

State of Florida



Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

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DATE: FEBRUARY 17, 2000

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

FROM: DIVISION OF LEGAL SERVICES (JAEGER) *PS*
 DIVISION OF WATER AND WASTEWATER (MCCASKILL) *OSM*
 DIVISION OF AUDITING AND FINANCIAL ANALYSIS (ROMIG) *g*

RE: DOCKET NO. 971179-SU - DISPOSITION OF CIAC GROSS-UP FUNDS
 COLLECTED BY NORTH FORT MYERS UTILITY, INC. IN LEE COUNTY. *MSH*

AGENDA: 02/29/2000 - REGULAR AGENDA - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\LEG\WP\971179.RCM

CASE BACKGROUND

North Fort 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 1997 annual report, the utility reported gross operating revenues of \$1,958,553 and net operating income of \$446,362.

This docket was opened to determine whether North Ft. Myers Utility, Inc., should be required to refund excess gross-up collections for fiscal year 1994 (ended May 31, 1995), fiscal year 1995 (ended May 31, 1996), and fiscal year 1996 (ended May 31, 1997). Effective January 1, 1987, contributions-in-aid-of-construction (CIAC) became gross income and were depreciable for federal tax purposes. Therefore, by 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.

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However, the Small Business Job Protection Act of 1996 (the Act) provided for the non-taxability of CIAC collected by water and wastewater utilities effective for amounts received after June 12, 1996. Based on this change in the law, by Order No. PSC-96-1180-FOF-WS issued September 20, 1996, in Docket No. 960965-WS, the Commission revoked the authority of utilities to collect gross-up of CIAC and canceled 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 explained 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. To the extent a variance was required, the utility requested a variance.

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 in full 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. On November 12, 1997, OPC filed its Notice of Intervention and by Order No. PSC-97-1474-PCO-SU, the Commission acknowledged OPC's intervention.

Because the utility had entered into these "installment contract" agreements prior to June 12, 1996, staff initially treated the installment contracts as "income" in the year the contracts were entered into. However, upon realizing that the utility had not reported the amounts due as income and that the utility was not treating the installment payments received after June 12, 1996 as taxable income on its tax return, staff determined

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that such treatment would have given the utility a windfall. Therefore, staff revised its CIAC gross-up refund calculations to remove the installment contracts as being taxable income and the utility was advised accordingly.

In response, on December 12, 1997, the utility filed a certified copy of the amended tax returns with this Commission along with a copy of the return receipt from the Internal Revenue Service. Based on these revised tax returns, staff filed a recommendation on December 3, 1998, 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, 1995, and 1996, 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, to address the utility's request that 50% of its legal and accounting costs be offset against the refund amounts, and to address the utility's informal Settlement Offer filed October 2, 1998, and OPC's response to the utility's offer. However, this recommendation was deferred from the December 16, 1998, Agenda Conference.

Finally, at the May 4, 1999 Agenda Conference, the Commission considered staff's recommendation on all the above-noted concerns. In addition to those concerns, staff added the following issue:

Should the Commission order North Fort Myers Utility, Inc., to show cause, in writing within twenty-one days, why it should not be fined an amount up to \$5,000 for each offense for: 1) its apparent failure to timely request a variance for the continued collection of CIAC gross-up as required by Order No. PSC-96-1180-FOF-WS; 2) its apparent failure to file accurate annual reports for the years 1994, 1995, 1996, and 1997, in compliance with Rule 25-30.110(9), Florida Administrative Code; and 3) its apparent implementation of price-index rate increases based on inaccurate operating costs in violation of Section 367.081(4)(c), Florida Statutes?

In voting on this issue, the Commission determined that the utility should not be made to show cause why it should not be fined for its apparent failure to timely request a variance and its apparent failure to file accurate annual reports. However, the Commission required the utility to show cause, in writing, within 21 days why a fine in the total amount of \$15,000 should not be imposed for the utility having improperly implemented three price indexes in apparent violation of Section 367.081(4), Florida Statutes. This

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decision was memorialized by Order No. PSC-99-1068-PAA-SU, issued May 25, 1999. That Order further required any utility response to contain specific allegations of fact and law, and that if the utility raised material questions of fact and requested a hearing pursuant to Section 120.57, Florida Statutes, further proceedings would be scheduled before final determination is made. The portion of the Order addressing the show cause proceedings was issued as final agency action.

In that same Order, the Commission, by proposed agency action: (1) approved the utility's request for a variance from Order No. PSC-96-1180-FOF-WS (Order revoking authority to continue CIAC gross-up); (2) required the utility to refund a portion of CIAC gross-up for fiscal years 1994 and 1995; (3) ordered the utility to make no further refunds for fiscal year 1996; and (4) required the utility to refund portions of the price indexes for the years 1995, 1996, and 1997. However, by Petition on Proposed Agency Action filed June 15, 1999, OPC protested the proposed agency action portion of the Order and requested a formal hearing. As a result of this protest, a formal hearing is now scheduled for April 13-14, 2000.

On June 15, 1999, the utility filed its Response to Show Cause (Response). In that Response, the utility "contends that it is not in violation of any provision of Commission Rule, Statute or Order and to the extent the Commission determines that such violation exists, requested a hearing pursuant to the provisions of Chapter 120.57(1), Florida Administrative Code."

The staff originally filed its recommendation on the utility's Response for the October 5, 1999 Agenda Conference, by which staff recommended that the show cause issue merely be included in the hearing currently scheduled on the protest of Proposed Agency Action Order No. PSC-99-1068-PAA-SU. However, at the agenda conference, staff indicated that perhaps a show cause proceeding should not proceed at all. Therefore, the Commission voted to defer the item and have staff file another recommendation on the appropriate action for the Commission to take in this show cause proceeding.

In its revised recommendation filed on November 4, 1999, staff recommended that the utility not be fined for its apparent violation of Section 367.081(4)(c), Florida Statutes (improper implementation of price indexes), and that the show cause proceeding be terminated. However, the Commission voted to proceed with the show cause proceeding and to address it as an issue in the formal hearing scheduled pursuant to OPC's protest of PAA Order No.

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PSC-99-1068-PAA-SU. This decision was memorialized by Order No. PSC-99-2377-PCO-SU, issued December 6, 1999.

However, during the preparations for hearing, the parties reached a total settlement of the pending dispute. By Settlement Agreement, executed on February 4, 2000 and filed with the Commission on February 7, 2000, the parties proposed to fully dispose of this pending case. The purpose of this recommendation is to address the proposed Settlement Agreement.

DISCUSSION OF ISSUES

ISSUE 1: Should the Commission accept the Settlement Agreement reached by the parties?

RECOMMENDATION: Yes, the Settlement Agreement should be accepted in its entirety.

For those contributors who have paid the full amount of the original gross-up and CIAC charges, the utility should make a refund based on the contributors' pro rata share of the agreed upon total refund amount of \$300,000 for the fiscal years ended May 31, 1995 and May 31, 1996. For those contributors who are paying by installment, to the extent monies are still owing on installment contracts, that pro rata refund will first go to reduce installment payments still owed for the tax impact (CIAC gross-up), and secondly to credit any payments due for CIAC charges. If the pro rata refund is greater than the remaining installment payments for the combined CIAC gross-up charges and CIAC charges, the utility should make refunds as appropriate, and discontinue any further collections.

The refunds should be completed within 6 months of the date of the order. Within 30 days from the completion 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 completion 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. To the extent that the utility is unable to refund the full amount of the \$300,000, and upon verification by our staff, the undeliverable amount shall also be credited to CIAC. Further, on October 1, 1996, the utility refunded \$2,753.82 it collected for the period of June 1 through June 12, 1996, and no refund is required for the fiscal year 1996 (ended May 31, 1997). Finally, the show cause proceeding should be closed without penalty to the utility. (MCCASKILL, ROMIG, JAEGER)

STAFF ANALYSIS: By Order No. PSC-99-1068-PAA-SU, the Commission initially proposed to require NFMU to, among other things: (1) refund excess gross-up of CIAC in the amount of \$74,239 for fiscal year 1994 (ended May 31, 1995), and \$51,999 for fiscal year 1995 (ended May 31, 1996), plus any accrued interest; (2) show cause, in writing, within 21 days why a fine in the total amount of \$15,000 should not be imposed for the utility having improperly implemented

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three price indexes in apparent violation of Section 367.081(4), Florida Statutes; (3) make no further refunds for fiscal year 1996; and (4) refund, with interest, the portion of the revenues received as a result of the apparent improper implementation of the price indexes for the years 1995, 1996, and 1997. However, as stated above, OPC protested the PAA portion of the Order. Based on this protest, a formal hearing is scheduled for April 13-14, 2000.

In preparation for this hearing, the parties have reached a settlement. In the Settlement Agreement (Attachment 1), recognizing the "expensive uncertainty of continuing this proceeding," and wishing "to effectuate a settlement, which will affect all aspects of this case, including gross-up for NFMU, previously filed indexes, and the Show Cause proceeding," the parties agree as follows:

a. The parties agree to support this Settlement Agreement as the final disposition of all matters covered by Order No. PSC-99-1068-PAA-SU and specifically, all matters related to gross-up for NFMU, correction of index rate increases previously filed and considered in Order No. PSC-99-1068-PAA-SU, and all Show Cause proceedings referenced in Order No. PSC-99-1068-PAA-SU.

b. NFMU will immediately refund \$300,000 pro rata to customers who have made gross-up payments during the fiscal years ended May 31, 1995 and May 31, 1996. To the extent monies are still owing on installment contracts, that refund will go to reduce installment payments still owed for the tax impact first, and secondly to credit any payments due for CIAC charges. This refund amount will include any interest owing and no further calculations of interest will be applicable.

c. NFMU will book to CIAC at the end of the year 2000 an additional \$300,000.

d. There will be no rate reductions or refunds related to indexes considered in Order No. PSC-99-1068-PAA-SU. However, NFMU shall forgo the indexes due to be filed no later than March 31, 2000, 2001, and 2002 in the future.

e. NFMU has already foregone two indexes in hopes of settling this case, at a value of approximately \$20,000 per year each beginning in 1997.

f. NFMU shall not file for rate relief during the period of time that indexes are being foregone under item number 5 above (up through March 31, 2002), except under circumstances where additional requirements or costs are imposed by duly authorized authorities which necessitate changes in operations, capital additions, or taxes, for which NFMU may seek recovery.

g. The Order to Show Cause proceeding against NFMU shall be dismissed without penalty to NFMU, and this Settlement Agreement shall act as a settlement without further action for all of the alleged violations of Commission Rule, Order or Statute referenced in Order No. PSC-99-1068-PAA-SU as a basis for Show Causing, or possibly Show Causing NFMU.

h. The Settlement Agreement shall be submitted to the Commission as the resolution of all disputes and matters contained in Order No. PSC-99-1068-PAA-SU and in Docket No. 971179-SU, as quickly as is practicable. The parties agree that this Settlement Agreement is made solely for the purpose of settling the instant proceeding and can not be considered as a precedent to any other proceeding.

i. The parties hereto agree that all further action in the proceedings to be held in Docket No. 971179-SU as outlined in the Commission's previously issued Orders, schedules, and discovery in this case, shall be suspended pending Commission consideration of this Settlement Agreement.

j. The provisions of this Settlement Agreement are not severable and shall become effective only after the Commission has entered an order approving the Agreement in total. In the event the Settlement is not approved in whole, without modification, the Settlement Agreement shall be deemed withdrawn and null and void, and neither party may use this attempted Settlement Agreement in this or any other proceeding. If this Settlement Agreement is not approved by the Commission, both parties are free to pursue the full range of legal remedies which otherwise would be available to them.

Staff has reviewed the proposed settlement and notes that the refund of \$300,000 is significantly higher than that first proposed by the Commission in Order No. PSC-99-1068-PAA-SU (that Order required a total of \$126,238, plus interest, in CIAC gross-up to be

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refunded). Also, staff notes that there was a question of how some expenses should be treated in regards to CIAC gross-up as opposed to price indexing and overearning (whether expenses should be above the line for price indexing and overearnings, but below the line for calculating CIAC gross-up). While not specifically reaching this point, staff notes that the utility has already forgone two price indexes and has agreed to forego three more. Further, staff notes that the utility has agreed to forego filing for rate relief through March 31, 2002, "except under circumstances where additional requirements or costs are imposed by duly authorized authorities which necessitate changes in operations, capital additions, or taxes, for which NFMU may seek recovery." Finally, NFMU has agreed to credit \$300,000 to CIAC at the end of the year 2000.

Having reviewed all the above provisions, staff believes that the Settlement Agreement provides a fair and reasonable resolution of this matter. Staff believes that the stipulation between the parties reaches a reasonable compromise and is in the public interest. Therefore, staff recommends that the Commission accept the Settlement Agreement in its entirety.

For those contributors who have paid the full amount of the original gross-up and CIAC charges, the utility should make a refund based on the contributors' pro rata share of the agreed upon total refund amount of \$300,000 for the fiscal years ended May 31, 1995 and May 31, 1996. For those contributors who are paying by installment, to the extent monies are still owing on installment contracts, that pro rata refund will first go to reduce installment payments still owed for the tax impact (CIAC gross-up), and secondly to credit any payments due for CIAC charges. If the pro rata refund is greater than the remaining installment payments for the combined CIAC gross-up charges and CIAC charges, the utility should make refunds as appropriate, and discontinue any further collections.

The refunds should be completed within 6 months of the date of the order. Within 30 days from the completion 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 completion 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. To the extent that the utility is unable to refund the full amount of the \$300,000, and upon verification by our staff, the undeliverable amount shall also be credited to CIAC. Further, on October 1,

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1996, the utility refunded \$2,753.82 it collected for the period of June 1 through June 12, 1996, and no refund is required for the fiscal year 1996 (ended May 31, 1997).

Finally, as stated above, staff believes the Settlement Agreement to be in the public interest, and recommends the show cause proceeding be closed without penalty to the utility. This will avoid the time and expense of a hearing, and the settlement is dependent upon the closing of the show cause proceeding. Staff further notes that, pursuant to the Settlement Agreement, the utility will forego five price indexes. Therefore, it appears that the Settlement Agreement takes into account that the utility may have improperly implemented three price indexes, and staff believes no further action is warranted or required.

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ISSUE 2: Should this docket be closed?

RECOMMENDATION: No, this docket should remain open so that our staff may verify that the refunds have been made and that any unclaimed refunds have been credited to the CIAC account. Upon verification that the refunds have been made, that appropriate efforts have been made to distribute the unclaimed refunds, and upon the utility having credited the unclaimed refunds to the CIAC account, the docket should be closed administratively. (JAEGER)

STAFF ANALYSIS: This docket should remain open so that our staff may verify that the refunds have been made and that any unclaimed refunds have been credited to the CIAC account. Upon verification that the refunds have been made, that appropriate efforts have been made to distribute the unclaimed refunds, and upon the utility having credited the unclaimed refunds to the CIAC account, the docket should be closed administratively.

SETTLEMENT AGREEMENT

This agreement, made and entered into this 4th day of February, 2000, by and between North Fort Myers Utility, Inc., a Florida corporation, whose business address is Post Office Box 2547, Fort Myers, Florida 33902. (hereinafter referred to as "NFMU") and the Office of Public Counsel, whose address is 111 West Madison Street, Suite 812, Tallahassee, Florida 32301-1906 (hereinafter referred to as "OPC").

WHEREAS, NFMU filed its proposed disposition of gross-up funds for the fiscal years ended May 31, 1995 and 1996 which were considered in Docket No. 971179-SU.

WHEREAS, the Florida Public Service Commission, after extensive analysis, proposed certain action in the above-referenced Docket by Proposed Agency Action Order No. PSC-99-1068-PAA-SU with regard to gross-up, previously filed indexes, and a Show Cause proceeding relative to certain related actions of the NFMU.

WHEREAS, the OPC filed a timely protest of Commission Order No. PSC-99-1068-PAA-SU.

WHEREAS, recognizing the expensive uncertainty of continuing this proceeding the parties desire to effectuate a settlement, which will affect all aspects of this case, including gross-up for NFMU, previously filed indexes, and the Show Cause proceeding.

NOW, THEREFORE, in consideration of the premises and mutual undertakings and agreements herein contained and assumed, OPC and NFMU hereby covenant and agree as follows:

1. The foregoing recitations are true and correct and incorporated herein by this reference.
2. The parties agree to support this Settlement Agreement as the final disposition of all matters covered by Order No. PSC-99-1068-PAA-SU and specifically, all matters related to gross-up for NFMU, correction of index rate increases previously filed and considered in Order No. PSC-99-1068-PAA-SU, and all Show Cause proceedings referenced in Order No. PSC-99-1068-PAA-SU.
3. NFMU will immediately refund \$300,000 pro rata to customers who have made gross-up payments during the fiscal years ended May 31, 1995 and May 31, 1996. To the extent monies are still owing on installment contracts, that refund will go to reduce installment payments still owed for the tax impact first, and secondly to credit any payments due for CIAC charges. This refund amount will include any interest owing and no further calculations of interest will be applicable.
4. NFMU will book to CIAC at the end of the year 2000 an additional \$300,000.
5. There will be no rate reductions or refunds related to indexes considered in Order No. PSC-99-1068-PAA-SU. However, NFMU shall forgo the indexes due to be filed no later than March 31, 2000, 2001, and 2002 in the future.
6. NFMU has already foregone two indexes in hopes of settling this case, at a value of approximately \$20,000 per year each beginning in 1997.

7. NFMU shall not file for rate relief during the period of time that indexes are being foregone under item number 5 above (up through March 31, 2002), except under circumstances where additional requirements or costs are imposed by duly authorized authorities which necessitate changes in operations, capital additions, or taxes, for which NFMU may seek recovery.

8. The Order to Show Cause proceeding against NFMU shall be dismissed without penalty to NFMU, and this Settlement Agreement shall act as a settlement without further action for all of the alleged violations of Commission Rule, Order, or Statute referenced in Order No. PSC-99-1068-PAA-SU as a basis for Show Causing, or possibly Show Causing NFMU.

9. The signatories have the authority to execute this agreement and to bind their respective parties.

10. The Settlement Agreement shall be submitted to the Commission as the resolution of all disputes and matters contained in Order No. PSC-99-1068-PAA-SU and in Docket No. 971179-SU, as quickly as is practicable. The parties agree that this Settlement Agreement is made solely for the purpose of settling the instant proceeding and can not be considered as a precedent to any other proceeding.

11. The parties hereto agree that all further action in the proceedings to be held in Docket No. 971179-SU as outlined in the Commission's previously issued Orders, schedules, and discovery in this case, shall be suspended pending Commission consideration of this Settlement Agreement.

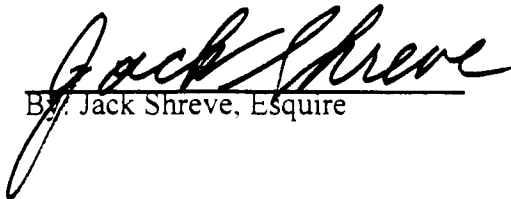
12. The provisions of this Settlement Agreement are not severable and shall become effective only after the Commission has entered an order approving the Agreement in total. In the event the Settlement is not approved in whole, without modification, the Settlement Agreement

shall be deemed withdrawn and null and void, and neither party may use this attempted Settlement Agreement in this or any other proceeding. If this Settlement Agreement is not approved by the Commission, both parties are free to pursue the full range of legal remedies which otherwise would be available to them.

NORTH FORT MYERS UTILITY, INC.

OFFICE OF PUBLIC COUNSEL


By: A.A. Reeves, III - Vice President


By: Jack Shreve, Esquire

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