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| State of Florida  pscSEAL | | 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: | January 2, 2020 | | |
| TO: | Office of Commission Clerk (Teitzman) | | |
| FROM: | Division of Economics (Galloway, Coston, Draper, Guffey, Hampson, McNulty, Rogers, Smith, Ward, Wu)  Division of Accounting and Finance (D. Andrews, M. Andrews, Brown, D. Buys, Cicchetti, Higgins, Mouring, Norris, Richards, Sewards, Snyder)  Division of Engineering (Graves, King, Knoblauch, Lewis)  Office of the General Counsel (DuVal, Dziechciarz) | | |
| RE: | Docket No. 20190083-GU – Application for rate increase in Highlands, Hardee, and Desoto Counties, by Sebring Gas System, Inc. | | |
| AGENDA: | 01/14/20 – Regular Agenda – Proposed Agency Action (Except for Issue 29) –  Interested Persons May Participate | | |
| COMMISSIONERS ASSIGNED: | | | All Commissioners |
| PREHEARING OFFICER: | | | Fay |
| CRITICAL DATES: | | | 01/14/20 (5-Month Effective Date Waived Through January 14, 2020) |
| SPECIAL INSTRUCTIONS: | | | None |

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Case Background

On April 1, 2019, Sebring Gas System, Inc. (Sebring or the Company) filed a test year notification letter with the Florida Public Service Commission (Commission), pursuant to Rule 25-7.140, Florida Administrative Code (F.A.C.), in which it stated its intent to use the calendar year 2020 as the projected test year for a proposed rate increase. The Company serves approximately 662 gas customers in Highlands, Hardee, and DeSoto counties.

By Order No. 24761, issued July 5, 1991, the Commission found Sebring to be a public utility subject to Commission jurisdiction. The Commission set initial rates for Sebring by Order No. PSC-92-0229-FOF-GU, issued April 20, 1992.[[1]](#footnote-1) Since 1992, the Company petitioned the Commission for a rate increase in 2004 with rates effective in 2005. In that docket, the Commission approved a jurisdictional rate base of $1,100,766 for the projected year ended December 31, 2005. The Commission also approved a weighted average overall rate of return of 8.64 percent, including a cost rate for common equity of 11.5 percent, with an authorized return on equity of plus or minus 100 basis points.[[2]](#footnote-2)

On June 5, 2019, Sebring filed its petition for a permanent rate increase with the Commission. The Company requested the Commission process its request as a Proposed Agency Action (PAA). In its petition filed on June 5, 2019, Sebring requested an increase of $309,847 in additional annual revenues. Its request was based on a 13-month average rate base of $5,085,214 for the projected test year ending December 31, 2020. Sebring’s requested overall rate of return is 7.70 percent, including a 12.5 percent mid-point return on common equity.

In its instant petition, the Company states that there are three key drivers for its request for a rate increase. According to the Company, the three key drivers include: 1) increases to rate base associated with extensions to serve new customers and additional personnel consistent with the expansion; 2) increases in regulatory costs, particularly those associated with federal pipeline safety, as well as increases in overall operating costs, including almost 15 years’ worth of inflation; and 3) income tax not currently included in customer rates and deferred income tax expense accumulated since the Company’s last rate case.[[3]](#footnote-3) The Company also states that it has managed to avoid seeking a base rate increase for over 15 years, but “[w]ithout the requested revenue increase...its overall rate of return will fall to 3.17%, well below its currently authorized rate of return of 8.64%.”[[4]](#footnote-4)

On April 3, 2019, the Office of Public Counsel (OPC) filed its Notice of Intervention in this proceeding, pursuant to Section 350.0611, Florida Statutes (F.S.). By Order No. PSC-2019-0226-PCO-GU, issued on June 12, 2019, the Commission acknowledged OPC’s intervention.[[5]](#footnote-5) A customer meeting was held on August 8, 2019. No customers attended the meeting and staff has not received any customer complaints.

In response to staff’s data requests, on November 12, 2019, Sebring submitted revised MFR G-Schedules, and on November 21, 2019, Sebring submitted revised MFR H-Schedules. In its revised MFR schedules, Sebring’s requested increase of $309,847 decreased to $302,041, and its requested rate base of $5,085,214 decreased to $5,044,363. By email dated August 22, 2019, Sebring waived the 5-month effective date through the December Agenda Conference. Sebring extended this waiver through the January 7, 2020 Agenda Conference by email dated November 18, 2019. After the January Agenda Conference’s rescheduling, Sebring extended its waiver through January 14, 2020, by email dated December 12, 2019. The Commission has jurisdiction over this request for a rate increase under Section 366.06, F.S.

Discussion of Issues

Issue :

 Is Sebring's projected test period for the 12-months ending December 31, 2020 appropriate?

Recommendation:

 Yes. With the adjustments recommended by staff in the following issues, the 2020 test year is appropriate. (Wu)

Staff Analysis:

 Sebring proposed to use the projected test period ending December 31, 2020, as the projected test year, with the historic base year being the 12-month period ended December 31, 2018. Sebring used actual data for the 2018 base year rate base, net operating income, and capital structure.[[6]](#footnote-6) The 2020 projected test year data was determined based upon the combination of 2018 data trended for customer growth, inflation, and payroll growth using the Commission-prescribed trending methodology, as well as a forecast of the Company’s growth.[[7]](#footnote-7) This growth includes the new service territories in the Cities of Wauchula and Arcadia as indicated in the Direct Testimony of Mr. Russell Melendy of Sebring.[[8]](#footnote-8)

The purpose of the test year is to represent the financial operations of a company during the period in which the new rates will be effective. Sebring petitioned the Commission to approve the Company’s proposed new tariff sheets with an effective date of January 1, 2020. The projected test year ending December 31, 2020 represents a relevant period upon which the Company’s operations should be analyzed for the purpose of establishing new base rates. This test period will reflect actual conditions and be indicative of the actual investments, expenses, and revenues during the first 12 months that new rates will be in effect. Therefore, Sebring’s proposed projected test year matches the timing of the Company’s projected investments and expenses with its projected revenues for the period following the date on which the new base rates become effective.

In the following issues, staff is recommending that certain adjustments be made to Sebring’s test year data. With the inclusion of these adjustments, staff believes that the 2020 projections of Sebring’s financial operations are appropriate to use as the basis for setting new rates.

Issue :

 Are Sebring's forecasts of customer growth and therms by rate class appropriate?

Recommendation:

 Yes. Staff recommends that Sebring’s forecasts of customer growth and therms by rate class for the 2020 projected test year, as contained in Document No. 10856-2019, revised Minimum Filing Requirements (MFRs) Schedule G-2, as revised on November 12, 2019, Pages 8 and 8.5 of 31, are appropriate. (Wu)

Staff Analysis:

 For the instant rate case, Sebring utilized the historical base year (HBY) 2018 data as a basis to develop the forecasts of customer growth and therms growth by rate class for 2019, which is the historical base year plus one (HBY+1) and the 2020 projected test year (PTY).

To achieve its forecast of customer growth, Sebring identified the potential new service areas, including the Cities of Wauchula and Arcadia. It then determined the potential customer additions related to the new service areas, as well as for the Company’s existing service territory.

Sebring primarily relied upon its management’s local knowledge to determine its projections of customer additions related to the new service areas.[[9]](#footnote-9) In his testimony, Mr. Russell Melendy, Project Manager of Sebring, testified that “[t]he Company is well aware of construction and building activities in the area,” and that he is very familiar with the proposed new service areas in the Cities of Wauchula and Arcadia.[[10]](#footnote-10) Mr. Russell Melendy asserted that Coker Fuel, which is also owned by the Melendy family, provided propane service in these areas, and many of Sebring’s projected new commercial and industrial customers for this rate case currently use propane provided by Coker Fuel or other competing propane companies. Mr. Russell Melendy claimed that as a local business-owner/operator and a two-term Hardee County Commissioner, his professional and public service experiences further expanded his involvement and understanding of these communities. Additionally, he indicated that Mr. Jerry Melendy, “in his capacity as [Sebring’s] President, is active in the Sebring community, participating in numerous community and civic events.”[[11]](#footnote-11) Mr. Russell Melendy averred that these activities, coupled with the Company management’s knowledge of the areas served through the ownership and participation in Coker Fuel, allow them the insight into the potential for customer growth in these areas.[[12]](#footnote-12) Sebring’s personnel also examined each community to identify growth potential.[[13]](#footnote-13) In its response to staff’s data requests, Sebring indicated that the majority of the new commercial and industrial customers in Wauchula and Arcadia projected by the Company have either requested Sebring for service, or have already paid their deposits to Sebring; and one large industrial customer has recently become an active customer of Sebring.[[14]](#footnote-14)

Using its forecast of customer growth, Sebring calculated the number of customers billed each month and by rate class for HBY+1 and PTY. It then multiplied that number by the average usage per customer each month to determine the projected therm usage. Sebring assumed that the average usage per customer, by month, for each rate class, for the HBY, HBY+1 and PTY is unchanged from the corresponding HBY month and rate class. The Company believes that this assumption is appropriate, and is not aware of any alternate methodology that would result in a more accurate projection of therm usage.[[15]](#footnote-15) Sebring explained that 2018 is a representative year, because weather is not a primary driver of usage for the Company’s customers, and there were no unusual circumstances affecting customer usage; thus, year-over-year consumption patterns are consistent.[[16]](#footnote-16) The Company further explained that a typical driver of therm usage for residential customers in many locations in the U.S. is cold weather. However, this is not so for Sebring due to the geographical location of the Company’s service territories and the competitiveness of the electric heat pump. Sebring has very few residential customers with furnaces. Commercial usage is usually more stable as it is rare for commercial accounts to utilize natural gas for traditional space heating purposes. As a result, the driver of the therm usage, by rate class, is simply the historical average usage per customer, by month.[[17]](#footnote-17)

Based on the information provided by the Company and staff’s analyses, staff recommends that Sebring’s forecasts of customer growth and therms by rate class as contained in MFRs Schedule G-2, as revised on November 12, 2019, pages 8 and 8.5 of 31, are appropriate for the instant rate case.

Issue :

 Are Sebring's estimated revenues from sales of gas by rate class at present rates for the projected test year appropriate?

Recommendation:

 Yes. Sebring’s estimated revenues from sales of gas by rate class at present rates for the projected test year are appropriate. (Wu)

Staff Analysis:

 Staff has reviewed MFR Schedule E-2, Page 1, where Sebring calculated present revenues from sales of gas at present rates for the projected test year, in the amount of $1,171,865, based upon its proposed billing determinants. The proposed billing determinants are derived from the forecasts of the number of customers and the therm usage per customer, consistent with staff’s recommendation in Issue 2. Staff believes that the Company’s estimation of revenues, in the amount of $1,171,865, from sales of gas, by rate class, at present rates for the 2020 projected test year is appropriate. As addressed separately in Issue 13, this revenue amount, plus the amount identified as Miscellaneous Service revenue ($14,335), equals staff’s recommended projected test year total operating revenue ($1,186,200) for Sebring.

Issue :

 Is the quality of service provided by Sebring adequate?

Recommendation:

 Yes. Sebring’s quality of service is adequate. (Knoblauch, Lewis)

Staff Analysis:

 Pursuant to Section 366.041, F.S., in fixing rates the Commission is authorized to give consideration, among other things, to the efficiency, sufficiency, and adequacy of the facilities provided and the services rendered. As part of its review, Commission staff held a publicly noticed meeting in Sebring, Florida on August 8, 2019. The meeting was scheduled to gather information regarding customer concerns about Sebring’s quality of service and its request for a rate increase. No customers attended the meeting. The Company also indicated that it received no customer complaints during the years 2017 and 2018. Staff additionally searched the Commission’s Consumer Complaint Tracking System, which showed no customer complaints filed against Sebring since January 1, 2014.

Pursuant to Rule 25-7.018, F.A.C., each utility shall keep a complete record of all interruptions affecting the lesser of 10 percent or 500 or more of its division meters. Based on the Company’s filing, there were no customer interruptions affecting either 10 percent or 500 meters during the historic test year ended 2018. Pursuant to Rule 25-7.064, F.A.C., the Company has tested all of its meters within 120 months of the test year, and all have been determined to be in compliance with testing requirements.

A review of Commission staff’s annual safety inspections of the Company’s facilities was also conducted. There were a total of 29 safety violations logged against Sebring from 2014 through 2018. The Company responded to the identified violations (which were varying in nature) and all were corrected. There were no violations logged during the 2019 safety inspection, and on October 29, 2019, the system was found in satisfactory compliance with state and federal natural gas safety rules.

Conclusion

Based on a review of information discussed above, staff recommends that Sebring’s quality of service is adequate.

Issue :

 What is the appropriate amount of capital additions to be included in base rates as utility Plant in Service?

Recommendation:

 Staff recommends capital additions totaling $1,960,692 be included in rate base. (Graves, Knoblauch, Lewis)

Staff Analysis:

 Sebring’s filing included capital additions of approximately $1,960,692. Staff reviewed the Company’s filings as well as responses to data requests and recommends that the costs associated with the capital additions be included in rate base. Staff’s review of the Company’s requests is discussed in greater detail below.

Expansion Projects

The Company’s traditional service territory has been the greater surroundings of the City of Sebring. In 2008, the Company developed a growth strategy that initially targeted two state prisons. The Commission approved Sebring’s petitions for special contracts with these two prisons.[[18]](#footnote-18) As part of the Company’s MFRs, Sebring included costs related to plant additions to serve growth in its traditional service territory as well as growth in the City of Wauchula and the City of Arcadia.[[19]](#footnote-19) The total estimated cost of these additions is $1,920,692.

The Company stated that the Cities of Wauchula and Arcadia are experiencing growth in the residential, commercial, and small industrial sectors. Specifically, the Company is anticipating the addition of 55 new customers, many of which are larger commercial accounts and small industrial accounts (rate classes TS-4 and TS-5).[[20]](#footnote-20) Considering the growth potential in those areas, the Company stated that it believes it is making a prudent investment in the initial distribution networks in those cities.

As discussed in Issue 2, staff has reviewed the Company’s projected customer additions and believes that they are appropriate for the instant case. In previous decisions addressing natural gas expansion, the Commission has recognized that all customers benefit from spreading fixed costs over a larger base of therm sales in future rate cases.[[21]](#footnote-21) Additionally, the Commission has recognized that all customers benefit from large load users, such as the aforementioned large commercial and small industrial accounts, because they are able to absorb a greater portion of fixed costs necessary to provide service.[[22]](#footnote-22) Giving consideration to the discussion above, it is reasonable to believe that the Arcadia and Wauchula expansion projects will benefit all customers.

In response to a staff data request, Sebring explained that the costs associated with the requested additions are based on its recent experience with similar installations, as well as conversations with contractors and material vendors.[[23]](#footnote-23) Staff recommends that Sebring’s reliance on recent projects, as well as input from contractors and vendors, is a reasonable means for projecting these costs. Therefore, staff recommends that $1,920,692 for the discussed plant additions is appropriate for inclusion in rate base.

Bypass Re-build

In its MFRs, Sebring included $40,000 for a re-build of a regulated bypass with Peoples Gas System. Additionally, through its Distribution Integrity Management Program (DIMP) plan, Sebring has determined that the safety risk of maintaining the existing equipment is greater than the cost of replacing the equipment. Therefore, based on its DIMP plan, Sebring is required to complete the replacement as soon as is reasonable.[[24]](#footnote-24) Mr. Bruce Christmas, a consultant for the Company indicated that the bypass re-build would incorporate over-pressure protection at the interconnection, and estimated that the re-build would occur in July of the projected test year.[[25]](#footnote-25)

Conclusion

Based on staff’s analysis of the Company’s expansion projects into the City of Wauchula and the City of Arcadia, staff believes the Company’s projected customer additions and costs are appropriate for the instant case. Therefore, staff recommends that $1,920,692 for the Wauchula and Arcadia plant additions is appropriate for inclusion in rate base. Additionally, staff recommends that the cost of the regulated bypass re-build also be included, resulting in capital additions totaling $1,960,692 ($1,920,692 + $40,000).

Issue :

 What is the appropriate amount of Plant in Service for the projected test year?

Recommendation:

 Based upon analysis of the information filed in this proceeding, staff recommends $7,928,320 (13-month average) as the appropriate amount of Plant in Service for the projected test year. (Higgins)

Staff Analysis:

 This issue addresses Sebring’s forecasted amount of Plant in Service for the projected test year. In this case, Plant in Service can generally be described as the total installed cost of utility property that is projected to be used and useful in providing natural gas distribution service during the projected test year.

The Company’s requested total amount of Plant in Service for the 2020 projected test year is $7,946,544 (13-month average).[[26]](#footnote-26) Staff is recommending the Commission find $7,928,320 (13-month average), for a difference of ($18,226), as the appropriate amount of Plant in Service for the projected test year. The difference between the two figures equals staff’s recommended adjustments to Account 376.1 - Mains – Plastic and Account 380.1 - Services – Plastic.[[27]](#footnote-27) The adjustments relate to plant items/amounts for which sufficient supporting documentation was not identified (Audit Control No. 2019-170-1-1).[[28]](#footnote-28) The corresponding proposed adjustments to Accumulated Depreciation are shown and discussed in Issue 7.

Shown in Table 6-1 below are the Company proposed and staff recommended projected test year plant amounts by function.

| Table 6-1 | | | | |
| --- | --- | --- | --- | --- |
| Proposed Projected Test Year (PTY) Plant in Service Amounts | | | | |
| **Plant Accounts** | **Plant Group Classification** | **Sebring**  **PTY**  **13-Month Average** | **Proposed Staff Adjustment** | **Staff Recommended**  **PTY**  **13-Month Average** |
| 301-302 | Intangible Plant | $131,409 | $0 | $131,409 |
| 374-387 | Distribution Plant | 7,306,846 | (18,226) | 7,288,620 |
| 390-397 | General Plant | 508,289 | 0 | 508,289 |
| **Total\*** | | $7,946,544 | ($18,226) | $7,928,320 |

Source: Sebring’s proposed PTY Plant in Service amounts as shown on MFR Schedule G1-10 (revised).

\*May not sum due to rounding.

Conclusion

Based upon analysis of the information filed in this proceeding, staff recommends $7,928,320 (13-month average) as the appropriate amount of Plant in Service for the projected test year.

Issue :

 What is the appropriate amount of Accumulated Depreciation for the projected test year?

Recommendation:

 Based upon analysis of the information filed in this proceeding, staff recommends $3,041,557 (13-month average) as the appropriate amount of Accumulated Depreciation for the projected test year. (Higgins)

Staff Analysis:

 This issue addresses Sebring’s forecasted amount of Accumulated Depreciation for the projected test year. Accumulated Depreciation can generally be described as the amount of capital recovered through depreciation expense. Accumulated Depreciation represents the measure/degree of capital recovery and is subtracted from gross plant (the difference of which represents net plant).

The Company’s requested total amount of Accumulated Depreciation for the Projected Test Year is $3,036,771 (13-month average).[[29]](#footnote-29) Staff is recommending the Commission find $3,041,557 (13-month average), for a difference of $4,787, as the appropriate amount. The difference between the two figures equals staff’s recommended adjustments to Account 376.1 - Mains – Plastic, Account 380.1 - Services – Plastic, and Account 392 - Transportation Equipment – Light Trucks. The adjustments relate to plant and reserve amounts for which sufficient supporting documentation was not identified (Audit Control No. 2019-170-1-1).[[30]](#footnote-30)

Further, Sebring, through Document No. 10856-2019, adjusted (from its petition as originally filed) Account 301 - Organizational Costs by ($4,400) due to an over-accrual which occurred in December 2019. The December 2019 accrual should have been $400, rather than the $4,800 that was booked. The adjustment results in a beginning 13-month average (December 2019) amount of Accumulated Depreciation and Amortization for Account 301 - Organizational Costs of $108,602.

Shown in Table 7-1 below are the Company’s proposed and staff’s recommended projected test year Accumulated Depreciation amounts by function.

| Table 7-1 | | | | |
| --- | --- | --- | --- | --- |
| Proposed Projected Test Year (PTY) Accumulated Depreciation Amounts | | | | |
| **Plant Accounts** | **Plant Group Classification** | **Sebring**  **PTY**  **13-Month Average** | **Proposed Staff Adjustment** | **Staff Recommended**  **PTY**  **13-Month Average** |
| 301-302 | Intangible Plant | $111,002 | $0 | $111,002 |
| 374-387 | Distribution Plant | 2,645,685 | (4,543) | 2,641,142 |
| 390-397 | General Plant | 280,083 | 9,330 | 289,413 |
| **Total\*** | | $3,036,771 | $4,787 | $3,041,557 |

Source: Sebring’s proposed PTY Accumulated Depreciation amounts as shown on MFR Schedule G1-12 (revised).

\*May not sum due to rounding.

Conclusion

Based upon analysis of the information filed in this proceeding, staff recommends the Commission find $3,041,557 (13-month average) as the appropriate amount of Accumulated Depreciation for the projected test year.

Issue 8:

 What is the appropriate amount of Working Capital Allowance for the projected test year?

Recommendation:

 The appropriate amount of Working Capital Allowance for the projected test year is $147,518. (Snyder)

Staff Analysis:

 Sebring recorded Working Capital Allowance for the projected test year of $147,518.[[31]](#footnote-31) Sebring used the balance sheet method to calculate the Working Capital Allowance which is determined by subtracting projected Current Liabilities from projected Current Assets. Current assets of $351,851, less current liabilities of $204,333, results in a Working Capital Allowance of $147,518. The Working Capital Allowance has been reviewed by staff. Staff believes that no adjustments were necessary. Schedule No. 1A reflects the working capital for the projected test year. Schedule No. 1B reflects staff’s recommended Working Capital Allowance Calculation.

Issue :

 What is the appropriate amount of Rate Base for the projected test year?

Recommendation:

 The appropriate amount of Rate Base for the projected test year is $5,021,353. (Snyder)

Staff Analysis:

 Sebring recorded Rate Base of $5,044,363 for the projected test year.[[32]](#footnote-32) Based upon staff’s recommended adjustments in the preceding issues, Rate Base should be reduced by $23,010, resulting in a total Rate Base of $5,021,353. Schedule No. 1A reflects staff’s recommended Rate Base for the projected year.

Issue :

 What is the appropriate capital structure for the projected test year ending December 31, 2020?

Recommendation:

 The appropriate projected test year capital structure consists of 34.64 percent common equity, 54.73 percent long-term debt, 0.75 percent short-term debt, 3.10 percent customer deposits, and 6.78 percent deferred income taxes. Regarding investor capital, this recommended capital structure consists of 38.43 percent common equity and 61.57 percent debt (60.73 percent long-term debt and 0.84 percent short-term debt). (Richards, D. Buys)

Staff Analysis:

 For the projected test year ending December 31, 2020, Sebring filed a revised capital structure consisting of 34.63 percent common equity, 54.72 percent long-term debt and 0.75 percent short-term debt. In addition to the investor sources of capital, the Company’s capital structure also includes 3.10 percent customer deposits and 6.79 percent accumulated deferred income taxes.

Staff made two adjustments to the Company’s capital structure. First, staff made a specific adjustment to reduce the accumulated deferred income tax balance by $470 to recognize a decrease in the State of Florida corporate income tax rate from 5.50 percent to 4.458 percent for three taxable years beginning on or after January 1, 2019. This adjustment is explained in Issue 12. Second, staff made a pro rata adjustment to remove $22,540 to reflect adjustments to decrease the distribution plant balance. Staff made a corresponding pro rata adjustment to the capital structure to reconcile the capital structure balance with rate base for the projected test year ending December 31, 2020.

Accordingly, staff recommends that the appropriate projected test year capital structure consists of 34.64 percent common equity, 54.73 percent long-term debt, 0.75 percent short-term debt, 3.10 percent customer deposits, and 6.78 percent deferred income taxes. Regarding investor capital, this recommended capital structure consists of 38.43 percent common equity and 61.57 percent debt (60.73 percent long-term debt and 0.84 percent short-term debt).

Issue :

 What is the appropriate return on equity?

Recommendation:

 The appropriate return on equity is 10.00 percent with a range of plus or minus 100 basis points. (Cicchetti, D. Buys)

Staff Analysis:

 Sebring’s current authorized return on equity (ROE) is 11.50 percent with a range of plus or minus 100 basis points. In Mr. Russell Melendy’s direct testimony, the Company requested to increase its ROE to 12.50 percent to generate additional annual cash flow of approximately $17,289 to recover its deferred income tax liability of $342,671 over the next 19.8 years.[[33]](#footnote-33) Mr. Melendy stated that Sebring is a small utility and a small change in revenues or expenses can affect the achieved ROE. Mr. Melendy also stated that in previous gas utility rate cases the Commission has recognized the riskiness of investing in small investor-owned natural gas utilities, and has authorized slightly higher allowed ROEs than for the larger companies.[[34]](#footnote-34)

To evaluate the reasonableness of Sebring’s requested ROE of 12.50 percent, staff used two widely accepted financial models to calculate the required returns on equity for a proxy group consisting of four publicly traded regulated natural gas companies: Atmos Energy Corporation, Northwest Natural Gas Company, ONE Gas, Inc., and Spire, Inc. Staff applied the discounted cash flow model (DCF) and the capital asset pricing model (CAPM) to the proxy group.

The DCF model is a valuation method used to estimate the required return on an investment based on its future cash flows. DCF analysis is used to determine the required return on equity for a company today, based on projections of how much money it will generate in the future. The simple average result for the proxy group of companies using the DCF model was 7.12 percent.

The CAPM represents the relationship between systematic risk and required ROE. The CAPM is used for pricing risky stock investments and generating required returns for investments given the risk of those investments compared to the market. The simple average result for the proxy group of companies using the CAPM method was 8.48 percent.

Staff agrees that Sebring is a very small gas utility compared to other gas utilities operating in Florida and nationwide. Sebring has just over 600 customers whereas other gas utilities have thousands of customers. Staff agrees with Mr. Melendy that due to its small size, Sebring has greater relative business and financial risk than other gas utilities. Because investors require a higher return to compensate for assuming greater risk, Sebring’s greater relative business and financial risk should be reflected in the allowed return on equity. Based on the results of the DCF and CAPM models, staff believes Sebring’s requested ROE of 12.50 percent is well above the required returns on equity for an investment in comparable companies and is therefore unreasonable. However, staff believes the expected returns of 7.12 percent and 8.48 percent derived from the DCF method and CAPM reflect a ROE that is too low for the investment risk associated with Sebring.

One measure of the increased risk is the variability of earnings. Earnings variability is the fluctuation of a company's net operating income over a given period. High earnings variability is generally considered undesirable because it makes investors less certain of future earnings per share and dividends. As such, a history of earnings variability is a measure of the riskiness of an investment in a particular company. The coefficient of variation (COV) is a measure of earnings variability that allows investors to compare volatility, or riskiness between investments. As shown below, staff calculated that Sebring’s net operating income (NOI) COV for the ten-year period from 2009 through 2018 was 53 percent. In comparison, the average COV for the same period for the four largest regulated natural gas companies in Florida was 23.27 percent. Additionally, the four national publicly traded natural gas companies collectively have an average COV of 22.37 percent. A summary of staff’s analysis is presented in Table 11-1.

Table 11-1

Natural Gas Utilities NOI Coefficient of Variations

|  |  |
| --- | --- |
| **Florida Companies** | **COV** |
| Sebring Gas System, Inc. | 52.99% |
|  |  |
| Florida Division of Chesapeake Utilities Corporation | 27.22% |
| Florida City Gas | 31.83% |
| Florida Public Utilities Company | 26.51% |
| Peoples Gas System | 7.50% |
| **Simple Average** (excluding Sebring) | **23.27%** |
|  |  |
| **National Companies** | **COV** |
| Atmos Energy Corporation | 20.16% |
| Northwest Natural Gas Company | 7.37% |
| ONE Gas, Inc. | 14.04% |
| Spire Inc. | 47.92% |
| **Simple Average** | **22.37%** |

Source: FPSC Annual Reports and Securities and Exchange Commission 10K Annual Reports

Another measure of financial risk is the amount of debt in the capital structure. The greater the amount of debt, the greater the financial risk for equity investors because equity investors are subordinate to debt investors. Sebring expects to carry a debt ratio of 61.57 percent in the projected test year as compared to only 50.18 percent on average for the proxy group. Therefore, Sebring’s expected ROE should be greater than the average for the proxy group to reflect the additional financial risk.

Accordingly, staff believes a reasonable return on equity for Sebring is 10.00 percent. A ROE of 10.00 percent represents a 6.75 percent risk premium over the average forecasted 30-year U.S. Treasury Bond interest rate of 3.25 percent. The 30-year U.S. Treasury Bond is widely accepted as a risk-free rate by the financial community. The 30-year U.S. Treasury Bond interest rate as published in the October, 1, 2019 Blue Chip Financial Forecasts is forecast to be 3.00 percent in the first quarter of 2020 and increase to 3.50 percent by the first quarter of 2021 for an average of 3.25 percent.

Additionally, Regulatory Research Associates (RRA) Regulatory Focus, issued July 22, 2019, published a summary of the major rate case decisions for gas utilities from January 2019 through June 2019. The report showed that the authorized ROEs for gas utilities range from 6.00 percent to 7.00 percent above the 30-year Treasury bond interest rate.

As discussed in Issue 12, Sebring plans to add approximately $1.2 million of long-term debt to its capital structure to fund its capital projects in the projected 2020 test year. This addition of long-term debt reduces the Company’s equity ratio from 51.04 percent to 38.43 percent. The RRA Regulatory Focus, issued July 22, 2019, indicated the average allowed equity ratio nationwide was 54.60 percent for the first six months of 2019, 50.09 percent in 2018, and 49.88 percent in 2017. The average allowed ROE for gas utilities as reported by RRA during the same time period was 9.63 percent for the first half of 2019 and 9.59 percent in 2018. By comparison, Sebring has a lower equity ratio than the nationwide average gas utility and therefore is riskier than the average gas utility. Consequently, it is reasonable that an investor would require a return on equity greater than 9.63 percent to make an equity investment in Sebring.

As discussed in Issue 20, staff recommends that Sebring will incur a deferred tax liability of $342,201, which is slightly lower than the Company’s requested amount of $342,671. However, staff believes the deferred tax liability should be recovered as income tax expense and not through an increase in the ROE.

Based on the aforementioned analysis, staff believes 10.00 percent, with a range of plus or minus 100 basis points, is the appropriate return on equity for Sebring.

Issue :

 What is the appropriate weighted average cost of capital including the proper components, amounts and cost rates?

Recommendation:

 The appropriate weighted average cost of capital is 6.46 percent for the projected test year ending December 31, 2020. (Richards, D. Buys)

Staff Analysis:

 Based on the recommended capital structure in Issue 10, and the recommended cost rate for common equity in Issue 11, the appropriate weighted average cost of capital (WACC) is 6.46 percent. In Issue 10, staff is recommending an equity ratio of 38.43 percent based on investor sources. In its revised filing, Sebring requested a WACC of 7.72 percent for the projected test year. The Company based its request on a cost rate of 12.50 percent for common equity, 5.95 percent for long-term debt, and 6.00 percent for short-term debt. Staff recommends three adjustments to the Company’s requested cost rates. In Issue 11, staff is recommending a cost rate of 10.00 percent for common equity. Additionally, the cost rates for long-term debt and short-term debt should both be reduced to 5.25 percent. In addition, staff recommends two adjustments to the cost of capital balance. One, a specific adjustment to reduce the accumulated deferred income tax balance by $470, and two, a pro rata adjustment of $23,010 to reconcile the capital structure to rate base as discussed in Issue 10.

Common Equity

Sebring requested a common equity balance of $1,746,957 at a cost rate of 12.50 percent for the revised projected test year ending December 31, 2020. In Issue 11, staff is recommending a return on equity of 10.00 percent. Staff made a pro rata adjustment to reconcile the capital structure to rate base, which decreased the amount of common equity by $7,807 to $1,739,150. Accordingly, staff recommends the appropriate amount of common equity is $1,739,150 at a cost rate of 10.00 percent.

Long-Term Debt

In its filing, the Company indicated it will require additions to its long-term debt balance to fund its capital projects and construction efforts. Sebring anticipates adding approximately $1.2 million of long-term debt in the projected 2020 test year. The total amount of long-term debt in the revised projected test year ending December 31, 2020 is $2,760,453. Staff made a pro rata adjustment to reconcile the capital structure to rate base which decreased the amount of long-term debt by $12,336 to $2,748,117. In his direct testimony, Mr. Russell Melendy stated that Sebring expects to pay 6.00 percent on its loan from Heartland National Bank and the average cost of long-term debt as reflected on MFR Schedule G-3, page 3, for the projected test year is 5.95 percent. However, the loan documents provided in the staff audit indicate the interest rate charged by the bank is a variable rate based on the Prime Rate as published in the Wall Street Journal, plus 0.50 percent.[[35]](#footnote-35) As of December 3, 2019, the Prime Rate as published in the Wall Street Journal was 4.75 percent. Further, the cost rate for long-term debt in the historic base year ended December 31, 2018, was 5.45 percent. Absent any documentation to support a cost rate of 6.00 percent, staff believes a cost rate of 5.25 percent during the projected test year of 2020 is more reasonable and appropriate. Accordingly, staff recommends the appropriate amount of long-term debt is $2,748,117 at a cost rate of 5.25 percent.

Short-Term Debt

The Company included a balance of $38,077 for short-term debt on MFR Schedule G3-2, page 2 of 11, in the revised projected test year ending December 31, 2020. Staff made a pro rata adjustment to reconcile capital structure to rate base which decreased the balance by $170 to $37,907. In his direct testimony, Mr. Russell Melendy stated the appropriate cost rate for short-term debt is 6.00 percent. This is based on a $250,000 line of credit attached to the long-term debt loan agreement with Heartland National Bank.[[36]](#footnote-36) The agreement is dated July 11, 2013. The agreement indicates the interest rate for a short-term line of credit is a variable rate based on Prime Rate plus 0.50 percent. However, the effective cost rate for short-term debt in the historic test year as reflected on MFR Schedule D-3 was 3.33 percent. In response to staff’s eleventh data request, Sebring explained market conditions are the reason for the increase in the interest rate from 3.33 percent to an estimated 6.00 percent. Staff requested documentation supporting the Company’s projected interest rate of 6.00 percent. Based on documents provided with the Company’s response to staff’s eleventh data request, it appears Sebring was paying 5.75 percent as recently as August 1, 2019. Prime Rate was 5.25 percent in August 2019. As of December 3, 2019, the Prime Rate as published in the Wall Street Journal was 4.75 percent. It appears Sebring’s cost of short-term debt is the same as its long-term debt, Prime Rate, plus 0.50 percent. Accordingly, staff recommends the appropriate amount of short-term debt is $37,907 at a cost rate of 5.25 percent.

Customer Deposits

Sebring included a balance of $156,205 for customer deposits at a cost rate of 2.86 percent in the revised projected test year. Staff verified the Company calculated the interest rate in adherence to Rule 25-7.083, F.A.C., Customer Deposits, and agrees with the cost rate requested by the Company. Staff made a pro rata adjustment to reconcile capital structure to rate base which decreased the customer deposit balance by $698 to $155,507. Accordingly, staff recommends the appropriate amount of customer deposits is $155,507 at a cost rate of 2.86 percent.

Accumulated Deferred Income Taxes

The Company included a balance of $342,671 for accumulated deferred income taxes (ADITs) at a zero cost rate in its capital structure for the revised projected test year ending December 31, 2020. Staff recommends a reduction of $470 to recognize a decrease in the State of Florida corporate income tax rate from 5.50 percent to 4.458 percent for three taxable years beginning on or after January 1, 2019.[[37]](#footnote-37) Staff calculated the effect of the reduced tax rate on the ADIT balance for the calendar years 2019 through 2021. The lower tax rate resulted in a decrease of $157 per year. For the three-year period the total decrease is $470. Further, in his direct testimony, Mr. Russell Melendy stated that the Company does not anticipate an increase in the amount of ADITs during the projected test year. Staff concurs with the Company that the pro forma projects requested by the Company should not generate additional ADITs. The Tax Cuts and Jobs Act of 2017 (TCJA) eliminated gas distribution systems from qualification for accelerated depreciation for Federal income tax purposes. Under the TCJA, certain types of property are not eligible for bonus depreciation in any taxable year beginning after December 31, 2017. One such exclusion from qualified property is for property primarily used in the trade or business of the furnishing or sale of gas or steam through a local distribution system or transportation of gas or steam by pipeline. This exclusion applies if the rates for the furnishing or sale have to be approved by a Federal, state or local government agency, a public service or public utility commission, or an electric cooperative.[[38]](#footnote-38) Staff reduced the ADITs by an additional $1,529 as a result of the pro rata adjustment to reconcile capital structure to rate base. Accordingly, staff believes the appropriate ADIT balance for the revised projected test year ending December 31, 2020 is $340,672.

Conclusion

Based on the adjustments described above, staff recommends the appropriate WACC is 6.46 percent. The recommended WACC, including the proper components, amounts and cost rates are presented in Schedule No. 2.

Issue :

 Are Sebring's projected Total Operating Revenues for the projected test year appropriate?

Recommendation:

 Yes. Sebring’s projected Total Operating Revenues for the 2020 projected test year are appropriate. (Wu)

Staff Analysis:

 Staff has reviewed Sebring’s calculations presented in Document No. 10856-2019, revised MFR Schedules G-2, Page 1, and Schedule G-2, Pages 8 and 8.5 of 31. Sebring’s projected revenues from the sales of gas, in the amount of $1,171,865, and miscellaneous service revenues, in the amount of $14,335, result in total operating revenue of $1,186,200. Staff believes that the Company’s estimation of $1,186,200 total operating revenues for the 2020 projected test year is appropriate.

Issue :

 Should an adjustment be made to the number of employees in the projected test year?

Recommendation:

 Staff recommends no adjustment to the Company’s proposed number of employees. Based on staff’s recommendation in Issue 5 for approval of the expansion projects in Arcadia and Wauchula, there will be a significant increase in the territory that Sebring will be serving. Therefore, staff recommends approval of one new accounting position and two new field employees. (Knoblauch, Lewis, M. Andrews)

Staff Analysis:

 Sebring proposed to add one new accounting position to handle an increase in workload and complexity of the workload. As discussed in Issue 15, staff recommends approval of the new accounting position.

As discussed in Issue 5, Sebring has proposed two expansion projects into the cities of Arcadia and Wauchula. Sebring is proposing the addition of 10,640 feet of steel mains and 30,000 feet of plastic mains to construct its Arcadia distribution system, and 15,500 feet of plastic mains for its Wauchula distribution system. The potential number of new customers that the Company identified is 27 for Arcadia and 28 for Wauchula, which largely consists of commercial and industrial customers.[[39]](#footnote-39) Due to the addition of these distribution systems, the Company has requested two new field employees. The field employees will be responsible for tasks such as line locates, leak surveys, meter turn-ons/offs, and inspections of mains and services installations that will be completed by contractors. Additionally, these employees will be responsible for two prisons that are served by Sebring near Arcadia and Wauchula.

Based on staff’s recommendation in Issue 5 for approval of the expansion projects in Arcadia and Wauchula, there will be a significant increase in the territory that Sebring will be serving. Also, Mr. Jerry Melendy indicated that the Arcadia, Sebring, and Wauchula distribution systems are not interconnected and are therefore three separate systems. Considering the expansion of service, as well as the independent nature of the three distribution systems, staff recommends approval of the two new field employees.

Issue :

 What is the appropriate amount of salaries and benefits to include in the projected test year?

Recommendation:

 The appropriate amount of salaries and benefits for the projected test year is $513,255. (M. Andrews)

Staff Analysis:

 Sebring included $513,652 in salaries and benefits in the projected test year. Staff removed $397 related to meter readings to reclassify the expense to Account 902.

In its petition, Sebring stated that like much of the utility industry in Florida, Sebring has experienced difficulty attracting and retaining qualified personnel. In 2018, Sebring experienced turn-over in three of its six field positions. Sebring believes that keeping existing employees is more prudent because of the significant time and expense necessary to train new employees. To motivate current employees to remain and to attract qualified personnel, Sebring has plans to increase wages for employees by an average of five percent for 2019 and 2020.

Sebring projects to add two new field employees to serve customers in the previously unserved areas of Wauchula and Arcadia. The impact on Sebring’s payroll expense is projected to be $97,230 for the projected test year, of which $20,241 will be capitalized.[[40]](#footnote-40) With the projected growth and added complexity of managing a regulated natural gas company, Sebring proposes to add one accounting position with a projected salary of $50,000. In response to a staff data request, Sebring stated that the workload has increased to a level that requires the additional accounting position. The additional accounting position will ensure compliance with the complex accounting regulations.[[41]](#footnote-41)

As discussed in Issue 14, staff recommends approval of the Company’s requested positions. Also, staff believes the increase in wages to be reasonable. Therefore, the appropriate amount of salaries and benefits for the projected test year is $513,255.

Issue :

 What is the appropriate amount of Rate Case Expense to include in the projected test year and what is the appropriate amortization period?

Recommendation:

 The appropriate amount of Rate Case Expense is $151,295 to be amortized over four years. Therefore, the appropriate amount to be included in Rate Case Expense for the projected test year is $37,824 ($151,295 / 4). (D. Andrews)

Staff Analysis:

 According to the MFRs, Sebring projected Rate Case Expense of $132,500 for this proceeding. Sebring proposed a four-year amortization period, resulting in annual Rate Case Expense of $33,125.

On October 17, 2019, Sebring provided staff with an updated estimate of Rate Case Expense based on actual expense to date and an estimate to complete the case.[[42]](#footnote-42) The documentation has been reviewed by staff. Sebring projected $100,000 in consulting fees. The Company provided a flat rate contract from the consultant that matched this amount for the instant case. In the prior rate case in 2004, $40,000 in Rate Case Expense was allowed for consulting service which was primarily related to the cost of service study. In the instant case, the consultant derived Sebring’s capital costs for the Company’s expansion, detailed capital costs related to other growth, and sponsored the cost of service study. Staff believes the increase in consulting fees is reasonable due to the additional work being provided by the consultant in the instant case and inflation since the last rate case. Therefore, staff recommends no adjustments for consulting services.

Sebring initially projected $30,000 for legal fees. The updated amount for legal expenses is $50,000, including $33,000 already incurred. The contract for legal services established a “soft” cap of $50,000.[[43]](#footnote-43) Based upon the work already performed and the work expected to be performed, staff believes legal expenses of $50,000 is reasonable. Therefore, staff recommends increasing legal expenses by $20,000. Further, miscellaneous expenses were projected to be $2,500. The updated amount for miscellaneous expense is $1,295, thus miscellaneous expenses should be reduced by $1,205. The adjustments above result in an increase of $18,795 ($20,000 - $1,205). This results in a total Rate Case Expense of $151,295 ($132,500 + $18,795)

As presented in the MFRs, Sebring requested that the Rate Case Expense be amortized over a period of four years. Staff believes the four-year amortization period to be reasonable and consistent with prior Commission decisions.[[44]](#footnote-44)

Based on the above, staff recommends that the appropriate amount of Rate Case Expense is $151,295 to be amortized over four years. The appropriate annual amount to be included in Rate Case Expense is $37,824 ($151,295 / 4). Therefore, Rate Case Expense should be increased by $4,699 ($37,824 - $33,125).

Issue :

 What is the appropriate amount of O&M expenses for the projected test year?

Recommendation:

 The appropriate amount of O&M expenses for the projected test year is $741,992. (M. Andrews)

Staff Analysis:

 Sebring included $739,587 in operation and maintenance (O&M) expenses for the projected test year. As discussed in Issue 15, staff decreased salaries and benefits by $397. Also, as discussed in Issue 16, staff increased Rate Case Expense by $4,699 for the projected test year. Based on staff’s analysis, staff recommends the following additional adjustments to Sebring’s O&M expense for the projected test year.

Operation & Maintenance Expense

Meter Reading Expense (902)

Sebring included $6,596 of meter reading expense in Account 902. In analyzing Sebring’s projected test year expenses, staff determined that $397 in meter reading expense was incorrectly recorded in Account 920. Staff recommends that the projected test year meter reading expense be increased by $397, resulting in a total projected test year meter reading expense of $6,993.

Office Supplies & Expense (921)

Sebring included $35,577 in the projected test year in Account 921, Office Supplies & Expense. Included in this amount is $49 related to late payment fees, and $1,831 for lobbying activities. Staff recommends the removal of these costs, resulting in a total decrease to the projected test year Office Supplies & Expense of $1,880, resulting in staff’s recommended total projected test year Office Supplies & Expense of $33,697.

Employee Pension & Benefits (926)

The Company included $43,146 for Employee Pension & Benefits expense in the projected test year. Staff recommends reducing the projected test year expense by $413 to remove costs not applicable to the period. Projected test year Employee Pension & Benefits expense recommended by staff is $42,733.

Conclusion

Based on the above adjustments and those discussed in Issues 15 and 16, staff recommends that O&M expense be increased by $2,405 resulting in a total O&M expense of $741,992 for the projected test year ending December 31, 2020.

Table 17-1 below reflects the adjustments to Operation and Maintenance Expense.

Table -1

O&M Adjustments

|  |  |
| --- | --- |
| **Account** | **Staff**  **Adjustment** |
| 902 Meter Reading Expense | $397 |
| 920 Administrative & General Salaries | (397) |
| 921 Office Supplies & Expense | (1,880) |
| 926 Employee Pension and Benefits | (413) |
| 928 Regulatory Commission Expense | 4,699 |
| **Total** | $2,405 |

Source: Staff’s Audit Report of Sebring Gas System, Inc.

\*May not sum due to rounding.

Issue :

 What is the appropriate amount of Depreciation and Amortization Expense for the projected test year?

Recommendation:

 Based upon analysis of the information filed in this proceeding, staff recommends $260,052 as the appropriate amount of Depreciation and Amortization Expense for the projected test year. (Higgins)

Staff Analysis:

 This issue addresses Sebring’s forecasted amount of Depreciation Expense for the projected test year. Depreciation expense can generally be described as the cost of utility plant (less net salvage) recovered over the service life of the asset. In ratemaking, depreciation expense is included in the revenue requirement calculation.

The Company’s requested total amount of Depreciation and Amortization Expense for the projected test year is $260,594.[[45]](#footnote-45) Staff is recommending the Commission find $260,052, for a difference of ($542), as the appropriate amount of Depreciation and Amortization Expense for the projected test year. The difference between the two figures equals staff’s recommended adjustments to Account 376.1 - Mains – Plastic and Account 380.1 - Services – Plastic. The expense adjustments correspond to the Plant in Service findings identified in staff’s Audit Report (Audit Control No. 2019-170-1-1) filed in this proceeding.[[46]](#footnote-46) Staff notes the depreciation expense amounts were calculated using the current Commission-approved depreciation rates for Sebring.[[47]](#footnote-47)

Shown in Table 18-1 below are the Company proposed and staff recommended projected test year Depreciation and Amortization Expense amounts by function.

| **Table 18-1** | | | | |
| --- | --- | --- | --- | --- |
| **Proposed Projected Test Year (PTY) Depreciation Expense** | | | | |
| **Plant Accounts** | **Plant Group Classification** | **Sebring**  **PTY** | **Proposed Staff Adjustment** | **Staff Recommended**  **PTY** |
| 301-302 | Intangible Plant | $4,800 | $0 | $4,800 |
| 374-387 | Distribution Plant | 215,273 | (542) | 214,731 |
| 390-397 | General Plant | 40,521 | 0 | 40,521 |
| **Total** | | $260,594 | ($542) | $260,052 |

Source: Sebring’s proposed PTY Depreciation Expense amounts as shown on MFR Schedule G2-23 (revised).

\*May not sum due to rounding.

Conclusion

Based upon analysis of the information filed in this proceeding, staff recommends $260,052 as the appropriate amount of Depreciation and Amortization Expense for the projected test year.

Issue :

 What is the appropriate amount of Taxes Other Than Income (TOTI) for the projected test year?

Recommendation:

 The appropriate amount of projected test year TOTI is $22,468. (M. Andrews)

Staff Analysis:

 Sebring recorded a TOTI balance of $22,931, for the projected test year. In response to staff’s data request, Sebring provided an updated projected tangible property tax with a reduction of $463 related to the low-income housing project that decided not to use natural gas in its facilities.[[48]](#footnote-48) This adjustment results in a decrease of projected test year TOTI of $463 resulting in a TOTI balance of $22,468.

Issue :

 What is the appropriate amount of deferred income tax expense for the projected test year?

Recommendation:

 The appropriate amount of annual income tax expense associated with the amortization of accumulated deferred income taxes for the projected test year ending December 31, 2020 is $19,011. (Smith, D. Buys)

Staff Analysis:

 The Company’s current rates do not include a provision for income tax expense. Further, the Company’s rates have never included current or deferred income tax expense. The Company explained that, in earlier years, Sebring incurred negative net income which generated loss carry-forwards which offset future Federal and State income taxes. Recently, the Company began to realize positive net income which eventually eliminated the net loss carry-forwards. During this period, the Company did not recognize its Federal or State deferred tax liability in its rate filings although it took advantage of accelerated depreciation and the reduced tax liability on its Federal and State income tax filings. Consequently, the Company incurred deferred tax liabilities from the timing differences between tax and book depreciation rates but failed to recognize the deferred taxes in its rate filings. Sebring admitted it was at fault and solely responsible for the error.

Sebring calculated it has a deferred income tax balance of $342,671 that will be reversing over the next 19.8 years, or approximately $17,307 per year. The Company proposed to recover this expense through a 1.00 percent increase to its return on equity, which equates to a net income of $17,289 per year. Staff disagrees with Sebring’s proposal and believes a more appropriate method to recover the expense is to calculate the exact amount and add it to the Company’s income tax expense. As discussed in Issue 12, staff recommends a $470 reduction to the deferred income tax balance to recognize a decrease in the State of Florida corporate income tax rate from 5.50 percent to 4.458 percent for three taxable years beginning on or after January 1, 2019. Accordingly, the appropriate accumulated deferred income tax balance on Sebring’s books is $342,201 ($342,671 - $470). The deferred taxes are expected to fully reverse over the next 18 years ending in a zero balance in 2037. The Company used an amortization period of 19.8 years that begins in early 2018 and ends in 2037. Staff recommends an amortization period of 18 years beginning in 2020 and ending in 2037 to correspond to the period when the new rates will go into effect. This equates to an annual deferred income tax expense of $19,011 ($342,201 / 18 years). Accordingly, staff recommends the appropriate amount of annual income tax expense associated with the amortization of accumulated deferred income taxes for the projected test year ending December 31, 2020 is $19,011.

Issue :

 What is the appropriate amount of Total Operating Expense for the projected test year?

Recommendation:

 The appropriate amount of Total Operating Expenses for the projected test year is $1,041,548. (M. Andrews)

Staff Analysis:

 Sebring recorded Total Operating Expenses of $1,021,137 in the projected test year. The application of staff’s adjustments in Issues 15, 16, 17, 18, 19, and 20 results in an increase of $20,411. The total adjustments increase Total Operating Expenses for the projected test year to $1,041,548. Schedule No. 4 reflects the application of staff’s adjustments and staff’s recommended Total Operating Expenses for the projected test year.

Issue :

 What is the appropriate amount of Net Operating Income for the projected test year?

Recommendation:

 The appropriate amount of Net Operating Income for the projected test year is $144,652. (M. Andrews)

Staff Analysis:

 Sebring recorded a Net Operating Income of $165,063 in the projected test year. Based upon staff’s recommendations in the preceding issues, staff recommends Net Operating Income of $144,652. Schedule No. 3 reflects the Net Operating Income for the projected test year.

Issue :

 What is the appropriate net operating income multiplier?

Recommendation:

 The appropriate net income multiplier is 1.3315, as shown on Schedule No. 5. (Sewards, Norris)

Staff Analysis:

 The Company’s calculation and staff’s calculation are shown on Schedule No. 5. The only difference between the Company’s calculation and staff’s calculation is the state income tax rate. The Company used 5.5 percent for its state income tax rate; staff has reduced the tax rate to 4.458 percent. Effective January 1, 2019, the Florida corporate income tax rate was reduced from 5.5 percent to 4.458 percent. Staff has recalculated the net operating income multiplier to reflect this reduction. As such, staff recommends that the appropriate net income multiplier is 1.3315.

Issue :

 What is the appropriate annual operating revenue increase for the projected test year?

Recommendation:

 The appropriate annual operating revenue increase for the projected test year is $239,647. (M. Andrews)

Staff Analysis:

 Sebring requested an annual operating revenue increase of $302,041 in the projected test year. Based upon staff’s recommended adjustments in the preceding issues, the annual operating revenue increase is reduced to $239,647. Schedule No. 6 reflects the revenue requirement for the projected test year.

Issue :

 What is the appropriate cost of service methodology to use to allocate costs to the rate classes?

Recommendation:

 The appropriate cost of service methodology to be used in allocating costs to the various rate classes is reflected in the cost of service study contained in Attachment A. (Hampson, Coston)

Staff Analysis:

 The purpose of a cost of service study is to allocate the approved total revenue requirement of the utility system among the various rate classes. Then, base rates are designed to recover the total revenue requirement attributable to that class. Base rates for Sebring include the fixed customer charge and the variable per-therm transportation charge, which are addressed in Issues 26 and 27, respectively. In rate design, the fixed customer charge is typically determined first and represents a portion of the overall rate requirement. The per-therm transportation charge for each class is determined by taking the remaining revenue requirement, and dividing by the projected therm volume of each rate class.

On November 21 2019, Sebring filed a revised cost of service study.[[49]](#footnote-49) Staff uses Sebring’s revised cost of service methodology and incorporates the staff-recommended adjustments to rate base, rate of return, operations and maintenance expenses, total depreciation and amortization, and the resulting annual operating revenue increase, as discussed in Issue 24. As such, the staff-recommended base rates are designed to recover $1,411,514 for the 2020 projected test year.[[50]](#footnote-50) In addition to base rate revenues, Sebring projects to receive $14,335 in other operating revenues from miscellaneous service charges, for a total of $1,425,849. Staff’s cost of service study is contained in Attachment A to the recommendation.

Issue :

 What are the appropriate customer charges?

Recommendation:

 The appropriate staff-recommended customer charges for each rate class are reflected in the table below. (Hampson, Coston)

**Staff-recommended Customer Charges**

|  |  |
| --- | --- |
| **Rate Class** | **Staff-recommended Customer Charges** |
| Transportation Service 1 (TS-1) | $12.00 |
| Transportation Service 2 (TS-2) | $20.00 |
| Transportation Service 3 (TS-3) | $70.00 |
| Transportation Service 4 (TS-4) | $225.00 |
| Transportation Service 5 (TS-5) | $1,000.00 |
| Third Party Supplier (TPS) | $3.50 |
| Special Contracts | $11,906.92 |

Staff Analysis:

 The customer charge is a fixed charge that applies to each customer’s bill within a rate class, no matter the quantity of gas used for the month. The customer charge is typically designed to recover costs related to the meter, regulator, services, and billing that are incurred no matter whether any gas is consumed. For any given revenue requirement, any customer-related costs that are not recovered through the customer charge are recovered through the per-therm charge. For example, a higher customer charge results in a lower per-therm charge.

Table 26-1 shows current customer charges, the Company-proposed customer charges, and the staff-recommended customer charges. Sebring classifies customers based on annual therm usage and does not distinguish between residential and commercial customers.

Table 26-1

Customer Charges by Rate Class

|  |  |  |  |
| --- | --- | --- | --- |
| **Rate Class** | **Current Charges** | **Company-proposed Charges** | **Staff-recommended Charges** |
| Transportation Service 1 (TS-1) | $9.00 | $15.00 | $12.00 |
| Transportation Service 2 (TS-2) | $12.00 | $30.00 | $20.00 |
| Transportation Service 3 (TS-3) | $35.00 | $200.00 | $70.00 |
| Transportation Service 4 (TS-4) | $150.00 | $650.00 | $225.00 |
| Transportation Service 5 (TS-5) | $500.00 | $3,875.00 | $1,000.00 |
| Third Party Supplier (TPS) | $3.00 | $3.50 | $3.50 |
| Special Contracts | $11,633.00 | $11,913.20 | $11,906.92 |

Source: Document No. 11050-2019, Revised MFR Schedule H-3, p 5.

As shown in the table above, staff recommends lower customer charges than the Company proposed for most rate classes. Staff has concerns that by significantly shifting cost recovery from the variable charge to the fixed customer charge, lower volume customers may see substantially higher bill increases, when compared to higher volume customers.

This shift in cost recovery may benefit large volume users who can offset the overall bill increase due to the higher customer charge with lower per-therm charges. Low-volume users, however, cannot benefit to the same extent from the lower per-therm charge. The shift to a higher fixed charge reduces the lower volume customer’s ability to affect their overall bill. Additionally, a shift to higher fixed charges reduces the incentive for a customer to conserve natural gas. Staff has evaluated the Company’s proposed customer charges in light of these trade-offs for different usage levels.

The Third Party Supplier rate schedule is charged to third party suppliers who sell gas to Sebring customers. Sebring performs administrative and payment processing functions on behalf of the third party suppliers. The $3.50 is a charge per customer served by the Third Party Supplier, and represents Sebring’s administrative and billing cost to perform these tasks.

Sebring’s Justification for Shifting Cost Recovery

In his testimony, Mr. Christmas states that Sebring’s proposed customer charges are a significant shift in the recovery of its approved revenue requirement through the fixed charge component of its proposed rate structure.[[51]](#footnote-51) Mr. Christmas defines Straight Fixed Variable (SFV) rate design as recovering Sebring’s fixed costs from its customers with fixed charges.

There is some merit in his argument that a Local Distribution Company (LDC) experiences little variable cost for building and maintaining infrastructure. SFV cost allocations are also consistent with the pricing schemes approved by the Federal Energy Regulatory Commission for interstate pipelines. The customer still experiences variability due to fluctuations in the cost of gas itself; however, purchased gas costs are a separate charge on customers’ bills. Staff is cognizant of Mr. Christmas’s arguments on behalf of shifting costs from the variable per-therm charge to the fixed customer charge, under the basis of SFV rate design.

In response to staff’s tenth data request, Sebring states that a benefit of its proposed customer charges is that bills are more levelized month-to-month. Sebring finds this to be beneficial for both customer and Company, because it “simulates a budget billing program” for the customer and the Company receives a more consistent cash flow month-to-month.[[52]](#footnote-52) However, staff does not believe the above argument outweighs the impacts of abnormally large increases to some customers’ bills. Under the Company proposed rates, lower volume customers in most rate classes could experience a significant monthly rate increase.[[53]](#footnote-53) Higher volume customers, on the other hand, may experience an overall decrease in their monthly bill, depending on usage.

Section 366.06(1), F.S., states that the Commission shall to the extent practicable, consider the cost of providing service to the class, as well as the rate history, value of service, and experience of the public utility. Shifting most of the Company’s base rate costs from the variable per-therm charge to the fixed customer charge would unduly impact small use customers. These customers may not benefit from the correspondingly lower therm charge resulting from such a shift.

Staff believes a fairer approach is to set the customer charge to minimize the impact on low therm users and let the therm charge capture the balance of the class revenue requirement. This is consistent with the Commission’s decisions in the 2004 Sebring rate proceeding,[[54]](#footnote-54) the 2009 Florida Division of Chesapeake Utilities Corporation rate proceeding,[[55]](#footnote-55) and the 2007 St. Joe Natural Gas Company, Inc. rate proceeding.[[56]](#footnote-56) Staff is recommending rates that would recover a greater proportion of costs through the fixed customer charge, compared to Sebring’s current rate design. Staff’s recommended rates are an incremental shift toward recognizing the operating characteristics of LDCs while providing some stability to customer rates and minimizing impacts on low users. Attachment B shows bill comparisons between Sebring’s current rates and staff-recommended rates.

Issue :

 What are the appropriate per therm transportation charges?

Recommendation:

 The appropriate staff-recommended per therm transportation charges for each rate class are reflected in the table below. (Ward)

Staff-Recommended Transportation Charges

|  |  |
| --- | --- |
| Rate Class | Staff Recommended Transportation Charges (dollar per therm) |
| TS-1 | 0.66965 |
| TS-2 | 0.46843 |
| TS-3 | 0.52481 |
| TS-4 | 0.39922 |
| TS-5 | 0.41589 |

Staff Analysis:

 The table below shows the transportation charges that are currently in effect, Sebring’s proposed charges as contained in the revised MFR Schedule H, and the staff-recommended charges. The staff-recommended charges are subject to change based on the Commission’s vote in other issues.

Table 27-1

Transportation Charges (dollar per therm)

|  |  |  |  |
| --- | --- | --- | --- |
| Rate Class | Current Rate | Company-proposed | Staff-recommended |
| TS-1 | 0.57140 | 0.33481 | 0.66965 |
| TS-2 | 0.49327 | 0.20787 | 0.46843 |
| TS-3 | 0.46677 | 0.16529 | 0.52481 |
| TS-4 | 0.33861 | 0.09619 | 0.39922 |
| TS-5 | 0.38136 | 0.04027 | 0.41589 |

Source: Document No. 11050-2019, Revised MFR Schedule H-3, p 5.

The staff-recommended transportation charges are higher than the Company-proposed charges because staff, in Issue 26, recommended lower customer charges for certain rate classes. For any given class revenue requirement, costs not recovered through the customer charge are recovered through the per-therm transportation charge. Therefore, a lower customer charge results in higher transportation charges.

Issue :

 What is the appropriate effective date for Sebring's revised rates and charges?

Recommendation:

 The revised rates and charges should become effective for meter readings on or after 30 days following the date of the Commission vote approving the rates and charges. Sebring should file revised tariffs to reflect the Commission-approved final rates and charges for administrative approval within five business days after the Commission’s vote. Pursuant to Rule 25-22.0406(8), F.A.C., customers should be notified of the revised rates in their first bill containing the new rates. A copy of the notice should be submitted to staff for approval prior to its use. (Ward)

Staff Analysis:

 All new rates and charges should become effective for meter readings on or after 30 days from the date of the Commission vote approving them. This will insure that customers are aware of the new rates before they are billed for usage under the new rates, and prevent the billing of usage under the new rates prior to their approval.

Sebring should file revised tariffs to reflect the Commission-approved final rates and charges for administrative approval within five business days after the Commission’s vote. Pursuant to Rule 25-22.0406(8), F.A.C., customers should be notified of the revised rates in their first bill containing the new rates. A copy of the notice should be submitted to staff for approval prior to its use.

Issue :

 Should Sebring be required to notify the Commission, within 90 days after the date of the final order in this docket, that it has adjusted its books for all the applicable accounts as a result of the Commission's findings in this rate case?

Recommendation:

 Yes, Sebring should be required to notify the Commission, in writing, that it has adjusted its books in accordance with any Commission ordered adjustments. Sebring should submit a letter within 90 days of the final order in this docket, confirming that the adjustments to all the applicable accounts have been made to the Company’s books and records. In the event the Company needs additional time to complete the adjustments, notice should be provided within seven days prior to deadline. Upon providing good cause, staff should be given administrative authority to grant an extension of up to 60 days. (Final Agency Action) (M. Andrews)

Staff Analysis:

 Sebring should be required to notify the Commission, in writing, that it has adjusted its books in accordance with any Commission ordered adjustments. Sebring should submit a letter within 90 days of the final order in this docket, confirming that the adjustments to all the applicable accounts have been made to the Company’s books and records. In the event Sebring needs additional time to complete the adjustments, notice should be provided within seven days prior to deadline. Upon providing good cause, staff should be given administrative authority to grant an extension of up to 60 days.

Issue :

 Should this docket be closed?

Recommendation:

 If no person whose substantial interests are affected by the proposed agency action files a protest within 21 days of the issuance of the order, this docket should be closed upon the issuance of a consummating order. (DuVal, Dziechciarz)

Staff Analysis:

 If no person whose substantial interests are affected by the proposed agency action files a protest within 21 days of the issuance of the order, this docket should be closed upon the issuance of a consummating order.

**Sebring Gas Systems**

**Docket No. 20190083-GU**

**Rate Base Calculation**

|  |  |  |  |
| --- | --- | --- | --- |
|  | COMPANY ADJUSTED | STAFF ADJS. | STAFF ADJUSTED |
|  |  |  |  |
| **Utility Plant** |  |  |  |
| Plant in Service | $7,946,544 |  | $7,928,320 |
| 376.1 Mains -Plastic |  | ($13,804) |  |
| 380.1 Services- Plastic |  | (4,422) |  |
|  |  |  |  |
| CWIP | 0 |  | 0 |
|  |  |  |  |
| Total Utility Plant | $7,946,544 | ($18,226) | $7,928,320 |
|  |  |  |  |
| Accum. Depr. And Amor. - Plant in Service | ($3,036,771) |  | ($3,041,557) |
| 376.1 Mains - Plastic |  | 1,767 |  |
| 380.1 Services - Plastic |  | 2,776 |  |
| 392 Transportation Equip- Light Trucks |  | (9,330) |  |
|  |  |  |  |
| Customer Advances for Constr. | ($12,928) |  | ($12,928) |
|  |  |  |  |
| Total Accum. Depr. And Cust. Adv. | ($3,049,699) | ($4,787) | ($3,054,485) |
|  |  |  |  |
| Net Utility plant | $4,896,845 |  | $4,873,835 |
|  |  |  |  |
| Working Capital Allowance | $147,518 |  | $147,518 |
|  |  |  |  |
| Total Rate Base | $5,044,363 | ($23,010) | $5,021,353 |

Source: Sebring’s proposed 2020 PTY Rate Base amount as shown on Revised MFR Schedule G1-1.

\*May not sum due to rounding.

**Sebring Gas Systems**

**Docket No. 20190083-GU**

**Working Capital Calculation**

|  |  |
| --- | --- |
| CURRENT & ACCRUED ASSETS |  |
|  |  |
| CASH | $209,874 |
| ACCOUNTS REC - NATURAL GAS | 44,089 |
| ACCOUNTS REC - FUEL | 0 |
| PLANT & OPER. MATERIAL SUPPL | 94,018 |
| PREPAYMENTS | 3,870 |
|  |  |
| TOTAL CURR. & ACCR. ASSETS | $351,851 |
|  |  |
| CURRENT & ACCRUED LIABILITIES |  |
|  |  |
| ACCOUNTS PAYABLE | $142,718 |
| NP COKER - CURRENT | 0 |
| FEDERAL INCOME TAXES PAYABLE | 8,540 |
| STATE INCOME TAXES PAYABLE | 2,367 |
| ACCRUED INTEREST PAYABLE | 32,912 |
| INTEREST PAYABLE - CUST DEPOSITS | 2,556 |
| UTILITY TAX - GROSS RECEIPTS | 2,937 |
| REGULATORY ASSESSMENT | 1,784 |
| REGULATORY ASSESSMENT - ECCR | 0 |
| SALES TAX PAYABLE | 642 |
| TANGIBLE & MUT TAX PAYABLE | 9,877 |
|  |  |
| TOTAL CURR. & ACCRUED LIAB. | $204,333 |
|  |  |
| NET WORKING CAPITAL INCLUDED IN RATE BASE | $147,518 |

Source: Sebring’s proposed 2020 PTY Working Capital as shown on Revised MFR Schedule G1-3.

\*May not sum due to rounding.

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Sebring Gas System** | | | | | | | | | | | |
| **Docket No. 20190083-GU** | | | | | | | | | | | |
| **Projected Test Year 12/31/2020** | | | | | | | | | | | |
| **Capital Structure – 13-Month Average** | | | | | | | | | | | |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | **COMPANY PROPOSED** | | | | | | |  |  |  |  |
|  | **PER** | **Specific** | **PRO** |  |  | **COST** | **WEIGHTED** |  |  |  |  |
|  | **BOOKS** | **Adjustment** | **RATA** | **ADJUSTED** | **RATIO** | **RATE** | **COST** |  |  |  |  |
| COMMON EQUITY | $1,746,957 | $0 |  | $1,746,957 | 34.63% | 12.50% | 4.33% |  |  |  |  |
| LONG TERM DEBT | $2,760,453 | $0 |  | $2,760,453 | 54.72% | 5.95% | 3.26% |  |  |  |  |
| SHORT TERM DEBT | $38,077 | $0 |  | $38,077 | 0.75% | 6.00% | 0.05% |  |  |  |  |
| CUSTOMER DEPOSITS | $156,205 | $0 |  | $156,205 | 3.10% | 2.86% | 0.09% |  |  |  |  |
| DEFERRED INCOME TAX | $342,671 | $0 |  | $342,671 | 6.79% | 0.00% | 0.00% |  |  |  |  |
|  | $5,044,363 | $0 |  | $5,044,363 | 100.00% |  | 7.72% |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | **COMPANY AS FILED** | | | | **STAFF RECOMMENDED ADJUSTMENTS** | | | | | | |
|  | **PER** | **Specific** | **PRO** |  | **Specific** | **ADJUSTED** | **PRO** | **Reconciled to** |  | **COST** | **WEIGHTED** |
|  | **BOOKS** | **Adjustment** | **RATA** | **ADJUSTED** | **Adjustment** | **BALANCE** | **RATA** | **Rate Base** | **RATIO** | **RATE** | **AVG COST** |
| COMMON EQUITY | $1,746,957 | $0 |  | $1,746,957 |  | $1,746,957 | ($7,807) | $1,739,150 | 34.64% | 10.00% | 3.46% |
| LONG TERM DEBT | $2,760,453 | $0 |  | $2,760,453 |  | $2,760,453 | ($12,336) | $2,748,117 | 54.73% | 5.25% | 2.87% |
| SHORT TERM DEBT | $38,077 | $0 |  | $38,077 |  | $38,077 | ($170) | $37,907 | 0.75% | 5.25% | 0.04% |
| CUSTOMER DEPOSITS | $156,205 | $0 |  | $156,205 |  | $156,205 | ($698) | $155,507 | 3.10% | 2.86% | 0.09% |
| DEFERRED INCOME TAX | $342,671 | $0 |  | $342,671 | ($470) | $342,201 | ($1,529) | $340,672 | 6.78% | 0.00% | 0.00% |
|  | $5,044,363 | $0 |  | $5,044,363 |  |  | ($22,540) | $5,021,353 | 100.00% |  | 6.46% |

**Sebring Gas System**

**Docket No.20190083-GU**

**2020 Projected Test Year**

**Net Operating Income**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | COMPANY |  | STAFF | |
|  | PTY 2020 |  | STAFF ADJS. | STAFF ADJUSTED |
| OPERATING REVENUES | $1,033,155 |  | $0 | $1,033,155 |
| REVENUES DUE TO GROWTH | 153,045 |  | 0 | 153,045 |
| TOTAL OPERATING REVENUES | $1,186,200 |  | $0 | $1,186,200 |
|  |  |  |  |  |
| **OPERATING EXPENSES** |  |  |  |  |
| OPERATIONS AND MAINTENANCE | 739,587 |  | 2,405 | 741,992 |
| DEPRECIATION &AMORTIZATION | 260,594 |  | (542) | 260,052 |
| TAXES OTHER THAN INCOME | 22,931 |  | (463) | 22,468 |
| CURRENT FEDERAL INCOME TAX EXP. | (1,546) |  | 0 | (1,546) |
| CURRENT STATE INCOME TAX EXP. | (429) |  | 0 | (429) |
| DEFERRED FEDERAL INCOME TAX EXP. |  |  | 14,906 | 14,906 |
| DEFERRED STATE INCOME TAX EXP. |  |  | 4,105 | 4,105 |
| TOTAL OPERATING EXPENSES | $1,021,137 |  | $20,411 | $1,041,548 |
|  |  |  |  |  |
| NET OPERATING INCOME | $165,063 |  |  | $144,652 |
|  |  |  |  |  |

**Sebring Gas System**

**Docket No. 00832019-GU**

**2020 Projected Test Year**

**Operating Expenses**

|  |  |  |  |
| --- | --- | --- | --- |
|  | COMPANY ADJUSTED | STAFF ADJS. | STAFF ADJUSTED |
| OPERATING EXPENSES |  |  |  |
|  |  |  |  |
| OPERATION &MAINTENANCE EXP. | $739,587 |  |  |
| 902 Meter Reading Exp. |  | $397 |  |
| 920 Admin &Gen Salaries |  | ($397) |  |
| 921 Office Supplies Exp. |  | ($1,880) |  |
| 926 Employee Pension & Benefits |  | ($413) |  |
| 928 Regulatory Commission Exp. |  | $4,699 |  |
| TOTAL O & M EXPENSE | $739,587 | $2,405 | $741,992 |
|  |  |  |  |
| DEPRECIATION & AMORT. EXP. | $260,594 |  |  |
| 376.1 Mains - Plastic |  | ($400) |  |
| 380.1 Services - Plastic |  | ($142) |  |
| TOTAL DEPRECIATION & AMORT. | $260,594 | ($542) | $260,052 |
|  |  |  |  |
| TAXES OTHER THAN INCOME | $22,931 |  |  |
|  |  | ($463) |  |
| TOTAL TAXES OTHER THAN INCOME | $22,931 | ($463) | $22,468 |
|  |  |  |  |
| INCOME TAX EXPENSE |  |  |  |
| Income Taxes - Federal | ($1,546) |  | ($1,546) |
| Income Taxes - State | ($429) |  | ($429) |
| Deferred Income Taxes - Federal | 0 | $14,906 | 14,906 |
| Deferred Income Taxes - State | 0 | $4,105 | 4,105 |
| TOTAL INCOME TAXES | ($1,975) | $19,011 | $17,036 |
|  |  |  |  |
| TOTAL OPERATING EXPENSES | $1,021,137 | $20,411 | $1,041,548 |

**Sebring Gas System**

**Docket No. 20190083-GU**

**2020 Projected Test Year**

**Net Operating Income Multiplier**

|  |  |  |  |
| --- | --- | --- | --- |
| DESCRIPTION | COMPANY PER FILING |  | STAFF |
| REVENUE REQUIREMENT | 100.0000% |  | 100.0000% |
| REGULATORY ASSESMENT RATE | 0.5000% |  | 0.5000% |
| BAD DEBT RATE | 0.0000% |  | 0.0000% |
| NET BEFORE INCOME TAX RATE | 99.5000% |  | 99.5000% |
| STATE INCOME TAX RATE | 5.5000% |  | 4.4580% |
| STATE INCOME TAX | 5.4725% |  | 4.4357% |
| NET BEFORE FEDERAL INCOME TAXES | 94.0275% |  | 95.0643% |
| FEDERAL INCOME TAX RATE | 21.0000% |  | 21.0000% |
| FEDERAL INCOME TAX | 19.7458% |  | 19.9635% |
| REVENUE EXPANSION FACTOR | 74.2817% |  | 75.1008% |
| NET OPERATING INCOME MULTIPLIER | 1.3462 |  | 1.3315 |
|  |  |  |  |

**Sebring Gas System**

**Docket No. 20190083-GU**

**2020 Projected Test Year**

**Revenue Deficiency Calculation**

|  |  |  |  |
| --- | --- | --- | --- |
| DESCRIPTION | COMPANY ADJUSTED |  | STAFF ADJUSTED |
|  |  |  |  |
| RATE BASE (AVERAGE) | $5,044,363 |  | $5,021,353 |
| RATE OF RETURN | 7.72% |  | 6.46% |
| REQUIRED NOI | $389,425 |  | $324,629 |
| OPERATING REVENUES | $1,186,200 |  | $1,186,200 |
| OPERATING EXPENSES | $1,021,137 |  | $1,041,548 |
| ACHIEVED NOI | $165,064 |  | $144,652 |
| NOI DEFICIENCY | $224,361 |  | $179,977 |
| EXPANSION FACTOR | 1.3462 |  | 1.3315 |
| REVENUE DEFICIENCY | $302,041 |  | $239,647 |





































1. Order No. PSC-92-0229-FOF-GU, issued April 20, 1992, in Docket No. 19910873-GU, *In re: Petition for approval of initial rates to be established by Sebring Gas System, a division of Coker Fuels, Inc.* [↑](#footnote-ref-1)
2. Order No. PSC-04-1260-PAA-GU, issued December 20, 2004, in Docket No. 20040270-GU, *In re: Application for rate increase by Sebring Gas System, Inc.* [↑](#footnote-ref-2)
3. Document No. 04735-2019, Sebring’s Petition, pp. 4 – 5, and Direct Testimony of Russell Melendy, p. 15. [↑](#footnote-ref-3)
4. Id., p. 3. [↑](#footnote-ref-4)
5. Order No. PSC-19-0226-PCO-GU, issued June 12, 2019, in Docket No. 20190083-GU, *In re: Application for rate increase in Highlands, Hardee, and Desoto Counties, by Sebring Gas System, Inc.* [↑](#footnote-ref-5)
6. Sebring’s working capital had been adjusted for any disallowed items before it was combined with Sebring’s net utility plant to arrive at the Company’s 2018 historical total rate base. Document No. 04735-2019, Direct Testimony of Jerry Melendy, pp.13 – 14. [↑](#footnote-ref-6)
7. The trending methodology used is detailed in Document No. 10856-2019, revised Minimum Filing Requirements (MFR) Schedule G-2, pp. 10 – 18. [↑](#footnote-ref-7)
8. Document No. 04735-2019, Direct Testimony of Russell Melendy, pp. 2 – 4. [↑](#footnote-ref-8)
9. Document No. 10721-2019, Sebring’s Responses to Staff’s Twelfth Data Request, p. 2. [↑](#footnote-ref-9)
10. Document No. 04735-2019, Direct Testimony of Russell Melendy, p. 5. [↑](#footnote-ref-10)
11. Id. [↑](#footnote-ref-11)
12. Id., pp. 3 and 5. [↑](#footnote-ref-12)
13. Document No. 10721-2019, Sebring’s Responses to Staff’s Twelfth Data Request, pp. 2 – 3. [↑](#footnote-ref-13)
14. Id., p. 3 and Document No. 08680-2019, Sebring’s Responses to Staff’s Sixth Data Request. [↑](#footnote-ref-14)
15. Document No. 07608-2019, Sebring’s Response to Staff’s Fourth Data Request, pp. 1 – 3. [↑](#footnote-ref-15)
16. Id. [↑](#footnote-ref-16)
17. Id., pp. 2 – 3. [↑](#footnote-ref-17)
18. Order Nos. PSC-13-0367-PAA-GU, issued August 8, 2013, in Docket No. 20130079-GU, *In re: Petition for approval of special contract with the Florida Department of Corrections, by Sebring Gas System, Inc.* and PSC-13-0366-PAA-GU, issued August 8, 2013, in Docket No. 20130130-GU, *In re: Petition for approval of special contract with the Florida Department of Corrections – DeSoto Correctional Institution, by Sebring Gas System, Inc.* [↑](#footnote-ref-18)
19. Sebring’s initial filing included main costs associated with a third expansion project of its existing system. In a subsequent filing, the Company amended its request and removed main costs associated with this project. [↑](#footnote-ref-19)
20. Document No. 08680-2019, Sebring’s Responses to Staff’s Sixth Data Request. [↑](#footnote-ref-20)
21. Order Nos. PSC-93-1833-FOF-GU, issued December 27, 1993, in Docket No. 19930883-GU, *In re: Petition by Peoples Gas System, Inc. to include in rate base the calculated historic cost and cost of conversion of distribution assets* and PSC-09-0375-PAA-GU, issued May 27, 2009, in Docket No 20080366-GU, *In re: Petition for rate increase by Florida Public Utilities Company.* [↑](#footnote-ref-21)
22. Order No. PSC-10-0029-PAA-GU, issued January 14, 2010, in Docket No. 20090125-GU, *In re: Petition for increase in rates by Florida Division of Chesapeake Utilities Corporation.* [↑](#footnote-ref-22)
23. Document No. 08568-2019, Sebring’s Responses to Staff’s Fifth Data Request. [↑](#footnote-ref-23)
24. Id. [↑](#footnote-ref-24)
25. Document No. 04736-2019, Direct Testimony of Bruce Christmas. [↑](#footnote-ref-25)
26. Document No. 10856-2019, Revised MFR Schedule G-1, p. 10. [↑](#footnote-ref-26)
27. Code of Federal Regulations, Title 18, Chapter I, Subchapter F, Part 201- Uniform System of Accounts Prescribed for Natural Gas Companies Subject to the Provisions of the Natural Gas Act for further information regarding standardized accounting protocol and numeration. [↑](#footnote-ref-27)
28. Document No. 08949-2019, Staff’s Audit Report. [↑](#footnote-ref-28)
29. Document No. 10856-2019, Revised MFR Schedules G. [↑](#footnote-ref-29)
30. Document No. 08949-2019, Staff’s Audit Report. [↑](#footnote-ref-30)
31. MFR Schedule G-1, pp. 2 – 3, as revised in Document No. 10856-2019. [↑](#footnote-ref-31)
32. MFR Schedule G-1, p. 1, as revised in Document No. 10856-2019. [↑](#footnote-ref-32)
33. Document No. 04735-2019, Direct Testimony of Russell Melendy, p. 16. [↑](#footnote-ref-33)
34. Id., p. 14. [↑](#footnote-ref-34)
35. Document No. 11449-2019, Staff Audit ACN 2019-170-1-1, Work Papers 33-3 to 33-3.6. [↑](#footnote-ref-35)
36. Document No. 11449-2019, Staff Audit ACN 2019-170-1-1, Work Papers 33-3 to 33-3.6. [↑](#footnote-ref-36)
37. Section 220.1105, F.S. [↑](#footnote-ref-37)
38. IRS Code §1.168(k)-2 and §163(j)(7)(A)(iv). [↑](#footnote-ref-38)
39. Document No. 08680-2019, Sebring’s Response to Staff’s Sixth Data Request. [↑](#footnote-ref-39)
40. Document No. 04735-2019, Direct Testimony of Jerry Melendy, p. 24. [↑](#footnote-ref-40)
41. Document No. 06177-2019, Sebring’s Responses to Staff’s Second Data Request. [↑](#footnote-ref-41)
42. Document No. 09458-2019, Sebring’s Redacted Responses to Staff’s Tenth Data Request. [↑](#footnote-ref-42)
43. In the event total charges exceed $50,000, the Company and the law firm would engage in discussions to determine what changes, if any, would be appropriate. [↑](#footnote-ref-43)
44. Order Nos. PSC-04-1260-PAA-GU, issued December 20, 2004, in Docket No. 040270-GU, *In re: Application for rate increase by Sebring Gas System, Inc.* and PSC-04-0565-PAA-GU, issued June 2, 2004, in Docket No. 20030954-GU, *In re: Petition for rate increase by Indiantown Gas Company.* [↑](#footnote-ref-44)
45. Document No. 10856-2019, Revised MFR Schedule G-2, p. 23. [↑](#footnote-ref-45)
46. Document No. 08949-2019, Staff’s Audit Report. [↑](#footnote-ref-46)
47. Order No. PSC-16-0574-PAA-GU, issued December 19, 2016, in Docket No. 20160174-GU, *In re: Request for approval of 2016 depreciation study by Sebring Gas System, Inc.* [↑](#footnote-ref-47)
48. Document No. 11050-2019, Sebring’s Responses to Staff’s Fourteenth Data Request. [↑](#footnote-ref-48)
49. Document No. 11050-2019, Revised MFR Schedule H-3, p. 5. [↑](#footnote-ref-49)
50. $1,411,514 = $1,171,865 (Issue 3) + $239,647 (Issue 24) [↑](#footnote-ref-50)
51. Document No. 04736-2019, Direct Testimony of Bruce Christmas, pp. 18-20. [↑](#footnote-ref-51)
52. Document No. 09451-2019, Sebring’s Responses to Staff’s Tenth Data Request. [↑](#footnote-ref-52)
53. Document No. 09001-2019, Sebring’s Responses to Staff’s Ninth Data Request, based on actual monthly customer therm usage in the 2018 Historic Base Year. [↑](#footnote-ref-53)
54. Order No. PSC-04-1260-PAA-GU, issued December 20, 2004, in Docket No. 20040270-GU, *In re: Application for rate increase by Sebring Gas System, Inc.* [↑](#footnote-ref-54)
55. Order No. PSC-10-0029-PAA-GU, issued January 14, 2010, in Docket No. 20090125-GU, *In re: Petition for increase in rates by Florida Division of Chesapeake Utilities Corporation*. [↑](#footnote-ref-55)
56. Order No. PSC-08-0436-PAA-GU, issued July 8, 2008, in Docket No. 20070592-GU, *In re: Petition for rate increase by St. Joe Natural Gas Company, Inc.* [↑](#footnote-ref-56)