Agenda Date: March 31, 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

Authorize PacifiCorp to record on an ongoing basis as a regulatory asset, an amount equal to the pretax charge against equity that would otherwise be necessitated by the recognition of the Company's Additional Minimum Liability as determined by the Financial Accounting Standard 87 which relates to pension liability.

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. Staff can find no reason to dispute this claim. The Company agrees that the regulatory asset will not affect rate base.

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.

The above factors are out of PacifiCorp's control. But there is one element in the Company's control, that is the level of cash contributions to the pension plan. Since the acquisition of PacifiCorp by Scottish Power, the contributions to the pension plan have decreased to one-third of the prior level. Staff finds this is a significant factor in the need for PacifiCorp to book an "Additional Minimum Liability" for its pension-related activities.

The posting of the debit side of the additional minimum liability to Other Comprehensive Income does negatively affect equity. If sufficient in magnitude, the debt-to-equity ratio could change enough to cause financial analysts to change their opinion of the company's strength. By granting the petition, the Commission may remove this potential consequence.

For purposes of this docket, Staff finds the request reasonable and recommends approval. Staff's concerns about the proper level of pension expense will be fully addressed in a general rate case.

Staff believes the Commission should not agree to the strict use of a FAS 87 determined expense for ratemaking purposes. The Commission should not have its options restricted in its ability to determine fair and reasonable rates. The Company agrees to leave the treatment of pension cost open for discussion in general rate cases.

Conclusion:

Staff supports PacifiCorp's request for authorization to record on an ongoing basis, 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.