

FLORIDA PUBLIC SERVICE COMMISSION  
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MEMORANDUM

February 5, 1998

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

FROM: *PA* DIVISION OF AUDITING & FINANCIAL ANALYSIS (CAUSSEAU, *TS*)  
*LEE, SICKEL, REVELL (SWAIN) [initials]*  
DIVISION OF ELECTRIC & GAS (BULECZA-BANKS) *[initials]*  
DIVISION OF LEGAL SERVICES (PAUGH) *[initials]* *JDJ*

RE: DOCKET NO. [REDACTED] - FLORIDA DIVISION OF CHESAPEAKE  
UTILITIES CORPORATION - 1996 DEPRECIATION FILING BY  
FLORIDA DIVISION OF CHESAPEAKE UTILITIES CORPORATION

AGENDA: 02/17/98 - REGULAR AGENDA - PROPOSED AGENCY ACTION -  
INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\AFA\WP\970428GU.RCM  
R:\PSC\AFA\123\CHRSDEP1.WK4

CASE BACKGROUND

On April 4, 1997, the Florida Division of Chesapeake Utilities Corporation (Chesapeake or Company) filed its regular depreciation study in accordance with Rule 25-7.045, Florida Administrative Code (F.A.C.). For reasons discussed in the filing, the Company asked for revision of current depreciation rates. This recommendation presents the results of staff's analysis of the Company's filing, as well as supplemental information provided by the Company as the analysis progressed.

DOCUMENT NUMBER DATE

[REDACTED] FEB -5 98

FF. [REDACTED] 1998

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DATE: February 5, 1998

**DISCUSSION OF ISSUES**

**ISSUE 1:** Should the current depreciation rates for the Florida Division of Chesapeake Utilities Corporation be revised?

**RECOMMENDATION:** Yes. A review of the Company's activity indicates a need to revise depreciation rates. Additionally, the Company perceives that some recent developments relate to competition, and wants depreciation rates which are responsive to current Company status. [SICKEL]

**STAFF ANALYSIS:** The current depreciation rates for Chesapeake are those provided in Order No. PSC-93-0025-FOF-GU, issued January 5, 1993. Those rates reflected Chesapeake's activity through January 1, 1992. Recently, a possibility of losing some industrial customers has prompted the Company to undertake rate restructuring. The distribution and general accounts are showing steady growth generally, but changing circumstances argue for careful review of recovery status in this regular five-year filing.

**ISSUE 2:** What is the appropriate implementation date for these recommended revisions to depreciation rates?

**RECOMMENDATION:** January 1, 1998. [SICKEL]

**STAFF ANALYSIS:** The Company has proposed January 1, 1998 as the date of implementation, and has provided data for each account to abut that date. Staff therefore recommends acceptance of this date.

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ISSUE 3: Should any reserve allocations be made?

RECOMMENDATION: Yes. Staff recommends the reserve allocations shown on Attachment A, page 9. These allocations bring each account more in line with its theoretically correct level.  
[SICKEL]

STAFF ANALYSIS: For three accounts, the activity seen in this study and the last has been somewhat erratic, rather than smoothly patterned. The equipment associated with the Autos, Data Processing, and VAX accounts is usually characterized as having a relatively short service life of 6 or 7 years. The Company had been acquired by new owners just before the last study, and as a result some changes were made in the Company's planning and operations. Thus, the activity appears sporadic when the circumstances at that study are compared to the present.

In the last study, both the vehicles (Account 392.1) and the computers (Account 391.1) had remaining lives less than 4 years. Prior to that study, the new owners decided to upgrade autos. The retirement level increased temporarily, and new investment was put on the books in that account. As a result, the current book reserve for the vehicles appears overstated. The spurts of activity have similarly resulted in understatement of reserve for the computer equipment. At the current time, the correct response is to smooth out the resulting impacts as much as possible. The reserve allocation will correct the reserve level and provide a smoothing effect on the annual expense amount.

The VAX equipment (Account 391.4) is unique to this company, providing data transmission and communication with Chesapeake headquarters out of state. It is subject to decisions of retirement and replacement in the five year period between studies, for reasons of compatibility. In fact, all current investment in this account, and related equipment, have in-service dates since the last study. It is entirely possible that much of the current equipment could be replaced before the next study. In effect, the recommended reserve allocation is merely a true-up of estimates made in the last study. It will bring the reserve in line with the retirement and investment activity which has transpired in the intervening period.

The recommended allocation will reduce the reserve for Account 392.1, Autos, to its theoretically correct level, and will correct the reserve deficiencies existing in the Data Processing and VAX accounts. The remaining surplus of \$137,952 can be used to help alleviate the reserve deficiency existing in Account 380, Steel Services. These allocations are detailed on Attachment A, page 9.

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In light of the possible impact on cost allocations, staff recommends that the Company make corresponding entries to the related depreciable expense accounts.

ISSUE 4: Should any recovery schedules be provided?

RECOMMENDATION: Yes. Current budget planning includes the retirement of the Company's mobile radios in the year 2000. Staff therefore recommends a recovery schedule to provide full recovery of the associated net investment of \$19,687 during the remaining life of the equipment. [SICKEL]

STAFF ANALYSIS: The investment associated with mobile radios which Chesapeake plans to retire in the year 2000 is \$30,755 as of January 1, 1998. The associated reserve is estimated at \$11,068, which indicates an unrecovered amount of \$19,687. Staff recommends that this net amount be withdrawn from the Communication Equipment account and recovered over the equipment's remaining period of service. The monthly recovery schedule expenses should be computed by dividing the net unrecovered investment by the estimated number of months of remaining life. Based on 30 months of service from January 1, 1998, the related expense for 1998 is estimated to be \$7,875, as shown on Attachment C, page 11. Any changes to investment amount or retirement dates should be correspondingly reflected in the expense amount booked.

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**ISSUE 5:** What are the appropriate remaining lives, net salvage, reserve amounts, and resultant depreciation rates for the Florida division of Chesapeake Utilities Corporation?

**RECOMMENDATION:** The staff recommended lives, salvages, reserves, and resultant depreciation rates are shown on Attachment B, page 10. Based on estimated January 1, 1998 investments and reserves, the revised rates produce an estimated decrease to annual expense of approximately \$1,900, as shown on Attachment C, page 11. [SICKEL]

**STAFF ANALYSIS:** The Company and staff have reached basic accord as to the treatment of recovery for Chesapeake. The Company has worked closely with staff during the process of analyzing its filing in this docket. The original filing emphasized mathematical analysis of historic data. During the analysis, much information relating to planning and Company specifics came to light.

The original filing did not include activity for 1997, but this information was provided upon staff request. This small company appears consistent and thorough in the records maintained to date. Its use of aged data when possible, and first-in first-out as a secondary choice, provided significant insight in several instances. Using the aged data provided, staff calculated account ages using the half-year convention.

Sometimes, the aged data was useful in the process of determining an appropriate retirement pattern. Statistical analysis, such as the simulated plant record and turnover methods, gave inconclusive results for several accounts. Further, the mathematical analysis of recent activity frequently resulted in cyclic peaks and valleys. Consequently, insight over and beyond the mere application of numerical analysis was desirable.

Staff's approach was to smooth the activity pattern, rather than reacting to a pattern reflecting sporadic or intermittent activity. Additionally, staff considered Company planning and a forward looking industry view. This included recognition of the installation of some new equipment of advanced design. After conversations between Company and staff, the Company is aware that the staff's approach avoids the instabilities associated with reacting to spurts of recent activity, and finds the practice acceptable.

It appears that the Company's estimate of future cost of removal and net salvage was based directly on recent retirement activity. However, the entire investment in an account, and the related equipment, should be recognized in determining an

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appropriate net salvage. Relatively small retirements may have an inordinately high removal cost. The recommended net salvage correctly relates to the type of activity expected from each account's total plant in service.

Some accounts are undergoing major reconfiguration. At least in part, this may be linked to both competitive source of supply and to availability of equipment of advanced design. In such cases, analysis of historical trends must be tempered by judicious recognition of future possibilities. The Account 385, Industrial Measuring and Regulating Equipment, is a case in point. Chesapeake reports that the majority of throughput goes to large industrial customers. Six additional industrial customers were to be added in 1997, bringing the total number to more than sixty. Accommodating changes in customer loads and upgrading to current customer standards compel many additions and replacements of equipment in this account.

The curve shape or life pattern selected for industrial equipment should reflect the retirement of some investment before the age of ten years, as seen in the Company's aged data. Although the mathematical analysis of history suggested an increase in service life from 30 to 31 years, staff believes it is inappropriate to increase the service life for the investment in this account. The recommended R3 curve is a conservative response to current dynamics. The Company expects some cost of removal for this type of equipment, and staff recommends a net salvage of 5% in line with this expectation. Again, Chesapeake has recognized the need to address current and future trends in capital recovery treatment, and has agreed with the recommended lives and salvage.

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**ISSUE 6:** 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 and recovery schedules?

**RECOMMENDATION:** Yes. The current amortization of ITCs and the flowback of excess deferred income taxes should be revised to reflect the approved depreciation rates and recovery schedules. Also, the utility should be required to file detailed calculations of the revised ITC amortization and flowback of excess deferred taxes at the same time it files its December 1998 surveillance report. [CAUSSEAU]

**STAFF ANALYSIS:** In issues previously addressed, staff recommends revisions to Chesapeake's depreciation rates and capital recovery schedules, to be effective January 1, 1998. Revising a utility's depreciation rates usually results in a change in its rate of ITC amortization and flowback of excess deferred income taxes.

Section 46(f)6) of the Internal Revenue Code states that the amortization of ITCs should be determined by the period of time used in computing depreciation expense for purposes of reflecting regulated operating results of the utility. Since staff is recommending a change in depreciation rates, it is also appropriate to change the amortization of ITCs.

Section 203(e) of the Tax Reform Act of 1986 (TRA) prohibits rapid write-back of protected (depreciation related) deferred taxes. In addition, Rule 25-14.013, Accounting for Deferred Income Taxes under SFAS 109, F.A.C., prohibits, without good cause shown, excess deferred income taxes associated with temporary differences from being reversed any faster than allowed under Section 203(e). Therefore, both the TRA and Rule 25-14.013, F.A.C., prohibit faster write-off of protected excess deferred taxes. Consequently, staff believes that the flowback of excess deferred taxes should be altered to comply with the TRA and Rule 25-14.013, F.A.C.

Staff recommends that the current amortization of ITCs and the flowback of excess deferred income taxes be revised to reflect the approved depreciation rates and recovery schedule. Also, the utility should be required to file detailed calculations of the revised ITC amortization and flowback of excess deferred taxes at the time it files its December 1998 surveillance report.

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**ISSUE 7:** Should the Company be authorized to amortize the cost of this depreciation study over three years as requested?

**RECOMMENDATION:** No. The Company should not be allowed to amortize the cost of this study over three years. [REVELL]

**STAFF ANALYSIS:** The cost of the depreciation study was approximately \$19,000 and was incurred in 1997. This expense represented approximately fifteen basis points effect on return on equity. The Company has requested that this expense be amortized over three years. Normally, depreciation studies are expensed as incurred rather than being deferred and amortized. In addition, the amount of the expense is relatively small. Therefore, staff is recommending that no amortization be allowed. If the Commission believes that an amortization period should be allowed, however, staff recommends that a five-year amortization period be used. A five-year amortization period would follow the usual Commission practice for amortization, and would match the five-year life of the study.

**ISSUE 8:** Should this docket be closed?

**RECOMMENDATION:** Yes. If no person whose substantial interests are affected by the Commission's proposed agency action, timely files a protest within twenty-one days of the issuance of this Order, this docket should be closed. [PAUGH]

**STAFF ANALYSIS:** Pursuant to Rule 25-22.029(4), F.A.C., any person whose substantial interests are affected by the Commission's proposed agency action shall have twenty-one days after issuance of the order to file a protest. If no timely protest is filed, the docket should be closed.



**CHESAPEAKE UTILITIES CORPORATION  
1997 STUDY**

DOCKET NO. 970428-GU  
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**RECOMMENDED RESERVE ALLOCATIONS**

<b>ACCOUNT</b>	<b>BOOK RESERVE 1/1/98 (\$)</b>	<b>THEORETICAL RESERVE (\$)</b>	<b>ALLOCATIONS (\$)</b>	<b>RESTATED RESERVE 1/1/98 (\$)</b>
380 Services - Steel	313,895	606,963	137,952	451,847
391.1 Data Processing - Equip	25,010	43,893	18,883	43,893
391.4 Vax Equipment	7,650	33,512	25,862	33,512
392.1 Autos	425,696	242,999	(182,697)	242,999
<b>TOTAL</b>	<b><u>772,251</u></b>	<b><u>927,367</u></b>	<b>0</b>	<b><u>772,251</u></b>

ATTACHMENT A  
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**CHESAPEAKE UTILITIES CORPORATION**  
**1997 STUDY**  
**COMPARISON OF RATES AND COMPONENTS**

DOCKET NO. 970428-CU  
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ATTACHMENT B  
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ACCOUNT	CURRENT			COMPANY REVISED PROPOSAL AND STAFF RECOMMENDED			
	AVERAGE REMAINING LIFE (YRS.)	NET SALVAGE (%)	REMAINING LIFE RATE (%)	AVERAGE REMAINING LIFE (YRS.)	NET SALVAGE (%)	RESERVE (%)	REMAINING LIFE RATE (%)
<b>GAS DISTRIBUTION</b>							
375 Structures & Improvements	38.0	(15.0)	3.0	34.0	(15.0)	13.48	3.0
376 Mains - Steel	30.0	(30.0)	3.4	29.0	(30.0)	36.78	3.2
376 Mains - Plastic	37.0	(30.0)	3.3	33.0	(30.0)	13.93	3.5
378 M&R Equipment - General	27.0	(5.0)	3.5	26.0	(5.0)	11.23	3.6
379 M&R Equipment - City	23.0	(5.0)	3.8	25.0	(5.0)	17.09	3.5
380 Services - Steel	24.0	(52.0)	5.7	21.0	(52.0)	45.93 **	5.1
380 Services - Plastic	32.0	(25.0)	3.5	21.0	(25.0)	8.64	5.5
381 Meters	15.7	0.0	4.5	13.9	0.0	37.18	4.5
382 Meter Installations	28.0	(5.0)	3.2	25.0	(5.0)	16.47	3.5
383 Regulators	24.0	0.0	3.4	21.0	0.0	24.70	3.6
385 M&R Equipment - Industrial	27.0	(5.0)	3.4	23.0	(5.0)	12.43	4.0
387 Other Equipment	22.0	(5.0)	3.8	5.0	(5.0)	20.97	16.8
<b>GENERAL PLANT</b>							
390 Structures & Improvements	36.0	(5.0)	2.6	32.0	5.0	22.77	2.3
391.1 Data Processing Equipment	3.5	2.0	7.6	2.9	0.0	58.53 **	14.3
391.2 Office Furniture	9.2	0.0	6.9	10.5	3.0	35.70	5.8
391.3 Office Equipment	7.2	0.0	9.4	7.7	0.0	27.63	9.4
391.4 Vax System Equipment	5.8	0.0	11.2	2.1	0.0	64.93 **	16.7
392.1 Transportation Equip. Autos/Lt. Trucks	3.4	12.0	23.8	3.1	15.0	40.98 **	14.2
392.2 Transportation Equip. Heavy Trucks	10.0	20.0	8.0 *	10.0	20.0	N/A	8.0 *
392.3 Transportation Equipment-Other	7.2	10.0	5.7	3.5	10.0	79.86	2.9
393 Stores Equipment	25.0	0.0	4.0 *	25.0	0.0	N/A	4.0 *
394 Tools & Work Equipment	15.0	0.0	5.7	12.8	0.0	31.58	5.3
396 Power Operated Equipment	8.4	0.0	8.0	8.1	0.0	36.53	7.8
397 Communication Equipment	14.6	0.0	6.7	9.3	0.0	36.51	6.8
398 Misc. Equipment	8.5	0.0	3.6	11.8	0.0	12.50	7.4
397 Communication Equipment year 2000 ret	14.6	0	6.7	2.5 year amortisation			

\* Denotes whole life rate  
 \*\* Denotes restated reserve after corrective action is taken

**CHESAPEAKE UTILITIES CORPORATION  
1997 STUDY  
COMPARISON OF RATES AND COMPONENTS**

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ATTACHMENT C  
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ACCOUNT	ESTIMATED INVESTMENT 1/1/98	ESTIMATED RESERVE 1/1/98	CURRENT		COMPANY REVISED PROPOSAL AND STAFF RECOMMENDED		
			RATE (%)	EXPENSES (\$)	RATE %	EXPENSES \$	CHANGE IN EXPENSES \$
<b>GAS DISTRIBUTION</b>							
375.0 Structures & Improvements	229,035	30,864	3.0	6,871	3.0	6,871	0
376.0 Mains - Steel	9,557,650	3,515,204	3.4	324,960	3.2	305,845	(19,115)
376.0 Mains - Plastic	2,860,981	372,652	3.3	94,412	3.5	100,134	5,722
378.0 M&R Equipment - General	551,068	61,892	3.5	19,287	3.6	19,838	551
379.0 M&R Equipment - City	837,469	143,093	3.8	31,824	3.5	29,311	(2,513)
380.0 Services - Steel	983,732	451,847 **	5.7	56,073	5.1	50,170	(5,903)
380.0 Services - Plastic	1,573,005	135,946	3.5	55,055	5.5	86,515	31,460
381.0 Meters	958,383	356,319	4.5	43,127	4.5	43,127	0
382.0 Meter Installations	679,556	111,931	3.2	21,746	3.5	23,784	2,038
383.0 Regulators	630,373	155,727	3.4	21,433	3.6	22,693	1,260
385.0 M&R Equipment - Industrial	1,264,251	157,179	3.4	42,985	4.0	50,570	7,585
387.0 Other Equipment	188,359	39,492	3.8	7,158	16.8	31,644	24,486
Total	20,313,862	5,532,146		724,931		770,502	45,571
<b>GENERAL PLANT</b>							
390.0 Structures & Improvements	321,807	73,277	2.6	8,367	2.3	7,402	(965)
391.1 Data Processing Equipment	74,993	43,893 **	7.6	5,699	14.3	10,724	5,025
391.2 Office Furniture	93,518	33,383	6.9	6,453	5.8	5,424	(1,029)
391.3 Office Equipment	57,779	15,966	9.4	5,431	9.4	5,431	0
391.4 Vax System Equipment	51,613	33,512 **	11.2	5,781	16.7	8,619	2,838
392.1 Transportation Equip. Autos/Lt. Trucks	592,970	242,999 **	23.8	141,127	14.2	84,202	(56,925)
392.2 Transportation Equip. Heavy Trucks	0	0	8.0 *	0	8.0 *	0	0
392.3 Transportation Equip. -Other	119,139	95,145	5.7	6,791	2.9	3,455	(3,336)
393.0 Stores Equipment	0	0	4.0 *	0	4.0 *	0	0
394.0 Tools & Work Equipment	76,556	24,179	5.7	4,364	5.3	4,057	(307)
396.0 Power Operated Equipment	229,481	83,835	8.0	18,358	7.8	17,900	(458)
397.0 Communication Equipment	26,285	9,597	6.7	1,761	6.8	1,787	26
398.0 Misc. Equipment	48,083	6,008	3.6	1,731	7.4	3,558	1,827
397.0 Communication Equipment year 2000 ret	30,755	11,088	6.7	2,061	2.5 yr amort.	7,867	5,806
Total	1,722,979	672,882		207,924		160,426	(47,498)
<b>Total Accounts</b>	<b>22,036,841</b>	<b>6,205,028</b>		<b>932,855</b>		<b>930,928</b>	<b>(1,927)</b>

\* Denotes whole life rate  
\*\* Denotes restated reserve after corrective action is taken