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February 28, 1997

VIA HAND DELIVERY

Ms. Jackie Gilchrist
Division of Water and Wastewater
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399

970000

Re: North Fort Myers Utility, Inc.
Post-June 12, 1996 Gross-up
Our File No. 16319.29

Dear Jackie:

As you know, North Fort Myers Utility, Inc. provides wastewater service to several subdivisions formerly receiving service through package plants. In each case, under the authority granted in its tariff, the Utility allowed each customer to either pay the connection charge and applicable gross-up at the time of connection of this system onto North Fort Myers's central sewer system, or to pay installment payments over a several year period for the total of such connection fee and gross-up monies owed. This installment arrangement was undertaken and authorized for the convenience of the customers who could not or chose not to pay those connection fees and gross-up at the time of connection. Several of these agreements continue to be outstanding and require payments after June 12, 1996.

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In the recent case involving Hudson Utilities and similar installment contracts, it was determined that installment payments should be continued on a going forward basis. In addition, the Commission allowed the Utility to retain all such installment payments received after June 12, 1996. It was not until we heard of this case after issuance of the order that we realized that the Commission perceived the collection of monies on these installment agreements to represent continuing gross-up of CIAC. North Fort Myers Utility, Inc. still does not agree with that characterization. Instead, the debt owing originally represented CIAC and gross-up. However, for those customers who chose to pay the amount owing over time, it became simply an installment debt authorized by tariff from the date that those individuals became

customers of North Fort Myers and agreed to make the installment payments.

After extensive review of tax returns, North Fort Myers has come to the conclusion that these installment contracts were not booked as income in the year entered into, but instead have been treated for the most part as income in the year in which the payments themselves were received. Therefore, installment payments received after June 12, 1996, are not being treated as taxable income on the Utility's tax return. This is the one distinction between North Fort Myers' situation and that of the recently processed Hudson Utilities case, where the utility was allowed to continue to collect the full amount of the installment payments. We believe that this difference should not represent the basis for a different conclusion in the case of North Fort Myers Utility, Inc.

There are two major factors that lend support to North Fort Myers' position that it should continue to collect the installment payments.

First, North Fort Myers views these payments as installment loan payments, not as payments of gross-up. Though the Utility must account for all gross-up collections in accordance with Commission orders, from the moment they were reduced to installment contracts, the future payments under those contracts no longer have the character of new gross-up. The alternative of installment payments with interest was undertaken for the convenience of the customers. As such, the continued collection of these installment payments does not represent continued collection of gross-up funds.

Secondly and most importantly, many of the customers within these subdivisions paid the applicable connection fees with gross-up in cash at the time of their connection rather than taking advantage of the installment contract arrangement. To now allow those customers using the installment option to pay a substantial lesser fee simply because of a change in the tax law works a discrimination against those persons who paid those charges in a timely manner. Such discrimination is unreasonable from those many individuals' perspectives.

Instead, the Utility proposes that all collections of post-June 12th installment payments which are not treated as income for tax purposes should be treated as CIAC after applicable interest is removed. In this way, all customers pay an equal and non-

discriminatory charge and all customers equally benefit from any change in the tax law. We believe this is the only reasonable solution under this set of circumstances.

The Utility's tax accountants at Arthur Anderson still have not provided the Utility with a definitive statement of whether or not the entire amount of those installment arrangements constituted CIAC and therefore taxable income at the time of connection and execution of the installment agreements. In fact, in the case of Hudson Utilities, the Commission specifically found merit to the contention apparently arrived at by Hudson's tax consultants that these installment contracts did constitute income at the time of connection and execution of the installment agreements. Therefore, there is certainly some risk (which the Commission obviously recognized by its approval of Hudson's continued collection of installment payments), that the IRS may ultimately determine that the monies collected under the installment contracts by North Fort Myers will, at some point, be determined to be taxable. If the Utility is authorized to continue the collection of these installment payments and treat them as CIAC, the Utility will be in position to be able to pay those taxes should that determination by the IRS arise, and simply reduce the CIAC level in an amount equal to the tax owed. If the Commission requires a refund of those post-June 12th installment payments at this point and requires the Utility to discontinue the collection of some portion of those payments, the Commission runs the risk that those payments may ultimately be found to be taxable. If so, an even greater discrimination will result based upon the receipt of gross-up from some customers and little or no gross-up payments from those customers utilizing the installment arrangement and a required investment in tax which <u>all</u> customers (even those who paid gross-up) will be required to pay for through rates.

In conclusion, North Fort Myers Utility, Inc. believes the continued collection of the entire installment payments is necessary to avoid a severe discrimination and injustice to those customers who paid their connection fees in a timely manner rather than on the installment basis. The only reasonable way in which this discrimination can be prevented and all of the customers treated equally (while at the same time preventing the Utility from receiving some windfall as a result of this change in tax law), is to allow the Utility to continue to collect the full amount of the installment payments and book all such payments not included in taxable income on the Utility's federal tax returns as CIAC. This

will benefit all customers equally and place an equal burden for funding the cost of the Utility's system on all customers.

While North Fort Myers Utility still does not believe that this situation constitutes one in which a variance from the Commission order discontinuing gross-up collections is necessary, to the extent the Commission deems that to be necessary, please consider this to be the request of North Fort Myers Utility, Inc. for such a variance. By copy of this letter to the Division of Records and Reporting, we are asked that it be treated as a variance from the requirements of Order No. PSC-96-1180-FOF-WS in the manner and for the reasons as outlined above.

Should you have any questions in this regard, please let me know. Otherwise, I trust that the Staff after full consideration of these facts will see that the Utility's proposal is the only reasonable one to prevent an unfair discrimination between customers.

Sincerely,

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