BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation into 1997 earnings in the Fernandina Beach Division of Florida Public Utilities Company.	DOCKET NO. 981678-EI ORDER NO. PSC-99-0022-FOF-EI ISSUED: January 4, 1999

The following Commissioners participated in the disposition of this matter:

JULIA L. JOHNSON, Chairman
J. TERRY DEASON
SUSAN F. CLARK
JOE GARCIA
E. LEON JACOBS, JR.

NOTICE OF PROPOSED AGENCY ACTION
ORDER DETERMINING AND DISPOSING
OF EXCESS EARNINGS FOR 1997

BY THE COMMISSION:

NOTICE is hereby given by the Florida Public Service Commission that the action discussed herein is preliminary in nature and will become final unless a person whose interests are substantially affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

Pursuant to this Commission's continuing earnings surveillance program, we noted that the 1997 earnings of the Florida Public Utilities Company - Fernandina Beach Division ("FPUC-FB" or "the Company") could exceed its maximum authorized return on equity (ROE) of 12.60%. By letter dated May 20, 1997, the Company agreed to cap its 1997 earnings at a 12.60% ROE. The disposition of any excess earnings was left to the discretion of this Commission, although the Company reserved 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 FPUC-FB for the 1997 calender year was issued July 6, 1998. The Company's response to the audit report was received 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.

Rate Base

In its December 1997 Earnings Surveillance Report (ESR), the Company reported a total "FPSC Adjusted" rate base of $15,739,406. Based on the following adjustments, however, we find that the Company's appropriate rate base for determining the amount of excess earnings for 1997 is $15,676,617. These adjustments and calculations are shown on Attachment A to this Order, which is incorporated herein by reference.

First, we find that adjustments for common plant allocations are necessary. 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 adjustments should be made: reduction of $51,809 from Plant in Service; reduction of $31,956 from Accumulated Depreciation; reduction of $11,113 from Depreciation & Amortization; reduction of $868 from Taxes Other Than Income; and increase of $9,918 to transportation expense.

Second, we find that an adjustment for application of 1996 overearnings to the Storm Damage Reserve is necessary. Included in working capital is $93,083 on a 13-month average basis related to the Company's 1996 excess earnings of $136,019. By Order No. PSC-97-1505-FOF-EI, issued November 25, 1997, the Commission stated that these excess earnings "shall be booked [to the Storm Damage Reserve] effective January 1, 1997 for ratemaking, earnings surveillance, and overearnings review purposes . . ." Accordingly, the Storm Damage Reserve should be increased by $42,936 (136,019 - 93,083 = 42,936) to reflect the application of all 1996 excess earnings to the Storm Damage Reserve. Because this account is a working capital liability, this adjustment reduces working capital. Therefore, we find that working capital should be reduced by $42,936.

Rate of Return

After making the following adjustments related to deferred revenue in the capital structure, we find that the appropriate overall rate of return for FPUC-FB for measuring 1997 excess earnings is 8.98%. These adjustments and calculations are shown on Attachment B to this Order, which is incorporated herein by reference.

In making these adjustments, we begin with the 13-month average capital structure from the Company's ESR for the period ending December 31, 1997. In its ESR, 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.

We find that $123,012 should be specifically included as deferred revenue in the capital structure with an effective interest rate of 5.59%. This amount represents a 13-month average of the Company's excess earnings plus interest for 1997. The 5.59% cost rate on the 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. This treatment of excess earnings as an item in the capital structure is consistent with the treatment of deferred revenue in our review of the Company's 1996 earnings in Order No. PSC-97-1505-FOF-EI.

We find that the remaining adjustments to rate base should be reconciled on a pro rata basis over investor-supplied sources of capital. In Order No. PSC-94-0983-FOF-EI, issued August 12, 1994, we 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 this range (12.60%), we find that the Company's weighted average cost of capital is 8.98%. This is the rate of return to be used to measure excess earnings.

Net Operating Income

In its December 1997 ESR, the Company reported a total "FPSC Adjusted" net operating income (NOI) of $1,554,542. Based on the following adjustments, we find that the appropriate NOI for determining the amount of excess earnings for 1997 is $1,559,020. These adjustments and calculations are shown on Attachment A to this Order, which is incorporated herein by reference.

First, we find that an adjustment for interest income on bank balances is necessary. The Company included interest-earning cash in working capital but did not include the related interest income in revenues. With regard to FPUC-FB's modified minimum filing requirements report, we determined, in Order No. PSC-94-0983-FOF-EI, that interest income should be included in revenues if 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 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 the end of the month rather than the average balance for the month. Thus, we find that revenues should be increased by $1,768 to include interest earned on bank balances above-the-line even though the Company's books show a negative cash balance.

Second, we find that an adjustment for imputed negative interest is necessary. In its December 1997 ESR, the Company showed 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 for this reduction 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, we disallowed the Company's adjustment to impute negative interest on a negative cash balance. Consistent with that Order, we find that $4,824 should be added back to revenues.

Third, we find that an adjustment for interest reconciliation is necessary. This adjustment is based on the reconciliation of the rate base and the capital structure due to our adjustments to rate base, as stated above. In this instance, Income Taxes should be increased by $920.

Finally, we find that an adjustment is necessary to account for the tax effects of the adjustments to rate base and NOI that we found appropriate above. The tax effect of these adjustments results in a $4,177 increase to Income Taxes.

Excess Earnings

Based on our findings above, we find that FPUC-FB's 1997 excess earnings total $248,145. This amount is comprised of $241,289 of excess earnings plus interest of $6,856. This represents an earned ROE of 15.34%, which exceeds the maximum authorized ROE of 12.60%. Our calculation of the excess earnings, absent interest, is shown in Attachment C to this Order, which is incorporated herein by reference.

Disposition of Excess Earnings

By Order Nos. PSC-97-0135-FOF-EI, issued February 10, 1997, and PSC-97-1505-FOF-EI, we ordered that FPUC-FB's excess earnings for 1995 and 1996 be applied to its Storm Damage Reserve. During the 1995 overearnings review, Florida Public Utilities 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. In Order No. PSC-97-1505-FOF-EI, we noted that there appeared to be a deficiency in FPUC-FB's Storm Damage Reserve even with the addition of the excess earnings for 1995.

We 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 as of September 30, 1998, was $413,668 for the Marianna Division. By Order No. 22224, issued November 27, 1989, we approved an annual accrual of $21,625 for the Fernandina Beach Division; no target amount for the reserve was set. The reserve balance as of September 30, 1998, was $379,569 for the Fernandina Beach Division.

By letter dated November 2, 1998, Florida Public Utilities Company requested that its Fernandina Beach Division's 1997 excess earnings be applied to the Storm Damage Reserve. The Company asserted 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, we recognized the need for the Fernandina Beach Division's accrual to be 25% greater than that of the Marianna Division based on size and location.

We agree with the Company's assertion 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, as well as the 1997 overearnings of $248,145 in this docket. Therefore, we find that FPUC-FB's 1997 overearnings should be applied to its Storm Damage Reserve.

Because FPUC-FB's excess earnings occurred during 1997 and interest has only been calculated for that year, we find that this increase to the Storm Damage Reserve should be made effective as of January 1, 1998, for all regulatory purposes. This treatment will eliminate the need for the calculation of any additional amounts of interest and includes the increased reserve in the determination of earnings for 1998. We note that this treatment is consistent with our previous orders concerning FPUC-FB's 1995 and 1996 earnings.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the Florida Public Utilities Company - Fernandina Beach Division achieved excess earnings for 1997 which, together with applicable interest, total $248,145, as discussed in the body of this Order. It is further

ORDERED that the Florida Public Utilities Company - Fernandina Beach Division shall apply its total 1997 excess earnings of $248,145 to its Storm Damage Reserve effective January 1, 1998, for ratemaking, earnings surveillance, and earnings review purposes. It is further

ORDERED that the provisions of this Order, issued as proposed agency action, shall become final and effective unless an appropriate petition, in the form provided by Rule 28-106.201, Florida Administrative Code, is received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings or Judicial Review" attached hereto. It is further

ORDERED that in the event this Order becomes final, this Docket shall be closed.

By ORDER of the Florida Public Service Commission this 4th day of January, 1999.

BLANCA S. BAYÓ, Director
Division of Records and Reporting

By: Kay Flynn
Kay Flynn, Chief
Bureau of Records

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

The action proposed herein is preliminary in nature. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, in the form provided by Rule 28-106.201, Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on January 25, 1999.

In the absence of such a petition, this order shall become effective on the day subsequent to the above date.

Any objection or protest filed in this docket before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

If this order becomes final and effective on the date described above, any party substantially affected may request judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or by the First District Court of Appeal in the case of a water or wastewater utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days of the effective date of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.

ATTACHMENT 3

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

	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	9.88%							0.07%	9.94%
RETURN ON EQUITY	15.02%							0.32%	15.34%

ATTACHMENT A
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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