State of Florida

Public Service Commission

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

DATE: November 13, 2014

TO: Office of Commission Clerk (Stauffer)

FROM: Division of Economics (Ollila, Higgins, Wu)
Division of Accounting and Finance (Cicchetti, Fletcher, Trueblood)
Office of the General Counsel (Barrera)

RE: Docket No. 140016-GU – 2014 depreciation study by Florida Public Utilities Company.

AGENDA: 11/25/14 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Brisé

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

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. In accordance with this rule, the Florida Division of Chesapeake Utilities Corporation, Florida Public Utilities Company, and Indiantown Gas Company filed their last depreciation studies on May 17, 2007 (Docket No. 070322-GU), March 21, 2008 (Docket No. 080170-GU), and December 10, 2008 (Docket No. 080548-GU), respectively.

On October 28, 2009, Chesapeake Utilities Corporation (Chesapeake) and Florida Public Utilities Company (FPUC) announced their corporate merger, whereby the gas and electric utilities of FPUC became a wholly owned subsidiary of Chesapeake. On November 5, 2009, pursuant to Rule 25-9.044(1), F.A.C., Chesapeake notified the Commission of its acquisition of

FPUC. On August 6, 2010, FPUC acquired Indiantown Gas Company. On October 22, 2013, FPUC notified the Commission of its acquisition of the natural gas system serving the City of Fort Meade, which was completed on December 2, 2013. The resulting gas divisions are FPUC Division, Chesapeake Division, Indiantown Division, and Fort Meade Division (collectively FPUC or the Company).

Chesapeake Division's depreciation study was due on or before May 17, 2012. On April 12, 2012, Chesapeake Division filed a request for a waiver of the filing requirement until August 17, 2012, which the Commission granted.[1] On June 25, 2012, Indiantown Division and Chesapeake Division filed a joint petition for waiver and extension of waiver of the depreciation study filing requirement until June 2013. Indiantown Division's and FPUC Division's depreciation studies were due no later than May 30, 2013 and December 10, 2013, respectively. The Company asserted that it anticipated requesting approval of a single set of blended depreciation rates in the filing, thus eliminating the need for any subsequent depreciation study required as a result of a potential consolidation of the Company's rates and tariffs. In a noticed informal meeting, staff and the Company agreed that the depreciation studies would be filed no later than January 15, 2014, less than one month past the due date for FPUC Division to file its depreciation study. The Commission granted the petition, requiring FPUC Division, Chesapeake Division, and Indiantown Division to file their depreciation studies no later than January 15, 2014.[2]

Depreciation studies filed pursuant to Rule 25-7.045, F.A.C., provide the Commission with the current plant information used to establish depreciation rates and lives of assets (investments) by FERC account, thereby matching the timing of the recovery of the assets to the expected life of the assets. Once the Commission approves changes to the Company's depreciation rates as a result of its review of the depreciation study, the Company's prospective earning surveillance reports will reflect the impact of the Commission's decision. In addition, the depreciation rates established in this docket will be used to determine the depreciation expense and accumulated depreciation in the Company's next rate case.

The Company filed its depreciation studies on January 13, 2014, and an update on July 2, 2014. Staff issued two data requests and a staff report. The Commission has jurisdiction pursuant to Sections 350.115 and 366.05, Florida Statutes (F.S.).

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[1] Order No. PSC-12-0354-PAA-GU, issued July 9, 2012, in Docket No. 120081-GU, In re: Petition for waiver of requirement of Rule 25-7.045(8)(a), F.A.C., to file depreciation study within five years from date of filing previous study, and for authorization to file next depreciation study August 17, 2012, by Florida Division of Chesapeake Utilities Corporation.

[2] Order No. PSC-12-0532-PAA-GU, issued October 8, 2012, in Docket No. 120178-GU, In re: Joint petition for waiver of depreciation study filing requirement of Rule 25-7.045(8)(a), F.A.C., by Florida Public Utilities, Indiantown Division and for extension of waiver of Rule 25-7.045(8)(a), by the Florida Division of Chesapeake Utilities Corporation.

Discussion of Issues

Issue 1: What are the appropriate depreciation rates?

Recommendation: Staff's recommended remaining lives, net salvage percentages, reserve percentages, and the resulting depreciation rates are contained in Attachment A. Attachment B shows a total annual expense of $7,197,946, which is $60,409 less than the Company proposed expense of $7,258,355. (Ollila, Higgins, Wu)

Staff Analysis:

Staff's recommendations are the result of comprehensive review of the Company's January 13, 2014 filing, its July 2, 2014 update, the Company's responses to two staff-issued data requests, the Company's response to the staff report,[3] and the Company's response to the Office of Public Council's September 5, 2014 letter expressing its concerns. FPUC's proposals for consolidated depreciation rates, the treatment of Florida Common Assets, and the application of depreciation rates approved in this proceeding to the Company's recently acquired Fort Meade Division are discussed individually.

Staff notes that only the accounts where staff and the Company initially differed on depreciation parameters are addressed in the staff analysis. As a result of the review and analytical process, staff and the Company now agree on the consolidation of rates, the treatment of Florida Common Assets, the application of depreciation rates to the Fort Meade Division, as well as lives, net salvage percentages, and the resulting depreciation rates for all accounts. Attachment A contains a comparison of Company proposed and staff recommended rates and components. Attachment B contains a comparison of Company proposed and staff recommended depreciation rates and associated expenses.

Consolidation of Depreciation Rates

As noted in the case background, subsequent to the 2007 and 2008 depreciation studies, Florida Public Utilities Company, the Florida Division of Chesapeake Utilities Corporation, and Indiantown Gas Company, through a combination of a merger and acquisitions, became one company with three sets of depreciation rates. The Company plans to consolidate its natural gas operations gradually, over several years, because the Company believes that this is the most efficient and effective way to consolidate for regulatory purposes. In 2014, the Company is requesting consolidated depreciation rates and a consolidated conservation program. During the 2015-2016 time frame the Company expects to request consolidation of the general rules and non-rate portions of the tariffs with best practices or common rules and regulations. The Company anticipates that a base rate proceeding may be necessary before the next depreciation study in 2019, and that consolidation of depreciation rates "will create an efficient step towards

[3] The staff report consists of staff's initial proposals, information necessary to understand staff's initial proposals, questions to the company, and summary tables which provide staff's initial position on inputs, rates, and resulting depreciation expense for all accounts.

that endeavor." The Company does not have a specific target date for full consolidation at this time.[4]

In its January 13, 2014 filing, FPUC concluded that the appropriate depreciation rates for the divisions were identical for each account based on the divisions' similar service environments, projected growth trends, and shared corporate parent assets. Subsequent to the Company's January filing, staff discussed with the Company other methods that could be used to develop a single set of rates for all three divisions. In FPUC's July 2014 update, its approach to developing consolidated depreciation rates depended on the individual component. For example, the investment, accumulated depreciation, and net salvage of a particular account were summed across the divisions while an account's consolidated age was calculated using weighted net investment. After an extensive review of the filings, including responses to data requests and the staff report, staff believes that the Company's consolidation methodology is reasonable.

Consolidated Annual Status Reports

Staff reviews each division's annual status reports for depreciation and accumulated depreciation on a yearly basis. Because FPUC developed its age and other calculations based on consolidated data, which may not match each division's accounts exactly, staff requested, and the Company agreed, to provide consolidated annual status reports beginning with the 2014 calendar year.[5]

Florida Common Assets

Florida Common Assets (common assets) are general account assets (e.g., buildings and furniture), located primarily in West Palm Beach, that are used by the gas divisions, the electric division, and the unregulated propane affiliates. These assets and their accumulated depreciation reside in the FPUC Division accounts. Previously, the depreciation rates for common assets were established in the FPUC Division study and used to depreciate the common assets. The Company proposes that the depreciation rates approved in this proceeding continue to be applied to its common assets. The Company further proposes that it be allowed to continue to allocate such assets and associated rates consistent with its current allocation methodology.[6] Staff believes that, for the purpose of setting depreciation rates in the instant proceeding, the current allocation factors are appropriate.

Acquisition of the City of Fort Meade's Gas Division and Its Depreciation Rates

In December 2013, the Company acquired the City of Fort Meade's gas division (Fort Meade Division). The Company requests that the Fort Meade Division be permitted to adopt the depreciation rates approved in this proceeding and that the purchase price/fair value of the assets, $670,000, be used as the basis for costs.[7] According to the Company, the new Fort Meade Division's service environment is similar to the other gas divisions. The Company anticipates

[4] The Company's response to the Staff Report, No. 20.
[5] The Company's response to the Staff Report, No. 21.
[6] The Company's response to Staff's Second Data Request, No. 18.
[7] The Company's response to the Office of Public Counsel's Comments of September 5, 2014, Item 1.

that the Fort Meade Division's planning, growth, technology, physical conditions, and trends will now be consistent with the other three divisions.[8]

The assets acquired from the City of Fort Meade had never been subject to rate regulation and, thus, to the Uniform System of Accounts (USOA). According to FPUC's response to Staff's Second Data Request, No. 23 and its attachment, as of September 2013, Fort Meade's gross plant totaled \$486,773, with \$395,140 of accumulated depreciation, resulting in net plant of \$91,633. According to the Company, it appears that the City of Fort Meade did not track or apply gross salvage and cost of removal in its accounting for these assets.

The records of the new Fort Meade Division are insufficient to determine assets by vintage year, FERC account, and components of remaining life. The Company proposes \$670,000 as a basis for the cost of assets; however, a letter from the Office of Public Counsel raises concerns about using the purchase price as a basis for cost. On a going forward basis, the Company asserts that, using available information pertaining to the number of services and meters, miles of mains, etc., in conjunction with information from its other natural gas systems, it can estimate asset values as a basis for setting depreciation rates. The Company has offered to submit this estimate to the Commission for review upon completion of the estimate.[9] Staff believes this would be beneficial information and should be provided to the Commission as soon as it is available.

Staff believes that, for the purpose of this proceeding, Fort Meade's gross plant should be used as the basis for estimating depreciation. Additionally, consistent with FPUC's request for consolidated rates and the small amount of Fort Meade Division's assets compared to the total (0.2% of consolidated gross plant),[10] staff believes that it is reasonable to apply the depreciation rates approved in this proceeding to the Fort Meade Division assets.

Reserve Transfers

The remaining life rate is self-correcting; that is, the rate increases or decreases based on whether there is a reserve imbalance, and if there is, the size of the reserve imbalance. The Commission has approved reserve transfers to reduce or eliminate reserve imbalances in the past.[11] However, Rule 25-7.045(7)(b), F.A.C., does not require that reserve transfers be made, only that the possibility of reserve transfers be investigated.

Staff investigated the use of reserve transfers in this proceeding, but believes that with the complexity of the proceeding, it is reasonable to postpone any use of reserve transfers until at least the next depreciation study. That depreciation study, with five years of consolidated data, will provide a better indication of whether reserve transfers are necessary, and if they are, what they should be.

[8] The Company's response to Staff's Second Data Request, No. 20.
[9] The Company's response to the Staff Report, No. 23.
[10] The Company's Exhibit AA Revised (8/8/14), page 1.
[11] Order No. PSC-14-0514-PAA-GU, issued September 25, 2014, in Docket No. 140051-GU, In re: 2014 depreciation study by Florida City Gas.

Net Salvage

Net salvage (NS), which is one of the inputs used to derive the depreciation rate, equals gross salvage less the cost of removal (COR). Regarding the accuracy of the data records associated with the NS, FPUC reported some non-typical or abnormal values for certain accounts of FPUC Division and Chesapeake Division in this depreciation study.[12] In response to staff's questions regarding the abnormal values, the Company indicated that it could not provide the requested information without further detailed investigation.[13] Upon further staff inquiry, the Company responded that to further investigate the anomalies would be a huge undertaking and might require additional personnel; it could be a very lengthy process that could take up to six months and would likely result in increased costs to the Company, which would likely impact customers.[14] However, the Company acknowledged that if the Commission were to direct the Company to conduct this level of review, it would do so; otherwise, going forward, it does intend to undertake efforts to review its practices in this regard in an effort to determine whether changes need to be implemented in order to reduce or avoid the occurrence of such abnormal results.[15]

Understanding the unique character of the instant depreciation study,[16] the complexity of the merger and acquisition processes that FPUC had gone through which had affected its depreciation accounting,[17] the low impact of the identified inaccurate NS records on the overall outcome of the study,[18] and the nature of a depreciation study,[19] staff recommends a pragmatic approach[20] to resolve the issue in the instant study, as implemented in the section below. Emphasizing the importance of maintaining the accuracy of historical data in preparing a depreciation study, staff urges the Company to undertake a thorough review of its policies and practices regarding the record-keeping in its depreciation accounting. The Company should implement a procedure of maintaining clear documentation on each gross salvage and COR booked so that these records can be verified by the Commission through its Annual Status Report reviewing process.

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[12] For example, FPUC Division reported negative 1256.75% as the 2012 NS value for Account 376.1. The affected Accounts include 376.1, 376.2, 380.1, 380.2 and 385.0, see Narrative, pages 5 – 6, and Exhibit L of the Depreciation Study.

[13] The Company's responses to Staff's Second Data Request, Nos. 5b, 6d, 7c, 7d, 7e, 8c, 8e, 9d and 9e.

[14] The Company's response to the Staff Report, No. 9.

[15] The Company's responses to Staff's Second Data Request, Nos. 5a, 6a, 7a, 8a, 8e, 9e and Staff Report, No. 9.

[16] Depreciation rates will be derived based on the consolidated data from the raw data of three individual divisions.

[17] There have been a lot of changes since the merger and acquisitions, and those employees most familiar with the records may not be with the Company any longer. See FPUC's response to Staff Report, No. 9.

[18] Staff believes the amount (in term of the depreciation expense and reserve) would be immaterial. None the less, staff also believes that it is very important to maintain data accuracy. However, for the discussed NS records in the instant study, the cost to clarify the inaccuracy appears to out-weigh the benefit that would result from the clarification process.

[19] It involves forecasting and estimation.

[20] That is, taking what the Company could provide now as the raw inputs for the instant study, but exercising more careful data analysis and making necessary adjustment to the abnormality in calculating the consolidated NS to determine the final depreciation rate for the affected account.

Individual Accounts

Account 376.1 Mains – Plastic

The current consolidated NS is negative 16.7%. The Company proposes a NS of negative 15%. In its depreciation study, the Company-calculated consolidated actual average NS is 40.63% for the study period, but acknowledged that the data contained non-typical salvage activity[21] and judged the historical data unusable for setting future depreciation rates.[22] The Company indicated that the salvage activity of the FPUC Division, whose NS was negative 17.76%, was considered more reliable and appeared to be more typical of what would be expected going forward, and this division represented 66% of retirement activity for this account.[23] Based on the above and in the absence of reliable historical data for the consolidated account, staff recommends a NS of negative 16%, which is closer to (a) the current consolidated NS value which was calculated based upon what the Commission prescribed for the account of each individual division of FPUC during that division's last depreciation study, (b) what the Commission prescribed for the FPUC Division during its last depreciation study, (c) what the FPUC Division actually experienced during the current study period, and (d) the industry average.

Account 376.2 Mains – Steel

The current consolidated NS is negative 23.0%. The Company proposes a NS of negative 30%. In its depreciation study, the Company-calculated consolidated actual average NS is negative 82.7% for the study period, but the Company acknowledged that the data contained non-typical salvage activity[24] and deemed the historical data unusable for setting future depreciation rates.[25] The Company indicated that the salvage activity of the FPUC Division, whose NS was negative 35.6%, was considered more reliable and appeared to be more typical of what would be expected. For this account, the Chesapeake Division represented a slightly higher percentage of the retirement activity (Chesapeake Division 53.6% versus FPUC Division 46.4% and Indiantown Division 0%). Staff notes that Chesapeake Division experienced a very large amount of COR annually through out the study period (from 67% to 1,445%). Staff also notes that the Company could not determine the cause(s) of the large COR for most of the years at this moment.[26] Given the lack of full understanding of the historical data, staff recommends a NS of negative 28% which is (a) closer to what the Commission prescribed for the account (three division consolidated based on the respective previous depreciation studies), (b) within the range of the industry average, and yet (c) reflecting the appearing increased trend of a higher COR shown in the current study period.

[21] Pages 5-7 of the narrative from the July 2, 2014 update to the depreciation study.
[22] The Company's response to Staff's Second Data Request, No. 5a.
[23] The Company acknowledged that it was unable to conduct a timely comprehensive analysis necessary to determine the precise cause for this anomaly to provide a specific explanation regarding the abnormality, but it intended to conduct a review to determine, going forward, if there are changes in its practices or policies that would help avoid such anomalies and atypical data in future. See the Company's responses to Staff's Second Data Request, Nos. 5a - 5c.
[24] Pages 5-7 of the narrative from the July 2, 2014 update to the depreciation study.
[25] The Company's response to Staff's Second Data Request, No. 6a.
[26] The Company's response to Staff's Second Data Request, No. 6d.

Account 380.1 Services – Plastic

The current consolidated NS is negative 17.8%. The Company proposes a NS of negative 25%. In its depreciation study, the Company-calculated consolidated actual average NS is negative 79.77% for the study period, but acknowledged that the data was deemed non-typical for abnormal results and judged the historical data unusable for setting future depreciation rates.[27] The Company indicated that the salvage activity of the FPUC Division, whose NS was negative 38.75%, was considered more reliable and appeared to be more typical of what would be expected.[28] Based on the above and in the absence of reliable historical data for the consolidated account, staff recommends a NS of negative 22% which is (a) the current consolidated NS value which was calculated based upon what the Commission prescribed for the account of each individual division of the FPUC during that division's last depreciation study, (b) closer to what the Commission prescribed for the FPUC Division during its last depreciation study, (c) staying close to what the FPUC Division actually experienced during the current study period, and (d) within the industry average.

Account 381.1 Meters - AMR Equipment

Chesapeake Division is the only division which has assets recorded in this account. During Chesapeake Division's last rate case, the Commission granted depreciation rate of 5% and prescribed average service life of 20 years and 0% NS for this account.[29] Staff concurs with the Company's proposed average service life of 20 years, R3 curve shape and plant age of 3.5 years. Using these parameters as the inputs, the calculated remaining life for this account is 16.7 years, rather than 17.1 years as the Company proposed. Thus, staff recommends 16.7 years remaining life for this account.

Account 390 – Structures and Improvements

The Company proposed 0% NS. This account saw a significant positive NS from the sale of a building in 2012, resulting in consolidated NS of 66%. In general, staff believes that one-time events are not necessarily predictive of the future. However, this positive NS is so significant, staff believes increasing the NS from 0 to 10% is a reasonable recognition of an unusual event.

Account 392.3 – Transportation – Heavy Trucks & Account 395 – Laboratory Equipment

These accounts have no investment. The Company proposed retaining these accounts for possible future use and asked the Commission to set a remaining life depreciation rate for each

[27] The Company's response to Staff's Second Data Request, No. 7a.
[28] For this account, FPUC Division represented 99.4% of the retirement activity. The Company acknowledged that it was unable to conduct a timely comprehensive analysis necessary to determine the precise cause for this anomaly to provide a specific explanation regarding the abnormality, and stated that "the Company intend[s] to undertake efforts to review its practices in this regard in an effort to determine whether changes need to be implemented in order to reduce or avoid the occurrence of such abnormal results." See the Company's response to Staff's Second Data Request, Nos. 7a - 7e.
[29] Order No. PSC-10-0029-PAA-GU, issued January 14, 2010, in Docket No. 090125-GU, In re: Petition for increase rates by Florida Division of Chesapeake Utilities Corporation.

account based on industry average or tax life. FPUC Division made the same request in its last depreciation study, Docket No. 080548-GU (2008 study), for the same reason. Staff reviewed industry data for Florida as well as what the Commission ordered in the FPUC Division's 2008 study. Staff notes that it can only recommend a whole life rate; there must be investment and accumulated depreciation in order to have a remaining life rate.

For each account, staff's recommendation is identical to what the Commission ordered in the 2008 study. For Account 392.3, staff recommends an average service life of 11 years and a 10% NS, which results in a whole life rate of 8.2%. For Account 395, staff recommends an average service life of 20 years and a 0% NS, which results in a whole life rate of 5%.

Account 399 – Miscellaneous Tangible

The Company proposed to retain the five-year amortization period currently authorized for this account. According to FPUC's Revised Exhibit AA as well as current data, the reserve for this account exceeds the investment. The Company proposed to stop the amortization and reverse the overage. Staff believes that the overage should be reversed, the amortization for existing investment should be discontinued, and that the amortization should apply to new investment.

Issue 2: What should be the implementation date for the new depreciation rates?

Recommendation: Staff recommends approval of the Company's proposed January 1, 2014 implementation date for revised depreciation rates. (Ollila)

Staff Analysis: Rule 25-7.045(6)(b), 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 the Company match an implementation date of January 1, 2014. Based upon staff's analysis, staff recommends approval of this date.

Issue 3: Should the Commission approve Florida Public Utilities Company's proposal to defer $61,851 associated with consulting fees as a regulatory asset, and to amortize the asset over a five-year period beginning January 1, 2014?

Recommendation: No. The Commission should approve Florida Public Utilities Company to defer $58,452 associated with consulting fees incurred by the Company in the development of the three depreciation studies that were subsequently consolidated. The $58,452 should be recorded as a regulatory asset in Account 182.3, Other Regulatory Assets, and be amortized to Account 407.3, Regulatory Debits, over a five-year period beginning January 2014. (Trueblood)

Staff Analysis: FPUC has requested approval to defer certain consulting fees incurred for the preparation of depreciation studies as a regulatory asset. According to the Company, its request is revenue neutral, consistent with Accounting Standards Codification 980 (ASC 980), and has no impact on the current rates to customers.

In its Petition, the Company contended that the establishment of a regulatory asset for expenses incurred by FPUC to develop three studies exceeded the typical annual consulting costs necessary to support the regulated business. Specifically, FPUC stated that the magnitude of developing three depreciation studies simultaneously necessitated retaining more extensive outside consulting services than was required in the development of FPUC's prior depreciation studies. The additional costs were not contemplated in the Company's last rate case, and these costs are not being recovered through another cost recovery mechanism.

The recognition and establishment of regulatory assets are addressed in ASC 980, which in part states:

> Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An entity shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:
>
> a. It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable cost for ratemaking purposes.
> b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.

The Company asserted that, pursuant to ASC 980, the Commission may approve FPUC's deferral of costs incurred from the consulting fees. FPUC maintains that the deferral of these costs matches the timing of these expenses with the periods in which the recovery of the revenue is recorded. Accordingly, the Company requested the establishment of a regulatory asset associated with the consulting fees and stated that it will lessen the impact on the Company and its ratepayers. FPUC requested that the regulatory asset be amortized over a five-year period from January 1, 2014 to December 31, 2018. In support of its request, FPUC asserted that establishment of the regulatory asset and amortization of the expenses over five years is consistent with prior Commission recognition stated in Order No. PSC-06-1042-PAA-EI:[30]

> This concept of deferral accounting allows companies to defer costs due to events beyond their control and seek recovery through rates at a later time. The alternative would be for the company to seek a rate case each time it experiences an exogenous event.

FPUC initially sought to record a regulatory asset for a total of $45,650 when the three separate depreciation studies were submitted. Subsequent to the Company's January filing, staff discussed with the Company the best way to develop a single set of rates for all three divisions. The Company provided an updated filing in July 2014, wherein consolidated rates were proposed for each account. According to the Company, in response to Staff's Second Data Request, the additional work was necessary to develop the consolidated depreciation study for the three companies. Based upon the additional work performed, FPUC stated that an additional cost of $16,151 would be incurred in 2014, that was not included in the original $45,650, for a total of $61,851.

Staff requested additional information from the Company regarding the consulting fees, and in response to Staff's First Data Request, the Company stated that it estimates a total cost for outside services of $61,851. FPUC also provided copies of invoices for services rendered by three outside vendors, Crystal Key Resources; Gunster, Yoakley and Stewart, P.A.; and Accounting Principals, that the Company utilized and subsequently paid approximately $61,851 for the development of the depreciation studies.[31] Staff reviewed the invoices from each of these vendors to determine if the amount proposed by the Company for the establishment of a regulatory asset was appropriate. Based on staff's review, two invoices from Crystal Key Resources contained amounts for which insufficient explanation was provided as to the work performed. As staff was unable to determine whether the invoiced amounts were associated with the development of the depreciation studies, staff reduced the expenses to remove these unsupported items. Specifically, the total amount for Crystal Key Resource's Invoice No. 533 was adjusted by $2,600 (13 hours @ $200) and Invoice No. 535 was adjusted by $800 (4 hours @ $200).

The total cost supported by the invoices provided by FPUC is $58,452, which is approximately $3,400 less than the amount proposed by the Company. Based on the above, staff recommends that the total expense be reduced by $3,400.

[30] See Order No. PSC-06-1042-PAA, issued December 19, 2006, in Docket No. 060674-EI. In re: Petition for authority to use deferral accounting for creation of a regulatory liability to record charges or credits that would have otherwise been recorded in equity pursuant to balance sheet treatment required by Statement of Financial Accounting Standards (SFAS) No. 158, by Progress Energy Florida, Inc.

[31] FPUC initially submitted separate depreciation studies for Chesapeake Division, FPUC Division, and Indiantown Division. After discussions with staff, the Company provided an updated filing in July 2014, wherein consolidated rates were proposed for each account.

Table 3-1 below shows a total requested regulatory commission expense of $61,851. It shows the $3,400 adjustment that staff is recommending, and the resultant $58,452 that staff believes FPUC should be allowed to record as a regulatory asset.

Table 3-1: Regulatory Commission Expenses for Regulatory Asset

Vendor	Invoice Amount	Staff Recommended Adjustment	**Staff Recommended Costs for Regulatory Asset ($)**
Crystal Key	$50, 700	$3,400	$47,300
Gunster	$4,112	$0	$4,112
Accounting Principals	$7,039	$0	$7,039
Total	$61,851	$3,400	$58,452

Source: Responses to Staff's First Data Request

The Office of Public Counsel (OPC) reviewed the Company's filing and responses to staff's data requests. OPC expressed concern with FPUC's request to establish a regulatory asset to amortize costs the Company incurred from utilizing outside consulting services to develop the depreciation studies. Specifically, OPC pointed out that, although FPUC stated that it is not unusual to incur costs for outside services for the development of depreciation studies, the Company did not incur any outside services expenses for FPUC's or Chesapeake's last depreciation study. Further, OPC stated that, if the Company has cut back on staff that resulted in cost savings associated with the acquisition adjustment, FPUC should not be allowed to establish a regulatory asset. OPC believes that the additional costs the Company incurred by utilizing outside services to complete the studies should be offset against the cost savings realized by FPUC from the acquisition adjustment that was approved following its merger with Chesapeake in 2009. Moreover, OPC pointed out that the invoices submitted for Accounting Principals lacked a description of the work performed or an explanation showing that the work performed was pertinent to the depreciation studies.

FPUC submitted a response to address the concerns raised by OPC. In the response, the Company reiterated that the need for additional outside consulting services varies from study to study and argued that the services related to the development of the study in this proceeding has nothing to do with the elimination of employee positions associated with the merger. Moreover, FPUC stated that the need for outside services was based on the timing and complexity of the tasks of providing depreciation studies for multiple divisions and from those studies developing appropriate blended rates. Further, FPUC argued that outside services were not utilized in the two dockets referenced by OPC because FPUC's staff had a working knowledge of depreciation studies and received assistance through an informal "staff assisted" process. The Company maintained that, although it engaged the services of two former employees to perform work specific to the development of the depreciation studies, the costs of the study should not be considered offset against the acquisition adjustment savings. Regarding the concern raised by OPC related to detail of the invoices, FPUC stated that the temporary agency does not provide details specific to tasks. The Company specifically requested a certain former employee because it knew he possessed the level of expertise needed for the depreciation studies and that was the only work performed by that temporary employee.

Based on the additional work associated with developing three separate depreciation studies, coupled with the extra efforts the Company undertook to consolidate the three studies, staff believes that the establishment of a regulatory asset is appropriate and that the consulting fees associated with these depreciation studies should be amortized to mitigate the impact on ratepayers. Therefore, staff recommends that the $58,452 of consulting fees be recorded as a regulatory asset in Account 182.3, Other Regulatory Assets, and be amortized to Account 407.3, Regulatory Debits, over a five-year period beginning January 2014. This treatment is revenue neutral and will not have any impact on current rates.

Issue 4: Should the current amortization of investment tax credits (ITCs) be revised to reflect the approved depreciation rates?

Recommendation: Yes. The current amortization of ITCs should be revised to match the actual recovery periods for the related property. The Company should file detailed calculations of the revised ITC amortization at the same time it files its surveillance report covering the period ending December 31, 2014. (Cicchetti)

Staff Analysis: In earlier issues, staff has recommended approval of revised depreciation rates for the Company, to be effective January 1, 2014, which reflect changes to most accounts' remaining lives to be effective January 1, 2014. Revising a utility's book depreciation lives generally results in a change in its rate of ITC amortization 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), IRC sections 167(l) and 46(f),[32] Federal Tax Regulations under the Code sections,[33] and section 203(e) of the Tax Reform Act of 1986 (the Act).[34]

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 be revised to reflect the remaining useful lives that underlie staff's proposed depreciation rates.

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."[35] 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 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.

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[32] 26 USC §§168(f)(2) and (i)(9); 26 USC §167(l); 26 USC §46(f).
[33] Treas. Reg. §1.168; Treas. Reg. §1.167; Treas. Reg. §1.46.
[34] Tax Reform Act of 1986, 1986-3 (Vol.1) C.B. 63, P.L. 99-514 (100 Stat. 2146) October 22, 1986.
[35] 26 USC §46(f)(6).

Issue 5: Should this docket be closed?

Recommendation: Yes. If no person whose substantial interests are affected by the Commission's 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. (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.

Attachment A

		Comparison of Rates and Components						
		Company Proposed			Staff Recommended			
	Distribution Plant	Average Remaining Life	Future Net Salvage	Remaining Life Rate	Average Remaining Life	Reserve	Future Net Salvage	Remaining Life Rate
Account #	Account Title	(Yrs.)	(%)	(%)	(Yrs.)	(%)	(%)	(%)
374.1	Land Rights	7.4	0	17.2	7.4	(27.05)	0	17.2
375	Structures & Improvements	18.9	0	2.5	18.9	53.46	0	2.5
376.1	Mains - Plastic	35.0	(15)	2.6	35.0	23.55	(16)	2.6
376.2	Mains - Steel	28.0	(30)	2.9	28.0	48.28	(28)	2.8
378	Measuring and Regulating Equip. - General	21.0	(5)	3.3	21.0	35.35	(5)	3.3
379	Measuring and Regulating Equip. - City Gate	22.0	(5)	3.4	22.0	29.44	(5)	3.4
380.1	Services - Plastic	34.0	(25)	2.7	34.0	31.65	(22)	2.7
380.2	Services - Other	24.0	(125)	6.5	24.0	69.43	(125)	6.5
381	Meters	16.2	0	3.7	16.2	39.47	0	3.7
381.1	Meters - AMR Equipment	17.1	0	4.4	16.7	25.40	0	4.5
382	Meter Installations	25.0	(10)	3.1	25.0	31.29	(10)	3.1
382.1	Meter Installations - MTU/DCU	33.0	(10)	2.6	33.0	24.39	(10)	2.6
383	House Regulators	16.7	0	3.3	16.7	45.59	0	3.3
384	House Regulator Installations	21.0	0	2.7	21.0	42.34	0	2.7
385	Industrial Meas. & Reg. Station Equip	16.9	0	3.4	16.9	43.13	0	3.4
387	Other Equipment	15.7	0	4.0	15.7	36.46	0	4.0
General Plant								
390	Structures & Improvements	31.0	0	2.4	31.0	26.69	10	2.0
391	Office Furniture	15.6	0	3.7	15.6	41.95	0	3.7
391.2	Office Equipment	10.1	0	6.1	10.1	38.67	0	6.1
391.3	Computer Hardware / Software	4.3	0	5.2	4.3	77.50	0	5.2
392.1	Transportation - Cars	5.1	10	11.0	5.1	33.94	10	11.0
392.2	Transportation - Light Trucks & Vans	4.8	20	8.0	4.8	41.84	20	8.0
392.3	Transportation - Heavy Trucks[36]	0.0	10	8.2	0.0	0.00	10	8.2
392.4	Transportation -	9.9	0	3.3	9.9	67.58	0	3.3

[36] Company requested new rate establishment.

Attachment A

Comparison of Rates and Components

Distribution Plant		Company Proposed			Staff Recommended			
Account #	Account Title	Average Remaining Life (Yrs.)	Future Net Salvage (%)	Remaining Life Rate (%)	Average Remaining Life (Yrs.)	Reserve (%)	Future Net Salvage (%)	Remaining Life Rate (%)
	Other							
393	Stores Equipment	5.8	0	5.8	5.8	66.40	0	5.8
394	Tools, Shop & Garage Equipment	3.8	0	7.4	3.8	71.94	0	7.4
395	Laboratory Equipment[37]	0.0	0	5.0	0.0	0.00	0	5.0
396	Power Operated Equipment	6.0	10	1.1	6.0	83.21	10	1.1
397	Communication Equipment	8.1	0	7.0	8.1	43.27	0	7.0
398	Miscellaneous Equipment	10.5	0	4.6	10.5	52.13	0	4.6
399	Miscellaneous Tangible	5 Year Amortization			5 Year Amortization			

[37] Company requested new rate establishment.

Attachment B

Comparison of Proposed Depreciation Rates and Associated Expenses

Distribution Plant Acct. #	Account Name	Company Proposed Rate (%)	Company Proposed Expenses ($)	Staff Proposed Rate (%)	Staff Proposed Expenses ($)
374.1	Land Rights	17.2	2,220	17.2	2,220
375	Structures & Improvements	2.5	23,937	2.5	23,937
376.1	Mains - Plastic	2.6	1,861,464	2.6	1,861,464
376.2	Mains - Other	2.9	1,538,280	2.8	1,485,236
378	Meas. & Reg. Station Equip - General	3.3	64,349	3.3	64,349
379	Meas. & Reg. Station Equip - City Gate	3.4	298,255	3.4	298,255
380.1	Services - Plastic	2.7	1,054,735	2.7	1,054,735
380.2	Services - Other	6.5	327,703	6.5	327,703
381	Meters	3.7	375,721	3.7	375,721
381.1	Meters - AMR Equipment	4.4	97,522	4.5	99,738
382	Meter Installations	3.1	204,677	3.1	204,677
382.1	Meter Installations - MTU/DCU	2.6	15,419	2.6	15,419
383	Regulators	3.3	137,650	3.3	137,650
384	Regulator Installations	2.7	28,271	2.7	28,271
385	Industrial Meas. & Reg. Station Equip.	3.4	61,736	3.4	61,736
387	Other Equipment	4.0	66,991	4.0	66,991
	Distribution Plant Totals		$6,158,930		6,108,102
General Plant					
390	Structures & Improvements	2.4	57,488	2.0	47,907
391	Office Furniture	3.7	31,320	3.7	31,320
391.2	Office Equipment	6.1	145,947	6.1	145,947
391.3/391.4	Computer Hardware & Software	5.2	218,619	5.2	218,619
392.1	Transportation - Cars	11.0	36,322	11.0	36,322
392.2	Transportation - Light Trucks & Vans	8.0	434,612	8.0	434,612
392.4	Transportation - Other	3.3	3,567	3.3	3,567
393	Stores Equipment	5.8	973	5.8	973
394	Tools, Shop & Garage Equipment	7.4	47,484	7.4	47,484
396	Power Operated Equipment	1.1	11,899	1.1	11,899
397	Communications Equipment	7.0	96,488	7.0	96,488
398	Miscellaneous Equipment	4.6	14,706	4.6	14,706
399	Other Tangible Property	5 Year Amortization		5 Year Amortization	
	General Plant Totals		$1,099,425		$1,089,844
	All Plant Totals		$7,258,355		$7,197,946