

**EXHIBIT NO. \_\_\_(MJS-6)  
DOCKET NO. UE-072300/UG-072301  
2007 PSE GENERAL RATE CASE  
WITNESS: MICHAEL J. STRANIK**

**BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,**

**Complainant,**

**v.**

**PUGET SOUND ENERGY, INC.,**

**Respondent.**

**Docket No. UE-072300  
Docket No. UG-072301**

**FIFTH EXHIBIT (NONCONFIDENTIAL) TO THE  
PREFILED REBUTTAL TESTIMONY OF  
MICHAEL J. STRANIK  
ON BEHALF OF PUGET SOUND ENERGY, INC.**

**JULY 3, 2008**

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Raymond J. O'Connor, Chairman;  
Georgiana Shelton, A. G. Souza  
and Oliver G. Richard III.

Eastern Edison Company ) Docket No. FA84-2-000

ORDER ON ACCOUNTING ADJUSTMENT

(Issued July 5, 1984)

Pursuant to Part 41 of the Commission's regulations, Eastern Edison Company (Eastern) and the Commission staff have filed initial and reply briefs concerning a dispute over a staff audit of Eastern's records and books for the period January 1, 1979 through December 31, 1981. At issue is whether, for accounting purposes, Eastern properly reduced its depreciation reserve by \$1,415,000 and increased its net plant-in-service included in rate base by the same amount, on the basis that that certain book depreciation amounts had not been recovered through retail rates. We conclude that Eastern improperly restated its depreciation expense for accounting purposes.

Background

Eastern Edison Company was formed in 1979 by the merger of Brockton Edison Company and Fall River Electric Company. It is a wholly owned subsidiary of Eastern Utility Associates, a holding company under the Public Utility Holding Company Act of 1935. Almost all of its service is provided at the retail level to 22 communities in Southeastern Massachusetts, including the cities of Brockton and Fall River, and its retail rates are regulated by the Massachusetts Department of Public Utilities (MDPU).

Prior to the 1979 merger, the depreciation rate on distribution properties owned by Fall River was increased twice. In 1975, Fall River increased the rate from 2.5% to 3.0%. In 1976, it increased the rate from 3.0% to 3.5%. However, according to Eastern, the company did not file any retail rate increases to recover the increased depreciation costs. In 1980, Eastern made a rate filing with the MDPU which reflected the 3.5% depreciation rate.

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Docket No. FA84-2-000

- 2 -

The MDPU allowed Eastern to restate its accumulated depreciation such that subsequent balance sheets have reflected an accumulated depreciation reserve that is \$1.4 million lower than if the restatement had not been made. 1/

The staff does not dispute that the MDPU has ratemaking jurisdiction over Eastern, but argues that the issue here is one of accounting -- how to account for a special asset created by the MDPU in the ratemaking process. It maintains that Eastern's

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1/ The events before the MDPU were as follows:

(1) The MDPU initially disallowed Eastern a depreciation rate above 2.5%, because of inadequate evidentiary support. Accordingly, it reduced Eastern's depreciation expense of 3.5%. D.P.U. 243 (Nov. 26, 1980).

(2) The MDPU then amended its decision in D.P.U. 243, concluding that its disallowance of the 3.5% depreciation rate necessitated corresponding adjustments to the depreciation reserve for the prior years when the higher depreciation rates were booked. Eastern was allowed to reduce its depreciation reserve and increase its rate base. Adjusting depreciation rates since 1975 to reflect a 2.5% charge resulted in a \$706,156 reduction in the depreciation reserve over this period. D.P.U. 243-A (Feb. 11, 1981).

(3) On February 24, 1981, Eastern asked the MDPU for accounting approval to record on its December 1980 books an adjustment to lower its depreciation reserve by \$1.24 million and increase net plant-in-service by the same amount.

(4) On March 3, 1981, Eastern informed the MDPU of computational errors indicating that the restated amount should be \$1.4 million.

(5) By letter order dated March 11, 1984, the MDPU approved the company's request to reflect in its 1980 and 1981 financial statements the requested reduction in depreciation reserve and increase in net plant-in-service.

(6) According to Eastern, it has been allowed to treat the \$1.4 million addition to net plant-in-service as rate base in a series of MDPU orders: D.P.U. 837 (Feb. 26, 1982); D.P.U. 1130 (Jan. 24, 1983); D.P.U. 1580 (Jan. 31, 1984). In D.P.U. 1580, the MDPU also approved an increase in depreciation rates to 4.05%, which incorporates the restated depreciation.

Docket No. FA84-2-000

- 3 -

accounting produces a distortion by reporting a negative depreciation expense for Fall River properties in 1980. The staff proposes to put the \$1.4 million into Account 186:

186 Miscellaneous deferred debits.

A. This account shall include all debits not elsewhere provided for, such as miscellaneous work in progress, and unusual or extraordinary expenses, not included in other accounts, which are in process of amortization and items the proper final disposition of which is uncertain. 18 C.F.R. Part 101.

Amounts in Account 186 would be amortized over the period of recovery permitted by the MDPU. According to the staff, this would be consistent with the Uniform System of Accounts, and would properly classify the amount as a special asset without impairing Eastern's ability to maintain its records consistent with the ratemaking process in Massachusetts.

Eastern proposes to classify the restated amount as net plant in service under Account 108, Accumulated provision for depreciation of electric utility plant, and argues that it is simply restating its depreciation reserve to follow the MDPU rate orders. It claims the Financial Accounting Standards Board requires a regulated enterprise to capitalize a cost as an asset if, as shown here, it is "probable" that the asset will be recovered in rates. 2/ Eastern further contends its proposal satisfies the Commission's responsibilities of maintaining the uniformity of its System of Accounts, and ensuring that utilities' financial statements properly recognize the economic impact of the ratemaking decisions that affect them.

DISCUSSION

Our reasons for denying Eastern's proposed restatement are that the adjustment of depreciation reserves through use of Account 108 results in retroactive accounting, and is contrary to general accounting principles and Commission regulations. 3/ As pointed

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2/ Statement of Financial Accounting Standards No. 71, December 1982, at 3.

3/ Eastern's proposal conflicts with two of our accounting requirements. Paragraph B of Electric Plant Instruction 1, 18 C.F.R. Part 101, provides:

B. ... Adjustments shall not be made to record in utility plant accounts amounts previously charged to operating expenses or to income deductions in accordance with the uniform system of accounts in effect at the time or in accordance with the discretion of management as exercised under a uniform system of accounts, or under accounting practices previously followed. (emphasis added)

(FOOTNOTE CONTINUED ON NEXT PAGE)

out by staff, Eastern's restatement distorted its net earnings in the year of restatement and made it appear more profitable than it actually was. 4/ One of the purposes of the Uniform System of Accounts is to provide to the public and regulatory authorities reliable information as to a utility's financial condition. To allow Eastern's proposed restatement would frustrate this purpose.

We have reviewed the actions of the MDPU, and circumstances indicate that Eastern will likely recover the restated depreciation amount through ratemaking at the retail level. However, as recognized by the courts, this Commission's accounting requirements take precedence over the actions of state regulators for books of account and published financial statements of utilities subject to our jurisdiction. 5/ In order to reflect the MDPU actions and at the same time be consistent with our accounting requirements, we find it appropriate to allow Edison to include the restated depreciation amount in Account 186. This comports with our recent treatment of carrying charges (AFUDC) accrued under state guidelines, but in excess of the amount allowed under our regulations. 6/

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(FOOTNOTE CONTINUED FROM PREVIOUS PAGE)

General Instruction No. 7.1, Paragraph B, 18 C.F.R. Part 101, provides:

Treatment as a prior period adjustment should not be applied to the normal, recurring corrections and adjustments which are the natural result of the use of estimates inherent in the accounting process. For example, changes in the estimated remaining lives of fixed assets affect the computed amounts of depreciation, but these changes should be considered prospective in nature and not prior period adjustments.

4/ According to the staff, Eastern reported that its Fall River properties had a negative depreciation expense of \$255,000 in 1980.

5/ In Appalachian Power Co. v. F.P.C., 328 F.2d 237, 246 (4th Cir. 1964), the court stated:

We agree with the Commission's determination that it, rather than state agencies, has the power to regulate the basic accounts which a company subject to its jurisdiction must use for financial reporting purposes.

The court further cited to the Supreme Court's finding in Northwestern Electric Co. v. F.P.C., 321 U.S. 119, 125 (1944), that state regulatory accounting actions are subordinate to Congress' appropriate exercise of the commerce power.

6/ Central Louisiana Electric Co., 77 FEP, 601, 297 (1984).

Docket No. RA84-2-000

- 5 -

Lastly, we will address Eastern's reliance on Nantahala Power & Co., Opinion Nos. 139 and 139-A, 19 FERC ¶61,152 (1982) and 20 FERC ¶61,430 (1982), in support of its position. In Nantahala, the Commission's chief accountant permitted the company to restate its depreciation reserve by reducing the accumulated depreciation in Account 108, which is what Eastern seeks to do here. That case, however, was a special situation involving a restatement of accelerated wartime depreciation, which had been taken during years when the company was not subject to our jurisdiction. The approval by the chief accountant noted that the adjustment appeared consistent with the intent of certain prior Commission orders permitting adjustment to Account 108 for companies newly subject to Commission jurisdiction. The adjustment was disallowed for ratemaking purposes in Opinion Nos. 139 and 139-A. Eastern's factual situation clearly is distinguishable. Its arguments in this regard therefore are dismissed.

The Commission orders:

(A) Eastern Edison Company is directed to state its accounts in accordance with this order.

(B) Eastern Edison's May 10, 1984 motion for leave to file supplemental brief is denied, and its May 10, 1984 supplemental brief is rejected. 7/

By the Commission.

( S E A L )

*Kenneth F. Plumb*

Kenneth F. Plumb,  
Secretary.

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7/ Commission regulations pertaining to Part 41 procedures do not permit the filing of supplemental briefs, and no good cause has been shown to justify a waiver of our regulations.

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FEDERAL ENERGY REGULATORY COMMISSION  
WASHINGTON, D.C. 20426

In Reply Refer To:  
OCA-DAS  
Docket No. AC93-30-000  
FEBRUARY 2, 1993

Florida Public Service Commission  
Division of Research & Regulatory Review  
Attention: Lynn Adams  
Regulatory Analyst IV  
101 East Gains Street  
Fletcher Building  
Tallahassee, FL 32399-0872

Ladies and Gentlemen:

We have reviewed your letter dated October 16, 1992, requesting clarification of the Commission's position on the propriety of transfers of accumulated depreciation. 1/

You reference two letters issued by the Commission that you characterize as "expressing contradictory opinions on reserve restatements." 2/ We have reviewed these letters and find no inconsistency in the application of the Commission's rules as expressed in them.

The letter order to Tampa Electric refers to the acquisition of assets that had previously been devoted to public service by another utility. Traditionally, regulatory commissions have required that cost-based rates be derived from the cost to the person who first devoted the property to public service (original cost). To accommodate this ratemaking practice, the Commission's Uniform System of Accounts requires companies to include amounts for property acquired as an operating unit or system in the plant-in-service account at original cost. Any difference between the acquisition cost, including rehabilitation cost and expenses incidental to the acquisition, and depreciated original cost are to be included in Account 114, Electric Plant Acquisition Adjustments.

1/ The letter was filed with the Commission on December 3, 1992.

2/ Bruder, Gentile & Marcoux, Docket No. AC91-96-000, November 22, 1991, and Tampa Electric Company, Docket No. AC91-102-000, December 6, 1991.

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Florida Public Service  
Commission

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where the amount of the acquisition adjustment is a credit balance however, the Commission has traditionally required the excess of the depreciated original cost on the books of the seller over the purchase price (fair value) of the buyer to be transferred to the depreciation reserve. This insures that the acquiring utility collects from its customers only the amount it paid for the property purchased. 3/ Although the difference between the book basis and the sales price may be viewed as being caused by insufficient depreciation recorded by the seller, it is not a depreciation accounting issue from the perspective of the buyer. Rather, the required accounting for the acquisition of an asset is a way to accommodate both the original cost convention and historical cost financial accounting in such circumstances.

On the other hand, the letter order to Bruder, Gentile & Marcoux on behalf of Florida Power Corporation pertains to depreciation accounting practices in general and the transfer of utility depreciation reserves between reserve accounts in particular. This letter, in a nutshell, stated that excesses or deficiencies in depreciation reserves should be corrected prospectively through adjustments in depreciation rates. Unlike the purchase/sale of utility assets situation mentioned in the Tampa letter, there was no change in ownership of utility assets involved in the Florida Power letter and no gain or loss to be recognized. Further, since different customer classes pay for different facilities, the transfer of depreciation reserves between depreciation accounts in the manner suggested could result in unfair subsidies.

In our view, the two situations are entirely different and the guidance previously given result is a consistent application of the Commission's accounting requirements.

Authority to act on this matter is delegated to the Chief Accountant pursuant to  $\square$  375.303 of the Commission's regulations.

3/ A loss would be recognized by the selling utility to the extent the sales price was less than its depreciated book value. The regulatory commission having jurisdiction over this utility's rates could, if consistent with its ratemaking practices to do so, grant future rate recovery of the loss on sale in recognition of insufficient depreciation being recorded while the property was owned by the utility.

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FEDERAL ENERGY REGULATORY COMMISSION  
WASHINGTON, D.C. 20426

OCA-AD  
Docket No. AC91-99-000  
November 22, 1991

Miller, Balis & O'Neil  
Attn: William T. Miller  
1101 Fourteenth Street, N.W.  
Suite 1400  
Washington, DC 20005

Dear Mr. Miller:

By letter dated August 21, 1991, you filed a request on behalf of Seminole Electric Cooperative, Inc. ("Seminole"), that we confirm FERC's accounting policy concerning the elimination of surpluses and deficiencies in the depreciation reserves over the remaining plant life without restating depreciation reserves.

In the letter you state that on January 4, 1991, the Florida Public Service Commission (FPSC), issued an order to Florida Power Corporation (Florida Power) to transfer amounts from depreciation reserves determined to be excessive to accounts determined to be deficient. You claim that the FPSC's order, if accepted by the FERC for cost of service purposes and applied to Seminole, would reduce the depreciation reserve allocable to Seminole and thereby increase the rate base allocable to Seminole. You claim that this would be an unreasonable result, since Seminole has already supported this investment in past rates.

The following response is intended to provide you with general guidance with respect to the FERC's depreciation policies. It is not intended to address the merits of your specific arguments of the ratemaking implications of the FPSC's order.

Under the Commission's Uniform system of Accounts, depreciation is viewed as an allocation process. It allocates the costs of depreciable property in a systematic and rational manner over the property's estimated service life. There are several acceptable methods that can be used to allocate the cost of an asset over the period expected to benefit from its use, but the method most widely used by utilities and the one most readily accepted by the Commission is the straight-line remaining life method. Under this method, over and under accruals of depreciation recorded in past accounting periods are corrected over the remaining life of

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the related property by adjusting the book depreciation rates prospectively.

-2-

The Uniform System of Accounts does not explicitly address the question of transferring overaccrued amounts of depreciation in certain accounts to offset underaccrued amounts recorded in certain other accounts. However, such transfers could, and in my view should be viewed as restatements of the previously recorded depreciation expense applicable to both accounts. The Commission has addressed the question of restatements of depreciation expense in at least two cases. One was a 1976 decision involving Equitable Gas Company and the other was a 1984 decision involving Eastern Edison Company. In both cases the Commission concluded that restatements of previously recorded depreciation expense was inappropriate. Copies of those decisions are enclosed.

Authority to act on this matter is delegated to the Chief Accountant pursuant to § 375.303 of the Commission's regulations. This letter order constitutes final agency action. Requests for rehearing by the Commission may be filed within 30 days of the date of issuance of this letter order, pursuant to 18 C.F.R. § 385.713.

On June 28, 1991, the Commission issued a "Notice Designating New Docket Prefixes for Letters Issued by the Chief Accountant". As part of this notice, the Commission informed applicants to file an original and seven copies of each request for an approval or an interpretation from the Chief Accountant. Accordingly for all future filings, please submit an original and seven copies of your request.

Sincerely Yours,

Russell E. Faudree, Jr.  
Chief Accountant

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In Reply Refer To:  
OCA-DAS  
Docket No. AC91-102-000  
December 6, 1991

Mr. Lester L. Lefler  
Vice President-Controller  
Tampa Electric Company  
P.O. Box 111  
Tampa, FL 33601-0111

Dear Mr. Lefler:

We have reviewed your proposed journal entries submitted with your letter dated August 28, 1991, to clear Account 102, Electric Plant Purchased or Sold, in connection with the purchase of the generating facilities of Sebring Utilities Commission, including the Phillips and Dinner Lake Plants.

The purchase resulted in a credit acquisition adjustment in the amount of \$10,451,530 1/ which you propose to record in Account 114, Electric Plant Acquisition Adjustments, and to amortize to Account 406, Amortization of Electric Plant Acquisition Adjustments, over the 23-year remaining life of the facilities.

With regard to credit acquisition adjustments, it is this Commission's policy to require credit acquisition adjustments arising from the acquisition of utility properties to be disposed of by crediting the acquisition adjustment to the accumulated provision for depreciation applicable to the properties acquired.

Your proposed journal entries are accepted for filing, provided that the credit acquisition adjustment is transferred from Account 114 to Account 108, Accumulated Provision for Depreciation of Electric Utility Plant, and subject to adjustment should additional information warrant.

Authority to act on this matter is delegated to the Chief Accountant pursuant to 375.303 of the Commission's regulations.

1/ Mr. Richard Walker of your Company informed my staff that the acquisition adjustment includes \$277,335 for rehabilitation costs, and that the additional costs to rehabilitate the assets, as noted in your letter, were expected to be minor in amount. Such additional costs will require a corresponding adjustment in the resulting acquisition adjustment.

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Tampa Electric Company

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This letter order constitutes final agency action. Requests for rehearing by the Commission may be filed within 30 days of the date of issuance of this letter order, pursuant to 18 C.F.R. §385.713.

On June 28, 1991, the Commission issued a "Notice Designating New Docket Prefixes for Letters Issued by the Chief Accountant". As part of this notice, the Commission informed applicants to file an original and seven copies of each request for an approval or an interpretation from the Chief Accountant. Accordingly for all future filings, please submit an original and seven copies of your request.

Sincerely yours,

Russell E. Faudree, Jr.  
Chief Accountant

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