

ORIGINAL

Timolyn Henry

From: James A. McGee [jmcgee@tampabay.rr.com]  
Sent: Tuesday, August 03, 2004 4:41 PM  
To: Filings@psc.state.fl.us  
Subject: PEF Petition re FAS 87

040816-EI

This electronic filing is made by  
James A. McGee  
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Docket No. None (initial pleading)

In re: Petition of Progress Energy Florida for authority to use deferral accounting for the creation of a regulatory asset in recognition of its minimum pension liability established in accordance with FAS 87.

On behalf of Progress Energy Florida.

Consisting of 11 pages.

The attached document for filing is Progress Energy's  
**Petition for authority to use deferral accounting for the creation of a regulatory asset in recognition of its minimum pension liability established in accordance with FAS 87,**  
including a filing letter.

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**JAMES A. MCGEE**  
ASSOCIATE GENERAL COUNSEL  
PROGRESS ENERGY SERVICE COMPANY, LLC

August 3, 2004

**VIA ELECTRONIC FILING**

Ms. Blanca S. Bayó, Director  
Division of the Commission Clerk  
and Administrative Services  
Florida Public Service Commission  
2540 Shumard Oak Boulevard  
Tallahassee, Florida 32399-0850

Re: Petition of Progress Energy Florida for authority to use deferral  
accounting for the creation of a regulatory asset in recognition of its  
minimum pension liability established in accordance with FAS 87.

Dear Ms. Bayó:

Enclosed for filing on behalf of Progress Energy Florida, Inc., is the  
subject Petition.

Please acknowledge your receipt of the above filing as provided in the  
Commission's electronic filing procedures. Thank you for your assistance in this  
matter.

Very truly yours,

s/ James A. McGee

JAM/scc  
Enclosure

DOCUMENT NUMBER-DA

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08443 AUG-31

FPSC-COMMISSION CLE

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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In re: Petition of Progress Energy Florida for authority to use deferral accounting for the creation of a regulatory asset in recognition of its minimum pension liability established in accordance with FAS 87.

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Docket No. \_\_\_\_\_

Submitted for filing:  
August 3, 2004

**PETITION**

Progress Energy Florida, Inc. (Progress Energy or the Company), hereby petitions the Florida Public Service Commission (the Commission) to authorize the use of deferral accounting for the creation of a regulatory asset to offset the Minimum Pension Liability the Company must recognize in accordance with Financial Accounting Standards (FAS) 87. In support hereof, Progress Energy states as follows.

**Introduction**

1. Progress Energy is a public utility subject to the regulatory jurisdiction of the Commission pursuant to Chapter 366, Florida Statutes. The Company's principal place of business is located at 100 Central Avenue, St. Petersburg, Florida 33701.

2. All notices, pleadings and correspondence required to be served on the petitioner should be directed to:

James A. McGee, Esquire  
Post Office Box 14042 (zip 33733)  
100 Central Avenue (zip 33701)  
St. Petersburg, Florida  
Facsimile: (727) 820-5519

## **Discussion**

3. The basic ratemaking tenant underlying this petition is that the cost of employee pension benefits included in utility rates should be recognized as the benefits are earned by employees, gradually and systematically over their years of service. The "normal" provisions of FAS 87 are consistent with the recognition of pension costs in this manner and, as described below, have been applied by the Commission in setting base rates. However, in situations where employee pension benefits become under-funded, another provision of FAS 87 is triggered which, in the interest of conservative financial reporting, requires an accounting practice that conflicts with the proper recognition of pension costs for ratemaking purposes.

4. This conflict arises in the form of a Minimum Pension Liability (MPL), which is the difference between a company's accumulated pension obligation and the fair value of the pension plan's assets set aside to meet this obligation. When such a shortfall exists, the company is required by FAS 87 to record the MPL as a balance sheet liability.

5. The differential that the MPL represents will fluctuate up or down over time primarily as a function of (a) decreases or increases in the financial markets that produce corresponding changes in the value of the pension plan assets, and (b) increases or decreases in market interest rates that affect the discount rate used to present-value the pension obligation. Consequently, using the MPL for

ratemaking purposes introduces a problematic degree of volatility into a utility's test year costs and into the base rates that result from these costs.

6. This will occur when a utility's test year coincides with a high or low point in the market cycle and/or interest rate cycle. Using the correspondingly high or low MPL for ratemaking purposes will have the effect of freezing the extreme in market and/or interest rate volatility in the utility's rates until the test year of its next rate case.

7. Using the MPL requirement of FAS 87 for ratemaking purposes is inconsistent with recognizing the expense of pension benefits as they are earned by employees, as would occur under the normal provisions of FAS 87. The MPL represents pension amounts that have not yet been earned and that would ordinarily be recognized in the future under FAS 87, *i.e.*, it is a special increase to the pension liability outside and apart from FAS 87's normal recognition of expense and liability. The objective of creating the regulatory asset requested by this petition is to offset and negate this undesirable ratemaking effect of FAS 87's MPL.

8. In accounting guideline OED-DRAP, issued March 29, 2004 in Docket No. AI04-2-000, the Federal Energy Regulatory Commission (FERC) responded to a number of requests for guidance on whether a regulatory asset should be recognized to offset the effect of a MPL on cost-based rate regulated companies. The FERC guideline states:

The cost of pension benefits provided to employees under a defined pension benefit plan are recognized as an expense at the time the employee provides related employment services. SFAS No. 87 contains a delayed recognition feature. This means that changes in the pension obligation and the value of assets set aside to meet these obligations are not recognized when they occur but are recognized systematically and gradually over subsequent periods. An entity that determines its pension allowance included in its costs based regulated rates on the basis of SFAS No. 87 adopts that same delayed recognition feature for ratemaking purposes. . . .

Therefore, in the circumstances described above and provided that it is probable that the pension allowance to be included in rates in future periods will continue to be calculated on the basis of SFAS No. 87, entities shall recognize a regulatory asset for the minimum pension liability otherwise chargeable to accumulated other comprehensive income related to its cost based rate regulated business segments.

A copy of this FERC guideline is attached to this petition as Exhibit A.

9. In Order No. PSC-92-1197-FOF-EI, issued October 22, 1992 in Docket No. 910890-EI, the Company's 1992 rate case, the Commission concluded that the practice initiated by the Company following its 1987 rate case, in which pension costs actually incurred pursuant to FAS 87 (apart from the MPL requirement) but not included in previously set base rates were deferred to the balance sheet, did not constitute a proper regulatory asset under FAS 71 absent Commission approval.<sup>1</sup> Prospectively, however, the Commission approved the use of accrual accounting in conjunction with FAS 87 to set the level of test year pension expense. The Commission stated:

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<sup>1</sup> In the settlement of its 1987 base rate proceeding, the Company's cost of service supporting the final settlement rates included regular pension expense set equal to zero in accordance with FAS 87. In the ensuing years, the Company recorded periodic pension expense on its books in accordance with FAS 87 and at the same time removed that entry from the income statement by recording the adjusting journal entries to comply with FAS 71. These entries were intended to conform the accounting for pension expense to the ratemaking treatment of pension expense established in the 1987 base rate proceeding. However, the Commission disallowed the use of this accounting practice in the Company's 1992 base rate proceeding retrospectively for the reasons set forth in paragraph 11 of this petition.

The purpose of FAS No. 87 is to accrue pension expense over the time employees earn benefits. While FPC will not make a cash contribution until 1993, the benefits earned by today's employees should be paid by today's ratepayers. Therefore, we shall use FAS No. 87 for ratemaking purposes. We approve FPC's request to set its pension expense at a level equal to the expense calculated for accounting purposes under the provisions of FAS No. 87.

10. In the current situation, however, the MPL requirement of FAS 87 requires that rates reflect the recognition of a liability amount that has not been recorded through normal FAS 87 expense and liability recognition. Progress Energy therefore requests Commission approval to create a regulatory asset as a direct offset to FAS 87's MPL, and to utilize deferral accounting for the purpose of insulating ratepayers from the rate impact of pension obligation amounts that are subject to variation and that have not been recognized through normal FAS 87 expense and liability recognition. In this manner, ratepayers will incur only the systematic and gradual effect of pension expense in rates in subsequent periods as it is accrued under FAS 87 or, in the case of a FAS 88 "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits" event, when that future obligation becomes realized. The accounting requested herein is illustrated as follows:

Account 182.xx	Minimum Pension Liability Deferral	\$100.00
Account 228.31	Minimum Pension Liability	(\$100.00)

Both of these accounts would be included in working capital for ratemaking and surveillance purposes, thus neutralizing any impact of this unrealized transaction on ratepayers.

11. To be clear, the regulatory asset requested by Progress Energy in this petition is unlike the Company's request in its 1992 rate case that the Commission denied on procedural grounds in Order No. PSC-92-1197-FOF-EI. In that order, the Commission stated:

"We believe the regulatory asset and its amortization should be disallowed for ratemaking purposes. First, in order to record an asset or a liability under FAS No. 71, there must be an indication from us that the asset or liability will be recoverable. In this case, there was no such indication. It was inappropriate for FPC to use FAS No. 71 without our prior approval."

Second, we do not believe pension expense should be "tracked." Pension expense will be run through earnings and will fluctuate. Earnings should be reviewed in aggregate with no true-up provision for certain expenses. If a true-up is allowed for one expense, it can easily be argued that all the expenses should be true-up. Other expenses also change, but the change itself does not justify deferring the expenses. Utilities are given an opportunity to recover their costs, not a guarantee. If costs change, the entire cost to serve must be reevaluated. Individual changes in costs should not be deferred for future recovery in another rate case.

In this case, the requested regulatory asset does not attempt to recognize realized pension expense that has been deferred from prior periods, but rather seeks to neutralize for ratemaking purposes an unrealized future obligation that FAS 87 requires the Company to recognize for financial reporting purposes. The Commission has already recognized the appropriateness of accrual accounting for pension expense under FAS 87 to achieve a systematic and gradual recovery of this expense through rates in subsequent periods. If, after the creation of the regulatory asset, all or a portion of the future obligation represented by the MPL becomes realized through a FAS 88 event, it would then be given current period

recognition to the event for ratemaking and surveillance reporting purposes consistent with prior Commission decisions.

WHEREFORE, Progress Energy respectfully requests that the Commission grant this petition and authorize the use of deferral accounting and the creation of a regulatory asset to recognize and offset the Company's Minimum Pension Liability established in accordance with FAS 87.

Respectfully submitted,

s/ James A. McGee

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Attorney for  
PROGRESS ENERGY FLORIDA, INC.

**EXHIBIT A**

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**FERC Accounting Guideline OED-DRAP**  
**Issued March 29, 2004 in Docket No. AI04-2-000**

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In Reply Refer To:  
OED-DRAP  
Docket No. AI04-2-000

March 29, 2004

Recognition of a Regulatory Asset for Minimum Pension Liability

TO ALL JURISDICTIONAL PUBLIC UTILITIES AND LICENSEES,  
NATURAL GAS COMPANIES, AND OIL PIPELINE COMPANIES

The generally lower interest rate environment of recent years and decline in value of assets set aside to meet pension obligations has resulted in many FERC jurisdictional entities recognizing a minimum liability for employee pension obligations. The Commission has received a number of requests for guidance on whether a regulatory asset should be recognized for some or all of the charge to other comprehensive income that is made at the time the minimum pension obligation is recognized. The following discussion responds to these requests.

**Facts:** An entity provides pension benefits to its employees under a defined pension benefit plan and recognizes pension expense (i.e. net periodic pension cost) for financial accounting and reporting purposes in accordance with Statement of Financial Accounting Standards No 87. (SFAS No. 87).<sup>1</sup> The rates the entity charges for services provided by a segment of its business are regulated by a third party regulator and are determined on the basis of the entity's costs. Development of the rates to be charged for services provided by this business segment include an allowance for employee pension benefits and the amount of that allowance is based on net periodic pension cost determined in accordance with SFAS No. 87. As a result of a decline in the value of its pension fund assets and an increase in the accumulated pension benefit obligation due to lower interest rates used to estimate that obligation on a present value basis, the entity determines that its accumulated pension benefit obligation exceeds the fair value of the assets set aside to meet that obligation. Consistent with the requirements of SFAS No. 87, the entity records a minimum pension liability for the amount of such excess.

**Question:** At the time the entity recognizes its minimum pension liability in accordance with SFAS No. 87, should it recognize a regulatory asset for the amount of the liability otherwise chargeable to accumulated other comprehensive income that relates to its cost based rate-regulated business segment?

**Response:** The cost of pension benefits provided to employees under a defined pension benefit plan are recognized as an expense at the time the employee provides related employment services. SFAS No. 87 contains a delayed recognition feature. This means that changes in the pension obligation and the value of assets set aside to meet these obligations are not recognized when they occur but are recognized systematically and gradually over subsequent periods.<sup>2</sup> An entity that determines its pension allowance included in its costs based regulated rates on the

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Financial Accounting Standards Board Statement of Financial Accounting Standards No 87, Employer's Accounting for Pensions

<sup>2</sup> Ibid. (See: Summary - Fundamentals of Pension Accounting)

basis of SFAS No. 87 adopts that same delayed recognition feature for ratemaking purposes. That is, changes in the pension obligation and assets set aside to meet those obligations are not included in rates when they occur but rather are included in rates systematically and gradually in subsequent periods. The recognition of a minimum pension liability which would otherwise be charged to accumulate other comprehensive income therefore constitutes a measurement of the changes in pension obligations and the value of plan assets that are to be included in the determination of rates in subsequent periods in so far as they relate to the cost based rate regulated segment of the entity.

Under the Commission's accounting requirements regulatory assets are to be established for those charges that would have been included in net income or accumulated other comprehensive income determinations in the current period under the general requirements of the Uniform System of Accounts but for it being probable that such items will be included in a different period(s) for purposes of developing rates that the utility is authorized to charge for its utility services.

Therefore, in the circumstances described above and provided that it is probable that the pension allowance to be included in rates in future periods will continue to be calculated on the basis of SFAS No. 87, entities shall recognize a regulatory asset for the minimum pension liability otherwise chargeable to accumulated other comprehensive income related to its cost based rate regulated business segments.

Further, the minimum pension liability, as well as, any related regulatory asset is not amortized over future periods. At each measurement date, the entry recorded for the previous measurement date is reversed and the computation redone. A new minimum liability and related regulatory asset would be recognized, if required, at the new measurement date.

This guidance is for accounting purposes only and does not limit the Commission from reviewing the reasonableness of the elements of pension expense included in future rate proceedings before the Commission.

John M. Delaware  
Deputy Executive Director  
and Chief Accountant