State of Florida

Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

RECEIVED-FPSC
99 SEP 23 AM 11:54
RECORDS AND REPORTING

-M-E-M-O-R-A-N-D-U-M-

DATE: SEPTEMBER 23, 1999

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYÓ)

FROM: DIVISION OF AUDITING AND FINANCIAL ANALYSIS (REVELL, D. DRAPER, MAILHOT, SLEMKEWICZ, C. ROMIG)
DIVISION OF ELECTRIC AND GAS (BREMAN)
DIVISION OF LEGAL SERVICES (JAYE)

RVE JS DM JDJ

RE: DOCKET NO. 991109-EI - INVESTIGATION INTO 1998 EARNINGS IN THE FERNANDINA BEACH DIVISION OF FLORIDA PUBLIC UTILITIES COMPANY.

AGENDA: 10/05/99 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\AFA\WP\991109.RCM
ATTACHMENTS 1 AND 2 ARE NOT AVAILABLE
R:\PSC\AFA\123\FPU_FB98.WK4
- ATTACHMENTS 3, 4, & 5

CASE BACKGROUND

Due to the Commission's continuing earnings surveillance program, Staff noted that the 1998 earnings of the Florida Public Utilities Company - Fernandina Beach Division (FPUC-FB or the Company) were in excess of the maximum authorized return on equity (ROE) of 12.60%. By letter dated May 5, 1998, the Company agreed to cap its 1998 earnings at a 12.60% ROE. (Attachment 1) The Commission was to use its discretion to dispose of any excess earnings. The Company, however, did reserve the right to request alternative dispositions such as additional contributions to its Storm Damage Reserve or the reduction of any depreciation reserve deficiencies. Staff issued an audit report for the 1998 calendar year on August 6, 1999.

DOCUMENT NUMBER-DATE
11476 SEP 23 99
FPSC-RECORDS/REPORTING

On August 12, 1999, the Company submitted a letter requesting that the 1998 overearnings be applied to the Fernandina Beach Storm Damage Reserve. (Attachment 2)

DISCUSSION OF ISSUES

ISSUE 1: What is the appropriate rate base for Florida Public Utilities Company - Fernandina Beach Division for determining the amount of excess earnings for 1998?

RECOMMENDATION: The appropriate rate base for FPUC-FB for determining the amount of excess earnings for 1998 is $15,842,739. (Attachment 3) (REVELL)

STAFF ANALYSIS: 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, Staff recommends that the appropriate rate base is $15,842,739.

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.

Adjustment 2: Application of 1997 Overearnings to the Storm Damage Reserve - 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, the Commission 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 the Order, the Storm Damage Reserve should be increased by $2,903 ($248,145-$245,242). Because this account is a working capital liability, the change reduces working capital. Therefore, Staff recommends that working capital be reduced by $2,903.

ISSUE 2: What is the appropriate overall rate of return for Florida Public Utilities Company - Fernandina Beach Division for determining the amount of excess earnings for 1998?

RECOMMENDATION: For measuring excess earnings, the appropriate overall rate of return is 9.13% based on the ROE cap of 12.60% and a 13-month average capital structure for the period ending December 31, 1998. (Attachment 4) (D. DRAPER)

STAFF ANALYSIS: Staff began with the 13-month average capital structure from the Company's ESR for the period ending December 31, 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.

Staff 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 as per 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 the previous earnings review of FPUC-FB (Order No. PSC-99-0022-FOF-EI, Docket No. 981678-EI).

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. Staff 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. Staff believes 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.

Staff reconciled the adjustments to rate base on a pro rata basis over investor-supplied sources of capital. The Commission established the return on common equity for FPUC-FB as 11.60% with a range from 10.60% to 12.60% (See Order No. PSC-94-0983-FOF-EI, issued August 12, 1994) Using the top of the range of 12.60%, staff calculated the weighted average cost of capital as 9.13%. This is the rate of return used to measure excess earnings.

<u>ISSUE 3</u>: What is the appropriate net operating income (NOI) for Florida Public Utilities Company - Fernandina Beach Division for determining the amount of excess earnings for 1998?

<u>RECOMMENDATION</u>: The appropriate NOI for FPUC-FB for determining excess earnings for 1998 is $1,530,969. (Attachment 3)(REVELL, C. ROMIG)

<u>STAFF ANALYSIS</u>: 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, Staff recommends that the appropriate NOI is $1,530,969.

<u>Adjustment 3:</u> 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, Staff recommends that the expenses be removed from the electric accounts. This reduces expenses by $7,796.72.

<u>Adjustment 4:</u> Interest Reconciliation - This adjustment is based on the reconciliation of the rate base and the capital structure due to Staff adjustments to rate base. In this instance, income taxes should be increased by $2,498.

<u>Adjustment 5:</u> Tax Effect of Other Adjustments - The tax effect of Staff's 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.

ISSUE 4: What is the amount of excess earnings for Florida Public Utilities Company - Fernandina Beach Division for 1998?

RECOMMENDATION: The amount of excess earnings for FPUC-FB for 1998 is $135,521 plus interest of $3,706, for a total of $139,228. (Attachment 5) (REVELL)

STAFF ANALYSIS: Based on the recommendations in the previous issues, Staff has determined 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%

ISSUE 5: What is the appropriate disposition of the 1998 excess earnings of Florida Public Utilities Company - Fernandina Beach Division?

RECOMMENDATION: The total amount of 1998 excess earnings of $135,521 plus interest of $3,706, should be applied to the FPUC-FB's Storm Damage Reserve. The effective date for booking the over earnings should be January 1, 1999, for rate making, earnings surveillance, and over earnings review purposes. (REVELL, BREMAN)

STAFF ANALYSIS: The Commission, by Order Nos. PSC-97-0135-FOF-EI, issued February 10, 1997, and PSC-97-1505-FOF-EI, issued November 25, 1997, 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. The Commission 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.

The Commission approved, by Order No. PSC-94-0170-FOF-EI, issued February 10, 1994, an annual accrual of $100,000 to establish a $1 million storm damage reserve over 10 years for the Marianna Division. The reserve balance at 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, 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 $643,944 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 due to a larger gross plant investment for Fernandina Beach than Marianna and a more vulnerable coastal location. 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.

Staff agrees with the Company's belief 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, Staff recommends that the 1998 over earnings be applied to the reserve.

Since the excess earnings occurred during 1998 and interest has only been calculated for that year, Staff is also recommending that the increase to the reserve 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 Nos. PSC-97-0135-FOF-EI, PSC-97-1505-FOF-EI, and PSC-99-0022-FOF-EI, in the prior FPUC-FB earnings dockets for 1995, 1996, and 1997.

Staff has reviewed the projected 1999 earnings of the Company. The Company projects that its achieved ROE for 1999 will be 12.2% which is under the authorized ceiling of 12.60%. As of the June, 1999 surveillance report, the Company's achieved ROE was 11.79%. Additionally, Order No. PSC-99-0954-PAA-EI, issued May 11, 1999, revised depreciation rates for the Company effective January 1, 1999. These rates will increase expenses by approximately $77,000 per year based on the January 1, 1999 investments. As a result of the above analysis, Staff does not believe that further action concerning the company's earnings is necessary at this time.

ISSUE 6: Should this docket be closed?

RECOMMENDATION: Yes. If no person whose interests are substantially affected by the proposed action files a request for a Section 120.57(1), Florida Statutes, hearing within 21 days of the Order, the Order will become final and effective upon the issuance of a consummating order. Because no further action will be required, this docket should be closed. (JAYE)

STAFF ANALYSIS: If no person whose interests are substantially affected by the proposed action files a request for a Section 120.57(1), Florida Statutes, hearing within 21 days of the Order, the Order will become final and effective upon the issuance of a consummating order. Because no further action will be required, this docket should be closed.

FLORIDA
PUBLIC UTILITIES COMPANY

98 MAY -7 AM 7:57
AUDITING &
FINANCIAL ANALYSIS DIV

P O Box 3395
West Palm Beach
FL 33402-3395

May 5, 1998

Mr Timothy J Devlin Director
Division of Auditing and Financial Analysis
FLORIDA PUBLIC SERVICE COMMISSION
2540 Shumard Oak Blvd
Tallahassee FL 32399-0865

Dear Mr. Devlin:

Florida Public Utilities Company agrees to cap its earned return on equity (ROE) for calendar year 1998 at 12.60% for the Fernandina Beach Electric Division. This cap represents the maximum authorized ROE for this division.

The calculation of the earned ROE will be based on the "FPSC Adjusted Basis" in the Earnings Surveillance Reports for December 1998, using the same adjustments approved in our last FPSC Fernandina Beach rate case. All reasonable and prudent expenses and investment will be allowed in the calculation, but no annualized or pro forma adjustments will be allowed. The calculation is subject to fine tuning by Florida Public Utilities Company and Commission audit.

The disposition of any excess earnings shall be left to the discretion of the Commission. In addition to a direct cash refund, the Company may request consideration of other alternatives such as additional contributions to the storm damage reserve or the reduction of any depreciation reserve deficiencies.

Sincerely,

Darryl L. Troy
Vice President

cc: Jack Shreve, Office of Public Counsel
Gatlin, Schiefelbein, & Cowdery
F Cressman, FPU
J English, FPU
J Brown, FPU
G Bachman, FPU

DTROY/ fpsc-dev-roe.dt

Florida Public Utilities Company

August 12, 1999

Mr Timothy J Devlin Director
Division of Auditing & Financial Analysis
FLORIDA PUBLIC SERVICE COMMISSION
2540 Shumard Oak Blvd
Tallahassee FL 32399-0865

Re: 1998 Over-earnings - Fernandina Beach Electric Operations

Dear Mr. Devlin:

The Company requests that the total over-earnings for 1998 in Fernandina Beach Electric Operations be contributed to the Storm Damage Reserve in Fernandina Beach. We believe the Storm Damage Reserve to be deficient due to the following reasons:

1. The Company's first attempt to establish a Storm Damage Reserve was in our Marianna Rate Case, Docket No. 880558-EI (1988) Although the Company requested an annual allowance of $54,050 based on damages from Hurricane Kate, the Commission thought this was excessive and reduced the annual accrual to $17,300.

2. The Company again sought to establish a storm damage accrual in our Fernandina Beach Rate Case, Docket No. 881056-EI (1988). We again requested an annual accrual of $54,050 based on our argument in the previous Marianna case, the greater potential for loss due to a 25% larger gross plant investment and a more vulnerable coastal location. The final decision was to allow an annual accrual of $21,625 which was 25% larger than that allowed in the Marianna case.

3. In 1993, the Company again filed for rate relief in the Marianna division. In this Rate Case, Docket No. 930400-EI (1993), we requested the annual accrual be increased to $200,000 from the previous authorized level of $17,300. We also requested the Storm Damage Reserve be capped at $1 million. The reasons for this increase were the impact that Hurricane Andrew (1992) had on electric distribution property and on the insurance industry's coverage rates making it impossible to obtain coverage at a reasonable cost. The Final Order in Docket No. 930400-EI reads:

"Accordingly, we shall establish a storm damage reserve of $1 million, with the accrual period for the reserve set at 10 years at $100,000 per year." (Order No. PSC-94-0170-FOF-EI, p.23)

4. The current accumulated Storm Damage Reserves as of June 30, 1999, in Marianna and Fernandina Beach are as follows:

	Accumulated Reserve	**Annual Accrual**
Marianna	$488,665	$100,000
Fernandina Beach	643,932	21,600

It is apparent from items (1) through (4) that there is a deficiency in the Fernandina Beach accumulated Storm Damage Reserve. We are therefore requesting the 1998 excess revenues and interest be transferred to the Fernandina Beach Storm Damage Reserve.

Sincerely,

Darryl L. Troy
Vice President

cc:
J. Shreve – Public Counsel
Norman Horton
J. English - FPUC
J. Brown - FPUC
G. Bachman - FPUC
C. Martin - FPUC
Jay Revell - FPSC/fax (850) 413-6426
P. Foster
C. Stein - FPUC
SJ45-69(1998)
c/fpscroefb.98.dt

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%

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		
1997 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 5

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