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: January 10, 2007

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

FROM: Division of Economic Regulation (Gardner, Bulecza-Banks, Kyle, Marsh)
Office of the General Counsel (Brown)

RE: Docket No. 060496-GU – Application for approval of new depreciation rates effective January 1, 2007, by Peoples Gas System.

AGENDA: 01/23/07 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER:

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\060496.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. In accordance with this rule, the next scheduled depreciation study was due to be filed on or before April 3, 2006. On March 8, 2006, Peoples Gas System (Peoples or company) filed a petition for a waiver of the filing deadline imposed by the rule from April 3, 2006 to July 14, 2006, and succeeding depreciation studies by July 14 at least every five years thereafter. By Order No. PSC-06-0379-PAA-GU, in Docket No. 060199-GU, the Commission approved the waiver for extension of the filing date of the comprehensive depreciation study to July 14, 2006 and for succeeding depreciation studies. Therefore, on July 12, 2006, the company filed its regular comprehensive depreciation study in

accordance with the rule. Peoples' last comprehensive depreciation study was filed on April 3, 2001.

Staff has completed its review of Peoples' comprehensive depreciation study and presents its recommendation herein. The Commission has jurisdiction over this matter pursuant to Sections 366.04, 366.05, and 366.06, Florida Statutes (F.S.).

Discussion of Issues

Issue 1: Should currently prescribed depreciation rates of Peoples Gas System be changed?

Recommendation: Yes. A comprehensive review of Peoples' planning and activity since its prior depreciation filing indicates a need for a revision to the currently prescribed depreciation rates. (Gardner)

Staff Analysis: Peoples' last comprehensive depreciation study was filed on April 3, 2001, with an effective date of January 1, 2002. The study addressed the changes in planning and activity resulting from Peoples' acquisition of West Florida Natural Gas and becoming a division of Tampa Electric Company. This current study affords staff the opportunity to address the appropriate lives, salvage values, reserves, and resulting remaining life depreciation rates since the companies combined.

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

Issue 2. How should the Commission change the depreciation rates?

Recommendation: The Commission should approve the change in the lives, net salvages, reserves, and resulting depreciation rates as shown on Attachment A. These rates result in an increase in annual depreciation expense of approximately $1.9 million based on a January 1, 2007, investment date. (Gardner)

Staff Analysis: Staff has reviewed the company's proposed life, salvage, and reserve factors. The company's data and resulting expenses reflect the impact of current planning and adherence to regulatory requirements to ensure that assets are fully recovered at the time of retirement, as reflected on Attachments A and B. Attachment A shows a comparison of rate components (lives, salvages, and reserves). Attachment B shows the estimated resulting increased expenses based on estimated investments as of December 31, 2006. The reserve position reflects the reserve allocations recommended in Issue 3.

The company provided aged retirement data, proposed reserve transfers, and average age distributions of the surviving investments for each account. Investments, reserves, and activities were estimated through December 31, 2006. Based on the information provided, staff has determined the appropriate lives, net salvage values, and resultant depreciation rates for all accounts. This also included the rounding of some plant accounts average service and remaining lives to one decimal point up to 20 years and to the nearest whole year thereafter. The discussion that follows concerns only the plant accounts with proposed changes from the previously prescribed comprehensive depreciation study.

Distribution Plant

Mains and Services (Accounts 376 and 380)

Mains and services comprise approximately 84 percent of the investment in distribution plant. The company is continuing its cast iron replacement program, which is a system upgrade to relieve water infiltration and to increase system pressures.

Mains and service lines are generally abandoned in place upon retirement. This involves travel time for the crew, digging down to the main or service, cutting and capping, refilling the hole, and restoring the roadway. Restoring the roadway can become significant if the lines are under pavement. Surface restoration normally occurs at two locations for each retired service line; one at the point of the service riser, and the other at the property line or at the connection to the main. The galvanic action of dissimilar metals such as a galvanized steel service line running off a cast iron main requires that the line be cut at the main rather than the property line. Under these circumstances, paving restoration is required. Account 376-Mains has experienced early retirements due to government improvements that shorten the average service life. The company proposed to continue with a 40-year average service life which was approved in the previous study. The company requested an increase in negative net salvage from 45 percent to 50 percent for Mains-Other than Plastic and 10 percent to 15 percent for Mains-Plastic. Staff accepts the company's proposal as reasonable and in line with the gas industry.

Service lines removal costs are on a continuous climb for the industry due to the ever increasing costs of labor and materials in current dollars. Additionally, the embedded retirement costs for labor and materials for service lines are over 30 years old. Also, high retirements and/or high growth tend to increase early retirements. Plant subject to theft, damage, or public requirements can be expected to have a greater incident of early retirements than similar plant in a rural or small town setting. Account 380-Service Llines has experienced early retirements due to demolition, upgrades, and inactivity as explained previously. The company proposed to continue the use of an average service life of 32 years, increase negative net salvage from 80 percent to 90 percent for Service Lines-Other than Plastic, and from 35 percent to 50 percent for Service Lines-Plastic. Staff accepts the company's proposals as reasonable and in line with the gas industry.

Measuring and Regulating Station Equipment –General and City Gate (Accounts 378 and 379) Staff concurs with the company's proposal to continue with an average service life of 31 years and a net salvage of 5 percent for these accounts. These accounts contain similar types of equipment and therefore should have similar life and salvage characteristics. The majority of retirements that were subject to upgrades are minor items of equipment. Also retired were two older odorant injection systems, and the closing of a substation at the request of Jacksonville Electric Authority (JEA).

Meters (Account 381) Staff accepts the company's proposal of an average service life of 16 years and a 3 percent net salvage as reasonable and in line with the gas industry. In the previous depreciation study, the company outsourced its meter shop to North American Service Group. At that time, there was not sufficient history with the new company and its processes to determine the proper average service life. Therefore, a 23 year average service life and 5 percent net salvage was approved.

Meter and House Regulator Installations (Accounts 382 and 384) In the previous depreciation study, the company implemented a new tracking system that allowed it to track meter and regulator installations in a detailed manner. The tracking system works correctly, but the written report derived from the system is incorrect. Prior to Peoples' becoming a division of Tampa Electric Company, its policy was to retire the meter and regulator when the service ends regardless of reuse. This was not consistent with staff's direction to the company, which was, "installations are rarely retired prior to the date the service ends or when the meter is removed due to inactivity." The company has subsequently agreed with staff. Currently, the company is recreating the aged records and needs additional time to complete an accurate report. Upon its completion, staff has asked the company to provide an updated report on these accounts. For these accounts, the company also proposed the continued use of a previously prescribed average service life of 27 years and an increase in negative net salvage from 18 to 20 percent. Staff accepts the company's proposal as reasonable and in line with the gas industry.

General Plant

Computer Equipment (391.1) The company proposes an average service life increase from 6 to 8 years and a continued use of net salvage of 0 percent. Staff accepts the company's proposal as reasonable and in line with the gas industry.

Trucks ¾ to 1 Ton (Account 392.2) The company proposes an average service life decrease from 8 to 7 years and a continued use of net salvage of 10 percent. Staff accepts the company's proposal as reasonable and in line with the gas industry.

Trucks Over 1 Ton (Account 392.5) The company proposes the continued use of the previously prescribed average service life of 12 years and a decrease in net salvage from 12 to 10 percent. Staff accepts the company proposal as reasonable and in line with the gas industry.

Stores Equipment (Account 393) This account was fully depreciated prior to 2002 when additional equipment was added. The previously prescribed depreciation rate of 11.3 percent was based upon a fully depreciable investment of approximately $60,000, an average service life of 25 years, and net salvage of 0 percent. The current depreciable investment of approximately $4,300 was added in 2002. The company proposes to continue the average service life of 25 years with a net salvage of 0 percent. Staff accepts the company proposal as reasonable and in line with the gas industry.

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

Recommendation: Yes. Staff recommends the reserve allocations as shown below. These allocations bring each account more in line with its theoretically correct reserve level. (Gardner)

Staff Analysis: As part of its review of the company's depreciation study, staff reviewed the reserve position for each account. When significant surpluses and deficits exist, corrective reserve transfers between accounts should be recovered as quickly as possible, unless such recovery prevents the company from earning a fair and reasonable return on its investments. The effect of prior depreciation rates, average service lives, and net salvage projections results in surpluses and deficits that should be addressed. The reserve transfers presented are based upon the company's planning and expectation of future retirements, which may further impact several plant accounts balances. As staff reviews the company's annual status report of plant accounts, it will continue to monitor the company's reserve position. For this reason, staff recommends transferring these related reserve surpluses to help correct the existing reserve deficiencies in the accounts as shown below.

RESERVE ALLOCATIONS

ACCOUNT		Actual 01/01/2007 Reserve	Theoretical Reserve	Recommended Allocations	Restated 01/01/2007 Reserve
376.0	Mains-Other Than Plastic	126,516,763	137,268,879	509,008	127,025,771
378.0	Meas. & Reg. Stat. Equip.General	1,696,016	1,370,869	(231,324)	1,464,692
379.0	Meas. & Reg. Stat. Equip.-City Gate	2,338,572	1,956,690	(300,330)	2,038,242
381.0	Meters	6,928,784	23,868,445	647,670	7,576,454
383.0	Regulators	4,347,485	3,637,679	(625,024)	3,722,461
	Total	141,827,620	168,102,562	0	141,827,620

Issue 4: What should be the implementation date for the new depreciation rates?

Recommendation: January 1, 2007, should be the implementation date for Peoples' new depreciation rates as shown on Attachments A and B. (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, Peoples' supporting data and calculations have been provided to match a January 1, 2007, implementation date.

Issue 5: Should the current amortization of investment tax credits and the flowback 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, 2007. 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 (REGs) 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 examine 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 6: 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: At the conclusion of the protest period, if no protest is filed, this docket should be closed upon the issuance of a consummating order.

PEOPLES GAS COMPANY.
2006 DEPRECIATION STUDY

ATTACHMENT A

COMPARISON OF RATES AND COMPONENTS

	CURRENT					COMPANY/STAFF RECOMMENDED				
	AVERAGE	AVERAGE			REMAINING	AVERAGE	AVERAGE			REMAINING
ACCOUNT	SERVICE	REMAINING	NET	1/1/2007	LIFE	SERVICE	REMAINING	NET	1/1/2007	LIFE
	LIFE	LIFE	SALVAGE	RESERVE	RATE	LIFE	LIFE	SALVAGE	RESERVE	RATE
		(YRS.)	(%)	(%)	(%)		(YRS.)	(%)	(%)	(%)
DISTRIBUTION PLANT										
375.0 Structures & Improvements	40	30.0	0.0	17.66	2.7	40	28.0	0.0	21.9	2.8
376.1 - Mains - Other Than Plastic	40	28.0	-45.0	41.40	3.7	40	25.0	-50.0	*50.9	4.0
376.2 - Mains - Plastic	40	32.0	-10.0	21.20	2.8	40	31.0	-15.0	24.0	2.9
378 - Measuring and Regulating Ept. - General	31	22.0	-5.0	19.78	3.9	31	24.0	-5.0	*25.0	3.3
379 - Measuring and Regulating Ept. - City Gate	31	24.0	-5.0	32.69	3.0	31	24.0	-5.0	*24.4	3.4
380.0 - Services - Other Than Plastic	32	14.6	-80.0	83.13	6.6	32	12.8	-90.0	87.5	8.0
380.2 - Services - Plastic	32	24.0	-35.0	30.40	4.4	32	23.0	-50.0	32.1	5.1
381 - Meters	23	13.2	5.0	23.69	5.4	16	11.2	3.0	*22.6	6.6
382 - Meter Installations	27	18.0	-18.0	40.01	4.3	27	17.4	-20.0	32.8	5.0
383 - House Regulators	28	14.1	0.0	35.83	4.6	28	17.3	0.0	*38.6	3.5
384 - House Regulator Installations	27	18.4	-18.0	36.24	4.4	27	18.0	-20.0	28.4	5.1
385 -Industrial M & R Station Equip	32	22.0	0.0	34.35	3.0	32	20.0	-3.0	34.4	3.4
387 - Other Distribution Equipment	16	9.3	0.0	26.29	7.9	16	9.1	0.0	47.7	5.7
GENERAL PLANT										
390.0 Structures & Improvement	40	31.0	0.0	16.83	2.7	40	29.0	0.0	17.1	2.9
391.0 - Office Furniture	15	9.5	0.0	8.31	9.7	15	8.7	0.0	33.6	7.6
391.1 - Computer Equipment	6	1.6	0.0	68.35	19.8	8	3.1	0.0	77.7	7.2
391.2 - Office Machines	15	7.6	0.0	49.56	6.6	15	8.1	0.0	43.7	7.0
392.1 - Autos & Trucks 3/4 Ton	8	4.2	10.0	29.80	14.3	8	4.0	10.0	47.4	10.6
392.2- Autos & Trucks 3/4 to 1 Ton	8	7.1	10.0	9.77	11.3	7	3.9	10.0	32.2	14.8
392.3-Airplanes	15	14.5	75.0	0.35	1.7	15	10.5	75.0	5.5	1.9
392.4 Other Transportation Equipment	20	10.8	14.0	43.81	3.9	20	8.5	14.0	51.0	4.1
392.5-Trucks over 1 Ton	12	5.1	12.0	50.77	7.3	12	3.7	10.0	53.2	9.9
393.0-Stores Equipment	25	NA	NA	NA	11.3	25	2.4	0.0	95.6	1.8
394 - Tools, Shop & Garage Equipment	15	8.0	0.0	46.40	6.7	15	6.4	0.0	61.7	6.0
395.0-Laboratory Equipment	20	15.5	0.0	22.50	5.0	20	11.7	0.0	39.0	5.2
396 - Power Operated Equipment	15	6.8	5.0	51.83	6.3	15	4.1	5.0	73.6	5.2
397 - Communication Equipment	12	7.8	0.0	24.06	9.7	12	5.8	0.0	34.2	11.4
398 - Miscellaneous Equipment	17	11.1	0.0	65.00	3.2	17	9.8	0.0	57.7	4.3

*Denotes restated reserves after transfers.

PEOPLES GAS COMPANY.
2006 DEPRECIATION STUDY

ATTACHMENT B

COMPARISON OF EXPENSES

					CURRENT		COMPANY PROPOSED		STAFF SUGGESTED		
ACCOUNT											**CHANGE**
	1/1/2007	**1/1/2007**								**ESTIMATED**	**IN**
	INVESTMENT	**RESERVE**		**RATE**	**EXPENSES**	**RATE**	**EXPENSES**	**RATE**		**EXPENSES**	**EXPENSES**
DISTRIBUTION PLANT	($)	($)		(%)	($)	(%)	($)	(%)		($)	($)
375.0 Structures & Improvements	14,518,513	3,173,228		2.7	392,000	2.7	392,000	2.8		406,518	14,518
376.1 Mains Other Than Plastic	249,579,780	127,025,771	*	3.7	9,234,452	3.9	9,733,611	4.0		9,983,191	748,739
376.2 - Mains - Plastic	244,375,429	58,535,386		2.8	6,842,512	2.9	7,086,887	2.9		7,086,887	244,375
378 - Measuring and Regulating Ept. - General	5,858,413	1,464,692	*	3.9	228,478	3.4	199,186	3.3		193,328	-35,150
379 - Measuring and Regulating Ept. - City Gate	8,361,921	2,038,242	*	3.0	250,858	3.4	284,305	3.4		284,305	33,447
380.0 - Services - Other Than Plastic	37,221,547	32,574,935		6.6	2,456,622	8.2	3,052,167	8.0		2,977,724	521,102
380.2 - Services - Plastic	154,668,842	49,599,583		4.4	6,805,429	5.0	7,733,442	5.1		7,888,111	1,082,682
381 - Meters	33,466,693	7,576,454	*	5.4	1,807,201	6.6	2,208,802	6.6		2,208,802	401,601
382 - Meter Installations	34,614,235	11,335,017		4.3	1,488,412	5.0	1,730,712	5.0		1,730,712	242,300
383 - House Regulators	9,643,901	3,722,461	*	4.6	443,619	3.6	347,180	3.5		337,537	-106,082
384 - House Regulator Installations	12,762,371	3,623,764		4.4	561,544	4.9	625,356	5.1		650,881	89,337
385 -Industrial M & R Station Equip	9,366,913	3,224,033		3.0	281,007	3.4	318,475	3.4		318,475	37,468
387 - Other Distribution Equipment	1,737,703	828,902		7.9	137,279	**5.7**	99,049	5.7		99,049	-38,230
TOTAL DISTRIBUTION PLANT	**816,176,261**	**304,722,468**			**30,929,413**		**33,811,172**			**34,165,520**	**3,236,107**
GENERAL PLANT											
390.0 Structures & Improvement	1,176,285	201,029		2.7	31,760	2.9	34,112	2.9		34,112	2,352
391.0 -Office Furniture	3,105,726	1,042,960		9.7	301,255	9.6	298,150	7.6		236,035	-65,220
391.1 - Computer Equipment	9,605,498	7,461,279		19.8	1,901,889	7.2	691,596	7.2		691,596	-1,210,293
391.2 - Office Machines	651,777	284,486		6.6	43,017	6.9	44,973	7.0		45,624	2,607
392.1 - Autos & Trucks 3/4 Ton	7,370,626	3,496,478		14.3	1,054,000	10.4	766,545	10.6		781,286	-272,714
392.2- Autos & Trucks 3/4 to 1 Ton	3,682,379	1,183,702		11.3	416,109	14.8	544,992	14.8		544,992	128,883
392.3- Airplanes	6,029,716	328,692		1.7	102,505	1.9	114,565	1.9		114,565	12,060
392.4 - Other Transportation Equipment	271,562	138,431		3.9	10,591	4.1	11,134	4.1		11,134	543
392.5- Trucks Over 1 Ton	1,048,986	558,528		7.3	76,576	9.9	103,850	9.9		103,850	27,274
393.0 - Stores Equipment	56,473	54,008		11.3	6,381	1.9	1,073	1.8		1,017	-5,364
394 - Tools, Shop & Garage Equipment	3,912,405	2,411,938		6.7	262,131	6.0	234,744	6.0		234,744	-27,387
395.0 Laboratory Equipment	129,578	50,482		5.0	6,479	5.3	6,868	5.2		6,738	259
396 - Power Operated Equipment	1,886,714	1,389,199		6.3	118,863	5.2	98,109	5.2		98,109	-20,754
397 - Communication Equipment	5,641,583	1,927,246		9.7	547,234	11.4	643,140	11.4		643,140	95,906
398 - Miscellaneous Equipment	391,519	226,082		3.2	12,529	4.4	17,227	4.3		16,835	4,306
TOTAL GENERAL PROPERTY	**44,960,827**	**20,754,540**			**4,891,319**		**3,611,078**			**3,563,777**	-1,327,542
TOTAL Distribution & General Plant	**861,137,088**	**325,477,008**			**35,820,732**		**37,422,250**			**37,729,297**	**1,908,565**
TOTAL PLANT	**861,137,088**	**325,477,008**			**35,820,732**		**37,422,250**			**37,729,297**	**1,908,565**

*Denotes restated reserves after transfers.