COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF COLUMBIA GAS OF KENTUCKY, INC. TO ESTABLISH A REGULATORY ASSET RELATED TO PENSION AND OTHER POST-RETIREMENT BENEFIT EXPENSES	))))	CASE NO. 2009-00168

ORDER

On April 24, 2009, Columbia Gas of Kentucky, Inc. ("Columbia") filed an application seeking authority to establish a regulatory asset based on the difference between its current level of Pension and Other Post-Employment Benefits ("OPEB") expenses and the amount of Pension and OPEB expenses included in its base rates. It proposed to address recovery of the regulatory asset in its soon-to-be filed base rate case. Columbia subsequently filed Case No. 2009-00141 on May 1, 2009.[1] As noted, the application included a proposal addressing the recovery of a potential pension and OPEB related regulatory asset. This issue is discussed later in the Background section of this Order.

The procedural schedule established for this case allowed for discovery, intervenor testimony or comments, and rebuttal testimony or reply comments. The only intervenor in the case, the Office of the Attorney General ("AG"), issued one data request, but filed no testimony or comments. The Commission Staff issued two data requests to Columbia. In response to a July 24, 2009 Order directing the parties to

[1] Case No. 2009-00141, Application of Columbia Gas of Kentucky, Inc. for an Adjustment of Rates (Ky. PSC Oct. 26, 2009).

submit either a request for hearing or a statement that the record is complete, Columbia stated that the record was complete and the case could stand submitted for decision. The AG filed no response to this Order.

On July 24, 2009, the AG filed a motion to consolidate this case with Columbia's pending rate case, Case No. 2009-00141.[2] By its July 31, 2009 Order the Commission denied the AG's motion, citing that the AG was one of several intervenors in Columbia's rate case, but the only intervenor in this proceeding.

Columbia proposed to create a surcharge mechanism in Case No. 2009-00141 to recover the difference between the amount of pension and OPEB costs included in its base rates and its actual pension and OPEB costs. That proposal was eliminated in the September 14, 2009 settlement in that case, which provided for the AG to file testimony or comments in this proceeding and for Columbia to file rebuttal testimony or reply comments. The AG filed comments in this proceeding on October 16, 2009 to which Columbia filed reply comments on October 30, 2009.

BACKGROUND

Large privately-owned employers, such as Columbia, provide retirement plans for their employees as well as medical and life insurance for those employees when they become retirees. Retirement (pension) plan costs must be calculated according to the provisions of the Financial Accounting Standards Board's ("FASB") "Statement of Financial Accounting Standards ("SFAS") 87, Employers' Accounting for Pensions." Medical and life insurance plans, the components of OPEB costs, must be calculated pursuant to "SFAS 106, Accounting for Post Employment Benefits other than Pensions."

[2] Id.

Columbia's pension plan and OPEB plan are both administered by its parent, NiSource, Inc. ("NiSource"). In its application, Columbia indicated that its combined pension and OPEB expenses for 2009 were estimated to be $1,772,186 compared to a level of $377,127 incurred in 2008. According to Columbia's application, NiSource uses a mix of equities and fixed income investments to maximize a long-term return balanced against a prudent level of risk. Its portfolio includes a blend of fixed income and equity investments. Its equity investments are diversified among domestic and international stocks, growth and value investments, and small and large capitalizations.

The large downturn in financial markets in 2008 caused the value of NiSource's investments in its pension and OPEB plans to decline significantly. That value declined 30.3 percent in 2008 compared to growth in 2007 of 10.5 percent. By comparison, the value of the Standard & Poor's 500 index declined 38.5 percent, while the value of a common benchmark for international equities, the Morgan Stanley Capital International – Europe, Australia, and Far East Index, declined by 43.4 percent.

The record of this proceeding indicates that the risk of NiSource's portfolio is less than that of the various equity indices but greater than the collective risk of bond and Treasury Bill investments. In 2008, its losses were not as great as those of the equity indices, while in other years, its gains have tended to be less than those realized by the equity indices. NiSource's 20-year average performance was in line with the performances of the US Equity, Small Cap US Equity and High Yield Bonds.

DISCUSSION

Historically, Columbia has sought recovery of its test year net pension and OPEB expenses in its base rate cases. The pension and OPEB expense in the test year in its last base rate case before 2009, Case No. 2007-00008,[3] was $564,083. This amount consisted of a negative pension expense of $15,800 and OPEB expense of $579,883.

In his written comments, the AG stated his opposition to Columbia's request to create a regulatory asset. Arguing that pension and OPEB expenses averaged less than 0.5 percent of Columbia's operating and maintenance ("O&M") expenses over the last five years, the AG claimed the magnitude of the expenses does not support creating a regulatory asset. He also claimed Columbia's proposal represented an inappropriate move away from traditional regulation, stating that it would guarantee dollar-for-dollar recovery of the selected expenses.

The AG also stated that Columbia's request represents inappropriate single-issue ratemaking, arguing that future recovery of the regulatory asset through rates violates the matching principle as it pertains to establishing rates within a general rate case based on all the components within the utility's test year. The AG specifically pointed to the lack of volatility in the OPEB expense, comparing the expense for the last ten years to the 2009 amount. He argued that the OPEB expense is not volatile enough to warrant the treatment proposed by Columbia.

Columbia countered the AG by stating that its 2009 level of pension and OPEB expenses is extraordinary. It stated that the volatility caused by fluctuations in asset returns and long-term interest rates in 2008, which caused the large increase in its 2009 costs, was beyond its or NiSource's control and could not reasonably have been anticipated and included in its 2009 financial planning.

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[3] Case No. 2007-00008, Adjustment of Rates of Columbia Gas of Kentucky, Inc. (Ky. PSC Aug. 29, 2007).

Columbia disagreed with the AG on whether the magnitude of the expenses warrants regulatory asset treatment. The AG compared Columbia's pension and OPEB expenses to its total annual O&M expenses, including purchased gas costs expenses. Columbia argued that purchased gas costs, which are not a base rate item, should not be included when analyzing whether the magnitude of its pension and OPEB expenses is large enough to support creating a regulatory asset. It noted that when purchased gas costs are excluded, its pension and OPEB expenses make up nearly 6 percent of its O&M expenses, which it claims represents a significant portion of its expenses.

Columbia claimed that its proposal does not reflect a move away from traditional regulation. It argued that Commission precedent demonstrates that its authority to establish a system of accounts for utilities permits it, under certain circumstances, to approve the creation of a regulatory asset. Columbia stated that its proposal does not represent single-issue ratemaking, as the AG claims, because it does not affect rates; it merely establishes accounting treatment. It claimed that, although the pension fund is more volatile because it is larger and better funded than the OPEB fund, the volatility in both funds is caused by the same market factors, and both, therefore, warrant regulatory asset treatment.

In addition to responding to the AG's comments, Columbia also modified its request in its reply comments. Rather than establish a regulatory asset annually, it proposed to limit its request to the difference between the amount of pension and OPEB expenses included in its base rates and the amount of its actual pension and OPEB expenses it incurred in the first 10 months of 2009. This change is based on its recently approved base rate increase having gone into effect at the end of October and its response to Commission Orders in other recent regulatory asset cases wherein the Commission stated that it would not approve "open-ended" regulatory assets. Based on actual results through September 2009 and estimated results for October, Columbia's modified request is to establish a regulatory asset in the amount of $956,638, which consists of $808,845 in pension expense and $147,793 in OPEB expense.

CONCLUSION

In Case No. 2008-00440,[4] the Commission restated the categories of expense that it has traditionally allowed to be treated as regulatory assets. Those categories are:

> (1) an extraordinary, nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning; (2) an expense resulting from a statutory or administrative directive; (3) an expense in relation to an approved industry initiative; or (4) an extraordinary or nonrecurring expense that over time will result in a saving that fully offsets the cost.

The facts of this case do not warrant a departure from this standard. In fact, the statements of both Columbia and the AG indicate that the central issue is whether Columbia's pension and OPEB expenses fall within the first category identified above. Information provided by Columbia in response to a data request shows that its historical OPEB expense has been greater than that of its pension expense; however, the volatility of its OPEB expense has been much less than the volatility of its pension expense. In the last 10 years, its annual pension expense ranged from a negative $627,000 to $391,000, a range of more than $1.0 million. Its annual OPEB expense ranged from $529,273 to $912,228, a range of $383,000, over that same 10-year period.

[4] Case No. 2008-00440, Request of Kentucky-American Water Company for Approval to Defer Certain Expenses as Regulatory Assets (Ky. PSC Dec. 23, 2008).

The amounts of Columbia's pension and OPEB expenses for the first 10 months of 2009 will exceed the amounts included in its rates for that period. However, it must be demonstrated that these are extraordinary, nonrecurring expenses that could not have reasonably been anticipated or included in Columbia's planning, not just that they exceed the amounts included in rates.

Columbia's pension expense has shown a good deal of volatility over the years. In the period 1999 – 2008, there will have been six years in which it recorded a negative annual pension expense and four years in which it recorded a positive annual pension expense. Its 2009 level of pension expense is higher than in the 10 previous years. However, given the historical volatility of Columbia's pension expense, the Commission concludes that it would be incorrect to say that such an expense can be considered nonrecurring. Recognizing that Columbia's required contributions to its pension fund and its pension expense are impacted by the performance of the fund's investments, we cannot agree with Columbia that the impact of the 2008 downturn in the financial markets on its 2009 pension costs could not reasonably have been anticipated and included in its 2009 financial planning.

In the case of Columbia's OPEB expense, the record reflects that the likely level of expense for the first 10 months of 2009 will be roughly $631,000. At this level, it will exceed the amount included in Columbia's base rates for that period by approximately $148,000. Based on Columbia's estimates, the annual expense for all of 2009 can be projected to be roughly $758,000. The record reflects that this amount is within five percent of Columbia's average annual OPEB expense for the 1999 -- 2008 period. For a company of Columbia's size, incurring a level of expense which exceeds the amount included in rates and which varies from the historical average by what must be viewed as relatively minor amounts, we are not persuaded that Columbia's 2009 OPEB expense is extraordinary or nonrecurring. Therefore, the Commission concludes that Columbia's OPEB expense does not merit being treated as a regulatory asset.

SUMMARY

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that Columbia's modified request to establish a regulatory asset based on the difference between its actual pension and OPEB expenses for the first 10 months of 2009 and the amount of such expenses included in its base rates during that period should be denied.

IT IS THEREFORE ORDERED that Columbia's request for authorization to establish a regulatory asset based on the difference between the amount of pension and OPEB expenses it incurred during the first 10 months of calendar year 2009 and the amount included in its base rates during that period of time is denied.

For the Commission

ENTERED
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KENTUCKY PUBLIC
SERVICE COMMISSION

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