DE 02-221

UNITIL ENERGY SYSTEMS, INC.

Petition for Approval of an Accounting Order

Order Approving Request for Accounting Order Relating to Pension Plan

O R D E R N O. 24,107

December 31, 2002

I. PROCEDURAL HISTORY

On December 9, 2002, Unitil Energy Systems, Inc. ("UES"), filed with the New Hampshire Public Utilities Commission ("Commission") a petition for an accounting order permitting UES to record in Account 263, Pension Reserve, certain additional minimum liabilities associated with obligations for UES' employee pension plan, in order to recognize such amounts as a regulatory asset pursuant to Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 71, "Accounting for the Effects of Certain Types of Regulation." Additionally, UES requested permission to record offsetting charges in prepaid pension expense to Account 186. According to UES, the purpose of the accounting order is to allow UES to treat its additional minimum liability associated with its pension plan obligations as a regulatory asset under SFAS No. 71 and allow UES to avoid a reduction in equity that would otherwise be required under SFAS No. 87, "Employers' Accounting for Pensions." On December 13, 2002, the Commission Staff ("Staff") issued information requests to UES. Subsequently, UES provided responses to Staff's information requests and conducted technical sessions with Staff and the Office of the Consumer Advocate.

II. UES' POSITION

According to UES, a significant decline in the equity markets and falling interest rates have had a major impact on UES' obligations regarding employee pension plans. In the recently concluded settlement in DE 01-247, the Commission approved new base rates for UES which reflected a 2001 test year in which UES had pension income, after adjustment, of approximately $314,000. In contrast, UES stated in this filing that it expects to incur pension expense of approximately $200,000 in 2003.

UES stated that it was notified by its pension plan actuaries in October 2002 that due to the significant decline in the capital markets and lower interest rates, UES' estimated year-end pension plan assets, which are held in trust to meet employee pension obligations, would not cover the plan's Accumulated Benefit Obligation ("ABO") on December 31, 2002. Under the requirements of SFAS No. 87, UES will be required to recognize an additional minimum liability which will include the excess of the actuarially determined ABO over the value of the plan assets (i.e., the unfunded ABO) and a reversal of any previously recorded prepaid pension costs. As a result of the application of SFAS No. 87, UES would be required to reflect a significant reduction in equity for its pension plan obligations. UES is seeking an accounting order to address the potential reduction in equity it would otherwise be required to recognize at the end of 2002. According to UES, it is appropriate to recognize its additional minimum liability as a regulatory asset under SFAS No. 71 because, under New Hampshire rate making precedent, the costs for supporting utilities' employee pension plans are recovered through customer rates, rather than borne by shareholders.

Due to the estimated unfunded ABO at the December 31, 2002 measurement date, UES estimates that it would be required to reduce common equity in the amount of $9.8 million (by reversing the prepaid pension cost of $8.4 million and recognizing the current year unfunded ABO of $1.4 million), as prescribed by SFAS No. 87 and SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits."

The FASB pronouncements require that the additional minimum liability be recorded as a non-cash charge to Other Comprehensive Income ("OCI"). According to UES, such a charge would not affect the results of operations for 2002, but would require a reduction in UES' equity. UES stated that its current equity ratio is 35%, and that the charge to equity would result in a decline in the equity ratio to 27%. This charge to equity would be reversed in future periods when the value of the pension plan assets equals or exceeds the ABO.

UES requests permission to record its additional minimum liability, as defined above, as of December 31, 2002 (now estimated to be $9.8 million), as a regulatory asset pursuant to SFAS No. 71, in Account 263, Pension Reserve, with the offsetting charge to prepaid pension expense recorded in Account 186, Miscellaneous Deferred Debits. UES stated that it would perform an annual evaluation of its unfunded status and seeks permission to continue to account for pension obligations as described above in any year in which the value of UES' pension plan assets does not exceed its ABO. In addition, when the value of UES' pension plan assets once again exceeds the ABO, UES will notify the Commission and will cease recording the regulatory assets and associated remaining liability from its accounts. UES will also remove any additional minimum liability from its accounts.

UES asserts that issuance of the requested accounting order is consistent with the public interest because it will avoid significant pension accounting related swings to its debt-to-equity ratios based upon the movement of the capital markets. According to UES, the requested accounting will allow it to mitigate the potential adverse effect on its capitalization, credit quality and borrowing costs resulting from certain accounting requirements related to UES' pension plan assets which have been triggered by the substantial decline in the capital markets.

In response to inquiries from the Staff regarding the appropriateness of booking the entire additional minimum liability as a regulatory asset, UES confirmed that its outside auditors, Grant Thornton, found such accounting treatment consistent with SFAS No. 71.

In requesting Commission approval for such accounting, UES states that it is not seeking a change to existing policy or precedent on the recovery of costs related to employee pension plans. UES also states that it is not seeking an order allowing deferral of any such costs nor any change in its existing rates.

III. COMMISSION ANALYSIS

Based upon the above representations of UES, we find that the requested accounting order, subject to the following technical clarifications and modifications described below, will allow UES to treat its additional minimum liability associated with its pension plan obligation as a regulatory asset under SFAS No. 71. We also find that an accounting order is in the public interest because it will avoid significant pension accounting related swings in UES' debt-to-equity ratios based upon the movements of the capital markets and the potential negative impact on the Company's capitalization and credit. Accordingly, subject to the clarifications and modifications described below, we will approve UES' request.

We do not, however, grant UES an open-ended authorization to create such deferred accounts whenever pension liabilities exceed amounts earmarked for that purpose. Ultimately, it is the responsibility of utility management to use reasonable forecasting methods to anticipate pension liabilities and to meet those obligations in the most prudent manner. Swings in equity values and interest rates are to be expected in the economy and, in the instant case, the direction of the market may have been anticipated by many. Nevertheless, those issues are not properly before us at this time and we reserve for another day the question of whether UES could have or should have taken steps that would have dispensed with the need to petition the Commission for the creation of a regulatory asset on an expedited basis.

On a more technical point, UES' petition requested approval to record its additional minimum liability as a regulatory asset pursuant to SFAS No. 71 via the use of Account 263, Pension Reserve, and Account 186, Miscellaneous Deferred Debits. As the current version of the Federal Energy Regulatory Commission's Electric Uniform System of Accounts ("USOA") does not include Account 263, we are left to prescribe alternative treatment. Specifically, we will require that the additional minimum pension liability and the regulatory asset described in

UES' petition be recorded in Account 253, Other Deferred Credits, and Account 182.3, Other Regulatory Assets, respectively.

We emphasize that UES is not seeking any change to its rates as a result of the requested accounting order nor approval for any specific recovery of pension costs in future rates. In issuing this accounting order, we are not preapproving the recovery of a specific amount of pension expenses in future rates, and are in no way changing our existing policies or precedents on what constitutes a recoverable operating expense. Any request in future rate proceedings for recovery of employee pension expenses will be subject to review by all parties and approval by this Commission under existing precedent. In such a case, UES will bear the burden of demonstrating that any employee pension expense is reasonable in amount, prudently incurred and appropriate for recovery in rates.

Finally, given the questions being raised generally concerning the adequacy of corporate funding of pension plans, we find it would be of assistance to the Commission to collect fund status information more frequently over the next several years, and to that end we will direct UES to file quarterly and annual reports on its pension fund.

Based upon the foregoing, it is hereby

ORDERED, that UES' request to record its current additional minimum liability related to its pension plan as a regulatory asset pursuant to SFAS No. 71 is approved, subject to the modifications described herein; and it is

FURTHER ORDERED, that, until further order of the Commission, UES will file quarterly reports on the status of its pension plan no later than 45 days following the end of each calendar quarter; and it is

FURTHER ORDERED, that, until further order of the Commission, UES will perform an annual evaluation of the funding status of its pension plan and shall file an annual report with the Commission detailing the results of that evaluation with the initial report due after the determination of the final December 31, 2002 amounts; and it is

FURTHER ORDERED, that UES will notify the Commission when the value of its pension plan assets once again exceeds its ABO, and UES at that time will cease recording the regulatory asset and will remove any additional minimum liability from its books of account.

By order of the Public Utilities Commission of New Hampshire this thirty-first day of December, 2002.

Thomas B. Getz Chairman	Susan S. Geiger Commissioner	Nancy Brockway Commissioner

Attested by:

Michelle A. Caraway
Assistant Executive Director