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FILED

IN THE SUPREME COURT OF FLORIDA NOV 28 1983

SID J. WHITE
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Chief Deputy Clerk

TAMARON HOMEOWNERS ASSOCIATION, INC.,	)	
Petitioner,	)	
vs.	)	CASE NO. 63,626
TAMARON UTILITIES, INC.,	)	
Respondent.	)	

AMICUS CURIAE BRIEF
ON BEHALF OF
FLORIDA CITIES WATER COMPANY

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PREFACE

Florida Cities Water Company will be referred to herein as "FCWC". Petitioner Sarasota County will be referred to as "County". Tamaron Homeowners Association, Inc. will be referred to as "Homeowners".

STATEMENT OF THE CASE

FLORIDA CITIES WATER COMPANY, (FCWC), is a water and sewer utility operating in Sarasota County, Florida. Its rates and charges are regulated by the Board of County Commissioners of Sarasota County, Florida. FCWC also operates as a water and sewer utility in Hillsborough County under the authority of the Board of County Commissionsers of Hillsborough County, and in Lee County under the authority of the Florida Public Service Commission.

In this proceeding, the Supreme Court has before it the question of the constitutionality of the ratemaking section of Sarasota County Ordinance No. 80-62. This is significant to FCWC because on January 7, 1982, the Board of County Commissioners of Sarasota County pursuant to its Ordinance No. 80-62 issued its Resolution No. 82-02 affecting the rates of FCWC in Sarasota County. That Resolution is pending on appeal in the Twelfth Judicial Circuit, County of Sarasota. On April 25, 1983, the Twelfth Judicial Circuit Court in and for Sarasota County, Florida, entered an Order which provided as follows:

> ORDERED that this proceeding be and the same is hereby abated until a final order has been entered by the District Court of Appeal of Florida, Second District, disposing of the pending Motion for Rehearing in the case of Sarasota County, Tamaron Homeowners Association, Inc., Jacob and Gladys G. Gwynne, and Theodore and Lula L. Wildman, Appellants, v. Tamaron Utilities, Inc., Appellee, Case Nos. 82-1594 and 92-1744, and pending final ruling on appeal of that case, if such appeal is taken.

FCWC's appeal remains abated until this Court has made its determination in its review of the Second District Court of

Appeal's Opinion in this the Tamaron case.

In this brief, FCWC does not wish to argue the facts which are now present before the Court in this case. FCWC does, however, wish to support the opinion of the Second District Court of Appeal in this case. In its opinion, the Second District Court held that where depreciation on property contributed in aid of construction ("CIAC" property) is not allowed as an operating expense, a utility is constitutionally entitled to add back into the calculation of its rate base, depreciation which has been accumulated on contributed property. For the reasons discussed herein, FCWC believes that the Second District Court's holding was correct and should be affirmed.

ARGUMENT

Initially, it should be noted that FCWC does not assert that a utility is constitutionally entitled to recovery of depreciation on CIAC property as an operating expense. Nor does FCWC assert that a utility is constitutionally entitled to earn a return on CIAC property by including such property in rate base. What FCWC does assert, and what the District Court recognized, is that under the ratemaking process adopted in Florida and in Sarasota County, depreciation accumulated on CIAC property must be added back to

rate base in order to prevent CIAC property from effectively being deducted twice from rate base.*/

In order to understand why such an "add-back" is necessary, it must first be recognized that all assets depreciate over time regardless of whether the asset is financed with investor supplied capital (debt/equity) or developer/customer supplied capital (CIAC). As a consequence, under generally accepted accounting principles, depreciation on a utility's assets, regardless of the method of financing, is accumulated in a depreciation reserve account.

A utility's "rate base", (i.e., the value of the property upon which a utility is entitled an opportunity to earn a return), is calculated by first subtracting the utility's reserve for accumulated depreciation, including depreciation accumulated on CIAC property, from gross utility plant in-service to arrive at net utility plant in service. The utility's total gross CIAC property (undepreciated) is then deducted from net utility plant to arrive at the rate

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*/ A distinction should be made between the treatment of depreciation on CIAC funded property by Tamaron Utilities, Inc. and FCWC. Tamaron Utilities, Inc. seeks to recover depreciation on CIAC funded property as an operating expense, whereas FCWC does not recover depreciation on CIAC funded property as an operating expense. FCWC's arguments in this brief will deal only with circumstances where depreciation on CIAC funded property is not recovered as an operating expense in the ratemaking process and an add-back of accumulated CIAC property to rate base is required.

base. It is apparent that accumulated depreciation on CIAC must be added back to rate base so that it is not effectively deducted twice - once in the deduction of accumulated depreciation from gross utility plant in arriving at net utility plant and again in the deduction of undepreciated gross CIAC property from net utility plant.

In other works, such an "add-back" is necessary to insure that CIAC property has no effect, either negative or positive, on rate base. If such an "add-back" of accumulated CIAC depreciation is not made, rate base will be reduced by more than the amount of CIAC property and a utility will effectively be denied an opportunity to earn a return on the value of utility property in which it has made an investment.

In Citizens v. Florida Public Service Commission, 399 So.2d 9 (1981) the First District Court of Appeals explained and illustrated the necessity of the "add-back" with a formula which is as follows:

$$RB = (X + Y) - [(A + B) + X] + A$$

In that formula, X represents CIAC, Y represents invested capital in utility assets, (X + Y) represents the total assets of the utility, A represents accumulated depreciation on CIAC, B represents accumulated depreciation on invested

capital, and (A + B) represents accumulated depreciation on total assets.*/

To illustrate why an add-back is required, and why the formula set forth in Citizens v. Florida Public Service Commission is correct, assume a utility with a $1,000,000 plant with a 40-year life and 2 1/2% annual depreciation rate. Assume further that the plant was financed half by investment capital and half by CIAC. Initially, the utility's rate base will be $500,000, calculated as follows:

Gross Utility Plant	$1,000,000
Less Accumulated Depreciation	-0-
Net Utility Plant	1,000,000
Less CIAC	(500,000)
Add Accumulated Depreciation of CIAC	-0-
Rate Base	$ 500,000

The rate base by source of funds can be broken down as follows:

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*/ One might conclude that such a formula is not necessary when all of the assets of the utility are CIAC. That is, however, usually not the case. It must be remembered that regardless of whether an asset is purchased with investment or CIAC funds, it wears out (depreciates), and therefore depreciation charges should be accumulated in a reserve account over time to recognize this erosion process. Where depreciation on CIAC property is not allowed as a recoverable operating expense, the depreciation expense on CIAC property charged to income as an operating cost is offset, for ratemaking purposes, by a like credit to income representing the amortization of the CIAC fund. Thus, the net effect on the rate payer is zero.

	Source of Funds		
	Investment Capital	CIAC Funds	Total
Gross Utility Payment	$500,000	$500,000	$1,000,000
Less Accumulated Depreciation	-0-	-0-	-0-
Less CIAC		(500,000)	(500,000)
Add Accumulated Depreciation of CIAC		-0-	
Rate Base	$500,000	-0-	$ 500,000

Thus the rate base equals the amount of investment capital.

Now assume that the utility is allowed to depreciate the entire plant, but is not allowed to recover depreciation expense on CIAC in its rates. Under generally accepted accounting principles, the utility will depreciate the CIAC fund over the expected life of the assets funded. This is the procedure followed by Florida Public Service Commission. After twenty years, the situation would be as follows:

Gross Utility Plant	$1,000,000	
Less Accumulated Depreciation	(500,000)	(1)
Net Utility Plant	500,000	
Less CIAC	(500,000)	
Add Accumulated Depreciation of CIAC	250,000	(2)
Rate Base	$ 250,000	

((1) debit to expense - (2) credit to expense = net depreciation expense allowed in rates)

Rate base by source of funds would be broken down as follows:

	Source of Funds			
	Investment Capital	CIAC Funds	Total	
Gross Utility Plant	$ 500,000	$ 500,000	$1,000,000	
Less Accumulated Depreciation	(250,000)	(250,000)	(500,000)	(1)
Net Utility Plant	250,000	250,000	500,000	
Less CIAC		(500,000)	(500,000)	
Add Accumulated Depreciation of CIAC		250,000	250,000	(2)
Rate Base	$ 250,000	$ -0-	$ 250,000	

((1) debit to expense - (2) credit to expense = net depreciation expense allowed rates)

As this example illustrates, the accumulated depreciation on CIAC must be added back if rate base is to equal the $250,000 of net utility plant financed with investment capital. If there is no add-back, the utility would have a zero rate base after 20 years, even though it would have recovered only one-half of its original $500,000 investment in plant through depreciation charges from the ratepayer. Thus, the add-back as shown on the line entitled "Add Accumulated Depreciation of CIAC" is necessary in order to avoid an unconstitutional taking of the utility's property without compensation.

The application of the formula adopted in Citizens v. Florida Public Service Commission reaches the same result. Using the hypothetical immediately above, the following would be true: X = $500,000, Y = $500,000, X + Y represents $1,000,000, A represents $250,000, B

represents $250,000, (A + B) represents $500,000. We then have rate base = ($500,000 + $500,000) - [($250,000 + $250,000) + $500,000] + $250,000. When those numbers are calculated, the rate base is $250,000 which represents the depreciated utility plant financed with investor supplied capital. However, without the add-back of the $250,000 (accumulated depreciation on CIAC) at the conclusion of the Court's formula, there would be a double counting of CIAC property and the utility will have been denied an opportunity to earn a return on $250,000 of its investment.

For the reasons discussed above, an add-back of accumulated depreciation on CIAC is always required where depreciation on CIAC is not recovered as an allowable operating expense. In their briefs, the County and the Homeowners purport to demonstrate that such an add-back is neither required nor appropriate. The County's and Homeowners' arguments, however, demonstrate a fundamental misunderstanding of the ratemaking process.

At page 15 of its brief, the County sets forth a hypothetical in which a utility is made up entirely of CIAC property with a gross plant of $100 and a useful life of 10 years. In its Example A concerning that hypothetical, the County asserts that the utility will properly have a zero

rate base during each year of the life of that plant, even if no add-back for accumulated depreciation on CIAC property is made. The County, however, has failed to take into account the fact that whether or not an asset is supplied with investor supplied funds (debt/equity) or customer and developer supplied funds (CIAC), depreciation on that asset is booked in an accumulated depreciation reserve which is subtracted from gross plant in arriving at a rate base.

For example, at the end of its ten year life, the $100 gross plant in the County's hypothetical will have been completely depreciated. In arriving at a rate base at that time, $100 of accumulated depreciation (no matter whether this was depreciation on investor financed assets or contributed assets) would first be deducted from gross plant to arrive at net plant. From net plant, the $100 of CIAC would be subtracted leaving a negative $100 rate base. Contrary to the County's assertion, therefore, the $100 of accumulated depreciation on CIAC would have to be added back to arrive at a zero rate base.

In example C, at page 16 of its brief, the County purports to demonstrate that an add-back of depreciation in its hypothetical would improperly result in a rate base of $100 in year ten of the plant's life. Again, the County fails to recognize that accumulated depreciation would first

be deducted from gross plant in developing the rate base. After accumulated depreciation and gross CIAC have been deducted, the net plant at the end of ten years would be negative $100. Therefore, the adding back of accumulated depreciation on CIAC brings the rate base to zero, not to the $100, as claimed by the County.*/

At page 18 of its brief, Homeowners erroneously assert that adding back CIAC depreciation to rate base would result in the improper inclusion of CIAC property in rate base thereby creating a "windfall" for the utility. Like the County, Homeowners fail to recognize that in arriving at rate base, the accumulated depreciation on all property, including CIAC, would first be deducted from gross plant before gross CIAC is deducted. Accordingly, where CIAC depreciation is not allowed as an operating expense, an add-back of accumulated depreciation on CIAC property is required to insure that the net effect of CIAC on rate base is neither negative nor positive.**/

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*/ Example B on page 16 of the County's brief is not relevant because it does concern a deduction of CIAC from the rate base. FCWC agrees that the $100 of contributions in the hypothetical should be deducted from the rate base and that no return is required on contributed property. As in the County's examples A and C, however, there would be a deduction of all depreciation on all assets in arriving at the rate base. Accordingly, in order to avoid the subtracting CIAC twice from rate base, the accumulated depreciation on CIAC must be added back. This is true unless the deduction of accumulated depreciation reserve is net of amortization on the CIAC.

**/ If the CIAC deducted from gross plant is net of accumulated depreciation, an add-back would not be needed. That is not, however, the way the regulatory process works. Both before the Florida Public Service Commission and the Board of County Commissioners of Sarasota County, it is the gross CIAC that is deducted and not the net of accumulated depreciation on CIAC that is deducted.

Both the County and Homeowners rely on State v. Hawkins, 364 So.2d 723 (Fla. 1978) to support their argument against the necessity of the add-back of accumulated depreciation on CIAC. That reliance is misplaced. The Court in Hawkins held only that an add-back of CIAC depreciation to rate base is inappropriate in cases where a utility is allowed to recover CIAC depreciation as an operating expense.

The County points out in its brief on page 9, that subsequent to the Hawkins case, §367.081(2), Fla. Stat. was amended to provide that CIAC property is not to be included in rate base, and that depreciation on contributed assets is not to be allowed as an operating expense for ratemaking purposes. The County underlines that portion of §367.081(2), Fla. Stat. 1981, in its quote at the bottom of page 9 of its brief. Apparently, the County wishes this Court to ignore the phrase just before the underlined provision which provides that:

> ...accumulated depreciation on such contributions shall not be used to reduce the rate base....

The purpose of that phrase is to make sure that in setting rates for water and sewer utilities, CIAC property is not "double-counted" by subtracting both gross CIAC property and accumulated depreciation on CIAC property from rate base. Pursuant to the statute, in order to assure that accumulated depreciation on CIAC is not used to reduce rate base, such depreciation must be added back since the accumulated depreciation reserve subtracted from gross utility

plant includes depreciation booked on both CIAC and non-CIAC property. Contrary to the County's assertion at page 10 of its brief, the Florida statute is, in fact, "persuasive argument" for the Second District Court's holding that an add-back to rate base of accumulated depreciation on CIAC is constitutionally required where CIAC depreciation is disallowed as an operating expense.

CONCLUSION

Florida Cities Water Company urges this Court to deny certiorari and affirm the Opinion of the District Court of Appeal, Second District.

DATED This 28th day of November, 1983.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY That a true and correct copy of the foregoing Amicus Curiae Brief on behalf of Florida Cities Water Company has been furnished by U.S. Mail addressed to Mr. Daniel Joy, 2055 Wood Street, Suite 200, Sarasota, FL 33577, Mr. Richard E. Nelson and Mr. Omer Causey, Nelson Hesse Cyril Smith Widman & Herb, 2070 Ringling Boulevard, Sarasota, FL 33577, and to Mr. James H. Burgess, Jr., Syprette, Meshad, Resnick & Lieb, P.A., P. O. Box 1238, Sarasota, FL 33578, this 28th day of November, 1983.

B. Kenneth Gatlin