STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DG 07-024

Northern Utilities, Inc.

Petition for an Accounting Order

Order Approving Staff Recommendations Regarding Accounting Order Pertaining to Certain Pension and Post Retirement Benefits Other Than Pension Plans

O R D E R N O. 24,863

June 20, 2008

I. Procedural History and Background

On February 28, 2007, Northern Utilities, Inc. (Northern) filed a petition for an accounting order requesting authority, pursuant to Financial Accounting Standard No. 71 (FAS 71), to recognize a regulatory asset (or liability) in order to defer certain charges (or credits) associated with the funded status of the Company's defined benefit pension and PBOP (post retirement benefits other than pension) plans that would otherwise be accounted for as shareholders equity pursuant to FAS 158.[1] Northern sought to establish a regulatory asset in an initial amount of approximately $2.4 million. According to Northern, without an accounting order from the Commission, a reduction to shareholders' equity of $2.4 million must be recorded because of the mandated accounting treatment. Northern stated that its request was appropriate because, under New Hampshire law and Commission precedent, a utility's prudently incurred pension and PBOP obligations are recoverable through rates.

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[1] The Financial Accounting Standards Board issued FAS 158 in September 2006 and Northern adopted it for the fiscal year ended December 31, 2006. Northern stated that this standard requires companies to recognize the funded status of their plans as a net asset or liability with an offsetting entry (net of tax benefits) to accumulated other comprehensive income (OCI) in the shareholders' equity section of the balance sheet. Northern noted that FAS 158 did not change how pensions and PBOPs are accounted for in the income statement since annual pension and PBOP expense continues to be based on other accounting standards, i.e., FAS 87 and 106.

Following discovery, on November 9, 2007 Staff filed its analysis of the petition and the information obtained discovery. Staff noted that the Financial Accounting Standards Board (FASB) issued FAS 158 to better communicate information regarding pension plans and PBOPs with the specific objectives of requiring employers to:

> a. recognize the overfunded or underfunded status of a single-employer defined benefit postretirement plan as an asset or liability in its statement of financial position and to *recognize changes* in that funded status in comprehensive income . . .in the year in which the changes occur [emphasis added]; and
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> b. measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions.

In addition, Staff stated that FAS 158 requires the use of the "projected benefit obligation" in the calculation of the funded status of pension plans, rather than the "accumulated benefit obligation" formerly required by FAS 87.[2]

Staff did not question the propriety of establishing a regulatory asset but recommended that it be initially established in an amount reflecting the change in the funded status of the pension and PBOP plans in the year in which the change occurs, i.e., 2006. Specifically, Staff recommended that the Commission authorize a pension-related regulatory asset regarding Northern's New Hampshire division in the initial amount of $492,848, a reduction of $734,061 from Northern's proposed amount of $1,226,909, and a PBOP-related regulatory asset for Northern's New Hampshire division in the initial amount of $1,227,988, a reduction of $2,891 from Northern's proposed amount of $1,230,879. Staff's recommendation was subject to its understanding that Northern was not seeking any change to its rates as a result of the requested

[2] According to Staff, the projected benefit obligation includes an assumption of future salary levels, and since the amount of the projected benefit obligation is greater than the amount of the accumulated benefit obligation, Staff expected that the funded status of a pension plan would be stated more conservatively (i.e., the obligation would be in a larger amount, all else equal) than it has been in the past.

accounting order nor approval for any specific recovery of pension or PBOP costs in future rates. According to Staff, any request in future rate proceedings for recovery of employee pension and PBOP expenses should be subject to Commission approval.

Staff also reported that, during discovery, it had learned Northern had not complied in 2005 and 2006 with a prior Commission order, *FAS 106 Accounting for Post Retirement Benefits Other Than Pensions*, 78 NH PUC 211, Order No. 20,806 (1993), requiring the funding of PBOP at amounts not less than the full accrual expense on a quarterly basis. Consistent with this order, Staff further recommended that Northern be required to maximize the use of tax deductions for contributions to the irrevocable external trusts and that deferred tax assets resulting from non-deductible contributions be recognized as rate base additions, provided the contributions are made prudently.

By secretarial letter, the Commission allowed Northern to respond to Staff's letter by December 7, 2007. Northern's response included the affidavit of its controller, Robert G. Kriner. Northern stated that the difference between Northern's requested amount for the PBOP-related regulatory asset and Staff's recommended amount was due to differing assumptions about the effective tax rate to be used. Northern confirmed that after discussions between the Company and Staff, Staff had agreed with the tax rate used by Northern for the deferred tax calculation.

According to Northern, the difference between Northern's requested amount for the pension-related regulatory asset and Staff's recommended amount was due to differing interpretations of the adoption and implementation of FAS 158. Northern explained that Staff believed the pension-related OCI amounts recorded as of December 2005 should continue to fall under the FAS 87 rules and that Northern should have requested regulatory asset treatment at the time the original OCI amounts under FAS 87 were recorded in 2002. By contrast, Northern's position was that the entire pension component included in the December 2006 OCI balance ($1,226,908) relates to the adoption of FAS 158 and the amount previously recorded in OCI relating to the FAS 87 additional minimum liability concept was eliminated due to the adoption of FAS 158.

Finally, Northern stated that, as of September 30, 2007, the Company’s irrevocable external trusts were funded in compliance with Order No. 20,806. Northern committed to fund those trusts quarterly as required by the order.

On May 22, 2008, Staff filed a letter outlining a proposed resolution of the docket, to which Northern agreed in the interest of expediting the resolution of the docket, even though it did not agree in principle with all of Staff’s written comments and recommendations. Specifically, Northern requested that the record reflect that it does not agree with Staff’s position regarding the application of FAS 158, and that it accepts Staff’s comments and recommendations solely for the purpose of resolving this proceeding.

Regarding the amount of the PBOP regulatory asset for Northern’s New Hampshire Division, Staff recommended that the 2006 layer in the amount of $1,230,879 be eligible for treatment as a regulatory asset, calculated as follows: Account 270, Capital Surplus, Other Comprehensive Income--OPEB FAS 158 reflects a charge in the amount of $4,139,151, and after deducting the Maine division portion at 50 percent and the tax benefit at 40.525 percent, the net after-tax amount is $1,230,879.

Regarding the pension-related regulatory asset for Northern’s New Hampshire division, Staff concluded that the amount Northern sought represents the cumulative effect of all charges to equity (via OCI) since 2002. Staff stated that only the 2006 layer of the amounts reported in Northern's 2002-2006 annual reports, Account 270, Capital Surplus, Other Comprehensive Income, Pension, or $494,127, qualifies for treatment as a regulatory asset, calculated as follows: the pension-related charge to Account 270 for the year 2006 is $1,661,630 and after deducting the Maine Division's portion at 50 percent[3] and the tax impact at 40.525 percent, the net after-tax amount is $494,127.

Staff reiterated that its recommendation comports with FAS 158, which requires employers to recognize the overfunded or underfunded status of a single-employer defined benefit postretirement plan as an asset or liability in its statement of financial position and to "*recognize changes* in that funded status in comprehensive income…*in the year in which the changes occur*." (Emphasis added.) Since the change occurred in 2006, Staff stated that only the 2006 amount should be eligible for consideration as a regulatory asset. Staff also noted that its recommendation also comports with FAS 158 since it allows for an increase in the regulatory asset to reflect the projected benefit obligation, not the accumulated benefit obligation.

Staff stated further that its recommendation is consistent with FAS 71. According to this accounting standard, if regulation provides assurance that incurred costs will be recovered in the future, public utilities are required to capitalize those costs. Staffed pointed out that FAS 71 applies only to costs incurred in one year but allocated to different years for purposes of recovery. Staff's recommendation for regulatory asset treatment applies only to 2006.

Staff also stated that its recommendation is consistent with the requirement in Part 201, Account 182.3(B) of the FERC (Federal Energy Regulatory Commission) Uniform System

[3] Staff did not examine the estimated fifty percent allocation and reserves judgment regarding the reasonableness of this allocation until Northern files its next base rate case.

of Accounts that regulatory assets pertain only to current year costs. Although Staff noted that the Uniform System of Accounts does not apply directly to the regulation of gas utilities in New Hampshire, Staff believed that it is nevertheless instructive to consider in the proper application of state-approved accounting standards.

Staff's recommendation acknowledged Northern's pension-related charges to equity in prior years but noted that Northern opted not to petition the Commission for authority to record regulatory asset in those years in order to avoid a charge against its equity.

In addition, Staff asserted that its recommendation is simple to administer. For example, in Northern's 2007 annual report, the funded status is equal to the net of the pension liability Account 242 (Table 32, Miscellaneous Unadjusted Credits) and the pension asset Account 132 (Table 18, Prepayments). According to Staff, the change in the balance of these accounts will represent the change in the funded status of Northern's pension plan.

Finally, Staff stated that its recommendation reflects a balancing of shareholder and ratepayer interests because Northern's petition for a regulatory asset is allowed in part ($494,127) and rejected in part ($732,782). However, although Staff's recommendation provided that a portion be rejected, Staff agreed that the Company should have the opportunity to reinstate all or part of that amount based on the annual change in the funded status of the pension plan going forward. As set forth below, any improvement in the funded status would reduce both the regulatory asset and the 2002-2005 pension-related charges to equity on a pro rata basis until the equity charges have been fully reinstated.

Staff noted that the Company's proposed accounting treatment, as summarized in Mr. Kriner's affidavit, used payments made to the pension plan to reduce its previously recorded charges to equity until these previously recorded charges are entirely eroded. His affidavit included a new provision that arose out of discussions between Staff and the Company pertaining to the accounting for any amounts that the Commission might exclude from the Company's requested regulatory asset amount. Staff stated that this provision was not in the original affidavit filed with the petition on February 28, 2007. Specifically, Item 10 of Mr. Kriner's affidavit provided:

> in the event that the Commission concurs with Staff's recommendations to only allow the incremental change in pension OCI amounts from 2006 forward to be recorded as a regulatory asset, Northern will segregate and amortize the previously reported [additional minimum liability] related balance from OCI as *payments* are made to fund the pension plan until the [additional minimum liability] is fully eroded.

(Emphasis added.)

Staff stated that Mr. Kriner's affidavit has the effect of reinstating all of the prior year 2002-2005 pension-related charges to equity before any reduction is applied to the 2006 regulatory asset. Staff recommended the use of the annual change in the funded status of the pension plan rather than the payments made to fund the pension plan.

In addition, Staff recommended an allocation formula to apportion the annual change in the funded status of the pension plan between the previously recorded pension-related charges to equity and the regulatory asset based on the following:

Previously reported additional minimum liability for 2002-2005	$ 732,782	60%
Recommended regulatory asset	$ 494,127	40%
Total	$1,226,909	100%

This formula reflects the percentage relationship between the previously reported additional minimum liability for 2002-2005 and the current year reported change in the pension-related funded status, as reported in the Company's 2006 annual report.

The accounting entries reflecting Staff recommendations are as follows and assume that the Commission approves the recommended amount of $494,127 for the regulatory asset:

146 Misc. Suspense-Regulatory Asset	$494,127
270 Capital Surplus–Pension OCI (Equity)	$494,127

In 2007, under Staff's allocation approach, Northern actually eroded $667,519 of the $732,782 previously reported additional minimum liability balance from OCI during the years 2002-2005. The annual change in the funded status of Northern's pension plan was an improvement of $1,112,531. Sixty percent of this amount is allocated to erode the additional minimum liability balance, or $667,519, with 40 percent allocated to reduce the regulatory asset balance, or $445,012. The following entry records this item:

242 Misc. Unadjusted Credits-Pension Liability	$1,112,531	
270 Capital Surplus-OCI (Equity)		$667,519
146 Misc. Suspense-Regulatory Asset		$445,012

If in 2008 the annual change in the funded status of Northern's pension plan were an additional favorable $108,772,[4] Northern would erode the entire remaining balance of $65,263 of previously reported additional minimum liability from 2002-2005 (i.e., $108,772 x 60 percent) and the regulatory asset will be reduced by $43,509 (i.e., $108,772 x 40 percent). The following entry records this item:

[4] This number was presented for illustrative purposes.

242 Misc. Unadjusted Credits-Pension Liability	$108,772
270 Capital Surplus-OCI (Equity)	$65,263
146 Misc. Suspense-Regulatory Asset	$43,509

Once the previously reported additional minimum liability for 2002-2005 of $732,782 is fully eroded, any future annual changes in the funded status of the pension plan will be reflected as an increase or decrease in the pension-related regulatory asset.

On the other hand, if in 2008 the annual change in the funded status of Northern's pension plan is an unfavorable $108,772, then Northern will erode none of its remaining $65,263 and the regulatory asset will increase by the full amount of $108,772. The entry to record this item is as follows:

146 Misc. Suspense-Regulatory Asset	$108,772
242 Misc. Unadjusted Credits-Pension Liability	$108,772

If in 2009 the annual change in the funded status of Northern's pension plan is a favorable $108,772, then Northern will reduce the regulatory asset by $108,772. The entry to record this item is as follows:

242 Misc. Unadjusted Credits-Pension Liability	$108,772
146 Misc. Suspense-Regulatory Asset	$108,772

Once the previously reported additional minimum liability for 2002-2005 of $732,782 is fully eroded, all future annual changes in the funded status of the pension plan will be reflected as an increase or decrease in the pension-related regulatory asset.

According to Staff, its recommendation uses the "change in the funded status" of Northern's pension plan to reinstate equity charges in prior years related to additional minimum liability balances for several reasons:

1. Staff's recommendation employs the same method to reinstate the Company's equity, going forward, that the Company used to create its charge to equity in the years 2002-2005. Specifically, under the provisions of FAS 87, the Company charged equity in 2002-2005 due to the excess of the accumulated benefit obligation over the fair value of the pension plan assets. Staff stated its recommendation is appropriate since it reinstates equity using the same rationale going forward.

2. FAS 158 states that the employer is required to "recognize the overfunded or underfunded status" of a single-employer defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in comprehensive income.

3. The use of the "change in the funded status" is fair and reasonable because Northern gets an opportunity to fully reinstate its OCI as the funded status changes (i.e., becomes overfunded, or less underfunded). In fact, Northern will reinstate approximately 91 percent of its pension-related charges to equity in 2007.[5]

4. Under FAS 158, the funded status is reported on the Company's annual report to the Commission; hence, it is simple to monitor the amount of the change in the funded status (i.e. Account 242, Table 32). By comparison, the Company's payments are not separately displayed in Northern's Account 242 on the annual report and would require discovery to determine.

Assuming the Commission approves Staff's recommendations set forth above, Northern will reflect the amounts approved by the Commission beginning in its 2007 annual report. Staff also acknowledged that the Company has come into compliance with Commission Order No. 20,806.

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[5] Northern advised Staff that the 2007 change in the funded status of its pension plans was $1,112,531. Under Staff's recommendation, Northern will reinstate approximately 60 percent, or $667,519. Therefore, of a total amount rejected of $732,782, Northern will reinstate approximately 91 percent in the year 2007, with the remaining balance of $65,263 subject to reinstatement in future years. In the meantime, the allowed portion of $494,127 would be recorded on Northern's books as a regulatory asset.

Finally, Staff outlined several limitations and caveats to its recommendations. Staff stated that its recommendations relate only to items reflected on Northern's balance sheet and do not apply to any items on Northern's income statement, including pension and PBOP expense. It is understood that Northern is not seeking any change to its rates as a result of the requested accounting order nor approval for any specific recovery of pension or PBOP expense in future rates and any request in future rate proceedings for recovery of employee pension and PBOP expense will be subject to full Commission review and approval. Because the entries provided for in Staff's recommendations would result in offsetting assets and liabilities, they will not have any effect on rate base. It is further understood that no return will be earned on any regulatory asset created in accordance with Staff's recommendations. Finally, it is understood that, notwithstanding Staff's recommendations, if in a future rate proceeding there is an unanticipated adverse impact on ratepayers as a result of approval of Staff's comments, any recovery of such costs may be addressed at that time. Staff's recommendations do not bind the Commission, Staff, or Northern to a particular ratio for ratemaking purposes, and the equity ratio used in the determination of rates will be subject to review and approval in the usual manner.

II. Commission Analysis

Since Staff's May 22 letter reflects understandings reached by Northern and Staff, we will consider it using the standards normally employed when considering settlements. N.H. Code Admin. Rules Puc 203.20(b) provides that the Commission will approve a disposition of any contested case by settlement if the Commission determines that "the result is just and reasonable and serves the public interest." As set forth below, we find that the settlement agreement satisfies these standards and we therefore approve it.

In *Unitil Energy Systems, Inc.*, Order No. 24,107 (2002), we approved a request for an accounting order in circumstances similar to those present here. The utility sought to treat its additional minimum liability associated with its pension plan obligations as a regulatory asset under FAS 71 and allow it to avoid a reduction in equity that would otherwise be required under FAS 87, “Employers’ Accounting for Pensions.”

Unitil had been notified by its pension plan actuaries that, due to a significant decline in the capital markets and lower interest rates, its estimated year-end pension plan assets would not cover the plan’s accumulated benefit obligation as of December 31, 2002. Unitil further stated that, under FAS 87, it would be required to recognize an additional minimum liability which would include the excess of the actuarially determined additional minimum liability over the value of the plan assets (i.e., the unfunded additional minimum liability) and a reversal of any previously recorded prepaid pension costs. As a result, Unitil stated it would be required to reflect a significant reduction in equity for its pension plan obligations.

According to Unitil, it was appropriate to recognize its additional minimum liability as a regulatory asset under FAS 71 because, under Commission ratemaking precedent, the costs for supporting utilities’ employee pension plans are recovered through customer rates, rather than borne by shareholders. Unitil asserted that issuance of the requested accounting order was consistent with the public interest because it would avoid significant pension accounting-related swings to its debt-to-equity ratios based upon the movement of the capital markets and that the requested accounting would allow it to mitigate the potential adverse effect on its capitalization, credit quality and borrowing costs resulting from certain accounting requirements related to Unitil’s pension plan assets which had been triggered by the substantial decline in the capital markets. Unitil stated that it did not seek an order allowing the deferral of pension-related costs nor any change in existing rates.

The Commission found that the accounting order, subject to certain technical clarifications and modifications, would allow Unitil to treat its additional minimum liability associated with its pension plan obligation as a regulatory asset under FAS 71. The Commission also found that an accounting order was in the public interest because it would avoid significant pension accounting related swings in Unitil debt-to-equity ratios based upon the movements of the capital markets and the potential negative impact on the Company's capitalization and credit.

The Commission emphasized that it was not granting Unitil an open-ended authorization to create such deferred accounts whenever pension liabilities exceed amounts earmarked for that purpose. The Commission underscored management's responsibility to use reasonable forecasting methods to anticipate pension liabilities and to meet those obligations in the most prudent manner and pointed out that swings in equity values and interest rates are to be expected in the economy. The Commission nevertheless stated those issues were not properly before it and the Commission reserved the question of whether Unitil 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.

The Commission emphasized that Unitil was 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. The Commission also stated it was not pre-approving the recovery of a specific amount of pension expenses in future rates, and was not changing its existing policies or precedents on what constitutes a recoverable operating expense. Finally, the Commission warned that any request in future rate proceedings for recovery of employee pension expenses would be subject to review by all parties and approval by the Commission under existing precedent, and Unitil would bear the burden of demonstrating that any employee pension expense is reasonable in amount, prudently incurred and appropriate for recovery in rates.

Northern requested the Maine Public Utilities Commission (Maine PUC) to issue an accounting order similar to that now requested of us in respect to Northern's Maine division. The Maine PUC granted the request in an amount equal to the net difference between the estimated liability and a deferred tax asset attributable to the Maine division[6] resulting from compliance with FAS 158, i.e., $2,446,238. *Northern Utilities, Inc.*, Accounting Order, Docket No. 2007-113 (2007). Northern indicated to the Maine PUC that, without an accounting order, the adoption of FAS 158 would cause a reduction to shareholders' equity of 6.45 percent. The Maine PUC found that the requested accounting order met the goal of the accounting standards by having the total unfunded status of Northern's pension and PBOP plans fully disclosed on its books and records while properly reflecting the reality of Northern's regulated status, pointing out that Northern will eventually recover through rates the costs of these plans as calculated under the relevant accounting standards, FAS 87, 88, and 106. The Maine PUC noted that the recording of a regulatory asset will not impact Northern's revenue requirement or resulting rates as it will not change the amount to be expensed, nor would it have any impact on rate base. In addition, the Maine PUC stated that, if in a future rate proceeding there is an unanticipated adverse impact on ratepayers as a result of the accounting order, any recovery of costs would be

[6] Northern had provided the Maine PUC with actuarial reports on the proper allocation of the entries necessary to adopt FAS 158 as a whole. Northern then assigned 50 percent of this entry to each of its Maine and New Hampshire Divisions, an allocation method deemed reasonable in view of the similar number of customers and the size of the Divisions and the fact that the allocation did not impact the revenue requirements.

addressed at that time and also that the order did not bind it to a particular equity ratio for ratemaking purposes.

Considering the particular facts and circumstances of this case and the two accounting orders cited above, we are satisfied that there is an adequate basis for approving Staff's recommendation that a regulatory asset be established for the pension and PBOP-related obligations of Northern's New Hampshire division. Staff and Northern hold differing views about the appropriate implementation of FAS 158 in respect to the amount of the pension-related regulatory asset to be established. However, Staff's recommendation, to which Northern has acceded, does not require us to rule on which reading of FAS 158 is correct, and we do not do so here.

Staff's recommendation proceeds by retaining the additional minimum liability reported for 2002-2005 on Northern's balance sheet and by adding a regulatory asset for the incremental change in the funded status of Northern's pension plan in the amount of $494,127, as Staff had initially calculated. Staff's recommendation also adopts an allocation formula, based on the relative amounts of the additional minimum liability reported for 2002-2005 and the initial regulatory asset, which is used to reduce the additional minimum liability balance depending on the annual change in the funded status of the pension plan. Under the scenarios included in Staff's recommendation, "favorable" changes reduce the additional minimum liability balance and the regulatory asset in the proportions established by the allocation formula. "Unfavorable" changes do not reduce the additional minimum liability balance but do increase the amount of the regulatory asset. Once the additional minimum liability balance is fully eroded, all further changes in the funded status of the pension plan will be reflected as an increase or decrease in the pension-related regulatory asset.

We have often pointed out that settlements provide an opportunity for creative problem solving and achieving results more in line with the parties' expectations. *See e.g.*, *Verizon New England, Inc.*, Order No. 24,823 (February 25, 2008) and *National Grid, plc*, Order No. 24,777 (2007). This case is an example of parties taking advantage of such an opportunity. While the agreed-upon solution is not entirely simple to administer, we are satisfied that it is appropriate, particularly given the limitations and caveats expressed in Staff's recommendation, all of which we adopt. We note that those limitations and caveats are consistent with those the Commission and the Maine PUC have expressed in the accounting orders cited above.

In closing, we note Staff's view that Northern has come into compliance with Order No. 20,806. Staff did not recommend further enforcement action for any non-compliance by Northern. Strictly speaking, the issue of compliance is outside the scope of an accounting order and we will reserve for an appropriate future docket the question of whether Northern has fully cured any non-compliance so as to make ratepayers whole.

Based upon the foregoing, it is hereby

ORDERED, Staff's recommendations as set forth in its letter filed on May 22, 2008 are approved.

By order of the Public Utilities Commission of New Hampshire this twentieth day of June, 2008.

Thomas B. Getz Chairman	Graham J. Morrison Commissioner	Clifton C. Below Commissioner

Attested by:

Lori A. Normand
Assistant Secretary