STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 91-M-0890 - In the Matter of the Development of a Statement of Policy Concerning the Accounting and Ratemaking Treatment for Pensions and Postretirement Benefits Other than Pensions.

STATEMENT OF POLICY AND ORDER CONCERNING THE ACCOUNTING AND RATEMAKING TREATMENT FOR PENSIONS AND POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

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APPENDICES
I. INTRODUCTION

On March 19, 1992, we issued a Notice Soliciting Comments (Notice) which contained a staff proposal regarding the accounting and ratemaking treatment to be applied to three major and interrelated accounting pronouncements issued by the Financial Accounting Standards Board (FASB). These three Standards are:

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1. The FASB is the private sector's independent rulemaking body for the accounting profession. Although the Securities and Exchange Commission (SEC) has statutory authority to establish financial and reporting standards, the FASB's standards are officially recognized as authoritative by the SEC and the American Institute of Certified Public Accountants.
Statement of Financial Accounting Standards (SFAS) 
No. 87 - "Employers' Accounting for Pensions"

SFAS No. 88 - "Employers' Accounting for Settlements and Curtailments of Defined Benefits Pension Plans and for Termination Benefits"

SFAS No. 106 - "Employers' Accounting for Postretirement Benefits Other Than Pensions"

Although the first two pronouncements were generally effective in 1987,^ we awaited the FASB's issuance of an Exposure Draft on the accounting for Postretirement Benefits Other Than Pensions (OPEB) in the summer of 1989, before beginning the process of developing a generic Statement of Policy on these interrelated accounting principles. All three Standards deal with the complex issues of accounting for, and measurement of, employers' cost of employee benefits received after retirement, but earned during the employees' working career. Since pensions and OPEBs are both forms of deferred compensation, and since the pronouncements are complementary, we are addressing their accounting/ratemaking treatment in one Statement of Policy (Policy).

1. SFAS No. 106 is generally effective for fiscal years beginning in 1993. However, it is not mandatory until fiscal years beginning after December 15, 1994 for employers who have less than 500 plan participants and are non-public enterprises. The Statement of Policy recognizes this delay feature for the small companies.

2. On September 22, 1987, we issued an Order authorizing companies to adopt the provisions of SFAS No. 87 if done in the context of a rate proceeding. Companies could adopt SFAS No. 87 outside a rate proceeding, but only if the differences between pension expense, as calculated under SFAS No. 87, and current rate allowances were deferred for Commission disposition.
II. Overview

After a careful review of all comments submitted in response to the Notice, we are adopting all three accounting Standards, with some revisions to the provisions specified in the Notice, for accounting and ratemaking purposes effective with this Order and retroactive to January 1, 1993. All affected companies must have their regulatory accounting records in compliance with this Policy by October 1, 1993.

The Statement of Policy shall be followed in all instances for regulatory accounting and ratemaking purposes unless particular circumstances demonstrate it to be inappropriate or unwarranted. Before special treatment will be allowed, the party seeking divergent treatment must:

(1) demonstrate that the cost or other impact of implementing the contested provision(s) would be an unjustifiable burden on its New York utility ratepayers, and (2) submit an alternative plan that fulfills the objectives of the Policy.

In the broadest sense, the Policy merges two, sometimes competing, objectives into a comprehensive accounting/ratemaking strategy: it blends a desire to recognize generally accepted accounting principles (GAAP) in Commission rate decisions (when

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1. Thirty parties responded to Staff's proposal; 25 jurisdictional utilities, 2 of the "Big Six" accounting firms and 3 Intervenors who often participate in rate cases (the New York State Consumer Protection Board (CPB), Multiple Intervenors, and Federal Executive Agencies). A list of the respondents is attached as Appendix B.

2. Attached as Appendix A.
they do not conflict with our regulatory objectives) with the
need to introduce accounting changes into rates in a smooth and
efficient manner.

In summary, the Policy accomplishes the following
primary objectives:

- adopts the three GAAP pronouncements for accounting and
  ratemaking purposes. For SFAS Nos. 87 and 88, it
  utilizes some options of the new accounting rules to
  recognize pension gains (and losses) faster than most
  companies heretofore have chosen to do. It also
  preserves other pension savings and, together with
  pension gains, directs their use to mitigate increases
  in future OPEB rate allowances.

- adopts recognition of OPEB costs in rates as they are
  earned by employees (accrual accounting). This
  constitutes a switch from the current pay-as-you-go
  (cash basis) practice.

- moderates the rate impact of adopting accrual accounting
  for OPEB through the use of a phase-in plan and a long-
  term amortization of the obligation that has built up in
  the past.

III. Major Provisions of the Statement of Policy

The Policy accomplishes its main objectives through the
following features:

- mitigates the substantial rate impacts related to
  adopting SFAS No. 106 by:

  - establishing a rate phase-in plan for OPEB that
    allows five-years for rate allowances to reach the
    full annual SFAS No. 106 expense level;

  - amortizing over 20 years the OPEB liability that
    has built up over approximately the last 2 decades
    (the transition obligation);

  - rededicating excess pension plan assets (where
    available) to begin funding future OPEB
    liabilities;
amortizing previously unrecognized pension gains (where available); and

preserving pension expense reductions (past and future) occasioned by the adoption of SFAS No. 87.

complies with GAAP by adopting accrual accounting for OPEB and establishing a rate phase-in plan that conforms with FASB guidelines.

is consistent with the accounting and ratemaking treatment for pensions and OPEBs adopted by both the Federal Communications Commission (FCC) and the Federal Energy Regulatory Commission (FERC).

helps staff monitor OPEB costs by establishing additional reporting requirements, and both requires implementation of cost containment measures for OPEB and allows for incentives if companies reduce annual costs.

safeguards customers from inaccurate actuarial and health care cost assumptions, as well as reduced OPEB costs in the event a national health care program is implemented, by requiring utilities to defer the difference between actual costs and rate allowances for OPEB and dedicating OPEB allowances exclusively for that purpose.

calls for a re-examination in approximately 5-7 years of the accounting/ratemaking impacts on companies and the results of the Policy's provisions on pension and OPEB funding and expense levels.

1. Along with other Annual Report changes for 1993, new schedules containing additional reporting requirements for pensions/OPEB will be considered at a later Commission session.
IV. Responses to the Notice - Specific Issues

A. Use of SFAS No. 87 For Rate Purposes

All parties, except New Rochelle, agree that SFAS No. 87 should be adopted for rate purposes. New Rochelle proposes that the tax contribution method be retained and argues that, since it funds only the minimum amount required by ERISA and IRS regulations, the amount is not excessive and its fund balance has not approached the Full Funding Limitations established in the tax regulations.

SFAS No. 87 provides a more objective tool for measuring and evaluating pension expense than the current accounting method does. The tax contribution method espoused by New Rochelle is less desirable under current circumstances because the Federal Internal Revenue Code (IRC) specifies only the minimum and maximum amounts that must/may be funded. This standard is too broad and leaves the company with wide discretion as to the amount it will expense and fund. This situation is exacerbated by the fact that the IRC also allows actuaries to chose any one of several methods to determine the range of funding. As a

1. TDS Telecom (Edwards, Oriskany Falls & Port Byron Telephone Companies) noted that its employee pension plan is a defined contribution plan (DCP) and that this type of plan was not specifically addressed in the Notice. Although the Notice focused on defined benefit pension plans, it is also applicable to DCPs, as is the Policy adopted herein.

2. Under this method the amount allowed in rates for pensions generally equals the amount the utility deposits in a dedicated external pension trust.

result, the funding level calculated under the tax contribution method is extremely subjective.

SFAS No. 87 provides a superior method for quantifying and apportioning pension costs among current and future customers. Therefore, we adopt SFAS No. 87 for accounting and rate purposes, subject to the restrictions and other provisions described below and detailed in the attached Statement of Policy.

B. Rate Treatment for Prior Deferrals of SFAS No. 87 Amounts

By our September 22, 1987 order we directed all Class A and B utilities that adopt SFAS No. 87 before issuance of a final Statement of Policy to defer the difference between the allowance in current rates for pension costs and costs recorded according to SFAS No. 87, unless the change is made in the context of a rate proceeding. Several utilities request guidance as to how the balance of the deferrals created by that order will be treated for rate purposes.

The disposition of these deferrals will be determined on a case-by-case basis. Companies should propose a disposition of SFAS No. 87 amounts deferred in accordance with the September 22, 1987 order in the same rate filing in which they address recovery of the effects of adopting SFAS No. 106. Companies that do not file for recovery of the costs covered by this Policy by June 1, 1995, must submit an accounting/ratemaking plan to the Commission.

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1. This is addressed in Section III,C,2 of the attached Statement of Policy.
proposing a disposition of these deferred SFAS No. 87 balances by September 1, 1995.

C. Use of SFAS No. 106 for Rate Purposes

   All commenting utilities and the two CPA firms favor the adoption of SFAS No. 106 for rate purposes; however, the three Intervenor parties oppose its adoption. The major arguments in opposition are:

   1. Pay-As-You-Go (PAYGO) is less costly than accrual accounting.

   2. Adoption of SFAS No. 106 is not required by GAAP because SFAS No. 71 allows regulated utilities to use different accounting if the same treatment is followed for ratemaking.

   3. The accrual approach will cause intergenerational inequity since customers will pay the costs of employees that are currently providing service and also pay the costs of employees who provided services in the past.

1. PAYGO is Less Costly

   While the PAYGO approach may produce lower rates in the short-run, it creates offsetting long-term rate impacts. Continued use of PAYGO would inevitably result in future customers being required to bear a disproportionately high percentage of the total costs.

   The Intervenors' "present value" analyses are flawed because they contain inconsistent assumptions for the discount rates and fund earnings rates. These assumptions are critical because they help quantify future liabilities on the one hand and fund earnings on the other. These assumptions, as used in the
SFAS No. 106 calculations, must be based on consistent and interrelated economic circumstances in order to produce valid results. When these components are made consistent and then applied to the PAYGO proponents' studies, the results show the total impact of PAYGO and accrual, in the long run, to be equivalent. Thus, taking into account the time value of money, accrual accounting (assuming funding) is no more costly than PAYGO in real terms. Further, accrual accounting (i.e., SFAS No. 106) achieves an objective PAYGO cannot match -- it evens out OPEB costs over different periods of time and thus provides a fair and systematic cost allocation among current and future utility customers.

2. SFAS No. 71 Permits Utilities to Stay on PAYGO

SFAS No. 71\(^1\) (paragraph 9), permits deferral of current expenses so long as there is a corresponding understanding and commitment by the regulator that the "regulatory asset" thus created has a reasonable probability of recovery in future rate allowances. The Intervenors recommend continued use of PAYGO for rates indefinitely and the establishment of a regulatory asset for all differences between the OPEB costs determined under PAYGO and SFAS No. 106.

The issue of establishing a regulatory asset for the differences between SFAS No. 106 costs and PAYGO rate allowances

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was reviewed extensively by the EITF.\(^1\) On January 21, 1993, the EITF reached a consensus agreement that

"... a regulatory asset related to SFAS No. 106 costs should not be recorded by the regulator if the regulator continues to include OPEB costs in rates on a PAYGO basis."

Thus, the EITF rejected PAYGO as an acceptable treatment for rate regulated entities primarily because the regulatory body could not provide assurance the resulting long-term regulatory asset would actually be recovered in the future. The EITF also adopted several other provisions that apply only to rate-regulated entities for SFAS No. 106 costs. Our Statement of Policy complies with all provisions of the EITF's ruling.

3. Intergenerational Equity

The inequity referred to by the Intervenors pertains to the benefits earned in the past that have not yet been recognized or paid. The cost of these benefits is commonly referred to as "prior service costs." In accordance with one of the options in SFAS No. 106, the Notice proposes that this amount be amortized over a minimum of 20 years as part of the annual OPEB accrual.

The extent of the intergenerational inequity is overstated by the Intervenor parties since the majority of prior service costs are applicable to employees currently in, and

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1. The Emerging Issues Task Force (EITF) of the FASB was formed in 1984 to provide timely financial accounting and reporting guidance on new, often narrow, business transactions. A consensus reached by the EITF is a source of GAAP.
expected to remain in, the companies' workforces for a number of years. The customers who will pay for the prior service costs, if SFAS No. 106 is used, are either the same customers who received the services of the employees to whom the liability relates, or are closer in time to when the service was rendered than future customers will be.

Conclusion

SFAS No. 106 provides a superior method for quantifying and apportioning OPEB costs among current and future customers. We therefore adopt SFAS No. 106 for accounting and rate purposes, effective with this Order, and retroactive to January 1, 1993, subject to the restrictions and other provisions detailed in the attached Statement of Policy.

D. Phase-in Proposal - OPEB

The two CPA Firms strongly support the phase-in plan, characterizing it as a reasonable and practical approach to soften the rate impacts. Twelve utilities find the proposed phase-in acceptable. However, three of these utilities think the minimum rate of phase-in (.25% of operating revenues) is too low and/or the maximum length of the phase-in should be shortened to 4 years. NYT, on the other hand, expresses concern that the Notice's target rate of phase-in (i.e., 1% of operating revenues) may be too large for some companies. NYT also proposes that, in order to maintain consistency, the phase-in should be at the incremental rate of 20% each year for 5 years.
Nine utilities oppose phasing-in the revenue requirement impact, reasoning that:

1. the Phase-in violates the expense recognition required by SFAS No. 106;
2. a phase-in is unnecessary except in extreme cases;
3. staff's plan will leave the New York State utility industry in noncompliance with other states which adopt SFAS No. 106 without restrictions;
4. the required deferrals may never be recovered, especially in view of the increasing competitive nature of the electric, gas and telecommunications industries; and
5. the phase-in method is inherently arbitrary, subjective and does not allow a company's true cost to be reflected in its prices.

The three intervenor parties oppose the phase-in proposal consistent with their overall objection to adopting SFAS No. 106 for rate purposes. MI also states that if SFAS No. 106 is adopted, the first part of the proposed phase-in should be accomplished over 10 years rather than the 5 years proposed in the Notice.

The significant rate impact caused by the adoption of SFAS No. 106 argues strongly for some form of phase-in plan. Moreover, the FASB, through the EITF, has decided that for rate regulated entities the additional cost of adopting SFAS No. 106 should be recognized in rates within about five years of the utility's adoption of SFAS No. 106, with any cost deferrals from the phase-in period being recovered within approximately 20 years from adoption of the Standard.

We concur with the Notice that a phase-in plan is needed to mitigate the impact on customer bills and to allow for a
smooth transition from the PAYGO method. We adopt the phase-in plan proposed in the Notice with the modification that the maximum amortization period for the phase-in related deferrals will be extended from the proposed 10 years to the 20 years allowed by the EITF.\(^1\)

Arguments that a phase-in plan for SFAS No. 106 is unnecessary, except in extreme cases, are unfounded. The plan calls for each utility's implementation of this Policy to be examined on a case-by-case basis. We may shorten or ignore the proposed phase-in if we conclude such action is appropriate given the circumstances of a particular utility, the impact on customers and rates, or other valid reasons. The case-by-case review also answers the concerns of those companies which criticized the rate of phase-in as either too fast or slow. We will base the phase-in within the revenue benchmark ranges proposed in the Notice on an as needed basis.

The argument that the proposed plan will result in inconsistencies among New York state utilities and between New York utilities and those of other states is incorrect given the EITF's ruling and the almost universal adoption of that accounting plan. Moreover, it is not uncommon to have a variety of rate plans, all slightly different, for similar items of expense (e.g., Demand Side Management costs). Despite the varied ratemaking approaches we may apply, they are all implemented in

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1. The phase-in plan contained in the Notice predates the EITF's ruling.
accordance with our regulatory objectives and, in this instance, pension and OPEB rate elements will be guided by the detailed provisions of the Policy.

The concern that the pension and OPEB deferrals may never be recovered because of competition or deregulation is speculative at this time and for the near future. Moreover, under a deregulated framework, the recovery of such deferrals would be just one of many issues. Should we acquire the necessary legislative authority to deregulate an industry, or a portion thereof, we would review the proper rate treatment of all regulatory assets and liabilities in the context of a global deregulation plan.

Finally, claims that the deferral accounting is "arbitrary" and "subjective" are also misplaced. The deferrals in question are in strict compliance with the parameters outlined by the EITF and they constitute a reasonable ratemaking approach, considering the major rate impact OPEB poses.

E. Restriction on Selection of Options

SFAS Nos. 87 and 106 provide options that allow employers latitude when determining pension/OPEB costs. Staff thoroughly analyzed these options in order to determine how they could best meet our regulatory objectives and their recommendations were presented in the Notice. Most of the utilities and the CPA firms generally argue that the accounting Standards should be adopted in their entirety and that the
features embodied in the Standards should be left exclusively to management.

It is clearly proper to limit the application of GAAP pronouncements in our ratemaking practices when they conflict with our regulatory objectives. In the instant case, some of the options available in the Standards for calculating the level of component costs could produce results that would be contrary to our objectives of intergenerational equity and of mitigating rate impacts. Further, our restriction of these options for ratemaking purposes does not violate any provision of SFAS Nos. 87, 88 or 106.

The restriction that raised the strongest objection was the proposal to prohibit the use of the "corridor approach" to recognize certain pension/OPEB gains and losses. As a hedge against volatility in the year-over-year level of expense, both SFAS Nos. 87 and 106 allow employers the option to delay recognition of certain gains/losses. The most conservative method allowed by SFAS Nos. 87 and 106 for recognizing these delayed gains and losses, and the one universally adopted by New York utilities, is the "corridor approach." However, since companies may use any method of recognition that would cause a more rapid recognition of these gains and losses than would the corridor approach, employers have significant leeway in the period over which these gains and losses may be recognized.
The "corridor approach" allows employers to accumulate gains/losses until they reach a threshold; once this level is reached, the amount in excess of this corridor is amortized over a period of approximately 20 years. The Notice proposed to prohibit the "corridor approach" and to require instead that the annual pension/OPEB expense calculation reflect a 10-year amortization of the total amount of gains and losses, without any threshold level.

Commentors argue for retaining the "corridor approach" stating that it is a sound mechanism for mitigating the potential volatility in rates that could result from the SFAS Nos. 87 and 106 expense calculations and from the effects of stock market fluctuations on the value of pension and OPEB fund assets.

While extreme volatility of pension and OPEB expense is undesirable for rate purposes, using the "corridor approach" for recognizing gains/losses is an overly conservative mechanism that does not comport with our ratemaking objectives in this instance. We therefore adopt the Notice's proposed 10-year amortization plan for gains/losses and reject the "corridor

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1. 10% of the greater of (1) the market-related value of plan assets, or 2) the projected benefit obligation.

2. For example, Con Edison's 1991 corridor could contain a net gain or loss of $300 million.
approach" for ratemaking purposes. We will review this decision in the reexamination phase of this Policy, scheduled in 5-7 years.  

The 10-year amortization plan retains some of the averaging benefits of the "corridor approach," thereby reducing volatility, yet recognizes all gains and losses over a reasonable period of time. Additionally, the elimination of the corridor will not impose unwarranted burdens on companies, and we view the 10-year amortization plan as an improvement in the determination of pension and OPEB expense for rate purposes.

The Notice contains numerous technical provisions concerning the adoption and implementation into rates of SFAS Nos. 87, 88, and 106. We adopt all those provisions to the extent they are not modified by the following:

1. companies which initially adopt SFAS No. 87 on or after January 1, 1993 should amortize the transition asset/obligation over the periods(s) specified in the Policy;

2. the Notice's proposal to require the use of a three year market-related value for valuing pension/OPEB plan assets is not adopted; and

3. companies which:

1. The Notice stated (Appendix A, page 18) that any gains or losses should be placed in a deferred account and amortized. This is incorrect. No deferral account should be used since the amounts will not yet have been recognized on the company's books. The Notice should have stated that 1/10th of the gains and losses should be recognized as part of the annual pension expense calculation. The unrecognized portion of these gains and losses will not be included in the rate base calculation.

2. We agree with the Notice's recommendation to review the Policy after a reasonable period of time has elapsed and after all parties have gained sufficient experience. We conclude the review should be made in 5-7 years.

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a. on the basis of an established history of amending their pension/OPEB plans, shorten the amortization period of prior service costs arising from plan amendments, or

b. change the method used to select an assumption or determine the value of plan assets or liabilities, or

c. select a different option, where there is a choice,

must file notification with the Director of the Office of Accounting and Finance within 30 days of enacting the change(s). However, such notification is not necessary if the cumulative impact on pension and OPEB expense, when combined, is less than .05% of the company's common equity and less than $5 million.

F. Proposed Deferrals

Due to the unique nature of pension and OPEB costs, the Notice contains provisions requiring the use of deferral accounting procedures, at least through the 5-7 year review. The objectives of these provisions are to:

1. protect against inaccurate pension/OPEB projections until sufficient experience is gained to assure their accuracy; and

2. monitor pension/OPEB rate allowances that have yet to be paid out as benefits or deposited into an external pension/OPEB trust(s).

Several commentors question the propriety and need for deferral accounting claiming pension/OPEB expense projections are no different than other expense forecasts used in setting rates. They also argue that, if deferral accounting must be adopted, rate base should be adjusted for the deferred balance, rather than accruing a noncash return, and such treatment should be applied equally to both negative and positive deferral balances.
Deferral accounting procedures are needed at least during the 5-7\(^1\) year review period to facilitate a smooth and complete implementation of the phase-in plan and to preserve the impact of the discontinuance of the "corridor approach."\(^2\)

Moreover, employers will be reviewing and revising pension/OPEB expense levels often for assumption changes, plan amendments and for the effects of implementing this Policy. Deferral accounting will mitigate the volatility in rate and expense differences during the transition period.

Finally, in the event a national health care program is implemented in the near future, OPEB rate allowances may be considerably different from actual costs; deferral accounting will buffer these differences and protect all parties from unforeseen consequences.

The amount of pension/OPEB rate allowances not deposited into an external fund (or paid out in benefits expense) will be accounted for using the internal reserve method. Some commentors argue that these amounts (net of their tax effect) should be deducted from rate base. As stated in the Notice, we considered applying rate base treatment for this item but opted for accruing a carrying charge. The carrying charge method matches the timing

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1. The amount deferred during the 5-year phase-in, which constitutes the difference between the rate allowances and actual expense that has not been fully recovered, is likely to require deferral beyond the 5-7 year review period.

2. This latter feature is especially important for companies which do not file rate proceedings as described in Section III,C,2 of the Policy Statement.
of the interest accrual on funds with the actual receipt/disbursement of those funds. The rate base method cannot provide this degree of accuracy because of regulatory lag. Moreover, complicated Internal Revenue Code provisions will determine the amount of pension/OPEB contributions that can legally be made to the external trust arrangements. The availability of cash and alternative investment opportunities will also affect the actual level of funding. Since the level of contributions may be difficult to predict during the implementation phase and thereafter, accruing a carrying-charge on the amounts not deposited into an external fund (or paid out in benefits expense) provides a more accurate method of compensating parties for the time value of money.

We do not expect companies to deposit in external funds more than they receive in rates. Therefore, the accrual of carrying-charges will be allowed only on credit balances in the pension and OPEB internal reserves. Companies seeking to accrue a carrying-charge on debit balances must petition for Commission authority or seek such approval in a rate proceeding.

G. Funding

The Notice proposed to require companies to deposit rate allowances for OPEB into tax-effective, external trust fund(s) to the maximum extent they so qualify. The Notice also listed three conditions that would have to be met for such contributions to be judged "tax-effective." Since there are currently few external trust fund arrangements for OPEB that qualify as "tax-effective,"
the Notice proposed that any portion of the OPEB rate allowance not deposited into "tax-effective" external funds would be retained by the company and could be used for regulated utility purposes. The amounts so retained would be accounted for as an internal reserve (similar to depreciation and decommissioning reserves).

About one third of the commenting utilities objected to this requirement claiming that it unnecessarily encumbered their flexibility to effectively manage their OPEB funding assets. Of particular concern was the effect this definition of "tax-effective" would have on their ability to fund the OPEB plans of management and other nonunion employees. The commentors claimed the requirement would preclude the use of VEBA trusts\(^1\) for these employees since, unlike "collectively bargained" VEBAs,\(^2\) the income earned on VEBA trusts for non-union and management employees is taxed when earned.

The objective of prioritizing tax-effective funding was to obtain the most efficient funding vehicles available, not to bias OPEB funding of union employees over that of management or

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1. Voluntary Employees' Benefit Association (VEBA) trusts are external OPEB trust funds for which cash contributions are tax deductible under Internal Revenue Code (IRC) Section 501(c)(9). However, they must meet strict requirements specified in the IRC.

2. VEBAs established for a company's current and retired employees who are employed (or were employed immediately before retiring) under a collectively bargained labor agreement.
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nonunion employees. In view of the limited number of tax-
advantage vehicles available for funding OPEB, we are deleting
two of the conditions listed in the Notice's definition of "tax-
effective," as that term applies to OPEB funding, and retaining
only the condition that contributions must qualify for a federal
income tax deduction in the tax year the deposit is made.

The Notice proposed the same restrictions on pension
fund contributions as those provided on OPEB contributions.
However, for pensions, there are currently sufficient funding
vehicles available that meet all three conditions in the Notice's
definition of "tax-effective." Therefore, there is no need to
revise this requirement for pensions.

H. Settlements and Curtailments

The Notice proposed several main provisions dealing with
the settlement/curtailment of pension/OPEB plan benefits. The
major provisions require companies to:

1. follow SFAS No. 88 and the applicable provisions of
   SFAS No. 106 to determine gains or losses from the
   settlement or curtailment of employee pension and
   OPEB plans and the granting of termination benefits;

2. notify the Director of the Office of Accounting and
   Finance prior to consummation of any such
   transaction(s);

3. defer all gains from settlements, curtailments, etc.
   on the utility's books for future Commission
   disposition; and

4. file a petition with the Commission if they wish to
defer a loss for future rate recognition.

Most commentors either agreed or did not respond to
these proposals. However, NYT argued for equal treatment for
both gains and losses and noted that advance notification may not be feasible or practical as the transaction may be part of negotiations with employee labor unions. RTC argued that settlements only reduce the current pension or OPEB expense, not the ultimate liability.

Experience shows that settlements can reduce the ultimate pension/OPEB liability.¹ There will be instances where a settlement of all or part of the benefit plan is appropriate and others where it will not. Utilities should periodically investigate the economic advantages of settling portions of their pension/OPEB liabilities.

In some situations it may not be possible for the utility to notify the Director of the Office of Accounting and Finance in advance of the transaction. Thus the written notification procedures are changed to "... filed within 30 days of the transaction."

The Notice's asymmetric treatment of gains and losses arising from pension/OPEB settlements/curtailments is appropriate because utilities have no incentive to defer gains since shareholders would be the primary beneficiaries of such transactions. Moreover, pension fund assets have been funded primarily (if not exclusively) with ratepayer provided funds, and since large amounts of market and actuarial gains have been

¹. For example, in 1989 a jurisdictional company settled part of its pension plan by purchasing annuities. In doing so the company recognized a material gain and the company was no longer liable for the payment of pension benefits to the affected retirees.
excluded from the pension expense calculations, it is equitable that pension gains realized from settlements/curtailments be preserved for ratepayers.

On the other hand, a company that incurs a loss in a settlement/curtailment transaction should be required to demonstrate how the transaction is in the ratepayers' interest. Having different accounting treatment for such gains and losses does not disadvantage companies; rather it adds a regulatory step to the approval process. However, such authorization will be considered only for material amounts and only if the company submits a petition within 60 days of the transaction proposing the accounting and ratemaking treatment to be applied to the net loss.1

I. Early Retirement Savings

Early retirement programs allow utilities to trim their labor force and to reduce payroll costs. Among other things, however, these programs shift the cost of providing fringe benefits for the early retiree from a current operating cost to the OPEB fund. In the current ratemaking process, companies retain the savings from avoided salaries/wages and fringe

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1. The petition must contain a detailed derivation of the net loss, including the derivation of all of the annual costs and savings, both direct and indirect for both pensions and OPEB, related to, or generated by, the action that gave rise to the loss. Such amounts shall be quantified for the period of time commencing with the inception of the action or incident and ending with the projected date of company's next rate change.
benefits until the next rate proceeding. Meanwhile, increased annual pension and OPEB costs are thrust upon future customers.

The Notice tried to correct for this cost shifting by requiring companies to defer the savings from avoided fringe benefit costs related to the early retirees until the early retirements have been recognized in rates.\(^1\) The captured savings would be used to help defray the related OPEB costs which commence being paid from the OPEB fund(s) immediately upon the employee's retirement. However, in order to prevent establishing a disincentive to this type of cost containment program, the Notice did not target wage and salary savings for capture. Several utilities misunderstood this and thought we were proposing to capture all of the savings while not providing for recovery of the associated costs.

In instances where the company is not requesting to defer for subsequent recovery the costs it has/will incur as a result of a broad based early retirement program, the capture of the limited amount of savings, as proposed, is appropriate.\(^2\) However, since broad based early retirement programs may give rise to a loss in the short-term, but over the long-term result in a significant net savings, the company may wish to seek deferral and subsequent recovery of its costs. In instances

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1. Notice, page 5

2. The "savings" subject to this capture shall be an amount equal to the revenue requirement reduction applicable to the OPEB (i.e., health care coverage, life insurance, and prescription drug plan(s), etc.) of those employees electing early retirement.
where the early retirement program can be shown to be in the best interests of the ratepayers, companies may petition for recovery of significant program costs. Upon petition, early retirement amounts (both costs and savings) will be accorded appropriate deferral accounting treatment, with recovery decided in subsequent proceedings pursuant to our conventional standards of prudence.¹

Such petitions are to be filed with the Commission within 60 days of the consummation of the transaction and must demonstrate the transaction is in the ratepayers' best interests. The petition should quantify all costs and savings (both direct and indirect) to be incurred/realized as a result of the early retirement program from its inception to the projected effective date of company's next rate change; or beyond that date if ratepayers are receiving long-term benefits from the action. Such petition may include a proposal for the sharing of the net savings resulting from the early retirement program.

J. Use of Pension Surpluses to Offset OPEB Expenses

Jurisdictional utilities were requested to comment on the feasibility of using excess pension fund assets that may

exist to mitigate the rate impact of adopting SFAS No. 106. Fifteen utilities, plus CPB and MI, responded.

The responding utilities oppose the use of pension assets to fund OPEB, contending the pension liability is continuous and that all money in the fund must be used for pension purposes. They claim the proposal would merely result in the transfer of assets from pensions to other employee benefit costs and will not produce any long-term benefit. They infer that the proposal is an attempt to avoid, or artificially reduce, rate allowances for OPEB. They also pointed out, as did the Notice, that the legal restrictions associated with pension fund withdrawals, VEBAs, and Section 401(h) transfers may encumber the use of pension funds for OPEB purposes.¹

CPB proposes that excess pension assets be used to reduce rates rather than being shifted to cover "highly uncertain OPEB costs." MI supports the concept of using excess pension assets for OPEB but argues that SFAS No. 106 should not be used for rate purposes.

Reducing the long-run cost of employee benefits is not the intent behind the proposal to transfer excess pension funds to OPEB (where a transfer is both practical and legally permissible). Nor is the intent of the proposal to ignore OPEB in rates. Rather, it is intended to strike some balance between a retiree benefit fund that is overfunded and a retiree benefit

¹. Like VEBAs, Section 401(h) transfers are one of the few types of tax deductible vehicles available, but they also are subject to strict federal requirements.
fund that is dramatically underfunded. Because the pension funds of some of our jurisdictional companies are considerably in excess of their current accumulated obligations, it is logical to apportion some of this excess to OPEB, if possible.

In the first rate filing submitted after this Policy is issued, jurisdictional companies should describe their efforts to allocate pension plan assets in excess of pension benefits obligations to tax-effectively fund SFAS No. 106 related liabilities. The filings are to include all particulars related to such assignments, such as amounts, dates, investment vehicles used, tax effects, etc. Companies electing not to assign excess pension plan assets are to provide a complete explanation of this decision in the rate proceeding wherein they implement the provisions of this Policy.¹

K. Implementation Plans – Rate Recovery

The Notice provided several methods whereby companies could file to implement the Statement of Policy in rates. There were no comments opposing the implementation methods proposed. However, the date for filing the implementation plan is modified, and another modification is necessary for situations where companies will not be filing for a rate change by the terminal date(s) established by the Policy.

¹ Due to strict federal requirements covering these vehicles and options, they may not be a reasonable option for a particular utility. Thus, we are not requiring they be made but they must be given consideration.
The date for submitting an implementation plan is changed from "the date SFAS No. 106 is adopted" to "June 1, 1995" for companies which must adopt SFAS No. 106 in 1993. This change provides time for companies to develop a well conceived ratemaking plan and to gather employee actuarial and demographic data.\footnote{This will leave approximately 3 years to effectuate the OPEB phase-in.} Although the deadline for filing a rate plan is extended, the deferral and carrying-charge requirements described in the Policy must be applied for regulatory accounting purposes commencing January 1, 1993\footnote{Some companies adopted SFAS No. 87 for regulatory accounting purposes prior to January 1, 1993 in accordance with our September 22, 1987 order. Deferrals made prior to January 1, 1993 in accordance with that order are to remain segregated from deferrals made in accordance with this Policy. If this previous deferral, net of any portion which has been accorded rate base treatment, has a credit balance, a carrying-charge shall be accrued on the net balance at a rate, and in the manner, described in Section III,A,7 of the Policy. If the net balance is a debit amount, no interest shall be accrued. For companies which keep their books and records on a fiscal year basis, these deferral and carrying-charge accrual requirements, as they apply to OPEB, are effective commencing with the company's first fiscal year beginning after December 15, 1992.} (January 1, 1995 for companies that meet the requirements for the delayed implementation).

Companies with pending rate proceedings, may amend their filings to include the effects of implementing the provisions of this new Statement of Policy no later than filing of Briefs on Exception.

Single-issue rate filings for the purposes of implementing SFAS No. 106 will not be accepted. Companies which
are not required to adopt SFAS No. 106 until fiscal years beginning after December 15, 1994 will have until January 1, 1996 to file a rate and accounting plan.

If a company does not file for a rate change within the time limits specified in the Statement of Policy, the company shall cease to qualify for recording a regulatory asset for the impact of SFAS No. 106. In such a case, all deferrals of SFAS No. 106 costs that have been established in anticipation of rate recovery are to be charged to current period income by the end of the latest authorized filing period.

L. Actions to Control OPEB Costs

The Notice proposed that all utilities be required to take certain actions to control OPEB costs. Most of the responding utilities indicated they have been taking the actions outlined and that no further requirements need to be imposed. Some company commentors believe the decision to initiate cost reductions in their OPEB programs should be left to management and should not be directed by the Commission.

The recommendations contained in the Notice do not force companies to implement any particular action or meddle in management prerogatives. All utilities, including those that adopt SFAS No. 106 without requesting rate treatment, are to demonstrate in their first rate case following adoption of SFAS No. 106 that they have taken the actions to control OPEB that are listed in Section III,C,4 of the Policy.
M. OPEB Cost Control Incentives

Utilities normally have a financial incentive to control costs between rate changes because they are allowed to retain some/all of the savings achieved beyond the rate allowance granted for the costs. However, the deferral mechanisms adopted herein, although necessary under the circumstances, will capture any efficiencies gained through effective management of the program. Since OPEB is a significant expense, utilities should have incentives to minimize program costs consistent with workforce morale and productivity objectives.

The specific incentives will be based on results that can be clearly demonstrated and supported and on the following considerations: the level of effort involved, ingenuity shown, the long-term nature of the savings, the amount of the annual savings achieved relative to the annual cost, and other pertinent factors identified by the utility.

N. Plans Which Cover More Than Jurisdictional Utility Employees

Many consolidated corporate structures cause jurisdictional companies' employees to be participants in pension/OPEB plans that cover regulated, non-regulated, and/or out-of-state employees.¹ The diverse population covered by these consolidated plans and the multi-jurisdictional arenas with

¹ Jurisdictional utilities in this category include Central Hudson, O&R, NFG, Alltel, AT&T-NY, GTE New York, TDS TELCOM, NYSTA, NYT, RTC, Jamaica, Long Island Water, New Rochelle, NY-American and Spring Valley.
their multiple regulatory or statutory requirements could cause administrative problems, if the various authorities have inconsistent standards. Because the Notice proposed restrictions on certain SFAS No. 87 and SFAS No. 106 provisions for ratemaking purposes, some respondents with consolidated employee benefit plans claim this would cause a need for additional accounting records and actuarial studies. This, they argue, would increase costs ultimately borne by New York ratepayers. They propose, instead, that SFAS Nos. 87, 88, and 106 be adopted without any restrictions.

Our accounting and ratemaking decisions strive to avoid duplicate or unnecessary recordkeeping and to minimize ratemaking conflicts with other authorities that have complementary responsibilities. In this instance some conflict appears unavoidable because of the competing interests involved and what may be different price setting philosophies. To achieve the regulatory objectives outlined herein, the commentors' proposal to eliminate all restrictions is rejected. However, if a jurisdictional company which participates in a consolidated group pension/OPEB plan with non-jurisdictional affiliates can demonstrate severe hardship or inequity as a direct result of our Statement of Policy, we will consider a waiver of the identified, onerous provision(s). Any such filing must clearly explain the conflict, justify the exemption sought, and provide an
alternative proposal that clearly satisfies the objectives of the Statement of Policy.¹

In a related matter, the Notice proposed prohibiting the commingling of OPEB monies provided by New York State ratepayers with funds from other affiliates in a consolidated group. This segregation of New York funds is intended to provide added protection from non-jurisdictional affiliates realizing any financial or other advantage from the steady flow and availability of ratepayer money.²

Accordingly, all funds granted for SFAS No. 106 costs, plus any pension related or other funds or credits the company transfers or is otherwise directed to use for OPEB purposes, are to be used exclusively for the payment of trustee fees, associated income taxes (if any), and for the cost of postretirement benefits paid to or for employees who have worked at and for the jurisdictional company for the qualifying period(s) and under the qualifying conditions. When an external

¹. On December 18, 1992 New York Telephone Company (NYT) filed an accounting plan that included full adoption of SFAS Nos. 87, 88 and 106. We will address this request in a separate proceeding. In the interim, NYT may record its pension and OPEB costs in accordance with the provisions of its proposed plan, subject to future reversal and reconciliation, and in accord with our final decision in that proceeding.

². Consolidated pension plans and pension funds already exist and therefore cannot be treated similarly without substantial administrative and Treasury Department complications. Therefore, existing pension funds are exempt from this prohibition on commingling.
fund is established for the deposit of these funds, no corporation, affiliate, subsidiary, partnership, etc. other than the jurisdictional company is to be allowed to have control over, access to, or the authority to withdraw funds from such account.

CONCLUSION

SFAS Nos. 87, 88 and 106 provide a superior method for determining pension and OPEB expense for rate purposes. For the most part our accounting and ratemaking objectives are compatible with those of the FASB. However, certain restrictions need to be applied to the newly adopted Accounting Statements so that their implementation in rates meets our regulatory objectives. Also, many difficult assumptions and subjective estimates are necessitated by the Statements. Thus, full deferral of rate allowance variations is being instituted to protect companies and ratepayers from potential volatility, at least until the 5-7 year review is completed.

Since the impact of SFAS No. 106 on rates will be material, we are adopting various rate mechanisms, including a phase-in plan and the use of excess pension fund assets, to temper its impact. Finally, utilities should strive to control their OPEB costs to the greatest extent possible. To encourage cost containment we have outlined a plan that allows companies to share in the savings realized from such efforts.
The Commission Orders:

1. The attached Statement of Policy concerning the accounting and ratemaking treatment for pensions and postretirement benefits other than pensions is adopted for all jurisdictional utilities that are subject to the Uniform Systems of Accounts, effective with this Order, and retroactive to January 1, 1993.

2. This proceeding is continued.

By the Commission,

JOHN J. KELLIHER
(SIGNED)
Secretary
STATEMENT OF POLICY CONCERNING THE ACCOUNTING AND RATEMAKING TREATMENT FOR PENSIONS AND POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

I. Introduction

This Statement of Policy is provided to efficiently and effectively implement our new policy for the accounting and rate treatment for pensions and postretirement benefits other than pensions (OPEB). Our new policy is rooted in the following three interrelated pronouncements issued by the Financial Accounting Standards Board.

- Statement of Financial Accounting Standards (SFAS) No. 87 - "Employers' Accounting for Pensions"
- SFAS No. 88 - "Employers' Accounting for Settlements and Curtailments of Defined Benefits Pension Plans and for Termination Benefits"
- SFAS No. 106 - "Employers' Accounting for Postretirement Benefits Other Than Pensions"

This Statement of Policy (Policy) shall be followed in all instances unless particular circumstances demonstrate it to be inappropriate. However, before special treatment will be granted, a utility must make a strong and clear showing why the Policy should not apply in its particular case and/or how it would cause undue financial or operational harm if adhered to.

Due to the unique nature of the subject matter, the results of this Policy will be reviewed in five to seven years. Jurisdictional utilities and other interested parties will be invited to participate and provide staff with any relevant information and comments.

II. General Policy

SFAS Nos. 87, 88, and 106, subject to certain restrictions, shall be used for accounting and ratemaking purposes for all applicable transactions as of
January 1, 1993. For SFAS No. 106 this effective date applies only to employers who have more than 500 benefit plan participants in the aggregate, or are public enterprises. Absent special permission, all other entities shall not use SFAS No. 106 until fiscal years beginning after December 15, 1994.

III. Provisions

A. Pensions

1. Unless otherwise provided, the provisions of this Policy for pensions shall be reflected in rates at the same time as the provisions for OPEB are reflected in rates. The requirements for OPEB are provided below.

2. Commencing January 1, 1993, companies shall defer the difference between 1) the rate allowances for pensions, less any pension rate allowance the company is directed to use for OPEB purposes, and 2)

1. For companies which keep their regulatory books and records on a fiscal year basis, the applicable date, as it applies to SFAS No. 106, shall be the beginning of the company's first fiscal year beginning after December 15, 1992. For SFAS Nos. 87 and 88, the date will remain January 1, 1993.

2. A public enterprise is defined in SFAS No. 87 as an enterprise (a) whose debt or equity securities are traded in a public market, either on a stock exchange or in the over-the-counter market (including securities quoted only locally or regionally), or (b) whose financial statements are filed with a regulatory agency in preparation for the sale of any class of securities.

3. For the purpose of determining the level of deferrals required by this Statement of Policy for both pensions and OPEB, "rate allowance" for electric, gas and water companies shall be calculated by the following formula:

\[
\text{rate allowance} = \frac{\text{projected expense allowed in last rate proceeding}}{\text{projected sales (e.g. Kwh, Therm, or Gallons)}} \times \text{actual sales}
\]

For telephone companies it shall be the amount allowed in the company's last rate proceeding.
pension expense determined as required by this Statement of Policy. ¹

3. Companies which initially adopt SFAS No. 87 on or after January 1, 1993 are to amortize the transition amount over the average remaining service period of its employees, or 15 years, whichever is longer. ²

4. Commencing January 1, 1993, all companies are to recognize, as part of their SFAS No. 87 expense calculation, all gains or losses described in Paragraph 29 of SFAS No. 87, except those not yet reflected in the market-related value of plan assets (if the company uses that method to value plan assets), over a 10-year period calculated on a vintage year basis. For those companies which have already adopted SFAS No. 87 for regulatory accounting and ratemaking purposes, these gains or losses accumulated and unrecognized as of January 1, 1993 are to be considered one vintage year.

5. By Order dated September 22, 1987, we authorized utilities to adopt SFAS No. 87 before the effective date of this Policy if the accounting change was made in the context of a rate proceeding or if the company deferred the impact of the change. Companies are to propose a disposition of SFAS No. 87 amounts deferred in accordance with the 1987 Order in the same rate filing in which they address recovery of the effects of adopting SFAS No. 106. ³ Companies which do not file for recovery of the costs covered by this Policy by

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¹ For the purpose of calculating this deferral, both the "rate allowance" and "pension expense" shall only include the amount charged to expense accounts (i.e., not charged to construction, depreciation expense and rate base allowance related to capitalized pension costs.

² The "transition amount" is the unrecognized net asset or obligation at the date SFAS No. 87 is adopted.

³ This is addressed in Section III,C,2.
June 1, 1995, must submit an accounting/ratemaking plan to the Commission proposing a disposition of these deferred SFAS No. 87 balances by September 1, 1995.

Deferrals made prior to January 1, 1993 in accordance with our September 22, 1987 order are to remain segregated from deferrals made in accordance with Sections III,A,2 and III,A,7 herein. If the deferral made in accordance with the September 22, 1987 order, net of any portion which has been accorded rate base treatment in a rate proceeding, has a credit balance, interest shall be accrued on that net balance at a rate, and in the manner, described in Section III,A,7 herein. If the net balance is a debit amount no interest shall be accrued.

6. Starting with the company's first proceeding in which SFAS No. 106 is considered for rates, the company must report on its efforts to allocate pension plan assets in excess of pension benefit obligations to fund OPEB related liabilities on a tax-effective basis. This must include all particulars related to such assignments including, but not limited to, amounts, dates, investment vehicles used, tax effects, etc. Companies electing not to assign excess pension plan assets must provide a complete explanation of such decisions. All subsequent rate filings shall update this data, until the requirement is rescinded by the Director of the Office of Accounting and Finance either on a case-by-case or generic basis.

7. All companies shall make maximum use of tax-effective external

1. The prescribed procedures for implementing SFAS No. 106 into rates are described below.
funding vehicles for deposits of pension funds.  
Commencing January 1, 1993, an amount of the recorded pension liability equivalent to the following shall be classified as (transferred to) an internal reserve account:

1. the pension rate allowance, plus

2. the actual amount of pension costs that are charged to construction, less

3. any pension related funds or credits the company is directed to use for OPEB purposes.

The funds represented by the internal reserve may be commingled with other utility funds and used for regulated utility purposes until such time as the funds are used for payment of pension benefits, deposited into an external pension trust(s), or the Commission orders some other disposition.

For rate purposes, the pension internal reserve shall not be used

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1. For the purpose of this Policy, "tax-effective funding vehicle" for pensions is defined as an externally held pension dedicated account or trust arrangement (trust) that: 1) will allow payments to the trust to qualify as a current federal income tax deduction, 2) the income earned on the fund balance accumulates tax free, and 3) the employee is not taxed until the benefit is actually received or not taxed at all. This definition differs from that used for OPEB funding.

2. These entries shall be made no less than monthly and, except for the amounts representing actual charges to construction, shall be based upon amounts that are proportional, and on an annual basis equal, to the annual test period allowances.

3. For the purpose of this calculation the "rate allowance" shall only include the amount charged to expense accounts (i.e., not charged to construction, depreciation expense and rate base allowance related to capitalized pension costs).

4. The portion of pension costs allocated to capital accounts shall be included in the internal reserve since such costs earn a return by virtue of their inclusion in rate base or construction work in progress and through the rate allowance for depreciation accruals.
to reduce rate base unless otherwise directed by the Commission.¹
Instead, interest is to be accrued monthly on amounts recorded in the
reserve (net of its tax effects) at the company's latest authorized
pretax rate of return. Such interest shall be recorded in a separate
subaccount in the internal reserve and interest shall be compounded
thereon² on a monthly basis using the same pretax rate of return.
If the cumulative net-of-tax balance in this reserve (including
accrued interest) is a debit, no accrual of interest is to be made
for that month.³ Companies shall apply deferred income tax
accounting for the difference between book and tax treatment of SFAS
No. 87 costs, in accordance with the Commission's Statement of Policy
on SFAS No. 109.⁴

8. The assumed discount rate used to determine pension and OPEB expense
must be based on the rates of return currently available on high-
quality bonds, and other market indicators which are of similar
duration and risk, whose cash flows match the timing and amount of
the expected benefit payments. If settlement of the obligation with
a third-party insurer is possible, the rate of return inherent in the
amount at which the obligation can be settled is relevant in

¹. However, for the purpose of calculating the company's earnings base vs.
capitalization adjustment in rate proceedings, the amount in the internal
reserve may be added to the company's capitalization.

². The cumulative interest balance less its related deferred tax.

³. A debit balance can occur only when management, at its discretion, decides to
make contributions in excess of rate allowances or if it accrues a negative
pension expense. In rate proceedings companies may seek prospective interest
accruals or rate base treatment for debit balances.

⁴. SFAS No. 109, Accounting For Income Taxes, Case 92-M-1005. An interim Policy
Statement was issued January 15, 1993 in this case.
determining the discount rate, but should not be a major factor unless settlement is imminent.

9. If a company shortens the amortization period for prior years service costs based on the contention that "it has a history of plan amendments," it must file notification with the Director of the Office of Accounting and Finance within 30 days of enacting the change(s). However, such notification is not necessary if the cumulative impact on annual pension and OPEB expense, when combined, is less than 0.05% of the company's common equity and less than $5 million.

10. If a utility 1) changes the method or manner in which it selects an assumption or determines the value of plan assets or liabilities or 2) selects a different option, where there is a choice, it is not an accounting change subject to Section 48 of the Commission's Rules of Procedure. However, it must file a notification with the Director of the Office of Accounting and Finance explaining the particulars within 30 days of enacting the change(s) if the cumulative impact on annual pension and OPEB expense, when combined, is 0.05% of the company's common equity or $5 million, whichever is less.

B. SFAS No. 88 - Settlements/Curtailments/Terminations & Termination Benefits

1. If a company settles, curtails, or terminates an employee pension plan, it is to notify the Director of the Office of Accounting and Finance in writing within 30 days of the transaction. The written
notice is to provide a full explanation and justification for the transaction and an estimate of its rate effects.

2. SFAS No. 88 shall be used to compute the gain or loss from all transactions covered by that statement. Companies are required to defer, for Commission disposition, any gains related to the settlement or curtailment of pension benefits and the termination of pension plans. Within 30 days of the completion of such transactions companies must file with the Commission for disposition of such gains in the same manner as prescribed for Pension Costs in Section III,B,1 above.

Any losses incurred due to the settlement/curtailment of pension benefits and terminated pension plans, or the granting or provision of special or contractual termination benefits, are not deferrable or recoverable in rates without Commission authorization. Granting of such authorization will be considered only for material amounts and only if the company files with the Commission a petition requesting such authorization within 60 days of the transaction. Such petition shall propose the accounting and ratemaking treatment to be applied to the net loss. The petition must fully support the quantification and derivation of all of the annual costs and savings, both direct and indirect for both pensions and OPEB, related to, or generated by, the action(s) that gave rise to the loss. Such amounts shall be quantified for the period of time commencing with the inception of the action or incident, and ending with the projected date of the company's next rate change.

3. The granting of a broad based early retirement program may give rise to a loss in the short-term, but over the long-term result in
significant net savings. In such instances companies may petition, as described immediately above, for recovery of significant program costs. Upon petition, early retirement amounts (both costs and savings) will be accorded appropriate deferral accounting treatment, with recovery decided in subsequent proceedings pursuant to our conventional standards of prudence.¹

Any such petition must demonstrate the transaction is in the best interests of ratepayers and must fully support the quantification and derivation of all of the annual costs and savings, both direct and indirect, for both pensions and OPEB, to be incurred/realized as a result of the early retirement program from its inception to the projected date of company's next rate change filing; and permissible beyond if ratepayers are receiving long-term benefits from the action. Such petition may include a proposal for the sharing of the net savings resulting from the early retirement program.

C. OPEB

1. Phase-In

a. The full annual level of prudently incurred OPEB expense will be recognized in rates using SFAS No. 106 within approximately five years from the date of adoption of SFAS No. 106 for accounting purposes. The rate phase-in may take place in steps.

b. Differences between 1) the rate allowance\textsuperscript{1} for OPEB expense, plus any pension related or other funds or credits the company is directed to use for OPEB purposes, and 2) OPEB expense determined as required herein, may be deferred for future recovery.\textsuperscript{2} These deferrals shall be recovered within approximately 20 years of the date SFAS No. 106 is adopted for accounting purposes.

c. The percentage increase in rates scheduled under this recovery plan for each future year shall be no greater than the percentage increase in rates scheduled under the plan for each immediately preceeding year. A recovery plan based on a straight-line basis phase-in may be allowed.

d. For regulatory accounting and ratemaking purposes, the transition obligation must be amortized over the company's employees' average remaining service period, or 20 years, whichever is longer.

e. All companies are to recognize, as part of their SFAS No. 106 expense calculation, all gains or losses described in Paragraph 56 of SFAS No. 106, except those not yet reflected in the market-related value of plan assets (if the company uses that method to

\textsuperscript{1} For the purpose of calculating this deferral, both the "rate allowance" and "OPEB expense" shall only include the amount charged to expense accounts (i.e., not charged to construction, depreciation expense and rate base allowance related to capitalized OPEB costs).

\textsuperscript{2} This deferral may commence January 1, 1993 for companies which adopt SFAS No. 106 effective that date. For companies which keep their books and records on a fiscal year basis, this deferral may commence with the company's first fiscal year beginning after December 15, 1992. However, until the effects of adopting SFAS No. 106 are reflected in rates, companies may record this regulatory asset only to the extent that such deferral will not result in the company earning in excess of its last allowed rate of return. This requirement (deferral allowed only to the extent that it will not result in excess earnings) does not apply to companies whose earnings are subject to company/ratepayer sharing provisions approved by this Commission.
value plan assets), over a 10-year period calculated on a vintage year basis. This method for recognizing gains and losses shall be effective at the date SFAS No. 106 is adopted for accounting purposes.

2. Rate Recovery

a. Companies with rate proceedings pending should amend such filings to include the effects of implementing the provisions of this Statement of Policy prior to the filing of Briefs on Exceptions.

b. Companies may reflect the impact of this Statement of Policy in staged rate filings already approved by the Commission.

c. Companies not covered by paragraphs 2.a. or 2.b. immediately above have until June 1, 1995 to file with the Commission rate changes to recover the effects of adopting SFAS No. 106 and SFAS No. 87\(^1\) (if not already adopted). Such filings shall encompass a general rate change whereby all elements of cost are presented and considered. Single-issue rate filings for the purposes of implementing SFAS No. 106 into rates shall not be accepted.

Companies that are not required to adopt SFAS No. 106 until fiscal years beginning after December 15, 1994 have one year from that effective date to file such rate plans.

d. If a company does not reflect the provisions of this Statement of Policy in rates within the guidelines provided in Sections III,C,2,a, b, and c above, it no longer qualifies for recording

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1. Filings made in accordance with Sections III,C,2,a, b, and/or c are to include any SFAS No. 87 deferrals made in accordance with our September 22, 1987 Order concerning adoption of SFAS No. 87 (see Section III,A,5 herein).
an OPEB related regulatory asset as allowed by Sections III,C,1,b and III,C,2.e.

Accumulated balances of deferred SFAS No. 106 costs on the books of companies which fail to meet the above prescribed filing requirements must be written-off by a charge to the income statement by the end of the latest of these allowed filing periods and no future OPEB costs may be recorded as regulatory assets until the company comes into compliance with the filing requirements or special permission is granted.

e. If there is no phase-in of SFAS No. 106 costs, or the phase-in is completed, the difference between 1) the rate allowance for OPEB, plus any pension related or other funds or credits the company is directed to use for OPEB purposes, and 2) the actual OPEB expense determined as required herein (less related productivity adjustments, disallowances, incentives, etc.) shall be deferred in a separate account. Future disposition of such amounts will be at the discretion of the Commission.

f. If a company shortens the amortization period for prior years service costs based on the contention that "it has a history of plan amendments," it must file notification with the Director of the Office of Accounting and Finance explaining all the particulars within 30 days of enacting the change(s). However, such notification is not necessary if the cumulative impact on

1. For the purpose of calculating this deferral, both the "rate allowance" and "OPEB expense" shall only include the amount charged to expense accounts (i.e., not charged to construction, depreciation expense and rate base allowance related to capitalized OPEB costs).
annual pension and OPEB expense, when combined, is less than 0.05% of the company's common equity and less than $5 million.

g. If a utility 1) changes the method or manner in which it selects an assumption or determines the value of plan assets or liabilities or 2) selects a different option, where there is a choice, it is not an accounting change subject to Section 48 of the Commission's Rules of Procedure. However, it must be reported to the Director of the Office of Accounting and Finance within 30 days of enacting the change(s) if the cumulative impact on annual pension and OPEB expense, when combined (if similar or related changes are applicable to both), is 0.05% of the company's common equity or $5 million, whichever is less.

3. Funding

a. External Funding

(1) Companies are required to make the maximum use of tax-effective funding vehicles\(^1\) for rate allowances\(^2\) received for OPEB unless such funding is economically unjustified in view of factors other than the difference in earnings rates for the internal reserve vs. the external trust. Deposits to such trust(s) shall be made no less than quarterly, in

1. For the purpose of this Policy, "tax effect funding vehicle" for OPEB is defined as an externally held OPEB dedicated account or trust arrangement (trust) that will allow payments to the trust to qualify for a current federal income tax deduction. This definition differs from that used for pension funding.

2. For purposes of determining the level of deferrals required by this Policy for OPEB, calculation of the OPEB rate allowance shall be consistent with the method defined in the footnotes to Section III,A,2 herein, plus any pension related or other funds or credits the company is directed to use for OPEB purposes.
amounts that are proportional, and on an annual basis equal, to the annual test period allowances that qualify for tax-effective deposits.

The trust must provide that any disbursements are limited to 1) the cost of postretirement benefits paid to, or for, employees who have worked at and for the jurisdictional company for the qualifying period(s) and under the qualifying conditions and 2) payments for expenses of the trust. ¹ The trustee must be independent of the company and authorized to make only those investments that are consistent with sound investment policies for trusts of this nature.

(2) For all external OPEB trusts, no corporation, affiliate, subsidiary, partnership, etc., other than the jurisdictional company shall have control over, access to, or the authority to withdraw funds from such account.

(3) Companies must establish OPEB plans separate from other corporations', affiliates', subsidiaries', partnerships', etc., plan(s), if such separation is necessary to adhere to the provisions of Sections III,C,3,a,(1) and/or III,C,3,a,(2) above and to qualify for income tax deductions or other tax advantages authorized for, or available to, similar qualified external trust arrangements.

¹ The limitations and safeguards detailed in Sections III,C,3,a,(1), (2), and (3) are equally applicable to pension fund assets transferred to the OPEB trust.
b. **Internal Funding**

(1) Commencing January 1, 1993, \(^1\) an amount of the recorded OPEB liability equivalent to the following shall be classified as (transferred to) an internal reserve account: \(^2\)

1. the OPEB rate allowance, \(^3\) plus

2. the actual amount of OPEB costs that are charged to construction, \(^4\) plus

3. any pension related or other funds or credits the company is directed to use for OPEB purposes.

The funds represented by the internal reserve may be commingled with other utility funds and used for regulated utility purposes until such time as the funds are used for payment of OPEB benefits, deposited into an external OPEB trust(s), or the Commission orders some other disposition.

For rate purposes, the OPEB internal reserve shall not be used to reduce rate base unless otherwise directed by the

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1. Or the company's effective date of adoption of SFAS No. 106, if that date is later than January 1, 1993.

2. These entries shall be made no less than monthly and, except for the amounts representing actual charges to construction, shall be based upon amounts that are proportional, and on an annual basis equal, to the annual test period allowances.

3. For the purpose of this calculation the "rate allowance" shall only include the amount charged to expense accounts (\(i.e.,\) not charged to construction, depreciation expense and rate base allowance related to capitalized pension costs).

4. The portion of the liability applicable to capital accounts shall be included in the internal reserve since such costs earn a return by virtue of their inclusion in rate base or construction work in progress and through the rate allowance for depreciation accruals.
Instead, interest is to be accrued monthly on amounts recorded in the reserve (net of its tax effects) at the company's latest authorized pretax rate of return. Such interest shall be recorded in a separate subaccount in the internal reserve and interest shall be compounded thereon on a monthly basis using the same pretax rate of return. If the cumulative net-of-tax balance in this reserve (including accrued interest) is a debit, no accrual of interest is to be made for that month. Companies shall apply deferred income tax accounting for the difference between book and tax treatment of SFAS No. 106 costs, in accordance with the Commission's Statement of Policy on SFAS No. 109.

(2) Should circumstances change and additional tax-effective external funding vehicles become available or economically justified, companies may deposit amounts represented by the internal reserve, including accrued interest, into such arrangements without Commission approval. A complete explanation of such transactions shall be reported to the Director of the Office of Accounting and Finance within 30

1. However, for the purpose of calculating the company's earnings base vs. capitalization adjustment in rate proceedings, the amount in the internal reserve may be added to the company's capitalization.

2. The cumulative interest balance less its related deferred tax.

3. A debit balance can occur only when management, at its discretion, decides to make contributions in excess of rate allowances. In rate proceedings companies may seek prospective interest accruals or rate base treatment for debit balances.

4. SFAS No. 109, Accounting for Income Taxes, is being developed in Case 92-M-1005. An interim Policy Statement was issued January 15, 1993 in that case.
days of such transfer. The external trust and any funds deposited into that trust must meet the requirements described herein.

(3) If a company or its parent (if an affiliate) institutes a broad-based early retirement program, the jurisdictional company's revenue requirement reductions (net of associated increases to retiree costs) applicable to the health care coverage, life insurance, and prescription drug plan(s) of those employees electing early retirement shall be credited to a separate subaccount of the OPEB Internal Reserve Account. This accounting shall commence when the early retirees become eligible to receive benefits from the company's postretirement benefit plan(s), shall be recorded monthly, and shall end when the savings resulting from the early retirement program are recognized in rates or otherwise disposed of by the Commission. Interest shall be accrued monthly and in the same manner, and at the same rate, as is done for the rest of the internal fund. Deferred tax accounting shall apply, as necessary. Recovery of the costs associated with early retirement programs is addressed in Section III,D below.

4. Rate Case Documentation and Minimum Cost Control Requirements

At a minimum, companies must establish a continuing program to analyze, at least annually, the feasibility of changes to plan

1. The corresponding debit is to be made to the OPEB expense account. The savings are not to be reduced by the cost of fringe benefits applicable to employees hired to replace any of the early retirees.
benefits, plan design, plan administration, funding, computer and
claims processing systems, and other appropriate areas to reduce the
overall cost of OPEB benefits. In every rate change proceeding, and
for each OPEB plan, the company must report the status of its
program, the initiatives considered and rejected, and the initiatives
taken, to reduce/control costs since its last rate proceeding.
Estimates of the effects of these initiatives (both those taken and
those rejected) on the overall cost of the plan(s), the annual cost
benefits, and impacts on current revenue requirement must be
provided. A detailed description of any plan amendments, with
estimates of their rate impact(s), must also be provided.
In the first rate proceeding filed following the issuance of this
Statement of Policy, companies must provide:
a. a complete description of the features and provisions of the
postretirement benefits plans other than pensions, such as the
benefits covered, deductibles, co-pay provisions,
threshold/limitations, eligible participants in addition to the
retiree, etc.
b. the formal written provisions of the plan(s) as they are
established in the official corporate rules, regulations,
employee collective bargaining agreements, employee
pension/welfare pamphlets distributed describing such benefits,
etc.
c. an analysis clearly showing how the company's postretirement
plan(s) compare with those of other New York State utilities and
at least three non-regulated enterprises' plans with regards to
features, benefits, cost per employee, cost per benefit, total
transition obligation, service costs, number of employees covered by the plans, and number of retirees covered by the plans.

If this analysis shows that the subject utility's plan(s) is more costly than those of the other employers shown, a detailed explanation must be provided explaining the difference and substantiating why the costlier benefits are justified.

d. An analysis clearly showing that the company's retiree benefit plan(s) are part of a comprehensive employee compensation and benefit package that is reasonable and necessary to attract and maintain a reliable and competent workforce.

5. Cost Control Incentives

As this policy requires deferral of all differences between actual OPEB costs and associated rate allowances (at least during the period of review), any savings the company may achieve through its cost control efforts are automatically captured for ratepayers. To provide a financial incentive to minimize OPEB costs, we will consider allowing companies to retain a portion of actual savings achieved from non-mandated OPEB cost control measures. Accordingly, before the Commission rules on the review of this Policy in about 5-7 years, utilities may propose an incentive arrangement consistent with productivity and workforce morale objectives. Such requests, which preferably should be made within the context of a rate proceeding, must include a complete description of the actions implemented, as well as a clear demonstration that savings have actually resulted at the claimed level. Additionally, it must be shown the action will have long term effects.
Proposals to share in the savings of future cost-containment actions may be made. However, substantial evidence and assurance must be provided that substantiate the savings will actually materialize. Incentives will not be granted when savings result from the mere trade-off of OPEB benefits for other employee compensation or fringe benefits.

D. SFAS No. 106 - Settlements/Curtailments/Terminations & Termination Benefits

Companies shall follow the appropriate provisions of SFAS No. 106 to determine gains and/or losses resulting from settling, curtailing, or terminating an OPEB plan or the granting, or provision, of special or contractual termination benefits. All notification, deferral, and petition requirements specified in Section III,B herein as being applicable to SFAS No. 88 transactions and broad based early retirement programs are also applicable to the comparable OPEB transactions.  

1. In the instance of a broad based early retirement program, see Section III,C,3,b,(3) of this Policy for additional requirements.
PARTIES SUBMITTING COMMENTS IN REACTION TO
THE NOTICE OF PROPOSED RULEMAKING IN
CASE 91-M-0890 REGARDING PENSION AND OPEB EXPENSE

Combination Electric & Gas Utilities

1. Central Hudson Gas and Electric Corporation
2. Consolidated Edison Company of New York, Inc.
3. Long Island Lighting Company
4. New York State Electric and Gas Corporation
5. Niagara Mohawk Power Corporation
6. Orange and Rockland Utilities, Inc.
7. Rochester Gas and Electric Corporation

Gas Only Utilities

8. Corning Natural Gas Corporation
10. The Brooklyn Union Gas Company

Telephone Utilities

11. ALLTEL New York, Inc.
12. AT&T Communications of New York, Inc.
13. Citizens Telephone Company
15. Edwards, Oriskany Falls & Port Byron Telephone Companies
16. New York State Telephone Association, Inc.
17. New York Telephone Company
18. Ogden Telephone Company
19. Rochester Telephone Corporation (and subsidiaries)

Water Companies

20. Jamaica and Sea Cliff Water Companies
21. Long Island Water Corporation
22. New Rochelle Water Company
23. New York-American Water Company
24. New York Water Service Corporation
25. Spring Valley Water Company

Utility Intervenors

26. Consumer Protection Board
27. Federal Executive Agencies
28. Multiple Intervenors

CPA Firms

29. Coopers & Lybrard, Certified Public Accountants
30. Arthur Anderson & Co. SC