State of Florida

Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

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COMMISSION CLERK

DATE: JUNE 19, 2003

TO: DIRECTOR, DIVISION OF THE COMMISSION CLERK & ADMINISTRATIVE SERVICES (BAYÓ)

FROM: DIVISION OF COMPETITIVE MARKETS & ENFORCEMENT (MAKIN, M. MARSHALL, BULECZA-BANKS)
DIVISION OF ECONOMIC REGULATION (SLEMKEWICZ, LESTER)
OFFICE OF THE GENERAL COUNSEL (J. BRUBAKER)

RE: DOCKET NO. 030363-GU - JOINT PETITION FOR APPROVAL OF GAS TRANSPORTATION AGREEMENT BETWEEN FLORIDA PUBLIC UTILITIES COMPANY AND CITY OF LAKE WORTH, AND REQUEST FOR EXPEDITED TREATMENT.

AGENDA: 07/01/03 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\CMP\WP\030363.RCM

CASE BACKGROUND

On July 21, 2000, Florida Public Utilities Company(FPUC or the Company) entered into a Gas Transportation Agreement with Lake Worth Generation (LWG) that was approved by Commission Order No. PSC-00-1002-PAA-GU, issued October 16, 2000. The Gas Transportation Agreement provided for (1) the construction of a natural gas pipeline and related facilities by FPUC to a power generation project being developed by LWG and the City of Lake Worth (CLW); (2) the transportation of natural gas to the Lake Worth Project and the CLW via the Lake Worth lateral; and (3) LWG's commitment to pay certain charges for the natural gas transportation services provided by FPUC over a 30 year period.

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The charges for natural gas transportation services were set at an amount that would permit the Company to recover a return of 11.17% on its undepreciated investment in the construction of the Lake Worth Lateral, plus a recovery of its operation and maintenance (O&M) expenses. LWG's obligation to pay for the natural gas transportation services was secured by an irrevocable letter of credit issued on July 6, 2001, provided to the Company in the amount of the initial estimated cost of construction of $5,490,449.

Construction of the Lake Worth Lateral was completed in June 2002, at a cost of $5,895,594, and FPUC thereafter initiated service to the Lake Worth project.

The gas transportation agreement required monthly payments by LWG in the amount of $109,423.28 for the first year of service, adjusted annually thereafter to account for depreciation of the Lake Worth lateral and adjustments to the O&M expenses. The gas transportation agreement also required LWG to increase the amount of the letter of credit to cover the actual cost of construction of the lateral, once the actual cost was confirmed.

In the fourth quarter of 2002, LWG notified FPUC that, due to financial difficulties encountered by LWG and its contractors in connection with the Lake Worth project, LWG would not be able to increase the letter of credit, or to make monthly payments prospectively beginning in December 2002.

FPUC, LWG and CLW subsequently entered into a Forbearance Agreement dated December 31, 2002, and an amended Forbearance Agreement, dated February 19, 2003. The objective of the Forbearance Agreement was to provide FPUC and CLW with an opportunity to attempt to negotiate a new gas transportation agreement that would enable CLW to proceed with the development of the LWG project, notwithstanding LWG's inability to perform its obligations to FPUC under the gas transportation agreement.

On April 22, 2003, FPUC and CLW filed a joint petition for approval of a Gas Transportation Agreement as a special contract under Rule 25-9.034(1), Florida Administrative Code.

This recommendation addresses the new Transportation Agreement between FPUC and CLW, and the appropriate disposition of the associated early contract termination fee.

Jurisdiction over this matter is vested in the Commission by several provisions of Chapter 366, Florida Statutes, including Sections 366.04, 366.05, and 366.06, Florida Statutes.

DISCUSSION OF ISSUES

ISSUE 1: Should the Commission approve the new Transportation Agreement between Florida Public Utilities (FPUC) and the City of Lake Worth (CLW)?

RECOMMENDATION: Yes. The Commission should approve the Gas Transportation Agreement between FPUC and CLW, effective the date of the Commission vote in this matter. (MAKIN, MARSHALL, BULECZA-BANKS, LESTER)

STAFF ANALYSIS: On March 31, 2003, FPUC and CLW entered into a new gas transportation agreement providing for natural gas transportation service on the Lake Worth lateral to the CLW.

Consistent with FPUC's obligations under the previously approved gas transportation agreement, FPUC would receive CLW's natural gas at the gate station interconnected with the Florida Gas Transmission system (FGT) near the intersection of Lake Worth Road and the Florida Turnpike in Palm Beach County, Florida, and redeliver such gas to the site of the Lake Worth project.

In the event CLW terminates the agreement for any reason other than FPUC's failure to perform due to any event of force majeure that continues for a period of six months or more, CLW must pay FPUC the full amount of FPUC's remaining undepreciated investment in the construction cost of the Lake Worth lateral.

FPUC conducted a cost of service study to calculate the actual construction cost and investment to own and operate the lateral main, as well as FPUC's portion of the cost of the gate station. The cost of service was designed to recover FPUC's investment made to construct the lateral main and gate station, provide a 8.77% rate of return on that investment, and recover the costs of operating and maintaining the dedicated facility. In addition, CLW shall pay to FPUC the actual delivered cost, plus 25%, for the cost of odorant for the Lake Worth lateral. FPUC will invoice the CLW after each delivery.

Under the terms of the agreement, a volumetric transportation rate per therm will not be applied. Instead, the CLW will be responsible for the cost of service through a transportation charge. The transportation charge for year one is $791,208, or $65,934 per month, which will be adjusted annually for O&M index changes and reduced deprecation expenses, and is intended to recover FPUC's costs of providing dedicated transportation services to the Lake Worth Project along with FPUC's investment in the construction of dedicated facilities (net depreciated plant).

As part of its calculation of the charges in the transportation agreement, FPUC employed a return on equity (ROE) of 12.40%. By Order No. PSC-95-0518-FOF-GU, issued April 26, 1995, in Docket No. 940620-GU, the Commission authorized a mid-point ROE of 11.40% for FPUC. The Company recognizes a range of plus or minus 100 basis points around the mid-point ROE for surveillance purposes. Therefore, staff believes the 12.40% ROE is reasonable for purposes of the transportation agreement.

Staff notes that a letter of credit provided security for FPUC's investment under the original transportation agreement between FPUC and LWG. The security for this new transportation agreement is as follows: the CLW's bond rating falls below BBB+ as determined by Standard and Poor's, then CLW will have to post a letter of credit in the amount of FPUC's undepreciated investment plus $37,900. CLW currently has insured bonds that are rated AAA. Staff believes this form of security is acceptable.

ISSUE 2: Should the Commission approve FPUC's proposal to give the Commission jurisdiction over any excess earnings for calendar year 2003 and to accrue up to a maximum of $2 million in its environmental reserves for calendar year 2003?

RECOMMENDATION: Yes, the Commission should approve FPUC's proposal (Attachment 1) to give the Commission jurisdiction over any excess earnings for calendar year 2003 and to accrue up to a maximum of $2 million in its environmental reserves for calendar year 2003. (SLEMKEWICZ)

STAFF ANALYSIS: FPUC has received a $1.5 million early contract termination fee as a result of the new Gas Transportation Agreement with the CLW. The $1.5 million will be included in regular operating revenues and will substantially increase FPUC's earnings for calendar year 2003. In fact, FPUC expects that the inclusion of this amount as operating revenue will result in its achieving excess earnings for calendar year 2003. FPUC is seeking approval to offset its potential excess earnings for calendar year 2003 by accruing up to a maximum of $2 million to its environmental reserves.

FPUC has stated that the current estimate for future environmental costs indicates at least a $2 million reserve shortfall in the amount necessary for projected environmental clean-up expenditures. By Order No. 24094, issued February 12, 1991, in Docket No. 900151-GU, the Commission authorized FPUC to record a 10-year accrual of $240,000 per year for expenses associated with the environmental clean-up of manufactured gas plant sites. This accrual and its 10-year duration was subsequently affirmed by Order No. PSC-95-0518-FOF-GU, issued April 26, 1995, in Docket No. 940620-GU. The 10-year accrual period has expired and FPUC has ceased making accruals to its environmental reserves.

Staff believes that, FPUC's proposal is a reasonable solution to address both the potential excess earnings for calendar year 2003 and, to some degree, the projected shortfall in the environmental clean-up reserves. Therefore, staff recommends that the Commission approve FPUC's proposal in Attachment 1. Although FPUC's proposal gives the Commission jurisdiction over all excess earnings for calendar year 2003, the disposition of any excess earnings not offset by accruals to the environmental reserves should be determined in a separate forum.

ISSUE 3: Should this docket be closed?

RECOMMENDATION: Yes. If a protest is filed by a person whose substantial interests are affected within 21 days of the Commission Order approving this agreement, the agreement should remain in effect pending resolution of the protest. If no protest is filed, this docket should be closed upon the issuance of a Consummating Order. (BRUBAKER)

STAFF ANALYSIS: If a protest is filed by a person whose substantial interests are affected within 21 days of the Commission Order approving this agreement, the agreement should remain in effect pending resolution of the protest. If no protest is filed, this docket should be closed upon the issuance of a Consummating Order.

Docket No. 030363-GU

Date: June 19, 2003

Attachment 1

Florida Public Utilities Company

P.O. Box 3395
West Palm Beach, FL 33402-3395

03 APR 28 AM 9: 33

April 24, 2003

Mr. Timothy Devlin
Florida Public Service Commission
2540 Shumard Oak Blvd
Tallahassee, FL 32399-0950

Dear Mr. Devlin:

Florida Public Utilities Company's Consolidated Natural Gas Division (FPUC) seeks approval by the Florida Public Service Commission (FPSC) through confirmation of our treatment of the $1,500,000 early contract termination fee from our new Gas Transportation Agreement with the City of Lake Worth as operating revenues for the calendar year 2003 in account "Other Gas Revenue 495". We would also like the FPSC to consider allowing any excess earnings in the year 2003, which may primarily result from recognition of this fee, to be disposed of through additional accruals to our environmental reserves.

We feel that the fee is appropriate to be credited to "Other Gas Revenue 495" because it relates to a portion of that agreement which provided for a cash-out settlement to Florida Public Utilities Company for changing the primary terms of our original agreement with Lake Worth Generation. As a result of this treatment, we are currently expecting over earnings of approximately $700,000-$1,000,000 for 2003.

Based on our environmental expert's projection of future environmental costs, our existing funds are currently deficient by over $2,000,000 and accordingly, we request permission to accrue excess 2003 earnings into this environmental fund. This allowance to accrue any excess to the environmental reserve will reduce the future impact to rate payers at our next rate proceeding which will increase base rates to provide for an adequate environmental reserve.

We respectfully request your approval confirming our treatment of the $1,500,000 fee in account "Other Gas Revenue 495" and to allow any potential Natural Gas 2003 excess earnings, up to the maximum of $2,000,000 be accrued and placed in our environmental reserves. If you require any additional information, please contact me at (561) 838-1725 or email me at cmmartin@fpuc.com.

Sincerely,

Cheryl M. Martin

Cheryl M. Martin
Controller

cc: George Bachman
Jack English
Chuck Stein
Office of Public Counsel
SJ 45-69 2003 NG OE