Agenda Date: April 27, 2005
Item No.: A2

Docket: UE-031878

Company Name: PacifiCorp, dba Pacific Power & Light Company

Staff: Thomas Schooley, Regulatory Analyst
Roland Martin, Regulatory Analyst
Christian Ward, Regulatory Analyst

Recommendation:

Set for hearing the petition of PacifiCorp in Docket UE-031878.

Background:

On November 17, 2003, PacifiCorp, doing business as Pacific Power & Light Company, ("PacifiCorp" or "the Company") filed a petition for an accounting order that would authorize the Company to record a regulatory asset per its FAS 87 determined Additional Minimum Liability. (Financial Accounting Standard 87 relates to pension expenses and liabilities.) Absent the Commission's authorization, the Company would record a charge to Accumulated Other Comprehensive Income ("AOCI"), a part of the owner's equity section of the balance sheet. The Company claims this could affect certain financial indicators and potentially harm the Company's credit rating. The petition is consistent with treatment granted in other states where PacifiCorp has utility operations.

In accordance with FAS 87, an Additional Minimum Liability must be recognized if the Accumulated Benefit Obligation ("ABO") for an employer's pension plan exceeds the fair value of plan assets by more than the amount currently recorded as the pension fund liability (or the Unfunded Accrued Pension Cost Liability). The ABO is the present value of the plan's accrued benefits without pay projections. The balancing entry to the Additional Minimum Liability is a charge to Accumulated Other Comprehensive Income. The petition before you requests authorization to record the charge not to AOCI, but to a regulatory asset balancing account. This accounting avoids the negative consequence of reducing the Company's equity and the associated effects on the Company's financial ratios. The Company states in its petition, "Nothing in this Petition is intended to request approval regarding future ratemaking treatment of the costs for which regulatory asset treatment is requested."

The petition also requests definitive recognition by the Commission that the FAS 87 determined level of pension expense will be used for ratemaking purposes.

Discussion:

PacifiCorp claims in the petition that the level of pension expense is unaffected by approving the accounting treatment sought for the FAS 87 additional minimum liability. The Company agrees that the regulatory asset will not affect rate base. Staff would like to more firmly establish this claim in the context of the factors leading to the need for PacifiCorp to record an additional minimum pension liability.

The Additional Minimum Liability as determined by FAS 87 arises because of various factors. Declining stock prices reduce the value of the equity portion of the pension plan. Declining interest rates raise the prices of bonds mitigating some of the equity losses. The reduced interest rates however means the Company must use a lower discount rate in determining the present value of the future pension liability. Thus the liability increases. The combined effect at PacifiCorp pushed the pension liability to be significantly over the level of pension assets. Staff is concerned that reduced contributions to the pension assets over the past few years is a contributing factor to the excess of pension obligations over the pension assets.

PacifiCorp argues that the requested accounting treatment is in the public interest because the alternative, which is to use generally accepted accounting principles, would require the posting of the debit side of the additional minimum liability to Other Comprehensive Income, thereby negatively affecting the company's stockholder equity level. Staff acknowledges that, if sufficient in magnitude, GAAP treatment of this item could change the debt-to-equity ratio enough to affect financial analysts' assessment of the company's strength.

However, Staff is uncertain if the magnitude of this equity effect would alter the analysts' views of PacifiCorp's financial strength. PacifiCorp has provided no analysis of the likely effect on its equity levels with and without the requested accounting treatment, but Staff estimates that even at the full level of the charge to AOCI claimed by the company, granting the petition would likely decrease PacifiCorp's equity ratio by approximately one percentage point. This may or may not have a material effect on an analyst's assessment of the company. Moreover, even if this action reduced analysts' concerns about the company's equity levels, it could well increase analysts' concerns about the level of regulatory assets on the company's books.

In addition, Staff has concerns that by approving the accounting petition there is a greater risk of future rate increases than what the company suggests in the petition.

Finally, Staff believes that adherence to GAAP with respect to pension costs is prudent because PacifiCorp's current situation may, in part, be due to internal decisions of the Company. The need for PacifiCorp to post an additional minimum pension liability has several contributing factors and a full record will shed light on the scope of conscious decisions by the Company versus external factors outside the Company's control. It is reasonable to hold PacifiCorp to the GAAP standards for their own actions.

The petition also raises a question as to whether, for ratemaking purposes, the Commission should exclusively use the expense level determined under FAS 87. Staff believes the Commission should not have its options restricted in its ability to determine fair and reasonable rates and recommends that this portion of the petition be denied as well. The treatment of pension cost should be left open for discussion and decision in general rate cases.

Conclusion:

Staff recommends setting for hearing the matter of PacifiCorp's request for authorization to record as a regulatory asset an amount equal to the pretax charge against equity that would otherwise be recognized as an Additional Minimum Liability under Financial Accounting Standard 87.