

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-**

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**DATE:** May 10, 2007

**TO:** Commission Clerk (Cole)

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

**RE:** Docket No. 060504-GU – Request for approval of depreciation study for five-year period 2001 through 2005 by Sebring Gas System, Inc.

**AGENDA:** 05/22/07 – Regular Agenda – Proposed Agency Action - Interested Persons May Participate

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICER:** Carter

**CRITICAL DATES:** None

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\060504.RCM.DOC

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**Case Background**

Rule 25-7.045, F.A.C., requires natural gas companies to file a comprehensive depreciation study once every five years. On July 21, 2006, Sebring Gas System, Inc. (Sebring or company) filed its 2006 depreciation study in compliance with this rule. The company's last depreciation review was filed June 25, 2001, with an effective date of January 1, 2002. Sebring has 2005 operating revenues of \$477,097, and fewer than 500 customers. Staff has completed its review of Sebring's depreciation study and presents its recommendation herein.

The Commission has jurisdiction pursuant to Sections 350.115 and 366.05, Florida Statutes.

### **Discussion of Issues**

**Issue 1:** Should the current depreciation rates for Sebring Gas System, Inc. be changed?

**Recommendation:** Yes. A review of the company's plans and activities indicates a need for a revision to the currently prescribed depreciation rates. (Marsh)

**Staff Analysis:** Sebring's last comprehensive depreciation study was filed on June 25, 2001. By Order No. PSC-03-0260-PAA-GU,<sup>1</sup> the Commission approved revised depreciation rates and components, effective January 1, 2002. The company has filed this 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 activity data indicates the need for revising depreciation rates.

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<sup>1</sup> Issued February 24, 2003, in Docket No. 010906-GU, In re: Request for approval of depreciation study for five-year period 1996 through 2000 by Sebring Gas System, Inc.

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

**Recommendation:** Staff recommends approval of the company's proposed January 1, 2007, date of implementation for revised depreciation rates. (Marsh)

**Staff Analysis:** Rule 25-6.0436, 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, 2007.

**Issue 3:** What are the appropriate depreciation rates?

**Recommendation:** Staff's recommended lives, net salvages, reserves, resultant depreciation rates, and recovery schedules are shown on Attachment A. Attachment B shows an increase in annual expenses of approximately \$9,373 based on January 1, 2007, investments. (Marsh)

**Staff Analysis:** Staff's recommendations are the result of a comprehensive review of Sebring's depreciation study. Attachment A shows a comparison of the currently approved depreciation rate parameters and those staff is recommending as appropriate, with which the company agrees. Attachment B shows a comparison of resultant expenses based on January 1, 2007, investments.

This filing was essentially a staff-assisted study. The company provided raw data with regard to additions and retirements for the 2001 - 2006 period. Staff determined the average age and worked with the company in developing life and salvage values. As a result of the review and analytical process, staff and Sebring agree on lives, net salvages, and resultant depreciation rates for all accounts.

**Depreciation Parameters**

The recommended changes in the depreciation life characteristics and the salvage parameters for the distribution and general plant accounts can be attributed mainly to two factors: updated account ages to reflect activity since the last represervation, such as new investment, and changes in the associated reserve position. The accounts with substantial changes are discussed below.

A staff surveillance audit was performed in 2002 in conjunction with Sebring's 2001 depreciation study, and the company completed a rate case in 2004. Due to the recent nature of the booked adjustments, sufficient time has not passed to determine whether changes in life parameters and rates are needed for many of the accounts. Except as discussed below, changes are due to increased or decreased investment which results in a change in age. The current lives and rates are reasonable when compared with industry averages.

**Leasehold Improvements (Account 390)**

This account was established in 1991 with a 40-year service life and a whole-life depreciation rate of 2.5%. However, the account was not included in subsequent depreciation studies. A staff audit adjustment was made as part of the 2004 rate case. At that time, a rate of 3.3% was used to bring the reserve up to date. In response to questions in the current case, the company advised staff that the account contains improvements to buildings that are not owned by the company.

The company booked an audit adjustment to add plant investment of \$2,800, with a reserve balance of \$1,039. However, the company has not accrued annual depreciation. Staff determined that the reserve balance should be \$1,309 as of December 31, 2006. An adjustment to add \$270, to correct the lack of accruals, is necessary to bring the reserve current as of December 2006. A curve is used to estimate the distribution of retirements. Using an R3 curve, an average service life of 40 years, and the current average age of 15.5 years, staff is recommending an average remaining life of 24.5 years and zero net salvage.

**Transportation Equipment – Other (Account 392.3)**

Due to the findings of the 2001 FPSC audit, the company should have removed \$743.50. This adjustment was made in the rate case, but not in the depreciation study. The company was also informed

to remove the investment of \$1,030. However, the journal entries were not completed until 2004. During the intervening period, the company continued to book depreciation expense. As a result, the company is carrying a \$180 reserve balance. An adjustment should be made to the company's books to reduce the reserve to zero. Staff has made the appropriate changes for this study.

The account appears reasonable and in line with industry averages to continue use of an S5 curve for future additions, with a 20 year average service life, and zero net salvage. A whole life rate of 5.0% is recommended for future additions.

#### Power Operated Equipment (Account 396)

In the 2001 study, it was noted that the investment in this account had been fully recovered. A whole life rate was established for new equipment. In 2005, the company added investment to the account, but calculated the depreciation on the entire investment, including the portion that had previously been fully depreciated. The company also used the old rate of 2.1% instead of the whole life rate of 6.7%. This resulted in errors to depreciation expense and to the reserve. Using the half-year convention, the reserve balance for the new equipment should be \$784.

The company advised staff that the old equipment is still in use. Therefore, staff believes it is appropriate to place the new investment in a sub-account with a reserve of \$784 as of January 1, 2007, with annual depreciation expense of \$523. All depreciation of the old equipment should cease.

Staff accepts the company's continuation of the previously prescribed average service life of 15 years and zero net salvage which appears reasonable and in line with the regulated gas industry.

The account reserve positions shown on Attachment A reflect the corrective adjustments detailed above.

**Issue 4:** 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 account 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					
Accounts		Actual 01/01/2007 Reserve	Theoretical Reserve	Recommended Allocations	Restated 01/01/2007 Reserve
376.1	Mains-Steel	\$119,112	\$124,967	\$ 5,855	\$124,967
376.2	Mains-Plastic	309,448	298,981	(10,467)	298,981
378.0	Measuring & Regulated. Equip-Gen. Embedded	2,709	5395	2,686	5,395
379.0	Measuring & Regulated Equip-General New	20,985	25,701	4,716	25,701
380.1	Services-Steel	336,908	339,302	2,394	339,302
380.2	Services - Plastic	103,577	56,828	(22,348)	81,229
381.0	Meters	79,015	90,162	11,147	90,162
382.0	Meter Installations	26,985	27,761	776	27,761
383.0	House Regulators	13,293	15,943	2,650	15,943
384.0	House Regulator. Installations	22,899	24,019	1,120	24,019
386.0	Property on Customers Premises	18,492	21,137	2,645	21,137
387.0	Other Equipment	3,809	2,509	(1,300)	2,509
391.1	Office Equipment	204	330	126	330
	<b>Total</b>	<b>\$1,057,436</b>	<b>\$1,033,035</b>	<b>\$0</b>	<b>\$1,057,436</b>

**Issue 5:** 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. (Gervasi)

**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.

SEBRING GAS SYSTEM, INC.  
 DOCKET NO. 060504-GU  
 2006 DEPRECIATION STUDY

ATTACHMENT A

COMPARISON OF RATES AND COMPONENTS

ACCOUNT	CURRENT					COMPANY/STAFF RECOMMENDED					
	AVERAGE	AVERAGE	NET	1/1/2002	REMAINING	AVERAGE	AVERAGE	NET	1/1/2007	REMAINING	
	SERVICE	REMAINING	NET	RESERVE	LIFE	SERVICE	REMAINING	NET	RESERVE	LIFE	
	LIFE	LIFE	SALVAGE	RESERVE	RATE	LIFE	LIFE	SALVAGE	RESERVE	RATE	
	(YRS.)	(%)	(%)	(%)		(YRS.)	(%)	(%)	(%)	(%)	
<b>DISTRIBUTION PLANT</b>											
376.1 - Mains - Steel	45.0	17.1	-30.0	93.49	2.1	45.0	14.9	-30.0	86.79	*	2.9
376.2 - Mains - Plastic	45.0	36.0	-30.0	38.85	2.5	45.0	34.0	-30.0	31.40	*	2.9
378 - Measuring and Regulating Ept. - Gen. - Embedded	33.0	20.0	-2.0	89.11	0.6	33.0	16.2	-2.0	51.78	*	3.1
378.1 - Measuring and Regulating Ept. - Gen. - New	33.0	33.0	-2.0	N/A	3.1	33.0	33.0	-2.0	N/A		3.1
379 - Measuring and Regulating Ept. - City Gate	32.0	21.0	-2.0	50.27	2.5	32.0	17.0	-2.0	47.60	*	3.2
380.1 - Services - Steel	40.0	12.8	-30.0	110.91	1.5	40.0	10.5	-30.0	95.35	*	3.3
380.2 - Services - Plastic	40.0	28.0	-30.0	49.78	2.9	40.0	33.4	-30.0	29.15	*	3.0
381 - Meters	25.0	11.5	0.0	61.78	3.3	25.0	9.3	0.0	62.80	*	4.0
382 - Meter Installations	34.0	19.7	-5.0	58.95	2.3	34.0	16.7	-5.0	53.23	*	3.1
383 - House Regulators	30.0	17.2	0.0	53.49	2.7	30.0	13.1	0.0	56.77	*	3.3
384 - House Regulator Installations	34.0	17.8	-3.0	69.53	1.9	34.0	14.8	-3.0	58.60	*	3.0
386 - Property on Customers' Premises	20.0	11.5	0.0	43.62	4.9	20.0	7.8	0.0	61.00	*	5.0
387 - Other Equipment	25.0	13.3	0.0	47.74	3.9	25.0	15.0	0.0	40.00	*	4.0
<b>GENERAL PLANT</b>											
390.0 Leasehold Improvements	40	29.5	0.0	30.25	3.3	40.0	24.5	0.0	46.75	*	2.2
391.1 - Office Furniture	18	8.4	0.0	0.00	11.9	18.0	5.6	0.0	68.61		5.6
391.2 - Office Equipment	12	7.2	0.0	73.76	3.6	12.0	4.6	0.0	84.95	*	3.3
392.1 - Transportation Trucks	8	3.4	15.0	42.41	12.5	8.0	3.2	15.0	65.53		6.1
392.3 - Transportation - Other	20	10.5	0.0	56.60	9.7	20.0	0.0	0.0	N/A		5.0
394 - Tools, Shop & Garage Equipment	15	5.5	0.0	31.67	12.4	15.0	12.7	0.0	19.54		6.3
396 - Power Operated Equipment - Embedded	15	0.0	0.0	N/A	N/A	15.0	0.0	0.0	100.00	N/A	
396 - Power Operated Equipment - New	15	15.0	0.0	N/A	6.7	15.0	13.5	0.0	10.05		6.7
397 - Communication Equipment	12	7.5	0.0	29.84	9.4	12.0	3.0	0.0	76.85		7.7

\*Denotes restated reserves after transfers



SEBRING GAS SYSTEM, INC.  
DOCKET NO. 060504-GU  
2006 DEPRECIATION STUDY

ATTACHMENT B

COMPARISON OF EXPENSES

ACCOUNT	CURRENT				STAFF SUGGESTED			
	1/1/2007	1/1/2007			ESTIMATED		CHANGE	
	INVESTMENT	RESERVE	RATE	EXPENSES	RATE	EXPENSES	IN EXPENSES	
	(\$)	(\$)	(%)	(\$)	(%)	(\$)	(\$)	
<b>DISTRIBUTION PLANT</b>								
376.1 - Mains - Steel	143,988	124,967	* 2.1	3,024	2.9	4,176	1,152	
376.2 - Mains - Plastic	952,168	298,981	* 2.5	23,804	2.9	27,613	3,809	
378 - Measuring and Regulating Ept. - Gen. - Embedded	10,419	5,395	* 0.6	63	3.1	323	260	
378.1 - Measuring and Regulating Ept. - Gen. - New	0	0	3.1	N/A	3.1	N/A	N/A	
379 - Measuring and Regulating Ept. - City Gate	53,994	25,701	* 2.5	1,350	3.2	1,728	378	
380.1 - Services - Steel	355,849	339,302	* 1.5	5,338	3.3	11,743	6,405	
380.2 - Services - Plastic	287,298	83,749	* 2.9	8,332	3.0	8,619	287	
381 - Meters	143,570	90,162	* 3.3	4,738	4.0	5,743	1,005	
382 - Meter Installations	52,152	27,761	* 2.3	1,199	3.1	1,617	418	
383 - House Regulators	28,084	15,943	* 2.7	758	3.3	927	169	
384 - House Regulator Installations	40,988	24,019	* 1.9	779	3.0	1,230	451	
386 - Property on Customers' Premises	34,650	21,137	* 4.9	1,698	5.0	1,733	35	
387 - Other Equipment	6,273	2,509	* 3.9	245	4.0	251	6	
<b>TOTAL DISTRIBUTION PLANT</b>	<b>2,109,433</b>	<b>1,059,626</b>		<b>51,328</b>		<b>65,703</b>	<b>14,375</b>	
<b>GENERAL PLANT</b>								
390.0 Leasehold Improvements	2,800	1,309	* 3.3	92	2.2	62	-30	
391.1 - Office Furniture	481	330	11.9	57	5.6	27	-30	
391.2 - Office Equipment	19,801	16,820	* 3.6	713	3.3	653	-60	
392.1 - Transportation Trucks	69,468	45,523	12.5	8,684	6.1	4,238	-4,446	
392.3 - Transportation - Other	0	0	9.7	0	5	0	0	
394 - Tools, Shop & Garage Equipment	6,897	1,348	12.4	855	6.3	435	-420	
396 - Power Operated Equipment - Embedded	1,444	1,444	N/A	0	N/A	0	0	
396 - Power Operated Equipment - New	7,799	784	6.7	523	6.7	523	0	
397 - Communication Equipment	972	747	9.4	91	7.7	75	-16	
<b>TOTAL GENERAL PROPERTY</b>	<b>106,862</b>	<b>66,996</b>		<b>11,015</b>		<b>6,013</b>	<b>-5,002</b>	
<b>TOTAL Distribution &amp; General Plant</b>	<b>2,216,295</b>	<b>1,126,622</b>		<b>62,343</b>		<b>71,716</b>	<b>9,373</b>	
<b>TOTAL PLANT</b>	<b>2,216,295</b>	<b>1,126,622</b>		<b>62,343</b>		<b>71,716</b>	<b>9,373</b>	

\*Denotes restated reserves after transfers