BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation into 1999 earnings of Florida Public Utilities Company - Fernandina Beach Division.	DOCKET NO. 001147-EI ORDER NO. PSC-00-1883-PAA-EI ISSUED: October 16, 2000

The following Commissioners participated in the disposition of this matter:

J. TERRY DEASON, Chairman
E. LEON JACOBS, JR.
LILA A. JABER
BRAULIO L. BAEZ

NOTICE OF PROPOSED AGENCY ACTION
ORDER DETERMINING AND DISPOSING OF
EXCESS EARNINGS FOR 1999

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.

Pursuant to this Commission's continuing earnings surveillance program, we noted that the 1999 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%. As a result, an earnings audit of the Company's books and records was performed, and the audit report was issued on June 19, 2000.

By letter dated February 17, 2000, the Company agreed to cap its 1999 earnings at a 12.60% ROE. The Commission was to use its discretion to dispose of any excess earnings. The Company, however, did reserve the right to request alternative disposition such as additional contributions to its Storm Damage Reserve or the reduction of any depreciation reserve deficiencies. On July 20, 2000, the Company submitted a letter requesting that the 1999 overearnings be applied to the Fernandina Beach Storm Damage Reserve.

At the end of 1999, Florida Public Utilities-Fernandina Beach Division served approximately 12,800 customers on Amelia Island in Nassau County. This included approximately 11,445 residential, 1,340 commercial accounts, and two industrial accounts.

Jurisdiction over the subject matter of this docket is vested in the Commission pursuant to Sections 366.04, 366.05, and 366.06, Florida Statutes.

Rate Base

In its 1999 Earnings Surveillance Report (ESR), the Company reported a total "FPSC Adjusted" rate base of $16,132,575. Based on the adjustments discussed below, we find that the appropriate rate base is $16,170,276. These adjustments and calculations are shown in Attachment A to this Order, which is incorporated herein by reference.

Common Plant Allocations - According to Audit Exception 1, the Company used amounts determined in 1998 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, 1999. Based on a recalculation using the updated amounts, the following increases to FPUC-FB should be made: $99,661 to Plant in Service and $20,786 to Accumulated Depreciation; and a decrease of $1,720 to Depreciation Expense.

Application of 1998 Overearnings to the Storm Damage Reserve - Included in working capital is $94,800 on a 13-month average basis related to the 1998 excess earnings of $139,228. In the review of 1998 earnings, in Order No. PSC-99-2119-PAA-EI, issued October 25, 1999, we stated, "...the 1998 excess earnings [$139,228] of FPUC-FB shall be applied to the FPUC-FB's Storm Damage Reserve" effective January 1, 1999. Based on the Order, the Storm Damage Reserve should be increased by $44,428 ($139,228-$94,800). Because this account is a working capital liability, the change reduces working capital. Therefore, working capital should be reduced by $44,428.

Working Capital - Allocation of Accounts Payable - In computing the allowance for working capital, the Company used 1998 base revenue allocation factors of 18.5% instead of 1999 factors of 18.1% to allocate other accounts payable (accounts payable not directly associated with a specific division) to the Fernandina Beach Electric Division. The application of the updated allocation factors decreases FPUC-FB's accounts payable and thereby increases its working capital by $3,254.

Rate of Return

After making the following adjustments, we find that the appropriate overall rate of return for FPUC-FB is 8.96% based on the ROE cap of 12.60% and a 13-month average capital structure for the period ending December 31, 1999. These adjustments and calculations are shown on Attachment B to this Order, which is incorporated herein by reference.

In making these adjustments, we begin with the 13-month average capital structure from the Company's earnings surveillance report (ESR) for the period ending December 31, 1999. 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.

We find that a specific adjustment should be made in the amount of $101,467. This amount represents our calculation of the 13-month average balance of excess earnings for 1999. This amount was included as a separate line item in the capital structure and was assigned an effective cost rate of 5.06%. 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 (see Order No. PSC-99-2119-PAA-EI, issued October 25, 1999).

We find that a specific adjustment should be made to reduce customer deposits by $132,186. The customer deposit account in the Fernandina Beach Division includes both water and electric customers. The amount included in the cost of capital schedule is allocated to the electric division based on a revenue factor. The factor of 94.7% is the factor used in the 1995 Fernandina Beach Water rate case to separate water and electric customer deposits.

In the 1999 Fernandina Beach Water rate case for the historical test year ended December 31, 1998, the Company used a revenue factor of 24.5% for the water customers. Conversely, the factor for the electric customers should be 75.5%. We believe that the customer deposits should be allocated using the factor from the most recent Fernandina Beach Water rate case. Our calculations comparing the 94.7% and the 75.5% show that customer deposits should be reduced by $132,186.

The Company calculated an effective customer deposit cost rate of 6.57%, by using interest expense for 1999, which included an estimated interest expense for the month of May, and a 13-month average balance of customer deposits. Using actual interest expenses for the year and the 13-month average balance of customer deposits, we calculate an effective cost rate of 6.35% for customer deposits. We find that using actual interest expenses in determining the cost rate is appropriate.

We find that the remaining adjustments to rate base should be reconciled 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%, we find that the weighted average cost of capital as 8.96%. This is the rate of return to be used to measure excess earnings.

<u>Net Operating Income</u>

In its December 1999 Earnings Surveillance Report, the Company reported an "FPSC Adjusted" net operating income of $1,565,836. Based on the adjustments discussed below, we find that the appropriate net operating income is $1,573,213.

<u>Out of Period Expenses</u> - The Company included an adjustment increasing operation and maintenance expenses that were incurred in December 1999 but not accrued until January 2000. However, these expenses in the amount of $6,575 were already in the December 1999 general ledger. Therefore, we find that an adjustment of $6,575 should be made to remove the duplicate expenses from 1999 expenses.

<u>Charitable Contributions and Institutional/Goodwill Advertising</u> - The Company recorded expenses for charitable contributions, which the Commission has a general policy of disallowing. In addition, one of these expenses was recorded twice. Therefore, we find that an adjustment of $3,403 should be made to remove these expenses from NOI. Also, the Company included

advertising expenses in the amount of $597 in Account 115.4010.9301, Institutional/Goodwill Advertising. These ads were Thanksgiving and Christmas greetings from the Company and did not promote either safety or conservation related themes. Therefore, we find that an adjustment of $597 to reduce 1999 expenses should be made, resulting in a total decrease of $4,000 to Operation & Maintenance Expenses - Other.

Tax Effect of Other Adjustments - The tax effect of our adjustments to NOI results in a $4,918 increase in income taxes.

Interest Reconciliation and ITC Interest Synchronization - This adjustment is based on the reconciliation of the rate base and the capital structure due to adjustments to rate base. In this instance, income taxes should be increased by $292.

Excess Earnings

Based on our findings above, we find that FPUC-FB's excess earnings for 1999 are $199,380 plus interest of $5,290, for a total of $204,670. This represents an achieved ROE of 14.73% which exceeds the maximum ROE of 12.60%. Our calculation of the excess earnings, including interest, is shown in Attachment C to this Order, which is incorporated herein by reference.

Disposition of Excess Earnings

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.

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 Company's Marianna Division. The reserve balance at June 30, 2000, was $588,661 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 June 30, 2000, was $732,511 for the Fernandina Beach Division.

By letter dated July 20, 2000, the Company requested that the 1999 overearnings for FPUC-FB 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 24%. 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's belief that there continues to be a deficiency in the Storm Damage Reserve for the Fernandina Beach Division even after contributing overearnings from prior years. Therefore, we find that the 1999 overearnings should be applied to the reserve.

Since the excess earnings occurred during 1999 and interest has only been calculated for that year, we find that the increase to the reserve be made effective as of January 1, 2000, 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 2000. This treatment is consistent with Order Nos. PSC-97-0135-FOF-EI, PSC-97-1505-FOF-EI, PSC-99-0022-FOF-EI, and PSC-99-2119-PAA-EI in the prior FPUC-FB earnings dockets.

Establishment of Storm Damage Reserve Ceiling

The first storm damage accrual for the FPUC-FB was authorized in 1989 in Docket 881056-EI, Order No. 22224, issued November 27, 1989. It stated, "...we feel that it is appropriate to normalize expenses caused by unusual events, such as storms, and therefore will allow the utility to establish this account. However...we will allow an annual accrual of $21,625, which is 25% larger than that allowed in the Marianna rate case." Earlier in 1989, the Commission approved a Storm Damage accrual of $17,300 yearly for the Marianna Division.

After Hurricane Andrew did extensive damage to South Florida and Louisiana in 1992, the Company found it increasingly difficult to purchase storm-related insurance for either of its electric divisions. When the Company filed for a rate increase for the Marianna Division in 1993, it requested an increase in the Storm Damage Reserve from the original $17,300 per year approved in 1989, to an increase to $200,000 yearly until the requested ceiling of $1,000,000 was reached. The Commission approved the ceiling of $1,000,000, but felt that an annual accrual of $100,000 would result in lesser pressure on rates. The approved ceiling and annual accrual are still in effect for the Marianna Division.

The Fernandina Beach Division has not had a full rate case since the original establishment of its reserve in 1989, and in spite of the insurance difficulties caused by Hurricane Andrew, the Company has not requested an increase in its accrual or the establishment of a ceiling for the reserve. For several years, however, the FPUC-FB has experienced rapid growth due to Amelia Island's development as a resort area. This rapid growth resulted in several years of overearnings. The Commission, at the Company's request, has ordered these overearnings placed in the Storm Damage Reserve. As of June 30, 2000, the reserve amount is $732,511, or slightly less than half of the recommended ceiling.

We find that a ceiling should be established in conjunction with the finding below to grant the Company the flexibility to increase its annual accrual to the Reserve whenever it feels earnings will justify such increases. Additionally, we find that the ceiling should be set higher than the ceiling set for Marianna since the Fernandina Beach Division has approximately 10% more in gross distribution plant. For these reasons, we find that a ceiling should be established for the Storm Damage Reserve at $1,500,000.

Increase in Annual Accrual for Storm Damage Reserve

As noted, the Fernandina Beach Division's Storm Damage Reserve account has a relatively low balance of $732,511 as of June 30, compared to the approved ceiling of $1,500,000. At the current accrual amount of $21,625 annually, it will take over 35 years to reach the target level, assuming no storm damage. The present amount of the storm damage reserve would be sufficient to replace only approximately 3 1/2% of gross distribution plant in the event of a major storm.

We find that the Company should be given the flexibility to increase its annual accrual to the accumulated provision account, when the Company believes it is in a position from an earnings standpoint to do so, up to the ceiling of $1,500,000. This is similar flexibility that the Commission granted Gulf Power Company in Order No. PSC-96-0023-FOF-EI, issued January 19, 1996. Florida Public Utilities is still required to record an annual accrual to the Fernandina Beach Storm Damage Reserve of at least $21,625 until the Reserve reaches $1,500,000. Also, the Company shall provide a statement on its future earnings surveillance report when the adjustment is made to increase the amount charged to expense.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the Florida Public Utilities Company - Fernandina Beach Division achieved excess earnings for 1999 which, together with applicable interest, total $204,670, as discussed in the body of this Order. It is further

ORDERED that the Florida Public Utilities Company - Fernandina Beach Division shall apply its total 1999 excess earnings of $204,670 to its Storm Damage Reserve, effective January 1, 2000, for ratemaking, earnings surveillance, and earnings review purposes. It is further

ORDERED that the Storm Damage Reserve ceiling for Florida Public Utilities Company - Fernandina Beach Division be established at $1,500,000. It is further

ORDERED that Florida Public Utilities - Fernandina Beach Division may increase its annual accrual in the Storm Damage Reserve above the present $21,625 yearly accrual until the accumulated provision account balance reaches $1,500,000. 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 16th day of October, 2000.

Blanca S. Bayó

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 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 6, 2000.

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.

ATTACHMENT A

FLORIDA PUBLIC UTILITIES COMPANY
FERNANDINA BEACH ELECTRIC DIVISION
DOCKET NO. 001147-EI
REVIEW OF 1999 EARNINGS

	As Filed FPSC Adjusted Basis	Common Plant Allocations	Application of 1998 Overearnings to Storm Damage Reserve	Working Capital Allocation of A/P	Out of Period Expenses	Charitable Contributions Advertising Expense	Interest Reconciliation/ ITC Synchronization	Total Adjustments	Total Adjusted Rate Base
RATE BASE									
Plant in Service	$27,588,524	$99,661						$99,661	$27,688,185
Accumulated Depreciation	10,718,104	20,786						20,786	10,738,890
Net Plant in Service	16,870,420	78,875						78,875	16,949,295
Property Held for Future Use	0							0	0
Construction Work in Progress	234,788	0						0	234,788
Net Utility Plant	17,105,208	78,875						78,875	17,184,083
Working Capital	(972,633)		(44,428)	3,254				(41,174)	(1,013,807)
Total Rate Base	$16,132,575	$78,875	($44,428)	$3,254				$37,701	$16,170,276
INCOME STATEMENT									
Operating Revenues	$6,457,339							$0	$6,457,339
Operating Expenses:									
Operation & Maintenance - Fuel	0							0	0
Operation & Maintenance - Othe	1,951,810				(6,575)	(4,000)		(10,575)	1,941,235
Depreciation & Amortization	1,026,552	(1,720)						(1,720)	1,024,832
Taxes Other Than Income	1,435,448							0	1,435,448
Income Taxes - Current	490,604	647			2,474	1,505	292	4,918	495,522
Deferred Income Taxes (Net)	24,116							0	24,116
Investment Tax Credit (Net)	(37,027)							0	(37,027)
(Gain)/Loss on Disposition	0							0	0
Total Operating Expenses	4,891,503	(1,073)			(4,101)	(2,495)	292	(7,377)	4,884,126
Net Operating Income	$1,565,836	$1,073	$0	$0	$4,101	$2,495	($292)	$7,377	$1,573,213
EQUITY RATIO	45.07%							0.00%	45.07%
OVERALL RATE OF RETURN	9.71%							0.02%	9.73%
RETURN ON EQUITY	14.68%							0.05%	14.73%

ATTACHMENT B

FLORIDA PUBLIC UTILITIES COMPANY
FERNANDINA BEACH ELECTRIC DIVISION
DOCKET NO. 001147-EI
REVIEW OF 1999 EARNINGS

CAPITAL STRUCTURE AS FILED - FPSC ADJUSTED	Amount	Ratio	Cost Rate	Weighted Cost
Long Term Debt	$5,141,971	31.87%	9.93%	3.17%
Short Term Debt	1,930,043	11.96%	5.56%	0.67%
Preferred Stock	135,143	0.84%	4.75%	0.04%
Customer Deposits	651,980	4.04%	6.57%	0.27%
Common Equity	5,913,464	36.66%	12.60%	4.62%
Deferred Income Taxes	2,036,649	12.62%	0.00%	0.00%
Tax Credits - Zero Cost	1,719	0.01%	0.00%	0.00%
Tax Credits - Weighted Cost	321,606	1.99%	10.44%	0.21%
Total	$16,132,575	100.00%		8.96%

ADJUSTED	Amount	Adjustments Specific	Adjustments Pro Rata	Adjusted Total	Ratio	Cost Rate	Weighted Cost
Long Term Debt	$5,141,971		$26,814	$5,168,785	31.96%	9.93%	3.17%
Short Term Debt	1,930,043		10,065	1,940,108	12.00%	5.56%	0.67%
Preferred Stock	135,143		705	135,848	0.84%	4.75%	0.04%
Customers Deposits	651,980	(132,186)		519,794	3.21%	6.35%	0.20%
1999 Excess Earnings	0	101,467		101,467	0.63%	5.06%	0.03%
Common Equity	5,913,464		30,837	5,944,301	36.76%	12.60%	4.63%
Deferred Income Taxes	2,036,649			2,036,649	12.60%	0.00%	0.00%
Tax Credits - Zero Cost	1,719			1,719	0.01%	0.00%	0.00%
Tax Credits - Weighted Cost	321,606			321,606	1.99%	10.44%	0.21%
Total	$16,132,575	($30,719)	$68,420	$16,170,276	100.00%		8.96%

FLORIDA PUBLIC UTILITIES COMPANY
FERNANDINA BEACH ELECTRIC DIVISION
DOCKET NO. 001147-EI
REVIEW OF 1999 EARNINGS

Adjusted Rate Base		$16,170,276
ROR @ 12.60% ROE	X	8.96%
Maximum allowed Net Operating Income		1,448,857
Achieved Net Operating Income		1,573,213
Excess Net Operating Income		124,356
Revenue Expansion Factor	X	1.6033
Excess Revenues		199,380
Interest		5,290
TOTAL 1999 EXCESS REVENUE		$204,670