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Public Service Commission

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

DATE: August 7, 2008

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Marsh)
Office of the General Counsel (Fleming)

RE: Docket No. 080163-GU – Petition for approval to create regulatory subaccount of meter installation to capitalize all incurred and future costs associated with installation of encoder receiver transmitters (ERTs) under provisions of Statement of Financial Accounting Standard No. 71, Accounting for the Effects of Certain Types of Regulation (SFAS 71); and requesting depreciation of installation costs of ERTs over 15-year period beginning January 1, 2008, by Florida City Gas.

AGENDA: 08/19/08 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: McMurrian

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\080163.RCM.DOC

Case Background

Pursuant to Rule 25-7.045(3)(a), Florida Administrative Code (F.A.C.), gas utilities are required to maintain depreciation rates and accumulated depreciation reserves in accounts or subaccounts as prescribed in Rule 25-7.046, F.A.C. Rule 25-7.045(3)(b), F.A.C., further provides that "[u]pon establishing a new account or subaccount classification, each utility shall request Commission approval of a depreciation rate for the new plant category." On March 18, 2008, Florida City Gas (FCG or company) filed its petition to establish depreciation rates for its

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Encoder Receiver Transmitter (ERT) installation costs. The devices are used for automated meter reading by radio signal. FCG requests to establish a new subaccount classification for capitalization of previously incurred and future installation costs of the ERTs.

On July 10, 2008, FCG filed a letter discussing the reasons it believes its petition should be granted, specifically with regard to capitalization of installation costs that were expensed in 2006 and 2007. The letter is addressed in Issue 1.

Staff has completed its review and presents its recommendations herein. The Commission has jurisdiction in this matter pursuant to Sections 366.04, 366.05, and 366.06, Florida Statutes (F.S.).

Discussion of Issues

Issue 1: Should FCG be allowed to capitalize installation costs associated with the addition of ERTs?

Recommendation: Installation costs incurred during 2008 for the addition of ERTs on existing meters should be capitalized beginning January 1, 2008. However, installation costs that were expensed prior to 2008 should not be capitalized. (Marsh)

Staff Analysis: FCG began the installation of ERT devices in its Port St. Lucie (PSL) service area in January 2006. The company states that since that time, it has installed 7,811 ERT devices in the PSL service area. Further, in 2007, FCG began ERT installations in the Miami area, with 39,669 ERT devices installed as of February 2008. Additionally, all new meters installed in any area are fitted with an ERT device before installation. FCG states that its goal is to install ERT devices on all FCG meters by the end of 2009. As of February 29, 2008, there are 23,211 meters in Miami and 42,902 meters in Brevard that are still awaiting an ERT device.

Since January 2006, FCG has expensed the costs to install ERTs on existing meters, while capitalizing the cost of the ERT equipment and including such costs in the meters account. The company is requesting that a new subaccount of ERT installation costs be created to capture the installation expenses as capitalized costs, including those that were previously expensed. The company expensed installation costs of $142,821 in 2006 and $302,372 in 2007. The total installation costs to add ERTs or replace non-compatible meters are estimated to be approximately $2.3 million. The four-year overall project has an estimated cost of $8.4 million. The installation costs that were previously expensed total approximately 5 percent of the projected project cost.

Pursuant to Rule 25-7.0461, F.A.C., a minor item that is added can be treated in the same manner as an addition of a retirement unit. All depreciable property is comprised of retirement units and minor items. A retirement unit is an item that is capitalized. When a minor item constitutes a betterment, which may make the item more efficient, the cost should be charged to the appropriate plant account. The rule requires that such minor items have a cost of more than $500 to receive this treatment. Although each individual ERT in this case has a cost of less than $500, the four-year overall project has an estimated cost of $8.4 million. Staff believes that it is appropriate, given the magnitude of the project, to capitalize the costs, including the installation costs.

On July 10, 2008, FCG filed a letter, included as Attachment A, discussing the reasons it believes its petition should be granted, specifically with regard to capitalization of installation costs that were expensed in 2006 and 2007. Staff is not persuaded by the company's arguments that retroactive capitalization of previously expensed costs should be allowed. If these costs are allowed to be capitalized, previously filed financial statements would have to be restated to reflect the change in accounting methodology. This treatment would also increase rate base and may result in higher rates in the future for the company's ratepayers. When depreciation studies are filed pursuant to Rule 25-7.045, F.A.C., the requested effective date for the implementation of the revised depreciation rates is either the beginning of the same fiscal year during which the study is filed or a later date. This requirement discourages the retroactive application of the

revised depreciation rates to prior fiscal years. Although the company submits as an alternative that it would be willing to accept retroactive capitalization of 2007 costs and forego the 2006 amounts, the treatment has the same impact, albeit for one year instead of two.

While staff agrees with FCG that benefits will arise from the use of ERTs, such as improvements to the billing process, increased operating efficiency, and improved customer service, staff does not believe that is justification for the retroactive prior period application. The company had ample opportunity to ask for the requested accounting treatment when it began to add ERTs in January 2006. FCG first contacted the Commission about this matter on January 31, 2005, stating that it was making improvements to its meter sets by installing ERTs. Subsequently, staff provided the company with a copy of Rule 25-7.0461, F.A.C., titled Capitalization Versus Expensing, advising that the company should contact staff if it had further questions. The subject of ERTs arose again on October 3, 2006, when the company filed testimony with its request for approval of an acquisition adjustment, stating that the ERTs costs were not an ongoing expense, but was for a project that would benefit FCG. As late as May 2007, FCG stated in response to an informal staff data request that, because the amounts associated with ERTs were expensed and not capitalized, ". . . there are no life parameters or depreciation methodologies associated with these costs."

FCG states in its July 10, 2008 letter that it "has been unable to identify an absolute prohibition on revised accounting treatment applied for prior years." Staff asked the company in a meeting on June 30, 2008, whether it was aware of any cases in which the Commission allowed such retroactive treatment. FCG's response to that question contained in its letter is that "FCG does not deny that such treatment is not common, nor should it be." Staff believes the very absence of such cases is significant, and that a company would have to demonstrate extraordinary circumstances to change its accounting retroactively, several years after the fact.

FCG states that retroactive capitalization of the installation costs will not cause FCG to exceed its authorized ROE. The authorized ROE midpoint is 11.25 percent with a range of 10.25 percent to 12.25 percent. Based on staff's analysis, if the 2006 ERT expenditures of $142,821 had not been expensed in 2006, the company's achieved return on equity (ROE) would have increased from 10.67 percent to 10.85 percent, an 18 basis point increase. If the 2007 ERT expenditures of $302,372 had not been expensed in 2007, the company's achieved ROE would have increased from 7.06 percent to 7.38 percent, a 32 basis point increase. Staff notes that both the 7.06 percent and the 7.38 percent ROEs include the amortization of the acquisition adjustment and regulatory assets approved in Docket No. 060657-GU.[1] Excluding the authorized acquisition adjustment amortization for 2007, the achieved ROE would be 11.75 percent including the ERT expenditures and 12.11 percent excluding the ERT expenditures.

FCG states that Florida Power & Light Company (FPL) accounts for its ERTs in an identical manner, advising that the accounting treatment was approved in FPL's 2005

[1] Order No. PSC-07-0913-PAA-GU, issued November 13, 2007, in Docket No. 060657-GU, In re: Petition for approval of acquisition adjustment and recognition of regulatory asset to reflect purchase of Florida City Gas by AGL Resources, Inc.

depreciation study.[2] Thus, FCG notes that approval of its accounting treatment is not a case of first impression, due to the FPL case. However, staff notes that the FPL case was resolved through a settlement, so that the Commission did not vote directly on the ERT issue. Further, unlike FCG, FPL requested its accounting treatment in advance, as part of its depreciation study, and did not ask for retroactive treatment.

The company argues that to deny its request to capitalize costs that were previously expensed would put an inequitable burden on the company's shareholders for costs which benefitted the ratepayers. However, staff believes this argument does not apply, because staff is not recommending that the cost be disallowed. Rather, the company made a decision to expense the costs during the years they were incurred. In cases where there is inequitable treatment, the Commission might want to consider a retroactive change, However, as previously noted, such instances would be rare. Staff believes it is appropriate to consider any such requests on a case-by-case basis.

In conclusion, staff believes that the company's request to capitalize its ERT installation costs has merit, due to the magnitude of the project and the benefits to be realized. Nevertheless, staff believes in this instance it is appropriate to grant the request on a prospective basis only. Therefore, staff recommends that installation costs of ERTs on existing meters be capitalized beginning January 1, 2008. Installation costs that were expensed prior to 2008 should not be capitalized.

[2]Order No. PSC-05-0902-S-EI, issued September 14, 2005, in Docket No. 050188-EI, In re: 2005 comprehensive depreciation study by Florida Power & Light Company.

Issue 2: Should the Commission establish a subaccount with depreciation rates for the ERT Installations?

Recommendation: Yes. Account 382.1, ERT Installations, should be established with a 15-year average service life, and a resulting depreciation rate of 6.7 percent for the ERTs. (Marsh)

Staff Analysis: FCG proposed a 15-year average service life for its ERTs. The company currently records meter installations in Account 382. Staff believes it is appropriate to establish Account 382.1 to capture the cost of the ERT installations.

Staff believes the proposed life of 15 years is appropriate for 2008. The average remaining life of the company's meters is approximately 15 years. The ERT equipment is included in that account at this time. Therefore, staff believes it is appropriate to have a matching life for the installations.

Pursuant to Rule 25-7.045(8)(a), F.A.C., a gas utility is required to file a depreciation study for Commission review at least once every five years. Staff is reviewing FCG's most recent study, which will be used to establish depreciation rates effective January 1, 2009. This will afford staff and the company opportunities to review the depreciation rate for the ERT Installations in the context of the meters and retirements of meters resulting from incompatibility.

Therefore, staff recommends that Account 381.2, ERT Installations, be established with a 15-year average service life, and a resulting depreciation rate of 6.7 percent for the ERTs.

Issue 3: What should be the effective date for the implementation of the new depreciation rate for the ERT Installations?

Recommendation: The effective date for the implementation of the new depreciation rate for the ERT Installations should be January 1, 2008. (Marsh)

Staff Analysis: FCG has requested that a depreciation rate for the ERT Installations be effective on January 1, 2008.

As stated in Issue 1, when depreciation studies are filed pursuant to Rule 25-7.045, F.A.C., the requested effective date for the implementation of the revised depreciation rates is either the beginning of the same fiscal year during which the study is filed or a later date. An effective date of January 1, 2008, is consistent with the rule. As discussed in Issue 1, retroactive treatment is not appropriate. Therefore, staff recommends that the requested effective date of January 1, 2008, should be approved.

Issue 4: 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 issuance of a consummating order. (Fleming)

Staff Analysis: 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 the order, this docket should be closed upon the issuance of a consummating order.

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July 10, 2008

VIA HAND DELIVERY

Mr. Tim Devlin
Director of Economic Regulation
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

RE: Docket No. 080163-GU - Petition for approval to create regulatory subaccount of meter installation to capitalize all incurred and future costs associated with installation of encoder receiver transmitters (ERTs) under provisions of Statement of Financial Accounting Standard No. 71, Accounting for the Effects of Certain Types of Regulation (SFAS 71); and requesting depreciation of installation costs of ERTs over 15-year period beginning January 1, 2008, by Florida City Gas.

Dear Mr. Devlin:

On March 18, 2008, Florida City Gas (FCG or Company) filed its above-referenced petition requesting that the Commission approve the creation of a regulatory sub-account for purposes of capitalizing costs associated with the installation of encoder receiver transmitters (ERTs), including both costs incurred to date as well as costs incurred in the future. FCG also requested approval to depreciate the costs of installing the ERTs over a 15-year period beginning January 1, 2008.

Consistent with its commitment in Docket No. 060657-GU, FCG has not requested any rate adjustment associated with this Petition.

Specifically, by its Petition, FCG has asked permission to take the following actions:

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- allow FCG to create a sub-account for purposes of capitalizing ERT installation costs, which includes contractor, internal labor, and material costs associated with installing ERTs on FCG meters;
- allow FCG to recover the both the costs that have been incurred in 2006 and 2007 for this project, as well as future costs for completion of the ERT installation project; and
- allow FCG to depreciate these costs over a 15-year period, in view of the fact that the ERTs have a 15-year expected life.

At the outset, let me first emphasize that a favorable ruling on this Petition will further endorse that installation of the ERT equipment is ultimately very beneficial to FCG's ratepayers in that the new technology allows FCG to continue to improve its billing processes, to increase its operating efficiency, and to enhance customer service. Specifically, the ERT's greatly improve the accuracy of meter reads, allowing meter readers to read 10,000 meters per day with 100% accuracy and without the challenges of high fences and threatening dogs.

As you know, in recent weeks, the Company became aware that both technical staff of the PSC and the Public Counsel's Office have raised concerns regarding our plan to capitalize the installation costs associated with this project in 2006 and 2007. Your staff was kind enough to meet with us on June 30 to clarify those concerns. The meeting was very helpful, and FCG appreciates the thoughtful discussion had with staff at that meeting. We take the concerns that have been raised very seriously and appreciate the opportunity to respond to those concerns via this letter.

Our understanding is that PSC staff fully appreciates the value and benefits of this program for FCG's customers and supports the requested treatment for expenses incurred in 2008 and beyond. It appears that the sole concern pertains to the timing of the requested capital treatment of the program expenses. The concern expressed is that revising the accounting treatment for the ERT installation costs for prior years does not comply with the standards set forth in the Uniform System of Accounts, Title 18, Subchapter F, Part 201 and Rule 25-7.0461, Florida Administrative Code. We began our internal pilot program in Port St. Lucie in 2006. After a thoughtful assessment of the results there, we moved forward with the ERT installation in other markets in the last quarter of 2007. Staff has, however, suggested that capitalization of these costs would have been appropriate had the sub-account been established in 2006 when these costs were first incurred.

In this very unique, limited circumstance, FCG believes there are overarching policy and practical reasons that justify capitalizing these costs incurred in prior years. We respectfully submit our analysis for your consideration.

Practical Considerations

First and foremost, the ERT program has significant benefits for FCG's customers. FCG proactively sought to improve service quality using the ERT program. However, rather than assume there were benefits, FCG took a meticulous thoughtful approach of selecting target locations for an internal pilot and then studied the results before moving forward. It was only after deliberative consideration of the true costs and benefits of this program that FCG proactively implemented the ERT program in an effort to further improve customer service. Failure to allow FCG to capitalize the costs incurred over the period that FCG was analyzing the efficacy of the program will penalize the company for its thoughtful approach to implementation and perversely incent the implementation of future programs without similar, careful study.

Second, FCG has been unable to identify an absolute prohibition on revised accounting treatment applied for prior years. FCG does not deny that such treatment is not common, nor should it be. FCG does, however, believe that in this case, a thoughtful and reasoned analysis of the benefits of allowing such revised accounting treatment, as opposed to the detrimental impact associated with rejecting FCG's request, will lead staff to conclude that the benefits significantly outweigh any concerns staff may have about the revised accounting.

Third, capitalization of these costs for prior years will not cause FCG to exceed its approved ROE for either period and will have no impact on customer rates. It will also ensure continued corporate shareholder confidence in the value of the ERT program to AGL Resources as a whole. On the other hand, if the costs for 2006 and, more crucially 2007, cannot be capitalized, corporate shareholders will be required to assume the costs of the implementation of a program that benefits, primarily, FCG's customers.

Legal Considerations

Courts over the years have recognized that while there are certainly legitimate reasons for strictly construing and applying accounting regulations, there are circumstances in which the agency should also give equal consideration to the policy impacts of such strict application. Courts have also emphasized that one of the fundamental principles of ratemaking is that costs should be borne by those who benefit from them.[1] In this limited situation, FCG asks that the Commission staff balance its concerns regarding strict application of the USOA rules with due consideration for: (1) the customer benefits derived from this ERT program; (2) the impact that failure to allow the revised accounting treatment will have on that program; and (3) the proper allocation of costs associated with the program. Furthermore, we believe the accounting

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[1] See Minnesota Power & Light Co. v. FERC, 852 F. 2d 1070 (8th Cir. 1988)(addressing the proper accounting treatment of attorneys' fees, the Court concluded it was inequitable for the company to bear the burden of expenses associated with obtaining refund benefiting wholesale customers of the company and remanded to the FCC for further review on that issue). See also Gulf Power Co. v. FERC, 983 F.2d 1095 (DC Cir. 1993)(in addressing FERC's denial of retroactive waiver in the context of a pass through clause, the Court noted that FERC failed to take into account the fact that Gulf did not receive a windfall by passing on the costs, and has only recovered costs incurred in producing savings for customers.)

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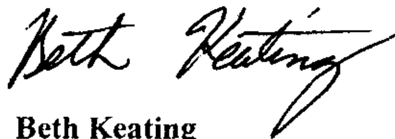
treatment is identical to that which the Commission allowed for Florida Power and Light in approving the Stipulation and Settlement of FPL's 2005 Depreciation Study.[2] Thus, the requested treatment is by no means a case of first impression for this Commission. FCG asks only that it be allowed to implement the same accounting approach accepted in that proceeding in order to fully recognize the benefits of this program.

Based on the foregoing, FCG urges the Commission to approve our petition to capitalize the costs associated with the ERT program for all prior years. In the alternative, in an effort to move this forward and work within Staff's concerns, FCG would agree that the $142,821 in costs associated with the installation of ERTs from our Port St. Lucie pilot program in 2006 could be excluded from consideration of FCG's Petition and would not be included in the regulatory sub-account created for the purpose of capitalizing ERT installation costs. FCG emphasizes that it would maintain its request with regard to 2007, particularly in view of the fact that the 2007 costs were incurred in the 4th quarter of that year. FCG suggests this alternative in the interest of facilitating further fruitful discussion regarding the requested accounting treatment. *This alternative approach will not impact the Company's ability or desire to move forward with the ERT installation program in 2008 and beyond.*

As always, we appreciate the opportunity to work to address concerns raised by PSC staff and the productive discussions we have had on this issue to date. If you have any questions or concerns, please do not hesitate to call. We look forward to your thoughts regarding the analysis and options set forth in this letter.

Sincerely,



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cc: Office of Public Counsel (J.R. Kelly, Charles Beck)
Division of Economic Regulation (Marshall Willis, Cheryl Bulecza-Banks)
Commission Clerk

[2] Order No. PSC-05-0902-S-EI, September 14, 2005.

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