Public Service Commission

State of Florida

-M-E-M-O-R-A-N-D-U-M-

DATE: December 7, 1995

TO: Blanco Bayó, Director, Records and Reporting

FROM: Joy Kelly, Chief, Bureau of Reporting

RE: UNDOCKETED WORKSHOP

IN RE: WORKSHOP ON GROSS-UP OF CONTRIBUTION IN AID OF CONSTRUCTION, HELD 11-29-95

DOCUMENT NOS. 12208, 12-7-95

The transcript for the above-described hearing has been completed and is forwarded for placement in the docket file, including attachments.

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NONE

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NONE

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Public Service Commission

Docket #

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DOCKET NO. 950020 - PU

W.S.
~~HEARING~~ TRANSCRIPT DATED: 11-29-95

BEGINNING DOC. # 12208-95 VOL. # —

ENDING DOC. # VOL. #

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

RE: UNDOCKETED

WORKSHOP ON GROSS-UP OF

CONTRIBUTIONS IN AID OF CONSTRUCTION

TAKEN AT THE INSTANCE OF: Florida Public Service Commission

DATE: Wednesday, November 29, 1995

TIME: Commenced at 1:00 p.m. Concluded at 3:15 p.m.

PLACE: 4075 Esplanade Way, Room 148 Tallahassee, Florida

REPORTED BY: JANE FAUROT Notary Public in and for the State of Florida at Large

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COMMISSIONER DIANE K. KIESLING

Ralph Jaeger, Esquire
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Beth Salek
Connie McCaskill
Bill Lowe
Marty Deterding, Esquire
Robert Nixon
Jim Moore
Bob Gordon
Kenneth Gatlin
Paul Freeman

P R O C E E D I N G S

CHAIRMAN CLARK: This is the workshop on gross-up of contributions in aid of construction, and I understand there has been a notice issued for this workshop. Will you go ahead and read that notice.

MR. JAEGER: Yes, Commissioner Clark. Pursuant to notice issued November 2nd, 1995, this time and place has been designated for a Commission workshop on the gross-up of contributions in aid of construction, CIAC.

CHAIRMAN CLARK: Okay. I don't think we need to take appearances, but maybe it would be appropriate to sort of go around and everybody introduce themselves, starting with the Staff.

MR. JAEGER: I'm Staff Counsel, Ralph Jaeger.

MS. CAUSSEAUX: Anne Causseaux, Auditing and Financial Analysis.

MS. SALAK: Beth Salak, Auditing and Financial Analysis.

MS. McCASKILL: Connie McCaskill, Division of Water and Wastewater.

MR. LOWE: Bill Lowe, Division of Water and Wastewater.

MR. DETERDING: Marty Deterding, Rose, Sundstrom and Bentley, here on behalf of the Florida Waterworks

Association and several of the affected utilities utilizing gross-up.

MR. NIXON: Robert Nixon, I'm a CPA from Clearwater, I'm appearing on behalf of the Florida Waterworks Association and 14 other utility clients.

MR. MOORE: My name is Jim Moore, I am President of Gulf Utility and President of the Florida Waterworks Association.

MR. GORDON: I'm Bob Gordon, and I am CEO of Avitar (phonetic) Utilities. Florida Cities and Poinciana Utilities are subsidiaries of that company.

MR. GATLIN: I'm Kenneth Gatlin, I'm an attorney for Florida Cities Water Company and Poinciana Utilities.

MR. FREEMAN: I'm Paul Freeman, Vice President, Southwest Florida Capital Corporation, representing our company.

CHAIRMAN CLARK: Okay. On my agenda we have the next item being a Staff historical perspective.

MS. SALAK: Yes, ma'am. It's Staff's attempt that we will give a sort presentation discussing selected orders. You have that sitting on your bench. And then Mr. Lowe will move into discussing some of the problems we have encountered with the gross-up on CIAC.

As you're probably aware, the gross-up of CIAC came about because of the change in tax laws effective 1/1/87, contributions in aid of construction were no longer considered nontaxable. As a result, as early as May of '86, the Commission started to try to find a solution to any problems that may be encountered by that.

We found as early as Order Number 16120, the Commission allowed utilities to file tariffs that were suggesting different methods of coping with the possible repeal of the Section 118(b), which is the one that allowed the nontaxability of CIAC. Those tariffs were going to be reviewed on a case-by-case basis. By July of '86, the Commission authorized contingency clauses and developer agreements. Basically, the developer could be required to pay additional sums for service availability in case there actually was a change in the tax law where CIAC became nontaxable. We feel the section created a situation that justified an increase for that utility. And, third, the Commission would make the determination of the amount of the additional payment to be made.

In December of '86, the Florida Waterworks Association filed an emergency petition, and that was granted for the application for emergency approval of amended service availability policies. We did have some modifications to that. Basically, that order allowed utilities to collect from contributors an amount equal to the tax impact of CIAC; it set out a simple gross-up formula, it required the filing of annual CIAC tax impact reports; it required the refund of any excess monies collected; and it also had a requirement for an escrow account that would accrue interest.

That was in effect and not modified until approximately 1987, when Palm Coast came in and asked for modification to the gross-up formula. They asked to use what is known as the net present value formula, where you take into account the benefits of the depreciation that will be received on the tax return on the contributions. That was granted to them. They are still the only company that I am aware of that are using the present net value formula. Everyone else is using the full gross-up formula. In addition, Palm Coast also got a waiver of the escrow requirement agreement, since it was an affiliate, ITT, that was paying the gross-up.

In October of '87, an order stating that sole proprietorships, partnerships, and S corporations may not gross-up went out that was reiterating what I believe was the Commission's policy to never allow income taxes for those companies.

By 1989, it was clear that some points needed to be clarified or embellished upon, so the Staff of the Commission issued a PAA order. Basically, the Order 21266 indicated that you could retain the gross-up, but it would be a limited option. You needed preapproval to gross-up; that you would have to show an actual tax liability exists, that cash flow was inadequate, that you would check into alternatives and have found that the gross-up was the most cost-effective alternative. You had to show your interest coverage, and you had to file tariffs. That was protested by the Florida Waterworks Association, which led into a hearing that culminated in Order 23541, which was issued October of 1990.

Again, the approval had to be obtained to continue gross-up; there was a filing that had to be made; and you have probably seen it in many of our recommendations where we filed the items that have to be filed where you have to show a demonstration of a tax liability, a cash flow statement, a statement of interest coverage, a statement of alternative financing that you have tried other alternatives. You have to show a general justification for the gross-up; why you made to it, why management believes that's the best alternative, the gross-up method selected, and as I indicated earlier, everyone has the full gross-up except Palm Coast, and also your proposed tariffs. I would point out that to date with the refiling, we have only had one company that has been denied, and it was indicated that they could try again. But everyone else has been approved under these criteria.

In that same order there were several other things indicated. The companies that do not gross-up, the investment in taxes will be included as investment and will earn a return in their formula. NOLs, investment net operating losses, and investment tax credits used in determining how much the refunds will be would be on an above-the-line basis, so we would have a calculation between how much of it applied to above-the-line operations and how much of it applied to below-the-line operations. Normalization would be required, and the tax depreciation benefits should be passed back to the ratepayers. As I mentioned, refunds are still required under that order.

As Mr. Lowe will tell you, that's where many of our problems are arising. We have approximately, I think, 25 utilities that are still authorized to gross-up. We have over 20 companies that we need to address their refunds. Some of those go back as far as

1987. Many of them are multiple years, and as Mr. Lowe will address, that is part of the reason for the gross-up workshop today. After what I call -- most of the requirements of Order Number 23541 are still in place.

After that order, in February of '91, there was an order that was issued that reiterated that annual reports had to be filed, and it also established a filing deadlines that companies could go back and restate their reports that they had filed '87 through '90 to look at NOLs and ITCs on an above-the-line basis. There have been some minor modifications to the gross-up formula since that date, but, in general, as I stated, the order that came out, 23541 requirements are basically those in effect today.

Now, I will ask Mr. Lowe to discuss the problems we have been facing.

MR. LOWE: Commissioners, the gross-up problem, as far as Staff sees it, or as my division sees it, is that there are -- I have got three or four people in my division that do literally nothing but these things. They do some other related duties, and it just seems an unnecessary waste of resources. They have become little mini-rate cases for ever year's worth that are there. As Ms. Salak said, some of them go back to

1987, and there are 25 of them that are grossing up. Some of them have seven open years which have become seven little mini-rate cases. They keep compounding, they keep requiring more and more time. The money that's involved in the refunds, or the amount of money that is subject to refund is now becoming material. That's kind of an incidental item, but the companies are now becoming -- it has become enough money they are willing to fight for it, so they fight harder for it. But I think the major problem that I see, and one that we are going to be facing here coming up in some of these is that the regulatory commission expense, the expense of hiring the consultants to come up here and do battle with Staff, or Public Counsel, or whoever, is increasing, and has been increasing dramatically. And those costs are going to be passed on to somebody at some point in the g me, and that really concerns me.

As far as the problems within the process, we have been through, and the Commission has voted on the effects of first year depreciation on the CIAC and the net operating losses. The companies are still not satisfied with those particular items. We are personally concerned that on the net operating losses we may be double-dipping the companies. If we are doing it in a rate case expense and reducing their income taxes before those NOLs, we may be getting them again when we hit them on the CIAC.

The companies have proposed all kinds of used and useful adjustments. They were very difficult in a very limited proceeding for us to be anywhere near accurate, when you are dealing with something as complex as used and useful is in this industry. They file them constantly on all of these open years. They make many other smaller adjustments when they make the filings that we have to go through and spend an inordinate amount of time on.

And I guess the last concern that most of the Staff has is who are the companies refunding to? You've got a customer contribution that in a lot of instances a developer or a builder has paid that contribution. You would assume that the homeowner paid -- or I guess you could make the assumption that the homeowner, the ultimate customer, paid that contribution. But when we make those refunds back, we make them back to whoever paid them, and that concerns a lot of the Staff. Those, I think, are the major problems. In other words, the amount of time that we are spending on these, the compounding of them, and then the just skillions of little adjustments that are being made to them that we are having to analyze and try to figure out what to do with.

CHAIRMAN CLARK: Ms. Salak, have we finished Staff's historical perspective?

MS. SALAK: Yes, I believe we have, and are ready to move into the industry comments.

CHAIRMAN CLARK: Mr. Deterding.

MR. DETERDING: Commissioners, in response to Staff opening this informal proceeding and the Staff workshop, we appeared on behalf of the Waterworks Association and several affected companies last -- I believe it was August, and went away from that meeting trying to find a method that would simplify this process and also ensure that the utility and the ratepayers are adequately protected, and make it easier for everybody to understand gross-up and accounting for it.

The problems arose, I believe, as Mr. Lowe said, in major part with the attempts to segregate between above-the-line and below-the-line expenses and revenues, and that's where most of the arguments and discussions have occurred in trying to determine the appropriate refunds. We have proposed a solution that I handed to you dated October 5th, 1995. I believe it's also in your packet. Basically, we are trying to both simplify the process and to ensure that it's easy to track the monies and what has happened to them, and to ensure that the proper person gets the benefit of whatever depreciation benefits there are resulting. As a starting off point, you need to recognize that there is a tax impact of every dollar of CIAC gross-up collected. It is income per the IRS, and, therefore, in one way or another it has a tax impact to that utility company. What we have proposed to do is to simply amortize all of those benefits back to the general body of ratepayers on a regular amortization schedule, so that the customers will in the end receive -- over the life of those assets receive all of the tax benefits back to them in the form of revenue. I will let Mr. Nixon get a little more into the detail of that, but this is based on the Commission's conclusion which has been repeated throughout the orders that have discussed the issue, that while a developer may contribute the initial gross-up, that ultimately the costs are passed through to the general body of ratepayers, and that, in effect, the ratepayers are the contributors of gross-up monies.

The current system analyzing above and below-the-line attempts to segregate those costs, those monies that should go to the contributor, back to the contributor as a result of one snapshot of one year of tax impact. Gross-up and the related CIAC has a long-term effect, and, therefore, any one year is bound to give you varied results depending upon the other circumstances that come into play.

So what we have attempted to do is something that you can track in an annual report without a yearly reporting, because it is a flat amortization. Because all the benefits will flow back to the general body of ratepayers in the form of an additional revenue, that amortization is treated as a revenue item, it will be easy to see whether or not the appropriate amount is being amortized, it will be easy to track the additions and the amount amortized on those, and it will be easy to account for in the form of whether or not that or that in combination with all other factors are causing the company to overearn. In effect, what you will get is a pass-through of al benefits back to the general body of ratepayers, unlike the current situation that at least initially passes a significant portion of those benefits back to the contributor who originally put up the cash. I would like Mr. Nixon to give just a general outline of that proposal with a little bit more detail than I have offered.

CHAIRMAN CLARK: Go ahead, Mr. Nixon.

MR. NIXON: Just to repeat briefly what Marty said, our proposal is based on the Commission's previous finding that the ratepayer and the contributor are ultimately the same person. Our proposal, then, recognizes that previous finding and says we want to give 100 percent of the gross-up back to the general body of ratepayers. Under this proposal it would greatly simplify and eliminate the reporting requirements. No refunds would be made back to contributors, there would be no need to keep gross-up in an escrow account, and we believe that under this scenario there would be no reason that you should not liberally grant gross-up authority to companies requesting it that otherwise qualify.

To achieve this, we are proposing a method of accounting which does the following: Whatever gross-up amounts are collected in a given year are amortized back to above-the-l ne income, and this would be shown as a separate line item in the annual report. I can tell you that for many of my clients that amortization number would be a very large number and would probably continue to build over a period of 20 to 40 years depending upon the life of the asset.

As this income is reported on an above-the-line basis, the company at some point is going to have to reduce its revenue requirement, because they are going to be overearning, and the intent of this proposal is to reduce the revenue requirements of the utility and give the benefit directly back to the ratepayers. I have an illustrative assumption, which I won't go through all the details with you now, but I have presented -- if you look on Pages 1 and 2 of the handout -- I have shown the effect of our proposal on an income statement assuming that the company received $500,000 of depreciable CIAC. And I presented the income statement at the end of year one and at the end of year 40. As you can see, there is no effect on the income statement, so there would not be an effect on the cost of service both in a negative way or a positive way at the end of the 40-year period. There would be, however, probably revenue reductions during those intervening years. There is no effect on the rate base. There is no material effect on the balance sheet.

The positive feature of this program, again, is that 100 percent of the gross-up is passed through back to the ratepayer who ultimately is the contributor. We believe that this proposal is something you should consider carefully, that it is in the benefit of both the company and the utility. The customer gets the benefits of gross-up returned to him, in exchange for that, the company is realized an equal benefit through the tax depreciation on the contributed assets. That's all I have.

COMMISSIONER DEASON: Let me ask a question. Your example is assuming a 20-year tax life on the assets?

MR. NIXON: Yes, sir.

COMMISSIONER DEASON: But you're amortizing it over 40 years, basically for ratemaking purposes?

MR. NIXON: Well, for book purposes, yes.

COMMISSIONER DEASON: Why that difference?

MR. NIXON: Simply because the 40 years is closer to the rates prescribed by the Commission per your depreciation rule for book purposes. There is going to be a difference in depreciation rates for both book and tax. On the books we'll be depreciating the contributed assets over the recommended useful lives per your depreciation rule, but for tax purposes we are allowed to use an accelerated form of depreciation on the tax return.

COMMISSIONER DEASON: But the basis for your proposal, other than simplifying it, is to get the benefits back to the contributors which are ultimately the ratepayers?

MR. NIXON: Yes.

COMMISSIONER DEASON: And these benefits, which as

I understand, primarily take the form of depreciation expense on these assets, these contributed assets, which are allowed under the new IRS provisions, that those benefits are going to accrue over the 20-year period, which is the taxable life of those assets, am I looking at that correctly?

MR. NIXON: Yes. The utility would get the benefit of the depreciation on its tax return over 20 years. That is, I think, the generally prescribed tax life that a company would have to use on its tax return for book purposes. And generally accepted accounting principles, you have to use a depreciation rate that more closely resembles the estimated useful life of the asset. So there is a difference between the tax life and the book life of the assets. However, those differences are accounted for with deferred income taxes. And part of our proposal would be that in the event the company is in for a rate case, those deferred tax liabilities resulting from these contributed assets would be included in the company's capital structure at zero cost.

MR. DETERDING: One of the problems we have experienced with this whole gross-up thing is the attempts to -- on the one hand, you're looking at tax, on the other hand you're looking at book, and you're trying to put the two together, and it's next to impossible. I think with this proposal the one thing that's left is simply what you're talking about, the difference in depreciation lives which will be accounted for completely through a deferred tax zero cost capital item. So, that benefit, as well, that timing difference benefit is also accounted for under our proposal.

COMMISSIONER DEASON: Well, I thought -- I mean, I thought I heard Mr. Nixon, or maybe it was you say there was not going to be any balance sheet effects of the proposal. And it seems to me that if you are going to account for this difference, it's going to have a balance sheet effect.

MR. DETERDING: Well, you do have to accrue a deferred tax, that is correct. You are correct. That would be an effect of this proposal. But I think you have got some deferred taxes currently as a result of gross-up, as well. So, that is the simplest approach to meld this combined book and tax situation. And I think this is by far the simplest approach that could be arrived at, and it also is one, I think, that meets what I believe to be the Commission's desire to make sure the benefits of gross-up, the tax benefits of gross-up, the depreciation, all those benefits are passed back to somebody. I mean, I think the intent was that they be passed back to the person who ultimately paid the cost of that gross-up, and based upon the Commission's finding that the customers ultimately do pay that, those will all flow back to the general body of ratepayers.

MR. NIXON: Commissioner, when I mentioned there was no balance sheet impact, just to clarify that, the intent of that statement was to show that there is no impact on the retained earnings to the company. You are going to have an impact on deferred tax assets and liabilities, but it's not an impact on the balance sheet that is to the benefit of the company. The benefit to the company will only occur through depreciation taken on its tax return.

COMMISSIONER DEASON: Thank you.

MS. McCASKILL: Commissioners, regarding the utility's proposal, I have reviewed it, and basically overall to a degree I can agree with it. I think what is not addressed, they indicate in their proposal that there will be no refund, that would assume that we always look -- that we look at CIAC in isolation; it's always going to be a taxable event.

Order 23541 stated that to the extent the utility has a tax liability, it will collect the gross-up. So if there is no tax liability, there will be a refund. So at issue would be if we believe that we should be talking about the utility tax liability or the tax effect of CIAC, because CIAC is a taxable event, it will always have a tax effect, but there won't necessarily always be a tax liability. Order 23541 indicated that we would not look at CIAC in isolation, so that is an issue, also. Are we just going to look at it by itself and say it is a taxable event, you collect it, or are we going to look at it with everything else. And that has to be resolved. Although, I must agree with the utility that these general entries does simplify things as far as the accounting, but we do not to address the issue of whether or not we are talking about the tax liability or the tax effect of the CIAC.

CHAIRMAN CLARK: Let me ask you a question along those lines. When they come in and ask for the gross-up, they are indicating that it will have a tax effect for them.

MS. McCASKILL: Right. They they are supposed to demonstrate to us that they will have a tax liability as a result of collecting the CIAC.

CHAIRMAN CLARK: Well, I thought you said -- maybe I'm wrong -- I thought you said it always creates a tax liability when you take it.

MS. McCASKILL: No. It will always have a tax effect, but it may not necessarily create a tax liability.

CHAIRMAN CLARK: All right. You're saying it's a taxable event, and whether or not you pay taxes depends on what else is in your income statement.

MS. McCASKILL: Right.

CHAIRMAN CLARK: Okay. Now, are you suggesting that on the front end we still make an assessment as to whether or not they will, in fact, have an effect, a liability such that they have to pay taxes, and once they do, we would allow the gross-up. But then on the back end we may allow them to amortize it rather than giving a refund?

MS. McCASKILL: Right. What I'm saying is that on the front end we need to determine if we're talking about a tax liability or a tax effect. If we're talking about the tax effect, there would never be a refund, because --

CHAIRMAN CLARK: Okay. I see what you're saying.

MR. DETERDING: Commissioners, on that point, a point I think I made earlier, and I just wanted to reiterate, as Connie was saying, there is a tax effect, and in the long run there is a tax consequence of CIAC always. If you have got -- what we are currently doing is looking at above-the-line tax benefits. You have got NOLs, that often has been a basis for proposing a refund, above-the-line NOLs. Well, if you use --

CHAIRMAN CLARK: Net operating losses, is that what you're talking about?

MR. DETERDING: Yes. Net operating losses, carry forwards; current or carry forwards.

CHAIRMAN CLARK: You have to remember that I'm not an accountant.

MR. DETERDING: I'm sorry. Those tax benefits, those assets that you have to use to offset the income tax that would otherwise accrue on that CIAC. If you use them now to offset this CIAC, then you do not have those available in the future to offset incomes taxes from general revenues. So, in the long run, all CIACs are going to the detriment of the utility, and, therefore, its ratepayers cause a tax effect. And that's why our proposal is to just give all -- that the Commission should liberally grant gross-up, and I want to do as an aside note that I know of, the only two companies I'm aware of who have asked for gross-up I have been involved in in the last year, one has been denied and one has been proposed to be denied. So I do believe it has become more strict, and I believe that under our proposal there wouldn't be a need to worry about that, because all benefits would accrue to the general body of ratepayers.

If a company felt the need to gross-up, any benefits that accrued as a result of that would flow back to the general body of ratepayers. And for the most part there are timing differences in any case because after you get all those depreciation benefits out, it's really just a timing question. So, our proposal, I think, simplified it not only in the reporting, but ensuring that all benefits flow back and also in ensuring that if a company requests gross-up, the only people who are going to benefit from that is the general body of ratepayers by getting that tax liability resulting from CIAC paid by the cost causer, the original contributor.

MS. SALAK: I just wanted to add one comment to what Marty said, and just a clarification point. No matter what we do with gross-up, whether we allow it or don't allow it, the mere fact that CIAC is taxable is going to use up your net operating losses, it's going to use up your -- if you have any investment tax credits or carry forwards, they are going to be used up. So, if you have CIAC and it's taxable, there will not be as many net operating losses available to be used to offset revenue requirements, no matter what we do here today.

MR. DETERDING: But if you have gross-up, and you amortize it back, as in our proposal, then there is the benefit of that, the tax benefit of that depreciation on contributions now allowed under the code to flow back to the general body of ratepayers.

COMMISSIONER DEASON: What's wrong with that proposal, Staff? I know it is inconsistent with prior Commission policy, that being that there needs to be establishment or a showing that there is an actual tax liability. And, of course, that takes into consideration the net operating losses and whatever else may affect a particular tax payment situation. But if under the proposal the general body of ratepayers are going to be, in effect, made whole, and it's just a question of timing, what is the problem in that?

MR. LOWE: Commissioner Deason, I have no problem at all with it.

MS. McCASKILL: Right.

COMMISSIONER DEASON: You agree it does simplify the approach or not?

MR. LOWE: I think it does simplify it tremendously. But I guess the only flaw I see in it is that to me it would be onward looking unless the utilities are proposing to somehow or another retroactively apply it to all of these we have still got open, which somewhere along the line we still have to resolve the 25 companies, and in some cases seven open years worth.

COMMISSIONER DEASON: You're talking about pending refunds?

MR. LOWE: Pending refunds, yes, sir. But, as far as, you know, the proposal here, I have not reviewed it in depth, but it looks very similar to some of the ideas that I proposed at the Staff workshop that we had earlier.

COMMISSIONER DEASON: So, you're saying that if the issue of pending refunds can be resolved one way or the other that it would simplify it on a going forward basis?

MR. LOWE: Oh, yes, sir. I think it would be make life easier for everybody. And I think it would resolve that problem of who gets the refund.

MS. McCASKILL: And, Commissioner Deason, while to me this would simplify everything, I think the important thing to me is for Staff to decide, though, or the Commission to decide is this the appropriate thing to do. I know it will pass back all the benefits back to the ratepayer, but it's perhaps that some of this shouldn't have been collected anyway. We are not talking about small amounts of gross-up, so to the extent that we are going to allow a utility to impose these costs on a contributor, I think we need to be satisfied that we are doing the appropriate thing, and allowing them to collect what they need and no more. Because we are talking about large sums of money.

COMMISSIONER DEASON: And I don't disagree with you, but I think it is true, though, that when you say "don't need," that means that there may not actually be the need to actually write a check out to the IRS for that year, but to be in that situation you're using up other tax benefits, namely the NOLs. And there is an economic cost of using up those NOLs in the current period.

MS. McCASKILL: I agree with that totally. But even in the utility's itself, it showed that it collected $301,667 in gross-up, yet the actual tax expense is 294,612. Now, that's a small difference. But I guess my point is, you know, we want to make sure we are doing the appropriate thing, and they are collecting the appropriate amount.

COMMISSIONER DEASON: And, I agree, that difference is large, and that's why I was asking the questions about the difference between the amortization periods, because if there is going to be actual dollars collected in excess of what is necessary to pay, I wanted to make sure that time value of that was adequately accounted for, and that was the reason I was concerned about the difference between the tax year for depreciation and their proposed amortization based upon a book life. And it may need to have some extra monitoring to make sure the deferred taxes are appropriately accounted for, and that there is not a hidden benefit to the company, that it is, in reality, a simplification which keeps the company whole, but does not benefit them, and that the ratepayers as a whole are, indeed, made whole.

MS. McCASKILL: Right.

MR. LOWE: And, Commissioner Deason, I guess the major concern that I saw in what they proposed, and Mr. Deterding also repeated it, was that applications to gross-up should be liberally granted. I don't know that we have ever liberally granted anything, and I don't know that we need to set that precedence in anything. I think that if we set out what the rules of the game are up front, then everybody can follow those. There are too many -- nuances, I guess, is the word I'm looking for -- even down to as simple as to what tax rate you are going to use, because some of the companies are not in the maximum tax brackets, and never would be, because of the size of the utility. So, therefore, there is some need for review and proof up front in all cases.

MS. SALAK: And I think along that same line is that keeping in mind that every time we have a gross-up we are creating a tax on a tax, and that we have actually creating more of a tax burden than there was originally. So, I think that you do have to weigh carefully before you actually allow the gross-up.

MR. NIXON: I don't think we are proposing any change, Commissioners, in the preapproval process. I think what we are saying when we asked that an application be liberally granted, is that you don't hold the company to trying to project out for five or fifteen years to make sure that you have no question whatsoever that the company may not actually write a check to pay for the tax. I think what we're saying is that if you can demonstrate that you have a tax liability on an above-the-line basis, and show a reasonable projection of the amount of CIAC you expect to collect, and you demonstrate the cash flow need, and the unavailability of other resources, and the times interest earned ratio, the same criteria we have now, it wouldn't be a problem. I think what we are seeing is we are seeing applications where companies meet all your criteria, except Staff wonders whether three or four years down the road we are actually going to be writing a check for the tax. And I think that's where we are hung up. And I think in those cases gross-up authority should be granted liberally, given that the company has met all the other criteria.

MR. DETERDING: If you're going to continue to focus on whether or not they write a check, then I think that ignores the tax benefit that you are otherwise giving up when you do not gross-up and you do collect CIAC. If you don't pay cash to the IRS, then you reduce the available tax assets to utilize to moderate the level of rates by keeping your actual tax liability from operations down.

So, that's why between that fact and the fact that all benefits flow back to the general body of ratepayers, which the Commission has already determined in several proceedings, including First District Court of Appeal proceedings, are ultimately paid by the general body of ratepayers, and if you flow all of these costs back -- all of these benefits back to them, then there should be no need for as much scrutiny as has been recently given to the granting of gross-up authority. Because if you recognize that you're going to lose some tax assets, some benefit by collecting CIAC, then you should want a company to gross-up, because that way it will eliminate the possibility or reduce the possibility that rates will be driven upward by the investment in that tax.

COMMISSIONER DEASON: Well, I think this brings me to my next question. In those situations, where for whatever reason the Commission decides to deny the gross-up authority and CIAC is collected, and it is taxable, there is an effect on the company, and that would be that there would be negative deferred taxes as a result. And that negatively impacts the general body of ratepayers, does it not?

MR. DETERDING: Absolutely.

COMMISSIONER DEASON: So there is two sides to that coin. In trying to reach a reasonable ground, we have got to be cognizant of both, and that if we are overzealous in denying gross-up, that has its negative implications, as well.

MR. DETERDING: Absolutely.

MR. MOORE: Commissioner, for the record, my name is Jim Moore, and I'm President of the Florida Waterworks Association, which is the industry association. I think one thing that maybe the wordsmithing of liberally grant, what we are trying to get at is predictability from an industry point of view.

In the context of how we fund our industry with our lenders and in the attempt to raise capital in an industry that historically is under-capitalized, I can't emphasize enough in dealing with outsiders it is necessary for them to be able to understand with some certainty what we can expect in the way of tax liability attendant to the treatment of CIAC by the Commission. So, I think what we were searching for here is predictability in the administration of this. We are not looking for a free lunch or something that is not equitable. So, that's our hope as an industry.

CHAIRMAN CLARK: Mr. Moore, did you want to add anything else at this point to the presentation?

MR. MOORE: No. Only as an overview, I might say that, you know, I see this as a win/win situation. There are simplification, there is absolutely benefit to the customers of the utilities who are the ones that should benefit from this. And from the utilities' point of view, I can tell you that most companies in the industry are small, and the reduced cost of compliance, and administration, and reporting would be viewed by our industry truly as a windfall. This is very difficult, and very difficult to be done by people on the payroll of the utilities without hiring outside consultants. In fact, it's impossible to file the reports as it exists today. So, we are very hopeful that we can find common ground to move forward, and we think this works for everybody. We think it's even-handed, and hopefully you will, too.

CHAIRMAN CLARK: Are there any more comments from the industry?

MR. GORDON: I would like to make a few comments. From our perspective, we follow pretty closely along the line, if not directly along the line with the industry as presented. I represent two companies; Florida Cities Water Company, which pays the gross-up, and Poinciana Utilities, which collects the gross-up. We have presented to you a summary of -- and I have a brief summary of our proposal which, again, follows, and I would just like to read these six points. And they are -- and I think it simplifies the whole CIAC issue. And the first is that CIAC creates a taxable event. I think everybody agrees with that. The utility should be allowed to collect the tax in the form of a CIAC gross-up. CIAC gross-up should be calculated without consideration of first year depreciation. CIAC gross-up should be treated in a manner similar to a service availability charge, and not be subject to refund. Excess CIAC gross-up taxes only result from changes in tax rates. The concept of above-the-line and below-the-line transactions and the effect of net operating losses is eliminated when the position that tax creates -- CIAC creates a taxable event is adopted. When CIAC gross-up is allowed to be collected, service rates should be designed to return the collection of that tax to the ratepayers, which we do today in Poinciana Utilities. Annual reporting and an unwieldy verification process for both the utilities and the FPSC will be greatly simplified if these points are considered.

As to the payment of the taxes by Florida Cities Water Company, that has become a disaster. And it has become a disaster because the company has had to use its equity funds to pay those taxes. Its lenders are not going to lend us money to pay taxes. Because when a lender lends you money, he wants to see the source of that money being able to earn the cost of the money and a way of funding that to be repaid. We have run into this situation, and we undoubtedly will be coming before the Commission to seek to have the CIAC gross-up allowed by Florida Cities Water Company.

As far as the comments relating to the liability for taxes, we are now -- the problem that is created is you are taking two types of income and putting them together. You're taking operating income, which income varies from day-to-day, year-to-year, versus CIAC income which is known and measurable. The inequity occurs in a situation of, let's say, that I don't have a tax liability because I had an operating loss in a particular year. It was a particularly wet year, there is conservation, I had excess chemical costs, or what have you, and I can have an operating loss. And I can then receive a CIAC and not have to pay any taxes. The following year -- and under that circumstance, as it would be today, I would not collect any tax. The following year -- and so that particular contributor, he gets a pretty good deal.

The following year, my earnings come back and I have taxable income, and I get another contributor, but this contributor I would collect a tax from. So I can have a house on this lot where the contributor paid no tax, and a contributor on another lot that paid a full tax. And the only difference is because my operating income in one year was impacted to create a tax loss, where in the other year it was a taxable year. And that's what the inequity is in this, combining operating income with the CIAC.

MR. DETERDING: Commissioners, if I will may. Mr. Lowe raised a point that I would like to real briefly address. He talked about the perspective nature of this proposal. I believe that the orders that have previously been issued by this Commission require a refund where there is not a tax effect of CIAC. That is the wording, I believe, that is utilized in those orders. I believe that if you did adopt this proposal, that it is simply a refinement of how you define the tax effect of CIAC, and could be applied to those outstanding reports. It would not cause any inequity in doing so, and would, in my opinion, simply be a refinement of the existing standards established in those orders. So, I do not believe that it has to be applied simply prospectively. The issues are all still out there if we apply the existing criteria that are almost insurmountable. I mean, as the Staff said, there are cases out there still from 1987 that have not been resolved, because every time you open one issue you seem to open ten more. And I do believe this can be applied to those outstanding reports.

COMMISSIONER DEASON: Are you simply suggesting that whatever refunds that are pending, that those would no longer become pending and that the refunds would not take place, and that that would just be added to the amortization?

MR. DETERDING: You would simply add that to the amount that must be amortized back into rates, yes, sir.

CHAIRMAN CLARK: Mr. Gatlin, do you have anything to add?

MR. GATLIN: I don't have any now, thank you.

CHAIRMAN CLARK: Mr. Freeman.

MR. FREEMAN: Yes. I would just like to make some comments, because I'm sure they are going to not get adopted, or not get taken tremendously seriously. We have taken a position since the beginning of CIAC, and it is at odds with the industry in certain respects. I think in all respects. In some respects, it's at odds with the Commission Staff. The two things that we don't disagree on is that CIAC has a tax consequence and has tax impact. We are not looking for a free lunch. We are looking for fair treatment, we are looking to be recognized, we are looking to be dealt with.

The old story of the Constitution, it says, "We, the people." We, the people, is everybody, and it includes companies, it includes developers, it includes other than the general body of ratepayers. We also do not believe that losses and other items which are normal business results should counted against the utility. So, I don't have any disagreement with Mr. Gordon's problem that we are looking for that. We have a disagreement on who pays the CIAC. In Staff's opinion, it is the general body of ratepayers. In our opinion, it is either the contributor or it is someone who is a successor to a unit, whether that is a commercial, or individual, or residence to the contributor.

People on a system prior to 1986 paid nothing, so I don't know how they could have contributed to CIAC property that is depreciable. Customers that come on in 1995 are paying on a different basis than customers that came on in 1987. They are all different. We don't have problem with refunds or credits going to those people. Our problem is that when the Public Service Commission does that, then there might be a rate case, because we think that we subsidize those rates that they theoretically are lowering as a result of this, and that isn't fair. I don't know of any other --

COMMISSIONER DEASON: Let me ask you a question. I hate to interrupt, but what about -- we hear from customers all the time; in fact, we had a service hearing last night, and customers were saying we don't want to pay for growth. They are saying that we are just fine with our plan as it is, but when we start adding new people to our little system, they have to go out and build a whole new plant, and we have to pay a return on that. So, I mean, this is one case where development perhaps is paying a little bit more, but if you're becoming part of a system which has a lower embedded cost than if you had to build your own system, isn't that negatively impacting the other general body of ratepayers?

MR. FREEMAN: Well, see, I don't really agree with that, and there is ways to handle it. But when you have ratepayers on it, when you have customers on a system that's not 100 percent utilized -- and I don't mean used and usable, I mean, toilets flushing and sinks running -- then there is a cost that is being shared by people that were utilizing the system that would decrease as people are connected to the system. So that is a problem, and I don't know exactly what to do with that problem. As far as growth is concerned, we pay for growth. We pay for the plant that is being added. We pay for the lines that we build. When this was introduced, the question was we don't want the utility impacted and we don't want the customer rate base impacted, so in order to not impact them, how do we handle this? And we also were given the alternatives, and at one point there seemed to be some feeling on the part of the Commission that maybe what we do is discourage tax on tax add on and encourage alternatives. That hasn't been done. The true cost is net present value. If someone asked me if we have a position, if we have any objection to net --

(Power failure. Brief interruption.)

CHAIRMAN CLARK: We are ready to continue the workshop. Mr. Freeman, you were making a presentation, an electrifying presentation.

MR. FREEMAN: That it wasn't.

I'm going to try to get back on the points I wanted to cover, so I may be fragmented a little bit as a result. Where we were, I think, was our position is that if net present value is what is grossed up by a utility, there is ultimately no extra charge to anyone. The utility will b. negative cash flow in the first couple of years to some extent, although when you start something, eight or nine years after it was done there is certainly not the effect there would have been in 1987, and we don't believe probably any. But if net present value was there, I don't think there needs to be any regulation or anybody looking at it, because that formula takes into account the refund, the actual cost of the receipt of the property, and if that were the case, we believe that at least it would encourage utilities to go that route.

Certainly we believe that the larger utilities, the Class A and maybe Class B utilities could do that. A number of states actually use net present value or no gross-up on Class A utilities. Inasmuch as I understand there is an argument that it is difficult to go deal with one utility different than another, it's my understanding that you've got separate sections, one for Class A and Class B utilities and one for Class C utilities. So it's not something that would be without precedent certainly at the Commission.

Anything other than net present value which we think encourages, to some extent, as opposed to discourage the tax on tax, a full tax on tax gross-up does not. We think it ought to be regulated. I don't have a problem with simplifying procedures if somebody has got some disagreements as to how refunds are done and administrative nightmares, but to take the industry and put them in a non-regulated position when you've got a monopoly is something that we just don't believe is right. If that's the case, and we want to streamline everything, you know, we could go a step further and say why do we need rates, why do we need ratemaking, and then, you know, we are to some extent here because when you own a piece of land and there is a monopoly and there is a franchise area, we have nowhere to go.

And as much as when we deliver a product it needs to be competitive or someone is not going to buy it, water and sewer rates do not necessarily have to be competitive. The way everything is done is what is your cost, how much is your investment, what do you earn on it, what is there. And when I'm in a market that's broader than a utility service area, there is a tremendous effect on us, on our business, on anybody else in that area if rates, if charges, if CIAC add-on tax is not competitive with the other utilities.

If somebody said, "Gee, you know, we will do this, but we will give you a place to go, or give you an alternative, or let you take property that's at the edge of somebody else's franchise area and move it in," then that might be something that's a little more palatable. But we can't do that right now, and that is a problem from our standpoint. It's like I started with, some of the things that I agreed with the industry on as far as the losses and as far as the tax consequences, from a first-year depreciation standpoint, I'm not sure if I agree or I don't agree, because the first year's depreciation is taken in that year. It probably should be in the calculation unless it's someplace else where it would be refunded. My biggest disagreement with Staff is who pays the cost of the CIAC? Or who pays the cost of the add-on and who pays the cost of the contribution? If I have a competitor and my competitor does not pay CIAC add-on tax, I cannot include that in my price.

So, the fact that maybe I do or maybe I don't recover all of my costs doesn't mean I passed it on. I ate it in my gross profit margin, because I'm doing business at a lower gross profit margin. If I own real estate and Lenar (phonetic) comes in and they want to buy a piece of property from me, and I have got CIAC, a utility with CIAC add-on tax, they come in and they say, "Gee, that tax is going to cost me X dollars a unit. I'm going to pay you X dollars less per acre to buy that property." Now, if you can tell me that on that basis the general body of ratepayers is paying something, then that's something that's different than the principles of business that I have learned.

When I sell a house, if everybody was on the same wavelength, or I sell a building, or I returned something on my building, if I had that cost, theoretically the person that buys my unit succeeds to that cost. That cost is a portion of a cost. If it costs a million dollars to build lines, and lift stations, and water meters, and everything in a subdivision, the day it's turned over, the first year's depreciation is not borne by the one resident that moved in. When you finish a subdivision of 140 units, the total cost of all of that is not borne by those 140 units, because maybe those lines service 1,000 units, or they service another 500 units. Those units that aren't being lived in, those units that aren't on a system, are not in the general body of ratepayers, because they don't turn on water and they don't flush toilets. So I don't know a better way than to go back and say it's the contributor.

But if somebody told me, and they tell me that as property is sold that any benefits would go back to the successor in title, I don't have a problem with that. It's very, very simple. It's as Mr. Moore said, it's something that gives us the ability to predict and project as opposed to having a cost that's not recaptured, not recapturable, but somebody said it is. As far as the determination of whether or not the general body of ratepayers is the ultimate payer, and as I said, the general body of ratepayers includes people that never paid it. People that are on a system

-- I mean, Gulf Utilities is building a line right now to Florida Gulf Coast University, which is wonderful. Florida Gulf Coast University is going to be on that system, and they are part of the general body of ratepayers, and they are not paying CIAC add-on tax on their line. And as much as I'm all for them getting any benefit that they can, that could be a private developer. That could be my competitor. And there is no reason for that competitor or that competitor's customer that is not incurring that cost to pay it.

And from the standpoint of what the Commission decided, I'm sorry, the Commission did not agree with me, we have a respectful disagreement. I'm sorry, the First District didn't agree with me. I have a feeling the Florida Supreme Court will not agree with me. So, that means we are going to go back to the place I was going to go to in the first place, and we'll see if the Federal District Court will. And if they don't, then we probably will give up. But we don't quit easily on issues that we feel very strongly about.

As far as refunds and how to handle it, what we have is -- and forget whether I agree or disagree for a minute on general body of ratepayers. We have a system that says the general body of ratepayers are getting this. There is no question -- as much as I'm agreeing there is a tax from the contribution, there is no question that the depreciation that wasn't there in pre-'87 is generating a benefit. So what we are trying to do is give that benefit back to someone. And if you're telling me it's the general body of ratepayers, then what I'm trying to do is figure out how they are getting it.

Now, if I'm here and this is a Southern Bell hearing, or if it's a Florida Power and Light hearing, it is my understanding -- and I'm not ever here -- but it is my understanding that the way the Commission handles that is they say, "Gee, there is an overcharge; let's write a check. Let's send the check to whoever the exchange number is. The customers that are serviced by that power plant. What do we do here?

CHAIRMAN CLARK: That's incorrect.

MR. FREEMAN: Okay. I mean, I have seen refunds on overcharges, and they do it. What we have got here is we have got a significant amount of money --

CHAIRMAN CLARK: But it's not based on who is served by what power plant, because you really don't know who is served by what power plant.

MR. FREEMAN: In this case we know. From a utility standpoint, I know that if it is Florida Cities -- and they are not my utility, so we will pick on them for a minute -- if it was Florida Cities that has a tax savings in 1995 as a direct result of depreciation benefits, then somehow we ought to be able to take a check and write it back or save people money in 1995. When we take and spread it over 20 or 40 years -- the 40 is even more aggressive -- what we are doing is we are letting the money, the cash accumulate in the utility. They have the money, they have the money interest free, they have it for that entire period of time. And when you take a utility that had very little cash in 1987, had moderate earnings from 1987 to 1995, and has tremendous unaccounted cash, somehow that tells me it's coming from someplace. I think a lot of it is coming from the CIAC tax.

And I don't know what studies have been done, what evaluation has been done on utilities that are collecting a gross-up, how much cash they really have in the bank that's other than what is there. But if you give me something today, and maybe I will give it back to you later, that would be great. I don't know a consumer advocate -- me not necessarily being one -- but I don't know a consumer advocate that would sit here and say your promise to give me something in future that I'm going to get, because what happens is somehow they never get it. And this benefit, I don't see that ratepayer that you're looking to protect ever getting unless they get cash each year. If he gets cash each year, he is getting something. If he doesn't, what they are doing is they are getting an accounting entry. So, now I'm a utility, I have this cash at the end of the year, I go build a line someplace, now I have investment. Who got any benefit? I don't see it. You know, my experience is that benefits don't get to the consumer. I just don't think they are going to get there at this point, either.

COMMISSIONER DEASON: Let me ask you a question on that. As I understand the proposal, if there is going to be an accumulation of additional deferred income taxes which are going to be accounted for as a cost resource of capital, which will then ultimately result in a lower cost of service to the general body of ratepayers, how is that not a benefit?

MR. FREEMAN: The disagreement we have here is using the word ultimately result. If I'm getting something this year, why can't I pay it back? If I sell a house to a customer, and I get something that is ultimately his, he doesn't let me wait a year and two years and five years to go back and give it to him. Now, I was talking to Mr. Gordon, and I guess they do some calculation in Poinciana which theoretically gives it back to the ratepayer sooner. The way your order is, and the way the system is currently, it reduces rate base. When it reduces rate base, what happens is when a utility later would come in and have a rate case, which they may never need, but if they needed a rate case, it then would come into play.

My question is if they took the savings and invested it during that period, and invested the interest that they earned on that money that wasn't theirs in the first place, I could over-invest in my system. I could invest back more money than I was due to refund, just because it's there because I was ultimately giving it back. If I had to give it back every year, and I had to give it back to I don't care who, whether it's the contributor, their successor, or the general body of ratepayers, but if I had to give it back every year, whether it be a credit for utility service or something, then it's not there to reinvest in the system. It's not there over a period of time. And my big problem here is that everybody -- you know, there is two parties; there is the utilities and there is the general body of ratepayers. And it's like going some place and saying everybody in this country is male or female, but they are not male or female, you know, there is other --

CHAIRMAN CLARK: That's news to me.

(Simultaneous conversation.)

MR. FREEMAN: Well, what happens is when you look at people, you look at the different hats they wear. They may be male, they may be female, but some of them are wearing ethic hats, some of them are wearing other minority hats.

CHAIRMAN CLARK: But they all fall into the category of either male or female.

MR. FREEMAN: But, what I'm saying is everybody that is here is not in a general body of ratepayers.

CHAIRMAN CLARK: The developers, that's the other person.

MR. FREEMAN: Well, who is a developer?

CHAIRMAN CLARK: Well, your clients are. I mean, as I understand your concern, your concern is the developer who pays the CIAC is not getting the benefit.

MR. FREEMAN: Right. But a church is a developer; an individual homeowner is a developer if he buys a lot and he's my friend.

CHAIRMAN CLARK: But they will also be a ratepayer.

MR. FREEMAN: But are they a ratepayer to the extent that they are paying for this advantage to put on a system.

CHAIRMAN CLARK: What advantage to put on a system?

MR. FREEMAN: I've got a ratepayer that was on the system in 1986, he paid nothing for CIAC, he paid nothing toward the depreciation. I have a friend of mine that is on Florida Cities line.

CHAIRMAN CLARK: You mean he paid no service availability charges.

MR. FREEMAN: We pay service availability charges and we pay gross-up on top of them.

CHAIRMAN CLARK: I guess what I'm trying to clarify, are you saying this friend did not even pay service availability charges?

MR. FREEMAN: No, my friend is looking to get on a system now. He happens to be in the Florida Cities area.

CHAIRMAN CLARK: Well, he will pay a service availability charge.

MR. FREEMAN: He will pay a service -- and if they charge CIAC, he would pay CIAC on it. He would also pay to build his line and pay CIAC on it. What he is doing is creating depreciable assets by paying his tax. In 1986, the person that did the same thing did not create a depreciable asset. What he did was he contributed a line, did not pay any tax, the line was not depreciated. He then paid a service availability charge. The service availability charge created a reduction in the plant, in the depreciable basis of the plant. Now, because by paying the tax, we are creating depreciable items, those items generate a benefit. They come back. And the question is who gets that benefit. Does that benefit go to someone that didn't pay it.

CHAIRMAN CLARK: As I understand your position, your position is the developer who paid it should get the benefit.

MR. FREEMAN: No, I don't like the word developer. My position is the person, the company, the customer, the entity, or the institution.

CHAIRMAN CLARK: Should get the direct refund.

MR. FREEMAN: Should get the direct refund. And if it's not, if it is an individual customer, it's real simple, because it goes with that unit. If my friend puts his unit on-line, then whatever would come back would go to him because it's one person. If it's a multi-unit -- I don't care if you come back and tell me as people move in those are the ratepayers that we want to give the benefit to, I can live with that, that's not a problem.

CHAIRMAN CLARK: Well, your position, then, is the same as in the case that you had before us that's on appeal that you are going to take to the federal court, as I understand it.

MR. FREEMAN: My position is that I think there is a benefit. I don't think the general body of ratepayers pays for that benefit. My other position is that if there is a benefit -- and the utility industry is admitting there is a benefit -- why is it not being refunded on an annual basis?

CHAIRMAN CLARK: So, first of all, your position is you shouldn't charge a gross-up for taxes.

MR. FREEMAN: No, that's not true. That's not true. My position is that we think the net present value is the gross-up that should be charged. If a full gross-up is charged, we will pay a full gross-up.

CHAIRMAN CLARK: But then if it is not actually paid in taxes, then you should get the refund?

MR. FREEMAN: No. No, that's a different issue. That's a different issue. I think that that's where the confusion is. The money that -- the money I contribute this year, okay, I'm assuming is paid in taxes, okay. I'm assuming there is no refund. This year is 1995. In 1996, that property is getting a depreciation deduction. It reduces the tax that is paid by the utility.

CHAIRMAN CLARK: And you think you should get the benefit of that?

MR. FREEMAN: The proportionate benefit as opposed to what was contributed.

CHAIRMAN CLARK: And that is a different position than what you took in your case before the Commission.

MR. FREEMAN: No, I don't think it is.

CHAIRMAN CLARK: It's the same position?

MR. FREEMAN: I think it's basically the same position. I think that -- I'm not sure it's being understood, but I believe it's the same position. And I believe that if someone told me that, that the ratepayer that is created from those contributions gets that benefit, then I don't have a problem. But I don't believe that that benefit needs to be measured in gallons of usage. It's an easier calculation than that.

COMMISSIONER DEASON: Now, if the gross-up were calculated on a net present value basis, would that be equitable?

MR. FREEMAN: In my opinion, it's equitable. The only question --

COMMISSIONER DEASON: There would be no need for future refunds as you characterize it?

MR. FREEMAN: No. There would no need future refunds, there would be no need for anything.

COMMISSIONER DEASON: Now, what happens if it is calculated on a net present value basis and there is actually a negative cash flow influence on the company, which causes them to have negative deferred taxes, which causes them to have to go and borrow capital to cover that. Doesn't that negatively impact the remaining general body of ratepayers?

MR. FREEMAN: It does and it doesn't. The way the net present value calculation is done, it assumes that that money, that negative cash flow is earning, so the depreciation benefits actually pay the return. The return on the money, the negative cash flow the utility is out is taken into account. Now, that creates a burden on the utility.

COMMISSIONER DEASON: But you're saying it's in the calculation --

MR. FREEMAN: It's in the calculations, but that doesn't mean it doesn't necessarily create a burden on the utility. In the first year it could certainly create a burden on the utility. What we have now are utilities that to a great extent have seven or eight years of property built up that's being depreciated. So I'm not sure it does create a burden on the utility today. That argument in 1987 is different than that argument in 1995. But to the extent it is, do I have a problem coming up with a solution to handle the negative cash flow? No.

Because our problem is we are paying 67 percent, roughly, 60-some-odd percent add-on on top of whatever we are contributing. Anything less than that is a benefit. Net present value is somewhere 37 or 38 percent. And if I have to pay something on top of net present value over a period of time to help fund cash flow, that's certainly better than -- what we have is the worst of all systems from our standpoint, and it was just the thing the other day -- actually it wasn't the other day, it was last night -- in Fort Myers where a development is on the television, one of the NBC stations did something. What they were doing is what the environmental cost is on the cost of a new home. And it actually was pro-new community. You know, how it's maybe not needed, and maybe there is too much cost, and maybe the burden shifted a little bit too much.

But what we are looking at here is the cost of a $130,000 unit, $3,500 or $4,000. That's a lot of money. It's a lot of money that we think could be avoided if people would put their heads together and try and come up with a system to minimize as opposed to, "Gee, let's maximize. It doesn't matter. We really don't care, because we think the only people that are paying this are developers." It's not John and Mary Smith, who just got married, and are trying to afford their first house and they can't afford it, okay. And that is who it does impact on, not their parents who owned the house in 1986. But it does impact on them that are in the market today.

Thank you.

CHAIRMAN CLARK: Mr. Gatlin.

MR. GATLIN: Yes. I understand every aspect of the gross-up questions before the Commission in this workshop. But, Mr. Freeman did refer to the Gulf case, and that involved Gulf Utility applying to the Commission to use the full gross-up formula. Mr. Freeman's company protested that Proposed Agency Action order, and we went to two or three days of hearings. The Commission decided that full gross-up was appropriate and did not have to apply net present value, as Mr. Freeman suggested. And also on the question of who pays CIAC, the Commission ruled on that. Mr. Freeman's company appealed this to the District Court of Appeal. And the District Court of Appeal, through a unanimous opinion, affirmed the Commission, and said the record and the Commission's policy on full gross-up was okay, and allowed the Commission order to stand.

I just wanted to make sure that the Commission understood that as Mr. Freeman, in fact, indicated, most of the issues that he's talking about have been examined very closely by the Commission in that case, and affirmed in the Court, and he has now -- district court, and he has petitioned for jurisdiction in the Supreme Court, that is pending on the jurisdictional briefs at the moment.

CHAIRMAN CLARK: Anything further? Mr. Deterding.

MR. DETERDING: I have a couple of quick comments. Mr. Freeman has talked about the discrimination, in effect, that may result. And one thing he noted was between those who got on the system in '85 and those who got on in '87, because there was not a gross-up prior to '87. There is some disparate treatment when you are flowing back these benefits to the general body of ratepayers, as some people may not have been paying gross-up and may have gotten a benefit. But I think we have found over the years there is always going to be some. I think the charge of this Commission is to minimize it. If you want to see disparate treatment, look at what Mr. Gordon --

CHAIRMAN CLARK: Desperate or disparate?

MR. DETERDING: Look at the distinction that happens, as Mr. Gordon noted, between any given two years and based upon what may occur totally outside of gross-up and totally outside of the CIAC collected simply from changes in the weather or otherwise, and add onto that under the current system that you may be utilizing loss carry forwards that occurred 12 years ago, and trying to apply them into the system. And then when those run out, the change that occurs then of what people pay.

So, I think those differences are always going to be there, and the Commission's charge is to minimize them. And I believe that the system that we are proposing sets out a flat amortization that if a development of 140 units isn't built out in three or four or five years, that's unusual. And, therefore, the majority of those people are going to get the majority of the benefit accruing to them. As to net present value, it still doesn't respond to, as Commissioner Deason noted, the question of ability to fund those up-front costs. You've got those up front costs, despite what -- you may ultimately get that recovered through the process of time, but, you also have the more important issue which is the one which this Commission has ruled on in Gulf's case, and in other cases, I believe, that the general body of ratepayers ultimately pays for the gross-up even though paid up front by the developer. And if that is true, then you, by using net present value, are simply spreading a portion of that cost back to the developer, who does not ultimately pay it, instead of all of it. And so I think the net present value, while softening the blow on the developer, doesn't really answer the ultimate questions that are involved in this.

CHAIRMAN CLARK: Okay.

MR. FREEMAN: I would just like to make one last comment. I think that our position, or the position I laid out which states that net operating losses really should not be part of this calculation, overstates what Mr. Deterding did, because I happen to agree with Mr. Gordon, and as easy as it is to come up with a formula that says if you contribute property, this is our cost, it is just as easy to come up with a formula that says we are going to receive benefits over a period of time, and these are the benefits we are getting each year, ignoring what the net operating loss carry forwards are, or carry backs, and making assumptions.

Second of all, the term that I really seriously disagree with is the flat amortization, because I like the term of flat refund, and I like to follow the cash.

I like to know where the cash is, where it's going. No one is telling me there is no cash benefit on an annual basis that's being received by the utilities. But what they are doing is they are telling me amortize the cash. Now, if I ask my kids, they don't understand it. They know how to spend the cash, they know how to make the cash, they don't know how to amortize it.

And what you're doing is allowing an industry or companies in an industry to accumulate money at someone's expense under the guise that someone else is getting the benefit or someone is getting the benefit who paid for it, but they are not getting the benefit now, they are getting it later over a period of time maybe. And if there is a benefit, and we know what that is, and they can come up with a flat amortization number, then you can take that flat amortization number and work it down to cash and write checks, and take 29 cents off of it, or 31 cents off of it, so that they don't have to bear the postage, or put it on somebody's bill as a credit. But, that's the biggest deepest problem I have is that these people that are being -- that we are trying so hard to protect, or that you all are trying so hard to protect, I don't see them being protected anyway. I see the only people that are being protected are the utility companies. I wish somebody would protect me half as much. That's all I have to say, and I will not respond, so I thank you.

CHAIRMAN CLARK: Staff, is there anything further?

MR. LOWE: Only a couple of general comments that we need to do some research on what Mr. Deterding said about the past orders, because us just talking, we don't believe that those order say effect, we believe they say liability. And if they do, in fact, say liability, we are not sure that we can go back and use a new methodology when we have orders that said certain things, we may have to continue to use those particular things.

And that if we do pick up this type process either prospectively, or retroactively, or what have you, it's going to require rule changes to the annual report rule, uniform system of accounts will need to be modified. We presently have a rewrite in the works. Ms. Causseaux and Mr. Willis are working on that now, so it could be included in that. And probably service availability rules should be modified to layout so the companies would know what to file and what have you.

CHAIRMAN CLARK: Well, let me ask you this. Is it Staff's belief that they should recommend to us a change in how we deal with CIAC, particularly refunding of it? Are you going to propose a rule to accomplish that?

MR. LOWE: I believe so. I mean, we haven't discussed it all yet, but I think that's appropriate.

CHAIRMAN CLARK: Are you expecting direction from us now, or are you going to go back and develop a rule and bring it to us at agenda?

MR. LOWE: Unless you tell me otherwise, I think that's a good idea. We will develop a rule and bring it to you at agenda.

CHAIRMAN CLARK: And what you will do is just go through your process of reviewing the policy, and if you all think it's a good idea, you will bring it before us at rulemaking?

MR. LOWE: Yes, ma'am. But we still have to deal with the 25 companies that presently have the gross-up method, and what to do with the refunds on those. And that would not be in the rulemaking process.

CHAIRMAN CLARK: Well, I would expect in your recommendation you would cover how this rule should affect them, if at all.

MS. SALAK: Meanwhile, we need to start processing them again. We were asked to not do it for a while until the workshop was held, but it's our intent to start processing the refunds once more and sending them to agenda until we get a rule in place.

CHAIRMAN CLARK: All right. Refresh my memory. You were asked by the Commission not to process them?

MS. SALAK: Internally we were requested not to do it. We were told not to do it.

CHAIRMAN CLARK: You wanted to sort of explore a policy before you deal with another recommendation on refunds.

MS. SALAK: Right. So we did that. And I don't know how long the rule process would take, we just hate to keep --

COMMISSIONER DEASON: Well, as a legal issue, if we do decide to change the rule on a going-forward basis, whether that could legally affect prior orders which say there are going to be refunds calculated based upon certain assumptions or whatever, that being a liability test, and that we may not have the authority, assuming we wanted to change it, we may not have the authority to affect those refunds.

MR. GATLIN: Madam Chairman, I hesitate to interrupt, but there is not a rule now, and it has been a policy developed on a case-by-case individual basis. I'm not sure there is a rule that requires either liability or -- well, I know there is not a rule.

CHAIRMAN CLARK: Well, it would depend on the order, what the order said.

COMMISSIONER KIESLING: Incipient policy.

MR. GATLIN: Well, I mean, it's case-by-case. There is not a Chapter 25 rule on it.

CHAIRMAN CLARK: Staff, is there anything further you are expecting from us today at this workshop?

MS. SALAK: No.

CHAIRMAN CLARK: Okay. Is there anything further participants would like to add?

MR. GATLIN: Thank you.

CHAIRMAN CLARK: Thank you.

(The workshop was concluded at 3:15 p.m.)

CERTIFICATE OF REPORTER

STATE OF FLORIDA)

COUNTY OF LEON)

I, JANE FAUROT, Court Reporter, do hereby certify that the foregoing proceedings was taken before me at the time and place therein designated; that my shorthand notes were thereafter translated under my supervision; and the foregoing pages numbered 1 through 65 are a true and correct record of the proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor relative or employee of such attorney or counsel, or financially interested in the foregoing action.

DATED THIS 7th day of December, 1995.

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