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: August 7, 2008

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Marsh)
Office of the General Counsel (Fleming)

RE: Docket No. 080163-GU – Petition for approval to create regulatory subaccount of meter installation to capitalize all incurred and future costs associated with installation of encoder receiver transmitters (ERTs) under provisions of Statement of Financial Accounting Standard No. 71, Accounting for the Effects of Certain Types of Regulation (SFAS 71); and requesting depreciation of installation costs of ERTs over 15-year period beginning January 1, 2008, by Florida City Gas.

AGENDA: 08/19/08 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: McMurrian

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\080163.RCM.DOC

Case Background

Pursuant to Rule 25-7.045(3)(a), Florida Administrative Code (F.A.C.), gas utilities are required to maintain depreciation rates and accumulated depreciation reserves in accounts or subaccounts as prescribed in Rule 25-7.046, F.A.C. Rule 25-7.045(3)(b), F.A.C., further provides that "[u]pon establishing a new account or subaccount classification, each utility shall request Commission approval of a depreciation rate for the new plant category." On March 18, 2008, Florida City Gas (FCG or company) filed its petition to establish depreciation rates for its

Encoder Receiver Transmitter (ERT) installation costs. The devices are used for automated meter reading by radio signal. FCG requests to establish a new subaccount classification for capitalization of previously incurred and future installation costs of the ERTs.

On July 10, 2008, FCG filed a letter discussing the reasons it believes its petition should be granted, specifically with regard to capitalization of installation costs that were expensed in 2006 and 2007. The letter is addressed in Issue 1.

Staff has completed its review and presents its recommendations herein. The Commission has jurisdiction in this matter pursuant to Sections 366.04, 366.05, and 366.06, Florida Statutes (F.S.).

Discussion of Issues

Issue 1: Should FCG be allowed to capitalize installation costs associated with the addition of ERTs?

Recommendation: Installation costs incurred during 2008 for the addition of ERTs on existing meters should be capitalized beginning January 1, 2008. However, installation costs that were expensed prior to 2008 should not be capitalized. (Marsh)

Staff Analysis: FCG began the installation of ERT devices in its Port St. Lucie (PSL) service area in January 2006. The company states that since that time, it has installed 7,811 ERT devices in the PSL service area. Further, in 2007, FCG began ERT installations in the Miami area, with 39,669 ERT devices installed as of February 2008. Additionally, all new meters installed in any area are fitted with an ERT device before installation. FCG states that its goal is to install ERT devices on all FCG meters by the end of 2009. As of February 29, 2008, there are 23,211 meters in Miami and 42,902 meters in Brevard that are still awaiting an ERT device.

Since January 2006, FCG has expensed the costs to install ERTs on existing meters, while capitalizing the cost of the ERT equipment and including such costs in the meters account. The company is requesting that a new subaccount of ERT installation costs be created to capture the installation expenses as capitalized costs, including those that were previously expensed. The company expensed installation costs of $142,821 in 2006 and $302,372 in 2007. The total installation costs to add ERTs or replace non-compatible meters are estimated to be approximately $2.3 million. The four-year overall project has an estimated cost of $8.4 million. The installation costs that were previously expensed total approximately 5 percent of the projected project cost.

Pursuant to Rule 25-7.0461, F.A.C., a minor item that is added can be treated in the same manner as an addition of a retirement unit. All depreciable property is comprised of retirement units and minor items. A retirement unit is an item that is capitalized. When a minor item constitutes a betterment, which may make the item more efficient, the cost should be charged to the appropriate plant account. The rule requires that such minor items have a cost of more than $500 to receive this treatment. Although each individual ERT in this case has a cost of less than $500, the four-year overall project has an estimated cost of $8.4 million. Staff believes that it is appropriate, given the magnitude of the project, to capitalize the costs, including the installation costs.

On July 10, 2008, FCG filed a letter, included as Attachment A, discussing the reasons it believes its petition should be granted, specifically with regard to capitalization of installation costs that were expensed in 2006 and 2007. Staff is not persuaded by the company's arguments that retroactive capitalization of previously expensed costs should be allowed. If these costs are allowed to be capitalized, previously filed financial statements would have to be restated to reflect the change in accounting methodology. This treatment would also increase rate base and may result in higher rates in the future for the company's ratepayers. When depreciation studies are filed pursuant to Rule 25-7.045, F.A.C., the requested effective date for the implementation of the revised depreciation rates is either the beginning of the same fiscal year during which the study is filed or a later date. This requirement discourages the retroactive application of the revised depreciation rates to prior fiscal years. Although the company submits as an alternative that it would be willing to accept retroactive capitalization of 2007 costs and forego the 2006 amounts, the treatment has the same impact, albeit for one year instead of two.

While staff agrees with FCG that benefits will arise from the use of ERTs, such as improvements to the billing process, increased operating efficiency, and improved customer service, staff does not believe that is justification for the retroactive prior period application. The company had ample opportunity to ask for the requested accounting treatment when it began to add ERTs in January 2006. FCG first contacted the Commission about this matter on January 31, 2005, stating that it was making improvements to its meter sets by installing ERTs. Subsequently, staff provided the company with a copy of Rule 25-7.0461, F.A.C., titled Capitalization Versus Expensing, advising that the company should contact staff if it had further questions. The subject of ERTs arose again on October 3, 2006, when the company filed testimony with its request for approval of an acquisition adjustment, stating that the ERTs costs were not an ongoing expense, but was for a project that would benefit FCG. As late as May 2007, FCG stated in response to an informal staff data request that, because the amounts associated with ERTs were expensed and not capitalized, ". . . there are no life parameters or depreciation methodologies associated with these costs."

FCG states in its July 10, 2008 letter that it "has been unable to identify an absolute prohibition on revised accounting treatment applied for prior years." Staff asked the company in a meeting on June 30, 2008, whether it was aware of any cases in which the Commission allowed such retroactive treatment. FCG's response to that question contained in its letter is that "FCG does not deny that such treatment is not common, nor should it be." Staff believes the very absence of such cases is significant, and that a company would have to demonstrate extraordinary circumstances to change its accounting retroactively, several years after the fact.

FCG states that retroactive capitalization of the installation costs will not cause FCG to exceed its authorized ROE. The authorized ROE midpoint is 11.25 percent with a range of 10.25 percent to 12.25 percent. Based on staff's analysis, if the 2006 ERT expenditures of $142,821 had not been expensed in 2006, the company's achieved return on equity (ROE) would have increased from 10.67 percent to 10.85 percent, an 18 basis point increase. If the 2007 ERT expenditures of $302,372 had not been expensed in 2007, the company's achieved ROE would have increased from 7.06 percent to 7.38 percent, a 32 basis point increase. Staff notes that both the 7.06 percent and the 7.38 percent ROEs include the amortization of the acquisition adjustment and regulatory assets approved in Docket No. 060657-GU.[1] Excluding the authorized acquisition adjustment amortization for 2007, the achieved ROE would be 11.75 percent including the ERT expenditures and 12.11 percent excluding the ERT expenditures.

FCG states that Florida Power & Light Company (FPL) accounts for its ERTs in an identical manner, advising that the accounting treatment was approved in FPL's 2005

[1] Order No. PSC-07-0913-PAA-GU, issued November 13, 2007, in Docket No. 060657-GU, <u>In re: Petition for approval of acquisition adjustment and recognition of regulatory asset to reflect purchase of Florida City Gas by AGL Resources, Inc</u>.

depreciation study.[2] Thus, FCG notes that approval of its accounting treatment is not a case of first impression, due to the FPL case. However, staff notes that the FPL case was resolved through a settlement, so that the Commission did not vote directly on the ERT issue. Further, unlike FCG, FPL requested its accounting treatment in advance, as part of its depreciation study, and did not ask for retroactive treatment.

The company argues that to deny its request to capitalize costs that were previously expensed would put an inequitable burden on the company's shareholders for costs which benefitted the ratepayers. However, staff believes this argument does not apply, because staff is not recommending that the cost be disallowed. Rather, the company made a decision to expense the costs during the years they were incurred. In cases where there is inequitable treatment, the Commission might want to consider a retroactive change, However, as previously noted, such instances would be rare. Staff believes it is appropriate to consider any such requests on a case-by-case basis.

In conclusion, staff believes that the company's request to capitalize its ERT installation costs has merit, due to the magnitude of the project and the benefits to be realized. Nevertheless, staff believes in this instance it is appropriate to grant the request on a prospective basis only. Therefore, staff recommends that installation costs of ERTs on existing meters be capitalized beginning January 1, 2008. Installation costs that were expensed prior to 2008 should not be capitalized.

[2] Order No. PSC-05-0902-S-EI, issued September 14, 2005, in Docket No. 050188-EI, In re: 2005 comprehensive depreciation study by Florida Power & Light Company.

Issue 2: Should the Commission establish a subaccount with depreciation rates for the ERT Installations?

Recommendation: Yes. Account 382.1, ERT Installations, should be established with a 15-year average service life, and a resulting depreciation rate of 6.7 percent for the ERTs. (Marsh)

Staff Analysis: FCG proposed a 15-year average service life for its ERTs. The company currently records meter installations in Account 382. Staff believes it is appropriate to establish Account 382.1 to capture the cost of the ERT installations.

Staff believes the proposed life of 15 years is appropriate for 2008. The average remaining life of the company's meters is approximately 15 years. The ERT equipment is included in that account at this time. Therefore, staff believes it is appropriate to have a matching life for the installations.

Pursuant to Rule 25-7.045(8)(a), F.A.C., a gas utility is required to file a depreciation study for Commission review at least once every five years. Staff is reviewing FCG's most recent study, which will be used to establish depreciation rates effective January 1, 2009. This will afford staff and the company opportunities to review the depreciation rate for the ERT Installations in the context of the meters and retirements of meters resulting from incompatibility.

Therefore, staff recommends that Account 381.2, ERT Installations, be established with a 15-year average service life, and a resulting depreciation rate of 6.7 percent for the ERTs.

Issue 3: What should be the effective date for the implementation of the new depreciation rate for the ERT Installations?

Recommendation: The effective date for the implementation of the new depreciation rate for the ERT Installations should be January 1, 2008. (Marsh)

Staff Analysis: FCG has requested that a depreciation rate for the ERT Installations be effective on January 1, 2008.

As stated in Issue 1, when depreciation studies are filed pursuant to Rule 25-7.045, F.A.C., the requested effective date for the implementation of the revised depreciation rates is either the beginning of the same fiscal year during which the study is filed or a later date. An effective date of January 1, 2008, is consistent with the rule. As discussed in Issue 1, retroactive treatment is not appropriate. Therefore, staff recommends that the requested effective date of January 1, 2008, should be approved.

Issue 4: 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 issuance of a consummating order. (Fleming)

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 the order, this docket should be closed upon the issuance of a consummating order.