COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC EMERGENCY DOCKET RELATED TO THE NOVEL CORONAVIRUS COVID-19	))	CASE NO. 2020-00085

O R D E R

On March 16, 2020, the Commission established this docket in response to a state of emergency brought on by the pandemic of the novel coronavirus, COVID-19. The Commission's Order entered on March 16, 2020, *inter alia*, directed utilities to temporarily cease disconnections for nonpayment, waive all late payment charges, and urged utilities to offer lenient payment plans for current unpaid balances.[1] On September 21, 2020, the Commission issued an Order that, *inter alia*, lifted the moratorium on residential disconnections for nonpayment as of October 20, 2020, but found good cause to continue the moratorium on the assessment of late payment fees for residential customers until December 31, 2020.[2]

Some utilities have recently petitioned the Commission to establish regulatory assets for certain expenses or lost revenue related to the COVID-19 pandemic, which the Commission is addressing by separate Order.[3] Based upon those requests, the

[1] Order at 3–5 (Ky. PSC Mar. 16, 2020).

[2] Order at 6–7 (Ky. PSC Sept. 21, 2020).

[3] *See e.g.* Case No. 2020-00257, *Electronic Application of Kentucky-American Water Company for an Order Approving the Establishment of a Regulatory Asset* (filed July 29, 2020).

Commission has determined that it should provide guidance on what COVID-19 related items utilities may not receive regulatory asset treatment.

In the September 21, 2020 Order the Commission prohibited utilities from assessing late fees on any past-due residential amounts accrued between March 16, 2020, and December 31, 2020, directing that such residential customer accounts should be considered "on time" for all purposes as long as the customers timely pay their bill for current service and any amount required under the default or an agreed-upon payment plan.[4] The Commission terminated the moratorium on disconnection and the assessment of late payment fees for nonresidential accounts as of October 20, 2020, finding that commercial and industrial customers had access to forgivable federal loans and other financing options not available to residential customers.[5]

Utilities were expressly permitted to apply and defer carrying charges to past-due amounts paid pursuant to a payment plan in order to finance the payment plans for arrearages accumulated between March 16, 2020, and October 1, 2020.[6] The Commission approved such financing costs for deferral accounting, with recovery in a subsequent proceeding either through rate base or as part of capitalization in later proceedings.[7] The Commission, however, made no specific provision for recovery or other regulatory accounting treatment for revenue lost from other sources.

[4] Order at 8 (Ky. PSC Sept. 21, 2020).

[5] *Id.* at 12.

[6] *Id.* at 10.

[7] *Id.* at 10–11.

As an initial matter, a utility must obtain Commission approval for accounting adjustments before establishing any expense as a new regulatory asset. A regulatory asset is created when a utility is authorized to capitalize an expenditure that would be recorded as a current expense under traditional accounting rules. A utility may request recovery of the capitalized amount in future rates, but recovery is subject to Commission review and approval. The authority to establish regulatory assets arises out of the Commission's plenary authority to regulate utilities under KRS 278.040 and its authority to establish a system of accounts for utilities under KRS 278.220.

The Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of Regulation, which was codified as Accounting Standards Codification (ASC) 980, Regulated Operations, provides the criteria for recognition of a regulatory asset.[8] Supplemental to generally accepted accounting principles (GAAP), long-standing Commission precedent provides

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[8] 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.

that regulatory assets may be established when a utility incurs (1) an extraordinary, nonrecurring expense that could not have been reasonably 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 savings that fully offsets the cost.[9]

Other than allowing deferral accounting for the carrying charges as discussed above, the Commission has not affirmatively approved deferral accounting for any other items. What follows below is a nonexhaustive list of what is not allowed for deferral accounting as a regulatory asset.

Lost Revenues

As mentioned above, some utilities have requested to establish regulatory assets to recover "lost revenues," such as revenue lost from reduced sales, forfeited late fees, or forfeited reconnection fees. As discussed below, these lost revenues are not subject to deferred accounting treatment.

A regulatory asset is created when a rate-regulated business is authorized by its regulatory authority to capitalize an expenditure that, under traditional accounting rules, would be recorded as a current expense. "Lost revenues" are not incurred costs that would otherwise be charged as an expense, and therefore do not meet the criteria under ASC 980-340-25-1 for recognition of a regulatory asset.[10] To meet the recognition criteria, these amounts would need to qualify as alternative revenue program, for which

[9] *See* Case No. 2008-00436, *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* (Ky. PSC Dec. 23, 2008).

[10] https://www2.deloitte.com/content/dam/Deloitte/us/Documents/energy-resources/pur-covid-update-september2020.pdf

there are specific requirements under ASC 980-605 related to accounting recognition as revenues and a regulatory asset. ASC 980-605-25-1 and 25-2 segregate the major alternative revenue programs into two categories, Type A and Type B. As ASC 980-605-25-2 explains:

> • "Type A programs adjust billings for the effects of weather abnormalities or broad external factors or to compensate the [rate-regulated] utility for demand-side management initiatives." Examples include no-growth plans and similar conservation efforts.
>
> • "Type B programs provide for additional billings (incentive awards) if the [rate-regulated] utility achieves certain objectives, such as reducing costs, reaching specified milestones, or demonstratively improving customer service."[11]

Based on the above, claimed "lost revenues", from any source, do not meet the requirements that would allow for GAAP recognition as a regulatory asset and, therefore, utilities should not request to establish its "lost revenues" as a regulatory asset.

Immaterial Expenses

In order for an expense to qualify for deferral accounting, it must, at the very least, be material. Immaterial expenses will not be approved for regulatory asset treatment.

Historically the Commission has denied regulatory asset treatment for expenses deemed immaterial.[12] As discussed above, Commission precedent has established

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[11] https://www2.deloitte.com/content/dam/Deloitte/us/Documents/energy-resources/us-er-power-utilities-accounting-financial-reporting-and-tax-research-guide.pdf

[12] *See* Case No. 2000-00120, *Application of Kentucky-American Water Company to Increase Its Rates* (Ky. PSC Nov. 27, 2000), final Order at 20–22 and Case No. 2008-00440, *Request of Kentucky-American Water Company for Approval to Defer Certain Expenses as Regulatory Assets* (Ky. PSC Aug. 26, 2009). Case No. 2006-00472, *General Adjustment of Electric Rates of East Kentucky Power Cooperative, Inc.* (Ky. PSC July 7, 2007); Case No. 2008-00456, *Application of Louisville Gas and Electric Company for an Order Approving the Establishment of a Regulatory Asset* (Ky. PSC Dec. 22, 2008); Case No. 2008-00457, *Application of Kentucky Utilities Company for an Order Approving the Establishment of a Regulatory Asset* (Ky. PSC Dec. 22, 2008); Case No. 2009-00168, *Application of Columbia Gas of Kentucky, Inc. to Establish a Regulatory Asset Related to Pension and Other Post-Retirement Benefit Expenses* (Ky. PSC Dec. 23, 2009); Case No. 2009-00174, *Application of Kentucky Utilities Company for an Order Approving the Establishment of a Regulatory Asset* (Ky. PSC Sept. 30, 2009); Case No. 2009-00175, *Application of Louisville Gas and Electric Company for an Order Approving the Establishment of a*

categories of expenses appropriate for regulatory asset treatment, including "extraordinary, nonrecurring expenses." The Commission previously determined that immaterial expenses cannot be considered extraordinary based on our finding that materiality is synonymous with the term extraordinary, and, pursuant to precedent, if an expense is not extraordinary, then it cannot be material. Before a utility requests regulatory asset treatment for an asset, it should first determine whether the expense is material to its operations and financial position. For example, if a nonrecurring expense is .5 percent of a utility's annual reporting operating expenses, then it certainly does not qualify as "material." While there is no bright line rule as to what is deemed "material," utilities should thoroughly consider the materiality of an expense before seeking regulatory asset treatment for the expense.

The above is intended to provide guidance to utilities should they seek to request regulatory asset treatment of an expense or expenses. The Commission, however, will determine each request on its own merits, and the limitations discussed in this Order should not be interpreted to mean that the Commission will approve any other item not discussed herein for regulatory asset treatment.

Regulatory Asset (Ky. PSC Sept. 30, 2009); Case No. 2009-00352, *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 Company in Connection with Three Major Event Storms in 2009* (Ky. PSC Dec. 22, 2009); Case No. 2011-00380, *Application of Louisville Gas and Electric Company for an Order Approving the Establishment of a Regulatory Asset* (Ky. PSC Dec. 27, 2011); Case No. 2012-00445, *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 Company in Connection with Four 2012 Major Storm Events* (Ky. PSC Jan. 7, 2013); Case No. 2016-00180, *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 Company in Connection with the Two 2015 Major Storm Events* (Ky. PSC Dec. 12, 2016); Case No. 2018-00304, *Electronic Joint Application of Kentucky Utilities Company and Louisville Gas and Electric Company for an Order Approving the Establishment of Regulatory Liabilities and Regulatory Assets* (Ky. PSC Dec. 20, 2018); and Case No. 2018-00416, *Application of Duke Energy Kentucky, Inc. for an Order Approving the Establishment of a Regulatory Asset* (Ky. PSC Mar. 25. 2019).

IT IS THEREFORE ORDERED that:

1. What a utility may request for regulatory asset treatment is clarified consistent with the discussion above; and

2. The Commission retains the right to modify, alter, or retract any portion of this Order, or any Order in this proceeding, at any time.

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By the Commission

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KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Linda C. Bridwell

Executive Director