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CHAIRMAN BAEZ

P O Box 3395
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March 11, 2004

The Honorable Braulio L. Baez, Chairman
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

040216-GU

Dear Chairman Baez:

After considerable review and analysis, Florida Public Utilities Company ("FPUC" or the "Company") finds it necessary to file with the Florida Public Service Commission ("Commission") a request for an increase in our Consolidated Natural Gas division's rates and charges in order that we may have the opportunity to earn a fair rate of return on our investment in utility plant and working capital. Earning a fair rate of return will enable us to continue our high quality of service and maintain financial integrity, which are in the best interest of our customers. The Company has experienced and is expected to experience continued increases in expenses. Despite efforts to keep expenses down, many are beyond the control of the Company and we expect a continued significant declining rate of return in our Consolidated Natural Gas operations. Our last natural gas rate proceeding, Docket No. 940620-GU authorized an increase in revenues, which went into effect in May 1995.

In this proceeding the Company will be proposing to combine the base rates for their acquired customers from the recent acquisition of the assets of South Florida Natural Gas (Atlantic Utilities) (SFNG) with the preexisting customers in their Consolidated Natural Gas division. The customers have been combined in our operations of the Consolidated Natural Gas division; however, the base rates and charges for the acquired customers are still as approved in the last SFNG rate proceeding. We have previously combined the PGA rates for these same groups of customers. We will also be requesting approval for some of the related goodwill from this acquisition to be allowed in rate base as an acquisition adjustment.

In accordance with Rule 25-7.140, F.A.C., Test Year Notification, we have selected the twelve-month period ending December 31, 2005 as the projected test year for our petition to increase our rates and charges. We offer the following reasons for selecting this period:

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1. The calendar year serves also as our fiscal year for accounting purposes.

2. The new rates developed in this rate case will be effective close to January 1, 2005.

3. The Company believes the proposed 2005 test year will accurately reflect the economic conditions in which the Consolidated Natural Gas Division will be operating during the first twelve months the new rates will be in effect.

4. The overall rate of return for the twelve-month periods ending December 31, 2004 and 2005 will decline well below our allowable rate of return based on our projections for 2004 and 2005. The overall rate of return for the twelve-month period ending December 31, 2003 is 6.22%, excluding a one time special revenue fee paid in conjunction with a special contract relating to our pipeline constructed in Lake Worth.

As required in the above rule, we submit the following major factors, which necessitate a rate increase along with their estimated annual revenue requirement impact:

1. Recent events have had a significant unfavorable impact to earnings in upcoming financial periods. The decline of the stock market in 2002 has greatly decreased the value of the pension plan assets and has significantly increased pension expense in 2003, and is expected to continue in 2004 and 2005. Current actuarial estimates show pension expense increasing by approximately $1,057,000 in 2004 over 2002 and the estimated annual impact to the Consolidated Natural Gas Division is $547,000. These increases are expected to continue in 2005 as well.

2. Industry events, the events of September 11, 2001, and the recent stock market decline, have resulted in greatly increased insurance costs. Insurance expenses in 2004 have increased $300,000 since 2002. The increase in 2005 is expected to be $731,000; this includes an increase of approximately $560,000 due to medical insurance. The estimated annual impact to the Consolidated Natural Gas Division is $500,000 in 2005 over 2004.

3. Accounting, auditing, and tax service expenses increased $135,000 in 2004 over 2002. Expenses are expected to increase by an additional $50,000 annually in 2005 over 2003 & 2004. This is due to additional work requirements of recent regulations on the external auditors including Sarbanes-Oxley Act and an expanded internal audit and tax program as well as additional regulation related to accelerated filing. The estimated annual impact to the Consolidated Natural Gas Division is $25,000.

4. On December 3, 2002 the Company entered into an agreement to sell certain assets comprising its water utility system to the City of Fernandina Beach. Condemnation by the city had also been a concern and was a factor in our decision to sell the water division. The sale and closing of this transaction took place on March 27, 2003. The Company lost synergies as a result of this sale and the estimated annual impact to the Consolidated Natural Gas Division is $300,000.

5. Based on a review of the adequacy of environmental reserves, the reserves are currently deficient. To bring the reserves to an adequate level over a period of ten years, the estimated annual impact to the Consolidated Natural Gas Division is estimated to be $900,000.

6. The Company requires a new operations/warehouse complex in our South Florida area. Our South Florida operations/warehouse complex ranges in age of 20 years to over 70 years of age and the current facilities are inadequate to fulfill our current and future requirements. The estimated annual costs related to this new property is not known at this time but is expected to result in increases over $50,000 annually in 2005.

7. Significant costs for a bare steel replacement program are expected to be $600,000 annually.

8. Increased concentration and efforts in our customer service areas to provide better service to our customers has also caused recent increases. The estimated annual impact to costs is over $100,000 since 2002.

9. Increased road construction as well as housing and commercial construction has dramatically increased the number of times FPUC's facilities had to be located and the related costs to our company.

10. Expanded our operating hours of our dispatch and Installation and Maintenance departments and increased it to 6 days a week to better service our customers. This has contributed to increases in operating costs.

11. Inflationary effect on new and replacement utility plant and on operating expenses over the 10-year period since our last rate case. The estimated annual impact to the Consolidated Natural Gas Division is unknown at this time.

12. Adjustments in annual depreciation expense that may result from revised new depreciation rates effective with the finalization of our consolidated natural gas depreciation study to be filed in conjunction with this rate proceeding. The estimated annual impact to the Consolidated Natural Gas Division is unknown at this time.

Since our last natural gas rate case, the following measures were implemented for the purpose of reducing revenue requirements:

1. Managing capital expenditures to stay in line with expected increases in customer growth and inflation. Reviewed capital expenditures to try and ensure the increase in net plant per customer amount was kept consistent.

2. Merged our Delray Beach Customer Service and Sales office with the WPB office and sold the property, thus, increasing effectiveness and decreasing O&M associated with having the additional property.

3. Instituted a meter-sampling program approved by the PSC.

4. Improved efficiencies in the office productivity by expanding the use of computers. This included the use of email to increase communication productivity and reduce paperwork. This also includes automation of engineering work by moving to computer aided design and a Marketing Generation Construction Order System.

5. Issuance of short-term and long-term debt with favorable interest rates to assist in the financing requirements of capital and operating expenditures.

6. Changed external audit firms to help offset the cost increases as a result of expanding requirements from the SEC and accounting regulations.

7. Sale of the water division at a favorable price delayed our need to issue additional equity, and also allowed us to pay down our line of credit.

8. To hold down rising medical insurance costs we have made changes in medical programs, premiums and deductibles over the years. In 2003 the Company made revisions to the insurance plan to help minimize the effect on operating income in 2004 and 2005.

9. The Company historically has been able to manage costs. Steps are taken to budget and find ways to keep costs down on a continual basis.

FPUC will be filing MFR schedules consistent with current Commission minimum filing requirements and those filed in our last rate case for our Consolidated Natural Gas Division, Docket No. 940620-GU. Finally, the calendar year 2005 will be presented as the projected test year, calendar year 2004 will be presented as the projected prior year and the calendar year 2003 will be presented as the historic year.

The Company has not undertaken this filing without a considerable amount of study. We have undertaken to provide quality service to our customers and to tightly control our expenses. Our rates are among the lowest in Florida; but we are experiencing increases, which are beyond our control, and we cannot continue to maintain a high quality of service and customer satisfaction at the current rates.

We plan to file the minimum filing requirements (MFRs) for rate relief on or before June 1, 2004 and will advise you if this date cannot be met. We also will be seeking interim rate relief. We are requesting that the Commission allow this rate proceeding to be processed as a Proposed Agency Action (PAA) as authorized in section 366.06(4), Florida Statutes. If you need any additional information, please let me know.

Sincerely,

George M. Bachman
CFO and Treasurer

CC:
Norman Horton, Esq.
Jack English
Don Kitner
Cheryl Martin
Marc Schneidermann
Bob Smith
Chuck Stein
Gas rate case SJ