

State of Florida



Public Service Commission  
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TALLAHASSEE, FLORIDA 32399-0850

COMMISSIONER  
CLERK

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**DATE:** December 28, 2011

**TO:** Office of Commission Clerk (Cole)

**FROM:** Division of Economic Regulation (Bulecza-Banks, Cicchetti, Higgins, Ollila) *Mc D.G.*  
Office of the General Counsel (Barrera) *ALM* *WRP* *SMD*

**RE:** Docket No. 110233-GU – Petition for approval of 2011 Depreciation Study by Sebring Gas Systems, Inc.

**AGENDA:** 01/10/12 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICER:** Edgar

**CRITICAL DATES:** None

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\110233.RCM.DOC

**Case Background**

Rule 25-7.045, Florida Administrative Code (F.A.C.), requires natural gas companies to file a comprehensive depreciation study once every five years. On July 22, 2011, Sebring Gas System, Inc. (Sebring or Company) filed its 2011 depreciation study in compliance with this rule. The Company's last depreciation review was filed July 21, 2006, with an effective date of January 1, 2007. Sebring had 2010 operating revenues of \$559,707, and fewer than 600 customers. Staff has completed its review of Sebring's depreciation study and presents its recommendations herein.

The Commission has jurisdiction pursuant to Sections 350.115 and 366.05, Florida Statutes.

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**Discussion of Issues**

**Issue 1:** Should currently prescribed depreciation rates and recovery schedules of Sebring Gas Systems be revised?

**Recommendation:** Yes. A review of the Company's plans and activities indicates a need for a revision to the currently prescribed depreciation rates. (Higgins)

**Staff Analysis:** Sebring's last comprehensive depreciation study was filed on July 21, 2006. By Order No. PSC-07-0482-PAA-GU,<sup>1</sup> the Commission approved revised depreciation rates and components, effective January 1, 2007. The Company has filed this current study in accordance with Rule 25-7.045, F.A.C., which requires natural gas companies to file a comprehensive depreciation study at least once every five years from the submission date of the previously filed study. A review of the Company's activity data indicates the need for revising depreciation rates.

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<sup>1</sup> Issued June 7, 2007, in Docket No. 060504-GU, In re: Request for approval of depreciation study for five-year period 2001 through 2005 by Sebring Gas System, Inc.

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**Issue 2:** What should be the implementation date for new depreciation rates and recovery schedules?

**Recommendation:** Staff recommends approval of the company's proposed January 1, 2011, date of implementation for revised depreciation rates. (Higgins)

**Staff Analysis:** Rule 25-7.045, F.A.C., requires that the data submitted in a depreciation study, including plant and reserve balances or company estimates, "should be brought to the effective date of the proposed rates." The supporting data and calculations provided by Sebring match an implementation date of January 1, 2011.

**Issue 3:** What are the appropriate depreciation rates and recovery schedules?

**Recommendation:** Staff's recommended lives, net salvages, reserves, resultant depreciation rates, and recovery schedules are shown on Attachment A. Attachment B shows a decrease in annual expenses of approximately \$201 based on December 31, 2010, investments. (Higgins, Ollila)

**Staff Analysis:** Staff's recommendations are the result of a comprehensive review of Sebring's depreciation study. Attachment A shows a comparison of the currently approved depreciation rate parameters and those staff is recommending as appropriate. The Company agrees with Staff's recommended rate parameters. Attachment B shows a comparison of resultant expenses based on December 31, 2010, investments.

This filing was essentially a staff-assisted study. The Company provided raw data with regard to additions and retirements for the 2006 - 2010 period. Staff determined the average age and worked with the Company in developing life and salvage values. As a note, only the accounts where staff and the Company initially differed on depreciation parameters are addressed in this staff analysis. However, as previously mentioned staff calculated property ages for all of Sebring's accounts, and computed the average remaining lives of these accounts. As a result of the review and analytical process, staff and Sebring now agree on lives, net salvages, and resultant depreciation rates for all accounts.

Account 380.1 – Services Steel

Sebring proposed retaining the current 40-year average service life for this account. Between 2006 and 2010 there were no retirements and minimal additions to this account, resulting in an increase in age from 39.2 years in 2006 to 43.0 years in this study. Staff recommended to Sebring that the average service life be increased to 48 years; the age of the investment is greater than the average service life and there is no program to replace steel services. Sebring is in agreement with a 48-year average service life for steel services.

Account 391.1 – Office Furniture

Staff calculated the average age of property in this account to be 19.6 years. The Company proposed an average service life (ASL) of 18 years. Staff believes a 25-year ASL for this account better reflects its actual mortality experience. The Company agreed with staff's finding.

Account 391.2 – Office Equipment

Staff calculated the average age of property in this account to be 9.8 years. The Company proposed an ASL of 12 years. Staff believes a 15-year ASL for this account better reflects its actual mortality experience. The Company agreed with staff's finding.

Account 396 – Power Operating Equipment (New)

Staff calculated an average age of 9.7 years for the property in this account. Given a zero net salvage percentage and a 15-year ASL, staff calculated the average remaining life (ARL) to be 5.4 years. The Company proposed a 13.5-year ARL. After reviewing staff's finding, the company agreed that the ARL for this account is 5.4 years.

#### Account 397 – Communication Equipment

Staff has calculated the average age of property in this account to be 13.5 years. The Company proposed an ASL of 12 years. Staff believes a 18-year ASL for this account better reflects its actual mortality experience. The Company agreed with staff's finding.

#### Reserve Transfers

As part of its review of Sebring's depreciation study, staff reviewed the book reserve position for each account. Based on staff's recommended life and salvage inputs for this study, staff determined Sebring's theoretical or calculated reserve. The difference between an account's book and theoretical reserve may be described as a positive or negative imbalance, or as a surplus or deficiency. When negative or positive imbalances occur, corrective transfers among accounts should be made as quickly as possible, unless this action prevents the Company from earning a fair and reasonable return on its investments.

Overall, Sebring's book reserve is greater than its theoretical reserve. Staff's recommended reserve reallocation results in all but three accounts reset to their theoretical reserves. The accounts which have book reserves greater than theoretical reserves after the reallocation are:

- Account 376.2 – Mains Plastic: Prior to the reallocation, this account's book reserve was 104.3 percent of its theoretical reserve. After the reallocation, the book reserve is 103.3 percent of the theoretical reserve.
- Account 380.1 – Services Steel: Prior to the reallocation, this account's book reserve was 117.6 percent of its theoretical reserve. After the reallocation, the book reserve is 116.1 percent of the theoretical reserve.
- Account 380.2 – Services Plastic: Prior to the reallocation, this account's book reserve was 144.5 percent of its theoretical reserve. After the reallocation, the book reserve is 119.7 percent of the theoretical reserve.

Staff's recommended reserve allocation is in Table 3-1.

**Table 3-1: Recommended Reserve Allocation**

Account		12/31/10 Reserve	Theoretical Reserve	Recommended Transfers	Restated Reserve
376.1	Mains – Steel	\$135,837	\$134,262	(\$1,575)	\$134,262
376.2	Mains – Plastic	\$443,149	\$425,069	(\$4,048)	\$439,101
378	M & R Eq. General Embedded	\$4,002	\$6,396	\$2,394	\$6,396
379	M & R Eq. City Gate	\$27,912	\$32,089	\$4,177	\$32,089
380.1	Services – Steel	\$383,968	\$326,394	(\$5,000)	\$378,968
380.2	Services – Plastic	\$145,745	\$100,847	(\$25,000)	\$120,745
381	Meters	\$105,700	\$117,114	\$11,414	\$117,114
382	Meter Installations	\$34,186	\$34,332	\$146	\$34,332
383	House Regulators	\$17,020	\$19,078	\$2,058	\$19,078
384	House Regulator Installations	\$28,015	\$27,916	(\$99)	\$27,916
386	Property on Customers’ Premises	\$25,422	\$21,483	(\$3,939)	\$21,483
387	Other Equipment	\$4,984	\$3,710	(\$1,274)	\$3,710
390	Leasehold Improvements	\$1,505	\$664	(\$841)	\$664
391.1	Office Furniture	\$407	\$312	(\$95)	\$312
391.2	Office Equipment	\$19,662	\$15,186	(\$4,476)	\$15,186
392.1	Transportation Trucks	\$37,128	\$57,066	\$19,938	\$57,066
394	Tools, Shop & Garage Equipment	\$3,610	\$3,045	(\$565)	\$3,045
396	Power Operated Equipment – New	\$1,992	\$9,053	\$7,061	\$9,053
397	Communication Equipment	\$1,053	\$777	(\$276)	\$777
	<b>Total</b>	<b>\$1,421,297</b>	<b>\$1,334,793</b>	<b>\$0</b>	<b>\$1,421,297</b>

**Issue 4:** Should the current amortization of investment tax credits (ITCs) and flow back of excess deferred income taxes (EDITs) be revised to reflect the approved depreciation rates?

**Recommendation:** Yes. The current amortization of ITCs and the flowback of EDITs 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 EDITs at the same time it files its surveillance report covering the period ending December 31, 2011. (Cicchetti)

**Staff Analysis:** In earlier issues, staff has recommended approval of revised depreciation rates for the Company, to be effective January 1, 2011, which generally reflect changes to accounts' remaining lives to be effective January 1, 2011. Revising a utility's book depreciation lives generally results in a change in its rate of ITC amortization and flowback of EDITs in order to comply with the normalization requirements of the Internal Revenue Code (IRC or Code) set forth in sections 168(f)(2) and (i)(9), former IRC sections 167(l) and 46(f),<sup>2</sup> Federal Tax Regulations under the Code sections,<sup>3</sup> and section 203(e) of the Tax Reform Act of 1986 (the Act).<sup>4</sup>

Staff, the Internal Revenue Service (IRS), and independent outside auditors look at 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. The books are also reviewed to determine if they are in compliance with the regulatory guidelines in regard to normalization. Therefore, staff recommends the current amortization of ITCs and the flowback of EDITs be revised to reflect the remaining useful lives that underlie staff's proposed depreciation rates.

Former section 46(f)(6) of the Code 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."<sup>5</sup> Since staff is recommending changes to the Company's remaining lives, it is also important to change the amortization of ITCs to avoid violation of the provisions of the former IRC section 46 and its underlying Treasury Regulations. The consequence of an ITC normalization violation is a repayment of unamortized ITC balances to the IRS.

Section 203(e) of the 1986 Act prohibits rapid flow back of depreciation-related (protected) EDITs to the utility's customers. Further, Rule 25-14.013, F.A.C., Accounting for Deferred Income Taxes Under SFAS 109, generally prohibits EDITs from being written off any faster than allowed under the Act. The Act, ASC 740,<sup>6</sup> and Rule 25-14.013, F.A.C., regulate the flowback of EDITs. Therefore, staff recommends that the flowback of EDITs be adjusted to comply with the Act, ASC 740, and Rule 25-14.013, F.A.C.

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<sup>2</sup> 26 USC §§168(f)(2) and (i)(9); 26 USC §167(l); 26 USC §46(f).

<sup>3</sup> Treas. Reg. §1.168; Treas. Reg. §1.167; Treas. Reg. §1.46.

<sup>4</sup> Tax Reform Act of 1986, 1986-3 (Vol.1) C.B. 63, P.L. 99-514 (100 Stat. 2146) October 22, 1986.

<sup>5</sup> 26 USC §46(f)(6).

<sup>6</sup> FASB ASC 740 (Topic 740 of the Financial Accounting Standards Board Accounting Standards Codification). Cross Reference: Accounting for Income Taxes, Statement of Financial Accounting Standards No. 109 (Financial Accounting Standards Board, 1992).

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**Issue 5:** Should this docket be closed?

**Recommendation:** Yes. If no person whose substantial interests are affected by the proposed agency action files a timely request for a hearing within 21 days of the issuance of the order, this docket should be closed upon the issuance of a consummating order. (Barrera)

**Staff Analysis:** If no person whose substantial interests are affected files a timely request for a hearing within 21 days, no further action will be required and this docket should be closed upon the issuance of a consummating order.

SEBRING GAS SYSTEM, INC.  
DOCKET NO. 110233-GU  
2011 DEPRECIATION STUDY

ATTACHMENT A

COMPARISON OF RATES AND COMPONENTS

ACCOUNT	CURRENT					COMPANY/STAFF RECOMMENDED				
	AVERAGE SERVICE	AVERAGE REMAINING	NET	01/01/2007	REMAINING LIFE	AVERAGE SERVICE	AVERAGE REMAINING	NET	12/31/2010	REMAINING LIFE
	LIFE	LIFE	SALVAGE	RESERVE	RATE	LIFE	LIFE	SALVAGE	RESERVE	RATE
	(YRS.)	(YRS.)	(%)	(%)	(%)	(YRS.)	(YRS.)	(%)	(%)	(%)
<b>DISTRIBUTION PLANT</b>										
376.1 - Mains - Steel	45.0	14.9	(30)	86.79	2.9	45.0	12.7	(30)	93.17	* 2.9
376.2 - Mains - Plastic	45.0	34.0	(30)	31.40	2.9	45.0	34.2	(30)	31.84	* 2.9
378 - Measuring and Regulating Ept. - Gen. - Embedded	33.0	16.2	(2)	51.78	3.1	33.0	13.1	(2)	61.39	* 3.1
378.1 - Measuring and Regulating Ept. - Gen. - New	33.0	33.0	(2)	N/A	3.1	33.0	33.0	(2)	N/A	3.1
379 - Measuring and Regulating Ept. - City Gate	32.0	17.0	(2)	47.60	3.2	32.0	16.5	(2)	49.20	* 3.2
380.1 - Services - Steel	40.0	10.5	(30)	95.35	3.3	48.0	14.3	(30)	106.11	* 1.7
380.2 - Services - Plastic	40.0	33.4	(30)	28.32	3.0	40.0	32.0	(30)	29.21	* 3.1
381 - Meters	25.0	9.3	0	62.80	4.0	25.0	12.1	0	51.60	* 4.0
382 - Meter Installations	34.0	16.7	(5)	53.23	3.1	34.0	17.1	(5)	51.99	* 3.1
383 - House Regulators	30.0	13.1	0	56.77	3.3	30.0	10.5	0	65.35	* 3.3
384 - House Regulator Installations	34.0	14.8	(3)	58.60	3.0	34.0	13.7	(3)	61.90	* 3.0
386 - Property on Customers' Premises	20.0	7.8	0	61.00	5.0	25.0	9.5	0	62.00	* 4.0
387 - Other Equipment	25.0	15.0	0	40.00	4.0	25.0	15.5	0	38.00	* 4.0
<b>GENERAL PLANT</b>										
390.0 Leasehold Improvements	40	24.5	0	46.75	2.2	40.0	38.0	0	5.00	* 2.5
391.1 - Office Furniture	18	5.6	0	68.61	5.6	25.0	8.8	0	64.73	* 4.0
391.2 - Office Equipment	12	4.6	0	84.95	3.3	15.0	5.8	0	61.14	* 6.7
392.1 - Transportation Trucks	8	3.2	15	65.53	6.1	8.0	2.7	15	56.38	* 10.6
394 - Tools, Shop & Garage Equipment	15	12.7	0	19.54	6.3	15.0	10.3	0	30.99	* 6.7
396 - Power Operated Equipment - New	15	13.5	0	10.05	6.7	15.0	5.4	0	63.82	* 6.7
397 - Communication Equipment	12	3.0	0	76.85	7.7	18.0	5.0	0	72.01	* 5.6

\*Denotes restated reserves after transfers

SEBRING GAS SYSTEM, INC.  
DOCKET NO. 110233-GU  
2011 DEPRECIATION STUDY

ATTACHMENT B

COMPARISON OF EXPENSES

ACCOUNT	CURRENT				STAFF SUGGESTED		
	12/31/2010	12/31/2010			ESTIMATED	CHANGE	
	INVESTMENT	RESERVE	RATE	EXPENSES	RATE	EXPENSES	
	(\$)	(\$)	(%)	(\$)	(%)	(\$)	
<b>DISTRIBUTION PLANT</b>							
376.1 - Mains - Steel	144,104	134,262*	2.9	4,179	2.9	4,179	
376.2 - Mains - Plastic	1,379,199	439,101*	2.9	39,997	2.9	39,997	
378 - Measuring and Regulating Ept. - Gen. - Embedded	10,419	6,396*	3.1	323	3.1	323	
378.1 - Measuring and Regulating Ept. - Gen. - New	0	0	3.1	0	3.1	0	
379 - Measuring and Regulating Ept. - City Gate	65,221	32,089*	3.2	2,087	3.2	2,087	
380.1 - Services - Steel	357,144	378,968*	3.3	11,786	1.7	6,071	
380.2 - Services - Plastic	413,307	120,745*	3.0	12,399	3.1	12,813	
381 - Meters	226,965	117,114*	4.0	9,079	4.0	9,079	
382 - Meter Installations	66,036	34,332*	3.1	2,047	3.1	2,047	
383 - House Regulators	29,194	19,078*	3.3	963	3.3	963	
384 - House Regulator Installations	45,098	27,916*	3.0	1,353	3.0	1,353	
386 - Property on Customers' Premises	34,650	21,483*	5.0	1,733	4.0	1,386	
387 - Other Equipment	9,762	3,710*	4.0	390	4.0	390	
<b>TOTAL DISTRIBUTION PLANT</b>	<b>2,781,099</b>	<b>1,335,194</b>		<b>86,336</b>		<b>80,688</b>	
						<b>(5648)</b>	
<b>GENERAL PLANT</b>							
390.0 Leasehold Improvements	13,278	664*	2.2	292	2.5	332	
391.1 - Office Furniture	482	312*	5.6	27	4.0	19	
391.2 - Office Equipment	24,838	15,186*	3.3	820	6.7	1,664	
392.1 - Transportation Trucks	101,216	57,066*	6.1	6,174	10.6	10,729	
394 - Tools, Shop & Garage Equipment	9,826	3,045*	6.3	619	6.7	658	
396 - Power Operated Equipment - New	14,185	9,053*	6.7	950	6.7	950	
397 - Communication Equipment	1,079	777*	7.7	83	5.6	60	
						<b>(23)</b>	
<b>TOTAL GENERAL PROPERTY</b>	<b>164,904</b>	<b>86,103</b>		<b>8,965</b>		<b>14,412</b>	
						<b>5447</b>	
<b>TOTAL PLANT</b>	<b>2,946,003</b>	<b>1,421,297</b>		<b>95,301</b>		<b>95,100</b>	
						<b>(201)</b>	

\*Denotes restated reserves after transfers