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MEMORANDUM

MARCH 9, 1998

TO: DIVISION OF RECORDS AND REPORTING JP RVE

FROM: DIVISION OF LEGAL SERVICES (PAUGH)

RE: DOCKET NO. 970428-GU - 1996 DEPRECIATION FILING BY FLORIDA DIVISION OF CHESAPEAKE UTILITIES CORPORATION

98-0371-FOF-GU

Attached is a NOTICE OF PROPOSED AGENCY ACTION ORDER APPROVING DEPRECIATION RATES to be issued in the above referenced docket. (Number of pages in order - 10)

LJP/js
Attachment
cc: Division of Electric and Gas (Bulecza-Banks)
Division of Auditing and Financial Analysis (Causseaux, Lee, Sickel, Revell, Swain)
I:970428or.ljp

faxed 3/10.
mailed

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: 1996 depreciation filing by Florida Division of Chesapeake Utilities Corporation.	DOCKET NO. 970428-GU ORDER NO. PSC-98-0379-FOF-GU ISSUED: March 9, 1998

The following Commissioners participated in the disposition of this matter:

JULIA L. JOHNSON, Chairman
J. TERRY DEASON
SUSAN F. CLARK
JOE GARCIA
E. LEON JACOBS, JR.

NOTICE OF PROPOSED AGENCY ACTION
ORDER APPROVING DEPRECIATION RATES

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 interests are substantially affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

CASE BACKGROUND

On April 4, 1997, the Florida Division of Chesapeake Utilities Corporation (Chesapeake or Company) filed its regular depreciation study in accordance with Rule 25-7.045, Florida Administrative Code (F.A.C.). For reasons discussed in the filing, the Company asked for revision of current depreciation rates.

DECISION

Based on our review of the Company's current activities, we find that there is a need to revise the Company's depreciation rates. The current depreciation rates for Chesapeake are those provided in Order No. PSC-93-0025-FOF-GU, issued January 5, 1993. Those rates reflected Chesapeake's activity through January 1,

1992. Recently, a possibility of losing some industrial customers has prompted the Company to undertake rate restructuring. The distribution and general accounts are showing steady growth generally, but changing circumstances indicate the need for careful review of recovery status in this regular five-year filing.

The appropriate implementation date for the approved depreciation rates is January 1, 1998. The Company has proposed January 1, 1998, as the date of implementation, and has provided data for each account to abut that date. We find the date to be reasonable.

We find the reserve allocations shown on Attachment A render each account more consistent with its theoretically correct level. For three accounts, the activity seen in this study and the last has been somewhat erratic, rather than smoothly patterned. The equipment associated with the Autos, Data Processing, and VAX accounts is usually characterized as having a relatively short service life of 6 or 7 years. The Company was acquired by new owners just before the last study. As a result, some changes were made in the Company's planning and operations. Thus, the activity appears sporadic when the circumstances at the time of that study are compared to the present.

In the last study, both the vehicles (Account 392.1) and the computers (Account 391.1) had remaining lives less than 4 years. Prior to that study, the new owners decided to upgrade automobiles. The retirement level increased temporarily, and new investment was put on the books in that account. As a result, the current book reserve for the vehicles appears overstated. The spurts of activity have similarly resulted in understatement of reserve for the computer equipment. The appropriate action is to smooth out the resulting impacts as much as possible. The reserve allocation will correct the reserve level and provide a smoothing effect on the annual expense amount.

The VAX equipment (Account 391.4), which provides data transmission and communication with Chesapeake headquarters out of state, is unique to this company. It is subject to decisions of retirement and replacement in the five year period between studies, due to equipment compatibility. In fact, all current investments in this account, and related equipment, have in-service dates since the last study. It is possible that much of the current equipment could be replaced before the next study. In effect, the reserve allocation is merely a true-up of estimates made in the last study.

It will bring the reserve in line with the retirement and investment activity which has transpired in the intervening period.

The approved allocation will reduce the reserve for Account 392.1, Autos, to its theoretically correct level, and will correct the reserve deficiencies existing in the Data Processing and VAX accounts. The remaining surplus of $137,952 can be used to help alleviate the reserve deficiency existing in Account 380, Steel Services. These allocations are detailed on Attachment A, page 9. In light of the possible impact on cost allocations, we find that the Company should make corresponding entries to the related depreciable expense accounts.

Current budget planning includes the retirement of the Company's mobile radios in the year 2000. We find that a recovery schedule to provide full recovery of the associated net investment of $19,687 during the remaining life of the equipment is reasonable.

The investment associated with mobile radios which Chesapeake plans to retire in the year 2000 is $30,755 as of January 1, 1998. The associated reserve is estimated at $11,068, which indicates an unrecovered amount of $19,687. We find that this net amount should be withdrawn from the Communication Equipment account and recovered over the equipment's remaining period of service. The monthly recovery schedule expenses should be computed by dividing the net unrecovered investment by the estimated number of months of remaining life. Based on 30 months of service from January 1, 1998, the related expense for 1998 is estimated to be $7,875. Any changes to investment amount or retirement dates should be correspondingly reflected in the expense amount booked.

We find that the appropriate remaining lives, net salvages, reserve amounts, and resultant depreciation rates are as shown on Attachment B.

The Company's original filing emphasized mathematical analysis of historic data. During the analysis, extensive information relating to planning and Company specifics became apparent. The original filing did not include activity for 1997, but this information was provided by the Company. Its use of aged data when possible, and first-in, first-out as a secondary choice, provided significant insight in several instances. Using the aged data provided, the account ages were calculated using the half-year convention.

The aged data was also useful in the process of determining an appropriate retirement pattern. Statistical analysis, such as the simulated plant record and turnover methods, gave inconclusive results for several accounts. Further, the mathematical analysis of recent activity frequently resulted in cyclic peaks and valleys. Consequently, insight beyond the mere application of numerical analysis was desirable.

The approach was to smooth the activity pattern, rather than reacting to a pattern reflecting sporadic or intermittent activity. Additionally, Company planning was considered with a forward looking industry view. This included recognition of the installation of some new equipment of advanced design. As a result of this process, the Company avoids the instabilities associated with reacting to spurts of recent activity.

It appears that the Company's estimate of future cost of removal and net salvage was based directly on recent retirement activity. However, the entire investment in an account, and the related equipment, should be recognized in determining an appropriate net salvage. Relatively small retirements may have an inordinately high removal cost. The net salvage correctly relates to the type of activity expected from each account's total plant in service.

Some accounts are undergoing major reconfiguration. At least in part, this may be linked to both competitive source of supply and to availability of equipment of advanced design. In such cases, analysis of historical trends must be tempered by judicious recognition of future possibilities. Account 385, Industrial Measuring and Regulating Equipment, is an example. Chesapeake reports that the majority of throughput goes to large industrial customers. Six additional industrial customers were to be added in 1997, bringing the total number to more than sixty. Accommodating changes in customer loads and upgrading to current customer standards compel many additions and replacements of equipment in this account.

The curve shape or life pattern selected for industrial equipment should reflect the retirement of some investment before the age of ten years, as seen in the Company's aged data. Although the mathematical analysis of history suggested an increase in service life from 30 to 31 years, it is inappropriate to increase the service life for the investment in this account. The recommended R3 curve is a conservative response to current dynamics. The Company expects some cost of removal for this type of equipment, and a net salvage of 5% is in line with this expectation. Chesapeake has recognized the need to address current and future trends in capital recovery treatment and has agreed with the recommended lives and salvage.

The current amortization of investment tax credits (ITCs) and the flowback of excess deferred income taxes should be revised to reflect the approved depreciation rates and recovery schedules. In addition, the Company should file detailed calculations of the revised ITC amortization and flowback of excess deferred taxes at the same time it files its December 1998 surveillance report. Revisions to Chesapeake's depreciation rates and capital recovery schedules are to be effective January 1, 1998. Revising a utility's depreciation rates usually results in a change in its rate of ITC amortization and flowback of excess deferred income taxes.

Section 46(f)6 of the Internal Revenue Code states that the amortization of ITCs should be determined by the period of time used in computing depreciation expense for purposes of reflecting regulated operating results of the utility. As such, it is appropriate to change the amortization of ITCs along with the change in depreciation rates.

Section 203(e) of the Tax Reform Act of 1986 (TRA) prohibits rapid write-back of protected (depreciation related) deferred taxes. In addition, Rule 25-14.013, Florida Administrative Code, Accounting for Deferred Income Taxes under SFAS 109, prohibits, without good cause shown, excess deferred income taxes associated with temporary differences from being reversed any faster than allowed under Section 203(e). Therefore, both the TRA and Rule 25-14.013, Florida Administrative Code, prohibit faster write-off of protected excess deferred taxes. Consequently, the flowback of excess deferred taxes should be altered to comply with the TRA and Rule 25-14.013, Florida Administrative Code.

In sum, the current amortization of ITCs and the flowback of excess deferred income taxes should be revised to reflect the approved depreciation rates and recovery schedule. Also, the utility is required to file detailed calculations of the revised ITC amortization and flowback of excess deferred taxes at the time it files its December 1998 surveillance report.

The Company has requested that the cost of this depreciation study be amortized over three years. The cost of the study was approximately $19,000 and was incurred in 1997. This expense represented approximately fifteen basis points effect on return on equity. Normally, depreciation studies are expensed as incurred rather than being deferred and amortized. In addition, the amount of the expense is relatively small. Therefore, we find that the Company shall not be allowed to amortize the cost of this depreciation study over three years as requested.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the depreciation rates for the Florida Division of Chesapeake Utilities Corporation are hereby revised as set forth in the body of this order and as illustrated in Attachment B to this order. It is further

ORDERED that the implementation date for the revised depreciation rates is January 1, 1998. It is further

ORDERED that the reserve allocations as set forth in Attachment A are approved. It is further

ORDERED that a recovery schedule to provide full recovery of the associated net investment of $19,687 for mobile radios during the remaining life of the equipment is approved. It is further

ORDERED that the appropriate remaining lives, net salvages, reserve amounts and resultant depreciation rates are as shown on Attachment B to this order. It is further

ORDERED that the current amortization of investment tax credits and the flowback of excess deferred income taxes shall be revised to reflect the approved depreciation rates and recovery schedules. The Company shall file detailed calculations of the revised investment tax credit amortization and flowback of excess deferred taxes at the same time it files its December, 1998, surveillance report. It is further

ORDERED that the Company shall not be permitted to amortize the cost of the depreciation study associated with this filing.

ORDERED that the provisions of this Order, issued as proposed agency action, 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 or Judicial Review" attached hereto. It is further

ORDERED that in the event this Order becomes final, this Docket shall be closed.

By ORDER of the Florida Public Service Commission this 9th day of March, 1998.

BLANCA S. BAYÓ, Director
Division of Records and Reporting

By: Kay Flynn
Kay Flynn, Chief
Bureau of Records

(S E A L)

LJP

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, 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 or judicial review 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 and will not become effective or final, except as provided by Rule 25-22.029, Florida Administrative Code. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, as provided by Rule 25-22.029(4), Florida Administrative Code, in the form provided by Rule 25-22.036(7)(a) and (f), 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 March 30, 1998.

In the absence of such a petition, this order shall become effective on the day subsequent to the above date as provided by Rule 25-22.029(6), Florida Administrative Code.

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.

If this order becomes final and effective on the date described above, any party substantially affected may request judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or by the First District Court of Appeal in the case of a water or wastewater utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days of the effective date of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.

ATTACHMENT A

CHESAPEAKE UTILITIES CORPORATION
1997 STUDY

APPROVED RESERVE ALLOCATIONS

ACCOUNT	BOOK RESERVE 1/1/98 ($)	ALLOCATIONS ($)	RESTATED RESERVE 1/1/98 ($)
Services - Steel	313,895	137,952	451,847
391.1 Data Processing -	25,010	18,883	43,893
391.4 Vax Equipment	7,650	25,862	33,512
392.1 Autos	425,696	(182,697)	242,999
TOTAL	772,251	0	772,251

ATTACHMENT B

CHESAPEAKE UTILITIES CORPORATION
1997 STUDY
COMMISSION APPROVED RATES

ACCOUNT		AVERAGE REMAINING LIFE (YRS.)	NET SALVAGE (%)	RESERVE (%)	REMAINING LIFE RATE (%)
GAS DISTRIBUTION					
375	Structures & Improvements	34.0	(15.0)	13.48	3.0
376	Mains - Steel	29.0	(30.0)	36.78	3.2
376	Mains - Plastic	33.0	(30.0)	13.03	3.5
378	M&R Equipment - General	26.0	(5.0)	11.23	3.6
379	M&R Equipment - City	25.0	(5.0)	17.09	3.5
380	Services - Steel	21.0	(52.0)	45.93	5.1
380	Services - Plastic	21.0	(25.0)	8.64	5.5
381	Meters	13.9	0.0	37.18	4.5
382	Meter Installations	25.0	(5.0)	16.47	3.5
383	Regulators	21.0	0.0	24.70	3.6
385	M&R Equipment - Industrial	23.0	(5.0)	12.43	4.0
387	Other Equipment	5.0	(5.0)	20.97	16.8
GENERAL					
390	Structures & Improvements	32.0	5.0	22.77	2.3
391.1	Data Processing Equipment	2.9	0.0	58.53	14.3
391.2	Office Furniture	10.5	3.0	35.70	5.8
391.3	Office Equipment	7.7	0.0	27.63	9.4
391.4	Vax System Equipment	2.1	0.0	64.93	16.7
392.1	Transportation Equip.	3.1	15.0	40.98	14.2
392.2	Transportation Equip. Heavy	10.0	20.0	N/A	8.0 *
392.3	Transportation Equipment-	3.5	10.0	79.86	2.9
393	Stores Equipment	25.0	0.0	N/A	4.0 *
394	Tools & Work Equipment	12.8	0.0	31.58	5.3
396	Power Operated Equipment	8.1	0.0	36.53	7.8
397	Communication Equipment	9.3	0.0	36.51	6.8
398	Misc. Equipment	11.8	0.0	12.50	7.4
397 Communication Equipment year 2000 ret		2.5 year			

* Denotes whole life rates