DECISION MEMORANDUM

TO: COMMISSIONER KJELLANDER
COMMISSIONER SMITH
COMMISSIONER HANSEN
COMMISSION SECRETARY
COMMISSION STAFF
LEGAL

FROM: DONOVAN E. WALKER

DATE: FEBRUARY 3, 2006

SUBJECT: INTERMOUNTAIN GAS COMPANY'S APPLICATION TO CHANGE ITS COMPOSITE DEPRECIATION RATE – CASE NO. INT-G-05-3

On October 28, 2005, Intermountain Gas Company (Intermountain Gas, Company) filed an Application to change its composite depreciation rate with the Commission. On November 23, 2005, the Commission issued Order No. 29917, Notice of Application and Notice of Modified Procedure, setting a comment deadline of January 24, 2006. Commission Staff was the only party to file comments, and recommended approval of the Company's Application with minor adjustments.

THE APPLICATION

The Commission set Intermountain Gas Company's current composite depreciation rate at 3.93% in Case No. INT-G-02-4. Order No. 29187. The Company was directed to submit an updated depreciation study three years from entry of that Order. *Id.* The Company contracted the services of AUS Consultants to perform an update to the 2002 depreciation study. According to the Application, the results of this study indicate that the current composite rate is over depreciating the Company's assets. Consequently, Intermountain Gas is requesting a decrease in its composite depreciation rate from 3.93% to 3.37%. This would decrease Intermountain Gas's annual depreciation accrual by $1,998,923. The Company does not seek to change its prices as a result of this Application.

The current study addresses, among other things, lengthening the depreciation lives of the Company's mains and services and a corresponding adjustment to net salvage of that same plant. The Application states that the continued use of plastic in the Company's mains and services, coupled with the increasing evidence of the benefits of plastic's longer service life and lower costs vs. steel, necessitates the proposed change in mains and services.

The study update was based upon the books and records of the Company as of September 30, 2004. The Company requests that the decrease in annual composite depreciation rate be made effective the beginning of its fiscal year, October 1, 2005. The Company attached a summary of the study as Exhibit 1 to its Application.

STAFF COMMENTS

Staff reviewed the Company's Application, the updated study, and performed an analysis on the requested decrease in depreciation rates. Staff recommends approving the Company's Application with adjustments to three accounts that results in a relatively minor overall change in the annual depreciation expense as requested.

The major changes in the depreciation expense are generally attributed to a lengthening of the useful life of mains and services due to the use of plastic pipe as opposed to steel, as well as adjustments to the net salvage value. Although several accounts changed in the new depreciation study, 99.9% of the overall decrease in depreciation expense is attributable to changes in three accounts: Account 376 – Mains; Account 380 – Services; and Account 392 – Transportation Equipment.

Account 376 – Mains

This account represents the Company's investment in distribution mains. The depreciation study recommended that according to a life analysis, the life of these investments should be increased. The mains currently have a service life of 44 years, and the study recommends a service life of 51.4 years. Because the service life is different for steel pipe and for plastic pipe, the service life is weighted. When the longer service life is applied to the investments made in this account, the ultimate result is a reduction in the annual depreciation expense of $966,990. Staff reviewed the increase in the service life of these investments and agrees that this is a reasonable change.

Account 380 – Services

This account contains the Company's investment in the service lines that provide gas to individual customers. The study recommends increasing the service life from 36 years to 45.3 years. This account, like the distribution mains, is weighted to take into account both the steel and plastic pipe. This adjustment results in a reduction in the annual depreciation expense of $1,149,559. Staff agrees that this adjustment is reasonable and recommends its approval.

Additionally, Staff found that an accounting entry in this account was posted incorrectly. To correct the error, this account should have included an additional $5,261,089.50 of investment. Account 381 – Meters should be reduced by $5,370,634.10; and Account 378 – Regulator Station Equipment should have been increased by $109,544.60. When these correcting entries are made, the annual depreciation expense is reduced by $60,002. Instead of the annual depreciation expense of $11,036,164 as requested by the Company, the correct annual depreciation expense should be $10,976,162. Although this correction does not change the Company's total investment balance, it causes the depreciation expense to change because of the different service lives and salvage values in the affected accounts.

Account 392 – Transportation Equipment

This account contains the Company's investment in compressed natural gas (CNG) equipment, automobiles, light trucks, vans, SUVs, heavy trucks, utility boxes, and trailers. The study recommended continuing the current nine-year service life. However, it recommended that the net salvage value be adjusted from 15% to 5%. This causes an annual depreciation expense increase of $102,184. Staff agrees that this adjustment is reasonable and recommends that it be accepted.

Other Issues

Staff revisited an accounting problem that was recognized by the Commission in the Company's prior Application to establish depreciation rates. Case No. INT-G-02-4, Order No. 29187. The Company has corrected this accounting problem, and now has accounting procedures in place that will insure that when any asset is retired from use, the appropriate original investment is removed from the appropriate account. Staff does not believe that the previous accounting problem has an impact of the balances used in this depreciation study, and that it is thus reasonable to utilize the results of the study.

Staff also reviewed the useful life of the liquefied natural gas (LNG) plant with the Company. The Company stated that it intends to perform the necessary research and study in the next 12 months to support a decision regarding whether or not to keep the LNG facility for a longer period or replace it with additional peaking capacity from the Northwest Pipeline. The useful life of the LNG plant was previously set at 15 years. Staff supported this 15 year service life at the time it was set commenting that the LNG facility was more economical than acquiring firm peaking capacity. Staff recommends that there is presently no reason to disturb this figure as long as the Company makes a firm commitment to bring before the Commission a decision on the prudence of the LNG plant. The Company's review should include more than a straight economic analysis. Risk associated with supply should also be part of the review. Staff recommends that the issue of remaining life and salvage value should be addressed after the Company evaluates its peaking capacity options and files its next depreciation case with the Commission.

STAFF RECOMMENDATION

Staff recommends that the Company's Application be approved with the following corrected account balances:

Account 378	Regulator Station Equipment	Increased by $109,544.60
Account 380	Services	Increased by $5,261,089.50
Account 381	House Meters	Decreased by $5,370,634.10

These changes will decrease the proposed annual depreciation expense by an additional $60,002, for a total annual depreciation expense of $10,976,162 or an overall rate of 3.35%.

Additionally, Staff recommends that the Commission adopt the Company's recommendation to implement the new depreciation rates effective at the beginning of the Company's fiscal year, October 1, 2005.

COMMISSION DECISION

Does the Commission wish to grant or deny the Company's Application to change its composite depreciation rate? Does the Commission wish to make the adjustments recommended by Staff?

DONOVAN E. WALKER

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