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: March 24, 2022

TO: Office of Commission Clerk (Teitzman)

FROM: Division of Economics (Smith II) JGH
Division of Accounting and Finance (D. Buys, Osorio) ALM
Office of the General Counsel (Sandy, Crawford) JSC

RE: Docket No. 20210183-GU – Petition for approval of 2021 depreciation study by Sebring Gas System, Inc.

AGENDA: 04/05/22 – Regular Agenda – Proposed Agency Action - Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: La Rosa

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

Case Background

Rule 25-7.045, Florida Administrative Code (F.A.C.), requires natural gas public utilities to file a comprehensive depreciation study with the Florida Public Service Commission (Commission) for review at least once every five years from the submission date of the previous study or pursuant to Commission order. Sebring Gas System, Inc.'s (Sebring or the Company) last depreciation study was filed on July 20, 2016. The Company's 2021 depreciation study was due to be filed on or before July 20, 2021. Sebring filed its 2021 depreciation study on November 18, 2021. Staff would note that no parties were materially impacted as a consequence of the late filing.

Sebring serves approximately 711 customers, and reported 2020 operating revenues of approximately $1,242,000.[1] Staff has completed its review of Sebring's 2021 Depreciation Study and presents its recommendations to the Commission herein.

The Commission is vested with jurisdiction over these matters through several provisions of the Florida Statutes (F.S.), including Sections 350.115, 366.05, and 366.06, F.S.

[1] Sebring Gas System's Annual Report of Natural Gas Utilities Form PSC/AFA 20, at December 31, 2020, filed with the Florida Public Service Commission on May 21, 2021.

Discussion of Issues

Issue 1: Should currently prescribed depreciation rates for Sebring Gas System be revised?

Recommendation: Yes. The review of Sebring's plant depreciation information indicates a need for revising the Company's currently prescribed depreciation rates. (Smith)

Staff Analysis: Sebring's last depreciation study was filed on July 20, 2016. By Order No. PSC-16-0574-PAA-GU, the Commission approved revised depreciation rates that became effective January 1, 2017.[2]

Rule 25-7.045, F.A.C., 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 or pursuant to Commission order. A review of the Company's plant activity and data indicates the need for revising depreciation rates. Staff's recommended depreciation components and rates are discussed in Issue 3 and shown on Attachments A, B, and C.

[2] Order No. PSC-16-0574-PAA-GU, issued December 19, 2016, in Docket No. 20160174-GU, *In re: Request for approval of 2016 depreciation study by Sebring Gas Systems, Inc.*

Issue 2: What should be the implementation date for newly proposed depreciation rates?

Recommendation: Staff recommends January 1, 2022, for implementing newly proposed depreciation rates as shown on Attachments A, B, and C to this recommendation. (Smith)

Staff Analysis: Rule 25-7.045, 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, 2022.

Issue 3: What are the appropriate depreciation parameters and resulting rates?

Recommendation: Staff recommends the Commission approve the lives, reserve percentages, net salvage percentages, and resulting remaining life depreciation rates for Sebring that are shown on Attachments A and C. As shown on Attachment B, the corresponding depreciation expense effect of staff's rate recommendations is an increase of $4,342 annually, or 1.8 percent, based on December 31, 2021 investments. (Smith)

Staff Analysis: Staff's recommendations are the result of a comprehensive review of Sebring's plant depreciation data filed in this docket. Attachments A and C to this recommendation show a comparison of certain currently-approved depreciation parameters and rates to those staff is recommending become effective January 1, 2022 (Issue 2). Staff and the Company are in agreement on all proposed depreciation parameters and resulting rates.[3] Displayed on Attachment B is a comparison of depreciation expenses between currently-approved and proposed rates based on December 31, 2021 investments.

The Company provided plant addition and retirement data spanning 2017-2021 (2021 projected), proposed net salvage values, proposed average service lives, and proposed Iowa-type survivor curves.[4] With this information, staff determined the average age of investments on an account-by-account basis, then applied the results to Sebring's proposed curve/life combinations for determining account-specific average remaining lives. Sebring's proposed account-specific average service lives are unchanged from its prior study.

Plant Additions

Sebring's total plant investment experienced moderate growth over the current study period. In its last depreciation study filing, the Company experienced substantial growth (almost 89 percent) mainly due to initiating gas service to two state correctional institutes in Hardee and Desoto Counties. The Company stated in 2016 that it did not foresee similar levels of investment growth and believed that its system would revert to more typical growth patterns for this study period.[5] In keeping with the Company's expectation, during the 2017-2021 period (2021 projected), the Company's system grew by approximately 22 percent, or from approximately $5.8 million to approximately $7.1 million. Over half of this system growth is attributable to the additions within Account 376.2 – Mains – Plastic and Account 380.2 – Services – Plastic.

Plant Retirements

The Company's plant has experienced minimal retirement activity over the study period. Expressed as a percentage of study period additions, plant retirements total approximately three percent from 2017-2021.[6]

[3] Sebring's Response to 2021 Depreciation Study Staff Report, No. 2 and "Sebring March 7, 2022 Correspondence – Response to Staff Account 382.1 Depreciation Parameters" DN-01657-2022.
[4] "Iowa-type Curves" are a widely-used group of generalized survivor curves that contain the range of survivor characteristics usually experienced by public utilities, as well as companies in other industries.
[5] Docket No. 20160174-GU, Sebring's Responses to Staff's First Data Request, No. 7, DN 08031-2016.
[6] Formula is Study Period Retirements ÷ Study Period Additions or $41,051 ÷ $1,321,694 = 3.11%

Average Service and Remaining Lives

Neither Sebring, nor staff, propose any changes to the Company's currently-authorized, account-specific, average service lives. Consistent with its review of the Company's prior depreciation study, and as mentioned above, staff computed account-specific average remaining lives (shown on Attachment A) by first aging Sebring's projected plant investments at December 31, 2021, then applying the results to the Company's Iowa Curve and service life selections on an account-by-account basis. From this review, staff determined that no changes were necessary to the average service lives. However, staff does recommend the Company closely monitor the life characteristics of all its investments for evaluating if any average service life adjustments are warranted as part of future depreciation studies.

Net Salvage

Without experiencing meaningful levels of retirement over a period of time, Company-specific net salvage investigations may prove inconclusive. Thus, staff compared the Company's currently-authorized/proposed-for-continued-use net salvage levels to those experienced by other natural gas distribution companies. With the exception of Account 392.1 – Transportation – Trucks, staff believes Sebring's currently-authorized/proposed net salvage values remain in line with those net salvage values currently being estimated by its industry peers and should continue to be used for applicable ratemaking purposes.

In its filing, the Company did not request any changes to its currently authorized net salvage levels.[7] However, in response to the Staff Report[8] and discussions between staff and Sebring's accountant, the Company provided staff with information that substantiates the need for a lower net salvage percentage for Account 392.1 – Transportation – Trucks. Sebring stated that over the last five years, net salvage related to this account was between five and ten percent. The Company also explained that at the time of retirement, these trucks had very high mileage, which lowered the resale value.

Staff compared Sebring's net salvage level for this account to the approved net salvage levels of three other natural gas companies in Florida. The average net salvage level for those three companies is eleven percent. Based on the above, staff recommends a ten percent net salvage value for Account 392.1 – Transportation – Trucks.

Iowa Curves

Sebring did not request any changes to its currently-approved application of Iowa curves to its plant accounts. As part of our review, staff evaluated each account's projected net book value five years into the future. This timeframe matches the timing of the filing of Sebring's next depreciation study, when staff would next have a chance to adjust Sebring's depreciation rates. Two accounts, Accounts 380.1 – Services – Steel and 386 – Property on Customer's Premises, indicated a negative net book value by the end of 2026 if no further investments were made in these accounts. Staff's analysis shows that applying the S1 curve to both accounts more

[7] Sebring's Petition for approval of 2021 depreciation study, filed November 18, 2021.
[8] DN 01519-2022.

appropriately matches each account's life characteristics and would prevent the probable over-depreciation issue found with maintaining the currently-approved S2 curve. Therefore, staff is recommending the application of the S1 curve to both accounts as shown on Attachment C.

Reserve Transfers

As part of reviewing Sebring's 2021 Depreciation Study, staff calculated the book reserve balance of each plant account. Staff also calculated the associated theoretical reserve balance of each plant account, using the current recommended life and net salvage inputs. The difference between an account's book and theoretical reserve amounts may be described as an imbalance, either positive or negative, or as a surplus or deficiency. When imbalances are present, corrective transfers among accounts should be considered, and if warranted, should be performed.

The specific depreciation reserve transfer proposals are presented in Table 3-1, and explained further below:

Table 3-1
Accumulated Depreciation Transfers

Acct. No.	Account Title	Transfer Amount
380.1	Service - Steel	(100,184)
380.2	Service - Plastic	108,283
386	Property on Customers' Premises	(8,099)

Staff evaluated each account's reserve imbalance as a percentage of its book reserve. Accounts 380.1 and 386 had the largest imbalance on a percentage basis. Therefore, staff made transfers to reduce those accounts to their theoretically correct levels. Staff then used the total from those two transfers to increase the reserve of Account 380.2 – Service – Plastic. Staff notes that its current rate recommendations incorporate all proposed reserve transfers discussed in this section.

Conclusion

Staff recommends the Commission approve the lives, net salvages, reserves, and resulting depreciation rates for Sebring that are shown on Attachments A and C. The expense effect of staff's plant depreciation rate recommendations, which is shown on Attachment B, is an increase of $4,342 annually, or 1.8 percent, based on December 31, 2021 investments.

Issue 4: Should the current amortization of investment tax credits (ITCs) and flow back of excess deferred income taxes (EDITs) be revised to reflect the approved depreciation rates and amortization schedules?

Recommendation: Yes. The current amortization of ITCs should be revised to match the actual recovery periods for the related property. The Company should file detailed calculations of the revised ITC amortization at the same time it files its earnings surveillance report covering the period ended December 31, 2021, as specified in Rule 27-7.1352, F.A.C. (Osorio, D. Buys)

Staff Analysis: In Issue 3, staff has recommended approval of revised depreciation rates for the Company, which reflect changes to most accounts' remaining lives to be effective January 1, 2022. Revising a utility's book depreciation lives generally results in a change in its rate of ITC amortization in order to comply with the normalization requirements of the Internal Revenue Code (IRC or Code) set forth in Federal Tax Regulations under the Code sections,[9] Sections 168(f)(2) and (i)(9),[10] former IRC Sections 167(l), and 46(f),[11] and Section 203(e) of the Tax Reform Act of 1986 (the Act).[12]

Staff, the Internal Revenue Service (IRS), 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. The books are also reviewed to determine if they are in compliance with the regulatory guidelines in regard to normalization.

Former IRC Section 46(f)(6) of the Code indicated 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.[13] While Section 46(f)(6) was repealed, under IRC Section 50(d)(2), the terms of former IRC Section 46(f)(6) remain applicable to public utility property for which a regulated utility previously claimed ITCs. Since staff is recommending changes to the Company's remaining lives, it is also important to change the amortization of ITCs to avoid violation of the provisions of IRC Section 50(d)(2), and its underlying Treasury Regulations. The consequence of an ITC normalization violation is a repayment of unamortized ITC balances to the IRS. Therefore, staff recommends the current amortization of ITCs should be revised to match the actual recovery periods for the related property. The Company should file detailed calculations of the revised ITC amortization at the same time it files its earnings surveillance report covering the period ended December 31, 2021, as specified in Rule 25-7.1352, F.A.C.

[9] Treas. Reg. §1.168; Treas. Reg. §1.167; Treas. Reg. §1.46.
[10] 26 US Code §§168(f)(2) and (i)(9).
[11] Under IRC Section 50(d)(2), the terms of former 26 US Codes §167(l) and §46(f), which were repealed by the Revenue Reconciliation Act of 1990 (Pub. L. No. 101-508, §11812(a)(1-2)(1990)), remain applicable to public utility property for which a regulated utility previously claimed ITCs, which is the case here. (I.R.S. Priv. Ltr. Rul. 200933023, 1n.1 (May 7, 2009)).
[12] Tax Reform Act of 1986, Pub. L. No. 99-514 (100 Stat. 2085, 2146)(1986).
[13] Former 26 USC §46(f)(6) (establishing proper determination of ratable portion).

Issue 5: Should this docket be closed?

Recommendation: Yes. If no protest is filed by a person whose substantial interests are affected within 21 days of the issuance of the Order, this docket should be closed upon the issuance of a Consummating Order. (Sandy)

Staff Analysis: If no protest is filed by a person whose substantial interests are affected within 21 days of the issuance of the Order, this docket should be closed upon the issuance of a Consummating Order.

Acct. No.	Account Title	Comparison of Rates and Components Current[1] Average Remaining Life (yrs)	Future Net Salvage (%)	Remaining Life Rate (%)	Staff Recommended Average Remaining Life (yrs)	Theoretical Reserve (%)		Future Net Salvage (%)	Remaining Life Rate (%)
Distribution Plant									
376.1	Main - Steel	14.6	(30)	2.9	11.8	95.73		(30)	2.4
376.2	Main - Plastic	33.8	(30)	2.9	31.1	39.81		(30)	3.0
378	Measuring & Regulating Equip. Gen - Embedded	16.0	(2)	3.1	16.7	50.28		(2)	3.0
379	Measuring & Regulating Ept. - City Gate	27.6	(2)	3.2	22.9	28.58		(2)	3.2
380.1	Service - Steel	11.8	(30)	1.0	13.1	94.63	*	(30)	2.7
380.2	Service - Plastic	30.7	(30)	3.2	26.2	43.62	*	(30)	3.3
381	Meters	9.4	0	3.8	9.1	63.71		0	4.0
382	Meter Installations	19.5	(5)	3.1	22.6	34.94		(5)	3.1
383	House Regulations	7.0	0	3.1	12.0	60.47		0	3.3
384	House Regulator Installations	14.7	(3)	3.0	15.3	57.25		(3)	2.9
386	Property on Customers' Premises	6.9	0	2.3	6.6	73.60	*	0	4.0
387	Other Equipment	16.8	0	4.0	11.8	52.69		0	4.1
General Plant									
390	Leasehold Improvements	40.0	0	2.5	27.6	30.98		0	2.5
391.1	Office Furniture	25.0	0	4.0	16.3	34.74		0	4.1
391.2	Office Equipment	15.0	0	4.4	2.2	85.26		0	0.3
392.1	Transportation - Trucks	8.0	15	9.0	1.9	68.53		10	8.0
394	Tools, Shop & Garage Equipment	15.0	0	6.7	7.2	51.51		0	6.5
396	Power Operated Equipment - New	15.0	0	6.7	4.1	72.43		0	2.0
397	Communication Equipment	18.0	0	5.6	12.7	28.94		0	5.4

[1] Order No. PSC-16-0574-PAA-GU

*Denotes a Reserve Transfer

Comparison of Expenses						
		Current		Staff Recommended		
Account No.	Account Title	Depreciation Rate (%)	Annual Expense ($)	Depreciation Rate (%)	Annual Expense ($)	Change In Expense ($)
Distribution Plant						
376.1	Main - Steel	2.9	5,435	2.4	4,498	(937)
376.2	Main - Plastic	2.9	85,484	3.0	88,431	2,947
378	Measuring & Regulating Equip. Gen - Embedded	3.1	705	3.0	682	(23)
379	Measuring & Regulating Ept. - City Gate	3.2	39,732	3.2	39,732	(0)
380.1	Service - Steel	1.0	3,498	2.7	9,446	5,948
380.2	Service - Plastic	3.2	34,400	3.3	35,475	1,075
381	Meters	3.8	14,179	4.0	14,925	746
382	Meter Installations	3.1	6,934	3.1	6,934	(0)
383	House Regulations	3.1	1,618	3.3	1,723	105
384	House Regulator Installations	3.0	2,505	2.9	2,421	(84)
386	Property on Customers' Premises	2.3	812	4.0	1,412	600
387	Other Equipment	4.0	928	4.1	952	24
	TOTAL DISTRIBUTION PLANT		196,230		206,631	10,401
General Plant						
390	Leasehold Improvements	2.5	332	2.5	332	0
391.1	Office Furniture	4.0	121	4.1	124	3
391.2	Office Equipment	4.4	1,471	0.3	100	(1,371)
392.1	Transportation - Trucks	9.0	27,693	8	24,616	(3,077)
394	Tools, Shop & Garage Equipment	6.7	2,262	6.5	2,194	(68)
396	Power Operated Equipment - New	6.7	2,070	2.0	618	(1,452)
397	Communication Equipment	5.6	2,624	5.4	2,530	(94)
	TOTAL GENERAL PLANT		36,573		30,514	(6,059)
	TOTAL		232,803		237,145	4,342

Current and Proposed Depreciation Components							
		Current			Staff Recommended		
Account No.	Account Title	Curve Type	Average Service Life	Age	Curve Type	Average Service Life	Age
Distribution Plant							
376.1	Main - Steel	S3	45	33.4	S3	45	38.4
376.2	Main - Plastic	S3	45	11.2	S3	45	13.9
378	Measuring & Regulating Equip. Gen - Embedded	R3	33	18.7	R3	33	17.8
379	Measuring & Regulating Ept. - City Gate	R3	32	4.5	R3	32	9.5
380.1	Service - Steel	S2	48	49.0	S1	48	53.7
380.2	Service - Plastic	S2	40	9.4	S2	40	14.2
381	Meters	R4	25	16.5	R4	25	16.8
382	Meter Installations	S2	34	15.3	S2	34	11.7
383	House Regulations	R4	30	24.5	R4	30	18.9
384	House Regulator Installations	S2	34	21.9	S2	34	21.1
386	Property on Customers' Premises	S2	25	23.6	S1	25	28.6
387	Other Equipment	S4	25	8.2	S4	25	13.2
General Plant							
390	Leasehold Improvements	R3	40	8.0	R3	40	13.0
391.1	Office Furniture	S2	25	16.6	S2	25	9.0
391.2	Office Equipment	S3	15	13.1	S3	15	17.2
392.1	Transportation - Trucks	S2	8	7.4	S2	8	8.4
394	Tools, Shop & Garage Equipment	S3	15	10.2	S3	15	8.0
396	Power Operated Equipment - New	S4	15	6.3	S4	15	11.3
397	Communication Equipment	S4	18	2.5	S4	18	5.3