC should be changed upon staff's completion of its review of the proposals and comments offered by the workshop participants. In addition, staff was directed to consider ways to simplify the process and determine whether there were viable alternatives to the gross-up.

However, on August 1, 1996, The Small Business Job Protection Act of 1996 (The Act) passed Congress and was signed by President Clinton on August 20, 1996. The Act provided for the non-taxability of CIAC collected by water and wastewater utilities effective retroactively for amounts received after June 12, 1996. As a result, on September 20, 1996, in Docket No. 960965-WS, Order No. PSC-96-1180-FOF-WS was issued to revoke the authority of utilities to collect gross-up of CIAC and to cancel the respective tariffs unless, within 30 days of the issuance of the order, affected utilities requested a variance. Based on the above, there was no longer a need to review the Commission's policy to determine any changes and on September 16, 1996, the Commission voted to close Docket No. 960397-WS. However, as established in Order No. PSC-0686-FOF-WS, all pending CIAC gross-up refund cases are being processed pursuant to Order Nos. 16971 and 23541.

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Eagle Ridge is a Class B wastewater utility providing service to 606 customers in Lee County. According to its 1995 annual report, the utility reported operating revenues of \$338,486 and a net operating loss of \$53,052.

DISCUSSION OF ISSUES

ISSUE 1: Should Eagle Ridge Utilities, Inc. be required to refund excess gross-up collections for 1993 and 1994?

RECOMMENDATION: Yes, the utility should refund \$14,589 for 1993 and \$5,655 for 1994, plus accrued interest through the date of refund, for gross-up collected in excess of the above-the-line tax liability resulting from the collection of taxable CIAC. According to Orders Nos. 16971 and 23541, all amounts should be refunded on a pro rata basis to those persons who contributed the taxes. The refunds should be completed within 6 months of the effective date of the order. Within 30 days from the date of the refund, the utility should submit copies of canceled checks, credits applied to monthly bills or other evidence that verifies that the utility has made the refunds. Within 30 days from the date of the refund, the utility also should provide a list of unclaimed refunds detailing the contributor and the amount, and an explanation of the efforts made to make the refunds. (GILCHRIST)

STAFF ANALYSIS: In compliance with Orders Nos. 16971 and 23541, Eagle Ridge filed its 1993 and 1994 annual CIAC reports regarding its collection of gross-up for each year. By letter dated June 18, 1996, staff submitted preliminary refund calculation numbers to the utility. By letter dated July 22, 1996, the utility responded that it did not agree with staff's preliminary calculations. Specifically, the utility disagrees with staff's classifying the entire amount of its management fees as above-the-line expense. Also, the utility believes that \$9,479, the costs associated with preparing the utility's gross-up reports should be deducted from the refund due to the contributors. Staff believes that the contributor should not be held responsible for the legal and accounting charges incurred by the utility in determining whether he is entitled to a refund. Staff acknowledges that these costs are incurred to satisfy regulatory requirements, but the request for a reduction to the contributors refund amount is not the appropriate place to seek recovery of these fees. The utility may seek recovery of these expenses in a rate case proceeding.

Staff has calculated the gross-up required to pay the tax liability resulting from the collection of taxable CIAC by grossing-up the net taxable CIAC amount, in accordance with the method adopted in Order No. PSC-92-0961-FOF-WS.



ANNUAL GROSS-UP REFUND AMOUNTS

Based upon the foregoing, staff has calculated the amount of refund per year which is appropriate. Our calculations, taken from the information provided by the utility in its gross-up reports filed each year are reflected on Schedule No. 1. A summary of each year's refund calculation follows.

1993

The utility proposes that no refund is appropriate for 1993. Staff believes that a refund of \$14,589 is appropriate.

In its filing, the utility classified \$30,135 of its management fees as above-the-line expense and \$26,459 as below-the-line expense. Staff classified the entire \$56,594 as above-the-line expense. The utility explains that rates for the utility were originally set in 1985, in connection with the utility's original certificate application. Further, the utility has indicated that the Commission approved an annual expense of \$7,500 for management and administrative services in Order No. 14133, issued February 27, 1985. The utility adjusted the \$7,500 figure to reflect customer growth and to reflect the change in the Consumer Price Index (CPI), resulting in management fees of \$30,135. Also, the utility noted that it had an operating loss of \$62,373 in 1993.

In response to what the utility has stated above, staff notes that the utility's annual report for 1993 shows management fees to be \$56,594. When staff reviewed the utility's annual report to determine whether it was overearning, the entire amount of \$56,594 was considered to be utility related and used and useful. For annual report review purposes, this expense was included and considered when determining the utility's net income; therefore, staff believes that the \$56,594 management fee should be included as above-the-line expense in calculating the utility's taxable income.

Further, the utility states that it had an operating loss of \$67,593 in 1993. Staff believes that the utility's operating loss should not determine whether the management fees should be classified as an above or below the line expense. The utility had the option of filing for a rate case, but chose not to do so.

Based on the above, staff has adjusted management fees to reflect \$56,594 as above-the-line expense. Staff's adjustment to management fees changed the utility's reported above-the-line taxable income of \$3,440 to an above-the-line loss of \$23,019.

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Order No. 23541 requires that CIAC income be netted against the above-the-line loss; therefore, not all of the CIAC collected would create a tax liability. The utility's CIAC report indicates a total of \$158,366 in taxable CIAC was received, with \$5,195 being deducted for the first year's depreciation, resulting in CIAC of \$151,371. When this amount is netted against staff's above-the-line loss of \$23,019, the amount of taxable CIAC resulting in a tax liability is \$130,152, instead of the \$153,171 as calculated by the utility. Staff used the 37.63% combined marginal federal and state tax rate as provided in the 1993 CIAC Report to calculate the tax effect of \$78,525. The utility collected \$93,114 of gross-up monies; therefore, staff calculates a refund of \$14,589.

The refunds should be completed within 6 months of the effective date of the order. Within 30 days from the date of the refund, the utility should submit copies of canceled checks, credits applied to monthly bills or other evidence that verifies that the utility has made the refunds. Within 30 days from the date of the refund, the utility also should provide a list of unclaimed refunds detailing the contributor and the amount, and an explanation of the efforts made to make the refunds.

1994

The utility proposes that no refund is appropriate for 1994. Staff believes that a refund of \$5,655 is appropriate.

In its filing, the utility classified \$26,214 of its management fees as above-the-line expense and \$23,786 as below-the-line expense. Based on the same reasoning as stated above, staff classified the entire \$50,000 of management fees as above-the-line expense. Staff's adjustment to management fees changed the utility's reported above-the-line taxable income of \$15,516 to an above-the-line taxable loss of \$8,019. Order No. 23541 requires that CIAC income be netted against the above-the-line loss; therefore, not all of the CIAC collected would create a tax liability. The utility's CIAC report indicates a total of \$127,684 in taxable CIAC was received, with \$3,407 being deducted for the first year's depreciation, resulting in CIAC of \$124,277. When this amount is netted against staff's above-the-line-taxable loss of \$8,019, the amount of taxable CIAC resulting in a tax liability is \$116,007, instead of the \$124,277 as calculated by the utility. Staff used the 37.63% combined marginal federal and state tax rate as provided in the 1994 CIAC Report to calculate the tax effect of \$69,990. The utility collected \$75,645 of gross-up monies; therefore, staff calculates a refund of \$5,655.

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ISSUE 2: Should the docket be closed?

RECOMMENDATION: No. Upon expiration of the protest period, the docket should remain open pending verification of the refunds. Staff should be given administrative authority to close the docket upon verification that the refunds have been completed. (JAEGER, GILCHRIST)

STAFF ANALYSIS: Upon expiration of the protest period, the docket should remain open pending completion and verification of the refunds. Staff recommends that administrative authority be granted to staff to close the docket upon verification that the refunds have been made.



STAFF CALCULATED GROSS-UP REFUND

Eagle Ridge Utilities, Inc.

SOURCE: (Line references are from CIAC Reports)

	1993	1994
	-----	-----
1 Form 1120, Line 30 (Line 15)	\$ 224,074	\$ 192,633
2 Less CIAC (Line 7)	(158,366)	(127,684)
3 Less Gross-up collected (Line 19)	(93,114)	(75,645)
4 Add First Year's Depr on CIAC (Line 8)	5,195	3,407
5 Add/Less Other Effects (Lines 20 & 21)	(808)	(981)
6	-----	-----
7 Adjusted Income Before CIAC and Gross-up	\$ (23,019)	\$ (8,270)
8		
9 Taxable CIAC (Line 7)	\$ 158,366	\$ 127,684
10 Less first years depr. (Line 8)	\$ (5,195)	\$ (3,407)
11	-----	-----
12 Adjusted Income After CIAC	\$ 130,152	\$ 116,007
13 Less: NOL Carry Forward	\$ 0	\$ 0
14	-----	-----
15 Net Taxable CIAC	\$ 130,152	\$ 116,007
16 Combined Marginal state & federal tax rates	37.63%	37.63%
17	-----	-----
18 Net Income tax on CIAC	\$ 48,976	\$ 43,653
19 Less ITC Realized	0	0
20	-----	-----
21 Net Income Tax	\$ 48,976	\$ 43,653
22 Expansion Factor for gross-up taxes	1.6033349	1.6033349
23	-----	-----
24 Gross-up Required to pay tax effect	\$ 78,525	\$ 69,990
25 Less CIAC Gross-up collected (Line 19)	(93,114)	(75,645)
26	-----	-----
27 (OVER) OR UNDER COLLECTION	\$ (14,589)	\$ (5,655)
28	=====	=====
29		
30 TOTAL YEARLY REFUND	\$ (14,589)	\$ (5,655)
31	=====	=====
32		
33 PROPOSED REFUND (excluding interest)	(20,244)	
34	=====	