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M E M O R A N D U M

October 23, 1997

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

FROM: DIVISION OF WATER & WASTEWATER (GILCHRIST) *Bayo*  
DIVISION OF AUDITING AND FINANCIAL ANALYSIS (CAUSSEAU) *CA*  
DIVISION OF LEGAL SERVICES (JAEGER) *J*

RE: DOCKET NO. 971179-SU - DISPOSITION OF GROSS-UP FUNDS  
COLLECTED BY NORTH FT. MYERS UTILITY, INC.  
COUNTY: LEE

AGENDA: NOVEMBER 4, 1997 - REGULAR AGENDA - PROPOSED AGENCY  
ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: I:\PSC\WAW\WP\971179.RCM

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CASE BACKGROUND

North Ft. Myers Utility, Inc. (NFMU or utility) is a Class A wastewater utility providing service to approximately 5,360 customers in Lee County. According to its 1996 annual report, the utility reported gross operating revenues of \$1,740,435 and net operating income of \$219,571.

As a result of the repeal of Section 118(b) of the Internal Revenue Code, contributions-in-aid-of-construction (CIAC) became gross income and were 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. The information would also determine whether refunds of gross-up would be appropriate. 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, should be refunded on a pro rata basis to those persons who contributed the taxes.

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In Order No. 23541, the Commission required any water and wastewater utility already collecting the gross-up on CIAC and wishing to continue, to file a petition for approval with the Commission on or before October 29, 1990. NFMU filed for authority to continue to gross-up on December 27, 1990. By Order No. 25532, issued December 24, 1991, NFMU 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 provisions 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. This order 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 Orders 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, the Small Business Job Protection Act of 1996 (The Act) was signed into law 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. Although NFMU did not request a variance, it explains in a letter dated January 10, 1997, that it did not believe that the continued collection of the installment payments constituted a variance, but merely a payment of a debt over a period of time. Since there was no longer a need to review the Commission's policy on the gross-up of CIAC, on October 8, 1996, Order No. PSC-96-1253-FOF-WS, was issued closing Docket No. 960397-WS. However, as established in

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Order No. PSC-0686-FOF-WS, all pending CIAC gross-up refund cases are being processed pursuant to Orders Nos. 16971 and 23541.

NFMU provides wastewater service to several subdivisions (Forest Park, Lake Arrowhead, Carriage Village, Tamiami Village, and Lazy Days) formerly receiving service through package plants. In each case, under the authority granted in its tariff, NFMU allowed each customer to either pay the plant capacity charge and applicable gross-up at the time of connection onto the utility's central wastewater system or pay by installment payments over a seven-year period for the total amount owed. This installment arrangement was undertaken and authorized for the convenience of the customers who could not or chose not to pay their plant capacity fees and gross-up at the time of connection.

Although the Act provided for the non-taxability of CIAC collected by water and wastewater utilities for amounts received after June 12, 1996, several of the contractual agreements between the customers and the utility continue to be outstanding and require payments after June 12, 1996. As a result, on November 18, 1996, staff received a call from the Office of Public Counsel (OPC), advising staff that several customers had contacted OPC regarding the status of the customer's obligation to continue paying the gross-up amount of the installment payment to NFMU.

From March 17, 1997, through March 25, 1997, staff received approximately seventeen letters and numerous telephone calls from customers of NFMU, wanting to know how could NFMU be allowed to continue to collect gross-up from its customers when the Commission has an order stating that the utility's authority to collect gross-up has been canceled. Staff advised the customers that the utility could continue to collect gross-up if it had not collected all of the gross-up it was entitled to receive from those customers who are paying by installment. Further, staff assured the customers that this matter would be investigated thoroughly and a recommendation to the Commission would be made accordingly.

The disposition of gross-up funds collected by NFMU in 1992 and 1993 were addressed in Docket No. 961263-SU and Order NO. PSC-97-0062-FOF-SU, was issued accordingly. The purpose of this recommendation is to address the utility's request for a variance from Order No. PSC-96-1180-FOF-WS, to address the disposition of gross-up funds collected by the utility in 1994 and 1995, including the concerns of Mr. Pete Longjohn, President of Tamiami Village Homeowners Association, and the concerns expressed in the letters and telephone calls received from customers of NFMU, and to address the utility's proposal that 50% of its legal and accounting costs be offset against the refund amount.

DISCUSSION OF ISSUES

ISSUE 1: Should North Ft. Myers Utility's request for a variance from Order No. PSC-96-1180-FOF-SU, be granted?

RECOMMENDATION: Yes, North Ft. Myers Utility's request for a variance from Order No. PSC-96-1180-FOF-WS, should be granted. If the Commission approves staff's recommendation, NFMU's tariffs for gross-up authority should not be canceled. The utility should file revised tariffs to allow for the continued collection of gross-up taxes on CIAC that is paid in installments from customers that entered into installment contracts prior to June 12, 1996. Once the Utility has collected the entire amount of taxes it is entitled to receive from the customers paying by installment, NFMU should submit canceled tariff sheets to the Commission. Also, the provision allowing customers in Forest Park, Lake Arrowhead, Carriage Village, Lazy Days Village and Tamiami Village, the option of paying the system capacity charges in monthly installments over a seven-year period at 10% interest should be removed from the utility's tariff and a revised tariff sheet should be submitted accordingly. (GILCHRIST, CAUSSEAU, JAEGER)

STAFF ANALYSIS: Order No. PSC-96-1180-FOF-WS, revoked the authority of utilities to collect gross-up of CIAC and required the cancellation of the respective tariffs unless, within 30 days of the issuance of the order, affected utilities requested a variance. In its letter of January 10, 1997, the utility explains why its request for a variance was not filed in a timely manner. The utility explains that it was not aware that the Commission considered the installment contracts as somehow requiring a variance from Commission Order No. PSC-96-1180-FOF-WS. The utility goes on to say that it has always taken the position that the installment contract arrangement which is authorized pursuant to the provisions of the utility's tariff (other than the gross-up provisions) simply was allowing the customers to pay a debt for service availability charges and gross-up fees over an extended period of time, and, that it is not now and has never been considered by the utility to be continued collection of gross-up.

Although NFMU does not believe that this situation constitutes one in which a variance from Commission Order No. PSC-96-1180-FOF-WS, is necessary, to the extent the Commission deems it to be necessary, by letter dated February 28, 1997, the utility requested such a variance from the order. In its letter of February 28, 1997, the utility reiterates that the debt owing originally represented CIAC and gross-up, and, for those customers who chose to pay the amount owing over time, it became simply an

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installment debt authorized by tariff from the date that those individuals became customers of NFMU and agreed to make the installment payments.

As mentioned previously, the utility charges its mobile home customers a service availability charge of \$462, and in accordance with its tariff, the utility allows customers residing in Forest Park, Lake Arrowhead, Carriage Village, Lazy Days Village, and Tamiami Village the option of paying system capacity charges in monthly installments over a seven-year period at 10% interest. By letter dated January 10, 1997, the utility indicated that the gross-up tax due from the customers residing in these parks is \$278. Staff believes that the request for a variance is necessary because in the absence of a variance, the authority of NFMU to collect gross-up of CIAC is revoked and the respective tariffs are canceled. Upon revocation, staff believes that the utility can not collect from its customers a gross-up tax that it is no longer authorized to collect nor can the utility collect from its customers a gross-up charge that is no longer present in its tariff. The utility states that it views the payments as installment loan payments, not as payments of gross-up. Nonetheless, in staff's opinion, the utility's collection of the payments as installment loan payments does not alter the fact that a portion of the payment collected from the customers paying by installment is used to pay the gross-up tax related to CIAC.

NFMU should be allowed to collect from the customers, the gross-up portion of the installment payment that it is entitled to receive prior to the change in the tax law. Therefore, staff recommends that the request by NFMU for a variance from Order No. PSC-96-1180-FOF-WS, be granted. If the Commission approves staff's recommendation, NFMU's tariffs for gross-up authority should not be canceled. The utility should file revised tariff sheets to allow for the continued collection of gross-up taxes on CIAC that is paid in installments from customers that entered into the installment contracts prior to June 12, 1996. Once the utility has collected the entire amount of taxes on the CIAC installment agreements it is entitled to receive, the utility should submit canceled tariff sheets to the Commission and the utility's service availability policy should be revised also. Specifically, the provision allowing customers in Forest Park, Lake Arrowhead, Carriage Village, Lazy Days Village and Tamiami Village, the option of paying the system capacity charges and gross-up in monthly installments over a seven-year period at 10% interest would no longer be necessary, once the entire amount owed to the utility has been collected. Therefore, this provision should be removed from the utility's service availability policy, and a revised tariff sheet should be submitted accordingly.

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**ISSUE 2:** Should North Ft. Myers Utility, Inc. be required to refund excess gross-up collections for fiscal year 1994 (ends May 31, 1995) and fiscal year 1995 (ends May 31, 1996)?

**RECOMMENDATION:** The Commission should accept the settlement offer of North Ft. Myers Utility, Inc., to allow it to offset 50% of the legal and accounting fees incurred in any one year against the refund for that year. Therefore, for the fiscal year ending May 31, 1995, North Ft. Myers Utility, Inc., overcharged its contributors \$14,520 of gross-up. Some of the contributors paid the gross-up in full and some paid by installment. Therefore, the utility should make a cash refund to the contributors who have paid the full amount of the gross-up, based on their pro rata share of the \$14,520 overcharged amount. The utility should also refund interest accrued from May 31, 1995 to the date of the refund. However, for those contributors who are paying by installment, the utility should reduce (credit) the principal amount due on their installment payments by their pro rata share of the overcharge, plus accrued interest from May 31, 1995 to the date of the refund. To the extent that the principal amount owing under any installment contract is less than the contributor's pro rata share of the refund amount plus accrued interest, the utility should make a cash refund of the difference, and discontinue collections from the contributor. 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 the 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 should also provide a list of unclaimed refunds detailing contributor and amount, and an explanation of the efforts made to make the refunds. No refund is required for excess gross-up collections for the fiscal year ended May 31, 1996. (GILCHRIST, CAUSSEAU)

**STAFF ANALYSIS:** In addressing the verbal and written concerns expressed by the customers of NFMU, staff asked the utility to provide information concerning the customers who paid capacity charges and gross-up up front and to provide information concerning the customers who are paying capacity charges and gross-up by installments. By letters dated January 15, 1997, February 28, 1997, March 31, 1997, April 7, 1997, and June 23, 1997, NFMU responded to staff's request for additional information regarding this matter. In its letters of February 28, 1997, and April 7, 1997, the utility indicated that the installment contracts were not booked as income in the year entered into, but instead for book and tax purposes, the installment payments were treated as income in the year in which the payments themselves were received. The utility stated that each payment offsets an accounts receivable

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which was booked at the time the contract was entered into for the entire amount of the contract.

Staff believes that CIAC is income in the year received and "receipt" occurs when the entity knows it has a legal right to the money and the amount of money is known. The amount to which NFMU is entitled is established by tariff and by the installment contract agreements it made with its customers. CIAC is a "condition precedent" to the receipt of service, which means CIAC must be paid before a customer will be served. The payment may be a lump sum or by installments. Staff believes NFMU must have been certain that it had a right to the CIAC or it would not have provided service to those who are paying by installment. Based on the reasoning above, staff has treated the installment contracts as "income" in the year the contracts were entered into. Although the facts of this case are different from the ones in the Hudson case, staff believes that this treatment is consistent with the decision made in Docket No. 961270-SU, by Order No. PSC-97-0040-FOF-SU, regarding the disposition of gross-up funds collected by Hudson Utility.

In compliance with Orders Nos. 16971 and 23541, NFMU filed its 1994 and 1995 annual CIAC reports regarding its collection of gross-up for fiscal years ended May 31, 1995 and 1996, respectively. By letter dated December 10, 1996, staff submitted preliminary refund calculation numbers to the utility regarding 1994 gross-up collections for the fiscal year ended May 31, 1995. On January 9, 1997, the utility filed a response to staff's letter of December 10, 1996. In its response, the utility revised its original refund calculation to include \$9,175 of miscellaneous income as above the line income. Such income was determined by the utility to be miscellaneous service revenue from reconnect fees, and as such, staff agrees that \$9,175 should be classified above the line; appropriate schedules were revised and resubmitted accordingly. Also, the utility indicated that it disagrees with staff's imputation of first year's depreciation for 1994. A more detailed discussion of staff's adjustment for first year's depreciation follows. By letter dated May 14, 1997, the preliminary refund calculation sent to the utility on December 10, 1996, was updated to include the revisions submitted by the utility in its letter of January 9, 1997. In addition, staff submitted preliminary refund calculation numbers to the utility regarding 1995 gross-up collections for the fiscal year ended May 31, 1996.

By letter dated July 15, 1997, the preliminary refund calculations for 1994 and 1995 that were originally sent to the utility on December 10, 1996, were updated to reflect the installment contracts as income in the year the contracts were

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entered into. By letter dated August 23, 1997, the utility stated that they were in general agreement with staff's refund calculations for 1994 and 1995 for the fiscal years ended May 31, 1995 and 1996, respectively. In addition, the utility provided documentation supporting the legal and accounting costs incurred for processing the gross-up refund reports. Also, NFMU is requesting that 50% of the legal and accounting costs be offset against the refund amount.

Staff 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 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.

##### 1994

If the Commission votes to offset the refund by 50% of the legal and accounting costs, the utility proposes a refund of approximately \$12,789 for fiscal year 1994(ends May 31, 1995). However, the utility proposes a credit to CIAC because there are a large number of contributors (520) who are entitled to the refund. Further, the utility argues there is an obvious discrimination of allowing a refund only to contributors during this one year, while no refund is applicable to contributors during other years. Given these factors, NFMU requests that the entire refund amount of \$12,789 be booked to CIAC, thereby, benefitting all customers and avoiding the significant additional costs of processing any refund to a large number of contributors.

Staff believes a refund of \$14,520 is appropriate for fiscal year 1994 (ends May 31, 1995). According to the utility, approximately 520 contributors are entitled to receive a refund, and each contributor would receive approximately \$11. Normally, when the refund amount per customer is small or insignificant, staff would agree that the refund amount should be booked as CIAC; however, because of the tremendous customer involvement in this docket, staff believes the utility should be ordered to do a refund. The utility asserts there is an obvious discrimination of allowing a refund only to contributors during one year, while no



refund is applicable to contributors during other years. Staff disagrees with this assertion because the tax liability associated with the collection of CIAC is determined on an annual basis, and the appropriateness of a refund is calculated accordingly.

In its filing, the utility did not make a deduction for first year's depreciation. The utility explains that an adjustment for first year's depreciation was not made because the utility did not receive any contributions of physical property during the fiscal year, increases in contributed property resulted entirely from the acquisition of existing systems and their historic cost basis, and that plant additions were funded through increases in company debt.

In response to the utility's statements, staff agrees, that no adjustment for first year's depreciation should be made on contributed property resulting from the acquisition of existing systems, thus, no adjustment was made. However, staff has made an adjustment for first year's depreciation for cash contributions received during the period. Staff has assumed that cash CIAC was converted to property and accordingly, first year's depreciation has been calculated. By definition, CIAC charges are intended for plant and are to be utilized for the acquisition, or construction of utility property; therefore, staff believes that cash CIAC collected will be converted into property and, thus, depreciated. Staff believes to the extent that cash CIAC is used and useful, first year's depreciation exists because the cash either pays for a prior investment made by the utility or it provides for new plant in the year it is received by the utility. In addition, staff notes that depreciation is an allowable deduction for federal income tax purposes, which the utility claimed on its federal tax returns in determining taxable income. Depreciation is an integral part of the determination of taxable income, which should be calculated by reducing the amount of taxable CIAC collected in each year by the amount of first year's depreciation deduction taken by the utility. Based on the foregoing, staff has calculated first year's depreciation on CIAC net of contributed property resulting from the acquisition of existing systems.

The utility's 1994 CIAC report reveals that the utility received taxable CIAC of \$590,150 and gross-up of \$338,017 for the fiscal year ended May 31, 1995. As previously stated, staff has treated the installment contracts as "income" in the year the contracts were entered into. According to the utility, all of the Forest Park installment contracts fall within the fiscal year ended May 31, 1994, and all of the Carriage Village installment contracts fall within the fiscal year ended May 31, 1995. Therefore, CIAC has been reduced by \$28,676 and increased by \$41,736 to reflect all of the Forest Park installment contracts as being received within

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the fiscal year ended May 31, 1994, and all of the Carriage village installment contracts as having been received within the fiscal year ended May 31, 1995. As a result, taxable CIAC is calculated to be \$603,210; and staff deducted \$21,090 for the first year's depreciation, resulting in net taxable CIAC of \$582,120.

The utility's 1994 CIAC report indicates that the utility was operating at a loss before the inclusion of CIAC in income. 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. When CIAC in the amount of \$582,120 is netted against staff's calculated loss of \$42,771, the amount of taxable CIAC resulting in a tax liability is \$539,349. Staff used the 37.63% combined marginal federal and state tax rates as provided in the 1994 CIAC Report to calculate net income taxes of \$202,957. When this amount is multiplied by the expansion factor for gross-up taxes, the amount of gross-up required to pay the tax effect on the CIAC is calculated to be \$325,408. The utility collected \$338,017 of gross-up monies. This amount, has been reduced by \$17,301 to remove the gross-up collected from the customers of Forest Park. Further, staff imputed gross-up in the amount of \$25,116 to reflect the gross-up due from the Carriage Village installment contracts. As a result, the total amount of gross-up charged is \$345,832; Therefore, staff calculates a refund of \$20,424.

The utility has provided documentation supporting legal and accounting fees of \$15,397.81 for fiscal year ended May 31, 1995. Staff reviewed these costs and determined \$11,808.17 to be legitimate expenses. Fifty percent (50%) of this amount is \$5,904. When this amount is offset against the \$20,424, the refund for 1994 for the fiscal year ended May 31, 1995 is calculated to be \$14,520.

Staff notes that the Commission has considered on several occasions, the question of whether an offset should be allowed pursuant to the orders governing CIAC gross-up. In Dockets Nos. 961076-WS, and 970275-WS, by Orders Nos. PSC-97-0657-AS-WS and PSC-97-0816-FOF-WS, respectively, the Commission accepted the utility's settlement proposals that 50% of the legal and accounting costs be offset against the refund amount. In general, the utility argues that the legal and accounting costs should be deducted from the amount of the contributors' refund, as the contributors are the cost-causers and as such, those costs should be recovered from the cost-causers.

Staff notes that it was the change in the tax laws and not the contributors that imposed a new cost on the utilities associated with CIAC. Further, staff believes that once the contributors have

paid the gross-up taxes on the CIAC, the contributors have fulfilled their obligation under Orders Nos. 16971 and 23541. Since those orders also provide that gross-up in excess of the utility's actual tax liability should be refunded on a pro rata basis to those persons who contributed the taxes, staff believes that once the tax liability is determined, it is the responsibility of the Commission to ensure that excess payments of CIAC taxes are refunded in compliance with those Orders. Therefore, staff does not believe that a reduction in the amount of refund a contributor is entitled to receive as a result of his overpayment of gross-up taxes is appropriate. Staff acknowledges that those costs were incurred to satisfy regulatory requirements; however, staff does not believe that the contributors should be held responsible for the legal and accounting costs incurred to determine whether they are entitled to a refund. Staff views those costs as a necessary cost of doing business, and as such, staff believes it is appropriate for the utility to seek recovery of those amounts in a rate case proceeding. Finally, staff believes that this situation is similar to when a utility files for an increase in service availability charges. The costs of processing the utility's service availability case is borne by the general body of ratepayers, although the charges are set for future customers, only.

However, as in the other cases referenced herein, staff recognizes in this case that acceptance of the utility's request would avoid the substantial cost associated with a hearing, which may in fact exceed the amount of the legal and accounting cost to be recovered. Staff further notes that the actual costs associated with implementing the refunds have not been included in these calculations and will be absorbed by the utility. Moreover, staff believes the utility's request is a reasonable "middle ground". Therefore, staff recommends that while not adopting the utility's position, the Commission grant NFMU's request that it be allowed to offset 50% of the legal and accounting fees against the refund. For fiscal year 1994, the utility had legitimate legal and accounting fees of \$11,808. Therefore, taking half of this amount, the refund for 1994 is reduced by \$5,904.

By letter dated October 15, 1997, the utility reiterates and continues to argue that the refund amount should be booked to CIAC. The utility presented the following arguments to further support its position:

- (1) There are over 500 customers to which refunds would have to be made, including several commercial customers, and several customers in the Carriage Village subdivision. The amount of any refund to these customers would average approximately \$11

apiece with by far the largest amounts going to commercial customers. Therefore, the cost of the refunds alone for this many customers would substantially offset any benefit which these customers would receive.

- (2) All refunds that would be made for the fiscal year ended May 31, 1994, would go only to those residential customers within the Carriage Village subdivision. As these gross-up calculations have been relatively controversial, with the change in the tax law, and with the installment contracts, the most vocal customers would be unaffected by the proposed refund. As such, those other customers are likely to be very upset if customers within the Carriage Village subdivision receive a refund and the others do not. For the small amount of the refund involved and the cost related, the utility believes it is best for all concerned to simply book the excess collections to CIAC.
- (3) Both because of the tax laws related to recognition of income and fluctuations in taxable income that have occurred over the years, certain customers who contributed and signed installment agreements during one year would be entitled to nothing while those who signed installment agreements in the fiscal year ended May 31, 1995, would be entitled to a small refund. This may appear to the customers to be inequitable since nothing they have done has caused this result. The utility believes that the customers may view this as discrimination. As such, it is likely that a refund to a few will be unpopular regardless of the fact that the utility would be able to explain.

Given these factors, NFMU requests that the entire refund amount be booked to CIAC, thereby, benefitting all customers and avoiding the significant additional costs of processing any refund to a large number of contributors.

If the Commission approves staff's proposed refund, the refund will be distributed to approximately 520 customers and each contributor would receive approximately \$11. The refund would be minimal, and, normally, when the refund amount per customer is small or insignificant, staff would agree that the refund amount should be booked as CIAC. In this case, staff acknowledges that the cost of making the refund may exceed the benefit of the refund,

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and, we believe the arguments presented by the utility have merit; however, because the customers are highly involved in this docket, staff believes the customers who paid gross-up in full would rather receive a refund (although small) than have the refund amount booked to CIAC. Regarding the utility's statement that customers who made contributions in 1994 may view the refund as inequitable or discriminatory if refunds were made to contributors in 1995 only, as previously stated, the tax liability associated with the collection of CIAC is determined separately for each annual period, and the appropriateness of a refund is calculated accordingly based on the amount of taxable CIAC in the period being reviewed. Therefore, there is no discrimination. Therefore, based on the circumstances in this particular case, staff believes the utility should be ordered to do a refund. The utility should also refund accrued interest from May 31, 1995 through the date of the refund. 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 the 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 should also provide a list of unclaimed refunds detailing contributor and amount, and an explanation of the efforts made to make the refunds.

The customers who are paying by installment will not receive a cash refund; rather, the utility proposes, and staff agrees that each of these customers would be notified that the principal amount owing under their installment contract would be reduced by their pro rata share of the refund amount. The utility has indicated that it is willing to make the appropriate calculations for the customer depending upon the year of the installment contract and notify the customers in accordance with that revision. Staff believes this is a reasonable approach because the customers would get full benefit of the lower amount of gross-up owed, and the utility would not be required to make refunds to customers before payments are received from those customers. In addition, to the extent that the principal amount owing under any installment contract is less than the contributor's pro rata share of the refund amount, plus accrued interest, the utility should make a cash refund of the difference, and discontinue collections from the contributor.

1995

The utility proposes that no refund is appropriate. Staff agrees that a refund of gross-up collections for fiscal year 1995 (ended May 31, 1996) is not appropriate.

The utility's 1995 CIAC report reveals that the utility received taxable CIAC of \$1,068,861. This amount includes CIAC received from the customers of Forest Park and Carriage Village. As previously explained, staff has treated the installment contracts as "income" in the year the contracts were entered into, and because the Forest Park and Carriage Village installment contract fall within the fiscal years ended May 31, 1994 and 1995, respectively, CIAC has been reduced by \$14,738 and \$10,639, respectively, to remove those amounts. According to the information provided by the utility, all of the Tamiami Village, Lake Arrowhead and Lazy Days installment contracts fall within the fiscal year ended May 31, 1996. Therefore, staff imputed \$114,333, \$173,904, \$56,855 of CIAC that is due from the Tamiami Village, Lake Arrowhead, and Lazy Days installment contracts, respectively, to reflect the total installment contract amount in the fiscal year ended May 31, 1996. As a result, taxable CIAC is \$1,388,576 and staff deducted \$21,863 for the first year's depreciation and \$296,184 for CIAC associated with the purchase of existing systems not grossed up, resulting in net taxable CIAC of \$1,070,529.

The utility's 1995 CIAC report indicates that the utility was operating at a loss before the inclusion of CIAC in income. 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. When CIAC in the amount of \$1,070,529 is netted against staff's calculated loss of \$28,028, the amount of taxable CIAC resulting in a tax liability is \$1,042,501. Staff used the 37.63% combined marginal federal and state tax rates as provided in the 1995 CIAC Report to calculate net income taxes of \$392,293. When this amount is multiplied by the expansion factor for gross-up taxes, the amount of gross-up required to pay the tax effect on the CIAC is calculated to be \$628,977. The utility collected \$402,730 of gross-up monies. This amount has been reduced by \$8,868 and \$6,402 to remove the gross-up collected from the customers of Forest Park and Carriage Village, respectively. Further, staff imputed \$68,802, \$104,654, and \$34,211 of gross-up that is due from the Tamiami Village, Lake Arrowhead and Lazy Days installment contracts, respectively. As a result, the total amount of gross-up charged is \$595,127. The utility required more in gross-up to pay the tax impact than the utility collected; therefore, no refund is necessary.

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ISSUE 3: 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)

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

North Fort Myers Utility  
 SOURCE: (Line references are from CIAC Reports)

	1994	1995
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1 Form 1120, Line 30 (Line 15)	\$ 865,768	\$ 1,429,893
2 Less CIAC (Line 7)	(590,150)	(1,068,861)
3 Less Gross-up collected (Line 19)	(338,017)	(402,730)
4 Add First Year's Depr on CIAC (Line 8)	21,090	15,966
5 Add/Less Other Effects (Lines 20 & 21)	(1,462)	(2,296)
6	-----	-----
7 Adjusted Income Before CIAC and Gross-up	\$ (42,771)	\$ (28,028)
8		
9 Actual CIAC Collected	\$ 590,150	\$ 1,068,861
10 Add Installment Contracts - Carriage Village	41,736	
11 Add Installment Contracts - Tamiami Village		114,333
12 Add Installment Contracts - Lake Arrowhead		173,904
13 Add Installment Contracts - Lazy Days		56,855
14 Less CIAC received from Forest Park	(28,676)	(14,738)
15 Less CIAC received from Carriage Village		(10,639)
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16 Taxable CIAC	\$ 560,439	1,360,548
17 Less first years depr. (Line 8)	(21,090)	\$ (21,863)
18 Less CIAC associated with purchase of existing systems not grossed-up		(296,184)
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19 Adjusted Income After CIAC	\$ 539,349	\$ 1,042,501
20 Less: NOL Carry Forward	0	0
21	-----	-----
22 Net Taxable CIAC	\$ 539,349	\$ 1,042,501
23 Combined Marginal state & federal tax rates	37.63%	37.63%
24	-----	-----
25 Net Income tax on CIAC	\$ 202,957	\$ 392,293
26 Less ITC Realized	0	0
27	-----	-----
28 Net Income Tax	\$ 202,957	\$ 392,293
29 Expansion Factor for gross-up taxes	1.6033349	1.6033349
30	-----	-----
31 Gross-up Required to pay tax effect	\$ 325,408	\$ 628,977
32 Actual Gross-up Collected	338,017	402,730
33 Add Installment Contracts - Carriage Village	25,116	
34 Add Installment Contracts - Tamiami Village		68,802
35 Add Installment Contracts - Lake Arrowhead		104,654
36 Add Installment Contracts - Lazy Days		34,211
38 Less Gross-up Received from Forest Park	(17,301)	(8,868)
39 Less Gross-up Received from Carriage Village		(6,402)
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40 Gross-up Charged	\$ 345,832	\$ 595,127
41 (OVER) OR UNDER COLLECTION	\$ (20,424)	\$ 33,850
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42 TOTAL YEARLY REFUND	\$ (20,424)	\$ 0
43 Offset of Legal and Accounting Fees	5,904	0
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43 PROPOSED REFUND (excluding interest)	\$ (14,520)	\$ 0
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