

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF EAST KENTUCKY POWER)	
COOPERATIVE, INC. FOR AN ORDER APPROVING THE)	
ESTABLISHMENT OF A REGULATORY ASSET FOR THE)	CASE NO.
DEPRECIATION AND ACCRETION EXPENSES)	2018-00027
ASSOCIATED WITH THE SMITH STATION LANDFILL)	
ASSET RETIREMENT OBLIGATIONS)	

ORDER

On January 17, 2018, East Kentucky Power Cooperative, Inc. (“EKPC”) filed an application seeking approval to establish a regulatory asset for depreciation and accretion expenses associated with EKPC’s new J. K. Smith Station landfill (“Smith Station”) Asset Retirement Obligations (“ARO”).¹ EKPC has established AROs for the Smith Station landfill closure and post-closure costs.

There are no intervenors in this proceeding. EKPC responded to one information request from Commission Staff.

Pursuant to KRS 278.220, the Commission has adopted a uniform system of accounts for EKPC, which was issued by the United States Department of Agriculture, Rural Utilities Service (“RUS”).² With respect to AROs, the RUS Uniform System of Accounts (“RUS USoA”) states:

¹ See generally Financial Accounting Standards Board Accounting Codification (“ASC”) Topic 410-20, *Asset Retirement Obligations*.

² Codified as 7 C.F.R. pt. 1767. The current version of the RUS system of accounts became effective May 27, 2008, and is also published and referenced as RUS Bulletin 1767B-1.

An asset retirement obligation represents a liability for the legal obligation associated with the retirement of a tangible long-lived asset that a company is required to settle as a result of an existing or enacted law, statute, ordinance, or written or oral contract or by legal construction of a contract under the doctrine of promissory estoppel. An asset retirement cost represents the amount capitalized when the liability is recognized for the long-lived asset that gives rise to the legal obligation. The amount recognized for the liability and an associated asset retirement cost shall be stated at the fair value of the asset retirement obligation in the period in which the obligation is incurred.³

The RUS USoA requires that when a utility records the liability for an ARO, the electric utility plant giving rise to the legal obligation is to be charged with the associated asset retirement costs. The asset retirement costs are then depreciated over the life of the asset that gives rise to the ARO. In periods subsequent to the initial recording of the ARO, the utility shall recognize the period-to-period changes of the ARO due to the accretion of the liability. The utility shall monitor measurement changes of the ARO on a timely basis, and shall recognize such changes as an adjustment to the liability and the corresponding electric utility plant.

In case 2014-00432,⁴ the Commission approved EKPC's request to establish regulatory assets for accretion and depreciation expense associated with AROs for asbestos and ash impoundments at various EKPC generating stations, including the William C. Dale Generating Station ("Dale Station"), which was retired in 2016.

The Smith Station landfill was placed into operation in 2016 as part of the retirement of the Dale Station ash ponds and relocation of approximately 560,000 cubic

³ 7 C.F.R. § 1767.15(y).

⁴ *Application of East Kentucky Power Cooperative, Inc. for an Order Approving the Establishment of Regulatory Assets for the Depreciation and Accretion Expenses Associated with Asset Retirement Obligations* (Ky. PSC July 21, 2015).

yards of coal ash from the ash ponds. This involved excavating and trucking the Dale Station coal ash to the Smith Station landfill in eastern Clark County, Kentucky. The Smith Station landfill and relocation of the Dale Station coal ash were approved in Case No. 2014-00252.⁵ EKPC completed the relocation of the coal ash in December 2017.

AROs for the Smith Station landfill were established for landfill closure costs and post-closure costs totaling \$1,193,220 as of December 31, 2016. EKPC established a landfill closure ARO for capping, drainage, grading, and revegetation costs of the landfill to meet the requirements of the United States Environmental Protection Agency's Final Rule for Disposal of Coal Combustion Residuals from Electric Utilities final rule ("CCR Rule")⁶ and 401 KAR 45:110. The balance of the ARO established for closure of the landfill was \$612,960 on January 1, 2017.⁷ EKPC also established an ARO for the post-closure activities, which primarily include groundwater and surface water monitoring, leachate management, erosion control, and inspections to meet the requirements of the CCR Rule and 401 KAR 45:110. The post-closure ARO balance was \$580,260 on January 1, 2017.⁸

⁵ *Application of East Kentucky Power Cooperative, Inc. for a Certificate Of Public Convenience and Necessity for Construction of an Ash Landfill at J.K. Smith Station, the Removal of Impounded Ash from William C. Dale Station for Transport to J.K. Smith and Approval of a Compliance Plan Amendment for Environmental Surcharge Recovery* (Ky. PSC Mar. 6, 2015).

⁶ 80 Fed. Reg. 21,301 (Apr. 17, 2015) (codified at 40 C.F.R. pts. 257 and 261).

⁷ Response to Commission Staff's Initial Request for Information ("Staff's First Request"), Item 2.b. The ARO balance is the net present value ("NPV") of expected cash flows using a credit-adjusted risk-free rate for the life of the asset. The current cost estimate is expected to be approximately \$2.6 million as of June 30, 2049, adjusted for an inflation rate of 2.5%.

⁸ *Id.* The ARO balance is the NPV of expected cash flows using a credit-adjusted risk-free rate for the life of the asset. The current cost estimate is expected to be approximately \$4.8 million as of December 31, 2079, adjusted for an inflation rate of 2.5%.

In accordance with RUS USoA requirements, EKPC recorded depreciation expense for the ARO-related assets and accretion expense for the ARO-related liabilities on a monthly basis. For the year ending December 31, 2017, the ARO related depreciation expense was \$28,071, and the accretion expense was \$55,007, for a total expense of \$83,078.⁹ The closure portion of the Smith Station landfill ARO is currently being depreciated until June 2049.¹⁰ The post-closure ARO is being depreciated through 2079, as the CCR Rule requires post-closure care for 30 years.¹¹

Under the RUS USoA, EKPC must currently recognize depreciation and accretion expense even though cost recovery will be deferred. EKPC records monthly depreciation expense for the ARO-related assets and accretion expense for the ARO-related liabilities. EKPC believes that the actual ARO settlement costs will ultimately be recoverable in rates or through the Environmental Surcharge Mechanism (“ESM”) when costs are finalized.¹² However, EKPC states that this creates a mismatch of revenue and expenses in its financial statements because expenses are recognized as the ARO balances are accreted and depreciated, but the revenue will not be recognized until the actual costs are recovered through rates or the ESM.¹³ EKPC states that this mismatch will also distort future financial performance as future revenues will be inflated; thus overstating financial performance. In order to rectify this situation, EKPC is requesting

⁹ Application at 5.

¹⁰ Response to Staff’s First Request, Item 3. The Smith Station landfill was designed with excess capacity to serve as an emergency storage facility for ash from EKPC’s coal-fired units. Therefore, the closure portion of the ARO is being depreciated consistent with the depreciable life of EKPC’s most recently constructed coal-fired unit, Spurlock Unit 4.

¹¹ *Id.*

¹² Application at 5.

¹³ *Id.*

authority to establish a regulatory asset for the 2017 Smith Station landfill ARO-related depreciation and accretion expenses of \$83,078. EKPC is also requesting that all subsequent depreciation and accretion expenses associated with the Smith Station landfill AROs be recorded as a regulatory asset.¹⁴ At this time, EKPC is requesting the regulatory asset treatment for accounting purposes only.¹⁵

The Commission has previously approved regulatory assets for EKPC and other jurisdictional utilities. Such approval has been granted when a utility has incurred: (a) an extraordinary, nonrecurring expense which could not have been reasonably anticipated or included in the utility's planning; (b) an expense resulting from a statutory or administrative directive; (c) an expense in relation to an industry sponsored initiative; or (d) an extraordinary or nonrecurring expense that over time will result in a saving that fully offsets the cost.¹⁶ EKPC believes its request to establish a regulatory asset for the Smith Station landfill ARO-related depreciation and accretion expenses is consistent with the second listed example, as the ARO-related depreciation and accretion expenses result from the accounting requirements of RUS USoA and ASC Topic 410-20.¹⁷

EKPC is requesting authorization to establish a regulatory asset for ARO-related depreciation and accretion expenses resulting from Smith Station landfill ARO balances

¹⁴ Application at 6.

¹⁵ *Id.*

¹⁶ See Case No. 2010-00449, *Application of East Kentucky Power Cooperative, Inc. for an Order Approving the Establishment of a Regulatory Asset for the Amount Expended on Its Smith 1 Generating Unit* (Ky. PSC Feb. 28, 2011), Order at 4. See also Case No. 2008-00436, *The Application of East Kentucky Power Cooperative, Inc. for an Order Approving Accounting Practices to Establish a Regulatory Asset Related to Certain Replacement Power Costs Resulting from Generation Forced Outages* (Ky. PSC Dec. 23, 2008), Order at 44.

¹⁷ Application at 6-7.

at December 31, 2016 beginning in January 2017, and for all subsequent years to 2017. If this request cannot be acted on by March 1, 2018, EKPC requests that the Commission direct EKPC to record a credit to expense and a debit to the regulatory asset account for \$83,078 in the 2018 financial statements to bring the regulatory asset account balance to the amount requested for December 31, 2017, and to also record all accretion and depreciation in 2018 and subsequent years as regulatory assets.

The Commission has reviewed the information provided by EKPC and finds that the proposed regulatory asset should be approved.

IT IS THEREFORE ORDERED that:

1. The accounting treatment requested by EKPC to classify depreciation and accretion expense related to the Smith Station landfill AROs as a regulatory asset is approved for 2017 and subsequent years.

2. The regulatory asset accounts established in this case are for accounting purposes only.

3. EKPC shall record a credit to expense and a debit to the regulatory asset accounts for \$83,078 in the 2018 financial statements to bring the regulatory asset account balance to the amount requested for December 31, 2017.

4. EKPC shall, within 14 days of the date of this Order, file with the Commission the accounting entries made on its books to effectuate the creation of the regulatory assets.

5. EKPC shall file annually updated ARO calculations reflecting any studies, reports, or change in other assumptions for the ARO balances as originally recorded herein. The annual update shall be based upon the balances of December 31 of each

year and the updated calculations shall be submitted at the time EKPC files its annual report with the Commission.

6. Any document filed in the future pursuant to ordering paragraphs 4 and 5 herein shall reference this case number and shall be retained in the utility's general correspondence file.

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By the Commission

ENTERED
MAR 08 2018
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:



Executive Director

for Bruce Hanson

Case No. 2018-00027

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