

STATE OF NEW HAMPSHIRE

Inter-Department Communication

DATE: September 30, 2009

AT (OFFICE): NHPUC

JEM

FROM: Steven E. Mullen
Assistant Director – Electric Division

SUBJECT: DE 09-155, Unitol Energy Systems, Inc. – Petition for an Accounting Order

TO: Commissioners
Debra Howland, Executive Director



On August 26, 2009, Unitol Energy Systems, Inc. (UES) filed a Petition for an Accounting Order requesting approval to defer, until the time of its next base rate case, certain costs it incurred associated with the December 2008 ice storm. In its petition, UES described the extent of the “substantial” damage to its New Hampshire distribution system resulting from the storm and described the amount of expenses incurred as “extraordinary and non-recurring...because it is unusual and infrequent relative to UES’ history of providing electric service to its customers where a normal amount of storm damage is to be expected.” On September 24, 2009, UES sent in a revised filing clarifying that it was seeking the relief in accordance with Statement of Financial Accounting Standards (FAS) No.71, *Accounting for the Effects of Certain Types of Regulation*.

According to UES, in its last base rate case, which involved a 2005 test year during which no major storm occurred, rates were set at a level whereby UES recovers approximately \$170,000 annually from its customers for storm repair expenses. In contrast, UES said it incurred approximately \$3.2 million of expenditures to restore service after the December 2008 ice storm. Of those costs, UES stated that just over \$1.2 million were capitalized as construction related expenditures, with the remaining almost \$2.0 million recorded as expenses. UES is requesting that the latter amount (an actual amount of \$1,941,947) be deferred and recorded as a regulatory asset until such time as the Commission issues a final order in its next distribution base rate proceeding. UES further stated that it “...is not seeking to change its rates, nor seeking pre-approval of the recovery in rates of the costs incurred...”

In accordance with paragraph 9 of FAS 71, a utility

...shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:

a. It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for ratemaking purposes. (footnote omitted)

b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.

If at any time the incurred cost no longer meets the above criteria, that cost shall be charged to earnings.

At first glance, the above language may give one pause as the ice storm costs at issue in this proceeding have not been audited nor otherwise reviewed by the Commission. So, one might think that approving deferral of the costs would effectively give UES a form of "guarantee" that it would eventually be able to recover all of the costs included in the regulatory asset, despite the fact that those costs have not been reviewed. However, the last sentence of the quoted section above along with Paragraph 10 of FAS 71 put regulated entities on notice that the costs in a regulatory asset are not guaranteed recovery. Paragraph 10 reads as follows:

10. Rate actions of a regulator can reduce or eliminate the value of an asset. If a regulator excludes all or part of a cost from allowable costs, the carrying amount of any asset recognized pursuant to paragraph 9 of this Statement shall be reduced to the extent of the excluded cost. Whether other assets have been impaired shall be judged the same as for enterprises in general and FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, shall apply. (footnote omitted)

Applying Paragraph 10 to the case at hand, if the Commission approves UES' requested accounting treatment and allows UES to defer the roughly \$2 million of ice storm costs in a regulatory asset, the amount in that asset would still be subject to whatever findings the Commission makes once the ice storm costs are reviewed. By requesting deferral of its ice storm costs, UES will avoid having to charge the entire amount to expense in the current period and instead would be able to recover its prudently incurred costs over whatever period and in whatever manner the Commission ultimately decides at the time of UES' next distribution rate case.

To put the \$2 million of costs in perspective, review of UES' most recent Form F-1 filed in accordance with Puc 308.11 reveals that UES' distribution-related operation and maintenance expenses (excluding depreciation, amortization, taxes and the ice storm expenses) for the twelve months ended June 30, 2009 were approximately \$14.3 million and its net operating income was approximately \$8.4 million. The earned return on equity over that twelve-month period was 6.41%, a rate below UES' last allowed return on equity of 9.67%. If UES' requested accounting treatment is denied, the ice storm expenses would increase UES' current operation and maintenance expenses and further reduce UES' earnings. Considering that UES' current distribution rates recover approximately \$170,000 per year for storm recovery expenses, the \$2 million that is the subject of its petition certainly appears to be extraordinary in nature.

In light of all the above, Staff recommends that UES' request to defer and record in a regulatory asset \$1,941,947 of expenses related to the December 2008 ice storm be approved. As stated above, although those costs have not yet been reviewed by the Commission, the Commission will still be free to make determinations including, but not limited to, the appropriate amount to be recovered, the manner and timing of recovery, and what, if any, return should be applied to the unrecovered balance.

Please let me know if you have any questions or would like to discuss this issue further.

cc: Tom Frantz
Suzanne Amidon
Service List