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| State of FloridapscSEAL | Public Service CommissionCapital Circle Office Center ● 2540 Shumard Oak BoulevardTallahassee, Florida 32399-0850-M-E-M-O-R-A-N-D-U-M- |
| DATE: | March 24, 2022 |
| TO: | Office of Commission Clerk (Teitzman) |
| FROM: | Division of Economics (Smith II)Division of Accounting and Finance (D. Buys, Osorio)Office of the General Counsel (Sandy, Crawford) |
| RE: | Docket No. 20210183-GU – Petition for approval of 2021 depreciation study by Sebring Gas System, Inc. |
| AGENDA: | 04/05/22 – Regular Agenda – Proposed Agency Action - Interested Persons May Participate |
| COMMISSIONERS ASSIGNED: | All Commissioners |
| PREHEARING OFFICER: | La Rosa |
| CRITICAL DATES: | None |
| SPECIAL INSTRUCTIONS: | None |

 Case Background

Rule 25-7.045, Florida Administrative Code (F.A.C.), requires natural gas public utilities to file a comprehensive depreciation study with the Florida Public Service Commission (Commission) for review at least once every five years from the submission date of the previous study or pursuant to Commission order. Sebring Gas System, Inc.’s (Sebring or the Company) last depreciation study was filed on July 20, 2016. The Company’s 2021 depreciation study was due to be filed on or before July 20, 2021. Sebring filed its 2021 depreciation study on November 18, 2021. Staff would note that no parties were materially impacted as a consequence of the late filing.

Sebring serves approximately 711 customers, and reported 2020 operating revenues of approximately $1,242,000.[[1]](#footnote-1) Staff has completed its review of Sebring’s 2021 Depreciation Study and presents its recommendations to the Commission herein.

The Commission is vested with jurisdiction over these matters through several provisions of the Florida Statutes (F.S.), including Sections 350.115, 366.05, and 366.06, F.S.

Discussion of Issues

Issue 1:

 Should currently prescribed depreciation rates for Sebring Gas System be revised?

Recommendation:

 Yes. The review of Sebring’s plant depreciation information indicates a need for revising the Company’s currently prescribed depreciation rates. (Smith)

Staff Analysis:

 Sebring’s last depreciation study was filed on July 20, 2016. By Order No. PSC-16-0574-PAA-GU, the Commission approved revised depreciation rates that became effective January 1, 2017.[[2]](#footnote-2)

Rule 25-7.045, F.A.C., requires natural gas companies to file a comprehensive depreciation study at least once every five years from the submission date of the previously filed study or pursuant to Commission order. A review of the Company’s plant activity and data indicates the need for revising depreciation rates. Staff’s recommended depreciation components and rates are discussed in Issue 3 and shown on Attachments A, B, and C.

Issue 2:

 What should be the implementation date for newly proposed depreciation rates?

Recommendation:

 Staff recommends January 1, 2022, for implementing newly proposed depreciation rates as shown on Attachments A, B, and C to this recommendation. (Smith)

Staff Analysis:

 Rule 25-7.045, F.A.C., requires that the data submitted in a depreciation study, including plant and reserve balances or Company estimates, “shall be brought to the effective date of the proposed rates.” The supporting data and calculations provided by Sebring match an implementation date of January 1, 2022.

Issue 3:

 What are the appropriate depreciation parameters and resulting rates?

Recommendation:

 Staff recommends the Commission approve the lives, reserve percentages, net salvage percentages, and resulting remaining life depreciation rates for Sebring that are shown on Attachments A and C. As shown on Attachment B, the corresponding depreciation expense effect of staff’s rate recommendations is an increase of $4,342 annually, or 1.8 percent, based on December 31, 2021 investments. (Smith)

Staff Analysis:

 Staff’s recommendations are the result of a comprehensive review of Sebring’s plant depreciation data filed in this docket. Attachments A and C to this recommendation show a comparison of certain currently-approved depreciation parameters and rates to those staff is recommending become effective January 1, 2022 (Issue 2). Staff and the Company are in agreement on all proposed depreciation parameters and resulting rates.[[3]](#footnote-3) Displayed on Attachment B is a comparison of depreciation expenses between currently-approved and proposed rates based on December 31, 2021 investments.

The Company provided plant addition and retirement data spanning 2017-2021 (2021 projected), proposed net salvage values, proposed average service lives, and proposed Iowa-type survivor curves.[[4]](#footnote-4) With this information, staff determined the average age of investments on an account-by-account basis, then applied the results to Sebring’s proposed curve/life combinations for determining account-specific average remaining lives. Sebring’s proposed account-specific average service lives are unchanged from its prior study.

***Plant Additions***

Sebring’s total plant investment experienced moderate growth over the current study period. In its last depreciation study filing, the Company experienced substantial growth (almost 89 percent) mainly due to initiating gas service to two state correctional institutes in Hardee and Desoto Counties. The Company stated in 2016 that it did not foresee similar levels of investment growth and believed that its system would revert to more typical growth patterns for this study period.[[5]](#footnote-5) In keeping with the Company’s expectation, during the 2017-2021 period (2021 projected), the Company’s system grew by approximately 22 percent, or from approximately $5.8 million to approximately $7.1 million. Over half of this system growth is attributable to the additions within Account 376.2 – Mains – Plastic and Account 380.2 – Services – Plastic.

***Plant Retirements***

The Company’s plant has experienced minimal retirement activity over the study period. Expressed as a percentage of study period additions, plant retirements total approximately three percent from 2017-2021.[[6]](#footnote-6)

***Average Service and Remaining Lives***

Neither Sebring, nor staff, propose any changes to the Company’s currently-authorized, account-specific, average service lives. Consistent with its review of the Company’s prior depreciation study, and as mentioned above, staff computed account-specific average remaining lives (shown on Attachment A) by first aging Sebring’s projected plant investments at December 31, 2021, then applying the results to the Company’s Iowa Curve and service life selections on an account-by-account basis. From this review, staff determined that no changes were necessary to the average service lives. However, staff does recommend the Company closely monitor the life characteristics of all its investments for evaluating if any average service life adjustments are warranted as part of future depreciation studies.

***Net Salvage***

Without experiencing meaningful levels of retirement over a period of time, Company-specific net salvage investigations may prove inconclusive. Thus, staff compared the Company’s currently-authorized/proposed-for-continued-use net salvage levels to those experienced by other natural gas distribution companies. With the exception of Account 392.1 – Transportation – Trucks, staff believes Sebring’s currently-authorized/proposed net salvage values remain in line with those net salvage values currently being estimated by its industry peers and should continue to be used for applicable ratemaking purposes.

In its filing, the Company did not request any changes to its currently authorized net salvage levels.[[7]](#footnote-7) However, in response to the Staff Report[[8]](#footnote-8) and discussions between staff and Sebring’s accountant, the Company provided staff with information that substantiates the need for a lower net salvage percentage for Account 392.1 – Transportation – Trucks. Sebring stated that over the last five years, net salvage related to this account was between five and ten percent. The Company also explained that at the time of retirement, these trucks had very high mileage, which lowered the resale value.

Staff compared Sebring’s net salvage level for this account to the approved net salvage levels of three other natural gas companies in Florida. The average net salvage level for those three companies is eleven percent. Based on the above, staff recommends a ten percent net salvage value for Account 392.1 – Transportation – Trucks.

***Iowa Curves***

Sebring did not request any changes to its currently-approved application of Iowa curves to its plant accounts. As part of our review, staff evaluated each account’s projected net book value five years into the future. This timeframe matches the timing of the filing of Sebring’s next depreciation study, when staff would next have a chance to adjust Sebring’s depreciation rates. Two accounts, Accounts 380.1 – Services – Steel and 386 – Property on Customer’s Premises, indicated a negative net book value by the end of 2026 if no further investments were made in these accounts. Staff’s analysis shows that applying the S1 curve to both accounts more appropriately matches each account’s life characteristics and would prevent the probable over-depreciation issue found with maintaining the currently-approved S2 curve. Therefore, staff is recommending the application of the S1 curve to both accounts as shown on Attachment C.

***Reserve Transfers***

As part of reviewing Sebring’s 2021 Depreciation Study, staff calculated the book reserve balance of each plant account. Staff also calculated the associated theoretical reserve balance of each plant account, using the current recommended life and net salvage inputs. The difference between an account’s book and theoretical reserve amounts may be described as an imbalance, either positive or negative, or as a surplus or deficiency. When imbalances are present, corrective transfers among accounts should be considered, and if warranted, should be performed.

The specific depreciation reserve transfer proposals are presented in Table 3-1, and explained further below:

**Table 3-1**

**Accumulated Depreciation Transfers**

|  |  |  |
| --- | --- | --- |
| Acct.  | Account Title | Transfer |
| No. | Amount |
| 380.1 | Service - Steel | (100,184) |
| 380.2 | Service - Plastic | 108,283  |
| 386 | Property on Customers’ Premises | (8,099) |

Staff evaluated each account’s reserve imbalance as a percentage of its book reserve. Accounts 380.1 and 386 had the largest imbalance on a percentage basis. Therefore, staff made transfers to reduce those accounts to their theoretically correct levels. Staff then used the total from those two transfers to increase the reserve of Account 380.2 – Service – Plastic. Staff notes that its current rate recommendations incorporate all proposed reserve transfers discussed in this section.

**Conclusion**

Staff recommends the Commission approve the lives, net salvages, reserves, and resulting depreciation rates for Sebring that are shown on Attachments A and C. The expense effect of staff’s plant depreciation rate recommendations, which is shown on Attachment B, is an increase of $4,342 annually, or 1.8 percent, based on December 31, 2021 investments.

Issue 4:

 Should the current amortization of investment tax credits (ITCs) and flow back of excess deferred income taxes (EDITs) be revised to reflect the approved depreciation rates and amortization schedules?

Recommendation:

 Yes. The current amortization of ITCs should be revised to match the actual recovery periods for the related property. The Company should file detailed calculations of the revised ITC amortization at the same time it files its earnings surveillance report covering the period ended December 31, 2021, as specified in Rule 27-7.1352, F.A.C. (Osorio, D. Buys)

Staff Analysis:

 In Issue 3, staff has recommended approval of revised depreciation rates for the Company, which reflect changes to most accounts’ remaining lives to be effective January 1, 2022. Revising a utility’s book depreciation lives generally results in a change in its rate of ITC amortization in order to comply with the normalization requirements of the Internal Revenue Code (IRC or Code) set forth in Federal Tax Regulations under the Code sections,[[9]](#footnote-9) Sections 168(f)(2) and (i)(9),[[10]](#footnote-10) former IRC Sections 167(l), and 46(f),[[11]](#footnote-11) and Section 203(e) of the Tax Reform Act of 1986 (the Act).[[12]](#footnote-12)

Staff, the Internal Revenue Service (IRS), and independent outside auditors look at a company's books and records, and the orders and rules of the jurisdictional regulatory authorities to determine if the books and records are maintained in the appropriate manner. The books are also reviewed to determine if they are in compliance with the regulatory guidelines in regard to normalization.

Former IRC Section 46(f)(6) of the Codeindicated that the amortization of ITC 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.[[13]](#footnote-13) While Section 46(f)(6) was repealed, under IRC Section 50(d)(2), the terms of former IRC Section 46(f)(6) remain applicable to public utility property for which a regulated utility previously claimed ITCs. Since staff is recommending changes to the Company’s remaining lives, it is also important to change the amortization of ITCs to avoid violation of the provisions of IRC Section 50(d)(2), and its underlying Treasury Regulations. The consequence of an ITC normalization violation is a repayment of unamortized ITC balances to the IRS. Therefore, staff recommends the current amortization of ITCs should be revised to match the actual recovery periods for the related property. The Company should file detailed calculations of the revised ITC amortization at the same time it files its earnings surveillance report covering the period ended December 31, 2021, as specified in Rule 25-7.1352, F.A.C.

Issue 5:

 Should this docket be closed?

Recommendation:

 Yes. If no protest is filed by a person whose substantial interests are affected within 21 days of the issuance of the Order, this docket should be closed upon the issuance of a Consummating Order. (Sandy)

Staff Analysis:

 If no protest is filed by a person whose substantial interests are affected within 21 days of the issuance of the Order, this docket should be closed upon the issuance of a Consummating Order.







1. Sebring Gas System’s Annual Report of Natural Gas Utilities Form PSC/AFA 20, at December 31, 2020, filed with the Florida Public Service Commission on May 21, 2021. [↑](#footnote-ref-1)
2. 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 Systems, Inc.* [↑](#footnote-ref-2)
3. Sebring’s Response to 2021 Depreciation Study Staff Report, No. 2 and “Sebring March 7, 2022 Correspondence – Response to Staff Account 382.1 Depreciation Parameters” DN-01657-2022. [↑](#footnote-ref-3)
4. “Iowa-type Curves” are a widely-used group of generalized survivor curves that contain the range of survivor characteristics usually experienced by public utilities, as well as companies in other industries. [↑](#footnote-ref-4)
5. Docket No. 20160174-GU, Sebring’s Responses to Staff’s First Data Request, No. 7, DN 08031-2016. [↑](#footnote-ref-5)
6. Formula is Study Period Retirements ÷ Study Period Additions or $41,051 ÷ $1,321,694 = 3.11% [↑](#footnote-ref-6)
7. Sebring’s Petition for approval of 2021 depreciation study, filed November 18, 2021. [↑](#footnote-ref-7)
8. DN 01519-2022. [↑](#footnote-ref-8)
9. Treas. Reg. §1.168; Treas. Reg. §1.167; Treas. Reg. §1.46. [↑](#footnote-ref-9)
10. 26 US Code §§168(f)(2) and (i)(9). [↑](#footnote-ref-10)
11. Under IRC Section 50(d)(2), the terms of former 26 US Codes §167(l) and §46(f), which were repealed by the Revenue Reconciliation Act of 1990 (Pub. L. No. 101-508, §11812(a)(1-2)(1990)), remain applicable to public utility property for which a regulated utility previously claimed ITCs, which is the case here. (I.R.S. Priv. Ltr. Rul. 200933023, 1n.1 (May 7, 2009)). [↑](#footnote-ref-11)
12. Tax Reform Act of 1986, Pub. L. No. 99-514 (100 Stat. 2085, 2146)(1986). [↑](#footnote-ref-12)
13. Former 26 USC §46(f)(6) (establishing proper determination of ratable portion). [↑](#footnote-ref-13)