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: December 5, 2013

TO: Office of Commission Clerk (Stauffer)

FROM: Division of Accounting and Finance (Trueblood, Bullard, Buys, Gardner, Fletcher, Maurey, Prestwood)
Division of Economics (Ollila)
Division of Engineering (L'Amoreaux)
Office of the General Counsel (Klancke)

RE: Docket No. 120311-GU – Petition for approval of positive acquisition adjustment to reflect the acquisition of Indiantown Gas Company by Florida Public Utilities Company.

AGENDA: 12/17/13 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Administrative

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\AFD\WP\120311.RCM.DOC

Case Background

On December 11, 2012, Florida Public Utilities Company (FPUC or Company) filed a petition seeking approval of the appropriate accounting recognition of a positive acquisition adjustment that reflects its purchase of Indiantown Gas Company (Indiantown or IGC), and to place the positive acquisition adjustment on the books of the FPUC-Indiantown Division (FPUC-Indiantown). FPUC's investor-owned natural gas operations are subject to regulation by the

Commission under Chapter 366, Florida Statutes (F.S.). FPUC also has an electric division that likewise is subject to Commission regulation under Chapter 366, F.S.

FPUC currently has approximately 54,000 natural gas distribution and 31,000 electric customers in various parts of Florida. It also has an unregulated propane distribution business that operates in certain parts of Florida through its wholly-owned subsidiary, Flo Gas. FPUC is a Florida Corporation located in West Palm Beach, Florida, and a subsidiary of Chesapeake Utilities Corporation (CUC), which is a Delaware Corporation, located in Dover, Delaware.

On August 6, 2010, FPUC entered into an asset purchase agreement with IGC, whereby FPUC acquired substantially all of the natural gas assets of IGC, approximately 700 additional customers, and assumed certain liabilities. FPUC paid IGC $1,188,305 in cash; and, no non-cash consideration was provided or exchanged.

In its Petition, FPUC asks the Commission to allow the $745,800 purchase price premium for the acquisition of Indiantown to be recorded as a positive acquisition adjustment. It further asks to amortize the adjustment over 15 years beginning August 1, 2010, using the straight line amortization method; to record the adjustment and amortization expense in accounts 114 and 406, respectively; and to find that earnings for IGC are within the allowable rate of return (ROR) range as of December 31, 2011. The Company is not requesting approval of any rate adjustment.

On January 25, 2013, staff submitted its First Data Request to FPUC. Four additional data requests were submitted over the course of the case. The Company's response to the Fifth Data Request was received on November 13, 2013.

On March 7, 2013, the Office of Public Counsel (OPC) notified FPUC of its concerns regarding the Company's filing and responses to Staff's First Data Request. On March 19, 2013, FPUC submitted its response to OPC's concerns to the Commission.

On May 1, 2013, staff notified FPUC-Indiantown that it would be conducting an audit. The audit was completed on August 7, 2013 and FPUC-Indiantown's response to the audit findings was received on August 27, 2013.

This recommendation addresses FPUC's petition for the recognition of a positive acquisition adjustment. The Commission has jurisdiction over this matter pursuant to Sections 366.06 and 366.076 F.S.

Discussion of Issues

Issue 1: Should the Commission approve FPUC's proposal to record a $745,800 positive acquisition adjustment to be amortized over a 15-year period, beginning August 1, 2010?

Recommendation: Yes. FPUC should be allowed to record the $745,800 purchase price premium as a positive acquisition adjustment to be amortized over a 15-year period, beginning August 1, 2010. The acquisition adjustment should be recorded in Account 114 – Gas Plant Acquisition Adjustments and the amortization expense should be recorded in Account 406 – Amortization of Gas Plant Acquisition Adjustments. The level of the actual cost savings supporting FPUC's request should be subject to review in FPUC's next rate case proceeding, and if it is determined in that proceeding that the cost savings no longer exist, the acquisition adjustment could be partially or totally removed as deemed appropriate by the Commission. FPUC-Indiantown should file its earnings surveillance reports (ESRs) with and without the effect of the acquisition adjustment. (Trueblood, L'Amoreaux, Gardner, D. Buys, Bullard, Ollila)

Staff Analysis: FPUC requests Commission approval to record the $745,800 purchase price premium on the books of FPUC-Indiantown as a positive acquisition adjustment in Account 114 – Gas Plant Acquisition Adjustments and to record the amortization expense in Account 406 – Amortization of Gas Plant Acquisition Adjustments. The Company also seeks approval to amortize the recorded amount over a 15-year period beginning August 1, 2010, using a straight line amortization schedule. FPUC is not requesting any transaction or transition costs attributable to the acquisition of IGC's natural gas business, nor is the Company requesting any rate adjustment at this time.

On August 6, 2010, FPUC acquired substantially all of the natural gas assets of IGC and assumed certain liabilities, primarily customer deposits. Subsequently, FPUC established a new operating entity, FPUC-Indiantown Division, to maintain separate books and records apart from the rest of Chesapeake's and FPUC's natural gas operations.

The purchase price used to calculate the premium was the total cash paid in the acquisition transaction. FPUC prepared a bottom-up valuation calculation to support the fair value of IGC's natural gas operations. The bottom-up evaluation calculation used a methodology similar to the one utilized in the Discounted Cash Flow (DCF) method of the Income Approach performed by independent valuation experts to determine the fair value of FPUC's natural gas business in Chesapeake's acquisition of FPUC.[1] The bottom-up valuation shown in Exhibit MK-2 of witness Kim's testimony was prepared by FPUC's accounting staff. FPUC asserts that the fair value of IGC's natural gas operations is approximately $1.2 million and thus is comparable to the $1,188,305 paid by FPUC in the acquisition transaction.

The net book value of IGC's assets at the time of the acquisition was $442,504, which included an adjustment of $3,909 to reduce the book value of certain assets subsequent to the

[1] See Order No. PSC-12-0010-PAA-GU, issued January 3, 2012, in Docket No. 110133-GU, In re: Petition for approval of acquisition adjustment and recovery or regulatory assets, and request for consolidation of regulatory filings and records of Florida Public Utilities Company and Florida Division of Chesapeake Utilities Corporation.

acquisition. In this acquisition, the Company paid $1,188,305 in cash, and no non-cash consideration was provided or exchanged as a part of the transaction. The purchase price, which exceeded the book value by $745,800, included a five-year Non-compete Agreement of $450,000, a three-year Operations and Maintenance (O&M) Agreement of $150,000, and a three-year Consulting Agreement of $300,000. The Company clarified in a response to a staff data request that the Consulting and O&M Agreement amounts were not included in the calculation of the purchase premium. The Non-compete Agreement was assigned a $450,000 value because that amount was negotiated by the parties to incent the buyer to agree to the sale. Likewise, FPUC contends that since it had to pay the $450,000 for the Non-compete Agreement in order to close the deal, it should be allowed to include that amount in the premium purchase price.

FPUC recognizes that the Commission has generally applied five factors when determining whether the requested accounting recognition is appropriate. Those factors are: (1) increased quality of service; (2) lower operating costs; (3) increased ability to attract capital for improvements; (4) lower operating cost of capital; and (5) more professional and experienced managerial, financial, technical and operational resources.[2] To determine if FPUC has adequately demonstrated the potential or actual qualitative and quantitative benefits to the customers of FPUC-Indiantown as a result of the acquisition, staff analyzed each of these five factors.

1. Increased Quality of Service

FPUC contends IGC customers are benefitting from the acquisition through increased service quality as a result of FPUC's investments in a new state-of-the-art telephone system, Customer Information System technology, expansion of bill payment options, improved reliability, and expanded access to web-based information and services. FPUC also contends it has enhanced the customer experience through effective employee training, third party payment centers, and utilization of third party providers for certain functions.

In November 2011, FPUC consolidated its Customer Information System with IGC's system, thus providing for the coordination of all Customer Care (call centers, billing and collections, and meter reading) and field services activities (service connections and disconnections, meter changes, etc.) that impact customers. FPUC also provided additional employee training specifically designed to enhance the skill set of employees so that they have the capabilities to provide such services. As a result, customer inquiries can be handled by virtually any customer representative.

[2] See Order No. 23376, issued August 21, 1990, in Docket No. 891309-WS, In re: Investigation of Acquisition Adjustment Policy; Order No. 23858, issued December 11, 1990, in Docket No. l 891353-GU, In re: Application of Peoples Gas Systems, Inc. for a rate increase; Order No. PSC-04-1110-PAA-GU, issued November 8, 2004, in Docket No. 040216-GU, In re: Application for rate increase by Florida Public Utilities Company; Order No. 07-0913-PAA-GU, issued November 13, 2007, in Docket No. 060657-GU, In re: Petition for approval of acquisition adjustment and recognition of regulatory asset to reflect purchase of Florida City Gas by AGL Resources, Inc., and Order No. PSC-12-0010-PAA-GU, issued January 3, 2012, in Docket No. 110133-GU, In re: Petition for approval of acquisition adjustment and recovery or regulatory assets, and request for consolidation of regulatory filings and records of Florida Public Utilities Company and Florida Division of Chesapeake Utilities Corporation.

In addition, IGC customers now receive a full page bill instead of a post card-sized statement. The new statement describes all components of the bill, compares current usage with previous usage, and provides other useful information to the customer.

Customers receive additional benefits from the consolidation, such as multiple payment options. FPUC expanded its payment locations by contracting with Fiserv, Inc., to accept utility payments at Fiserv's network locations, primarily at over 300 Wal-Mart stores in the state. Customers do not incur any additional charges or fees to use this service. FPUC claims this is very convenient for customers by providing all customers access to walk-in payment locations.

The Company has also utilized third-party providers to improve service to customers. These providers, plumbing and HVAC companies, perform turn-key operations from service line installation through meter turn-on. This has resulted in faster customer connections at a lower cost to the Company.

In examining the customer complaints filed with the Commission, FPUC had 39 complaints filed during the 39 month period August 1, 2010, through November 5, 2013, or an average of one complaint per month. However, FPUC's witness Perea asserts that since the acquisition, no complaints have been filed with the Commission from IGC's former customers.

2. <u>Lower Operating Cost</u>

FPUC states that there are no initial capacity cost savings. However, FPUC believes that as part of its future synergies and cost savings, it can provide the acquired IGC customers with capacity cost savings due to its current contracts for interstate pipeline capacity from Florida Gas Transmission Company, LLC (FGT) and Gulfstream Natural Gas System, LLC (Gulfstream).

FPUC-Indiantown's estimated Net Operating Cost Savings are illustrated in Table 1-1 below.

Table 1-1
Total Net Operating Cost Savings

Operating Cost Savings-Capacity		$0
Operating Cost Savings-Cost of Capital		$2,215
Operating Cost Savings-Personnel Related		$134,306
Operating Cost Increases-Increase in Income Tax Rate		$(25,384)
Total Net Operating Cost Savings		$111,137

The cost of capital savings are a reduction of 0.24 percent, which represents a decline in the overall cost of capital of 24 basis points. This results in a lower annual revenue requirement of $2,215. The $2,215 represents annual operating cost savings for the Company.

The Company states that IGC customers will benefit from Chesapeake's experience operating and maintaining the following system facilities: (1) distribution mains; (2) operating pressures up to 721 pounds; (3) serving approximately 70 industrial customers and 13 counties in

Florida; and (4) operating approximately 35 city gate stations interconnected with FGT, Gulfstream, and Southern Natural Gas Company (SONAT). FPUC believes that experience operating the facilities will provide technical and operational skills and knowledge that would be used to improve the operational performance of the former IGC system. Additionally, the Company stated that its personnel are highly proficient with electronic measurement, communications, odorizing equipment, and other technical distribution and transmission system devices.

Prior to acquisition, IGC was a very small, family-owned business, that was staffed by only two employees. Several of IGC's required services were contracted to Indiantown LP Gas, LLC, which is the family-owned non-regulated propane business. FPUC stated that IGC's cost of service was high due to its lack of economies of scale. Furthermore, IGC lacked the operational and management resources to expand the system beyond its existing distribution area. The West Palm Beach division, which is FPUC's largest natural gas distribution division, is located near IGC. According to the Company, this division will provide personnel activities such as customer service, accounting, and scheduled O&M tasks, which go beyond the day-to-day activities that are completed under the O&M Agreement with Indiantown LP Gas. The costs incurred for services provided by the West Palm Beach division are charged to FPUC-Indiantown on a percentage-of-time basis. The Company believes that IGC's location can strategically provide future opportunities to advance and harvest many significant synergies and cost savings for the ratepayer.

As a result of the acquisition, there have been personnel-related cost savings of $134,306. In calculating the cost savings, the Company used a comparative analysis of the O&M expenditures from IGC's 2010 and FPUC-Indiantown's 2011 Earnings Surveillance Reports (ESR) to establish the overall cost savings. (Exhibit CM-3-Revised) The initial cost savings totaled $187,792. As a result of the staff audit, a reduction of $53,486 was identified which resulted in the revised savings amount of $134,306. FPUC did not hire any of IGC's staff as employees. The Company entered into two contracts with the owners of Indiantown LP Gas which include: (1) a three-year O&M Agreement at $50,000 per year to handle turn-ons and turn-offs, walk-in payments, and simple day-to-day operations, to ensure local service would not be disrupted; and (2) a Consulting Agreement at $100,000 per year. Even with the implementation of the two agreements at an annual cost of $150,000, the Company states that it still achieved personnel-related cost savings in the amount of $134,306 annually.

According to the Company's Response to Staff's Fifth Data Request, the Consulting Agreement with Indiantown LP Gas ended July 31, 2013, and the O&M Agreement will terminate on July 31, 2014. Initially, the total contracted amount of the agreements were included in the calculations of the operating cost savings as a reoccurring cost. The inclusion of the $150,000 represents half of the costs of the O&M expense reported on the 2011 ESR. With the termination of the Consulting Agreement in July 2013 and the eventual end of the O&M Agreement in the future, it is anticipated that the operating cost savings at FPUC-Indiantown will be greater from 2015 through 2025.

The identified cost savings are offset by the change in the applicable tax rate. The combined federal and state income tax rate for IGC, prior to the acquisition, was 19.675 percent.

However, after the acquisition by FPUC, the combined income tax rate changed to 38.575 percent. When the 18.90 percent difference is applied to the $134,306 operating cost savings, it results in an incremental income tax expense of $25,384 annually. Therefore, the calculation of the operating costs for the 15-year amortization period shows a reduction to the overall savings to account for the change in the income tax rate before and after the acquisition. As shown on Table 1-1 above, the net operating cost savings is $111,137.

3. Increased Ability to Attract Capital

Staff believes that post acquisition, IGC, as a division of FPUC, which is an affiliate of Chesapeake, is in a better position to attract capital for system growth and improvements. At the time of the acquisition, IGC did not have a credit rating due to its small size and was extremely limited in its ability to attract capital. By comparison, FPUC's parent, Chesapeake Utilities Corporation, has access to $140 million of short-term debt through four short-term lines of credit and one revolving short-term credit facility. In addition, Chesapeake obtained over $110 million of competitively priced unsecured long-term debt over the 10-year period prior to FPUC's acquisition of IGC.[3] Furthermore, Chesapeake's long-term debt is rated as NAIC 1 by the National Association of Insurance Commissioners (NAIC), which is equivalent to Standard and Poor's credit rating range of AAA to A-.

4. Lower Overall Cost of Capital

Post-acquisition, IGC benefits from a lower overall cost of capital with demonstrated savings. The amount of savings is computed using the appropriate rate base and the pre-acquisition and post-acquisition overall weighted average cost of capital. FPUC compared the midpoint overall weighted average cost of capital of 8.92 percent as reported in IGC's June 30, 2010 ESR to the midpoint overall weighted average cost of capital of 8.68 percent as reported in FPUC-Indiantown's December 31, 2011 ESR. The midpoint overall weighted average cost of capital decreased by 0.24 percent or 24 basis points. The difference of 24 basis points was multiplied by the rate base amount of $569,879 as of December 31, 2011. The result was savings of $1,368, which when multiplied by the net operating income multiplier of 1.61970, produced total savings of $2,215. The Company's calculation of the cost of capital savings is consistent with the method approved by the Commission in Docket No. 110133-GU.[4] FPUC-Indiantown's proposed cost of capital savings amount of $2,215 is illustrated in Table 1-2 below:

[3] The effective interest rate for long-term debt as of December 31, 2011, was 6.91 percent.

[4] See Order No. PSC-12-0010-PAA-GU, issued January 3, 2012, in Docket No. 110133-GU, In re: Petition for approval of acquisition adjustment and recovery of regulatory assets, and request for consolidation of regulatory filings and records of Florida Public Utilities Company and Florida Division of Chesapeake Utilities Corporation.

Table 1-2
Company's Cost of Capital Savings Calculation

Cost of Capital	
ICG June 30, 2010 ESR	8.92%
FPUC-Indiantown Division December 31, 2011	- 8.68%
Difference in Average Cost of Capital	.24%
Rate Base at December 31 ,2011	x $569,879
Required Net Operating Income	$1,368
Net Operating Income Multiplier	x 1.61970
Company Computed Cost of Capital Savings	$2,215

The lower cost of capital is attributed to a change in the capital structure component ratios and the addition of zero-cost deferred taxes in the post-acquisition FPUC-Indiantown capital structure as compared to the pre-acquisition IGC capital structure. The FPUC-Indiantown post-acquisition capital structure reflects the allocated share of the overall Chesapeake Utilities Corporation's capital structure and cost rates. Consequently, staff believes IGC benefits from a lower overall weighted cost of capital as a result of the acquisition by FPUC.

5. More professional and experienced managerial, financial, technical and operational resources

FPUC's largest natural gas distribution operating division is adjacent to Indiantown. The Company states that this geographic proximity provides significant synergies and cost savings. IGC's unbundled transportation service, mainly to large industrial customers, is similar to the operational background of Chesapeake. Chesapeake serves customers in 13 counties in Florida, which include approximately 70 industrial customers that each consume over 100,000 therms per year.

The Company points out that Chesapeake is experienced in mild and cold climates, urban and rural areas, natural gas and propane distribution operations, intrastate and interstate natural transmission pipelines, and propane trading. FPUC states that these technical and operational skills and knowledge can be used to further improve the operational performance of IGC. As noted above, the Florida operations of Chesapeake encompass a wide variety of operational characteristics and the experience operating and maintaining these facilities sets the combined company apart from most other natural gas utilities in Florida.

As a member of the Chesapeake family, FPUC's personnel have become highly proficient with electronic measurement, communications, odorizing equipment, and other technical distribution and transmission system devices. These employees operate electronic measurement devices on residential (small) and industrial (large) meters, as well as, the communication networks for data transmission of such devices, which requires a high level of technical proficiency and training that the Company has provided its employees. Chesapeake also has approximately 35 city gate stations in Florida which are interconnected with three major interstate transmission pipelines: FGT, Gulfstream and SONAT.

FPUC-Indiantown asserts that the quality of service provided to customers since the acquisition has improved due to technical, managerial, and operational resources provided by FPUC and through contractual agreements with third-party consultants and payment companies. FPUC did not retain any former IGC employees. However, certain former IGC employees continue to provide services to the utility as independent contractors through a contractual agreement with Indiantown LP Gas that keeps its local customer service intact. This contract specifies operations and maintenance tasks such as meter turn on and off, emergency response and repairs, meter reading, meter painting, meter maintenance, meter removal, leak investigations, customer payments, billing, staffing of phones, customer payment, payment reconciliation and customer collection activities.

Since the acquisition, Customer Care functions have been consolidated into one department that focuses on the efficient delivery of meter-to-cash activities. To further its goal of achieving a positive customer experience consistently with each meter-to-cash interaction opportunity, FPUC retained the Profitable Group to review and offer suggestions to improve its operations. The Profitable Group is a human resources consulting and training organization which specializes in performance improvement in the areas of service, sales, efficiency, and productivity. The Company states that it has implemented employee training modules to improve its operations.

Additionally, the Company has implemented two technological improvements to further enhance its customer service-centered platform. In November 2011, former IGC customer information was consolidated into FPUC's Customer Information Systems to organize field services and Customer Care activities. This technological improvement allows customers to access services either through the regular call center or after hours service. The Company has also finalized the installations of state-of-the-art telephony technologies which collect a "wide variety of valuable customer call metrics" needed to continually improve their customer service activities. Staff notes that these tools show a decrease in average speed of call answer, call abandonment rate, and average call handle time since the acquisition of IGC. Another type of telephony technology used is Verint. This system monitors and records calls for training customer care representatives. Billing statement upgrades provide customers details of current and previous usage, as well as, a description of all components previously unavailable to IGC customers.

Under Chesapeake, the Company has also increased its safety initiatives. Each of the five Division offices has a Safety Coordinator position. Chesapeake is a multiple winner of the American Gas Association (AGA) Safety Award which recognizes companies that show exceptional employee safety performance throughout the year. To obtain this award, companies must have zero employee fatalities, employee days away from work because of injury and a restricted or transferred incident rate that is lower than the industry average, and an Occupational Safety and Health Administration recordable incident rate lower than the industry average. The Company states that Chesapeake earned this award for seven consecutive years. Also, Chesapeake has received the AGA Industry Leader in Accident Prevention Certificate in 2010 and 2011, and won the Safety Achievement Award for having the lowest vehicle incident rate for utilities of their size in 2011.

6. Amortization Period

The Company proposed a 15-year amortization period for its $745,800 acquisition adjustment ($49,720 per year). According to FPUC, although the Commission has approved 30-year amortizations for other gas acquisition adjustments, the Commission authorized a 15-year amortization for Chesapeake's acquisition of Central Florida Gas (Docket No. 870118-GU).[5] FPUC explained that in the instant docket as well as Docket No. 870118-GU, the acquired company was "relatively small" with respect to the number of customers and the size of the rate base. FPUC also asserted that the acquisition premiums in the two cases are "not significant" when compared to the size of the acquiring company. FPUC believes that its proposed 15-year amortization period in the instant case is appropriate based on the size of the acquisition and what it described as a "relatively low" revenue requirement for the acquisition adjustment. FPUC also asserted that the overall remaining life of the purchased assets, and the level of achieved savings, is consistent with a 15-year amortization period. In IGC's last depreciation study completed in 2009, the overall weighted remaining life of the purchased assets was 19.4 years.

Staff believes that the Company's reference to the 1987 case supports FPUC's position, but is not dispositive by itself. However, there are two other considerations that staff believes support a 15-year amortization. First, the overall weighted remaining life of the purchased assets is consistent with an amortization period of 15 years. Second, the use of a 15-year amortization period results in the operational cost savings discussed previously. Staff, therefore, recommends approval of a 15-year amortization period.

Conclusion

Table 1-3 shows the costs and savings associated with the acquisition adjustment. The amounts in the column labeled "Savings" represent the annual operating cost savings discussed earlier. The amounts in the next column labeled "Costs" represents the annual revenue requirement associated with recovery of the premium paid over book value. This amount consists of two components. The first component is the straight-line amortization of the acquisition adjustment of $49,720 ($745,800 divided by 15). The second component is the revenue requirement associated with the return on the unamortized balance. The amount in this column declines over time as the acquisition adjustment is amortized. The next column labeled "Net Savings (Costs)" represents the annual cost or savings in each year. As this analysis shows, the annual savings goes positive in 2016. The final column labeled "Cumulative Savings" represents the cumulative savings over the 15-year amortization period. This analysis shows that cumulative positive savings are achieved in 2021 and that the transaction will produce $200,449 of total savings over the 15-year amortization period.

Staff believes FPUC has demonstrated there will be sufficient future savings to offset the amortization of the acquisition adjustment over 15 years. Therefore, staff recommends that FPUC be allowed to record the $745,800 purchase price premium as a positive acquisition

[5] See Order No. 18716, issued January 26, 1988, in Docket No. 870118-GU, In re: Petition of Central Florida Gas Company to increase its rates and charges.

adjustment to be amortized over a 15-year period beginning August 1, 2010. The positive acquisition adjustment should be recorded in Account 114 – Gas Plant Acquisition Adjustments and the amortization expense should be recorded in Account 406 – Amortization of Gas Plant Acquisition Adjustments. However, the cost savings supporting FPUC's request should be subject to review in FPUC's next rate proceeding, and if it is determined that the cost savings no longer exist, the acquisition adjustment could be partially or totally removed as deemed appropriate by the Commission. FPUC-Indiantown should file its ESRs with and without the effect of the acquisition adjustment.

Table 1-3
Calculation of Net Savings/(Costs)[6]

Year	Savings	Costs (Revenue Requirement Associated with Premium)	Net Savings/(Costs)	Cumulative Savings/(Costs)
2010	$46,308	$59,626	($13,318)	($13,318)
2011	$111,137	$138,631	($27,494)	($40,812)
2012	$111,137	$132,318	($21,180)	($61,992)
2013	$111,137	$126,004	($14,867)	($76,859)
2014	$111,137	$119,691	($8,554)	($85,413)
2015	$111,137	$113,378	($2,241)	($87,654)
2016	$111,137	$107,065	$4,072	($83,582)
2017	$111,137	$100,752	$10,386	($73,196)
2018	$111,137	$94,338	$16,699	($56,497)
2019	$111,137	$88,125	$23,012	($33,485)
2020	$111,137	$81,812	$29,325	($4,160)
2021	$111,137	$75,499	$35,638	$31,478
2022	$111,137	$69,186	$41,952	$73,430
2023	$111,137	$62,872	$48,265	$121,695
2024	$111,137	$56,559	$54,578	$176,273
2025	$54,253	$30,077	$24,176	$200,449

[6] The savings shown in Table 1-3 for the partial years 2010 and 2025 are prorated amounts based on the effective date of acquisition. FPUC-Indiantown Division projects net savings annually beginning in 2016, and cumulative savings of $200,449 over the 15-year amortization period. All figures shown in Table 1-3 were taken from the Company's revised Exhibit CM-4.

Issue 2: What is the amount, if any, of excess earnings for 2011 and 2012 for the FPUC-Indiantown Division?

Recommendation: The FPUC-Indiantown Division does not have excess earnings for 2011 and 2012, based on the inclusion of the acquisition adjustment recommended in previous issues. (Trueblood, D. Buys)

Staff Analysis: FPUC-Indiantown submitted its Revised December 2011 ESR and its December 2012 ESRs on November 5, 2012 and March 29, 2013, respectively. The 2011 ESR reported an "FPSC Adjusted" ROR of 25.73 percent resulting in an achieved ROE of 42.51 percent; and the 2012 ESR reported an "FPSC Adjusted" ROR of 19.45 percent resulting in an achieved return on equity (ROE) of 32.66 percent. The returns for 2011 and 2012 exceeded the top of the authorized ROE range of 12.50 percent. The ROE for 2011 of 42.51 percent and the ROE for 2012 of 32.66 percent were calculated excluding the effects of the acquisition adjustment. Per the Company's calculations, inclusion of the acquisition adjustment reduces the ROR for 2011 to 7.45 percent and the ROR for 2012 to 7.36 percent, lowering the achieved ROEs below the authorized maximum of 12.50 percent.

FPUC-Indiantown's Revised December 2011 ESR and its December 2012 ESR were audited by the staff auditors and the audit report[7] was submitted on August 7, 2013. FPUC-Indiantown filed its response[8] to the audit report on August 27, 2013. Based upon the review of the audit report and FPUC-Indiantown's response, staff made certain adjustments to the rate base, net operating income, and capital structure (Attachments A, B, D, & E). After making these adjustments, staff calculated a revised 2011 ROR of 25.73 percent and a 2012 ROR of 16.28 percent, and a revised 2011 ROE of 39.81 percent and a 2012 ROE of 26.47 percent, representing possible excess earnings of $91,719 for 2011 and $52,084 for 2012 (Attachments C & F). While this calculation excludes any consideration of the acquisition adjustment, it does include the cost savings actually realized during 2011 and 2012.

As discussed in previous issues, staff is recommending approval of the recovery and amortization of the acquisition adjustment premium. When the acquisition adjustment is included in the calculations, the 2011 and 2012 ROEs are reduced to 12.39 percent and 8.33 percent, respectively, and no excess net operating income (Attachments C & F). These returns are less than the authorized maximum ROE of 12.50 percent. Therefore, staff recommends that FPUC-Indiantown does not have any excess earnings for 2011 and 2012 based on the inclusion of the acquisition adjustment.

[7] See Document No. 04579-13, filed August 7, 2013, in Docket No. 120311-GU.
[8] See Document No. 05016-13, filed August 27, 2013, in Docket No. 120311-GU.

Issue 3: What is the appropriate disposition of the 2011 and 2012 excess earnings, if any, for the FPUC-Indiantown Division?

Recommendation: The FPUC-Indiantown Division does not have any excess earnings for 2011 and 2012. Staff notes that this issue is moot if the recommendation in Issue 2 is approved. (Trueblood)

Staff Analysis: As discussed in Issue 2, staff is recommending that there are not any excess earnings. However, if the Commission determines there are excess earnings and a refund is warranted, the deposition of the excess earnings should be based on the amount of the refund. In evaluating the appropriate method for disposing of any refund amounts, consideration should be given to the dollar amount, the administrative efficiency and cost of the disposition method, and the potential benefit to the ratepayers. Any refund should also be made with interest calculated using the commercial paper rate as provided in Rule 25-7.091(4), Florida Administrative Code (F.A.C.) Staff notes that this issue is moot if the recommendation in Issue 2 is approved.

Issue 4: Should this docket be closed?

Recommendation: Yes. If no person whose substantial interests are affected by the proposed agency action files a protest within 21 days of the issuance of the order, this docket should be closed upon the issuance of the consummating order. (Klancke)

Staff Analysis: If no person whose substantial interests are affected by the proposed agency action files a protest within 21 days of the issuance of the order, the docket should be closed upon issuance of the consummating order.

FLORIDA PUBLIC UTILITIES COMPANY
FPUC - INDIANTOWN DIVISION
DOCKET NO. 120311-GU
REVIEW OF 2011 EARNINGS

	As Filed FPSC Adjusted Basis	Proforma Adjustments Acquisition Adjustment	Interest Synch	Total Adjustments	Total Adjusted Rate Base
RATE BASE					
Plant in Service	$1,179,669	$745,800	$0	$745,800	$1,925,469
Accumulated Depreciation	(690,265)	(45,575)	0	(45,575)	(735,840)
Net Plant in Service	$489,404	$700,225	$0	$700,225	$1,189,629
Property Held for Future Use	0	0	0	0	0
Construction Work in Progress	0	0	0	0	0
Net Utility Plant	$489,404	$700,225	$0	$700,225	$1,189,629
Working Capital	80,476	0	0	0	80,476
Total Rate Base	$569,880	$700,225	$0	$700,225	$1,270,105
INCOME STATEMENT					
Operating Revenues	$613,342	$0	$0	$0	$613,342
Operating Expenses:					
Operation & Maintenance - Fuel	3,095	0	0	0	3,095
Operation & Maintenance - Other	334,516	0	0	0	334,516
Depreciation & Amortization	39,071	49,720	0	49,720	88,791
Taxes Other Than Income	6,066	0	0	0	6,066
Income Taxes - Current	83,939	(19,179)	(5,554)	(24,733)	59,206
Deferred Income Taxes (Net)	0	0	0	0	0
Investment Tax Credit (Net)	0	0	0	0	0
(Gain)/Loss on Disposition	0	0	0	0	0
Total Operating Expenses	$466,687	$30,541	($5,554)	$24,987	$491,674
Net Operating Income	$146,655	($30,541)	$5,554	($24,987)	$121,668

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CAPITAL STRUCTURE				Weighted	
AS FILED - FPSC ADJUSTED	Amount	Ratio	Cost Rate	Cost	
Long Term Debt	$147,411	25.87%	6.91%	1.79%	
Short Term Debt	32,570	5.72%	1.24%	0.07%	
Short Term Debt Refinanced	17,932	3.15%	6.33%	0.20%	
Preferred Stock	0	0.00%	0.00%	0.00%	
Customer Deposits	19,197	3.37%	6.57%	0.22%	
Common Equity	317,112	55.65%	12.50%	6.96%	
Deferred Income Taxes	35,657	6.26%	0.00%	0.00%	
Tax Credits - Zero Cost	0	0.00%	0.00%	0.00%	
Tax Credits - Weighted Cost	0	0.00%	9.59%	0.00%	2.28%
Total	$569,879	100.00%		9.24%	

		Adjustments		Adjusted			Weighted
ADJUSTED	Amount	Specific	Pro Rata	Total	Ratio	Cost Rate	Cost
Long Term Debt	$147,411	$0	$200,419	$347,830	27.39%	6.91%	1.89%
Short Term Debt	32,570	0	44,282	76,852	6.05%	1.24%	0.08%
STD Refinanced LTD	17,932	0	24,380	42,312	3.33%	6.33%	0.21%
Customer Deposits	19,197	0	0	19,197	1.51%	6.57%	0.10%
Common Equity	317,112	0	431,144	748,256	58.91%	12.50%	7.36%
Deferred Income Taxes	35,657	0	0	35,657	2.81%	0.00%	0.00%
Tax Credits - Zero Cost	0	0	0	0	0.00%	0.00%	0.00%
Tax Credits - Weighted Cost	0	0	0	0	0.00%	9.97%	0.00%
Total	$569,879	$0	$700,225	$1,270,104	100.00%		9.64%

INTEREST SYNCHRONIZATION					
			Effect on		Effect on
	Adjustments	Cost Rate	Interest Exp.	Tax Rate	Income Taxes
Long Term Debt	$200,419	6.91%	$13,849	38.575%	($5,342)
Short Term Debt	44,282	1.24%	549	38.575%	(212)
STD Refinanced LTD	0	6.33%	0	38.575%	0
Customer Deposits	0	6.57%	0	38.575%	0
Total	$244,701		$14,398		($5,554)

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		Excluding Acquisition Adjustment	Acquisition Adjustment		Including Acquisition Adjustment
Adjusted Rate Base		$569,880	$700,225		$1,270,105
Adjusted Required Rate of Return @ 12.50% ROE	x	9.64%		x	9.64%
Required Net Operating Income		$54,936			$122,438
Adjusted Achieved Net Operating Income	-	146,655	($24,987)	-	121,668
Net Operating Income Excess/(Deficiency)		91,719			(770)
Revenue Expansion Factor	x	1.6197		x	1.6197
Revenue Excess/(Deficiency)		$148,557			($1,247)
Achieved Rate of Return		25.73%			9.58%
Achieved Return on Equity		39.81%			12.39%

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	As Filed FPSC Adjusted Basis	Audit Finding No. 1 13 Month Avg. Recalculation	Audit Finding No. 2 Working Capital Understated	Audit Finding No. 6 O&M Not Allocated	Audit Finding No. 9 Depreciation Exp. Not Allocated	Proforma Acquisition Adjustment	Interest Synch	Total Adjustments	Total Adjusted Rate Base
RATE BASE									
Plant in Service	$1,300,801	$22,060	$0	$0	$0	$745,800	$0	$767,860	$2,068,661
Accumulated Depreciation	(729,877)	(340)	0	0	0	(145,013)	0	(145,353)	(875,230)
Net Plant in Service	$570,924	$21,720	$0	$0	$0	$600,787	$0	$622,507	$1,193,431
Property Held for Future Use	0	0	0	0	0	0	0	0	0
Construction Work in Progress	0	0	0	0	0	0	0	0	0
Net Utility Plant	$570,924	$0	$0	$0	$0	$0	$0	$622,507	$1,193,431
Working Capital	97,844	0	36,033	0	0	0	0	36,033	133,877
Total Rate Base	$668,768	$21,720	$36,033	$0	$0	$600,787	$0	$658,540	$1,327,308
INCOME STATEMENT									
Operating Revenues	642,530	0	0	0	0	0	0	0	642,530
Operating Expenses:									
Operation & Maintenance - Fuel	0	0	0	0	0	0	0	0	0
Operation & Maintenance - Other	387,963	0	0	7,705	0	0	0	7,705	395,668
Depreciation & Amortization	40,545	884	0	0	3,214	49,720	0	53,818	94,363
Taxes Other Than Income	8,940	0	0	0	0	0	0	0	8,940
Income Taxes - Current	75,009	0	0	0	0	(19,179)	(298)	(19,477)	55,532
Deferred Income Taxes (Net)	0	0	0	0	0	0	0	0	0
Investment Tax Credit (Net)	0	0	0	0	0	0	0	0	0
(Gain)/Loss on Disposition	0	0	0	0	0	0	0	0	0
Total Operating Expenses	$512,457	$884	$0	$7,705	$3,214	$30,541	($298)	$42,046	$554,503
Net Operating Income	$130,073	($884)	$0	($7,705)	($3,214)	($30,541)	$298	($42,046)	$88,027

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CAPITAL STRUCTURE AS FILED - FPSC ADJUSTED	Amount	Ratio	Cost Rate	Weighted Cost
Long Term Debt	$154,878	23.16%	6.09%	1.41%
Short Term Debt	48,702	7.28%	1.37%	0.10%
Preferred Stock	0	0.00%	0.00%	0.00%
Customer Deposits	9,787	1.46%	5.18%	0.08%
Common Equity	365,745	54.69%	12.50%	6.84%
Deferred Income Taxes	89,655	13.41%	0.00%	0.00%
Tax Credits - Zero Cost	0	0.00%	0.00%	0.00%
Tax Credits - Weighted Cost	0	0.00%	0.00%	0.00%
Total	$668,767	100.00%		8.43%

ADJUSTED	Amount	Adjustments Specific	Pro Rata	Adjusted Total	Ratio	Cost Rate	Weighted Cost
Long Term Debt	$154,878	$0	$179,148	$334,026	25.17%	6.09%	1.53%
Short Term Debt	48,702	0	56,334	105,036	7.91%	1.37%	0.11%
STD Refinanced LTD	0	0	0	0	0.00%	6.33%	0.00%
Customer Deposits	9,787	0	0	9,787	0.74%	5.18%	0.04%
Common Equity	365,745	0	423,058	788,803	59.43%	12.50%	7.43%
Deferred Income Taxes	89,655	0	0	89,655	6.75%	0.00%	0.00%
Tax Credits - Zero Cost	0	0	0	0	0.00%	0.00%	0.00%
Tax Credits - Weighted Cost	0	0	0	0	0.00%	9.80%	0.00%
Total	$668,767	$0	$658,540	$1,327,307	100.00%		9.11%

INTEREST SYNCHRONIZATION

	Adjustments	Cost Rate	Effect on Interest Exp.	Tax Rate	Effect on Income Taxes
Long Term Debt	$0	6.09%	$0	38.575%	$0
Short Term Debt	56,334	1.37%	772	38.575%	(298)
STD Refinanced LTD	0	6.33%	0	38.575%	0
Customer Deposits	0	5.18%	0	38.575%	0
Total	$56,334		$772		($298)

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		Excluding Acquisition Adjustment	Acquisition Adjustment		Including Acquisition Adjustment
Adjusted Rate Base		$726,521	$600,787		$1,327,308
Adjusted Required Rate of Return @ 12.50% ROE	x	9.11%		x	9.11%
Required Net Operating Income		$66,186			$120,918
Adjusted Achieved Net Operating Income	-	118,270	($30,243)	-	88,027
Net Operating Income Excess/(Deficiency)		52,084			(32,891)
Revenue Expansion Factor	x	1.6197		x	1.6197
Revenue Excess/(Deficiency)		$84,360			($53,274)
Achieved Rate of Return		16.28%			6.63%
Achieved Return on Equity		26.87%			8.33%