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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

ATTORNEY GENERAL'S COMMENTS

Comes now the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("Attorney General"), and in accordance with the Kentucky Public Service Commission's ("Commission") July 16, 2019 procedural schedule, hereby tenders his Comments on East Kentucky Power Cooperative, Inc.'s ("EKPC") Verified Application ("Application").

Introduction

As explained in detail below, although the Attorney General appreciates and understands EKPC's ultimate goal of capitalizing and amortizing certain costs to eliminate the need to expense those costs during accounting periods, thus reducing the impact the costs have on margins, he nevertheless regretfully recommends the Commission deny the Application. The basis of the Attorney General's recommendation is two-fold: 1) the requested relief is unavailable under Accounting Standards Codification ("ASC") 980-340-25-1, and 2) the expenses at hand are beyond the categories "previously . . . approved for inclusion in a regulatory asset."[1] Said

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[1] *In the Matter of: 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*, Order, Case No. 2010-00449 (Ky. Commission Feb. 28, 2011) at 4.

differently, while the Attorney General would like to support EKPC's proposal, the requested relief is not proper.

As an initial matter, it is necessary to note that EKPC requests Commission approval to "(1) establish regulatory assets . . . and (2) amortize those regulatory assets."[2] Under Generally Accepted Accounting Principles ("GAAP"), ASC 980-340-25-1 permits a regulated utility to capitalize costs that would otherwise be charged to expense if both of two criteria are met. But-for the "Commission's precedent [that] requires that the utility obtain approval prior to establishing a regulatory asset," EKPC would have the discretion to create a regulatory asset, but it must nevertheless seek Commission approval to amortize a regulatory asset.[3] The second part of this equation is inherent in the requirements and criteria of ASC 980-340-25-1 itself.

<u>Amortization and Recovery Under ASC 980-340-25-1</u>

The first criterion of ASC 980-340-25-1 requires that in order to book a regulatory asset 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." Therefore, the accounting standard seems to require (or at least understand it is probable) that the utility will receive revenue "in an amount at least equal to the capitalized cost" initially included in the regulatory asset. Regarding the costs for which EKPC requests the blanket regulatory asset approval, the utility proposes to "begin amortizing immediately upon completion based on a reasonable time period not to exceed the number of years the expenditure is expected to provide

[2] Application, Case No. 2019-00146 (Ky. Commission May 13, 2019) at 2.
[3] Application, Case No. 2019-00146 (Ky. Commission May 13, 2019) at 4.

benefits to EKPC."[4] For major maintenance costs, it is EKPC's intent to amortize the costs "over the anticipated recurrence cycles."[5] For instance, under EKPC's proposal, if in January 2020 the utility replaces a major maintenance item that it expects it will need to replace again in five (5) years, upon completion EKPC will immediately begin amortizing it, with the regulatory asset being fully amortized in January 2025. If EKPC extends the time before its next rate case test-year beyond January 2025, EKPC will not recover any future revenue related to the regulatory asset for rate-making purposes as required by ASC 980-340-25-1. Even, again *arguendo*, if EKPC sought a rate case where the major maintenance item regulatory asset was partially amortized prior to the test-year, the future revenue allowed for rate-making purposes in the test-year would never be "in an amount at least equal to the capitalized cost." Therefore, under EKPC's proposal, it is not probable that the utility will recover revenue for rate-making purposes "in an amount at least equal to the capitalized cost" as required by GAAP.

Importantly, EKPC's instant proposal is distinguishable from its implemented plan for the cancelled Smith 1 generation unit regulatory asset ("Smith 1 Regulatory Asset") approved in Case No. 2010-00449 and allowed to begin amortization in Case No. 2015-00358.[6] The Smith 1 Regulatory Asset was a result of EKPC's cancelled Smith Unit 1, the costs for which the Commission explicitly found "were prudently incurred."[7] The unit was cancelled primarily because of increased capital costs and a

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[4] Application, Case No. 2019-00146 (Ky. Commission May 13, 2019) at 9.
[5] EKPC Response to Commission Staff's Initial Request for Information, Case No. 2019-00146 (Ky. Commission July 17, 2019) at Request and Response to 9c.
[6] *In the Matter of: 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*, Case No. 2010-00449; *In the Matter of: Application of East Kentucky Power Cooperative, Inc. for Deviation from Obligation Resulting From Case No. 2012-00169*, Case No. 2015-00358.
[7] Order, Case No. 2010-00449 (Ky. Commission Feb. 28, 2011) at 6.

reduction in anticipated load.[8] Nevertheless, in contrast to the current proposal, regarding the Smith 1 Regulatory Asset, "it is 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."[9] In lieu of returning the millions-of-dollars in benefits derived from its participation in the PJM capacity market directly to customers, EKPC will net those benefits "through the amortization of the Smith 1 Regulatory Asset,"[10] and in EKPC's next rate case "EKPC shall request that its rates be adjusted to reflect the amortization expense of the Smith 1 Regulatory Asset."[11] Therefore, contrary to its proposal in this matter, EKPC will recover for rate-making purposes revenue at least equal to the capitalized cost of the Smith 1 Regulatory Asset.

The Attorney General is not recommending, nor did EKPC request, that the Commission permit regulatory asset treatment for certain expenses with deferral until the utility's next rate case. Such treatment is inappropriate, and as explained below, contrary to Commission precedent. Furthermore, contrary to EKPC's arguments otherwise,[12] if EKPC amortizes any portion of a regulatory asset in an accounting period prior to the test-year in a subsequent rate case, the Commission's ability to deny recovery of those amortized costs is limited, if not impossible. This fact is alluded to in EKPC's Application, wherein the utility notes that in the event the Commission

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[8] *Id.*

[9] ASC 980-340-25-1.

[10] *In the Matter of: Application of East Kentucky Power Cooperative, Inc. for Deviation from Obligation Resulting From Case No. 2012-00169*, Motion to Accept and Approve Stipulation and Recommendation of the Parties, Case No. 2015-00358 (Ky. Commission Aug. 8, 2016) Exhibit A: Stipulation and Recommendation at 3; *See also* Order, Case No. 2015-00358 (Ky. Commission Jan. 10, 2017) at 11, ordering item 2, granting EKPC's motion to accept and approve the proposed Stipulation and Recommendation.

[11] Motion to Accept and Approve Stipulation and Recommendation of the Parties, Case No. 2015-00358 (Ky. Commission Aug. 8, 2016) Exhibit A: Stipulation and Recommendation at 5.

[12] EKPC Response to Attorney General's Initial Data Requests, Case No. 2019-00146 (Ky. Commission Jul. 17, 2019) at Response to 5a.

finds that an establishment of a regulatory asset was "undertaken in bad faith or without reasonable justification," its remedy is merely to "revoke the authority sought to be granted herein," and in the future require "EKPC to seek prior authorization" for regulatory asset accounting.[13]

<u>Establishment of A Regulatory Asset Under Commission Precedent</u>

The Commission has "summarized the categories of expenses that ha[ve] previously been approved for inclusion in a regulatory asset," including:

> (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 nonrecurring expense that over time will result in a savings that fully offsets the costs.[14]

EKPC has not claimed that its instant proposal fits neatly within any of the previously approved categories, but rather that the "costs expected to be incurred . . . most closely resemble the criteria listed" in the first category above.[15] EKPC's argument seems to be that its description of the expenses at hand as "non-routine costs that were not anticipated or included in EKPC's base rates" is comparable to the category of "extraordinary nonrecurring expenses which could not have reasonably been anticipated or included in the utility's planning."[16] Respectfully, the nature of the expenses are not comparable.

The Commission's first stated category initially speaks to the extraordinary and nonrecurring nature of an expense. At a minimum, the major maintenance expenses

[13] Application, Case No. 2019-00146 (Ky. Commission May 13, 2019) at 10.
[14] Order, Case No. 2010-00449 (Ky. Commission Feb. 28, 2011) at 4.
[15] Application, Case No. 2019-00146 (Ky. Commission May 13, 2019) at 5.
[16] Application, Case No. 2019-00146 (Ky. Commission May 13, 2019) at 5; Order, Case No. 2010-00449 (Ky. Commission Feb. 28, 2011) at 4.

are not extraordinary and will occur again within an anticipated time horizon. In fact, EKPC intends, as discussed *supra*, to amortize major maintenance costs "over the anticipated recurrence cycles."[17] Furthermore, although EKPC does not believe that any minor items of property or major maintenance expense were included in its most-recent rate case,[18] whether a cost was anticipated or included in the test year of a base rate case is not the Commission's precedent.[19] The Commission's standard is whether the expense could not have reasonably been anticipated or included in the utility's planning.[20] Anticipated or included in a test-year and anticipated or included in a utility's planning are two distinct and different standards. The Attorney General can find no place in the record where EKPC has argued that the utility failed to anticipate or plan for these expenses, or that they were necessarily surprised by their occurrence or frequency. On the contrary, the basis of the Application is that "EKPC *anticipates* the need to replace high-cost, non-routine minor items of property," and that "EKPC also *periodically incurs* major maintenance expenses," and in light of the *anticipated* incurrence and level of these costs, EKPC seeks pre-approval for regulatory deferral treatment.[21] The fact that EKPC is <u>anticipating</u> and <u>planning</u> for these costs via the Application is evidence enough that the proposal does not fit within the Commission's first category of expenses previously afforded regulatory asset treatment.

[17] EKPC Response to Commission Staff's Initial Request for Information, Case No. 2019-00146 (Ky. Commission July 17, 2019) at Request and Response to 9c.
[18] EKPC Response to Attorney General's Initial Data Requests, Case No. 2019-00146 (Ky. Commission Jul. 17, 2019) at Response to 3.
[19] Application, Case No. 2019-00146 (Ky. Commission May 13, 2019) at 5.
[20] Order, Case No. 2010-00449 (Ky. Commission Feb. 28, 2011) at 4.
[21] Application, Case No. 2019-00146 (Ky. Commission May 13, 2019) at 7-9, emphasis added.

Conclusion and Recommendation

As noted above, the Attorney General appreciates the purpose and intent of EKPC's Application, namely "to avoid spikes in operating expenses which might trigger base rate increases and the costs associated with those base rate cases."[22] Typically, the Attorney General would support such an intent. However, EKPC's proposal to book the regulatory assets exceeds the Commission's categories of previously approved expenses, and the proposed amortization violates the GAAP standard. Nevertheless, the Attorney General has found nothing in the record to indicate that EKPC is precluded from requesting approval from the Commission and the Rural Utilities Service ("RUS") to change its accounting practices to capitalize the costs at hand moving forward.[23] Such a change would be the most straightforward way to accomplish EKPC's goal of not expensing minor items of property and major maintenance, assuming of course the costs are allowed to be capitalized. The Commission, in denying the Application at hand, could nonetheless indicate its support for such an accounting change.

WHEREFORE, based on the Attorney General's review of the record and relevant standards and precedent, he respectfully recommends the Commission deny EKPC's Application.

[22] Application, Case No. 2019-00146 (Ky. Commission May 13, 2019) at 2; *See,* EKPC Response to Nucor Steel Gallatin's First Set of Data Requests, Case No. 2019-00146 (Ky. Commission Jul. 17, 2019) Response to Requests 1 and 2, detailing the expected impact on TIER of the proposed treatment compared to the status quo.

[23] *See* EKPC Response to Nucor Steel Gallatin's First Set of Data Requests, Case No. 2019-00146 (Ky. Commission Jul. 17, 2019) Response to Request 5, stating, "neither the RUS nor the Commission allows EKPC to change its system of accounts without prior approval."

Respectfully submitted,

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Certificate of Service and Filing

Counsel certifies that an original and ten photocopies of the foregoing were served and filed by hand delivery to Ms. Gwen R. Pinson, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; counsel further states that true and accurate copies of the foregoing were mailed via First Class U.S. Mail, postage pre-paid, to:

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This 28th day of August, 2019.

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