COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN 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	)))))	CASE NO. 2014-00432

ORDER

On December 10, 2014, East Kentucky Power Cooperative, Inc. ("EKPC") filed an application seeking approval to establish regulatory assets for certain depreciation and accretion expenses associated with Asset Retirement Obligations ("ARO")[1] for asbestos abatement and ash removal costs.

There are no intervenors in this proceeding. EKPC responded to one request for information from Commission Staff, and an informal conference was held on January 21, 2015.

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) 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

[1] *See* Financial Accounting Standards Board Accounting Codification Topic 410-20, *Asset Retirement Obligations* ("ASC Topic 410-20").

[2] Codified as 7 CFR Part 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.

> 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]

During 2011, information became available for EKPC to reasonably quantify ARO's for asbestos abatement at certain of its generating plants, which is required by law to be removed or contained if the plants are renovated or demolished. In March 2011, EKPC recognized and established an ARO liability of $1,905,278 related to asbestos abatement at Dale Station Units 1 and 2.[4] During 2012, EKPC was able to quantify an ARO for asbestos abatement at Dale Units 3 and 4 and the Cooper Station.[5] As of December 31, 2012, the ARO liability in connection with asbestos abatement was $4,875,498.[6] During 2013, EKPC increased its ARO for legal obligations associated with ash ponds and landfills that existed in prior periods but were not recorded until 2013.[7] In December 2013, EKPC revised its ARO estimates for the reclamation and capping of ash disposal sites at its coal-fired generation facilities.[8] As of December 31, 2013, EKPC's total ARO liability was $32,238,032, composed of $5,127,906 in AROs

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[3] RUS USoA, Section 1767.15, General Instructions, subpart (y), *Accounting for asset retirement obligations*.

[4] Application at 3.

[5] *Id.*

[6] *Id.*

[7] *Id.* at 3-4.

[8] *Id.* at 4.

associated with asbestos abatement and $27,110,126 associated with remediating ash disposal sites.[9]

As explained in the application, EKPC records monthly depreciation expense for the ARO-related assets and accretion expense for the ARO-related liabilities. Based on the monthly depreciation and accretion expense, at the end of 2014, the ARO-related depreciation and accretion expense will be $5,275,341 and $1,077,266, respectively.[10] EKPC is of the opinion that the actual ARO settlement costs will ultimately be recoverable in rates or through the Environmental Surcharge mechanism if the Commission so authorizes.[11] However, EKPC must currently recognize depreciation and accretion expense, even though cost recovery will be deferred. EKPC states that this creates a mismatch of revenue and expenses in its financial statements, resulting in reduced margins and understatement of financial performance for 2014.[12] 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 that the Commission reclassify the 2014 ARO-related depreciation and accretion expenses as regulatory assets with a total balance of $6,352,607.[13] EKPC is also requesting in the instant case that all subsequent ARO-related depreciation and accretion expenses associated with the ARO balances on

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[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] *Id.*

[13] *Id.* at 5.

December 31, 2013, be recorded as regulatory assets.[14] EKPC is requesting the regulatory asset treatment for accounting purposes only.[15] EKPC stated that it did incur depreciation and accretion expenses on the AROs in 2013, but did not believe the level of expense for 2013 would justify the effort to restate its 2013 financial statements.[16]

Currently, none of the assets associated with the AROs in the instant case are included in EKPC's environmental surcharge. EKPC has filed an application in Case No. 2014-00252[17] wherein it is requesting approval for a Certificate of Public Convenience and Necessity to construct a special waste landfill at the J.K. Smith Station, and for approval to amend its Environmental Compliance Plan for purposes of recovering the cost of that project through its Environmental Surcharge. The project includes the actual costs to relocate the ash pond contents from the Dale Station to the Special Waste Landfill at the J.K. Smith Station. EKPC states that the completion of that project will eventually settle the ARO liability associated with that project, with any gain or loss being transferred to the ARO regulatory asset at the time of settlement. EKPC states that if the Commission grants its request to establish a regulatory asset for the ARO-related depreciation and accretion expenses, the portion of the regulatory asset associated with the Dale Station Ash Pond project included in Case No. 2014-00252 will be amortized as actual costs are recovered through the environmental

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[14] EKPC's response to Commission Staff's First Request for Information ("Staff's First Request"), Item 7.

[15] Application at 5.

[16] EKPC's response to Staff's First Request, Item 9.c.

[17] Case No 2014-00252, *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).

surcharge.[18] Finally, EKPC states that it will request amortization and recovery mechanisms for the remaining ARO-related assets in future cases as actual projects are identified.[19]

The Commission has previously approved regulatory assets for EKPC and other jurisdictional utilities. Such approval has been granted where a utility has incurred (a) an extraordinary, nonrecurring expense which could not have reasonably been 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.[20] EKPC believes its request to establish regulatory assets for the ARO-related depreciation and accretion expenses is consistent with the second example listed above, as the ARO-related depreciation and accretion expenses result from the accounting requirements of RUS USoA and ASC Topic 410-20.[21]

The Commission has previously approved the establishment of regulatory assets for ARO-related depreciation and accretion expenses for Louisville Gas and Electric

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[18] Application at 7.

[19] *Id.*

[20] 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), Final Order at 4.

[21] Application at 6.

Company ("LG&E")[22] and Kentucky Utilities Company[23] when those utilities adopted Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations*.[24] In Case No. 2004-00421,[25] the Commission found that one-time ash transfer costs should be deferred and amortized over four years since the ash transfer cost extended the life of the ash pond at Mill Creek and the cost to accomplish the life-extension should be treated as a capital expenditure. In addition, the Commission found that LG&E should be allowed the opportunity to earn a reasonable rate of return on the unamortized balance of the deferred costs in the environmental rate base.[26]

The Commission has reviewed the information provided by EKPC and finds that, with the exception of the depreciation and accretion expenses associated with the ash transfer costs, the proposed regulatory assets should be approved. In Case No. 2014-00252, the Commission found that the ash transfer costs associated with the project proposed to reclaim the Dale Ash Ponds did not extend the life of that ash pond and, therefore, should be treated as an expense rather than a capital item for ratemaking purposes.

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[22] Case No. 2003-00426, *Application of Louisville Gas and Electric Company for an Order Approving and Accounting Adjustment to be Included in Earnings Sharing Mechanism Calculations for 2003* (Ky. PSC Dec. 23, 2003), Final Order.

[23] Case No. 2003-00427, *Application of Kentucky Utilities Company for an Order Approving an Accounting Adjustment to be Included in Earnings Sharing Mechanism Calculations for 2003* (Ky. PSC Dec. 23, 2003), Final Order.

[24] Statement of Financial Accounting Standards No. 143 is now codified as ASC Topic 410.

[25] Case No. 2004-00421, *The Application of Louisville Gas and Electric Company for Approval of Its 2004 Compliance Plan for Recovery by Environmental Surcharge* (Ky. PSC June 20, 2005), Final Order.

[26] *Id*. at 9-10.

While the Commission is hereby granting approval for depreciation and accretion expenses as regulatory assets in 2014 and subsequent years, those amounts should be limited to the projects approved in the instant case. Furthermore, the Commission should be informed of any increase of more than 10 percent in the ARO balances after 2014 to determine whether a formal proceeding may be necessary to address such changes. If future ARO balances increase by more than 10 percent, EKPC must file for supplemental authority to record the excess amounts in the ARO-related depreciation and accretion expenses.

IT IS THEREFORE ORDERED that:

1. With the exception of the ash transfer costs associated with the project addressed in Case No. 2014-00252, the accounting treatment requested by EKPC to classify depreciation and accretion expense related to its asbestos abatement and ash-disposal projects as regulatory assets is approved for 2014 and subsequent years.

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

3. 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.

4. EKPC shall file annually on December 31, based on any new or revised studies or reports, updated ARO calculations by location. The updated calculations shall be submitted at the same time EKPC files its annual report with the Commission.

5. EKPC shall inform the Commission of any change of more than 10 percent in the ARO balances after 2014.

6. Any document filed in the future pursuant to ordering paragraphs 3, 4, and 5 herein shall reference this case number and shall be retained in the utility's general correspondence file.

By the Commission

ENTERED

MAR 06 2015

KENTUCKY PUBLIC SERVICE COMMISSION

ATTEST:

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