

State of Florida



Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

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

DATE: September 23, 2004

TO: Director, Division of the Commission Clerk & Administrative Services (Bayó)

FROM: Division of Economic Regulation (Gardner, Colson, Haff, Kenny)
Office of the General Counsel (Brubaker)

RE: Docket No. 040352-GU – 2004 depreciation study by Florida Public Utilities Company.

AGENDA: 10/05/04 – Regular Agenda – Proposed Agency Action - Interested Persons May Participate

CRITICAL DATES: Rate Case Hearing, Docket No. 040216-GU,
October 19, 2004

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\040352.RCM.DOC

Case Background

Florida Public Utilities Company (FPUC or company) filed its last depreciation study for its natural gas division on March 10, 1999 with an effective date of January 1, 2000. FPUC requested and received Commission approval by Order No. PSC-02-0906-PAA-GU, issued July 8, 2002, of its acquisition of South Florida Natural Gas (SFNG), and to consolidate depreciation rates for the combined assets of FPUC and SFNG effective January 1, 2002. Rule 25-7.045(8)(a), Florida Administrative Code, requires natural gas utilities to file a comprehensive depreciation study for each category of depreciable property for Commission review at least once every five years from the submission date of the previous study unless otherwise required by the Commission. On April 20, 2004, FPUC filed its regular depreciation study in accordance with this rule.

Staff has completed its review of the depreciation study and presents its recommendation herein. The Commission has jurisdiction in this matter pursuant to Sections 366.04, 366.05, and 366.06, Florida Statutes.

Discussion of Issues

Issue 1: Should currently prescribed natural gas depreciation rates of Florida Public Utilities Company be revised?

Recommendation: Yes. A comprehensive review of FPUC's planning and activity since its prior depreciation filing indicates a need for a revision in the currently prescribed depreciation rates for natural gas. (Gardner, Colson, Haff)

Staff Analysis: FPUC acquired the assets of SFNG on December 21, 2001. The last comprehensive depreciation represcription for FPUC and SFNG was made March 19, 1999 and May 29, 1998, respectively. The existing depreciation rates are blended rates approved for the assets affected by the acquisition of SFNG by Order No. PSC-02-0906-PAA-GU, in Docket No. 020240-GU, issued July 8, 2002. The current study affords staff the opportunity to address the appropriate lives, salvage values, reserves, and resulting remaining life depreciation rates for the combined rates.

In summary, the resulting effects of the merger activities which have occurred since the last comprehensive depreciation review as well as changes in account activity and company planning indicate that currently prescribed depreciation rates should be revised.

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Issue 2: Should FPUC's proposed implementation date of January 1, 2005, for new depreciation rates and amortization schedule be approved?

Recommendation: Yes. (Gardner, Colson, Haff)

Staff Analysis: The company's supportive data and related calculations support the January 1, 2005 implementation date which is the earliest practicable date for utilizing the revised rates and schedules. Staff recommends approval of this date.

Issue 3: Should any corrective reserve allocations between accounts be made?

Recommendation: Yes. Staff recommends the corrective reserve allocations shown in Attachment A. This action will bring each affected account more in line with its theoretically correct reserve level. (Gardner, Colson, Haff)

Staff Analysis: This is the first comprehensive review of FPUC's combined investments and reserves since its acquisition of SFNG. The staff-recommended allocations shown in Attachment A address major imbalances generally brought about by past estimates of life and salvage factors. The recommended corrective action will bring each affected account's reserve more in line with its calculated theoretically correct level. The company and staff are in agreement regarding proposed transfers.

Issue 4: Should the remaining lives, net salvage values, reserve amounts, and resulting depreciation rates proposed by FPUC be approved?

Recommendation: Yes. The Staff's recommended lives, net salvage values, reserves, amortization schedule, and resultant depreciation rates shown in Attachment B should be approved. (Gardner, Colson, Haff)

Staff Analysis: Staff's recommendations are the result of a comprehensive review of FPUC's depreciation study. Attachment B shows a comparison of the current and proposed rate components (lives, salvages, and reserves). Attachment C shows a comparison of resultant expenses based on December 31, 2004 combined investments. Attachment C also shows an estimated resulting increase in annual expenses of approximately \$159,000. The \$159,000 increase in annual expense will decrease return on earnings from 5.04 per cent to 4.21 per cent or .83 basis points.

This filing was essentially a staff-assisted study. The company provided consolidated aged retirement and average age data from 1999-2003 for each account. As a result of the review and analytical process, staff and the company agree on lives, net salvage values, and resultant depreciation rates for all accounts. The recommended rates also reflect the corrective reserve allocations addressed in Issue 3.

The recommended changes in distribution and general plant depreciation rates can be attributed mainly to consolidated data reflecting: (1) updated account ages to reflect activity since the last depreciation studies, (2) the acquisition of SFNG through the combining of accounts, and, (3) changes in the associated reserve position. Additionally, a new account, (Miscellaneous Tangible - Account 399) is being established to amortize the cost of FPUC's customer service training program which will be updated every five years. Staff recommends a five year amortization for this investment.

Issue 5: Should the current amortization of investment tax credits and flow back of excess deferred income taxes be revised to reflect the approved depreciation rates and recovery schedules?

Recommendation: Yes. The current amortization of investment tax credits (ITC) and the flowback of excess deferred income taxes (EDIT) 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 EDIT at the same time it files its surveillance report covering the period ending December 31, 2005. (Kenny)

Staff Analysis: In earlier issues, staff recommends approval of the company's proposed remaining lives, to be effective January 1, 2005. Revising a utility's book depreciation lives generally results in a change in its rate of ITC amortization and flowback of EDIT in order to comply with the normalization requirements of the Internal Revenue Code (IRC) and underlying Regulations (REGs) found in Sections 46, 167, and 168, and 1.46, 1.67, and 1.68, respectively.

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. Since staff is recommending approval of the company's proposed 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, Accounting for Deferred Income Taxes Under SFAS 109, Florida Administrative Code, generally prohibits EDIT from being written off any faster than allowed under the Act. The Act, SFAS 109, and Rule 25-14.013, Florida Administrative Code, regulate the flowback of EDIT. Therefore, staff recommends that the flowback of EDIT be adjusted to comply with the Act, SFAS 109, and Rule 25-14.013, Florida Administrative Code.

Staff, the Internal Revenue Service, 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 and to determine the intent of the regulatory bodies in regard to normalization. Therefore, staff recommends that the current amortization of ITC and the flowback of EDIT be revised to reflect the approved remaining lives.

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Issue 6: Should this docket be closed?

Recommendation: Yes. 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. (Brubaker)

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.