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October 2, 1998

ROBERT M. C. ROSE
OF COUNSEL

VIA HAND DELIVERY

Ralph Jaeger, Esquire
Division of Legal Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399

971179-5U

Re: North Fort Myers Utility, Inc.
Disposition of Gross-up Funds for the Fiscal Years Ended
May 31, 1995 and May 31, 1996
Our File No. 16319.29

Dear Ralph:

I am writing to you in order to outline the Utility's proposal for settlement of the above-referenced gross-up disposition proceedings so that we can discuss and finalize those settlement criteria in advance of our submittal of a formal settlement proposal requiring action by the Commission. Please review the proposals outlined below and the attachments and get back to me as soon as possible so that we can formalize this.

Settlement Proposal

North Fort Myers Utilities filed its proposed disposition of gross-up funds with the Florida Public Service Commission in accordance with the requirements of Order No. 23541 for the fiscal years ended May 31, 1995 and May 31, 1996 on September 30, 1996 and April 7, 1997 respectively. The Utility has expended substantial monies and effort in revising its reports and information supplied in order to accommodate the Commission staff's revised methods of reviewing disposition of gross-up funds which are substantially different than the methods previously utilized by the staff, and Commission in ordering the appropriate gross-up disposition for the years 1987 through 1994. The original filing by the Utility was in accordance with the previous eight gross-up disposition decisions of the Commission related to this Utility.

The parties have disagreed over what are appropriate treatments of above-the-line and below-the-line expenses in calculating

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the proposed disposition of gross-up funds. Rather than to continue to debate these and the related issues, the Utility would like to propose a settlement offer which we believe will be in the best interest of both the Utility and the customers in the long run.

1. The Utility will treat, solely for the purposes of gross-up disposition, certain expenses as below-the-line which were originally reported on the Utility's annual reports as above-the-line expenses. We have attached hereto as **Exhibit "A"** a revised schedule showing the proposed disposition of gross-up funds after consideration of these expenses as below-the-line for gross-up purposes only. That schedule also shows the amount of gross-up funds to be distributed in accordance with that revised calculation. The Utility maintains its position that those expenses are appropriately above-the-line for rate analysis and annual reporting purposes. The Utility will refund 1995 and 1996 gross-up funds in accordance with consideration of these funds as below-the-line and the calculations outlined in **Exhibit "A"** hereof.

2. To the extent the Utility is required to refund overpayments of gross-up funds to those who paid gross-up monies and service availability charges on installment basis, the Utility will apply those as credits including interest at the installment contract rate, to those customers in the form of a reduction of the amount owed under those installment contracts. To the extent a refund is still owing after such reduction, it will be provided in the form of all others not on the installment basis. All other refunds of gross-up due will be refunded utilizing the interest earned on the gross-up escrow account.

3. Certain of these expenses which the Utility contends are below-the-line for gross-up purposes have been utilized in index calculations for the years 1994, 1995 and 1996. **Exhibit "B"** hereof shows the calculation of the amount of the additional revenues accrued to the Utility for those expenses as a result of indexing in each year. While the Utility maintains its position that those are appropriate above-the-line expenses for rate setting and indexing purposes, in the interest of settlement the Utility is willing to make allowances as though those expenses would not have been subject to indexing in 1994, 1995 and 1996. Because of the substantial cost of implementing a rate reduction or a refund, which costs benefit neither the Utility nor its customers, the Utility instead proposes to forego implementation of indexing expenses for the years 1997, 1998 and 1999 as an alternative to refund and rate reductions of those prior indexes. Based upon the calculations as outlined in **Exhibit "C"**, it is estimated that the customers of the Utility will receive a substantially higher benefit by the Utility's agreement not to index rates than it would through an agreement to refund and reduce rates currently. In just three years, the financial benefit received by the customers under

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the Utility's proposal will exceed that which would accrue to the customers under a refund and rate reduction proposal. A substantial additional benefit will continue to accrue throughout the life of the Utility as a result of the Utility's agreement not to implement these three years of indexes. The customers will continue to receive that excess benefit indefinitely.

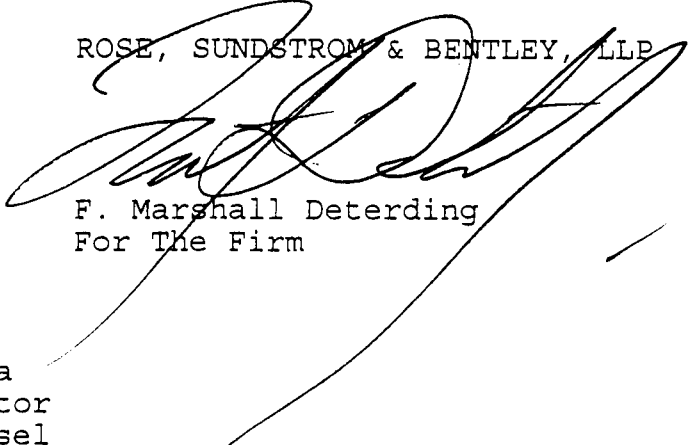
4. The Utility will not seek to recover the additional gross-up costs which it has incurred (totalling approximately \$20,000) since the last time the Utility reported to the Commission on the total of such costs in February of 1998. Nor will the Utility request to offset any of the proposed refunds by any portion of such additional costs or any estimates of additional costs to complete this case (which would add at least 5,000 more to such totals).

I trust that this adequately and clearly outlines the settlement proposal offered by the Utility and that the staff is in agreement that in the relatively short term, the customers will receive a substantially higher benefit from this proposal than from a refund and/or rate reduction. While we are willing to discuss the terms of this settlement proposal, we are relatively firm on our desire not to implement any refund of indexes, in order to avoid the costs related thereto. We believe the proposal we have outlined will allow us to avoid the substantial costs related to any such refund, and simplify the entire process for all concerned while benefitting the customers substantially more than a refund.

After you and the staff have had a chance to review this settlement proposal, please contact me and we can firm up the submission of the formal settlement proposal.

Sincerely,

ROSE, SUNDSTROM & BENTLEY, LLP



F. Marshall Deterding
For The Firm

FMD/tmg
cc: Ms. Jackie Gilchrist
Ms. Jennifer Iwenjiora
Blanca S. Bayo, Director
Office of Public Counsel
Mr. Tony Reeves
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North Ft. Myers Utility, Inc.
Revised Gross-up Refund
Fiscal Years Ended May 31, 1995 and 1996

	Year Ended <u>05/31/95</u>	Year Ended <u>05/31/96</u>
Amended above the line loss before CIAC as filed	\$ (28,641)	\$ (25,594)
Adjustments:		
Reclassify "testing to above the line (ATL) (1)	(69,542)	(45,100)
Reclassify 40% of General Manager's salary ATL (2)	<u>(45,987)</u>	<u>(56,645)</u>
Revised loss before CIAC	(144,170)	(127,339)
Taxable CIAC	<u>619,015</u>	<u>1,434,249</u>
	474,845	1,306,910
Less: CIAC not grossed-up	-	(477,842)
First year depreciation on CIAC	<u>(22,120)</u>	<u>(25,196)</u>
Net taxable CIAC	452,725	803,872
Combined effective tax rate	37.63 %	37.63 %
Tax on CIAC	<u>170,360</u>	<u>302,497</u>
Factor for gross-up	<u>1.6033</u>	<u>1.6033</u>
Gross-up required to pay tax	273,138	484,993
Gross-up collected	<u>(355,431)</u>	<u>(546,104)</u>
Excess gross-up collected	(82,293)	(61,111)
Less: 50% of accounting & legal fees	<u>8,926</u>	<u>9,980</u>
Proposed gross-up refund	<u>\$ (73,367)</u>	<u>\$ (51,131)</u>
Total refund both years	<u>\$ (124,498)</u>	
(1) Tax expenses classified as "engineering & testing":		
General Manager's salary	\$ 114,969	\$ 141,613
Testing	46,807	26,996
Plant supplies	<u>22,735</u>	<u>18,104</u>
Total classified as "engineering & testing" for tax	184,511	186,713
Less: General Manager's salary	<u>(114,969)</u>	<u>(141,613)</u>
Total "testing" reclassified ATL	<u>\$ 69,542</u>	<u>\$ 45,100</u>
(2) General Manager's salary (fiscal year)	\$ 114,969	\$ 141,613
Percentage of time devoted to ATL activities	<u>0.40</u>	<u>0.40</u>
Total related to ATL activities	<u>\$ 45,987</u>	<u>\$ 56,645</u>



North Ft. Myers Utility, Inc.
 Proforma Indexed Rate Adjustments for Below the Line
 Reclass of Certain Operating Expenses
 Years Ended December 31, 1994, 1995 & 1996

	<u>1994</u>	<u>1995</u>	<u>1996</u>
1994 and 1995 O&M expenses that were indexed (1)	\$ 1,224,773	\$ 1,244,107	\$ 201,306
Less: 60% of General Manager's salary to below the line (BTL)	(107,058)	(63,694)	(90,987)
Officer's salaries to BTL	(178,734)	(173,607)	(205,854)
Legal expense to BTL	<u>(152,480)</u>	<u>(136,418)</u>	<u>-----</u>
Proforma O&M expenses to be indexed	786,501	870,088	904,465
GNP Price Deflator Index	<u>0.0195</u>	<u>0.0249</u>	<u>.0213</u>
Increase in O&M expense	15,336	21,665	19,265
Divide by Regulatory Assesment Fee expansion factor	<u>0.955</u>	<u>0.955</u>	<u>.955</u>
Total proforma increase in revenue	16,059	22,686	20,173
Actual indexed revenue increase expected	<u>(25,008)</u>	<u>(32,438)</u>	<u>(26,764)</u>
Difference (potential refund)	<u>\$ (8,949)</u>	<u>\$ (9,752)</u>	<u>\$ (6,591)</u>

SUMMARY

1994	\$ 8,949
1995	9,752
1996	<u>6,591</u>
TOTAL	<u>\$25,292</u>

Notes: (1) Per indexed rate schedules filed and approved by PSC.

North Ft. Myers Utility, Inc.
Settlement Proposal

1. Proposal

- a. Gross-up refund based on 60% of General Manager's salary classified as a below the line expense; officer's salaries and legal expense classified below the line (BTL).
- b. No index adjustments for three years.
- c. No refund of 1994, 1995, or 1996 indexed revenue increases.
- d. No rate reductions.

2. Impact

a. Gross-up refund (05/31/95 - \$73,367; 05/31/96 - \$51,131)	<u>\$ 124,498</u>
b. 1998 index adjusted for BTL expenses (YE 12/31/97)	20,061
Number of years	<u>3</u>
	<u>60,183</u>
Estimated 1999 index, say (YE 12/31/98)	20,000
Number of years	<u>2</u>
	<u>40,000</u>
Estimated 2000 index, say (YE 12/31/99)	18,000
Number of years	<u>1</u>
	<u>18,000</u>
Total estimated revenue forgone	<u>118,183</u>
Total impact	<u><u>\$ 242,681</u></u>

Notes: (1) See Exhibit "A".