

SERVICE DATE  
AUG 16 1994

**NOTE: An important notice to parties about administrative review appears at the end of this order.**

**BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Petitions of )	
U S WEST COMMUNICATIONS, INC. )	DOCKET NO. UT-930074
Relating to the Effective Date for )	
the Accounting Change to Implement )	
SFAS 106, Post Retirement Medical )	
Benefits, and a Ratemaking )	DOCKET NO. UT-930307
Adjustment for the Pension Asset )	
. . . . . )	
In the Matter of the Petition of )	
U S WEST COMMUNICATIONS, INC. )	DOCKET NO. UT-931378
Relating to the Implementation of )	FINDINGS OF FACT,
SFAS 112, Employers' Accounting for )	CONCLUSIONS OF LAW
Post Employment Benefits )	AND INITIAL ORDER
. . . . . )	

**PROCEEDINGS:** This proceeding consists of two petitions by U S West Communications relating to the adoption and implementation of new accounting procedures promulgated by the Financial Accounting Standard Board (FASB), and one petition relating to the inclusion of a pension asset in ratebase. Docket UT-930074 is the company's request to adopt Statement of Financial Accounting Standards No. 106, Employers' Accounting for Post-Retirement Benefits Other Than Pensions, (SFAS 106) effective January 1, 1992. Docket UT-930307 requests Commission authorization to include a pension asset in ratebase on an on-going basis effective with the 1992 sharing year. Docket UT-931378 requests Commission approval of the company's use for accounting purposes of SFAS 112, Employers' Accounting for Post-Employment Benefits, effective January 1, 1993. The matters were consolidated by order of the Commission and set for hearing.

**HEARINGS:** Hearings were held on these petitions in Olympia before Administrative Law Judge Lisa A. Anderl on November 1, 1993, and May 16 and 17, 1994. The parties filed briefs by July 8, 1994.

**APPEARANCES:** U S West Communications, Inc., (USWC or U S WEST) was represented by Edward T. Shaw, attorney, Seattle. The Commission Staff was represented by Steven W. Smith, assistant attorney general, Olympia. The public was represented by Robert F. Manifold, assistant attorney general, Seattle. Intervenor MCI Telecommunications Corporation (MCI) was represented by Brooks Harlow, attorney, Seattle. Intervenor

TRACER was represented by Arthur A. Butler, attorney, Seattle. Intervenor Telephone Pioneers of America was represented by Harold Grimes, chapter officer. Intervenor Washington Independent Telephone Association (WITA) was represented by Richard A. Finnigan, attorney, Tacoma.

SUMMARY: This initial order recommends denial of U S WEST's petition for early adoption of SFAS 106 and the petition to include a pension asset in rate base. This order would grant the petition to adopt SFAS 112 for ratemaking purposes effective January 1, 1994.

MEMORANDUM

Background

On January 20, 1993, U S WEST filed a petition in Docket UT-930074 requesting Commission approval of the company's request to adopt Statement of Financial Accounting Standards No. 106, Employers' Accounting for Post-Retirement Benefits Other Than Pensions, (SFAS 106) effective January 1, 1992. The Commission had previously approved implementation of SFAS 106 effective January 1, 1993. Early adoption of SFAS 106 would result in the company funding \$25 million for 1992; \$10.9 million would be ratepayer sharing dollars under the company's alternative form of regulation (AFOR).

On March 23, 1993, U S WEST filed a request in Docket UT-930307 for Commission authorization to include a pension asset in rate base on an on-going basis effective with the 1992 sharing year. U S WEST's calculation of this asset is \$67 million. The impact on ratepayers for 1992 would be \$4 million.

On November 12, 1993, U S WEST filed a request in Docket UT-931378 for Commission approval of the company's use for accounting purposes of SFAS 112, Employers' Accounting for Post-Employment Benefits, effective January 1, 1993. If granted, this accounting petition would involve a one-time catch up entry of \$9 million on the company's books, to reflect the liability for disability and worker's compensation claims.

The matters were consolidated by order of the Commission and set for hearing. The parties prefiled all their direct and rebuttal testimony. Hearings for cross-examination of that testimony took place on May 16 and 17, 1994, in Olympia, Washington. U S WEST presented three witnesses: Margaret Wright, the state finance director; Wayne Borkowski, CPA and adjunct professor at Pacific Lutheran University; and Gene Wickes, an actuary with Towers Perrin. Commission Staff's witness was Teresa Pitts, policy specialist. Public Counsel and TRACER jointly sponsored Steven Carver, a consultant with

Utilitech, Inc. The other intervenors did not present any witnesses.

The parties filed briefs, which were due on July 8, 1994. Staff, Public Counsel, TRACER, and MCI oppose the petitions. U S WEST and WITA urge the Commission to grant the petitions. Telephone Pioneers of America did not file a brief.

SFAS 106 / DOCKET NO. UT-930074

This petition is the company's request for Commission approval to adopt Statement of Financial Accounting Standards No. 106, Employers' Accounting for Post-Retirement Benefits Other Than Pensions, (SFAS 106) effective January 1, 1992. The Commission had previously approved implementation of SFAS 106 effective January 1, 1993.<sup>1</sup>

Post-retirement benefits other than pensions are benefits such as health insurance which U S WEST and many other companies provide to retirees and dependents. These benefits have, in the past, been accounted for on a pay-as-you-go basis, with the company recognizing the liability when payment is incurred. The FASB, in promulgating SFAS 106, recognized that the liability for these benefits is generated because of the retiree's employment and ordered that the liability must be accrued on the company's books over the course of the employment during which the benefits are earned. The FASB has required companies to implement SFAS 106 effective with fiscal years after December 15, 1992 and has encouraged earlier adoption. The FCC has authorized companies to implement SFAS 106 effective on or before January 1, 1993.

Implementation of SFAS 106 involves a catch up entry for benefits earned to date, and the ongoing annual obligation. At the time SFAS 106 is adopted, the company faces a catch up entry, also known as the transition benefit obligation (TBO) which represents the amount of vested post-retirement benefits other than pensions which have been earned by employees to date. The company had not booked this liability in the past because on a pay-as-you-go basis it was not required to. SFAS 106 allows the company to take this liability all at once (as it did for

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<sup>1</sup> The Commission approved a settlement agreement between the company and Staff on January 16, 1990, in Dockets U-89-2698F and U-89-3245-P. Paragraph 18E of that agreement provides that if the FCC and the FASB approve or mandate SFAS 106, the company could petition for approval to make accruals and the Staff agreed not to oppose accruals in principle. Staff did not oppose the implementation of SFAS effective January 1, 1993.

financial accounting purposes) or to amortize it over a period no longer than 20 years or the remaining service life of the employees, which is what the company proposes for ratemaking. The other element is the current or annual liability for the post-retirement benefits other than pensions. This amount is calculated actuarially and is subject to annual true-ups to reflect actual events.

The company's main reason for advocating the early adoption of SFAS 106 is that it is good accounting, that early adoption was chosen for financial reporting purposes and that the regulatory treatment should be consistent with and reflect this reality. The company's other reason for requesting early adoption of SFAS 106 is because it contends that such early adoption would cost less in the long run and would thus benefit the ratepayers. Early adoption would result in the company funding \$25 million for 1992; \$10.9 million of that would be ratepayer sharing dollars under the company's alternative form of regulation (AFOR).

This order rejects the company's argument that early adoption should be approved in order to be consistent with the method chosen for financial reporting purposes. First, regulatory accounting is not the same as financial accounting. Everyone, including the FASB, recognizes that what may be mandated for financial reporting purposes may be treated differently for regulatory or ratemaking purposes. SFAS 71 was adopted to address this particular situation.<sup>2</sup> Secondly, the company's desire for consistency is in itself inconsistent -- the company does not ask that the entire TBO be written off in 1992, as it did for financial accounting purposes.<sup>3</sup> The company proposes that the TBO be amortized over 17.3 years. The company's consistency argument is not persuasive.

As Public Counsel points out, the standard for analyzing this petition should be whether a grant of the petition is consistent with the public interest. In order to establish public interest, the company has emphasized the potential

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<sup>2</sup> This statement, entitled "Accounting for the Effects of Certain Types of Regulation", addresses deviations from generally accepted accounting principles for regulated firms and describes booking and reporting guidelines when ratemaking methodology differs from generally accepted accounting principles.

<sup>3</sup> This order would likely recommend approval of early adoption if the company's desire for consistency manifested itself in a willingness to write off the TBO for ratemaking purposes as it did for financial accounting purposes, but that is not at issue here.

ratepayer benefit of early adoption -- calculated savings of \$12-\$24 million over the next 17 years because of the earlier funding of the obligation. However, Staff and Public Counsel argue that these benefits are speculative at best, and in any event would not begin to accrue until 1998, which is the break even point.

Staff further suggests that if the petition is granted, it should be granted only on several conditions, including that the company be required to amortize the TBO over 20 years instead of 17.3, that the amount of the obligation be recalculated based on the company's current defined contributions plan, and that the medical plan asset be recalculated. The company opposes these conditions and argues that the level of expense is not at issue in this proceeding. This initial order will not recommend granting the petition for early adoption, so the conditions are not at issue. This order agrees that these issues may be better explored in a ratemaking or revenue requirements proceeding.

On the question of whether the petition for early adoption is in the public interest, this initial order concludes that the benefits to the ratepayer are highly speculative and that they do not outweigh the initial cost of funding the obligation a year earlier. The calculation of \$12-\$24 million in savings to the ratepayer is based on traditional, rate base, rate of return regulation. However, no one at the hearing seriously suggested that U S WEST would be regulated in that way in the future. For the past four years U S WEST has been regulated under an alternative form of regulation. It seems likely that future regulatory frameworks will continue to evolve to accommodate an ever more competitive market for this industry.<sup>4</sup>

This order concludes that US West has not established that there would be any ratepayer benefit to early adoption. There would be a certain reduction in sharing dollars of \$10 million for 1993. Early adoption of SFAS 106 is not consistent with the public interest. The petition should be denied.

PENSION ASSET / DOCKET NO. UT-930307

On March 23, 1993, U S WEST filed a request in Docket UT-930307 for Commission authorization to include a pension asset in rate base on an on-going basis effective with the 1992 sharing

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<sup>4</sup> Several parties cited the Commission's policy statement to US WEST in a letter earlier this year, suggesting that price cap regulation will be the direction of the future. This order cannot ignore that clear statement of the likely future regulatory form and the probability that U S WEST will not be subject to rate of return regulation.

year. U S WEST's calculation of this asset is \$67 million. The impact on ratepayers for 1992 would be a reduction in sharing dollars of \$4 million.

The pension asset

The parties agree that since 1987 the company has had money in its pension fund in excess of that which is required for financial reporting purposes. The company has not contributed any money to the pension fund since that time, but an excess amount still exists. This has created pension expense credits and a corresponding pension asset. In general, the reason for this is that the pension fund performed and provided returns far beyond U S WEST's expectations.

The company claims that it must be allowed to earn a return on the pension asset, or it would be unfair to shareholders, who the company says have provided the funds which are the pension asset. The company argues that the pension credits benefit ratepayers by reducing revenue requirement and therefore rates and/or increasing sharing. This benefit to the ratepayer is viewed by the company as the buying back or reimbursement of the dollars which originally created the asset. The company concludes that the asset is thus shareholder provided and argues that the shareholders must be allowed to earn a return on this asset.

Staff argues that during the time up until 1987, contributions to the pension fund were entirely recovered in rates and that the pension asset was created by ratepayer provided funds, not shareholder funds.

Aside from this argument, Staff argues more generally that the pension asset is only one element of a working capital analysis. To the extent that miscellaneous assets are shareholder supplied, they are properly included in ratebase as investor supplied working capital. The company has not done a working capital analysis and therefore cannot say what a total analysis would produce in terms of inclusion in ratebase. Even accepting that an increase in this asset represents an increase in stockholders' investment, staff rejects this piecemeal approach, and argues that investor-supplied working capital should be reviewed on an all inclusive basis.

Public Counsel and TRACER argue that quantification of net pension recoveries from or benefits provided to ratepayers is impossible. These parties point out that the company's calculations are based on assumptions regarding cost of service and the recovery of pension costs which are unsupported conjecture. They urge the Commission to deny this petition.

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Assuming, arguendo, that this is the appropriate proceeding in which to consider inclusion of a pension asset, the first thing that must be established is that the asset is shareholder supplied. The company argues that the ratepayers have benefitted from reduced rates or additional sharing as a result of the pension credits on U S WEST's books and that the ratepayers have essentially been reimbursed for their contributions to the pension fund. However, because the shareholders do not have access to the cash in the pension fund, they should at least be allowed to earn a return on this asset.<sup>5</sup> Staff and Public Counsel argue that contributions to the pension fund were recoverable in rates and the asset is ratepayer supplied, not shareholder supplied. Additionally, Mr. Carver's testimony, and Public Counsel on brief, point out that any level of reimbursement is not quantifiable and cannot be determined with any certainty. As discussed below, this order concludes that this is not the proper proceeding in which to consider this request. However, if a decision on this issue were required, this order would adopt the position of Public Counsel that the amount is not quantifiable and therefore deny the petition on that basis.

This order concludes that the company should not be allowed to include a pension asset in ratebase as requested in this petition. The inclusion in ratebase of this asset, even if otherwise appropriate, should be done as one element of a total working capital analysis. To do otherwise would allow the company to pick and choose working capital adjustments, petitioning for inclusion of increased amounts without necessarily considering whether there have been offsetting decreases. The petition should be denied.

#### Deferred Taxes

The other issue which comes up in connection with the pension asset is the company's treatment of the deferred taxes associated with that asset. Those taxes total \$23 million as of 1993. The company has always normalized those deferred taxes, which then become a ratebase offset.

Public Counsel suggests that if the Commission denies this petition, it might be appropriate to eliminate the accumulated deferred taxes as a ratebase offset. Staff argues

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<sup>5</sup> Even if this order were to accept the company's analysis, which it does not, only \$39 million of the asset is argued to have been paid back to the ratepayer -- it is not clear how this would justify inclusion in ratebase of a \$67 million pension asset.

that the company is required by rule<sup>6</sup> to be flowing through those tax benefits, as no exceptions to the flow-through requirement have been granted by the Commission, nor is normalization required by federal tax regulations. Staff requests that the company be required to flow through the tax benefits in the 1993 earnings for sharing. The company did not specifically address the issue of normalization versus flow-through on brief, but does seem to agree with Public Counsel's position regarding removal of the deferred taxes as a ratebase offset.

It appears that the company is improperly normalizing the deferred taxes associated with the pension asset and should be required to flow through those benefits beginning with the 1993 earnings for sharing. There is no support or justification on this record for normalizing the tax timing benefits as the company has done. This order also concludes that to the extent these taxes have been deferred and not flowed through to the ratepayers in the past, they should, in the appropriate proceeding, be subtracted from ratebase.

SFAS 112 / DOCKET NO. UT-931378

On November 12, 1993, U S WEST filed a request in Docket UT-931378 for Commission approval of the company's use for accounting purposes of SFAS 112, Employers' Accounting for Post-Employment Benefits, effective January 1, 1993. If granted, this accounting petition would involve a one-time catch up entry of \$9 million on the company's books, to reflect the liability for disability and workmen's compensation claims.

The FCC has ordered U S WEST to adopt SFAS 112 effective January 1, 1994. The FASB has required SFAS 112 accounting for all fiscal years beginning after December 15, 1993. The expenses involved in this petition are those expenses associated with claims wherein the disabling event has already occurred, so that the fact of the obligation is certain. The amount of the obligation, for medical expenses, disability payments, etc., varies with each claim and must be estimated.

In support of its petition, U S WEST argues that it is merely requesting permission to adopt accounting practices that reflect reality. The accrual required by SFAS 112 is, U S WEST argues, a superior and more accurate way to keep its books for these legitimate and unavoidable expenses and should be adopted for that reason, not avoided because of impact on revenue requirement. Nor would U S WEST want to amortize the impact over

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<sup>6</sup> WAC 480-120-031(1)(f) provides that unless specific exceptions are granted or required, the company shall flow-through tax benefits to the extent allowed by federal tax regulations.



three to five years, as suggested by Mr. Carver, because the impact is small and does not need to be phased in. U S WEST concludes that the Settlement Agreement clearly contemplates that necessary and desirable accounting changes should be made as they come up during the life of the AFOR and that this petition should be granted to comply with the letter and spirit of that agreement.

Staff and Public Counsel oppose this petition on the grounds that the amounts cannot be reliably estimated and that the accrual is nothing more than an accounting entry based on questionable projections.<sup>7</sup> These parties also point out that the \$9 million will not be placed in a separate account to fund future obligations, that the company will in fact continue to pay the obligations as they are incurred, and that the annual on-going expense will not change significantly as a result of the transition from pay-as-you-go to accrual accounting.

This order concludes that it is appropriate to allow U S WEST to adopt SFAS 112 as set forth in its petition, with the modification that the effective date should be January 1, 1994. This later effective date is consistent with FASB and FCC required implementation, and no reason was advanced for early adoption. On the merits of the petition, this order concludes that the accrual method is appropriate for the disability and worker's compensation liabilities<sup>8</sup> where the disabling event has already occurred. Although future amounts must be estimated, and necessarily are not exact or certain, the amounts are subject to reasonable projection.

Having discussed the oral and documentary evidence concerning all material matters, and having stated findings and conclusions, the Commission now makes the following summary of those facts. Those portions of the preceding detailed findings pertaining to the ultimate findings are incorporated herein by this reference.

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<sup>7</sup> Staff notes that the actuarial report underlying these estimates contains cautions about the uncertainty of estimates and the possibility of unanticipated events which might cause the actual results to vary significantly from the estimates.

<sup>8</sup> Adoption of SFAS is approved in this order only as to the items and methods of calculation proposed in this proceeding. This is specifically limited to the company's long- and short-term disability plans, disability pension plan and self-insured worker's compensation. It does not include other items which fall under the general heading of post-employment benefits, including severance benefits, job training and other items.

FINDINGS OF FACT

1. The Washington Utilities and Transportation Commission is an agency of the state of Washington vested by statute with authority to regulate rates, services, facilities, practices, rules, accounts, securities, and transfers of public service companies, including telecommunications companies.

2. Petitioner U S WEST is engaged in the business of providing telecommunications services to customers in the state of Washington as a public service company.

3. The company has requested adoption of SFAS 106 for ratemaking purposes effective January 1, 1992 instead of the previously approved January 1, 1993. With early adoption, the company would fund an additional \$25 million in 1992, reducing sharing available to ratepayers by \$10.9 million. Potential net benefits to ratepayers from early adoption would not accrue, if at all, until 1998. The potential benefit to ratepayers, as calculated by the company, is \$12-\$24 million over the next 17 years. These benefits are not likely to occur as calculated by the company, as the method used assumes circumstances not likely to continue through the next 17 years.

4. The company has requested inclusion in ratebase of a pension asset in the amount of \$67 million on an on-going basis effective with 1992. The pension asset does exist in that amount as a result of an excess amount in the company's pension fund. The pension asset is one element of total working capital. No total working capital calculation was presented in this proceeding.

5. The company has requested adoption of SFAS 112 effective January 1, 1993. The FASB has required SFAS 112 accounting for all fiscal years beginning after December 15, 1993. The expenses involved in this petition are those expenses associated with claims wherein the disabling event has already occurred, so that the fact of the obligation is certain. The amount of the obligation, for medical expenses, disability payments, etc., varies with each claim and must be estimated; the amounts are subject to reasonable projection. No reason was advanced for early adoption.

CONCLUSIONS OF LAW

1. The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of and the parties to this proceeding.

2. The petition in Docket No. UT-930074 for approval of early adoption of SFAS 106 for ratemaking purposes effective January 1, 1992, should be denied as not in the public interest.

3. The petition in Docket No. UT-930307 for inclusion in ratebase of a pension asset should be denied. This addition to ratebase should properly be proposed in a total working capital calculation, which was not presented in this case.

4. The petition in Docket No. UT-931378 for approval of adoption of SFAS 112 for ratemaking purposes effective January 1, 1993, should be modified to request an effective date of January 1, 1994, and, as modified, should be granted.

On the basis of the foregoing findings of fact and conclusions of law, the undersigned Administrative Law Judge enters the following initial order.

ORDER

WHEREFORE, IT IS HEREBY ORDERED That, the petitions by U S WEST in Docket Nos. UT-930074 and UT-930307 for adoption of SFAS 106 effective January 1, 1992, and for inclusion of the pension asset in ratebase are denied. The petition for adoption of SFAS 112, as described and limited in the text of this order, is granted, with the modification that the effective date should be January 1, 1994, not January 1, 1993, as originally requested.

DATED at Olympia, Washington and effective this 16th day of August, 1994.

OFFICE OF ADMINISTRATIVE HEARINGS



LISA A. ANDERL  
Administrative Law Judge

**NOTICE TO PARTIES:**

This is an initial order only. The action proposed in this order is not effective until a final order of the Utilities and Transportation Commission is entered. If you disagree with this initial order and want the Commission to consider your comments, you must take specific action within a time limit as outlined below.

Any party to this proceeding has twenty (20) days after the service date of this initial order to file a Petition for Administrative Review, under WAC 480-09-780(2). Requirements of a Petition are contained in WAC 480-09-780(3). As provided in

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DOCKET NO. UT-930074, et al.

WAC 480-09-780(4), any party may file an Answer to a Petition for Administrative Review within ten (10) days after service of the Petition. A Petition for Reopening may be filed by any party after the close of the record and before entry of a final order, under WAC 480-09-820(2). One copy of any Petition or Answer must be served on each party of record and each party's attorney or other authorized representative, with proof of service as required by WAC 480-09-120(2).

In accordance with WAC 480-09-100, all documents to be filed must be addressed to: Office of the Secretary, Washington Utilities and Transportation Commission, 1300 South Evergreen Park Drive S.W., PO Box 47250, Olympia, Washington, 98504-7250. After reviewing the Petitions for Administrative Review, Answers, briefs, and oral arguments, if any, the Commission will by final order affirm, reverse, or modify this initial order.