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In the Matter of the Application of)
United Water Missouri Inc. for an)
Accounting Authority Order Relating)
to FAS 106.)

ACCOUNTING AUTHORITY ORDER

On November 5, 1997, United Water Missouri Inc. (Company) filed an application for issuance of an accounting authority order (AAO) authorizing the deferral of post-retirement benefit expense other than pensions (PBOP). The Company is a wholly-owned subsidiary of United Waterworks Inc., which in turn is wholly owned by United Water Resources (UWR). The Company states that in conjunction with other operating companies within the UWR system and through its parent company, United Waterworks, Inc., it provides health care benefits and other PBOPs to its retired employees.

The Company states in its application that the Financial Accounting Standards Board (FASB) issued Financial Accounting Standard (FAS) 106 in December of 1990 which prescribes the accounting for PBOPs. According to the Company, FAS 106 implements a basic premise of generally accepted accounting principles (GAAP) that accrual accounting provides more accurate and useful financial information than does cash basis or pay-as-you-go (PAYGO) accounting.

The Company points out on January 21, 1993, the report of FASB's Emerging Issues Task Force (EITF) Issue 92-12 was released. The report provided that the period for deferring recognition of the difference between a regulated company's PBOP costs, as accounted for under FAS 106, and the level of PBOP costs reflected in existing rates as a regulatory asset would run through December 31, 1997, so that the Company must immediately charge those costs to expense on its books and financial statements.

The Company states that on April 22, 1994, the former parent of the Company, GWC Corp. (GWC), merged with UWR. The Company affirms that prior to the merger neither the Company nor GWC had adopted FAS 106; however, as of the date of merger, UWR adopted FAS 106 for all utility subsidiaries of the former GWC Corp., including the Company.

In May of 1994, the Missouri General Assembly passed, and on July 12, 1994, the Governor signed into law, HB 1405 which was later codified as Section 386.315, RSMo 1994¹. The Company states that this statute directs the Commission to recognize FAS 106 costs for PBOPs for ratemaking purposes in the future and allows utilities who have received rate orders after January 1, 1993, and prior to the enactment of HB 1405, the opportunity to recover their annual level of FAS 106 costs through a "one-time" tariff filing.

In 1995 the Company set up external funding mechanisms for employees and retirees in the form of Voluntary Employee Benefit Association (VEBA) trusts which restrict disbursements solely to qualified retiree benefits as required by Section 386.315.2. The Company states that

¹All statutory references are to the Revised Statutes of Missouri, 1994, unless otherwise indicated.

VEBA trusts have been funded annually to the extent that contributions to the trusts are tax deductible.

The Company notes that it filed its last rate case in March of 1994 prior to the merger and prior to the adoption of FAS 106 by the Company. The Company did not request recovery of PBOP expenses in its rate filing and no PBOP expense was reflected in the cost of service in the Commission's order in Case No. WR-94-297.

The Company requested in its application that pursuant to Section 386.315 the Commission issue its AAO prior to December 31, 1997, and include the following language:

(a) The Company is authorized to maintain on its books its regulatory asset which represents the excess of its FAS 106 PBOP expense over the pay-as-you-go amount that the Company has been booking since 1994, with said deferral continuing until the effective date of a Report and Order in the Company's next general rate proceeding; and,

(b) That the Commission intends that rates established in the Company's next general rate case will include, among other things, the Company's prudently incurred FAS 106 expense pertaining to post-retirement benefits other than pensions in accordance with Section 386.315 as well as an amortization of the Company's prudently incurred FAS 106 costs deferred pursuant to this AAO, over a period of time ending no later than December 31, 2012.

On December 24 the Staff of the Commission (Staff) filed its Memorandum in the official case file which recommended that the Commission deny the Company's application for an accounting authority order. Staff indicates FAS 106 mandated for financial reporting purposes that most entities must change to an accrual method of accounting for PBOPs effective January 1, 1993. The use of accrual accounting for PBOPs, according to Staff, means that utilities must attempt to estimate and charge to expense the PBOPs earned by employees during the current period of service. Staff states that moving to an accrual method of accounting for PBOPs will, for most utilities, sharply increase the PBOP expense charged on the financial

statements. Staff states that an AAO must meet the standards of FAS 71 which allows a utility to capitalize a cost on its financial statements that under GAAP would normally be expensed if the utility's regulators authorize such treatment and if it is "probable" that the utility will recover such capitalized costs in future rates. Costs that are capitalized by utilities pursuant to FAS 71 are called "regulatory assets."

Staff reports that EITF Abstract No. 92-12 provides the following tests before any regulatory asset can be booked for PBOP costs by a utility for financial reporting purposes:

- (1) that the deferral period for PBOPs, i.e. the period of time in which the excess of FAS 106 costs over PAYGO amounts is booked as a regulatory asset, be limited to approximately five years; and

- (2) that the amortization period (i.e., recovery period in rates) for the resulting regulatory asset be set, at maximum, for an additional fifteen years.

Staff states that the EITF in effect required that public utility commissions make a commitment that for rate purposes PBOPs must begin to be treated on an accrual basis within approximately five years of the deferral order, and that the utility be on a complete FAS 106 basis for ratemaking for PBOPs within 20 years of the order, before any regulatory asset can be booked.

Staff states that HB 1405 which was later codified as Section 386.315, among other things:

- (1) directs the Commission to recognize FAS 106 costs for PBOPs for ratemaking purposes in the future; and

- (2) allows utilities who have received rate orders after January 1, 1993 and prior to the bill's effective date of August 28, 1994, the opportunity to recover their annual level of FAS 106 costs through a "one-time" tariff filing.

Staff states that on March 10, 1994, the Commission issued an order authorizing the merger of the former parent of the Company, GWC, with UWR. On April 22, 1994, the date of the merger, UWR adopted FAS 106 for all utility subsidiaries of the former GWC including the Company. Prior to the merger, neither the Company nor GWC had adopted FAS 106.

According to Staff, the Company filed its last rate case, Case No. WR-94-297, on March 25, 1994, which was prior to the merger and prior to the adoption of FAS 106 by the Company. The Company filed its testimony and exhibits on April 29, 1994, while the Staff filed its recommendation on September 8, 1994. The test year ordered in the case was the twelve months ending December 31, 1993, updated through June 30, 1994. Hearings on the rate request were held November 7 through November 9, 1994, with the Commission issuing the report and order on February 8, 1995.

Staff does not agree that it is necessary or appropriate for the Commission to issue an AAO to the Company concerning the FAS 106 expense. Staff is convinced that Section 386.315 directs the Commission to recognize in rates the actual level of expense for FAS 106 expense. Staff also believes that based on the filing schedule and updated test period in the Company's last rate case, the Company has already had the opportunity to address any concerns regarding FAS 106. In fact, Staff points out that the Company litigated a pension issue in the last rate case in which the Commission determined that the record in the case showed that GWC did not use FAS 106 accounting for PBOP's because the adoption of FAS 106 would not have a material effect on the Company's financial statements. Therefore, according to Staff, rates that were established in the last rate case would be materially the same whether the Commission had used FAS 106 or PAYGO to calculate the appropriate level of expense for PBOPs.

Staff argues that because the Company adopted FAS 106 in April of 1994 and because the rates that were established in February of 1995 included the appropriate level of PBOP costs, any subsequent change in PBOP expense should be viewed like a change to any other revenue or expense item subsequent to the setting of rates, which are not subject to recovery or deferral in isolation. Staff notes that the Company has not alleged that any extraordinary event has occurred which would justify deferral of PBOPs and that it would now be inappropriate to allow the deferral of amortization of any increase in an expense level that has occurred since the order in the last rate case. If the Company determines it has material unrecovered current expenses for FAS 106 PBOP expense, then Staff believes the proper course of action is for the Company to file a general rate increase request. Staff states that if the Commission grants the AAO, then Staff recommends that the Commission: (1) allow deferral only for costs booked during the 1997 year and prospectively, instead of retroactively back to 1994; and (2) reserve the right to review any PBOP costs deferred pursuant to the order until the Company's next rate proceeding.

On December 30 the Office of the Public Counsel (Public Counsel) filed a Motion for Denial of Application for Accounting Authority Order. Public Counsel recommends that the Commission deny the Company's AAO application for the following reasons: (1) The Company has made no allegation that the PBOP expenses in question are extraordinary in any respect, much less non-recurring; therefore, an AAO would be extremely inappropriate as demonstrated by the Commission's decision for In re St. Louis County Water Company, Case No. WR-96-263, Report and Order dated December 31, 1996, p. 13; (2) Section 386.315 already provides the Company with assurance that the Commission will recognize FAS 106 costs for PBOP expense, and the Company does not need further assurance that the

(Commission will follow the law; (3) The Company had an opportunity to address any issue with regard to FAS 106 during its previous rate case, Case No. WR-94-297, and chose not to use FAS 106 accounting at that time although the hearing was held over two months after the statute became law.

On January 20, 1998, the Company filed a Response to Staff's Memorandum and to Public Counsel's Motion for Denial. The Company argues that both Staff's and Public Counsel's recommendations are partially based on a misunderstanding of the facts surrounding the chronology of the Company's last rate case and the Company's adoption of FAS 106. The Company states that although it is true that the Company adopted FAS 106 for accounting purposes as of the date of the merger, it did not record its FAS 106 liability on the date of the merger or in April of 1994. Instead, according to the Company, it completed its evaluation of its post-retirement benefit plans other than pensions and recorded the liability in December of 1994. Therefore, the Company states that the evidentiary record was closed by the time the liability was determined and recorded on the Company's books, and there was no opportunity to address this decision within that rate case.

The Company notes that the Report and Order in Case No. WR-94-297 states that the Company had not adopted FAS 106 for ratemaking purposes and that "the record in this case shows that the Company does not use FAS 106 accounting for OPEBs because the adoption of FAS 106 would not have a material effect on the Company's financial statements." The Company stated it later determined that the failure to adopt FAS 106 was the result of actuarial error, and it therefore adopted FAS 106 in December of 1994. According to the Company, the amounts to be deferred are \$16,695 for the partial year of 1994, \$108,897 for the year 1995, \$225,576 for the year 1996, and \$315,777 for the year 1997. The Company notes that UWR, the

Company's ultimate parent, decided in the beginning of 1995 to provide the former employees of GWC's subsidiaries the same level of post retirement benefits that were being provided to all other employees of UWR.

The Company notes that both Staff and Public Counsel point out that the Company has not identified an extraordinary event that should be the basis for this AAO. In response, the Company argues that FAS 106 itself is an extraordinary event because it represented a radical change from the previous pay-as-you-go methods.

The Company states that it seeks the AAO so that the Company is allowed to preserve this issue for its next rate case. The Company states it intends to file a rate case in late 1998 which would properly place the recoverability of these deferred amounts before the Commission and allow the Commission to review and assess the assumptions and estimates used in determining the FAS 106 expenses. The Company states that in the event the Commission should choose to deny this application because it believes there is no extraordinary event, then the Company requests that the Commission issue an order which acknowledges the provisions of Section 386.315 and provides that the Company can continue to defer FAS 106 expenses until the next rate case.

On January 30 Staff filed a reply to the Company's response. Staff argues that most of the deferrals from 1994 through 1997 were caused not by the implementation/adoption of FAS 106, but rather by the business decision of the Company's parent company to provide uniform PBOPs to employees corporate-wide. Staff states this business decision is not an extraordinary event beyond the control of the parent company. Staff further contends that correction of the Company's past error by issuance of an AAO now would constitute retroactive ratemaking and single issue ratemaking. Staff points out that even if the issuance of FAS 106 was an

(extraordinary event as alleged, it occurred in 1994 and therefore does not justify the issuance of an AAO in 1998.

On February 2 the Company filed comments concerning Staff's reply. The Company states that Staff erred in assuming that the deferrals in question were caused by a business decision made by the parent company. The Company asserts that Staff's arguments concerning retroactive ratemaking and single issue ratemaking are irrelevant because rate treatment cannot result from this proceeding. The Company requests that if the Commission believes that a formal AAO is not the appropriate mechanism to preserve this issue, then, in the alternative, the Company asks that the Commission merely state in any order of denial that it has no objection to the continued deferral of these amounts until such time as they are brought before the Commission for decision.

(The Commission has reviewed the application filed by the Company, the Staff's memorandum, the motion filed by Public Counsel, the response filed by the Company, the reply filed by Staff and the comments filed by the Company. The Commission notes that the response of the Company filed on January 20 was untimely. Commission rule 4 CSR 240-2.080(12) provides, "Parties shall be allowed ten (10) days from the date of filing in which to respond to any motion or other pleading unless otherwise ordered by the Commission." The Company's response was filed 27 days after Staff's recommendation and 21 days after Public Counsel's motion.

(The Commission determines that it is not appropriate to issue the Company an AAO for costs incurred retroactive to 1994. The Commission finds it persuasive that the Company previously took a position that it need not request this authority. Now, after more than three years, the Company believes an AAO is appropriate retroactive to 1994. The Commission

concludes that it will allow deferral only for costs booked during the 1997 year and prospectively, instead of retroactively back to 1994.

The Commission will grant the Company an AAO for such costs booked during the 1997 year and prospectively. The Commission will authorize the Company to maintain on its books its regulatory asset which represents the excess of its FAS 106 PBOPs over the pay-as-you-go amount that the Company has been booking since 1997, with said deferral continuing until the effective date of a Report and Order in the Company's next general rate proceeding. The Commission concludes it is appropriate to express its intent to include in the rates established in the Company's next rate proceeding, the Company's current prudently incurred FAS 106 expense in accordance with Section 386.315, RSMo 1994, as well as an amortization of the prudently incurred FAS 106 costs deferred pursuant to this order, over a period of time ending no later than December 31, 2012. With the exception of the foregoing, the Commission concludes that any ratemaking determination regarding the costs to be deferred is not warranted, and the Commission will reserve the right to consider the ratemaking treatment to be accorded these expenditures in a later proceeding.

IT IS THEREFORE ORDERED:

1. That the Application for Accounting Authority Order filed by United Water Missouri Inc. on November 5, 1997, is approved in part and denied in part as provided herein.

2. That United Water Missouri Inc. is authorized to maintain on its books its regulatory asset which represents the excess of its Financial Accounting Standard 106 Post-Retirement Benefit Expense Other Than Pensions over the pay-as-you-go amount that the United Water Missouri Inc. has been booking since January 1, 1997, with said deferral continuing

until the effective date of a Report and Order in the next general rate proceeding of United Water Missouri Inc.

3. That the Commission intends that the rates established in United Water Missouri Inc.'s next general rate case will include, among other things, the Company's prudently incurred Financial Accounting Standard 106 expense pertaining to Post Retirement Benefit Expense Other Than Pensions incurred since January 1, 1997, in accordance with Section 386.315, RSMo 1994, as well as an amortization of the prudently incurred Financial Accounting Standard 106 costs deferred pursuant to this Accounting Authority Order, over a period of time ending no later than December 31, 2012.

4. That except as otherwise indicated in ordered paragraph 3, nothing in this order shall be considered a finding of the Commission regarding ratemaking determinations concerning the costs to be deferred. The Commission further reserves the right to consider the ratemaking treatment to be accorded these expenditures in a later proceeding.

5. That this order shall become effective on February 18, 1998.

BY THE COMMISSION



Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge

(S E A L)

Lumpe, Ch., Crumpton, Murray,
and Drainer, CC., concur.

G. George, Regulatory Law Judge

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COMMISSION COUNSEL
PUBLIC SERVICE COMMISSION