

State of Florida

Commissioners:  
THOMAS M. BEARD, CHAIRMAN  
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BETTY EASLEY  
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MICHAEL WILSON



DIVISION OF WATER & SEWER  
CHARLES H. HILL, DIRECTOR  
(904) 488-8482  
**ORIGINAL FILE COPY**

Public Service Commission

April 25, 1991

Mr. B. Kenneth Gatlin  
Gatlin, Woods, Carlson & Cowdery  
1709-D Mahan Drive  
Tallahassee, FL 32308

Dear Mr. Gatlin:

Subject: Docket No. 900991-WS, Poinciana Utilities, Inc.  
Request for Authority to Continue Gross-up of CIAC

We have reviewed the above noted application. Several questions and concerns have been raised, which need to be addressed before this docket can be processed further. Each item will be addressed separately.

- ACK \_\_\_\_\_ 1. The amounts of CIAC and Advances for Construction reported on the CIAC Reports for 1987, 1988 and 1989 do not agree with CIAC and Advances for Construction reported in the Annual Reports on Schedules F-19 and F-20 for the respective years. Please provide a reconciliation of the amounts in the CIAC Reports to the Annual Reports.
- AFB \_\_\_\_\_
- APP \_\_\_\_\_
- CAF \_\_\_\_\_
- CMU \_\_\_\_\_ 2. Page 1 of the filing indicates that equity capital includes \$1,556,000 of interest free advances from Poinciana's parent that will be converted to paid-in-capital prior to the end of the year. Was this amount previously classified as "advances from associated companies" or "advances for construction"?
- CTR \_\_\_\_\_
- EAG \_\_\_\_\_
- LEG \_\_\_\_\_
- LIN \_\_\_\_\_ 3. Appendix F, Cash Forecast, reflects contributions of \$1,662,000 and \$3,891,000 for 10/90 and 12/91, respectively as sources of funds. Does these amounts include any advances for construction? If so, how much? If not, why aren't advances for construction included as a source of funds?
- OPe \_\_\_\_\_
- RCH \_\_\_\_\_
- SEC 1 \_\_\_\_\_ 4. Appendix E reflects reductions of \$233,000 and \$474,000 as reimbursement of interest. Please explain these adjustments and how the reimbursement works. Is the interest that is being reimbursed interest on outside debt or debt owed to the parent? Does the parent make interest
- WAS \_\_\_\_\_
- OTH \_\_\_\_\_

DOCUMENT NUMBER-DATE  
04007 APR 25 1991  
PSC-RECORDS/REPORTING

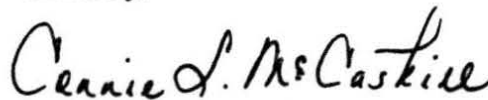
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payments for Poinciana and then Poinciana reimburses the parent?

5. Is interest on advances from parent company on Appendix D and G associated with the due from affiliates amount reflected on Page 1 of the filing?
6. Please provide copies of tax returns for the years 1987, 1988 and 1989.
7. Does the utility have any deferred taxes and ITCs? If so, why aren't these amounts reflected on the balance sheet and income statements in the utility's annual reports?
8. What is the balance of any NOLs on an above the line basis?
9. Order No. 23541 requires utilities to demonstrate the existence of an above the line tax liability. Please provide the information in Appendix D and E on a used and useful basis; i.e., all revenues and expenses that are used and useful should be reported above the line while revenues and expenses that are non used and useful should be reported below the line. The receipt of prepaid CIAC and non-used and useful property CIAC should be reported below the line. Also, please provide the used and useful calculations.

The above referenced information must be received before the application can be processed further. If you have any questions, please let me know.

Sincerely,



Connie L. McCaskill  
Regulatory Analyst Supervisor

CLM:cm

cc: Division of Records and Reporting  
Division of Financial Analysis (A. Causseaux, Salak, Hicks)  
Division of Water and Sewer (S. Causseaux)

FLORIDA PUBLIC SERVICE COMMISSION

Fletcher Building  
101 East Gaines Street  
Tallahassee, Florida 32399-0850

MEMORANDUM

AUGUST 29, 1991

TO : DIRECTOR, DIVISION OF RECORDS AND REPORTING

FROM : DIVISION OF WATER AND SEWER (MCCREILL) *OK*  
DIVISION OF LEGAL SERVICES (FEIL) *OK*  
DIVISION OF AUDIT & FINANCIAL ANALYSIS (THICKS, SALAK) *OK*  
*RHDM*

RE : UTILITY: POINCIANA UTILITIES, INC.  
DOCKET NO.: 900991-WS  
COUNTIES: OSCEOLA AND POLK  
CASE: PETITION FOR CONTINUATION OF GROSS-UP OF  
CONTRIBUTIONS-IN-AID-OF-CONSTRUCTION (CIAC)

AGENDA : SEPTEMBER 10, 1991 - PROPOSED AGENCY ACTION - PARTIES  
MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

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DOCUMENT NUMBER-DATE

00696 AUG 29 1991

FPSC-RECORDS/REPORTING

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**CASE BACKGROUND**

By Order No. 16971, issued December 18, 1986, the Commission granted approval for water and wastewater utilities to amend their service availability policies to meet the tax impact on contributions-in-aid-of-construction (CIAC) resulting from the amendment of Section 118(b) of the Internal Revenue Code. Order No. 23541, issued October 1, 1990, ordered utilities currently grossing-up CIAC to file a petition for continued authority to gross-up and also ordered that no utility may gross-up CIAC without first obtaining the approval of this Commission. Orders No. 16971 and 23541 also prescribed the accounting and regulatory treatments for the gross-up and required refunds of certain gross-up amounts collected. On December 18, 1990, pursuant to Commission Order No. 23541, Poinciana Utilities, Inc. filed its petition for continuation of CIAC tax gross-up. Upon review of the information filed, it was determined that additional clarifying or explanatory information was needed and the utility was so notified on April 25, 1991. The utility filed the additional information on May 10, 1991.

Poinciana Utilities, Inc. is a wholly-owned subsidiary of Avatar Utilities, Inc. The company is a Class B water and wastewater utility and provides water and wastewater services in its franchise area spanning adjacent areas in Osceola and Polk Counties. Based on the 1990 Annual Report on file with the commission, the utility served approximately 3,527 water and 3,391 wastewater customers at the end of December 31, 1990. Gross operating revenues were reported as \$653,532 for the water system and \$1,038,419 for the wastewater system. Net operating income was reported as \$79,604 and \$110,498 for water and wastewater, respectively.

**DISCUSSION OF ISSUES**

**ISSUE 1:** Should Poinciana Utilities, Inc. be allowed to continue to gross-up Contributions-in-aid-of-construction (CIAC) utilizing the full gross-up method?

**RECOMMENDATION:** Yes, the Commission should allow the utility to continue to gross-up CIAC using the full gross-up method. The collections of the CIAC gross-up should be made in accordance with the provisions of Orders No. 16971 and 23541. The tariffs should be approved as filed, and become effective upon the expiration of the protest period, if no timely protests are received. (MCCASKILL, HICKS, SALAK)

**STAFF ANALYSIS:** Order No. 23541 required that all utilities, that wished to collect the gross-up, file a petition for approval of the gross-up with this Commission. The order stated that each utility demonstrate that a tax liability exists and that alternate sources of funds are not available at a reasonable cost. Utilities were required to file the following information to demonstrate the need to gross-up: Demonstration of Actual Tax Liability, Cash Flow Statement (except for Class C Utilities), Statement of Interest Coverage, Statement of Alternative Financing, Justification for Gross-up, Gross-up Method Selected and Proposed Tariffs. On December 18, 1990, Poinciana Utilities, Inc. filed information which it believed demonstrated its need to continue the gross-up as previously approved. We have completed our review of the information filed, and our findings are as discussed below:

**DEMONSTRATION OF ACTUAL TAX LIABILITY:** Our review of the financial information filed by the utility indicates that Poinciana Utilities, Inc. will incur an actual above-the-line tax liability as a result of its collection of CIAC. The utility is currently in a net earnings position after years of operating losses. For the twelve month period ended October 31, 1990, the utility reflected taxable income, which included CIAC income, of \$1,108,000 and an actual above-the-line tax liability of \$417,000. Based on the projected operating results presented for the twelve month period ended December 31, 1991, the utility reflected taxable income of \$221,000 and an associated tax liability of \$83,000, excluding CIAC. When CIAC is included, taxable income is calculated to be \$3,176,000 and the associated tax liability is \$1,195,000; an increase of \$1,112,000 in the tax liability due to the taxability of CIAC. Poinciana Utilities, Inc., therefore, is projected to satisfy the Order's minimum requirement that utilities grossing up CIAC acutally have an above-the-line tax liability.

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**CASH FLOW STATEMENT:** Projected cash flow statements were presented for the periods ended October 1990 and projected December 1991. The purpose of the cash flow statement is to demonstrate whether liquid funds are available to pay taxes on CIAC. The utility states that it does not have adequate cash flow to pay income taxes on contributions-in-aid-of-construction and construction advances on its own, due to the company's low customer base versus its high value of plant in service. The cash flow statements reflect a net cash deficit for both periods. Sources of funds are reflected as \$1,923,000 and \$4,205,000 for October 1990 and December 1991, respectively. The cash receipts or sources of funds are primarily from advances-in-aid-of-construction from Avatar Properties. The utility stated that because the company has not had the financial resources to construct the utility systems, its basic program is to have the developer finance the cost through contributions or advances-for-construction. These amounts are \$1,662,000 (86.43%) for October 1990 and \$3,891,000 (92.53%) for December 1991 of the total sources of funds provided. The application or uses of funds totalled \$2,712,000 for October 1990 and \$6,153,000 for December 1991. These amounts are primarily for construction and refund of advances. Advances are repaid with contributions from future customers. With construction and refund of advances of \$2,712,000 and \$6,153,000 the net cash deficit is \$789,000 and \$1,948,000, excluding payment of taxes, for October 1990 and December 1991, respectively. When the payment of taxes are included, the net cash deficit is \$1,206,000 for the period ended October 1990 and \$3,143,000 for December 1991.

The tax liability on the CIAC income exceeds the sources of funds generated from operations; therefore, it appears that although operations provide a limited source of capital, adequate sources of funds are not available from operations to fully fund the taxes on CIAC. Further, the utility reported a net cash deficit for the periods ended October 1990 and December 1991; therefore, liquid funds are not available to fund taxes on CIAC.

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

Based on the data submitted for the utility, the company does not meet the standard established in Order No. 23541. At October 1990 the TIE ratio was 1.75. At December 1991, the TIE ratio is



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projected to be 1.47. For both periods, the TIE is slightly below the threshold of 2.00 established in Order No. 23541.

**STATEMENT OF ALTERNATIVE FINANCING:** The utility stated that sources of financing by the company to pay taxes as an alternative to grossing up CIAC are not available. The utility stated that because the company has not had the financial resources to construct the utility systems, its basic program is to have the developer finance the cost through contributions or advances for construction.

The financial information submitted by the utility indicates that the utility's TIE ratio is below the threshold of 2x, established in Order No. 23541. This may affect its ability to borrow money in the financial market at a reasonable cost. In addition, the utility has a net cash deficit in its cash flows which indicates that the utility does not have liquid funds. Finally, the utility has a deficit in its retained earnings. This may impair the utility's ability to borrow money in the financial market at a reasonable cost due to the lack of internally generated funds. Based on the foregoing, it appears that sources of financing by the company to pay taxes as an alternative to grossing up CIAC may not be available.

**JUSTIFICATION FOR THE GROSS-UP:** The utility states that Poinciana Utilities, Inc. does not have adequate cash flow to pay income taxes on CIAC and construction advances on its own. Further, the utility states that for the year 1991, Poinciana Utilities, Inc.'s projected cash forecast includes approximately \$2,000,000 in cash advances from affiliates to fund construction plus \$474,000 to pay interest on debt. In addition, it stated that \$900,000 is projected as taxes on gross-up from customers and affiliates to pay the income taxes on contributions and construction advances, and that cash projections for 1992 result in similar cash funding requirements to cover required cash disbursements. Therefore, Poinciana Utilities, Inc. believes it needs to continue grossing up and collecting income taxes on CIAC and construction advances from developers and other contributors to meet its cash outflow requirements.

Our review of the information filed by the utility indicates that the utility will incur an actual above-the-line tax liability as a result of its collection of CIAC. The information also indicates that the utility has a net deficit in its cash flows for 1990 and 1991. Therefore, liquid funds are not available to finance the taxes on CIAC. The utility also stated that sources of financing by the utility as an alternative to grossing up, are not available. Further, the company's TIE ratio is below the threshold

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of 2x as established in Order No. 23541. As a result of the above, there appears to be justification for this utility to continue to gross-up CIAC.

**GROSS-UP METHOD SELECTED:** The utility stated that it selected the full gross-up method versus the net present value method due to its cash position. The utility stated that because the company has not had the financial resources to construct the utility's systems, its basic program is to have the developer finance the cost of construction of the utility systems through contributions or advances for construction. Therefore, the full gross-up method was selected because it provides more cash flow presently which the company needs to fund CIAC taxes, due to its cash position.

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

**OTHER CONSIDERATIONS:** A review of Poinciana's 1990 Annual Report indicates that the utility's achieved overall rate of return was 4.97% for the water system and 2.57% for the wastewater system. Neither return is compensatory in light of the 11.58% return authorized in Docket No. 881503-WS, Order No. 22166, issued November 9, 1989. In that docket, the utility was authorized a 13.95% return on equity with a range of plus or minus one percent. Currently, the utility is earning below the low end of the range of reasonableness. For 1990, the utility's achieved return on equity was (8.84%) for the water system and (18.57%) for the wastewater system. When these factors are considered, staff does not believe it is in the interest of either the utility or the ratepayers to increase a NOI deficiency.

In consideration of the above, Staff recommends that Poinciana Utilities, Inc. be allowed to continue the gross-up of CIAC utilizing the full gross-up method. Further, Orders No. 16971 and 23541 prescribed the accounting and regulatory treatments and record keeping for the gross-up, and required refunds of certain gross-up amounts collected. Staff recommends that the CIAC collections be made in accordance with those Orders and that all matters discussed in the body of those Orders are expressly incorporated herein by reference.

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ISSUE 2: Should the docket be closed?

RECOMMENDATION: Yes, if no protests are received, the docket should be closed upon expiration of the protest period.  
(MCCASKILL)

STAFF ANALYSIS: Upon the expiration of the protest period, if no protests have been received, the docket should be closed.