State of Florida

Public Service Commission

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-M-E-M-O-R-A-N-D-U-M-

DATE: FEBRUARY 7, 2002

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

FROM: DIVISION OF ECONOMIC REGULATION (MEEKS, P. LEE, GARDNER, LESTER, C. ROMIG, HAFF)
OFFICE OF THE GENERAL COUNSEL (STERN)

RE: DOCKET NO. 010789-EI - 2001 DEPRECIATION AND DISMANTLING STUDY BY GULF POWER COMPANY.

AGENDA: 02/19/02 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: RATE CASE HEARINGS IN DOCKET NO. 010949-EI, FEBRUARY 25 - 28, 2002 AND MARCH 1, 2002

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\WP\010789.RCM
R:\010789GPC.123 - ATTACHMENTS B-C

CASE BACKGROUND

Rule 25-6.0436, Florida Administrative Code, requires electric utilities to file comprehensive depreciation studies at least once every four years. Additionally, Order No. 24741, issued July 1, 1991, in Docket No. 890186-EI, ordered electric utilities to file fossil dismantlement studies in conjunction with their depreciation studies. Accordingly, Gulf Power Company (Gulf or company) filed its regular quadrennial comprehensive depreciation and dismantlement studies (study) on May 29, 2001.

On September 10, 2001, Gulf filed its Petition for a rate increase in Docket No. 010949-EI. Gulf has based its rate relief on a projected test year of June 1, 2002, through May 31, 2003. The projected test year includes the effects of Gulf's proposed deprecation rates and dismantlement provision submitted in the

instant docket as well as the first full twelve months of operation for the new unit at the Smith Plant. The Office of Public Counsel (OPC) has intervened in the rate case and filed testimony on depreciation that argues against certain aspects of Gulf's study. OPC has not intervened in this docket, but its positions as set out in the rate case are provided in the recommendation where relevant.

Staff has completed its review of Gulf's depreciation and dismantlement studies and presents its recommendation herein.

DISCUSSION OF ISSUES

ISSUE 1: Should Gulf's current depreciation rates, amortization schedules, and provision for dismantlement be revised?

RECOMMENDATION: Yes. A review of the company's plans and activity indicates the need for revising its depreciation rates and provision for dismantlement. (MEEKS)

STAFF ANALYSIS: Gulf's current depreciation rates and dismantlement provision were approved effective January 1, 1997. In keeping with Rule 25-6.0436, Florida Administrative Code, and pursuant to Order No. 24741, the company filed a quadrennial comprehensive study on May 29, 2001, covering dismantlement and depreciation requirements. Since the time of the last represcription, changes brought about by company activity and planning suggest the need to review and revise depreciation rates and dismantlement accruals where appropriate.

The company has provided production plant investment stratified into homogeneous categories within each account at each steam generation site. As a result of this stratification of investment, recovery provisions can be more closely matched to the life characteristics of specific investment categories for steam generation of electric power. Taken together with changes in net plant balances and updated planning, the need for revision of recovery provisions is indicated.

Additionally, a new generating unit at the Smith Plant location, Smith Unit 3, is expected to be placed into service in June 2002. Even though the company did not request a depreciation rate and dismantlement provision within the current study for Smith Unit 3, the instant proceeding relates to a comprehensive review of the lives, salvages, and resulting depreciation rates for Gulf. As such, this docket is the appropriate forum to address all depreciation rates for Gulf, including Smith Unit 3, which is expected to begin service June 2002.

Finally, this study provides an opportunity to review the annual accrual for the provision of dismantlement of Gulf's fossil fueled generation plants following the retirement of those installations. This represents the first opportunity to address a dismantlement provision for the Pea Ridge unit that went into service in 1998.

ISSUE 2: What should be the implementation date for the recommended depreciation rates and dismantlement provision?

RECOMMENDATION: Staff recommends approval of the company's proposed January 1, 2002, date of implementation for the new depreciation rates and dismantlement accruals. Additionally, staff recommends an effective date for the depreciation rate and dismantlement provision for Smith Unit 3 that is concurrent with the in-service date of the unit. (MEEKS)

STAFF ANALYSIS: Gulf has proposed a January 1, 2002, implementation date for revised depreciation rates and annual dismantlement provision. The company submitted data and related calculations match this date. Therefore, staff recommends approval of Gulf's proposed implementation date as being the earliest practicable date for utilizing the revised rates, recovery/amortization schedules, and dismantlement accruals.

For Smith Unit 3, depreciation of the investment should begin when the unit begins service to the public, currently anticipated on or before June 1, 2002. Therefore, the recommended implementation date for the Smith Unit 3 depreciation rate and dismantlement accrual coincides with the unit's actual in-service date.

ISSUE 3: What is the appropriate annual provision for dismantlement?

RECOMMENDATION: Staff recommends an annual provision for dismantlement of $6.2 million beginning January 1, 2002, as shown on Attachment A. This represents an increase of approximately $560,000 over the current approved annual accrual. Additionally, an annual dismantlement provision of about $310,000 is recommended for Smith Unit 3, effective with its in-service date currently estimated to be June 1, 2002. At that time the total annual dismantlement provision will be $6.5 million. Further, staff recommends that Gulf provide site-specific dismantlement studies for both Pea Ridge and Smith Unit 3 at the next review cycle. (LESTER, LEE, MEEKS)

STAFF ANALYSIS: Prior to the 1990's, the provision for dismantlement cost recovery was included in the basic depreciation rates for each electric utility. By Order No. 24741 (Dismantlement Order), issued July 1, 1991, in Docket No. 891086-EI, the Commission determined its policy for ratemaking and accounting for the treatment of costs associated with the dismantlement of fossil-fueled generating facilities. The Dismantlement Order concluded that the provision for dismantlement should be accounted as an annual fixed dollar accrual separate from the depreciation rate. Also, the Dismantlement Order established the methodology for calculating the annual accrual. The fixed accrual amount is based on a four-year average of the accruals related to the years between depreciation study reviews. Furthermore, utilities are required to provide updated dismantlement studies at least once every four years in connection with their depreciation study. The purpose of these studies is to reflect changes in estimates, inflation, regulatory, or environmental requirements, and any newly discovered public health and safety issues.

Gulf's currently approved annual dismantlement accruals are $5.7 million, based on 1998 dismantlement base cost estimates of $83,505,000. The current annual accruals reflect Gulf's initial move to a dismantlement accrual determination based on the methodology approved by the Dismantlement Order. Prior to 1998, Gulf's annual dismantlement accruals were determined using a straight-line amortization of the estimated dismantlement costs over the remaining life of each fossil unit.

In accordance with the methodology established by the Dismantlement Order, the company's proposed annual accrual of $5.5

million, excluding the provision for Smith Unit 3, is based on current dismantlement cost estimates, escalated to future costs through the time of dismantlement. The future costs less amounts recovered to date have then been discounted in a manner that accrues the costs over the remaining life span of each plant. After making adjustments to the estimated rates of inflation included in Gulf's study to reflect the summer 2001 DRI Review of the U.S. Economy - Long Range Focus inflation rate forecasts, staff calculates a four year average annual accrual of approximately $6.2 million.

Since the 1998 study, Gulf's base cost estimates for dismantlement have increased approximately $7.1 million, excluding the impact of Smith Unit 3. This increase is attributed to inflation over the last four year period, changes in the current market price of scrap materials, and inclusion of the Pea Ridge cogeneration facility. Gulf notes that the study continues to assume a "pull down" methodology of structural dismantlement in unit pricing. This methodology assumes the structure or building is simply pulled down. Metal shears are then used to break down the scrap, thus making handling and removal easier. Staff notes that site restoration costs comprise about 6% of Gulf's current dismantlement cost estimates.

According to Gulf, the dismantlement cost estimate for Pea Ridge is based on Southern Company's system-wide average dismantlement costs for cogeneration and combined cycle plants. While use of system-wide averages is satisfactory for an initial cost estimate, staff recommends that Gulf provide a site-specific dismantlement study at the next review cycle.

Gulf's dismantlement cost basis relies on engineering drawings, purchase orders and associated engineering records, Continuing Property Records reports for each plant, cost models, other dismantling cost estimates utilized by Southern Company when plant specific data cannot be found, and discussions with engineering and plant operations personnel. Additionally, differences in scope between units resulting from fuel firing types and dual capabilities are considered. Site reclamation costs are derived from a survey of current and recent historical construction contracts around the Southern electric system. Additional overhead and indirect costs are included in the cost estimates, as in the 1998 study. The value of scrap is estimated from current market values, adjusted for loading, transportation, and preparation.

The last factor considered in the dismantlement base cost estimate is a contingency to cover uncertainty. As in its previous study, Gulf assumes a 10% contingency, comprised of 5% for pricing variance and 5% for scope or quantity variations. According to Gulf, the pricing contingency provides a level of confidence that the estimate will not overrun due to pricing error. The scope omission contingency of 5% considers the conceptual nature of the base cost estimates and the difficulty in obtaining quantity and weight records. This factor also includes a recognition of hazardous waste environmental assessments that can only be performed at the time of dismantlement.

A contingency is defined in the American Association of Cost Engineers' Cost Engineers' Notebook as a "specific provision for unforeseeable elements of cost within the defined project scope; particularly important where previous experience relating estimates and actual costs has shown that unforeseeable events which will increase costs are likely to occur." Such unforeseeable events include bad weather, labor strikes, equipment failure, and other unforeseen circumstances. Contingencies are not a means to "cushion" estimates or to account for inflation. They are used solely to assure that adequate funds are available in the event that something unpredictable as well as costly occurs while in the process of dismantling a fossil-fueled generating plant.

The contingency factor is commonly a weighted average of the item-by-item contingency factors applied to plant-specific categories in the cost estimate. The individual item contingency factors usually reflect the degree of uncertainty associated with each cost estimate. Certainly, updating cost estimates every four years should minimize the unforeseen components of costs, but staff also believes that such updates will not completely eliminate unforeseen events. Staff asserts that contingency factors are found in nearly all engineering, consulting, construction, and demolition estimates as an appropriate provision in cost estimates.

Staff notes that initial dismantlement cost estimates filed by utilities in accordance with Order No. 24741 assumed a 20% contingency factor. Since that time, contingency factors have generally decreased. In the case of one utility where a weighted contingency factor was determined based on item contingency factors applied to plant specific categories, a 16% contingency resulted.

The company proposed 10% contingency may be too optimistic and may not fully consider the uncertainties associated with pricing

and scope variances that may occur. On the other hand, in pre-filed testimony filed in Gulf's rate case, OPC questions whether dismantlement will occur and concludes that the dismantlement of Gulf's existing generating units is an unlikely event. Further, OPC requests that the Commission reconsider this issue of dismantlement to determine whether such a liability really exists.

In the Dismantlement Order, it is noted that the associated costs of dismantlement will be incurred at the time of ultimate physical demolition/removal of each unit and will be offset by any attended salvage from removal of the assets. The Dismantlement Order also recognized that cost estimates would need to be updated to reflect results from site-specific studies, improvement in technology and possible regulatory changes as well as re-evaluating alternative methodologies and updated inflation rate forecasts. Furthermore, the Dismantlement Order notes that while the timing of ultimate removal certainly could remain a question, there will undoubtedly come a time dismantlement will be necessary and site restoration will likewise be required.

While no plants within the Southern Company system have been dismantled, staff notes that other Florida utilities have retired and dismantled fossil generating facilities. For example, Florida Power and Light's Palatka Units 1 and 2 and Cutler Units 1, 2, 3, and 4 were retired and completely dismantled during the past decade. Likewise, FPC has dismantled several units within the past decade. Also, the repowering of generating units requires the removal and disposal of large amounts of existing investment. While the investment associated with the retired items of plant are recovered through capital recovery schedules, the associated costs of removing and disposing the retired assets are charged against the dismantlement reserve.

Smith Unit 3

As discussed previously in the recommendation, the instant docket is the appropriate forum to address the depreciation rate and dismantlement provision for Smith Unit 3, planned to be operational in June 2002. The depreciation rate recommendation is addressed in Issue 5. For the provision of dismantlement, Gulf provided a dismantlement cost estimate of $4,750,000, at staff's request. Because this unit is not yet in service, a site-specific study could not be performed.

Gulf's dismantlement cost estimate at this time relies on the assumptions for Georgia Power based on similar projects that are expected to go into operation in 2002. According to Gulf, the average estimated demolition of units in the Georgia Power Company system reflects $35,116/MW for coal fired plants. Assuming that the investment of a combined cycle plant is about 25% of a coal plant, the average demolition costs of a combined cycle plant should be about $5,047,971. Gulf also looked at the dismantlement cost estimates for two of Georgia Power Company's plants that are the same generation combined-cycle plants and the same design as Smith Unit 3. The demolition costs for each of those units are estimated at $4,750,000. For this reason and for purposes of an initial dismantlement cost estimate, Gulf has assumed dismantlement costs of $4,750,000 for Smith Unit 3. This translates to a four year average levelized annual accrual of $310,341, using the latest DRI inflation forecast. Staff recommends that the Commission find Gulf's initial dismantlement estimate to be satisfactory, recognizing that a site-specific study in four years may reflect the need to review the estimate.

Conclusion

To summarize, staff recommends that the four year average annual accrual for fossil fuel dismantlement, beginning January 1, 2002, should be $6.2 million, as shown on Attachment A. In addition, staff recommends the annual accrual increase $310,341 following the in-service date of Smith Unit 3. At that time the annual dismantlement provision will be $6.5 million. Further, site-specific dismantlement studies for Pea Ridge and Smith Unit 3 should be provided as part of Gulf's next dismantlement study.

ISSUE 4: 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 for the month its revised rates become effective. (C. ROMIG)

STAFF ANALYSIS: In earlier issues, staff recommends revisions to the company's remaining lives, to be effective January 1, 2002. 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 Sections 46, 167, and 168 of the Internal Revenue Code (IRC) and Sections 1.46, 1.67, and 1.68 of the Treasury Regulations.

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 rate making 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 Section 46, IRC, and Section 1.46 of the Treasury Regulations.

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, Florida Administrative Code, generally prohibits EDIT from being written off any faster than allowed under the Act. The Act, SFAS 109, and Rule 25-14.013, Florida Administrative Code, 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, Florida Administrative Code.

Staff, the Internal Revenue Service, and independent outside auditors look to 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 amortization of ITCs and the flowback of EDIT be revised to reflect the approved remaining lives. The utility should also produce work papers to show how the revisions were made.

ISSUE 5: What are the appropriate depreciation rates?

RECOMMENDATION: The staff recommended lives, net salvages, reserves, and resultant depreciation rates are shown on Attachment B. These rates result in an increase in annual depreciation expense of approximately $1 million, based on January 1, 2002 investments as shown on Attachment C. Including the impact of Smith Unit 3, the increase in annual expense is approximately $12.4 million. (P. LEE, MEEKS, GARDNER, HAFF)

STAFF ANALYSIS: Staff's recommendations are the result of a comprehensive review of the company's submitted study. Attachment B shows a comparison of rate components (lives, salvages, and reserves). Attachment C shows the estimated resultant annual expenses based on January 1, 2002 investments. A summary of the changes in annual expenses are as follows:

	$(000)
Production	2,531.8
Transmission	(772.2)
Distribution	(1,204.1)
General	529.6
Total rates	1,085.1
Provision for Dismantlement	564.6
Total change in depreciation and dismantlement expenses	1,649.7
Smith Unit 3	
Depreciation rate	10,477.8
Dismantlement provision	310.3
Total increase including Smith Unit 3	12,437.8

As a result of the review and analytical process, Gulf agreed with the staff's recommended life and salvage parameters for all accounts, through its January 15, 2002, response to the staff report dated December 24, 2001. The most significant changes in expenses relate to the increase in depreciation rates for the production plants. A major impact is due to the inclusion of Smith Unit 3, which is based on the estimated in-service investment of $209,556,000 as provided on the MFR's in the rate case.

The instant proceeding relates to a comprehensive review of the lives, salvages, and resulting depreciation rates for Gulf. As such, this docket is the appropriate forum to address all depreciation rates for Gulf, including Smith Unit 3, which is expected to begin service June 2002. Gulf's initially filed study did not address a depreciation rate for Smith Unit 3. Gulf subsequently provided staff life and salvage estimates with supporting rationale for the new unit.

While no party has intervened in this instant proceeding, a disagreement among parties has been raised in the rate case relating to the appropriate life for Smith Unit 3. Furthermore, OPC argues through pre-filed testimony in the rate case that the lives of all of Gulf's production plants are too low, thus resulting in an excessive amount of depreciation expense. OPC makes no mention of the lives for the transmission, distribution, or general plant accounts.

Production

The most significant change in depreciation expense resulting from staff's recommendation is seen in the production plant function. As in previously filed depreciation studies, Gulf has utilized its continuing property record system to provide in-depth stratified information for the assets in an account at a specific unit.

A generating station, or a generating unit, can be looked at as a box containing an assortment of various types of assets which can be expected to experience varied service lives. Stratification is the determination that this account at this unit has so many dollars of pumps, piping, rotors, or structures, etc., with each of these strata expected to have a certain service life. Gulf's engineers, in conjunction with accounting personnel, stratified the retirement units in production plant into categories with life expectancies of 20 years, 35 years, and the full life span of the plant. The life of the account is then determined by compositing the life expectancy of the various strata. This approach provides a more accurate determination of the required depreciation components than the historical approach of determining the pattern of interim retirements and life expectancy of the generating plant without identifying the contents or quantifying the varying life characteristics of the assets.

While the pre-filed testimony in the rate case has not been subject to cross examination, the Commission should note that OPC's witnesses rely on the life span approach, which considers the date

of final retirement and factors in a provision for interim retirements to derive the average service life. OPC's witness conclude that the overall life spans assumed for Gulf's production plants in the filed depreciation study are too short and not supported. OPC recommends that a minimum 55-year life span be established for each steam production unit and a minimum 24-year life span be established for each Other Production unit. Further, OPC recommends that Gulf be required to file studies reflecting retirement plans, forecasts, technological obsolescence, adequacy of capacity, economics, and competitive pressures. The resulting effect has not been quantified by OPC's witnesses, except to state that, at a minimum, Gulf's proposed depreciation rates not be approved and the company be ordered to continue use of its existing approved depreciation rates.

Gulf's proposal is to maintain depreciation rates at the total plant site level even though the development of its life parameters are provided for each account within the unit for each site. Ideally, where large components of the investment have a remaining life foreseeably different from the average, there is an argument for separate rates. This might be by account by unit within the plant site, by account by plant site, or for some major project that will retire substantial dollars before recovery. According to Gulf, application of a composite rate results in essentially the same amount of depreciation expense as applying individual rates by account, unit or plant. The company also asserts that it would be burdensome to maintain the depreciation reserve at a more detailed level, especially with the advent of competition.

Staff's recommendation in this proceeding is to maintain depreciation rates at a site level. However, this recommendation should not be construed to mean that further subcategorization may not be in order in the future. The need for additional subcategorization will be addressed in future depreciation represcriptions as circumstances change and life patterns for the various strata become more refined. The goal is to match recovery with consumption.

Smith Unit 3

Smith Unit 3 is a state-of-the-art combined-cycle baseload unit, expected to be in-service on or before June 2002. In Gulf's rate case filing, the company has included the effects of the new unit in rate base and net operating income for the projected test year. Because the purpose of this instant proceeding is to address the appropriate depreciation rates for Gulf, it is proper that the depreciation rate for Smith Unit 3 be addressed.

At the beginning of an installation's operation, typically a whole life rate is used. In the course of operation, various additions, retirements, and other activity may impact the capital recovery position of the installation. To respond to changes in life pattern and reserve level, a move from the whole life depreciation technique to the remaining life technique is made.

The company's proposed 20-year average service life for Smith Unit 3 is predicated on the assumption that approximately 60% of the facility will last 25 years and about 40% will have a life of 12.5 years. The 20-year service life is also the life assumed in the cost effectiveness analyses included Gulf's need determination filing (Docket No. 990325-EI) for Smith Unit 3. However, as OPC notes through pre-filed testimony in the rate case, Gulf assumed a 30-year life in Docket No. 010827-EI, Gulf's purchased power arrangement petition regarding Smith Unit 3. Further, OPC's witnesses argue that life spans in the 55-year range are more the norm for combined-cycle units based on a national survey. OPC also notes that a 30-year average service life is more consistent with the design life of the unit.

In support of its proposal, Gulf states that 20 years is consistent with average service lives approved by the Commission for combined-cycle units and industry expectations. Furthermore, Gulf states that since combined-cycle technology is relatively new to the Southern electric system, a depreciation study which includes combined-cycle units has not yet been performed by any of the operating companies. According to Gulf, the design life for combined-cycle plants are typically in the range of 30-40 years. The design life, by its very nature, is typically an estimate of the physical life. Physical or functional life is an estimate of how long the assets will physically work. In contrast, average service life or economic life relates to the period time the assets will provide service. The physical life is often a good deal longer than the life assumed for providing service. A good example is the manual cordboards used by telephone companies for operator services. While this equipment can still physically work, it has not been technologically obsolete and not providing service to customers for many years. In determining life expectancies of new technologies, considerations should be given to historical trends and to other factors such as functional and technological obsolescence and the existence of competitive pressures. According to Gulf, the combined-cycle technology is very sensitive to obsolescence, not from a safety or operational standpoint, but from an economic dispatch perspective. Increased efficiencies, lower capital costs, and higher capacities of newer generations of the combined-cycle technology are all drivers of obsolescence. Taking

these factors into consideration, Gulf estimates a 20-year service life as being appropriate for Smith Unit 3. Staff recommends that the Commission find that the company's proposed life and salvage parameters are reasonable and consistent with Commission decisions for similar Florida installations.

Transmission, Distribution and General Plant

The transmission, distribution, and general plant accounts mainly reflect the status-quo. In other words, the service life and salvage values approved in the last represcription are being maintained. The recommended remaining lives simply reflect an update of activity. However, some accounts indicate a change in service life, expected retirement dispersion, or net salvage estimates is warranted. The accounts reflecting the most significant changes are discussed below.

Transmission Plant:

Account 353 - Station Equipment: Gulf's proposed retirement dispersion and a 45-year average service life is predicated on longer life indications resulting from statistical analyses. This results in a 37-year remaining life and appears to be acceptable.

The company's proposal of negative 5% salvage is based on less salvage and cost of removal currently being recorded. However, the company indicated in its response to staff data requests that a large portion of the retirements booked during 1997-2000 reflect corrections resulting from physical inventories of its assets, with no related salvage or cost of removal being recorded. This naturally distorts the removal costs and salvage when compared to the retirements. In view of this fact, the most recent activity should not be relied on to support a change in the currently prescribed salvage factor. Staff recommends retention of the negative 10% net salvage factor. The company concurs.

Account 354 - Towers and Fixtures: The company has proposed a change in average service life from 45 years to 50 years. This increase in life expectancy reflects a move toward a longer life indication which is supported by the submitted data. The resulting remaining life of 25 years appears to be acceptable.

A change in the net salvage factor from negative 20% to negative 30% is proposed by the company. Gulf asserts that the most recent activity indicates a decrease in gross salvage and an increase in removal costs. However, the overall retirement rate has been less than one percent with no retirements recorded in 2000

and none forecasted for 2001. Such insufficient retirement activity makes any meaningful statistical analysis impossible. With this in mind, staff recommends retaining the current net salvage factor of negative 20%.

Account 356 - Overhead Conductors and Devices: This account has experienced substantial growth since the last depreciation study in 1997, with an increase in investment of over 100% estimated by the end of 2001. The majority of the new investment is due to the construction and upgrading of transmission facilities as a result of new generating capacity and load growth. Gulf asserts that the life indications are clearly increasing. Both the 50-year average service life and selected mortality dispersion appear to match recent activity. With future activity expected to continue in line with this pattern, staff recommends acceptance of the company's proposed life parameters. The company proposed salvage factor of negative 30% is a move toward recent indications and appears to be acceptable.

Distribution Plant:

Account 362 - Station Equipment: The company data supplied for this account indicates that the plant is experiencing longer life indications. The company proposed mortality dispersion of R1.5 and an average service life of 40 years represent a move in this direction. Staff recommends that the Commission find the resulting average remaining life of 29 years to be acceptable.

However, the company proposed net salvage factor of a negative 5% is a concern. The company indicates reliance on recent experience in selecting the net salvage factor. As part of the company's response to staff's initial review, Gulf notes that retirement adjustments made during the last four years relate to adjustments to its continuing property records. Inventory adjustments such as these distort the relationship between the retirements and salvage costs and should not be considered indicative of future conditions. With this in mind, staff recommends retention of the currently prescribed negative 10% net salvage factor. The company concurs.

Account 365 - Overhead Conductors and Devices: This is another account where statistics indicate a longer life. The company proposed R0.5 mortality dispersion and 34-year average service life reflect a move in line with these indications. A resulting remaining life of 25 years is acceptable and in line with current industry experience.

The company has also proposed a change in the net salvage factor for this account from negative 10% to negative 5%. This is in line with recent experience and future expectations for this type of plant.

Account 369.1 - Overhead Services and Account 369.2 - Underground Services: The company has proposed a change in mortality dispersion and average service life for both overhead and underground services. Staff recommends acceptance of the company proposed retirement dispersions and average service lives as being in line with current industry projections.

However, the net salvage factors proposed by the company are based on recent experience which appears to be distorted. In response to staff's information requests, the company stated that an error was discovered and corrected in 1996 regarding the recording of removal costs for both overhead and underground services. In addition, Gulf implemented new salvage procedures in 1999 regarding the allocation of salvage to the various distribution accounts. Between the errors in removal costs and the new salvage procedures, the reliance of this data for the determination of future net salvage factors is questionable. Without a full understanding of the impact of the new salvage method, staff recommends continuation of the currently prescribed net salvage factor of negative 15% for overhead services and negative 5% for underground services. The company concurs.

Account 370 - Meters: There is no conclusive documentation warranting a change in the current service life for this account. The recommended remaining life of 15.2 years simply reflects an update of activity since the last depreciation review. With regards to salvage, this account will be impacted by the new salvage allocation program implemented in 1999. However, two years of data is insufficient to warrant changing the currently prescribed negative 3% net salvage factor at this time.

Account 373 - Street Lighting and Signal Systems: The company proposed 16-year average service life and 10.8 year average remaining life appear to be acceptable.

Regarding net salvage, the company proposed a change in the net salvage factor from negative 10% to zero. The salvage data from years 1997 through 2000 is somewhat clouded due to inventory adjustments, Hurricane George, and the impact of the new salvage allocation program. The company's proposal of zero net salvage reflects the account's recent experience and the expectations that salvage and removal costs will offset. Recognizing that gross

salvage exceeded removal costs by about 8% for the activity years 1999 and 2000 and the activity for 1997 and 1998 are considered atypical, staff recommends retention of the currently prescribed negative 10% salvage factor at this time.

General Plant:

Account 392.2 - Transportation - Light Trucks: In the case of Transportation-Light Trucks, the company has proposed a longer average service life of 9 years and a decrease in the net salvage factor from 20% to 15%. This is reflective of the account's recent activity and is in line with company's current replacement policy. The company's proposed life and salvage factors appear to be in line with the account's activity and are acceptable.

Account 392.3 - Transportation - Heavy Trucks: The company has proposed a change in mortality dispersion and average service life. The resulting 4.7-year average remaining life is in line with the account's recent experience and current company guidelines for a 10-year replacement cycle with variance allowed for mileage and maintenance history. The proposed life and salvage parameters are reasonable and acceptable.

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. (STERN)

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.

Attachment A

FOSSIL DISMANTLEMENT ACCRUAL

PLANT	CURRENT ACCRUAL ($)	COMPANY PROPOSED ACCRUAL ($)	CHANGE IN ACCRUAL ($)	STAFF RECOMMENDED ACCRUAL ($)	CHANGE IN ACCRUAL ($)
Daniel	792,938	724,822	(68,116)	884,541	91,603
Crist	2,825,842	2,866,326	40,484	3,140,335	314,493
Scholz	511,321	527,395	16,074	559,991	48,670
Smith	1,208,663	1,240,212	31,549	1,326,240	117,577
Scherer	312,723	185,846	(126,877)	277,757	(34,966)
Total Steam	**5,651,487**	**5,544,601**	**(106,886)**	**6,188,864**	**537,377**
Pea Ridge	-0-	24,927	24,927	25,854	25,854
Smith Turbine	9,845	11,259	1,414	11,217	1,372
Total Other	**9,845**	**36,186**	**26,341**	**37,071**	**27,226**
Total-Steam & Other	**5,661,332**	**5,580,787**	**(80,545)**	**6,225,935**	**564,603**
Smith Unit 3	-0-	-0-	-0-	310,341	310,341
Grand Total	**5,661,332**	**5,580,787**	**(80,545)**	**6,536,276**	**874,944**

DOCKET NO. 010789-EI
DATE: FEBRUARY 7, 2002

GULF POWER COMPANY
2001 STUDY
COMPARISON OF RATES AND COMPONENTS

Attachment B

ACCOUNT	CURRENT				COMPANY PROPOSAL				STAFF RECOMMENDATION			
	AVERAGE REMAINING LIFE (YRS.)	NET SALVAGE (%)	RESERVE (%)	REMAINING LIFE RATE (%)	AVERAGE REMAINING LIFE (YRS.)	NET SALVAGE (%)	ESTIMATED RESERVE (%)	REMAINING LIFE RATE (%)	AVERAGE REMAINING LIFE (YRS.)	NET SALVAGE (%)	ESTIMATED RESERVE (%)	REMAINING LIFE RATE (%)
STEAM PRODUCTION PLANT												
Plant Daniel	26.0	(7.0)	43.52	2.4	19.8	(4.0)	48.00	2.8	19.8	(4.0)	48.00	2.8
Plant Crist	17.7	(3.0)	41.19	3.5	14.1	(3.0)	48.33	3.9	14.1	(3.0)	48.33	3.9
Plant Scholz	13.2	(2.0)	68.87	2.5	9.3	(3.0)	75.60	2.9	9.3	(3.0)	75.60	2.9
Plant Smith	16.6	(4.0)	51.23	3.2	14.0	(3.0)	57.04	3.3	14.0	(3.0)	57.04	3.3
Plant Scherer	35.0	(4.0)	30.60	2.1	32.8	(4.0)	37.54	2.0	33.0	(4.0)	37.54	2.0
OTHER DEPRECIABLE STEAM PRODUCTION												
310.0 Plant Daniel Easements	34.0	0.0	53.37	1.4	24.5	0.0	57.14	1.7	25.0	0.0	57.14	1.7
311.0 Plant Daniel Rail Tracks	34.0	0.0	56.42	1.3	24.5	0.0	60.33	1.6	25.0	0.0	60.33	1.6
OTHER PRODUCTION												
Pea Ridge	20.0	0.0	0	5.0 *	16.5	0.0	17.7	5.0	16.5	0.0	17.70	5.0
Smith Turbine	8.5	0.0	93.42	0.8	4.5	0.0	95.96	0.9	4.5	0.0	95.96	0.9
TRANSMISSION PLANT												
350.0 Easements	26.0	0.0	36.51	2.4	32.0	0.0	45.68	1.7	32.0	0.0	45.68	1.7
352.0 Structures & Improvements	35.0	(10.0)	33.24	2.2	29.0	(5.0)	41.86	2.2	29.0	(5.0)	41.86	2.2
353.0 Station Equipment	27.0	(10.0)	36.63	2.7	37.0	(5.0)	28.68	2.1	37.0	(10.0)	28.68	2.2
354.0 Towers and Fixtures	20.0	(20.0)	71.15	2.4	25.0	(30.0)	71.62	2.4	25.0	(20.0)	71.62	1.9
355.0 Poles and Fixtures	27.0	(40.0)	31.95	4.0	26.0	(40.0)	29.79	4.2	26.0	(40.0)	29.79	4.2
356.0 Overhead Conduct. & Devices	21.0	(20.0)	59.43	2.9	40.0	(30.0)	29.34	2.5	40.0	(30.0)	29.34	2.5
358.0 Underground Conductors & Devices	31.0	(5.0)	17.71	2.8	33.0	0.0	29.31	2.2	32.0	(5.0)	29.31	2.4
359.0 Roads & Trails	26.0	0.0	30.97	2.7	24.0	0.0	38.49	2.5	24.0	0.0	38.49	2.6
DISTRIBUTION PLANT												
361.0 Structures & Improvements	27.0	(10.0)	30.63	2.9	29.0	(5.0)	40.74	2.2	29.0	(5.0)	40.74	2.2
362.0 Station Equipment	27.0	(10.0)	27.70	3.0	29.0	(5.0)	32.24	2.5	29.0	(10.0)	32.24	2.7
364.0 Poles, Towers & Fixtures	24.0	(60.0)	35.68	5.2	22.0	(70.0)	40.51	5.8	22.0	(60.0)	40.51	5.4
365.0 Overhead Conductors	23.0	(10.0)	36.40	3.2	25.0	(5.0)	41.94	2.5	25.0	(5.0)	41.94	2.5
366.0 Underground Conduit	26.0	0.0	50.25	1.9	33.0	0.0	59.54	1.2	33.0	0.0	59.54	1.2
367.0 Underground Conduct. & Devices	21.0	0.0	29.49	3.4	20.0	10.0	28.99	3.0	20.1	0.0	28.99	3.5
368.0 Line Transformers	21.0	(15.0)	37.05	3.7	20.5	(25.0)	38.14	4.2	20.5	(15.0)	38.14	3.7
369.1 Overhead Services	19.6	(15.0)	53.54	3.1	23.0	(25.0)	56.79	3.0	23.0	(15.0)	56.79	2.5
369.2 Underground Services	21.0	(5.0)	26.91	3.7	29.0	0.0	28.86	2.4	29.0	(5.0)	28.86	2.6
369.3 Service-House power Boxes	8.4	0.0	73.25	3.2	6.7	0.0	80.15	3.0	6.7	0.0	80.15	3.0
370.0 Meters	19.0	(3.0)	45.15	3.0	26.0	0.0	40.24	2.3	15.2	(3.0)	40.24	4.1
373.0 Street Lights	10.7	(10.0)	30.46	7.4	10.8	0.0	36.80	5.8	10.8	(10.0)	36.80	6.8
GENERAL PLANT												
390.0 Structures & Improvements	30.0	0.0	29.14	2.4	30.3	(5.0)	37.24	2.2	30.0	(5.0)	37.24	2.3
392.2 Transportation Equip.-Light Trucks	3.5	20.0	63.28	4.8	5.0	15.0	46.75	7.7	5.0	15.0	46.75	7.7
392.3 Transportation Equip.-Heavy Trucks	7.2	20.0	29.49	7.0	4.7	20.0	36.15	9.4	4.7	20.0	36.15	9.3
392.9 Transportation Equip.-Trailers	11.8	15.0	25.24	5.1	8.7	20.0	31.63	5.6	8.7	20.0	31.63	5.6
396.0 Power Operated Equipment	6.3	15.0	64.47	3.3	9.8	20.0	23.92	5.7	9.8	15.0	23.92	6.2
397.0 Communication Equipment	10.0	(2.0)	8.87	9.3	7.1	0.0	33.48	9.4	7.1	0.0	33.48	9.4
Smith Unit 3	N/A	N/A	N/A	N/A	20.0	0.0	0.0	5.0 *	20.0	0.0	0.0	5.0 *

* Denotes Whole Life Rate

GULF POWER COMPANY
2001 STUDY
COMPARISON OF EXPENSES

ACCOUNT	01/01/2002 ESTIMATED INVESTMENT	01/01/2002 ESTIMATED RESERVE	CURRENT RATE (%)	CURRENT EXPENSES ($)	COMPANY PROPOSAL RATE (%)	COMPANY PROPOSAL EXPENSES ($)	COMPANY PROPOSAL CHANGE IN EXPENSES ($)	STAFF RECOMMENDATION RATE (%)	STAFF RECOMMENDATION EXPENSES ($)	STAFF RECOMMENDATION CHANGE IN EXPENSES ($)
STEAM PRODUCTION PLANT										
Plant Daniel	213,576,382	102,527,000	2.4	5,125,833	2.8	5,980,139	854,306	2.8	5,980,139	854,306
Plant Crist	402,808,000	194,671,000	3.5	14,098,280	3.9	15,709,512	1,611,232	3.9	15,709,512	1,611,232
Plant Scholz	29,771,000	22,506,000	2.5	744,275	2.9	863,359	119,084	2.9	863,359	119,084
Plant Smith	115,890,000	66,104,000	3.2	3,708,480	3.3	3,824,370	115,890	3.3	3,824,370	115,890
Plant Scherer	181,532,417	68,151,000	2.1	3,812,181	2.0	3,630,648	(181,533)	2.0	3,630,648	(181,533)
Subtotal	943,577,799	453,959,000		27,489,049		30,008,028	2,518,979		30,008,028	2,518,979
OTHER DEPRECIABLE STEAM PRODUCTION										
310.0 Plant Daniel Easements	77,000	44,000	1.4	1,078	1.7	1,309	231	1.7	1,309	231
311.0 Plant Daniel Rail Tracks	2,741,618	1,654,000	1.3	35,641	1.6	43,866	8,225	1.6	43,866	8,225
Subtotal	2,818,618	1,698,000		36,719		45,175	8,456		45,175	8,456
OTHER PRODUCTION										
Pea Ridge	10,481,920	1,855,000	5.0	524,096	5.0	524,096	0	5.0	524,096	0
Smith Turbine	4,341,531	4,166,000	0.8	34,732	0.9	39,074	4,342	0.9	39,074	4,342
Subtotal	14,823,451	6,021,000		558,828		563,170	4,342		563,170	4,342
TOTAL PRODUCTION PLANT	961,219,868	461,678,000		28,084,596		30,616,373	2,531,777		30,616,373	2,531,777
TRANSMISSION PLANT										
350.0 Easements	9,632,194	4,400,000	2.4	231,173	1.7	163,747	(67,426)	1.7	163,747	(67,426)
352.0 Structures & Improvements	4,161,283	1,742,000	2.2	91,548	2.2	91,548	0	2.2	91,548	0
353.0 Station Equipment	78,086,679	22,398,000	2.7	2,108,340	2.1	1,639,820	(468,520)	2.2	1,717,907	(390,433)
354.0 Towers and Fixtures	25,174,077	18,029,000	2.4	604,178	2.4	604,178	0	1.9	478,307	(125,871)
355.0 Poles and Fixtures	38,957,220	11,607,000	4.0	1,558,289	4.2	1,636,203	77,914	4.2	1,636,203	77,914
356.0 Overhead Conduct. & Devices	52,961,135	15,538,000	2.9	1,535,873	2.5	1,324,028	(211,845)	2.5	1,324,028	(211,845)
358.0 Underground Conductors & Devices	13,612,397	3,990,000	2.8	381,147	2.2	299,473	(81,674)	2.4	326,698	(54,449)
359.0 Roads & Trails	54,561	21,000	2.7	1,473	2.5	1,364	(109)	2.6	1,419	(54)
TOTAL TRANSMISSION PLANT	222,639,546	77,725,000		6,512,021		5,760,361	(751,660)		5,739,857	(772,164)
DISTRIBUTION PLANT										
361.0 Structures & Improvements	10,042,900	4,091,000	2.9	291,244	2.2	220,944	(70,300)	2.2	220,944	(70,300)
362.0 Station Equipment	114,739,102	36,990,000	3.0	3,442,173	2.5	2,868,478	(573,695)	2.7	3,097,956	(344,217)
364.0 Poles, Towers & Fixtures	86,402,587	35,002,000	5.2	4,492,935	5.8	5,011,350	518,415	5.4	4,665,740	172,805
365.0 Overhead Conductors	97,757,780	41,003,000	3.2	3,128,249	2.5	2,443,945	(684,304)	2.5	2,443,945	(684,304)
366.0 Underground Conduit	1,210,865	721,000	1.9	23,006	1.2	14,530	(8,476)	1.2	14,530	(8,476)
367.0 Underground Conductors & Devices	61,038,353	17,697,000	3.4	2,075,304	3.0	1,831,151	(244,153)	3.5	2,136,342	61,038
368.0 Line Transformers	147,640,148	56,309,000	3.7	5,462,685	4.2	6,200,886	738,201	3.7	5,462,685	0
369.1 Overhead Services	34,702,397	19,706,000	3.1	1,075,774	3.0	1,041,072	(34,702)	2.5	867,560	(208,214)
369.2 Underground Services	23,655,778	6,828,000	3.7	875,264	2.4	567,739	(307,525)	2.6	615,050	(260,214)
369.3 Service-House power Boxes	4,680,257	3,751,000	3.2	149,768	3.0	140,408	(9,360)	3.0	140,408	(9,360)
370.0 Meters	35,446,398	14,265,000	3.0	1,063,392	2.3	815,267	(248,125)	4.1	1,453,302	389,910
373.0 Street Lights	40,468,681	14,894,000	7.4	2,994,682	5.8	2,347,183	(647,499)	6.8	2,751,870	(242,812)
TOTAL DISTRIBUTION PLANT	657,785,246	251,257,000		25,074,476		23,502,953	(1,571,523)		23,870,332	(1,204,144)

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DATE: FEBRUARY 7, 2002

GULF POWER COMPANY
2001 STUDY
COMPARISON OF EXPENSES

ACCOUNT	01/01/2002 ESTIMATED INVESTMENT	01/01/2002 ESTIMATED RESERVE	CURRENT RATE (%)	CURRENT EXPENSES ($)	COMPANY PROPOSAL RATE (%)	COMPANY PROPOSAL EXPENSES ($)	COMPANY PROPOSAL CHANGE IN EXPENSES ($)	STAFF RECOMMENDATION RATE (%)	STAFF RECOMMENDATION EXPENSES ($)	STAFF RECOMMENDATION CHANGE IN EXPENSES ($)
GENERAL PLANT										
390.0 Structures & Improvements	50,669,554	18,870,000	2.4	1,216,069	2.2	1,114,730	(101,339)	2.3	1,165,400	(50,669)
392.2 Transportation Equip.-Light Trucks	4,744,533	2,218,000	4.8	227,738	7.7	365,329	137,591	7.7	365,329	137,591
392.3 Transportation Equip.-Heavy Trucks	17,591,412	6,359,000	7.0	1,231,399	9.4	1,653,593	422,194	9.3	1,636,001	404,602
392.9 Transportation Equip.-Trailers	1,191,934	377,000	5.1	60,789	5.6	66,748	5,959	5.6	66,748	5,959
396.0 Power Operated Equipment	539,366	129,000	3.3	17,799	5.7	30,744	12,945	6.2	33,441	15,642
397.0 Communication Equipment	16,517,385	5,530,000	9.3	1,536,117	9.4	1,552,634	16,517	9.4	1,552,634	16,517
TOTAL GENERAL PLANT	91,254,184	33,483,000		4,289,911		4,783,778	493,867			529,642
TOTAL DEPRECIABLE PLANT	1,932,898,844	824,143,000		63,961,004		64,663,465	702,461		65,046,115	1,085,111
FOSSIL DISMANTLEMENT	0	77,942,000		5,661,332		5,580,787	(80,545)		6,225,935	564,603
GRAND TOTAL	1,932,898,844	902,085,000		69,622,336		70,244,252	621,916		71,272,050	1,649,714
FOSSIL DISMANTLEMENT-SMITH UNIT 3	N/A	N/A		N/A		N/A	N/A		310,341	310,341
OTHER PRODUCTION - SMITH UNIT 3	209,556,000 **	0	N/A	N/A	N/A	N/A	N/A	5.0 *	10,477,800	10,477,800
GRAND TOTAL INCL. SMITH UNIT 3	2,142,454,844	902,085,000		69,622,336		70,244,252	621,916		82,060,191	12,437,855

* Denotes Whole Life Rate.
** Estimated in-service investment from Docket No. 010949-EI