

State of Florida



Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

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DATE: DECEMBER 4, 2003

TO: DIRECTOR, DIVISION OF THE COMMISSION CLERK & ADMINISTRATIVE SERVICES (BAYÓ)

FROM: DIVISION OF ECONOMIC REGULATION (GARDNER, KENNY) *BB JS*
DIVISION OF COMPETITIVE MARKETS & ENFORCEMENT (P. LEE) *OK dm*
OFFICE OF THE GENERAL COUNSEL (JAEGER) *PSL*

RE: DOCKET NO. 020853-EI - 2002 DEPRECIATION FILING BY FLORIDA PUBLIC UTILITIES COMPANY. *ALM*

AGENDA: 12/16/03 - REGULAR AGENDA -PROPOSED AGENCY ACTION-INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: FEBRUARY 18-19, 2004 - RATE CASE HEARING DOCKET NO. 030438-EI, PETITION FOR RATE INCREASE BY FLORIDA PUBLIC UTILITIES COMPANY

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\WP\020853.RCM

CASE BACKGROUND

Rule 25-6.0436, Florida Administrative Code (F.A.C.), requires investor owned electric companies to file a comprehensive depreciation study at least once every four years. On July 20, 2002, Florida Public Utilities Company (FPU or company) filed its regular depreciation study for the Fernandina Beach division in accordance with this rule. On August 12, 2003, FPU updated the depreciation study to reflect the combined Fernandina Beach and Marianna electric divisions. FPU's last comprehensive depreciation study was filed on May 2, 2001, for Marianna and April 27, 1998, for Fernandina Beach.

The main emphasis of the current study is to establish depreciation rates for the combined assets of Fernandina Beach and

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Marianna and to recognize the effects of the changes brought by the combination of the two divisions. The Commission has jurisdiction in this matter through the provisions of Chapter 366, Florida Statutes, including Sections 366.04, 366.05, and 366.06, Florida Statutes.

DISCUSSION OF ISSUES

ISSUE 1: Should currently prescribed depreciation rates of Florida Public Utilities Company be changed?

RECOMMENDATION: Yes. A comprehensive review of Florida Public Utilities' (FPU or company) planning and activity for the combined electric divisions indicates a need for a revision in currently prescribed depreciation rates. (GARDNER, P. LEE)

STAFF ANALYSIS: FPU operates two electric divisions, Marianna and Fernandina Beach. FPU's last comprehensive depreciation study was filed for the Marianna division on May 2, 2001, with an effective date for revised depreciation rates of January 1, 2002. The last depreciation study for Fernandina Beach was filed on April 27, 1998, with an effective date for revised depreciation rates of January 1, 1999. For each of the electric divisions, separate depreciation rates have historically been maintained for the investments. The current study represents the consolidation of investments, reserves, and activity for the two divisions. Also, this consolidation is consistent with the company's filed application for a rate increase in which it has asked for the two systems to be consolidated for ratemaking purposes. This case is scheduled to be addressed in February 2004 in Docket No. 030438-EI, Petition For Rate Increase By Florida Public Utilities Company. The depreciation rates currently applied to the Fernandina Beach and Marianna investments are those approved by Order No. PSC-99-0954-PAA-EI, issued May 11, 1999, Docket No. 980583-EI, In Re: 1998 depreciation study by Florida Public Utilities Company, Fernandina Beach Division, and by Order No. PSC-01-2270-PAA-EI, issued November 19, 2001, Docket No. 010669-EI, In Re: Request for approval of implementation date of January 1, 2002, for new depreciation rates for Marianna Electric Division by Florida Public Utilities Company.

In summary, this combined study affords Staff the opportunity to address the appropriate lives, salvage values, reserves, and remaining life depreciation rates for the combined divisions.

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ISSUE 2: What should be the implementation date for the new depreciation rates?

RECOMMENDATION: Staff recommends approval of the company's requested January 1, 2004, implementation date for new rates. (GARDNER, P. LEE)

STAFF ANALYSIS: FPU has proposed an implementation date for new depreciation rates of January 1, 2004. Originally, FPU proposed an implementation date of January 1, 2003. However, when the study was updated to include the Marianna assets, the company revised its proposed implementation date to January 1, 2004, for new depreciation rates for combined divisions. A January 1, 2004 date closely approximates the date of new revenues currently being addressed in Docket No. 030438-EI, Petition For Rate Increase By Florida Public Utilities Company. In keeping with Rule 25-6.0436, Florida Administrative Code (F.A.C), all supportive data and calculations coincide with this date. Staff recommends approval of a January 1, 2004 implementation date as being the earliest practicable date for utilizing the revised rates.

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ISSUE 3: Should any corrective reserve allocations between accounts be made?

RECOMMENDATION: Yes. Staff's recommended corrective measures are shown on Attachment A. This action brings each account's reserve more in line with its theoretically correct level. (GARDNER)

STAFF ANALYSIS: Reserve imbalances are primarily a matter of differences between current and past projections. This is the first overall review of FPU's combined divisions' investments and reserves. The combined effect of rates and allocations results in surpluses and deficits which should be addressed. Staff recommends corrective action only for those accounts that have significant changes and imbalances as shown on Attachment A.

In the case of FPU, a reserve deficiency is apparent for Overhead Conductors, Account 356; Line Transformers, Account 368; and Transportation-Heavy Trucks, Account 392.3. The calculated reserve surpluses existing in Station Equipment, Account 353, Overhead Conductors, Account 365, and Transportation-Light Trucks and Vans, Account 392.2, can be used to correct the accounts with deficiencies. This action will bring each affected account's reserve more in line with its calculated theoretical level.

In light of the possible impact on cost allocations, the company should make corresponding entries to the related depreciation expense accounts.

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ISSUE 4: What are the appropriate depreciation rates?

RECOMMENDATION: The staff recommended lives, net salvages, reserves, and resultant depreciation rates are shown on Attachment B. The result is an estimated decrease in annual depreciation expense of approximately \$72,000, based on January 1, 2004 combined investments as shown on Attachment C. (GARDNER, LEE)

STAFF ANALYSIS: Staff's recommendations are the result of a comprehensive review of FPU's submitted data and information for the combined electric divisions. Attachment B shows a comparison of the currently approved and recommended rate components (lives, salvages, and reserves) and rates. Currently, rates and components reflect a composite of the rates and components currently prescribed for each division. The investments and reserves reflect estimated amounts as of January 1, 2004 restated to reflect corrective measures recommended in Issue 3.

This filing was essentially a staff-assisted study. The company provided aged retirement data and the average age distributions of the surviving investments for each account for each division. Staff worked with the company in developing appropriate life and salvage values from submitted plant data. Investments, reserves, and activity were actual through September 2003 and then estimated through December 2003 on a combined electric division basis.

As a result of the review and analytical process, FPU has agreed with staff concerning life and salvage values for each account. The recommended changes in depreciation rates can be attributed mainly to (1) updated account ages to reflect activity since the last depreciation study for each division, and (2) the consolidation of Fernandina Beach and Marianna through the combining of account investments and reserves. A brief discussion of salient matters is set forth below.

Transmission Plant

Fernandina Beach is the only FPU division that has transmission assets. The retirement activity for each of the transmission accounts has been insufficient to perform any meaningful statistical analysis. This makes it necessary to rely on industry averages for life and salvage parameters. The

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recommended service life projections and net salvage for Land Rights, Account 350.1; Station Equipment, Account 353; and Overhead Conductors and Devices, Account 356, are more in line with industry averages.

Land Rights, Account 350.1

The current average age for this account's investment is 29 years. A service life of 50 years is recommended for this account as being more in line with life expectations of other regulated electric utilities in Florida. A remaining life of 21 years is recommended for this account.

Station Equipment, Account 353

The service lives for Station Equipment range from 35 to 45 years for the regulated electric utilities in Florida, with an industry average of about 41 years. Staff recommends an increase of the currently prescribed service life from 35 to 40 years which is more in line with the industry average. This account has experienced no retirement activity in the past 8 years. Additionally, the account has experienced a growth rate of 1 per cent in the last 5 years.

Overhead Conductors and Devices, Account 356

Service lives for Overhead Conductors and Devices range from 34 to 40 years for the other Florida regulated utilities, averaging about 37 years. An increase in service life from 36 to 40 years is recommended to bring this account more in line with the industry averages. There has been major growth in this account in 2002 due to completion of the re-conductoring of a single circuit 138KV transmission line and the addition of a second circuit on the line. There were no retirements for the period of 1996-2002.

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Distribution Plant

The recommended changes in the distribution plant depreciation rates reflect a move more in line with current industry expectations.

Land Rights, Account 360.1

The service lives for land rights range from 30 to 60 years throughout the regulated electric utilities in Florida. Staff recommends an average service life of 56 years which is in line with the industry average of regulated utilities in Florida. An average age of 15.6 years for the Fernandina Beach and Marianna combined assets used with a 56 year average service life results in a 40-year average remaining life.

Station Equipment, Account 362

This account has a composite service life of 32 years, but the industry expectations range from 30 to 38 years, averaging 36 years. As of the last study for Marianna, the service life of 38 years was approved, and currently this division has only 27% of the combined investments for 2004. The Fernandina Beach division has 72% of the combined plant investment but the 1998 depreciation study approved only 30 years service life. Although it may be on the high end of the industry's service life, 38 years is recommended to bring the combined investments of the divisions more in line with the industry expectations. A 38 year average service life used with an average age of 13.8 for the combined investments, results in the recommended average remaining life of 24 years.

The composite net salvage for this account is a negative 6%. Other regulated Florida companies indicate a net salvage ranging from negative 10% to positive 15%. The recommended net salvage for this combined account is negative 10% which is more in line with other electric utilities and the experience of this account.

Poles, Towers, and Fixtures, Account 364

This account experienced a 55% growth rate during the 1998-2002 period because of the replacement of many decayed poles. The removal of the poles is very labor intensive as evidenced by the 1998-2002 recorded cost of removal average, which is greater than

100% with realized gross salvage of about 5%. Retirements have averaged less than 1%. Other Florida regulated electric utilities are experiencing net salvage factors ranging from negative 25% to negative 60%, averaging negative 35%. The recommended net salvage of negative 40% gives recognition to these labor trends. Also, the recommended service life of 33 years is more in line with industry expectations.

Overhead Conductors and Devices, Account 365

The removal of this plant equipment is labor-intensive and is reflected in the account's net salvage experience. For other regulated Florida utilities, net salvage ranges from negative 5% to negative 50%, averaging negative 28%. A negative net salvage of 30% is recommended as being more in line with these trends.

Line Transformers, Account 368

The composite net salvage for this account is a negative 15%. Other Florida utilities indicate a net salvage ranging from negative 10% to negative 25%. A negative 20% net salvage is recommended which is more in line with other electric utilities and the experience of the account.

Overhead Underground Services, Account 369

Retirements averaging .06% during the 1998-2002 period have been insufficient to rely on for life and salvage determination. This makes reliance on industry average necessary. A 34 year service life and a negative 30% net salvage are recommended as being more in line with industry expectations. An average age of 12 years results in a 23 year average remaining life.

Street Lighting and Systems, Account 373

A net salvage of negative 10% is recommended as being more in line with the indicated experience of this account and other regulated electric utilities' expectations.

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General Plant

Transportation-Light Trucks and Vans, Account 392.2

The recommended service life of 8 years is in line with the retirement experience of the account. An average age of 4.1 years results in an average remaining life of 3.9 years.

Transportation-Heavy Trucks, Account 392.3

A 12 year service life is recommended as indicated by the submitted retirement data for the combined divisions. An average age of 8.3 years results in an average remaining life of 3.7 years.

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ISSUE 5: Should the current amortization of investment tax credits (ITCs) and the flowback of excess deferred income taxes be revised to reflect the approved depreciation rates and recovery schedules?

RECOMMENDATION: Yes. The current amortization of ITCs and the flowback of excess deferred income taxes (EDIT) should be revised to match the actual recovery periods for the related property. The utility should file detailed calculations of the revised ITC amortization and flowback of EDIT at the same time it files its surveillance report covering the period ending December 31, 2004. (KENNY)

STAFF ANALYSIS: In earlier issues, staff recommends revisions to the company's remaining lives, to be effective January 1, 2004. Revising a utility's book depreciation lives generally results in a change in its rate of ITC amortization and flowback of EDIT, in order to comply with the normalization requirements of the Internal Revenue Code (IRC) and underlying Regulations (REGs) found in Sections 46, 167, and 168, and 1.46, 1.67, and 1.68, respectively.

Section 46(f)(6), IRC, states that the amortization of ITCs should be determined by the period of time actually used in computing depreciation expense for ratemaking purposes and on the regulated books of the utility. Since staff is recommending a change in remaining lives, it is also important to change the amortization of ITCs to avoid violation of the provisions of sections 46 and 1.46, IRC and REGs, respectively.

Section 203(3) of the Tax Reform Act of 1986 (the Act) prohibits rapid flowback of depreciation related (protected) EDIT. Further, Rule 25-14.013, Accounting for Deferred Income Taxes Under SFAS 109, F.A.C., generally prohibits EDIT from being written off any faster than allowed under the Act. The Act, SFAS 109, and Rule 25-14.013, F.A.C., regulate the flowback of EDIT. Therefore, staff recommends that the flowback of EDIT be adjusted to comply with the Act, SFAS 109, and Rule 25-14.013, F.A.C.

Staff, the Internal Revenue Service, and independent outside auditors look at a company's books and records and at the orders and rules of the jurisdictional regulatory authorities to determine if the books and records are maintained in the appropriate manner and to determine the intent of the regulatory bodies in regard to normalization. Therefore, staff recommends that the current

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amortization of ITCs and the flowback of EDIT be revised to reflect the approved remaining lives. In order for there to be a clear audit trail, a prudent utility should revise ITCs and EDIT amortization and produce work papers to show how the revisions were made.

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ISSUE 6: 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. (JAEGER)

STAFF ANALYSIS: At the conclusion of the protest period, if no protest is filed, this docket should be closed upon the issuance of a consummating order.

RECOMMENDED RESERVE ALLOCATIONS				
	Actual 01/01/2004 Book Reserve	Theoretical Reserve	Recommended Allocations	Restated 01/01/2004 Reserve
	(\$)	(\$)	(\$)	(\$)
353 Station Equipment	860,904	697,472	(163,432)	697,472
356 OH Conductors	246,674	525,175	163,432	410,106
365 OH Conductors	4,418,287	4,040,289	(377,998)	4,040,289
368 Line Transformers	5,784,837	6,413,721	377,998	6,162,835
392.2 Light Trucks	326,279	231,848	(94,431)	231,848
392.3 Heavy Trucks	813,872	1,032,304	94,431	908,303
Total	12,450,853	12,940,809	0	12,450,853

FLORIDA PUBLIC UTILITIES
2002 DEPRECIATION STUDY
COMPARISON OF RATES AND COMPONENTS

ACCOUNT	CURRENT			STAFF RECOMMENDED			
	AVERAGE	NET	REMAINING	AVERAGE	NET	ESTIMATED	REMAINING
	REMAINING	NET	LIFE	REMAINING	NET	1/1/04	LIFE
	LIFE	SALVAGE	RATE	LIFE	SALVAGE	RESERVE	RATE
	(YRS.)	(%)	(%)	(YRS.)	(%)	(%)	(%)
TRANSMISSION PLANT							
350.1 - Land Rights	27.0	0.0	2.1	21.0	0.0	53.16	2.2
352 - Structures and Improvements	32.0	0.0	2.1	25.0	0.0	49.04	2.0
353 - Station Equipment	23.0	10.0	2.5	24.0	10.0	34.8	2.3
354 - Towers and Fixtures	28.0	(10.0)	1.8	24.0	(20.0)	67.92	2.2
355 - Poles and Fixtures	27.0	(30.0)	3.8	27.0	(30.0)	26.94	3.8
356 - Overhead Conductors and Devices	23.0	(10.0)	3.1	31.0	(20.0)	21.08	3.2
359 - Roads and Trails	18.9	0.0	3.9	13.9	0.0	46.04	3.9
DISTRIBUTION PLANT							
360.1 - Land Rights	45.0	0.0	1.9	40.0	0.0	23.56	1.9
361 - Structures and Improvements	23.0	0.0	2.2	34.0	0.0	25.28	
362 - Station Equipment	18.5	(6.0)	3.6	24.0	(10.0)	38.95	3.0
364 - Poles, Towers, and Fixtures	20.0	(26.0)	4.2	23.0	(40.0)	42.54	4.2
365 - Overhead Conductors & Devices	18.9	(27.0)	4.4	22.0	(30.0)	46.4	3.8
366 - Underground Conduit	40.0	0.0	2.0	41.0	0.0	18.94	2.0
367 - Underground Conductors & Devices	23.0	0.0	2.8	24.0	0.0	31.21	2.9
368 - Line Transformers	16.0	(15.0)	4.2	15.8	(20.0)	53.06	4.2
369 - Services	22.0	(26.0)	3.9	23.0	(30.0)	42.54	3.8
370 - Meters	15.4	(10.0)	3.6	15.4	(10.0)	54.29	3.6
371 - Installation on Customers' Premises	8.4	13.0	6.4	9.0	15.0	29.76	6.1
373 - Street Lighting & Signal Systems	15.0	(3.0)	4.7	14.6	(10.0)	28.34	5.6
GENERAL PLANT							
390 - Structures & Improvements	39.0	(3.0)	2.1	36.0	0.0	27.99	2.0
392.1 - Transportation-Cars	3.5	15.0	10.8	3.1	15.0	56.40	9.2
392.2 - Transportation-Light Trucks & Vans	2.9	10.0	13.0	3.9	10.0	45.93	11.3
392.3 - Transportation - Heavy Trucks	6.3	10.0	8.8	3.7	10.0	54.77	9.5
392.4 - Transportation - Vans	14.0	5.0	3.4	20.0	5.0	15.47	4.0
396 - Power Operated Equipment	5.3	5.0	5.4	4.3	5.0	67.71	6.3

FLORIDA PUBLIC UTILITIES
 2002 DEPRECIATION STUDY
 COMPARISON OF EXPENSES

ACCOUNT	01/01/2004 INVESTMENT	01/01/2004 RESERVE	CURRENT		STAFF RECOMMENDED		
			RATE (%)	EXPENSES (\$)	RATE (%)	EXPENSES (\$)	CHANGE EXPENSES (\$)
TRANSMISSION PLANT							
350.1 - Land Rights	56,519	30,044	2.1	1,187	2.2	1,243	56
352 - Structures and Improvements	26,401	12,948	2.1	554	2.0	528	(26)
353 - Station Equipment	2,004,229	697,472 •	2.5	50,106	2.3 *	46,097	(4,009)
354 - Towers and Fixtures	244,665	166,167	1.8	4,404	2.2	5,383	979
355 - Poles and Fixtures	2,349,304	632,892	3.8	89,274	3.8	89,274	0
356 - Overhead Conductors and Devices	1,945,093	410,106 •	3.1	60,298	3.2 *	62,243	1,945
359 - Roads and Trails	6,788	3,125	3.9	265	3.9	265	0
TOTAL TRANSMISSION PLANT	6,576,490	1,922,710		206,088		205,033	(1,055)
DISTRIBUTION PLANT							
360.1 - Land Rights	16,188	3,815	1.9	308	1.9	308	0
361 - Structures and Improvements	96,042	24,283	2.2	2,113	2.2	2,113	0
362 - Station Equipment	3,805,275	1,482,261	3.6	136,990	3.0	114,158	(22,832)
364 - Poles, Towers, and Fixtures	7,744,022	3,293,966	4.2	325,249	4.2	325,249	0
365 - Overhead Conductors & Devices	8,707,520	4,040,289 •	4.4	383,131	3.8 *	330,886	(52,245)
366 - Underground Conduit	2,193,163	415,492	2.0	43,863	2.0	43,863	0
367 - Underground Conductors & Devices	3,989,658	1,245,008	2.8	111,710	2.9	115,700	3,990
368 - Line Transformers	11,614,852	6,162,835 •	4.2	487,824	4.2 *	487,824	0
369 - Services	6,958,775	2,959,982	3.9	271,392	3.8	264,433	(6,959)
370 - Meters	3,074,461	1,669,232	3.6	110,681	3.6	110,681	0
371 - Installation on Customers' Premises	1,575,822	468,891	6.4	100,853	6.1	96,125	(4,728)
373 - Street Lighting & Signal Systems	1,104,292	312,988	4.7	51,902	5.6	61,840	9,938
TOTAL DISTRIBUTION PLANT	50,886,870	22,079,043		2,026,016		1,953,180	(72,836)
GENERAL PROPERTY							
390 - Structures & Improvements	1,363,383	381,604	2.1	28,631	2.0	27,268	(1,363)
392.1 - Transportation-Cars	96,020	54,151	10.8	10,370	9.2	8,834	(1,536)
392.2 - Transportation-Light Trucks & Vans	504,786	231,848 •	13.0	65,622	11.3 *	57,041	(8,581)
392.3 - Transportation - Heavy Trucks	1,658,320	908,303 •	8.8	145,932	9.5 *	157,540	11,608
392.4 - Transportation - Vans	107,072	16,561	3.4	3,640	4.0	4,283	643
396 - Power Operated Equipment	116,642	78,973	5.4	6,299	6.3	7,348	1,049
TOTAL GENERAL PROPERTY	3,846,223	1,671,439		260,494		262,314	1,820
TOTAL RATES	61,302,773	25,673,193		2,286,510		2,215,494	(72,017)

*Denotes restated reserve after corrective transfers.