State of Florida

Public Service Commission

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RECORDS AND REPORTING

-M-E-M-O-R-A-N-D-U-M-

DATE: AUGUST 17, 2000

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

FROM: DIVISION OF ECONOMIC REGULATION (REVELL, D. DRAPER, C. ROMIG) DIVISION OF LEGAL SERVICES (HART)

RE: DOCKET NO. 001146-EI - INVESTIGATION INTO 1999 EARNINGS OF FLORIDA PUBLIC UTILITIES COMPANY - MARIANNA DIVISION.

AGENDA: 08/29/00 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: PLEASE PLACE BEFORE DOCKET NO. 001147-EI

FILE NAME AND LOCATION: S:\PSC\ECR\WP\001146.RCM
ATTACHMENTS 1 & 2 ARE NOT AVAILABLE
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ATTACHMENTS 3, 4 & 5

CASE BACKGROUND

Due to the Commission's continuing earnings surveillance program, it was noted by Staff that the earnings of the Florida Public Utilities Company - Marianna Division (FPUC-M or the Company) on the December 31, 1999 Earnings Surveillance Report were within three basis points of the maximum authorized return on equity (ROE) of 11.85%. As a result, Staff conducted an earnings audit of the Company's books and records, and the audit report was issued June 15, 2000. The Company's response to the audit was received on July 6, 2000.

On July 19, 2000, FPUC-M submitted a letter to the Staff of the Florida Public Service Commission (Staff) in which it agreed to cap the earnings of the Marianna Division at 11.85% for calender year 1999. (Attachment 1) The disposition of any excess earnings was left to the discretion of the Commission. The Company,

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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.

On July 20, 2000, the Company submitted a letter requesting that the 1999 overearnings be applied to the Marianna Division's Storm Damage Reserve. (Attachment 2) In calendar year 1996, the Marianna Division overearned by $36,143 plus interest of $1,005. The total amount of $37,148 was included in Marianna's Storm Damage Reserve.

FPUC-M serves approximately 11,900 customers in portions of Jackson, Calhoun and Liberty Counties. This includes about 9,600 residential and 2,100 commercial customers.

Jurisdiction over the subject matter of this docket is vested in the Commission pursuant to Sections 366.04, 366.05, and 366.06, Florida Statutes.

DISCUSSION OF ISSUES

ISSUE 1: What is the appropriate amount of rate base for Florida Public Utilities Company-Marianna Division for determining the amount of excess earnings for 1999?

RECOMMENDATION: The appropriate rate base for the Marianna Division for 1999 is $12,551,895. (REVELL)

STAFF ANALYSIS: Per the December 1999 Earnings Surveillance Report, the Company reported a total "FPSC Adjusted" rate base of $12,537,252. Based on the adjustment discussed below, the Staff recommends that the appropriate rate base is $12,551,895.

Allocation of Accounts Payable: In computing the allowance for working capital, the Company used the 1998 base revenue allocation factor of 20.9% instead of the 1999 factor of 19.1%. This factor is used to allocate accounts payable that are not directly associated with a specific division. As a result of the percentage allocation change, an adjustment of $14,643 should be made to decrease the Marianna Divisions's portion and thereby increase its working capital.

ISSUE 2: What is the appropriate overall rate of return for Florida Public Utilities Company-Marianna Division for 1999?

RECOMMENDATION: The appropriate overall rate of return is 8.51% based on the ROE cap of 11.85% and a 13-month average capital structure for the period ending December 31, 1999. (Attachment 4) (D. DRAPER)

STAFF ANALYSIS: Staff began with the 13-month average capital structure from the Company's earnings surveillance report (ESR) for the period ending December 31, 1999. 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.

The Company calculated an effective customer deposit cost rate of 6.30% by using interest expenses for 1999, which included estimated interest expenses for the months of May and October, and a 13-month average balance of customer deposits. Using actual interest expenses for the year and the 13-month average balance of customer deposits, staff calculated an effective cost rate of 5.92% for customer deposits. Staff believes that using actual interest expenses in determining the cost rate is appropriate.

Staff made a specific adjustment in the amount of $4,244. This amount represents staff's calculation of the 13 month average balance of excess earnings for 1999. This amount was included as a separate line item in the capital structure and was assigned an effective cost rate of 5.06%. The cost rate on excess earnings is based on a 12-month average of the 30-day commercial paper rate. The 30-day commercial paper rate is applied as per Rule 25-6.109, Florida Administrative Code. In order to maintain uniformity between divisions, the treatment of excess earnings as an item in the capital structure is consistent with the treatment of excess earnings in the 1998 earnings review of the Fernandina Beach Division (see Order No. PSC-99-2119-PAA-EI, issued October 25, 1999).

Staff reconciled the adjustments to rate base on a pro rata basis over investor-supplied sources of capital. The Commission established the return on common equity for FPUC-M as 10.85% with a range from 9.85% to 11.85% (Order No. PSC-94-0170-FOF-EI, issued February 10, 1994). Using the top of the range of 11.85%, staff calculated the weighted average cost of capital as 8.51%.

ISSUE 3: What is the appropriate net operating income for Florida Public Utilities Company-Marianna Division for determining the amount of excess earnings for 1999?

RECOMMENDATION: The appropriate net operating income for the Marianna Division for 1999 is $1,073,368. (REVELL, C. ROMIG)

STAFF ANALYSIS: Per the December 1999 Earnings Surveillance Report, the Company reported an "FPSC Adjusted" net operating income of $1,067,060. Based on the adjustments discussed below, Staff recommends that the appropriate net operating income is $1,073,368.

Revenue Adjustment: The Company made refunds of $8,513 to various companies for overbilling for the period February 1994 through June 1999. Since a total of $7,919 was for periods other than calendar year 1999, revenues should be increased $7,919 to reflect the correct revenues applicable to 1999.

Out of Period Expenses: A review of the January 1999 general ledger showed that the Company recorded expenses of $1,433 and $1,682 in January 1999 which were applicable to December 1998. These two expenses total $3,115, and should be removed from the 1999 income statement.

Income Tax Expense/Interest Reconciliation and ITC Synchronization: The tax effect of the income statement adjustments is $4,152. The interest reconciliation and ITC interest synchronization are a fallout based on the reconciliation of the rate base and the capital structure due to the Staff adjustment to the rate base. In this instance, income taxes should be increased by $574.

ISSUE 4: What is the amount of excess earnings for Florida Public Utilities Company-Marianna Division for 1999?

RECOMMENDATION: The total amount of excess earnings for the Marianna Division for 1999 is $8,340 plus interest of $221. (REVELL)

STAFF ANALYSIS: Based on its recommendations in the above issues, Staff has determined that the excess earnings for 1999 are $8,340, plus interest of $221. This represents an earned ROE of 11.99%, which exceeds the maximum authorized ROE of 11.85%.

ISSUE 5: What is the appropriate disposition of the 1999 excess earnings for Florida Public Utilities Company-Marianna Division?

RECOMMENDATION: The total amount of 1999 excess earnings of $8,561, including interest, should be contributed to Marianna's Storm Damage Reserve. The booking of this amount should be effective as of January 1, 2000, for rate making, earnings surveillance, and overearnings review purposes. (REVELL)

STAFF ANALYSIS: In its July 20, 2000, letter, the Company requested that the 1999 overearnings be applied to the Marianna Division's Storm Damage Reserve. The total Storm Damage Reserve for Marianna amounted to $588,661 as of June 2000. The approved level of the reserve was addressed in Order No. PSC-94-0170-FOF-EI, resulting from Marianna's last rate case. In that Order, the Commission established a targeted storm damage reserve of $1 million, with an annual accrual of $100,000. Staff agrees with the Company that the total reserve is inadequate and will continue to be for the next several years. Therefore, Staff recommends that the $8,561 of excess earnings be included in the Storm Damage Reserve.

Since the excess earnings occurred during 1999 and interest has only been calculated for that year, Staff recommends that the increase in the reserve be made effective January 1, 2000, for all regulatory purposes. This would eliminate the need for the calculation of any additional amounts of interest and would include the increased reserve in the determination of earnings for the year 2000.

ISSUE 6: Should the Company's Storm Damage Reserve ceiling of $1,000,000 be increased?

RECOMMENDATION: Yes. The Storm Damage Reserve ceiling for FPUC-M should be raised from $1,000,000 to $1,400,000. (REVELL)

STAFF ANALYSIS: In Order No. PSC-94-0170-FOF-EI, the Marianna Division's Storm Damage accrual was raised from $17,300 to $100,000 annually. Additionally, a ceiling of $1,000,000 for the Reserve was established. As mentioned in Issue 5, at June 30, 2000, the Accumulated Storm Damage Reserve for FPUC-M was $588,661. The Storm Damage Reserve is used primarily to replace distribution plant which has been damaged or destroyed by accidents or natural disasters and which is not covered by insurance. Since year-end 1992, which was the last full year before the present cap was set, and year-end 1999, the Company's gross distribution plant increased 37.4% and net distribution plant increased 21.6%.

The order required the Company to submit, with its Annual Report, the status and reasonableness of the reserve, the annual accrual amount, and the availability of distribution system insurance. Hurricane Andrew, which struck south Florida in 1992, did not cause any damage to the FPUC-M facilities but made the purchase of insurance, if available, extremely expensive for the coverage granted. The Company was recently told that insurance coverage would be roughly dollar-for-dollar; that is, the yearly premiums would equal the benefits. The Company has concluded that insurance is still virtually unobtainable, and the establishment of a reserve balance sufficient to cover at least a large portion of storm damages is necessary.

Staff believes that the Company's distribution plant balance has increased enough since 1992 to warrant an increase in its Accumulated Storm Damage Reserve. Therefore, Staff recommends that the Company's Reserve be increased from $1,000,000 to $1,400,000.

ISSUE 7: Should Florida Public Utilities-Marianna Division be allowed the flexibility to increase its annual accrual above the present $100,000 yearly accrual until the accumulated provision account balance reaches $1,400,000?

RECOMMENDATION: Yes. Effective January 1, 2000, FPUC-M should be allowed to increase its annual accrual above the present $100,000 yearly accrual until the accumulated provision account balance reaches $1,400,000. (REVELL)

STAFF ANALYSIS: As noted in the prior issue, the Marianna Division's Storm Damage Reserve account has a relatively low balance of $588,661 as of June 30, compared to the recommended target balance of $1,400,000. At the current accrual amount of $100,000 annually, it will take over eight years to reach the target level, assuming no storm damage. The present amount of the storm damage reserve would be sufficient to replace only approximately 2 1/2% of gross distribution plant in the event of a major storm.

Staff recommends that the Company be given the flexibility to increase its annual accrual to the accumulated provision account, when the Company believes it is in a position from an earnings standpoint to do so, up to the ceiling of $1,400,000. This is similar flexibility that the Commission granted Gulf Power Company in Order No. PSC-96-0023-FOF-EI, issued January 19, 1996. Florida Public Utilities is still required to record an annual accrual to the Storm Damage Reserve of at least $100,000 until the Reserve reaches $1,400,000. Also, the Company shall provide a statement on its future earnings surveillance report when the adjustment is made to increase the amount charged to expense.

ISSUE 8: Should this docket be closed?

RECOMMENDATION: Yes. If no person whose interests are substantially affected by the proposed action files a request for a Section 120.57(1), Florida Statutes, hearing within 21 days of the Order, the Order will become final and effective upon the issuance of a consummating order. Because no further action will be required, this docket should be closed. (HART)

STAFF ANALYSIS: If no person whose interests are substantially affected by the proposed action files a request for a Section 120.57(1), Florida Statutes, hearing within 21 days of the Order, the Order will become final and effective upon the issuance of a consummating order. Because no further action will be required, this docket should be closed.

Florida Public Utilities Company

401 South Dixie Highway
West Palm Beach, Fl 33401

July 19, 2000

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 1999 at 11.85% for the Marianna 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 1999, using the same adjustments approved in our last FPSC Marianna rate case. All reasonable and prudent expenses and investment will be allowed in the calculation, but no annualized or proforma 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,

Cheryl M. Martin

Cheryl M. Martin
Manager of Corporate Accounting

CC: Jack Shreve, Office of Public Counsel
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Florida Public Utilities Company

July 20, 2000

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

Re: 1999 Over-earnings - Marianna Electric Operations

Dear Mr. Devlin:

The Company requests that the total over-earnings for 1999 in Marianna Electric Operations be contributed to the Storm Damage Reserve in Marianna. 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 as of June 30, 2000, in Marianna and Fernandina Beach are as follows:

	Accumulated Reserve	**Annual Accrual**
Marianna	$588,661	$100,000
Fernandina Beach	732,511	21,600

It is apparent from items (1) through (4) that there is a deficiency in the Marianna Division accumulated Storm Damage Reserve. We are therefore requesting the 1999 excess revenues and interest be transferred to the Marianna Storm Damage Reserve.

Sincerely,

Cheryl Martin

Cheryl Martin
Manager of Corporate Accounting

cc:
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FLORIDA PUBLIC UTILITIES COMPANY
MARIANNA ELECTRIC DIVISION
DOCKET NO. 001146-EI
REVIEW OF 1999 EARNINGS

	As Filed FPSC Adjusted Basis	Accounts Payable Allocation	Revenue Adjustment	Out of Period Adjustments	Interest Reconciliation/ ITC Synchronization	Total Adjustments	Total Adjusted Rate Base
RATE BASE							
Plant in Service	$22,678,529					$0	$22,678,529
Accumulated Depreciation	9,332,439					0	9,332,439
Net Plant in Service	13,346,090					0	13,346,090
Property Held for Future Use	0					0	0
Construction Work in Progress	100,777					0	100,777
Net Utility Plant	13,446,867					0	13,446,867
Working Capital	(909,615)	14,643				14,643	(894,972)
Total Rate Base	$12,537,252	$14,643				$14,643	$12,551,895
INCOME STATEMENT							
Operating Revenues	$5,827,140		$7,919			$7,919	$5,835,059
Operating Expenses:						0	0
Operation & Maintenance - Fuel	0					0	0
Operation & Maintenance - Other	2,266,241			(3,115)		(3,115)	2,263,126
Depreciation & Amortization	863,094					0	863,094
Taxes Other Than Income	1,338,797					0	1,338,797
Income Taxes - Current	234,084		2,980	1,172	574	4,726	238,810
Deferred Income Taxes (Net)	81,861					0	81,861
Investment Tax Credit (Net)	(23,997)					0	(23,997)
(Gain)/Loss on Disposition	0					0	0
Total Operating Expenses	4,760,080		2,980			1,611	4,761,691
Net Operating Income	$1,067,060		$4,939	($1,943)		$6,308	$1,073,368
EQUITY RATIO	45.07%					0.00%	45.07%
OVERALL RATE OF RETURN	8.51%					0.04%	8.55%
RETURN ON EQUITY	11.83%					0.16%	11.99%

ATTACHMENT 4

DOCKET NO. 001146-EI
DATE: AUGUST 17, 00

MARIANNA ELECTRIC DIVISION
DOCKET NO. 001146-EI
REVIEW OF 1999 EARNINGS

CAPITAL STRUCTURE				Weighted
AS FILED - FPSC ADJUSTED	Amount	Ratio	Cost Rate	Cost
Long Term Debt	$3,927,051	31.32%	9.93%	3.11%
Short Term Debt	1,474,022	11.76%	5.56%	0.65%
Preferred Stock	103,212	0.82%	4.75%	0.04%
Customer Deposits	627,815	5.01%	6.30%	0.32%
Common Equity	4,516,259	36.02%	11.85%	4.27%
Deferred Income Taxes	1,716,739	13.69%	0.00%	0.00%
Tax Credits - Zero Cost	364	0.00%	0.00%	0.00%
Tax Credits - Weighted Cost	171,790	1.37%	10.10%	0.14%
Total	$12,537,252	100.00%		8.53%

		Adjustments		Adjusted			Weighted
ADJUSTED	Amount	Specific	Pro Rata	Total	Ratio	Cost Rate	Cost
Long Term Debt	$3,927,051		$4,075	$3,931,126	31.32%	9.93%	3.11%
Short Term Debt	1,474,022		$1,530	1,475,552	11.76%	5.56%	0.65%
Preferred Stock	103,212		$107	103,319	0.82%	4.75%	0.04%
Customers Deposits	627,815			627,815	5.00%	5.92%	0.30%
1999 Excess Earnings		4,244		4,244	0.03%	5.06%	0.00%
Common Equity	4,516,259		$4,687	4,520,946	36.02%	11.85%	4.27%
Deferred Income Taxes	1,716,739			1,716,739	13.68%	0.00%	0.00%
Tax Credits - Zero Cost	364			364	0.00%	0.00%	0.00%
Tax Credits - Weighted Cost	171,790			171,790	1.37%	10.10%	0.14%
Total	$12,537,252	$4,244	$10,399	$12,551,895	100.00%		8.51%

ATTACHMENT 4
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ATTACHMENT 5

FLORIDA PUBLIC UTILITIES COMPANY
MARIANNA ELECTRIC DIVISION
DOCKET NO. 001146-EI
REVIEW OF 1999 EARNINGS

Adjusted Rate Base		$12,551,895
ROR @ 11.85% ROE	X	8.51%
Maximum allowed Net Operating Income		1,068,166
Achieved Net Operating Income		1,073,368
Excess Net Operating Income		5,202
Revenue Expansion Factor	X	1.6033
Excess Revenues		8,340
Interest		221
TOTAL 1999 EXCESS REVENUE		$8,561