BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Investigation of 1995 earnings of Florida Division of Chesapeake Utilities Corporation.	DOCKET NO. 970023-GU ORDER NO. PSC-97-0136-FOF-GU ISSUED: February 10, 1997

The following Commissioners participated in the disposition of this matter:

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

NOTICE OF PROPOSED AGENCY ACTION
ORDER DISPOSING OF EXCESS EARNINGS FOR 1994 AND 1995

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

By Order No. PSC-95-0160-FOF-GU, issued on February 6, 1995, the Commission approved the Florida Division of Chesapeake Utilities Corporation's (Chesapeake or Company) proposal regarding the capping of its earnings for calendar years 1994 and 1995. In Order No. PSC-95-1205-FOF-GU, issued on September 28, 1995, we determined the overearnings for 1994 to be $62,360. As stated in Order No. PSC-95-0160-FOF-GU, these 1994 revenues were deferred until 1995.

Chesapeake's December 1995 Earnings Surveillance Report, filed on February 27, 1996, indicated that the Company had overearned for 1995. Therefore, in accordance with the provisions of Order No. PSC-95-0160-FOF-GU, our staff conducted an audit of the surveillance report. On November 15, 1996, the Company filed a revised Earnings Surveillance Report which still indicated there were overearnings in 1995. This Order addresses the calculation of the Company's overearnings for 1995 and the disposition of the overearnings for both 1994 and 1995.

For the purposes of calculating the 1995 overearnings, we determined that Chesapeake's 1995 earnings should be capped at an ROE of 11.5%, which yields a rate of return of 9.25%. (Attachment 2) In Order No. PSC-95-0160-FOF-GU, we accepted the Company's offer to cap 1994 earnings at a Return on Equity (ROE) of 12.0% and to cap 1995 earnings at an ROE of 12.0% plus or minus an adjustment based on the relative change in long-term interest rates. The adjustment was to be calculated by subtracting the average yield on 30-year Treasury bonds for the period October, November, and December, 1994, from the average yield on 30-year Treasury bonds for October, November, and December, 1995. The average yield for each three-month period was to be determined by averaging the applicable monthly averages as reported in the Moody's Bond Survey. In addition, we stated that the upward or downward adjustment resulting from this calculation, for purposes of determining the 1995 earnings cap, should not exceed 50 basis points.

The average monthly yields on 30-year Treasury bonds as reported by Moody's for the months of October, November, and December, 1994 were 7.93%, 8.07%, and 7.87%, respectively. The average monthly yields on 30-year Treasury bonds as reported in Moody's for the months of October, November, and December, 1995 were 6.37%, 6.25%, and 6.06%, respectively. Subtracting the average for the three-month period in 1994 of 7.96% from the average for the three-month period in 1995 of 6.23% produces a spread of 173 basis points. Because we limited the adjustment resulting from this calculation to a maximum of 50 basis points, the earnings cap for 1995 is 11.5%.

We find that the amount of overearnings for 1995 is $229,678. (Attachment 1) This amount is based on the adjustments made by the Company in its original 1995 Earnings Surveillance Report (ESR), the Company's adjustments in its revised ESR, and our additional adjustments. All adjustments are discussed below.

Adjustment 1: Self Insurance Reserve - As part of the Company's last rate case, Order No. 23166, Working Capital was adjusted to include an insurance reserve established by Chesapeake. This reserve was intended to provide for the deductibles and other uncovered costs of the Company's insurance. In the original ESR for calendar year 1995, this reserve account had not been adjusted for actual claims. The Company included this adjustment in the revised ESR. We find this adjustment to be reasonable.

Adjustment 2: Interest Payable - The Company is only a division of Chesapeake Utilities Corporation, therefore, it does not have any debt on its books as all debt is reflected on the consolidated books. Because of this, the Company did not include in the original ESR an amount for the accrued interest payable which the Company would have incurred on a stand-alone basis. The Company, in the revised ESR, reflected this accrual with an adjustment of $102,304 which reduces Working Capital. We reviewed the calculation of this adjustment and consider it reasonable.

<u>Adjustment 3</u>: **Flex Rate Liability** - In the original ESR, the Company treated this liability as a deduction from Working Capital. Because this account accrues interest at the thirty day commercial paper rate and consists of an amount owed to customers, the liability is similar to Short Term Debt, and thus should be included in the Capital Structure. In the revised ESR, the Company included this liability account in the Capital Structure. We find that this adjustment of $256,568 is reasonable.

<u>Adjustment 4</u>: **Reserve for Refunds** - This account includes the accrued amount of overearnings for 1994 and 1995. In the original ESR, the Company removed this accrual from Working Capital. In the revised ESR, the Company included the accrual in the Working Capital calculation, resulting in a reduction in Rate Base of $131,180. We find that the amount of the accrual reasonably reflects the estimated amount of excess earnings for 1995 and the actual amount determined for 1994.

<u>Adjustment 5</u>: **Income Tax Accrual** - In the original ESR, the Company did not reduce the tax accrual accounts for its portion of Chesapeake Utilities Corporation's total stand-alone quarterly tax payments. As a result, the accrual accounts were overstated. In the revised ESR, the Company adjusted these accounts by the amount of $700,055. Upon review, we find that this adjustment is proper.

Based on the above adjustments, the Company increased its Net Operating Income (NOI) by $2,973 due to the change in the interest synchronization adjustment. We find that this is an appropriate adjustment.

<u>Adjustment 6</u>: **Overrecovery of Purchased Gas Cost** - In addition to the Company's adjustments, we made an additional adjustment which involves the Company's Unrecovered Purchased Gas Cost (PGA) account. According to the 1995 ESR, the Company removed an overrecovery of $693,286 from Working Capital. The Company states that it has been diligent in trying to reduce PGA overrecoveries and that the factors which caused the overrecoveries were beyond the Company's control. Therefore, the Company believes that it should not be penalized for its overrecovered PGA balance and the appropriate treatment of the PGA balance should be as a component of Capital Structure.

It has been our policy that these overrecoveries should be treated as cost-free liabilities which are used to reduce a utility's working capital allowance. See Docket No. 830012-EU (Tampa Electric Company) and Docket No. 960502-GU (City Gas Company). If overrecoveries are not recognized in Working Capital, Rate Base is increased and the utility earns a return on the overrecovery. In other words, the ratepayer provides the interest on the overrecovery. By including overrecoveries as a reduction to Working Capital, a company will have an incentive to make its projections for the cost recovery clause as accurate as possible and avoid large overrecoveries. We also note that Chesapeake had opportunities to reduce overcollections during 1995. For these reasons, we find that the $693,286 overrecovery should be a reduction to Working Capital. This reduction in Working Capital results in a pro rata change in the Capital Structure. In addition, there is a $9,458 adjustment to decrease Net Operating Income for interest synchronization.

Considering the above adjustments, we find that the Company's 1995 thirteen-month average Rate Base to be $15,016,701, with Net Operating Income of $1,529,607. The resulting rate of return is thus 10.14%, and using the adjusted Capital Structure, the Return on Equity is 13.27%, or 1.77% above the cap. The excess Net Operating Income for calendar year 1995 is $140,562, resulting in overearnings of $229,678.

We also find that Chesapeake's overearnings for 1994 and 1995 shall be credited to the Company's accumulated reserve for environmental clean-up costs. The Company is still in the process of evaluating the extent and cost of the environmental clean-up of a former gas manufacturing site. Because of this, it faces a potentially significant expense for this item. In a recent proposal to the Florida Department of Environmental Protection, the Company estimated these costs to be between approximately $475,000 and $1.5 million.

In order to provide for this major expense, in Order No. PSC-95-0160-FOF-GU, we allowed Chesapeake in 1994 to retroactively resume its $71,114 annual accrual to its environmental clean-up reserve. We further allowed the Company to offset the 1994 excess earnings against any costs incurred in 1995.

Even though Chesapeake did not incur a significant amount of environmental clean-up expenses in 1995, it is probable that the Company will continue to incur these expenses in the near future. Therefore, we approve the Company's proposal to apply its excess earnings for 1994 and 1995 to the accumulated reserve for environmental costs. As of December 31, 1995, the reserve balance was $64,181. By crediting the reserve balance with the amount of the overearnings for 1994 and 1995, the balance as of December 31, 1995 is $356,219. This revised balance is still significantly below the estimate for the total cost of the clean-up.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the Florida Division of Chesapeake Utilities Corporation's excess earnings for 1994 of $62,360 and 1995 of $229,670, shall be credited to the accumulated reserve for environmental clean-up costs. 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

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

By ORDER of the Florida Public Service Commission, this 10th day of February, 1997.

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BLANCA S. BAYÓ, Director
Division of Records and Reporting

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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 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.

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 March 3, 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.

ATTACHMENT 1

FLORIDA DIVISION OF
CHESAPEAKE UTILITIES CORPORATION
DOCKET NO. 970023-GU

CALCULATION OF 1995 EXCESS REVENUE

NET OPERATING INCOME PER REVISED ESR		$1,539,065
FPSC Adjustment #6:		
Interest	(9,458)	
Total Adjustments		(9,458)
Adjusted NOI		$1,529,607
RATE BASE PER ESR		$15,709,986
FPSCAdjustment #6:		
Work. Cap. - Overrecovery of Purch. Gas Cost	(693,286)	
Total Adjustments		(693,286)
Adjusted Rate Base		$15,016,700
RCR @ 11.50% ROE	x	9.25%
Maximum allowed NOI		1,389,045
Achieved NOI		1,529,607
Excess NOI		140,562
NOI Multiplier	x	1.634
TOTAL 1995 EXCESS REVENUE		$229,679

FLORIDA DIVISION OF CHESAPEAKE UTILITIES CORPORATION, INC.
DOCKET NO. 970023-GU

ATTACHMENT 2

1995 CAPITAL STRUCTURE

	PER ESR	FPSC SPECIFIC ADJUSTMENTS	FPSC ADJUSTED	RATIO (%)	COST RATE (%)	WEIGHTED COST (%)
LONG TERM DEBT - IRB	668,269		668,269	4.45%	6.65%	0.30%
LONG TERM DEBT - OTHER	4,362,890	(247,780)	4,115,110	27.40%	8.63%	2.36%
SHORT TERM DEBT	1,000,882	(49,292)	951,590	6.34%	6.06%	0.38%
FLEX RATE LIABILITY	256,568		256,568	1.71%	6.02%	0.10%
CUSTOMER DEPOSITS	428,306		428,306	2.85%	8.48%	0.24%
COMMON EQUITY	8,045,068	(396,213)	7,648,855	50.94%	11.50%	5.86%
INVESTMENT TAX CREDIT	418,860		418,860	2.79%	0.00%	0.00%
DEFERRED INCOME TAXES	529,143		529,143	3.52%	0.00%	0.00%
DEFERRED INCOME TAXES 109	(25,569)		(25,569)	-0.17%	0.00%	0.00%
REGULATORY ASSET/LIAB. 109	25,569		25,569	0.17%	0.00%	0.00%
TOTAL	15,709,986	(693,285)	15,016,701	100.00%		9.25%