

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE
COMMISSION

IN THE MATTER OF:

THE APPLICATION OF COLUMBIA GAS)
OF KENTUCKY, INC. FOR AN ORDER)
APPROVING ACCOUNTING PRACTICES TO) Case No. 2009-00168
ESTABLISH A REGULATORY ASSET RELATED)
TO PENSION AND OTHER POST-RETIREMENT)
BENEFIT EXPENSES)

ATTORNEY GENERAL'S COMMENTS

A. Background

On April 23, 2009, Columbia Gas of Kentucky ("CKY") filed an application with the Public Service Commission ("PSC" or the "Commission") in Case No. 2009-00168 to request an Accounting Order from the PSC allowing CKY to defer as a regulatory asset or regulatory liability the difference between its annual pension and other post-employment benefits ("OPEB") expenses calculated pursuant to SFAS 87 and SFAS 106 and the annual pension and OPEB expenses included in base rates. The Company requested that this Accounting Order become effective retroactive to January 1, 2009. CKY is seeking this Accounting Order because of its claim that "Pension and OPEB costs are volatile due to the return on assets and discount rates – factors that are beyond the control of Columbia."¹

On May 1, 2009, CKY filed a base rate case in Case No. 2009-00141. A

¹ April 23, 2009 Application, page 4, paragraph (k).

Stipulation and Recommendation was recently executed by the parties to this proceeding and is currently being reviewed by the Commission. If the Commission approves the Stipulation and Recommendation, the rates from Case No. 2009-00141 are expected to become effective November 1, 2009.

In summary, CKY is requesting that it be allowed to defer as a regulatory asset or regulatory liability, from January 1, 2009 until the rate effective date of CKY's next base rate case,² the difference between: (1) its annual pension and other OPEB expenses calculated pursuant to SFAS 87 and SFAS 106; and (2) the annual pension and OPEB expenses included in base rates. The recovery of the deferred amounts accrued in the regulatory asset/regulatory liability would be addressed in the Company's next base rate proceeding.

B. Attorney General's Recommendation

The Attorney General recommends that the Commission reject CKY's request for the establishment of the pension/OPEB related regulatory asset/regulatory liability, for the reasons that are outlined below.

In its recent August 26, 2009 Order in Case No. 2008-00440, in which the Commission denied Kentucky-American Water Company's request for certain expense deferrals in a regulatory asset, the Commission made the following policy statement regarding the establishment of regulatory assets:

The Commission has previously identified four categories of expense that may be treated as regulatory assets. These are:

- (1) an extraordinary, nonrecurring expense which could not have

² This would be the rate case following the pending rate case in Case No. 2009-00141.

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

The requested deferred pension/OPEB expenses do not fall within any of these four categories.

First, pension and OPEB expenses are one of many annually recurring operating expenses that are included in the rates paid by CKY's customers for gas service. The recovery of pension and OPEB expenses traditionally is considered as one of several cost components during a base rate case, and normally is considered in the context of the Company's overall costs, revenue and capital structure. This has been the case in the Company's pending base rate proceeding, Case No. 2009-00141, which proceeding reflects pro forma pension and OPEB expense levels that are reasonably anticipated and very much included in CKY's planning. In this regard, the Attorney General's revenue requirement witness in the Company's base rate case in Case No. 2009-000141, Mr. Robert Henkes, stated on page 52 of his direct testimony:

I have accepted the Company's proposed pension expenses of \$980,525 and OPEB expenses of \$791,661 in this case. If the Commission were also to accept these numbers, this will provide the Company with the assurance that its base rates to be implemented as a result of this case will include the very high annual rate recovery level of \$1,772,186 for

³ *In re*: Request Of Kentucky-American Water Co. For Approval To Defer Certain Expenses As Regulatory Assets, Case No. 2008-00440, Order dated Aug. 26, 2009, p.2 (*citing In re*: East Kentucky Power Cooperative, Inc. , Case No. 2008-00436, Order dated Dec 23, 2008, p. 4).

the Company's pension and OPEB expenses.

Thus, the proposed pension/OPEB expense deferrals do not represent extraordinary, nonrecurring expenses which could not have reasonably been anticipated or included in the utility's planning.

Second, the proposed pension/OPEB expense deferrals do not result from a statutory or administrative directive or industry sponsored initiative. In this regard, it should also be noted that Columbia Gas is the only utility in Kentucky that has applied for such a pension/OPEB-related Accounting Order.

Third, the proposed pension/OPEB expense deferrals do not represent extraordinary or nonrecurring expenses that result in savings over time. Furthermore, the potential expense deferrals should be considered immaterial when compared to CKY's total expenses. In the table below, the Company's actual pension and OPEB O&M expenses are listed as a percentage of the Company's total O&M expenses in each of the last 5 years:

| | <u>Pension/OPEB O&M⁴</u> | <u>Total O&M⁵</u> | <u>Percentage</u> |
|-----------------|---|----------------------------------|-------------------|
| 2004 | \$ 920,452 | \$130,288,021 | 0.71% |
| 2005 | \$ 871,132 | \$148,926,843 | 0.58% |
| 2006 | \$ 606,730 | \$144,485,593 | 0.42% |
| 2007 | \$ 537,585 | \$135,688,837 | 0.40% |
| 2008 | <u>\$ 377,127</u> | <u>\$182,978,365</u> | <u>0.21%</u> |
| Total for 5 Yrs | \$3,313,026 | \$742,367,659 | 0.45% |

As shown in the table, during the last 5 years, the Company's combined pension and OPEB expenses have, on average, been less than one-half of one

⁴ Application of CKY for Accounting Order, Case No. 00168, paragraph j on page 3.

⁵ Response to AG-1-2 in Case No. 2009-00141.

percent of the Company's total operation and maintenance expenses. While the Company's estimated pension/OPEB expenses for 2009 amount to \$1,772,186, this still represents a very small percentage of the Company's total budgeted 2009 O&M expenses.⁶ It should also be noted that the Company's sole reason for the requested Accounting Order, i.e., the volatility of its pension and OPEB expenses, certainly does not apply to the OPEB expenses. In the table below, the Company's actual OPEB expenses for each of the last 10 years are as follows:

| | <u>OPEB Expenses⁷</u> |
|---------------------|----------------------------------|
| 1999 | \$887,141 |
| 2000 | \$912,228 |
| 2001 | \$879,978 |
| 2002 | \$857,533 |
| 2003 | \$697,269 |
| 2004 | \$630,804 |
| 2005 | \$658,342 |
| 2006 | \$710,863 |
| 2007 | \$542,312 |
| 2008 | <u>\$529,273</u> |
| Average for 10 Yrs. | \$730,574 |
| 2009 Estimated | \$791,661 |

The Attorney General does not believe that the numbers in the above table indicate any particularly significant volatility in the Company's annual OPEB expenses. It should additionally be recognized that a significant portion of the Company's annual OPEB expenses consists of a fixed annual expense amount of \$281,698 for the amortization of the Transition Obligation, which has no year-to-

⁶ The total budgeted 2009 O&M expenses are not available to the AG. However, if one assumes the same total O&M expense level for 2009 as the actual 2008 total O&M number of \$182,978,365, the estimated 2009 pension/OPEB ratio of total O&M expense would be 0.97%.

⁷ Response to PSC-2-55 and table on page 5 of the Konold Testimony in Case No. 2009-00141.

year volatility whatsoever.

In summary, the proposed pension/OPEB expense deferrals do not represent extraordinary or nonrecurring expenses that result in savings over time and are not material enough to warrant the extraordinary treatment proposed by the Company in the form of the requested Accounting Order.

The Attorney General also submits that the proposed pension/OPEB related Accounting Order represents an inappropriate move away from traditional regulation. In this regard, the Attorney General notes that, while it is true that the approval of a regulatory asset does not affect the Company's current rates, it essentially almost pre-ordains that CKY's ratepayers will be liable for payment of the regulatory asset at some future date. The proposed deferral mechanism therefore provides for a guaranteed, dollar-for-dollar recovery of certain selected expenses in-between-rate cases. One of the most important tenets of ratemaking is that utilities are not guaranteed cost recovery; rather, the ratemaking process entitles the utility to no more than a reasonable opportunity to recover its costs. Regulation is not intended to be a mechanism whereby a utility is guaranteed dollar-for-dollar recovery of its cost. This inappropriate kind of regulation is generally referred to as reimbursement ratemaking. Instead, traditional regulation is based on the principle that the utility has an opportunity to recover its costs. By proposing the pension/OPEB expense deferral mechanism, the Company has completely disregarded the foundation upon which the regulatory process was developed, that is, that regulation is

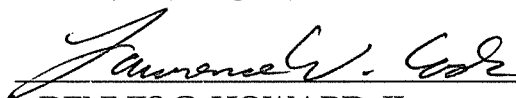
supposed to be a substitute for competition. This principal of regulation was designed to stimulate a utility to act as it would if it were in a competitive industry. Clearly, if a utility's eventual cost recovery is guaranteed, this represents a departure from traditional ratemaking foundations. Competitive entities do not have any such cost recovery guarantees. Regulation is intended to take the place of competition; therefore, regulated entities should not receive guaranteed recovery of their costs if such guarantees are not available in the competitive marketplace.

Moreover, the proposed pension/OPEB related Accounting Order represents inappropriate single-issue ratemaking. A very important principle of proper ratemaking is the principle of "matching" all of the components in the ratemaking formula. In other words, at the time rates are set or changed, all of the ratemaking components that determine a utility's revenue requirement within a defined test period must be considered and subjected to regulatory review. The proposed Accounting Order and eventual rate recovery of the expenses deferred under the Accounting Order violate this matching principle because it would permit CKY to eventually change its future rates based on the consideration of only two selected ratemaking components retroactively experienced between the Company's base rate cases. This proposal effectively decreases the cost of providing service to current customers at the expense of future customers, thereby creating a case of intergenerational inequity. This single-issue ratemaking proposal is inappropriate and should be rejected by the

Commission.

If the Commission is to tread down this road, it would encourage utility companies to request this "novel" treatment for any cost that deviates from recent, limited history even when the degree of volatility that cost presents does not effect the company's financial condition.⁸ The Commission should therefore refuse to permit the establishment of regulatory assets unless the conditions set forth in its Order dated Aug. 22, 2009 in Case No. 2008-00440 are present. Those conditions being absent in the instant matter, the Attorney General respectfully moves that the Commission DENY the establishment of the proposed regulatory asset.

Respectfully submitted,
JACK CONWAY
ATTORNEY GENERAL


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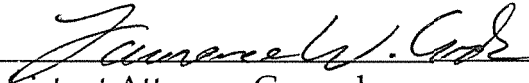
⁸ In recent history the Commonwealth, and the United States in general, has seen motor fuel costs, health care costs, and pension costs escalate only to return to normal or to otherwise market levels as based on long-term history.

Certificate of Service and Filing

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

Hon. Stephen B. Seiple
Attorney at Law
Columbia Gas of Kentucky, Inc.
P.O. Box 117
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this 16th day of October, 2009



Assistant Attorney General