

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation into 1996  
earnings of Florida Public  
Utilities Company - Fernandina  
Beach Division.

DOCKET NO. 971227-EI  
ORDER NO. PSC-97-1505-FOF-EI  
ISSUED: November 25, 1997

The following Commissioners participated in the disposition of  
this matter:

JULIA L. JOHNSON, Chairman  
J. TERRY DEASON  
SUSAN F. CLARK  
DIANE K. KIESLING  
JOE GARCIA

NOTICE OF PROPOSED AGENCY ACTION  
ORDER DISPOSING OF 1996 OVERTURNINGS

BY THE COMMISSION:

NOTICE is hereby given by the Florida Public Service  
Commission that the action discussed herein is preliminary in  
nature and will become final unless a person whose interests are  
substantially affected files a petition for a formal proceeding,  
pursuant to Rule 25-22.029, Florida Administrative Code.

CASE BACKGROUND

During the course of our continuing earnings surveillance  
program, we noted in 1995 that the earnings of the Fernandina Beach  
Division of Florida Public Utilities Company (Fernandina Beach or  
the Company) were in excess of the maximum authorized return on  
equity (ROE) of 12.60%. Commission staff met with the Company, and  
as a result of that meeting, the Company agreed to cap its earnings  
at 12.60%. The Company submitted a letter dated September 5, 1996,  
in which it also agreed to cap its 1996 earnings at a 12.60% Return  
On Equity (ROE). The disposition of any excess earnings was left  
to our discretion. The Company, however, reserved the right to  
request alternative dispositions such as additional contributions  
to its storm damage reserve or the reduction of any depreciation

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FPSD-REGULATORY REPORTING

reserve deficiencies. An Audit Report for the 1996 calendar year was issued on July 10, 1997. The Company's response to the audit report was received on July 30, 1996.

On October 3, 1997, the Company submitted a letter agreeing with our calculation of 1996 excess earnings in the amount of \$132,340, plus interest of \$3,679. In addition, the Company requested that the total amount of \$136,019 be contributed to the Storm Damage Reserve in Fernandina Beach.

#### DISCUSSION OF ISSUES

Based on the adjustments discussed below, we find that the appropriate rate base for Florida Public Utilities Company-Fernandina Beach Division for 1996 is \$14,902,638. Pursuant to its December 1996 Earnings Surveillance Report, the Company reported a total "FPSC Adjusted" rate base of \$15,243,888. (Attachment 1)

Construction Work in Progress: In Audit Exception 3, the Company calculated a 13-month average expenditure of \$106,759 on a work order. The Company accrued Allowance for Funds Used During Construction (AFUDC) on this amount. The Company also included this amount in the Construction Work in Progress (CWIP) account. This accounting created a double return on the investment. Therefore the \$106,759 included in AFUDC has been removed from the 13-month average rate base to eliminate the double counting. In its response to the audit report, the Company agreed with the adjustment.

Working Capital: In Audit Exception 4, the Company did not follow our normal procedure of excluding net fuel underrecoveries from working capital. In this instance the amount that should be removed from working capital is \$213,168. Its response to the audit report indicated that the Company recognized past Commission practice on this issue and agreed to the amount of excess earnings for the purpose of closing this docket. The Company asserted, however, that working capital should be adjusted to zero. The Company also stated that it recognized our past practice of removing underrecoveries from working capital. However, the Company believes that both underrecoveries and overrecoveries, when they occur, should be excluded from working capital.

Provision for 1995 and 1996 rate refunds: In its surveillance report, the Company decreased working capital by \$37,298 on a 13-

month average basis for rate refunds related to overearnings. The account contains amounts related to both 1995 and 1996. The amount related to 1995 is \$31,606, and the amount related to 1996 is \$5,692. These working capital entries have been reversed in order to determine the total amount of the excess earnings for 1996.

Application of 1995 overearnings to the Storm Damage Reserve: In December, 1996, the Company transferred \$63,506 in accruals for overearnings from the Rate Refunds Pending account to the Storm Damage Reserve account. However, we ordered the increase in the reserve be made effective January 1, 1996. Changing the date of the increase from December, 1996, to January, 1996, increased the 13-month average balance for this account by \$58,621. Since this account is a liability account in working capital, the change had the effect of reducing working capital by \$58,621. Therefore, we reduced working capital by \$58,621.

We find that for the purpose of measuring excess earnings, the appropriate overall rate of return for the Fernandina Beach Division is 9.04% based on the ROE cap of 12.60% and a 13-month average capital structure for the period ending December 31, 1996. We began with the 13-month average capital structure from the Company's earnings surveillance report for the period ending December 31, 1996. In its earnings surveillance report, the Company removed its investment in Flo-Gas entirely from common equity in a manner consistent with previous cases. The Company specifically identified deferred taxes, investment tax credits and customer deposits.

We have included the amount of \$5,692 as deferred revenue in the capital structure with an effective interest rate of 5.70%. This amount represents excess earnings for the 1996 year. The cost rate on deferred revenue is the 30 day commercial paper rate as stated in Rule 25-6.109, Florida Administrative Code. The treatment of excess earnings as an item in the capital structure is consistent with the treatment of deferred revenue in the recent earnings review of Tampa Electric Company (see Order No. PSC-97-0436-FOF-EI, issued April 17, 1997). We reconciled the remaining adjustments to rate base on a pro rata basis over investor-supplied sources of capital. We established the return on common equity for Fernandina Beach as 11.60% with a range from 10.60% to 12.60%. It is calculated that the weighted average cost of capital as 9.04%. (Attachment 2) This is the rate of return used to measure excess earnings.

Based on the adjustments discussed below, we find that the appropriate net operating income of the Fernandina Beach Division for 1996 is \$1,427,238. Pursuant to the December 1996 Earnings Surveillance Report, the Company reported a "FPSC Adjusted" net operating income of \$1,385,236. (Attachment 1)

Refund Provision: In 1996, the Company reduced revenues \$5,776 and \$74,000, respectively, related to the 1995 and 1996 overearnings. In order to properly determine the amount of 1996 overearnings, these amounts should be included in revenues. We have reversed these amounts in order to determine the total amount of the excess earnings for 1996.

Medical self insurance expense under allocated: In Audit Exception 5, the Company made an error of \$9,900 in the allocation of medical self insurance expenses between the Fernandina Beach Division and Flo-Gas. Flo-Gas is a wholly-owned unregulated subsidiary of Florida Public Utilities Company. The error caused the expenses to Fernandina Beach to be lower than actual expenses by this amount. To reflect the proper amount of expense for Fernandina Beach, expenses have been increased by \$9,900. As stated in its response to the audit report, the Company agrees with this adjustment.

Interest income on cash in Working Capital: In Audit Disclosure 3, the Company included interest earning cash in working capital but did not include the related interest income in revenues. In the Company's Modified Minimum Filing Requirements review in Docket 930720-EI, we determined that the interest income should be included in revenues if the interest bearing cash is included in working capital. Therefore, operating revenues should be increased by \$1,425. As stated in its response to the audit report, the Company agrees with the statement of facts, but believes it did record the interest income adjustment properly based on Order PSC-0170-FOF-EI, the order for the Marianna Electric Division.

Revenue reduction for imputed negative interest: In the surveillance report, the Company had a negative cash position for the 13 months ending December 31, 1996. Therefore, the Company made an adjustment to reduce revenues of Fernandina Beach by an allocated amount of \$6,432. The stated rationale was that if the Company had to add interest income to revenues for any interest earned on a positive cash position, it could impute negative interest earned on a negative balance of cash and make a corresponding reduction to revenues. We disagreed with the

Company's adjustment and find that the \$6,432 reduction to revenues the Company made because of negative imputed interest must be added back to operating revenues. The Company did not pay any interest on the negative balance of cash. The Company should not make reductions to revenue to benefit from this fact. It should be noted that many companies routinely carry negative balances of cash due to aggressive cash management policies. A negative balance of cash does not necessarily indicate cash flow or other financial problems.

In its response to the audit report, the Company agreed with the statement of facts. The Company, believes, however, that the interest income adjustment was reported properly based on Order No. PSC-94-0170-FOF-EI. The section on interest bearing cash in that order states that any interest earned on cash in working capital is to be included in revenues. This order does not address Company adjustments to revenue for imputed negative interest.

Interest Synchronization: This is a fallout adjustment based on the reconciliation of the rate base and the capital structure due to adjustments to the rate base. In this instance, income taxes should be increased by \$6,480.

We find that the amount of excess earnings for the Fernandina Beach Division for 1996 is \$132,340, plus interest of \$3,679. Based on our findings in the previous issues, we have determined that the excess earnings for 1996 are \$132,340, plus interest of \$3,679. (Attachment 3) This represents an earned ROE of 14.16%, which exceeds the maximum authorized ROE of 12.60%.

We find that the 1996 excess earnings in the amount of \$136,019, including interest, shall be contributed to Fernandina Beach's Storm Damage Reserve. This amount should be booked effective January 1, 1997, for ratemaking, earnings surveillance, and overearnings review purposes. During the last overearnings review for this division, the Company requested that the excess earnings be contributed to the Storm Damage Reserve. The Company cited the current disparity of the reserve and accrual levels between its Marianna and Fernandina Beach Divisions. As of December, 1996, the level of the reserve balances for the two divisions are approximately equal. However, we agree that there appears to be a deficiency in the Storm Damage Reserve for Fernandina Beach, even with the addition of the excess earnings for 1995.

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Because the excess earnings occurred during 1996 and interest has only been calculated for that year, we also find that the increase will be made effective as of January 1, 1997, for all regulatory purposes. This will eliminate the need for the calculation of any additional amounts of interest and will include the increased reserve in the determination of earnings for 1997.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the appropriate amount of rate base for Florida Public Utilities Company-Fernandina Beach Division for determining the amount of excess earnings for 1996 is \$14,902,638. It is further

ORDERED that the appropriate overall rate of return for Florida Public Utilities Company-Fernandina beach Division for determining the amount of excess earnings for 1996 is 9.04% based on the Return On Equity cap of 12.60% and a 13 month average capital structure for the period ending December 31, 1996. It is further

ORDERED that the appropriate net operating income of the Florida Public Utilities Company-Fernandina Beach Division for 1996 is \$1,427,238. It is further

ORDERED that the amount of excess earnings for the Florida Public Utilities Company-Fernandina Beach Division for 1996 is \$132,340, plus interest in the amount of \$3,679. It is further

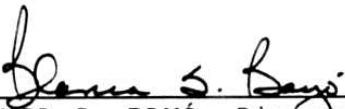
ORDERED that the appropriate disposition of the 1996 excess earnings in the amount of \$136,019 of the Florida Public Utilities Company-Fernandina Beach Division is contribution to the Storm Damage Reserve. This amount shall be booked effective January 1, 1997 for ratemaking, earnings surveillance, and overearnings review purposes. It is further

ORDERED that the provisions of this Order, issued as proposed agency action, shall become final and effective unless an appropriate petition, in the form provided by Rule 25-22.036, Florida Administrative Code, is received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings or Judicial Review" attached hereto. It is further

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ORDERED that in the event this Order becomes final, this Docket shall be closed.

By ORDER of the Florida Public Service Commission this 25th day of November, 1997.

  
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BLANCA S. BAYÓ, Director  
Division of Records and Reporting

( S E A L )

LJP

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

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The action proposed herein is preliminary in nature and will not become effective or final, except as provided by Rule 25-22.029, Florida Administrative Code. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, as provided by Rule 25-22.029(4), Florida Administrative Code, in the form provided by Rule 25-22.036(7)(a) and (f), Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on December 16, 1997.

In the absence of such a petition, this order shall become effective on the day subsequent to the above date as provided by Rule 25-22.029(6), Florida Administrative Code.

Any objection or protest filed in this docket before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

If this order becomes final and effective on the date described above, any party substantially affected may request judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or by the First District Court of Appeal in the case of a water or wastewater utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days of the effective date of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.



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ATTACHMENT 1

FERNANDINA BEACH ELECTRIC DIVISION  
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REVIEW OF 1996 EARNINGS

As Filed FPSC Adjusted Basis	Remove CWIP from Rate Base [X 3]	Reduce W/C for Fuel Underrecov. [X 4]	Provision for 1995 Rate Refund	Provision for 1996 Rate Refund	Additional Storm Damage 1995 Excess Earnings	Underalloc Medical Self Insurance [X 5]	Interest Income on Bank Balances [AD 3]	Reverse Negative Imputed Interest Income	Interest Reconciliatio	Total Adjustments	Total Adjusted Rate Base
<b>RATE BASE</b>											
Plant in Service	\$23,689,652									0	\$23,689,652
Accumulated Depreciation	8,508,695									0	8,508,695
Net Plant in Service	15,180,957	0	0	0	0	0	0	0	0	0	15,180,957
Property Held for Future Use	0									0	0
Construction Work in Progress	165,684	(106,759)								(106,759)	58,925
Net Utility Plant	15,346,641	(106,759)	0	0	0	0	0	0	0	(106,759)	15,239,882
Working Capital	(102,753)		(213,168)	31,606	5,692	(58,621)				(234,491)	(337,244)
<b>Total Rate Base</b>	<b>\$15,243,888</b>	<b>(\$106,759)</b>	<b>(\$213,168)</b>	<b>\$31,606</b>	<b>\$5,692</b>	<b>(\$58,621)</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>(\$341,250)</b>	<b>\$14,902,638</b>
<b>INCOME STATEMENT</b>											
Operating Revenues	\$5,689,684			\$5,776	\$74,000			\$1,425	\$6,432	\$87,633	\$5,777,317
Operating Expenses:										0	0
Operation & Maintenance - Fuel	(2)									0	(2)
Operation & Maintenance - Other	1,651,498					9,900			9,900	1,661,398	
Depreciation & Amortization	824,613									824,613	
Taxes Other Than Income	1,415,050									1,415,050	
Income Taxes - Current	251,724	0	0	2,174	27,846	0	(3,725)	536	2,420	6,480	35,731
Deferred Income Taxes (Net)	187,487			0							187,487
Investment Tax Credit (Net)	(25,922)										(25,922)
(Gain)/Loss on Disposition	0										0
<b>Total Operating Expenses</b>	<b>4,304,448</b>	<b>0</b>	<b>0</b>	<b>2,174</b>	<b>27,846</b>	<b>0</b>	<b>6,175</b>	<b>536</b>	<b>2,420</b>	<b>6,480</b>	<b>45,631</b>
<b>Net Operating Income</b>	<b>\$1,385,236</b>	<b>\$0</b>	<b>\$0</b>	<b>\$3,602</b>	<b>\$46,154</b>	<b>\$0</b>	<b>(\$6,175)</b>	<b>\$889</b>	<b>\$4,012</b>	<b>(\$6,480)</b>	<b>\$42,002</b>
<b>EQUITY RATIO</b>											
	43.52%									0.00%	43.52%
<b>OVERALL RATE OF RETURN</b>	<b>9.09%</b>									<b>0.49%</b>	<b>9.58%</b>
<b>RETURN ON EQUITY</b>	<b>12.69%</b>									<b>1.47%</b>	<b>14.16%</b>

ATTACHMENT 2  
FERNANDINA BEACH ELECTRIC DIVISION  
DOCKET 971227-EI  
REVIEW OF 1996 EARNINGS

**CAPITAL STRUCTURE**

<u>AS FILED - FPSC ADJUSTED</u>	<u>Amount</u>	<u>Ratio</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Long Term Debt	\$5,431,474	35.63%	9.97%	3.55%
Short Term Debt	1,331,579	8.74%	6.19%	0.54%
Preferred Stock	143,062	0.94%	4.75%	0.04%
Customer Deposits	597,462	3.92%	6.57%	0.26%
Common Equity	5,321,426	34.91%	12.60%	4.40%
Deferred Income Taxes	2,017,200	13.23%	0.00%	0.00%
Tax Credits - Zero Cost	724	0.00%	0.00%	0.00%
Tax Credits - Weighted Cost	400,961	2.63%	10.32%	0.27%
<b>Total</b>	<b>\$15,243,888</b>	<b>100.00%</b>		<b>9.07%</b>

<u>ADJUSTED</u>	<u>Amount</u>	<u>Adjustments</u>		<u>Adjusted Total</u>	<u>Ratio</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
		<u>Specific</u>	<u>Pro Rata</u>				
Long Term Debt	\$5,431,474		(\$154,112)	\$5,277,362	35.41%	9.97%	3.53%
Short Term Debt	1,331,579		(\$37,782)	1,293,797	8.68%	6.19%	0.54%
Preferred Stock	143,062		(\$4,059)	139,003	0.93%	4.75%	0.04%
Customers Deposits	597,462			597,462	4.01%	6.57%	0.26%
1996 Deferred Revenue	0	5,692		5,692	0.04%	5.70%	0.00%
Common Equity	5,321,426		(\$150,989)	5,170,437	34.69%	12.60%	4.37%
Deferred Income Taxes	2,017,200			2,017,200	13.54%	0.00%	0.00%
Tax Credits - Zero Cost	724			724	0.00%	0.00%	0.00%
Tax Credits - Weighted Cost	400,961			400,961	2.69%	10.64%	0.29%
<b>Total</b>	<b>\$15,243,888</b>	<b>\$5,692</b>	<b>(\$346,942)</b>	<b>\$14,902,638</b>	<b>100.00%</b>		<b>9.04%</b>

**INTEREST RECONCILIATION**

	<u>Amount</u>	<u>Cost Rate</u>	<u>Interest Exp.</u>	<u>Tax Rate</u>	<u>Effect on Income Tax</u>
Long Term Debt	5,277,362	9.97%	526,153		
Short Term Debt	1,293,797	6.19%	80,086		
Customer Deposits	597,462	6.57%	39,253		
1996 Deferred Revenue	5,692	5.70%	324		
Tax Credits - Weighted Cost	400,961	5.10%	20,449		
Staff Interest Expense			666,266		
Company Interest Expense			683,485		
Staff Adjustment			17,219	37.63%	6,480

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ATTACHMENT 3  
**FLORIDA PUBLIC UTILITIES COMPANY**  
**FERNANDINA BEACH ELECTRIC DIVISION**  
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**REVIEW OF 1996 EARNINGS**

Adjusted Rate Base		\$14,902,638
Achieved Rate of Return	9.58	
Maximum Rate of Return	9.04	
Excess Rate of Return	<u>          </u>	X <u>          0.54%</u>
Excess Net Operating Income		80,474
Revenue Expansion Factor		X <u>          1.6445</u>
Excess Revenues		<u>          \$132,340</u>