**DIRECT SUPPLMENTAL TESTIMONY**
**OF**
**CHERYL MARTIN,**
**IN**

**FLORIDA PUBLIC UTITITIES COMPANY**
**DOCKET NO 080366-GU**

**IN RE: PETITION OF**
**FLORIDA PUBLIC UTILITIES COMPANY**
**FOR A NATURAL GAS RATE INCREASE**

**Q. Please state your name, affiliation, business address and summarize your academic background and professional experience.**

A. My name is Cheryl Martin. I am the Controller for Florida Public Utilities Company (FPU), which has a business office at 401 South Dixie, West Palm Beach, Florida 33401. I have been employed by FPU since 1985 and performed numerous accounting functions until I was promoted to Corporate Accounting Manager in 1995 with responsibilities for managing the Corporate Accounting Department including regulatory accounting (Fuel, PGA, conservation, rate cases, Surveillance reports, reporting), tax accounting, external reports, and special projects. In January 2002 I was promoted to my current position of Controller where my responsibilities are the same as above with additional responsibilities in the purchasing and general accounting areas and Security and Exchange Commission (SEC) filings. I have been an expert witness for numerous proceedings before the Florida Public Service Commission (FPSC) including rate relief in Docket Numbers 881056-EI, 930400-EI, 030438-EI and 070304-EI for electric and 900151-GU, 940620-GU, 040216-GU for natural gas. I graduated from Florida State University in 1984 with a BS degree in Accounting. Also, I am a Certified Public Accountant in the state of Florida.

**Q. What is the purpose of your supplemental testimony in this proceeding?**

A. To provide additional details on items identified as potential issues in the full hearing as well as to discuss material items that have changed with respect to our projected test year and original testimony filed in our original MFRs.

**Q. Is the revenue increase granted by the Florida Public Service Commission based on a 2009 projected test year still appropriate?**

A. Yes, outside of the items identified in our supplemental testimony, in all material respects the authorized revenue requirement and rates approved at the PAA agenda are still appropriate. We have identified some material items that have changed since our original filing for the projected 2009 test year and those should be considered for adjustments to the revenue requirement.

**Q. What items have changed and should be considered as adjustments to our 2009 projected test year, and the required revenue increase?**

A. Our pension expense for 2009 is going to materially exceed our original projection due to the amortization of the amount previously deferred as a regulatory asset-retirement plans, and the pension plan freeze. The pension curtailment expense for 2009 has been recorded in the first quarter of 2009, and increased expenses by $2.3 million ($1.2 million natural gas division only). This pension related expense was not taken into account in our original filing, but is appropriate for rate recovery. See the supplemental testimony provided by April Lundgren for more details on this adjustment.

Also, property taxes are expected to exceed our projections and far exceed expected inflation. The property tax projections should be revised to reflect the current expectations by the taxing agencies. See April Lundgren's testimony for a revision to this projection.

Since the PAA order has been protested and a full hearing will be required, rate case expenses are expected to significantly increase over our original projections. In addition, the costs associated with the post merger rate case related filings were not included in the original rate case amortization expense and should be included for rate case expense and recovery. Details of this adjustment and additional testimony will follows on this subject.

**Q Has the Company identified any other rate base related item that requires additional review and possible adjustments?**

A. Yes. The amount of AEP costs that should be transferred to rate base has changed due to computational errors and adjustments to estimates. We have provided testimony and a revised schedule reflecting the correct amount of this adjustment. See supplemental testimony provided by Don Kitner and Doreen Cox for more information. In addition, fall out related amounts will impact the income statement.

**Q. Should the projected test year be adjusted by temporary expense reductions that occurred as a primary result of the pension curtailment cost, cash and covenant issues that occurred in early 2009?**

A. No, the projected test year 2009 reflects the first full year that the new rates will be in effect, and accordingly, should not be adjusted for any temporary unusual reductions to expenses that may have occurred before rates were put into effect.

Significant increases in our pension expense and pension liability caused covenant issues with our fuel supplies and concerns over our bank covenants relating to our credit line. This also increased required pension contributions for 2009, over and above our current budgeted amounts for this same period, and those included in this rate proceeding. This pension liability issue resulted in the Company requesting managers to take some temporary cost reductions or cost deferral measures in early

2009. The declining stock market, concerns on possible further declines which would significantly impact our pension liability, along with concerns over our liquidity, and possible environmental cleanup funding required us to take unusual immediate action and focus to temporarily reduce cash outflow. There was also uncertainty with respect to environmental payments and costs, and we needed to be sure we were able to fund the requirement payments if they were accelerated. Management took immediate steps to address these concerns by freezing the pension plan. Management action strengthened our financial positions and our covenant issues have been satisfied. Temporary action and expense deferrals are no longer required, and the business is operating back on a normal basis.

**Q. What were the environmental concerns that required the Company to take some temporary cash outflow reductions?**

A. On April 30, 2009, we received a Remedial Action Order (RAO) issued by the Florida Department of Environmental Protection (FDEP) requiring additional testing and assessment activities and the removal of all contaminated soil and leachable source material present at our former Manufactured Gas Plant site in West Palm Beach.

On May 5, 2009 we received notice from FDEP of their withdrawal of the aforementioned RAO and a meeting was established for May 12, 2009 to begin discussions on a remediation plan for this site.

At a meeting on May 12th additional work to satisfy FDEP was agreed upon that resulted in $450,000 of additional assessment and testing with an additional

$570,000 of work contemplated. The level of these expenditures was not expected at the beginning of 2009.

Subsequent to the May 12th meeting a series of phone conferences and meetings with FDEP were held to discuss further assessment and remediation options which could be agreed upon by the parties. The remedies being considered now are within the previously projected and reported $18 million range, although a final determination has not yet been reached.

**Q. What is the amount of rate case expense included in the PAA order and revenue requirement authorized in this rate proceeding?**

A. The PAA order approved total rate case expense of $603,643 to be amortized over a period of four years at $150,911 annually.

**Q. What is revised projected amount of total rate case expense and the annual amortization amount for purposes of rate recovery including costs associated with the full hearing and subsequent post merger rate case related filing?**

A. The total amount of projected rate case expense is now expected to be $1,661,318. The annual amount of amortization would be $415,330. Included in the total rate case expense amount is $500,000 related to the subsequent filing requirements related to the merger issue. See Exhibit CMM1 attached for the updated projection on rate case expenses.

**Q. Explain the period of time used for amortization of rate case expense and the amount included in rate base?**

A. We have amortized our expected rate case expenses over a period of four years. Our last rate proceeding was four years ago. The expected period of time to file another rate proceeding is within that same period of time and four years is the appropriate number of years to amortize this expense. These expenses were necessary and prudent and we feel that recovery should be allowed over the expected period. We also feel working capital should include the amount of unamortized rate case expense for 2009. See Jim Mesite's supplemental testimony for more details on this item.

**Q. What is the basis for the rate case regulatory expense included in the projected test year?**

A. We have projected rate case expense based on specific forecasts including the cost to use consultants to assist us in preparation and support of a rate case and the cost for representation and consultation by an attorney. We are not staffed at a level to allow for preparation of rate proceedings, MFRs or the additional rate case related work load required after the MFRs are filed. Internally our work load has increased since our last gas rate case was filed without an offsetting increase in staff or expertise within the Company, and we require additional resources beyond the level required in our last gas rate case. We do not have the expertise in all areas to help facilitate the preparation of a rate case; therefore we had to hire the expertise and extra assistance to complete this process. We also had to utilize temporary accounting staff and consultants to assist in the extra rate case work beyond the normal work load of the accounting department. With a full hearing required, we also expect significant additional rate case expenses associated with the work load required for responding to interrogatory and document requests, depositions, supplemental and rebuttal testimony and hearing requirements. Actual expenses through June 2009 have been included in the revised rate case projection.

The merger related filing ordered in the PAA hearing may also create a significant work load to the Company once the details have been finalized with respect to specific filing requirements, and we will incur additional rate case expenses associated with this subsequent rate case project. At this time we are anticipating similar work load requirements to our PAA filing, and accordingly have used that as a basis for that portion of the projection.

**Q. Have you included specific information about the merger in this rate case filing or projections?**

A. No. The MFRs were prepared before the merger agreement, and there was no consideration or projection for a possible merger. Also, it is premature to say that the merger definitely will be consummated and we do not know the detailed impact of the merger. We must continue to operate as a going concern, and we are in need of immediate rate relief. The important point is that regardless of whether the merger is finalized, it will not impact the projected test year outside of increased costs associated with pre-merger related activity and the subsequent merger filing requirements in this rate proceeding.

**Q. Should the premerger and merger related costs be approved for deferral as a deferred regulatory asset and considered for recovery and amortization in a future rate proceeding?**

A. Yes, these expenses should be approved for deferral as a regulatory asset then considered for recovery and amortization in the next rate proceeding. The Company does not expect the merger to result in any costs savings in the projected test year but actual expenses will be higher in 2009 due to the pre-merger related activities. These expenses have not been included in our projected test year filing. Since the merger is expected to benefit our customers in the long run, it would be appropriate to allow recovery and amortization of these costs over the period beginning with the next rate proceeding or at the period of time the synergies begin. They should be approved for deferral as a regulatory asset in this rate proceeding.

**Q. You are proposing to establish merger related costs as regulatory assets. Why is this appropriate?**

A. By establishing the transaction and transition costs or premerger and merger related costs as regulatory assets, the Company would be afforded the opportunity to match these specific costs of the transaction with the benefits. These costs can be specifically attributed to the transaction components: either the plant assets of the acquired company or the premium paid and recorded as an acquisition adjustment. If these costs are associated to the plant assets, they should be amortized over the approved life of the plant assets, approximately 30 years on average. If these costs are associated with the premium paid and recorded as an acquisition adjustment, they should be amortized concurrent to the anticipated operating savings. The Company therefore believes that the transaction and transition costs should be recorded as Regulatory Assets, with the amortization suspended until the next rate proceeding, unless the operating savings subsequent to closing place the combined company in an over-earnings situation. If this were to occur, then the Company's proposal is to begin the amortization of the regulatory assets at such amounts necessary to reduce the combined company's earnings to the top of the authorized range. For purposes of earning reviews if levels exceeds the high point of the authorized Return on Equity, inclusive of the positive acquisition adjustment, transaction costs and transition costs (merger related costs), amortizing the positive acquisition adjustment and Regulatory Assets at such amounts to reduce the earnings level to the high point of the authorized Return on Equity for the combined company.

**Q. Should the Company adjust their revenue requirement for any possible synergies that may occur in 2010 or 2011 after the projected test year?**

A. No, our projected test year is 2009 and future synergies if any would not impact this test year. Future rate proceedings, and annual surveillance reports and earning reviews may be impacted by possible synergies; however, the synergies along with future normal cost increases, rate base changes, acquisition adjustments and the amortization of pre and post merger costs would also be appropriate for consideration for any future rate proceedings and or earnings reviews. It would not be appropriate to isolate certain 2010 or 2011 expense savings without also taking into effect other cost increases, acquisition adjustments, amortization of merger related costs, and other applicable changes unless those cost savings created over earnings in 2010 or 2011 in the natural gas segment. The Commission staff reviews the earnings in future years through the surveillance reporting and if overearnings exist, they would do an analysis and provide for a possible refund to customers for applicable, if any, overearnings.

**Q. Are you aware that the petition and testimony filed by Chesapeake Utilities in Docket 090125-GU addresses proposed post merger actions?**

A. Yes. I have seen the proposal.

**Q. Should the Commission consider the alternative filing requirement proposed by Chesapeake in that petition and testimony?**

A. Yes, with perhaps consideration for an additional two months (20 months after the merger is consummated) to file the appropriate data. Given the additional work load that would be required, and the timing of the two rate proceedings currently being considered, post merger filing requirements may need to be extended to 20 months following a merger.

**Q. Would you agree with the proposal included in the Chesapeake docket?**

A. I would but I should also point out that this is a proposed merger at this time. If the merger is approved, I believe that the alternative proposal as described in the testimony of Thomas Geoffroy is a reasonable and appropriate proposal. The dockets are and should be reviewed and resolved separately but I recognize the fact that there is a pending merger and for that reason I suggest any post merger actions should be consistent.

**Q. Do you feel it is appropriate to consider this post merger alternative as it would relate to FPUC if the merger is consummated by Chesapeake?**

A. Yes

**Q. Does this conclude your written prepared testimony?**

A. Yes.

Rate Case Projected Expenses- Consolidated Natural Gas Rate Case 2009 Projected Test Year

| | | Original Projected Amount | Actual 6/30/09 | Additional PAA costs | Final costs PAA | Remaining expenses over PAA-Est. | Final Est costs if Full Hearing | Description or Calculation of full rate proceeding amount |
|---|---|---|---|---|---|---|---|---|
| **Outside Consultants:** | | | | | | | | |
| **Christensen Associates** | Consulting Fees | 354,500 | 271,253 | | 271,253 | 221,000 | 492,253 | Estimate from Consultants |
| | | | | | | 25,000 | 25,000 | |
| | **Net** | **354,500** | **271,253** | | **271,253** | **246,000** | **517,253** | |
| **Darryl Troy** Accounting | Consulting Fees | 47,250 | 22,176 | | 22,176 | - | 22,176 | Using Temp employees for full hearing |
| | Other Costs | 1,000 | | | - | | - | |
| | **Net** | **48,250** | **22,176** | | **22,176** | **-** | **22,176** | |
| **Jennifer Starr** | Consulting Fees | 5,000 | 114 | | 114 | - | 114 | Using Temp employees for full hearing |
| | Other Costs | 500 | | | - | - | - | |
| | **Net** | **5,500** | **114** | | **114** | **-** | **114** | |
| **Legal Services:** | | | | | | | | |
| **Doc Horton** | Legal Services | 100,000 | 42,577 | 5,000 | 47,577 | 75,000 | 122,577 | Est. from Attorney, Messer, Doc Horton |
| | Costs | 7,500 | | | - | 7,500 | 7,500 | Estimate |
| Additional Legal Services | | | | | | 25,000 | 25,000 | 1/4 legal estimate for additional services from other attorneys |
| | **Net** | **107,500** | **42,577** | **5,000** | **47,577** | **107,500** | **155,077** | |
| **Additional Personnel, Overtime and Temporary Pay:** | | | | | | | | |
| Temporary/OT/Add'l Pay | Costs | 207,000 | 179,315 | 1,000 | 180,315 | 110,000 | 290,315 | Similar costs to PAA hearing portion. |
| | **Net** | **207,000** | **179,315** | **1,000** | **180,315** | **110,000** | **290,315** | ( Three additional personnel total 80 per week avg $45 per hour, 7mths, overtime/extra pay) |
| **Travel Expenses:** | | | | | | | | |
| **Service and Hearings** | | | | | | | | |
| Hotel | | 5,900 | 6,389 | | 6,389 | 8,400 | 14,789 | 7 people, four trips, total 8 nights |
| Travel | | 6,900 | 1,803 | | 1,803 | 9,000 | 10,803 | airline tickets, $500 for 7 two times, and car travel 1,000, rental and tolls $ 1000 |
| Meals | | 2,600 | 40 | | 40 | 2,800 | 2,840 | 7 persons at $40 per day, 10 days |
| Other | | 2,400 | 233 | | 233 | 2,400 | 2,633 | Telephone, parking, other |
| | **Net** | **17,800** | **8,466** | | **8,466** | **22,600** | **31,066** | |
| **Other Travel to WPB, and FPSC** | | | | | | | | |
| Hotel | | 6,300 | | | - | 3,150 | 3,150 | 7 persons at 150 per night, 3 nights meetings |
| Travel | | 7,300 | | | - | 8,000 | 8,000 | Airline tickets, car rental tolls 1000 $ 500 times 2 trips, 7 people |
| Meals | | 1,680 | | | - | 1,680 | 1,680 | 7 people at 40 per day 6 days |
| Other | | 1,000 | | | - | 1,000 | 1,000 | telephone parking other |
| | **Net** | **16,280** | **-** | | **-** | **13,830** | **13,830** | |
| **Mailing, Office Supplies, Adm Costs, Other** | | | | | | | | |
| customer hearing notices | | 15,750 | 23,004 | | 23,004 | 16,100 | 39,104 | 52000 customers @ .30, plus 500 extra (Full hearing ) |
| agenda hearing notices | | 15,750 | 10,399 | | 10,399 | 16,100 | 26,499 | 52000 customers @ .30, plus 500 extra (Full hearing) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Final rate notices | | 15,750 | | 15,750 | 15,750 | 16,100 | 31,850 | 52000 customers @ .30, plus 500 extra (Full hearing) |
| Ads for newspapers | | 25,000 | 9,534 | | 9,534 | 10,000 | 19,534 | 2 division, local ads, cost for service ad (Est from prior ads) |
| Office Supplies | | 5,000 | 1,417 | | 1,417 | 5,000 | 6,417 | Estimate paper costs for data requests, interrogs, doc requests |
| | | | | | - | - | - | |
| Other Costs | | 10,000 | 3,085 | | 3,085 | 5,000 | 8,085 | Estimate |
| Post Rate Case/merger related filing costs | | - | - | | - | 500,000 | 500,000 | Estimate based on prior costs |
| | **Net** | **87,250** | **47,438** | **15,750** | **63,188** | **568,300** | **631,488** | |
| | **TOTAL** | **844,080** | **571,338** | **21,750** | **593,088** | **1,068,230** | **########** | |
| 4 years | Annual Expense | $ 211,020 | | | $ 148,272 | | $415,330 | |
| **Amortized Expenses** | | | **(11,902.86)** | | | | | |
| **BALANCE** | | | **559,435** | | | | | |

| Costs | | Balance |
|---|---|---|
| Dec-07 | | - |
| Jan-08 | | - |
| Feb-08 | | - |
| Mar-08 | | - |
| Apr-08 | | - |
| May-08 | | - |
| Jun-08 | | - |
| Jul-08 | 20000 | 20,000 |
| Aug-08 | 40000 | 60,000 |
| Sep-08 | 40000 | 100,000 |
| Oct-08 | 150000 | 250,000 |
| Nov-08 | 100000 | 350,000 |
| Dec-08 | 100000 | 300,000 |
| 13 mth Average | | 83,077 |
| 12 month Total | | |

| | | Amortization | Balance |
|---|---|---|---|
| | Dec-08 | | 300,000 |
| | Jan-09 | 60000 | 360,000 |
| | Feb-09 | 60000 | 420,000 |
| | Mar-09 | 60000 | 480,000 |
| | Apr-09 | 60000 | 540,000 |
| | May-09 | 53088 | 593,088 |
| | Jun-09 | 10000 | 603,088 |
| | Jul-09 | 10000 | 613,088 |
| | Aug-09 | 10000 | 623,088 |
| | Sep-09 | 119000 | 742,088 |
| | Oct-09 | 119000 | 861,088 |
| | Nov-09 | 119000 | 980,088 |
| | Dec-09 | 181230 | 1,161,318 |
| 13 mth Average | | | 636,687 |
| 12 month Total | | $ - | |
| | 2010 | 500000 | 1,661,318 |