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 3, 1998

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYÓ)

FROM: DIVISION OF AUDITING AND FINANCIAL ANALYSIS (MERTA, DRAPER, L. ROMIG, C. ROMIG)
DIVISION OF ELECTRIC AND GAS (BREMAN)
DIVISION OF LEGAL SERVICES (C. KEATING)

RE: DOCKET NO. 981678-EI - INVESTIGATION INTO 1997 EARNINGS IN THE FERNANDINA BEACH DIVISION OF FLORIDA PUBLIC UTILITIES COMPANY.

AGENDA: 12/15/98 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: ATTACHMENTS 1 THROUGH 5 ARE NOT AVAILABLE

FILE NAME AND LOCATION: S:\PSC\AFA\WP\981678.RCM
R:\PSC\AFA\123\981678.WK4

CASE BACKGROUND

Due to the Commission's continuing earnings surveillance program, it was noted that the 1997 earnings of the Florida Public Utilities Company - Fernandina Beach Division (FPUC FB or the Company) were in excess of the maximum authorized return on equity (ROE) of 12.60%. The Company submitted a letter to Staff dated May 20, 1997, in which it agreed to cap its 1997 earnings at a 12.60% ROE. (Attachment 1) The disposition of any excess earnings was left to the discretion of the Commission. The Company, however, did reserve the right to request alternative dispositions such as additional contributions to its storm damage reserve or the reduction of any depreciation reserve deficiencies. An Audit Report for the 1997 calender year was issued on July 6, 1998. The Company's response to the audit report was received on July 14, 1998.

On November 2, 1998, the Company submitted a letter requesting that the 1997 overearnings be applied to the Fernandina Beach Storm Damage Reserve. (Attachment 2)

DISCUSSION OF ISSUES

ISSUE 1: What is the appropriate rate base for Florida Public Utilities Company - Fernandina Beach Division for determining the amount of excess earnings for 1997?

RECOMMENDATION: The appropriate rate base for Florida Public Utilities Company - Fernandina Beach Division for determining the amount of excess earnings for 1997 is $15,676,617. (L. ROMIG, MERTA)

STAFF ANALYSIS: In its December 1997 Earnings Surveillance Report, the Company reported a total "FPSC Adjusted" rate base of $15,739,406. Based on the adjustments discussed below, Staff recommends that the appropriate rate base is $15,676,617. (Attachment 3)

Adjustment 1: Common Plant Allocations - According to Audit Exception 1, the Company used amounts determined in 1995 to allocate common plant between the electric and water divisions. However, these amounts should have been updated to reflect the current amounts as of December 31, 1997. Based on a recalculation using the updated amounts, the following reductions should be made: $51,809 to plant in service; $31,956 to accumulated depreciation; $11,113 to depreciation expense; and $868 to taxes-other. Transportation expense should be increased by $9,918.

Adjustment 2: Application of 1996 Overearnings to the Storm Damage Reserve - Included in working capital is $93,083 on a 13-month average basis related to the 1996 excess earnings of $136,019. In the review of 1996 earnings, in Order No. PSC-97-1505-FOF-EI, issued November 25, 1997, the Commission stated, "[T]his amount shall be booked [to the Storm Damage Reserve] effective January 1, 1997 for ratemaking, earnings surveillance, and overearnings review purposes. . ." Based on the Order, the Storm Damage Reserve should be increased by $42,936 (136,019 - 93,083 = 42,936). Since this account is a working capital liability, the change reduces working capital. Therefore, Staff recommends that working capital be reduced by $42,936.

ISSUE 2: What is the appropriate overall rate of return for Florida Public Utilities Company - Fernandina Beach Division for determining the amount of excess earnings for 1997?

RECOMMENDATION: The appropriate overall rate of return for Florida Public Utilities Company - Fernandina Beach Division for measuring the amount of excess earnings for 1997 is 8.98%, based on the ROE cap of 12.60% and a 13-month average capital structure for the period ending December 31, 1997. (DRAPER)

STAFF ANALYSIS: Based on the adjustment discussed below, Staff recommends that the appropriate overall rate of return for FPUC-FB for measuring 1997 excess earnings is 8.98%. (Attachment 4)

Adjustment 3: Deferred Revenue in the Capital Structure - Staff began with the 13-month average capital structure from the Company's earnings surveillance report for the period ending December 31, 1997. In its earnings surveillance report, the Company removed its investment in Flo-Gas entirely from common equity in a manner consistent with previous cases. The Company specifically identified deferred taxes, investment tax credits, and customer deposits.

Staff specifically included $123,012 as deferred revenue in the capital structure with an effective interest rate of 5.59%. This amount represents a 13-month average of the excess earnings plus interest for the 1997 year. The cost rate on deferred revenue is based on a 12-month average of the 30 day commercial paper rate. The 30 day commercial paper rate is applied pursuant to Rule 25-6.109, Florida Administrative Code. The treatment of excess earnings as an item in the capital structure is consistent with the treatment of deferred revenue in the previous earnings review of FPUC-FB. (see Order No. PSC-97-1505-FOF-EI)

Staff reconciled the remaining adjustments to rate base on a pro rata basis over investor-supplied sources of capital. In Order No. PSC-94-0983-FOF-EI, issued August 12, 1994, the Commission established the return on common equity for FPUC-FB as 11.60% with a range from 10.60% to 12.60%. Using the top of the range of 12.60%, Staff calculated the weighted average cost of capital as 8.98%. This is the rate of return used to measure excess earnings.

ISSUE 3: What is the appropriate net operating income (NOI) for Florida Public Utilities Company - Fernandina Beach Division for determining the amount of excess earnings for 1997?

RECOMMENDATION: The appropriate NOI for Florida Public Utilities Company - Fernandina Beach Division for determining the amount of excess earnings for 1997 is $1,559,020. (L. ROMIG, C. ROMIG, MERTA)

STAFF ANALYSIS: In its December 1997 earnings surveillance report, the Company reported a total "FPSC Adjusted" NOI of $1,554,542. Based on the adjustments discussed below, Staff recommends that the appropriate NOI is $1,559,020. (Attachment 3)

Adjustment 4: Interest Income on Bank Balances - The Company included interest-earning cash in working capital but did not include the related interest income in revenues. With regard to the Fernandina Beach Division's modified minimum filing requirements report, the Commission determined, in Order No. PSC-94-0983-FOF-EI, that the interest income should be included in revenues if the interest-bearing cash is included in working capital. The Company earned interest on its cash account even though the 13-month average of cash in working capital was negative. This is because the bank uses an average monthly cash balance to calculate interest earned on cash - the 13-month average of cash in working capital is based on the cash balance at month end rather than the average balance for the month. Staff recommends that revenues be increased by $1,768 to include interest earned on bank balances above-the-line even though the per books cash balance was negative.

Adjustment 5: Imputed Negative Interest - In its earnings surveillance report, FPUC-FB had a negative cash position for the 13 months ending December 31, 1997. Thus, the Company made an adjustment to reduce revenues by $4,824. The rationale was that if the Company had to add interest income to revenues for interest earned on a positive cash position, it could impute negative interest earned on a negative balance of cash, thereby reducing revenues. Many companies, including FPUC-FB, routinely carry negative cash balances of cash due to aggressive cash management policies. A negative cash balance does not necessarily indicate cash flow or other financial problems. In Order No. PSC-97-1505-FOF-EI, the Commission disallowed the Company's adjustment to impute negative interest on a negative cash balance. Consistent with that Order, Staff recommends that $4,824 be added back to revenues.

Adjustment 6: Interest Reconciliation - This adjustment is based on the reconciliation of the rate base and the capital structure due to Staff adjustments to rate base. In this instance, income taxes should be increased by $920.

Adjustment 7: Tax Effect of Other Adjustments - The tax effect of Staff's adjustments to rate base and NOI results in a $4,177 increase to income taxes.

ISSUE 4: What is the amount of excess earnings for Florida Public Utilities Company - Fernandina Beach Division for 1997?

RECOMMENDATION: The amount of excess earnings for Florida Public Utilities Company - Fernandina Beach Division for 1997 is $241,289 plus interest of $6,856 for a total of $248,145. (L. ROMIG, MERTA)

STAFF ANALYSIS: Based on the recommendations in the previous issues, Staff has determined that FPUC-FB's excess earnings for 1997 are $241,289 plus interest of $6,856 for a total of $248,145. This represents an earned ROE of 15.34%, which exceeds the maximum authorized ROE of 12.60%. (Attachment 5)

ISSUE 5: What is the appropriate disposition of the 1997 excess earnings of Florida Public Utilities Company - Fernandina Beach Division?

RECOMMENDATION: The total amount of 1997 excess earnings of $241,289, plus interest of $6,856, should be applied to the Florida Public Utilities Company - Fernandina Beach Division's Storm Damage Reserve. The effective date for booking the overearnings should be January 1, 1998, for ratemaking, earnings surveillance, and overearnings review purposes. (MERTA, L. ROMIG, BREMAN)

STAFF ANALYSIS: The Commission, by Order Nos. PSC-97-0135-FOF-EI, issued February 10, 1997, and PSC-97-1505-FOF-EI, found that FPUC-FB's excess earnings for 1995 and 1996 should be applied to the Storm Damage Reserve. During the 1995 overearnings review, the Company filed a letter requesting that any overearnings be applied to the Storm Damage Reserve because of the disparity of the reserve and accrual levels between its Marianna and Fernandina Beach electric divisions. The Commission stated in Order No. PSC-97-1505-FOF-EI that there appeared to be a deficiency in the Storm Damage Reserve even with the addition of the excess earnings for 1995.

The Commission approved, by Order No. PSC-94-0170-FOF-EI, issued February 10, 1994, an annual accrual of $100,000 to establish a $1 million storm damage reserve over 10 years for the Marianna Division. The reserve balance at September 30, 1998, was $413,668 for the Marianna Division. For the Fernandina Beach Division, the Commission approved, by Order No. 22224, issued November 27, 1989, an annual accrual of $21,625; no target amount for the reserve was discussed in the order. The reserve balance at September 30, 1998, was $379,569 for the Fernandina Beach Division.

By letter dated November 2, 1998, the Company requested that the 1997 overearnings for Fernandina Beach be applied to the Storm Damage Reserve. The Company believes that the reserve is deficient based on the greater potential for loss due to a larger gross plant investment for Fernandina Beach than Marianna and a more vulnerable coastal location. The gross plant investment in Fernandina Beach exceeds that of Marianna by approximately 22%. In the 1988 Fernandina Beach rate case, the Commission recognized the need for the accrual to be 25% greater than that of Marianna based on size and location.

Staff agrees with the Company's belief that there continues to be a deficiency in the Storm Damage Reserve for the Fernandina Beach Division even after contributing overearnings from 1995 and

1996, and the 1997 overearnings of $248,[illegible] in this docket. Therefore, Staff recommends that the 1997 overearnings be applied to the reserve.

Since the excess earnings occurred during 1997 and interest has only been calculated for that year, Staff is also recommending that the increase to the reserve be made effective as of January 1, 1998, for all regulatory purposes. This eliminates the need for the calculation of any additional amounts of interest and includes the increased reserve in the determination of earnings for 1998. This treatment is consistent with Order Nos. PSC-97-0135-FOF-EI and PSC-97-1505-FOF-EI, in the prior FPUC-FB earnings dockets for 1995 and 1996.

ISSUE 6: Should this docket be closed?

RECOMMENDATION: This docket should be closed if no person whose substantial interests are affected by the proposed action files a protest within the 21-day protest period. (C. KEATING)

STAFF ANALYSIS: At the conclusion of the protest period, if no protest is filed, this docket should be closed.

FLORIDA
PUBLIC UTILITIES COMPANY

P O Box 3395
West Palm Beach
FL 33402-3395

May 20, 1997

97 MAY 23 PM 3 08

Mr Timothy J Devlin Director
Division of Auditing and Financial Analysis
FLORIDA PUBLIC SERVICE COMMISSION
2540 Shumard Oak Blvd
Tallahassee FL 32399-0865

Dear Mr Devlin:

Florida Public Utilities Company agrees to cap its earned return on equity (ROE) for calendar year 1997 at 12.60% for the Fernandina Beach Electric Division. This cap represents the maximum authorized ROE for this division.

The calculation of the earned ROE will be based on the "FPSC Adjusted Basis" in the Earnings Surveillance Reports for December 1997, using the same adjustments approved in our last FPSC Fernandina Beach rate case. All reasonable and prudent expenses and investment will be allowed in the calculation, but no annualized or pro forma adjustments will be allowed. The calculation is subject to fine tuning by Florida Public Utilities Company and Commission audit.

The disposition of any excess earnings shall be left to the discretion of the Commission. In addition to a direct cash refund, the Company may request consideration of other alternatives such as additional contributions to the storm damage reserve or the reduction of any depreciation reserve deficiencies.

Sincerely,

Darryl L Troy
Vice President

cc Jack Shreve, Office of Public Counsel
Wayne Schiefelbein, Gatlin, Woods, et al
F Cressman, FPU
J Brown, FPU
J English, FPU
G Bachman, FPU
DLTROY fpsc-dev-roe dt

Florida Public Utilities Company

November 2, 1998

Mr Timothy J Devlin Director
Division of Auditing & Financial Analysis
FLORIDA PUBLIC SERVICE COMMISSION
2540 Shumard Oak Blvd
Tallahassee FL 32399-0865

Re 1997 Over-earnings - Fernandina Beach Electric Operations

Dear Mr Devlin:

The Company requests that the total over-earnings for 1997 in Fernandina Beach Electric Operations be contributed to the Storm Damage Reserve in Fernandina Beach. We believe the Storm Damage Reserve to be deficient due to the following reasons

1. The Company's first attempt to establish a Storm Damage Reserve was in our Marianna Rate Case, Docket No. 880558-EI (1988). Although the Company requested an annual allowance of $54,050 based on damages from Hurricane Kate, the Commission thought this was excessive and reduced the annual accrual to $17,300.

2. The Company again sought to establish a storm damage accrual in our Fernandina Beach Rate Case, Docket No. 881056-EI (1988). We again requested an annual accrual of $54,050 based on our argument in the previous Marianna case, the greater potential for loss due to a 25% larger gross plant investment and a more vulnerable coastal location. The final decision was to allow an annual accrual of $21,625 which was 25% larger than that allowed in the Marianna case.

3. In 1993, the Company again filed for rate relief in the Marianna division. In this Rate Case, Docket No. 930400-EI (1993), we requested the annual accrual be increased to $200,000 from the previous authorized level of $17,300. We also requested the Storm Damage Reserve be capped at $1 million. The reasons for this increase were the impact that Hurricane Andrew (1992) had on electric distribution property and on the insurance industry's coverage rates making it impossible to obtain coverage at a reasonable cost. The Final Order in Docket No. 930400-EI reads

"Accordingly, we shall establish a storm damage reserve of $1 million with the accrual period for the reserve set at 10 years at $100,000 per year." (Order No. PSC-94-0170-FOF-EI, p.23)

4. The current accumulated Storm Damage Reserves in Marianna and Fernandina Beach are as follows:

	Accumulated Reserve	Annual Accrual
Marianna	$413,668	$100,000
Fernandina Beach	379,569	21,600

It is apparent from items (1) through (4) that there is a deficiency in the Fernandina Beach accumulated Storm Damage Reserve. We are therefore requesting the 1997 excess revenues and interest be transferred to the Fernandina Beach Storm Damage Reserve.

Sincerely,

Darryl L. Troy
Vice President

cc:
J. Shrev
W. Schiefelbein
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FLORIDA PUBLIC UTILITIES COMPANY
FERNANDINA BEACH ELECTRIC DIVISION
DOCKET NO. 981678-EI
REVIEW OF 1997 EARNINGS

ATTACHMENT 3

DOCKET NO. 981678-EI
DATE: DECEMBER 3, 1998

	As Filed FPSC Adjusted Basis	Common Plant Allocations	Application of 1996 Overearnings to Storm Damage Reserve	Interest Income on Bank Balances	Imputed Negative Interest	Interest Reconciliation/ ITC Synchronization		Total Adjustments	Total Adjusted Rate Base
RATE BASE									
Plant in Service	$25,022,274	($51,809)						($51,809)	$24,970,465
Accumulated Depreciation	9,252,418	(31,956)						(31,956)	9,220,462
Net Plant in Service	15,769,856	(19,853)	0	0	0	0	0	(19,853)	15,750,003
Property Held for Future Use	0							0	0
Construction Work in Progress	299,654	0						0	299,654
Net Utility Plant	16,069,510	(19,853)	0	0	0	0	0	(19,853)	16,049,657
Working Capital	(330,104)		(42,936)					(42,936)	(373,040)
Total Rate Base	$15,739,406	($19,853)	($42,936)	$0	$0	$0	$0	($62,789)	$15,676,617
INCOME STATEMENT									
Operating Revenues	$5,982,386			$1,768	$4,824			$6,592	$5,988,978
Operating Expenses								0	0
Operation & Maintenance - Fuel	0							0	0
Operation & Maintenance - Other	1,664,836	9,918						9,918	1,674,754
Depreciation & Amortization	874,610	(11,113)						(11,113)	863,497
Taxes Other Than Income	1,408,893	(868)						(868)	1,408,025
Income Taxes - Current	525,967	776	0	665	1,815	920		4,177	530,144
Deferred Income Taxes (Net)	(20,589)							0	(20,589)
Investment Tax Credit (Net)	(25,873)							0	(25,873)
(Gain)/Loss on Disposition	0							0	0
Total Operating Expenses	4,427,844	(1,287)	0	665	1,815	920	0	2,114	4,429,958
Net Operating Income	$1,554,542	$1,287	$0	$1,103	$3,009	($920)	$0	$4,478	$1,559,020
EQUITY RATIO	44.09%							0.00%	44.09%
OVERALL RATE OF RETURN	9.86%							0.07%	9.94%
RETURN ON EQUITY	15.02%							0.32%	15.34%

ATTACHMENT 3
PAGE 1 OF 1

ATTACHMENT 4

FLORIDA PUBLIC UTILITIES COMPANY
FERNANDINA BEACH ELECTRIC DIVISION
DOCKET NO. 981678-EI
REVIEW OF 1997 EARNINGS

CAPITAL STRUCTURE AS FILED - FPSC ADJUSTED	Amount	Ratio	Cost Rate	Weighted Cost
Long Term Debt	$5,355,292	34.02%	9.95%	3.39%
Short Term Debt	1,574,342	10.00%	6.26%	0.63%
Preferred Stock	140,363	0.89%	4.75%	0.04%
Customer Deposits	622,394	3.95%	6.57%	0.26%
Common Equity	5,575,322	35.42%	12.60%	4.46%
Deferred Income Taxes	2,095,891	13.32%	0.00%	0.00%
Tax Credits - Zero Cost	1,272	0.01%	0.00%	0.00%
Tax Credits - Weighted Cost	374,530	2.38%	10.60%	0.25%
Total	$15,739,406	100.00%		9.03%

		Adjustments		Adjusted			Weighted
ADJUSTED	Amount	Specific	Pro Rata	Total	Ratio	Cost Rate	Cost
Long Term Debt	$5,355,292	($52,096)	($26,591)	$5,276,605	33.66%	9.95%	3.35%
Short Term Debt	1,574,342	(15,315)	(7,817)	1,551,210	9.90%	6.26%	0.62%
Preferred Stock	140,363	(1,365)	(697)	138,301	0.88%	4.75%	0.04%
Customers Deposits	622,394			622,394	3.97%	6.57%	0.26%
1997 Deferred Revenue	0	123,012		123,012	0.78%	5.59%	0.04%
Common Equity	5,575,322	(54,236)	(27,684)	5,493,402	35.04%	12.60%	4.42%
Deferred Income Taxes	2,095,891			2,095,891	13.37%	0.00%	0.00%
Tax Credits - Zero Cost	1,272			1,272	0.01%	0.00%	0.00%
Tax Credits - Weighted Cost	374,530			374,530	2.39%	10.60%	0.25%
Total	$15,739,406	$0	($62,789)	$15,676,617	100.00%		8.98%

INTEREST RECONCILIATION

	Amount	Cost Rate	Interest Exp	Tax Rate	Effect on Income Tax
Long Term Debt	$5,276,605	9.95%	$525,022		
Short Term Debt	1,551,210	6.26%	97,106		
Customer Deposits	622,394	6.57%	40,891		
1997 Deferred Revenue	123,012	5.59%	6,876		
Tax Credits - Weighted Cost	374,530	4.99%	18,689		
Staff Interest Expense			688,585		
Adj. Company Interest Expense			691,029		
Staff Adjustment			$2,444	37.63%	$920

ATTACHMENT 5

FLORIDA PUBLIC UTILITIES COMPANY
FERNANDINA BEACH ELECTRIC DIVISION
DOCKET NO. 981678-EI
REVIEW OF 1997 EARNINGS

Adjusted Rate Base			$15,676,617
Achieved Rate of Return	9.94%		
Maximum Rate of Return	8.98%		
Excess Rate of Return		X	0.96%
Excess Net Operating Income			150,496
Revenue Expansion Factor		X	1.6033
Excess Revenues			$241,289