

DECISION MEMORANDUM

**TO: COMMISSIONER KJELLANDER
COMMISSIONER SMITH
COMMISSIONER HANSEN
JEAN JEWELL
COMMISSION STAFF
LEGAL**

FROM: LISA NORDSTROM

DATE: JANUARY 16, 2003

**RE: IN THE MATTER OF THE APPLICATION OF INTERMOUNTAIN GAS
COMPANY TO INCREASE ITS COMPOSITE DEPRECIATION RATE.
CASE NO. INT-G-02-4.**

Intermountain Gas Company filed an Application on October 18, 2002, requesting authority to increase its composite depreciation rate from 3.71% (3.93% when weighted by 9/30/01 assets) to 4.08%. The Company stated that this 0.15% increase is necessary in order to accrue the proper dollars over the remaining service life of the Company's property. If approved, the higher rate would increase Intermountain's annual depreciation accrual and decrease Intermountain's ratebase by \$428,482 annually. Although the Company's depreciation expense would increase under its proposal, the present Application does not request a related increase in customer rates.

Based on an updated depreciation study by AUS Consultants, the Company's Application concluded that the current rate is under-depreciating its assets, the original cost of which increased from \$234,093,752 to \$280,990,082 during the three-year period. Likewise, the accumulated reserve increased from \$116,479,251 to \$143,992,182. The current study advocated an annual depreciation and amortization expense accrual of \$11,462,932 for the remaining life of the Company's property. The study cited by the Application also discussed Intermountain's planned deployment of electronic meter reading equipment and the recovery of the associated investment, as well as the service life and estimated removal cost of the Company's LNG facilities. The Company requested that the increase to the annual composite depreciation rate and amortizations be made effective at the beginning of the Company's fiscal year, October 1, 2002.

STAFF COMMENTS

Staff noted that the majority of Intermountain's requested increase in depreciation rates consisted of three items. First, the Company sought to extend the service life of the Liquefied Natural Gas (LNG) plant in Nampa. Second, the Company requested an increase in the negative salvage cost accumulated to retire transmission and distribution mains due to increased costs at retirement. Finally, the Company is implementing an electronic meter reading system (ERT) that will require new accounts and new depreciation rates.

Staff conducted its review by analyzing the depreciation study and workpapers prepared by AUS Consultants, the Company's depreciation consultant. During its review, Staff encountered a problem with the Company's accounting data used to substantiate the study. The Company upgraded its accounting software in 2000, which caused problems with the way some asset retirements and salvage costs were recorded. The misallocated dollars associated with problematic accounting data were significant and would have made a major impact on the results of the study. The Company has indicated that it is working to improve the accounting system.

1. Account No. 363 - The LNG Plant

The LNG plant has been in service since 1976. The Company proposed to extend the life of the facility by 5 years to approximately 35 years, making the remaining life of the plant approximately 10 years. The Company based its support for a 35-year useful life on information obtained from a study conducted by the American Gas Association (AGA study)¹, not by any defect or limitation within the facility itself.

By contrast, Staff recommended a remaining life of 15 years instead of only 10 for several reasons. First, the Company overhauled the primary compressor associated with the liquefaction process in 2000 and intends to overhaul the gas turbine prime mover next year. Second, the Company stated that the LNG facility's controls, which are electrical and pneumatic, would be replaced with electronic and hydraulic controls between 2004 and 2006. Third, the Company had no plans to replace the LNG facility with any other type of equipment or contract. In a discussion with Company officials, Staff learned that acquiring peaking services providing benefits similar to those derived from the LNG facility would be significantly more expensive than maintaining the current unit. Furthermore, the Company's 2002 IRP did not indicate a

¹ A Survey of Depreciation Statistics, AGA Accounting Services Committee, EEI Property Accounting & Valuation Committee, 1998-1999.

replacement of the facility. The Company continues to update the unit as needed, including making significant overhauls of its major parts. Finally, while the AGA study lists equipment similar to the equipment recently replaced or proposed to be updated (compressors, connections, gauges and instruments, etc.) with lives in the 25-30 year range, it also contains facilities with 40 and 50-year lives. Staff believes that a 40-year life is reasonable in this case, especially since the Company will perform another depreciation study in 3 years.

For these reasons, Staff recommended that the Company depreciate the LNG plant over another 15 years for an approximate average service life of 37 years. This would require an annual depreciation rate of 1.29% instead of the Company-proposed rate of 1.69%, and would reduce the Company's proposed annual depreciation expense by \$30,658.²

2. Account No. 367 – Transmission Mains

Depreciation on the Company's transmission mains, which are used to transport the gas between the Company's distribution system and the Northwest Pipeline interstate system, is currently calculated based on a 44-year life and a 32% negative salvage cost. These mains generally have long lives and are simply capped instead of being removed at retirement.

The Company sought to change the life of one particular transmission main running through the Fort Hall Indian Reservation from 44 years to 20 years. Although this main has an estimated useful life of 44 years, the easement across the reservation is limited to 20 years and ends approximately in 2015. By that time, the Company will need to renegotiate the easement and may not be able to secure future use of the transmission line. The Company recommended that the useful life of the transmission main be reduced to only 20 years instead of 44.

Staff indicated that it was reasonable to base the life of an asset on its known useful life. Although the Company currently believes there is a good chance it will not be able to renew its easement, the Company did not provide evidence in support of that belief. The other party has not indicated whether or not it will renew the easement. Since approximately 12 years remain on the easement, the Commission will have time to adjust the account if necessary as more information becomes available. However, because there is some uncertainty, Staff believes it is reasonable to depreciate this main faster than the rest of the account and monitor the situation carefully. By reducing the life of the main that runs through the reservation to a point

² The rate currently authorized for the LNG facility is 1.10%. Staff's proposal would allow the Company to accrue an additional \$14,563 each year.

mid-way between the expected life of 44 years and the easement's life of 20 years, Staff believes that additional depreciation can be taken until the uncertainty surrounding the life of the easement can more fully be determined. Staff recommended that a life of 32 years be used on the line through the reservation such that the weighted average life of the total account is approximately 40 years.

Overall, transmission mains have experienced a net negative salvage value of only 6.9%. However, during the last few years retirement costs have been higher, resulting in greater negative net salvage. Since 1992, the account has experienced negative salvage costs of 185%. Although it noted that the last few years have been even higher, Staff indicated that very little plant has been retired in this account. During the last five years, only 0.000% to 0.056% of the account has been retired annually because only a few projects were undertaken each year. Staff believes it is not reasonable to extrapolate a significant increase in negative salvage costs based on such a small number of retirements. Furthermore, some of the retirements were expensive projects that were not typical. The AGA study provided no information on transmission mains, so Staff could not use the AGA study for support. Finally, the Company's poor accounting records cast a shadow over the integrity of the Company's study. Staff stated that the Company needed to improve its accounting controls to make sure that retirements are performed correctly and have additional transactions take place before Staff believes it is reasonable to change the depreciation rates in this account. Thus, Staff recommended that the salvage costs remain at negative 32% until the Company can correctly track retirement costs and show that an increase is necessary.

By making these two changes, Staff recommended an annual rate of 2.96% instead of the Company's proposed 4.26%, thus reducing Company's proposed depreciation expense in this account by \$394,040.³

3. Account No. 376 – Distribution Mains

The Company's study recommended that the service life of its distribution mains be increased slightly to 44 years from 42. Staff supports the extension of the service life because the 44 years seems to better reflect the 40 to 65 year lives listed in the AGA study.

³ The rate presently authorized for the transmission mains account is 3.57%. Staff's proposal would reduce the amount the Company accrues by \$184,896 each year.

Staff explained that overall net salvage values from 1975 through 2001 have been a negative 41%. From 1992 through 2001, negative salvage value was 56% and increased to 71% in the last five years. Currently the Company uses a negative salvage value of 40% and recommends a change to 60%. Staff supported this change for three reasons. First, the Company consistently had a significant number of retirements in this account that even out the wide ranges of amounts seen in the transmission mains account. Second, data from the previous Company study showed evidence that the negative salvage cost for this account was beginning to increase. This current depreciation study substantiates the findings of the last study. Finally, the data in the AGA study suggested that a 60% negative salvage cost was in line with other utilities. Therefore, Staff recommended that the Commission adopt the Company's request to change the depreciation rate from 3.60% to 4.02%.

4. Account No. 381.2 – Electronic Meter Reading Equipment and Account No. 382.2 – Electronic Meter Reading Equipment Installation Labor

Intermountain Gas is currently implementing an automated/remote system that uses electronic devices to record and transmit the customer's usage to a radio-receiving device. The ERT device consists of a circuit board with a semiconductor chip radio transmitter and a lithium battery. The electronics and battery are housed in a sealed plastic enclosure that is mounted on the meter. Staff stated that this device has a battery life of approximately 15-19 years and has little or no value once the battery has been depleted. Since the life of the device is approximately 15 years, the Company recommended that the life of the equipment be rated at 15 years. Staff agreed that it is appropriate to set the depreciation rate based on the life of the equipment and recommended that these new accounts be depreciated at a rate of 6.63% as requested by the Company.

5. Staff Recommendations

In sum, Staff recommended that the Company's Application be approved with the following changes:

1. The LNG plant be given a remaining life of 15 years instead of 10.
2. The negative salvage rate of 32% for account 367 should remain unchanged instead of increased to 50% as proposed by the Company.
3. The life of the transmission line through the reservation should be reduced to 32 years instead of the 20 years proposed by the Company.

These changes would give an overall depreciation rate of 3.93% and a total annual depreciation expense of \$11,038,234. This would allow for an increase in depreciation expense of \$3,784 per year instead of the \$428,482 requested by the Company. Staff also recommended that the Commission adopt the Company's recommendation to implement the new depreciation rates effective at the beginning of Intermountain's fiscal year, October 1, 2002. Finally, Staff's comments advocated that Intermountain Gas file another depreciation study for Commission and Staff review in another three years.

INTERMOUNTAIN GAS REPLY COMMENTS

On January 15, 2003, Intermountain Gas Company filed reply comments explaining that the purpose of the Company's Application was to update the depreciation parameters and rates established in Case No. INT-G-99-2. Intermountain maintained that the depreciation rates proposed in the Application were appropriate to recover its investment in plant in service, adjusted for net salvage, over its' useful life.

While the Company believes that its proposed depreciation parameters were supported by the depreciation study, the Company also acknowledged the concerns raised by the Staff in their comments. Intermountain believes the next study to be filed in three years will shore up many of the parameters filed with this case and provide Staff with an added measure of confidence in the Company's recommendations. Therefore, Intermountain respectfully suggests that the Commission adopt the changes as proposed by the Staff.

It should be noted that while Intermountain's reply comment deadline does not end until January 22, 2003, Mike McGrath indicated orally that the Company promptly filed its comments to allow the Commission to decide this case without further delay. Intermountain has indicated that this would better facilitate the Company's financial reporting.

COMMISSION DECISION

Does the Commission wish to approve Intermountain's Application subject to the changes recommended by the Commission Staff?

Lisa Nordstrom

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