BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,	)	
	)	DOCKET UE-010453
IN THE MATTER OF THE PETITION OF PACIFICORP	)	ORDER GRANTING ACCOUNTING PETITION
For an Accounting Order Authorizing the Establishment of a Regulatory Asset or Liability to Account for the Effects of Certain Derivative and Hedging Financial Accounting Rules	)	
. . . .	)	

BACKGROUND

1 On April 4, 2001, PacifiCorp, (or the "Company") filed a petition with this Commission pursuant to Chapter 80.04 RCW and WAC 480-09-420(7) seeking an order authorizing the establishment of a regulatory asset or regulatory liability associated with the implementation of Statements of Financial Accounting Standards 133 and 138 (FAS 133/138), Accounting for Derivative Instruments and Hedging Activities.

2 The Company proposes the following accounting treatment:

- To record the fair value of various resource acquisition contracts according to FAS 133/138, as assets, in FERC Account 186, Miscellaneous Deferred Debits, or as liabilities, in FERC Account 253, Other Deferred Credits.
- Simultaneously record offsetting regulatory assets and/or liabilities to the FAS 133/138 assets and/liabilities, using the FERC accounts, 182.3 for Regulatory Assets and FERC, account 254 for Regulatory Liabilities.

There would be no effect shown in the Company's income statement. The balance sheet would reflect both the fair value adjustment and the offsetting regulatory asset or liability in the separate accounts stated above. Under the proposed accounting, when the obligations under an affected contract are fulfilled, any gain or loss recognized under the standard would be reversed, and the offsetting regulatory asset or liability would be reversed, resulting in no net gain or loss upon settlement of the contract.

3 FAS 133 was issued by the Financial Accounting Standards Board (FASB) in June 1998. The FASB amended it with FAS 138 in June 2000. PacifiCorp requests that the accounting treatment become effective for financial accounting entries beginning with the Company's adoption of FAS 133/138 on April 1, 2001.

4 PacifiCorp, in the provision of service to its retail and wholesale customers, enters into contracts such as power purchase and sale contracts. Further, the company may enter contracts to hedge the price related to purchases and sales of energy. Many of the contracts such as certain power purchase and sale contracts, generation capacity, transmission capacity, and physical daily power purchase options, meet the definition of a derivative as defined in FAS 133/138. As a result, PacifiCorp will be required to book assets or liabilities, created by the difference in each contract's stated price and the current market price, in financial statements issued between the time of the original contract and the final settlement of the contract terms. In offsetting bookkeeping entries, PacifiCorp will have to record gains and losses in their income statements. For contracts that are ultimately fulfilled by the delivery of the energy, the interim gains and losses related to the valuing of the contracts at fair value will offset, resulting in no net gain or loss upon settlement of contract other than the actual expense or revenue generated by the contract. Further, these accounting entries will have no direct effect on the company's cash flows.

5 Assessment of PacifiCorp's contracts required to be reported at fair value under FAS 133/138 indicates that the non-cash earnings adjustment to implement the standards, as of March 23, 2001, is estimated to range from a gain of $269 million to a loss of $1,049 million. This illustrates the extreme volatility the standards will introduce to the Company's earnings. The Company claims that small changes in market prices will result in significant volatility. According to PacifiCorp, recording gains or losses of the stated magnitude would cause significant volatility to the Company's retained earnings and thereby significantly impact (increasing or decreasing) the Company's ability to pay dividends, without a corresponding change in cash flow from operating results. Financing arrangements of the Company could also be impacted.

DISCUSSION:

6 Normally, the Commission establishes rates by determining a company's rate of return for a historical period pro-formed for all known and measurable changes. In these analyses, purchase and sales contracts for energy are generally pro-formed to the actual known and measurable prices contained in the contracts for the rate period. Market prices have not been considered relevant to the pricing of contracts which have stated prices. The adoption of FAS 133/138 by PacifiCorp will result in the Company's financial statements being inconsistent with the normal practice used by this Commission in setting rates. The use of fluctuating market pricing rather than embedded contract pricing is not appropriate for setting rates, particularly when the fluctuating market prices have no long term impact on the company's earnings or cash flow.

7 Therefore, the Commission accepts the proposed accounting for derivatives and hedging activities as contained in PacifiCorp's petition. Acceptance of the accounting treatment of these activities in no way makes determination on the prudence of any energy contract or derivative for rate making purposes. The future non-cash impacts of the accounting convention imposed by FAS 133/138 will be excluded from the Commission's determination of cost of service with respect to the contracts.

8 This matter was brought before the Commission at its regularly scheduled open meeting on April 25, 2001. The Commissioners, having been fully advised in the matter, and having determined the following order to be consistent with the public interest, directed the Secretary to enter the following order and related provisions.

FINDINGS

THE COMMISSION FINDS:

9 (1) PacifiCorp is an electrical company and a public service company as defined by RCW 80.04.010 and, as such, is subject to the Commission's jurisdiction. PacifiCorp also provides retail electric service as a public utility in the states of California, Idaho, Oregon, Utah, and Wyoming.

10 (2) On April 4, 2001, PacifiCorp filed with the Commission a Petition for an Accounting Order Authorizing the Establishment of a Regulatory Asset or Liability to Account for the Effects of Certain Derivative and Hedging Financial Accounting Rules.

11 (3) The accounting treatment proposed by PacifiCorp is reasonable and should be approved.

ORDER

12 THE COMMISSION ORDERS That:

13 It has jurisdiction over the subject matter and the parties to these proceedings;

14 PacifiCorp's petition is granted, the Company is authorized to record regulatory assets and liabilities in account 182.3, Other Regulatory Assets and account 254 Other Regulatory Liabilities, to offset the assets and liabilities required by FAS 133/138 related to certain derivatives and hedging activities described in the Company's petition. These entries are to be made simultaneously with the entries required by FAS 133/138.

15 Nothing herein shall be construed to waive or otherwise impair the jurisdiction of the Commission over rates, services, accounts, and practices of Applicant, PacifiCorp.

16 THE COMMISSION ORDERS FURTHER That it retains jurisdiction over the subject matter and the Parties to effectuate the provisions of this Order.

DATED at Olympia, Washington, and effective this 25th day of April, 2001.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

CAROLE J. WASHBURN
Secretary