

FLORIDA PUBLIC SERVICE COMMISSION
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MEMORANDUM

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FPSC - Records/Reporting

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

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

RE: DOCKET NO. 970275-WS - DISPOSITION OF GROSS-UP FUNDS
COLLECTED BY HYDRATECH UTILITIES, INC.
COUNTY: MARTIN

AGENDA: June 24, 1997 - REGULAR AGENDA - PROPOSED AGENCY ACTION-
INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: I:\PSC\WAW\WP\970275.RCM

CASE BACKGROUND

As a result of the repeal of Section 118(b) of the Internal Revenue Code (I.R.C.), contributions-in-aid-of-construction (CIAC) became gross income and were depreciable for federal tax purposes. In Order No. 16971, issued December 18, 1986, the Commission authorized corporate utilities to collect the gross-up on CIAC in order to meet the tax impact resulting from the inclusion of CIAC as gross income.

Order No. 16971 and Order No. 23541, issued December 18, 1986 and October 1, 1990, respectively, require that utilities annually file information which would be used to determine the actual state and federal income tax liability directly attributable to the CIAC. The information would also determine whether refunds of gross-up would be appropriate. These orders also required that all gross-up collections for a tax year, which are in excess of a utility's actual tax liability for the same year, should be refunded on a pro rata basis to those persons who contributed the taxes.

In Order No. 23541, the Commission required any water and wastewater utility already collecting the gross-up on CIAC and wishing to continue, to file a petition for approval with the Commission on or before October 29, 1990. By Order No. 25525, issued December 20, 1991, Hydratech Utilities, Inc. (Hydratech) or

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issued December 20, 1991, Hydratech Utilities, Inc. (Hydratech or Utility) was granted authority to gross-up CIAC using the full gross-up formula.

On September 9, 1992, this Commission issued Proposed Agency Action (PAA) Order No. PSC-92-0961-FOF-WS, which clarified the provision of Orders Nos. 16971 and 23541 for the calculation of refunds of gross-up of CIAC. On September 14, 1992, PAA Order No. PSC-92-0961A-FOF-WS was issued. This order included Attachment A which reflects the generic calculation form. No protests were filed, and the Order became final.

On March 29, 1996, Docket No. 960397-WS was opened to review the Commission's policy concerning the collection and refund of CIAC gross-up. Workshops were held and comments and proposals were received from the industry and other interested parties. By PAA Order No. PSC-96-0686-FOF-WS, issued May 24, 1996, staff was directed to continue processing CIAC gross-up and refund cases pursuant to Orders Nos. 16971 and 23541; however, staff was also directed to make a recommendation to the Commission concerning whether the Commission's policy regarding the collection and refund of CIAC should be changed upon staff's completion of its review of the proposals and comments offered by the workshop participants. In addition, staff was directed to consider ways to simplify the process and determine whether there were viable alternatives to the gross-up.

However, on August 1, 1996, the Small Business Job Protection Act of 1996 (The Act) passed Congress and was signed into law by the President on August 20, 1996. The Act provided for the non-taxability of CIAC collected by water and wastewater utilities effective retroactively for amounts received after June 12, 1996. As a result, on September 20, 1996, in Docket No. 960965-WS, Order No. PSC-96-1180-FOF-WS was issued to revoke the authority of utilities to collect gross-up of CIAC and to cancel the respective tariffs unless, within 30 days of the issuance of the order, affected utilities requested a variance. Since there was no longer a need to review the Commission's policy on the gross-up of CIAC, on October 8, 1996, Order No. PSC-96-1253-FOF-WS was issued, closing Docket No. 960397-WS. However, as established in PAA Order No. PSC-96-0686-FOF-WS, all pending CIAC gross-up refund cases are being processed pursuant to Order Nos. 16971 and 23541.

On March 20, 1997, staff filed its recommendation for the April 1, 1997, agenda conference regarding refunds of excess gross-up collected by Hydratech in 1995. On April 21, 1997, Order No. PSC-97-0454-FOF-WS, was issued requiring a refund of \$71,902 for 1995.

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On May 12, 1997, Hydratech filed a timely protest of the referenced order, and the matter has been set for hearing. In order to avoid the time and expense of further litigation in this docket, the utility submitted a settlement offer along with its petition. Hydratech is proposing that a settlement effectively splitting the legal and accounting costs between the rate payer and the contributor be recognized. This would be consistent with the decision made by the Commission at the May 19, 1997 Agenda Conference, in Docket No. 961076-WS, regarding the disposition of gross-up funds collected by Hydratech in 1991-1994. The purpose of this recommendation is to address this settlement offer and the disposition of gross-up funds collected by the utility in 1995. If the Commission accepts the utility's proposed settlement, the hearing date will be canceled accordingly.

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DISCUSSION OF ISSUES

ISSUE 1: Should the Commission accept Hydratech Utilities, Inc.'s settlement proposal of May 12, 1997, for the disposition of gross-up funds collected?

RECOMMENDATION: Yes, the Commission should accept Hydratech Utilities, Inc.'s settlement proposal of May 12, 1997, regarding the disposition of gross-up funds collected in 1995. Based on acceptance of the settlement offer, staff recommends that \$3,374 and \$2,437 of accounting and legal fees, respectively, be offset against the calculated refund of \$71,902. As a result, the utility should be ordered to refund \$66,091, plus accrued interest through the date of the refund, for gross-up collected in excess of the above-the-line tax liability resulting from the collection of taxable CIAC.

According to Orders No. 16971 and 23541, all amounts should be refunded on a pro rata basis to those persons who contributed the taxes. The refunds should be completed within 6 months of the effective date of the order. Within 30 days from the date of the refund, the utility should submit copies of canceled checks, credits applied to the monthly bills or other evidence that verifies that the utility has made the refunds. Within 30 days from the date of the refund, the utility should also provide a list of unclaimed refunds detailing contributor and amount, and an explanation of the efforts made to make the refunds. (GILCHRIST)

STAFF ANALYSIS: In compliance with Order No. 16971, Hydratech filed its annual CIAC report regarding its collection of gross-up for 1995. As previously stated, on March 20, 1997, staff filed its recommendation for the April 1, 1997, agenda conference. On May 21, 1997, PAA Order No. PSC-97-0454-FOF-WS, was issued requiring a refund of \$71,902 for 1995. On May 12, 1997, Hydratech filed a timely protest of the Order. In its petition of May 12, 1997, the utility argues that the legal and accounting costs are appropriately applicable to the gross-up process and, therefore, should be used to reduce the amount of gross-up refundable rather than being charged to the general body of ratepayers through the rate-setting process. Further, the utility states, to do so would be directly contrary to the requirements of Commission Order Nos. 16971 and 23541 issued to govern the filing and processing of gross-up reports. However, staff has not found any provisions in either Order for the netting of the costs of preparing the refund reports with the contributors' refund.

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At the May 19, 1997, Agenda Conference, in Docket No. 961076-WS, which addressed the disposition of gross-up funds collected by Hydratech in 1991-1994, the Commission voted to accept Hydratech's settlement proposal to offset the legal and accounting fees incurred in preparing the CIAC gross-up reports with the contributors refund amount. In its Petition of May 12, 1997, Hydratech indicated that it is willing to accept a similar arrangement with regard to this case. The utility submitted its proposed offer of settlement, whereby it is proposing that 50% of the legal and accounting fees be offset against the refund calculated for 1995.

In PAA Order No. PSC-97-0454-FOF-WS, the amount of excess collections of CIAC for 1995 was calculated to be \$71,902. The utility has provided documentation supporting legal and accounting fees of \$11,623.25. Staff reviewed these costs and determined that all of the legal and accounting fees submitted by the utility are directly associated with preparing the required reports and calculating the tax effect, and, thus, are considered to be legitimate expenses. Fifty percent (50%) of this amount is \$5,811. When this amount is offset against the \$71,902, the refund for 1995 is calculated to be \$66,091.

Staff notes that the Commission has considered on several occasions, the question of whether an offset should be allowed pursuant to the orders governing CIAC gross-up. In its last vote on the issue, the Commission voted to accept Hydratech's settlement proposal that 50% of the legal and accounting costs be offset against the refund amount. In general, the utility argues that the legal and accounting costs should be deducted from the amount of the contributors' refund, as the contributors are the cost-causers and as such, those costs should be recovered from the cost-causers. Staff notes that it was the change in the tax laws and not the contributors that imposed a new cost on the utilities associated with CIAC.

Further, staff believes that once the contributors have paid the gross-up taxes on the CIAC, the contributors have fulfilled their obligation under Orders No. 16971 and 23541. Since those orders also provide that gross-up in excess of the utility's actual tax liability should be refunded on a pro rata basis to those persons who contributed the taxes, staff believes that once the tax liability is determined, it is the responsibility of the Commission to ensure that excess payments of CIAC taxes are refunded in compliance with those Orders. Therefore, staff does not believe that a reduction in the amount of refund a contributor is entitled to receive as a result of his overpayment of gross-up taxes is appropriate. Staff acknowledges that those costs were incurred to

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satisfy regulatory requirements; however, staff does not believe that the contributors should be held responsible for the legal and accounting costs incurred to determine whether they are entitled to a refund. Staff views those costs as a necessary cost of doing business, and as such, staff believes it is appropriate for the utility to seek recovery of those amounts in a rate case proceeding. Finally, staff believes that this situation is similar to when a utility files for an increase in service availability charges. The costs of processing the utility's service availability case is borne by the general body of ratepayers, although the charges are set for future customers, only.

However, as in the other Hydratech case (Docket No. 961076-WS), staff recognizes in this case that acceptance of the settlement proposal would avoid the substantial cost associated with a hearing, which may in fact exceed the amount of the legal and accounting cost to be recovered. Staff further notes that the actual costs associated with making the refunds have not been included in these calculations and will be absorbed by the utility. Moreover, staff believes the utility's settlement proposal is a reasonable "middle ground". Therefore, staff recommends that while not adopting the utility's position, the Commission accept Hydratech's settlement proposal.

If the Commission approves the settlement, the refunds should be completed within 6 months of the effective date of the order. Within 30 days from the date of the refund, the utility should submit copies of canceled checks, credits applied to the monthly bills or other evidence that verifies that the utility has made the refunds. Within 30 days from the date of the refund, the utility should also provide a list of unclaimed refunds detailing contributor and amount, and an explanation of the efforts made to make the refunds.

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ISSUE 2: Should the docket be closed?

RECOMMENDATION: No. If the Commission accepts Hydratech's settlement proposal, upon expiration of the 21 day protest period, if no protest is received from a substantially affected person, this docket should remain open pending staff's verification of refunds. Staff should be given administrative authority to close the docket upon verification that the refunds have been completed.
(CYRUS-WILLIAMS)

STAFF ANALYSIS: Upon expiration of the 21 day protest period, if a timely protest is not received from a substantially affected person, this docket should remain open pending completion and verification of the refunds. Staff recommends that administrative authority should be granted to staff to close the docket upon verification that the refunds have been made.