

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: 2008 depreciation study by Florida
Public Utilities Company.

DOCKET NO. 080548-GU
ORDER NO. PSC-09-0229-PAA-GU
ISSUED: April 13, 2009

The following Commissioners participated in the disposition of this matter:

MATTHEW M. CARTER II, Chairman
LISA POLAK EDGAR
KATRINA J. McMURRIAN
NANCY ARGENZIANO
NATHAN A. SKOP

NOTICE OF PROPOSED AGENCY ACTION ORDER APPROVING DEPRECIATION
RATES AND RECOVERY SCHEDULES FOR FLORIDA PUBLIC UTILITIES COMPANY

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 (F.A.C.).

I. Background

Rule 25-7.0145, F.A.C., requires natural gas utilities to file comprehensive depreciation studies at least once every five years from the submission date of the previous study unless otherwise required by this Commission. On December 10, 2008, Florida Public Utilities Company (FPUC or Company) filed its regular depreciation study in accordance with this rule.

We have jurisdiction in this matter pursuant to Sections 366.04, 366.05, and 366.06, Florida Statutes (F.S.)

II. Depreciation Rates and Recovery Schedules

The Company's last comprehensive depreciation study was filed on April 20, 2004, with an effective date for new depreciation rates of January 1, 2005. The current study is in accord with the five-year depreciation review cycle for gas companies required by Rule 25-7.045, F.A.C. A review of FPUC's activity since the last study indicates the need to revise depreciation rates and the need for recovery schedules.

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FPSC-COMMISSION CLERK

The Company requests that its new depreciation rates be implemented coincident with new base rates approved in its current rate proceeding, in Docket No. 080366-GU. The original depreciation filing was based on data supporting a January 1, 2009, implementation date.

To properly express capital recovery requirements, a reserve-sensitive formula, such as remaining life, should utilize components reflecting the recovery position at the point of implementation of revised depreciation rates. Subsequent to the original depreciation filing, FPUC updated all supporting depreciation data and calculations to match a July 1, 2009, date, the estimated date new base rates will be effective. Accordingly, this date is approved and shall be used to more closely match the increase in depreciation rates to new base rates.

After a comprehensive review of FPUC's depreciation study, our approved depreciation rate parameters are shown on Attachment A.

The purpose of depreciation is to recover a company's prudently invested capital over the period of time the assets representing that capital are providing service. Depreciation is not intended to fund the replacement of plant. However, it does create internally generated funds that the Company can use for anything within legal constraints, including purchasing new plant.

A depreciation study provides an opportunity to review a company's present recovery position (depreciation reserve) and determine whether any changes should be made to the existing pattern of recovery (depreciation rates). A prime concern of the depreciation study is life and salvage. As part of the review process, the prudence of company planning (including additions and retirements), technological impacts, retirement and salvage practices, and other related activities are reviewed. The average service life for each account refers to the average expected period the equipment under discussion is expected to provide service to the public. This recognizes that some equipment may live much longer or much shorter than the average life. The average service life is projected based on experience or estimates. The average remaining life is the remaining period of service which can be expected, on the average, from the equipment under study. This period is measured from the time of implementation of the depreciation rates being designed to the expected ultimate retirement of the embedded investment associated with the given equipment. Average remaining lives are derived through planning for retirement or derived as a function of the age of the equipment, its expected average service life, and the expected future retirement pattern (mortality curve shape).

The Company provided aged retirement data and average age distributions of the surviving investments for each account. Investments, reserves, and activity were estimated through June 30, 2009. For the most part, the underlying average service life and mortality dispersion for each account continue to be appropriate and reasonable. Based on the information FPUC provided, we have determined the appropriate average remaining lives, net salvage values, and resultant depreciation rates for all accounts. Differences between our calculations and the Company are mainly due to: (1) average age calculations, (2) rounding, and (3) use of mortality tables in determining the average remaining lives. In some accounts, FPUC inadvertently assigned an age to plant estimated to be added during the first half of 2009 that reflected older investment rather than new. With rounding, we continue the practice of rounding remaining lives less than 20 years to one decimal point and to the nearest year thereafter.

Our changes to depreciation rates can be attributed mainly to two factors: (1) updated account ages to reflect activity since the last represetion, such as new investment, and (2) changes in the associated reserve position. The accounts with substantial changes are discussed below.

A. Distribution Plant

1. Land Rights (Account 374.1)

This account contains the cost of easements. It currently has a negative reserve balance of \$7,053 due to the retirement of an easement associated with a project cancelled by the City of Winter Springs. The negative reserve translates into a positive rate base component on which the Company earns a return. Additionally, the negative reserve represents an unrecovered amount of investment that no longer exists. Logic dictates that nonlife related deficiencies, such as this, be recovered as fast as economically practicable. Considering the amount, the negative reserve shall be separately recovered over a five-year period. A whole life rate based on a 30-year average service life and zero net salvage is approved for the remaining account investment.

2. Mains (Account 376) and Services (Account 380)

Mains and services comprise about 84 percent of FPUC's investment in the distribution plant function and about 72 percent of the Company's total depreciable investment. During the 2004-2008 period, the Company's retirement rate for steel and plastic mains averaged less than one percent, making reliance on industry averages for life and salvage necessary. Although there has been minimal retirement activity, the 70-percent growth in the investment in plastic mains is indicative that plastic is the technology of choice. For steel mains (Account 376.02), scant retirement activity indicates that the Company has no wholesale replacement strategy in place, but rather is replacing older mains that are experiencing maintenance problems. FPUC has proposed retaining the currently-prescribed 45-year average service life for both the steel and the plastic mains accounts. We find that a 45-year average service life remains reasonable, and the approved remaining lives are the product of applying each account's average age with the underlying mortality dispersions.

Service lines connect the main to the meter on the customer's premises. The retirement rate for plastic service lines has averaged less than one percent since the last study. The retirement rate for steel services has averaged about 1.5 percent. The steel services account investment has decreased about 10 percent since the last review, with retirements averaging nearly 16 times the amount of additions. This activity is indicative of an obsolete technology being phased out and replaced with more efficient technology. As new services are generally plastic, only \$14,000 has been added to the steel services account since 2004, compared to over \$7 million for plastic services.

In FPUC's last base rate proceeding in 2004 (Docket No. 040216-GU), we approved a 50-year recovery for expenditures to replace aging bare steel mains and services (the Bare Steel Replacement Program). It appears that the Company is receiving additional annual revenues of \$566,000 in exchange for the commitment to spend at least that much in installing replacement

pipe. The mains and services subject to retirement and replacement in any given year are based on age or maintenance history. The recovery mechanism essentially funds the replacement with new plastic pipe. The additional revenues are treated as a contribution towards the cost of installing the new pipe. For example, if the Company installs \$700,000 in replacement plastic services, this cost would be offset by the contribution of \$566,000, resulting in a net amount of \$134,000 being recorded as an addition subject to depreciation.

The Company's Bare Steel Replacement Program does not address the retirement or cost of removal of the bare steel pipe being retired and replaced. Eventually, the Company plans to replace all of its embedded bare steel mains and services with plastic pipe, as the bare steel facilities encounter maintenance problems. FPUC asserts it has no specific plans for retiring its remaining steel mains and services, other than a commitment that it will spend at least \$566,000 each year in connection with installing plastic pipe in the Bare Steel Replacement Program. To the extent the Company develops plans for the retirement of the remaining steel mains and services investments, the associated net investments, as well as the cost of removal, can be withdrawn from the account and recovered through a capital recovery schedule or be used in developing an average remaining life. In this manner, the unrecovered net investments subject to retirement can be amortized over the associated planned period of service remaining.

At this time, in approving the life for steel services, we consider that: (1) the replacement program is a 50-year program, (2) the Company has no plans for retiring the remaining steel services, and (3) the current average age of the surviving investment is about 32 years. These considerations lead us to conclude that the age of the embedded bare steel service lines can reasonably be expected to exceed 36 years of age at retirement. The Company proposes to maintain the currently prescribed average service life of 36 years, resulting in an average remaining life of 7.9 years. Based on the information provided, we find it is reasonable to expect that steel services will experience a longer average service life. Therefore, we find that an average service life of 38 years with an average remaining life of 12.3 years is appropriate.

The main question with the services and mains accounts is the cost of removal portion of the net salvage component. Net salvage consists of gross salvage less cost of removal. Gross salvage is the amount realized for the property retired due to the sale, reimbursement, or reuse. Cost of removal relates to costs incurred in connection with the retirement from service and the disposition of the related assets. When a main or service line is retired, it is generally abandoned in place rather than physically removed. Abandoning the line typically involves labor and material costs associated with a crew traveling to the site, digging down to the pipe, cutting and capping the pipe, refilling the hole, and restoring the roadway. Restoring the roadway can be significant if the main or service is located under pavement. Surface restoration normally occurs at two locations for each service line retired: one at the point of the service riser, and the other at the property line or the connection to the main. The galvanic action of dissimilar metals such as a galvanized steel service line running off a cast iron main requires that the line be cut at the main rather than at the property line. Net salvage for retiring mains and services usually consists of no gross salvage but significant removal costs.

Since the last review, the cost of removal has averaged over 50 percent for retiring plastic services, and over 200 percent for retiring steel mains and services. The Company acknowledges

the minimal retirement activity for steel mains and has proposed a slight decrease, from negative 15 percent net salvage to negative 20 percent. For steel services, the Company proposes a decrease in net salvage from negative 71 percent to negative 125 percent. For plastic services, the Company proposes a decrease in net salvage from negative 15 percent to negative 25 percent. We do not question the amounts that FPUC booked for the retirement and cost of removal activity in the 2004-2008 period, nor the relative consistency of that activity (considering inflation) with previous experience. However, we are concerned about the use of a 125 percent cost of removal figure for steel services in arriving at depreciation expenses for the future of the account. Further, we are concerned with the underlying assumption that the minimal sample of 2004-2008 activity is representative of the universe of the entire account, and that past inflation is indicative of the future. The dilemma is whether it should be assumed that the historic inflation pattern will continue and therefore be provided recovery.

If a 125 percent cost of removal component is used in the design of the depreciation rate for steel services, a remaining life rate of 11.1 percent results. The life component of this rate is 4.9 percent with a cost of removal component of 6.2 percent. If this rate had been in effect for each of the years 2005-2008, the annual provision, through depreciation expense, for cost of removal would have averaged about \$136,000, while the annual realized cost of removal averaged about \$152,000. The argument can be made that presuming continued inflation, a 125 percent cost of removal component is not adequate. It can also be argued that depreciation is being used to provide future costs of removal of plant now serving the public. Recognizing the state of the economy, we believe the current rate of inflation will continue, at least in the short term. We therefore approved FPUC's proposed negative net salvage component of 125 percent. Our staff will monitor future costs and recommend adjustments as needed.

A somewhat different situation exists for plastic services if a 25 percent cost of removal component is used in the design of its depreciation rate. The resulting remaining life rate is 3.8 percent, with a life component of 3.0 percent and a cost of removal component of 0.8 percent. If this remaining life rate had been in effect for each of the years 2005-2008, the annual provision, through depreciation expense, for cost of removal would have averaged about \$159,000, while the annual realized cost of removal averaged about \$70,000. In this situation, depreciation expense associated with future costs of removal would have been more than twice the actual removal costs booked. The excess depreciation expense over realized cost of removal is likely due to the presumption of continued inflation, and that tomorrow's inflated cost of removal is being provided at today's dollars. It can also be argued that the higher depreciation rate would have the effect of decreasing rate base, a desirable side effect.

If the currently prescribed 15 percent cost of removal component is maintained, the remaining life rate is 3.4 percent with a life component of 2.9 percent and a cost of removal component of 0.5 percent. Going through the same exercise as before, the annual provision, through depreciation expense, for cost of removal would have averaged about \$99,000, while the annual realized cost of removal averaged about \$70,000. While depreciation expense would still be in excess of realized removal costs, we believe this considers adequate inflation. Therefore, we find that retaining the currently prescribed net salvage component of negative 15 percent for the plastic services account is appropriate.

3. Measuring and Regulating Equipment (Accounts 378 and 379)

These accounts contain equipment used to maintain the correct operating pressure throughout the distribution system. The Company has proposed reducing the currently prescribed average service lives for these accounts from 31 years and 30 years, respectively, to 27 years for each account. Retirement activity for each of these accounts has historically been sporadic and minimal. This data does not lend support to a reduction in average service life as the Company reasons. Therefore, we shall maintain the current underlying average service lives for each account.

The Company's proposed reduction in net salvage from zero to negative 10 percent for Account 378 is based primarily on removal costs incurred in 2006 for the retirement of System Control and Data Acquisition (SCADA) equipment. Recognizing the minimal activity experienced in this account while also recognizing some removal costs are likely at retirement, we find a negative five percent net salvage is appropriate.

Because both Account 378 and Account 379 contain similar equipment, we believe the two accounts are likely to experience similar life and salvage patterns. For this reason, we shall approve a negative five percent net salvage for Account 379 as well.

4. Other Equipment (Account 387)

The Company proposes a decrease in average service life from 30 years to 25 years to recognize historical retirement activity and the account's average age. We believe a 25-year average service life is reasonable based on the industry expectations for this account. Based on this recalculated age, we find that an average remaining life of 17.6 years is appropriate.

B. General Plant

For many general plant accounts, the differences between our findings and the Company's positions are due to our recalculated average ages of the surviving investment. For two accounts, we are approving a longer average service life that better reflects future expectations.

1. Passenger Cars (Account 392.1)

The age of the passenger cars that retired during the 2004-2008 period averaged over nine years, indicating an average service life longer than the currently prescribed eight years. We find that a 10-year average service life, a 4.2-year average remaining life, and a 10 percent net salvage are more reflective of the account's activity and life expectations.

2. Light Trucks & Vans (Account 392.2)

This account is experiencing the most significant change in expense in the General Plant function. We calculated the average remaining life using mortality life tables and find our calculations are more reflective of the account's activity since the last study.

3. Heavy Trucks (Account 392.3)

While FPUC currently does not own any heavy trucks, it expects to purchase some in the future. The Company has requested approval of a remaining life rate to apply to investment added to this account. For new investment, a whole life rate is the appropriate rate design given that there is no reserve associated with new investment. Based on gas industry averages in the State, we find an 11-year average service life and a 10 percent net salvage value is appropriate. At the next depreciation review, the recovery of this account will be reviewed and analyzed for any needed revisions and possible move to a remaining life rate design.

4. Communication Equipment (Account 397)

The communication equipment account is comprised of telecommunications equipment, including 2-way radio equipment, and GPS tracking and directional units. Telecommunications equipment is subject to technological changes that can impact life expectations. FPUC proposes decreasing the average service life for this account from 14 years to 13 years based on increased retirement activity since the last depreciation study review. The 2004-2008 activity period includes a 2005 retirement representing about 70 percent of the retirements booked during the period and about 52 percent of the total retirements booked in the last 14 years. Nearly 85 percent of the total 2005 retirement was related to the replacement of the Company's telecommunications system.

We find the Company's proposed decrease in average service life is more in line with the expected life of the related equipment. Therefore, the average remaining life is adjusted to reflect an average age of 4.7 years.

5. Miscellaneous Equipment (Account 398)

This account has experienced significant growth since the last review. Nearly 87 percent of the account's investment has been added since 2006. Additions in 2006 alone represent nearly 45 percent of the growth. Retirements have generally been sporadic, with a retirement rate during the 2004-2008 period averaging 1.7 percent.

FPUC believes a reduction in average service life from 17 years to 15 years is indicated based on the average age of the investments retiring. We disagree. A 15-year average service life with an R2 retirement pattern and an average age of three years indicates more retirements than the minimal amount this account has actually experienced. Therefore, we shall maintain the existing 17-year average service life.

We shall also maintain the currently prescribed zero net salvage. In the past 14 years, this account has realized minimal gross salvage in only one year. The limited salvage and retirement activity does not indicate the need to revise the net salvage component.

III. Current Amortization of ITC and Flowback of Excess Deferred Income Taxes (EDIT)

As stated above, we have revised remaining lives to be effective July 1, 2009. Revising a utility's book depreciation lives generally results in a change in its rate of investment tax credits (ITC) amortization and flowback of EDIT in order to comply with the normalization requirements of the Internal Revenue Code (IRC) and its underlying Regulations (REGs) found in Sections 46, 167, and 168, and 1.46, 1.67, and 1.68, respectively.

Our staff, the Internal Revenue Service, and independent outside auditors examine a company's books and records and the orders and rules of the jurisdictional regulatory authorities to determine if the books and records are maintained in the appropriate manner and to determine the intent of the regulatory bodies in regard to normalization. Therefore, the current amortization of ITC and the flowback of EDIT shall be revised to reflect the approved remaining lives.

Section 46(f)(6), IRC, states that "the amortization of ITC should be determined by the period of time actually used in computing depreciation expense for ratemaking purposes and on the regulated books of the utility." Because we are approving revised remaining lives, it is also important to change the amortization of ITC to avoid violation of the provisions of Sections 46, IRC, and 1.46, REGs.

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, F.A.C., Accounting for Deferred Income Taxes Under SFAS 109, generally prohibits EDIT from being written off any faster than allowed under the Act. The Act, SFAS 109, and Rule 25-14.013, F.A.C., regulate the flowback of EDIT. Therefore, the flowback of EDIT shall be adjusted to comply with the Act, SFAS 109, and Rule 25-14.013, F.A.C.

Based on the above, the current amortization of ITC and the flowback of EDIT are hereby revised to match the actual recovery periods for the related property. The Company shall file detailed calculations of the revised ITC amortization and flowback of EDIT at the same time it files its surveillance report covering the period ending December 31, 2009.

In consideration of the above, it is

ORDERED that the prescribed lives, net salvages, reserves, and resultant depreciation rates and recovery schedules of the Florida Public Utilities Company shall be revised as set forth on Attachment A of this Order. It is further

ORDERED that the new depreciation rates and recovery schedules shall be implemented as of July 1, 2009. It is further

ORDERED that the current amortization of investment tax credits (ITC) and the flowback of excess deferred income taxes (EDIT) are hereby revised to match the actual recovery periods for the related property. It is further

ORDERED that Florida Public Utilities Company shall file detailed calculations of the revised ITC amortization and flowback of EDIT at the same time it files its surveillance report covering the period ending December 31, 2009. It is further

ORDERED that all attachments to this Order are incorporated herein by reference. 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 Commission Clerk, 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 if no substantially affected person files a protest to this Proposed Agency Action Order within 21 days of its issuance, a Consummating Order shall be issued and the docket shall be closed.

By ORDER of the Florida Public Service Commission this 13th day of April, 2009.



ANN COLE
Commission Clerk

(S E A L)

RRJ

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 Office of Commission Clerk, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on May 4, 2009.

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.

FLORIDA PUBLIC UTILITIES COMPANY
2008 CONSOLIDATED NATURAL GAS DEPRECIATION STUDY
DOCKET NO. 080548-GU
CONSOLIDATED DEPRECIATION RATES
COMMISSION APPROVED RATES AND COMPONENTS

ACCOUNT		APPROVED - CONSOLIDATED			REMAINING LIFE RATE (%)
		AVERAGE REMAINING LIFE (YRS.)	NET SALVAGE (%)	6/30/2009 RESERVE (%)	
DISTRIBUTION PLANT					
3741	Land Rights	30.0	0.0	0.0	3.3
375	Structures & Improvements	14.4	0.0	55.60	3.1
3761	Mains - Plastic	37.0	-10.0	19.28	2.5
3762	Mains - Steel	23.0	-20.0	54.54	2.8
378	Measuring and Regulating Ept. - General	19.0	-5.0	32.57	3.8
379	Measuring and Regulating Ept. - City Gate	21.0	-5.0	25.23	3.8
3801	Services - Plastic	26.0	-15.0	26.91	3.4
3802	Services - Other	12.3	-125.0	89.06	11.1
381	Meters	17.8	0.0	39.49	3.4
382	Meter Installations	26.0	-5.0	26.90	3.0
383	House Regulators	18.0	0.0	39.29	3.4
384	House Regulator Installations	24.0	-5.0	32.10	3.0
385	Indus. Meas. & Reg. Station Equip	10.0	0.0	21.96	7.8
387	Other Equipment	17.6	0.0	17.54	4.7
GENERAL PLANT					
390	Structures & Improvemts.	30.0	0.0	20.67	2.6
3911	Office Furniture	14.7	0.0	28.82	4.8
3912	Office Equipment	9.2	0.0	32.69	7.3
3913	Computers	4.7	0.0	47.95	11.1
3921	Transportation-Cars	4.2	10.0	35.12	13.1
3922	Transportation- Light Trucks & Vans	6.9	10.0	30.93	8.6
3923	Transportation-Heavy Trucks	11.0	10.0	0.0	8.2
3924	Transportation -Trailers	8.5	0.0	56.13	5.2
393	Stores Equipment	18.0	0.0	28.58	4.0
394	Tools, Shop & Garage Equipment	6.6	0.0	52.45	7.2
395	Laboratory Equipment	20.0	0.0	n/a	5.0
396	Power Operated Equipment	8.4	5.0	37.93	6.8
397	Communication Equipment	8.8	0.0	19.07	9.2
398	Miscellaneous Equipment	14.4	0.0	13.59	6.0
399	Miscellaneous Tangible				5 Year Amortization
374.1	Land Rights Recovery Schedule				5 Year Amortization