

FLORIDA PUBLIC SERVICE COMMISSION  
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Tallahassee, Florida 32399-0850

MEMORANDUM

FEBRUARY 5, 1998

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FPSC - Records/Reporting

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

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

RE: DOCKET NO. 980178-BU - DISPOSITION OF GROSS-UP FUNDS  
COLLECTED BY EAGLE RIDGE UTILITIES, INC.  
COUNTY: LEE

AGENDA: FEBRUARY 17, 1998 - REGULAR AGENDA - PROPOSED AGENCY  
ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\MAW\WP\980178.RCM

CASE BACKGROUND

Eagle Ridge is a Class B wastewater utility providing service to 606 customers in Lee County. According to its 1996 annual report, the utility reported operating revenues of \$374,953 and net operating income of \$15,030.

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, 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.

DOCUMENT NUMBER-DATE

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FPSC RECORDS - REPORTING

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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 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 (PAA) 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, PAA Order No. PSC-92-0961A-FOF-WS, was issued which included Attachment A which reflects the generic calculation form. No protests were filed, and these Orders 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 October 8, 1996, Order No. PSC-96-1253-FOF-WS was issued closing Docket No. 960397-WS. However, as established in Order No. PSC-96-0686-FOF-WS, all pending CIAC gross-up refund cases are being processed pursuant to Orders Nos. 16971 and 23541. The disposition of gross-up funds collected by the utility in 1995 was handled in Docket No. 970121-SU and Order No. PSC-97-0329-FOF-

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SU was issued accordingly. The purpose of this docket is to address the disposition of gross-up funds collected by the utility in 1996 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 Eagle Ridge Utilities, Inc. be required to refund excess gross-up collections for 1996?

RECOMMENDATION: No. The utility over collected CIAC gross-up in the amount of \$361; however, staff recommends that the Commission accept the utility's request to offset 50% of the legal and accounting fees incurred (\$2,619) against the refund amount of \$361. Although the utility is entitled to offset \$2,619; only, \$361 of this amount will be used to offset the refund of \$361. When the offset is made, no refund is required for 1996. (GILCHRIST, CAUSSEAU)

STAFF ANALYSIS: In compliance with Orders Nos. 16971 and 23541, Eagle Ridge filed its 1996 annual CIAC report regarding its collection of gross-up. The utility calculated its above-the-line income to be \$69,395. Staff adjusted the utility's above-the-line income by \$604 to reflect first year's depreciation as above the line. As a result, staff calculated above the-line-income to be \$68,791. By letter dated January 12, 1998, staff submitted preliminary refund calculation numbers to the utility. By letter dated January 23, 1998, the utility stated that while they do not agree with staff's calculation of above-the-line taxable income, it does not intend to raise that issue since the adjustment made by staff did not affect the proposed 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-POF-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.

The utility's 1996 CIAC report indicates that the utility was in a taxable position on an above-the-line basis prior to the inclusion of taxable CIAC and gross-up. Therefore, all of the taxable CIAC received would be taxed. The report indicates a total of \$22,498 in taxable CIAC was received, with \$604 being deducted for the first year's depreciation. Staff used the 37.63% combined

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marginal federal and state tax rate as provided in the 1996 CIAC Report to calculate the tax effect. The reported 37.63% combined marginal federal and state tax rate applied to the net \$21,894 results in the income tax effect of \$8,239. 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 \$13,210. The utility collected \$13,571 of gross-up monies. Therefore, the utility collected \$361 more in gross-up than was required to pay the tax impact; however, staff recommends that no refund be required.

The utility provided documentation requesting legal and accounting fees of \$5,436. Staff reviewed these costs and determined that \$5,237 of the legal and accounting fees submitted by the utility are directly associated with preparing the required reports and calculating the tax effect, and, thus, are considered to be legitimate expenses. Fifty percent (50%) of this amount is \$2,619. Although the utility is entitled to offset \$2,619; only, \$361 of this amount will be used to offset the refund of \$361. When the legal and accounting fees of \$361 are offset against the refund amount of \$361, there is nothing left to refund, thus no refund would be required for 1996.

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

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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 Eagle Ridge's request that it be allowed to offset 50% of the legal and accounting fees against the refund. The utility had legitimate legal and accounting fees of \$5,237. Fifty percent (50%) of this amount is \$2,619. Although the utility is entitled to offset \$2,619; only, \$361 of this amount will be used to offset the refund of \$361. When the legal and accounting fees of \$361 are offset against the refund amount of \$361, there is nothing left to refund, thus no refund would be required for 1996.

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ISSUE 2: Should the docket be closed?

RECOMMENDATION: Yes, this docket should be closed upon the expiration of the protest period. (JAEGER)

STAFF ANALYSIS: If the Commission approves staff's recommendation, no further action in this docket would be required. Therefore, upon the expiration of the protest period, the docket should be closed.

COMMISSION CALCULATED GROSS-UP REFUND

Eagle Ridge Utilities, Inc.  
 SOURCE: (Line references are from CIAC Reports)

	1996
	-----
1 Form 1120, Line 80 (Line 15)	\$ 68,791
2 Less CIAC (Line 7)	(22,498)
3 Less Gross-up collected (Line 19)	(18,571)
4 Add First Year's Depr on CIAC (Line 8)	604
5 Add/Less Other Effects (Lines 20 & 21)	(68)
6	-----
7 Adjusted Income Before CIAC and Gross-up	\$ 38,258
8	
9 Taxable CIAC (Line 7)	\$ 22,498
10 Less first years depr. (Line 8)	\$ (604)
11	-----
12 Adjusted Income After CIAC	\$ 55,152
13 Less: NOL Carry Forward	\$ 0
14	-----
15 Net Taxable CIAC	\$ 21,894
16 Combined Marginal state & federal tax rates	37.63%
17	-----
18 Net Income tax on CIAC	\$ 8,239
19 Less ITC Realized	0
20	-----
21 Net Income Tax	\$ 8,239
22 Expansion Factor for gross-up taxes	1.6083349
23	-----
24 Gross-up Required to pay tax effect	\$ 18,210
25 Less CIAC Gross-up collected (Line 19)	(18,571)
26	-----
27 (OVER) OR UNDER COLLECTION	\$ (361)
28	=====
29 TOTAL YEARLY REFUND	\$ (361)
30 Offset of Legal and Accounting Fees	\$ 361
31	-----
32 PROPOSED REFUND (excluding interest)	\$ 0
33	=====