

October 30, 2009

Mr. Jeff Derouen
Executive Director
Public Service Commission
Commonwealth of Kentucky
211 Sower Boulevard
P. O. Box 615
Frankfort, KY 40602

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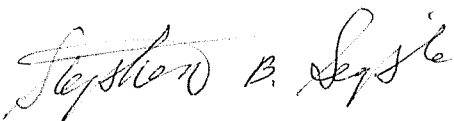
PUBLIC SERVICE
COMMISSION

RE: Case No. 2009-00168

Dear Mr. Derouen,

Enclosed for filing are the original and ten (10) copies of Columbia Gas of Kentucky, Inc.'s Reply Comments in the above docket. Should you have any questions about this filing, please contact me at 614-460-4648. Thank you!

Sincerely,



Stephen B. Seiple
Assistant General Counsel

Enclosures

cc: All Parties of Record
Hon. Richard S. Taylor

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:)
)
THE APPLICATION OF COLUMBIA GAS)
OF KENTUCKY, INC. FOR AN ORDER AP-)
PROVING ACCOUNTING PRACTICES TO)
ESTABLISH A REGULATORY ASSET RE-)
LATED TO PENSION AND OTHER POST-)
RETIREMENT BENEFIT EXPENSES.)

Case No. 2009-00168

**REPLY COMMENTS OF
COLUMBIA GAS OF KENTUCKY, INC.
TO THE COMMENTS OF ATTORNEY GENERAL'S OFFICE**

BACKGROUND

On April 23, 2009, Columbia Gas of Kentucky, Inc. ("Columbia") filed an Application requesting authority to revise its accounting procedures as of January 1, 2009, to provide for the deferral of the difference between Columbia's annual pension and other post-retirement benefits ("OPEB") expense calculated pursuant to FASB Accounting Standards Codification ("ASC") Topic 715¹, "Compensation – Retirement Benefits" and the annual pension and OPEB expense included in Columbia's base rates. Pursuant to Columbia's Application, only those amounts attributable to operation and maintenance ("O&M") expense would be deferred and recognized as a regulatory asset or regulatory liability pursuant to the provisions of ASC Topic 980², "Regulated Operations." The Application further requested that these amounts be collected from, or,

¹ The Pre-Codification references are SFAS No. 87 and SFAS No. 106.

² The Pre-Codification reference is SFAS 71.

returned to customers through the amortization of the regulatory asset or liability in Columbia's subsequent base rate proceeding, in whatever manner deemed appropriate by the Commission.

Pursuant to the Commission's Order dated October 9, 2009, the Attorney General filed Comments on October 16, 2009 opposing Columbia's Application. In accordance with the Commission's October 9 Order, Columbia files these Reply Comments. As discussed more fully below, (1) Columbia's pension and OPEB expenses represent extraordinary expenses which could not have been reasonably anticipated or included in Columbia's planning; (2) the treatment requested in Columbia's Application does not conflict with traditional regulation; (3) the treatment requested in Columbia's Application does not equate to impermissible "single-issue rate-making;" and, (4) Columbia is now limiting its requested accounting authority to the last ten months of 2009.

ARGUMENT

In its Comments the Attorney General's office first recognizes that the Commission has permitted the establishment of regulatory assets and liabilities as long as certain criteria are satisfied.³ The Attorney General explains why it believes Columbia has not satisfied these criteria. However, in apparent disregard for the Commission's precedent permitting the accounting treatment at issue here, the Attorney General concludes that the establishment of regulatory assets and liabilities is contrary to accepted ratemaking principles. For the reasons discussed below, the Commission should reject the Attorney General's inconsistent arguments and grant the authority requested in Columbia's Application.

³ Attorney General Comments at 2-3.

1. Columbia's Pension and OPEB Expenses Represent Extraordinary Expenses Which Could Not Have Been Reasonably Anticipated or Included in Columbia's Planning

As noted in the Attorney General's Comments, the Commission in its August 26, 2009, Order in Case No. 2008-00440 recently reiterated the four categories of expense that may be treated as regulatory assets.⁴ The first of the four categories of eligible expenses are those that are "an extraordinary, nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning." Columbia's Application is premised upon the fact that its 2009 pension and OPEB expenses are properly includable in this category.⁵

The Attorney General argues that pension and OPEB expense costs are not extraordinary and nonrecurring because such expenses are routinely included in the ratemaking process, and were included in Columbia's recent base rate case, Case No. 2009-00141.⁶ This argument misses the mark. Columbia is not arguing that pension and OPEB expenses are extraordinary, nonrecurring and unanticipated in planning processes. What Columbia is asserting is that due to the volatility of the expenses the *level* of the expense became extraordinary, nonrecurring and impossible to anticipate for planning purposes.⁷

The Attorney General next argues that Columbia's expenses are not extraordinary. In making this argument the Attorney General states that Columbia's pension and OPEB expenses are "immaterial" because for the last five years such expenses have constituted only .5% of Columbia's total O&M expenses.⁸ However, the comparison of pension and OPEB expenses to the O&M expenses that the Attorney General presents are severely distorted because the O&M expenses consist primarily of gas supply expenses. The Attorney General estimated that 2009 pen-

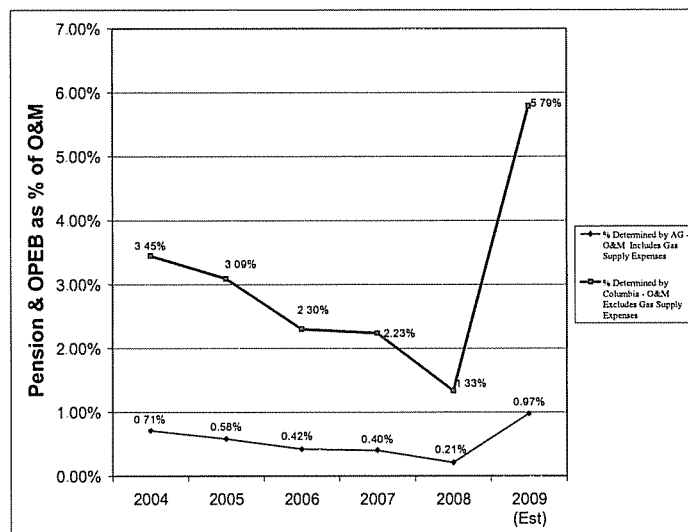
⁴ See *In the Matter of Request of Kentucky-American Water Company for Approval to Defer Certain Expenses as Regulatory Assets*, Case No. 2008-00440, Order (August 26, 2009) at 2.

⁵ Columbia Application at 6.

⁶ Attorney General Comments at 3.

⁷ Columbia Application at 4-6.

sion and OPEB expenses were 0.97% of total O&M expense.⁹ Gas supply expenses are not a base rate item, and when one removes the impact of gas supply expenses from the Attorney General’s equation, the result is that pension and OPEB O&M expenses constitute nearly 6% of total O&M, which represents a significant expense to Columbia. The table below provides a comparison of pension and OPEB O&M expense as a percentage of O&M exclusive of gas supply expenses (as calculated by Columbia) to the pension and OPEB O&M expense as a percentage of O&M inclusive of gas supply expenses (as provided by the Attorney General). This table dramatically illustrates just how volatile pension and OPEB expense levels have become over the last year due to the market conditions described in Columbia’s Application.



Nonetheless, the Attorney General not only disputes the materiality of Columbia’s pension and OPEB expenses, but further maintains that pension and OPEB expenses are not volatile, and thus not extraordinary.¹⁰ Columbia disagrees. As explained in Columbia’s Application, pension and OPEB expense levels have become volatile due to the return on plan assets and discount rates – factors that are beyond the control of Columbia. The market value of Columbia’s pension

⁸ Attorney General Comments at 4.

⁹ Attorney General Comments at 5.

and OPEB plan assets are subject to significant changes caused by fluctuations in asset returns available in the capital markets and fluctuations in long-term interest rates.¹¹ As a result of the recent economic crisis, the value of pension plan and OPEB assets plummeted in 2008, resulting in an extraordinary increase in 2009 pension and OPEB expense of approximately 745% and 50%, respectively, over the previous year.¹² Because the drivers of these expenses are volatile and beyond Columbia's control, these increases could not have been reasonably anticipated and therefore, were not included in Columbia's initial 2009 financial planning analysis.

The level of both pension and OPEB expense is subject to volatility resulting from the return on plan assets and discount rates. During the recent economic downturn, the main driver of expense volatility was asset returns. Because the pension plan is larger and better funded than the OPEB plans in aggregate, the impact of asset return volatility was more apparent on pension expense than OPEB expense. However, both OPEB and pension expense are subject to volatility resulting from the same factors. Additionally, as the Attorney General noted, Columbia's annual OPEB expenses includes a fixed annual expense of \$281,698 for the amortization of the Transition Obligation.¹³ This fixed annual expense masks the volatility in the remainder of the OPEB expenses.

Using the OPEB expenses that the Attorney General utilized, the graph below illustrates the significant difference in the volatility of OPEB expense when the fixed Transition Obligation is removed from the equation. For example, 2009 OPEB expense increased 50% over 2008 expense when including the Transition Obligation. Excluding the Transition Obligation, 2009

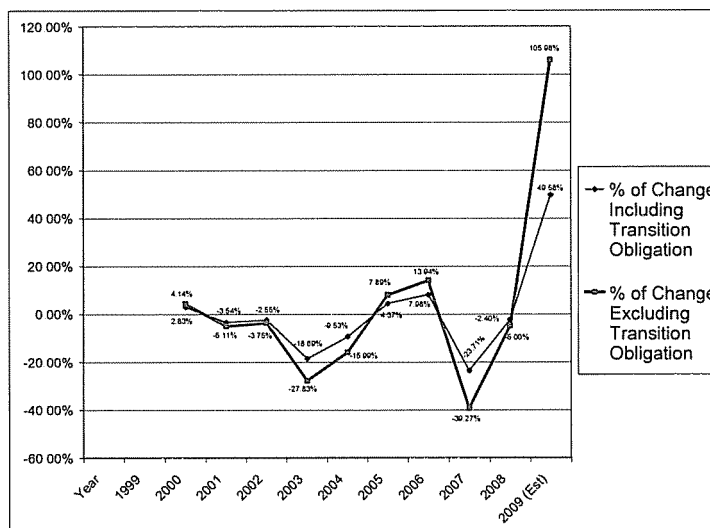
¹⁰ Attorney General Comments at 5-6.

¹¹ Columbia Application at 3-6.

¹² Columbia Application at 4.

¹³ Attorney General Comments at 5-6.

OPEB expense increased 106% over 2008 expense. Under either scenario, the graph below illustrates the volatility of Columbia’s OPEB expense.



2. The Treatment Requested in Columbia’s Application Does Not Conflict With Traditional Regulation

The Attorney General claims that the accounting treatment requested by Columbia represents a “move away from traditional regulation” because it guarantees recovery of a cost rather than providing a mere opportunity for cost recovery.¹⁴ The Attorney General is incorrect as to both of its assertions.

First, Columbia has simply asked for authority to establish regulatory assets and/or liabilities. Columbia’s Application made it clear that these assets or liabilities would be collected from, or, returned to customers through amortization of the asset or the liability in Columbia’s subsequent base rate case proceedings, in whatever manner deemed appropriate by the Commission.¹⁵ While the Attorney General apparently believes that approving the requested accounting authority “preordains” dollar-for-dollar recognition of the regulatory asset or liability in future

¹⁴ Attorney General Comments at 6-7.

¹⁵ Columbia Application at 7.

rate proceedings,¹⁶ the Commission never guarantees rate recovery. For example, in 2008 the Commission approved the creation of a regulatory asset for East Kentucky Power Cooperative, Inc.; however, in so doing the Commission made it clear that rate recovery issues were reserved for consideration in a separate base rate proceeding. The Commission ordered that, “[a]mortization of the asset and rate recovery of the resulting expense shall be reserved for consideration in East Kentucky’s pending base rate case....”¹⁷ The Commission’s consideration of the recovery of a regulatory asset in a separate base rate case is not equivalent to guaranteed recovery of the regulatory asset. As is true with any revenue or expense included in a utility’s rate case application, the Commission retains great discretion as to the recognition or non-recognition of all levels of revenue and expense.

Columbia also disagrees with the Attorney’s General’s assertion that the approval of regulatory assets and/or regulatory liabilities represents any kind of move away from traditional regulation. The Attorney General’s Comments cite the Commission’s Order in Case No. 2008-00440 in support of its arguments. Yet that Order makes it clear that as part of the traditional ratemaking process there are circumstances under which the Commission may properly authorize the creation of regulatory assets and/or liabilities. The Commission has clearly held that its statutory authority to regulate utilities and to establish a system of accounts permits it to establish regulatory assets.¹⁸ The Attorney General should not now be permitted to second guess this Commission precedent.

¹⁶ Attorney General Comments at 6.

¹⁷ *In the Matter of 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*, Case No. 2008-00436, Order (December 23, 2008) at Ordering Paragraph No. 3.

¹⁸ *In Re Kentucky American Water Company*, Case No. 2008-00440, Order August 26, 2009) at 2.

3. The Treatment Requested in Columbia’s Application Does Not Equate to Impermissible “Single-Issue Ratemaking.”

The Attorney General argues that the accounting authority requested in this case represents “single issue ratemaking,” which the Attorney General considers to be “inappropriate.”¹⁹ As explained above, the establishment of regulatory assets and liabilities is not an issue of first impression before the Commission, and the Commission has previously found that it has the authority to grant applications such as this, notwithstanding the Attorney General’s concerns about “single-issue ratemaking.”

Columbia’s Application does not represent “single-issue ratemaking,” contrary to the Attorney General’s contention. The Commission has defined single-issue ratemaking as, “focusing exclusively on one or more closely related items of revenue and expense, to the exclusion of all other items of revenue and expense.”²⁰ The policy behind the prohibition is based upon the impression that, “[o]ften times a change in one item of the revenue formula is offset by a corresponding change in another component of the formula.”²¹ In the instant Application no rates are being established – this is only a request to establish accounting. Any ratemaking will take place in Columbia’s next rate case.

Furthermore, in acting upon Columbia’s request for accounting authority, the Commission is not acting in a vacuum. The Commission recently reviewed Columbia’s revenue requirement in Case No. 2009-00141, and the Comments and Reply Comments being filed in this case

¹⁹ Attorney General Comments at 7.

²⁰ *In the Matter of: the Application of Louisville Gas and Electric Company for Approval of New Rate Tariffs Containing a Mechanism for the Pass Through of MISO-Related Revenues and Costs Not Already Included in Existing Base Rates; In the Matter of: the Application of Kentucky Utilities Company for Approval of New Rate Tariffs Containing a Mechanism for the Pass-Through of MISO-Related Revenues and Costs Not Already included in Existing Base Rates*, Case Nos. 2004-459, 2004-460, Order (December 22, 2004) at 5.

²¹ *In the Matter of: Big Rivers electric Corporation’s Proposed Mechanism to Credit Customers Amounts Recovered in Judicial Proceedings Involving Fuel Procurement Contracts*, Case No. 1994-00453, Order (February 21, 1997) at 7 (quoting *Bus. & Pro’l People for the Pub. Interest v. Illinois Comm. ’n*, 585 N.E.2d 1032 (Ill. 1991)).

are the result of an agreement among the parties to do so.²² The Commission need not consider this Application in isolation, but to the extent it feels the need to do so can administratively notice any revenue requirement information in Case No. 2009-00141 that the Commission deems relevant.

5. Columbia is Limiting its Request for the Authorization of a Regulatory Asset to the First Ten Months of 2009

While not addressed in the Attorney General’s Comments, the Commission has recently expressed concern about authorizing “open-ended” regulatory assets. In a series of cases involving damage to electric company facilities as a result of wind and ice storms, the Commission has authorized the creation of regulatory assets. In the first three of these cases the Commission stated that, “[t]he Commission would not be meeting its regulatory responsibilities if, under the circumstances of unusual or extraordinary storm damage costs, it were to authorize the creation of an ‘open-ended’ regulatory asset that did not limit the amount that could be included in the asset.”²³ In each of these cases, the Commission limited the regulatory asset to the level of storm damage repair expense estimated in the companies’ initial applications.

In two subsequent cases, the Commission again limited the regulatory asset to the level of storm damage repair expense estimated in the companies’ initial applications. In so doing, the Commission slightly modified its statement about “open-ended” deferrals and stated, “[t]he Commission would not be meeting its regulatory responsibilities if, under the circumstances of unusual or extraordinary storm damage costs, it authorized a utility to create an ‘open-ended’

²² *In the Matter of: the Application of Columbia Gas of Kentucky, Inc., for an Adjustment in Rates*, Case No. 2009-00141, Stipulation and Recommendation (September 14, 2009).

²³ *In the Matter of: Application of Louisville Gas and Electric Company for an Order Approving the Establishment of a Regulatory Asset*, PSC Case No. 2008-00456, Order (December 22, 2008); *In the Matter of: Application of Kentucky Utilities Company for an Order Approving the Establishment of a Regulatory Asset*, PSC Case No. 2008-00457, Order (December 22, 2007); *In the Matter of: Application of Duke Energy Kentucky, Inc. for an Order Approving the Establishment of a Regulatory Asset*, PSC Case No. 2008-00476, Order (January 7, 2009).

regulatory asset.”²⁴ While the Commission has expressed concern about the creation of regulatory assets that are open-ended as to amount, it appears that the Commission’s concern might now be broader – perhaps implying, for example, that the creation of regulatory assets should not be open-ended with respect to duration.

Given the Commission’s recent pronouncements about open-ended deferrals, and given that the Commission recently authorized Columbia to establish new rates in PSC Case No. 2009-00141, effective October 27, 2009, which rates are based upon more recent pension and OPEB expense levels, Columbia is now willing to limit its request for the establishment of a regulatory asset to recognize the extraordinary pension and OPEB expense levels for the first ten months of 2009. Columbia respectfully requests that it be allowed to defer, for possible future recovery, the difference between the pension and OPEB costs charged to O&M expense and the amounts collected in base rates from January 1, 2009 through the end of October 2009.

In its Application, Columbia had estimated that its actual pension and OPEB expenses for 2009 would exceed the amount of those expenses incorporated within base rates by \$1,208,103. As shown in the table below, due to the adverse market conditions described earlier in these Reply Comments, Columbia’s actual pension and OPEB expense for the first ten months (nine months actual, one month estimated) of 2009 is estimated to be \$956,638 more than the level of pension and OPEB included in Columbia’s base rates for that same period.

²⁴ *In the Matter of: Application of Kentucky Utilities Company for an Order Approving the Establishment of a Regulatory Asset*, PSC Case No. 2009-00174, Order (September 30, 2009); *In the Matter of: Application of Louisville Gas and Electric Company for an Order Approving the Establishment of a Regulatory Asset*, PSC Case No. 2009-00175, Order (September 30, 2009).

Columbia Gas of Kentucky, Inc.
Estimated Pension and OPEB Deferral
For the Ten Months Ending October 31, 2009

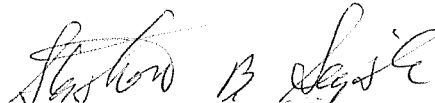
	2009 Pension			2009 OPEB (Includes Transition Obligation)			Total Deferral
	Expense	Rates	Deferral	Expense	Rates	Deferral	
<i>actual</i> January	\$ 136,918	\$ (1,317)	\$ 138,235	\$ 44,110	\$ 48,324	\$ (4,214)	\$ 134,021
<i>actual</i> February	\$ 54,549	\$ (1,317)	\$ 55,866	\$ 90,010	\$ 48,324	\$ 41,686	\$ 97,552
<i>actual</i> March	\$ 77,072	\$ (1,317)	\$ 78,389	\$ 64,450	\$ 48,324	\$ 16,126	\$ 94,515
<i>actual</i> April	\$ 77,372	\$ (1,317)	\$ 78,689	\$ 59,092	\$ 48,324	\$ 10,768	\$ 89,457
<i>actual</i> May	\$ 75,970	\$ (1,317)	\$ 77,287	\$ 58,889	\$ 48,324	\$ 10,565	\$ 87,852
<i>actual</i> June	\$ 74,882	\$ (1,317)	\$ 76,199	\$ 62,855	\$ 48,324	\$ 14,531	\$ 90,730
<i>actual</i> July	\$ 74,201	\$ (1,317)	\$ 75,518	\$ 59,516	\$ 48,324	\$ 11,192	\$ 86,710
<i>actual</i> August	\$ 77,277	\$ (1,317)	\$ 78,594	\$ 65,293	\$ 48,324	\$ 16,969	\$ 95,563
<i>actual</i> September	\$ 73,717	\$ (1,317)	\$ 75,034	\$ 63,409	\$ 48,324	\$ 15,085	\$ 90,119
<i>estimated</i> October	\$ 73,717	\$ (1,317)	\$ 75,034	\$ 63,409	\$ 48,324	\$ 15,085	\$ 90,119
YTD 10/09	\$ 795,675	\$ (13,170)	\$ 808,845	\$ 631,033	\$ 483,240	\$ 147,793	\$ 956,638

Columbia will limit its request for the establishment of a regulatory asset to this level of \$956,638. The actual amount deferred could be less once actual data for October is available. By limiting its request for the establishment of a regulatory asset to the first ten months of 2009 Columbia has eliminated any concern the Commission might have about the “open-endedness” of Columbia’s request – both as to amount and duration.

WHEREFORE, for the reason stated herein, Columbia respectfully requests that the Commission reject the Attorney General’s Comments and approve Columbia’s Application. Columbia respectfully renews its request for expedited Commission consideration of the Application before the end of 2009 so that Columbia’s books for calendar year 2009 will not have to reflect the extraordinary impact of the 2009 pension and OPEB expense levels addressed herein.

Respectfully submitted,

COLUMBIA GAS OF KENTUCKY, INC.

By: 
Stephen B. Seiple, Counsel of Record

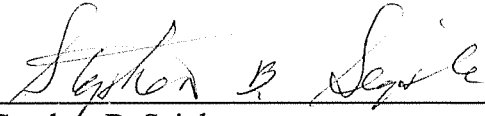
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Attorneys for
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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Reply Comments of Columbia Gas of Kentucky, Inc., was served upon all parties of record by regular U. S. mail this 30th day of October 2009.



Stephen B. Seiple
Attorney for
COLUMBIA GAS OF KENTUCKY INC.

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