

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-

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DATE: June 26, 2014

TO: Office of Commission Clerk (Stauffer)

FROM: Division of Economics (McNulty, Draper) *EJD*
 Division of Accounting and Finance (Buys, Trueblood, Vogel) *WBM*
 Office of the General Counsel (Brownless, Barrera, Young) *J.W.D.*

RE: Docket No. 140025-EI – Application for rate increase by Florida Public Utilities Company. *CSB*

AGENDA: 07/10/14 – Regular Agenda – Decision on Interim Rates – Participation is at the Discretion of the Commission

COMMISSIONERS ASSIGNED: Edgar, Balbis, Brown

PREHEARING OFFICER: Brown

CRITICAL DATES: Company Waived 60-Day Suspension Date until 7/10/14

SPECIAL INSTRUCTIONS: None

Case Background

Florida Public Utilities Company (FPUC or Company) filed a test year notification letter to the Commission on January 31, 2014, in which the Company indicated its intent to seek a permanent increase in its rates and charges based on a test year ending September 30, 2015. On April 28, 2014, FPUC filed its petition for an increase in base rates, as well as minimum filing requirements schedules (MFRs) and the direct testimony of 9 witnesses, thereby initiating this proceeding. The Company is engaged in business as a public utility providing electric service as defined in Section 366.02, Florida Statutes (F.S.), and is subject to the jurisdiction of the Commission. FPUC serves more than 31,000 retail customers in four counties, including the Company's Northwest Division (Marianna) and its Northeast Division (Amelia Island). FPUC's base rates for its two divisions are consolidated into a single Electric Division, unlike the Company's fuel rates (i.e., purchased power) which are separate for the two divisions.

FPUC requested an increase in base rates and charges to generate \$5,852,171 in gross annual revenues. FPUC stated in its petition that the requested test year period ending September 30, 2015, is the most relevant period upon which the Company's operations should be analyzed for purposes of establishing rates for the period new rates will be in effect. The Company further stated that this period will be indicative of its actual revenues, expenses, and investment during the first 12 months that the new rates will be in effect.

FPUC also requested an interim rate increase in its base rates and charges to generate \$2,433,314 in additional gross revenues. The Company has based its interim request on a historical test year ended September 30, 2013.

On February 4, 2014, the Office of Public Counsel (OPC) filed its notice of intervention in this proceeding.¹ A hearing has been scheduled for September 15-18, 2014.²

The Commission last granted FPUC a \$3,856,897 rate increase by Order No. PSC-08-0327-FOF-EI.³ In that order, the Commission found the Company's jurisdictional rate base to be \$40,209,549 for the projected test year ended December 31, 2008. The allowed rate of return was found to be 7.64 percent for the test year using an 11.00 percent return on equity.

This recommendation addresses FPUC's interim rate increase request and the suspension of the requested permanent rate increase. The Company filed a letter in this proceeding on May 5, 2014, in which it agreed to a limited waiver of the 60-day timeframe for interim rate authorization set forth in Section 366.071(2), F.S., until the July 10, 2014 Commission Conference. The Commission has jurisdiction over this request for a rate increase and interim rate increase under Sections 366.06 and 366.071, F.S.

¹ On April 18, 2014, OPC's Notice of Intervention was acknowledged by Order No. PSC-0179-FOF-EI.

² Order No. PSC-0194-PCO-EI, issued May 1, 2014, in Docket No. 140025-EI, In re: Application for rate increase by Florida Public Utilities Company.

³ Order No. PSC-08-0327-FOF-EI, issued May 19, 2008, in Docket No. 070304-EI, In re: Petition for rate increase by Florida Public Utilities Company.

Discussion of Issues

Issue 1: Should the \$5,852,171 permanent base rate increase and its associated tariff revisions requested by FPUC be suspended pending a final decision in this docket?

Recommendation: Yes. The \$5,852,171 permanent base rate increase and its associated tariff revisions requested by FPUC should be suspended pending a final decision in this docket. (McNulty, Draper)

Staff Analysis: FPUC filed its petition, testimony, and minimum filing requirements on April 28, 2014. The Company has requested a total permanent base rate increase of \$5,852,171 based on a projected test year ending September 30, 2015.

Historically, especially when a projected test year has been involved, the Commission has suspended the requested permanent rate schedules in order to adequately and thoroughly examine the basis for the new rates. The suspension of the rate increase is authorized by Section 366.06(3), F.S., which provides:

Pending a final order by the Commission in any rate proceeding under this section, the commission may withhold consent to the operation of all or any portion of the new rate schedules, delivering to the utility requesting such increase, within 60 days, a reason or written statement for withholding its consent.

Because FPUC's requested permanent rate relief is based on a projected test year, staff recommends that the Commission suspend the requested base rate increase and its associated tariff revisions to allow staff and interveners sufficient time to adequately investigate whether the request for permanent rate relief is appropriate.

Issue 2: Is FPUC's proposed rate base of \$54,511,326 for the interim historical test year for the 12-month period ended September 30, 2013, appropriate?

Recommendation: Yes. FPUC's proposed rate base of \$54,511,326 for the interim historical test year for the 12-month period ended September 30, 2013, is appropriate. (Trueblood)

Staff Analysis: The proposed interim historical test year rate base of \$54,511,326 is the year-end amount for the 12-month period ended September 30, 2013. Staff has reviewed the rate base adjustments made in the current interim filing for consistency with the findings made in the Company's last rate case order. Based on staff's preliminary review, FPUC made the applicable and appropriate adjustments consistent with the previous rate case. Therefore, staff recommends that \$54,511,326 is the appropriate amount of rate base for the 2013 interim historical test year ended September 30, 2013. The calculation is shown on Attachment A.

It should be noted that 2013 is also the historical base year ended September 30, 2013, that was used to develop the 2015 projected test year for the requested permanent base rate increase. The historical test year data is currently being audited as part of the normal ratemaking review process in this docket.

Issue 3: Are FPUC's proposed return on equity of 10.00 percent and overall cost of capital of 6.37 percent appropriate for the purpose of determining interim rates?

Recommendation: No. Although FPUC's proposed return on equity of 10.00 percent is appropriate, the Company's proposed overall cost of capital of 6.37 percent is not appropriate. The appropriate overall cost of capital for purposes of determining interim rates is 6.13 percent. (D. Buys, Vogel)

Staff Analysis: Pursuant to Section 366.071(2)(a), F.S., the appropriate return on equity (ROE) for purposes of determining an interim rate increase is the minimum of the Company's currently authorized ROE range. FPUC's authorized ROE and range is 11.00 percent plus or minus 100 basis points. The Commission set the return and range by Order No. PSC-08-0327-FOF-EI.⁴ For its interim request, the Company appropriately used an ROE of 10.00 percent.

FPUC's proposed overall cost of capital of 6.37 percent includes a cost rate of 20.83 percent for long-term debt directly assigned to FPUC (FPUC legacy debt) and a cost rate of 5.84 percent for long-term debt allocated to FPUC from its parent, Chesapeake Utilities Corporation (CUC). The FPUC legacy debt included three separate secured first mortgage bonds that were issued by FPUC prior to CUC's acquisition of FPUC in 2009. In May 2013, CUC redeemed two of the three bonds leaving only one bond with a coupon rate of 9.08 percent as of the end of the interim test year. The cost rate of 20.83 percent assigned to the FPUC legacy debt in the capital structure is not reflective of the Company's actual cost of the remaining bond. FPUC inappropriately included the interest expense for the two redeemed bonds with the interest expense for the remaining bond which increased the effective cost rate of the FPUC legacy debt.

To calculate the cost rate of long-term debt for both the FPUC legacy debt and the CUC allocated debt, the Company divided the total accumulated interest expense for the 12-month interim test year ended September 30, 2013, by the one-month outstanding debt balance as of September 30, 2013. Staff believes this method is not appropriate and violates the matching principal by using the cumulative annual balance in the numerator and using the end of period monthly balance in the denominator. Staff believes a more appropriate method to calculate the embedded cost of debt for the interim cost of capital is to use the one-month ending balance as of September 30, 2013, for both the interest expense (numerator) and outstanding amount of debt (denominator) and annualizing the result. This method results in a cost rate of 13.09 percent for the FPUC legacy debt ($\$70,352 \div \$6,450,270 \times 12 = 13.09\%$), and a cost rate of 6.05 percent for the CUC allocated debt ($\$505,936 \div \$100,285,726 \times 12 = 6.05\%$).

After adjusting the cost rates for long-term debt in FPUC's proposed capital structure in MFR Schedule G-19a, the appropriate overall cost of capital for purposes of determining interim rates is 6.13 percent. Attachment B details the calculation of the Company's overall cost of capital.

⁴ Order No. PSC-08-0327-FOF-EI, issued May 19, 2008, in Docket No. 070304-EI, In re: Petition for rate increase by Florida Public Utilities Company.

Issue 4: Is FPUC's proposed net operating income of \$1,981,784 for the interim historical test year for the 12 months ended September 30, 2013, appropriate?

Recommendation: Yes. FPUC's proposed net operating income of \$1,981,784 for the interim historical test year for the 12-month period ended September 30, 2013, is appropriate. (Trueblood)

Staff Analysis: The proposed interim test year net operating income of \$1,981,784 is the year end amount for the 12-month period ended September 30, 2013. Staff has reviewed the net operating income adjustments made in the current interim filing for consistency with the findings made in the Company's last rate case. Based on staff's preliminary review, FPUC made all of the applicable and appropriate adjustments consistent with the previous rate case. The calculation is shown on Attachment A.

It should be noted that the historical base year ended September 30, 2013, was used to develop the 2015 projected test year for the requested permanent base rate increase. The 2013 historical test year data is currently being audited as part of the normal ratemaking review process in this docket.

Issue 5: Is FPUC's proposed net operating income multiplier of 1.6335 appropriate?

Recommendation: Yes. The appropriate net operating income multiplier for purposes of determining interim rates is 1.6335. (Trueblood)

Staff Analysis: On MFR Schedule G-18, the Company calculated a net operating income multiplier of 1.6335 using a 35.00 percent federal income tax rate and a 5.50 percent state income tax rate. Additionally, the Company applied a .072 percent factor for regulatory assessment fees and a .266 percent bad debt rate. Staff has reviewed the Company's calculation of the net operating income multiplier and believes no adjustments are necessary. Therefore, staff recommends that 1.6335 is the appropriate net operating income multiplier. The calculation is shown below.

Table 5-1

Calculation of Net Operating Income Multiplier		
Line	Description	
1	Revenue Requirement	100.000%
2	Regulatory Assessment Fee	(0.072%)
3	Bad Debt Rate	(0.266%)
4	Net Before Income Taxes	99.662%
5	Combined State/Federal Income Tax@ 38.44	(38.444%)
6	Revenue Expansion Factor	61.217%
7	Net Operating Income Multiplier (100% / Line 6)	1.6335

Issue 6: Should FPUC's requested interim rate increase of \$2,433,314 and percentage increase factor of 14.91 percent be granted?

Recommendation: No. An interim rate increase of \$2,221,168 with a percentage increase factor of 13.61 percent should be granted. (Trueblood)

Staff Analysis: FPUC requested interim rate relief of \$2,433,314 for the historical test year ended September 30, 2013, is based upon its jurisdictional year-end rate base of \$54,511,326. When calculating the requested interim rate relief, the Company used an adjusted rate of return of 6.37 percent. As discussed in Issue 3, after adjusting the cost rates for long-term debt in FPUC's proposed capital structure in MFR Schedule G-19a, the appropriate overall cost of capital for purposes of determining interim rates is 6.13 percent.

The recommended increase would allow the Company the opportunity to earn an overall rate of return of 6.13 percent and the minimum of the range of return on equity of 10.00 percent. After a determination of the permanent rate increase has been made, the interim rate increase will be reviewed to determine if any portion should be refunded to the ratepayers.

The calculation of the interim rate increase and the percentage increase factor are shown below.

Table 6-1

Calculation of Interim Rate Relief and Percentage Increase	
Jurisdictional Adjusted Rate Base	\$54,511,326
Overall Rate of Return Recommended	x 6.13%
Jurisdictional Net Operating Income Recommended	\$3,341,544
Jurisdictional Adjusted Net Operating Income	\$1,981,784
Income Deficiency/(Excess)	\$1,359,760
Net Operating Income Multiplier	x 1.6335
Interim Revenue Increase/(Decrease)	\$2,221,168
Base Rate Revenues	\$16,320,819
Percentage Increase Factor	13.61%

Issue 7: How should the interim revenue increase for FPUC be distributed among the rate classes?

Recommendation: The percentage increase factor recommended in Issue 6 should be applied uniformly to all existing base rates and charges to derive the interim base rates and charges, as required by Rule 25-6.0435, Florida Administrative Code (F.A.C.). The interim rates should be made effective for all meter readings made on or after 30 days from the date of the vote approving any interim increase. FPUC should file revised tariff sheets for administrative approval that reflect the Commission-approved percentage increase factor and resulting interim rates. FPUC should give notice to customers of the interim increase commencing with the first bill for service that reflects the approved increase. A copy of the notice should be submitted to staff for approval prior to its issuance. (Draper)

Staff Analysis: In Issue 6, staff recommended an interim increase of \$2,221,168 and a percentage increase factor of 13.61 percent. Rule 25-6.0435, F.A.C, requires that any percentage increase factor be applied uniformly to all existing base rates and charges to derive interim base rates and charges. Attachment C shows the interim revenue increase to the various rate classes. FPUC should file revised tariff sheets for administrative approval that reflect the Commission-approved percentage increase factor and resulting interim rates.

Attachment D contains present rates and interim rates for the major rate classes based on staff's recommended interim increase. Attachment E contains monthly residential bills that show the impact of the interim rates.

The interim rates should be effective for all meter readings made on or after 30 days from the date of the Commission vote approving any interim increase. FPUC should be required to give appropriate notice to customers commencing with the first bill for service that reflects the approved interim increase that explains the nature, purpose, and effect of the increase. A copy of the notice should be submitted to staff for approval prior to its issuance.

Issue 8: What is the appropriate security to guarantee the amount collected subject to refund?

Recommendation: The appropriate security to guarantee the funds collected subject to refund is a corporate undertaking contingent on receipt of a written guarantee by CUC. (D. Buys, Vogel)

Staff Analysis: FPUC has requested that all funds collected subject to refund be secured by a corporate undertaking through its parent, CUC. The criteria for a corporate undertaking include sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. Staff reviewed CUC's 2011, 2012, and 2013 financial statements in its Form 10K Annual Reports filed with the United States Securities and Exchange Commission to determine if CUC can support a corporate undertaking in the amount of \$2,221,168. Staff's analysis shows CUC has sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund of the requested interim revenue increase. For all three years, CUC's working capital has been positive, and the current ratio has been greater than one, demonstrating that it has sufficient liquidity. CUC's equity ratio was 61 percent in 2011, 60 percent in 2012, and 54 percent in 2013, indicating significant equity ownership. In addition, CUC has a strong and improving interest coverage ratio over the three-year period. Finally, CUC's net income has been on average 13 times greater than the requested corporate undertaking amount, indicating good profitability.

Staff believes FPUC, through its parent, has adequate financial resources to support a corporate undertaking in the amount requested. Based on this analysis, staff recommends that a corporate undertaking in the amount of \$2,221,168 is acceptable contingent on receipt of a written guarantee by CUC. This brief financial analysis is only appropriate for deciding if FPUC can support a corporate undertaking in the amount requested and should not be considered a finding regarding staff's position on other issues in this proceeding.

Issue 9: Should this docket be closed?

Recommendation: No. This docket should remain open pending the Commission's final resolution of the Company's requested rate increase. (Brownless, Barrera, Young)

Staff Analysis: This docket should remain open pending the Commission's final resolution of the Company's requested rate increase.

FLORIDA PUBLIC UTILITIES COMPANY, INC.
 ELECTRIC DIVISION
 DOCKET NO. 140025-EI
 INTERIM TEST YEAR
 SEPTEMBER 30, 2013

	As Filed by <u>Company</u>	Staff <u>Adjustments</u>	Total Adjusted <u>Rate Base</u>
<u>RATE BASE</u>			
Plant in Service	\$99,867,655	\$0	\$99,867,655
Accumulated Depreciation	(50,707,813)	0	(50,707,813)
Net Plant in Service	49,159,842	0	49,159,842
Property Held for Future Use	0	0	0
Construction Work in Progress	4,831,630	0	4,831,630
Net Utility Plant	53,991,472	0	53,991,472
Working Capital	519,854	0	519,854
 Total Rate Base	 <u>\$54,511,326</u>	 <u>\$0</u>	 <u>\$54,511,326</u>
 <u>INCOME STATEMENT</u>			
Operating Revenues	\$17,017,891	\$0	\$17,017,891
Operating Expenses:			
Operation & Maintenance - Fuel	0	0	0
Operation & Maintenance - Other	10,580,760	0	10,580,760
Depreciation & Amortization	2,893,320	0	2,893,320
Taxes Other Than Income	947,994	0	947,994
Income Taxes - Current	(602,119)	0	(602,119)
Deferred Income Taxes (Net)	1,218,774	0	1,218,774
Investment Tax Credit (Net)	(2,622)	0	(2,622)
(Gain)/Loss on Disposition	0	0	0
Total Operating Expenses	15,036,107	0	15,036,107
 Net Operating Income	 <u>\$1,981,784</u>	 <u>\$0</u>	 <u>\$1,981,784</u>
 OVERALL RATE OF RETURN	 <u>3.64%</u>		 <u>3.64%</u>

FLORIDA PUBLIC UTILITIES COMPANY
Historical Test Year Ended 09/30/2013

Class of Capital	COMPANY AS FILED (MFR Schedule G-19a)						STAFF ADJUSTMENTS					
	Company Total Per Books	Adjustments		System Adjusted	Pro-Rata Factor	Jurisdictional	Adjustments		Staff Adjusted	Ratio	Cost Rate	Weighted Cost
		Specific	Pro Rata				Specific	Pro Rata				
Common Equity	\$269,788,479	\$4,902,898	\$0	\$274,691,377	9.01%	\$24,741,850	\$0	\$0	\$24,741,850	45.39%	10.00%	4.54%
Long-term Debt	\$100,387,699			\$100,387,699	9.01%	\$7,705,266			\$7,705,266	14.14%	6.05%	0.86%
Long-term Debt - FPU Only	\$6,450,270	0	0	\$6,450,270	29.73%	\$1,917,785	0	0	\$1,917,785	3.52%	13.09%	0.46%
Short-term Debt	\$91,297,347	0	0	\$91,297,347	9.01%	\$8,223,284	0	0	\$8,223,284	15.09%	0.84%	0.13%
Preferred Stock	\$0	0	0	\$0	9.01%	\$0	0	0	\$0	0%	0%	0.00%
Customer Deposits	\$3,375,525	0	0	\$3,375,525		\$3,375,525	0	0	\$3,375,525	6.19%	2.33%	0.14%
Deferred Income Taxes	\$8,547,616			\$8,547,616		\$8,547,616			\$8,547,616	15.68%	0%	0%
Tax Credits - Zero Cost	\$0	0	0	\$0		\$0	0	0	\$0	0%	0%	0%
Tax Credits - Weighted Cost	\$0	0	0	\$0		\$0	0	0	\$0	0%	8.69%	0%
TOTAL	\$479,846,936	\$4,902,898	\$0	\$484,749,834		\$54,511,326	\$0	\$0	\$54,511,326	100.00%		6.13%

FLORIDA PUBLIC UTILITIES COMPANY
ALLOCATION OF INTERIM RATE INCREASE
DOCKET NO. 140025-EI

RATE CODE	(1) RATE SCHEDULE	(2)	(3)	(4)	(5)
		TOTAL BASE REVENUE AT PRESENT RATES	\$ INTERIM INCREASE	% INCREASE	TOTAL BASE REVENUE AT INTERIM RATES
RS	RESIDENTIAL	\$9,194,257	\$1,251,285	13.61%	\$10,445,542
GS	GENERAL SERVICE	\$1,899,170	\$258,466	13.61%	\$2,157,636
GSD	GENERAL SERVICE DEMAND	\$2,465,678	\$335,564	13.61%	\$2,801,242
GSLD	GENERAL SERVICE LARGE DEMAND	\$935,244	\$127,281	13.61%	\$1,062,525
GSLD-1	GENERAL SERVICE LARGE DEMAND	\$233,605	\$31,792	13.61%	\$265,397
SB	STANDBY	\$169,003	\$23,000	13.61%	\$192,003
OL	OUTDOOR LIGHTING	\$1,045,071	\$142,228	13.61%	\$1,187,299
SL	STREET LIGHTING	\$378,791	\$51,551	13.61%	\$430,342
TOTAL		<u>\$16,320,819</u>	<u>\$2,221,168</u>	<u>13.61%</u>	<u>\$18,541,987</u>

FLORIDA PUBLIC UTILITIES COMPANY
PRESENT AND INTERIM RATES
DOCKET NO. 040025-EI

RATE CODE	RATE SCHEDULE	PRESENT RATES	INTERIM INCREASE	INTERIM RATES
RS	<u>RESIDENTIAL SERVICE</u>			
	CUSTOMER CHARGE	\$12.00	\$1.63	\$13.63
	ENERGY CHARGE (cents/kWh)	1.958	0.27	2.224
GS	<u>GENERAL SERVICE</u>			
	CUSTOMER CHARGE	\$18.00	\$2.45	\$20.45
	ENERGY CHARGE (cents/kWh)	1.927	0.26	2.189
GSD	<u>GENERAL SERVICE DEMAND</u>			
	CUSTOMER CHARGE	\$52.00	\$7.08	\$59.08
	ENERGY CHARGE (cents/kWh)	0.340	0.05	0.386
	DEMAND CHARGE (\$/kW)	\$2.80	\$0.38	\$3.18
GSLD	<u>GENERAL SERVICE LARGE DEMAND</u>			
	CUSTOMER CHARGE	\$100	\$13.61	\$113.61
	ENERGY CHARGE (cents/kWh)	0.145	0.02	0.165
	DEMAND CHARGE (\$/kW)	\$4.00	\$0.54	\$4.54

FLORIDA PUBLIC UTILITIES COMPANY
BILL COMPARISONS - PRESENT VS. INTERIM RATES
DOCKET NO. 140025-EI

RESIDENTIAL SERVICE

PRESENT RATES

INTERIM RATES

Customer Charge

Customer Charge

\$12.00

\$13.63

Energy Charge (c/kWh)

Energy Charge (c/kWh)

1.958

2.224

Fuel - Northwest Division (c/kWh)

Fuel - Northwest Division (c/kWh)

9.74 (first 1,000 kWh)

9.74

10.99 (above 1,000 kWh)

10.99

Fuel - Northeast Division (c/kWh)

Fuel - Northeast Division (c/kWh)

8.975 (first 1,000 kWh)

8.975

10.225 (above 1,000 kWh)

10.225

Conservation Factor (c/kWh)

Conservation Factor (c/kWh)

0.1

0.1

NORTHWEST DIVISION

NORTHEAST DIVISION

kwh Usage	Present	Interim	Percent Increase	Dollar Increase	Present	Interim	Percent Increase	Dollar Increase
	Monthly Bill	Monthly Bill			Monthly Bill	Monthly Bill		
800	\$109.11	\$112.97	3.53%	\$3.85	\$102.83	\$106.69	3.75%	\$3.85
900	\$121.21	\$125.34	3.40%	\$4.13	\$114.15	\$118.28	3.62%	\$4.13
1,000	\$133.31	\$137.71	3.30%	\$4.40	\$125.47	\$129.87	3.51%	\$4.40
1,100	\$159.52	\$164.19	2.93%	\$4.67	\$150.89	\$155.56	3.10%	\$4.67
1,200	\$172.90	\$177.84	2.86%	\$4.95	\$163.48	\$168.43	3.03%	\$4.95
1,300	\$186.28	\$191.50	2.80%	\$5.22	\$176.08	\$181.30	2.96%	\$5.22
1,500	\$213.05	\$218.81	2.71%	\$5.76	\$201.28	\$207.04	2.86%	\$5.76
2,000	\$279.96	\$287.09	2.55%	\$7.13	\$264.27	\$271.39	2.70%	\$7.13

Bills include Gross Receipts Taxes