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December 4, 2000

BY HAND DELIVERY

Blanca Bayó
Director, Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399

RECEIVED-FPSC
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RECORDS AND REPORTING

Re: City Gas -- Docket No. 000768-GU

Dear Ms. Bayó:

Enclosed for filing on behalf of City Gas Company of Florida are the original and fifteen copies of its Response to the Staff's Rate Case Audit Report.

If you have any questions regarding this filing, please call.

Very truly yours,

Richard D. Melson

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CAF _____ RDM/mee
CMP 1 Enclosures
COM 5cc: Certificate of Service
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FPSC-RECORDS/REPORTING

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing was furnished to the following by Hand Delivery this 4th day of December, 2000:

Marlene Stern
Florida Public Service Commission
Division of Legal Services
2540 Shumard Oak Boulevard
Tallahassee, FL 32399

Norman H. Horton
Messer, Caparello & Self, P.A.
P.O. Box 1876
Tallahassee, FL 32301



Attorney

ORIGINAL

Audit Exceptions

- (1) We agree.
- (2) We agree.
- (3) We agree that a portion of Accounts Receivable-Other should be allocated to non-utility operations. See response to Disclosure No. 9 for discussion of the appropriate factor.
- (4) We agree that a portion of materials and supplies should be allocated to non-utility operations. See response to Disclosure No. 9 for discussion of the appropriate factor.
- (5) We agree.
- (6) We disagree. The Dispatch Department is currently a standby service for City Gas utility. It is available to City Gas around the clock for emergency situations, and in fact, has proven to be invaluable in the short time it has been available to us. In emergency situations the Dispatch Department has provided full emergency dispatching services around the clock to the City Gas Utility divisions, its customers and the general public. The following is a list of several recent examples and the benefits the operating divisions and its customers have received with these occurrences.
 - Storm and Hurricane threat staffing and response.
 - Odorization System Failure.
 - Localized Flooding.
 - System Interruptions, etc.

In each of the listed events, the Dispatch Department was available and able to fully identify and focus its trained staff on the safety considerations, customer needs and the over-all severity of each of these occurrences. The Dispatch Department is directly linked to all emergency and field response Staff & Management, and is able to quickly direct the implementation of needed actions and or resources. Its service allows us to properly address the safety of our customers and of our system. Additionally, it is staffed by a fully qualified operational group, and handles utility emergencies as a matter of routine.

In consideration of the need for current staffing levels in order to provide us with this dependable standby service, the full cost of the department should be allocated to City Gas utility. When confirming the correct level of expense to include in City Gas's rates, we noted that we had made an error by inappropriately allocating a portion of the total Dispatch Department cost to the Appliance Business. Since the Dispatch Department deals only with utility matters, total costs for this department should have been allocated only to the regulated operations of Florida and New Jersey. As a result, the correct level of expense to include in City Gas's rates is \$469,775.

- (7) In general we agree with this adjustment with the exception of account 912. This charge in fiscal 1999 represents charges for City Gas's Florida field collection vehicles. It is appropriately trended into 2001, as no provision was made for this item in the Customer Care budget, and as such, it is not double counted. As a result, the auditor's proposed adjustment to O&M should decrease by \$11,320 ($\$10,671 \times 1.03 \times 1.03$) to \$62,942. The revised state tax effect is \$3,462 and the federal tax effect is \$21,400.
- (8) We agree.
- (9) We agree with the first part of the adjustment, which removes \$213,823 from the 2001 trended amount.

We do not agree with the second part of the adjustment that removes \$351,911 from expense in order to allocate bill production and postage to the appliance business. No such adjustment was made in the Company's previous rate case because the Commission recognized that the appliance leasing customers are all gas utility customers as well. Further, City Gas would be sending a bill to these customers each month for their utility service whether they leased appliances or not. The additional lines to add the appliance leasing charges add no incremental costs to bill production or postage. We only include the leasing charges as a matter of convenience. In fact, if we were not already billing these customers for gas service we would not send out a monthly bill since the amount is fixed during the lease term; we would provide them with a coupon book to be used to remit monthly payments.

If an allocation were to be made for the appliance leasing customers it should be done using the three-factor method. This is the method that is generally used by the Company to allocate common and semi-common costs. It is a method that Audit Staff has reviewed and approved in past rate proceedings. Please refer to the response to Disclosure 9 for a discussion of the appropriate factor.

Finally, if the number of customers portion of the allocation factor were to be adjusted, it should not be done by adding the number of appliance leasing customers to the current total of customers and developing a percentage, as Audit Staff has recommended. That would result in an incorrect total number of customers since the leasing customers would be counted twice. The more appropriate approach would be to split the leasing customers

in half, assigning a half to both the utility and the non-utility, as discussed further in the response to Disclosure 9. That would result in a non-utility percentage of customers of 19.32% (.5 x 38,920/100,719).

- (10) We agree.
- (11) We agree.
- (12) We disagree. The \$270,557 of projected expense represents a recurring level of expenditure for project development. Every year many of the projects on which we do preliminary studies and negotiations will not ultimately be constructed. We acknowledge the accounting should follow the guidelines set forth in 18 CFR Chapter 1, Balance Sheet account 183.2.; however, the instructions for this account also say that if construction does not result, the charge shall be made to account 426.5, Other Deductions, or the appropriate operating expense account. We believe that the company should have some level of expense, recurring in nature, for projects which ultimately do not result in construction. Audit Staff has assigned all of the expense incurred to projects which have come to fruition. Based on previous years' experience, approximately 90% of the expenditures incurred for project development ultimately are expensed because the related projects do not make it to the construction stage. Therefore, the appropriate level of expense includible in operating expense is \$243,000 (90% of \$270,557).
- (13) We agree that a portion of these expenses should be allocated to non-utility operations. See response to Disclosure No. 9 for discussion of the appropriate factor.
- (14) See response to Disclosure No. 9 for discussion of the appropriate factor.
- (15) We agree.
- (16) We agree.
- (17) We agree.
- (18) We agree.
- (19) We agree that the interest per books amount used in the interest reconciliation calculation is incorrect; however, the correct amount for the projected year is \$5,336,242. The auditors picked up \$5,225,425 which incorrectly excludes the amortization of debt expenses. The amortization of debt discount and loss on reacquired debt is both an element of interest on the books and a factor in the determination of the cost of debt in the rate of return and is appropriately included in interest expense. The interest synchronization calculation simply replaces the interest recorded on the books with the interest element of the return on rate base for purposes of calculating income taxes. Not

backing out the amortization of debt expenses would result in a double counting of this expense in the determination of income taxes.

- (20) We agree.
- (21) We agree that we misstated O&M expense in 2000, and that this has no impact on 2001 O&M.

Audit Disclosures

- (1) See response to engineer's report. However, since the proper accounting is to expense the normal level of cancelled projects, the company is entitled to recover the normal recurring level of expense for work initiated to develop projects that do not materialize. Based on the average of the 3 years presented in the case, \$206,000 per year is the appropriate level of expense to include in rates, net of the state and federal tax impact of \$11,330 and \$70,040, respectively. This represents a fair estimate of this normal cost of doing business, and it is not currently reflected in the 2001 O&M expenses (as we did not anticipate writing off cancelled projects in the numbers filed).
- (2) The acquisition adjustment amounts are correct and the amortization expense is correct, however, the 13 month average of accumulated amortization is incorrect. The correct amounts are as follows:

GDU	\$58,134
Vero Lateral	9,100
Homestead Lateral	19,990

At the request of Audit Staff, we had prepared a justification for including the acquisition adjustments in rate base. This write-up (Audit Request #92) is attached for your convenience.

- (3) See response to engineer's report.
- (4) We agree.
- (5) We do not believe that the 3 and 4 year periods used by the auditors in their calculations of average bad debts are appropriate, as they date back to 1996. The company has experienced a significant increase in the level of bad debts since that time, especially in its Miami territory. The level included in the filing is accurately reflects our recent experience.
- (6) See response to engineer's report.

- (7) The Company agrees with the statement of facts and is taking Staff's comments into consideration.
- (8) We agree with the statement of facts.
- (9) We disagree with two aspects of Audit Disclosure No. 9.

First, we disagree with the conclusion that it would be appropriate to develop a different allocation factor (such as revenues) to replace customer count in the three-factor methodology. The use of a revenue factor presents several difficulties, including selecting a proper definition of revenues (i.e. are purchased gas costs included or excluded) and the introduction of volatility due to the nature of the non-regulated energy brokerage business.

Second, we disagree with the conclusion that the exclusion of leased appliance customers from the customer factor used to split City Gas' share of common costs between the regulated and non-regulated business results in an understatement of costs being allocated to the appliance business. No appliance customers from any NUI division were included in the initial allocation of NUI corporate costs among its divisions. Therefore the City Gas share of the corporate allocation does not include any additional dollars due to the existence of its appliance customers. If a customer factor that includes customers assigned to the non-utility business is included when this pot of dollars is reallocated between the City Gas regulated and non-regulated businesses, dollars which were initially allocated to City Gas solely as the result of its total customer count would be allocated to the appliance business based on an inconsistent approach to customer counting. (That is, incoming costs based on 100,719 customers would be reallocated on the basis of 139,639 customers.)

In addition, in reviewing the original allocation filed in the MFRs -- which resulted in a 12.5% allocation to the appliance business -- we have discovered that the labor factor was calculated in a way that overallocates common costs to the utility business. Personnel on the appliance business payroll perform substantial regulated work for the utility (e.g., turn-ons, turn-offs, high bill complaints, CO investigations, meter change-outs, relights, etc.). In fact, based on the 2001 budget, 42% of the appliance business direct labor supports regulated utility operations. To avoid an overallocation of common costs to the utility business based on the payroll factor, 42% of the appliance payroll should have been assigned to the utility. In both the original City Gas allocation and the Audit Staff's allocation, however, 100% of the appliance business payroll was assigned to the appliance labor factor. The result is that the three-factor average of 12.5% allocated to the appliance business is higher than it would be if the labor factor had been properly calculated.

Considering all issues, City Gas is willing to forego correcting this misapplication of the labor factor and to stand by its original allocation of 12.5%. (We note that based on 2001

budget figures, the Audit Staff recalculated this number as 12.2%, which is also acceptable to City Gas.) However, if the customer factor is adjusted for any reason, then City Gas believes that the labor factor should be adjusted as well.

Finally, if the Commission staff decides to recommend that some customer count should be assigned to the non-utility business when calculating a three-factor average, that assignment should not be done in the manner that Audit Staff has recommended. Their approach of attributing the full number of appliance business customers to the appliance business has the effect of double counting these customers. There are 38,920 customers who lease water heaters. City Gas has a total of 100,719 customers. The methodology used by the audit staff suggests that City Gas total customer count is the sum of these two numbers, or 139,639. But City Gas does not have 139,639 customers. We only send out 100,719 bills per month. Of these customers, 38,920 utilize both utility service and appliance leasing. Therefore, we believe that if any assignment is made to the appliance business, it is more appropriate to assign these 38,920 customers 50% to the utility and 50% to the appliance business.

The impact of adjusting both the customer factor (using the 50-50 split for customers who are common to the utility and appliance business) and the labor factor would be to increase the allocation to the non-regulated business from 12.2% to 15.5%. The tables below show the individual and combined effect of adjusting these two factors.

Customer Count	Original	Audit Staff	Adjusted
Utility	100,719	100,719	81,259
Appliance Bus	<u>0</u>	<u>38,920</u>	<u>19,460</u>
Total	100,719	139,639	100,719
Customer Factor	0%	27.9%	19.3%
Three Factor Avg	12.5%	21.5%	18.7%

Labor Dollars	Original	Audit Staff	Corrected
Utility	\$5,002,000	NA	\$5,620,000
Appliance Bus	1,565,000	NA	947,000
Total	\$5,567,000	NA	\$5,567,000
Labor Factor	23.8%	NA	14.4%
Three Factor Avg	12.5%	NA	9.1%

Combined Impact	Original	Audit Staff	Adjusted/Corrected
Three Factor Avg	12.5%	21.5%	15.5%

As stated above, the company believes that the appropriate allocation factor to use is 12.5%, as originally filed. However, if a change were to be made to the customer number factor to attribute customers to appliance leasing, then the initial miscalculation of the labor factor should be corrected at the same time, and the appropriate allocation factor would be 15.5%. Following past practice, this same three-factor percentage would also be used in the common plant allocation addressed in the engineer's report and anywhere else the three-factor method is considered the appropriate factor to use.

The impact of adopting an adjusted three-factor percentage of 15.5% (as compared to the 12.5% as filed in the MFRs) is shown below:

1. Total working capital would be decreased by an additional \$36,708 for the M&J allocation.
 2. O&M expense would be decreased by an additional \$25,362 for the A&G allocation.
 3. O&M expense would be decreased by an additional \$216,467 for corporate allocations.
 4. O&M expense would be reduced by an additional \$58,496 for NUI and E-Town benefits and related costs. Also please note that this item deals not only with group insurance, but all benefit costs for NUI and E-Town.
- (10) We agree that we used the incorrect amount of tax revenues and tax expense, and that since both are adjusted out, there is no impact on NOI.
- (11) We agree.

City Gas Company of Florida
2000 Rate Case
Audit Request #92

- 1. Please provide an explanation as to how the following acquisition adjustments benefit the customers.**

GDU

The GDU ("General Development Utilities") system had originally been constructed by General Development Corporation in connection with real estate development of the Port St. Lucie area. The developer's financial problems led to the transfer of the underground propane system first to St. Lucie County and then to the City of Port St. Lucie, neither of which had built or owned any other propane assets or had any long-term desire to invest in propane distribution systems. The purchase of the underground system by City Gas assures that the system will be maintained in accordance with proper pipeline safety standards by a responsible and experienced party that can be held accountable for any failures to properly maintain safety. Moreover, the great body of citizens of the City of Port St. Lucie further benefits by the fact that City Gas actively invests in the system for growth, thereby assuring access to natural gas by any additional parties who meet the tariff feasibility standards. Further, because City Gas was able to purchase the system for less than it would have cost for it to have recreated a distribution system in the exact service area, the local citizenry and the general body of City Gas ratepayers benefit from lower cost access to system growth potential in this service area.

Overall, City Gas is entitled to rate base treatment of the GDU acquisition system adjustment because the acquisition of the GDU system benefited the former propane customers by lowering their rates, while providing them and their neighbors with a safer, more reliable product and access to City Gas' regulated protections for safety, consumer affairs and pricing. The entire City Gas customer base benefited from the improved throughput from serving the propane customers, who bear a fair share of City Gas' necessary fixed costs including capacity costs for the delivery of gas to the city gate.

Vero Beach Lateral

The Vero Beach lateral had originally been constructed by FGT to serve the local community by providing natural gas to fuel the local power plant. Over time, the lateral ceased to provide benefit to the community as increased supply requirements began to be met by larger alternate feeds to the power plant. Accordingly, FGT placed the lateral on the market so that an alternate owner could use it to again benefit the community. City Gas became that alternate owner of this unique opportunity to recreate benefit in a pipeline that otherwise may have become abandoned without benefit to the community.

The purchase of the Vero Beach lateral by City Gas assures that the system will be maintained in accordance with proper pipeline safety standards by a responsible and experienced party that can be held accountable for any failures to properly maintain safety. Moreover, the great body of citizens of the City of Vero Beach further benefits by the fact that City Gas actively invests in the system for growth, thereby assuring access to natural gas by any parties who meet the tariff feasibility standards. Further, because City Gas was able to purchase the Vero Beach lateral for substantially less than it would have cost for it to have recreated a distribution pipeline in the exact service area, the local citizenry and the general body of City Gas ratepayers benefit from lower cost access to system growth potential in this service area.

Overall, City Gas is entitled to rate base treatment of the Vero Beach lateral acquisition adjustment because the acquisition of the Vero Beach lateral allowed us to provide safe and reliable natural gas service to a community that would not otherwise have retail access to natural gas. For example, we extended service to the newly constructed Indian River Mall on SR60, as well as providing natural gas service to the ancillary commercial growth developing along SR60. In addition, many former commercial propane customers along the route have chosen to convert to natural gas, which provides them with a more reliable and safer fuel source. The entire City Gas customer base benefits from the improved throughput from serving these customers, who bear a fair share of fixed costs, including capacity costs.

It is important to allow the investors in City Gas to earn on the Vero Beach acquisition adjustment in order to encourage future lower cost beneficial system expansions such as this, as the acquisition adjustment accounts for substantially all of the purchase price of the lateral. If City Gas had been required to construct a new pipeline in order to earn a fair return on the initial expansion in the Vero Beach area, the cost would have been substantially higher. That would result in customers paying rates to support a higher rate base investment, and some customers that benefit from this lower cost alternative may not have gained access to natural gas because an alternate route or a longer term build out plan may have been chosen. At the same time, all potential customers in the Vero Beach area who offer loads that justify new pipeline construction still enjoy an equal opportunity to gain service in the future without harm to other ratepayers. Overall, the decision to expand service by acquiring the Vero Beach lateral provides a substantial good for the community and the City Gas ratepayers that would not have been realized in an alternate approach. Consequently, the investors in City Gas should earn a fair return on the full purchase price of the lateral.

Homestead Lateral

The Homestead lateral had originally been constructed by FGT to serve the local community by providing natural gas to fuel the local power plant. Over time, the lateral ceased to provide benefit to the community as increased supply requirements began to be met by larger alternate feeds to the power plant. Accordingly, FGT placed the lateral on the market so that an alternate owner could use it to again benefit the community. City Gas became that alternate owner of this unique opportunity to recreate benefit in a pipeline that otherwise may have become abandoned and without benefit to the community.

The purchase of the Homestead lateral by City Gas assures that the system will be maintained in accordance with proper pipeline safety standards by a responsible and experienced party that can be held accountable for any failures to properly maintain safety. Moreover, the great body of citizens of the City of Homestead further benefits by the fact that City Gas actively invests in the system for growth, thereby assuring access to natural gas by any parties who meet the tariff feasibility standards. Further, because City Gas was able to purchase the Homestead lateral for substantially less than it would have cost for it to have recreated a distribution pipeline in the exact service area, the local citizenry and the general body of City Gas ratepayers benefit from lower cost access to system growth potential in this service area.

Overall, City Gas is entitled to rate base treatment of the Homestead lateral acquisition adjustment because the acquisition of the Homestead lateral allowed us to provide safe and reliable natural gas service to a community that would not otherwise have retail access to natural gas. For example, the acquisition of the Homestead lateral allowed us to provide service to Kendall Foods, as well as provide service to new commercial development along US 1. In addition, approximately 50 additional commercial accounts along the route will be converted from propane to natural gas, providing them with a more reliable and safer fuel source, and the same protections as mentioned above. Again the entire City Gas customer base benefits from the improved throughput from serving these customers, who will bear a fair share of fixed costs, including capacity costs.

It is important to allow the investors in City Gas to earn on the Homestead acquisition adjustment in order to encourage future lower cost beneficial system expansions such as this, as the acquisition adjustment accounts for substantially all of the purchase price of the lateral. If City Gas had been required to construct a new pipeline in order to earn a fair return on the initial expansion in the Homestead area, the cost would have been substantially higher. That would result in customers paying rates to support a higher rate base investment, and some customers that benefit from this lower cost alternative may not have gained access to natural gas because an alternate route or a longer term build out plan may have been chosen. At the same time, all potential customers in the Homestead area who offer loads that justify new pipeline construction still enjoy an equal opportunity to gain service in the future without harm to other ratepayers. Overall, the decision to expand service by acquiring the Homestead lateral provides a substantial good for the community and the City Gas ratepayers that would not have been realized in an alternate approach. Consequently, the investors in City Gas should earn a fair return on the full purchase price of the lateral.