

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: NOVEMBER 19, 1998

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYO)

FROM: DIVISION OF AUDITING AND FINANCIAL ANALYSIS (CAUSSEAU, HOLROYD, ZEE, SWAIN)
DIVISION OF ELECTRIC AND GAS (MILLS) *CM CRB*
DIVISION OF LEGAL SERVICES (ELIAS) *RVE*

RE: DOCKET NO. 980700-GU - 1997 DEPRECIATION STUDY BY ATLANTIC UTILITIES, A FLORIDA DIVISION OF SOUTHERN UNION COMPANY D/B/A SOUTH FLORIDA NATURAL GAS. *APC* *RET* *WMS* *100*

AGENDA: 12/01/98 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\AFA\WP\980700.RCM

CASE BACKGROUND

South Florida Natural Gas Company (SFNG or the company) filed its last depreciation study on December 21, 1992 with an effective date of January 1, 1993. Rule 25-7.045(8)(a), Florida Administrative Code, requires gas companies to file a study for each category of depreciable property for Commission review at least once every five years from the submission date of the previous study unless otherwise required by the Commission. In accordance with this Rule, SFNG's next depreciation study was due on or before December 21, 1997. By Order No. PSC-98-0706-FOF-GU, issued May 21, 1998, the company was granted an extension of time to file its depreciation study no later than May 31, 1998. The company filed its regular five-year comprehensive study on May 29, 1998, for Commission review. Staff has completed its review of the study and presents its recommendations herein.

DOCUMENT NUMBER-DATE

13025 NOV 19 98

FPSC-RECORDS/REPORTING

DISCUSSION OF ISSUES

ISSUE 1: Should the current depreciation rates for South Florida Natural Gas Company be changed?

RECOMMENDATION: Yes. A review of the company's current capital recovery position indicates the need to revise the current depreciation rates. (HOLROYD)

STAFF ANALYSIS: SFNG filed its last depreciation study on December 21, 1992 with an effective date of January 1, 1993. Under Rule 25-7.045(8), Florida Administrative Code, gas companies are to file a comprehensive depreciation study at least once every five years. Changes since the last study brought about by activity and company planning indicate the need to revise currently prescribed depreciation rates.

ISSUE 2: What should be the date of implementation for new rates?

RECOMMENDATION: Staff recommends approval of the company's proposed July 1, 1998 date of implementation for the new depreciation rates. (HOLROYD)

STAFF ANALYSIS: The company proposed July 1, 1998 implementation date for new depreciation rates matches the beginning of its fiscal year. Data and related calculations have been provided abutting this date. Staff therefore recommends its approval.

ISSUE 3: Should any corrective reserve measures be made?

RECOMMENDATION: Yes. Staff recommends the corrective measures shown on Attachment A, page 8. (LEE)

STAFF ANALYSIS: As part of staff's review of the company's study, a review of the reserve position for each account was also performed. Staff's approach to reserve transfers is where significant surpluses and deficits exist, corrective reserve transfers between accounts should be considered. Significant imbalances are those that result in abnormal depreciation rates for the ongoing account. Such is the case for Distribution Structures & Improvements and Measuring & Regulating Industrial Equipment. The existence of reserve surpluses in these accounts cause an abnormality in the resulting depreciation rates. For this reason, staff recommends transferring these related reserve surpluses to help correct the existing reserve deficiency in the Steel Services account as shown on Attachment A.

ISSUE 4: What are the appropriate depreciation rates for SFNG?

RECOMMENDATION: The staff recommended remaining lives, net salvages, reserves, and resultant depreciation rates are shown on Attachment B, page 9. These recommendations result in an increase in annual depreciation expense of about \$13,800, based on July 1, 1998 investments and reserves as shown on Attachment C, page 10. (HOLROYD, LEE)

STAFF ANALYSIS: Staff's recommendations are the result of a comprehensive review of the company's submitted study. The company's initially proposed remaining service lives represented the difference between each account's average service life and its average age. This implies all investment retiring simultaneously, with no ongoing retirements. Such a pattern of expected retirements (curve shape, retirement dispersion, or mortality dispersion) represents an idealized situation where the equipment is so designed and manufactured as to live efficiently until the precise year the company determined replacing equipment was ready. In reality, there is no plant type where the company has such full control over retirement. The nearest would be heavy trucks or trailers, where maintenance problems and accidents can modify the pattern.

In selecting a curve shape, staff works from averages, modifying the average as necessary for any peculiarities of the given company. A basic premise is that a similar plant type, used in a similar fashion, will have the same curve shape.

Certain patterns of activity will change the curve shape. High retirements and/or high growth tend to increase early retirements (infant mortality). A stagnant situation has the opposite effect. Plant subject to theft, damage, or public requirements can be expected to have a greater incidence of infant mortality than similar plant in a rural or small town setting.

The expected average service life for each account is estimated from an analysis of historic activity, expected impact of factors such as growth and technological change, and industry averages. Staff's review of each account's activity indicates that the service lives and curve shapes recommended in the last depreciation review basically remain reasonable. As a result, the recommended remaining life for each account simply reflects an update of activity since the last study.

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As a result of the review and analytical process, SFNG has agreed with staff on all life and salvage parameters for each account. The major increase in annual expenses is attributed to the recommended cost of removal parameters for the Steel Mains and Steel Services accounts.

The investment associated with mains and services represents almost 80% of the total depreciable investment for SFNG. 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. Recommended removal factors are based on information received from the company detailing labor and material: generally associated with abandonment under pavement and abandonment not under pavement.

Since the last depreciation review, the company purchased some computer equipment in 1997. According to the reserve information submitted in the current study, a 20% depreciation rate (five-year life with zero net salvage) has been utilized with this investment. Even though this rate is reasonable for computer equipment, the company violated Rule 25-7.045, Florida Administrative Code, by not petitioning the Commission for approval of the depreciation rate prior to its initiation. However, no harm has come to the customers of St. Joe due to this violation. In fact, the associated depreciation expenses and resultant rate base are more correct now than if the related investment had assumed the same depreciation rate as Furniture and Office Equipment which was 3.3%. For this reason, staff is recommending no penalty be assessed for the violation. In the future, however, the company should petition the Commission, in accord with the Rule, anytime a new account is established thus necessitating the need for a new depreciation rate.

It is staff's understanding that the company has been recording motor vehicle trade-in allowances as gains or losses. This activity should be properly treated as gross salvage and credited to the reserve. The recommended net salvage factor reflects that appropriate accounting for this type of activity will be made in the future.

ISSUE 5: Should the current amortization of investment tax credits (ITCs) and the flowback of excess deferred income taxes be revised to reflect the approved depreciation rates?

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 June 30, 1999. (CAUSSEAU)

STAFF ANALYSIS: In earlier issues, staff recommends revisions to the company's remaining lives, to be effective July 1, 1998. 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 underlying Regulations (REGs) found in Sections 46, 167, and 168 and 1.46, 1.67, and 1.68, respectively.

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 rate making purposes and on the regulated books of the utility. Since staff is recommending a change in remaining lives, it is also important to change the amortization of ITC to avoid violation of the provisions of sections 46 and 1.46, IRC and REGs, respectively.

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, Accounting for Deferred Income Taxes Under SFAS 109, Florida Administrative Code, generally prohibits EDIT from being written off any faster than allowed under the Act. Therefore, the Act, SFAS 109, and Rule 25-14.013, Florida Administrative Code 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, Florida Administrative Code.

Staff, Internal Revenue Service, and independent outside auditors look to a company's books and records and at 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 that the current

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amortization of ITC and the flowback of EDIT be revised to reflect the approved remaining lives. In order for there to be a clear audit trail, a prudent utility will revise ITC and EDIT amortization, and produce work papers to show how the revisions were made.

ISSUE 6: Should this docket be closed?

RECOMMENDATION: This docket should be closed if no person whose interests are substantially affected by the proposed agency action files a protest within the 21-day protest period. (ELIAS)

STAFF ANALYSIS: At the conclusion of the protest period, if no protest is filed, this docket should be closed.

**SOUTH FLORIDA NATURAL GAS COMPANY
CORRECTIVE RESERVE TRANSFERS**

	<u>7/1/98 Book Reserve</u> (\$)	<u>Theoretical Reserve</u> (\$)	<u>Reserve Transfer</u> (\$)	<u>Restated Reserve</u> (\$)
<u>Gas Distribution</u>				
Structures & Improvements	2,730	2,219	(511)	2,219
Services - Steel	268,249	355,689	2,569	270,818
M&R Equipment - Industrial	<u>10,146</u>	<u>8,088</u>	<u>(2,058)</u>	<u>8,088</u>
Total	281,125	365,996	0	281,125

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Attachment B

SOUTH FLORIDA NATURAL GAS COMPANY
 1997 STUDY
 COMPARISON OF RATES AND COMPONENTS

ACCOUNT	CURRENT			COMPANY/STAFF RECOMMENDED			
	AVERAGE REMAINING LIFE	NET SALVAGE	REMAINING LIFE RATE	AVERAGE REMAINING LIFE	NET SALVAGE	RESERVE	REMAINING LIFE RATE
	(YRS.)	(%)	(%)	(YRS.)	(%)	(%)	(%)
GAS DISTRIBUTION							
375.0 Structures & Improvements	6.3	0.0	1.9	6.2	0.0	79.53	3.3
376.0 Mains - Steel	17.9	(21.0)	3.1	19.1	(25.0)	58.09	3.5
376.0 Mains - Plastic	33.0	(14.0)	2.9	33.0	(15.0)	15.38	3.0
378.0 MGR Equipment - General	14.4	(3.0)	2.7	27.0	(3.0)	19.87	3.1
379.0 MGR Equipment - City Gate	12.3	(3.0)	2.6	13.6	(3.0)	63.05	2.9
380.0 Services - Steel	17.7	(34.0)	4.6	16.2	(60.0)	67.55	5.7
380.0 Services - Plastic	31.0	(29.0)	3.8	31.0	(40.0)	12.74	4.1
381.0 Meters	13.4	0.0	3.0	10.9	0.0	63.46	3.4
382.0 Meter Installations	26.0	(5.0)	2.8	22.0	(5.0)	25.20	3.6
383.0 Regulators	19.4	0.0	3.5	21.0	0.0	30.07	3.3
385.0 MGR Equipment - Industrial	6.9	0.0	0.9	7.5	0.0	78.25	2.9
387.0 Other Equipment	24.0	0.0	3.0	28.0	0.0	25.48	2.7
GENERAL PLANT							
390.0 Structures & Improvements	16.7	0.0	4.4	13.9	0.0	28.39	5.2
391.1 Office Furniture and Equipment	9.2	0.0	3.3	9.6	0.0	62.30	3.9
391.2 Computer Equipment	5.0	0.0	20.0	4.0	0.0	19.30	20.2
491.0 Office Machines Embedded **	4.2	0.0	0.2	N/A	N/A	N/A	N/A
491.0 Office Machines (Additions after 1/1/98) *	15.0	0.0	6.7	15.0	0.0	0.00	6.7
392.0 Transportation Equipment	4.9	0.0	13.9	4.3	10.0	30.33	13.9
394.0 Tools, Shop, & Garage Equipment	3.8	0.0	2.8	5.6	0.0	89.75	1.8
395.0 Laboratory Equipment	9.5	0.0	2.4	4.9	0.0	89.43	2.2
396.0 Power Operated Equipment	8.5	0.0	6.5	9.5	0.0	18.86	8.5
397.0 Communication Equipment	10.0	0.0	10.0	7.9	0.0	20.87	10.0
398.0 Misc. Equipment	12.4	0.0	6.7	8.1	0.0	44.31	6.9

* Whole life rate.
 ** Old equipment fully accrued

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Attachment C

SOUTH FLORIDA NATURAL GAS COMPANY
 1997 STUDY
 COMPARISON OF EXPENSES

ACCOUNT	7/1/98 INVESTMENT § (\$)	7/1/98 RESERVE § (\$)	CURRENT		COMPANY/STAFF RECOMMENDED		
			RATE (\$)	EXPENSES (\$)	RATE (\$)	EXPENSES (\$)	CHANGE IN EXPENSES (\$)
GAS DISTRIBUTION							
375.0 Structures & Improvements	2,790	2,219	1.9	53	3.3	92	39
376.0 Mains - Steel	1,023,976	594,819	3.1	31,743	3.5	35,839	4,096
376.0 Mains - Plastic	814,545	125,312	2.9	23,622	3.0	24,436	814
378.0 MGR Equipment - General	39,870	7,924	2.7	1,076	3.1	1,236	160
379.0 MGR Equipment - City	14,351	9,049	2.6	373	2.9	416	43
380.0 Services - Steel	400,912	270,818	4.6	18,442	5.7	22,852	4,410
380.0 Services - Plastic	370,238	47,168	3.8	14,069	4.1	15,180	1,111
381.0 Meters	215,225	136,583	3.0	6,457	3.4	7,318	861
382.0 Meter Installations	151,003	38,046	2.8	4,228	3.6	5,436	1,208
383.0 Regulators	80,739	24,282	3.5	2,824	3.3	2,664	(162)
385.0 MGR Equipment - Industrial	10,336	8,088	0.9	93	2.5	300	207
387.0 Other Equipment	14,168	3,610	3.0	425	2.7	383	(42)
TOTAL	3,138,153	1,267,918		103,407		116,152	12,745
GENERAL PLANT							
390.0 Structures & Improvements	19,567	5,555	4.4	861	5.2	1,017	156
391.0 Office Furniture & Equipment	10,561	6,579	3.3	349	3.9	412	63
391.1 Computer Equipment	30,752	5,936	20.0 *	6,150	20.2	6,212	62
491.0 Office Machines Embedded	2,268	2,268	0.2	5	N/A	0	(5)
491.0 Office Machines (Additions after 1/1/98)	2,185	30	6.7 *	146	6.7 *	146	0
392.0 Transportation Equipment	59,432	18,026	13.9	8,261	13.9	8,261	0
394.0 Tools, Shop, & Garage Equipment	9,265	8,315	2.8	259	1.8	167	(92)
395.0 Laboratory Equipment	823	736	2.4	20	2.2	18	(2)
396.0 Power Operated Equipment	42,397	7,997	6.5	2,756	8.5	3,604	848
397.0 Communication Equipment	1,859	388	10.0	186	10.0	186	0
398.0 Misc. Equipment	3,649	1,617	6.7	244	6.9	252	8
TOTAL	182,758	57,447		19,237		20,275	1,038
Total Accounts	3,320,911	1,325,365		122,644		136,427	13,783

* Whole life rate.
 ** Old equipment fully accrued.
 *** Denotes restated reserve after corrective reserve measures.
 § Excludes CIAC.