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: August 5, 2004

TO: Director, Division of the Commission Clerk & Administrative Services (Bayó)

FROM: Division of Economic Regulation (Kaproth, Romig, Brinkley, Kenny, Lester, Wheeler, Winters)
Office of the General Counsel (Jaeger)

RE: Docket No. 040270-GU – Application for rate increase by Sebring Gas System, Inc.

AGENDA: 08/17/04 – Regular Agenda – Decision on Interim Rates – Participation is at the Commissioners' Discretion

CRITICAL DATES: 60-Day Suspension Date: August 29, 2004
5 Months Effective Date : November 30, 2004

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\040270.RCM.DOC
R:\PSC\ECR\123\040270-ATT6A-7
Attachments 6 & 7 are not electronically submitted

Case Background

This proceeding commenced on June 30, 2004, with the filing of a petition for a permanent rate increase by Sebring Gas System, Inc. (Sebring or the Company). Sebring requested an increase of $234,641 in additional annual revenues. The Company based its request on a 13-month average rate base of $1,132,523 for the projected test year ending December 31, 2005. The requested overall rate of return is 8.65% based on an 11.50% return on common equity.

The Company also requested an interim rate increase of $110,957. The interim increase request was calculated using a 13-month average rate base of $782,836 and an overall rate of return of 7.13% based on a return on equity of 10.00%. The interim test year is the period ended December 31, 2003.

The Commission set initial rates by Order No. PSC-92-0229-FOF-GU, issued April 20, 1992, in Docket No. 910873-GU, In Re: Petition for approval of initial rates to be established by Sebring Gas System, a division of Coker Fuels, Inc. In that Order the Commission found the Company's jurisdictional rate base to be $1,055,175 for the projected year ended December 31, 1993. The allowed rate of return was found to be 10.86% for the test year using a 12.00% return on equity.

The Commission ordered a reduction of the authorized return on equity by Order No. PSC-93-1774-FOF-GU, issued December 10, 1993, in Docket No. 931103-GU, In Re: Investigation into the appropriate equity return for SEBRING GAS SYSTEM, INC. In that order the Commission lowered the 12.00% to an 11.00% mid-point for its authorized rate of return with a range of plus or minus 100 basis points.

Pursuant to Section 366.06(4), Florida Statutes (F.S.), Sebring requested that the Commission process its petition for rate relief using Proposed Agency Action (PAA) procedures. Under that section, the Commission must enter its vote on the PAA within five months of the date on which a complete set of minimum filing requirements (MFRs) is filed with the Commission. On June 30, 2004, the MFRs were filed and on July 16, 2004, the MFRs were determined to meet the filing requirements under Rule 25-7.039(1)(a), Florida Administrative Code (F.A.C.). Therefore, the commencement date was established as June 30, 2004, and the statutory five-month timeframe pursuant to Section 366.06(4), F.S., began. The Commission has jurisdiction over this request for a rate increase and an interim rate increase under Sections 366.06(2) and (4), and 366.071, F.S.

Discussion of Issues

Issue 1: Should the request for a permanent increase in rates and charges be suspended for Sebring?

Recommendation: Yes. Staff recommends that the requested permanent increase in rates and charges of $234,641 be suspended for Sebring. (Kaproth, Romig)

Staff Analysis: Sebring filed its MFRs on June 30, 2004. The Company requested a permanent rate increase of $234,641 which would produce an 8.65% overall return on its 13-month average adjusted rate base. This overall rate of return was calculated using an 11.50% return on equity. The Company also requested interim rate relief in accordance with Section 366.071, F.S. Staff recommends that it is reasonable and necessary to require further amplification and explanation regarding this data, and to require production of additional and/or corroborative data. This further examination will include on-site investigations by staff accountants/auditors and engineers. Based on the foregoing, and to allow staff time to complete its review of the Company's MFRs, staff recommends that the proposed rates be suspended.

Pursuant to Section 366.06(3) and 366.071(2)(a), F.S., the Commission must take action to suspend the permanent rates and act on the interim request within 60 days of the filing. If the Commission has not taken action by November 30, 2004, or if the Commission's action is protested by a party other than the utility, Sebring may place its requested rates into effect under bond, escrow, or corporate undertaking subject to refund, upon notice to the Commission and upon filing the appropriate tariff.

Issue 2: Is Sebring's proposed interim test year rate base of $782,836 appropriate?

Recommendation: No. Rate Base should be increased by $10,951 to $793,787 to reflect a $10,951 increase to Working Capital. (Brinkley)

Staff Analysis: In its filing, the Company used the Balance Sheet method to calculate Working Capital of $20,553. For purposes of determining the interim Rate Base, staff recommends that Working Capital be calculated as one-eighth of Operations and Maintenance (O&M) Expense which is consistent with the method used in Order No. PSC-92-0229-FOF-GU, issued April 20, 1992, in Docket No. 910873-GU, In Re: Petition for approval of initial rates to be established by Sebring Gas System, a division of Coker Fuels, Inc.

In Issue 3, staff is recommending two adjustments to O&M Expense totaling $703. (See Adjustments 2 and 3.) If these adjustments are approved, O&M Expense would be $252,029. Under the one-eighth of O&M Expense method of calculating Working Capital, Working Capital would be $31,504. Therefore, staff recommends that Working Capital be increased by $10,951. As a result, Rate Base would also be increased by $10,951 to $793,787.

Issue 3: Is Sebring's proposed interim test year net operating income of ($32,891) appropriate?

Recommendation: No. The appropriate interim test year net operating income for Sebring is ($29,999). (Kaproth, Romig, Kenny, Winters)

Staff Analysis: Sebring proposed an interim test year net operating income of ($32,891). Staff proposes the following adjustments, resulting in an interim net operating income of ($29,999).

Adjustment 1: Purchased Gas Adjustment (PGA) – The Company did not remove the PGA Revenues, the PGA Gas Cost or the related Regulatory Assessment Fees (RAFs) from its interim test year net operating income. To correct this, Revenues, O&M Gas Expense and Taxes Other should be decreased by $392,547, $390,584 and $1,963, respectively.

Adjustment 2: Lobbying Expense – The Company incorrectly made an adjustment to increase O&M Expenses by $100 for lobbying expenses. The Company intended to reduce O&M Expenses by $100. To correct this error, O&M expense should be reduced by $200.

Adjustment 3: American Gas Association (AGA) and Florida Natural Gas Association (FNGA) Dues – The Company included $2,950 in AGA dues and $400 in FNGA dues in its 2003 O&M Expenses. Following discussions with the Company, we have determined that approximately 15% of each association's dues relates to lobbying activities. Therefore, O&M Expenses have been reduced by $503.

Adjustment 4: Intangible Taxes **-** The Company included state intangible taxes of $26 in its MFRs. It was determined that the intangible tax was paid by Sebring as agent for its stockholders. Consistent with prior Commission practice, staff recommends that intangible taxes paid on behalf of stockholders be disallowed and, therefore, that Taxes Other be reduced by $26.

Adjustment 5: Property Taxes - The Company included property taxes of $4,775 in its MFRs. It was determined that through an error in recording the monthly accrual, the property taxes were overstated by $330. Property taxes for 2003 were $4,445. To correct this error, Taxes Other should be reduced by $330.

Adjustment 6: Occupational Licenses - The Company included $557 for Occupational Licenses in its MFRs. It was determined that this amount incorrectly included $77 for a vehicle tag. To correct this error, Taxes Other should be reduced by $77.

Adjustment 7: Regulatory Assessment Fees - The Company included $3,184 of RAFs in its MFRs. In Adjustment 1, staff recommends decreasing RAFs by $1,963 for the RAFs related to the PGA Revenues, leaving a balance of RAFs related to Base Rate Revenue of $1,221. Calculating RAFs on the Base Rate Revenues, excluding PGA Revenues, results in RAFs of $1,357. Therefore, RAFs and Taxes Other should be increased by $136.

Adjustment 8: Tax Effect of Other Adjustments - Staff made an adjustment to increase the Company's income tax expense by $197. This adjustment is a fallout based on other income and expense adjustments.

Adjustment 9: Interest Reconciliation Adjustment - Staff made an adjustment to decrease income tax expense by $2,089. The Company included a positive $187 interest reconciliation adjustment in its calculation of income tax expense. Based on the Company's capital structure, the interest reconciliation adjustment should have been $97, a $90 decrease. Additionally, the interest reconciliation adjustment has been decreased by $1,999 to reflect the appropriate amount of interest based on staff's recommended interim capital structure. Therefore, the appropriate interest reconciliation adjustment to include in income tax expense is ($1,902).

Issue 4: Is Sebring's proposed return on equity of 10.00% and its overall cost of capital of 7.13% appropriate for purposes of determining interim rates?

Recommendation: No. Though Sebring's appropriate return on equity is 10.00%, staff believes the Commission should reduce the balance of common equity in the capital structure. This results in an overall cost of capital for interim purposes of 6.07%. (Lester)

Staff Analysis: Sebring's authorized return on equity and range is 11.00% plus or minus 100 basis points. The Commission set the return and range by Order No. PSC-93-1774-FOF-GU, issued December 10, 1993, in Docket No. 931103-GU, In re: Investigation into the appropriate equity return for Sebring Gas System, Inc. For its interim request, Sebring used a return on equity of 10.00%, as required by Subparagraph 366.071(5)(b)3., F.S. Staff agrees that this is the appropriate return on equity for calculating interim rates.

In developing its capital structure for interim rates, Sebring reclassified an account payable to Coker Fuel, Inc. as common equity. The account payable represents funds received by Sebring from Coker Fuel, Inc. Sebring determined that, given its diminished equity position, the account payable should be reclassified as additional paid-in-capital. In May 2004, Sebring made this adjustment, retroactive to December 31, 2003.

Staff believes the Commission should reverse this adjustment. Though the adjustment may be appropriate for the projected test year, it was made after the 2003 period upon which the interim rates are based. Further, staff believes the calculation of interim rates should be conservative. The appropriate reversing adjustment on a 13-month average basis is a $216,496 reduction to common equity. The resulting overall cost of capital for interim purposes is 6.07%.

Issue 5: Is Sebring's proposed revenue expansion factor of 79.9234% and its interim net operating income multiplier of 1.2512 appropriate?

Recommendation: Yes. The proposed interim revenue expansion factor of 79.9234% and the proposed interim net operating income multiplier of 1.2512 are appropriate. (Romig, Kenny)

Staff Analysis: The Company's calculation, with which staff agrees, is shown on Attachment 4. The appropriate revenue expansion factor is 79.9234% and the appropriate net operating income multiplier is 1.2512.

Issue 6: Should Sebring's requested interim revenue increase of $110,957 be granted?

Recommendation: No. After making the previous adjustments, the interim revenue increase for Sebring should be $97,821. (Kaproth, Romig)

Staff Analysis: The Company requested $110,957 in interim revenue relief for the historical base year ended December 31, 2003. Based on the Company's calculations and adjustments, this would have allowed the Company to earn an overall rate of return of 7.13%. Based on the previously discussed staff adjustments, staff has determined the interim rate base to be $793,787, and the net operating income to be ($29,999). Applying a 6.07% overall rate of return, the Company is entitled to $97,821 in interim rate relief, as shown on Attachment 5.

Issue 7: How should the interim revenue increase for Sebring 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 thirty days from the date of the vote approving any interim increase. Sebring should file revised tariff sheets reflecting the interim rates prior to sending the first bill that reflects the increase, and should give notice to customers of the interim increase commencing with the first bill for service that reflects the increase. (Wheeler)

Staff Analysis: As shown on Attachments 6A and 6B, staff has determined the cents-per-therm increases to be applied to each rate class based on staff's recommended interim increase of $97,821. 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. Attachment 7 contains monthly bill amounts for each rate class comparing the present rates with the staff-recommended interim rates.

The interim rates should be made effective for all meter readings made on or after thirty days from the date of the Commission vote approving any interim increase. Sebring should file revised tariff sheets reflecting the interim rates prior to sending the first bill that reflects the increase, and 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 the Division of Economic Regulation for approval prior to its use.

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

Recommendation: The appropriate security to guarantee the funds collected subject to refund is an irrevocable letter of credit, a surety bond, or an escrow agreement. Staff recommends that Sebring pursue the least expensive method. If necessary, the refund should be with interest and undertaken according to Rule 25-7.040(3), F.A.C. (Lester)

Staff Analysis: Pursuant to Section 366.071(2)(b) and (c), F.S., revenues collected under interim rates are subject to refund with interest and shall be secured under bond or corporate undertaking pending final resolution of the rate case. As discussed in Issue 6, the recommended annual interim increase is $97,821. For corporate undertaking analysis purposes, staff used $49,389, which represents six months of the interim revenue increase plus a small allowance for interest.

To determine whether Sebring qualified for a corporate undertaking, staff analyzed Sebring's PSC Annual Reports for 2001, 2002, and 2003. Based on this analysis, staff concludes that Sebring has inadequate liquidity, negative equity, and negative net income. Staff does not believe Sebring qualifies for a corporate undertaking.

Staff recommends that the Company secure its interim increase with an irrevocable letter of credit, a surety bond, or an escrow agreement. If Sebring uses an irrevocable letter of credit or surety bond, the amount of the instrument should be $49,389, the named beneficiary should be the Florida Public Service Commission on behalf of the customers of Sebring Gas System, Inc., and the instrument should remain in effect until a final Commission order is issued in the rate case.

Alternatively, the Company could establish an escrow agreement with an independent financial institution. If Sebring uses an escrow agreement, the following conditions should be part of the agreement:

1) No refunds in the escrow account may be withdrawn by the Company without the approval of the Commission.

2) The escrow account shall be in an interest bearing account.

3) If a refund to the customers is required, the refund should be with interest and undertaken according to Rule 25-7.040(3), F.A.C.

4) If a refund to the customers is not required, the interest earned by the escrow account shall revert to the Company.

5) All information on the escrow account shall be available from the holder of the escrow account to a Commission representative at all times.

6) The amount of revenue subject to refund shall be deposited in the escrow account within seven days of receipt.

7) This escrow account is established by the direction of the Florida Public Service Commission for the purpose(s) set forth in its order requiring such account. Pursuant to Cosentino v. Elson, 263 So. 2d 253 (Fla. 3d DCA 1972), escrow accounts are not subject to garnishments.

8) The Director of the Division of the Commission Clerk and Administrative Services must be a signatory to the escrow agreement.

The Company should deposit 27% of gas revenues collected into the escrow account each month as security for a possible refund. In no instance should the maintenance and administrative costs associated with the refund be borne by the customers. These costs are the responsibility of the Company.

Issue 9: Should this docket be closed?

Recommendation: No. This docket should remain open to process the revenue increase request of the Company. (Jaeger)

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

COMPARATIVE AVERAGE RATE BASES

ATTACHMENT 1

SEBRING GAS SYSTEM, INC
DOCKET NO. 040270-GU
INTERIM TYE 12/31/03

		COMPANY		STAFF	
	TOTAL PER BOOKS	COMPANY ADJS.	COMPANY ADJUSTED	STAFF ADJS.	STAFF ADJUSTED
UTILITY PLANT IN SERVICE	2,079,948				
COMMON PLANT ALLOCATED	0				
ACQUISITION ADJUSTMENT	0				
PLANT HELD FOR FUTURE USE	0				
CONSTRUCTION WORK IN PROGRESS	0				
TOTAL PLANT	2,079,948	0	2,079,948	0	2,079,948
DEDUCTIONS					
ACCUM. DEPR.- PLANT IN SERVICE	(1,302,880)				
CUSTOMER ADV. FOR CONSTRUCTION	(14,785)				
TOTAL DEDUCTIONS	(1,317,665)	0	(1,317,665)	0	(1,317,665)
NET UTILITY PLANT	762,283	0	762,283	0	762,283
WORKING CAPITAL ALLOWANCE	(226,553)	247,106	20,553	10,951	31,504
TOTAL RATE BASE	$535,730	$247,106	$782,836	$10,951	$793,787

COMPARATIVE NOIs

SEBRING GAS SYSTEM, INC
DOCKET NO. 040270-GU
INTERIM TYE 12/31/03

ATTACHMENT 2

ADJ. NO.		TOTAL PER BOOKS	COMPANY ADJS.	COMPANY ADJUSTED	STAFF ADJS.	STAFF ADJUSTED
			COMPANY		STAFF	
	OPERATING REVENUES	663,875				
1	Remove PGA Revenue				(392,547)	
	TOTAL REVENUES	663,875	0	663,875	(392,547)	271,328
	OPERATING EXPENSES:					
	O&M GAS EXPENSE	390,584				
1	Remove Cost of Gas				(390,584)	
	OPERATION & MAINTENANCE EXPENSE	252,632				
	Remove FNG-PAC Contribution		100			
2	Correct Co. Adjustment - FNG-PAC				(200)	
3	Remove 15% of AGA & FNGA dues				(503)	
	TOTAL O & M EXPENSE	643,216	100	643,316	(391,287)	252,029
	DEPRECIATION & AMORTIZATION	59,627				
	TOTAL DEPRECIATION & AMORT.	59,627	0	59,627	0	59,627
	TAXES OTHER THAN INCOME	8,542				
1	Reduce RAFs for PGA Revenue				(1,963)	
4	Disallow Intangible Tax				(26)	
5	Correct Overaccrual of Property Taxes				(330)	
6	Correct Error in Occupational Licenses				(77)	
7	Increase RAFs to Calculated Amount				136	
	TOTAL TAXES OTHER THAN INCOME	8,542	0	8,542	(2,260)	6,282
	INCOME TAX EXPENSE		(14,906)			
8	Increase Income Tax Expense for NOI Adjustments				197	(14,709)
9	Interest Synch/Rec. Adj		187		(2,089)	(1,902)
	TOTAL INCOME TAXES	0	(14,719)	(14,719)	(1,892)	(16,611)
	TOTAL OPERATING EXPENSES	711,385	(14,619)	696,766	(395,439)	301,327
	NET OPERATING INCOME	($47,510)	$14,619	($32,891)	$2,892	($29,999)

CAPITAL STRUCTURE

SEBRING GAS SYSTEM, INC.
DOCKET NO. 040270-GU
INTERIM TEST YEAR 12/31/03

ATTACHMENT 3

	COMPANY ADJUSTMENTS				STAFF ADJUSTMENTS						
	PER BOOKS	SPECIFIC	PRO RATA	ADJUSTED PER BOOKS	PER BOOKS	SPECIFIC	PRO RATA	STAFF ADJUSTED	RATIO	COST RATE	WEIGHTED COST
COMMON EQUITY	293,330		(11,929)	281,401	293,330	(216,496)	27,220	104,054	13.11%	10.00%	1.31%
LONG TERM DEBT	471,510	0	(19,176)	452,334	471,510		167,040	638,550	80.44%	5.38%	4.33%
SHORT TERM DEBT	0		0	0	0		0	0	0.00%	0.00%	0.00%
CUSTOMER DEPOSITS	51,183	0	(2,082)	49,101	51,183		0	51,183	6.45%	6.76%	0.44%
INVESTMENT TAX CREDITS	0			0	0			0	0.00%	0.00%	0.00%
DEFERRED INCOME TAX	0			0	0			0	0.00%	0.00%	0.00%
	$816,023	0	($33,187)	$782,836	$816,023	($216,496)	$194,260	$793,787	100%		6.07%
	38.35%			**38.35%**	**38.35%**			**14.01%**			

NET OPERATING INCOME MULTIPLIER

SEBRING GAS SYSTEM, INC.
DOCKET NO. 040270-GU
INTERIM TYE 12/31/03

ATTACHMENT 4

DESCRIPTION	COMPANY PER FILING	STAFF
REVENUE REQUIREMENT	100.0000%	100.0000%
GROSS RECEIPTS TAX RATE	0.0000%	0.0000%
REGULATORY ASSESSMENT RATE	0.5000%	0.5000%
BAD DEBT RATE	0.0000%	0.0000%
NET BEFORE INCOME TAXES	99.5000%	99.5000%
STATE INCOME TAX RATE	5.5000%	5.5000%
STATE INCOME TAX	5.4725%	5.4725%
NET BEFORE FEDERAL INCOME TAXES	94.0275%	94.0275%
FEDERAL INCOME TAX RATE	15.0000%	15.0000%
FEDERAL INCOME TAX	14.1041%	14.1041%
REVENUE EXPANSION FACTOR	79.9234%	79.9234%
NET OPERATING INCOME MULTIPLIER	1.2512	1.2512

COMPARATIVE REVENUE DEFICIENCY CALCULATIONS
SEBRING GAS SYSTEM, INC. ATTACHMENT 5
DOCKET NO. 040270-GU
INTERIM TYE 12/31/03

		COMPANY ADJUSTED		STAFF
RATE BASE (AVERAGE)		$782,836		$793,787
RATE OF RETURN	X	7.13%	X	6.07%
REQUIRED NOI		$55,789		$48,183
Operating Revenues		663,875		271,328
Operating Expenses:				
Operation & Maintenance		643,316		252,029
Depreciation & Amortization		59,627		59,627
Amortization of Environ. Costs		0		0
Taxes Other than Income Taxes		8,542		6,282
Income Taxes		(14,719)		(16,611)
Total Operating Expenses		696,766		301,327
ACHIEVED NOI		(32,891)		(29,999)
NET REVENUE DEFICIENCY		88,680		78,182
Revenue Tax Factor		1.2512		1.2512
TOTAL REVENUE DEFICIENCY		$110,957		$97,821