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DIVISION OF ECONOMIC REGULATION
(850) 413-6900

Public Service Commission

December 24, 2001

Ms. Susan Ritenour
Assistant Secretary & Treasurer
Gulf Power Company
One Energy Place
Pensacola, Florida 32520

Re: DOCKET NO. 010789-EI

Dear Ms. Ritenour:

Enclosed are two copies of the Staff Report of your current depreciation study filed in the subject docket. The Company response to this is schedule for January 18, 2002, in order to meet the targeted recommendation date of February 7, 2002. In your response, please provide us with any concurrences, differences, and/or additional input.

Should you have any questions, or need further information, please do not hesitate to contact Pat Lee at (850) 413-6453 or Beverly Meeks at (840) 413-6920.

Sincerely,

Dale N. Mailhot

Dale N. Mailhot, Chief
Bureau of Surveillance/Accounting

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Enclosure

cc: Division of The Commission Clerk & Administrative Services
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Gulf Power Company
Docket No. 010789-EI
December 24, 2001

2001 DEPRECIATION STUDY
DOCKET NO. 010789-EI
STAFF REPORT

As a general statement, only those areas where staff disagrees with Gulf Power Company's (GPC or company) proposal or that need further clarification or information are addressed in the staff report.

1. Staff recommended average service lives and average remaining lives are rounded to one decimal point up to 20 years; the nearest whole year is used thereafter.

2. Please explain in detail how the 2001 estimated costs of removal and gross salvage were developed for each FERC account.

3. Please explain in detail how the Investment Recovery allocates the sale of scrap metal to the primary distribution FERC accounts.

4. In reference to GPC's response to questions raised concerning the removal costs for Accounts 369.1 and 369.2, please provide the details on the referenced error, how it occurred and what corrective action has been taken.

PRODUCTION PLANT

Staff finds the respective average service lives, salvage components and average remaining lives for production plant as a whole to be acceptable. However, we do have a question on the salvage factor for Plant Daniel. GPC proposes to change the existing salvage factor from a negative seven percent to a negative four percent. What is the basis for this change?

As mentioned in the Initial Review, staff believes that Smith Unit 3, the company's new combined cycle unit, should be included in this docket. A twenty-year average service life and zero salvage factor for a combined cycle unit is considered by staff to be within the range of reasonableness. This is consistent with average service lives approved by the Florida Public Service Commission and industry expectations. It is understood that the recommended whole life depreciation rate will be effective with the in service date of Smith Unit 3 which is estimated to be June, 2002.

DISMANTLEMENT

GPC's last dismantlement study was filed in 1997, in which an annual accrual of $5,661,332 was approved by this Commission. In this current study, GPC has proposed a levelized annual fossil dismantlement accrual from 2002 - 2006 of $5,580,787. This is a decrease of $80,545 and does not include Smith Unit 3. The calculation of the accrual is based on the methodology for dismantlement established by Order No. 24751, issued on July 1, 1991 in Docket No. 890186-EI. The inflation factors GPC used were based on the March 2001 inflation factors from Economy.Com, Inc. The main items that affected costs in this updated study are escalation and incorporating the changes in the price of scrap.

The company has stated that "Daniel and Scherer plants were only escalated from their latest submitted report to December 31, 2001." Please explain this statement.

How were the base costs estimates updated in this current filing?

Staff has updated the inflation factors based on the Summer 2001 issue of The U.S. Economy. The resulting levelized annual accrual is $6,225,935 excluding Smith Unit 3.

Staff has updated the Company's proposed accrual for Smith Unit 3 from $280,608 to $310,341 using the same inflation factors as mentioned above. This results in a levelized annual accrual of $6,536,276 as shown below:

	Company Current Expense	Staff Proposed Expense	Change
Plant Daniel	$ 792,938	$ 884,541	$ 91,603
Plant Crist	$2,835,842	$3,140,335	$314,493
Plant Scholz	$ 511,321	$ 559,991	$ 48,670
Plant Smith	$1,208,663	$1,326,240	$117,577
Plant Scherer	$ 312,723	$ 277,757	$(34,966)
Total Steam	**$5,651,487**	**$6,188,864**	**$537,377**
Pea Ridge	$ -0-	$ 25,854	$ 25,854
Plant Smith Turbine	$ 9,845	$ 11,217	$ 1,372
Plant Smith Unit 3	$ -0-	$ 310,341	$310,341
Total Other	**$ 9,845**	**$ 347,412**	**$347,412**
Grand Total	**$5,661,332**	**$6,536,276**	**$874,944**

TRANSMISSION PLANT

1. **Account 352 - Structures and Improvements:** A change in the salvage factor is proposed from a negative 10 percent to a negative 5 percent based on the most recent 10-year band of experience. It is staff's opinion that this account has experienced insufficient retirement activity to perform any meaningful statistical analysis. However, the company proposal reflects a move more in line with the range of industry expectations and is acceptable to staff.

2. **Account 353 - Station Equipment:** GPC has proposed a change from the currently prescribed R2 curve shape and 40-year average service life to an S0.5 curve shape and a 45-year average service life. This change is based on the account experiencing a longer life indication. However, the company has also stated in its response to staff's Initial Review that a large portion of the retirements booked during 1997 -

2000 are corrections resulting from physical inventories of their assets. How were these retirements handled in the life analysis?

The estimated 2001 gross additions for this account are $21,867,000, which almost doubles the investment in this account. What is the cause and reason for this increase?

As requested in staff's Initial Review, GPC provided the rationale for changing the salvage factor for this account. Simply stated, the Company's proposal of a negative 5 percent is based on the fact that less salvage and cost of removal are currently being recorded. However, the company has also stated in its response that a large portion of the retirements booked during 1997 - 2000 are corrections resulting from physical inventories of their assets, with no related salvage or cost of removal being recorded. This naturally distorts the removal costs and salvage when compared to the retirements. In view of this fact, staff does not believe that the most recent 10-year band should be relied on to support a change in the currently prescribed salvage factor. Staff is inclined to retain the negative 10 percent salvage.

Please provide a breakdown between regular retirements and the inventory retirements for each year, 1997 through 2000.

3. **Account 354 - Towers and Fixtures:** A change in the salvage factor from a negative 20 percent to a negative 30 percent is proposed by the company. GPC asserts that the most recent activity indicates a decrease in salvage and an increase in removal costs. However, the overall retirement rate has been less than one percent with no retirements recorded in 2000 and none forecasted for 2001. Such insufficient retirement activity makes any meaningful statistical analysis impossible. With this in mind, staff is inclined to retain the current salvage factor of a negative 20 percent.

4. **Account 356 - Overhead Conductors and Devices:** This account has experienced a substantial growth rate since the last depreciation study in 1997 with an increase of over 100% estimated by the end of 2001. In response to staff's initial request, GPC indicated that the average service life trend was **declining** and, at the same time, "the average service life indications were clearly an **increase** and the selection reflects a 10-year increase from the existing." This appears to be a contradiction. Additionally, using the proposed average service life of 50 years results in an average remaining life of 40 years which is almost double the currently prescribed remaining life of 21 years. What is taking place in this account that supports such a change?

The company asserts that the proposed net salvage value of negative 30 percent represents the actual removal costs associated with rebuilding and reconducting several lines. How much investment was retired in connection with this rebuilding and reconducting? Does the Company believe that this recent activity (1999 - 2000) is indicative of the future removal costs and gross salvage in this account? Please explain your response in detail. In addition, GPC has indicated that the proposal also reflects the retirement and removal of a transmission line. Please provide the following:

A. Which transmission line was retired and when?

B. How much investment was retired?

C. What was the associated removal costs and gross salvage?

5. **Account 358 - Underground Conductors and Devices:** This account consists mainly of submarine cable installed during 1988 and 1989 at the Bayou Chico-Naval Air Station and Choctaw locations. It is expected that these submarine cables will not experience any type of interim retirement pattern and will be retired in place. This supports the retention of the currently prescribed SQ curve rather than a change to the company proposed R3 curve shape. Using the average age of 12.9 years together with the SQ curve shape and a 45-year average service life produces an average remaining life of 32 years.

   Staff is of the opinion that the current salvage factor of a negative 5 percent is still appropriate for this account instead of the company proposed zero salvage factor. Our reasoning is that these cables will likely incur some removal costs even though it is expected that they will be retired in place. These removal costs will in all probability involve the costs to dig down to, cap off and secure the cables.

DISTRIBUTION PLANT

1. **Account 361 - Structures and Improvements:** The company proposes a change in the salvage factor from a negative 10 percent to a negative 5 percent based on current indications. However, as noted under Account 352 above, it is staff's opinion that this account has experienced insufficient retirement activity to perform any meaningful statistical analysis. However, the company's proposal reflects a move more in line with the range of industry expectations and is acceptable to staff.

2. **Account 362- Station Equipment:** While staff finds the proposed life parameters to be acceptable, the proposed salvage factor of a negative 5 percent causes some

concern. As part of the company's response to staff's initial review, it was pointed out that the increase in retirements for 1997 and 1999 was due to a review between GPC's physical assets and its Continuing Property Records (CPRs) which resulted in retirements. Since these are basically adjustments to the account, no gross salvage or removal costs are incurred. From the company's response, the argument could be made that the last four years of removal costs and salvage in relationship to the retirements are not typical for this account. With this in mind, substantial reliance should not be placed on the most recent experience. Staff is inclined to retain currently prescribed negative 10 percent salvage factor.

Please provide a breakdown beginning with 1997, between normal retirements and inventory retirements for each year in which the inventory retirements are included.

Is the company still experiencing removal costs in conjunction with PCB?

3. **Account 364 - Poles, Towers and Fixtures:** The proposed salvage factor of a negative 70 percent is a concern to staff. The company has stated that removal costs are declining due to less labor being charged to pole replacement jobs. This is due in part to the reduction from 3 to 2 man and from 2 to 1 man line crews which reduces labor charges. When asked about the negative gross salvage amounts shown for 1998 and 1999, the company responded that this was due to large amounts of "unclassified salvage" being reversed out of this account and reclassified to the proper FERC account. Since these amounts net out to a negative figure, one would ascertain that these amounts pertain to a prior year. It is difficult to see a trend in the last four years of activity when you consider the negative salvage for 1998 and 1999. While staff agrees with the company that there seems to be a decline in removal costs, the gross salvage data is distorted by these large negative figures. All things being equal, if the removal costs decline you would expect the net salvage to be reduced not increased. The company has placed reliance on the 3 to 5 year experience which, in staff's opinion, is misleading by the inclusion of the negative salvage figures. Until more reliable data is available, staff is of the opinion that the currently prescribed salvage factor of negative 60 percent should be retained.

4. **Account 367 - Underground Conductors and Devices:** A change from zero to a ten percent future net salvage factor is proposed by GPC. This account has experienced a net salvage ranging from a negative 3 percent to a positive thirty-three percent over the past 10 years with the average being a positive 5 percent. The two most recent years (1999 - 2000) have experienced an average of 10 percent net salvage. According to the data provided by the company, a new methodology for allocating salvage was implemented in 1999. Until more data is available concerning the impact of the new salvage method, staff recommends retaining the

currently prescribed salvage factor of zero at this time.

5. **Account 368 - Line Transformers:** Gulf has proposed a change in the salvage factor from a negative 15 percent to a negative 25 percent. The company has stated that the proposal recognizes the most recent activity which indicates a decline in gross salvage and an **increase** in the removal costs. Staff agrees that the data shows a decline in gross salvage but disagrees that it shows an increase in removal costs. The most recent five year band shows removal costs of about 31%, **dropping** to 29% in the recent three year band. A definite **decrease** is shown for years 1998 through 2000. At this time, staff is inclined to maintain the currently prescribed salvage factor of a negative 15%.

6. **Account 369.1 - Overhead Services:** The company has stated that an error was discovered and corrected in 1996 regarding the recording of removal costs for these services. (Meaning both Overhead and Underground Services.) If the data is to be believed, it would appear that the cost of removal error began in 1986 and continued through 1996. If we exclude the erroneous years, we get an average net salvage of negative 25 percent. In addition, Gulf implemented new salvage procedures in 1999 to allocate salvage to the various distribution accounts. The impact of this new procedure is shown by $113,800 of salvage booked to this account for 1999 and 2000 after eleven years of virtually zero salvage being shown. Between the errors in removal costs and the new salvage procedures, staff questions the reliance on this data for the determination of future net salvage. Staff has requested additional information regarding the new salvage procedures (See Item 3, Page 1). Until more data is available concerning the impact of the new salvage method, staff recommends continuation of the net salvage factor of negative 15 percent at this time.

7. **Account 369.2 - Underground Services:** The Company has stated that an error was discovered and corrected in 1996 regarding the recording of removal costs for these services. (Meaning both Overhead and Underground Services.) If the data is to be believed, it would appear that the cost of removal error began in 1986 continued through 1996. In addition, Gulf has implemented new salvage procedures in 1999 to allocate salvage to the various distribution accounts. As noted in Account 369.1 above, staff questions the reliance on this data for the determination of future net salvage. Staff recommends continuation of the net salvage factor of negative 5 percent at this time.

8. **Account 369.3 - House Power Panel Services:** The Company proposes to maintain the current life and salvage parameters for this account. This is acceptable to staff. (Note: This account is being systematically retired in place, with no salvage or cost of removal.) The company has stated that this account will be completely retired by

2030. How was the date of 2030 determined?

9. **Account 370 - Meters:** The company proposed curve shape of L0 and average service life of 32-years is on the high side of the Florida industry average service lives which range from 25 to 30-years. This is a substantial change supported only by the SPR runs. What is happening in this account to make a longer life feasible?

Staff is inclined to select the S6 curve shape and a 27-year average service life based on the submitted runs.

The last five and ten year band of net salvage activity has averaged around negative 3 percent. The company has proposed a zero salvage factor. As noted under previous accounts, the company implemented a new salvage allocation program in 1999. While this new program will impact the salvage for this account, staff is of the opinion that two years of data is insufficient to warrant changing the currently prescribed negative 3 percent net salvage factor at this time.

10. **Account 373- Street Lighting and Signal Systems:** The salvage data for years 1997 through 2000 is somewhat clouded due to inventory adjustments, Hurricane George, and the impact of the new salvage allocation program. The company's proposal of a zero salvage factor reflects the recent experience and expectations that salvage and removal costs will offset. However, it is noted that gross salvage exceeded the removal costs by about 8 percent for the activity years 1999 and 2000. Staff does not believe that reliance on the recent experience is valid since the most recent four years are not considered typical or indicative of future for this account. Staff recommends retention of the currently prescribed salvage factor of a negative 10 percent at this time.

GENERAL PLANT

1. **Transportation Equipment - General:** In response to staff's inquiry on the 2000 year of activity regarding equal amounts of investment and reserve being added to these accounts, the company informed staff that a physical inventory between actual assets and company records was performed. As a result, adjustments were made during 2000 to the respective investment and reserve to reflect the inventory findings which included the retirement of some vehicles. The Company stated, "The cost of the vehicle was used to **reduce** the investment account and the related reserve account." However, the amounts shown on the activity report for the year 2000 **increase** the investment and reserve. Please explain.

Please provide for each transportation account for each year 1997 through 2000, a breakdown between the regular retirement and adjustment amounts, together with an explanation for each adjustment, that resulted from the physical inventory.

2. **Account 392.2 - Transportation Equipment - Light Trucks:** Since the company has performed a physical inventory of this account, please identify the equipment represented in the year 1962 by $2,329.

3. **Account 392.4 - Transportation Equipment - Trailers:** Explain the large increase in retirements for the 1999 year of activity. Provide a breakdown of the figures that make up the negative retirement amount for 2000.

   The 20 percent net salvage factor proposed by the Company causes staff some concern. This category usually contains material handling equipment and trailers. Since this is highly specialized equipment, it is hard to believe that a 20 percent future net salvage factor is likely to be realized when this equipment is finally removed from service, particularly in view of the fact that the average age at retirement is approximately 14 years. Until clarification is received regarding the 1999 and 2000 year of activity, staff is not making a recommendation on salvage at this time.

4. **Account 396 - Power Operated Equipment:** This category normally contains a variety of power operated equipment ranging from ATVs and air compressors to cranes. The Company proposed change is based primarily on two retirements over the last 20 years. One retirement (1994) was the sale of the sod farm equipment which, in staff's opinion, should be excluded from any analysis in the salvage determination since it does not relate to a regulated electric utility's equipment. So this really comes down to only one retirement in 1999 which realized 32 percent net salvage from the sale of the Go-Track/air compressor and hoist and crane. The majority of the remaining investment in this account is made up "ATV and crane and derrick." Staff is of the opinion that, with such limited retirement experience, a change in the net salvage factor from the current 15 percent to the company proposed 20 percent is not justified at this time. Staff recommends retaining the current net salvage factor of 15%.

5. **Account 397 - Communication Equipment:** Did the Company perform a physical inventory on this account? If so, what were the results? What communication equipment is represented by the 100% surviving investment of $55,328 and $27,876 for the years 1903 and 1900, respectively?

   The Company has indicated that the negative salvage for the 1999 year of activity is associated with the sale of the 2GHz system. Please provide a breakdown between the salvage associated with the sale and regular salvage amounts.

Staff has no recommendation at this time on this account until the above data is supplied.