

State of Florida



Public Service Commission
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DATE: January 12, 2011

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Slemkewicz, Cicchetti, Draper, P. Lee, Maurey)
Office of the General Counsel (Crawford)

Handwritten initials and signatures: JS, MC, EAD, P, Lee, PSZ, CH, ALM, [Signature]

RE: Docket No. 100462-GU – Joint petition of Peoples Gas System and Office of Public Counsel for approval of stipulation and settlement agreement for possible overearnings for calendar year ending December 31, 2010.

AGENDA: 01/25/11 – 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\ECR\WP\100462.RCM.DOC

Case Background

Through the Commission's continuing earnings surveillance program, staff noted that Peoples Gas System (PGS or Company) had reported an achieved return on equity (ROE) of 13.73 percent on its March 2010 Earnings Surveillance Report (ESR). This reported ROE exceeded the 11.75 percent maximum ROE authorized in Docket No. 080318-GU.¹ Staff subsequently contacted PGS concerning the reported overearnings. On June 9, 2010, PGS

¹ Order No. PSC-09-0411-FOF-GU, issued June 9, 2009, in Docket No. 080318-GU, In re: Petition for Rate Increase by Peoples Gas System.

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FPSC-COMMISSION CLERK

submitted a letter² to staff in which it agreed to cap its earnings at an 11.75 percent ROE for calendar year 2010. In the letter, PGS proposed applying any overearnings to increase the storm damage reserve up to the \$1 million target level, and that the remainder (if any) of such overearnings be used to increase the environmental reserve, and/or other purposes benefitting both the Company and its customers before any customer refunds are ordered.

On December 16, 2010, a Joint Petition for Approval of Stipulation and Settlement Agreement (Joint Petition) was filed by PGS and the Office of Public Counsel (Joint Movants). The Stipulation and Settlement Agreement (Stipulation) is intended to resolve all of the issues relating to the Company's overearnings for the calendar year ended December 31, 2010.

This recommendation addresses the proposed Stipulation. Jurisdiction over this matter is vested in the Commission by several provisions of Chapter 366, including Sections 366.04, 366.05 and 366.06, Florida Statutes.

² Document No. 10088-10 in Docket No. 100462-GU.

Discussion of Issues

Issue 1: Should the Commission approve the proposed Stipulation concerning PGS' overearnings for the year ended December 31, 2010?

Recommendation: Yes. (Slemkewicz, Draper, P. Lee)

Staff Analysis: Through the Commission's continuing earnings surveillance program, staff noted that PGS had reported an achieved ROE of 13.73 percent on its March 2010 ESR. This reported ROE exceeded the 11.75 percent maximum authorized ROE. Staff contacted PGS concerning the reported overearnings. On June 9, 2010, PGS submitted a letter to staff in which it agreed to cap its earnings at an 11.75 percent ROE for calendar year 2010.

Subsequently on December 16, 2010, a Joint Petition was filed by PGS and the Office of Public Counsel. The Stipulation (Attachment A) is intended to resolve all of the issues relating to the Company's overearnings for the calendar year ended December 31, 2010. The major elements contained in the Stipulation are:

- 2010 earnings capped at an 11.75 percent ROE (Paragraph 2)
- \$3 million refund as a one-time credit to customers' bills (Paragraph 1)
- Overearnings in excess of \$3 million to be used to correct or mitigate deficiencies in the depreciation reserve (Paragraph 3)

The proposed Stipulation consists of 8 paragraphs of agreement between the Joint Movants. Staff believes that several of the paragraphs merit comment or clarification. These are as follows:

Paragraph 1: Paragraph 1 provides that PGS will refund \$3 million to its customers in the form of a one-time credit on customer bills. Refunds will be applied only to active bills at the time the refunds are being made, and the refund amount will be based on each customer's cents-per-therm consumption during the month the refund is made. The refund will be made one month following the date the Commission's order approving this agreement becomes final. PGS states that assuming the refund is made in March 2011, a residential customer using 20 therms would receive a one-time refund of \$3.74.

Paragraph 2: PGS' 2010 earnings are capped at an ROE of 11.75 percent. Per its September 2010 ESR, PGS reported an achieved ROE of 15.96 percent on an FPSC Adjusted Basis which exceeds the 11.75 percent ROE cap by 4.21 percent. However, the actual amount of any overearnings will be based on the 12-month period ended December 31, 2010. The December 2010 ESR is not due to be filed until February 15, 2011. In response to a staff data request, dated January 5, 2011, PGS estimates that the total overearnings will be approximately \$11.5 million for 2010. Once the December 2010 ESR is received, an audit will be conducted to determine the actual amount of the 2010 overearnings.

Paragraph 3: PGS proposes to use any overearnings in excess of \$3 million to correct or mitigate any deficiencies subsequently identified by PGS and Staff. PGS indicates that in its last depreciation study filed with the Commission, where new depreciation rates were implemented on January 1, 2007, there was a \$46.5 million deficiency between the actual depreciation reserve balance and the theoretical reserve balance. Although not known with certainty, PGS anticipates that the study it files this year will show a reserve deficiency in excess of \$25 million. PGS' next depreciation study is presently scheduled to be filed with the Commission on July 13, 2011.

Staff has reviewed the terms of the Stipulation, and believes that the Stipulation provides a reasonable resolution for the disposition of any 2010 overearnings and is in the public interest. Therefore, staff recommends approval of the Stipulation.

Issue 2: Should this docket be closed?

Recommendation: No. This docket should remain open until PGS files a refund report indicating that the entire \$3 million refund has been completed. After the refund has been verified by staff, this docket should be closed administratively. (Crawford)

Staff Analysis: No. This docket should remain open until PGS files a refund report indicating that the entire \$3 million refund has been completed. After the refund has been verified by staff, this docket should be closed administratively.

STIPULATION AND SETTLEMENT AGREEMENT

This Stipulation and Settlement Agreement (this "Agreement") is made and entered into as of the 16th day of December 2010, by and between Peoples Gas System ("PGS" or the "Company"), and the Office of Public Counsel ("OPC"), sometimes referred to hereinafter collectively as the "Parties" and individually as a "Party".

WHEREAS, by Order No. PSC-09-0411-FOF-GU ("Order No. 09-0411"), issued June 9, 2009 in Docket No. 080318-GU, the Florida Public Service Commission (the "Commission") granted in part and denied in part PGS' petition for a rate increase and, among other things, awarded PGS a 10.75 percent return on common equity ("ROE") midpoint with a range of plus or minus 100 basis points for surveillance reporting purposes;

WHEREAS, primarily as a result of record low temperatures in Florida during the first quarter of 2010, PGS' Earnings Surveillance Report ("ESR") for the aforementioned quarter indicated the Company's earnings exceeded the top of its authorized ROE range established by Order No. 09-0411;

WHEREAS, representatives of the Parties and Commission Staff ("Staff") met to discuss the Company's March 2010 ESR and, as requested by Staff, by letter dated June 9, 2010, PGS agreed, subject to certain conditions, to cap its 2010 calendar year earned ROE at 11.75 percent, the top of the range established by Order No. 09-0411;

WHEREAS, PGS' ESRs for the second and third quarters of 2010 continued to reflect an earned ROE above the top of the range established by Order No. 09-0411, and PGS recorded a provision in each such report to recognize the Company's anticipated 2010 overearnings (the "Existing Provision");

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WHEREAS, Staff has raised questions regarding certain deficiencies in the Company's depreciation reserves through data requests directed to PGS in connection with the Company's

DOCUMENT NUMBER DATE
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FPSC-COMMISSION CLERK

2008 and 2009 annual status reports contained in its annual reports filed pursuant to Rule 25-7.014(3), *Florida Administrative Code*;

WHEREAS, representatives of PGS and OPC have met and engaged in negotiations for the purpose of reaching agreement on the disposition of any overearnings (as defined in PGS' letter dated June 9, 2010) for the 2010 calendar year; and

WHEREAS, the Commission's approval of this Agreement will remove uncertainties with respect to the disposition of any PGS overearnings for the 2010 calendar year, and provide substantial short term and long term benefits for the Company's customers.

NOW, THEREFORE, in consideration of the foregoing and the covenants contained herein, the Parties hereby stipulate and agree as follows:

1. Upon final approval of this Agreement by the Commission, PGS will refund a total of \$3,000,000 to its customers in the form of a one-time credit to customer bills, such refund to be effected as hereinafter described. Refunds will be applied only to active bills at the time the refunds are being made. The refunds will commence with Cycle 1 billing one month following the date the Commission's order approving this Agreement becomes final and non-appealable. The refunds will be made on a volumetric cents-per-therm, basis based on each customer's consumption during the month the refund is applied to the customer's bill. The portion of the total refund amount allocable to each customer class, and the cents-per-therm refund factors will be determined in the same manner used by PGS to allocate and recover costs under the energy conservation cost recovery clause in Docket No. 100004-GU (as first approved by the Commission's Order No. 23576 in Docket No. 900002-EG). Any overpayment or underpayment of the one-time refund amount will be trued-up in a subsequent period.

2. Calculation of PGS' earned ROE to determine the amount of any earnings above an 11.75 percent ROE will be on an "FPSC Adjusted Basis" as set forth in the Company's ESR required by Rule 25-7.1352, *Florida Administrative Code*, for December 31, 2010, using the

adjustments made in the Company's rate proceeding in Docket No. 080318-GU, but excluding that portion of the Company's share of net revenues derived from Off-System Sales that exceeds \$2,068,676. See Orders Nos. 09-0411 and PSC-10-0208-S-GU. All reasonable and prudent expenses and investment will be included in the calculation.

3. The amount of any overearnings, calculated as provided in paragraph 2 of this Agreement, in excess of \$3,000,000 shall be used to correct or mitigate deficiencies in the Company's depreciation reserves as may be agreed by PGS and Staff. In its ESR for the final quarter of 2010, PGS will assign \$3,000,000 of any overearnings against the Existing Provision with any remaining balance resulting from a year-end ROE above 11.75 percent, as calculated pursuant to paragraph 2 of this Agreement, credited to the depreciation reserve adjustments contemplated by this paragraph 3. Such ESR will contain a pro forma adjustment for the portion of Off-System Sales revenues to be retained by PGS as described in paragraph 2.

4. Final Commission approval of this Agreement in its entirety will resolve all matters arising out of PGS' overearnings for the year ending December 31, 2010.

5. The provisions of this Agreement are contingent upon approval of this Agreement in its entirety by the Commission. The Parties agree that they will support this Agreement and will not request or support any order, relief, outcome or result in conflict with the terms of this Agreement in any administrative or judicial proceeding relating to, reviewing or challenging the establishment, approval, adoption or implementation of this Agreement or the subject matter hereof.

6. The Parties agree to jointly petition the Commission for approval of this Agreement at the earliest possible time in order to facilitate implementation of the refund and other provisions hereof, and will urge the Commission to take final agency action approving this Agreement at the earliest possible time.

7. In the event the Commission rejects or modifies this Agreement, in whole or in part, the Parties agree that this Agreement shall become void unless such rejection or modification is ratified by the Parties, and that thereafter each Party may pursue its interests as those interests may exist, and neither Party will be bound by or make reference to this Agreement before the Commission, any court, or any other administrative body.

8. This Agreement may be executed in counterpart originals, and a facsimile or scan of the original signature shall be deemed an original.

IN WITNESS WHEREOF, the Parties have caused this Agreement to be executed by their duly authorized representatives as of the day and year first above written.

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PEOPLES GAS SYSTEM

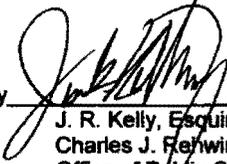
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