

BEFORE THE PUBLIC SERVICE COMMISSION

In re: Petition for authority to use deferral accounting for creation of a regulatory asset in recognition of minimum pension liability established in accordance with Financial Accounting Standards (FAS) 87, by Progress Energy Florida, Inc.

DOCKET NO. 040816-EI
ORDER NO. PSC-04-1216-PAA-EI
ISSUED: December 8, 2004

The following Commissioners participated in the disposition of this matter:

BRAULIO L. BAEZ, Chairman
J. TERRY DEASON
RUDOLPH "RUDY" BRADLEY
CHARLES M. DAVIDSON

NOTICE OF PROPOSED AGENCY ACTION
ORDER AUTHORIZING PROGRESS ENERGY TO USE DEFERRAL
ACCOUNTING ACCORDING TO FAS NO. 71 AND TO CREATE A
REGULATORY ASSET TO OFFSET THE MINIMUM PENSION LIABILITY

BY THE COMMISSION:

NOTICE is hereby given by the Florida Public Service Commission that the action discussed herein is preliminary in nature and will become final unless a person whose interests are substantially affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

Progress Energy Florida, Inc. (Progress Energy or the Company) requested authority from the Commission to use deferral accounting to create a regulatory asset to recognize and offset the minimum pension liability the Company must record in accordance with Statement of Financial Accounting Standards No. 87 (FAS No. 87). We have jurisdiction pursuant to Chapter 366, Florida Statutes, to address Progress Energy's request. The Company's financial reporting is governed by Generally Accepted Accounting Principles of which Financial Accounting Standards are a part. FAS No. 87 prescribes accrual accounting for the cost of defined benefit pension plans.

FAS No. 71 allows regulated companies to defer costs and create regulatory assets provided the regulatory agency grants authority for such a deferral. The regulator must be a third party regulator and the Company's rates must be based on cost. A regulatory asset may be recovered in the future through regulated rates.

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FPSC-COMMISSION CLERK

The Company accounts for pension costs in accordance with FAS No. 87. Under FAS No. 87, an actuarial study is undertaken to determine the accumulated pension benefit obligation (APBO). The APBO is the "earned" pension or the present value of the plan's accrued benefits, without pay projections, using the discount rate chosen for the year-end. If the value of the pension plan assets exceeds the APBO, no adjustment is recorded for financial reporting. However, if the value of the pension plan assets is less than the APBO, then the difference between the two is compared to the accrued pension cost and that difference must be recorded as an additional liability, the minimum pension liability. Absent Commission approval, the offset is to other comprehensive income, which reduces common equity.

We have previously recognized FAS 87 for ratemaking purposes. In Progress Energy's 1992 rate case, Order No. PSC-92-1197-FOF-EI, issued October 22, 1992, in Docket No. 910890-EI, In Re: Petition for a rate increase by Florida Power Corporation, states that "... we have decided to use FAS No. 87 to determine pension expense." In addition, the Order states:

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

As discussed above, the minimum pension liability depends on how much the APBO exceeds the market value of the assets in the pension trust fund and the accrued pension cost recorded for financial reporting. Declines in long-term interest rates have resulted in lower discount rates, which cause a company's APBO to be higher. Further, the market value of plan assets fluctuates with stock and bond prices.

FAS No. 71 allows regulated companies to defer costs and create regulatory assets. To create a regulatory asset, a regulated company must have the approval of its regulator. This concept of deferral accounting allows companies to defer costs due to events beyond their control and seek recovery through rates at a later time. The alternative would be for the Company to seek a rate case each time it experiences an exogenous event. According to Progress Energy's petition, the minimum pension liability and the regulatory asset will be included in working capital for ratemaking and surveillance purposes. Since these offsetting amounts would cancel one another, the impact on ratepayers will be neutralized. Without the deferral, working capital, other comprehensive income, and common equity would be reduced.

As noted in Progress Energy's petition, the regulatory asset requested by the Company in this petition is unlike the Company's request in its 1992 rate case that we denied on procedural grounds in Order No. PSC-92-1197-FOF-EI, issued October 22, 1992, in Docket No. 910890-EI, In Re: Petition for a rate increase by Florida Power Corporation. The Order states:

We believe the regulatory asset and its amortization should be disallowed for ratemaking purposes. First, in order to record an asset or a liability under FAS No. 71, there must be an indication from us that the asset or liability will be

recoverable. In this case, there was no such indication. It was inappropriate for FPC to use FAS No. 71 without our prior approval.

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

In this case, the requested regulatory asset does not attempt to recognize realized pension expense that has been deferred from prior periods, but rather seeks to neutralize for ratemaking purposes an unrealized future obligation that FAS No. 87 requires the Company to recognize for financial reporting purposes. The minimum pension liability and any related regulatory asset are not amortized over future periods. At each measurement date, Progress Energy will reverse the previous entry and repeat the computation. The Company will recognize a new minimum pension liability and related regulatory asset, if required.

For 2004, the Company will not know the amount of its minimum pension liability until it closes its books at the end of the year. The value of pension plan assets at the end of the year is used to determine the minimum pension liability.

We note that the Federal Energy Regulatory Commission (FERC), through an accounting guideline, allows the creation of a regulatory asset as an offset to the minimum pension liability. The FERC guideline notes that a regulator can still review the amounts for reasonableness in future rate proceedings.

In summary, we believe that the FAS No. 87 requirement to record a minimum pension liability when its pension trust fund becomes under-funded conflicts with the theory that the cost of employee pension benefits included in utility rates should be recognized as the benefits are earned by employees, gradually and systematically over their years of service. For this reason, we hereby authorize Progress Energy to use deferral accounting according to FAS No. 71 and to create a regulatory asset that will offset the minimum pension liability. We also find that the approval to record the regulatory asset for accounting purposes does not limit our ability to review the amounts for reasonableness in future rate proceedings.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that Progress Energy Florida, Inc. is hereby authorized to use deferral accounting according to Financial Accounting Standard No. 71 and to create a regulatory asset that will offset its minimum pension liability. It is further

ORDERED that our approval to record the regulatory asset for accounting purposes does not limit our ability to review the amounts for reasonableness in future rate proceedings of Progress Energy Florida, Inc. It is further

ORDERED that the provisions of this Order, issued as proposed agency action, shall become final and effective upon the issuance of a Consummating Order unless an appropriate petition, in the form provided by Rule 28-106.201, Florida Administrative Code, is received by the Director, Division of the Commission Clerk and Administrative Services, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings" attached hereto. It is further

ORDERED that in the event this Order becomes final, this docket shall be closed.

By ORDER of the Florida Public Service Commission this 8th day of December, 2004.

BLANCA S. BAYÓ, Director
Division of the Commission Clerk
and Administrative Services

By: Kay Flynn
Kay Flynn, Chief
Bureau of Records

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing that is available under Section 120.57, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing will be granted or result in the relief sought.

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Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

The action proposed herein is preliminary in nature. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, in the form provided by Rule 28-106.201, Florida Administrative Code. This petition must be received by the Director, Division of the Commission Clerk and Administrative Services, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on December 29, 2004.

In the absence of such a petition, this order shall become final and effective upon the issuance of a **Consummating Order**.

Any objection or protest filed in this/these docket(s) before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.