BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation into 1998 earnings in the Fernandina Beach Division of Florida Public Utilities Company.	DOCKET NO. 991109-EI ORDER NO. PSC-99-2119-PAA-EI ISSUED: October 25, 1999

The following Commissioners participated in the disposition of this matter:

JOE GARCIA, Chairman
J. TERRY DEASON
SUSAN F. CLARK
E. LEON JACOBS, JR.

NOTICE OF PROPOSED AGENCY ACTION
ORDER DETERMINING AMOUNT AND DISPOSITION OF 1998 EXCESS EARNINGS FOR FLORIDA PUBLIC UTILITIES COMPANY-FERNANDINA BEACH DIVISION

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.

By letter dated May 5, 1998, Florida Public Utilities Company - Fernandina Beach Division (FPUC-FB or the Company) agreed to cap its 1998 earnings at its maximum authorized return on equity (ROE) of 12.60 per cent. The Commission's audit report for the 1998 calendar year issued on August 6, 1999. On August 12, 1999, the Company submitted a letter requesting that the 1998 overearnings be applied to the Fernandina Beach Storm Damage Reserve.

I. THE APPROPRIATE RATE BASE FOR FLORIDA PUBLIC UTILITIES COMPANY - FERNANDINA BEACH DIVISION FOR DETERMINING THE AMOUNT OF EXCESS EARNINGS FOR 1998

In its 1998 Earnings Surveillance Report (ESR), the Company reported a total "FPSC Adjusted" rate base of $15,833,129. Based on the adjustments discussed below, we believe that the appropriate rate base is $15,842,739. Our findings are included in Attachment One which is incorporated into and made a part of this Order.

A. Adjustment 1: Common Plant Allocations - According to Audit Exception 1

The Company used amounts determined in 1997 to allocate common plant between the electric and water divisions. However, these amounts should have been updated to reflect the current amounts as of December 31, 1998. Based on a recalculation using the updated amounts, the following reductions should be made: $5,013 to Plant in Service; $17,526 to Accumulated Depreciation; and $813 to Depreciation Expense.

B. Adjustment 2: Application of 1997 Overearnings to the Storm Damage Reserve

The amount included in working capital is $245,242, on a 13-month average basis, related to the 1997 excess earnings of $248,145. In the review of 1997 earnings, in Order No. PSC-99-0022-FOF-EI, issued January 4, 1999, in Docket No. 981678-EI, we stated, ". . . Fernandina Beach Division shall apply its total 1997 excess earnings of $248,145 to its Storm Damage Reserve effective January 1, 1997, for rate making, earnings surveillance, and earnings review purposes." Based on that Order, the Storm Damage Reserve should be increased by $2,903 ($248,145 less $245,242). Because this account is a working capital liability, the change reduces working capital. Therefore, we believe that working capital should be reduced by $2,903.

II. The Appropriate Overall Rate of Return for Florida Public Utilities Company - Fernandina Beach Division for Determining the Amount of Excess Earnings for 1998

In its ESR, 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.

The Commission audit specifically included $69,123 as excess earnings in the capital structure with an effective interest rate of 5.60%. This amount represents excess earnings for the 1998 year. The cost rate on excess earnings is based on a 12-month average of the 30 day commercial paper rate. The 30 day commercial paper rate is applied pursuant to 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 excess earnings in our previous reviews of FPUC-FB earnings, such as that discussed in Order No. PSC-99-0022-FOF-EI, Docket No. 981678-EI, issued January 4, 1999.

The company calculated the cost rate for short-term debt as 6.24% by using the actual interest expense and the weighted average monthly balance outstanding for short-term debt. This weighted average monthly balance outstanding is calculated by totaling the balance of outstanding short-term debt for each day and then dividing by the number of days in the year. The Commission audit report calculated a cost rate of 5.67% for short-term debt by using the actual interest expense and the 13-month average balance for short-term debt. We believe that 5.67% is the appropriate cost rate to use for short-term debt for the following two reasons. First, using the 13-month average balance allows the recovery of only the actual interest expense incurred. Second, this method is consistent with the 13-month average balances reported in the capital structure and rate base. Unless this adjustment is made, applying the cost rate calculated by the company to the 13-month average balance of short-term debt would result in an over-recovery of interest expense accrued by the company in 1998.

We reconciled the adjustments to rate base on a pro rata basis over investor-supplied sources of capital. We previously established the return on common equity for FPUC-FB as 11.60% with a range from 10.60% to 12.60% in Order No. PSC-94-0983-FOF-EI, issued August 12, 1994, in Docket No. 930820-EI. Using the top of the range of 12.60%, we find that the weighted average cost of capital is 9.13%. This is the rate of return used to measure excess earnings. Our findings are detailed in Schedule Two which is incorporated into and made a part of this Order.

III. The Appropriate Net Operating Income (NOI) for Florida Public Utilities Company - Fernandina Beach Division for Determining the Amount of Excess Earnings for 1998

In its December, 1998 earnings surveillance report, the Company reported a total "FPSC Adjusted" NOI of $1,528,097. Based on the adjustments discussed below, we believe that the appropriate NOI is $1,530,969. Our findings are detailed in Schedule Three which is incorporated into and made a part of this Order.

A. Adjustment 3: Legal Fees

Included in Account 923.2, Legal Fees and Expenses, was a charge for $7,796.72 to legal expenses related to an employee of the Water Division. The Company has indicated that this expense should not have been charged to the Electric Division. Therefore, we believe that the expenses should be removed from the electric accounts. This reduces expenses by $7,796.72.

B. Adjustment 4: Interest Reconciliation

This adjustment is based on the reconciliation of the rate base and the capital structure based upon adjustments to rate base. In this instance, income taxes should be increased by $2,498.

C. Adjustment 5: Tax Effect of Other Adjustments

The tax effect of the adjustments to rate base and NOI results in a $5,738 increase in income taxes. This adjustment includes Adjustment 4, Interest Reconciliation, of $2,498.

IV. The amount of excess earnings for Florida Public Utilities Company - Fernandina Beach Division for 1998

Based upon our findings for the issues discussed above, we believe that FPUC-FB's excess earnings for 1998 are $135,521 plus interest of $3,706, for a total of $139,228. This represents an earned ROE of 14.05% which exceeds the maximum ROE of 12.60%

V. The Appropriate Disposition of the 1998 Excess Earnings of Florida Public Utilities Company - Fernandina Beach Division

By Order No. PSC-97-0135-FOF-EI, issued February 10, 1997, in Docket No. 961542-EI, and Order No. PSC-97-1505-FOF-EI, issued November 25, 1997, in Docket No. 971227-EI, we found that FPUC-FB's excess earnings for 1995 and 1996 should be applied to the Storm Damage Reserve. During the 1995 over earnings review, the Company filed a letter requesting that any over earnings be applied to the Storm Damage Reserve because of the disparity of the reserve and accrual levels between its Marianna and Fernandina Beach electric divisions. We stated in Order No. PSC-97-1505-FOF-EI, that there appeared to be a deficiency in the Storm Damage Reserve even with the addition of the excess earnings for 1995.

By Order No. PSC-94-0170-FOF-EI, issued February 10, 1994, in Docket NO. 930400-EI, we approved an annual accrual of $100,000 to establish a $1 million storm damage reserve over 10 years for the Marianna Division. The reserve balance on June 30, 1999, was $461,167 for the Marianna Division. For the Fernandina Beach Division, the Commission approved, by Order No. 22224, issued November 27, 1989, in Docket No. 881056-EI, an annual accrual of

$21,625; no target amount for the reserve was discussed in the order. The reserve balance at August 31, 1999, was $647,550 for the Fernandina Beach Division.

By letter dated August 12, 1999, the Company requested that the 1998 over earnings for Fernandina Beach be applied to the Storm Damage Reserve. The Company believes that the reserve is deficient based on the greater potential for loss at FPUC-FB because of its larger gross plant investment and a more vulnerable coastal location than FPUC-Marianna. The gross plant investment in Fernandina Beach exceeds that of Marianna by approximately 22%. In the 1988 Fernandina Beach rate case, the Commission recognized the need for the accrual to be 25% greater than that of Marianna based on size and location.

We agree with the Company that there continues to be a deficiency in the Storm Damage Reserve for the Fernandina Beach Division even after contributing over earnings from 1995, 1996, and 1997. Therefore, we believe that it is proper to apply the 1998 over earnings to the Storm Damage Reserve.

Because the excess earnings occurred during 1998 and interest has only been calculated for that year, we believe that the increase to the reserve should be made effective as of January 1, 1999, for all regulatory purposes. This eliminates the need for the calculation of any additional amounts of interest and includes the increased reserve in the determination of earnings for 1999. This treatment is consistent with: Order No. PSC-97-0135-FOF-EI, issued February 10, 1997, in Docket No. 961542; Order No. PSC-97-1505-FOF-EI, issued November 25, 1997, in Docket No. 971227; and, Order No. PSC-99-0022-FOF-EI, issued January 4, 1999, in Docket No. 981678.

It is therefore,

ORDERED by the Florida Public Service Commission that the appropriate rate base for Florida Public Utilities Company - Fernandina Beach Division for determining the amount of excess earnings for 1998 is $15,842,739. 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 1998 is 9.13%. It is further

ORDERED that the appropriate net operating income for Florida Public Utilities Company - Fernandina Beach Division for determining the amount of excess earnings for 1998 is $1,530,969. It is further

ORDERED that the amount of excess earnings for Florida Public Utilities Company - Fernandina Beach Division for 1998 is $139,228, or an earned return on equity of 14.05%. It is further

ORDERED that the 1998 excess earnings of Florida Public Utilities company - Fernandina Beach Division shall be applied to the FPUC-FB's Storm Damage Reserve. It is further

ORDERED that the provisions of this Order, issued as proposed agency action, shall become final and effective upon the issuance of a Consummating Order unless an appropriate petition, in the form provided by Rule 28-106.201, 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" attached hereto. It is further

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 October, 1999.

BLANCA S. BAYÓ, Director
Division of Records and Reporting

By: Kay Flynn
Kay Flynn, Chief
Bureau of Records

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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 that is available under Section 120.57, 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 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.

The action proposed herein is preliminary in nature. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, in the form provided by Rule 28-106.201, 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 November 15, 1999.

In the absence of such a petition, this order shall become final and effective upon the issuance of a Consummating Order.

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.

FLORIDA PUBLIC UTILITIES COMPANY
FERNANDINA BEACH ELECTRIC DIVISION
DOCKET NO. 991109-EI
REVIEW OF 1998 EARNINGS

	As Filed FPSC Adjusted Basis	Common Plant Allocations	Application of 1997 Overearnings to Storm Damage Reserve	Legal Fees	Interest Reconciliation/ ITC Synchronization	Total Adjustments	Total Adjusted Rate Base
RATE BASE							
Plant in Service	$26,459,843	($5,013)				($5,013)	$26,454,830
Accumulated Depreciation	10,039,158	(17,526)				(17,526)	10,021,632
Net Plant in Service	16,420,685	12,513	0		0	12,513	16,433,198
Property Held for Future Use	0					0	0
Construction Work in Progress	284,128	0				0	284,128
Net Utility Plant	16,704,813	12,513	0		0	12,513	16,717,326
Working Capital	(871,684)		(2,903)			(2,903)	(874,587)
Total Rate Base	$15,833,129	$12,513	($2,903)		$0	$9,610	$15,842,739
INCOME STATEMENT							
Operating Revenues	$6,376,995					$0	$6,376,995
Operating Expenses:						0	0
Operation & Maintenance - Fuel	0					0	0
Operation & Maintenance - Other	1,962,644	0		(7,797)		(7,797)	1,954,847
Depreciation & Amortization	931,060	(813)				(813)	930,247
Taxes Other Than Income	1,484,708	0				0	1,484,708
Income Taxes - Current	653,100	306	0	2,934	2,498	5,738	658,838
Deferred Income Taxes (Net)	(156,811)					0	(156,811)
Investment Tax Credit (Net)	(25,803)					0	(25,803)
(Gain)/Loss on Disposition	0					0	0
Total Operating Expenses	4,848,898	(507)	0		2,498	(2,872)	4,846,026
Net Operating Income	$1,528,097	$507	$0	($4,863)	($2,498)	$2,872	$1,530,969
EQUITY RATIO	46.13%					0.00%	46.13%
OVERALL RATE OF RETURN	9.65%					0.01%	9.66%
RETURN ON EQUITY	13.80%					0.25%	14.05%

ATTACHMENT 2

FLORIDA PUBLIC UTILITIES COMPANY
FERNANDINA BEACH ELECTRIC DIVISION
DOCKET NO. 991109-EI
REVIEW OF 1998 EARNINGS

CAPITAL STRUCTURE AS FILED - FPSC ADJUSTED	Amount	Ratio	Cost Rate	Weighted Cost
Long Term Debt	$5,332,312	33.68%	9.93%	3.35%
Short Term Debt	1,480,194	9.35%	6.24%	0.58%
Preferred Stock	139,373	0.88%	4.75%	0.04%
Customer Deposits	640,270	4.04%	6.57%	0.27%
Common Equity	5,953,039	37.60%	12.60%	4.74%
Deferred Income Taxes	1,938,005	12.24%	0.00%	0.00%
Tax Credits - Zero Cost	1,891	0.01%	0.00%	0.00%
Tax Credits - Weighted Cost	348,045	2.20%	10.67%	0.23%
Total	$15,833,129	100.00%		9.22%

ADJUSTED	Amount	Adjustments: Specific	Adjustments: Pro Rata	Adjusted Total	Ratio	Cost Rate	Weighted Cost
Long Term Debt	$5,332,312	($28,562)	$3,971	$5,307,721	33.50%	9.93%	3.33%
Short Term Debt	1,480,194	(7,928)	1,102	1,473,368	9.30%	5.67%	0.53%
Preferred Stock	139,373	(747)	104	138,730	0.88%	4.75%	0.04%
Customers Deposits	640,270			640,270	4.04%	6.57%	0.27%
1998 Excess Earnings	0	69,123		69,123	0.44%	5.60%	0.02%
Common Equity	5,953,039	(31,886)	4,433	5,925,586	37.40%	12.60%	4.71%
Deferred Income Taxes	1,938,005			1,938,005	12.23%	0.00%	0.00%
Tax Credits - Zero Cost	1,891			1,891	0.01%	0.00%	0.00%
Tax Credits - Weighted Cost	348,045			348,045	2.20%	10.62%	0.23%
Total	$15,833,129	$0	$9,610	$15,842,739	100.00%		9.13%

INTEREST RECONCILIATION

	Amount	Cost Rate	Interest Exp.	Tax Rate	Effect on Income Tax
Long Term Debt	$5,307,721	9.93%	$527,057		
Short Term Debt	1,473,368	5.67%	83,540		
Customer Deposits	640,270	6.57%	42,066		
1998 Deferred Revenue	69,123	5.60%	3,871		
Tax Credits - Weighted Cost	348,045	4.75%	16,544		
Staff Interest Expense			673,077		
Adj. Company Interest Expense			679,717		
Staff Adjustment			$6,640	37.63%	$2,498

ATTACHMENT 3

FLORIDA PUBLIC UTILITIES COMPANY
FERNANDINA BEACH ELECTRIC DIVISION
DOCKET NO. 991109-EI
REVIEW OF 1998 EARNINGS

Adjusted Rate Base		$15,842,739
ROR @ 12.60% ROE	X	9.13%
Maximum allowed Net Operating Income		1,446,442
Achieved Net Operating Income		1,530,969
Excess Net Operating Income		84,526
Revenue Expansion Factor	X	1.6033
Excess Revenues		135,521
Interest		3,706
TOTAL 1998 EXCESS REVENUE		$139,228