

State of Florida



Public Service Commission

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

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

DATE: September 17, 2008

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Marsh, Buys, Draper, Kyle, Springer)
Office of the General Counsel (Klancke, Fleming)

RE: Docket No. 080318-GU – Petition for rate increase by Peoples Gas System.

AGENDA: 09/29/08 – Regular Agenda – Decision on Interim Rates – Participation is limited to Commissioners and Staff

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Skop

CRITICAL DATES: 10/10/08 (60-Day Suspension Date)

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\080318.RCM.DOC

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Case Background

This proceeding commenced on August 11, 2008, with the filing of a petition for a permanent rate increase by Peoples Gas System (Peoples or Company). Peoples requested an increase in its retail rates and charges to generate \$26,488,091 in additional gross annual revenues. This increase would allow the Company to earn an overall rate of return of 8.88 percent or an 11.50 percent return on equity (range 10.50 percent to 12.50 percent). The Company based its request on a projected test year ending December 31, 2009. Peoples stated that this test year is the appropriate period to be utilized because it represents the conditions to be faced by the Company, and is representative of the customer base, investment requirements, throughput levels, and overall cost of service to be realized for the period when the new rates will be in effect.

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Peoples has also requested an interim rate increase in its retail rates and charges to generate \$3,748,000 in additional gross annual revenues. This increase would allow the Company to earn an overall rate of return of 8.31 percent or a 10.25 percent return on equity which is the minimum of the currently authorized range of 10.25 percent to 12.25 percent. The Company based its interim request on a historical test year ended April 30, 2008.

The Commission last granted Peoples a \$12,050,000 rate increase by Order No. PSC-03-0038-FOF-GU.¹ In that order, the Commission found the Company's jurisdictional rate base to be \$505,441,206 for the projected test year ended December 31, 2003. The allowed rate of return was found to be 8.83 percent for the test year using an 11.25 percent return on equity.

Pursuant to Section 366.06(4), F.S., Peoples requested to proceed under the rules governing changes in rates and charges. Under Section 366.06(4), F.S., the Commission must enter its vote within eight months of the date on which a complete set of minimum filing requirements (MFRs) were filed with the Commission. The eight-month effective date would be April 11, 2009. However, Peoples has agreed to an extension of the effective date to and including May 19, 2009.² The Commission has jurisdiction over this request for a rate increase and interim rate increase under Sections 366.06(2), and 366.071, Florida Statutes.

¹Order No. PSC-03-0038-FOF-GU, issued January 6, 2003, in Docket No. 020384-GU, In re: Petition for rate increase by Peoples Gas System.

² Letter dated August 25, 2008, Document No. 07723-08.

Discussion of Issues

Issue 1: Should the \$26,488,091 permanent base rate increase and its associated tariff revisions requested by Peoples Gas System be suspended pending a final decision in this docket?

Recommendation: Yes. The \$26,488,091 permanent base rate increase and its associated tariff revisions requested by Peoples Gas System should be suspended pending a final decision in this docket. (Marsh)

Staff Analysis: Peoples filed its petition, testimony, and MFRs on August 11, 2008. The Company has requested a total permanent base rate increase of \$26,488,091 based on a projected test year ending December 31, 2009.

Historically, especially when a projected test year has been involved, the Commission has suspended the requested permanent rate schedules in order to adequately and thoroughly examine the basis for the new rates. The suspension of the rate increase is authorized by Section 366.06(3), Florida Statutes, which provides:

Pending a final order by the commission in any rate proceeding under this section, the commission may withhold consent to the operation of all or any portion of the new rate schedules, delivering to the utility requesting such increase, within 60 days, a reason or written statement of good cause for withholding its consent.

Staff recommends that the Commission suspend the requested permanent rate schedules to allow staff and any intervenors sufficient time to adequately investigate whether the request for permanent rate relief is appropriate. The Commission must take action to suspend the permanent rates and act on the interim request within 60 days of the filing, which is on or before October 10, 2008. As stated in the case background, the permanent rates will take effect May 19, 2009, absent a Commission vote.

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Issue 2: Is Peoples Gas System's proposed April 30, 2008 interim test year rate base of \$515,212,000 appropriate?

Recommendation: Yes. The appropriate interim test year rate base for Peoples is \$515,212,000. (Marsh)

Staff Analysis: In its filing, the Company proposed an interim test year thirteen month average rate base of \$515,212,000 for the period ended April 30, 2008.

Staff has reviewed MFR Schedule F-3 rate base adjustments made in the current filing for consistency with the findings made in the Company's last rate case Order No. PSC-03-0038-FOF-GU. Based on staff's preliminary review, it appears that Peoples has made the applicable and appropriate adjustments that are consistent with the previous rate case. Therefore, staff recommends that \$515,212,000 is the appropriate amount of rate base for the 2008 interim test year. The calculation is shown on Attachment A.

It should be noted that 2007 is the historical base year that was utilized in part to develop the 2009 projected test year for the requested permanent base rate increase. The 2007 historical test year data is currently being audited as part of the normal ratemaking review process in this docket.

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Issue 3: Are Peoples Gas System's proposed return on equity of 10.25 percent and overall cost of capital of 8.31 percent appropriate for the purpose of determining interim rates?

Recommendation: Yes. Peoples proposed return on equity of 10.25 percent and overall cost of capital of 8.31 percent are appropriate for purposes of determining interim rates. (Springer, Buys)

Staff Analysis: Pursuant to Section 366.071(2)(a), F.S., the appropriate return on equity (ROE) for purposes of determining an interim rate increase is the minimum of the Company's currently authorized ROE range. Peoples' authorized ROE is 11.25 percent with a range of plus or minus 100 basis points. The Commission set the ROE in Order No. PSC-03-0038-FOF-GU. For its interim request, Peoples used an ROE of 10.25 percent. Staff agrees that the resulting overall cost of capital of 8.31 percent is appropriate for calculating interim rates. Attachment B details the calculation of the Company's overall cost of capital.

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Issue 4: Is Peoples Gas System's proposed April 30, 2008 interim test year net operating income of \$40,534,000 appropriate?

Recommendation: No. The appropriate interim test year net operating income for Peoples is \$41,366,000. (Marsh, Buys, Kyle)

Staff Analysis: The proposed interim test year net operating income of \$40,534,000 is the twelve month amount for the year ended April 30, 2008. Staff has reviewed the net operating income adjustments made in the current interim filing for consistency with the findings made in the Company's last rate case.

Section 366.071(5)(b)1, F.S., requires that the achieved rate of return for interim rates be calculated by applying appropriate adjustments consistent with those which were used in the most recent individual rate proceeding of the public utility. In Peoples' most recent rate proceeding, a parent debt adjustment was made to income tax expense, pursuant to Rule 25-14.004, F.A.C. However, Peoples failed to make a parent debt adjustment in the MFRs supporting its interim request.

The interim MFRs filed by Peoples are based on a test year ended April 30, 2008, and do not include the data needed to calculate the parent debt adjustment. The Company did, however, include three of the four required elements for calculating the parent debt adjustment in its MFRs for final rates: a parent debt ratio of 19 percent, a parent debt cost rate of 7.3 percent, and a consolidated income tax rate of 38.575 percent. To approximate the final element (equity dollars for Peoples excluding retained earnings) for interim purposes, staff reviewed the Company's Annual Report for the year ended December 31, 2007. The amount of paid-in capital reported by Peoples in its Annual Report was \$155,550,000. Based upon the best information available and consistent with the methodology prescribed by Rule 25-14.004(4), F.A.C., staff calculated a parent debt adjustment of \$832,000. Accordingly, staff recommends that an adjustment be made to reduce income tax expense by \$832,000 in determining Peoples' achieved rate of return for interim rate purposes.

Staff recommends that the appropriate interim test year net operating income is \$41,366,000 after making the parent debt adjustment. The calculation of net operating income is shown on Attachment A.

Issue 5: Is Peoples Gas System's proposed interim net operating income multiplier of 1.6436 appropriate?

Recommendation: Yes. Peoples' proposed interim net operating income multiplier of 1.6436 is appropriate. (Marsh)

Staff Analysis: On MFR Schedule F-6, the Company calculated a net operating income multiplier of 1.6436 using a 35 percent federal income tax rate and a 5.5 percent state income tax rate. Additionally, the Company applied a .5 percent factor for regulatory assessment fees. Staff has reviewed the Company's calculation of the net operating income multiplier and is not proposing any adjustments. Therefore, staff recommends that 1.6436 is the appropriate net operating income multiplier. The calculation is shown below.

<u>Line</u>	<u>Description</u>	
1	Revenue Requirement	100.0000%
2	Gross Receipts Tax	0.0000%
3	Regulatory Assessment Fee	(0.5000)%
4	Bad Debt Rate	<u>(0.4511)%</u>
5	Net Before Income Taxes	99.0489%
6	Combined State/Federal Income Tax @ 38.575%	<u>(38.2081)%</u>
7	Revenue Expansion Factor	<u>60.8408%</u>
8	Net Operating Income Multiplier	<u>1.6436</u>

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Issue 6: Should Peoples Gas System's requested interim revenue increase of \$3,748,000 and percentage increase factor of 2.42 percent be granted?

Recommendation: No. After making the above adjustments, the interim revenue increase for Peoples should be \$2,380,000, for a percentage increase of 1.54 percent. (Marsh)

Staff Analysis: Peoples requested interim rate relief of \$3,748,000 for the test year ended April 30, 2008. This would allow the Company to earn an overall rate of return of 8.31 percent and the minimum of the range on return on equity of 10.25 percent.

As discussed in Issue 4, staff has made a parent debt adjustment to Peoples' net operating income. This adjustment affects the calculation of the interim increase to be granted in this docket. The calculation of the recommended \$2,380,000 interim rate relief and the 1.54 percent increase factor is shown below. This would allow the Company to earn an overall rate of return of 8.31 percent and a 10.25 percent return on equity, the minimum of the range. After a determination of the permanent rate increase has been made, the interim rate increase will be reviewed to determine if any portion should be refunded to the ratepayers.

Jurisdictional Adjusted Rate Base	\$515,212,000
Adjusted Overall Rate of Return	x <u>8.31%</u>
Jurisdictional Adjusted Revenue Requirement	\$42,814,000
Jurisdictional Adjusted Net Operating Income	<u>(41,366,000)</u>
Income Deficiency/(Excess)	\$1,448,000
Net Operating Income Multiplier	x <u>1.6436</u>
Interim Revenue Increase/(Decrease)	\$2,380,000
Base Rate Revenues	-:- <u>154,709,414</u>
Percentage Increase Factor	<u>1.54%</u>

Issue 7: How should the interim revenue increase for Peoples Gas System be distributed among the rate classes?

Recommendation: Any interim revenue increase approved should be applied evenly across the board to all rate classes based on their base rate revenues, as required by Rule 25-7.040, F.A.C., and should be recovered on a cents-per-therm basis. The interim rates should be made effective for all meter readings made on or after 30 days from the date of the vote approving any interim increase. The Company should give notice to customers of the interim increase commencing with the first bill for service that reflects the increase. (Draper)

Staff Analysis: As shown on Attachments C and D, staff has determined the cents-per-therm increases to be applied to each rate class based on staff's recommended interim increase of \$2,380,000. The increases were calculated using the methodology contained in Rule 25-7.040, F.A.C., which requires that any increase be applied evenly across the board to all rate classes based on their base rate revenues. A residential customer using 20 therms will see the bill increase from \$42.94 to \$43.21 or by \$0.27. The bill includes purchased gas costs of 127.033 cents per therm.

The interim rates should be made effective for all meter readings made on or after 30 days from the date of the Commission vote approving any interim increase. Peoples should be required to give appropriate notice to customers commencing with the first bill for service that reflects the approved interim increase that explains the nature, purpose, and effect of the increase. A copy of the notice should be submitted to staff for approval prior to distribution to the customers.

Issue 8: What is the appropriate security to guarantee the funds collected subject to refund?

Recommendation: The appropriate security to guarantee the funds collected subject to refund is a corporate undertaking. (Springer, Buys)

Staff Analysis: Peoples has requested that all funds collected subject to refund be secured by a corporate undertaking. The criteria for a corporate undertaking include sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. Staff reviewed Peoples' financial statements to determine if the Company can support a corporate undertaking for the amount of \$2.4 million. Peoples' 2007, 2006, and 2005 financial statements were used to determine the financial condition of the Company. This analysis shows Peoples has experienced a decline in liquidity that has remained at insufficient levels throughout the three-year review period. In addition, Peoples has maintained an adequate but declining interest coverage ratio during this period. However, Peoples' average equity ratio over the three-year period has been stable at approximately 56 percent, which is sufficient in this instance based on Peoples' overall financial condition. Finally, net income has been on average ten times greater than the requested corporate undertaking amount. Peoples' financial performance has demonstrated adequate levels of profitability, interest coverage, and equity capitalization to offset the decline in liquidity.

Staff believes Peoples has adequate resources to support a corporate undertaking in the amount requested. Based on this analysis, staff recommends that a corporate undertaking of \$2.4 million is acceptable. The brief financial analysis contained herein is only appropriate for deciding if the Company can support a corporate undertaking in the amount proposed and should not be considered a finding regarding staff's position on other issues in this proceeding.

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Issue 9: Should this docket be closed?

Recommendation: No. This docket should remain pending the Commission's final resolution of the company's requested rate increase. (Klancke, Fleming)

Staff Analysis: This docket should remain open pending the Commission's final resolution of the company's requested rate increase.

ATTACHMENT A

PEOPLES GAS SYSTEM
DOCKET NO. 080318-GU
INTERIM TEST YEAR
APRIL 30, 2008
(\$ in Thousands)

	<u>As Filed by Company</u>	<u>Parent Debt Adjustment</u>	<u>Total Adjustments</u>	<u>Total Adjusted Rate Base</u>
<u>RATE BASE</u>				
Plant in Service	\$900,625		0	\$900,625
Acquisition Adjustment	2,302		0	2,302
Customer Advances for Construction	(6,399)		0	(6,399)
Accumulated Depreciation	(371,120)		0	(371,120)
Net Plant in Service	525,407	0	0	525,407
Property Held for Future Use	0		0	0
Construction Work in Progress	21,119		0	21,119
Net Utility Plant	546,525	0	0	546,525
Working Capital	(31,313)		0	(31,313)
Total Rate Base*	\$515,212	0	0	\$515,212

*Total does not foot due to rounding.

INCOME STATEMENT

Operating Revenues	\$169,003		0	\$169,003
Operating Expenses:				
Operation & Maintenance - Gas	0		0	0
Operation & Maintenance - Other	65,254		0	65,254
Depreciation & Amortization	40,216		0	40,216
Taxes Other Than Income	8,077		0	8,077
Income Taxes - Current	13,848	(832)	(832)	13,016
Deferred Income Taxes (Net)	1,074		0	1,074
Investment Tax Credit (Net)	0		0	0
(Gain)/Loss on Disposition	0		0	0
Total Operating Expenses	128,469	(832)	(832)	127,637
Net Operating Income	\$40,534	\$832	\$832	\$41,366
OVERALL RATE OF RETURN	7.87%		0.16%	8.03%
RETURN ON EQUITY	9.36%		0.32%	9.68%

Peoples Gas System
 FPSC Adjusted Capital Structure
 Interim Test Year 4/30/2008
 Docket No. 080318-GU

Attachment B

CAPITAL STRUCTURE

	COMPANY ADJUSTMENTS			STAFF ADJUSTMENTS						
	PER BOOKS	SPECIFIC	PRO RATA	ADJUSTED PER BOOKS	SPECIFIC	PRO RATA	STAFF ADJUSTED	RATIO	COST RATE	WEIGHTED COST
Common Equity	\$268,072	(\$1,257)	(\$8,283)	\$258,532	\$0	\$0	\$258,532	50.18%	10.25%	5.14%
Long-term Debt	\$195,536	(\$3,637)	(\$5,958)	\$185,941	0	0	\$185,941	36.09%	7.23%	2.61%
Short-term Debt	\$12,863	0	(\$399)	\$12,464	0	0	\$12,464	2.42%	4.65%	0.11%
Customer Deposits (Residential)	\$9,448	0	0	\$9,448	0	0	\$9,448	1.83%	6.00%	0.11%
Customer Deposits (Commercial)	\$25,309	0	0	\$25,309	0	0	\$25,309	4.91%	7.00%	0.34%
Inactive Deposits	\$319			\$319	0	0	\$319	0.06%	0.00%	0.00%
Deferred Income Taxes	\$25,113	(\$1,992)		\$23,121	0	0	\$23,121	4.49%	0.00%	0.00%
Tax Credits - Zero Cost	\$0	\$79	0	\$79	0	0	\$79	0.02%	0.00%	0.00%
	\$536,660	(\$6,807)	(\$14,640)	\$515,213	\$0	\$0	\$515,213	100.00%		8.31%

PEOPLES GAS SYSTEM
ALLOCATION OF INTERIM RATE INCREASE
DOCKET NO. 080318-GU

ATTACHMENT C

(1) RATE CODE	(2) RATE SCHEDULE	PRESENT BASE RATE REVENUE				INTERIM INCREASE			
		(3) AVERAGE BILLS	(4) THERM SALES	(5) CUSTOMER CHARGE	(6) ENERGY CHARGE	(7) TOTAL BASE REVENUE	(8) INTERIM INCREASE	(9) % INCREASE	(10) (7) / (3) * 100 INCREASE IN CENTS PER THERM
RS	RESIDENTIAL	304,446	69,612,632	\$ 35,634,790	\$26,220,990	\$61,855,780	\$951,569	1.54%	1.367
SGS	SMALL GENERAL SERVICE	5,631	2,794,818	\$1,324,616	\$753,343	\$2,077,959	\$31,967	1.54%	1.144
GS-1	GENERAL SERVICE	19,055	106,076,187	\$6,698,316	\$24,445,257	\$31,143,573	\$479,103	1.54%	0.452
GS-2	GENERAL SERVICE	3,069	72,759,327	\$1,269,890	\$16,201,319	\$17,471,209	\$268,771	1.54%	0.369
GS-3	GENERAL SERVICE	801	71,872,443	\$426,398	\$14,038,844	\$14,465,242	\$222,529	1.54%	0.310
GS-4	GENERAL SERVICE	146	45,903,685	\$145,435	\$8,183,709	\$8,329,144	\$128,133	1.54%	0.279
GS-5	GENERAL SERVICE	101	67,342,396	\$175,650	\$6,761,850	\$6,937,500	\$106,724	1.54%	0.158
CLS	COMMERCIAL STREET LIGHTING	64	763,660	\$0	\$97,970	\$97,970	\$1,507	1.54%	0.197
NGVS	NATURAL GAS VEHICLE SERVICE	15	447,521	\$6,370	\$62,711	\$69,081	\$1,063	1.54%	0.237
WHS	WHOLESALE	11	1,623,071	\$9,200	\$221,095	\$230,295	\$3,543	1.54%	0.218
SIS	SMALL INTERRUPTIBLE SERVICE	29	55,043,516	\$51,900	\$3,977,995	\$4,029,895	\$61,995	1.54%	0.113
IS	INTERRUPTIBLE SERVICE	15	159,300,620	\$37,800	\$5,537,797	\$5,575,597	\$85,773	1.54%	0.054
ISLV	LARGE INTERRUPTIBLE SERVICE	2	199,359,551	\$5,850	\$2,420,320	\$2,426,170	\$37,323	1.54%	0.019
TOTAL		333,385	852,899,427	\$45,786,215	\$108,923,201	\$154,709,416	\$2,380,000	1.54%	

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**PEOPLES GAS SYSTEM
 PRESENT AND STAFF RECOMMENDED INTERIM RATES
 DOCKET NO. 080318-GU**

ATTACHMENT D

RATE CODE RATE SCHEDULE	PRESENT RATE	STAFF RECOMMENDED INTERIM INCREASE	STAFF RECOMMENDED INTERIM RATE
RS RESIDENTIAL			
CUSTOMER CHARGE	\$10	N/A	\$10
ENERGY CHARGE (cents/therm)	37.667	1.367	39.034
SGS SMALL GENERAL SERVICE			
CUSTOMER CHARGE	\$20	N/A	\$20
ENERGY CHARGE (cents/therm)	26.955	1.144	28.099
GS-1 GENERAL SERVICE			
CUSTOMER CHARGE	\$30	N/A	\$30
ENERGY CHARGE (cents/therm)	23.045	0.452	23.497
GS-2 GENERAL SERVICE			
CUSTOMER CHARGE	\$35	N/A	\$35
ENERGY CHARGE (cents/therm)	22.267	0.369	22.636
GS-3 GENERAL SERVICE			
CUSTOMER CHARGE	\$45	N/A	\$45
ENERGY CHARGE (cents/therm)	19.533	0.310	19.843
GS-4 GENERAL SERVICE			
CUSTOMER CHARGE	\$85	N/A	\$85
ENERGY CHARGE (cents/therm)	17.828	0.279	18.107
GS-5 GENERAL SERVICE			
CUSTOMER CHARGE	\$150	N/A	\$150
ENERGY CHARGE (cents/therm)	10.041	0.158	10.199
CLS COMMERCIAL STREET LIGHTING			
CUSTOMER CHARGE	\$0	N/A	\$0
ENERGY CHARGE (cents/therm)	12.829	0.197	13.026
NGVS NATURAL GAS VEHICLE SERVICE			
CUSTOMER CHARGE	\$35	N/A	\$35
ENERGY CHARGE (cents/therm)	14.013	0.237	14.250
WHS WHOLESALE			
CUSTOMER CHARGE	\$100	N/A	\$100
ENERGY CHARGE (cents/therm)	13.622	0.218	13.840
SIS SMALL INTERRUPTIBLE SERVICE			
CUSTOMER CHARGE	\$150	N/A	\$150
ENERGY CHARGE (cents/therm)	7.227	0.113	7.340
IS INTERRUPTIBLE SERVICE			
CUSTOMER CHARGE	\$225	N/A	\$225
ENERGY CHARGE (cents/therm)	3.522	0.054	3.576
ISLV LARGE INTERRUPTIBLE SERVICE			
CUSTOMER CHARGE	\$225	N/A	\$225
ENERGY CHARGE (cents/therm)	1.002	0.019	1.021