

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: October 11, 2007

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Slemkewicz, Draper, Maurey, Springer,)
Office of the General Counsel (Brown, Fleming)

RE: Docket No. 070304-EI – Petition for rate increase by Florida Public Utilities Company.

AGENDA: 10/23/07 – Regular Agenda – Decision on Interim Rates – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Argenziano

CRITICAL DATES: 10/29/07 (60-Day Suspension Date)
04/30/08 (8-Month Effective Date)

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\070304.RCM.DOC

Case Background

This proceeding commenced on August 30, 2007, with the filing of a petition for a permanent rate increase by Florida Public Utilities Company (FPUC or Company). FPUC requested an increase in its retail rates and charges to generate \$5,249,895 in additional gross annual revenues. This increase would allow the Company to earn an overall rate of return of 8.07 percent or a 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, 2008. FPUC stated in its petition 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 actual revenues, expenses and investments to be realized under the new rates.

FPUC has also requested an interim rate increase in its retail rates and charges to generate \$790,784 in additional gross annual revenues. This increase would allow the Company to earn an overall rate of return of 7.80 percent or a 10.50 percent return on equity. 10.50 percent is the minimum of the currently authorized return on equity range of 10.50 percent to 12.50 percent. The Company based its interim request on a historical test year ended December 31, 2006.

The Commission last granted FPUC a \$1,820,373 rate increase by Order No. PSC-04-0369-AS-EI.¹ In that order, the Commission found the Company's jurisdictional rate base to be \$36,379,034 for the projected test year ended December 31, 2004. The allowed rate of return was found to be 7.86 percent for the test year using an 11.50 percent return on equity. In addition, the Northeast (Fernandina Beach) and Northwest (Marianna) Electric Divisions were consolidated into a single Electric Division for ratemaking purposes.

This recommendation addresses the suspension of the requested permanent rate increase and the consideration of the requested interim rate increase. The Commission has jurisdiction pursuant to Sections 366.06(2) and (4), and 366.071, Florida Statutes.

¹ Order No. PSC-04-0369-AS-EI, issued April 6, 2004, in Docket No. 030438-EI, In re: Petition for rate increase by Florida Public Utilities Company.

Discussion of Issues

Issue 1: Should the \$5,249,895 permanent base rate increase and its associated tariff revisions requested by Florida Public Utilities Company be suspended pending a final decision in this docket?

Recommendation: Yes. The \$5,249,895 permanent base rate increase and its associated tariff revisions requested by Florida Public Utilities Company should be suspended pending a final decision in this docket (Slemkewicz, Draper)

Staff Analysis: FPUC filed its petition, testimony, and minimum filing requirements on August 30, 2007. The Company has requested a total permanent base rate increase of \$5,249,895 based on a projected test year ending December 31, 2008.

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.

Because FPUC's requested permanent rate relief is based on a projected test year, 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.

Issue 2: Is FPUC's proposed 2006 interim test year rate base of \$38,057,241 appropriate?

Recommendation: Yes. FPUC's proposed 2006 interim test year rate base of \$38,057,241 is appropriate. (Slemkewicz)

Staff Analysis: The proposed interim test year rate base of \$38,057,000 is the thirteen month average amount for the period ended December 31, 2006. Staff has reviewed the rate base adjustments made in the current interim filing for consistency with the findings made in the Company's last rate case order. Based on the staff's preliminary review, it appears that FPUC has made the applicable and appropriate adjustments that are consistent with the previous rate case. Therefore, staff recommends that \$38,057,241 is the appropriate amount of rate base for the 2006 interim test year. The calculation is shown on Attachment A.

It should be noted that 2006 is also the historical base year that was utilized to develop the 2008 projected test year for the requested permanent base rate increase. The 2006 historical test year data is currently being audited as part of the normal ratemaking review process in this docket.

Issue 3: Are FPUC's proposed return on equity of 10.50 percent and overall cost of capital of 7.80 percent appropriate for the purpose of determining interim rates?

Recommendation: Yes. FPUC's proposed return on equity of 10.50 percent and overall cost of capital of 7.80 percent are appropriate for purposes of determining interim rates. (Springer)

Staff Analysis: Pursuant to Section 366.071(2)(a), Florida Statutes, 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. FPUC's authorized ROE and range is 11.50 percent plus or minus 100 basis points. The Commission set the return and range by Order No. PSC-04-0369-AS-EI. For its interim request, FPUC used an ROE of 10.50 percent. Staff agrees that the resulting overall cost of capital is appropriate for calculating interim rates. Attachment B details the calculation of the Company's overall cost of capital.

Issue 4: Is FPUC's proposed 2006 interim test year net operating income of \$2,476,531 appropriate?

Recommendation: Yes, FPUC's proposed 2006 interim test year net operating income of \$2,476,531 is appropriate. (Slemkewicz)

Staff Analysis: The proposed interim test year net operating income of \$2,476,531 is the twelve month amount for the year ended December 31, 2006. 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. Based on the staff's preliminary review, it appears that FPUC has not made all of the applicable and appropriate adjustments that are consistent with the previous rate case. Staff recommends that the following adjustments be made.

Adjustment 1: Franchise Fees – Franchise fees are billed as a separate line item on the customers' bills. Franchise fees are not considered a general expense applicable to all of the Company's customers. The appropriate franchise fee rate is applied to only those customers' bills that reside within the franchising entity's boundaries. Therefore, neither the revenues nor the expenses related to franchise fees should be included in the income statement for ratemaking purposes. Both operating revenues and taxes other than income should be reduced by \$2,012,636. Since these amounts offset each other, there is no effect on the amount of net operating income.

Adjustment 2: Gross Receipts Tax – Although the gross receipts tax is applicable to all of the Company's customers, it is billed as a separate line item on the customers' bills. Therefore, neither the revenues nor the expenses related to the gross receipts tax should be included in the income statement for ratemaking purposes. Both operating revenues and taxes other than income should be reduced by \$1,185,123. Since these amounts offset each other, there is no effect on the amount of net operating income.

After considering these two adjustments, staff recommends that \$2,476,531 is the appropriate amount of net operating income for the 2006 interim test year. The calculation is shown on Attachment A.

It should be noted that 2006 is also the historical base year that was utilized to develop the 2008 projected test year for the requested permanent base rate increase. The 2006 historical test year data is currently being audited as part of the normal ratemaking review process in this docket.

Issue 5: Is FPUC's proposed net operating income multiplier of 1.6075 appropriate?

Recommendation: Yes, the appropriate net operating income multiplier for interim rate purposes is 1.6075. (Slemkewicz)

Staff Analysis: On MFR Schedule G-18, the Company calculated a net operating income multiplier of 1.6075 using a 34 percent federal income tax rate and a 5.5 percent state income tax rate. Additionally, the Company applied a .072 percent factor for regulatory assessment fees and a .188 percent bad debt rate. Staff has reviewed the Company's calculation of the net operating income multiplier and is not proposing any adjustments. Therefore, staff recommends that 1.6075 is the appropriate net operating income multiplier. The calculation is shown below.

<u>Line</u>	<u>Description</u>	
1	Revenue Requirement	100.000%
2	Gross Receipts Tax	0.000%
3	Regulatory Assessment Fee	(0.072)%
4	Bad Debt Rate	<u>(0.188)%</u>
5	Net Before Income Taxes	99.740%
6	Combined State/Federal Income Tax @ 37.63%	<u>(37.532)%</u>
7	Revenue Expansion Factor	<u>62.208%</u>
8	Net Operating Income Multiplier (100%/Line 7)	<u>1.6075</u>

Issue 6: Should FPUC's requested interim rate increase of \$790,784 and percentage increase factor of 5.86 percent be granted?

Recommendation: Yes. FPUC's requested interim rate increase of \$790,784 and percentage increase factor of 5.86 percent should be granted. (Slemkewicz, Draper)

Staff Analysis: FPUC requested interim rate relief of \$790,784 for the historical test year ended December 31, 2006. This would allow the Company to earn an overall rate of return of 7.80 percent and the minimum of the range on return on equity of 10.50 percent. 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.

The calculation of the \$790,784 of interim rate relief and the percentage increase factor is shown below.

Jurisdictional Adjusted Rate Base	\$38,057,241
Overall Rate of Return Requested	x <u>7.80%</u>
Jurisdictional Net Operating Income Requested	\$2,968,465
Jurisdictional Adjusted Net Operating Income	<u>(2,476,531)</u>
Income Deficiency/(Excess)	\$491,934
Net Operating Income Multiplier	x <u>1.6075</u>
Interim Revenue Increase/(Decrease)	\$790,784
Base Rate Revenues	-:- <u>13,505,654</u>
Percentage Increase Factor	<u>5.86%</u>

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

Recommendation: The percentage increase factor approved in Issue 6 should be applied uniformly to all existing base rates and charges to derive the interim base rates and charges, as required by Rule 25-6.0435, Florida Administrative Code. 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. FPUC should also file tariff sheets for administrative approval that reflect the Commission-approved interim base rates and charges. 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: In Issue 6, staff has recommended an interim increase of \$790,784 and a percentage increase factor of 5.86 percent. Rule 25-6.0435, Florida Administrative Code, requires that any percentage increase factor be applied uniformly to all existing base rates and charges to derive interim base rates and charges. Attachment C shows the proposed interim revenue increase to the various rate classes. In its MFRs, Schedule G-22, FPUC shows present rates and proposed interim rates for all rate classes. If the Commission approves a different percentage increase factor, FPUC shall refile Schedule G-22, for staff review, to show the calculation of all base rates and charges based on the Commission-approved percentage increase factor. FPUC should also file tariff sheets for administrative approval that reflect the Commission-approved interim base rates and charges.

Attachment D contains monthly residential bills that show the impact of the proposed interim rates. Attachment E contains present and proposed interim rates for the major rate classes.

The interim rates should be effective for all meter readings made on or after thirty days from the date of the Commission vote approving any interim increase. FPUC 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 its issuance.

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 a corporate undertaking. (Springer)

Staff Analysis: FPUC 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 FPUC's financial statements to determine if the Company can support a corporate undertaking for the amount of its interim rate increase of \$790,784. FPUC's 2004, 2005 and 2006 financial statements were used to determine the financial condition of the Company. This analysis shows FPUC has experienced a decline in liquidity that has remained at insufficient levels during the three-year review period. However, FPUC's average equity ratio over the three-year period has been stable at 47 percent which is sufficient in this instance based on FPUC's overall financial condition. In addition, FPUC has experienced a strong and improving interest coverage ratio. Finally, net income has been on average five times greater than the requested corporate undertaking amount. FPUC's financial performance has demonstrated adequate levels of profitability, interest coverage, and equity capitalization to offset the decline in liquidity.

Staff believes FPUC has adequate resources to support a corporate undertaking in the amount requested. Based on this analysis, staff recommends that a corporate undertaking of \$790,784 is acceptable. This brief financial analysis 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 open to process the Company's revenue increase request. (Brown)

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

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Attachment A

FLORIDA PUBLIC UTILITIES COMPANY, INC.
ELECTRIC DIVISION
DOCKET NO. 070304-EI
INTERIM TEST YEAR
DECEMBER 31, 2006

As Filed by Company	Adjustment 1 <u>Franchise Fees</u>	Adjustment 2 Gross Receipts <u>Tax</u>	Interest <u>Synch</u>	Total <u>Adjustments</u>	Total Adjusted <u>Rate Base</u>
Plant in Service					\$72,309,200
Accumulated Depreciation					(32,166,112)
Net Plant in Service	0	0			40,143,088
Property Held for Future Use					0
Construction Work in Progress					1,454,260
Net Utility Plant	0	0			41,597,348
Working Capital					(3,540,107)
Total Rate Base	\$0	\$0			\$38,057,241

INCOME STATEMENT

Operating Revenues	\$17,408,307	(2,012,636)	(1,185,123)	(3,197,759)	\$14,210,548
Operating Expenses:					
Operation & Maintenance - Fuel	0			0	0
Operation & Maintenance - Other	7,707,300			0	7,707,300
Depreciation & Amortization	2,711,100			0	2,711,100
Taxes Other Than Income	3,960,093	(2,012,636)	(1,185,123)	(3,197,759)	762,334
Income Taxes - Current	781,393		0	0	781,393
Deferred Income Taxes (Net)	(195,788)			0	(195,788)
Investment Tax Credit (Net)	(32,322)			0	(32,322)
(Gain)/Loss on Disposition	0			0	0
Total Operating Expenses	14,931,776	(2,012,636)	(1,185,123)	(3,197,759)	11,734,017
Net Operating Income	\$2,476,531	\$0	\$0	\$0	\$2,476,531
OVERALL RATE OF	6.51%			0.00%	6.51%
RETURN ON EQUITY	7.00%			0.00%	7.00%

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Florida Public Utilities
 FPSC Adjusted Capital Structure
 Interim Test Year 12/31/06
 Docket No. 070304-EI
 13-Month Average

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	\$14,078,859	\$0	\$0	\$14,078,859	\$0	\$0	\$14,078,859	36.99%	10.50%	3.88%
Long-term Debt	\$15,801,612	0	0	\$15,801,612	0	0	\$15,801,612	41.52%	8.03%	3.33%
Short-term Debt	\$1,036,586	0	0	\$1,036,586	0	0	\$1,036,586	2.72%	7.29%	0.20%
Preferred Stock	\$187,953	0	0	\$187,953	0	0	\$187,953	0.49%	4.75%	0.02%
Customer Deposits	\$2,136,661	0	0	\$2,136,661	0	0	\$2,136,661	5.61%	6.07%	0.34%
Deferred Income Taxes	\$4,674,449	0	0	\$4,674,449	0	0	\$4,674,449	12.28%	0.00%	0.00%
Tax Credits - Zero Cost	\$0	0	0	\$0	0	0	\$0	0.00%	0.00%	0.00%
Tax Credits - Weighted Cost	\$141,120	0	0	\$141,120	0	0	\$141,120	0.37%	9.10%	0.03%
	\$38,057,240	\$0	\$0	\$38,057,240	\$0	\$0	\$38,057,240	100.00%		7.80%

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Attachment C

FLORIDA PUBLIC UTILITIES COMPANY
 ALLOCATION OF INTERIM RATE INCREASE
 DOCKET NO. 070304-EI

RATE CODE	(1) RATE SCHEDULE	(2)		(3)		(4) %	(5) TOTAL BASE REVENUE AT INTERIM RATES
		TOTAL BASE REVENUE AT PRESENT RATES	\$	INTERIM INCREASE	INCREASE		
RS	RESIDENTIAL	\$7,593,546		\$444,618		5.86%	\$8,038,164
GS	GENERAL SERVICE	\$1,448,830		\$84,832		5.86%	\$1,533,662
GSD	GENERAL SERVICE DEMAND	\$2,208,265		\$129,298		5.86%	\$2,337,564
GSLD	GENERAL SERVICE LARGE DEMAND	\$643,312		\$37,667		5.86%	\$680,979
GSLD-1	GENERAL SERVICE LARGE DEMAND	\$545,955		\$31,967		5.86%	\$577,922
OL	OUTDOOR LIGHTING	\$853,003		\$49,945		5.86%	\$902,948
SL	STREET LIGHTING	\$212,743		\$12,457		5.86%	\$225,200
TOTAL		<u>\$13,505,654</u>		<u>\$790,784</u>		<u>5.86%</u>	<u>\$14,296,438</u>

FLORIDA PUBLIC UTILITIES COMPANY
 BILL COMPARISONS - PRESENT VS. RECOMMENDED INTERIM RATES
 DOCKET NO. 070304-EI

RESIDENTIAL SERVICE

PRESENT RATES

Customer Charge
\$10.00

Energy Charge (c/kWh)
1.373

Fuel - Marianna (c/kWh)
5.348

Fuel - Fernandina Beach (c/kWh)
6.355

Conservation Factor (c/kWh)
0.06

INTERIM RATES

Customer Charge
\$10.59

Energy Charge (c/kWh)
1.453

Fuel - Marianna (c/kWh)
5.348

Fuel - Fernandina Beach (c/kWh)
6.355

Conservation Factor (c/kWh)
0.06

MARIANNA

FERNANDINA BEACH

kwh Usage	MARIANNA				FERNANDINA BEACH			
	Present Monthly Bill	Recommended Interim Monthly Bill	Percent Increase	Dollar Increase	Present Monthly Bill	Recommended Interim Monthly Bill	Percent Increase	Dollar Increase
800	\$65.90	\$67.16	1.91%	\$1.26	\$74.16	\$75.42	1.70%	\$1.26
900	\$72.85	\$74.19	1.84%	\$1.34	\$82.15	\$83.49	1.63%	\$1.34
1,000	\$79.81	\$81.23	1.79%	\$1.43	\$90.13	\$91.56	1.58%	\$1.43
1,100	\$86.76	\$88.27	1.74%	\$1.51	\$98.12	\$99.63	1.54%	\$1.51
1,200	\$93.71	\$95.30	1.70%	\$1.59	\$106.11	\$107.70	1.50%	\$1.59
1,300	\$100.67	\$102.34	1.66%	\$1.67	\$114.10	\$115.77	1.47%	\$1.67

Bills include Gross Receipts Taxes

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Attachment E

**FLORIDA PUBLIC UTILITIES COMPANY
 PRESENT AND PROPOSED INTERIM RATES
 DOCKET NO. 070304-EI**

RATE CODE	RATE SCHEDULE	PRESENT RATES	INTERIM INCREASE	PROPOSED INTERIM RATES
RS	<u>RESIDENTIAL SERVICE</u>			
	CUSTOMER CHARGE	\$10.00	\$0.59	\$10.59
	ENERGY CHARGE (cents/kWh)	1.373	\$0.08	1.453
GS	<u>GENERAL SERVICE</u>			
	CUSTOMER CHARGE	\$14.00	\$0.82	\$14.82
	ENERGY CHARGE (cents/kWh)	1.473	\$0.09	1.559
GSD	<u>GENERAL SERVICE DEMAND</u>			
	CUSTOMER CHARGE	\$44.00	\$2.58	\$46.58
	ENERGY CHARGE (cents/kWh)	0.232	\$0.01	0.246
	DEMAND CHARGE (\$/kW)	\$2.48	\$0.15	\$2.63
GSLD	<u>GENERAL SERVICE LARGE DEMAND</u>			
	CUSTOMER CHARGE	\$75.00	\$4.39	\$79.39
	ENERGY CHARGE (cents/kWh)	0.086	\$0.01	0.091
	DEMAND CHARGE (\$/kW)	2.89	\$0.17	3.06