State of Florida

Public Service Commission

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

DATE: March 23, 2006

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

FROM: Division of Economic Regulation (Gardner, Colson, Haff, Lester, McRoy, Sickel, Kyle)
Office of the General Counsel (Brown)

RE: Docket No. 050381-EI – Depreciation and dismantlement study at December 31, 2005, by Gulf Power Company.

AGENDA: 04/04/06 – Regular Agenda –Proposed Agency Action–Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\050381.RCM.DOC

Case Background

By Order No. PSC-02-0787-FOF-EI, issued July 13, 2002, in Docket No. 010949-EI, In re: Request for rate increase by Gulf Power Company, the Commission approved Gulf Power Company's (Gulf or company) current depreciation rates, amortization schedules, and dismantlement provision with an effective date of January 1, 2002. Rule 25-6.0436, Florida Administrative Code, requires investor-owned electric utilities to file comprehensive depreciation studies at least once every four years. On May 31, 2005, Gulf filed its regular depreciation study in accordance with this rule. Staff has completed its review of the study and presents its recommendation herein.

This recommendation addresses the approval of new depreciation rates and fossil dismantlement accruals for 2006. Staff is recommending a decrease in the amount of $3,185,349 in annual depreciation expense from the 2002 Commission approved expenses, an increase of

$54,547 in annual accrual for fossil dismantlement, and an implementation date of January 1, 2006. The company concurs with staff's recommendations.

The Commission has jurisdiction over these matters through Chapter 350.115 and several provisions of Chapter 366, Florida Statutes, including Sections 366.04, 366.05, and 366.06.

Discussion of Issues

Issue 1: What should be the implementation date for the recommended depreciation rates, amortization schedules, and dismantlement provision?

Recommendation: Staff recommends the company's proposal of January 1, 2006, as the implementation date for Gulf's new depreciation rates, amortization schedules, and dismantlement provisions as shown on Attachments A, B, and C. (GARDNER)

Staff Analysis: Rule 25-6.0436, F.A.C., requires that 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." In this regard, Gulf's supporting data and calculations have been provided matching a January 1, 2006, implementation date.

Issue 2: Should the Commission revise Gulf's currently approved annual accrual for dismantlement?

Recommendation: Yes. Staff recommends a total annual provision for dismantlement of $5,886,660 beginning January 1, 2006, as shown on Attachment A. This represents an increase of $54,547 over the current approved annual accrual. The recommended $5,886,660 annual accrual includes $107,319 related to Plant Scherer Unit 3 unit power sale (UPS) contracts. These accruals reflect current estimates of dismantlement cost on a site-specific basis using the latest inflation forecasts and a 10% contingency factor. The company concurs with staff's recommendation. (GARDNER, LESTER)

Staff Analysis: By Order No. 24741 (Dismantlement Order), issued July 1, 1991, in Docket No. 890186-EI, In re: Investigation of the ratemaking and accounting treatment for the dismantlement of fossil-fueled generating stations, the Commission determined its policy for ratemaking and accounting for the treatment of costs associated with the dismantlement of fossil-fueled generating facilities. The Dismantlement Order concluded that the provision for dismantlement should be accounted for as an annual fixed dollar accrual separate from the depreciation rate. Prior to the 1990's, the provision for dismantlement cost recovery was included in basic depreciation rates for each electric utility.

The Dismantlement Order established the methodology for calculating the annual accrual. The fixed accrual amount is based on a four-year average of the accruals related to the years between depreciation study reviews. In addition, utilities are required to provide updated dismantlement studies at least once every four years in connection with their depreciation study.[1] The Dismantlement Order also provided that if a company is partial owner of any plant, in state or out of state, it should be contractually responsible for dismantlement costs in proportion to its share of ownership. Because Plant Scherer Unit 3 is dedicated to wholesale UPS contracts, the dismantlement expense is not included for earnings surveillance purposes.

Since Gulf's 2001 dismantlement study, base cost estimates for the various dismantlement activities have changed as shown below:

FOSSIL DISMANTLEMENT BASE COST ESTIMATES		
PLANT	**2001 Study**	**2005 Study**
Plant Crist	**$ 56,368,000**	**$ 67,387,000**
Plant Daniel	**17,052,500**	**19,700,500**
Plant Schotz	**10,126,000**	**10,955,000**
Plant Smith	**23,676,000**	**25,836,000**
Plant Scherer	**5,109,000**	**3,839,625**
Plant Smith Combustion Turbine	**134,000**	**143,000**
Plant Pace (Pea Ridge)	**314,000**	**129,000**
Plant Smith Unit 3	**4,750,000**	**5,062,000**
Total Base Cost Estimates	**$ 117,529,500**	**$133,052,125**

[1] These policies were codified in Rule 25-6.04364, Florida Administrative Code, adopted December 30, 2003.

Gulf's cost estimates are based on site-specific studies and reflect an increase of about 13% from the 2001 study. The major factors contributing to the changes in cost estimates are: (1) update of inflation factors, (2) the addition of Plant Crist Unit 7 selective catalytic reduction (SCR), and (3) the addition of Smith Unit 3 combined cycle.

Gulf's currently approved annual accrual for fossil fuel dismantlement is $5,832,103. Its proposed annual accrual of $5,836,672 is based on inflation factors from Economy.com as of April 2005. At the request of staff, Gulf updated its accrual to reflect the most recent inflation factors. This updated accrual, reflecting inflation factors as of January 2006, represents an increase over the current accrual of $54,557. Staff believes it is reasonable for the accrual to reflect the most recent inflation estimates. The company agrees with staff's recommendation that the revised annual accrual should be $5,886,660.

As with previous studies, Gulf has included a 10% contingency factor to cover uncertainty in the dismantlement cost estimates. The factor is comprised of a 5% pricing contingency and a 5% scope omission contingency. The pricing contingency provides a level of confidence that the estimates are reasonable. The scope omission contingency gives consideration to the conceptual nature of the base cost estimates and the difficulty in obtaining quantity and weight records. This factor also includes a recognition that hazardous waste environmental assessments can only be performed at the time of dismantlement.

In summary, staff recommends that the four year average annual accrual for fossil fuel dismantlement, beginning in 2006 should be $5,886,660.

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

Recommendation: The staff recommended lives, net salvages, reserves, and resulting depreciation rates are shown on Attachment C. These rates result in a decrease in annual depreciation expense by $3,494,534 based on January 1, 2006 investments, and the removal of Plant Scherer Unit 3 as shown on Attachment D. Gulf concurs with staff's recommendation. (GARDNER, COLSON, HAFF, MCROY, SICKEL)

Staff Analysis: Staff's recommendations are the result of a comprehensive review of the company's submitted study. Attachment C shows a comparison of rate components (lives, salvages, and reserves). Attachment D shows the estimated resulting annual expenses based on January 1, 2006 investments. A summary of the changes in annual expense are as follows:

Expenditures By Function	
Production	($2,311,387)
Transmission	46,088
Distribution	218,944
General	(1,193,551)
Total Rates/Amortizations	($3,239,906)
Provision for Dismantlement	54,557
Total Change in Annual Expenses	($3,185,349)

In the current study, the significant changes in expenses relate to the exclusion of Plant Scherer Unit 3, change in average service lives, increase in net salvage, and the resulting increase/decrease in depreciation rates for production plant.

Production

A major impact to production plant is the exclusion of Plant Scherer Unit 3, a coal fired generating unit located in Georgia. Gulf has a 25 % ownership interest in Scherer Unit 3 and it is completely dedicated to wholesale unit power sale contracts. By Order No. 23573, issued October 3, 1990, in Docket No. 891345-EI, In re: Petition of Gulf Power Company for an increase in its rates and charges, Scherer Unit 3 has been excluded from rate base since the company began selling the capacity from the unit as wholesale unit power sales in 1992. The order states that the arrangement would continue until 2010. Staff will continue to review the life and salvage parameters in establishing the depreciation rate for Scherer Unit 3, but will not include the resulting depreciation expense in the overall calculations of depreciation expenses for Florida's ratepayers. Also, staff will monitor the termination of the unit power sale contracts and the possible return of capacity to the Florida ratepayers in future depreciation studies. Gulf concurs with staff's recommendation for the removal of Scherer Unit 3 depreciation expenses.

Transmission, Distribution, and General Plant

The transmission, distribution, and general plant accounts show an increase in service life and salvage parameters over the last depreciation study. The recommended remaining lives simply reflect an update of activity. Staff reviewed the proposed changes to plant accounts service life, expected retirement dispersion, and net salvage and found them to be reasonable and in line with Florida industry practices.

Distribution

For 2006, Gulf requests approval for the establishment of a 50 year average service life, net salvage value of zero, and a whole life rate of 2 percent for distribution account 360.2 Easements and Rights of Way. Staff finds this to be acceptable and in line with Florida industry practices for a new account.

The recommended remaining lives for general plant reflect an update of each account's activity since the last review. Underlying service lives and mortality dispersions are still considered appropriate and reasonable. Also, the amortized general plant investments represent high volume items of small value which do not warrant individual tracking. These investments represent less than 0.5 per cent of Gulf's proposed January 1, 2006 total plant in service. The use of amortization is consistent with the Commission's efforts to simplify the depreciation study process, where possible, and is reasonable and acceptable.

In summary, staff recommends that Gulf's proposed life and salvage parameters are reasonable and acceptable and appear to be in line with industry practices for transmission, distribution, and general plant.

Issue 4: Should the current amortization of investment tax credits (ITC) and the 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, 2006. (KYLE)

Staff Analysis: In earlier issues, staff has recommended approval of the company's proposed remaining lives, to be effective January 1, 2006. 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 its underlying Regulations found in Sections 46, 167, and 168, and 1.46, 1.67, and 1.68, respectively.

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 the current amortization of ITC and the flowback of EDIT be revised to reflect the approved remaining lives.

Section 46(f)(6), IRC, states that "the amortization of ITC should be determined by the period of time actually used in computing depreciation expense for ratemaking purposes and on the regulated books of the utility." 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, Florida Administrative Code, Accounting for Deferred Income Taxes Under SFAS 109, generally prohibits EDIT from being written off any faster than allowed under the Act. The Act, SFAS 109, and Rule 25-14.013, 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.

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. (BROWN)

Staff Analysis: 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.