

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE JOINT PETITION OF KENTUCKY POWER)
COMPANY, KENTUCKY UTILITIES COMPANY,)
LOUISVILLE GAS AND ELECTRIC COMPANY, AND)
UNION LIGHT, HEAT AND POWER COMPANY FOR) CASE NO.
CERTAIN ACCOUNTING AND RATEMAKING) 92-043
AUTHORITY ASSOCIATED WITH THE IMPL-)
MENTATION OF STATEMENT OF FINANCIAL)
ACCOUNTING STANDARDS NO. 106)

O R D E R

On July 17, 1992, the Commission issued an Order granting a joint petition for reconsideration filed by Kentucky Power Company, Kentucky Utilities Company, Louisville Gas and Electric Company, The Union Light, Heat and Power Company, Western Kentucky Gas Company, and Kentucky-American Water Company ("Petitioners"). Reconsideration was granted to afford the Petitioners an opportunity to present testimony and evidence on the financial impact of the Commission's June 8, 1992 Order denying certain accounting and rate-making relief related to the Petitioners' implementation of Statement of Financial Accounting Standards No. 106 ("SFAS 106"). Testimony was submitted by the Petitioners, Kentucky Industrial Utility Customers ("KIUC"), and the Attorney General's office, Utility and Rate Intervention Division ("AG"). A hearing was held at the Commission's offices on September 29, 1992, and briefs were filed on November 2, 1992.

The Petitioners have requested that the Commission by Order:

- 1) Confirm the adoption of accrual accounting for Other Post-

Employment Benefits ("OPEB") costs for regulatory purposes; 2) Authorize as a regulatory asset a temporary cost deferral that addresses any regulatory lag; and 3) Authorize the amortization of the transition obligation created by this accounting change.

In its decision of June 8, 1992, the Commission found that the relief requested by the Petitioners should be denied without prejudice to their rights to seek such relief individually by filing a rate application. In that Order, the Commission found that accounting changes have been adopted by utilities in the past without any prior formal approval by the Commission and explained that:

To decide in this case that the Petitioners will be entitled to future rate recovery of the deferred cost, the Commission would have to address all of the rate-making issues surrounding the SFAS 106 costs. This would require an investigation of the unique facts and circumstances applicable to each of the Petitioners in order to determine the reasonableness of implementing SFAS 106, as well as the reasonableness of the benefit levels provided by each Petitioner and the cost of implementation. The Commission's ultimate decision must be based upon the justification presented by each petitioner and, thus, the decision may differ among the Petitioners.¹

The request of the Petitioners involves two primary issues. The first issue involves the adoption of SFAS 106 for regulatory purposes. The second issue involves the creation of a regulatory asset.

Adoption of SFAS 106

Witnesses for the Petitioners included a CPA and partner in the firm of Arthur Andersen & Company, and an actuary and president

¹ June 8, 1992 Order, pages 3 and 4.

of Chicago Consulting Actuaries. The witnesses presented testimony on behalf of the Petitioners which generally discussed the accounting and actuarial aspects of implementing SFAS 106. The Petitioners are seeking approval of the principle that they will be allowed to include in costs of service reasonable and necessary SFAS 106 costs, including amounts temporarily recorded as regulatory assets.² The Petitioners presented exhibits³ to illustrate the estimated revenue requirements impact of SFAS 106 expense on three of the Petitioners under various hypothetical rate-making scenarios. The Petitioners stated in the prepared testimony that issues involving funding, measurement assumptions and benefit levels should not be addressed within the context of this proceeding but rather that a general rate case would be the most appropriate proceeding in which to address such issues on a utility-by-utility basis.⁴

Testimony was also presented by the Petitioners on the need to temporarily record as a regulatory asset the difference between OPEB expense on an accrual basis and OPEB expense on a cash basis. They alleged that without deferral of these incremental costs, they will not recover a reasonable and necessary cost of providing utility services.⁵ The Petitioners also discussed the theory and

² Direct Testimony of Benjamin McKnight, pages 6 & 7.

³ *Id.*, Exhibit 1, pages 1, 2 & 3 of 3.

⁴ *Id.*, page 26.

⁵ *Id.*, pages 19 & 20.

objectives underlying SFAS 106.⁶ Testimony was also presented on the cost calculation mechanics from an actuarial perspective.⁷

It is the position of KIUC that SFAS 106 is simply an accounting change that results in a timing difference between the incurrence of the expense and the actual payment for the expense and that, over time, all reasonable expenses will be recovered by the utility. For this reason, KIUC believes that the current Pay As You Go ("PAYGO") methodology should be maintained for rate-making purposes.⁸ KIUC argues that maintaining this methodology avoids the doubling up of cost and the attendant intergenerational inequities associated with accrual accounting for OPEB costs.⁹ KIUC also argues that the underlying actuarial assumptions are uncertain by nature, speculative and subject to manipulation¹⁰ and that adoption of SFAS 106 for regulatory purposes will provide a disincentive to the utilities to control OPEB costs whereas the marketplace in the competitive environment is forcing other industries to contain and reduce OPEB costs.¹¹

It is the position of the AG that OPEB costs should continue to be accounted for under the current practice of PAYGO for several reasons. First, the AG argues that market forces will sharply

⁶ Direct Testimony of Thomas Terry, page 6.

⁷ Id., page 6.

⁸ Id., page 20.

⁹ Id., page 23.

¹⁰ Id., page 21.

¹¹ Id., page 24.

limit if not preclude price increases for competitive unregulated industries to recover the increased cost of OPEBs; and that public utilities suffer none of the effects of market forces but instead rely on the regulators to substitute for the market.¹² The second point raised by the AG is that if pre-approval of SFAS 106 expenses is granted by regulators, public utilities will have no incentive to contain costs.¹³ Thirdly, the AG argues that the PAYGO methodology is verifiable whereas the accrual methodology is based on estimates and subject to manipulation.¹⁴ Finally, the AG reiterates the position taken by KIUC in pointing out that SFAS 106 is only an accounting change that creates a timing difference for this (the OPEB) expense item and that continuance of the PAYGO methodology gives the utilities recovery of their OPEBs so long as the expenses are prudent and reasonable.¹⁵

The Commission, having considered the evidence of record, finds that although the reconsideration was granted for the specific purpose of considering the financial impact of SFAS 106 costs on the Petitioners' respective operations, the Petitioners' witnesses presented no direct testimony on this issue. In addition, none of the Petitioners sponsored a company witness to discuss the specific effect of SFAS 106 on their respective operations, although some information relating to the annual cost

¹² Brief of the AG, page 1.

¹³ Id., page 2.

¹⁴ Id., pages 3 and 4.

¹⁵ Id., pages 7, 8 and 9.

of the accounting change and the overall impact on earnings was provided for some of but not all of the Petitioners in response to Commission and Intervenor data requests. The Petitioners have not presented persuasive evidence that the failure to grant the relief requested would result in financial impairment. The Commission affirms its previous decision that the adoption of SFAS 106 should be considered on a case-by-case basis in the context of a general rate case and reaffirms that the Petitioners do not need prior approval to adopt SFAS 106 for accounting purposes.

Creation of a Regulatory Asset

Petitioners request approval to create a regulatory asset¹⁶ to temporarily record the incremental OPEB costs until new rates are established in individual rate cases for each Petitioner. They argue that without the creation of the regulatory asset, their earnings will be decreased and their ability to attract capital weakened.¹⁷ Petitioners argue further that they will not recover their reasonable SFAS 106 costs because of a time-lag, commonly known as "regulatory lag," between implementation of SFAS 106 for financial reporting purposes and the inclusion of SFAS 106 expense levels in rates.

Petitioners contend that in their next rate case, the Commission will have the opportunity to decide whether the decision

¹⁶ Statement of Financial Accounting Standards No. 71 ("SFAS 71") provides for the creation of a regulatory asset by a regulated enterprise if it is probable that recovery of the asset will ultimately be included in the regulated entity's rates.

¹⁷ Brief of Joint Petitioners, page 3.

by the utility to record a regulatory asset was reasonable, considering all of the circumstances, including each Petitioner's earnings. KIUC states that allowing the Petitioners to record such regulatory assets would actually reduce future Commission's options because the authorization of the deferral amounts to a regulatory promise.¹⁸

The position of the AG is that a regulatory asset can only be utilized if this Commission gives assurance of future recovery of all OPEBs and that such assurances cannot be provided until the future expense levels are known.¹⁹ The AG states that the pre-approval requested by the utilities, if granted, would not be reversible later no matter what the circumstances and would be tantamount to issuing the utilities a blank check for OPEB costs. The AG further argues that if these costs were challenged in the future, utility screams of retroactive rate-making would be invoked.²⁰

KIUC argues that the Petitioners have not proven that the Commission's refusal to create a regulatory asset will cause Petitioners' earnings to drop below a just and reasonable level.²¹ KIUC claims that, for at least three of the Petitioners, actual rates of return are sufficiently high, given today's economic climate, that denial of the request would not reduce their earnings

¹⁸ Main Brief of KIUC, page 17.

¹⁹ Brief of AG, page 15.

²⁰ Id., page 15.

²¹ Main Brief of KIUC, page 18.

below a just and reasonable level even after recognition of the SFAS 106 accrual level of expense.²²

While the Commission ruled in the June 8, 1992 Order that the accounting for OPEB costs under SFAS 106 would not require Commission approval, the Commission also ruled that whether the costs would be includable for rate-making purposes would have to be decided based upon the justification presented by each Petitioner in its rate proceeding, and, thus, the decision might differ among the Petitioners. The failure of Petitioners to file applications for rates to recover the increased OPEB costs does not by itself constitute a basis for future recovery of so-called "unrecovered" costs. Without the detailed financial information that would be provided in a general rate case, the Commission cannot determine whether the costs are or are not being recovered.

Petitioners have had adequate time since the issuance of SFAS 106 to file formal rate proceedings to seek recovery of the SFAS 106 level of expense in rates prior to the implementation date of January 1, 1993. There appears no justification in this proceeding to establish on a generic basis a regulatory asset for any of the SFAS 106 costs. There is some evidence to suggest that at least three of the utilities have the ability to absorb the increased costs. With respect to three other Petitioners, the evidence is too thin to draw any inferences on the impact of any increased costs. However, if any of the utilities elects to create a

²² Id., page 11.

regulatory asset, the Commission will certainly consider the need for recovery of the deferred costs in future rate cases.

On December 11, 1992, the Petitioners filed a motion to supplement the record with recently issued minutes of the Emerging Issues Task Force of the Financial Accounting Standards Board. The minutes set forth numerous tentative conclusions regarding the appropriate circumstances for a rate regulated enterprise to recognize as a regulatory asset the incremental OPEB costs. The Commission will allow the record to be supplemented at this late date. The minutes are only tentative conclusions and, in any event, not binding on the Commission for either accounting or rate-making purposes.

For all of the above reasons, the Commission finds that the June 8, 1992 Order in this proceeding should be affirmed.

Also pending before the Commission is KIUC's motion to strike the document entitled "Executive Summary" which was filed on November 2, 1992. KIUC alleges, in two interrelated arguments, that the "Executive Summary" was prepared by the Petitioners after they received the briefs of KIUC and the AG, thus rendering the "Executive Summary" to be a reply brief which was not authorized by the Commission's briefing schedule. Kentucky Power Company ("Kentucky Power") responded to KIUC's motion by stating that: 1) the "Executive Summary" was not prepared by the Petitioners but, as indicated in the document, by Kentucky Power individually; 2) the filing of separate briefs by Petitioners was discussed without objection at the September 29, 1992 hearing; and 3) the "Executive

"Summary" was prepared prior to receipt of other parties' briefs and, therefore, is not a reply brief.

The Commission finds no merit in KIUC's motion. The issue of Petitioners filing separate briefs was discussed at the hearing and is consistent with the established briefing schedule. There is no evidence that Kentucky Power's "Executive Summary," which was timely filed, was prepared after the receipt of KIUC's or the AG's briefs.

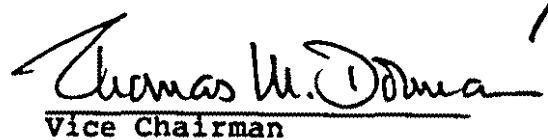
IT IS THEREFORE ORDERED that:

1. Petitioners' motion to supplement the record be and it hereby is granted.
2. KIUC's motion to dismiss Kentucky Power's "Executive Summary" brief be and it hereby is denied.
3. The Commission's June 8, 1992 Order denying the Petitioners' relief without prejudice be and it hereby is affirmed in all respects.

Done at Frankfort, Kentucky, this 17th day of December, 1992.

PUBLIC SERVICE COMMISSION


G. E. D. Davis
Chairman


Thomas M. Danna
Vice Chairman


Robert M. Davis
Commissioner

ATTEST:



Don Mills
Executive Director