

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

Application Of Kentucky Power Company For An)	
Order Approving Accounting Practices To Establish)	
Regulatory Assets And Liabilities Related To The)	Case No. 2016-00180
Extraordinary Expenses Incurred By Kentucky Power)	
In Connection With Two 2015 Major Storm Events)	

Motion For Partial Rehearing Of The Commission's
November 3, 2016 Order

Kentucky Power Company respectfully moves the Public Service Commission of Kentucky pursuant to KRS 278.400 for rehearing of the Commission's November 3, 2016 Order.¹ Kentucky Power seeks rehearing of that portion of the Commission's Order prohibiting Kentucky Power, and all other jurisdictional utilities, from recording regulatory assets on their books for accounting purposes prior to the receipt of a Commission order approving the action. Specifically, Kentucky Power requests that the Commission amend the *2016 Deferral Order* to permit jurisdictional utilities to defer, consistent with Financial Accounting Standards Board Accounting Standards Codification ("FASB Codification" or "ASC") 980-340-25-1, Major Event storm and other extraordinary expenses for subsequent Commission review and approval.

FASB Codification 980-340-25-1 imposes a duty on utility management to exercise its independent judgment to determine when the requirements of the accounting standard are satisfied and the expense is probable of later recovery, subject to final determination by the

¹ Order, *In the Matter of: Application Of Kentucky Power Company For An Order Approving Accounting Practices To Establish Regulatory Assets And Liabilities Related To The Extraordinary Expenses Incurred By Kentucky Power In Connection With Two 2015 Major Storm Events*, Case No. 2016-00180 (Ky. P.S.C. November 3, 2016) ("*2016 Deferral Order.*") [**EXHIBIT 1** .]

Commission. The requested relief would not impose any limitation on the Commission's ability to review the deferral, or the creation of the corresponding regulatory asset; nor does it limit the Commission's authority to consider the ratemaking treatment, if any, to be accorded the regulatory asset in a future base rate case.

Kentucky Power acknowledges the Commission's plenary jurisdiction over utilities pursuant to KRS 278.040, as well as its authority pursuant to KRS 278.220 to establish a system of accounts for jurisdictional utilities. Nevertheless, the Commission erred by imposing a "bright-line rule" that could distort utility financial statements, and would result in arbitrary outcomes based upon the period between the date of a storm and the closing of the Company's financial statements.

Kentucky Power seeks rehearing of the *2016 Deferral Order* to permit the development of a further record and to provide an opportunity for the Commission to re-examine its "bright-line rule" affecting an entire industry.

BACKGROUND

A. Major Event Storm Expenses.

1. The Nature Of Major Storm Events And Expenses.

Requiring utilities to receive Commission authorization prior to deferring an expense and creating a regulatory asset, even when management believes, as contemplated by FASB Codification 980-340-25-1, that the expense is otherwise probable of recovery, is particularly problematic in the case of Major Event storm costs. Unlike other expenses eligible for deferral, such as the establishment of voluntary severance plans or office consolidation initiatives,² utilities may be unable to file applications seeking the requisite Commission authorization for

² See Order, *In the Matter of: Application of Duke Energy Kentucky, Inc. For An Order Approving The Establishment Of A Regulatory Asset Related To The Voluntary Opportunity And Other Post-Retirement Expenses*, Case No. 2010-00523 (Ky. P.S.C. July 14, 2014).

Major Event storm expenses in time to permit the Commission to review the application and issue its order prior to the end of the utility's fiscal year.³

First, and most importantly, a utility has no control over the timing of Major Event storms⁴ or their consequent remediation efforts. Indeed, the statistical definition of a Major Event storm limits such events to storms that exceed those a system is designed to minimize.⁵ A utility's inability to time its Major Event storm expenditures increases the likelihood that the company will be unable to secure Commission approval prior to the closing of its financial statements, and thus its ability under Commission precedent⁶ to defer the expenses and establish a regulatory asset, notwithstanding the best efforts and diligence of the Commission and the utility alike.

Second, the requirement that an application seeking to defer Major Event Storm expenses and establish a corresponding regulatory asset include only those expenses in excess of base rate amounts exacerbates the likelihood the "clock will expire"⁷ before the Commission can consider and act on an application. Certainly, it will skew any such application toward the end of the

³ See e.g., *In the Matter of: Application of Kentucky Power Company For An Order Approving Accounting Practices To Establish Regulatory Assets And Liabilities Related To Extraordinary Expenses Incurred By Kentucky Power Company In Connection With Four Major Storm Events*, Case No. 2012-00445 at 5-6 (Ky. P. S.C. January 7, 2013) (*2012 Deferral Order*) (denying Company's December 21, 2012 application to amend its application to include Major Event storm expenses incurred in connection with an October 29, 2012 storm because the Commission lacked sufficient time "to review and process the amended request" prior to the date required by Kentucky Power to book the expenses or deferral in connection with its 2012 financial statements.)

⁴ See generally, William Sidney Porter, *The Complete Edition of O. Henry* (2005) ("We may achieve climate but weather is thrust upon us.")

⁵ See e.g. Cheryl A. Warren, *IEEE 1366 And Regulatory Implications* at 12, SEE Conference (June 29, 2006), <http://grouper.ieee.org/groups/td/dist/sd/doc/2006-07-IEEE1366-Regulatory-Implications.pdf> (last accessed November 11, 2016).

⁶ See e.g. *2016 Deferral Order* at 7 (denying authorization to create a regulatory asset with respect to 2015 Major Event storm costs that were expensed in 2015 and that subsequently were deferred in 2016); Order, *In the Matter of: Application of Duke Energy Kentucky, Inc. For An Order Approving The Establishment Of A Regulatory Asset Related To The Voluntary Opportunity And Other Post-Retirement Expenses*, Case No. 2010-00523 at 6 (Ky. P.S.C. July 14, 2011) ("there is no basis for establishing a regulatory asset in 2011 for costs which were booked as expenses in 2010....")

⁷ *Id.*

utility's fiscal year. As a result, the expenses most likely to qualify for deferral are at an increased risk of exclusion under the *2016 Deferral Order*.

Third, because outages resulting from Major Storm Events can imperil the health, welfare, and safety of the Company customers “a crisis mode of operation is required to respond.”⁸ Storm restoration efforts thus oftentimes require “extraordinary efforts.”⁹ To meet these demands, utilities deploy outside resources, including those outside the state, in meeting their obligations to restore service to their customers promptly and safely. For example, in connection with the July 2015 thunderstorms Kentucky Power employed the resources of 22 outside contractors from 13 states including Kentucky.¹⁰ Outside vendor invoices were received over a five-month period.

Although Kentucky Power estimates total Major Event storm costs prior to receipt of vendor invoices,¹¹ its estimates of the operation and maintenance expense component of the total Major Event storm – and hence the amount to be deferred – will vary from the actual values determined following receipt of all invoices. Because these estimates can serve as a “cap” on the total deferral authorized by the Commission,¹² the need to employ outside contractors may result in differing treatment of the operation and maintenance expenses of the same Major Event storm. Those expenses that exceed the “cap” are required to be expensed, while the remaining expenses

⁸ See e.g. Cheryl A. Warren, *IEEE 1366 And Regulatory Implications* at 13, SEE Conference (June 29, 2006), <http://grouper.ieee.org/groups/td/dist/sd/doc/2006-07-IEEE1366-Regulatory-Implications.pdf> (last accessed November 11, 2016).

⁹ Order, *Petition of Duke Energy Indiana, Inc. For Approval Of Authority For Deferred Accounting Treatment For Operating Expenses Associated With The Restoration Of Extensive System Damage From The January 27, 2009 Ice Storm*, Case No. 43743 at 11 (Ind. Util. Reg. Com'n. July 14, 2010) [**Exhibit 2.**]

¹⁰ Contractor crews traveled from West Virginia, Virginia, Alabama, Michigan, Ohio, Illinois, Indiana, North Carolina, Pennsylvania, South Carolina, Texas, and Louisiana to support the Company's restoration efforts.

¹¹ See *infra* at 6.

¹² Order, *In the Matter of: Application Of Louisville Gas And Electric Company For The Establishment Of A Regulatory Asset*, Case No. 2011-00380 at 5 (Ky. P.S.C. December 27, 2011).

are deferred and eligible for recovery, if subsequently approved by the Commission, in future rates.¹³

Fourth, the extraordinary restoration efforts required by Major Event storms carry with them an extraordinary price tag:

The issues in this case demonstrate the financial risk that storm events can present to investor owned public utilities, which have an obligation to provide reasonable and adequate service to customers in their monopoly service territory. In many such instances, fulfillment of this obligation during and following storm events can only be met by extraordinary efforts that oftentimes come at an extraordinary expense.¹⁴

These storm restoration expenses, in turn, can have “a significant impact on ... [a utility’s] financial results, depending on the accounting treatment they are afforded.”¹⁵ Thus, Major Event storm expenses, if not properly accounted for, can distort a utility’s financial statements.

2. Accounting For Major Event Storm Operation and Maintenance Expenses.

During a Major Event storm Kentucky Power compiles data that enable it to estimate the total costs associated with the storm. Based on the type of Major Event storm, for example ice, wind, or thunderstorm, and the Company’s historical experience with the particular type of storm, Kentucky Power estimates the “splits” among capital, retirement, and operation and maintenance expense¹⁶ amounts included in the total cost. The Company adjusts the “splits”

¹³ *Id.*

¹⁴ Order, *Petition of Duke Energy Indiana, Inc. For Approval Of Authority For Deferred Accounting Treatment For Operating Expenses Associated With The Restoration Of Extensive System Damage From The January 27, 2009 Ice Storm*, Case No. 43743 at 11 (Ind. Util. Reg. Com’n. July 14, 2010).

¹⁵ *In the Matter of: Application Of Duke Energy Kentucky, Inc. For An Order Approving The Establishment Of A Regulatory Asset*, Case No. 2008-00476 at 3 (Ky. P.S.C. January 7, 2009); *See also, In the Matter of: Application Of Louisville Gas And Electric Company For An Order Approving The Establishment Of A Regulatory Asset*, Case No. 2011-00380 at 4 (Ky. P.S.C. December 27, 2011).

¹⁶ The operation and maintenance expense is the difference between the total Major Event storm costs and the sum of the capital and retirement costs.

after receipt of all invoices and work orders. It can require four to six months to receive invoices from outside vendors and complete the process of determining the actual amounts to be booked. Although the estimated “splits” made based upon data gathered during the course of storm and the Company’s experience with the type of storm are reasonable, the actual operation and maintenance expense will vary from the estimate.

B. This Proceeding.

Kentucky Power filed its application on May 31, 2016 seeking to create a regulatory asset in the amount of \$4,694,230. The regulatory asset amount comprised the difference between the jurisdictional incremental operation and maintenance expense incurred by the Company in connection with a March 2015 Major Event storm and a July 2015 Major Event storm¹⁷ and the Major Event storm operation and maintenance expense included in the Company’s base rates.¹⁸ Kentucky Power deferred \$4,377,336 of the requested regulatory asset in 2015. The remaining \$316,894 in jurisdictional incremental 2015 Major Storm expense was expensed on the Company’s 2015 financial statements, but subsequently was reclassified in March 2016 as a deferral.¹⁹

The Commission issued its Order in this proceeding on November 3, 2016. The Order authorized the Company to “establish a regulatory asset in the amount of \$4,377,336...”²⁰

Authority to create a regulatory asset was denied with respect to the \$316,894 balance of the

¹⁷ A Major Event storm is defined by Institute of Electrical and Electronic Engineers Standard 1366 as one that exceeds reasonable design and operational limits of an electric power system. *2016 Deferral Order* at 1 n.1.

¹⁸ Application, *In the Matter of: Application Of Kentucky Power Company For An Order Approving Accounting Practices To Establish Regulatory Assets And Liabilities Related To The Extraordinary Expenses Incurred By Kentucky Power In Connection With Two 2015 Major Storm Events*, Case No. 2016-00180 at Exhibit 2 (Filed May 31, 2016).

¹⁹ *2016 Deferral Order* at 6-7. Kentucky Power erroneously stated at paragraph 25 of its application that the entire \$4,694,230 had been deferred on its 2015 financial statements. Although the misstatement in paragraph 25 was inadvertent, Kentucky Power agrees it should have discovered and brought its error to the Commission’s attention more promptly. *Id.*

²⁰ *Id.* at 7.

requested \$4,694,230 because the Company expensed the balance on its 2015 financial statements prior to creating a regulatory asset in the amount in 2016.²¹

In the *2016 Deferral Order* the Commission expressed concern that the Company deferred the 2015 jurisdictional incremental Major Storm expense on its 2015 books prior to receiving Commission approval to create the regulatory asset associated with the deferral.²² The Commission first noted “Kentucky Power knew, or should have known, that the application should have been filed before Kentucky Power recorded the regulatory asset, even if doing so meant that cost estimates would have been used in the application.”²³ It then concluded:

Finally, we take the opportunity to place Kentucky Power and all jurisdictional utilities on notice that Commission authorization is required before a utility can record as a regulatory asset an expense that meets one of the four criteria cited earlier in this order. The Commission believes that to provide reasonable assurance of a utility’s ability to recover the cost of items²⁴ that meet one or more of the four criteria cited earlier in this order which the Commission has used to authorize the establishment of regulatory assets the utility must be able to show that Commission approval to establish the regulatory asset has been granted.²⁵

Kentucky Power seeks rehearing of this portion of the *2016 Deferral Order* along with Ordering paragraph 5.²⁶

²¹ *Id.* at 9.

²² *Id.* at 7.

²³ *Id.*

²⁴ Kentucky Power understands the Commission’s statement at page 9 of the *2016 Deferral Order* concerning a “reasonable assurance of a utility’s ability to recover the cost of items” to refer the FASB Codification 980-340-25-1 requirement that “[a]n enterprise shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met: 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 the inclusion of that cost in the allowable costs for ratemaking purposes”

²⁵ *2016 Deferral Order* at 9.

²⁶ *Id.* at 10 (“Kentucky Power and all jurisdictional utilities shall Commission authorization prior to recording regulatory assets on its books for accounting purposes as discussed in this order.”)

ARGUMENT

A. The Standard For Rehearing.

KRS 278.400 authorizes “any party to the proceedings” to apply for rehearing of a Commission order within 20 days of service of the order. The Commission interprets the statute as “provid[ing] closure to Commission proceedings by limiting rehearing to new evidence not readily discoverable at the time of the original hearings.”²⁷ The statute requires and the Commission expects “the parties to Commission proceedings to use reasonable diligence in the preparation and presentation of their cases and serves to prevent piecemeal litigation of issues.”²⁸ Rehearing is not a vehicle for a party to reargue or re-litigate an issue fully addressed by the parties in the proceedings leading to the original order.²⁹

The Commission nevertheless enjoys the discretion to grant rehearing³⁰ to consider new arguments,³¹ particularly where the argument could not reasonably have been raised before. In addition, rehearing will be granted when required to address any errors or omissions in its orders.³² Each of these bases support rehearing here.

²⁷ *In the Matter of: Application Of Kentucky-American Water Company For A Certificate Of Public Convenience And Necessity Authorizing Construction Of The Northern Division Connection*, Case No. 2012-00096 at 4 (Ky. P.S.C. January 23, 2014).

²⁸ *Id.*

²⁹ *In the Matter of: D.P.I. Teleconnection, L.L.C. v. BellSouth Telecommunications, Inc. d/b/a AT&T Kentucky*, Case No. 2009-00127 at 3 (Ky. P.S.C. March 2, 2012) (rejecting motion for rehearing where movant failed to raise new arguments and arguments raised were fully considered in original order).

³⁰ *In the Matter of: Adjustment Of Rates Of General Telephone Company Of Kentucky*, Case No. 8859 at 1 (Ky. P.S.C. June 28, 1984) (Commission exercised its discretion to grant second petition for rehearing to ensure due process).

³¹ *In the Matter of: America’s Tele-Network Corp.’s Alleged Violation of KRS 278.535*, Case No. 2000-00421 at 2 (Ky. P.S.C. March 23, 2001) (limiting scope of rehearing to new arguments raised in petition).

³² *In the Matter of: Application of Jessamine-South Elkhorn Water District For A Certificate Of Public Convenience And Necessity To Construct And Finance A Waterworks Improvement Project Pursuant To KRS 278.020 And 278.300*, Case No. 2012-00470 at 11 (January 3, 2014).

The mandate that Commission approval be obtained prior to a utility deferring an expense and creating a regulatory asset was never squarely presented in this case. Although the issue of the Company's deferral of the expense prior to receiving a Commission order was raised in two Staff data requests,³³ it was limited to the facts of this proceeding and the imposition of a "bright-line" rule going forward was never contemplated by the Company. Moreover, although the Company explained its understanding of the basis under FASB Codification 980-340-25-1 for deferring the expenses associated with two 2015 Major Event storms prior to receiving Commission approval, it never was called on to address the issues associated with the "bright-line rule" described by the Commission in its *2016 Deferral Order*. Indeed, while putting Kentucky Power on notice that the rule would be applied prospectively, the Commission authorized Kentucky Power to establish a regulatory asset in this case.³⁴

The grant of rehearing also will permit the Company to raise arguments (detailed below) that extend beyond the facts of the case. For the same reason, because the *2016 Deferral Order* establishes a rule that is made expressly applicable to "all jurisdictional utilities," rehearing would permit other utilities, that are affected by the rule but were not parties to this proceeding, to address the issue by seeking leave to intervene, or seeking leave to file an *amicus* brief, or by seeking leave to file written comments. Finally, rehearing will permit the Commission to address the issues identified below.

³³ Kentucky Power Response to KPSC 1-4(a), *In the Matter of: Application Of Kentucky Power Company For An Order Approving Accounting Practices To Establish Regulatory Assets And Liabilities Related To The Extraordinary Expenses Incurred By Kentucky Power In Connection With Two 2015 Major Storm Events*, Case No. 2016-00180 (Ky. P.S.C.. Filed July 1, 2016) ; Kentucky Power Response to KPSC 2-2(a), *In the Matter of: Application Of Kentucky Power Company For An Order Approving Accounting Practices To Establish Regulatory Assets And Liabilities Related To The Extraordinary Expenses Incurred By Kentucky Power In Connection With Two 2015 Major Storm Events*, Case No. 2016-00180 (Ky. P.S.C.. Filed Aug 12, 2016).

³⁴ This is not to suggest that the Commission's Order authorizing the Company to establish a regulatory asset is inconsistent with the establishment of a prospective rule, or that the authorization of the regulatory asset in any way undercuts the Commission's legal authority to establish a prospective rule. To the contrary, although the Company believes the Commission erred in establishing the prospective rule that it did, the use of prospective rulemaking is to be commended.

B. Requiring A Commission Order Approving The Proposed Accounting Treatment For Major Event Storm Costs Prior To The Company Being Authorized To Defer The Expenses And Create A Regulatory Asset On Its Books May Produce Arbitrary And Unreasonable Outcomes.

Unlike many other extraordinary expenses that may be eligible for deferral and the creation of a regulatory asset, a utility has no control over the timing of a Major Event storm. For example, tornadoes, heavy thunderstorms and high winds, and heavy snowfalls occur in October,³⁵ November,³⁶ and December.³⁷ Yet, no matter the alacrity with which a utility compiles and files its application seeking approval of the deferral of Major Event storm expenses and the creation of a corresponding regulatory asset, or the Commission's diligence in reviewing and acting on the request, there is a calendar date after which it will be impossible to secure Commission approval in time to record the deferral and regulatory asset on a utility's financial statements. Indeed, a utility may require a decision as early as January 8 of the succeeding year.³⁸ Certainly, a mid-December Major Event storm, no matter how extraordinary in scope or costly to remedy, would have to be expensed because of insufficient time to prepare the application using estimates and obtain Commission approval prior to the Company's annual financial statements closing early the following January. Indeed, there may be insufficient time

³⁵ See National Weather Service, PAST WEATHER EVENTS ARCHIVE <https://www.weather.gov/jkl/events> (October 7, 2014 supercell thunderstorms and tornadoes in Bath, Bourbon, Harrison, Pike, and Scott counties; October 29, 2012 heavy snowstorm and Major Event storm in Kentucky Power's service territory; October 26, 2010 tornadoes and severe thunderstorms in Barren, Bullitt, Fayette, Harrison, Trimble, Warren, and Woodford counties; October 9, 2009 tornadoes and straight line winds in Breckinridge, Casey, Marion and Monroe counties; October 18, 2007 high winds and tornadoes in Breckinridge, Bullitt, Hancock, Jefferson, Marion, Meade, and Perry counties) (last retrieved November 19, 2016).

³⁶ See *id.* (November 15, 2005 violent storms and tornadoes in Hopkins, Logan, Simpson, and Warren counties; November 22, 1992 F4 status tornado in Carroll, Gallatin, and Boone Counties.)

³⁷ See *id.* (December 23, 2015 severe thunderstorms in central Kentucky; December 21, 2013 tornadoes and straight line winds in Barren, Harrison, Hart, and Taylor counties; December 22, 2004 ice and snow storms in central Kentucky.)

³⁸ See *e.g.* 2012 Deferral Order at 5-6 (Denying December 21, 2012 motion for leave to amend application to seek recovery of October 2012 Major Event storm expenses because "the Commission would have just eight business days in which to review and process the amended request.")

to prepare an application and obtain Commission approval for an October Major Event storm.³⁹ Yet, the same storm occurring six months earlier could be presented in time to obtain Commission approval prior to the closing of the Company's annual financial statements.

In such an instance the determination of whether Major Event storm expenses may be considered for deferral and the creation of a regulatory asset turns not on the nature of the storm, or the nature or magnitude of the expenses incurred, or the Company's actions in responding to the storm or filing the application, or the exercise by Kentucky Power management of its judgment as to whether the expenses are probable of recovery, or even the Commission's consideration of the facts and the exercise of its expertise and regulatory authority over the Company's accounting practices. Instead, the sole determinant is the date of the Major Event storm and its relation to the closing of the Company's financial statements. Moreover, the reasons identified above at pages 3-5 – including the incremental nature of Major Event storm expenses eligible for deferral – exacerbate the likelihood the Commission will be unable to act in time to authorize the deferral prior to the closing of the Company's financial statements.

The “bright-line rule” risks distortion of the Company's financial statements for the period in which the extraordinary expenses are incurred⁴⁰ because of a factor outside the control of the Commission and Company alike. Modification of the rule as requested herein would not diminish the Commission's jurisdiction or its ratemaking authority. As such, the “bright-line rule” is, respectfully, arbitrary.

³⁹ *Id.*

⁴⁰ See Order, *In the Matter of: Application Of Duke Energy Kentucky, Inc. For An Order Approving The Establishment Of A Regulatory Asset*, Case No. 2008-00476 at 3 (Ky. P.S.C. January 7, 2009); Order, *In Re: Petition Of Kingsport Power Company D/B/A AEP Appalachian Power For Approval Of Deferred Accounting*, Docket No. 13-00121 at 3 (Tenn. Regulatory Auth. November 13, 2013) [**EXHIBIT 3**].

The Commission's "bright-line rule" threatens a second arbitrary result. Even where it is possible for the utility to file an application in time for the Commission to issue an order authorizing the deferral and the creation of the regulatory asset prior to the closing of the utility's annual financial statements, it is not uncommon for only estimates to be available at the time of the Commission's Order.⁴¹ In such instances, the amount of the deferral approved is limited to the lesser of the actual jurisdictional incremental Major Event storm operation and maintenance expenses or the estimate provided the Commission:

A downward adjustment to the amount of the regulatory asset will be necessary if total actual costs are less than the amount being approved herein. In the event that LG&E's total actual costs exceed ... [the approved amount], the excess should be expensed. The 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" regulatory asset.⁴²

Again, the amount to be deferred could be determined by a factor other than the merits of the deferral. Moreover, that factor – the timing of the Major Event storm – lies wholly outside the control of the Commission and the Company. It is not necessary for the Commission to abandon its regulatory responsibilities or authorize an "open-ended regulatory asset." Nor does the Company seek one. Instead, it would be sufficient and appropriate for the Commission to modify its "bright-line rule" to permit utility management to exercise its judgment, subject to subsequent Commission review and approval, concerning the probability of recovery of the Major Event storm expenses.

⁴¹ See e.g., Order, *In the Matter of: Application Of Louisville Gas And Electric Company For The Establishment Of A Regulatory Asset*, Case No. 2011-00380 at 5 (Ky. P.S.C. December 27, 2011)

⁴² *Id.*

C. FASB Codification 980-340-25-1 Permits Management To Determine In The First Instance Whether An Expense Should Be Deferred.

“A regulatory asset is created when a utility is authorized to capitalize an expenditure that under traditional accounting rules would be recorded as a current expense.”⁴³ The Commission previously has recognized two purposes served by the establishment of regulatory assets: “first, a utility does not want a material, nonrecurring cost to distort its earnings for the period in which the cost is incurred;⁴⁴ second, the utility desires to defer the cost for recovery when its rates are reset in a future general rate case.”⁴⁵

ASC 980, including FASB Codification 980-340-25-1, “applies to general purpose external financial statements of utilities that have regulated operations...” if, as in the case of Kentucky Power, the three criteria established by FASB Codification 980-10-15-2 are met.⁴⁶ “The application of ASC 980 is not an elective option. If the ... [three] criteria are met by a utility, ASC 980 should be applied.”⁴⁷

ASC 980, and particularly the treatment under FASB Codification 980-340-25-1 of regulatory assets and liabilities, is founded upon the recognition of the nature and consequences of rate regulation:

⁴³ *In the Matter of: 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*, Case No. 2015-00141 at 3 (Ky. P.S.C. August 31, 2015).

⁴⁴ *See also, Order, In Re: Petition Of Kingsport Power Company D/B/A AEP Appalachian Power For Approval Of Deferred Accounting*, Docket No. 13-00121 at 3 (Tenn. Regulatory Auth. November 13, 2013) (“Removing non-recurring costs from expenses to a deferred account will result in normalized reported regulated expense levels for the period.”)

⁴⁵ *In the Matter of: Application Of Duke Energy Kentucky, Inc. For An Order Approving The Establishment Of A Regulatory Asset*, Case No. 2008-00476 at 3 (Ky. P.S.C. January 7, 2009).

⁴⁶ Robert L. Hahne & Gregory A. Aliff, ACCOUNTING FOR PUBLIC UTILITIES § 12.02[1] (2016) (“ACCOUNTING FOR PUBLIC UTILITIES”).

⁴⁷ *Id.*

ASC 980 recognizes a principal consideration introduced by rate regulation is the cause-and-effect relationship of costs and revenues – an economic dimension that, in some circumstances, **should affect** accounting for rate-regulated utilities. Thus, a utility should capitalize a cost (as a regulatory asset) or recognize an obligation (as a regulatory liability) if **it is probable** through the ratemaking process, there will be a corresponding increase or decrease in future revenues.⁴⁸

The deferral of a cost that otherwise would be required to be expensed turns in the first instance on the probability the deferred amount may be recovered through future rates.⁴⁹ If probable of recovery, the utility is required to defer the expense and create the regulatory asset.⁵⁰

FASB Codification 980-340-25-1 contemplates that, as with most if not all accounting decisions, the determination of whether an expense should be deferred and a regulatory asset created for later review and determination of recovery by the Commission lies in the first instance with the utility's management:

In this context, “probable”⁵¹ is considered a relatively high threshold and substantial evidence is typically required to support the recognition of regulatory assets. Evidence that a regulatory asset is probable of recovery **is a matter of professional judgment based on the facts and circumstances of each case. Utility management must positively represent that each regulatory asset is probable of recovery in future rates.**

Utility management is not given *carte blanche* in determining whether an expense is probable of future recovery and thus the expense is required to be deferred. Rather, management's

⁴⁸ ACCOUNTING FOR PUBLIC UTILITIES § 12.02[2] (emphasis supplied).

⁴⁹ *Id.* See also *In the Matter of: Application Of Duke Energy Kentucky, Inc. For An Order Approving The Establishment Of A Regulatory Asset*, Case No. 2008-00476 at 3 (Ky. P.S.C. January 7, 2009) (“the utility desires to defer the cost for recovery when its rates are reset in a future general rate case.”)

⁵⁰ FASB Codification 980-340-25-1 (“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...”) (emphasis supplied); ACCOUNTING FOR PUBLIC UTILITIES § 12.02[1] ; *id.* at [2] (“Rate-regulated utilities that are within the scope of ASC 980 are required to capitalize as a regulatory asset an incurred cost that would otherwise be charged to expense if future recovery in rates is probable.”)

⁵¹ The FASB ASC Master Glossary defines “probable” as “the future event or events are likely to occur.”

representation that an expense is probable of future recovery should be corroborated.⁵² Evidence supporting such a determination can include, but is not limited to:

- (1) Rate orders from the regulator specifically authorizing recovery of the costs in rates.
- (2) Previous rate orders from the regulator allowing recovery for substantially similar costs.⁵³
- (3) Written approval from the regulator approving future recovery in rates.
- (4) Analysis of recoverability from internal or external legal counsel.⁵⁴

Significantly, and consistent with management's ultimate responsibility for its financial statements, there is no requirement under FASB ASC 980 that a utility receive an order from the regulator authorizing the deferral of the expenses and creation of a corresponding regulatory asset prior to doing so if that management determines the expenses are probable of future recovery. Moreover, as the Commission expressly recognized in the *2016 Deferral Order*,⁵⁵ as well as multiple other orders authorizing the creation of a regulatory asset,⁵⁶ a Commission

⁵² ACCOUNTING FOR PUBLIC UTILITIES § 12.02[2].

⁵³ Kentucky Power's management principally relied upon this evidence in determining the expense was probable of recovery and hence should be deferred and a regulatory asset created. *See* Kentucky Power Response to KPSC 1-4(a), *In the Matter of: Application Of Kentucky Power Company For An Order Approving Accounting Practices To Establish Regulatory Assets And Liabilities Related To The Extraordinary Expenses Incurred By Kentucky Power In Connection With Two 2015 Major Storm Events*, Case No. 2016-00180 (Ky. P.S.C.. Filed July 1, 2016) ; Kentucky Power Response to KPSC 2-2(a), *In the Matter of: Application Of Kentucky Power Company For An Order Approving Accounting Practices To Establish Regulatory Assets And Liabilities Related To The Extraordinary Expenses Incurred By Kentucky Power In Connection With Two 2015 Major Storm Events*, Case No. 2016-00180 (Ky. P.S.C.. Filed Aug 12, 2016).

⁵⁴ ACCOUNTING FOR PUBLIC UTILITIES § 12.02[2].

⁵⁵ *2016 Deferral Order* at 8-9 ("As previously stated, the authorization to establish the regulatory asset as requested by Kentucky Power is for accounting purposes only. The Commission's determination of the amount of the regulatory asset authorized herein that is to be amortized and recovered in rates will be determined in Kentucky Power's next rate case, following a detailed review of Kentucky Power's storm preparedness, its response to outages, and system reliability, all of which are issues of great interest to the Commission. Particular attention will be paid to the effectiveness of Kentucky Power's vegetation management program to mitigate outages.... It is expected that the scope of the Commission's review will include Kentucky Power's efforts to 'harden' its system as opportunities to do so arise and the recommendations it adopted in response to the Commission's report on the 2008 Wind Storm and the January 2009 Ice Storm.")

⁵⁶ *See e.g., In the Matter of: Application Of Duke Energy Kentucky, Inc. For Approval To Establish A Regulatory*

accounting order does not guarantee future recovery through rates. That determination is, and should be, reserved for a later day, when it can be fully explored in the context of the utility's next general rate case.

The decisions of other regulatory bodies approving deferrals and regulatory assets are instructive. In *In Re: Petition Of Kingsport Power Company D/B/A AEP Appalachian Power For Approval To Defer Certain Costs Associated With Winter Storms Occurring In December 2009*,⁵⁷ the Tennessee Regulatory Authority approved in October 2010 Kingsport's deferral in 2010 of winter storm expenses associated with two December 2009 storms even though Kingsport "previously booked the storm expenses...." A similar result was reached by the Virginia State Commerce Commission in *Application Of Appalachian Power Company For A Statutory Review Of Its Rates, Terms, And Conditions For The Provision Of Generation, Distribution, And Transmission Services Pursuant To § 56-585.1 Of The Code Of Virginia*.⁵⁸ There, during the course of a 2010 review of its rates Appalachian Power sought approval to defer on its 2010 books "substantial costs from storms in December 2009...." The Virginia Commission approved the 2009 deferral and stated that a decision on whether Appalachian

Asset, Case No. 2016-00159 at 6 (Ky. P.S.C. July 22, 2016) ("The regulatory asset established in this case is for accounting purposes only. The amount, if any, of the regulatory asset, which includes company labor, authorized herein that is to be amortized and recovered in rates shall be determined in Duke Kentucky's next gas rate case."); *2012 Deferral Order* at 7 ("The amount, if any, of the regulatory asset authorized herein that is to be amortized and recovered in rates shall be determined in Kentucky Power's next rate case based on an examination of its storm preparedness, its storm restoration efforts, reliability improvement efforts and the reasonableness of the costs incurred."); *In the Matter of: Application Of Louisville Gas And Electric Company For The Establishment Of A Regulatory Asset*, Case No. 2011-00380 at 4 (Ky. P.S.C. December 27, 2011) ("The Commission notes that the authorization of a regulatory asset is not an assurance that these costs will be recovered in rates. A decision on rate recovery will be made only after fully examining the reasonableness of these costs in the context of a future rate case.") *See also*, *In the Matter of: Application Of Kentucky Utilities Company For The Establishment Of A Regulatory Asset*, Case No. 2009-00174 at 5 (Ky. P.S.C. December 27, 2011) (delaying ability to seek recovery of regulatory asset in a general rate case until "after the Commission completes its review of disaster preparedness and storm restoration efforts of the utilities under its jurisdiction.")

⁵⁷ Docket No. 10-00144 at 2 (Tenn. Regulatory. Auth. October 5, 2010) [EXHIBIT 4].

⁵⁸ Case No. PUE-2009-00030 at 21 (Va. State Corp. Comm. July 15, 2010) [EXHIBIT 5].

Power would be permitted to recover the asset was postponed ““until such time as a request for recovery is made and subsequently ruled upon by the Commission.””⁵⁹

Kentucky Power provides the decisions of other regulatory bodies above as recognition of the fact a regulatory body does not surrender its authority over jurisdictional utilities, or their accounting practices, by permitting utilities in the first instance to determine, consistent with FASB Codification 980-340-25-1, whether the expenses are probable of recovery and hence are required to be deferred. Such an approach reserves to the Commission the sole ability to review in a subsequent accounting proceeding the utilities’ decision to defer the expenses and create a regulatory asset, as well as the Commission’s ability to review in the Company’s next general rate case the recoverability in whole or part of the regulatory asset. Equally important, according utility management the ability in the first instance to defer an expense and create a regulatory asset avoids the unreasonable and arbitrary outcomes described above resulting from the Commission’s “bright-line rule.”

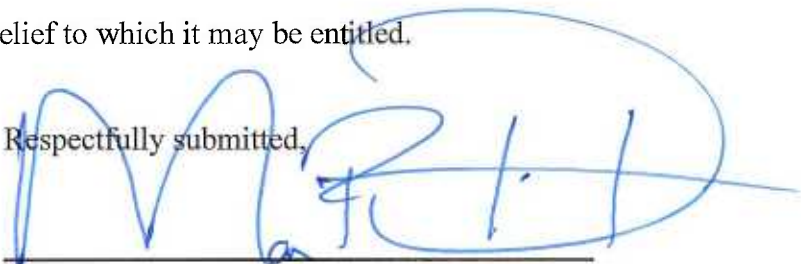
Absent the ability to evaluate and defer extraordinary expenses, subject to the Commission’s undiminished authority to review and accept, reject, or modify management’s determination, utility management may be required to evaluate and propose for Commission review other options.

⁵⁹ *Id.*

Wherefore, Kentucky Power Company respectfully requests the Commission to enter an Order:

1. Granting rehearing to permit the development of a further record and to provide an opportunity for the Commission to reexamine its “bright-line rule” affecting an entire industry;
2. Modifying the *2016 Deferral Order* to permit all jurisdictional utilities, subject to subsequent Commission review and approval, and consistent with FASB Codification 980-340-25-1, to defer expenses and create a corresponding regulatory asset, when in the judgment of management the expenses are probable of recovery; and
3. Granting all other necessary relief to which it may be entitled.

Respectfully submitted,



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