BEFORE THE PUBLIC SERVICE COMMISSION

In re: Depreciation and dismantlement study at December 31, 2005, by Gulf Power Company.	DOCKET NO. 050381-EI ORDER NO. PSC-07-0012-PAA-EI ISSUED: January 2, 2007

The following Commissioners participated in the disposition of this matter:

LISA POLAK EDGAR, Chairman
J. TERRY DEASON
ISILIO ARRIAGA
MATTHEW M. CARTER II
KATRINA J. TEW

NOTICE OF PROPOSED AGENCY ACTION
ORDER APPROVING REVISED DEPRECIATION RATES
AND FOSSIL DISMANTLEMENT ACCRUALS FOR 2007

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.

BACKGROUND

Rule 25-6.0436, Florida Administrative Code, requires investor-owned utilities to file comprehensive depreciation studies at least once every four years. The Commission authorized the approval of new depreciation rates for Gulf Power Company (Gulf) effective January 1, 2006, by Order No. PSC-06-0348-PAA-EI, issued in this docket on May 19, 2006. On October 9, 2006, Gulf filed a petition to modify the currently approved depreciation study to request an increase in the average service life and resulting depreciation rate changes for the coal fired generating Plant Crist Units 4, 5, 6, and 7; Plant Smith Units 1 and 2; and Plant Smith Unit 3 combined cycle. Gulf's request is part of its strategic planning to manage the increasing costs associated with the implementation and impact of new and related regulations from the Florida Department of Environmental Protection (FDEP) and the Federal Department of Environmental Protection Agency (EPA) for the Clean Air Interstate Rule (CAIR), and the Clean Air Mercury Rule (CAMR). As explained in detail below, we find that a decrease in annual depreciation expense for production plant in the amount of $7,526,991 is appropriate. We have jurisdiction over these matters through several provisions of Chapter 366, Florida Statutes, including Sections 366.04, 366.05, and 366.06.

DECISION

Depreciation Rates and Dismantlement

In Order No. PSC-06-0348-PAA-EI, we authorized Gulf to implement a change in depreciation rates and fossil dismantlement accruals effective January 1, 2006. After we issued that Order, the EPA and the FDEP implemented new regulations that affect Gulf's approved plant service lives. In June 2006, the FDEP adopted more stringent regulations for compliance with CAIR and CAMR than the EPA. Thereafter, in August 2006, Gulf finalized its strategy for compliance with the FDEP for both CAIR and CAMR.

To comply with CAIR and CAMR, Gulf proposes modifications to the approved rates and fossil dismantlement accruals that became effective January 1, 2006. The primary difference between the approved 2006 annual expense and provision for dismantlement and the proposed revision relates to the projection of longer service lives for Plant Crist Units 4, 5, 6, and 7, Plant Smith Units 1 and 2, and Plant Smith Unit 3 combined cycle. The proposed change in life parameters requires recalculation of depreciation rates.

Gulf provided a comparative analysis of the life estimates and trends for all applicable plant for the 2005 depreciation study and the partial modification of that study for the Plant Crist Units, Plant Smith Units, and Plant Smith Unit 3 combined cycle. In the last depreciation study, Gulf requested a change in production plant units from a 45 to 55 year service life. At that time, Gulf based the change on current maintenance, which showed that units with 45 to 50 year lives could meet customers' needs beyond that life span. Gulf reviewed the useful lives of the Southern electric system and the Florida electric industry and determined that a 55 year useful life was reasonable at the time to meet its current needs.

In this petition, Gulf is asking to increase the average service lives from the original study. This change would increase the service life for Plant Crist Units and Plant Smith Units 10 years, from 55 to 65 years. For Plant Smith Unit 3 combined cycle Gulf requests a 9 year increase in service life, from 25 to 34 years. Gulf's initial strategy to comply with the new environmental regulations is to make a significant investment in environmental controls at the coal fired generating units at the Crist and Smith plants. For the period of 2006 through 2009, Gulf intends to expend a capital outlay for plant in the amount of \$576.7 million to replace equipment and to implement environmental controls for Plants Crist and Smith, which will extend the useful life of these units. Gulf believes that, with a reasonable level of maintenance, the coal fired generating units at Plants Crist and Smith will continue to serve the customers' needs for an additional ten years beyond their current retirement dates. Gulf relies upon the experience gained from the operation of Plant Scholz, where it expects a useful life of 58 years, and the Southern electric system's experience with coal fired plants with expected useful lives of 60-65 years. This position is similar to the actions taken by electric utilities in other states to comply with CAIR and CAMR requirements. It is also consistent with a report prepared by the staff of the Michigan Public Service Commission entitled, "Michigan Capacity Need Forum: Staff Report to the Michigan Public Service Commission Report," issued January 2006. The report proposed the following assumptions on plant retirements: " ...units built since 1950 should expect to realize longer economic life than older units. The group recommends a 65 year retirement age be used for modeling coal fired generating units. While it is likely that some will retire sooner than 65 years old and some will retire later, 65 years is a reasonable modeling assumption."[1]

We find that the proposed life parameters for production plants owned by Gulf are reasonable and in line with the life span methodology of other regulated Florida electric utilities. We do recognize, however that several factors, such as regulatory changes, new technologies, and growth, will continue to affect the useful lives of electric production plants. Our staff will continue to monitor the utilities' annual status reports and future depreciation studies for changes in life parameters that may result from new regulations and other factors.

In summary, the depreciation rates and provision for dismantlement shall be adjusted to reflect the proposed plants' current life expectancy. This adjustment will decrease production plant annual expenses for depreciation and fossil dismantlement by an estimated $6,879,574 and $647,417, respectively, as shown on Attachments A and C to this Order. The total decrease in annual expenses for production plant will be an estimated $7,526,991. Gulf's filing shows an estimated decrease in the amount of $8,020,043 annual expenses. Our adjustment for annual expenses is less than Gulf's $540,775 which is due to the rounding of life parameters and the recalculation of the depreciation rate of Plant Crist. January 1, 2007, shall be the implementation date for Gulf's revised depreciation rates and provision for fossil dismantlement as shown on Attachments A, B, and C of this Order. This date is consistent with Rule 25-6.0436, Florida Administrative Code, which requires that 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." In this regard, Gulf's data and calculations match a January 1, 2007, implementation date.

<u>Changing Depreciation Rates</u>

We approve the change in the lives, net salvages, reserves, and resulting depreciation rates as shown on Attachment B to this Order, and we note that Gulf concurs with this change. We reviewed Guff's proposed life, salvage, and reserve factors, as well as the establishment of a fixed levelized annual accrual for dismantlement of fossil plants, in accordance with Order No. 24741, issued July 1, 1991, in Docket No. 890186-EI, <u>In re: Investigation of the ratemaking and accounting treatment for the dismantlement of fossil fueled generating stations</u>. Our analysis of Gulf's data indicates that the resulting expenses reflect the impact of current planning and adherence to regulatory requirements to ensure that assets are fully recovered at the time of retirement as reflected on Attachments B and C. Attachment B shows a comparison of rate components (lives, salvages, and reserves). Attachment C shows the estimated resulting annual

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[1] Michigan Public Service Commission's report was prepared by Operations and Wholesale Markets Division, Section 6.1 Plant Retirements, page E-11.

expenses based upon January 1, 2007, investments. A summary of changes to the annual expense is as follows:

FUNCTIONAL CHANGE TO ANNUAL DEPRECIATION

PRODUCTION	($6,879,574)	(See Attachment C)
FOSSIL DISMANTLEMENT	($ 647,117)	(See Attachment A)
Total Depreciation and Dismantling Cost	($7,526,691)	

In the revised depreciation study, the significant changes in expenses relate to the change in average service life, the increase in net salvage, and the resulting decrease in depreciation rates for production plant. Gulf uses three life categories of 1-20 years, 21-35 years, and 36 years through the life of the plant. Gulf used the same investment stratification from its last depreciation study. The remaining life of the categories increased by ten years for the 36 years through the life of the plant category and less than ten years for the other categories. The average remaining life rate decreased due to the increase in the average remaining life.

The major impact to production plant is a 21 percent decrease in production plant expense as of January 1, 2007. The capital investment for the period of 2006 to 2009, related to enhancement of the air emission controls, will significantly affect Gulf's cost recovery through the Environmental Cost Recovery Clause. At this time, there is no change to base rates. Also, the $7.5 million expense decrease represents approximately 75 basis points on return on equity.

As mentioned above, the activities requiring the change in depreciation rates addressed here comprise Gulf's efforts to comply with the requirements imposed by FDEP for CAIR and CAMR. Gulf states that the strategic planning to meet the Commission's directives on storm hardening has not been finalized yet. Also, the increase in service life of the Smith Unit 3 combined cycle was due to the Company's review of company-wide and Southern electric system experience in handling combined cycle plants. Our staff will continue to monitor the life parameters for production, transmission, and distribution.

Fossil Fuel Dismantlement

We approve a total annual provision for fossil fuel dismantlement of $5,239,243, as shown on Attachment A. This represents a decrease in the annual provision for fossil fuel dismantlement accruals of $647,417 for Plant Crist, Plant Smith, and Plant Smith Unit 3 combined cycle. These accruals reflect current estimates of dismantlement costs on a site-specific basis, using the latest inflation forecasts and a 10% contingency factor. In the Fossil Fuel Dismantlement Order No. 24741, issued July 1, 1991, in Docket No. 891086-EI, In re: Investigation of the ratemaking and accounting treatment for the dismantlement of fossil-fueled generating stations, the Commission established the methodology for the treatment of costs associated with the dismantlement of fossil-fueled generating facilities. The methodology depends on three factors: estimated base costs of dismantling the fossil fueled plants, projected inflation, and a contingency factor. The purpose of this revised review of fossil dismantlement for Plants Crist and Smith is to reflect changes in life estimates, inflation factors, and environmental requirements caused by the replacement and upgrading of Plant Crist Units 4, 5, 6, and 7, and Plant Smith Units 1 and 2, in response to the implementation of CAIR and CAMR regulations.

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. Utilities are required to provide updated dismantlement studies at least once every four years in connection with their depreciation study. Gulf provided an updated calculation of the four-year average of the accruals due to the change in life parameters for each requested plant site.

Gulf's currently approved annual accrual for fossil fuel dismantlement is $5,886,660. Its proposed annual accrual of $5,286,966 is based on inflation factors from Economy.com as of September 2006. Gulf updated its accruals to reflect the most recent inflation factors. The updated annual accrual, reflecting inflation factors as of November 2006, represents a decrease from the proposed accrual of $47,723. It is reasonable for the accrual to reflect the most recent inflation estimates, and Gulf agrees that the revised annual accrual should be $5,239,243, which represents a decrease of $647,417 from the currently approved level. Therefore, we find that the four year average annual accrual for fossil fuel dismantlement shall be $5,239,243.

Taxes

The current amortization of investment tax credits (ITC) and flow-back of excess deferred income taxes (EDIT) shall be revised to reflect the approved depreciation rates so that they match the actual recovery periods for the related property. Gulf shall file detailed calculations of the revised ITC amortization and flow-back of EDIT at the same time it files its surveillance report covering the period ending December 31, 2006.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that Gulf Power Company's proposed revised depreciation rates and fossil dismantlement accruals for 2007 are approved as set out in the body of this Order. It is further

ORDERED that the provisions of this Order, issued as proposed agency action, shall become final and effective upon the issuance of a Consummating Order unless an appropriate petition, in the form provided by Rule 28-106.201, Florida Administrative Code, is received by the Director, Division of the Commission Clerk and Administrative Services, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings" attached hereto. It is further

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

By ORDER of the Florida Public Service Commission this 2nd day of January, 2007.

Blanca S. Bayó

BLANCA S. BAYÓ, Director
Division of the Commission Clerk
and Administrative Services

(S E A L)

MCB

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 that is available under Section 120.57, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing will be granted or result in the relief sought.

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

The action proposed herein is preliminary in nature. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, in the form provided by Rule 28-106.201, Florida Administrative Code. This petition must be received by the Director, Division of the Commission Clerk and Administrative Services, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on January 23, 2007.

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

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

ATTACHMENT A

GULF POWER COMPANY
FOSSIL DISMANTLEMENT ACCRUAL

PLANT	CURRENT ACCRUAL (01/01/2006)	COMPANY PROPOSED ACCRUAL (10/09)2006	COMPANY PROPOSED CHANGE IN ACCRUAL	APPROVED ACCRUAL (01/01/2007)	APPROVED CHANGE IN ACCRUAL
	$	$	$	$	$
Plant Crist	3,053,458	2,694,383	359,075	2,659,829	393,629
Plant Smith	1,139,444	962,309	177,135	950,810	188,634
Plant Scholz	521,738	521,738	0	521,738	0
Plant Daniel	754,764	754,764	0	754,764	0
Total Steam(non-UPS)	5,469,404	4,933,194	476,210	4,887,141	582,263
Plant Smith CT	4,612	4,612	0	4,612	0
Plant Pace (Pea Ridge)	6,102	6,102	0	6,102	0
Smith Combined Cycle	299,223	235,739	63,484	234,069	65,154
Total Other Production	309,937	246,453	63,484	244,783	65,154
Total non-UPS Dismantlement	5,779,341	5,179,647	599,694	5,131,924	647,417
Plant Scherer (UPS)	107,309	107,319	0	107,319	0
Total Dismantlement	5,886,660	5,286,966	599,694	5,239,243	647,417

ATTACHMENT B

GULF POWER COMPANY
MODIFICATION OF 2005 DEPRECIATION STUDY
COMPARISON OF RATES AND COMPONENTS

	CURRENT				COMPANY PROPOSED					APPROVED			
ACCOUNT	AVERAGE REMAINING LIFE (YRS)	NET SALVAGE (%)	1/1/2006 RESERVE	REMAINING LIFE RATE (%)	AVERAGE REMAINING LIFE (YRS)	NET SALVAGE (%)	01/01/07 RESERVE (%)	REMAINING LIFE RATE (%)	AVERAGE SERVICE LIFE (YRS)	AVERAGE REMAINING LIFE (YRS.)	NET SALVAGE (%)	01/01/07 RESERVE (%)	REMAINING LIFE RATE (%)
Steam Production													
Plant Crist	17.9	-7.0	38.35	3.8	22.3	**-10.0**	40.01	3.1	34.0	22.0	-10.0	40.01	3.2
Plant Smith	15.2	-4.0	44.85	3.9	22.9	**-5.0**	48.26	2.5	35.0	23.0	-5.0	48.26	2.5
Other Production													
Smith Unit 3 Combined Cycle	21.0	0.0	4.68	4.0	34.0	**0.0**	4.34	3.1	34.0	31.0	0.0	4.77	3.1

GULF POWER COMPANY
MODIFICATION OF 2005 DEPRECIATION STUDY
COMPARISON OF EXPENSES

ACCOUNT	1/1/2007 ESTIMATED INVESTMENT ($)	1/1/2007 ESTIMATED RESERVE ($)	Approved Rates 1/1/2006 RATE (%)	Approved Rates EXPENSES ($)	Company Proposed RATE (%)	Company Proposed 1/1/2007 EXPENSES ($)	Company Proposed CHANGE IN EXPENSES	Approved Modifications RATE (%)	Approved Modifications 1/1/2007 ESTIMATED EXPENSES ($)	Approved Modifications CHANGE IN EXPENSES ($)
Steam Production										
Plant Crist	540,774,334	216,346,902	3.8	20,549,425	3.1	16,764,004	-3,785,421	3.2	17,304,779	-3,244,646
Plant Smith	139,008,110	67,086,424	3.9	5,421,316	2.5	3,475,203	-1,946,113	2.5	3,475,203	-1,946,113
Total Plant Crist & Smith	679,782,444	283,433,326		25,970,741		20,239,207	-5,731,534		20,779,982	-5,190,759
Other Production										
Smith Unit 3 Combined Cycle	187,646,111	8,954,192	4.0	7,505,844	3.1	5,817,029	-1,688,815	3.1	5,817,029	-1,688,815
Total Plant Crist, Smith & Smith Combined Cycle	867,428,555	292,387,518		33,476,585		26,056,236	-7,420,349		26,597,011	-6,879,574