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: May 8, 2008

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Gardner, Bulecza-Banks, Kyle, Slemkewicz)
Office of the General Counsel (Fleming)

RE: Docket No. 070322-GU – 2007 depreciation study by Florida Division of Chesapeake Utilities Corporation.

AGENDA: 05/20/08 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Skop

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\070322.RCM.DOC

Case Background

Rule 25-7.045, Florida Administrative Code (F.A.C), requires regulated natural gas utilities to file comprehensive depreciation studies once every five years. On May 17, 2007, the Florida Division of Chesapeake Utilities Corporation (Chesapeake or company) filed its depreciation study in accordance with this rule. Chesapeake's last comprehensive depreciation study was filed on May 8, 2002.

Staff has completed its review of the depreciation study and presents its recommendations herein. The Commission has jurisdiction to consider this matter pursuant to Sections 366.04, 366.05, and 366.06, Florida Statutes.

Discussion of Issues

Issue 1: Should the currently prescribed depreciation rates of the Florida Division of Chesapeake Utilities Corporation be changed?

Recommendation: Yes. A comprehensive review of Chesapeake's planning and activity since the last depreciation filing indicates a need for a revision in the currently prescribed depreciation rates. (Gardner)

Staff Analysis: Chesapeake's last comprehensive depreciation study was filed on May 8, 2002, with an effective date for revised depreciation rates of January 1, 2003. The current study is consistent with Rule 25-7.045, F.A.C, which requires gas utilities to file a comprehensive depreciation study at least once every five years from the submission date of the previously filed study.

During the last study, the company's average number of customers increased by four percent over the previous five years and its anticipated rate of growth anticipated to continue into the future. Currently, the company is not as optimistic about the increase in customer growth due to the current status of the economy. The company is more conservative in its approach to expansion and has tabled many of its projects.

As discussed in subsequent issues, changes in activity and company planning since the last study indicate the need to revise the currently prescribed depreciation rates; therefore, staff recommends that Chesapeake's currently prescribed depreciation rates should be changed.

Issue 2: What are the appropriate remaining lives, net salvage, and resultant depreciation rates for Chesapeake?

Recommendation: Staff's recommended remaining lives, net salvage values, reserves, and resultant depreciation rates are shown on Attachment A. The rates, based upon actual investments as of December 31, 2007, would result in a decrease in the annual depreciation expense of approximately $14,903 as summarized on Attachment B. (Gardner)

Staff Analysis: Staff's recommendation is the result of a comprehensive review of Chesapeake's filed depreciation study. Attachment A shows a comparison of the current and proposed rate components (lives, salvages, and reserves) along with the rate components staff is recommending for final approval. Investment and reserve positions, as shown and discussed in Issue 3 reflect actual amounts as of December 31, 2007, with the reserve positions restated to reflect the staff's recommended corrective measures.

A depreciation study provides an opportunity to review the present recovery position and determine whether any changes should be made to the existing pattern of recovery (depreciation rates). A prime concern of the depreciation study is life and salvage. As part of the review process, the prudence of company planning (including additions and retirements), technological impacts, retirement and salvage practices, and other related activities are reviewed. The average service life refers to the overall period the account is expected to serve the public and is projected based on experience or estimates. The average remaining life is the remaining period of service which can be expected from the equipment under study.

The company's filing provided aged retirement data for the 2002–2006 period and actual 2007 data. The company provided the average age distributions of the surviving investments for each account. Staff worked with the company in the development of appropriate life and salvage values. As a result of the review and analytical process, staff and the company agree on lives, net salvages, and resultant depreciation rates for all accounts.

The recommended changes in the distribution and general plant depreciation rates can be attributed mainly to: (1) updated account ages to reflect activity since the last represcription, and (2) the correction of reserve positions by transfers to appropriate accounts. A brief discussion of plant account life parameters with a recommended substantial change is set forth below.

Distribution Plant

Mains and Services (Accounts 376 and 380)

Mains and services comprise about 77 percent of the investment in the distribution plant function and about 72 percent of the company's total depreciable investment. When a main or service is retired, it is generally abandoned in place rather than being physically removed. Cost of removal is associated with activities incurred with the abandonment process. This involves labor and material costs associated with a crew to travel to the site, digging down to the pipe, cutting and capping the pipe, refilling the hole, and restoring the roadway. Restoring the roadway becomes significant if the main or service is located under pavement. Surface restoration normally occurs at two locations for each service line retired; one at the point of the

service riser, and the other at the property line or at the connection to the main. The galvanic action of dissimilar metals such as a galvanized steel service line running off a cast iron main requires that the line be cut at the main rather than the property line. Under these circumstances, paving restoration is required.

Steel services is a dying or declining asset since mains and services are now plastic instead of steel. The company requested an increase in service life for steel services from 35 to 40 years. This is in line with the company's current planning. As new mains and services are generally plastic rather than steel, only $111,025 of steel services has been added since 2002 compared to over $3.9 million of plastic services.

The recommended net salvage values are generally in line with each account's expectations. The retirement rate for steel services during the 2003-2007 period has averaged approximately 1 percent with cost of removal averaging over 25 percent. The company's original cost for steel service lines was low in comparison to the current costs for the removal of the lines. Normally, cost of removal for this account is over 100 percent, or can be as much as 200 percent, due to consistent activity and substantive retirements. However, the currently approved net salvage is a negative 80 percent and is in line with the regulated gas industry. The company believes there will be less activity in this account, but may have periods when more activity occurs causing an increase in the cost of removal. Therefore, due to current company planning and the sporadic nature of this account, the company believes a decrease in net salvage to a negative 50 percent is more appropriate on a going forward basis. Staff recommends that the company's requests for a negative 50 percent net salvage and an increase in service life from 35 to 40 years be approved.

Other Equipment (Account 387)

This account includes the cost to install all other distribution system equipment not provided for in the other accounts such as, street lighting equipment, lockers, gas masks, recording gauges, fire extinguishers, and other similar equipment. For this depreciation study, there has been no retirements in this account since 1997 and the current age of the equipment is 10.3 years. Since the last depreciation study, this account has experienced approximately 29 percent in growth. Over a ten year period, there has been more additions to this account than retirements. The currently approved service life for this account is 15 years and the company requests a life of 20 years. Staff recommends an increase in average service life for this account to 20 years.

General Plant

Data Processing Equipment (Account 391.1)

The investment of $73,108 in this account includes personal computers and printers. The interior of the main office was damaged during Hurricane Jeanne in 2005 and $95,198 of data processing equipment was retired due to the damage. At the time of the last study, the average service life of the equipment was seven years. According to the company, the equipment should last at least eight years, if not longer. The remaining equipment average age is currently 6.8 years. Staff recommends an eight year average service life and a zero net salvage, which is in line with the expectations of other companies with similar investments.

Issue 3: Should the Commission make any corrections to the reserve allocations between accounts?

Recommendation: Yes. Staff recommends the reserve allocations as shown below. These allocations bring each account more in line with its theoretically correct reserve level. (Gardner)

Staff Analysis: As part of its review of the company's study, staff reviewed the reserve position for each account. When significant surpluses and deficits exist, corrective reserve transfers between accounts should be considered. The effect of prior depreciation rates, average service lives, and net salvage projections results in surpluses and deficits that should be addressed. During this review, staff also recognized that the company overstated many of the plant accounts by continuing to depreciate the account beyond the recovery of the investment. For these reasons, staff recommends transferring these related reserve surpluses to help correct the existing reserve deficiencies in the accounts, as shown in the table below.

RESERVE RE-ALLOCATIONS

Account Number	Account Description	Actual Reserves (A)	Theoretical Reserves (B)	Reserve Transfers (C)	2008 Restated Reserves D= (A)+(C)
Distribution		($)	($)	($)	($)
376.1	Mains-Steel	$5,911,572	$6,366,000	$454,428	$6,366,000
376.2	Mains-Plastic	3,388,452	2,865,767	-454,428	2,934,024
378.0	Meas.& Reg. Eqpt.	300,504	327,676	27,172	327,676
381.0	Meters	744,061	744,570	509	744,570
382.0	Meter Installations	439,466	500,327	60,861	500,327
383.0	House Regulators	436,103	452,422	16,319	452,422
387.0	Other Equipment	301,397	122,635	-104,861	196,536
	Totals	$11,521,555	$11,379,397	-0-	$11,521,555
General Plant					
391.1	Data Processing Eqpt.	81,983	49,348	-32,635	49,348
391.4	Vax System Eqpt.	-2,956	0	2,956	0
392.1	Transport. Eqpt./Lt. Trk.	480,073	434,065	-520	479,553
396.0	Power Operated Eqpt.	355,489	385,552	30,063	385,552
398.0	Misc. Equipment	44,229	44,365	136	44,365
	Totals	$958,818	$913,330	-0-	$958,818

Issue 4: Should the current amortization of investment tax credits (ITC) and flowback of excess deferred income taxes be revised to reflect the approved depreciation rates and recovery schedules?

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. On an annual basis, Chesapeake should include detailed calculations of the revised ITC amortization and the flowback of EDIT in its December earnings surveillance reports beginning with the annual period ending December 31, 2008. (Kyle)

Staff Analysis: In earlier issues, staff has recommended approval of the company's proposed remaining lives, to be effective January 1, 2008. 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 its underlying Regulations (REGs) found in Sections 46, 167, and 168, and 1.46, 1.67, and 1.68, respectively.

Staff, the Internal Revenue Service, and independent outside auditors examine 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 and to determine the intent of the regulatory bodies in regard to normalization. Therefore, staff recommends the current amortization of ITC and the flowback of EDIT be revised to reflect the approved remaining lives.

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 ratemaking purposes and on the regulated books of the utility." Since staff is recommending approval of the company's proposed remaining lives, it is also important to change the amortization of ITC to avoid violation of the provisions of Sections 46, IRC and 1.46, REGs.

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, F.A.C., Accounting for Deferred Income Taxes Under Statement of Financial Accounting Standards (SFAS) 109, generally prohibits EDIT from being written off any faster than allowed under the Act. The Act, SFAS 109, and Rule 25-14.013, F.A.C., 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, F.A.C.

Issue 5: What should be the implementation date for new depreciation rates?

Recommendation: Staff recommends approval of the company's proposed January 1, 2008, date of implementation for the new depreciation rates. (Gardner)

Staff Analysis: Chesapeake has proposed an implementation date for new depreciation rates of January 1, 2008. All data and related calculations that have been submitted support this date. Staff recommends approval of this date as being the earliest practicable date for utilizing the revised depreciation rates.

Issue 6: Should this docket be closed?

Recommendation: Yes. 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 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 a consummating order.

CHESAPEAKE UTILITIES CORPORATION
DOCKET NO. 070322-GU
2007 DEPRECIATION STUDY

COMPARISON OF RATES AND COMPONENTS

Attachment A

ACCOUNT	CURRENT				COMPANY/STAFF RECOMMENDED			
	AVERAGE REMAINING LIFE (YRS.)	NET SALVAGE (%)	1/1/2003 RESERVE (%)	REMAINING LIFE RATE (%)	AVERAGE REMAINING LIFE (YRS.)	NET SALVAGE (%)	1/1/2008 RESERVE (%)	REMAINING LIFE RATE (%)
DISTRIBUTION PLANT								
375.0 - Structures & Improvements	32.0	-15.0	26.26	2.8	30.0	-15.0	29.97	2.8
376.1 - Mains - Steel	27.0	-30.0	40.26	3.3	25.0	-30.0	47.50	3.3
376.2 - Mains - Plastic	36.0	-30.0	12.99	3.3	34.0	-30.0	18.22	3.3
378.0 - Measuring and Regulating Ept. - General	23.0	-5.0	24.08	3.5	19.9	-5.0	35.35	3.5
379.0 - Measuring and Regulating Ept. - City Gate	24.0	-5.0	17.68	3.6	22.0	-5.0	28.57	3.5
380.1 - Services - Steel	18.1	-80.0	48.91	7.2	22.0	-50.0	73.98	3.5
380.2 - Services - Plastic	30.0	-25.0	17.96	3.6	30.0	-25.0	17.18	3.6
381.0 - Meters	14.9	0.0	41.99	3.9	16.7	0.0	33.20	4.0
382.0 - Meter Installations	26.0	-20.0	22.03	3.8	26.0	-20.0	31.60	3.4
383.0 - House Regulators	21.0	0.0	32.52	3.2	18.7	0.0	38.29	3.3
385.0 - Measuring & Regulating Eqpt.-Industrial	22.0	-5.0	11.13	4.3	19.0	-5.0	27.70	4.1
387.0 - Other Equipment	9.5	0.0	78.6	2.3	9.7	0.0	45.43	5.6
GENERAL PLANT								
390.0 - Structures & Improvements	29.0	5.0	28.9	2.3	37.0	5.0	19.57	2.0
391.1 - Data Processing Equipment	3.2	0.0	67.23	10.2	2.6	0.0	67.50	12.5
391.2 - Office Furniture	9.5	3.0	50.34	4.9	14.5	3.0	24.69	5.0
391.3 - Office Equipment	7.9	0.0	42.41	7.3	8.5	0.0	38.25	7.3
391.4 - Vax System Equipment	0.0	0.0	89.98	5.6	0.0	0.0	0.00	0.0
392.1 - Transp. Equip. - Autos/L. Trucks	2.9	15.0	51.32	11.6	3.0	15.0	46.84	12.7
392.3 - Transp. Equip. - Other	5.0	0.0	43.38	11.3	4.2	0.0	78.80	5.0
394.0 - Tools, Shop & Garage Equipment	7.6	0.0	73.36	3.5	5.7	0.0	82.23	3.1
396.0 - Power Operated Equipment	8.0	0.0	51.86	6.0	2.6	0.0	79.98	7.7
397.0 - Communication Equipment	10.5	0.0	19.81	7.6	8.6	0.0	39.37	7.1
398.0 - Miscellaneous Equipment	8.6	0.0	42.66	6.7	3.9	0.0	73.87	6.7

CHESAPEAKE UTILITIES CORPORATION
DOCKET NO. 070322-GU
2007 DEPRECIATION STUDY

COMPARISON OF EXPENSES

Attachment B

ACCOUNT	1/1/2008 INVESTMENT	1/1/2008 RESERVE	CURRENT RATE	CURRENT EXPENSES	COMPANY/STAFF RECOMMENDED RATE	COMPANY/STAFF RECOMMENDED EXPENSES	CHANGE IN EXPENSES
DISTRIBUTION PLANT	($)	($)	(%)	($)	(%)	($)	($)
375.0 - Structures & Improvements	362,317	108,600	2.8	10,145	2.8	10,145	0
376.1 - Mains - Steel	13,402,105	6,366,000	3.3	442,269	3.3	442,269	0
376.2 - Mains - Plastic	16,099,812	2,934,024	3.3	531,294	3.3	531,294	0
378.0 - Measuring and Regulating Ept. - General	926,947	327,676	3.5	32,443	3.5	32,443	0
379.0 - Measuring and Regulating Ept. - City Gate	2,781,101	794,585	3.6	100,120	3.5	97,339	-2,781
380.1 - Services - Steel	965,291	714,109	7.2	69,501	3.5	33,785	-35,716
380.2 - Services - Plastic	7,186,276	1,234,588	3.6	258,706	3.6	258,706	0
381.0 - Meters	2,242,682	744,570	3.9	87,465	4.0	89,707	2,242
382.0 - Meter Installations	1,583,312	500,327	3.8	60,166	3.4	53,833	-6,333
383.0 - House Regulators	1,181,568	452,422	3.2	37,810	3.3	38,992	1,182
385.0 - Measuring & Regulating Eqpt.-Industrial	1,538,823	426,220	4.3	66,169	4.1	63,092	-3,077
387.0 - Other Equipment	432,578	196,536	2.3	9,949	5.6	24,224	14,275
TOTAL DISTRIBUTION PLANT	**48,702,812**	**14,799,657**		**1,706,037**		**1,675,829**	**-30,208**
GENERAL PLANT							
390.0 - Structures & Improvements	556,927	109,004	2.3	12,809	2.0	11,139	-1,670
391.1 - Data Processing Equipment	73,108	49,348	10.2	7,457	12.5	9,139	1,682
391.2 - Office Furniture	157,682	38,934	4.9	7,726	5.0	7,884	158
391.3 - Office Equipment	268,767	102,806	7.3	19,620	7.3	19,620	0
391.4 - Vax System Equipment	0	0	5.6	0	0	0	0
392.1 - Transp. Equip. - Autos/L. Trucks	1,023,738	479,553	11.6	118,754	12.7	130,015	11,261
392.3 - Transp. Equip. - Other	18,202	14,344	11.3	2,057	5.0	910	-1,147
394.0 - Tools, Shop & Garage Equipment	153,592	126,298	3.5	5,376	3.1	4,761	-615
396.0 - Power Operated Equipment	482,061	385,552	6.0	28,924	7.7	37,119	8,195
397.0 - Communication Equipment	511,842	201,507	7.6	38,900	7.1	36,341	-2,559
398.0 - Miscellaneous Equipment	60,058	44,365	6.7	4,024	6.7	4,024	0
TOTAL GENERAL PLANT	**3,305,977**	**1,551,711**		**245,647**		**260,952**	**15,305**
TOTAL PLANT	**52,008,789**	**16,351,368**		**1,951,684**		**1,936,781**	**-14,903**