COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF DUKE ENERGY KENTUCKY, INC. FOR AN ORDER APPROVING THE ESTABLISHMENT OF A REGULATORY ASSET OR LIABILITY ASSOCIATED WITH PENSION SETTLEMENT ACCOUNTING	)))))	CASE NO. 2019-00352

O R D E R

On September 26, 2019, Duke Energy Kentucky, Inc. (Duke Kentucky) filed an application seeking authority to (1) establish regulatory assets and liabilities for the deferral of any income statement recognition of gains or losses realized from the settlement of defined benefit pension plan obligations and (2) amortize those regulatory assets or liabilities over the average remaining service period of the pension plan participants. Duke Kentucky stated that this proposal will allow it to avoid financial statement impacts that are lumpy, irrational, and not aligned with current rates and to treat all aspects of its pension plan accounting in a similar fashion.

The procedural schedule established for this case allowed for discovery. There are no intervenors. Duke Kentucky responded to two requests for information from Commission Staff. The record is now complete and the Commission will decide this case based on the evidence of record without a hearing.

BACKGROUND

In December 1982, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 71, Accounting for the Effects of Certain Types of Regulation, which was codified as Accounting Standards Codification (ASC) 980, Regulated Operations. ASC 980-340-25-1 provides the criteria for recognition of a regulatory asset.[1] Supplemental to the requirements of ASC 980, Commission precedent obligates Duke Kentucky to obtain approval prior to establishing a regulatory asset.[2] 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.[3]

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[1] ASC 980-340-25-1 provides, in full, as follows:

> **25-1** 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.

[2] Application at 7.

[3] 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.

In December 1985, the FASB issued SFAS No. 87, Employers' Accounting for Pensions, which was codified as ASC 715, Compensation – Retirement Benefits. ASC 715-30-35-24 provides the criteria for the minimum amortization of gains or losses, which result from changes in value of either the benefit obligation or the plan assets, included in accumulated other comprehensive income.[4]

In September 2006, the FASB issued SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, which was codified as ASC 715, Compensation – Retirement Benefits. ASC 715-30-35-79 through 35-83 provide the criteria for the maximum gain or loss realized from the settlement of defined benefit pension plan obligations (Pension Settlement Accounting). If the settlements are greater than the combined service cost and interest cost components of net periodic pension cost for the pension plan for the year, Pension Settlement Accounting requires income statement recognition of the pro rata portion of accumulated gains or losses equal to the percentage reduction in the projected benefit obligation.[5]

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[4] ASC 715-30-35-24 provides, in full, as follows:

> **35-24** As a minimum, amortization of a net gain or loss included in accumulated other comprehensive income (excluding asset gains and losses not yet reflected in market-related value) shall be included as a component of net pension cost for a year if, as of the beginning of the year, that net gain or loss exceeds 10 percent of the greater of the projected benefit obligation of the market-related value of plan assets. If amortization is required, the minimum amortization shall be that excess divided by the average remaining service period of active employees expected to receive benefits under the plan. The amortization must always reduce the beginning-of-the-year balance. Amortization of the net gain results in a decrease in net periodic pension cost; amortization of a net loss results in an increase in net periodic pension cost. If all or almost all of a plan's participants are inactive, the average remaining life expectancy of the inactive participants shall be used instead of average remaining service.

[5] Service cost is the actuarial present value of benefits attributed by the plan's benefit formula to services rendered by employees during the period. Interest cost is interest on the discounted projected benefit obligation at rates equal to the assumed discount rate. *See* ASC 715-30-34-6 and 34-8, respectively.

Pursuant to KRS 278.220, the Commission has established uniform systems of accounts for electric and gas companies that conform to the systems adopted by the Federal Energy Regulatory Commission (FERC USoA).[6] The FERC USoA do not provide implementation guidance for the accounting and reporting requirements of SFAS No. 158; however, the FERC issued accounting guidance on the adoption of the new standards.[7] The FERC USoA incorporate the requirements of SFAS No. 71.

DUKE KENTUCKY'S PROPOSAL

Duke Kentucky asserts that, in 2018, Duke Energy Corporation (Duke Energy) and its subsidiaries, including Duke Kentucky, undertook efforts to significantly reduce the number of employees for both the service company and the gas and electric operations.[8] Additionally, Duke Kentucky claims that many of those employees chose to take lump sum settlements from the pension plan in 2019, which resulted in Duke Energy triggering Pension Settlement Accounting for the first time and booking settlement accounting entries for the second quarter of 2019.[9] Duke Kentucky also anticipates recognizing future settlement charges because Duke Energy has closed its pension plans to new employees, which means the threshold amounts for triggering Pension Settlement

[6] Codified as 18 CFR Part 101, *Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to the Provisions of the Federal Power Act* (2006) and 18 CFR Part 201, *Uniform System of Accounts Prescribed for Natural Gas Companies Subject to the Provisions of the Natural Gas Act* (2006), respectively.

[7] FERC Docket No. AI107-1-000. *See* Duke Kentucky's response to Commission Staff's First Request for Information (Staff's First Request), Item 11.

[8] Application, page 4. Approximately 1,900 in total workforce reduction was achieved across Duke Energy.

[9] *Id. See also* Duke Kentucky's response to Staff's First Request, Item 4(f). Duke Kentucky proposes to include in the requested regulatory asset/liability, actual settlement charges of $243,841 and $78,087 that were recorded for the second quarter of 2019 and the third quarter of 2019, respectively.

Accounting will continue to decrease in the future.[10] Therefore, Duke Kentucky requests authority to establish regulatory assets for the settled portions of the gains or losses and to amortize them over the average remaining service period of the pension plan participants.[11] Duke Kentucky proposes that this treatment be granted for the Pension Settlement Accounting triggered in 2019 and any future Pension Settlement Accounting triggered.[12]

Duke Kentucky further claims that its request to establish a regulatory asset for Pension Settlement Accounting constitutes both "an expense resulting from a statutory or administrative directive" and "an extraordinary or nonrecurring expense that over time will result in a savings that fully offsets the cost."[13] Duke Kentucky asserts these expenses qualify as a result of a statutory directive because the triggering of pension settlement accounting and resultant recording of accounting journal entries stems from the application of prescriptive Generally Accepted Accounting Principles (GAAP) guidance contained in ASC Topic 715-30-55-166 through 168.[14] Duke Kentucky further asserts that settlement charges resulting from the triggering of Pension Settlement Accounting were attributable to Duke Energy's cost-saving initiatives, which, over time, will offset the costs incurred.[15] Duke Kentucky states that because it believes the deferral authority is

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[10] Application at 5.

[11] *Id*.

[12] *Id.* at 6.

[13] *Id*. at 8.

[14] Duke Kentucky's response to Commission Staff's Second Request for Information (Staff's Second Request), Item 2.

[15] Application at 8.

probable, it has recorded the settlement charges temporarily to Account 186, Other Deferred Debits.[16]

Duke Kentucky claims that it only seeks to defer expenses that are not currently included in base rates.[17] Duke Kentucky argues that its request will simply enable it to record all Pension Settlement Accounting impacts in the same manner as if the Pension Settlement Accounting had not been triggered.[18] Duke Kentucky states that it already has deferral authority for all other aspects of its pension plan accounting and this request is to keep the treatment of Pension Settlement Accounting consistent with all other aspects of its pension plan accounting.[19]

DISCUSSION

The requested relief is unavailable under ASC 980 and the expenses that Duke Kentucky seeks to defer are outside the categories previously approved for regulatory asset treatment. While Duke Kentucky is only precluded by Commission precedent from recognizing a regulatory asset without prior approval, the requirement that Duke Kentucky obtain Commission approval to amortize a regulatory asset is inherent to the criteria of ASC 980. Duke Kentucky proposes to begin amortizing the requested regulatory asset in the month subsequent to deferral, and acknowledges that, under its proposal, the regulatory assets or liabilities would be amortized even if that amortization was not reflected in rates.[20]

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[16] Application at 9.

[17] *Id*. at 5.

[18] *Id*. at 6.

[19] *Id.*

[20] Duke Kentucky's response to Staff's First Request, Items 10 and 13(b).

Duke Kentucky's request to amortize the proposed regulatory assets without rate recovery 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." Under Duke Kentucky's proposal, it is not probable that Duke Kentucky 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.[21] Based on Duke Kentucky's request to amortize the proposed regulatory assets without concurrent rate recovery, Duke Kentucky does not request regulatory asset treatment for the purpose of future recovery of a current expense.

Even if Duke Kentucky's request for regulatory treatment were consistent with the requirements of ASC 980-340-25-1 with respect to the likelihood of future recovery, that standard and Commission precedent recognize that a utility's authority to record an expense as a regulatory asset is dependent on the Commission's approval of such treatment. Duke Kentucky asserts in its application that regulatory asset treatment is appropriate for the expenses triggered by Pension Settlement Accounting, because those expenses are the result of a statutory or administrative directive and, alternatively, because they are extraordinary or nonrecurring and over time will result in a savings that fully offset the cost. However, the Commission finds that Duke Kentucky has not

[21] While it may be appropriate to obtain a regulatory asset for less than the full amount of an incurred expense (i.e., a portion of the expense is not included in the regulatory asset and would be expensed in the year incurred), it is inappropriate to defer expenses when the utility has predetermined that it will not seek rate recovery of some portion of the regulatory asset. This Order should not be interpreted as prohibiting deferrals that are less than the incurred expense, only as prohibiting deferrals for a greater amount than could be included in future rates.

established that the expenses at issue fit within a category of expense for which regulatory asset treatment is appropriate or justify divergence from those categories.

Duke Kentucky contends that the Pension Settlement Accounting charges result from a statutory or administrative directive and identified GAAP as the statutory directive.[22] Duke Kentucky asserts that GAAP qualifies as a statutory directive because the prescriptive guidance is codified, and failure to follow such guidance could result in material misstatement of its financial statements or a qualified audit opinion.[23] However, an expense resulting from a statutory or administrative directive is incurred in pursuit of complying with those directives.[24] Duke Kentucky admits that Pension Settlement Accounting does not change the cost of the pension plan over the life of the plan but simply accelerates the recognition of the gain or loss.[25] Further, if an accounting standard or system of accounts that requires expensing a particular cost were a statutory or administrative directive that justified the treatment of that expense as a regulatory asset, then essentially any expense could fit within that standard, which would be unreasonable. Thus, the Commission finds that Duke Kentucky has failed to establish that the expenses at issue result from a statutory or administrative directive in a manner that justifies regulatory asset treatment.

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[22] Application at 8 and Duke Kentucky's response to Staff's First Request, Item 12(f).

[23] Duke Kentucky's response to Staff's Second Request, Item 2.

[24] *See* Case No. 2008-00308, *Joint Application of Duke Energy Kentucky, Inc., Kentucky Power Company, Kentucky Utilities Company and Louisville Gas and Electric Company for an Order Approving Accounting Practices to Establish Regulatory Assets and Liabilities Related to Certain Payments Made to the Carbon Management Research Group and the Kentucky Consortium for Carbon Storage* (Ky. PSC Oct. 30, 2008).

[25] Application at 8.

Duke Kentucky next argues that the pension settlement expenses should be treated as a regulatory asset because the expenses are extraordinary or nonrecurring and will result in savings over time that fully offset the cost.[26] The rationale for treating an expense that will result in future savings that fully offset the cost as a regulatory asset is that such treatment will result in better matching of costs and benefits because the savings derived from the expenditures will be in effect during the subsequent recovery of deferred expenses.[27] However, in this case, Duke Kentucky simply contends that the deferred expense will equal the amount of the regulatory asset and not result in actual, direct cost savings that will offset the expense.[28] Furthermore, Duke Kentucky has historically over-recovered its total pension costs for both electric and gas operations.[29] Thus, the Commission finds that Duke Kentucky has failed to establish that the expenses at issue are extraordinary or nonrecurring expenses that will result in future cost savings that fully offset the cost.

In an attempt to expand the categories of expense that may appropriately be granted regulatory asset treatment, Duke Kentucky also asserts that its request to record Pension Settlement Accounting charges as a regulatory asset and to amortize that asset

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[26] *See* Application at 8. ("The settlement charge resulting from the triggering of Pension Settlement Accounting was attributable to the Company's cost savings initiatives in reducing employee headcount, namely lump sum payments from the existing pension plans, which over time, will offset the costs incurred. Pension Settlement Accounting does not change the cost of the pension plan over the life of the plan, but accelerates the recognition of the gains/losses. The cost savings are derived from reducing headcount, but the pension costs remains unchanged.").

[27] *See* Case No. 2015-00141, *Request of Kenergy Corp. for Approval to Establish a Regulatory Asset in the Amount of $3,884,717 Amortized Over a Ten (10) Year Period* (Ky. PSC Aug. 31, 2015).

[28] Duke Kentucky's responses to Staff's First Request, Items 4(f), 12(d), and 16. S*ee also* Duke Kentucky's response to Staff's First Request, Item 12 (Duke Kentucky indicated that costs savings associated with the settlement payments would have been reflected in rates but was unable to identify any such cost savings).

[29] *Id.*, Item 3(a).

was "made to avoid recognition of expense or income impacts to its financial statements that are lumpy and irrational, and are not aligned with current rates."[30] However, expenses may be levelized in rates without creating a regulatory asset,[31] and in this case, the projected Pension Settlement Accounting expenses are not significant and will decrease over time,[32] so that if levelizing expenses justifies the creation of a regulatory asset in this case then there would be few cases where such treatment would not be justified. Thus, the Commission finds that Duke Kentucky's intention to levelize expenses does not support granting Duke Kentucky's request for a regulatory asset in this case.

CONCLUSION

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that Duke Kentucky's request to establish regulatory assets and liabilities for the deferral of any income statement recognition of gains or losses realized from the settlement of defined benefit pension plan obligations and to amortize those regulatory assets should be denied.

IT IS THEREFORE ORDERED that:

1. Duke Kentucky's request for authorization to establish regulatory assets and liabilities for the deferral of any income statement recognition of gains or losses

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[30] *Id.*, Item 16.

[31] *See* Case No. 2017-00321, *Electronic Application of Duke Energy Kentucky, Inc. for an Adjustment of the Electric Rates* (Ky. PSC Oct. 2, 2018), final Order, pages 3 – 4 (using a 4-year average to levelize vegetation management expense included in rates).

[32] *See* Application at 5 (indicating pension settlement costs in 2019 of $406,414 for Duke Energy Kentucky); Duke Kentucky's responses to Staff's First Request, Item 6(c) (indicating projected Pension Settlement Accounting costs for Duke Kentucky in 2021, 2022, 2023, and 2024 of $757,716, $593,903, $485,854, and $424,299 respectively).

realized from the settlement of defined benefit pension plan obligations and to amortize those regulatory assets is denied.

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

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By the Commission

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KENTUCKY PUBLIC SERVICE COMMISSION

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