State of Florida

Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

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

DATE: November 22, 2016

TO: Office of Commission Clerk (Stauffer)

FROM: Division of Economics (Higgins) TH JDH WBM ALM
Division of Accounting and Finance (Cicchetti, Wolmers) GW
Office of the General Counsel (Leathers)

RE: Docket No. 160174-GU – Request for approval of 2016 depreciation study by Sebring Gas System, Inc.

AGENDA: 12/06/16 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Patronis

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

Case Background

Rule 25-7.045, Florida Administrative Code (F.A.C.), requires natural gas public utilities to file a comprehensive depreciation study with the Florida Public Service Commission (Commission) for review at least once every five years from the submission date of the previous study. On July 20, 2016, Sebring Gas System, Inc. (Sebring or company) filed its 2016 depreciation study in compliance with the aforecited rule. The company's last depreciation study was filed July 22, 2011. Staff notes Sebring had 2015 operating revenues of approximately $959,000, serving 559 customers.[1] Staff has completed its review of Sebring's 2016 Depreciation Study and presents its recommendations to the Commission herein.

[1] Sebring Gas System's Annual Report of Natural Gas Utilities Form PSC/AFA 20, at December 31, 2015, filed with the Florida Public Service Commission on June 1, 2016.

The Commission is vested with jurisdiction over these matters through several provisions of the Florida Statutes, including Sections 350.115, 366.05, and 366.06, F.S.

Discussion of Issues

Issue 1: Should currently prescribed depreciation rates for Sebring Gas System be revised?

Recommendation: Yes. The review of Sebring's plant depreciation information indicates a need for revising the company's currently prescribed depreciation rates. (Higgins)

Staff Analysis: Sebring's last depreciation filing was made on July 22, 2011. By Order No. PSC-12-0043-PAA-GU, the Commission approved revised depreciation rates that became effective January 1, 2011.[2]

The company has filed its 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 plant activity and data indicates the need for revising depreciation rates. Staff's recommended depreciation components and rates are discussed in Issue 3 and shown on Attachments A and B.

[2] Order No. PSC-12-0043-PAA-GU, issued January 26, 2012, in Docket No. 110233-GU, In re: Petition for approval of 2011 Depreciation Study by Sebring Gas Systems, Inc.

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

Recommendation: Staff recommends January 1, 2017, for implementing newly proposed depreciation rates as shown on Attachments A and B to this recommendation. (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, "shall 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, 2017.

Issue 3: What are the appropriate depreciation parameters and resulting rates?

Recommendation: Staff recommends the Commission approve the lives, reserve percentages, net salvage percentages, and resulting remaining life depreciation rates for Sebring that are shown on Attachment A. As shown on Attachment B, the corresponding depreciation expense effect of staff's rate recommendations is a decrease of $6,980 annually, or 3.8 percent, based on December 31, 2016 investments. (Higgins)

Staff Analysis:

Staff's recommendations are the result of a comprehensive review of Sebring's plant depreciation data filed in this docket. Attachment A to this recommendation shows a comparison of certain currently-approved depreciation parameters and rates to those staff is recommending become effective January 1, 2017 (Issue 2). Staff and the company are in agreement on all proposed depreciation parameters and resulting rates.[3] Displayed on Attachment B is a comparison of depreciation expenses between currently-approved and proposed rates based on December 31, 2016 investments.

This filing was essentially a staff-assisted study. The company provided plant addition and retirement data spanning 2011-2016 (2016 projected), proposed net salvage values, proposed average service lives, and proposed Iowa-type survivor curves.[4] With this information, staff determined the average age of investments on an account-by-account basis, then applied the results to Sebring's proposed curve/life combinations for determining account-specific average remaining lives. Sebring's proposed account-specific average service lives are unchanged from its prior study.

As a result of the review and analytical process, staff and Sebring agree on lives, net salvage values, and resulting depreciation rates for all accounts as shown on Attachments A and B to this recommendation.

Plant Additions

Sebring's total plant investment has grown substantially over the study period. During the 2011-2016 period (2016 projected), the company's system grew by approximately 89 percent, or from approximately $2.9 million to approximately $5.6 million. Over two-thirds of this system growth is attributable to initiating gas services in 2013 to both the Hardee and Desoto Correctional Institutes. Specifically, Sebring invested in the construction of two new gate stations (Account 379.00 - Measuring & Regulating Station Equipment – City Gate) which were required in order to fulfill its newly acquired service contracts with the Florida Department of Corrections. Staff notes that these two special service contracts were approved by the Commission in 2013.[5] The

[3] Sebring's Response to 2016 Depreciation Study Staff Report, No. 6.

[4] "Iowa-type Curves" are a widely-used group of generalized survivor curves that contain the range of survivor characteristics usually experienced by public utilities, as well as companies in other industries.

[5] Order No. PSC-13-0366-PAA-GU, issued August 8, 2013, in Docket No. 130130-GU, In re: Petition for approval of special contract with the Florida Department of Corrections - DeSoto Correctional Institution, by Sebring Gas System, Inc., and Order No. PSC-13-0367-PAA-GU, issued August 8, 2013, in Docket No. 130079-GU, In re: Petition for approval of special contract with the Florida Department of Corrections, by Sebring Gas System, Inc.

two new gate stations tapped both the Gulfstream (serving the Hardee Institution), and Florida Gas Transportation pipelines (serving the Desoto Institution).

Additional investments attributable to newly-serving the correctional institutes include the installation of mains and meters placed downstream from the gate stations. The investments were recorded in: Account 376 - Mains – Plastic, and Account 382 - Meter Installations. The total investment required to initiate service to the correctional institutes was approximately $1.5 million. This investment is net of the approximate $250,000 refund paid to Sebring by Gulfstream and Florida Gas Transportation companies from mandatory prepayment of engineering and construction costs. In addition to the correctional institutions, over the study period Sebring also installed new plant/extending mainlines in Sebring, Florida, for serving businesses, a fire department, and a residential community.

In response to a staff data request, the company stated it does not foresee similar levels of investment growth as it experienced in 2013 and believes its system will revert to more typical growth patterns over the next study period.[6]

Plant Retirements

The company's plant has experienced minimal retirement activity over the study period. Expressed as a percentage of study period additions, plant retirements total under 2 percent from 2011-2016. Staff notes the refund associated with tapping the two transmission pipelines discussed in the *Plant Additions* section was initially recorded as retirement in 2014 (year of refund), but later correctly revised as a "reduction of plant addition," thus accurately reflecting the final investment amount.

Average Service and Remaining Lives

Neither the company, nor staff, propose any changes to Sebring's currently-authorized, account-specific, average service lives.[7] Staff does, however, recommend the company closely monitor the life characteristics of all its investments for evaluating if any average service life adjustments are warranted as part of future depreciation studies.

As similarly performed in the company's last depreciation review and mentioned above, staff computed account-specific average remaining lives (shown on Attachment A) by first aging Sebring's projected plant investments at December 31, 2016, then applying the results to the company's Iowa Curve and service life selections on an account-by-account basis.

Net Salvage

The company has not requested any changes to its currently authorized net salvage levels.[8] Without experiencing meaningful levels of retirement over a period of time, company specific net salvage investigations may prove inconclusive. Thus, staff compared the company's currently-authorized/proposed-for-continued-use net salvage levels to those experienced by other

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[6] Sebring's Responses to Staff's First Data Request, No. 7.
[7] Order No. PSC-12-0043-PAA-GU.
[8] Id.

natural gas distribution companies. Staff believes Sebring's currently-authorized/proposed net salvage values remain in-line to those currently being estimated by its industry peers and should continue to be used for applicable rate-making purposes.

Reserve Transfers

As part of reviewing Sebring's 2016 Depreciation Study, staff calculated the book reserve position of each plant account. Staff also calculated the associated theoretical reserve positions of each plant account, which are based on the current recommended life and net salvage inputs. The difference between an account's book and theoretical reserve amounts may be described as an imbalance, either positive or negative, or as a surplus or deficiency. When imbalances are present, corrective transfers among accounts should be evaluated, and if warranted, recommended to be performed. Staff discusses its recommended reserve transfers below.

Over the study period of 2011-2016, Sebring carried depreciation reserves of $9,788 in Account 399 – Prior Period Adjustment. This amount was associated with a prior rate case audit finding related to the appropriate level of accumulated depreciation. This audit finding was ultimately identified by Commission Order PSC-04-1260-PAA-GU.[9] As part of the data request process, the company was asked if it has any specific treatment proposals for this reserve amount and responded it did not.[10] Staff further inquired if the company was amenable to the Commission allocating this reserve to other plant accounts in a rational manner. The company was supportive of both staff's suggestion and transfer results/proposals. The specific depreciation reserve transfer proposals are presented in Table 3-1.

Table 3-1
Proposed Accumulated Depreciation Transfers

Acct. No.	Account Title	Reserve Transfer Amounts
376.1	Mains – Steel	2,357
379	Meas. & Reg. Station Equip.(City Gate)	2,129
380.2	Services - Plastic	2,058
382	Meter Installations	119
387	Other Equipment	153
394	Tools, Shop & Garage Equipment	2,972
399	Prior Period Adjustment	(9,788)

Staff's methodology was to first bring any account with a theoretically negative reserve position to its theoretically correct level. However, after bringing all accounts with theoretically negative

[9] Order No. PSC-04-1260-PAA-GU, issued December 20, 2004, in Docket No. 040270-GU, In re: Application for rate increase by Sebring Gas System, Inc.
[10] Sebring's Responses to Staff's First Data Request No. 1, and Sebring's Responses to 2016 Depreciation Study Staff Report, No. 1.

reserve positions to their correct levels, $2,058 of the original $9,788 remained. For this remainder, staff proposes allocating the entire amount to Account 380.2 – Services – Plastic, due to this account having an approximate 31-year average remaining life in which the surplus is spread over/amortized, as well as mitigating the minor expense increase associated with this account. Staff believes any effects resulting from the transfer are minimal due to the account's long remaining life, as well as the small transfer amount relative to overall investment.

Staff also recommends the Commission approve transferring $180, from Account 392 – Trans. Equipment – Other Vehicles to Account 392 – Trans. Equipment – Light Trucks, as the former account has no corresponding investment. Staff notes that its current rate recommendations incorporate all proposed reserve transfers discussed in this section.

Other Matters

For natural gas utilities, the Commission observes $500 as being the appropriate minimum threshold for capitalization of property, while minor items costing less than $500 are recorded as maintenance expense.[11] Staff in its review of Sebring's 2016 Depreciation Study became aware of a small number of capital entries which were below the $500 minimum threshold. However, staff notes the vast majority of capital items/plant entries are appropriately above the minimum threshold. Staff consulted with the company concerning these specific entries. The company claimed it ceased making capital entries below $500, and will only capitalize property valued at $500 or greater going forward.[12]

For calendar year 2012, the company recorded ($4,250) of plant retirements to Account 381 – Meters, while only recording ($330) to the account's corresponding reserve. For calendar year 2014, the company recorded ($20,647) of plant retirements to Account 392.1 – Transportation – Trucks, while only recording ($14,955) to the account's corresponding reserve. Staff proposes to correct accumulated depreciation levels by matching the reserve entries to the corresponding plant entries. This proposal results in reducing account 381's reserve by ($3,920), and account 392.1's reserve by ($5,692). Staff notes its current depreciation rate recommendations incorporate these proposed reserve reductions.

Conclusion

Staff recommends the Commission approve the lives, net salvages, reserves, and resultant depreciation rates for Sebring that are shown on Attachment A. The expense effect of staff's plant depreciation rate recommendations, which is shown on Attachment B, is a decrease of $6,980 annually, or 3.8 percent, based on December 31, 2016 investments.

[11] Rule 25-7.0461, F.A.C., and the Federal Energy Regulatory Commission Uniform System of Accounts, prescribed by the Code of Federal Regulations, Title 18, Subchapter F, Part 201 (2013).
[12] Sebring's Responses to Staff's First Data Request, No. 8.

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 and amortization schedules?

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 earnings surveillance report covering period ending December 31, 2017, as specified in rule 27-7.1352, F.A.C. (Cicchetti, Wolmers).

Staff Analysis: In Issue 2, staff has recommended approval of revised depreciation rates for the company, to be effective January 1, 2017, which reflect changes to most accounts' remaining lives to be effective January 1, 2017. 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),[13] former IRC section 167(l),[14, 15] former IRC Section 46(f),[16, 17] Federal Tax Regulations under the Code sections,[18] and section 203(e) of the Tax Reform Act of 1986 (the Act).[19]

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.

Former IRC Section 46(f)(6) of the Code indicated 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.[20] While, Section 46(f)(6) was repealed, under IRC Section 50(d)(2), the terms of former IRC Section 46(f)(6) remain applicable to public utility property for which a regulated utility previously claimed ITCs. 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 50(d)(2), and its underlying Treasury Regulations. The consequence of an ITC normalization violation is a repayment of unamortized ITC balances to the IRS. Therefore, staff recommends 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

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[13] 26 USC §§168(f)(2) and (i)(9).

[14] Former 26 USC §167(l) , repealed by Revenue Reconciliation Act of 1990, Pub. L. No. 101-508, §11812(a)(1-2)(1990).

[15] Under IRC Section 50(d)(2), the terms of former IRC section 167(l) remain applicable to public utility property for which a regulated utility previously claimed ITCs, which is the case here. (I.R.S. Priv. Ltr. Rul. 200933023, ln.1 (May 7, 2009)).

[16] Former 26 USC §46(f), repealed by Revenue Reconciliation Act of 1990, Pub. L. No. 101-508, §11813(1990).

[17] Under IRC Section 50(d)(2), the terms of former IRC section 46(f) remain applicable to public utility property for which a regulated utility previously claimed ITCs, which is the case here. (I.R.S. Priv. Ltr. Rul. 200933023, ln.1 (May 7, 2009)).

[18] Treas. Reg. §1.168; Treas. Reg. §1.167; Treas. Reg. §1.46.

[19] Tax Reform Act of 1986, Pub. L. No. 99-514 (100 Stat. 2085, 2146)(1986).

[20] Former 26 USC §46(f)(6) (establishing proper determination of ratable portion).

same time it files its earnings surveillance report covering the period ending December 31, 2017, as specified in Rule 25-7.1352, F.A.C.

Issue 5: 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 the issuance of a consummating order. (Leathers)

Staff Analysis: At the conclusion of the protest period, if no protest is filed, this docket should be closed upon the issuance of a consummating order.

Attachment A

Comparison of Rates and Components

Account Number	Account Title	Current[1] Ave. Rem. Life (yrs.)	Current[1] Future Net Salvage (%)	Current[1] Remaining Life Rate (%)	Staff Recommended Ave. Rem. Life (yrs.)	Staff Recommended Reserve (%)		Staff Recommended Future Net Salvage (%)	Staff Recommended Remaining Life Rate (%)
376.1	Mains - Steel	12.7	(30)	2.9	14.6	87.66%	*	(30)	2.9
376.2	Mains - Plastic	34.2	(30)	2.9	33.8	32.50%		(30)	2.9
378	Meas. & Reg. Equip. (Embedded)	13.1	(2)	3.1	16.0	52.87%		(2)	3.1
379	Meas. & Reg. Equip.(City Gate)	16.5	(2)	3.2	27.6	13.68%	*	(2)	3.2
380.1	Services - Steel	14.3	(30)	1.7	11.8	117.74%		(30)	1.0
380.2	Services - Plastic	32.0	(30)	3.1	30.7	31.29%	*	(30)	3.2
381	Meters	12.1	0	4.0	9.4	63.83%		0	3.8
382	Meter Installations	17.1	(5)	3.1	19.5	44.55%	*	(5)	3.1
383	House Regulators	10.5	0	3.3	7.0	78.21%		0	3.1
384	House Regulator Installations	13.7	(3)	3.0	14.7	59.17%		(3)	3.0
386	Property on Customers' Premises	9.5	0	4.0	6.9	83.87%		0	2.3
387	Other Equipment	15.5	0	4.0	16.8	32.80%	*	0	4.0
390	Leasehold Improvements	38.0	0	2.5	40.0	19.85%		0	2.5
391.1	Office Furniture	8.8	0	4.0	25.0	58.08%		0	4.0
391.2	Office Equipment	5.8	0	6.7	15.0	83.18%		0	4.4
392.1	Transportation - Trucks	2.7	15	10.6	8.0	68.73%		15	9.0
394	Tools, Shop & Garage Equipment	10.3	0	6.7	15.0	63.15%	*	0	6.7
396	Power Operated Equipment	5.4	0	6.7	15.0	48.99%		0	5.9
397	Communication Equipment	5.0	0	5.6	18.0	13.63%		0	5.6

[1] Order No. PSC-12-0043-PAA-GU.

*Denotes a Reserve Transfer; see Table 3-1.

Attachment B

Account Number	Account Title	Current[1] Depreciation Rate (%)	Current[1] Annual Expense ($)	Staff Proposed Depreciation Rate (%)	Staff Proposed Annual Expense ($)	Change In Expense ($)
	Comparison of Expenses					
376.1	Mains - Steel	2.9	5,409	2.9	5,409	0
376.2	Mains - Plastic	2.9	65,547	2.9	65,547	0
378	Meas. & Reg. Equip. (Embedded)	3.1	505	3.1	505	0
379	Meas. & Reg. Equip.(City Gate)	3.2	39,442	3.2	39,442	0
380.1	Services - Steel	1.7	5,992	1.0	3,525	(2,467)
380.2	Services - Plastic	3.1	20,891	3.2	21,565	674
381	Meters	4.0	11,044	3.8	10,492	(552)
382	Meter Installations	3.1	3,529	3.1	3,529	0
383	House Regulators	3.3	1,063	3.1	999	(64)
384	House Regulator Installations	3.0	1,892	3.0	1,892	0
386	Property on Customers' Premises	4.0	1,432	2.3	824	(608)
387	Other Equipment	4.0	894	4.0	894	0
390	Leasehold Improvements	2.5	332	2.5	332	0
391.1	Office Furniture	4.0	33	4.0	33	0
391.2	Office Equipment	6.7	2,096	4.4	1,377	(719)
392.1	Transportation - Trucks	10.6	19,402	9.0	16,474	(2,928)
394	Tools, Shop & Garage Equipment	6.7	1,071	6.7	1,071	0
396	Power Operated Equipment	6.7	2,647	5.9	2,331	(316)
397	Communication Equipment	5.6	1,713	5.6	1,713	0
	Total		**184,934**		**177,954**	**(6,980)**

[1] Order No. PSC-12-0043-PAA-GU.