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 REGULATORY ASSETS FOR PRESENT AND FUTURE MAINTENANCE EXPENSES	)))))	CASE NO. 2019-00146

ORDER

On May 13, 2019, East Kentucky Power Cooperative, Inc., (EKPC) filed an application seeking authority to (1) establish regulatory assets for present and future major maintenance expenses, including the replacement of high-cost, non-routine minor items of property, without the need to first obtain Commission approval and (2) amortize those regulatory assets over a reasonable period. EKPC stated that this proposal would allow EKPC to avoid spikes in operating expenses, which might trigger base rate increases and the costs associated with those base rate cases, while also diminishing the administrative burden currently resting upon the Commission. EKPC expressly limited its proposal to the establishment and amortization of the regulatory assets with the issue of recovery addressed in the conventional manner.

The procedural schedule established for this case allowed for discovery, intervenor testimony or comments, and rebuttal testimony or reply comments. The Attorney General of the Commonwealth of Kentucky, by and through the Office of Rate Intervention (Attorney General) and Nucor Steel Gallatin (Nucor) requested and were granted intervention. EKPC responded to two requests for information from Commission Staff and one request for information from each intervenor. The Attorney General and Nucor filed comments, and EKPC filed reply comments. EKPC and the Attorney General filed statements that the case record is complete, and this case may be submitted for decision on the current record without a hearing. The record is now complete, and the Commission will decide this case based on the evidence of record without a hearing.

BACKGROUND

EKPC is an electric utility and generation and transmission cooperative that provides electric generation capacity and electricity to its 16 member distribution cooperatives, which, in turn, distribute and sell electricity at retail to approximately 535,000 customers in 87 counties in Kentucky.[1] EKPC owns and operates a total of approximately 2,965 megawatts (MW) of net summer generating capability and 3,267 MW of net winter generating capability, composed of coal-fired units, natural gas-fired units, landfill gas-to-energy facilities, and a community solar facility.[2] EKPC's coal-fired units are the John S. Cooper Generating Station (Cooper Station) and the Spurlock Station.

Pursuant to KRS 278.220, the Commission has adopted a uniform system of accounts (USoA) for EKPC, which was issued by the United States Department of Agriculture, Rural Utilities Service (RUS).[3] The RUS USoA establishes that all utility property consists of retirement units and minor items of property. Retirement units are considered major components that are separately identified on EKPC's books; minor

[1] Application, at 3.

[2] *Id.*

[3] Codified as 7 CFR 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.

items of property are the associated parts or items of which the retirement units are composed. With respect to the replacement of minor items of property, the RUS USoA states that when a minor item of depreciable property is replaced independently of the retirement unit of which it is a part, the cost of replacement shall be charged to the maintenance account appropriate for the item.[4]

In December 1982, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of Regulation, which was codified as Accounting Standards Codification (ASC) 980.[5] ASC 980-340-25-1 provides the criteria for recognition of a regulatory asset.[6] Supplemental to the requirements of ASC 980, Commission precedent obligates utilities to obtain

[4] 7 CFR § 1767.16(j)(3)(iii). *See* EKPC's response to the Attorney General's Initial Request for Information (Attorney General's First Request), Item 1.

[5] *See* EKPC's response to Commission Staff's Second Request for Information (Staff's Second Request), Item 3.c.

[6] *See* EKPC's response to Commission Staff's First Request for Information (Staff's First Request), Item 1. ASC 980-340-25-1 provides, in full, as follows:

> Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An entity shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:
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> a. It is probable (as defined in Topic 450) that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.
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> b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.
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> A cost that does not meet these asset recognition criteria at the date the cost is incurred shall be recognized as a regulatory asset when it does meet those criteria at a later date.

approval prior to establishing a regulatory asset.[7] The Commission has historically approved regulatory assets where a utility has incurred (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 industry-sponsored initiative; or (4) an extraordinary or nonrecurring expense that over time will result in a saving that fully offsets the cost.[8]

EKPC'S PROPOSAL

EKPC asserts that as its power plants age, the costs to keep them operational are becoming higher and occurring more frequently than in the past, which could result in more frequent requests for regulatory asset treatment of maintenance expenses.[9] Additionally, EKPC claims that financial statement deadlines make year-end requests to establish regulatory assets inconvenient to both the Commission and EKPC and that the lag in timing between when costs are incurred and the subsequent issuance of an Order approving the establishment of a regulatory asset may result in financial statement volatility between reporting periods.[10] Therefore, EKPC requests authority to establish regulatory assets, without prior Commission approval of each deferral individually, for major maintenance costs, including the replacement of high-cost, non-routine minor items of property, which would otherwise be accounted for as maintenance expenses.[11] EKPC

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[7] Application at 4.

[8] Case No. 2008-00436, *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) at 4.

[9] Application at 8.

[10] *Id.* at 6.

[11] *Id.* at 8 and 9.

proposes that this treatment be applicable to: (1) the replacement of minor items of property in the amount of $500,000 or greater due to unanticipated[12] equipment failures or obsolescence; and (2) major maintenance costs of at least $1,500,000, which are not expected to recur for at least five years.[13] EKPC asserts that these costs most closely resemble an extraordinary, nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning, but that any cost that would otherwise be charged to expense may be capitalized if it is probable that such costs will be considered allowable for rate-making purposes.[14] Contrary to standard procedure, EKPC requests authority to begin amortization of the regulatory assets immediately upon completion of the underlying maintenance activity.[15] EKPC expressly states that the cost recovery of any regulatory assets established under the provisions of this case would continue to require Commission approval through a separate case, most likely a base rate case.[16]

EKPC claims that it only seeks to defer expenses that are not currently included in base rates.[17] EKPC argues that without the requested relief, including these costs in base rates could result in significant increases or decreases in rates, depending on the

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[12] *See* EKPC's response to Staff's First Request, Item 9.b. EKPC defines "unanticipated" failures or obsolescence as those conditions that were not anticipated as of the establishment of the asset and the determination of its depreciable life.

[13] Application at 8 - 9 and Exhibit 1. EKPC asserts projects which qualify for recovery through the Environmental Surcharge would be excluded. Under these limitations, EKPC expects $9.7 million of expenses to qualify for deferral in 2019, all of which relate to the Spurlock Station.

[14] *Id.* at 5.

[15] *Id.* at 9.

[16] *Id.* at 10.

[17] *Id.* at 8.

test year.[18] EKPC contends that the establishment of regulatory assets for these types of maintenance projects will enable it to defer these expenses and match them with future related revenues, thus eliminating adverse margin and rate impacts.[19] EKPC argues that, while immediate amortization will cause EKPC to forego recovery of some portion of the regulatory asset, this approach better matches the expense with the benefit derived from the underlying maintenance activities and results in a smaller mismatch of revenues and expenses than if regulatory asset treatment is not granted.[20] EKPC contends that its request complies with ASC 980 because, to the extent that the amortization of the regulatory assets does not trigger a base rate increase, the underlying costs are being recovered sufficiently in existing rates; similarly, if a combination of factors including amortization of the regulatory asset resulted in EKPC filing a base rate application, EKPC expects that the allowed rates would include the amortization expense.[21] EKPC further asserts that it may voluntarily forego future revenue without violating any accounting standards.[22]

To compensate for the lack of a formal application for each deferral, EKPC proposes to give the Commission written notice when it establishes a regulatory asset, which would include sufficient information to evaluate the nature, amount, and amortization period of the regulatory asset; EKPC also proposes to file an annual written

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[18] *Id.*

[19] *Id.*

[20] EKPC's response to Staff's First Request, Item 7.

[21] EKPC's response to Staff's Second Request, Item 3.d.

[22] EKPC's Comments at 10.

report with the Commission listing all existing regulatory assets established under the provisions of this case and including the accrued balances and amortization to date.[23]

INTERVENOR COMMENTS

Nucor's Comments

According to Nucor, EKPC should be given the benefit of the doubt, because the impact of approving or denying EKPC's request is minimal. Nucor states that both the minimal forecasted effect on EKPC's financial metrics after 2021 and EKPC's intent to establish retirement units at a more granular level going forward point to the insignificant impact of granting EKPC's request.[24] Therefore, Nucor opines that EKPC's proposal should be approved, either outright or on a pilot basis until EKPC's next base rate case.[25]

The Attorney General's Comments

The Attorney General recommends that the Commission deny EKPC's application because the requested relief is unavailable under ASC 980, and the expenses that EKPC seeks to defer are outside the categories previously approved for regulatory asset treatment.[26] The Attorney General notes that, while EKPC is only precluded by Commission precedent from recognizing a regulatory asset without prior approval, the requirement that EKPC obtains Commission approval to amortize a regulatory asset is inherent to the criteria of ASC 980.[27]

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[23] Application at 2.

[24] Nucor's Comments at 2 - 3.

[25] *Id.* at 3.

[26] Attorney General's Comments, at 1.

[27] *Id.* at 2.

The Attorney General avers that EKPC's request to amortize the proposed regulatory assets immediately upon completion of the underlying maintenance activity is contrary to the basic requirements set forth in ASC 980-340-25-1, which provides that it must be "probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes."[28] The Attorney General argues that under EKPC's proposal, it is not probable that EKPC will recover revenue "in an amount at least equal to the capitalized cost" because if the regulatory asset is partially or fully amortized prior to inclusion for ratemaking purposes, then future revenues will unambiguously be less than the initially capitalized amount.[29] However, the Attorney General does not recommend that the Commission grant half of EKPC's proposal and simply permit regulatory asset treatment for these expenses with deferral until EKPC's next rate case.[30]

The Attorney General also contends that EKPC's request seeks to expand the categories of expense that may appropriately be granted regulatory asset treatment.[31] The Attorney General argues that "an extraordinary nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning" is not equivalent to an expense that was not anticipated or included in EKPC's base rates.[32] The Attorney General contends that these expenses are explicitly precluded from standard regulatory asset treatment by the fact that EKPC anticipates and plans for the replacement of minor

[28] *Id.* at 2.

[29] *Id.* at 3.

[30] *Id.* at 4.

[31] *Id.* at 5.

[32] *Id.* at 6.

items of property and that the major maintenance expenses will periodically recur.[33] Nevertheless, the Attorney General states that the purpose and intent of EKPC's application is appreciated and that EKPC could request to change its accounting practices to capitalize these costs moving forward without the need to establish regulatory assets.[34]

DISCUSSION

Based on EKPC's request to amortize the proposed regulatory assets without concurrent rate recovery, EKPC does not request regulatory asset treatment for the purpose of future recovery of a current expense. As we noted in Case No. 2008-00436:

> A regulatory asset is created when a rate-regulated business is authorized by its regulatory authority to capitalize an expenditure that under traditional accounting rules would be recorded as a current expense. The reclassification of an expense to a capital item allows the regulated business the opportunity to request recovery in future rates of the amount capitalized.[35]

EKPC's current proposal is equivalent to normalization of expenses for financial reporting purposes, similar to that done for ratemaking purposes in a base rates case. While EKPC contends that it may lose the ability to properly reflect the underlying maintenance costs in base rates absent the proposed regulatory asset treatment, normalization of costs that have recurrence cycles of more than one year or that are irregular by their nature is a characteristic feature of ratemaking. Nothing precludes EKPC from including normalized maintenance expenses in either a historic or forecasted test year. Furthermore, granting EKPC's proposal for the purposes of correctly reflecting

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[33] *Id.*

[34] *Id.* at 7.

[35] Case No. 2008-00436, *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) at 3 - 4.

the benefit periods of the expenses in a rate case would further obscure the validity of the proposed accounting treatment because ASC 980 requires that the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. To the extent that EKPC would include regulatory asset amortization in its test year as a stand-in for normalized expenses, regulatory asset treatment would be all the more improper. Furthermore, while the exact timing of maintenance activities may not be within EKPC's ability to foresee, the general rhythmic nature of these costs and the immaterial difference of the costs as a whole compared to EKPC's historic costs[36] suggest that a base rate case is the more appropriate forum to address these costs.

While the Commission may authorize regulatory asset treatment for the future recovery of current expenses, RUS is the more appropriate regulatory authority to petition for departures of standard accounting practices. EKPC essentially requests modified regulatory asset treatment to effectuate a departure from the requirements of 7 CFR § 1767.16(j)(3)(iii) and to expense recurring but long-lived maintenance costs over multiple accounting periods. RUS has established procedures to request departures from accounting methods and principles.[37] Additionally, EKPC's goal of deferring rate cases can only be accomplished by influencing its financial performance metrics in relation to its debt covenants with RUS, which ostensibly requires RUS approval.[38] EKPC has not

[36] *See* Application, Exhibit 1, and EKPC's response to Staff's First Request, Item 5.a.

[37] 7 CFR § 1767.13.

[38] *See* EKPC's response to Staff's Second Request, Item 3.e.

communicated with RUS regarding EKPC's proposal in this case but maintains that RUS will be amenable to requests of this nature.[39]

CONCLUSION

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that EKPC's request to establish regulatory assets for present and future major maintenance expenses, including the replacement of high-cost, non-routine minor items of property, without the need to first obtain Commission approval and to amortize those regulatory assets should be denied.

IT IS THEREFORE ORDERED that:

1. EKPC's request for authorization to establish regulatory assets for present and future major maintenance expenses, including the replacement of high-cost, non-routine minor items of property, without the need to first obtain Commission approval and to amortize those regulatory assets is denied.

2. This case is closed and removed from the Commission's docket.

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[39] EKPC's response to Staff's First Request, Item 12 and Staff's Second Request, Items 3.a. and 3.b.

By the Commission

ENTERED

DEC 20 2019

KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Gwen R. Pinson

Executive Director

*L Allyson Honaker
Goss Samford, PLLC
2365 Harrodsburg Road, Suite B325
Lexington, KENTUCKY 40504

*David S Samford
Goss Samford, PLLC
2365 Harrodsburg Road, Suite B325
Lexington, KENTUCKY 40504

*Jody Kyler Cohn
Boehm, Kurtz & Lowry
36 East Seventh Street
Suite 1510
Cincinnati, OHIO 45202

*Justin M. McNeil
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

*Larry Cook
Assistant Attorney General
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

*Honorable Michael L Kurtz
Attorney at Law
Boehm, Kurtz & Lowry
36 East Seventh Street
Suite 1510
Cincinnati, OHIO 45202

*East Kentucky Power Cooperative, Inc.
4775 Lexington Road
P. O. Box 707
Winchester, KY 40392-0707