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BEFORE THE FLORIDA PUBLIC SERVICE

COMMISSION

In re: Request for rate increase DOCKET NO. 000768-GU

by City Gas Company of Florida. ORDER NO. PSC-01-0316-PAA-GU

ISSUED: February 5, 2001

The following Commissioners participated in the disposition of this matter:

E. LEON JACOBS, JR., Chairman J. TERRY DEASON LILA A. JABER BRAULIO L. BAEZ

NOTICE OF PROPOSED AGENCY ACTION

- **ORDER GRANTING REQUEST FOR RATE INCREASE**
-

BY THE COMMISSION:

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

CASE BACKGROUND

This proceeding commenced on August 25, 2000, with the filing of a petition for a permanent rate increase by City Gas Company of Florida, an operating division of NUI Corporation. (City or the Company). City requested an increase of \$7,181,988 in additional annual revenues. The Company based its request on a 13-month average rate base of \$113,986,770 for a projected test year of September 30, 2001. The requested overall rate of return is 7.88% based on an 11.70% return on equity.

The company also requested an interim increase of \$1,886,605, which was granted in Order No. PSC-00-2101-PCO-GU, issued November 6, 2000. It calculated the interim increase using a 13-month average rate base of \$94,745,493, at a 6.99% rate of return using a 10.30% return on equity. The interim test year is the period ended September 30, 1999.

City was last granted a rate increase in November 1996 in Docket No. 960502-GU. In Order No. PSC-96-1404-FOF-GU, issued November 20, 1996, the Company's jurisdictional rate base was found to be \$91,911,029 for the projected test year ending September 30, 1997. The authorized rate of return was found to be 7.87% for the test year using an 11.30% return on equity.

Pursuant to Section 366.06(4), [Florida Statutes](#), City requested to proceed under the rules governing Proposed Agency Action (PAA). Under this section, if a decision on a proposed rate increase is not made within five months of the filing, the utility is entitled to place the proposed rates in effect under bond or corporate undertaking. We have jurisdiction under Section 366.04, 366.05 and 366.06, [Florida Statutes](#).

Customer service hearings were held in Miami on October 23, 2000, in Port St. Lucie on October 24, 2000, and in Viera on October 25, 2000. Two customers attended the hearing in Miami.

I. QUALITY OF SERVICE

City's quality of service was reviewed by analyzing all complaints taken by our Division of Consumer Affairs for the period January, 1999, through the end of November, 2000. There were a total of 86 inquiries regarding City for this period. Of these, three were for complaints for which we did not have jurisdiction. Of the 83 complaints that were jurisdictional, four were considered to be rule violations. One of these violations involved the incorrect calculation of the deposit to be returned at the termination of service, and three involved misreading gas meters registering usage. All four rule violations were resolved to the customer's satisfaction in a timely manner. Since there were only four complaints involving rule violations, and there does not appear to be a continuing pattern to the complaints, we find that City's quality of service is satisfactory.

II. PROJECTED TEST PERIOD

The Company used actual data for the 1999 test year rate base, net operating income and capital structure. The projected test year was prepared using the components of City's budgeting process for 2000, updated for cost increases and planned staffing levels, then trended. The 1999 and certain plant additions for the first nine months of fiscal year 2000 have been analyzed and audited by the Commission.

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 in effect. New rates for City will go into effect 30 days after the January 16, 2000 agenda, or about February 15, 2000. City's 2001 fiscal year begins October 1, 2000 and ends September 30, 2001. Therefore, fiscal 2001 is an appropriate test year.

In the following discussion, we find that certain adjustments must be made to City's projected test year. With the inclusion of these adjustments, we find that 1999 and the projections of City's financial operations for 2001 are accurate enough to use as a basis for setting rates.

III. GROWTH AND THERM FORECAST

The Company is proposing to construct a natural gas pipeline in three phases from western West Palm Beach to Ft. Myers Shores, a distance of approximately 150 miles. The Company will construct Phases I and II concurrently from West Palm Beach to South Bay, a distance of approximately 105 miles. Phase III will be constructed from South Bay to Ft. Myers Shores, a distance of approximately 42 miles. The project is referred to as the Clewiston Pipeline Expansion Project.

The pipeline will pass through the communities of Belle Glade, Clewiston, South Bay, and La Belle, and the Company intends to serve hospitals, correctional facilities, and other commercial facilities along the pipeline. However, the main reason the Company is constructing the pipeline is the potential to provide service to several large citrus and sugar cane processors in the area. These processors presently are not being served by natural gas. The Company is confident, based on its initial surveys, that there is enough interest in taking gas service by them, and several other larger commercial accounts, that the project will be successful. At this time, the Company has no plans to serve any residential customers.

The customer and therm test year forecasts by rate class submitted in MFR Schedule G-2, pages 6-11 of 34, reflect additional customer and therm growth associated with the Clewiston Pipeline Expansion Project during the last 4 months of the test year. We find that these additional customers and therm sales shall be annualized for rate setting purposes to reflect a full 12 months sales on a going forward basis.

The Company's response to Staff's Request for Production of Documents (POD) No. 28 indicates that two rate classes are affected by this adjustment. This response lists projected annualized customer growth and therm sales associated with the pipeline extension by rate class and by customer. The Company requested that this information be treated as proprietary business information. The impact of this adjustment would increase test year revenues by \$1,866,852. This increase is addressed in more detail below.

IV. RATE BASE

In its MFRs, the Company included the rate base additions, revenues and expenses associated with the Clewiston Pipeline Expansion Project. The Company assumed that the project will be under construction, and not placed into service until June, 2001, of the test year, so revenues for the project are far smaller than would occur if the project was operational for a full year. The Company also provided the rate base additions, revenues and expenses on an annualized basis, which assumes a full year of operation for the project.

We find that for the purpose of setting rates, it is appropriate to reflect the first full year of operations, that is, the project shall be reviewed on an annualized basis to properly account for the project. Therefore, Plant in Service shall be increased by \$13,355,569, Construction Work In Progress (CWIP) shall be reduced by \$5,232,615, Depreciation Expense shall be increased by \$418,278, and Accumulated Depreciation shall be increased by \$272,832. In addition, revenues shall be increased by \$1,866,852. No adjustment shall be made to O&M Expenses or Taxes-Other since the MFR amounts were already stated on an annualized basis.

Upon review of the Company's projected plant additions for 2000 and the 2001 projected test year, and a subsequent audit, we determined that a number of projects were either canceled or delayed. This impacts the Company's 2001 projected test year and results in our requiring adjustments to reduce CWIP by \$35,000, Plant in Service by \$465,675, Accumulated Depreciation by \$12,254, and Depreciation Expense by \$14,228.

In March 1998, the Company purchased the GDU propane system in Martin County for \$1,132,220. The purchase price exceeded the net book value of the system, resulting in the excess being booked as an acquisition adjustment. After the sale of a propane delivery truck, the resulting acquisition adjustment amounted to \$745,001.

The existing propane system served approximately 1,200 customers, all of whom switched over to natural gas when it became available. The Company already had an existing line that passed through the GDU property, and the Company indicates that there are other opportunities for expansion into areas which are contiguous to the GDU purchase area. The system consisted of all underground mains and service pipes to individual homes in the four separate parcels that make up the GDU property.

City also provided revenue projections for both the projected test year and for 2002. Revenues for GDU for 2001 are projected to be \$302,000, with an increase to \$327,000 in 2002.

The Company also stated that had it built a new system to serve these customers, it would have cost two to three times as much per mile as it paid for the existing propane system. As a result, the cost per mile was less than the average embedded cost of City's system. This purchase enabled the Company to continue its growth in the Port St. Lucie area at a far lower cost that it would have incurred had it built a new system. The conversion also resulted in lower rates for the existing customers, because propane costs are far higher than natural gas, and the fixed costs of the system were spread over a larger base of customers. The customers did not incur any significant additional costs, as most, if not all, of the existing appliances were convertible to natural gas for a few dollars per unit.

A system that is converted to natural gas has a higher level of reliability and safety, which benefits the ratepayers of the system as well. Natural gas customers have a steady supply of gas and are usually not effected by weather conditions. Natural gas systems are regulated to a greater degree and the nature of the gas itself tends to be safer for end users.

Considering the additional safety, reliability, and lower cost of purchasing an existing system rather than constructing a new system, we find that the Company shall be allowed to recover this acquisition adjustment.

The Vero Beach lateral was originally built by Florida Gas Transmission Company (FGT) to serve a power plant in Vero Beach. Over time, this lateral was no longer needed by FGT, and FGT placed the lateral on the market for sale. City purchased this line in April 1996 for \$182,010. Since the system had a zero book value, the resulting acquisition adjustment amounted to \$182,010. For the projected test year, City expects this lateral to generate \$235,000 in revenues, and for 2002 the revenue is expected to more than double to \$550,000.

This line currently serves a number of commercial customers along State Road 60, a major road in the Vero Beach area. This area has experienced rapid growth and the Company expects that this growth will continue, as indicated by the revenue projections above. City also stated that the lateral was situated exactly where

City would have built an extension to serve customers if it had constructed the lateral.

The Company acquired the lateral for approximately 20% of what it would have cost had it built a new line to serve this area. The cost per mile of this lateral has the effect of lowering the embedded cost per mile of City's system, which benefits all of its ratepayers as its fixed costs are spread over a larger customer base.

The Company is expanding its system in its existing areas as new developments or potential commercial areas are developed. This lateral is located in a high growth area and will serve a large number of commercial customers in the future. The Company expects to connect several hundred additional homes in two housing developments west of Vero Beach.

As stated above, the purchase of this lateral enables the Company to expand its system at a fraction of the cost of new construction, and provides a high level of reliability and safety to its customers, and the Company expects the growth generated by this lateral to continue. For these reasons, this acquisition shall be allowed in rate base.

The Homestead lateral was originally constructed by FGT to provide service to a local power plant. Over time, this lateral was no longer needed to provide this service. It was sold to City in January, 2000, for \$450,000. City incurred additional costs of \$103,572 in purchasing the lateral. Since the lateral had no book value, the total acquisition adjustment was \$553,572. The Company projects that revenues generated by this lateral will be \$96,000 in the projected test year, and more than doubling to \$225,000 in 2002.

This lateral is approximately 16 miles in length and parallels US Highway 1 for much of its length. This addition to its system expands the territory the Company can serve by about 100 square miles. This territory covers an area of Dade County which the Company says it would have been unable to serve if they had to construct a new lateral. As is the case for the Vero Beach acquisition mentioned above, the Company was able to purchase the line for approximately one quarter to one fifth of the cost of new construction.

It allows the Company to pursue growth in areas that it would otherwise be unable to enter if it had to construct new facilities. City's existing facilities are too far north of this area to presently justify expansion into the Homestead area. However, the purchase price of this system, and its location in the US1 corridor, made it financially viable to purchase and pursue future growth opportunities in this area.

The Company anticipates that this area will experience a great deal of growth in the future, as the revenue projections above indicate. Even now, the Company is providing service to two large accounts, Kendall Foods and the Miami Water & Sewer Authority. Additionally, the Company is providing service to other smaller commercial accounts such as fast food restaurants, motels, and grocery stores. The company expects to begin residential service in 2002. As mentioned above, this purchase allows the Company to spread fixed costs over a larger customer base, and provide the higher reliability and degree of safety that a regulated natural gas company can provide. For these reasons, we find that the Homestead acquisition shall be allowed in rate base.

The Company's projected plant retirements are based on its construction budget. We find this projection acceptable.

Rule 25-12.045(1)(c), *Florida Administrative Code*, requires the physical retirement of service lines that have been inactive for more than five years. City has no service lines that have been inactive for more than five years. Therefore, no rate base adjustment is necessary.

The majority of common plant is allocated based on square footage and use. The square footage allocations of certain plant accounts were changed, which increased utility plant by \$332,984, Depreciation Reserve by \$230,822, and Depreciation Expense by \$40,787. CWIP shall be reduced \$18,278.

A portion of common plant is allocated based on a three-factor method incorporating payroll, plant, and number of customers which was approved in the Company's last rate case. This method was modified with regard to the allocation of customers. Under the modified approach, a customer is counted as either a regulated-only customer, an appliance-only customer, or a dual customer. Dual customers are considered to contribute 50% of their share of overhead, each to regulated and non-regulated operations. Each class of customer is considered to have an equal impact on overhead. Presently, there are no appliance-only customers.

Based on the Company's most recent actual numbers for each of the three factors, the overall non-utility percentage increased to 16.626% from 16.14% which was used in the last rate case. The Company, however, used 13.0% to allocate this portion of common plant to non-utility operations. To allocate using 16.626%, an adjustment shall be made to decrease plant by \$165,352, Depreciation Reserve by \$77,109, Depreciation Expense by \$6,903, and CWIP by \$6,357.

Other Equipment (Account 387) was reviewed and it was determined \$5,842 of minicorders, dollies, tools, and other equipment were not used and useful for utility purposes and therefore, a recommendation was made that it be removed from Plant. Additionally, Depreciation Reserve would be reduced by \$5,831. The effect to Depreciation Expense is immaterial.

Structures and Improvements (Account 390) associated with the 1995 renovation of the company's 1001 Office were retired when the company let its lease expire. The Code of Federal Regulations (CFR), 18 CFR 201, dictates that plant retirements are accounted for by debiting Depreciation Reserve and crediting Plant by the book cost of the plant, \$197,284. However, \$49,321 is the utility portion which shall be removed from Plant. Similarly, the \$49,321 is the utility portion of Depreciation Reserve which shall be removed from Plant. The undepreciated amount of the non-utility portion of book cost, \$130,503 shall be recorded as a loss in non-utility. The net reduction to utility Depreciation Expense is \$1,233 (\$4,931 is the total.)

According to the aforementioned adjustments, the total adjustments to Plant, Depreciation Reserve, and Depreciation Expense are increases of \$112,469, \$98,561, and \$32,651, respectively. The total adjustment to CWIP is a reduction of \$24,635.

The proportion of NUI Plant, Depreciation Reserve, and Depreciation Expense allocated down to the Company's non-utility operations represents 11.1% of the total amount allocated to the Company's utility and non-utility operations. Based upon the three-factor method discussed above, the proportion allocated to non-utility shall be 16.626%. The adjustment necessary to do this is a reduction to Plant, Depreciation Reserve, and Depreciation Expense of \$243,427, \$97,107, and \$35,549, respectively.

The total amount of CWIP for the projected test year is a fallout issue, based on adjustments discussed above. CWIP shall be reduced by \$5,232,615 in the Clewiston Pipeline Expansion Project; reduced by \$35,000 for canceled and delayed projects; and reduced by \$24,635 to reflect non-utility operations. The total of these adjustments is \$5,292,250. The appropriate amount of CWIP for the projected test year is \$1,417,684 (\$6,709,934-\$5,292,250).

The appropriate amount of Total Plant for the projected test year is \$185,784,407. This is a calculation based upon the decisions discussed above.

The appropriate projected test year Depreciation Reserve is \$68,397,507. This is a calculation based upon decisions discussed above. The projected test year Depreciation Reserve shall be increased \$272,832 for Accumulated Depreciation associated with the Clewiston Pipeline Expansion Project; decreased \$12,254 for Accumulated Depreciation related to canceled and delayed projects; increased \$98,561 for Accumulated Depreciation related to non-utility operations; and decreased \$97,107 for Depreciation Reserve related to non-utility operations. The total of these adjustments is an increase of \$262,032. Therefore, the appropriate amount of the Depreciation Reserve for the projected test year is \$68,397,507.

\$1,223,629 of Working Capital was allocated at 12.5%, or \$152,594 to non-utility operations. An additional \$50,487 shall be removed from utility to adjust the non-utility portion of Working Capital to 16.626% based on the three-factor allocation method discussed above.

Accounts Receivable - Other and Materials and Supplies were not allocated to non-utility at all. These accounts shall be reduced \$56,435 and \$178,532, respectively to adjust the portion of non-utility to 16.626%.

The Company has included \$270,557 in Account 870, Supervision and Engineering, for project development costs for the projected test year. Based on documentation provided, these costs consist of labor, car allowances, training, administrative, communications, travel, outside consultants and materials and supplies. Prior to 2000, the Company expended all of these costs. In 2000, however, the Company began to capitalize some of these costs as preliminary survey and investigation charges in compliance with the Uniform System of Accounts.

The Uniform System of Accounts under Balance Sheet Account 183.2, Other Preliminary Survey and Investigation Charges, states:

This account shall be charged with all expenditures for preliminary survey plans, investigations, etc. made for the purpose of determining the feasibility of utility projects under contemplation, ..."

If construction results, this account shall be credited and the appropriate utility plant account charged. If the work is abandoned, the charge shall be made to Account 426.5 - Other Deductions, or the appropriate operating expense account.

The \$270,557 in Account 870 represents the total amount of the charges allocated to the Company by NUI without any amounts being capitalized. On an actual basis for 2000, approximately 30% of the actual expenses for project development have been capitalized. It is difficult to determine whether this percentage is reasonable given the fact that there is no prior history to which it can be compared. Based on the facts as known, however, we find an adjustment shall be made to capitalize 30% of the charges included in the projected test year. Therefore, expenses shall be reduced by \$81,167 and working capital shall be increased by \$40,584. In addition, the Company shall establish specific guidelines for determining which expenses shall be capitalized and for determining when a project shall be considered abandoned and when the associated capitalized expenses shall be charged to operating expenses.

We find that the appropriate projected test year Working Capital is \$3,543,416. This is a calculation based upon the decisions made to reflect non-utility operations, corporate allocations, project development costs and the amortization of the gain on the sale of the Medley property.

We find that the appropriate projected test year Rate Base is \$120,930,316. This is a calculation based upon decisions discussed above.

V. COST OF CAPITAL

City proposed a return on equity (ROE) of 11.7%. In his deposition, Witness Roger Morin stated that he arrived at his recommendation of 11.7% by performing five risk premium analyses. The first two risk premium analyses are the Capital Asset Pricing Model (CAPM) and an empirical CAPM. The other three risk premium analyses were performed on prospective, historical, and allowed risk premium data from the natural gas distribution industry aggregate data. In addition, Mr. Morin performed a Discount Cash Flow (DCF) analysis on three surrogates for City's gas distribution business which included: a group consisting of the natural gas distribution utilities that make up Moody's natural gas distribution utility index, a group of generation divested electric utilities, and City's parent company, NUI. Mr. Morin's models use July, 2000, market data and allow for a 5% flotation cost, i.e., the cost to shareholders of issuing common stock.

The results of Mr. Morin's risk premium and DCF analyses range from 10.2% to 13.1%. Mr. Morin states that the midpoint for the risk premium models and the CAPMs is 11.1% and that the midpoint for the selected DCF models is 12.6%. He recommends the average of these two midpoints of 11.7% as his estimate of the appropriate ROE for City.

For his CAPM, Mr. Morin used a beta of .66 and a market risk premium of 6.9% derived from a historical risk premium and prospective DCF model. With a flotation cost adjustment of 5%, the CAPM result is 10.9%. Mr. Morin's analysis, using the empirical CAPM, produced a return of 11.4%. At deposition, Mr. Morin stated that the difference between the traditional CAPM analysis and his empirical CAPM analysis is intended to compensate for what he believes is a downward bias reflected in beta statistics that are less than 1.0.

Concerning the other three risk premium models, prospective, historical, and allowed, the prospective risk premium result of 10.2% is the most useful. The historical risk premium models are based on historical, earned returns which include several years when negative risk premiums occurred, i.e., bond returns exceeded earned returns on stocks. Prospectively, such a result is illogical since common stock is riskier than bonds and, therefore, investors require a higher return for common stock. In addition, using allowed returns in a risk premium model is circular. The allowed returns may be based on the analysis of previous stipulated ROEs, which may or may not be based on financial market data.

Mr. Morin's DCF results for Moody's index of natural gas distribution companies, generation divestiture electric utilities and City's parent company, NUI, used two different recognized earnings growth rates, IBES and Value Line. The results for the three groups mentioned and the two growth rates ranged from a high of 18.9% to a low of 12.4%. Analysts differ on what the appropriate growth rate shall be for the DCF model. Mr. Morin uses a projected earnings growth rate in his DCF model. Mr. Morin's DCF results would have been lower if a dividend growth rate, instead of an earnings growth rate, was used in his models.

The required return depends on investor expectations and can be estimated using financial models that, in turn, use inputs from the stock and bond markets. The required return is the minimum return necessary to attract capital. Investors' required return for an investment is the appropriate measure for deciding the appropriate cost rate for common equity because it meets the capital attraction and comparable risks standards of the Hope and Bluefield cases. A projected earnings growth rate is one type of growth rate that can be used in a DCF model to calculate a company's ROE. One criticism of using projected earnings growth is that it is more volatile than dividend growth rates. By using a dividend growth rate, a more stable and measurable stream of return can be estimated to match investors' expectations.

Regarding the risk position of City, the business risk of local distribution companies (LDCs) has increased due to some remaining uncertainties surrounding open access, competition from fuel oil and propane, and greater bargaining power of customers and suppliers. In addition, the Commission's recent decision to allow all non-residential customers to choose their natural gas supplier shall raise competition between marketers and LDCs, in turn exerting a downward pressure on natural gas prices (Docket No. 960725-GU, Order No. PSC-00-0630-FOF-GU). Mr. Morin testifies that City's financial risk is above average due to a lower than average common equity ratio and its small size. Mr. Morin further remarks that, although a slightly higher return would be warranted for City due to its size, the risk is largely offset by the favorable regulatory environment under which the company operates.

Ultimately, deciding the appropriate cost rate for common equity is a subjective process. In our opinion, Mr. Morin's DCF results would provide a lower return if a dividend growth rate instead of an earnings growth rate were used. We believe that an earnings growth rate is more volatile than a dividend growth rate. We believe using a dividend growth rate produces a more measurable stream of return in which to provide a better estimate of investors' expectations. In addition, we take exception with Mr. Morin's use of the historical and allowed risk premium models because of the inclusion of negative risk premiums in the historical risk premium model and the allowed risk premium model's circularity.

We believe that Mr. Morin's CAPM and prospective risk premium models provide a reasonable range for the cost of common equity. Therefore, we believe it is appropriate to average Mr. Morin's CAPM and prospective risk premium models to calculate an ROE. In addition, we will make an adjustment for City's smaller size and less than average equity ratio. Averaging Mr. Morin's risk premium models and adjusting for a smaller equity ratio would result in a cost rate for common equity of 11.5%. By using this method, we believe it allows for consideration of City's financial risk and meets the capital attraction and comparable risks standards of the Hope and Bluefield cases.

Our decisions typically allow a range for ROE of plus or minus 100 basis points for regulatory purposes such as measuring earnings and setting interim rates. Therefore, we find that the appropriate cost rate for common equity be 11.5%, plus or minus 100 basis points.

Per MFR Schedule G-3, Page 2 of 11, the Company proposes to include accumulated deferred taxes of \$10,488,832 in its projected 2001 test year capital structure. The accumulated deferred taxes have been specifically identified. Consistent with its last two rate cases, the per book amount, \$20,221,678, is reduced a total of \$9,732,846 for the taxes related to the NUI acquisition adjustment (\$5,939,530) and its non-utility leased appliance operations (\$3,793,316).

Per MFR Schedule G-3, Page 2 of 11, consistent with its last two rate cases, the Company proposes to include ITCs of \$883,654 in its projected 2001 test year capital structure at zero cost. The ITCs have been

specifically identified. We find that the amount and the cost rate, as filed, are appropriate.

Per MFR Schedule G-3, Page 2 of 11, the Company proposes to include accumulated deferred taxes of \$10,488,832 in its projected 2001 test year capital structure. This \$10,488,832 includes FAS 109 regulatory assets and liabilities. As such, the Company has appropriately reflected FAS 109 in its capital structure, such that it is revenue neutral.

In previous City rate cases, the company had agreed to use NUI's ratios of investors' sources of capital in its capital structure. NUI is the source of investor capital for City. Therefore, the company filed a subsidiary capital structure using the ratios of investor sources of capital adjusted to reflect NUI's capital structure.

NUI's capital structure was projected for the test year by including debt and common stock issues subsequent to the base year and allowing for the amortization of existing debt. An amount for leased appliances was removed directly from NUI's equity before calculating an equity ratio of 43.38%. By using these calculated ratios, City adjusted its capital structure to reflect the relative ratios of investor capital maintained at the parent company level. City then removed the total dollar amount of leased appliances, on a pro-rata basis, from its rate base. Although, it has been the Commission's practice to remove all non-utility investment at the company level specifically from common equity, there have been concerns with the low equity ratio of City. Consequently, we believed it to be prudent to allow the pro-rata adjustment of non-utility investments in City's capital structure over investor sources. This treatment is consistent with our decision in Order No. PSC-94-1570-FOF-GU issued December 19, 1994, regarding one of City Gas' previous rate cases. In addition, the company specifically removed the deferred tax amounts associated with the non-utility leased appliances in the capital structure.

In its MFRs, the company did not include capital leases in the calculation of its long-term debt. We believe capital leases shall be treated as debt. Therefore, specific adjustments have been made to investor sources to compensate for the inclusion of capital leases in the calculation of long-term debt. The resulting adjustment to NUI's ratio of investors' sources resulted in a change to its equity ratio from 43.38% to 43.49%. Capital leases are a form of long-term debt and shall be included in the calculation of long-term debt for capital structure purposes.

City is a wholly-owned subsidiary of NUI, which provides all investor capital to its subsidiaries. City has been financed entirely with common equity by its parent company. Therefore, for ratemaking purposes, we find that the appropriate capital structure for City's projected test year ending September 30, 2001, shall be based on the relative percentages of investor capital maintained at the parent level. City specifically identified the balances for ITCs, deferred income taxes, and customer deposits. The appropriate capital structure for City is discussed in more detail above.

Based on the utility's MFR filing and including the adjustment to long-term debt, the appropriate weighted average cost of long-term debt is 6.58%. Pro-rata adjustments were then made over investor sources to reconcile capital structure to rate base. We believe that the company's cost rate for customer deposits of 6.73%, is reasonable. In addition, we agree with the company that the ITCs and deferred taxes should have a zero cost rate. As was previously discussed, 11.50% is the appropriate cost rate for common equity.

Based on the relative amounts of investor capital, ITCs, deferred income taxes, customer deposits and the respective cost rates discussed above, the resulting weighted average cost of capital is 7.88%. Attachment 2 shows the components, amounts, cost rates and weighted average cost of capital associated with the September 30, 2001, projected test year capital structure.

VI. NET OPERATING INCOME

The Company made adjustments to remove \$25,129,968 in cost of gas revenues; \$25,004,943 in cost of gas and \$125,025 in taxes - other; which remove the effect of cost of gas, in net operating income. We find that these adjustments are appropriate.

Additionally, the Company made adjustments to remove \$2,319,744 in conservation revenue; \$2,308,203 in conservation expenses and \$11,541 in taxes - other; which removes the effect on conservation in net operating income. We find that these adjustments are appropriate.

We have reviewed the Company's revenues for the projected test year as filed and is no adjustment is necessary. However, several changes will be made as a result of annualizing the effects of the Clewiston Pipeline Expansion Project. We find that the revenues shall be increased by \$1,866,852 to recognize this change. Therefore, we find that the appropriate amount of projected test year total Operating Revenues is \$35,441,489.

In August, 1997, the Company sold its Medley property for a gain of \$788,169. The Company properly recorded the amount attributed to the regulated portion of \$180,556 above the line. City did not amortize any portion of this gain. In some cases, we have amortized gains on sales of property over five years, with the unamortized portion of the gain included in working capital as a cost-free liability. This regulatory treatment was stated in Order No. 11628, issued February 17, 1983, for Florida Power Corporation. The order stated "We are amortizing these gains/losses over a five-year period. In addition, we are also including the unamortized portion of these gains as cost-free current liabilities in the Company's working capital allowance...".

Had the company actually begun to amortize the gain in August, 1997, the remaining 13-month average unamortized balance for the 2001 test year would have been \$48,148. For ratemaking purposes, the five-year amortization period of the gain should have begun in August, 1997. Including this amount as a liability in working capital has the effect of reducing working capital. Therefore, the rate base shall be reduced by \$48,148 on a 13-month average basis.

An additional adjustment related to this transaction is the yearly amortization amount of \$36,111 ($\$180,556/5=\$36,111$). Amortization of gains are considered a "contra" expense. Therefore, we find that expenses shall be reduced by \$36,111 for the yearly amortization that was not recognized in the Company's filing.

This adjustment was also made to the Company's interim request, Order No. PSC-00-2101-PCO-GU, issued November 6, 2000.

Common expenses totaling \$3,382,957 shall be allocated to non-utility at 16.626% based on the three-factor method discussed above. The Company allocated these expenses 10.5% on average. The adjustment necessary to allocate these expenses at 16.626% to non-utility operations is a decrease of \$206,963.

Non-utility insurance expense recorded in a subaccount of Account 924, Property Insurance, was not

removed from expenses. An adjustment shall be made to remove non-utility insurance expense in the amount of \$37,557.

The Company did not allocate a portion of bill production and postage to non-utility. The Company stated that it includes a line on the utility bill for the appliance charge only as a convenience to its customers. Alternatively, the Company could give its appliance customers a coupon book with which to remit their monthly payments. The Company stated that it could produce and mail a coupon book for an annual charge of \$0.60 per appliance customer or \$23,352 in total. We find that reducing expenses of \$23,352 for 100% of the appliance business's avoided cost is appropriate.

The Company removed \$260,908 for projected test year expenses for membership dues, charitable contributions, and lobbying expenses representing expenses allocated from NUI to City. Based on information provided by the Company, \$4,685 in additional expenses recorded in Account 930.2, Miscellaneous General Expenses, should have been removed from 1999 expenses or \$4,970 after trending for similar type expenses.

Account 926, contains \$803,844 in expenses related to benefits for City employees, and \$1,313,407 for the allocated amount for NUI employees. The amounts in the MFRs were based on the Company's preliminary budget. These amounts were later revised downward to \$606,876 and \$964,731, respectively. In addition, the Company removed \$934,629 in expenses which related to non-regulated employees. An examination of the revised budgeted amounts indicated that the revised numbers did not include any non-regulated expenses, so the adjustment to remove the \$934,629 in expenses was made in error. The revised budget amount ($\$803,844 - \$606,876 + \$1,313,407 - \$964,731$) decreases expense by \$545,644. The improper removal of expenses for non-regulated employees increases expenses by \$934,629. The net increase to Account 926 is \$388,985 ($\$934,629 - \$545,644$).

Also, the Company included a reduction of benefits for capitalized labor in the amount of \$142,992, based on a 35% benefits rate on a capitalized labor amount of \$408,548. The revised budget amount of capitalized labor is \$460,268. The associated benefits are 38% based on 1999 actual data. Therefore, capitalized benefits shall be \$174,902 ($\$460,268 \times 38\%$). This recalculation decreases expense by \$31,910 ($\$174,902 - \$142,992$). This recalculation increases capitalized labor. As a result, Plant in Service is increased by \$31,910.

The Company had projected that it would incur total rate case expense of \$369,000, amortized over three years, with \$75,000 of this amount projected to be incurred if this case goes to hearing. The Company now projects a total rate case expense of \$339,905, assuming a hearing is not requested.

The documentation supplied by City has been reviewed, and the expenses incurred by the Company appear to be reasonable and prudent. A four year amortization period is appropriate for two reasons. It has been four years since City filed for a rate increase, and a four year amortization period was approved for the Florida Division of Chesapeake Utilities Corporation in Order No. PSC-00-2263-FOF-GU, issued November 28, 2000. We find that Account 928, Regulatory Commission Expenses, shall be reduced \$38,024, i.e., $[(\$369,000/3) - (339,905/4)]$, for the projected test year to reflect the reduced level of rate case amortization.

The company projected \$840,000 in bad debt expense for the year 2001, an increase of \$332,000 from 1999 to 2001. The company projected its bad debt expense to increase only \$15,240 from 1999 to 2000.

Witness Clancy stated on pages 16 and 17 of his testimony that "the increase is a result of a significant deterioration in the company's customer account collections in 2000 and its current delinquencies in its Miami Division. Write-offs for the past year have been running substantially over the historical experience, which was the basis for the uncollectible provision in 1999." The witness also states the higher level of expense in 2000 and 2001 should produce adequate allowance balances.

On pages 16 and 17 of his testimony, Witness Gruber summarized the methods the company has taken to improve its payments and collection methods to increase payment options for customers in arrears and to improve collections. The new steps to improve collections should help to reduce the uncollectible accounts in 2001 and to mitigate the tremendous projected \$332,000 increase in expense from 1999 to 2001.

In prior cases, we have tested the reasonableness of a company's bad debt expense by using a four year average of net write-offs as a percent of residential and commercial revenues. Based on this calculation for the 1997-2000 period, the average percent of net write offs is .947%. This methodology results in an allowable expense of \$542,559 for 2001. Therefore, we find that an adjustment shall be made to reduce the company's projected expense by \$297,441. This results in a reasonable amount of expense given the Company's stated goal of implementing strategies for reducing the level of bad debts. This adjustment also affects the bad debt component of the revenue expansion factor.

It should also be noted that this adjustment is for ratemaking purposes only. For surveillance, annual report and other reporting purposes, the company's actual bad debt expense shall be reported.

The Company incurred late fees of \$3,540 in the test year related to past due amounts for vehicles leased from SIS Express Car Rental, Inc., and expended to Account 880 - Other Expenses.

Late fees are penalty type expenses and should not be borne by the ratepayers. Therefore, test year expenses shall be reduced \$3,540 and projected expenses reduced \$3,775.

During the historic test year, the appliance operation was responsible for performing meter turn ons, turn offs, etc. Effective with the beginning of fiscal year ended September 30, 2000, the appliance business was separated from the utility business. The Company budgeted expenses in Account 878 - Meter and House Regulator Expenses in the amount of \$654,871 for meter turn ons, turn offs, read onlys and nonpayment turn ons for fiscal year ending September 30, 2001. Although the company budgeted for Account 878, it did not reduce the accounts where the charges for this type of work was performed. These accounts were trended and included in the expenses for projected year end 9/30/01 on MFR Schedule G-2. The total is \$217,910.

Expenses in Account 878 for projected fiscal year end 9/30/01 shall be reduced in the amount of \$217,910 to remove the effect of duplication expenses.

Monthly overhead for Utility Billing Service (UBS), an affiliate company that handles City's billing, was left in Account 921, Office Supplies and Expenses, even as the Company included it in Account 903, Customer Records and Collections Expenses. Duplicative expenses of \$213,823 related to UBS shall be removed from Account 921.

In the historical base year, City consolidated the customer care and collections operations for Elizabethtown Gas Company and City Gas Company. In the Company's process of modifying its accounts and budgets, it included expenses of \$62,885 twice. For this reason, O&M shall be reduced \$62,885.

NUI Corporate expenses allocated to the Company were charged to Account 923 and then allocated to non-utility at 11.2%. We determined the correct non-utility allocation to be 16.626% based on the three-factor allocation method explained above. Therefore, we find that an adjustment shall be made to remove \$273,202 of NUI Corporate expenses for non-utility operations. Similarly, administrative and general expenses were allocated to non-utility at 11.85%. Using the allocation rate of 16.626%, a reduction of \$33,192 to administrative and general expenses shall be made.

The Company is now using Elizabethtown Dispatching to dispatch its after-hours and emergency calls. We believe that the portion of the Elizabethtown Dispatching budget to be included in the Company's utility operations should be based on the ratio of City customers to total customers served for those periods in which City customers utilize the service adjusted for high call volume days and evenings. At present, the Company has 100,719 customers out of a total of 352,025 customers for a normal allocation rate of 28.611%. We suggest twice the allocation rate for high volume days, 57.222%.

The Company monitored the number of calls on all shifts for two weeks and found that 34% of all calls are after hours. The Company provided us with a list of days and hours when Florida operations were supported because of unusually high call volume. From July 1, 2000 to December 2, 2000, there were 16 high volume days, 8 of which were high volume during regular hours as well. It is projected that through the end of 2000, there will be 4 more high volume days, 2 of which will occur throughout regular hours as well as after hours. The calculation for City's allocation is as follows:

Budget: \$1,642,573

After-hours portion: \$558,475 (34%)

Regular-hours portion: \$1,084,098 (66%)

After-hours portion allocated to City:

$[(20/182 \text{ of days}) \times 57.222\% \times \$558,475]$

$+ [(162/182) \times 28.611\% \times \$558,475]$

= \$177,346

Regular-hours portion allocated to City:

$[(10/182) \times 57.222\% \times \$1,084,098]$

= \$34,085

Total City allocation: \$211,431.

We do not believe a portion of the regular-hours budget should be allocated to City on days when there is not unusually high call volume since City customers do not utilize the dispatching service then. Based on the preceding calculations, an adjustment shall be made to reduce dispatching expenses by \$199,623.

The Company included projected legal expenses of \$40,328 in Account 923 derived from \$38,013 of legal expenses incurred in 1999 relating to the Homestead Lateral acquisition. These costs were moved to the acquisition adjustment without being removed from Account 923. An adjustment shall be made to reduce Account 923 by \$40,328 to correct this error.

Six months of Call Center rent, \$29,911, was included in Account 931, Rents. This rent is now considered a part of NUI Corporation and is allocated to the Company at 25% in Account 903. Therefore the duplicative amount, \$29,911, shall be removed from Account 931. In addition, \$75,000 was projected for full year rent in Account 903 even though \$67,092 was actually realized. An adjustment shall be made to reduce rent by the Company's portion, or \$1,977, for this misprojection.

We find that the payroll rate increase, general inflation rate, and the customer growth rate used by the Company are appropriate.

Each O&M account was examined and the appropriate trend basis was used by the Company for each account.

The company purchased a two and a half year supply of odorant in 1998. The company included \$17,180 in Account 887 - Maintenance of Mains in 1999 and trended to \$18,226 in the projected test year.

Consistent with prior Commission decisions and in the company's last rate case, Order No. PSC-96-1404-FOF-GU, issued November 20, 1996, in Docket No. 960502-GU, the Company made an adjustment to amortize similar costs over a two year period. The company also made an adjustment, reducing expenses \$6,152 in its interim case, to amortize these costs over two and a half years. This adjustment was not made in the projected test year.

Therefore, it is appropriate to reduce 1999 expenses \$6,868 or projected expenses \$7,286 to reflect the application of the "inflation only" trend factors.

The appropriate amount of projected test year O&M expense is \$18,177,770. This is a calculation based on the decisions made above.

The appropriate amount of projected test year Depreciation and Amortization Expense is \$7,332,329. This is a calculation based on decisions discussed above. The projected test year Depreciation Expense shall be increased \$418,278 for Accumulated Depreciation associated with the Clewiston Pipeline Expansion Project; decreased \$14,228 for Accumulated Depreciation related to canceled and delayed projects; increased \$32,651 for Accumulated Depreciation related to non-utility operations; decreased \$35,549 for Depreciation Reserve related to non-utility operations; and decreased \$36,111 to amortize the gain on the sale of the Medley property. The total of these adjustments is an increase of \$365,041. Therefore, we find that the appropriate amount of the depreciation expense for the projected test year is \$7,332,329.

We find that the appropriate amount of Taxes Other Than Income Taxes is \$2,484,259. Per MFR G-2, Page 1 of 34, the Company proposes Taxes Other Than Income of \$2,523,303 for year 2001, as follows:

Payroll Taxes \$ 357,877

State Intangible 6,500

Utility Assessment (RAF) 177,379

Property Taxes 1,958,627

Sales Tax Discounts (1,080)

Use Tax 24,000

Total \$ **2,523,303**

The Utility Assessment Fees were recalculated by applying the Regulatory Assessment Fee (RAF) rate of .005 to the company adjusted revenue of \$33,574,637, resulting in Utility Assessment Fees of \$167,873, and a \$9,506 decrease to the Company requested amount of \$177,379. We also increase the Company Adjusted Revenue by \$1,866,852. Applying the .005 RAF rate to the \$1,866,852 increase in revenue, results in additional RAFs of \$9,334. The required adjustment is therefore a net decrease of \$172.

The Company proposes \$1,958,627 in property taxes. The Company did not allocate property taxes to non-utility operations. Property taxes for common plant allocated to non-utility properties are approximately \$15,261, calculated as follows:

Location Amount Non-utility % Non-utility

Miami

955 E. 25 St. \$22,526.67 41% \$ 9,235.93

Miami

933 E. 25 St. 13,606.74 19% 2,585.28

Titusville 1,239.21 58% 718.74

Rockledge 9,383.97 29% 2,721.35

Non-utility Property Taxes **\$15,261.31**

Taxes were reduced by \$15,261 for property taxes related to non-utility common plant. Projected property taxes of \$1,958,627 have been reduced by \$15,261 to \$1,943,366.

Use tax has been reduced by \$23,612. In Year 1999, the Company included \$388 in Taxes Other for Use Tax. In Year 2000, there is not adequate detail to determine the amount of Use tax in Taxes Other. In Year 2001, the Company included \$24,000 in Taxes Other for Use tax. Because we were unable to determine the reason for the increase, we reduced the Year 2001 amount to the Year 1999 amount, a reduction of \$23,612.

Our adjustments to Taxes Other reduces the Company proposed amount of \$2,523,304 by \$39,045 to the approved amount of \$2,484,259.

We find that the appropriate Income Tax Expense, including current and deferred income taxes, and interest

reconciliation is \$1,072,507. Per Company MFR G-2, Page 1 of 34, the Company requested Income Tax Expense of \$(81,193) for year 2001. Review of the Company's calculation disclosed that the Company calculated its interest reconciliation incorrectly, using an incorrect interest expense in its calculation of tax expense. To correct the Company's error and adjust for changes in rate base and capital structure, income tax expense was increased by \$40,918. In addition, Income Tax Expense was increased by \$1,112,781 for other adjustments to NOI. This increases Income Tax Expense by \$1,153,700 from \$(81,193) to \$1,072,507.

We find that the appropriate level of total operating expenses for the projected test year is \$29,066,864. This is a fallout calculation based on the decisions discussed above.

We find that the appropriate amount of projected test year Net Operating Income is \$6,374,625. (Attachment 3) This is a fallout calculation based on the decisions discussed above.

We find that the appropriate revenue expansion factor is 1.6269. Calculation of the revenue expansion factor/net operating income multiplier, as filed, and as approved, is shown on Attachment 4. The difference between the Commission and the company is the bad debt component in the expansion factor, resulting from the Commission's adjustment to bad debt expense.

We find that the appropriate projected test year revenue deficiency is \$5,132,356. This is a fallout calculation based on the decisions discussed above.

VII. INTERIM INCREASE

In this docket, the requested interim test year was the 12 months ended September 30, 1999. City was granted an interim increase by Order No. PSC-00-2101-PCO-GU, issued November 6, 2000.

Any interim increase is reviewed when final rates are derived to determine if any portion should be returned to the ratepayers. In this case, where the test period for permanent rates significantly overlap the interim period, the rate case review requirements should be used for affirmation of the interim increase.

Interim rates went into effect November 16, 2000, approximately six weeks after the beginning of the projected 2001 projected test year, and will continue for approximately three more months of the projected test year. Therefore, the test period for permanent rates includes the period interim rates are in effect. The use of information used to determine rate case requirements has been subject to investigation to determine the appropriateness for rate setting.

We find that no refund of the interim increase is required, since the increase approved for the projected test year exceeds the interim increase awarded.

VIII. REPORTING REQUIREMENTS

City will be required to submit, within 60 days after the date of the PAA Order in this docket, a description of all entries or adjustments to its future annual reports, rate of return reports, published financial statements, and books and records that will be required as a result of the Commission's findings in this rate case.

IX. RATE DESIGN AND TARIFF CHANGES

The appropriate billing determinants to be used in the projected test year are indicated on Attachment No. 6, page 15. These billing determinants include the effect of annualizing the customer and their growth associated with the Clewiston Pipeline Expansion Project.

The appropriate cost of service methodology to be used in allocating costs to the various rate classes is reflected in the Commission's cost of service study included in Attachment No. 6, pages 1-15. The study reflects the adjustments made to rate base, operations and maintenance expense, net operating income and projected test year base rate revenues.

All new rates and charges shall be effective for meter readings on or after 30 days from the date of the vote approving them. This will insure that customers are aware of the new rates prior to being billed for usage under the new rates. The rates and charges are detailed on Attachment No. 7.

Pursuant to Section 366.06(4), [*Florida Statutes*](#), if the Commission's action is protested by a party other than the utility, the utility may put its requested rates into effect under bond, escrow or corporate undertaking subject to refund. If the utility does put the rate into effect in this manner, it must first give notice to the Commission and file the appropriate tariffs. The utility must keep accurate records of amounts received in accordance with Section 366.06(3), [*Florida Statutes*](#).

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the findings of fact set forth herein are approved. It is further

ORDERED that all matters contained in the schedules attached hereto are incorporated herein by reference. It is further

ORDERED that City Gas Company of Florida's application for increased rates is hereby approved as set forth in the body of this Order. It is further

ORDERED that City Gas Company of Florida is authorized to collect increased revenues of \$5,132,356. It is further

ORDERED that no refund of the interim increase approved by Order No. PSC-00-2101-PCO-GU, issued November 6, 2000, shall be required. It is further

ORDERED that City Gas Company of Florida shall file revised tariffs reflecting the increased rates and charges approved in this Order and all other documents described herein, within 60 days from the date of this Order. It is further

ORDERED that the rate increase shall be effective on billings rendered for all meter readings taken on or after February 15, 2001. It is further

ORDERED that the provisions of this Order are issued as proposed agency action and shall become final and effective unless an appropriate petition, in the form provided by Rule 25-22.036, *Florida Administrative Code*, is received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings" attached hereto. It is further

ORDERED that this docket shall be closed upon issuance of a Consummating Order unless a person, whose substantial interests are affected by the Commission's decision, files a protest within 21 days of the issuance of the proposed agency action.

By ORDER of the Florida Public Service Commission, this 5th day of February, 2001.

/s/ Blanca S. Bayó
BLANCA S. BAYÓ, Director

Division of Records and Reporting

This is a facsimile copy. A signed copy of the order may be obtained by calling 1-850-413-6770.

(S E A L)

SOME (OR ALL) ATTACHMENT PAGES ARE NOT ON ELECTRONIC DOCUMENT.

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NOTICE OF FURTHER PROCEEDINGS

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

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

The action proposed herein is preliminary in nature. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, in the form provided by Rule 28-106.201, *Florida Administrative Code*. This petition must be received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on February 26, 2001.

In the absence of such a petition, this order shall become final and effective upon the issuance of a Consummating Order.

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

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