

Minnesota Public Utilities Commission
Staff Briefing Papers - Volume II of VII
Financial – part 1 of 2

Meeting Date: March 19, 2015 (Oral Argument) **Agenda Item #** ____
March 26, 2015 (Deliberations)

Company: Northern States Power Company d/b/a Xcel Energy

Docket No. E-002/GR-13-868
In the Matter of the Application of Northern States Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota

Issues: Qualified Pension Plans: What discount rate should be used to calculate the XES Plan costs for ratemaking? What amount of the amortized 2008 Market Loss is recoverable? Should additional rate mitigation alternatives for pension costs be adopted? Should the requested prepaid pension asset amount be included in rate base? What are future rate case filing requirements?

Retiree Medical Expense (FAS 106): What discount rate should be used to calculate the retiree medical benefit cost for ratemaking? What amount of the 2008 Market Loss should be included in rates?

Paid Leave/Total Labor (2014): Does the record show that total labor costs are reasonable or should the Commission adopt the Department's recommended adjustment?

Corporate Aviation Costs (2014): Should the Commission adopt the ALJ's recommendation and find that the Company has demonstrated it is reasonable to include \$954,425, or 50 percent of the approximately \$1.9 million the Company has budgeted in 2014 for corporate aviation costs on a Minnesota electric jurisdictional basis? Or, should the Commission adopt any or all the OAG's proposed adjustments which collectively would reduce test-year corporate aviation expense by \$920,000?

Pleasant Valley and Border Winds – 2015 Step: Should recovery of the Pleasant Valley and Border Wind Projects occur through base rates or through the Renewable Energy Standard (RES) Rider?

Annual Incentive Compensation Program: Has the Company's evaluation of its annual incentive program adequately met the Commission's 2012 rate case order requirements?

FERC Cost Comparison Study – KPI Benchmarks: Should the Commission

require the Company to add key performance indicators to address non-fuel O&M costs and transmission O&M costs?

Transmission Business Area – Cost Controls: Should the Commission establish recovery caps for transmission projects to the cost amounts stated in the Company’s certificate of need applications? Should the Commission require the Company to add a transmission projects cost control key performance indicator at the Vice President level?

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March 11, 2015

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Retirement Income Benefits

PUC Staff: Dorothy Morrissey

Introduction

Xcel provides retirement income benefits to its employees by offering both a defined contribution savings plan (i.e., 401(k) Plan) and a defined benefit plan (pension). Xcel's defined contribution plan provides for employer-match contributions into employees' retirement accounts on a current basis, up to a maximum of four percent of an employee's eligible compensation, whereas, the defined benefit plan specifies the amount of retirement benefit that will be payable to employees upon retirement. Xcel's underlying pension plan formulary that determines the benefit amounts payable has changed over the years, yet in general, employees are grandfathered into the formulary plans that were in effect at the time of their employment. Currently, Xcel offers a 5% Cash Balance Pension Plan to new hires which provides an earned pension benefit equivalent to five percent of the employee's salary for each year of employment.

Employee retirement income benefit plans (both the savings- and the pension-type plans) can be characterized as either qualified or non-qualified as determined by the Internal Revenue Service (IRS). Qualified plans provide tax advantages for both employer and employee, but the IRS imposes restrictions on the maximum annual benefit awarded and the maximum compensation that can be included in determining benefits. In contrast, non-qualified plans do not provide tax advantages, however, there are no statutory imposed restrictions/limitations on the benefits offered. The Department raised concerns with the Company's test year qualified and non-qualified pension plan requests. The non-qualified pension issue has been resolved, but some qualified pension plan issues remain disputed.

Non-Qualified Pension Expense - Resolved

RESOLVED: Parties agreed on a \$704,000 reduction in revenue requirements (the combined effect of the O&M and capital adjustments).

Xcel's non-qualified pension plan is also referred to as the Restoration Plan. Non-qualified pension cost is the cost for benefits derived from the portion of employee salary that exceeds the IRS wage threshold (i.e., above \$255,000 for 2013 or \$260,000 for 2014), or that exceed an annual benefit limit (\$205,000 for 2013, or \$210,000 for 2014). The Department opposed its inclusion in rates and recommended full disallowance of non-qualified pension cost because the benefit is an excessive charge to ratepayers. Xcel requested \$688,858 for the expensed non-qualified pension cost and a \$196,656 recovery of the capitalized portion of this cost. Though Xcel stated it disagreed with the Department's recommendation, in this instance Xcel decided to exclude the non-qualified pension benefit cost from its test year request, and monetized the removal of the combined expense/capitalized request to be a \$704,000¹ overall reduction to its revenue requirement. Consequently, the non-qualified pension expense dispute was resolved

¹ Xcel requested test year recovery for non-qualified pension costs via a \$688,858 operating expense and a \$196,656 capitalized cost.

between the parties. In Xcel's 2012 rate case, the Commission disallowed recovery of non-qualified pension costs.²

Qualified Pension Plans

(Collectively, disputed issues amount to approximately \$7.944 million [\$1.770 discount rate + \$6.174 market loss].)

Statement of the Issues

The qualified pension plan issues before the Commission include:

- What discount rate should be used to calculate the XES Plan costs for ratemaking,
- What amount of the amortized 2008 Market Loss is recoverable,
- Should additional rate mitigation alternatives for pension costs be adopted,
- Should the requested prepaid pension asset amount be included in rate base, and
- What are future rate case filing requirements?

The Company requests recovery of \$20.9 million for qualified pension expense.³ Prior to issue discussion, some company-specific historical information will serve to introduce this technical subject.

Company-specific Historical Information

Two Primary Plans, Two Methodologies

Qualified pension benefits allocated to the Minnesota jurisdiction are provided to employees through either the NSPM pension plan or the XES Plan, depending on the subsidiary for which the employee works. The methodology used to determine pension expense differs between these two plans, due in part to the inception date of the plans and the nature of the entity.

The NSPM pension plan has used an aggregate cost method (ACM) since 1975 to calculate pension expense. However, for fiscal years beginning in 1987, a new generally accepted accounting principle (GAAP) standard for pension accounting came into effect – Financial Accounting Standard No. 87 (FAS 87). As a rate regulated utility, the Company was allowed to continue use of the ACM for its existing NSPM pension plan cost calculations.⁴

Years later, in 2000, the Commission approved the merger of Northern States Power and New Century Energies which created Xcel Energy, Inc.⁵ Xcel Energy formed a service company subsidiary, Xcel Energy Services, Inc. (XES). XES, which is not a rate-regulated entity, adopted

² Docket No. E-002/GR-12-961. See Commission Order, p. 7 (September 3, 2013).

³ Ex. 83 at 61 (Schrubbe Rebuttal)

⁴ “GAAP expressly allows NSP to reflect the effects of regulation as explicitly provided for by SFAS 71 and SFAS 87, because that accounting has been accepted in prior rate proceedings.” Docket No. G-002/GR-09-1153, Ex. 25 at 8 (Moeller Rebuttal)

⁵ Docket E,G-002/PA-99-1031

the current pension accounting standard (i.e., FAS 87) to calculate its pension plan costs (XES Plan). Between these two plans, about 73% of the jurisdictional test year pension costs relates to the NSPM plan and 27% to the XES Plan.

2012 Rate Case Pension Mitigation

In Xcel's 2012 rate case⁶, pension expense had increased considerably over its prior operating years' largely due to the impact of the pension fund's 2008 market losses. The Commission adopted two mitigation proposals offered by Xcel to curb the impact of the peak 2008 market loss phase-in, one each for the respective NSPM and the XES pension plans.⁷ Xcel's current 2014 test year pension expense request reflects continuation of both mitigation strategies. The mitigation adopted for the NSPM Plan extended the amortization period used under the ACM calculation from 10 years to 20 years, effectively reducing the impact of market loss (or gain) recognized each year. To mitigate the XES Plan costs, the Commission adopted the ratemaking alternative to cap its pension expense at 2011 levels (about \$5.4 million, jurisdictional) and permit the excess of its allowable⁸ pension expense amount to be deferred to future years.

Intervening Party Overview

Department

The Department is concerned with the amounts that Xcel estimates in the 2014 test year for purposes of Qualified Pension and has ongoing concerns that Non-Qualified Pension costs are excessive benefits to require ratepayers to finance.⁹

The Department stated the appropriate amount included in rates for any cost is important in light of the requirement in Minn. Stat. §216B.03:¹⁰

Every rate made, demanded, or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable. ... Any doubt as to reasonableness should be resolved in favor of the consumer.

Pension expense set in a rate case is not a clear actual annual cost incurred by the Company, since pension expense is determined largely by several assumptions such as discount rate, expected return on asset, wage assumptions, and measurement date.¹¹

The ratemaking function is to set the appropriate amount of pension expense to ensure that the amount paid by ratepayers now for future employee benefits is reasonable going forward - until

⁶ Docket E-002/GR-12-961

⁷ Paragraph 186 of the Office of Administrative Hearing *Findings of Fact, Conclusion of Law and Recommendations*, order issued July 5, 2013, OAH 68-2500-30266.

⁸ For the 2012 rate case, the Commission adopted the recommendation to set the XES Plan discount rate to the expected return on assets rate (EROA) to determine the allowable XES Plan pension cost which is then compared to the 2011 mitigation cap.

⁹ Ex. 429 at 108 (Campbell Direct)

¹⁰ *Ibid.* at 99

¹¹ *Ibid.* at 109

the Company's next rate case.¹² In contrast, a utility's bookkeeping function reflects financial circumstances at a point in time and is based on requirements for financial reporting.¹³

The Department believes several biases exist with respect to pension expense. First, the Department stated that in rate cases, utilities overall have an incentive to maximize estimates of test year costs and minimize test year revenue.¹⁴ Second, the Department stated that the assumptions (inputs) used in calculating pension costs are selected by the Company and therefore lack independence.¹⁵ Finally, from its review of a pension fundamentals publication, the Department concluded that a primary concern of actuaries and outside auditors is understating pension expense in financial reporting.¹⁶

To ensure that the amount ratepayers pay for qualified pension expenses is reasonable, the Department proposed to (i) use a current measurement date to determine test year pension costs (XES and NSPM Plans), (ii) increase the discount rate to be the same as the expected return on pension assets when calculating the XES pension plan costs; and (iii) to exclude 50 percent of the 2008 pension fund market loss amortization amount from rates (XES and NSPM Plans).

Qualified Pension Measurement Date – Resolved

RESOLVED: Parties agreed on a \$1.011 increase in revenue requirements (the combined effect of the O&M and capital adjustments).

Pension benefit costs are determined at the beginning of an operating year, generally on December 31st preceding an operating year that begins January 1. Xcel's November 2013 initial filing used the available measurement date of December 31, 2012 to develop its 2014 test year pension cost request. The Department asked the Company to recalculate its test year pension cost using a measurement date of December 31, 2013, to capture most current pension position. Use of an updated measurement date *increased* the Company's revenue requirement request by \$1.011 million. The Company explained the increase in cost was primarily due to a lower market return experienced than expected as well as unfavorable demographic changes.¹⁷ The Department accepted use of the updated measurement date and the resulting increase to Xcel's revenue requirement.¹⁸

¹² Ex. 429 at 102 (Campbell Direct)

¹³ Ibid. at 100

¹⁴ Ibid. at 112

¹⁵ Ibid. at 112-113

¹⁶ Ibid. at 100

¹⁷ Ex. 83 at 13-14 (Schrubbe Rebuttal)

¹⁸ Ex. 435 at 88, 127 (Campbell Surrebuttal)

Qualified Pension Discount Rate - Disputed

(The discount rate dispute impacts the revenue requirement by \$1.770 million.)¹⁹

Employees' earn pension benefits currently, but will not receive payment of these benefits until retirement. Actuaries apply a discount rate to future benefit payments in order to calculate the present value of the obligation. A key relational fact about the discount rate is that the higher the discount rate, the lower the resulting present value of future benefit payments, and vice versa.

To calculate qualified pension expense, Xcel used a discount rate of 7.25 percent for the NSPM Plan, and used a discount rate of 4.74 percent (updated²⁰) for the XES Plan. These two plans' discount rates differ due to the underlying actuarial methods applied.²¹ The legacy NSPM Plan uses the aggregate cost method (ACM), a pre-FAS 87 methodology, which sets the discount rate to equal the expected return on assets (EROA) assumptions, a value based on the long-term expected portfolio return. Whereas the XES Plan applies the FAS 87 method, a methodology that prescribes that the discount rate assumption be based upon current available high quality bond yields. The Department objected to the 4.74 percent XES Plan discount rate, but did not object to the NSPM Plan discount rate.

Department

For the NSPM plan, the Department believes Xcel's proposed 7.25 percent discount rate is reasonable because the rate is the same as the expected return on assets (EROA) and its value is based upon a long-term perspective. However, the Department considered the XES Plan's discount rate (4.74 percent) unreasonable for ratemaking, stating that it was too low especially when compared with the expected 7.25 percent return on pension portfolio assets, and because it is based on a single point-in-time settlement measurement. The Department concluded that for determining the XES Plan costs for ratemaking purposes, it is neither necessary nor appropriate to use the lower discount rate and, in doing so, the Company has, for the 2014 test year, overstated its pension obligation and significantly increased pension expense to an unreasonable and unsupported level.

The Department stated that calculating pension expense requires comparing two measures, the value of the pension plan assets (i.e., investments designated for pension benefit payments), and the value of the pension obligation liability (i.e., future benefits to be paid to retirees), noting that the difference between these two assessments is used to calculate pension expense. In its analysis, the Department explained and distinguished certain factors' functions: that the EROA is used to inflate the value of pension plan assets to future years when the retirees will retire, while at the same time the discount rate is used to determine pension obligation liability in today's dollars to ensure that future funds will be available to meet that benefit liability. In this calculation, the inflation period and discount period cover *the same time period*; therefore, it does not make sense to use different rates for the discount rate and EROA. The Department

¹⁹ However, according to Xcel, this adjustment would effectively be a test-year expense reduction of \$216,000. Ex. 83 at 47 (Schrubbe Rebuttal) and Xcel Reply Brief at 60.

²⁰ The discount rate was updated to reflect a more current measurement date of December 31, 2013, rather than using the December 2012 measurement date.

²¹ Ex. 81, Schedule 3 (Moeller Direct)

concluded that using a lower discount rate artificially overstates pension expense for purposes of ratemaking and is, therefore, unreasonable. Accordingly, the Department recommended that the XES Plan's discount rate be set at 7.25 percent, the same as the pension fund's EROA. This approach ensures that the discount rate used to quantify the future pension cost obligation in current dollars is consistent with the level of expected return on pension assets.

The Department argued that its discount rate recommendation is consistent with the ALJ's proposed finding and the Commission's decision in Xcel's prior case²². Additionally, in past rate cases, the Department and the Commission recognized that, because GAAP accounting is capturing pension expense at a point in time, it tends to reflect the volatile ups and downs of the market and of discount rates; therefore, it is generally not appropriate to use GAAP for setting rates.²³ The Department acknowledged that in past rate cases, to mitigate the point in time concern, it has recommended the Commission adjust utilities' pension expense requests through averaging.²⁴ However, the Department's continual review of this issue has resulted in its current determination that equating the discount rate to the EROA makes sense, an approach introduced by the Department in Xcel's 2012 rate case. The Department does not support use of the five-year average discount rate for determining pension expense for the reasons it concluded that equalizing the discount rate to the EROA should be used.²⁵

The Department made clear that its recommendation is for the purposes of ratemaking, and not for financial statement accounting. Financial statement assumptions are short-term, point-in-time figures; therefore, financial accounting requirements do not and should not dictate Commission decisions. Ratemaking, on the other hand, is based on reasonably representative values, which typically requires a longer perspective that considers a broad range of factors and influences, including the perspective that it is in the public interest for rates to be set to allow the utility to be financially viable in the long run under reasonable management of the utility.²⁶ The Department pointed out that pension expense is not the only cost component that is treated differently in ratemaking than in other utility financial venues. For example, income taxes for ratemaking includes a recoverable amount using imputed tax rates, even though Xcel has not paid income taxes for many years, due to factors such as differences in depreciation assumptions. Instead of using extreme assumptions or numbers, ratemaking relies on normalized data that reasonably reflects costs and revenues expectations used to set rates.

The Department submitted that its current recommendation is reaffirmed in the *Fundamentals of Current Pension Funding and Accounting for Private Sector Pension Plans* paper (published in July 2004 by the American Academy of Actuaries). The paper indicated that the interest discount rate used for funding purposes under ERISA is based on the expected future rate of return on pension plan assets, an application similar to the Department's recommended approach.²⁷

²² Docket No. E-002/GR-12-961

²³ Ex. 435 pp. 80-81, (Campbell Surrebuttal), citing rate case Dockets E-015/GR-09-1151, E-017/GR-10-239 and E-002/GR-12-961, for Minnesota Power, Ottertail Power and Xcel Energy, respectively.

²⁴ Ex. 435 at 82 (Campbell Surrebuttal)

²⁵ Ex. 435 pp. 84-85 (Campbell Surrebuttal)

²⁶ Ex. 429 pp. 103-104 (Campbell Direct)

²⁷ Ex. 430, Attachment NAC-19 (Campbell Direct)

The Department reassured that neither pension funding requirements nor pensions paid to employees would change if the Commission, for ratemaking purposes, used a different discount rate than that used for financial reporting, explaining that pension funding amounts are determined by the Employee Retirement Income Security Act (ERISA) and that pension payments to employees are governed by contracts Xcel has with its employees.²⁸

The Department's pension discount rate recommendations included comprehensive adjustments to both the expensed and the capitalized portion of pension costs. To reflect the impact on the revenue requirement related to the reduced rate base, Xcel, in rebuttal, presented a rate-base-to-expense factor method to convert and monetize the Department's capitalized pension adjustment into expense-equivalent terms and the Department, in surrebuttal, accepted the rate-base-to-expense conversion factor method.²⁹ The Department's recommended change to the discount rate would decrease test year pension recovery request by \$1,770,000.³⁰

Xcel

Xcel explained its XES Plan discount rate is reasonable because: 1) it is based on objective, verifiable data from bond-matching studies; 2) it is consistent with discount rates used by the majority of utilities; and 3) the Company has consistently used the bond-matching approach to develop the FAS 87 discount rate. Xcel stated that its XES Plan discount rate is representative of interest rates over the last five years and this year's expected interest rates.

Stating that requiring the use of the EROA to set the discount rate for the XES Plan would lead to an artificial liability gain, Xcel argued against the Department's recommendation. Xcel indicated that use of the EROA is inconsistent with the methodology set forth in FAS 87 and would create permanent differences between rate recovery and generally accepted accounting principles (GAAP). The Company also noted that the Commission's decision in Xcel's last rate case to use the EROA as the discount rate was expressly limited based on the record in that case.³¹ The Company also pointed out that, in CenterPoint Energy's recent rate case, the Commission did not adopt the Department's recommendation to set the discount rate to the EROA; instead, the Commission approved a five-year average discount rate rather than the point in time discount rate, and had stated that "the factual record that resulted in the discount rate determination in the Xcel [2012] rate case does not pertain to the pension expense calculation here."³² The Company believes this to mean that each case must be examined on its own facts to determine what discount rate should be used.

Xcel does not believe its discount rate is artificially low because its calculation reflects current rates based upon measures prescribed by FAS 87. However, if the Commission decided to use

²⁸ Ex. 429 pp. 102-103 (Campbell Direct)

²⁹ Ex. 435 at 74 (Campbell Surrebuttal)

³⁰ Ex. 442 at 11 (Lusti Surrebuttal)

³¹ Commission's *Findings of Fact, Conclusion, and Order*, page 7, Docket E-002/GR-12-961, issued September 3, 2013 (Xcel Energy rate case).

³² Commission's *Findings of Fact, Conclusion, and Order*, page 12, Docket G-002/GR-13-316, issued June 9, 2014 (CenterPoint Energy rate case).

an average for calculating pension expense, Xcel calculated its (2010 – 2014) five-year average discount rate to be 5.05 percent.³³

Table 1 - XES Plan FAS 87 Discount Rates

2010	2011	2012	2013	2014	Average
6.00%	5.50%	5.00%	4.03%	4.74%	5.05%

Xcel noted that the Board of the Federal Reserve Bank has kept interest rates low and asserted that Xcel's customers have benefitted from this because Xcel has secured favorable debt rate costs on NSPM's recent bond issues.

ALJ

(ALJ Report, pp. 26 - 31, paragraphs 113 - 128)

125. In this case, by contrast, the Company provided a much more specific explanation of the differences between the FAS 87 accounting used for the XES Plan and the ACM accounting used for the NSPM Plan. The Company also provided a detailed explanation as to why it would be problematic to use the EROA as the discount rate for the XES Plan even though the NSPM Plan takes that approach.

126. As a result, the Administrative Law Judge reaches a different conclusion in this case. The record in this case demonstrates that both FAS 87 and the ACM are designed to ensure accurate reporting of pension expense but use different methodologies. For that reason, use of the FAS 87 bond-matching discount rate will help ensure that the XES Plan, which is subject to FAS 87, is fully funded. In addition, the record demonstrates that the Company's calculation of its FAS 87 discount rate was based on objective criteria and is similar to the rates used by other utilities. Finally, as the Company noted, if the discount rate had been equal to the EROA since the inception of the XES Plan, customers would have paid more in pension expense through the years because the service cost and interest cost elements of the FAS 87 calculation would have been higher. For these reasons, the Administrative Law Judge concludes the use of the FAS 87 discount rate is more reasonable than use of the EROA rate as the discount rate for the XES Plan.

127. The Administrative Law Judge also concludes that use of a five-year average of FAS 87 rates is more reasonable than the Company's proposed single year FAS 87 rate. A review of FAS 87 discount rates for the last five years shows that the 4.74 percent discount rate calculated by the Company in its Rebuttal Testimony is on the lower end of rates for the last five years.

128. To guard against the possibility that the current FAS 87 rate is somewhat lower than normal, the Administrative Law Judge recommends that the Commission set the discount rate for the XES Plan based on a five-year average of FAS 87 discount rates. Such an approach is consistent with the Commission's recent decisions in the CenterPoint and MERC rate cases, and addresses the Department's concern that the Company's proposed discount rate is based on a single point in time. The five year average for the Company results in a discount rate of 5.05 percent for the XES Plan. The Administrative

³³ Ex. 83 at 44 (Schrubbe Rebuttal)

Law Judge concludes that this rate is reasonable and strikes an appropriate balance between the Department's position and the Company's position.

Exceptions to the ALJ

Xcel

(Xcel Exceptions, pp. 45-49)

Xcel Exceptions request adoption of the ALJ pension-related recommendations.³⁴

Department

(Department Exceptions, pp. 30-39)

The Department believes that ratemaking does not need to mirror either financial reporting or pension funding requirements because neither the ratemaking function nor Minnesota law mirror either requirement.

The Department maintained its recommendation that the discount rate should be the same value as the EROA rate covering the same period of time.

The Department recommends ALJ Proposed Finding 126 be amended. The proposed modifications reflect that the Department does not agree:

- that the record supports a conclusion that "use of the FAS 87 bond-matching discount rate will help ensure that the XES Plan, which is subject to FAS 87, is fully funded,"
- that Xcel used objective criteria that was not dependent on the Company's assumptions
- with the ALJ's recommendation to use of the FAS 87 method as the basis for the discount rate.

With respect to the first item, FAS 87 is an accounting standard for financial statement purposes. As long as Xcel complies with its pension funding requirements under ERISA, and absent a Commission order that requires the approved test-year pension expense to be contributed directly to Xcel's pension funds, Xcel has discretion to use its rate case pension dollars however it chooses.

With respect to the second issue, Xcel did not show that its assumptions were independent of the Company. The question is not whether Xcel performed its study correctly, but whether the study, due to its lack of independence, unfairly favors the Company. In this case it is clear that Xcel, not the actuary, determined the discount rate assumptions.

³⁴ Xcel Exceptions, VI.B, p. 45.

As to the third set of Department revisions, for the reasons stated in the overview section of the Department's testimony, if adopted, the revisions would change the ALJ report to reflect a Commission decision that adopts the Department's recommended discount rate.

The Department proposed the following revisions to ALJ Proposed Finding 126:

126. As a result, the Administrative Law Judge ~~reaches a different conclusion in this case.~~ conclude that ~~the record in this case demonstrates that both FAS 87 and the ACM are designed to ensure accurate reporting of pension expense but use different methodologies. For that reason, use of the FAS 87 bond matching discount rate will help ensure that the XES Plan, which is subject to FAS 87, is fully funded. In addition, the record demonstrates that the Company's calculation of its FAS 87 discount rate was based on objective criteria and is similar to the rates used by other utilities. Finally, as the Company noted, if the discount rate had been equal to the EROA since the inception of the XES Plan, customers would have paid more in pension expense through the years because the service cost and interest cost elements of the FAS 87 calculation would have been higher. For these reasons, the Administrative Law Judge concludes the use of the FAS 87 discount rate is more reasonable than use of the EROA rate as the discount rate for the XES Plan.~~ For ratemaking purposes until the next rate case, and in order for the Commission to examine pension ratemaking issues more closely in a generic docket, the Commission concludes that it is reasonable to use the same discount rate as the EROA rate because the rates cover the same period of time for pension assets and pension liabilities. Therefore, for the XES plan, as for the NSPM plan, the Commission will use a discount rate of 7.25 percent which is equal to the EROA rate.

The Department recommends clarification to the ALJ Proposed Finding 104 to distinguish: 1) financial reporting and pension funding, and 2) the functions of discount rate and the EROA:

104. At a high level, both the ACM and FAS 87 attempt for financial reporting purposes and not pension funding purposes to determine the present value of future benefits and estimated earnings in the pension trust that have accumulated to determine the unfunded obligation. The present value of this unfunded obligation and the current-period earned value are the basis for determining the under or overfunded status of the pension fund, which is a component of the current- period pension expense accrual. Thus, both the ACM and FAS 87 accounting methods use ~~are affected by~~ the discount rate to calculate the pension liability and both methods use the expected return on assets or EROA assumptions to calculate estimated pension earnings. [footnote: Ex. 429 at 131-132 (Campbell Direct)] In addition, as discussed above, both methods provide for a smoothed recognition of unrealized gains and losses in plan asset earnings, such that the level of expense will change more gradually. [footnote omitted]

The Department recommends clarification to the ALJ Proposed Finding 113 to add a reference to make clear the XES Plan bond-matching study was not performed independent of the Company:

113. The Company's calculation of the pension expense for the XES Plan uses the discount rate provided by FAS 87, the accounting method prescribed for the XES Plan.

The primary source for the discount rate is a bond-matching study that is performed by the Company as of December 31 of each year. The study includes a matching bond for each of the individual projected payout durations within the plan based on projected actuarial experience. The study was selected and performed by Xcel rather than by an independent entity or actuary. [Ex. 429 at 112-113 and NAC-22 (Campbell Direct) (actuarial certificate stating that Xcel selected assumptions)]. The bonds used in the study must meet certain well- established criteria, and the Company employs numerous tests to validate the reasonableness of the discount rate produced by the bond-matching study. [footnotes omitted]

Staff Comments

Department Suggested Revisions to ALJ Report

In its exceptions, the Department offered revisions to the ALJ report section addressing the discount rate. Staff offers brief comments on these suggested changes.

ALJ Report Finding 126: Although the bulk of the Department's edits are consistent with a decision that adopts the Department's recommended discount rate approach, the suggested removal of the paragraph's second sentence (below) in and of itself could occur regardless of which discount rate the Commission approves:

“For that reason, use of the FAS 87 bond-matching discount rate will help ensure that the XES Plan, which is subject to FAS 87, is fully funded.”

As explained in the Department's Exceptions, the pension expense derived by generally accepted accounting principles does not ensure that a pension plan becomes fully funded. Absent any Commission directives, actual funding is guided by ERISA requirements and a company's policy; therefore, Staff believes the Department's recommended deletion of Finding 126's second sentence is appropriate. Staff included a decision alternative to make such modification independent of the discount rate decision.

ALJ Report Finding 104 repeats nearly word-for-word part of Xcel's testimony; however, the edits put forth by the Department could be adopted regardless of which discount rate the Commission approves.

ALJ Report Finding 113: The edits put forth by the Department could be adopted regardless of which discount rate the Commission approves.

Discount Rate and the XES Plan Mitigation

The discount rate authorized by the Commission not only impacts recoverable test year pension cost, it also determines the deferred amount created by the rate mitigation strategy implemented by the 2012 rate case. Each year's recoverable (or refundable) XES Plan deferral amount that results from the 2012 pension mitigation strategy is influenced by the discount rate. Therefore,

Staff recommends that, as part of the Commission's decision on the discount rate issue, the Commission also clearly state what discount rate (i.e., the decided point of reference), for purposes of determining the XES Plan's annual deferral amount, should be used between rate cases. For example, if the approved discount rate is based upon a 5-year average then, for purposes of calculating the XES Plan *deferral amount* in subsequent years' (between cases), the discount rate should be based upon a rolling 5-year average discount rate.

Record Clarification and Timing of Information

Certain actuarial assumptions, such as interest rates for discounting future benefit payments, are prescribed under § 430 of the Internal Revenue Code (IRC) and § 303 of the Employee Retirement Income Security Act of 1974 (ERISA) and are used to determine funding requirements [IRC § 430(h)(2)]. The IRC-prescribed interest rates are based upon the corporate bond yield curve, a composite of yields on investment grade corporate bonds in the top three quality levels available. Similarly, pension expense determination under GAAP (FAS 87) also looks to high quality bonds when developing discount rates.

Xcel's reply brief accurately made clear that the 2004 paper, *Fundamentals of Current Pension Funding and Accounting for Private Sector Pension Plans*,³⁵ included in the record as support to the Department's position, predated the Pension Protection Act of 2006 (PPA 2006) which changed the rules for pension contribution determination.³⁶ Even though the approach used to derive the discount rate may not be identical, both ERISA and GAAP base pension discount rates on corporate bond yields. Since Xcel presented this new information for the first time in its reply brief and this information was not subject to cross-examination, the Department's asserted that it should be given no material weight.³⁷ The Department witness introduced the paper in direct testimony, but only referred to it for purpose of supporting actuarial concern of understating pension costs.³⁸ It was in surrebuttal testimony³⁹ that the Department submitted its argument that the paper supported its discount rate approach in that its recommendation would not negatively impact Xcel's funding under ERISA⁴⁰. Although it is true that it was in the reply brief that Xcel first challenged that particular support for the Department's discount rate recommendation, it referred to factual public law that has been established for a few years and is accessible by parties.

Technical Discussion on Changing Discount Rates and "Artificial" Liability Gains

Among its other arguments, the Company stated an "artificial" liability gain would result if the Department's recommendation was adopted. Staff believes this concern merits further attention because it is a situation that arises for any company utilizing the FAS 87 pension methodology. The FAS 87 pension cost is the sum of five components: service cost, interest cost, expected return on assets, amortization of prior service cost and amortization of gains and losses. This

³⁵ Ex. 429, Attachment NAC-19 (Campbell Direct)

³⁶ Xcel Reply Brief, pp. 53-54.

³⁷ Department Exceptions at 36.

³⁸ Ex. 429 at 100 (Campbell Direct)

³⁹ Ex. 435 at 84 (Campbell Surrebuttal)

⁴⁰ Ex. 450 at 6 (Campbell Opening Statement)

periodic discount rate impacts three of these five components – service cost, interest cost and amortization of gains and losses. It is within the *amortization of gains and losses* component that any “liability gains” are incorporated. It is important to note that the function of the *amortization of gains and losses* component, in general terms, is to correct for prior years’ calculated pension cost amounts. Because the FAS 87 pension calculation is based on many assumptions or expectations about the future, the variance between those assumptions and what actually occurred is “corrected” in subsequent years’ pension cost calculations through the *amortization of the gains and losses* component.

Liability gains arise when a liability is reduced since its last valuation (or measurement), a reduction caused by a change in its value unrelated to payments on the debt. It is a gain to the one owing the obligation because its pay-off would require fewer dollars than it had previously. Accordingly, the change in pension obligation (liability) from its last measurement date can lead to a liability gain or loss. The discount rate is one of several assumptions used to determine the pension obligation (a liability) in present value terms. A higher discount rate would result in a lower pension obligation compared to results from use of a lower discount rate. Therefore, a change in the discount rate’s value from one measurement date to the next can cause a liability gain or loss.

Xcel explains its notion of an “artificial” liability gain as follows:

“[U]sing the EROA as the discount rate for FAS 87 creates an artificial liability gain that would not exist under a consistent application of ratemaking principles...Using the EROA as the FAS 87 discount rate increases that discount rate by roughly 300 basis points dramatically decreases the PBO and thereby makes it look as though the Company had just experienced a large liability gain...But if the Company had always been using the EROA as the FAS 87 discount rate, there would be no liability gain from using the EROA as the discount rate now.”⁴¹

Incurring liability gains or losses from year to year, in and of itself, is not unusual as actuarial assumptions change. Rather, the issue here is whether it is appropriate to include the liability gain (or loss) arising from a change in the *benchmark* used to select the appropriate discount rate for ratemaking purposes (e.g., changing from use of the high quality bond market yields to the pension portfolio’s EROA). Staff believes it would be inappropriate to include the liability gain (or loss) resulting from a change in the benchmark. An example follows to further illustrate the issue.

Table 2 below provides a comparison of pension cost components values and their differences between the use of Xcel’s XES Plan discount rate of 4.74 percent and a hypothetical discount rate of 7.50 percent (all other variables remaining the same).⁴² (Please note staff recognizes that the Department recommended use of a discount rate of 7.25 percent; however, a breakdown by pension cost components amounts using 7.25 percent rate was not found in the record.)

⁴¹ Ex. 81 pp. 87-88 (Moeller Direct)

⁴² Table 2 data source from Hearing Exhibit 128, Xcel’s response to MN PUC Information request No. 12.

XES Plan 2014 Test Year Qualified Pension Cost				
Amounts in \$1,000s				
Line	Cost Component	Actual Discount Rate 4.74% EROA 7.25%	Hypothetical Discount Rate 7.50% EROA 7.25%	Difference
a	Service Cost	20,993	16,086	(4,907)
b	Interest Cost	24,087	30,014	5,927
c	Expected Return on Assets	(32,085)	(32,085)	0
d	Amortization of Unrecognized Gains and Losses	13,749	6,118	(7,631)
e	Amortization of Prior Service Costs	245	245	0
f	Total Company (sum of lines a – e)	26,989	20,378	(6,611)
g	MN Jurisdictional Cost (Line f x 29.17% x 87.54%)	6,892	5,204	(1,688)

Total company pension cost is \$6.611 million lower when a 7.50 percent discount rate is used.

Fundamentally, the *service cost* and the *interest cost* components reflect pension costs for employee service rendered for the current year, whereas the function of *amortization of gains and losses* component provides for corrections of prior years' estimated pension cost inputs.⁴³ As Table 2 shows, in this scenario the overall difference in the total pension cost is largely influenced by the change in *amortization of unrecognized gains and losses* component which provided a reduction of \$7.631 million.

Staff believes that if the reason for a change in discount rate (from 4.74 percent to 7.50 percent) was due to a changed outlook of the same benchmark measure, the \$7.631 reduction would properly be reflecting the "corrective" nature of this component's function. Conversely, if the reason for the change in the discount rate is due to the use of different benchmark measures, then at least for the transition year, the impact that such change (the liability gain) has on the cumulative balance subject to the amortization of unrecognized gains and losses should be excluded when determining cost amount allowed in rates. Therefore, Staff suggests that if the Commission directs the Company to use the EROA as the discount rate, it should also consider modifying the pension cost calculation by also excluding the liability gain (or loss) caused by changing the benchmark upon which the discount rate variable is determined. Moreover, if the Commission decides to use a historical average of pension discount rates, because the benchmark used to develop the historical discount rates is consistent, any liability gain (or loss) that results should be included in the overall pension cost calculation.

⁴³ Current and past years' gains and losses are netted and accumulated each year and if (and when) the cumulative sum exceeds a threshold amount (a corridor specified by FAS 87), the amount in excess of the threshold, is subject to amortization, and will be included in the pension cost calculation (i.e., *amortization of unrecognized gains or losses*).

Qualified Pension 2008 Market Loss - Disputed

(The 2008 Market Loss dispute impacts the revenue requirement by \$6.174 million.)

Department

The Department quantified that the amortized 2008 Market Loss dollars accounts for 60.5 percent of the total pension expense sought for rate recovery by Xcel (or approximately \$12.1 million). The Department noted that, given the Company's recent contributions to the pension fund and based upon Xcel's projections, the pension fund assets are expected to exceed the pension obligations as soon as 2017. This projected growth in assets, relative to expected obligations, would likely reduce pension expense in future years. Given this expected downward trend in pension costs, the Department does not recommend setting pension expense recovery at Xcel's approximate \$20.9 million test year request but rather mitigate or normalize this expense amount to ensure reasonable assumptions are used for ratemaking purposes. Therefore, the Department recommended that rates reflect only 50 percent of the 2008 market loss component and recommended reevaluation of the pension plan funding position in Xcel's next rate case.

The Department concluded its recommendations are more independent, reflect a more realistic assumption of pension expense going forward, is fair to both ratepayers and Xcel, thus, reflecting reasonable ratemaking principles. The Department further stated it was unreasonable to require ratepayers to bear 100 percent of the 2008 market loss in light of Xcel's request to also recover from ratepayers the full costs for an additional retirement benefits plan, a 401(k) savings plan. Xcel contributes as much as four percent of employees' salaries into a 401(k). The 2014 test year costs for the 401(k) plan are: \$8.0 million expensed and \$1.4 million capitalized cost.⁴⁴

As further support of its recommended 50 percent exclusion of the 2008 market loss, the Department argued that Xcel's treatment of the market's effect on determining the pension level in rates is not symmetrical. The Department explained that in past years when there were excess gains, (i.e., causing pension expense to be negative) the gains were not given back to customers; rather, pension benefits were assumed to be \$0 cost in rate cases.⁴⁵ Yet in this and its 2012 case, Xcel is attempting to recover all the market loss from ratepayers. The Department made clear that pension fund gains in excess of expectations do not exclusively benefit ratepayers as suggested by Xcel⁴⁶, but also benefits the Company and its shareholders, by lessening cash flow needs (i.e., payments into the pension fund).

The Department also disagreed with Xcel on the interpretation of the Commission's September 3, 2013 Order in Docket No. E-002/GR-12-961, with respect to whether the 2008 market loss amortization was allowed to be presented in future rate case test years.⁴⁷

Xcel

The calculation of pension expense incorporates prior-period market gains and losses. Under the ACM and the FAS 87 methods, the 2008 market loss is netted with all other prior-period gains

⁴⁴ Ex. 78, Attachment DAF-1, Sch. 2 (Figoli Direct)

⁴⁵ Docket E-002/GR-12-961, Department Witness Campbell Surrebuttal, p. 59.

⁴⁶ Ex. 81 at 56 (Moeller Direct); Ex. 83 at 16 (Schrubbe Rebuttal)

⁴⁷ Ex. 435 at 86 (Campbell Surrebuttal)

and losses, and the net amount either increases or decreases the asset value. Xcel stated that the consistent inclusion of prior years' experience has provided customers with very substantial benefits over time, paying no pension expense at all for several years before 2008. It may be perceived that the magnitude of the 2008 Market Loss changed long-standing accounting and ratemaking practices for the Company, but Xcel assured this is not the case. The Company continues to include all prior performance as has been done since the inception of the pension plan, inclusive of the 2008 performance, in determining its test year pension expense. The Company's symmetrical method of including the prior years' experience of both gains and losses is necessary to determine an accurate level of pension expense. Xcel stated that neither shareholders nor employers have received any benefits from market gains in the years in which the pension trust funds' earnings exceeded expectations. The Company stated its \$20.9 million test year pension expense request is reasonable as confirmed by the following facts. The pension expense is:

- less than the \$23.9 million value of the benefit earned by employees in 2014;
- less than the \$36 million cash contributions the Company made in 2014;
- 5.4 percent of electric jurisdictional labor expense (\$20.9 / \$384.5).

ALJ

(ALJ Report, pp. 31 - 36, paragraphs 129 – 158)

147. In the last rate case, the Administrative Law Judge concluded that it was reasonable for the Company to recover its 2008 pension fund losses through its standard accounting practices.

148. The Commission agreed, but limited its decision to that rate case. As part of its Order, the Commission required the Company to provide further "evidence of the Company's policy and practice pertaining to past and future pension policies, including surplus, ... in the initial filing of its next rate case." The Commission also required the Company to "provide discussion and support why other stakeholders, other than ratepayers, should not bear pension costs, in general, and more specifically, not bear the pension costs related to the restoration of the fund's market losses."

149. That additional information requested by the Commission and the other evidence in the record demonstrate that the Company's proposed treatment of gains and losses, including the 2008 Market Loss, in calculating its test year qualified pension expense is reasonable. The record shows the Company's treatment of the 2008 Market Loss is consistent with the Company's long standing practice of including both market gains and losses in its calculation of the pension expense. While this approach results in a significant pension expense in the 2014 test year, ratepayers have received much more substantial benefits from this approach in prior years. As the Company demonstrated, the cumulative benefit to customers of recognizing both gains and losses has been approximately \$332 million on a Minnesota jurisdictional basis from 2000 to 2014.

...

152. In addition, the Administrative Law Judge concludes that none of the grounds set forth by the Department provide a reasonable basis for reducing the amount of the 2008 Market Loss reflected in the 2014 test year expense.

...

158. For these reasons, the Administrative Law Judge concludes that the Company's approach of recognizing pension gains and losses is reasonable, and the Company's proposed phase-in and amortization of the 2008 Market Loss should be included in the 2014 test year expense. It would not be reasonable to exclude the effects of the 2008 Market Loss when ratepayers have benefited substantially from past market gains. The Department's recommendation to reduce the amount included in the test year expense related to the 2008 Market Loss is not supported by the record.

Exceptions to the ALJ

Xcel

(Xcel Exceptions, pp. 45-49)

Xcel requested adoption of the ALJ pension-related recommendations.⁴⁸

Department

(Department Exceptions, pp. 39-47)

The Department maintained its recommendation and emphasized that it is not reasonable that ratepayers bear 100 percent of this extreme loss which makes up \$12.1 million of the \$19.9 million pension expense in 2014. The Department filed exceptions to ALJ Findings 149-151, 152-153, 154, 155-156, and 157-158.

The Department asserted that, in light of tremendous recovery in financial markets, it is troubling the 2008 market loss is without a material offsetting market gain and that the record does not demonstrate a reasonable basis for Xcel's pension fund to have so underperformed the market. Therefore, Findings 149 – 151 should be revised as follows:

149. That additional information requested by the Commission and the other evidence in the record demonstrate that the Company's proposed treatment of gains and losses, including the 2008 Market Loss, in calculating its test year qualified pension expense is not reasonable. The record shows the Company's treatment of the 2008 Market Loss is consistent with the Company's long standing practice of including both market gains and losses in its calculation of the pension expense, but it does not demonstrate reasonable grounds for Xcel to have experienced so little recovery (i.e. offsetting market gains) in the value of its pension asset during the recent, significant market recovery. ~~While this approach results in a significant pension expense in the 2014 test year, ratepayers have~~

⁴⁸ Xcel Exceptions, VI.B, p. 45.

~~received much more substantial benefits from this approach in prior years. As the Company demonstrated, the cumulative benefit to customers of recognizing both gains and losses has been approximately \$332 million on a Minnesota jurisdictional basis from 2000 to 2014.~~

150. In addition, as a result of recognizing pension asset earnings and losses, the pension expense recovered in rates has historically been well below the Service Cost (the actual cost of providing the pension benefit to Company employees). For example, as shown in the figure below, for the NSPM Plan, the pension expense has been below the Service Cost in every year since 2000. [Table 2 omitted] This fact, however, does not relieve Xcel of the obligation to demonstrate that it was reasonable for Xcel to have experienced so little recovery in the value of its pension asset during the recent, significant market recovery.

151. These facts do not demonstrate that the Company's approach fairly allocates both the gains and the losses to ratepayers.

To clarify, the Department explained its asymmetry characterization of Xcel's 2008 market loss proposal for setting rates, by pointing out that rates increase when pension expense is positive, but never decrease when pension expense is negative. Instead, in past years, the Department noted that the negative pension expense was treated as \$0 cost [rather than reducing rates]. Thus it recommends the following revisions to Findings 152 and 153.

~~152. In addition, the Administrative Law Judge concludes that none of the grounds set forth by the Department provide a reasonable basis for reducing the amount of the 2008 Market Loss reflected in the 2014 test year expense.~~

153. The Department's argument that the Company's approach is not symmetrical is correct in that Xcel's approach allows rates to increase when there is positive pension expense but not to decrease when pension expense is negative. Additionally, contrary to the Company's claim that it includes both market losses and market gains, and despite the financial market returning to above 2007 market levels, the Company has not included material market gains to offset material market losses, as expected based on recent financial market performance. ~~to fails to recognize the benefit to ratepayers of having the returning any excess to the pension fund. It would be inequitable to recognize the gains, but not the losses, in calculating the Company's pension expense for ratemaking purposes.~~

The Department disagrees with Finding 154. The Department's principal concern is that no party other than Xcel bears a burden of proof in this matter. Given that one could read Finding 154 language to suggest that the Department bears a burden of proof as to why Xcel's pension fund has not shared in the market recovery, the Department recommends that this proposed finding be deleted.

~~154. The Department's suggestion that the pension expense may be larger than necessary because the Company may not have reasonably managed its assets lacks proof~~

~~in the record. The Department's claim is not based on any empirical evidence such as a comparison of the performance of the Company's pension assets to the performance of other pension funds of a comparable size. Nor has the Department demonstrated that a reasonable pension fund manager would have managed the assets differently. Rather, the Department has only expressed a general concern about the performance of the assets. This vague concern does not demonstrate that the Company's test year qualified pension expense is unreasonable and should be reduced as recommended by the Department.~~

The Department exceptions requested deletion of ALJ Findings 155 and 156. As to Finding 155, the Department did not and does not recommend a reduction in Xcel's pension benefit to its employees. The Department explained the issue raised was the degree to which the 2008 market loss should be imposed on ratepayers in addition to ratepayers' already generous (100 percent) payment of qualified pension benefits (which requires no contribution to pension plans by the Company's employees) as well as paying for the "Company's" match of four percent towards the voluntary 401(k) plan.⁴⁹ As to Finding 156, the Department explained that its meaning of "short term" is that Xcel is not allowing its pension asset to recover in value (or not including financial market gains that should have occurred) before seeking from ratepayers very significant sums.⁵⁰

~~155.— Similarly, there is no evidence in the record to support the contention that the Company's pension expense should be reduced because the Company's retirement benefits are "generous" as claimed by the Department. To the contrary, the record shows that the Company's benefits are comparable to those of its peers, and its benefits for its new employees are lower than many of its peers. In addition, providing a competitive level of benefits is necessary for the Company to attract and retain the skilled employees who are needed to provide reliable service to ratepayers. [citations omitted]~~

~~156.— Likewise, the Department is mistaken when it claims that the Company is seeking "to get recovery of all of the 2008 market loss from ratepayers in the short term. As the Company explained, the Company is not seeking to recover all of the 2008 Market Loss in the short term. Rather, under FAS 87 and ACM, the loss is both phased-in and amortized resulting in recovery over the long term. [citations omitted]~~

The Department recommended deletion of Finding 157 and revisions to Finding 158. As to Finding 157, the Department maintained that making ratepayers pick up all of the 2008 market loss expense certainly would benefit shareholders. Moreover, to the extent that the Company's pension plan is overfunded in the future, then the Company's shareholders would benefit from not having to make payments into the pension fund even though pension expense continues to be recovered from ratepayers in rates.⁵¹ As to Finding 158, the Department stated that the Company has not shown why it is reasonable that its pension asset in this test-year does not reflect the very significant market gains that have occurred as of 2014. Thus, Xcel has not shown that it is reasonable for ratepayers to pay 100 percent of the 2008 market loss in this 2014 rate case.

⁴⁹ Ex. 435 at 90-91 (Campbell Surrebuttal); Ex. 450 at 6-7 (Campbell Opening).

⁵⁰ See Ex. 435 at 91 (Campbell Surrebuttal); Ex. 450 at 7 (Campbell Opening) (recommending that the 2008 market loss occurred but taking a longer period to recover the funds by allowing the pension funds to recover).

⁵¹ See Ex. 435 at 89-95 (Campbell Surrebuttal); Ex. 450 at 7 (Campbell Opening).

~~157. Finally, contrary to the Department's assertion, there is no benefit to the shareholders from this longstanding approach to calculating pension expense because the Company does not pay out the gains to shareholders. Instead, the gains help to reduce rate increases by limiting the future pension expense. [citation omitted]~~

158. For these reasons, the ~~Commission~~ Administrative Law Judge concludes that the Company's ~~approach of recognizing pension gains and losses is reasonable, and the Company's~~ proposed phase-in and amortization of the 2008 Market Loss should not fully be included in the 2014 test year expense. ~~It would not be reasonable to exclude the effects of the 2008 Market Loss when ratepayers have benefited substantially from past market gains.~~ The Department's recommendation to reduce the amount included in the test year expense related to the 2008 Market Loss by 50 percent is ~~not~~ supported by the record. [footnote: 450 at 6 (Campbell Opening).]

Staff Comments – 2008 Market Loss

Market Loss

In Xcel's 2012 rate case, the test year pension expense had increased significantly due primarily to the 2008 Market Loss which lead to a dispute between the Department and Xcel as to whether the loss should be included as part of its recoverable pension expense. The ALJ recommended allowing its inclusion. The Commission adopted the ALJ's recommendation for purposes of that proceeding, and also required additional information to be provided in future rate cases. In this 2013 case, even though the Department recommends allowing rates to reflect a portion of this market loss, there appears to be an interpretation disagreement between Xcel and the Department as to whether the 2012 Order permits the 2008 Market Loss to be included in the development of future rate requests.⁵² The relevant sections of the Commission's 2012 Order (issued September 3, 2013) follows:

2012 Order, page 7, bullet point "Pension Costs" reads, in part:

[The ALJ] also found that it was reasonable for the Company to recover its 2008 pension fund losses through its proposed amortization plan. She recommended disallowance of Restoration Plan costs.

The Commission concurs based on the record in this case, but will set additional reporting requirements for the next rate case and will clarify that the determination that the 2008 market loss may be included as a cost is limited to this proceeding and that the Company will earn no return on the unamortized asset loss balances.

2012 Order, page 42, reads, in part:

Pension Asset 2008 Market Loss – The Commission clarifies that its inclusion in qualified pension cost of the Company's 2008 market loss is limited to the facts of

⁵² Ex. 435, pp. 85-86 (Campbell Surrebuttal)

this case and is limited to this proceeding. Further evaluation and evidence of the Company's policy and practice pertaining to past and future pension policies, including surplus, must be provided in its next rate case. Any previously amortized 2008 Market Loss amounts that occurred prior to the filing of this rate case are not to be reflected in this or future test-year pension costs. And the Company shall not include a compensating return on the pension's unamortized asset loss balances.

2012 Ordering Paragraph 35, page 51, reads:

The Company's 2008 market loss shall be included in the qualified pension cost for ratemaking purposes; that determination is limited to this proceeding. Further evaluation and evidence of the Company's policy and practice pertaining to past and future pension policies, including surplus, shall be provided in the initial filing of its next rate case.

The Commission could provide in its Order additional clarity regarding the inclusion of the 2008 Market Loss for ratemaking. Although the Department raised the issue for Commission clarification, its current recommendation is to include a portion of the 2008 market loss in rates. Staff believes the intent of the 2012 rate case order was to require more comprehensive information to improve transparency and to substantiate market loss inclusion in future rate case test years, and to allow the Commission and the parties' further opportunity to revisit the issue in any utility's rate case.

Staff agrees with the Department's conclusion that pension fund gains provide benefits not only to ratepayers but also to the Company by easing pension contribution cash flow demands. However, if the ratemaking basis is expense accrual, rather than fund contribution based, staff has concerns with the 2008 Market Loss adjustment as proposed by the Department. First, the approach appears to be an asymmetrical adjustment because it does not likewise adjust the post-2008 gains/losses. Second, the Department's reasoning that the pension assets may soon converge with, and exceed, pension obligation (liability) does not acknowledge that expense recognition is not forgone upon the incidence of pension fund balance increases.⁵³ For instance, hypothetically, a company could fully fund its pension benefit prior to the benefits being earned by the employees; this would result in a similar outcome where pension assets exceed pension obligation (liability). Even though the hypothetical company fully funded its pension upfront, such action does not necessarily eliminate pension expense in future years, given that the benefits are earned (thus expensed) gradually over time. As stated and anticipated by the Department, the pension fund's positive investment earnings and growth will lessen future years' net pension expense, assuming all five pension components are included in determining rates, but there is no record certainty to what degree those returns will impact future years' pension expense. Considering that pension expense does not equate to the funds committed to be deposited into the pension fund, some commissions have addressed their discretionary-use-of-funds concern by directing utilities to contribute the allowed rate case expense amount into the trust fund. In recent years, however, Xcel's pension fund contributions have exceeded its annual expense.⁵⁴

⁵³ Ex. 429, p. 131 (Figure 2) and p. 133, Ins. 1-5 (Campbell Direct)

⁵⁴ Ex. 433, Attachment A to DOC IR 2106 (Campbell Direct Schedule NAC-26)

Because of the 2007-2009 economic downturn, coupled with coincident timing of the Pension Protection Act of 2006 requirements, scrutiny of pension fund investment risk has intensified. One of the underlying concerns is what ratepayer protections are needed, if any, in light of market swings or possible fund management concerns. The Company has demonstrated that, prior to 2008, when investment returns exceeded expectations, ratepayers benefited by years of reduced pension costs. However, the issue of pension investment risk and its impact on ratepayers is a potential challenge across all utilities. In the 2013 MERC rate case, a generic inquiry was authorized to review pension discount rate issues.⁵⁵ Should the Commission desire it, this inquiry's scope could be expanded to include discussion of pension investment risk.

Party Suggested Revisions to ALJ Report on 2008 Market Loss

In its exceptions, the Department offered revisions to the ALJ report section addressing the 2008 market loss. Staff offers brief comments on some of these suggested changes.

ALJ Findings 149, 151, 152, and 158: The Department's revisions would support a Commission decision adopting the Department's recommendation.

ALJ Finding 150: The Department's revision could be adopted independent of the Commission decision on this disputed issue.

ALJ Finding 153: The Department's revision to the first sentence adds clarity as to the point of the Department's argument, a point Xcel had not refuted. The Department's testimony, in this docket and in Xcel's 12-961 case, does not appear to cite a particular past rate case in which its test-year pension expense was negative and that such a disparity between requested recovery and the calculated expense had been noted. Staff conducted a limited review of other cases and found that in Xcel's 2005 electric rate case⁵⁶, its request of \$0 pension cost in rates was based on funding, rather than a calculated financial expense. (This now apparent shift in the basis of Xcel's request is addressed by staff in Future Case Filing Requirements.)

The second, new sentence, as currently written, implies the Company's pension fund portfolio performance mirrored the market gains, but the record has not established the portfolio's holdings realized gains during the market upswing.

ALJ Finding 154: The Department asks that this be deleted and staff agrees for the reasons stated in the Department's exceptions.

ALJ Findings 155 and 156: These paragraphs could remain to reflect the ALJ's interpretation.

ALJ Finding 157: Staff agrees with the Department that a well performing pension fund does provide benefit opportunities to shareholders as stated in testimony, so some revision to the paragraph first sentence may be considered. As an example, the first sentence could be changed to read, "The pension fund does not pay out the gains to shareholders," and the second sentence

⁵⁵ Commission Ordering paragraph 24 from Docket G-011/GR-13-617, Order issued October 28, 2014.

⁵⁶ Docket No. E-002/GR-05-1428, the Direct Testimony of Xcel Witness Linda Erickson.

could be retained. Or, in absence of revisions, the Commission could adopt the Department's deletion of the paragraph.

Qualified Pension Alternative Rate Recovery Proposals

(The Alternative Rate Recovery Proposals essentially do not change revenue requirements, rather may lower current rates by postponing recovery of current revenue requirement collection to later years.)

Xcel

Xcel offered two alternative proposals as a means to normalize its qualified pension expense and provide greater predictability as to test year expenses, while affording the Company greater certainty in the recovery of this expense. Xcel believes the proposed mechanisms will also allow for the resolution of concerns about the 2008 Market Loss in this case, as well as for future cases.

First proposal: Xcel totaled its five-year forecasted pension expense (2014 – 2018) and calculated an average annual cost over this time period. Rates would then be set upon this average. This proposal compares the (forecast-based) normalized annual average to Xcel's calculated actual qualified pension expense each year, with the difference being deferred each year until the normalized amount is revisited in 2017 or 2018, at which time the accumulated deferred amount will be amortized over a period of time approved by the Commission.

Table 3			
Total MN Jurisdictional Pension O&M Expense			
A	B	C	D
Year	Pension Cost 5-year forecast Discount: 4.74% EROA: 7.25%	5-Year Normalized Baseline	Difference to defer Proposed increase (decrease) to rate base, if B = actual (B - C)
2014	\$20,923,341	\$18,246,925	\$2,676,416
2015	\$19,581,485	\$18,246,925	\$1,334,560
2016	\$18,656,409	\$18,246,925	\$409,484
2017	\$16,779,111	\$18,246,925	\$(1,467,814)
2018	\$15,294,279	\$18,246,925	\$(2,952,646)
Actual Expense (sum years 2014- 2018, column B)	TBD		
Aggregate Normalized pension (sum col. C)		\$91,234,625	

Xcel proposed that the deferred amount be included in rate base, thus requests to earn a return on this deferral until it is amortized at the end of the normalization period. In the event the actual

expense is less than the normalized pension expense in aggregate, Xcel proposed to apply the excess amount as a credit to the calculated qualified pension expense for the next normalization period. Xcel proposed to provide annual compliance filings with information needed to confirm and verify the administration of this normalization method. Xcel proposed that the normalized baseline expense would be set for the five year period 2014 – 2018, then be reset in a future rate case filed near the end of this five-year period. With regard to the existing XES Plan cap approved by Commission in the 2012 rate case, Xcel believes continuing it would be reasonable, and any deferred amounts resulting from the XES Plan cap be amortized along with other amounts deferred under this proposal.

Second proposal: Xcel totaled its five-year forecasted pension expense (2014 – 2018) and calculated an average annual cost over this time period. Rates would then be set upon this average. Xcel would compare and defer the difference between the calculated average amount and the *lower* of either the actual qualified pension expense amount each year **or** the currently (2014) forecasted expense amounts for each year during this time period (i.e., 2014-2018). Given the expected declining trend in pension expense, under Proposal 2, there could never be a deferred asset at the end of 2018, although there could be a deferred liability if the actual amounts turn out to be less than forecasted. However, the Company proposes that the normalized pension expense be revisited in the Company's next rate case, (anticipated in November 2015, with a 2016 test year) and that the Company be allowed to offer a proposal in that rate case on how to amortize whatever deferred asset or liability exists at that time.

Table 4				
Total MN Jurisdictional Pension O&M Expense				
A	B	C	D	E
Year	Pension Cost 5-year forecast Discount: 4.74% EROA: 7.25%	5-Year Normalized Baseline	Actual Qualified Pension Expense	Difference to defer. Proposed increase (decrease) to rate base [(Lower of B or D) – C]
2014	\$20,923,341	\$18,246,925	\$20,923,341	\$2,676,416
2015	\$19,581,485	\$18,246,925	TBD	TBD
2016	\$18,656,409	\$18,246,925	TBD	TBD
2017	\$16,779,111	\$18,246,925	TBD	TBD
2018	\$15,294,279	\$18,246,925	TBD	TBD

As part of this second proposal, the Company proposes to revisit the normalization amount sooner because of the potential for uncontrollable variability of factors influencing pension expense and because Xcel believes it would be beneficial to gain experience with this proposed technique before using it over an extended period of time. If the Company does not file a rate case with a 2016 test year, and there is a significant, material change to its actual qualified pension expense, Xcel believed it would be reasonable for the Company to be able to present and explain those changes to the Commission, Department and other interested stakeholders and, if appropriate, make modifications to the normalized qualified pension expense amount (outside of a rate case). Akin to Xcel's first proposal, the Company believes it would be reasonable to

continue deferring the XES Plan cap amounts until the normalization period ends, at which time deferred amounts would be amortized.

Xcel believes both these proposals are fair, offer mitigation and provide rate stability as far as qualified pension expense is concerned. Xcel stated that if the Commission is inclined to adopt some mechanism to moderate pension expense, it should adopt one of these mechanisms, instead of changing the discount rate, to avoid creating an artificial liability gain and to avoid departing from GAAP accounting.

Department

Foremost, the Department prefers that the Commission adopt its recommendations. However, should the Commission not agree with the Department's recommendations, then the Department would support the second mitigation alternative proposed, but with several modifications. First, the deferral amount should not be included in rate base since the Company has already requested inclusion of its prepaid pension asset in rate base and earning a return on under-funding pension assets may signal an inappropriate incentive to make poor pension investment choices. Second, the Department recommended continuation of the 2012 rate case approved pension mitigation and the continued deferral of the cost amount resulting from the XES Plan cap. Third, allow Xcel to defer the difference between expense and the lesser of the actual or forecasted amounts, but rather than provide Xcel with certainty of future inclusion of deferral amortization in rates, Xcel should be required to make its case as to why recovery of any deferred amount should be allowed in future filing, such as showing that pension investment decisions were reasonable. Fourth, the annual allowed pension expense should be based upon setting the discount rate equal to the EROA.

ALJ

(ALJ Report, pp. 36 - 38, paragraphs 159 – 169)

168. Given the disagreement between the Department and the Company regarding the Company's new normalization proposals, it is not clear that adopting a new normalization mechanism for the qualified pension expense is in the public interest. Moreover, adopting either of the new proposals would have only a relatively small impact on the 2014 test year revenue requirement because the amount of the deferral would be approximately \$2.7 million at the most. Given the dispute regarding the new proposals and the limited benefit, the Administrative Law Judge recommends that the Commission not adopt either of the new normalization proposals set forth by the Company.

169. The Administrative Law Judge does, however, recommend that the normalization mechanism adopted in the last case be continued because both the Administrative Law Judge and the Commission determined that approach is beneficial to ratepayers.

Exceptions to the ALJ

Xcel

(Xcel Exceptions, pp. 45-49)

Xcel requested adoption of the ALJ pension-related recommendations.⁵⁷

Department

(Department Exceptions, pp. 47-48)

The Department requested adoption of its modified pension expense mitigation in the event the Commission does not agree to the Department's discount rate and 2008 market loss pension recommendations.⁵⁸

Staff Comments

General Discussion on Normalizing, Amortizing and Deferrals

Normalization involves the determination that a certain level of operating expense is normal and reasonable for ratemaking purposes. Normalization can be prospective in nature, thus aligned with the prospective nature of ratemaking. Rates are not developed nor intended to give the utility dollar-for-dollar recovery of specific past costs; this would constitute retroactive ratemaking. Some expenses increase, some decrease. Conversely, amortization is the process whereby the cost of a specific previously incurred expense is spread (amortized) over a future period for rate recovery. Deferral of costs from one period to subsequent rate case for recovery should be an extraordinary event that has significant adverse impact on the utility's financial condition (perhaps with consideration as to whether the utility was earning above its authorized rate of return at the time) or it should be an event that provides a future net benefit for ratepayers. Deferring costs is not necessarily beneficial to ratepayers in the long run. It is not reasonable to defer costs to insulate shareholders from any risks. Approving a particular expense for deferral should not guarantee that the recovery of that expense will be permitted in a base rate case. Rather, the utility could present arguments in its next case as to why those costs should be included, as not ordinary, nor recurring and how they fall outside the normal ratemaking principles.

Pension Mitigation Proposals

The retirement benefits introduction included an overview of the active pension mitigations established in the 2012 case. Here, Staff discussion addresses the Company's additional mitigation alternatives offered in this case and also introduces additional options for Commission consideration.

⁵⁷ Xcel Exceptions, VI.B, p. 45.

⁵⁸ Department Exceptions, IV.C.6, pp. 47-48.

The Company's first mitigation proposal provides the Company assured recovery of all its pension expense as Xcel calculates it using what Xcel selects for pension actuarial assumptions at each year's measurement date and, if adopted, removes qualified pension from future "case issues list" until 2017 or 2018. This proposal essentially dismisses the concerns parties may have with the Company's pension cost approach. The "normalized amount" only acts as a benchmark level to initially set rates, to remain in place for five years, but allows for true-up rate recovery (or returns) in later years. This approach could be characterized as single issue ratemaking. Moreover, approving guaranteed recovery of actual costs that the utility has yet to determine can lead to complacency rather than incentivize a company to actively manage and institute cost control measures. Due to these concerns, Staff does not recommend the adoption of this mitigation proposal. However, if the Commission has interest in pursuing this proposal, Staff recommends that no return should be earned on any deferred amount because, as mentioned previously, pension expense is not representative of actual cash requirements for pension benefits. Staff cautions with respect to the accumulation of any allowed deferral amounts. Xcel currently is accumulating deferred pension costs related to the XES Plan cap instituted in the 2012 rate case and we must avoid double counting the XES Plan deferred amounts that may also be reflected in any year's total pension expense determined deferred amounts.

With respect to the Company's second mitigation proposal, at the outset, the proposal appears to be more amenable to ratepayers; however, it adds conditions that dilute potential ratepayer-favorable outcome, and also has an underlying structure of single issue ratemaking. Furthermore, the proposal statement that it would result in no deferred asset outcome is contradictory because the proposal includes conditions to update prior to the 5-year period term end, allowing for the onset of amortization of accumulated deferrals within such revisions. As currently projected, assuming no mid-term revision, a deferred asset likely would accumulate the first three years, then reverse and resolve itself in Years 2017 and 2018 (illustrated in Table 3, Column D). Therefore, if Xcel would file and revisit this proposal in two or three years, and request amortization of any accumulated deferred amounts, it would most likely be a deferred asset position. Overall, the between-case conditions to permit change to the *benchmark normalized amount* for deferral accumulations, is not an approach staff would advise the Commission to employ without also invoking a rate change review because the approved base rates in effect would have been developed using a specified normalized level. Furthermore, instituting this mechanism which minimizes recovery risk by flexing and banking between-rate-case years' cost variability (future costs that the Company has yet to determine) could also lead to complacency rather than incentivize a company to actively manage and institute effective cost control measures.

The Department's preference to adopt the Company's second mitigation proposal with several modifications essentially creates a new mitigation option.

Additionally, as with any mitigation proposal, the Commission may want to consider whether these proposals give rise to, or perpetuate any intergenerational cost recovery concerns, or whether adoption of either proposal limits future application of an approach the Commission may pursue as a result of its generic pension inquiry⁵⁹ opened to investigate pension issues (i.e., discount rates).

⁵⁹ Docket G-011/GR-13-617 (MERC rate case), Order Paragraph 24, issued October 28, 2014.

Addressing Forecasted Pension Cost Trend in Rates

Presuming pension assumption inputs remain consistent, the Company's projected annual pension cost is expected to trend downward (see Table 3, Column B) as the 2008 Market Loss balance subject to amortization decreases.⁶⁰ If the Commission does not limit the 2008 Market Loss inclusion, yet wishes to incorporate this downward trend into its approved recovery amount without introducing further mitigations, Staff puts forth two options to consider. These options do not create new deferrals or refundable balances. One option is to allow in rates an amount that reflects the average of the annual projected expense over the expected rate life of this current case (Xcel expected a two-year rate case life⁶¹) wherein the projected expense amounts subject to averaging are calculated using the Commission-approved assumptions. A second option would be to allow in rates the 2014 test year expense level going forward, calculated using the Commission approved discount rate, and any excess amount allowed in rates over each subsequent years' calculated pension cost (if no rate case filed) using each year's current measurement date, will be applied toward the satisfaction (i.e., partial recovery) of the deferred asset⁶² created from capping the XES Plan amount (2012 rate case mitigation). In determining whether the 2014 rate level is in excess, the discount rate point-of-reference to be used in the subsequent years calculated pension costs may be specified by the Commission, to align with its decision on the disputed measure.

Prepaid Pension Assets in Rate Base

(Assuming an overall pretax rate of return of 11.42 percent, the revenue requirement impact is about \$6.1 million.)

Xcel requested to increase rate base by \$90.8 million for a prepaid pension asset (effectively a \$53.7 million rate base increase, net of accumulated deferred tax liability).⁶³ The Company stated that the prepaid pension asset represents what has been contributed by the Company but has not yet been expensed/recognized, nor is this asset accessible for other uses. In addition, the Company posits that the earnings generated by the prepaid pension asset effectively reduces pension expense, thus reduces the revenue requirement it otherwise would have been able to request in absence of the prepaid pension asset.⁶⁴ The Department acknowledged Xcel's inclusion of the prepaid pension asset in rate base without stating objection.⁶⁵ However, as discussed later, staff has some concerns because the record is unclear as to how the requested \$90.8 million prepaid asset was derived.

⁶⁰ Ex. 81, Attachment MPM-1, Schedule 5 (Moeller Direct)

⁶¹ Ex. 88 at 142 (Heuer Direct)

⁶² The XES Plan mitigation deferred asset from 2013 is about \$1.1 million; the XES Plan deferral amount from 2014 will be determined upon Commission decision in this case, but could approximate \$1.7 million (per Ex. 83, Schrubbe Rebuttal, Schedule 3 to RRS-1).

⁶³ Deferred Asset - Pension Expense (\$17,820,135 + 72,960,429) less Deferred Tax Liability – Pension Expense (\$7,280,399 + \$29,807,910) – Minnesota jurisdictional. See Table 23 and Table 24 of Moeller Direct Testimony.

⁶⁴ Ex. 81 pp. 121-128 (Moeller Direct)

⁶⁵ Ex. 435 at 101 (Campbell Surrebuttal)

ALJ

No discussion on this subject.

Exceptions to the ALJ

None

Staff Comments

Although the request for rate base inclusion of the prepaid pension asset has not been contested by intervenors, Staff believes the Commission may want to address the request and as guidance consider the following:

- What has the Commission decided on this issue in the past?
- Is it reasonable to require ratepayers to pay a return on a prepaid pension asset? And if so, for ratemaking purposes, how should the pension asset (or liability) rate base effect be calculated?
- What are Staff concerns with respect to the record and Xcel's prepaid asset request?

What has the Commission decided on this issue in the past?

Staff conducted a limited review of recent rate cases and found some discussion on pension asset in rate base in four cases: a 2010 MERC gas rate case, a 2013 MERC gas rate case, a 2010 Xcel electric rate case, and a 2009 Xcel gas rate case. Summaries of these most recent case decisions relating to pension assets follow:

MERC gas rate case, Docket G-007,011/GR-10-977:

The OAG recommended that rate base be reduced to reflect the cumulative difference between funding and expense levels for pensions and post-employment benefits from 2007 through the projected 2011 test year. MERC agreed to adjust the rate base for ratepayer supplied funds in the amount of \$71,159. The Commission adopted the ALJ Finding 179, which stated, "*The evidence demonstrates that MERC reduced the rate base by \$71,159, and that amount accurately reflects the difference between funding and expenses for its employee benefit obligations. No further adjustment is necessary.*"⁶⁶

MERC gas rate case, Docket G-011/GR-13-617:

MERC requested inclusion in rate base of various regulatory assets which, among them, included pension contributions that exceeded the amount recognized in pension expense. The Department recommended reducing the regulatory asset amount, primarily by excluding from rate base the regulatory assets created by benefit funding. The Department reasoned this rate base reduction because, 1) inconsistency between current case Company-supplied funds determination as

⁶⁶ Docket G-007,011/GR-13-617, Staff Briefing papers, p. 118 (issued May 17, 2012)

compared to past case determination of ratepayer supplied funds, 2) of a potential duplicate return on rate base of employee benefit expenses already covered through cash working capital, 3) the excess funded position is a temporary situation therefore not sufficient justification for permanent rate base recovery, and 4) the fund is not available for Company use. The Administrative Law Judge decided in favor of the Department's position and the Commission concurred.⁶⁷

Xcel electric rate case, Docket E-002/GR-10-971:

The inclusion of a pension asset in rate base was not specifically addressed by the Commission's decision, yet was effectively part of the Company's testimony and rate base.

Xcel Witness Moeller requested a \$3.8 million rate base inclusion⁶⁸ for pension funding that exceeded cost; no intervenor testimony objected to the request. In the end, all financial matters in this case were resolved through a partial settlement agreement which the Commission accepted. The Order stated:⁶⁹:

The Commission makes no findings on the merits of the issues resolved in the settlement, other than finding that these issues have been resolved in a manner that is reasonable, in the public interest, and supported by substantial evidence. The Commission does not and need not find that it would have decided each issue as it is decided in the settlement or as it is contingently decided in the Administrative Law Judge's Report. The Commission has analyzed these issues for the narrow purpose of ensuring that the resolutions adopted in the settlement are reasonable, supported by the record, and in the public interest.

Xcel gas rate case, Docket G-002/GR-09-1153:

Pension issues were raised by the OAG and an agreement between Xcel and the OAG emerged, which the Commission later found to be reasonable. A testimony document acted as the agreement and mentioned rate base treatment of employee benefits. Staff reviewed the document which indicates a pension rate base effect was agreed to in Xcel's 2009 gas rate case and that it would reflect the difference in the cumulative actual cash flow (deposits) and the expensed amounts, the same approach used for other postretirement benefit (FAS 106) rate base effect. Staff conclusion was formed by the following analysis:

In Xcel's most recent gas case⁷⁰, the Commission Order, stated in part:

⁶⁷ In the Matter of a Petition by Minnesota Energy Resources Corporation for Authority to Increase Natural Gas Rates in Minnesota, Docket No. G-011/GR-13-617, Commission Findings Of Fact, Conclusions, And Order, pp. 22-24 (October 28, 2014).

⁶⁸ Docket No. E-002/GR-10-971, Ex. 42 at 26 (Moeller Direct)

⁶⁹ *In the Matter of the Application of Northern States Power Company d/b/a Xcel Energy for Authority to Increase Rates for Electric Service in Minnesota*, Docket No. E-002/GR-10-971, Commission Findings Of Fact, Conclusions, And Order, page 7 (May 14, 2012).

⁷⁰ Docket G-002/GR-09-1153, *In the Matter of the Application of Northern States Power Company, a Minnesota Corporation, for Authority to Increase Rates for Natural Gas Service in Minnesota*, Findings of Fact, Conclusions of Law and Order (December 6, 2010), page 37.

At the oral argument before the Commission, Xcel indicated that it had come to an agreement with the RUD-OAG, evidenced in Exhibit 46, regarding the terms of its agreement regarding pension issues in future rate cases. ...The Commission finds the mandates contained in the agreement reasonable, and will require Xcel to so disclose in accord with Exhibit 46.

Exhibit 46 overview:

The “Exhibit 46” referenced in the Order above was evidentiary hearing testimony of Xcel Witness Moeller in the 2009 gas rate case that spoke to the resolution of pension issues with the OAG. Xcel agreed to withdraw its proposal to have a step rate increase (related to anticipated pension expense and funding volatility).

The Exhibit 46 agreement stated that the Company shall provide information updating its pension funding requirements/changes resulting from amendments to the Pension Protection Act (PPA), and comparing pension expenses determined under continued use of the Aggregate Cost Method of pension expense to a normalized method over a period of years. This information will identify any rate base effect arising from the use of either method. (emphasis added)

The Exhibit 46 agreement was stated to benefit ratepayers because the Parties will have the opportunity to review alternative approaches and work to ensure balancing the goals of including the lowest amount of expense in rates possible and minimizing long term costs to ratepayers as a result of the Company’s cash funding significantly exceeding the pension expense level collected in rates. The Company demonstrated that it had incorporated a negative rate base from its current FAS 106 position (postretirement benefits other than pensions), and proposed that any pension funding pursuant to the PPA would receive treatment consistent with the Company’s handling of SFAS 106. (emphasis added)

The 2009 gas case agreement between Xcel and the OAG mentioned future pension rate base effect, but its calculation method was not fully evident within the agreement. Though it states pension rate base effect was to be consistent with its FAS 106 rate base treatment, it is not clear to Staff from the agreement alone how the FAS 106 rate base effect was determined. A very limited review of the 2009 case record testimony did not resolve Staff’s question.⁷¹ However, in Xcel’s 2010 electric case, Xcel Witness Heuer’s testimony stated:

- Q. In Docket No. G-002/GR-09-1153, the Company agreed to provide a calculation of the reduction to rate base related to FAS 106. Has the Company made a reduction to rate base for FAS 106 in this case?
- A. Yes. The Company has reflected a reduction to rate base of approximately \$63.3 million to reflect FAS 106 expense recovery in excess of the Company’s related FAS 106 funding requirements.⁷²

⁷¹ The agreement did not confirm the approach discussed in testimony of the OAG Witness Lindell (Surrebuttal), and financial accounting standard differs. Exhibit 51 at 26, Ins. 17-22, Docket No. G-002/GR-09-1153.

⁷² Docket No. E-002/GR-10-971, Ex. 70 at 45 (Heuer Direct)

This Q&A suggests that FAS 106 rate base effect is the difference between cash flow and accumulated expense amounts, thus it is not a difference between plan asset value and the accumulated benefit obligation. According to the agreement from the Xcel's 2009 gas rate case, pension funding/expense rate base treatment would be consistent with the Company's handling of SFAS 106.⁷³

As a result of this analysis, Staff concludes that any pension rate base effect intended from Xcel's 2009 gas rate case would be the difference in cash flow and accumulated expense amounts.

Is it reasonable to require ratepayers to pay a return on a prepaid pension asset?

Pension funding requirements and pension expense determination are driven by separate guidance (ERISA vs. GAAP); therefore, it is not unusual that these two amounts in any one year can differ. With the PPA requirements and poor market performances coinciding, companies may find that pension funding requirements have exceeded what has been expensed.⁷⁴ As a result, the Commission may encounter similar requests by utilities in the future for rate base inclusion of pension assets. Prior to passage of the PPA, however, the opposite conditions were more probable – i.e., the expensed pension amounts exceeded the cash contributed to the pension fund. The Commission could either make a blanket decision to state its position on the matter, or rather base their decision case by case wherein a utility can clearly demonstrate in past cases when the pension funding-expense discrepancy resulted in a rate base reduction, the utility historically applied a reduction to rate base. Through a limited review of Xcel's past rate cases, Staff found that the Company did reduce rate base by a pension liability;⁷⁵ however, Staff was not able to verify the method used to calculate the pension liability.

If this is reasonable, then, for ratemaking purposes, how should the pension asset (or liability) rate base effect be calculated?

It is unclear from the record as to how Xcel calculated its \$90.8 million pension asset rate base amount. Therefore, if the Commission decides to allow inclusion of a pension asset in rate base, the Commission may also want to make clear the rate base calculation approach it finds appropriate. Staff has provided some questions to develop alternatives:

- Is a rate base return allowed on the prepaid pension amount that is the difference between the actual cash deposited into the qualified pension fund and the cumulative pension expensed amount since the inception of these plans (consistent

⁷³ Unlike pension benefits, FAS 106 obligations are not required to be funded. For its Minnesota jurisdiction, the Company's annual FAS 106 contributions equal the expected benefit payments [Ex. 81 (Moeller Direct) Attachment MPM-1, Schedule 12, p. 3.] Other jurisdictions (Texas, New Mexico and Colorado) require Xcel to fund its other postretirement benefit costs.

⁷⁴ Ex. 81 (Moeller Direct), Schedule 6, shows from 1950 – 2012, total company contribution amounted to \$745 million over the 63 year period. Thirty-three percent (33%) of those total contributions (or \$247 million) were made in recent years (2010-2012).

⁷⁵ The Non-plant asset and liabilities information is typically found in Xcel's Volume 4, Section III, Tab P2. Reviewed Dockets G-002/GR-09-1153, E-002/GR-08-1065 and G-002/GR-06-1429 itemized list included a pension liability reduction to rate base.

with the expected treatment of SFAS 106 Postretirement Benefits Other Than Pensions); or

- Is a rate base return allowed on the prepaid pension amount calculated in accordance with generally accepted accounting principles (FAS 87 – a valuation difference between fair value of pension asset and actuarially determined pension obligation); or
- Is a rate base return allowed on the prepaid pension amount that is not exclusively the Company's original investment deposits, but also includes the income generated by, and/or the growth in value of, the portfolio itself? (If this approach is adopted, it would require further refinement of the methodology and possibly input by the parties.)

The next segment provides further discussion which lead to these different alternatives.

What are staff concerns with respect to the record and Xcel's prepaid asset request?

Staff's main concern is that it is not clear how Xcel derived its \$90.8 million pension asset rate base request. Xcel Witness Mark Moeller testified that the prepaid pension asset is a timing difference between recognition of pension expense and actual cash flow.⁷⁶ Witness Moeller further indicated that the prepaid pension asset is calculated in accordance with the Statements of Financial Accounting Standards.⁷⁷ Upon limited review of the accounting standards⁷⁸, Staff believes that that Mr. Moeller's two statements, describing how a prepaid pension asset is determined, are not in agreement. The first statement suggests the asset results from the cumulative difference between the amount of cash the entity deposited into the fund and the amount of pension expense recognized. Whereas the second indicates the asset results from the accounting standard which measures of the difference between the fair value of plan assets and the projected pension obligation [the balance sheet asset (or liability) position]. Fair value of plan assets is not the same as the cumulative cash flowed into the fund; and the calculated projected pension obligation is not the same as the cumulative recognized pension expense.

Consequently, Staff's concern arises due to the discrepancy between these two statements and because Xcel's schedules do not make known the underlying composition of the requested prepaid asset rate base amount (Volume 4A, Tab P2-1). Xcel witness Moeller's direct testimony does provide a hypothetical example to illustrate a timing mismatch between cash payments and expense recognition, but the testimony does not, nor do schedules explicitly attest and support that Xcel's requested prepaid pension asset is simply derived in this manner. Nor is the illustrated method in accordance with the Statements of Financial Accounting Standards (SFAS) approach.

Furthermore, Xcel explains that pension asset balances represent the cumulative difference between what has been *contributed* to each plan and what has been expensed. It is vital to examine whether the face value understanding of the term *contributed* is the same as what Xcel intends. In other jurisdictions in which an Xcel utility operates, the Company's witness clearly

⁷⁶ Ex. 81 at 126 (Moeller Direct)

⁷⁷ Ex. 81 at 122 (Moeller Direct)

⁷⁸ SFAS No. 87, as amended, paragraph 35; SFAS No. 158, paragraph C2(j); and ASC 715-30-25.

testified that a prepaid pension asset amount does not result from just cash deposits made by the Company, but can be due to several reasons, including high market returns on plan assets.⁷⁹ Therefore, the term *contributed*, as used by Witness Moeller, may not equate to only cash deposits, but may include the returns generated by the investments as well. Unfortunately, in this case, the simple hypothetical example does not illustrate these other asset sources to which Xcel had more clearly testified to in another jurisdiction.

It is not clear to Staff through its review of testimony or the schedules⁸⁰ whether the prepaid pension amount requested in this case consists simply of the timing difference between cash deposits Xcel has made in excess of recognized pension expense, or rather includes reinvested market returns and growth of the portfolio, or is calculated in accordance with accounting standards. Yet found within Xcel's reply brief, it is stated that the prepaid pension asset is inclusive of contributions *and* asset returns.⁸¹ Therefore, if the Commission were allow in rate base a prepaid pension asset, staff believes it should also specify what is permitted in the pension rate base composition for ratemaking purposes.

The Commission may also want to know whether the cause for the Company's prepaid pension asset condition is purely the result of complying with ERISA minimum funding requirements. In that, should ratepayers be subject to pay a return on the portion of the pension asset that arose due to contributions in excess of what was required? The authorized overall rate of return in this case may exceed the Company's expected return on pension assets of 7.25 percent (i.e., a benefit measure to ratepayers in the form lowering future expense). To the extent any portion of the prepaid pension asset is a result of funding in excess of what is required by ERISA, and if the expected pension asset return is lower than what the requested or authorized rate of return on rate base is, perhaps the utility should be required to: 1) explain the reason for including the excess contribution portion in rate base, 2) quantify the ratepayer cost savings relative to incremental costs of rate base inclusion of excess contributions, and 3) discuss the effect this has on rates. Otherwise, the Commission could simply exclude the portion of that prepaid pension asset that is attributed to excess contributions.

Pension-Related Future Case Filing Requirements

Department

The Department noted concern with Xcel's actual 2013 pension fund performance, given that 2013 was a good financial market year.⁸² As a compliance item to this rate case, the Department recommended that the Commission require the Company to address in its initial filing in its next rate case why the Company's target asset allocations for their pension fund are reasonable, including ages of retirees and employees. Particularly, the Department requested that a

⁷⁹ The Direct Testimony of Gene H. Wickes on behalf of Southwestern Public Service Company (an Xcel Energy subsidiary), page 14, Before the New Mexico Public Regulation Commission, *In the Matter of Southwestern Public Service Company's Application for Revision of its Retail Rates Under Advice Notice No. 245*, Case No. 12-00350-UT.

⁸⁰ Ex. 14, Volume 4A, Tab P2-1, page 2-1D.

⁸¹ Xcel Reply Brief at 50.

⁸² Ex. 435, pp. 88-89 (Campbell Surrebuttal)

schedule⁸³ provided by Xcel in rebuttal, be expanded to include this information in its next rate case. The Department reasoned that this information should help determine if the Company's target asset allocations are reasonable for purposes of setting rates. Furthermore, due to the impacts that both the 2008 market decline and the subsequent years' market recoveries has had on the Company's pension fund, the Department also recommended that the Commission require Xcel, in their next rate case filing, to discuss its pension fund investment strategies and target asset allocations and the justifications for those decisions, from 2007 to the current date.

Xcel

Xcel agreed to the Department's recommendation that Company file in its next rate case its investment strategies, target asset allocations and justifications for those decisions from 2007 to the date of their next rate case filing.⁸⁴

ALJ

(ALJ Report, p. 38, paragraphs 170-171)

171. The Administrative Law Judge concludes the Department's request will provide useful information and recommends that the Commission require the Company to provide the agreed-upon information in its initial filing in the next rate case.

Exceptions to the ALJ

None

Staff Comments

In addition to the Departments recommendation, Staff suggests that the Commission direct the Company, in the initial filing of its future rate cases, to provide copies of the actuarial reports used to determine employee benefit costs. The actuarial study is a valuable underlying document to pension and other employee benefit costs. Staff also suggests that the Commission direct the Company to include identification and discussion of each non-qualified employee benefit cost included in its test years. Although the Company removed non-qualified pension costs from this case, the upfront transparency of continuing recovery request of these characterized benefits may assist future case investigations. Additionally, requiring enhanced testimony and schedules on the subject of prepaid pension asset in rate base may be useful to add clarity to this issue in future rate cases, thus Staff included this option for Commission consideration.

As previously noted in its 2008 Market Loss comments to ALJ Finding 153, Staff conducted a limited review to find prior cases in which pension expense was negative. In this limited review of Xcel electric rate cases, Staff found that, in past cases, the Company had based its pension cost level requests on its funding requirements and not on its calculated financial expense.⁸⁵ However, in its 2008 electric rate case, the Company began basing its pension cost level requests

⁸³ Ex. 31 (Tyson Rebuttal), Schedule 1

⁸⁴ Ex. 116 at 2 (Tyson opening statement)

⁸⁵ See E-002/GR-05-1428, Xcel Witness Erickson direct testimony, pp. 12-17.

on its calculated financial expense.⁸⁶ It is not unusual that pension funding and financial cost amounts differ at any one time as these two measures are guided by different regulation and standards. Furthermore, according to Xcel witness Moeller, pension expense determined under ACM and FAS 87 (financial reporting) will converge toward actual cash contributions.⁸⁷ Staff understands that Mr. Moeller is stating that over time, the sum of financial expense amounts would equal the sum of cash contributions. Given this supposition, it is Staff's recommendation that the Commission require the Company in its next case to discuss its change in pension ratemaking approach and provide historical comparison of these two different measures.

Pension-Related Decision Alternatives

Note: The Decision Alternatives denoted as "Staff" in this document are offered to broaden options for the Commission and do not necessarily represent Staff recommendations.

Qualified Pension Discount Rate Assumption

1. Direct the Company to use a five year average of discount rates (5.05 percent) determined under Financial Accounting Standard (FAS) 87 as the approved discount rate to determine its XES Plan pension costs for ratemaking purposes; **or** (ALJ, Xcel Exception)
2. Approve the Company's 2014 discount rate of 4.74 percent determined under Financial Accounting Standard (FAS) 87 as the discount rate to determine its XES Plan pension costs for ratemaking purposes; **or** (Xcel Rebuttal)
3. Direct the Company to use the Expected Return on Assets (EROA) value (7.25 percent) as the discount rate to determine its XES Plan pension costs for ratemaking purposes; and adopt the Department's revisions to ALJ Finding 126: (DOC)

126. As a result, the Administrative Law Judge ~~reaches a different conclusion in this case. – conclude that~~ the record in this case demonstrates that both FAS 87 and the ACM are designed to ensure accurate reporting of pension expense but use different methodologies. For that reason, use of the FAS 87 bond matching discount rate will help ensure that the XES Plan, which is subject to FAS 87, is fully funded. In addition, the record demonstrates that the Company's calculation of its FAS 87 discount rate was based on objective criteria and is similar to the rates used by other utilities. Finally, as the Company noted, if the discount rate had been equal to the EROA since the inception of the XES Plan, customers would have paid more in pension expense through the years because the service cost and interest cost elements of the FAS 87 calculation would have been higher. For these reasons, the Administrative Law Judge concludes the use of the FAS 87 discount rate is more

⁸⁶ See E-002/GR-08-1065, Xcel Witness Heuer rebuttal testimony, pp. 19-21.

⁸⁷ Ex. 81 at 42 (Moeller Direct)

reasonable than use of the EROA rate as the discount rate for the XES Plan. For ratemaking purposes until the next rate case, and in order for the Commission to examine pension ratemaking issues more closely in a generic docket, the Commission concludes that it is reasonable to use the same discount rate as the EROA rate because the rates cover the same period of time for pension assets and pension liabilities. Therefore, for the XES plan, as for the NSPM plan, the Commission will use a discount rate of 7.25 percent which is equal to the EROA rate;

(and, optionally)

4. Allow the Company, when calculating the recoverable pension cost, to exclude the artificial liability gain created from the change in the discount rate benchmark from the FAS 87 specified base (i.e., currently effective settlement or high-quality fixed-income investments) to the Expected Return on Assets base. (Staff)
5. Direct the Company to apply the Commission-approved discount rate point of reference when determining the XES Plan cost subject to deferral (or reversal) in subsequent years (i.e., non-rate case test-years) as the 2012 mitigation is continued (Docket E-002/GR-12-961). (Staff)

Optional Revisions to ALJ Findings on Pension Discount Rate

6. Delete the entire sentence, “*For that reason, use of the FAS 87 bond-matching discount rate will help ensure that the XES Plan, which is subject to FAS 87, is fully funded*”, from ALJ Report Finding 126. Finding 126 would then read as follows: (Staff)

126. As a result, the Administrative Law Judge reaches a different conclusion in this case. The record in this case demonstrates that both FAS 87 and the ACM are designed to ensure accurate reporting of pension expense but use different methodologies. ~~For that reason, use of the FAS 87 bond-matching discount rate will help ensure that the XES Plan, which is subject to FAS 87, is fully funded.~~ In addition, the record demonstrates that the Company’s calculation of its FAS 87 discount rate was based on objective criteria and is similar to the rates used by other utilities. Finally, as the Company noted, if the discount rate had been equal to the EROA since the inception of the XES Plan, customers would have paid more in pension expense through the years because the service cost and interest cost elements of the FAS 87 calculation would have been higher. For these reasons, the Administrative Law Judge concludes the use of the FAS 87 discount rate is more reasonable than use of the EROA rate as the discount rate for the XES Plan.

7. Adopt the Department’s revisions to ALJ finding 104: (DOC)

104. At a high level, both the ACM and FAS 87 attempt for financial reporting purposes and not pension funding purposes to determine the present value of future benefits and estimated earnings in the pension trust that have accumulated to determine the unfunded obligation. The present value of this unfunded obligation and the current-period earned value are the basis for determining the under or overfunded status of the pension fund, which is a component of the current- period pension expense accrual. Thus, both the ACM and FAS 87 accounting methods use are affected by the discount rate to calculate the pension liability and both methods use the expected return on assets or EROA assumptions to calculate estimated pension earnings. [footnote: Ex. 429 at 131-132 (Campbell Direct)] In addition, as discussed above, both methods provide for a smoothed recognition of unrealized gains and losses in plan asset earnings, such that the level of expense will change more gradually. [footnote omitted]

8. Adopt the Department's revisions to ALJ finding 113: (DOC)

113. The Company's calculation of the pension expense for the XES Plan uses the discount rate provided by FAS 87, the accounting method prescribed for the XES Plan. The primary source for the discount rate is a bond-matching study that is performed by the Company as of December 31 of each year. The study includes a matching bond for each of the individual projected payout durations within the plan based on projected actuarial experience. The study was selected and performed by Xcel rather than by an independent entity or actuary. [Ex. 429 at 112-113 and NAC-22 (Campbell Direct) (actuarial certificate stating that Xcel selected assumptions)]. The bonds used in the study must meet certain well-established criteria, and the Company employs numerous tests to validate the reasonableness of the discount rate produced by the bond-matching study. [footnotes omitted]

Qualified Pension Fund 2008 Market Loss

9. Reduce the 2008 Market Loss amount currently included in the test-year pension cost by one-half when determining the allowable pension cost level in this proceeding; and adopt the Department's revisions to ALJ Findings 149, 151, 152 and 158, as follows: (DOC)

149. That additional information requested by the Commission and the other evidence in the record demonstrate that the Company's proposed treatment of gains and losses, including the 2008 Market Loss, in calculating its test year qualified pension expense is not reasonable. The record shows the Company's treatment of the 2008 Market Loss is consistent with the Company's long standing practice of including both market gains and losses in its calculation of the pension expense, but it does not demonstrate reasonable grounds for Xcel to have experienced so little recovery (i.e. offsetting market gains) in the value of its

~~pension asset during the recent, significant market recovery. While this approach results in a significant pension expense in the 2014 test year, ratepayers have received much more substantial benefits from this approach in prior years. As the Company demonstrated, the cumulative benefit to customers of recognizing both gains and losses has been approximately \$332 million on a Minnesota jurisdictional basis from 2000 to 2014.~~

151. These facts do not demonstrate that the Company's approach fairly allocates both the gains and the losses to ratepayers.

~~152. In addition, the Administrative Law Judge concludes that none of the grounds set forth by the Department provide a reasonable basis for reducing the amount of the 2008 Market Loss reflected in the 2014 test year expense.~~

158. For these reasons, the Commission ~~Administrative Law Judge~~ concludes that the Company's ~~approach of recognizing pension gains and losses is reasonable, and the Company's proposed phase-in and amortization of the 2008 Market Loss should not fully be included in the 2014 test year expense. It would not be reasonable to exclude the effects of the 2008 Market Loss when ratepayers have benefited substantially from past market gains.~~ The Department's recommendation to reduce the amount included in the test year expense related to the 2008 Market Loss by 50 percent is not supported by the record. [footnote: 450 at 6 (Campbell Opening).]

or

10. Do not adjust the 2008 Market Loss amount included in the test-year pension cost when determining the allowable pension cost level. (Xcel, ALJ)

Optional Issues Related to 2008 Market Loss

11. Clarify the Commission's September 3, 2013 Order in Docket No. E002/GR-12-961 with respect to the inclusion of 2008 market loss in future cases:
 - A. The 2008 Market Loss inclusion in determining approved recoverable pension costs was limited to the Company's 2012 rate case, Docket No. E-002/GR-12-961 and not allowed to be carried over into future rate cases; (DOC) **or**
 - B. The 2008 Market Loss inclusion in determining approved recoverable pension costs was qualified as limited to the Company's 2012 rate case, Docket No. E-002/GR-12-961, in that it was subjected to future case filing requirements to improve transparency and to substantiate its inclusion in future test years. This decision reserved the opportunity for the Commission and the parties' to revisit the issue in any utility's rate case; (Staff) **or**
 - C. Some other interpretation offered by the Commission. (Staff)

12. Require the Company to deposit into the pension fund, at a minimum, the ratemaking approved pension cost amount each year until the Commission directs it to do otherwise. (Optional, Staff)
13. Expand the generic pension inquiry, from the Commission's October 28, 2014 Order in Docket G-011/GR-13-617, to include discussion on pension investment risk/rewards and ratepayer impacts. (Optional, Staff)

Optional Revisions to ALJ Findings on 2008 Market Loss

14. Adopt the Department's revision to ALJ Finding 150, as follows: (DOC)

150. In addition, as a result of recognizing pension asset earnings and losses, the pension expense recovered in rates has historically been well below the Service Cost (the actual cost of providing the pension benefit to Company employees). For example, as shown in the figure below, for the NSPM Plan, the pension expense has been below the Service Cost in every year since 2000. [Table 2 omitted] This fact, however, does not relieve Xcel of the obligation to demonstrate that it was reasonable for Xcel to have experienced so little recovery in the value of its pension asset during the recent, significant market recovery.

15. Adopt the Department's revision to ALJ Finding 153, as follows: (DOC)

153. The Department's argument that the Company's approach is not symmetrical is correct in that Xcel's approach allows rates to increase when there is positive pension expense but not to decrease when pension expense is negative. Additionally, contrary to the Company's claim that it includes both market losses and market gains, and despite the financial market returning to above 2007 market levels, the Company has not included material market gains to offset material market losses, as expected based on recent financial market performance. ~~to fails to recognize the benefit to ratepayers of having the returning any excess to the pension fund. It would be inequitable to recognize the gains, but not the losses, in calculating the Company's pension expense for ratemaking purposes.~~

16. Adopt the Department's revision to delete ALJ Finding 154, as follows: (DOC)

~~154.—The Department's suggestion that the pension expense may be larger than necessary because the Company may not have reasonably managed its assets lacks proof in the record. The Department's claim is not based on any empirical evidence such as a comparison of the performance of the Company's pension assets to the performance of other pension funds of a comparable size. Nor has the Department~~

~~demonstrated that a reasonable pension fund manager would have managed the assets differently. Rather, the Department has only expressed a general concern about the performance of the assets. This vague concern does not demonstrate that the Company's test year qualified pension expense is unreasonable and should be reduced as recommended by the Department.~~

17. Adopt the Department's revision to delete ALJ Finding 155, as follows: (DOC)

~~155.— Similarly, there is no evidence in the record to support the contention that the Company's pension expense should be reduced because the Company's retirement benefits are "generous" as claimed by the Department. To the contrary, the record shows that the Company's benefits are comparable to those of its peers, and its benefits for its new employees are lower than many of its peers. In addition, providing a competitive level of benefits is necessary for the Company to attract and retain the skilled employees who are needed to provide reliable service to ratepayers. [citations omitted]~~

18. Adopt the Department's revision to delete ALJ Finding 156, as follows: (DOC)

~~156.— Likewise, the Department is mistaken when it claims that the Company is seeking "to get recovery of all of the 2008 market loss from ratepayers in the short term. As the Company explained, the Company is not seeking to recover all of the 2008 Market Loss in the short term. Rather, under FAS 87 and ACM, the loss is both phased in and amortized resulting in recovery over the long term. [citations omitted]~~

19. Adopt the Department's revision to delete ALJ Finding 157, as follows: (DOC)

~~157.— Finally, contrary to the Department's assertion, there is no benefit to the shareholders from this longstanding approach to calculating pension expense because the Company does not pay out the gains to shareholders. Instead, the gains help to reduce rate increases by limiting the future pension expense. [citation omitted]~~

20. Adopt an alternative revision to ALJ Finding 157, as follows: (Staff)

~~157. Finally, contrary to the Department's assertion, there is no benefit to the shareholders from this longstanding approach to calculating pension expense because the Company The pension fund does not pay out the gains to shareholders. Instead, the gains help to reduce rate increases by limiting the future pension expense. [citation omitted]~~

Qualified Pension Mitigation Alternatives

21. Permit the 2012 rate case (Docket No. E-002/GR-12-961) qualified pension mitigation to continue (XES Plan capped at 2011 qualified pension cost level). (ALJ, Xcel, DOC)
22. Decide not to implement any of the proposed additional qualified pension expense mitigation plans; **or** (ALJ, Xcel Exception)
23. Adopt the Company's five-year pension mitigation proposal, alternative one⁸⁸, which sets rates to a five-year average of the projected qualified pension expense level calculated using the Company's current assumptions, including a XES Plan discount rate of 4.74 percent and an expected return on assets (EROA) of 7.25 percent. The difference between this normalized amount and each year's actual qualified pension expense amount, calculated using respective plan's accounting method (ACM or FAS 87), would be deferred and amortized over a period of time approved by the Commission. The Company would provide annual compliance reports, would reflect the deferred amount in rate base and the normalized rate amount would be revisited near the end of the five year period; **or** (Xcel Rebuttal)
24. Adopt the Company's five-year pension mitigation proposal, alternative two⁸⁹, which sets rates to a five-year average of the projected qualified pension expense level calculated using the Company's current assumptions, including a XES Plan discount rate of 4.74 percent and an expected return on assets (EROA) of 7.25 percent. The difference between this normalized amount and the lower of either that year's actual qualified pension expense amount (calculated using respective plan's accounting method - ACM or FAS 87), or the 2014 study's projected expense for that year (Table 3 , Column B), would be deferred. The normalized amount may be revisited prior to five-year term end, either through a rate case or outside of a rate case. Amortization may also begin prior to five-year term end. The Company would provide annual compliance reports and would reflect the deferred amount in rate base; **or** (Xcel Rebuttal)
25. Adopt the Department's modifications to the Company's five-year pension mitigation proposal, alternative two⁹⁰, which sets rates to a five-year average of the projected qualified pension expense level calculated using a discount rate equal to the expected return on assets (EROA) of 7.25 percent. The difference between this normalized amount and the lower of either that year's actual qualified pension expense amount (calculated using by setting the discount rate to equal the EROA), or the 2014 study's projected expense for that year (Table 3 , Column B), would be deferred. Deferred amounts are not included in rate base and future recovery of any deferred amounts is not presumed granted, rather the Company will be required to make a case and show why the amortized deferred amount should be allowed rate recovery; **or** (DOC conditional)

⁸⁸ Ex. 83, pp. 31-34 (Schrubbe Rebuttal)

⁸⁹ Ex. 83, pp. 34-38 (Schrubbe Rebuttal)

⁹⁰ Ex. 83, pp. 34-38 (Schrubbe Rebuttal)

26. Approve the qualified pension expense level in rates that is the average of the annual projected qualified pension expense over the expected rate life (Xcel expects a two-year rate case life⁹¹) wherein each year's projected expense amounts subject to averaging are calculated using the Commission-approved assumptions and the most proximate measurement date applicable to each year. Direct the Company to provide schedules for each year's qualified pension cost calculation, using similar layout provided in Exhibit 83, RRS-1, Schedule 3, within 10 days of the Commission's decision to assist in preparation of the Order; **or** (Staff, option 1)
27. Approve a 2014 Xcel qualified pension expense level in rates calculated using the Commission-approved discount rate. Direct that the excess of the 2014 amount allowed in rates over future years' qualified pension expense, also calculated using the Commission approved discount rate point-of-reference, is to be applied toward the recovery of the accumulated deferred XES Plan costs resulting from the 2012 rate case mitigation cap. Clarify that "future years" is to mean 2015 and each subsequent year's qualified pension expense if not a rate case test-year. Clarify that the recoverable XES Plan expense amount is to be calculated using the proximate measurement date appropriate for each operating year (12/31/2013 for 2014; 12/31/2014 for 2015, etc.) until the next rate case. Require the Company to file annual compliance reports which provides pension plans' cost calculation reports, the XES Plan accumulated deferred balance and the excess rate level recovery applied toward satisfying the deferral. Deferred amounts are not included in rate base. (Staff, option 2)

Prepaid Pension Asset

28. Determine that the qualified pension asset and associated deferred tax amounts should be removed from rate base; **or** (Staff)
29. Approve the Company qualified pension asset and associated deferred tax amounts rate base request (a net rate base increase of \$53.7 million); **or** (Xcel)
30. Determine that the qualified pension asset and associated deferred tax amounts, should be included in rate base, **and** the pension asset is to reflect: (Staff)
- A. The cumulative difference between actual cash deposits made by the Company reduced by the recognized qualified pension cost determined under ACM/FAS 87 method since plan inception, not to exceed the Company's filed request; **or**
- B. The cumulative difference between actual cash deposits made by the Company that did not exceed the minimum funding requirements, reduced by the recognized qualified pension cost determined under ACM/FAS 87 method since plan inception, but not to exceed the Company's filed request; **or**

⁹¹ Ex. 88 at 142 (Heuer Direct)

- C. The difference between the fair value of the qualified pension fund and the projected qualified pension obligation (FAS 87 reporting), not to exceed the Company's filed request; **or**
 - D. Determined in another manner specified by the Commission.
31. Clarify that the Commission decision on the rate base treatment of a qualified pension asset (or liability) is decided on a case-by-case manner. (Staff)

Pension-Related Future Case Filing Requirements

32. Direct the Company in the initial filing its next rate case to address why the Company's target asset allocations for its pension fund are reasonable and include participants' demographic information, such as ages of retirees and employees. The Company is to provide an update to its existing Exhibit 31, Schedule 1 (Tyson Rebuttal) and expand it to include this demographic information. (ALJ, DOC, Xcel)
33. Direct the Company in the initial filing of its next rate case to provide testimony on its investment strategies and target asset allocations for the qualified pension fund and the justifications for those decisions, for the period beginning with 2007 to the date of its next filing. (ALJ, DOC, Xcel)
34. Direct the Company in the initial filing its next rate case to provide copies of the actuarial reports used to determine employee benefit costs, including its schedules denoting each subsidiary's cost assignments for each benefit. The Company should also include workpapers that show the derivation of the jurisdictional portion of each benefit cost. (Staff)
35. Direct the Company in the initial filing its next rate case to provide testimony that identifies and discusses each non-qualified employee benefit cost included in its test years. (Staff)
36. Direct the Company in the initial filing of its next rate case to include testimony identifying the basis used for its requested rate base impact related to pensions. Additional schedules should be included that reflect the underlying calculation of the qualified pension asset (or liability) balances requested for rate base inclusion. (Staff)
37. Direct the Company in the initial filing of its next rate case to include testimony providing historical summary and discussion of the basis used for its pension cost request for ratemaking in each case, starting with the rate case filed prior to the merger forming Xcel Energy, Inc., and for each case filed since the merger. The overview shall discuss both its electric and gas rate case filings. The Company's discussion shall include explanation of its rationale for changing the basis of test-year pension cost request from one case to the next. The Company shall also provide a comparison between the calculated financial pension cost amount (ACM/FAS 87) and actual cash contribution amounts, on a total company and jurisdictional basis, from 1992 to current year. (Staff)

(Note: These decision alternatives correspond to alternatives II, A (1 through 8) on pp. 1 through 11, on the deliberation outline.)

Record Citations:

Qualified Pension in General

Heuer Rebuttal, Ex. 90 at 17-20
Tyson Opening Statement, Ex. 116 at 2-3
Evidentiary Hearing Transcript, Vol. 1 at 105-107, 125-132 (Tyson)
Moeller Direct, Ex. 81 at 12-44
Schrubbe Rebuttal, Ex. 83 at 1-8
Evidentiary Hearing Transcript, Vol. 2 at 20 (Schrubbe)
Figoli Direct, Ex. 78 at 66-73
Wickes Rebuttal, Ex. 85 at 1-9
Campbell Direct, Ex. 429 at 99-119, 134-136, 171-173
Campbell Surrebuttal, Ex. 435 at 74-79, 88
Campbell Opening Statement, Ex. 450 at 4
Evidentiary Hearing Transcript, Vol. 5 at 21-22 (Campbell)

Qualified Pension Measurement Date

Heuer Rebuttal, Ex. 90 at 19-20
Schrubbe Rebuttal, Ex. 83 at 8-15
Tyson Rebuttal, Ex. 31 at 15-21
Campbell Direct, Ex. 429 at 120-124, 172
Campbell Surrebuttal, Ex. 435 at 87-89
Campbell Opening Statement, Ex. 450 at 5
Lusti Surrebuttal, Ex. 442 at 11-12
Department Initial Brief at 117-118

Qualified Pension Discount Rate Assumption

Moeller Direct, Ex. 81 at 80-92
Schrubbe Rebuttal, Ex. 83 at 39-47
Schrubbe Opening Statement, Ex. 126 at 2-3
Evidentiary Hearing Transcript, Vol. 2 at 21-22, 26-30 (Schrubbe)
Tyson Rebuttal, Ex. 31 at 21-23
Campbell Direct, Ex. 429 at 114-119, 171-172
Campbell Surrebuttal, Ex. 435 at 79-87
Campbell Opening Statement, Ex. 450 at 5-6
Evidentiary Hearing Transcript, Vol. 5 at 39-44, 56-57, 66-68, 69-71 (Campbell)
Lusti Surrebuttal, Ex. 442 at 11
Department Initial Brief at 97-108
Xcel Initial Brief at 64-68
Department Reply Brief at 23-29
Xcel Reply Brief at 53-61

Qualified Pension 2008 Market Loss

Moeller Direct, Ex. 81 at 18-64

Schrubbe Rebuttal, Ex. 83 at 15-29
Schrubbe Opening Statement, Ex. 126 at 1-2
Evidentiary Hearing Transcript, Vol. 2 at 18-20, 31-34 (Schrubbe)
Wickes Rebuttal, Ex. 85 at 9-11
Tyson Rebuttal, Ex. 31 at 17-20 and Schedule 1
Tyson Opening Statement, Ex. 116 at 2-3
Evidentiary Hearing Transcript, Vol. 1 at 105-107, 125-132 (Tyson)
Campbell Direct, Ex. 429 at 124-134, 172-173
Campbell Surrebuttal, Ex. 435 at 89-95
Campbell Opening Statement, Ex. 450 at 6-7
Evidentiary Hearing Transcript, Vol. 5 at 33-39, 64-65, 68 (Campbell)
Lusti Surrebuttal, Ex. 442 at 11
Department Initial Brief at 108-115
Xcel Initial Brief at 53-64
Department Reply Brief at 30-32
Xcel Reply Brief at 41-53

Alternative Proposals

Schrubbe Rebuttal, Ex. 83 at 30-39
Evidentiary Hearing Transcript, Vol. 2 at 29-30 (Schrubbe)
Campbell Surrebuttal, Ex. 435 at 95-102
Campbell Opening Statement, Ex. 450 at 7-8
Department Initial Brief at 115-117

Prepaid Pension Asset

Moeller Direct, Ex. 81 at 121-128
Campbell Surrebuttal, Ex. 435 at 101

Future Filing Requirement

Campbell Surrebuttal, Ex. 435 at 88-89
Tyson Opening Statement, Ex. 116 at 2
Department Initial Brief at 114

Non-Qualified Plans

Heuer Direct, Exh. 88 at 142
Heuer Rebuttal, Exh. 90 at 21
Moeller Direct, Exh. 81 at 12, 108-113
Figoli Direct, Exh. 78 at 73-76
Figoli Rebuttal, Exh. 80 at 13-17
Campbell Direct, Exh. 429 at 105-110, 136-145, 174
Campbell Surrebuttal, Exh. 435 at 12-14
Campbell Opening Statement, Exh. 450 at 1
Lusti Direct, Exh. 437 at 41
Lusti Surrebuttal, Exh. 442 at 11-12

Retiree Medical Expenses (FAS 106)

PUC Staff: Dorothy Morrissey

(Disputed amount is a \$1.592 million adjustment/reduction in revenue requirements.)

Statement of the Issue

What discount rate should be used to calculate the retiree medical benefit cost for ratemaking?
What amount of the 2008 Market Loss should be included in rates?

Introduction

Post-retirement (or retiree) medical benefits are provided to retired employees for health care costs such as medical, dental, and vision. The Company discontinued offering retiree medical benefits for all active employees more than ten years ago. The current expense for retiree medical benefits is a legacy of the prior programs. Retiree medical benefit expense has been decreasing each year primarily due the fact, as time passes, fewer and fewer employees are eligible for the benefit and because the 20-year amortization of the transition obligation ended in 2012.⁹²

Table 5

Retiree Medical Expense NSPM Electric	
Year	\$ Amount
2008	8,003,011
2009	7,386,811
2010	6,312,334
2011	5,682,156
2012	6,174,119
2013 Forecast	4,354,981
2014 Test Year (revised)	3,446,278

Nonetheless, Xcel recently undertook initiatives to further reduce retiree medical benefit costs, effective January 1, 2013, by transitioning certain benefit recipients, its Medicare-eligible beneficiaries, from the Company plan options to the individual market. That initiative reduced the Company's financial liability, administrative responsibility, and gave it the opportunity for significant cost savings for the retiree groups that still had premium subsidies.⁹³

Cost for retiree medical benefit is determined actuarially using Financial Accounting Standard No. 106 (FAS 106). This approach calculates a current valuation of future benefit payments by employing various assumptions including a discount rate that is based upon current bond market

⁹² Ex. 81 at 116; See Table 19 (Moeller Direct), with 2014 Test Year update to rebuttal revision, Ex. 83 at 61, Table 10 (Schrubbe Rebuttal)

⁹³ Ex. 78 at 78 (Figoli Direct)

yields, medical cost trends, mortality rates, etc. The FAS 106 cost components and their calculation are near-identical to the XES Plan pension accounting (FAS 87) with the exception of asset gain and loss amortizations technique⁹⁴. The Company's updated measurement of this cost produced a test year expense of \$3,446,278 from the use of an assumed discount rate of 4.82 percent and expected return on (post-retirement health care portfolio) assets of 7.25 percent for bargaining and 6.25 percent for non-bargaining employees.⁹⁵

There are two unresolved issues between the Company and the Department with respect to retiree medical expenses: 1) the discount rate point-of-reference to use to calculate the retiree medical benefit cost for ratemaking, and 2) the amount of the 2008 Market Loss to include in rates. The parties' contentions with these two retiree medical benefit issues echo the similarly disputed issues discussed within the Company's qualified pension costs section.

Department

The Department identified that a critical issue for ratemaking is whether assumptions used to estimate retiree medical costs were reasonable in order to ensure that the amount ratepayers pay in current rates for these future employee benefits are just and reasonable (a requirement of Minn. Stat. 216B.03). The Department emphasized that the ratemaking function to establish reasonable levels of expenses in rates differs from the utility's accounting/bookkeeping function (which is to reflect financial circumstances at a point in time based on requirements for financial reporting).

As a result of its review, the Department recommended three adjustments to the retiree medical recovery request (to be consistent with its qualified pension recommendations):

- Use a more current measurement date to calculate the test year cost (a \$653,714 reduction to O&M) – now resolved;
- Reduce the 2008 market loss inclusion by 50 percent (an \$88,500 reduction to O&M); and
- Set discount rate assumption to equal the weighted average⁹⁶ EROA of 7.11 percent when calculating retiree medical costs (a \$1,472,433 reduction to O&M).

Both the expensed (O&M) and the capitalized amounts of the Company's test-year retiree medical cost would be subject to an adjustment accordingly.

In rebuttal, the Company agreed to the Department's recommended use of an updated measurement. The Department's two remaining recommendations pertaining to the 2008 Market Loss and the discount rate assumption were not resolved. The Department referred to its qualified pension discussion for its reasoning behind these retiree medical expense recommendations.

⁹⁴ Unlike Xcel's FAS 87 gain/loss phase in approach, FAS 106 gains and losses are fully incorporated in year realized and amortized over the average years to retirement for active plan participants expected to receive benefits (approximately 10 years).

⁹⁵ Ex. 423, Schedule ACB-19, attachment A to revised DOC IR 1189 (Byrne Direct)

⁹⁶ The postretirement benefit asset fund consists of two portfolio asset allocations, one with a 6.25 percent EROA (non-bargaining) and one with a 7.25 percent EROA (bargaining). See Ex. 423 at 38 (Byrne Direct).

The following points briefly recap the Department's arguments with respect to a reduction to the 2008 Market Loss inclusion in qualified pension:

- The Department had raised concern that the Company may not have reasonably managed its pension fund and missed off-setting market upswing opportunities.
- The Department also noted that Xcel employees receive generous benefits for which they bear no costs (i.e., a pension as well as a 401(k) match), and questioned whether it was just and reasonable to require ratepayers to fully bear costs of these generous benefits.
- The Department advanced that its recommended reduction to the 2008 Market Loss included in current rates would be symmetrical with past treatment because when a pension surplus produced a negative pension expense in the past, pension cost for ratemaking was increased to \$0.
- The Department also noted the projected near-term convergence of pension fund assets with pension liability. This projected outcome incorporates the expected future fund contributions and anticipated investment growth. Given this observation, the Department recommended reducing the 2008 Market Loss amount to effect in a better pension cost in rates going forward.

The following points recap the Department's qualified pension arguments with respect to setting the discount rate equal to the EROA for ratemaking:

- The EROA is based upon a long-term perspective and covers the same time period that the discount rate does. It does not make sense to use different rates for the discount rate and EROA.
- Using a lower discount rate would artificially overstates pension expense for purposes of ratemaking and is therefore unreasonable.
- Equalizing the discount rate to the EROA is consistent with the ALJ's finding in Xcel's E-002/GR-12-961 case.
- Assumptions used for financial statements are short-term, point-in-time figures. This is unlike ratemaking which typically requires a longer term perspective that considers a broad range of factors and influences.
- Use of a discount rate equal to the EROA mirrors a pension funding approach described in a cited paper published in 2004.
- The Department reassured that neither pension funding requirements nor pensions paid to employees would change if the Commission used a different discount rate for ratemaking purposes, than that used for financial reporting.

Xcel

The Company agreed to use the updated December 31, 2013 measurement date as it is the most current for the 2014 test year. Acceptance of this adjustment reduced the requested retiree medical expense by \$653,714 and the capitalized portion of this cost by \$184,716, which collectively monetized is an overall revenue requirement reduction of \$667,000.^{97,98}

⁹⁷ Ex. 83 at 11, 61 (Schrubbe Rebuttal)

⁹⁸ Ex. 90 at 22 (Heuer Rebuttal)

However, Xcel disagreed with the Department's partial 2008 Market Loss exclusion and the changed discount rate assumption for same reasons stated in the qualified pension section on these issues.⁹⁹ The following points recap the Company's arguments:

- Xcel's XES Plan discount rate is supported because it is based on objective, verifiable data from bond-matching studies; is consistent with discount rates used by the majority of utilities; and the method to develop the FAS 87 discount rate has been used consistently by Xcel.
- XES Plan's discount rate value is representative of past interest rates over the last five years.
- The Department's recommendation would lead to an artificial liability gain.
- The Commission decision in Xcel's last rate case to use the EROA as the discount rate was expressly limited based on the record in that case. In more recent case decisions, the Commission approved a five-year average discount rate to address the point-in-time concern, and did not adopt the Department's recommendation to set the discount rate to the EROA.

ALJ

(ALJ Report, pp. 39-41; paragraphs 172 – 184)

183. Because the Company's FAS 106 retiree medical expenses are calculated in the same manner as the qualified pension expense under FAS 87, the 2008 Market Loss should be treated in the same manner for both expenses. For the reasons discussed above in the Quantified Pension Expense Section, the Administrative Law Judge concludes that the Company's proposed inclusion of the 2008 Market Loss is reasonable and consistent with the Company's long-standing practice of including both market gains and losses in its calculation of this expense.

184. Similarly, for the reasons set forth in Quantified Pension Expense Section above, the Administrative Law Judge concludes that it is not appropriate to increase the FAS 106 discount rate to match the EROAs for the bargaining and non-bargaining employee plans. Instead, the updated FAS 106 discount rate of 4.82 percent should be used in calculating retiree medical expenses for the 2014 test year.

Exceptions to the ALJ

Xcel

(Xcel Exceptions, p. 45)

Footnote 153 within the Xcel Exceptions concurred with the ALJ.

Department

None filed.

⁹⁹ Ibid. at 29, 47

Staff Comments

Market Loss

The Department relied on arguments made in its qualified pension expense testimony to execute similar adjustments to the retiree medical benefit cost calculation. However, unlike employee pension benefits, the Company has not been required to actively and currently fund its Minnesota jurisdictional retiree medical benefit obligations. Thus, the Company has minimal funds¹⁰⁰ set aside for jurisdictional benefit payments and because of this, two of the Department's four arguments to reduce the 2008 Market Loss stated in its qualified pension do not apply to retiree medical benefits.

First, the Department's argument that the asset fund will soon converge/exceed the benefit liability has not been shown to hold true with the retiree medical asset fund. Rather, the available information indicates differently. The reported \$5 million retiree medical asset fund¹⁰¹ is well below the \$54 million retiree medical liability¹⁰² and it does not appear these balances will soon converge because of Xcel Energy, Inc.'s practice of limiting its contribution amounts to match the current year's expected payments¹⁰³. Depositing funds equal to expected payments will not likely increase the retiree medical asset fund.

Second, the record lacks evidence that the argument, *adjusting the 2008 Market Loss promotes symmetrical treatment as executed in prior years*, holds true with respect to retiree medical benefit costs. Rather, without having conducted exhaustive research, in past rate cases it is more likely that this FAS 106 determined cost did not produce a negative expense, but always a positive expense for the following reasons:

- 1) with minimal funds set aside, the investment returns from a small portfolio would not likely have fully offset the annual expense;
- 2) the 1993 transition costs were actively being amortized over 20 years (through 2012) which increased the current years' accrued FAS 106 expense; and
- 3) prior to 1993, the Company used a pay-as-you-go (PAYGO) approach prior to its adoption of FAS 106 and it is not likely that PAYGO would have produced a negative expense.

Discount Rate

For the retiree medical benefit cost, Staff would have a similar concern with the "artificial" liability gain that would arise should the Commission change the point-of-reference (or benchmark) used for the discount rate. This concern was discussed in the qualified pension – Discount Rate Staff Comments section, thus will not be repeated here. However, should the Commission decide to adopt use of an EROA to set the discount rate, it could address the artificial liability gain by removing the initial artificial liability gain amount in the year this approach takes effect, when calculating the overall recoverable benefit cost.

¹⁰⁰ Ex. 423, Schedule ACB-17, Xcel's response to DOC IR 1188, part A.

¹⁰¹ Ex. 423, Schedule ACB-17, Xcel's response to DOC IR 1188, part A.

¹⁰² Ex. 14, Volume 4A, Tab P2-1, p. P2-1C.

¹⁰³ Ex. 81 (Moeller Direct) Schedule 12, p. 3, final note.

A concern raised by the Department in its pension discussions, the FAS 106 discount rate reflects a single point-in-time rate measurement, like the pension FAS 87 discount rate. Although neither of the parties' testimony discussed the alternative to use an average discount rate for retiree medical costs, the Department did advocate adopting a long-term perspective. If the Commission wants to address the point-in-time concerns, yet not change the source for the discount rate, it could consider use of an average discount rate. The historic FAS 106 discount rates used to calculate postretirement medical benefit costs did not appear in testimony. However, Xcel Energy, Inc.'s publically available 2013 and 2012 10-K Annual Reports (Note 9) disclose that the Company's historic FAS 106 discount rates used to determine postretirement benefit costs for the years 2010 - 2013 were as follows:

Table 6

2014 Rebuttal Update	2013	2012	2011	2010
4.82%	4.10%	5.00%	5.50%	6.00%

Staff calculated the 5-year average discount rate to be 5.08 percent.¹⁰⁴ A decision alternative to use this average discount rate is included by staff.

Downward Cost Trend in Rates and Future Filing Requirements

In light of the downward trend of retiree medical benefit costs, the Commission could recognize this trend by allowing a levelized cost recovery amount that incorporates this expected decline. One option is to allow in rates an amount that reflects the average of the annual projected expense over the expected rate life of this current case (Xcel expects a two-year rate case life¹⁰⁵) wherein the projected expense amounts subject to averaging are calculated using the Commission-approved assumptions.

Staff suggests three future case filing requirements for the Commission's consideration. First, require Xcel to include the actuarial reports of retiree medical and other postemployment benefits because the study is an underlying document to these projected benefit cost amounts. The decision alternative which captures this suggestion is presented in the qualified pension section. Second, benefit cost projections beyond the test-year may be helpful to review, and a decision alternative specific to require this information in Xcel's next case is available. Third, Staff would like the Company to specifically discuss the drivers of the FAS 106 cost component "amortization of net gain/loss" in its jurisdictional postretirement benefit plans. This component appeared to have a significant impact on the test-year cost request.¹⁰⁶ Therefore, a discussion explaining the drivers of the component may be informative.¹⁰⁷

¹⁰⁴ $(4.82 + 4.10 + 5.00 + 5.50 + 6.00) / 5 \text{ years} = 5.08$

¹⁰⁵ Ex. 88 at 142 (Heuer Direct)

¹⁰⁶ For the NSP-MN Plan, total company, \$4.812 million of \$6.163 million net cost is attributed to amortized net gain/loss, and Xcel identified \$0.177 million was jurisdictional 2008 Market Loss. Ex. 81, Schedule 12, p. 3 (Moeller Direct) and Ex. 423 at 41 (Byrne Direct)

¹⁰⁷ Ex. 81, Schedule 12, p. 3 (Moeller Direct)

Decision Alternatives

Retiree Medical 2008 Market Loss

1. Adopt the Department's recommendation and reduce the 2008 Market Loss amortized amount included in the retiree medical benefit cost by 50-percent; **or** (DOC)
2. Determine that the requested 2008 Market Loss amortized amount may be included in the calculated retiree medical benefit cost. (Xcel, ALJ)

Retiree Medical Discount Rate

3. Determine that the discount rate used to calculate retiree medical benefit costs for ratemaking purposes shall be set to equal 7.11 percent, the weighted average expected return on assets (EROA) of the postretirement benefit fund; **or** (DOC)
4. Determine that the discount rate used to calculate retiree medical benefit costs for ratemaking purposes shall be set to equal 4.82 percent, the FAS 106 based rate measured on December 31, 2013; **or** (Xcel, ALJ)
5. Determine that the discount rate used to calculate retiree medical benefit costs for ratemaking purposes shall be set to equal 5.08 percent, the five year average of the FAS 106 based discount rates. (Staff)

Optional Levelized Ratemaking

6. Approve the retiree medical benefit cost level in rates that is the calculated average of the annual projected benefit cost over the expected rate life (Xcel expects a two-year rate case life¹⁰⁸). Each year's projected cost amount subject to averaging is to be calculated using the Commission-approved assumptions and the most proximate measurement date applicable to each year. Direct the Company to provide schedules for each year's retiree medical benefit cost calculation within 10 days of the Commission's decision to assist in preparation of the Order. (Staff)

Optional Future Filing Requirement

7. Direct the Company in the initial filing of its next electric rate case to discuss the cost components of the postretirement benefits plans cost (other than pensions) affecting Minnesota rates, particularly the drivers of the amortization of net gain/loss amount and the reasons this component amount has varied since its last rate case (E-002/GR-13-868). (Staff)
8. Direct the Company in the initial filing of its next electric rate case to provide the report of future years' actuarial cost projections of the postretirement benefits (other than

¹⁰⁸ Ex. 88 at 142 (Heuer Direct)

pensions), clearly identifying the assumptions and measurement point used to develop these projections. (Staff)

(Note: These decision alternatives correspond to alternatives II, B (1 through 4) on pp. 11-13 on the deliberation outline.)

Record Citations:

FAS 106 – Measurement Date Update (2014)

Heuer Rebuttal, Ex. 90 at 21-22
Schrubbe Rebuttal, Ex. 83 at 8-11, 60
Byrne Direct, Ex. 423 at 40-41, 43
Byrne Surrebuttal, Ex. 427 at 11-12
Byrne Opening Statement, Ex. 449 at 1

FAS 106 – Discount Rate and 2008 Market Loss (2014)

Heuer Rebuttal, Ex. 90 at 21-22
Moeller Direct, Ex. 81 at 12, 114-117, 120-121
Schrubbe Rebuttal, Ex. 83 at 29, 47, 60
Figoli Direct, Ex. 78 at 77-78
Byrne Direct, Ex. 423 at 37-43
Byrne Surrebuttal, Ex. 427 at 12, 22-24, 28-29
Byrne Opening Statement, Ex. 449 at 1
Evidentiary Hearing Transcript, Vol. 5 at 10-13 (Byrne)
Lusti Direct, Ex. 437 at 20, 37
Lusti Surrebuttal, Ex. 442 at 8
Xcel Initial Brief at 59-68
Department Initial Brief at 54-60
Xcel Reply Brief at 41-61

Paid Leave / Total Labor (2014)

PUC Staff: Dorothy Morrissey

(Disputed amount is a \$5.6 million adjustment/reduction in revenue requirements.)

Statement of the Issue

Does the record show that total labor costs are reasonable?

Department

The Department initially took issue with the Paid Leave amount built into the test year when compared to the historical paid leave amounts experienced by Xcel and recommended a downward adjustment. In response to the Company's rebuttal, the Department agreed it should evaluate total labor costs, of which paid leave is a component, and changed the focus to reasonableness of Xcel's total labor cost test year request of \$419.4 million.¹⁰⁹

The Department noted that in 2013, the Company experienced abnormally high labor costs (a 12.2 percent increase over 2012 actuals) due in part to the longer-than-planned nuclear plant outages at Monticello and Prairie Island, and an unusually high number of storms in 2013. While Xcel estimates that its 2014 test-year total labor costs will be lower than 2013 actuals, Xcel's request is an increase from its 2012 actuals of 7.8 percent, which equates to an annualized (year over year) increase of 3.9 percent – nearly four percent. Generally, a total labor cost increase of two to three percent over the costs of a normal year is reasonable; therefore, the Department concluded that the Company had not shown that its test-year amount was reasonable.

The Department found that Xcel experienced a three percent increase in total labor costs from 2011 to 2012, thus believed a three percent increase year-over-year was reasonable to determine a normalized total labor level. Using this approach the Department calculated a normalized test year amount shown in table below:

Table 7

Total Labor Costs in \$(millions) for NSPM Electric

	2011 Actual	2012 Actual	DOC 2013 Normalized	DOC Revised 2014
Labor Costs	\$377.7	\$388.9	\$400.6	\$412.6
Year-to-Year Change		3% increase	3% increase	3% increase

Source: Ex. 86 (Stitt Direct) Schedule 3a and Ex. 87 (Stitt Rebuttal) page 6, Table 1.

From this analysis, the Department concluded Xcel's total labor cost of \$419.4 million was unreasonable and recommended a \$5.6 million jurisdictional adjustment to Xcel's 2014 test-year

¹⁰⁹ Ex. 435 at 71-74 (Campbell Surrebuttal)

total labor cost.¹¹⁰ The Department argued that the fact that positions of the parties appear to be close does not justify Xcel's additional 0.9 percentage points over the more reasonable three percent annual increase. Doubt goes to the ratepayer.

Xcel

Since it was in the Department's surrebuttal that the Department's recommended total labor cost adjustment emerged (from its initial labor-related paid leave cost concerns), the Company was unable to respond in testimony, therefore responded in evidentiary hearings and in briefs. The Company disagreed with the Department's proposed adjustment and referred to the evidence on the record that demonstrated the reasonableness of its test year labor costs. In its initial filing, the Company provided total labor costs.¹¹¹ Additionally, each Company core operations witness provided a discussion of their O&M budgets, including labor costs, and the cost trends and drivers of these budgets.¹¹² For instance:

Company witness Mr. Timothy J. O'Connor justified the need for the Company's labor costs within the Nuclear Business Area:

These cost increases have been primarily driven by the cost increases for our internal labor for three following reasons: (1) we have added employees to meet regulatory and safety requirements, (2) we have increased compensation in order to attract and retain in-house expertise, and (3) we have increased our overall headcount in order to drive the performance excellence that will allow for long-term efficiency and sustainability.¹¹³

Company witness Mr. David C. Harkness had identified the need for Xcel's labor spend within the Business Systems Business Area, identifying increases in headcount in the Business Systems area.¹¹⁴

Xcel briefed that no party challenged the reasonableness, prudence, or necessity of the Company incurring these costs, on an individual basis. Furthermore, in the evidentiary hearings, the Company established that the drivers of the Company's labor costs above the Department's proposed three percent cap were due to increases in total labor costs of the Company's Nuclear and Business Systems Business units and no party had questioned that fact.^{115,116} The Company stated that the Department's adjustment would result in the Company *not* recovering its representative labor costs.

¹¹⁰ (\$419.4 Xcel request, minus \$412.6 DOC recommended level) x 87.572% Minnesota jurisdictional allocator found in Ex. 86, Sch. 3(a), p. 1 (Stitt Direct) per Ex. 435 at 74 (Campbell Surrebuttal)

¹¹¹ Ex. 17, Initial Filing, Vol. 6, Schedules 3 and 4.

¹¹² Ex. 51, O'Connor Direct at 81:1-118:24; Ex. 62, Harkness Direct at 56:21-83:23; Ex. 58, Mills Direct at 7:20-40:8; Ex. 65, Kline Direct at 9:9-27:12; Ex. 69, Foss Direct at 6:7-27-5.

¹¹³ Ex. 51, O'Connor Direct at 83:1-6.

¹¹⁴ Ex. 62 at 76 (Harkness Direct)

¹¹⁵ Ex. 129, Stitt Opening Statement at p. 2

¹¹⁶ Tr. Vol. 2 at 40:1-25 (showing no cross examination of Ms. Stitt by any party).

ALJ

(ALJ Report, pp. 41-44; paragraphs 185 – 199)

199. Based on a review of the record, the Administrative Law Judge concludes that the Company has demonstrated that its total labor cost for the 2014 test year is reasonable. The Company provided detailed testimony supporting its test year amount, and demonstrated that virtually all of the labor costs above the Department's proposed three percent cap come from the Company's Nuclear Business area and its Business Systems area. The Department has not provided any evidence showing that these particular labor costs (or any other particular labor costs) could be reduced or are not reasonable. The Department's suggestion that the Company should be limited to a three percent increase fails to consider the specific facts driving the 2014 test year expense. For these reasons, the Company has shown its test year expense is reasonable and no adjustment is necessary.

Exceptions to the ALJ

No exceptions were filed by the Department. The Company supports the ALJ's recommendation.¹¹⁷

Staff Comments

Given that the Company's budgeted annual base salary increase is three percent,¹¹⁸ the Department's decision to apply a three percent year-over-year increase in total labor costs appears to be a reasonable gage of labor cost trend, assuming a consistent employee count (internal or contracted). However, a change in the employee count variable can impact future labor costs.

In response to the Department's adjustment, the Company referenced its direct testimony which included discussion of employee count increases most notably in the nuclear operations. In that division, the Company stated it is increasing its nuclear-related employee count by 156 persons from its 2012 complement, adding 100 positions in 2013 and another 56 in 2014, with no additional employee growth expected after 2014.¹¹⁹ Xcel explained that for its nuclear division, the increase in internal labor costs has not created a similar decrease in contractor and consulting costs because: 1) many of the positions are new positions or are currently unfilled positions; 2) the hiring and onboarding process is lengthy for these very highly skilled positions and results in some overlap of internal and external costs; and, 3) the implementation of Xcel's performance excellence plan has increased contractor costs in the test year. Other operating divisions also spoke to an increase in employee headcount.¹²⁰ Without an offsetting employee reduction

¹¹⁷ Xcel Exceptions, p. 49.

¹¹⁸ Ex. 78 at 25, 27 (Figoli Direct) Ex. 62 at 76 (Harkness Direct); Ex. 59 at 105 (Mills Direct); Ex 51 at 105 (O'Connor Direct)

¹¹⁹ Ex. 51 at 89, Table 11 (O'Connor Direct)

¹²⁰ Ex. 62 at 76, 80 (Harkness Direct); Ex. 69 at 17 (Foss Direct)

(internal or contracted) in other divisions, the Company's highlighted portion of the record appears to indicate an expected net growth in labor headcount. Although Xcel Energy, Inc. has common costs spread among several subsidiaries, such as the Business Systems area under XES, Inc., among its four regulated utility subsidiaries, Xcel has only two nuclear plants, both of which are solely part of the Northern States Power system.

Decision Alternatives

1. Adopt the ALJ's finding that the Company has shown its total labor test year cost is reasonable and no adjustment is necessary; **or** (Xcel, ALJ)
2. Adopt the Department's recommended \$5.6 million reduction to the Company's jurisdictional total labor test year cost. (DOC)

(Note: These decision alternatives correspond to alternatives II, C (1 and 2) on p. 13 of the deliberation outline.)

Record Citations:

Stitt Direct, Ex. 86 at 37-38
Stitt Rebuttal, Ex. 87 at 1-9
Stitt Opening Statement, Ex. 129 at 1-2
Campbell Direct, Ex. 429 at 95-98, 108-109, 171
Campbell Surrebuttal, Ex. 435 at 69-74
Campbell Opening Statement, Ex. 450 at 4
Evidentiary Hearing Transcript, Vol. 5 at 32-33 (Campbell)
Lusti Direct, Ex. 437 at 42
Lusti Surrebuttal, Ex. 442 at 33
Department Initial Brief at 157-161
Xcel Initial Brief at 69-73
Department Reply Brief at 49-50
Xcel Reply Brief at 61-63

Corporate Aviation Costs (2014)

PUC Staff: Dorothy Morrissey

Statement of the Issues

Should the Commission adopt the ALJ's recommendation and find that the Company has demonstrated it is reasonable to include \$954,425, or 50 percent of the approximately \$1.9 million the Company has budgeted in 2014 for corporate aviation costs on a Minnesota electric jurisdictional basis? Or, should the Commission adopt any or all the OAG's proposed adjustments which collectively would reduce test-year corporate aviation expense by \$920,000?

Background

From Xcel's last rate case, the Commission's Order ("12-961 Order"), issued September 3, 2013 in Docket No. E-002/GR-12-961 the Commission, ordering paragraph 48, stated:

In the initial filing of its next rate case, the Company shall include more detailed flight data reports (preferably in live Microsoft Excel electronic format) of its corporate jet trip logs for its most recent 12-month operational period. The report, by flight, must identify the charged employee, each employee passenger and his/her assigned operating company, the other passengers on flight and reason for use, and primary purpose for scheduling the flight. The Company shall include information for the calculation of the requested recovery amount of corporate aviation.

OAG

Upon its review, the OAG concluded that the round trip cost associated with corporate aviation well exceeds commercial flight costs. The OAG noted that the Company's requested Corporate Aviation expense recovery of \$954,000 was an increase of 26 percent compared to Xcel's last case. The OAG also questioned Xcel's fulfillment of the Commission's Order and Minnesota Statute¹²¹ requiring specific information to be filed in this case.

Cost Request

In testimony, the OAG raised three general concerns with Xcel's requested recovery of corporate aviation expenses. First, the cost-per-flight is excessive particularly since flights for Minnesota electric operations are mostly between Denver and the Twin Cities. Second, many of the specific flights recorded by NSP do not have a ratepayer benefit. Finally, many of the specific flights recorded by NSP fail to include a sufficient business purpose necessary to determine if those flights were necessary to provide utility service.

The average cost paid by Xcel per one-way passenger corporate flight is approximately \$1,589 or approximately \$3,178 round trip. Most of the corporate jet flights were between Denver and St. Paul. After Xcel's 50-percent reduction to corporate aviation cost, ratepayers are paying

¹²¹ Minn. Stat. § 216B.16 Subd. 17

approximately \$795 for all one-way flights attributable to NSP Minnesota electric (\$1,589 divided by 2). The OAG suggested that \$300 is a more reasonable cost for a one-way flight between Denver and Minneapolis. Adopting a recovery allowance of \$300 per flight would amount to approximately \$360,300 as the jurisdictional share of all of NSP's corporate jet flights (or about \$594,000 less than Xcel's requested \$954,000). This initial recommendation only addresses the reasonableness of total jurisdictional expense and does not address the review of specific flights for necessity and reasonableness.

The OAG reviewed the purpose of corporate flights to determine if the travel was associated with a ratepayer benefit.

First, the OAG identified three categories of flights that should be disallowed because they were not for ratepayer benefit: personal use, investor benefit, and aviation use. Presuming the Commission adopted the OAG's \$300 per flight recovery amount, disallowing recovery of these flight categories would result in the following additional reductions:

Table 8 – No Ratepayer Benefit

Category	Cost Reduction (\$300/flight)
Personal Use	\$3,518
Investor Benefit	\$8,892
Aviation Use	\$4,104

The OAG reasoned that personal use, by its very nature, has no business purpose and should be removed. Flights for investor relations or shareholder meetings are incurred for investors' benefit and should be removed. Flights for aviation use would not be incurred if Xcel used commercial aviation, therefore the cost should be removed.

Second, the OAG raised concerns about the quality of Xcel's reporting and identified several flight description reasons that were insufficient to justify cost recovery or to meet the Commission's directive that Xcel list the "primary purpose" for each flight. Specifically, the OAG concluded that the thousands of flights reporting business purpose as either "Business Area Travel," "Director Travel," "Manager Travel," or "Xcel Executive Business Travel" should be removed. Presuming the Commission adopted the OAG's \$300 per flight recovery amount, disallowing recovery of these flight categories would result in the following additional reductions:

Table 9 – Insufficient Descriptions

Flight Purpose Description	Cost Reduction (\$300/flight)
Business Area Travel	\$162,980
Director / Manager Travel	\$ 65,466
Xcel Executive Business Travel	\$ 81,197

From Evidentiary Hearings examination of witnesses, the OAG also raised a concern that Xcel has no systematic process to review the requests to schedule corporate flights, other than limiting

authority to vice president level and upward.¹²² The OAG believes Xcel's corporate aviation practices do not provide enough information to satisfy the Commission's Order from the 2012 rate case or the requirements established by Minnesota law. These practices shift decision-making power from the Commission to Xcel's employees because the Commission is unable to determine what the flights were for or whether they were reasonable and necessary for the provision of utility service. Therefore, the OAG recommended that the Commission disallow these above-listed corporate aircraft expenses.

Commission 12-961 Order

In its verification of the Commission 12-961 Order, the OAG stated that the required flight reports do not include the individual employee to whom the flight is "charged" or the primary purpose of scheduling the flight. The OAG indicated that Xcel's initial testimony explained that flights are not "charged" to individual employees, but rather total corporate aviation costs are allocated to each company "using a three-digit work order".¹²³ Xcel also explained that Xcel's flight logs do not list a primary purpose for the flight, but noted that a business purpose is listed for each passenger. The OAG averred that both the Commission's Order and the statutory reporting requirements (Minn. Stat. § 216B.16, subd. 17) make clear that utilities must provide a business purpose for travel expenses that demonstrates that the expenses were reasonable and necessary for the provision of utility service.¹²⁴ In the event a utility fails to meet statutory reporting requirements, the Commission "may not allow" the utility to recover the expenses.

Xcel

The 2014 allocated budget for the Minnesota electric jurisdiction includes approximately \$1.9 million of corporate aviation costs and the Company has included 50 percent, or approximately \$954,000, in the test year cost of service. Xcel indicated that the increased 2014 test year corporate aviation costs are due to an assumed increase in flight hours which leads to higher fuel, maintenance and fuel costs (26 percent more than in 2013).¹²⁵

In its past two electric rate cases, Xcel requested recovery of 50 percent of the total test year corporate aviation expenses and was allowed to recover the requested amount. Xcel pointed out that the Commission has approved the recovery of corporate aviation expenses in the range of 50 to 75 percent in other electric rate cases.¹²⁶ Xcel stated that the benefits of using corporate aviation services include travel expense savings, employee time savings, increased in-flight productivity, scheduling convenience, reduced stress and post-trip fatigue, and personal security. Xcel believes these benefits result in more efficient and cost-effective provision of utility service. The Company retained a third-party consultant to perform a cost-benefit analysis of its corporate aircraft usage.¹²⁷ On a total Company basis, Xcel asserted the cost-benefit analysis of this study concluded that on average, 68 percent of the Company's corporate aviation expenses from

¹²² OAG Initial Brief at 27.

¹²³ Ex. 75 at 31 (O'Hara Direct)

¹²⁴ OAG Initial Brief at 27.

¹²⁵ Ex. 77, Schedule 1 (O'Hara Rebuttal)

¹²⁶ Examples include Minnesota Power, Docket Nos. E-015/GR-08-415 and E-015/GR-09-1151, and Otter Tail Power Company, Docket No. E-017/GR-10-239.

¹²⁷ Ex. 75 or 76, Schedule 10 (O'Hara Direct)

January 2012 to June 2013 were justified compared to commercial air travel.¹²⁸ Therefore, Xcel believes requesting recovery of only 50 percent of aviation costs is reasonable and that its reduced cost recovery request takes into account many of the OAG concerns like personal travel and travel related to investor relations.

Xcel stated that the OAG does not take into account the benefits of corporate aviation services. Xcel contends that the premise of the OAG's analysis and exclusion of costs due to vague business purposes is not appropriate because, 1) a valid business purpose is a requirement for scheduling a Company aircraft, and 2) the Aviation Services' reservation system or flight logs are not designed to collect detailed descriptions (it is not part of the Company's employee expense reporting system) and furthermore, Xcel stated in rebuttal that the corporate aviation costs are not covered by the Employee Expense Statute¹²⁹. Later in reply briefs, Xcel appears to acknowledge corporate aviation is addressed by the statute, and contends it used its standard account reports to meet its obligations as permitted per the statute.¹³⁰ Xcel expressed willingness to explore potential technical improvements of current system and to report those findings in its next rate case if the Commission prefers.

The corporate aviation travel coded as Xcel Executive Business Travel, Director Travel, Manager Travel, or Business Area Travel in the flight logs represents the travel necessary for these employees to fulfill their job requirements. Xcel argued that, over a 12-month period, 90 percent of passengers were Service Company employees whose work benefits all operating companies. For travel coded as Investor Relations and Shareholder Meetings, Xcel argued it needs to cultivate investor relations in order to have access to publicly held debt and equity capital which are reasonable and necessary functions to conduct our day-to-day business. Moreover, Minnesota law requires Xcel Energy to organize an annual shareholders' meeting. The travel coded as Aviation Use is necessary to maintain the aircraft and to reposition crew members. Finally, Xcel stated Personal Travel use is rare and is typically spouses accompanying to promote the public image of the Company or to cultivate business relationships.¹³¹ Personal travel use occurred on 34 occasions, not 36 as identified by the OAG.¹³²

Addressing the OAG's concern that corporate flight scheduling lacks a systematic review process, Xcel contends that the authorized schedulers are high-ranking employees responsible for the overall management of the Company who are expected to comply with all Company policies and are also responsible for enforcing Company policies. Xcel believes this in itself is a strong control and a review of the flight logs shows that the overwhelming majority of flights on the corporate aircraft are between city pairs where the Company has operations.¹³³

¹²⁸ Ex. 75, Schedule 10, p. 18 (O'Hara Direct)

¹²⁹ Minn. Stat. § 216B.16, Subd. 17 Travel, entertainment, and related employee expenses.

¹³⁰ Xcel Reply Brief at 92.

¹³¹ Ex. 77 at 8 (O'Hara Rebuttal)

¹³² Ex. 77 at 8, Schedule 3 (O'Hara Rebuttal)

¹³³ Xcel Reply Brief at 95

ALJ

(ALJ Report, pp. 126-132; paragraphs 548 – 566)

558. Based on the record in this case, the Administrative Law Judge concludes that the Company has demonstrated that it is reasonable to include \$954,425, or 50 percent of the approximately \$1.9 million that the Company has budgeted in 2014 for corporate aviation costs on a Minnesota electric jurisdictional basis. The Company's request is based on a detailed analysis of its costs, and properly considers increased productivity and employee time savings.¹³⁴ The Company's request is also consistent with Commission precedent.¹³⁵

559. Further, the OAG's proposed adjustments to the Company's test year expense are not supported by the record (e.g. cost per flight) or are already covered by the 50 percent reduction in Minnesota jurisdictional aviation expenses (e.g. personal travel).

...

564. The Commission may want to consider whether more specific Business Purpose codes should be implemented by the Company for use in future rate cases. To the extent the Commission believes additional detail regarding the Business Purpose for each passenger trip should be provided in future rate case filings, the Administrative Law Judge respectfully recommends that the Commission specify the level of detail that must be provided and ensure that the Company has sufficient time to change its data systems to comply in a timely manner.

565. Finally, the Administrative Law Judge concludes that the Company has substantially complied with Order Point 48 in the 2013 Rate Case Order. In that Order, the Commission provided in relevant part:

In the initial filing of its next rate case, the Company shall include more detailed flight data reports (preferably in live Microsoft Excel electronic format) of its corporate jet trip logs for its most recent 12-month operational period. The report, by flight, must identify the charged employee, each employee passenger and his/her assigned operating company, the other passengers on flight and reason for use, and primary purpose for scheduling the flight. The Company shall include information for the calculation of the requested recovery amount of corporate aviation.

¹³⁴ Ex. 32 at 28-30, GJO-1, Schedule 9 (O'Hara Direct); Ex. 34 at 2-6 (O'Hara Rebuttal).

¹³⁵ See Docket E002-GR/10-961 (Northern States Power Company); Docket E002-GR/12-961 (Northern States Power Company); Docket No. E015/GR-08-415 (Minnesota Power); Docket No. E015/GR-09-1151 (Minnesota Power); Docket No. E017/GR-10-239 (Otter Tail Power Company).

Exceptions to the ALJ

Xcel

(Xcel Exceptions, p. 55)

Xcel agreed with the ALJ's findings.

OAG

(OAG Exceptions, pp. 7-15)

The OAG disagrees with several of the ALJ's conclusions and specifically takes exception to Findings 558, 559, 562, 563, 564, 565, and 566 because Xcel did not provide a valid business purpose for thousands of flights and for that reason has failed to comply with both Minnesota law and the Commission's direct order. Minnesota law requires Xcel to separately itemize all travel expenses, including travel expenses related to corporate aircraft, and to provide the "date of the expense, the amount of the expense, the vendor name, and the business purpose of the expense." Xcel has not met these requirements, and as a result of its failure, Xcel has made it impossible for any third party to review whether its corporate aviation expenses are reasonable. The flight logs purport to provide the "business purpose" of the flights, but even a cursory review makes clear that the information provided in the flight logs is insufficient to determine the actual purpose for many of Xcel's flights. A sample of what Xcel provided as business purpose follows:

Table 10

Line No.	Business Purpose
150	BAT-Business Area Travel
151	BAT-Business Area Travel
152	BAT-Business Area Travel
153	BAT-Business Area Travel
154	BAT-Business Area Travel
155	DIR-Director Travel
156	DIR-Director Travel
157	BAT-Business Area Travel
158	MGR-Manager Travel
159	DIR-Director Travel
160	BAT-Business Area Travel
161	BAT-Business Area Travel
162	DIR-Director Travel
163	BAT-Business Area Travel
164	PER-Personal Travel
165	BAT-Business Area Travel
166	CNF-Conference/Convention
167	EXE-Xcel Executive Business Travel
168	BAT-Business Area Travel
169	DIR-Director Travel
170	PER-Personal Travel

The “business purpose” in the flight logs provides information only about who was on the flight, rather than why the employee was on the flight, what the flight was for, or whether the flight was necessary for the provision of utility services. Xcel assumes, without any oversight or controls, that all of its flights are for a valid business purpose. Ratepayers require more than assurances; so does Minnesota law. Just because a flight was between Company locations does not mean that it is reasonable for ratepayers to pay for it.

The OAG recommends that Finding 558 be modified as follows:

558. Based on the record in this case, the ~~Administrative Law Judge Commission~~ concludes that the Company has not demonstrated that it is reasonable to include \$954,425, or 50 percent of the approximately \$1.9 million that the Company has budgeted in 2014 for corporate aviation costs on a Minnesota electric jurisdictional basis. ~~The Company’s request is based on a detailed analysis of its costs, and properly considers increased~~

~~productivity and employee time savings. The Company's request is also consistent with Commission precedent.~~

The OAG recommends that Finding 559 be deleted.

~~559. Further, the OAG's proposed adjustments to the Company's test year expense are not supported by the record (e.g. cost per flight) or are already covered by the 50 percent reduction in Minnesota jurisdictional aviation expenses (e.g. personal travel).~~

The OAG recommends that Finding 562 be deleted and replaced with the following language:

~~562. Third, the record supports recovery for travel coded as: Executive Business Travel; Director Travel; Manager Travel; or Business Area Travel. The OAG argued that these Business Purpose descriptions, which account for about 86 percent of all passenger trips from September 2012 to August 2013, are insufficient to demonstrate that this travel is needed to provide utility service. The OAG maintains the descriptions are vague and not subject to internal review. The record, however, shows that flights on Company aircraft can only be scheduled for valid business reasons. In addition, approximately 97 percent of all corporate aircraft flights from September 2012 to August 2013 were between Company locations. These facts confirm that the flights coded as Executive Business Travel, Director Travel, Manager Travel and Business Area Travel were taken for valid business purposes.~~

562. Minnesota law requires Xcel to provide information about the "business purpose" of each flight before recovery is permissible. Xcel did not meet this requirement because the "business purpose" descriptions in Xcel's flight log do not provide any information to determine the true business purpose of the flights. Moreover, the testimony of Xcel's employees demonstrates that Xcel has no oversight ensuring that flights are for a valid purpose. Because Xcel has not demonstrated that the flights coded as Executive Business Travel, Director Travel, Manager Travel and Business Area Travel have a "business purpose" that indicates they are necessary for the provision of utility service, they must be disallowed.

The OAG recommends that Finding 563 be deleted.

~~563. Furthermore, the Commission has previously approved corporate aviation expenses for NSP and other utilities without~~

~~requiring the level of detail sought by the OAG. While the Commission did require the Company to provide certain flight log information with its initial filing in this rate case, the Commission's Order did not require the level of detail regarding the passenger's Business Purpose that the OAG argues should be required. Moreover, because the Commission's Order was issued in September 2013 and the Company made its filing initial filing [sic] in this rate case in November 2013, the Company did not have time to change its software to include the level of detail sought by the OAG for the applicable time period—flight logs from September 2012 to August 2013. Thus, while the Company could improve the level of detail in its Business Purpose descriptions, the Administrative Law judge concludes that the Company has provided sufficient evidence in this case to demonstrate that flights for Executive Business Travel, Director Travel, Manager Travel and Business Area Travel are reasonable and necessary for the provision of utility service.~~

The OAG recommends that Finding 564 be modified as follows:

564. The Commission orders the Company to provide more detailed information about the business purpose of its flights may want to consider whether more specific Business Purpose codes should be implemented by the Company for use in future rate cases. To the extent that the Commission believes additional detail regarding the Business Purpose for each passenger trip should be provided in future rate case filings, the The Administrative Law Judge respectfully recommends that the Commission specify the level of detail that must be provided, and ensure that the Company has sufficient time to change its data systems to comply in a timely manner. The Commission also orders the Company to create internal systems to review flight requests so that flights are only scheduled for reasons that are necessary for the provision of utility service. The Commission further orders the Company to keep accurate records of the actual business purpose for flights that are scheduled, rather than reducing all flights to a generic "code."

The OAG recommends that Finding 565 be deleted.

~~565. Finally, the Administrative Law Judge concludes that the Company has substantially complied with Order Point 48 in the 2013 Rate Case Order [sic]. In that Order, the Commission provided in relevant part:~~

~~In the initial filing of its next rate case, the Company shall include more detailed flight data reports (preferably in line~~

Microsoft Excel electronic format) of its corporate jet trip logs for its most recent 12-month operational period. The report, by flight, must identify the charged employee, each employee passenger and his/her assigned operating company, the other passengers on flight and reason for use, and primary purpose for scheduling the flight. The Company shall include information for the calculation of the requested recovery amount of corporate aviation.

The OAG recommends that Finding 566 be deleted.

566. As discussed above, the Company provided flight reports in live Microsoft Excel electronic format with its November 2013 initial filing in this rate case. The reports cover the 12-month period from September 1, 2012 to August 31, 2013. The reports include all of the information required by Order Point 48 except the data on the individual employee to whom the flight is “charged” and “the primary purpose for scheduling the flight.” The Company explained that it did not include this data because the Company’s software does not track these two categories of data. The Company also stated that flights are not charged to individual employees, but rather total corporate aviation costs are allocated to NSP and all other affiliates using a three-digit work order number. In addition, with regard to the primary purpose of the flight, the flight logs do include a “Business Purpose” for each passenger as discussed above. In sum, the Company complied with Order Point 48 to the best of its ability given the timing of the initial filing in this rate case.

Staff Comments

The Commission is tasked with determining whether Xcel’s requested corporate aviation costs are reasonable. Xcel included a study of corporate aviation benefits (Aviation Study) conducted by a third party to validate its position. In this study, employee time savings are used in the cost benefit analysis to support the requested amount of corporate aviation costs. The Commission may want to consider whether it agrees with the way employee time savings have been taken into account in Xcel’s Aviation Study.

The Aviation Study evaluated not only travel expenses but also focused on quantifying the following claimed corporate aviation benefits: employee time savings and increased productivity during transportation and wait time.¹³⁶ Over 70 percent of Xcel’s corporate aviation flights have been between Denver and St. Paul and the study provided an analysis of costs for air travel between these two cities.

¹³⁶ Ex. 75, Schedule 10, p. 3 (O’Hara Direct)

The Aviation Study included research to capture and quantify the value of employees' time using a measurement called: "Value per Man-Hour." The Value per Man-Hour (VMH) is a quantification of what the individual adds to the value of a company. The VMH is expressed as a factor of one's salary. Xcel's Aviation Study used a VMH value of two and used an average compensation based on passenger mix.¹³⁷ For example, if the average employee-passengers' hourly wages, benefits and incentives is determined to be \$125 per hour, the VMH in this Study would be \$250. When the employee travels and incurs three hours of nonproductive travel time, then the total *lost* Value per Man-Hour would be shown as \$750 in this Study. This loss adds to the overall cost of travel because \$750 of revenue typically generated (or costs saved) by the average employee-passenger is forgone while they travelled.¹³⁸

Staff has included some of the analysis from the Aviation Study in Table 11 (below). Staff created Column B to reflect only 50 percent of the study's stated corporate aviation cost to align with Xcel's requested recovery. Staff also created Column D to calculate the cost difference between travelling by corporate aviation (at 50 percent) and travelling commercially. For travel from Denver to Minneapolis, Column D shows that the cumulative difference in flight/employee costs is \$113.53 more per passenger using corporate aviation at 50 percent of its flight cost. For travel from Minneapolis to Denver, Column D shows that the cumulative difference in flight/employee costs is \$28.97 more per passenger using corporate aviation at 50 percent of its flight cost. These excess amounts (\$113.53 + \$28.97) over commercial travel represent about five percent of the *adjusted* corporate aviation costs (\$1,413.76 + \$1,380.54).

¹³⁷ Ex. 77 at 4 (O'Hara Rebuttal). Staff found that Minnesota Department of Transportation discusses advantages of its private aircraft use and contends that the value of employee time, using a base salary multiplier of 2 could easily be defended. <http://dotapp7.dot.state.mn.us/flyordrive/about.vm> (accessed February 25, 2015).

¹³⁸ Another viewpoint could observe that \$375 of actual wage/benefit costs were incurred (3 hours X \$125/hr.) on behalf of the employee's time, in addition to the travel expenses.

Table 11

2013 Xcel Corporate Aviation Study				
Cost for one way trip Per Person				
Denver to Minneapolis				
	Corporate		Commercial	Cost Difference
	Total Aviation \$	50% Aviation \$		
	A	B	C	D = B - C
Travel En Route	\$ 1,677.38	\$ 838.69	\$ 100.71	\$ 737.98
Lost Value per Man-Hour	\$ 575.07	\$ 575.07	\$1,199.52	\$ (624.45)
Total	\$ 2,252.45	\$ 1,413.76	\$1,300.23	\$ 113.53
Source: Exhibit 75 (O'Hara Direct) Schedule 10, page 17				
Minneapolis To Denver				
	Corporate		Commercial	Cost Difference
	Total Aviation \$	50% Aviation \$		
	A	B	C	D = B - C
Travel En Route	\$ 1,624.89	\$ 812.45	\$ 95.00	\$ 717.45
Lost Value per Man-Hour	\$ 568.09	\$ 568.09	\$1,256.57	\$ (688.48)
Total	\$ 2,192.98	\$ 1,380.54	\$1,351.57	\$ 28.97
Source: Exhibit 75 (O'Hara Direct) Schedule 10, page 20				

For travel between Denver and St. Paul, the Aviation Study determined corporate aviation door-to-door travel time is about 2 hours shorter than commercial travel and indicated that employees spend more in-flight time on productive work when using corporate aviation than on commercial flights. Therefore, as shown in Table 11, there is less lost VMH when using corporate aviation as compared to commercial service.

If the Commission accepts the argument for inclusion of employee time savings as support for allowing corporate aviation cost recovery, it could either determine the requested recovery amount is reasonable, or adjust the request downward (for example, by five percent) to equal the overall commercial costs (including VMH), as reported in the study.

If the Commission does not accept the inclusion of employee time savings as a reasonable rationale to allow the requested corporate aviation costs, then it could adopt the OAG's recommended adjustment to align the cost of flights to its estimated commercial fare costs.¹³⁹

The ALJ Finding No. 561 (inserted below) concluded that the Company's 50 percent reduction in effect included eliminating costs of flights that do not benefit ratepayers. However, this may not be the case. First, using the Aviation Study, Table 11 shows that after the 50 percent reduction of corporate aviation costs, the adjusted total cost of corporate aviation aligns closer to the total cost of commercial air travel when incorporating lost VMH costs. Given this observation that the reduction achieves a near match to commercial travel costs, crediting the reduction to that purpose then would not necessarily encompass any cost adjustment for flights that should be removed due to the lack of ratepayer benefit. Therefore, the Commission may want to consider the specific OAG recommendations that pertain to disallowing recovery of certain flights. Furthermore, though the ALJ acknowledged Xcel's statement that 10 percent of corporate aviation is initially allocated to the holding company, it is not unusual that a holding company costs are then charged back to its operating subsidiaries.

ALJ Finding No. 561 reads

561. Second, with regard to the OAG's suggestion that the Company's test year corporate aviation expense be reduced to account for costs that do not benefit ratepayers, the Administrative Law Judge concludes the Company's proposal to include only 50 percent of its total Minnesota jurisdictional aviation expense in the test year in effect excludes such costs. More specifically, flights for personal travel, shareholder meetings, investor relations, and aviation uses—the categories that the OAG asserted do not benefit ratepayers—together account for only 4.6 percent of all annual flights. Even if one accepts the OAG's view that none of these uses benefit ratepayers, the record does not support making an adjustment to exclude these uses as recommended by the OAG because the Company's test year expense already excludes 50 percent of the corporate aviation costs allocated to the Minnesota electric jurisdiction. In addition, about 10 percent of corporate aviation costs are allocated to Xcel Energy Inc., the holding company. Therefore, it is reasonable to conclude that the costs for the flights that the OAG alleges do not benefit ratepayers are already excluded either through the 50 percent reduction in 2014 Minnesota jurisdictional expense or through allocation to Xcel Energy Inc. Thus, no further adjustment is needed to account for purposes that do not benefit ratepayers.

In Table 12, the OAG's recommendations are listed along with each adjustment's financial impact under the two headings, "OAG" and "Xcel". "OAG" column illustrates adjustments should the Commission adopt a \$300 per flight cost limit. The "Xcel" columns illustrate adjustments should the Commission accept that Xcel's 50-percent corporate aviation cost, inclusive of lost VMH, is a reasonable starting point.

¹³⁹ In February 2015, Staff limited research verified that cost of first class seats, for mid-week flights between Denver and Minneapolis, scheduled 7+ days in advance cost \$500 roundtrip, and cost \$900 roundtrip if booked 3 days in advance.

Table 12

MN Jurisdiction Electric							
Corporate Aviation Cost Allocation:	32.57%						
	A	B	C		D	E	
			OAG		Xcel		
	Flight Count						
	Total Co.	Jur. Alloc.			Jur. Alloc.	Request 50%	
Recovery Amount Per One Way Flight:				\$300	\$1,588	\$795	
1	3,688	1,201.2		\$360,300	\$1,908,851	\$ 954,426	
Additional OAG Adjustments							
Disallow recovery of following purposes:							
2A	Personal Use (OAG)	36	11.7	\$ 3,518	\$ 18,648	\$ 9,324	
2B	Personal Use (Xcel)	34	11.1	\$ 3,322	\$ 17,612	\$ 8,806	
3	Investor Relations/Shareholder Mtg	91	29.6	\$ 8,892	\$ 47,138	\$ 23,569	
4	Aviation Use	42	13.7	\$ 4,104	\$ 21,756	\$ 10,878	
5	Business Area Travel	1,668	543.3	\$162,980	\$ 864,024	\$ 432,012	
6	Director/Manager Travel*	670	218.2	\$ 65,466	\$ 347,060	\$ 173,530	
7	Xcel Executive Business Travel	831	270.7	\$ 81,197	\$ 430,458	\$ 215,229	
	OAG Recommended Recovery	350	114	\$ 34,143	\$ 179,767	\$ 89,884	
	(line 1 minus lines 2A, 3-7)						
	* - Director Travel flight count totals 615; Manager Travel flight count totals 55.						

Decision alternatives for each adjustment are available for the Commission's consideration.

Satisfaction of Commission 12-961 Order

The Commission Order requesting identification of the "individual charged" requirement and "primary purpose for scheduling the flight" was based upon travel policy document provided by the Company. For corporate air travel, the policy states:

"Open seats on scheduled flights are available to any employee traveling for business at no charge to the business area. Reservations for open seats are made on a first-come-first-serve basis."¹⁴⁰

In an information request (IR), the Company provided additional information that stated:

"In 2008, the passenger charge process was ended and all cost for aircraft operation were directly charged through the [affiliate companies] allocation process."¹⁴¹

¹⁴⁰ Ex. 75, Schedule 2, p. 15 (O'Hara Direct)

¹⁴¹ Ex. 75, Schedule 11, p. 2 (O'Hara Direct)

The OAG conducted a review of this Commission requirement. However, Staff believes that Xcel's response in the IR clarified that "individual charged" predated the 2008 changes to the aviation cost allocation method, thus has resolved that aspect of the Commission's 12-961 Order Point No. 48. Further, Staff believes the Commission's intention behind requiring Xcel to report "primary business purpose" in its 12-961 Order was to allow for the evaluation of cost allocations in the event business divisions associated with the passengers were "not charged". Since, the information pursued was based upon an outdated cost allocation policy (pre-2008), Staff believes Xcel's clarification for "individual charged" serves to satisfy the underlying intent of the Commission request for "primary business purpose". The Company could review its existing travel policy document to verify that the 2008 aviation charge revisions are clear. However, the OAG's argument that reported information was insufficient to meet statutory requirements may be addressed separately.

Minnesota Statute § 216B.16 Subd. 17.

(Reproduction of the statute is not included in the briefing paper.)

The Minnesota Statute § 216B.16, subdivision 17 was added and enacted by legislature in May 2010 (2010 c 328 s 2). Since its enactment, Xcel has filed three electric cases (2010, 2012 and 2013). This may be the first case in which Xcel's corporate aviation flight logs have been examined since the statute's enactment, and in doing so, it brings forth for the first time the assessment of the Company's aviation system. Xcel stated that the corporate aviation scheduling system is separate from its other employee travel and expense reporting systems. Xcel pointed out that the statute requirement allows for the utility to use its standard accounting reports and that it has done so. Xcel expressed willingness to evaluate its existing aviation system and explore enhancements. The OAG believes that Xcel's report does not adequately meet the statutory requirements to disclose the "business purpose of the expense" and for that reason it was unable to determine if those flights were reasonable and necessary for the provision of utility service; therefore, the Commission should disallow the flights with stated business purpose as "Xcel Executive Business Travel", "Director Travel", "Manager Travel", or "Business Area Travel" that the OAG has identified. The recommended adjustment amounts are listed on lines 5 - 7 in Table 12 (above).

ALJ Findings 563 and 564 (below) speak to the Commission's 12-961 Order and case evidence. The ALJ Report does not give an opinion on the application of this statute.

563. Furthermore, the Commission has previously approved corporate aviation expenses for NSP and other utilities without requiring the level of detail sought by the OAG. While the Commission did require the Company to provide certain flight log information with its initial filing in this rate case, the Commission's Order did not require the level of detail regarding the passenger's Business Purpose that the OAG argues should be required. Moreover, because the Commission's Order was issued in September 2013 and the Company made its filing initial filing in this rate case in November 2013, the Company did not have time to change its software to include the level of detail sought by the OAG for the applicable time period – flight logs from September 2012 to August 2013. Thus, while the Company could improve the level of detail in its Business Purpose descriptions, the Administrative Law Judge concludes that the Company has provided

sufficient evidence in this case to demonstrate that flights for Executive Business Travel, Director Travel, Manager Travel and Business Area Travel are reasonable and necessary for the provision of utility service.

564. The Commission may want to consider whether more specific Business Purpose codes should be implemented by the Company for use in future rate cases. To the extent the Commission believes additional detail regarding the Business Purpose for each passenger trip should be provided in future rate case filings, the Administrative Law Judge respectfully recommends that the Commission specify the level of detail that must be provided and ensure that the Company has sufficient time to change its data systems to comply in a timely manner.

Although, the Commission has permitted recovery of 50 percent of corporate aviation costs in Xcel's prior two electric cases, in this case the OAG undertook a more in depth review of these flights, and included more information on the record than in the past two rate cases. The OAG has stated that the information Xcel provided from its aviation reporting system does not meet statutory requirements because it was unable to verify from that information if the flights were reasonable and necessary for the provision of utility service. Xcel stated it is willing to enhance the aviation reporting system, yet, the statute has been in place for several years. According to the statute, a utility must provide the business purpose of the expense, among other data, to assist the commission in its evaluation.

ALJ Report Modifications

The following provides Staff comments on the OAG recommended modifications to the ALJ Report.

ALJ Finding 558 (modify): If the Commission accepts any one of the OAG monetary adjustments, then adopt the OAG's recommended modification.

ALJ Finding 559 (delete): If the Commission decides that any one of the flight categories described as personal, investor relations or aviation services, is not covered by Xcel's 50-percent reduction, then adopt the OAG recommended deletion.

ALJ Finding 562 (delete/replace): If the Commission decides a flight business purpose description was insufficient for third party to ascertain whether it was reasonable or necessary expense for provision of utility service, then consider adopting the OAG's revisions.

ALJ Finding 563 (delete): If the Commission finds the business purpose detail did not meet statutory requirements, then adopt the OAG's recommended deletion.

ALJ Finding 564 (modify): Optional. However, should the Commission deny recovery based on insufficient business purpose description, it may need to modify this finding to make clear the utility's request for recovery in future cases will be dependent upon reporting improvements.

ALJ Finding 565 (delete): Staff disagrees with this deletion request because it believes Xcel's clarifying information was responsive to the intent of the Commission's 12-961 Order.

ALJ Finding 566 (delete): Staff disagrees with the bulk of the suggested sentence strikeouts. Most sentences are record facts. However, if the Commission decides the reported flight business purpose was insufficient, Staff would suggest striking the second to last sentence, which reads, "In addition, with regard to the primary purpose of the flight, the flight logs do include a 'Business Purpose' for each passenger as discussed above."

Decision Alternatives

1. Determine that the Company's recovery request of 50-percent of its jurisdictional corporate aviation costs is reasonable, subject to other Commission decided adjustments; (Xcel, ALJ) **or**
2. Determine that a corporate aviation flight cost recovery limit of \$300 per one-way trip is reasonable, subject to other Commission decided adjustments. (OAG)
3. Determine that the Company's 50-percent cost reduction to the jurisdictional corporate aviation costs captures the removal of flight costs that were incurred for reasons other than the provision of utility service; **or** (Xcel, ALJ)
4. Determine that the Company's 50-percent cost reduction to the jurisdictional corporate aviation costs does not capture the removal of flight costs that were incurred for reasons other than for the provision of utility service and the Commission shall strike ALJ Finding 559. The Commission finds that corporate aviation costs shall be further adjusted by the cost of flights categorized by the following business purpose reasons (Table 12): (OAG)
 - A. Personal Travel (36 total company flights); **or** (OAG)
 - B. Personal Travel (34 total company flights); (Xcel corrected number)
 - C. Investor Relations/Shareholder Meetings (91 total company flights); (OAG)
 - D. Aviation Use (42 total company flights). (OAG)
5. Determine that the following reported corporate flight travel business purposes are insufficient and do not permit the Commission to determine if the expense was reasonably and necessarily incurred for the provision of utility service, therefore fails to meet the requirements of Minnesota Statute § 216B.16 Subd. 17: (OAG)
 - A. Business Area Travel;
 - B. Director Travel;
 - C. Manager Travel;
 - D. Xcel Executive Business Travel.

And

6. Strike ALJ Findings 562 and 563 and replace ALJ Finding 562 to read: (OAG)

562. Minnesota law requires Xcel to provide information about

the “business purpose” of each flight before recovery is permissible. Xcel did not meet this requirement because the “business purpose” descriptions in Xcel’s flight log do not provide any information to determine the true business purpose of the flights. Moreover, the testimony of Xcel’s employees demonstrates that Xcel has no oversight ensuring that flights are for a valid purpose. Because Xcel has not demonstrated that the flights coded as Executive Business Travel, Director Travel, Manager Travel and Business Area Travel have a “business purpose” that indicates they are necessary for the provision of utility service, they must be disallowed.

7. Require the Company to adjust the corporate aviation costs further by the cost of flights for each flight with the stated description (Table 12) : (OAG)
 - A. Business Area Travel (1,668 total company flights);
 - B. Director Travel (615 total company flights);
 - C. Manager Travel (55 total company flights);
 - D. Xcel Executive Business Travel (831 total company flights).

8. Modify ALJ Finding 564 to read: (OAG)

564. The Commission orders the Company to provide more detailed information about the business purpose of its flights ~~may want to consider whether more specific Business Purpose codes should be implemented by the Company for use in future rate cases. To the extent that the Commission believes additional detail regarding the Business Purpose for each passenger trip should be provided in future rate case filings, the~~ The Administrative Law Judge respectfully recommends that the Commission specify the level of detail that must be provided, ~~and ensure that the Company has sufficient time to change its data systems to comply in a timely manner.~~ The Commission also orders the Company to create internal systems to review flight requests so that flights are only scheduled for reasons that are necessary for the provision of utility service. The Commission further orders the Company to keep accurate records of the actual business purpose for flights that are scheduled, rather than reducing all flights to a generic “code.”

9. Determine that the Company substantially complied with and has resolved Order Point 48 from the Commission Order issued September 3, 2013 in Docket No. E-002/GR-12-961; **or** (Xcel, ALJ)

10. Determine that the Company did not satisfactorily comply with Order Point 48 from the Commission Order issued September 3, 2013 in Docket No. E-002/GR-12-961 and that ALJ Findings 565 and 566 shall be stricken. (OAG)
11. Direct the Company to ensure that its travel policy document clearly reflects the current corporate aviation cost allocation process. (Staff)
12. Modify ALJ Finding 558, in order to reflect that the Commission adjusted the Company's requested corporate aviation amount, to read: (OAG)

558. Based on the record in this case, the ~~Administrative Law Judge-Commission~~ concludes that the Company has not demonstrated that it is reasonable to include \$954,425, or 50 percent of the approximately \$1.9 million that the Company has budgeted in 2014 for corporate aviation costs on a Minnesota electric jurisdictional basis. ~~The Company's request is based on a detailed analysis of its costs, and properly considers increased productivity and employee time savings. The Company's request is also consistent with Commission precedent.~~

(Note: These decision alternatives correspond to alternatives II, D (1 through 12) on pp. 13-15 on the deliberation outline.)

Record Citations:

O'Hara Direct, Ex. 75 at 28-32
O'Hara Rebuttal, Ex. 77 at 1-12
O'Hara Opening Statement, Ex. 124 at 1-2
Evidentiary Hearing Transcript, Vol. 1 at 250-251, 253-257 (O'Hara)
Lindell Direct, Ex. 370 at 47-58
OAG Initial Brief at 22-28
Xcel Initial Brief at 108-110
OAG Reply Brief at 1-3
Xcel Reply Brief at 90-95

Pleasant Valley and Border Winds – 2015 Step

PUC Staff: Dorothy Morrissey

Statement of the Issue

Should recovery of the Pleasant Valley and Border Wind Projects occur through base rates or through the Renewable Energy Standard (RES) Rider?

Introduction

Xcel expects to place two new wind facilities in service in 2015. The Pleasant Valley project is a 200 MW wind farm to be located near Austin, Minnesota.¹⁴² Border Winds is a 150 MW wind farm to be located in northeastern Rolette County, North Dakota.¹⁴³ Both facilities are being developed and constructed by RES Americas and once construction is complete, RES Americas will transfer ownership and operating responsibilities to Xcel Energy. Project development is on schedule to meet a late-2015 anticipated transaction closing and facilities in-service date. The impact of these two new facilities in Xcel's 2015 Step increases base rates revenue requirement by \$23.177 million (over the 2014 revenue requirements).¹⁴⁴ Three intervenors' addressed this issue.

Parties are in agreement that these wind facilities could alternatively be recovered through the renewable energy standards rider under the statutes (Minn. Stat. § 216B.1691; Minn. Stat. § 216B.1645, Subd. 2a).

Department

The Department initially recommended a 2015 Step rate base adjustment (reduction of \$5.96 million) to limit the project cost to the Commission-approved amounts but later withdrew this recommendation upon verification of Xcel's rebuttal explanation and support that the noted discrepancy was primarily due to Allowance for Funds Used During Construction (AFUDC) – capitalized financing costs.¹⁴⁵

The Department also recommended that the expected Production Tax Credits (PTCs) associated with operation of these new wind facilities in 2015 should be included in base rates similar to treatment of Xcel's existing wind facilities. Inclusion of the expected PTCs would effectively reduce Xcel's 2015 jurisdictional revenue requirement by \$11.903 million.¹⁴⁶ Recognizing that PTCs vary with wind generation output, the Department recommended continued use of the Renewable Energy Statute (RES) rider to true-up all PTCs. The Company agreed to these Department recommendations.¹⁴⁷

¹⁴² Docket No. E-002/M-13-603

¹⁴³ Docket No. E-002/M-13-716

¹⁴⁴ Ex. 95 at 3, See Table 4 (Robinson Direct)

¹⁴⁵ The Department had discovered a discrepancy in the Pleasant Valley and Border Wind Projects' costs shown in the 2015 Step and the Commission-approved amount (Docket Nos. E002/M-13-603 and E002/M-13-716, respectively).

¹⁴⁶ Ex. 451, DVL-EH-24, column (c) (Lusti Opening Statement); Ex. 442 at 38 (Lusti Surrebuttal)

¹⁴⁷ Ex. 26 at 20 (Sparby Rebuttal)

With regard to project recovery approach, the Department favors rate case (rate base inclusion) treatment in the 2015 Step, determined using the usual average of beginning and end of year project balances method for purposes of rate cases. The Department's preference is based on, 1) the likelihood that the facilities will be placed in service in 2015, 2) the multi-year capital projects not placed in service should result in refunds to customers, 3) Xcel's agreement to reflect 2015 estimated PTCs in base rates, and 4) base rate recovery treatment aligns with the Commission's desire to minimize use of riders. Nonetheless, the Department would not oppose RES Rider recovery recommended by the MCC, if that is the Commission's preference.¹⁴⁸

Minnesota Chamber of Commerce (MCC or Chamber)

The MCC expressed concern that the new wind projects may not be placed in service during this multi-year rate plan because the expected in service date is late 2015. Unforeseen circumstances could give rise to project delays and it would not be reasonable for Xcel to get cost recovery for projects that are not used and useful, nor have demonstrated output. Experience with the Company's Monticello and Sherco 3 facilities highlight the reality that delays can and do occur.

The MCC acknowledged that Xcel Witness Clark identified an approach for projects included in a multi-year rate case that get postponed beyond 2015:

As required by Order Points 29.B and 29.C, the Company will file a notice with the Commission and interested parties within 30 days of a material change to any project included in the multi-year plan. Further, for cancelled or postponed projects, the Company will file a proposal to adjust rates to stop collecting any costs related to the cancelled or postponed project, and to refund any costs already collected if the project meets the criteria for materiality. We refer to a material change as a "rate impact event". With few exceptions, any single project included in the 2015 Step should not be able to trigger a rate refund either through cancellation or postponement (due to the size of the projects).¹⁴⁹

However, the MCC believes that it would be a far more effective and prudent customer protection if the utility were to recover the costs only after these wind projects are placed into service; thus assuring that the costs are charged to ratepayers only if projects are used and useful. Therefore, the MCC recommended that Xcel either, 1) remove cost recovery for these wind projects from the 2015 Step and propose its cost recovery request in its anticipated November 2015 rate case (a timing that aligns more closely to the plants' late-2015 in-service dates), or 2) seek cost recovery through the renewable rider. The MCC argued that it would be unfair to ratepayers to allow the Company to "advance" the rate base treatment to mid-year (giving Xcel six months return) in the rate case when cost recovery from the use of an available rider would give Xcel a return for a shorter time period (i.e., late 2015, the earliest the plants are likely to go into service).¹⁵⁰ The available RES Rider allows Xcel the opportunity to seek recovery outside of rate case once plants are placed into service.

¹⁴⁸ Ex. 435 at 7-11 (Campbell Public Surrebuttal)

¹⁴⁹ Ex. 99 at 20 (Clark Direct)

¹⁵⁰ Ex 343 at 4 (Maini Direct)

The MCC compared the (2013 – 2015) cumulative revenue requirements of these projects if included in either base rates (\$23.177 million) or if recovered through the RES Rider (\$17.639 million) and determined these two scenarios result in a difference of \$5.538 million in revenue requirements over this period.¹⁵¹

Alternatively, if the Commission decides to allow Xcel to recover these wind facilities through base rates, the MCC recommended that rate base treatment be limited to the months the projects are anticipated to be in service, rather than a rate base derived from the average of beginning and year-end project balances. The MCC believes this alternative to be a fair way to limit the return on rate base to the months the projects are anticipated to be in service.

The MCC also recommended that Xcel provide a ratepayer protection mechanism to address operational and deliverability risk as well as cost overruns. In the Order approving the acquisition of these two wind facilities (issued December 13, 2013, in dockets 13-603 and 13-716),¹⁵² the Commission requested the MCC and Xcel to work together to propose a ratepayer risk protection mechanism.¹⁵³ In this rate case, the MCC requested that the Commission include an order point that sets the process and timeline for developing this mechanism to allow stakeholders ample time to work with, and respond to, the utility's proposal.

OAG

In its rebuttal testimony, the OAG stated its support for the adjustments proposed by Department witness Ms. Nancy Campbell for wind farm capital costs reduction of \$5.7 million and the inclusion of the associated production tax credits of approximately \$11 million.¹⁵⁴ The OAG believes Xcel's agreement to include PTCs in base rates has resolved this issue.¹⁵⁵

Xcel

Xcel explained that it sought rate base rather than rider treatment to comply with the Commission's recent Multi-Year Rate Plan Order¹⁵⁶ (Points 10, 11, 22), which required the Company to analyze and propose the elimination and reduction of the use of rate riders before filing its multi-year rate plan. Xcel had proposed to limit use of the RES Rider to incorporate actual PTCs after these wind facilities were in-service. Xcel agreed with the Department's recommendation to include the estimated 2015 PTCs in base rates and to true-up PTCs in the RES Rider.

Xcel does not oppose MCC's suggestion to use the RES Rider to recover capital costs of Pleasant Valley and Border Winds projects and their associated PTCs; doing so would reduce the

¹⁵¹ Ex. 345 at 3 (Maini Surrebuttal)

¹⁵² Filed pursuant to Minn. Stat. §§ 216B.1691 Renewable Energy Objectives and Minn. Stat. § 216B.1645 Power Purchase Contract Or Investment.

¹⁵³ Ex. 343 at 5 (Maini Direct) referencing Minnesota Chamber's Reply Comments dated October 1, 2013 in the following: In the Matter of the Petition of Xcel Energy for Approval of the Acquisition of 600 MW of Wind Generation Docket No. E-002/M-13-603 and In the Matter of the Petition of Xcel Energy for Approval of the Acquisition of 150 MW of Wind Generation Docket No. E-002/M-13-716

¹⁵⁴ Ex. 372 at 3-5 (Lindell Rebuttal)

¹⁵⁵ OAG Initial Brief at 40.

¹⁵⁶ June 17, 2013 Order Establishing Terms, Conditions, and Procedures for Multi-Year Rate Plans (Multi-Year Rate Plan Order), Docket E,G-999/M-12-587.

2015 Step by \$23.177 million.¹⁵⁷ However, if base rate recovery of these wind projects is decided by the Commission, Xcel opposes MCC's 13-month average method to determine the rate base amount for Pleasant Valley and Border Winds plant. All other capital projects use a beginning- and end-of-year average to determine rate base and a consistent method should be used for all capital additions.

While the Purchase and Sale Agreement (PSA) has provisions that would allow for a late closing under certain conditions, Xcel stated that the need to capture federal production tax credits (PTCs) to effectuate the closing will help to drive RES Americas to complete the project in 2015. In Evidentiary Hearings, Xcel offered a proposal to submit compliance reports to provide a comparison of its 2015 Step actual and test year revenue requirements and include proposals for rate refund in the event the total actual 2015 Step requirements is lower than the test year requirements.¹⁵⁸

In regards to a ratepayer protection mechanism to shift unanticipated costs/gains from customers to shareholders, Xcel stated its willingness to work with MCC and other stakeholder's, however, due to rate case time constraints, Xcel suggested that it report results of its efforts in the RES Rider docket.¹⁵⁹ Xcel submitted a letter to the Commission on December 22, 2014 stating discussions have begun, an initial proposal was shared and additional meetings were scheduled.¹⁶⁰

ALJ

(ALJ report, pp. 134-135; paragraphs 580 – 586)

586. The determination of whether to include the Pleasant Valley and Borders Wind project costs in the 2015 Step or RES rider depends upon whether the Commission seeks to limit the amount of funds recovered through riders or whether the Commission seeks to moderate the effects of the 2015 Step by including these costs in the RES rider. Either approach would result in reasonable treatment of these costs.

Exceptions to the ALJ

No exceptions were filed by the Department or the OAG.

Xcel

(Xcel Exceptions, pp. 40, 55-56)

Xcel agreed with the ALJ's conclusion.

MCC

¹⁵⁷ Ex. 97 at 7 (Robinson Rebuttal)

¹⁵⁸ Ex. 140 at 6-7 (Heuer Opening Statement)

¹⁵⁹ Ex. 100 at 29 (Clark Rebuttal)

¹⁶⁰ Letter electronically filed on December 22, 2014 in Docket Nos. E-002/M-13-603, M-13-716, GR-13-868 and M-14-733.

(MCC Exceptions, p. 4)

MCC filed exceptions asking the Commission to decide in favor of adopting the Renewable Energy Standard (RES) Rider recovery approach for the project. Its recommended edits to the ALJ Finding 586 are:

586. The determination of whether to include the Pleasant Valley and Borders Wind project costs in the 2015 Step or RES rider depends upon whether the Commission seeks to limit the amount of funds recovered through riders or whether the Commission seeks to moderate the effects of the 2015 Step by including these costs in the RES rider. ~~Either approach would result in~~ Because RES rider recovery reduces 2015 costs for ratepayers it results in most reasonable treatment of these costs and shall be used in this case.

Staff Comments

Xcel's initial rate case approach and the Department's preference to include these projects in base rates aligns with the Commission's multiyear rate plan order to minimize cost recovery through riders.¹⁶¹ However, the MCC's recommended use of the RES Rider as the recovery means for Xcel's future Pleasant Valley and Borders Winds facilities is not strongly opposed. The ALJ and the parties defer to Commission to express its preference.

From the Department's review of the projects' status and contract information, it concluded that the Company is likely to meet its late 2015 in-service dates. The projects' contracts include stated completion dates. In addition, regarding all of the multiyear rate plan's 2015 Step capital projects, the Department and the Company came to an agreement during the Evidentiary Hearing that in the event the total actual 2015 Step revenue requirements is lower than the total test year 2015 Step revenue requirement, the Company will include in a compliance filing a proposal for rate refund.¹⁶² This agreement between the parties provides ratepayer protections in the event capital projects are delayed.

Alternatively, recovery of wind projects through the RES Rider would not be new for Xcel, although doing so would increase the complexity to the existing rider's filing preparation and review.¹⁶³ Filed annually, Xcel's current use of the RES Rider is limited to truing up the wind production tax credits (PTCs). The current factor is zero percent.

The MCC's analysis pointed out that the 2013-2015 cumulative revenue requirements would be lower through use of the RES Rider than if recovery was in base rates. However, the MCC's statement that the RES Rider mechanism limits rate base treatment *to the months the project is in service* is not correct. The RES Rider statute provides utilities the opportunity to begin recovering a return on plant investments before the facility is placed into service (i.e., return on

¹⁶¹ June 17, 2013 Order Establishing Terms, Conditions, and Procedures for Multi-Year Rate Plans (Multi-Year Rate Plan Order), Docket E,G-999/M-12-587

¹⁶² Resolved Issues Nos. 35 and 36: "MYRP: Refund Mechanism Due to Postponed or Cancelled Capital Projects" and "MYRP: Compliance for 2015 Step Projects".

¹⁶³ The RES Rider was previously used for recovery of Xcel's Grand Meadows and Nobles Wind facilities prior to those facilities being rolled into base rates (in Xcel's 10-971 rate case).

projects' CWIP).¹⁶⁴ Nevertheless, the MCC's preferred weighted rate base technique is achieved through use of the RES Rider, because Xcel utilizes a return on rate base approach based upon monthly balances in the rider, rather than the average of the beginning- and end-of-year balances approach used in rate cases. Since the bulk of the projects' investment apparently occurs in late-2015, the weighted average rate base treatment produces a lower revenue requirement. On the other hand, if timing of plant additions occurred during the earlier months of the year, the revenue requirement from use of the weighted average rate base treatment would be higher than the average of beginning- and end-of-year rate base approach.

The following table compares the standalone years 2015 and 2016 estimated base rates and the rider revenue requirements for these projects (without the impact of PTCs).

Table 13			
Pleasant Valley and Border Winds Projects¹⁶⁵			
Capital Revenue Requirements			
\$ in millions			
Overall Rate of Return Assumed:		Currently Authorized 7.45% ¹⁶⁶	Rate Case Request 7.66%
Recovery Method:		Rider ¹⁶⁷	Base Rates
2015	Revenue Requirement:	\$15.382 ¹⁶⁸	\$22.952 ¹⁶⁹
	Rate Recovery	\$15.382	\$22.952
2016	Revenue Requirement	\$60.713 ¹⁷⁰	\$61
	Rate Recovery (if case filed)	\$60.713	\$22.952
	Rate Recovery (if no case filed)	\$60.713	\$61

¹⁶⁴ Minn. Stat. §§ 216B.1645, Subd. 2a (a)(2).

¹⁶⁵ Inclusive of Pleasant Valley Wind transmission facilities.

¹⁶⁶ Xcel applied the most recent Commission-authorized value when developing the rider's revenue requirement estimate. Use of a common overall rate of return would in fact occur and it would narrow the revenue requirement differences between these two recovery techniques.

¹⁶⁷ Border Wind; Pleasant Valley Wind & its associated Transmission facilities (RES and/or Transmission Cost Recovery Rider).

¹⁶⁸ Ex. 345 (Maini Surrebuttal) MCC IR No. 151, Attachment A, p. 1

¹⁶⁹ Ex. 95 at 13, Table 4 (Robinson Direct)

¹⁷⁰ Ex. 345 (Maini Surrebuttal) MCC IR No. 151, Attachment A, p. 1

Comparing rider revenue requirements with the base rate revenue requirements, Table 13 shows that use of rider recovery would net a rates savings amount in excess of \$7 million for 2015. Although the MCC's Reply Brief stated that the revenue requirement savings through use of the rider would be \$5.538 million, that amount reflected the net of the years 2013-2015, cumulative.

After 2015 and looking ahead to 2016, the first full year the plant is in operation, Staff anticipates there would be minimal difference in the revenue requirements between the rider and a rate case. Rider recovery provides a more precise outcome for the collection of determined revenue requirements of a particular project, whereas, base rate recovery from a single project perspective is not so precise. The potential rate recovery outcomes are summarized in four scenarios:

Scenario 1: The Commission decides to use RES Rider to recover 2015 project costs and **no** 2016 test-year rate case is filed. For 2016, the RES Rider rate would be designed to collect the 2016 revenue requirement and a total of \$76 million is recoverable over these two years.

Scenario 2: The Commission decides to use RES Rider to recover 2015 project costs and **a** 2016 test-year rate case is filed. In 2016, either, (1) the RES Rider rate would be designed to collect the 2016 revenue requirement or (2) the projects are rolled into base rates reflecting the 2016 revenue requirement. Either way, a total of \$76 million is recoverable over these two years.

Scenario 3: The Commission decides to use base rates to recover 2015 project costs and **no** 2016 test-year rate case is filed. Compared to the Rider's revenue requirement option, the overall rates charged to ratepayers in 2015 are \$7 million higher, and in 2016 are \$38 million lower. A total of \$46 million is recoverable over these two years.

Scenario 4: The Commission decides to use base rates to recover 2015 project costs and **a** 2016 test-year rate case is filed. Compared to the Rider's revenue requirement option, overall rates charged to ratepayers would be \$7 million more in 2015, but there would be no rate recovery difference in 2016. A total of \$84 million is recoverable over these two years.

These scenarios only summarize a single rate case item and do not capture the revenue requirement fluctuations that will occur in Xcel's other investment and operating cost recoveries.

Although the MCC's recommended approach moderates the 2015 Step increase, lowering the revenue requirement by approximately \$23 million, it shifts about \$16 million of rate collection this into a rider for 2015. The Commission could allow recovery of these future facilities through the RES Rider initially, and request Xcel in its next case, to roll these facilities into base rates.

Should the Commission directs recovery of these projects through the RES Rider, staff offers two suggestions. First, to avoid double counting the project's CWIP in both the rate case and the rider, parties should ensure that the rate case's CWIP and other rate case amounts are adjusted

accordingly. Second, the Commission should make it clear that the recoverable wind project costs through the rider would begin with 2015 revenue requirements and Xcel should not revise prior years' RES Rider revenue requirements to include these projects. Even though the MCC conducted a historical cumulative year revenue analysis, base rates are prospective in nature. Since any return amounts that would have been generated by the inclusion of CWIP in rate base are offset by AFUDC, theoretically netting to a zero revenue requirement, movement of project recovery from this rate case to the RES Rider, and beginning its recovery effective for 2015, should not lessen the recovery amount Xcel has sought (theoretically \$0 in 2014) through the rate case.

Regardless of the recovery method that is authorized, as an additional precaution, Staff suggests that the Commission also require Xcel to report and capture all forms of compensation paid/credited to Xcel, as a result of the contractors' failure to meet contract terms. This would ensure that such cost reductions can be reviewed and considered as a possible credit to ratepayers in a future proceeding.

The MCC also recapped a need for ratepayer protection from various project's risk discussed in a prior proceeding. In its Order approving Xcel's acquisitions of Pleasant Valley and Border Winds, issued December 13, 2013 in Docket Nos. E-002/M-13-603 and E-002/M-13-716, the Commission was open to a cost-recovery formula that helps tie compensation to performance and helps shield ratepayers from inappropriate risks. The Commission directed Xcel to work with the Chamber on alternative cost-recovery formulas designed to allocate risk and create incentives appropriately. Ordering Paragraphs 9 and 10, stated:

9. When Xcel submits a filing for cost recovery associated with the Pleasant Valley and Border Winds projects, Xcel shall clearly identify the amount of total interconnection costs and provide documentation and a justification for the total amount proposed to be included in rates.
10. By the earlier of a) January 1, 2015, or b) the date Pleasant Valley and Border Winds projects begin providing service, Xcel shall work with the Minnesota Chamber of Commerce on a cost recovery incentive mechanism.

Xcel indicated active stakeholder efforts were in progress.¹⁷¹ The MCC requested that the Commission include an order point in this case that sets the process and timeline to allow stakeholders ample time to work with Xcel and respond to the utility's proposal. A decision alternative provides one option.

Staff notes that the OAG had supported the Department's initial position to include the wind facilities associated PTCs in base rates as well as an adjustment to the plant amount. The Department later withdrew the plant adjustment recommendation. The OAG's initial brief only

¹⁷¹ On December 22, 2014, Xcel submitted a status update letter to the Commission indicating a proposal was shared in an initial meeting with the MCC and additional meetings were scheduled to occur in January 2015. Xcel will continue to keep the Commission apprised of progress in forthcoming status updates.

stated support for inclusion of the PTCs, therefore Staff did not include a decision alternative to reflect the Department's withdrawn plant adjustment.

Decision Alternatives

Recovery Approach

1. Determine that cost recovery for the Pleasant Valley and Border Winds facilities shall be reflected in base rates; **or** (Xcel, DOC)
2. Determine that cost recovery for the Pleasant Valley and Border Winds facilities shall be reflected in the Renewable Energy Standard (RES) Rider and modify ALJ Finding 586 to read: (MCC, not opposed: Xcel, DOC)

586. The determination of whether to include the Pleasant Valley and Borders Wind project costs in the 2015 Step or RES rider depends upon whether the Commission seeks to limit the amount of funds recovered through riders or whether the Commission seeks to moderate the effects of the 2015 Step by including these costs in the RES rider. ~~Either approach would result in~~ Because RES rider recovery reduces 2015 costs for ratepayers it results in most reasonable treatment of these costs and shall be used in this case.

If base rate recovery, then consider the following:

3. Direct the Company to include in base rates the Production Tax Credits associated with the operation of the Pleasant Valley and Border Winds facilities, in the amount disclosed in non-public Exhibit 432, Schedule NAC-7¹⁷², which reduces the 2015 Step revenue requirement by \$11.093 million. Permit true-up of the Production Tax Credits for these facilities in the Renewable Energy Standard Rider. (DOC, OAG, Xcel)
4. Decide that the Pleasant Valley and Border Winds facilities rate base is to be determined using the average of the beginning- and end-of-year plant balances (consistent with other capital treatment); **or** (Xcel, DOC)
5. Decide that the Pleasant Valley and Border Winds facilities rate base is to be determined using the 13-month weighted average. (MCC)

If RES Rider recovery, then consider the following:

6. Clarify that the recoverable Pleasant Valley and Border Winds project costs through the Renewable Energy Standard Rider may begin with these projects' 2015 revenue requirements and that Xcel shall not include project activity from prior years in the rider. (Staff)

¹⁷² Xcel's trade secret response to DOC Information Request No. 160, included in Campbell Direct Attachments – Trade Secret, Part 1.

7. Direct the Company to adjust Construction Work in Progress and other rate case components to remove the Pleasant Valley and Border Winds project costs from base rates. (Staff)
8. Direct the Company in its next rate case filing to include the Pleasant Valley and Border Winds projects in base rates and to adjust the Renewable Energy Standard Rider accordingly. (Staff)

Future Reporting Requirements

9. Require the Company to notify the Commission and to report and capture potential cost reductions or other forms of compensation that may be granted to Xcel Energy due to contract changes or contractors' failure to meet contract terms for either the Pleasant Valley or the Border Wind projects. Clarify that such cost reductions and compensation payments will be subject to Commission review for potential credits or refunds to ratepayers. (Staff)
10. Require the Company in its next Renewable Energy Standard (RES) Rider filing, or by September 1, 2015, to report the results of stakeholder discussions and proposals for alternative cost-recovery formulas for the Pleasant Valley and Border Winds project designed to allocate risks and create incentives. (MCC, Xcel)

(Note: These decision alternatives correspond to alternatives II, E (1 and 2) on pp. 16-17 of the deliberation outline.)

Record Citations:

Sparby Rebuttal, Ex. 26 at 20
Clark Rebuttal, Ex. 100 at 26-29
Mills Direct, Ex. 58 at 61-66
Mills Rebuttal, Ex. 60 at 11-15
Robinson Direct, Ex. 95 at 11-13, 37-38
Robinson Rebuttal, Ex. 97 at 3-7
Robinson Opening Statement, Ex. 132 at 1-2
Evidentiary Hearing Transcript, Vol. 2 at 96 (Perkett)
Perkett Rebuttal, Ex. 94 at 52-53
Campbell Direct, Ex. 429 at 32-42
Campbell Surrebuttal, Ex. 435 at 2-12
Campbell Opening Statement, Ex. 450 at 1
Lusti Direct, Ex. 437 at 47, 51
Lusti Surrebuttal, Ex. 442 at 39
Lindell Rebuttal, Ex. 372 at 3-5
Maini Direct, Ex. 343 at 2-6
Maini Surrebuttal, Ex. 345 at 1-4
Evidentiary Hearing Transcript, Vol. 4 at 13-16, 19-22 (Maini)
Department Initial Brief at 224-226

OAG Initial Brief at 40
Xcel Reply Brief at 81
MCC Initial Brief at 8-10
MCC Reply Brief at 3

Annual Incentive Compensation Program

PUC Staff: Dorothy Morrissey

Statement of the Issue

Has the Company's evaluation of its annual incentive program adequately met the Commission's 2012 rate case order requirements?

Introduction

From Xcel's last rate case, the Commission's Order, issued September 3, 2013 in Docket No. E-002/GR-12-961 the Commission, Order Point 30, stated:

Xcel shall evaluate the goals set for its annual incentive program to determine if they are too lenient or if they actually require stretching to meet; the Company shall file the results of the evaluation in its next rate case.

Xcel

The Company's Annual Incentive Plan (AIP) has three components: individual, business area, and corporate. For the individual component, employees have performance goals tied to job functions. The business area and corporate components use Key Performance Indicators (KPIs) to measure goals. Each business area uses a scorecard that identifies priorities, KPIs, and target goals.¹⁷³ KPI scorecards are approved by Xcel's senior management.

KPIs are based on past performance, industry benchmarking, and the Company's financial objectives.¹⁷⁴ The goals set require the Company to improve its performance to the greatest extent possible, but are not so high that they are unattainable.¹⁷⁵ These goals require the Company to improve or maintain performance based on past performance or when compared amongst its peers.¹⁷⁶ Xcel continues to adjust its KPI goals to establish realistically attainable, but increasingly challenging goals.¹⁷⁷

The achievement of a KPI does not lead to a "bonus" for the employee. If the goals are achieved and the AIP is paid at target (or 100 percent), the employee's compensation level for that year is

¹⁷³ Ex. 86 at 67 (Stitt Direct); Ex. 62 at 84 (Harkness Direct)

¹⁷⁴ Ex. 65 at 77 (Kline Direct); Ex. 51 at 133 (O'Connor Direct)

¹⁷⁵ Ex. 86 at 67-71 (Stitt Direct)

¹⁷⁶ Ex. 65 at 74 (Kline Direct)

¹⁷⁷ Ex. 58 at 87 (Mills Direct)

just then meeting market levels.¹⁷⁸ Anything less than 100 percent of the full AIP amount puts the employee at a compensation level below what other companies and utilities are paying.

Ten Xcel witnesses provided testimony and evaluated their respective business area's AIP targets to determine whether they are too easy to meet. Based upon the process for setting AIP goals and the fact that employees have not been able to achieve their AIP goals on some occasions, the Company concluded that its AIP goals strike the right balance between being difficult enough to challenge its employees, while not being so difficult as to serve as a disincentive.¹⁷⁹ The Company believes its Annual Incentive Program is reasonable and that the Company has complied with Order Point 30 issued in the Company's last electric rate case.¹⁸⁰

Department

The Department found that the Company witnesses commented in their Direct Testimony on Xcel's Key Performance Indicators (KPI); however, they did not address the actual results of those KPI indicators. The Department reviewed the actual results of KPIs over the 5-year period 2008-2012. From its review, the Department concluded that Xcel employees meet their KPI requirement goals nearly all of the time, often achieving in excess of the 100 percent target.¹⁸¹

Table 14

Year	Total Business Areas Reported	# with total of KPIs < 100%	# with total of KPIs ≥ 100%
2008	n/a	n/a	n/a
2009	16	1	15
2010	19	2	17
2011	16	3	13
2012	11	1	10

Source: Ex. 438, Schedule DVL-19 (Lusti Direct Public Attachments)

The Company did not report KPI results for the year 2008 because it did not achieve the minimum earnings level to pay incentive compensation.

To provide the Commission additional perspective on incentive compensation, the Department also evaluated NSP-Minnesota Total Company's (gas and electric) actual AIP compensation paid as a percentage of target. This is summarized below:

¹⁷⁸ Ex. 78 at 43 (Figoli Direct)

¹⁷⁹ Ex. 78 at 42 (Figoli Direct)

¹⁸⁰ Xcel Reply Brief at 116

¹⁸¹ Ex. 437 at 58 and Ex. 438, Schedule DVL-19 (Lusti Direct and Direct Public Attachments)

Table 15

Year	Actual AIP (\$000s)	Target AIP (\$000s)	% Paid to Target
2009	\$27,891	\$24,708	113%
2010	\$28,218	\$27,283	103%
2011	\$27,343	\$28,995	94%
2012	\$29,731	\$25,302	118%
2013	\$31,737	\$25,412	125%

Source: Ex. 438, Schedule DVL-37 (Lusti Direct Public Attachments)

Although 2013 shows the overall percentage of AIP paid equated to 125 percent of the target total, the Department explained that this percentage is not a uniform percentage paid to all employees. Rather, the Department found that the top twenty Xcel employees, as a group, received 192 percent of target level incentive compensation in 2013.¹⁸² However, the Department explained that ratepayers only pay for AIP amounts up to 15 percent of base compensation, which is referred to as a 15 percent cap. The Department believes the 15 percent cap is reasonable.

Because this is a compliance issue of the Commission, the Department indicated that the Commission will need to determine if Xcel's AIP is reasonable.

ALJ

(ALJ Report, pp. 225-228; paragraphs 1000 – 1009)

1009. The Administrative Law Judge concludes that the Company has complied with the Commission's directive from the last rate case and has demonstrated that its existing KPIs provide a proper incentive for its employees to perform well in key areas. The Company has also shown its proposed AIP expense is reasonable because it is based on a four-year average and includes a [1]5 percent cap.

Exceptions to the ALJ

No Exceptions were filed.

Staff Comments

The testimonies of ten Company witnesses collectively conclude that the Company's KPIs are not too lenient, but rather appropriately challenge employees to improve performance in many areas and to maintain the achievement of difficult goals. Some Company witnesses included current KPI targets and historical KPI performance.¹⁸³

Other than what is discussed in the next two sections (*FERC Cost Comparison Study – KPI Benchmarks* and *Transmission Business Area – Cost Controls*), the Department did not comment

¹⁸² Ex. 437 at 59 (Lusti Direct)

¹⁸³ Ex. 75 Schedules 14 and 15 (O'Hara Direct); Ex. 25 Schedule 2 (Sparby Direct); Ex. 58 Schedule 16 (Mills Direct); Ex. 51 Schedule 18 (O'Connor Direct); Ex. 65 Schedule 8 (Kline Direct); Ex. 69 Schedule 4 (Foss Direct)

on Xcel's KPIs, rather focused on their overall measured results. Review of the overall KPI perspective, it was concluded that Xcel regularly achieves its KPIs. However, the overall KPI scorecard percentage for any one business area is made up of several individual KPIs, many goals exceeding targets and other goals falling short of their targets. If the Commission has interest to study AIP KPI's more in depth, such an investigation could be conducted outside of a rate case.

The annual AIP payout amounts frequently exceed the 100 percent target. The Company uses earnings per share (EPS) as an overall affordability trigger for payments.¹⁸⁴

In spite of this frequent outstanding KPI performance, there are some ratepayer cost safeguards in place. The Company has capped its AIP request by excluding any AIP amounts over 15 percent of any individual's base salary, which carries out the Commission's restrictions originally implemented in NSP's 1992 Rate Case.¹⁸⁵ Also initiated in the 1992 Rate Case, the Company is to return to ratepayers the earned but unpaid incentive compensation recoverable in rates. These mechanisms provide the Commission tools to protect ratepayers and monitor the AIP Program on an ongoing basis.

Incentive programs tend to be fluid in nature, subject to revisions year-to-year. Therefore, in future rate cases, the Company should continue to provide AIP documents in its initial filing when rate recovery is sought.

Decision Alternatives

1. Determine that the Company has adequately complied with Order Point 30 issued in the prior electric rate case (Order issued September 3, 2013 in Docket No. E-002/GR-12-961); **or** (ALJ, Xcel)
2. Make a different determination.
3. Direct the Company in its future rate cases to provide Annual Incentive Program (Plan) documents when rate recovery is sought. (Staff)

(Note: These decision alternatives correspond to alternatives II, F (1 through 3) on pp. 17-18 of the deliberation outline.)

Record Citations:

Figoli Direct, Ex. 78 at 42-50

Gersack Direct, Ex. 71 at 40-44

Foss Direct, Ex. 69 at 48-51

¹⁸⁴ Ex. 78 at 39 (Figoli Direct)

¹⁸⁵ In the Matter of the Application of Northern States Power Company for Authority to Increase its Rates for Electric Service in the State of Minnesota, Commission Order After Reconsideration, Issued January 14, 1994, Docket E-002/GR-92-1185.

Harkness Direct, Ex. 62 at 84-87
Kline Direct, Ex. 65 at 74-77
O'Connor Direct, Ex. 51 at 130-133
Mills Direct, Ex. 58 at 86-87
Sparby Direct, Ex. 25 at 31-34
O'Hara Direct, Ex. 75 at 33-38
Stitt Direct, Ex. 86 at 66-71
Lusti Direct, Ex. 437 at 56-59
Lusti Direct Attachments, Ex. 438, DVL-20, Schedule 2 and DVL-37
Department Initial Brief at 253-256
Xcel Reply Brief at 114-116

FERC Cost Comparison Study – KPI Benchmarks

PUC Staff: Dorothy Morrissey

Statement of the Issue

Should the Commission require the Company to add key performance indicators to address non-fuel O&M costs and transmission O&M costs?

Introduction

Xcel Energy Services Inc. conducts an annual electric Federal Energy Regulatory Commission (FERC) Comparison Study, which ranks Xcel Energy's and its four operating companies current cost structure standing relative to peer companies. The Study includes benchmarks for the following metrics:¹⁸⁶

- Retail revenues,
- Fuel and purchased power costs,
- Non-fuel O&M,
- Total production non-fuel and steam production non-fuel expenses,
- Transmission O&M,
- Distribution O&M,
- Administrative and general (A&G) expenses, and
- Customer care costs.

The May 2013 Study reports peer benchmarking results from 2012 operations.¹⁸⁷ Performance relative to these metrics is measured in a variety of ways such as cost per retail customer, per MWh generated, per line mile, as percentage of revenue, etc.

Minnesota Chamber of Commerce (MCC or Chamber)

The MCC reviewed Xcel's 2013 FERC Comparison Study and noted some areas of concern with two cost benchmarks of NSPM against its sister companies, as well as its peers. NSPM is

¹⁸⁶ Ex. 67 at 38 (Kline Rebuttal)

¹⁸⁷ Ex. 343 at 43, and Attachment 11 (Maini Direct)

consistently trending below even the second quartile (in the bottom half) in both the non-fuel operations and maintenance (O&M) and transmission O&M benchmarks. The MCC concluded that Xcel needs to improve significantly with respect to these two cost benchmarks and recommended that Xcel develop key performance indicators (KPI) based on this peer analysis to help improve its operation efficiency in both of these areas.

Department

The Department agreed with the MCC's concern about the need for cost management KPIs.

Xcel

Xcel stated that the 2013 Benchmarking Study does not control for comparability of data, different tracking and reporting systems, relative size of a utility's transmission system, or other variations among utilities and as a result it is not appropriate to use the study's non-fuel and transmission O&M benchmarks as KPIs.

Nonetheless, Xcel stated that for non-fuel O&M costs, the Company has already implemented a KPI related to non-fuel O&M expense management for 2014, aimed at limiting recoverable growth to no more than 2.2 percent over 2013 actual recoverable O&M expense.¹⁸⁸ Therefore, Xcel does not believe an additional non-fuel KPI tied to the study is necessary at this time.

The Company stated its transmission costs rank somewhat higher than its peers due in part to differences in transmission system size, customer density, and whether or not peer companies are members of Regional Transmission Organizations.¹⁸⁹ For example, the Company pointed out that five of the top ten utilities with the lowest transmission O&M costs per MWh throughput have sold the vast majority of their transmission assets to a transmission company.

Also, utilities that have high transmission O&M costs per transmission line mile often provide service in some of the largest cities in the United States where transmission lines tend to be underground or in areas that are difficult to access for maintenance. Customer density is also higher in large cities. Both factors will increase transmission O&M costs per line mile.¹⁹⁰

The Company has offered to work with the Chamber to develop a reasonable KPI metric with respect to transmission costs.

Minnesota Chamber of Commerce - Surrebuttal

Although the Company indicated a KPI now exists for non-fuel O&M costs, the MCC noted that NSPM electric total company 2014 and 2015 budgeted amount changes exceed the KPI O&M growth limit of 2.2 percent, an inconsistency that Xcel had not explained. The MCC also recommended that in its next rate case, Xcel should refine the make-up of the comparative group it uses for peer benchmarking and explain why certain utilities were included in the comparative group and not others.

¹⁸⁸ Ex. 100 at 46 (Clark Rebuttal)

¹⁸⁹ Ex. 67 at 40-41 (Kline Rebuttal)

¹⁹⁰ Ex. 67 at 40-41 (Kline Rebuttal)

ALJ

(ALJ Report, pp. 228-230; paragraphs 1010 – 1017)

1016. The Administrative Law Judge concludes that the Company's KPI for non-fuel O&M growth management sufficiently addresses concerns raised by MCC and the Department relating to non-fuel O&M costs. Unlike the benchmark proposed by MCC from the 2013 Study, the Company's KPI for non-fuel O&M growth management is tied to costs recoverable from ratepayers and takes into account cost variations between Xcel Energy Inc.'s four operating companies. Therefore, the additional non-fuel O&M costs benchmark from the Study is not necessary.

1017. The arguments relating to the addition of a KPI for transmission O&M costs, however, raise valid cause for concern and justify further study. Therefore, the Administrative Law Judge recommends that, in the next rate case, the Company be required to present a new KPI for transmission O&M costs, including appropriate peer companies for comparison.

Exceptions to the ALJ

No Exceptions were filed.

Staff Comments

It does not appear that Xcel directly addressed the MCC's observation that the year-over-year 2014 and 2015 budgeted increases in non-fuel O&M costs (a 4.5 and a 2.6 percent increase, respectively), exceed the Company's stated KPI goal of limiting recoverable O&M cost increases to no more than 2.2 percent. In oral argument, the Commission may want to ask the Company to address this concern pointed out by the MCC. This additional information may be helpful to make certain the KPI Xcel brought forth in rebuttal testimony adequately addresses the MCC's concerns.

It is noteworthy that the Company has offered to work with the Chamber to develop a reasonable KPI metric for transmission costs and to eliminate the concerns related to the comparison group and the measures.

This section's set of decision alternatives captures ALJ Finding No. 1017. An additional transmission cost KPI concern is discussed in the next section, *Transmission Business Area – Cost Controls*, and an independent decision alternative exists for the KPI issue discussed therein.

Decision Alternatives

1. Determine that, at this time, the Company's key performance indicator (KPI) for non-fuel operations and maintenance (O&M) growth management sufficiently addresses concerns raised by MCC and the Department relating to non-fuel O&M costs; **or** (ALJ, Xcel)
2. Make no determination as to whether the Company's KPI target to restrict increases in its recoverable non-fuel O&M costs sufficiently addresses concerns raised by the parties. (MCC)
3. Require the Company, in the next rate case, to present a new key performance indicator (KPI) for transmission O&M costs; **or** (ALJ, MCC)
4. Take no action on the development of a new key performance indicator (KPI) for transmission O&M costs. (Xcel)
5. Require the Company, in the next rate case, to provide a comparison study of its transmission O&M costs by using appropriate peer companies, along with justification for why certain utilities were included or excluded; **or** (ALJ, MCC)
6. Do not require refinement of the peer benchmarking study of transmission O&M costs. (Xcel)

(Note: These decision alternatives correspond to alternatives II, G (1 through 6) on p. 18 of the deliberation outline.)

Record Citations:

Maini Direct, Ex. 343 at 43-45
Maini Surrebuttal, Ex. 345 at 27-28
Kline Rebuttal, Ex. 67 at 37-45
Clark Rebuttal, Ex. 100 at 44-47
Ouanes Rebuttal, Ex. 412 at 16
MCC Initial Brief at 30
Xcel Initial Brief at 120-122
MCC Reply Brief at 13
Xcel Reply Brief at 101-102

Transmission Business Area – Cost Controls

PUC Staff: Dorothy Morrissey

Statement of the Issues

Should the Commission establish recovery caps for transmission projects to the cost amounts stated in the Company's certificate of need applications? Should the Commission require the Company to add a transmission projects cost control key performance indicator at the Vice President level?

Introduction

From Xcel's last rate case, the Commission's Order, issued September 3, 2013 in Docket No. E-002/GR-12-96 the Commission, ordering point 30, stated:

Xcel shall evaluate the goals set for its annual incentive program to determine if they are too lenient or if they actually require stretching to meet; the Company shall file the results of the evaluation in its next rate case.

Minnesota Chamber of Commerce (MCC or Chamber)

The MCC believes Xcel's transmission system, on an overall basis, is reliably designed but remains concerned on the upward pressure with respect to transmission project costs. The MCC believes there are a lack of cost controls for both certificate of need (CN) and non-CN projects. Transmission is a major cost element both with respect to capital and operating expenses and, on a dollar per KW-month, is a fast-growing element in Xcel's rate structure. With over \$1.6 billion going into current transmission projects, this is certainly a material issue with material impacts and great uncertainty.¹⁹¹

The MCC believes that Xcel's transmission cost control in response to Commission Order Point 30 is inadequate and should be improved for both CN and non-CN projects by establishing firm cost caps and by including cost management goals as a key performance indicator (KPI).

The MCC suggested that use of cost caps could limit cost recovery for ratemaking and that actual costs exceeding CN filing cap would be subject to review by the Department. For projects that do not require a certificate of need, the MCC recommended that the Company and other MISO transmission owners set up a reasonable cost control mechanism at MISO that would be approved by FERC.

The MCC also believes that measures for cost control should be directly in the responsibility area of the transmission Vice President. The Chamber's recommendation is for Xcel to create a Key Performance Indicator for the Transmission Vice President, which would drive appropriate management of costs at a high level for the Company and ratepayers.

¹⁹¹ Ex. 340 at 17-18 (Schedin Direct)

The MCC believes proper cost control will yield prudence benefits and will reduce revenue requirements for all customers. The MCC states that addressing its concerns will have the benefit of reducing the upward pressure on transmission costs.

Xcel

Xcel argued against implementing recovery cost caps based on project estimates presented in the CN. Xcel explained that in the CN process significant information that will impact transmission projects total costs are still not finalized, such as the final route and length of the project which is determined through the Route Permit process. The complexity of the transmission permitting, siting, routing and construction process and length of time required to complete projects weighs against imposing a cost cap at the very early CN stage of a transmission project. Unlike a generation project where the design of the facility is the largest driver of cost uncertainty for a project, for a transmission project at the scoping estimate stage, the largest driver of cost uncertainty is the actual route of the line as well as any Route Permit conditions. Only after the Route Permit process is complete does Xcel have sufficient information to further refine its scoping estimates and narrow the range of uncertainty. Xcel stated its CN cost estimation process is consistent with industry standards and reasonably correlates with the State's statutory process for project development as well as challenges that may be encountered in the field.¹⁹²

Xcel stated that Job and Performance Goals that are common among Transmission employees include being held accountable for the performance of both the schedule and financial execution of projects (increasing as employee responsibility increases). An employee's annual incentive pay and merit increases are keyed on bringing projects in on time and on budget.¹⁹³ Individual project managers report to Managers of Transmission Project Management who report to Director of Transmission Portfolio Delivery. Each of these three management levels are held responsible for ensuring projects, under their responsibility, are completed on time and on budget. Their ability to deliver projects inside the goals is tied to their ability to earn annual incentive pay and merit salary increases.

The Director of Transmission Portfolio Delivery reports to the Vice President of Transmission. The Vice President of the Transmission business area, who reports to Xcel Energy senior management, is held responsible for the overall performance of Xcel's project management including budget activities.

Currently, the transmission business area's KPIs include safety, reliability, capital project on-schedule performance and regulatory compliance goals.¹⁹⁴

¹⁹² Ex. 67 at 17-22 (Kline Rebuttal)

¹⁹³ Ibid. at 6

¹⁹⁴ Ex. 65, Schedule 8 (Kline Direct)

ALJ

(ALJ Report, pp. 230-232; paragraphs [1017]1018 – 1024)

1017. The arguments relating to the addition of a KPI for transmission O&M costs, however, raise valid cause for concern and justify further study. Therefore, the Administrative Law Judge recommends that, in the next rate case, the Company be required to present a new KPI for transmission O&M costs, including appropriate peer companies for comparison.

...

1023. MCC has raised valid concerns about whether the Company has sufficient overall cost control mechanisms in place in its transmission business area. To address this issue, the Administrative Law Judge recommends that in the next rate case, the Company be required to propose a new cost control KPI at the Vice Presidential level for overall transmission costs. The new KPI should include a subcategory for transmission O&M costs to meet the recommendation in paragraph 1018 [1017] above.

1024. The Administrative Law Judge, however, agrees with the Company that the CON process is not designed to provide final cost estimates and, therefore, it would not be appropriate to establish price caps for transmission projects on that basis.

Exceptions to the ALJ

No Exceptions were filed.

Staff Comments

In a recent Certificate of Need order, the Commission decided to limit the amount of cost recovery allowed through a rider.¹⁹⁵ However, the Commission recognized that routing realities cannot always be foreseen and that recovery over the decided cap could be justified under some circumstances; therefore the Commission also permitted the utility to seek a higher recovery level in future proceedings, with proper documentation and explanation in their rider filings. Although, the MCC issued its recommendation in a rate case setting, the Commission may prefer to decide the issue in specific CN filings.

¹⁹⁵ *In the Matter of the Application of ITC Midwest LLC for a Certificate of Need for the Minnesota –Iowa 345 kV Transmission Line Project in Jackson, Martin, and Faribault Counties*, Docket No. ET-6675/CN-12-1053, Commission Order issued November 25, 2014.

Decision Alternatives

1. Cap Xcel's transmission project cost recovery to be limited to the projects' cost included in the Certificate of Need stage of project review; **or** (MCC)
2. Take no action on capping transmission project cost recovery in this proceeding. (Xcel, ALJ)
3. Require the Company, in the next electric rate case, to propose a new Vice Presidential level cost control key performance indicator (KPI) for overall transmission costs; **or** (ALJ, MCC)
4. Take no action on the development of a VP level transmission area cost control, key performance indicator. (Xcel)

(Note: These decision alternatives correspond to alternatives II, H (1 through 4) on pp. 18-19 of the deliberation outline.)

Record Citations:

Schedin Direct, Ex. 340 at 15-21
Schedin Surrebuttal, Ex. 342 at 9-11
Kline Rebuttal, Ex. 67 at 2-37
MCC Initial Brief at 7-8
Xcel Initial Brief at 122-123
MCC Reply Brief at 2-3
Xcel Reply Brief at 102

Active Health Care and Welfare Costs (2014) - Resolved

PUC Staff: Dorothy Morrissey

RESOLVED: Parties agreed on a \$1.082 million reduction in revenue requirements (the combined effect of O&M and capital adjustments).

Introduction

Xcel's "active health care costs" are the costs associated with providing health care coverage to the Company's employees. "Welfare costs" are the costs for miscellaneous employee benefits such as life insurance, employee assistance programs, tuition reimbursements, bus pass subsidies and administrative fees.¹⁹⁶ The Company requested recovery of a total of \$36.443 million in

¹⁹⁶ Ex. 80 Schedule 15 (Moeller Direct)

combined active health and welfare costs for the test year (\$33.264 million in active health care costs and \$3.179 million in welfare costs).¹⁹⁷

Department

The Department recommended adjusting the active health care expenses because the Company has over-recovered health care costs in the recent past and because other factors indicated that health care costs would not increase as much as the Company had forecasted in its 2014 test year. Xcel modified several aspects of its health care plan in 2011 and historical trends showed actual O&M costs have been significantly lower than forecasted.¹⁹⁸ The Department initially recommended using a three-year average of 2011-2013 actual health care costs to calculate the 2014 test year amount, and a corresponding proportional (9.1 percent) adjustment to all health care and welfare capital costs.¹⁹⁹ In Surrebuttal, the Department modified its recommendation to use an experienced-based inflation factor of 2.85 percent over 2013 claims expenses, which resulted in a total expense allowance of \$35.387 million and a corresponding proportional adjustment in capital costs (a reduction of \$1,056,493 in O&M and a reduction of \$225,480 in capitalized costs).²⁰⁰ The Department also requested that in its next rate case filing, the Company be required to provide historical active health care costs since 2011 for each calendar year, including both the per book amount and actual claims incurred expenses. The requested information should also detail the annual year-end Incurred But Not Reported (IBNR) accruals and subsequent reversals.

Xcel

The Company believed its method of calculating active health care and welfare costs is appropriate and the costs are reasonable and representative of the test year 2014. The calculations were based on the 2011 and 2012 actual health and welfare costs, adjusted for plan changes, inflation, and claim trends. During the Evidentiary Hearing, the Company accepted the Department's downward adjustment of \$1.082 million.

Decision Alternative

1. Direct the Company in its next rate case to provide historical active health care costs since 2011 for each calendar year, including both the per book amount and the actual claims expense. The Company shall include information detailing the annual year-end Incurred But Not Reported (IBNR) accruals and subsequent reversals. (DOC)

(Note: This decision alternative corresponds to alternatives II, I (1) on p. 19 of the deliberation outline.)

Record Citations:

Heuer Opening Statement, Ex. 140 at 2

¹⁹⁷ Ex. 80 at 129 (Moeller Direct)

¹⁹⁸ Ex. 423 at 35 (Byrne Direct)

¹⁹⁹ Ex. 423 at 37 (Byrne Direct)

²⁰⁰ Ex 427 at 21 (Byrne Surrebuttal)

Evidentiary Hearing Transcript, Vol. 3 at 140-141 (Heuer)
Moeller Direct, Ex. 81 at 112, 128-134
Schrubbe Rebuttal, Ex. 83 at 47-60
Evidentiary Hearing Transcript, Vol. 2 at 12 (Mills)
Schrubbe Opening Statement, Ex. 126 at 1
Evidentiary Hearing Transcript, Vol. 2 at 18 (Schrubbe)
Figoli Direct, Ex. 78 at 57-65
Byrne Direct, Ex. 423 at 27-37
Byrne Surrebuttal, Ex. 427 at 13-21, 27-28
Byrne Opening Statement, Ex. 449 at 3
Evidentiary Hearing Transcript, Vol. 5 at 9 (Byrne)
Lusti Direct, Ex. 437 at 38
Lusti Surrebuttal, Ex. 442 at 9
Department Initial Brief at 63-71

Post-Employment Benefits - Long-Term Disability and Workers' Compensation (FAS 112) (2014) - Resolved

PUC Staff: Dorothy Morrissey

RESOLVED: Parties agreed on a \$421,463 reduction in revenue requirements (the combined effect of the O&M and capital adjustments).

Introduction

Postemployment benefits are all types of benefits provided to former or inactive employees, their beneficiaries, and covered dependents. Those benefits may include salary continuation, supplemental unemployment benefits, severance benefits, disability-related benefits (including workers' compensation), job training and counseling, and continuation of benefits such as health care benefits and life insurance coverage.

Xcel

The Company requested recovery of \$3.79 million in O&M expenses and \$190,152 in capital costs related to post-employment benefits (primarily long-term disability and workers' compensation) for former or inactive employees after employment but before retirement.

All bargaining employees, as well as non-bargaining employees disabled prior to January 1, 2008 are covered under Xcel's self-insured long-term disability (LTD) plan, while non-bargaining employees disabled after January 1, 2008 are covered under a fully-insured plan.²⁰¹ Employees injured prior to August 1, 2001 are covered under the self-insured workers' compensation plan, and employees injured after that date are covered under a fully-insured plan. For the self-insured piece, the Company is required to accrue LTD and workers' compensation

²⁰¹ Ex. 81 at 118 (Moeller Direct)

costs according to Financial Accounting Standard (FAS) 112, while the fully-insured piece is simply the cost of the insurance premium incurred each year. The self-insured, FAS 112 accrual is actuarially determined and the Company used a measurement date of December 31, 2012 and a discount rate of 3.74 to calculate the FAS 112 test year expenses.²⁰²

In Rebuttal, the Company agreed to the Department's recommendation to update the FAS 112 measurement date to December 31, 2013.

Department

For the FAS 112 determined cost, the Department agreed on the Company's proposed discount rate of 3.74 percent because, 1) expenses are related to insurance and do not need to be fully-funded by investment plans as is required for pension, and 2) the cash flow duration is shorter therefore the discount rate is comparatively lower than the rate used for pension.²⁰³ However, the Department recommended updating the measurement date to December 31, 2013 to calculate test-year expense, because it is reasonable to use the most recent information available. A more current measurement date would reduce FAS 112 post-employment O&M expense by \$412,498 and capital costs by \$99,172.²⁰⁴ In Surrebuttal, the Department accepted the Company's calculation of the combined expense and capital adjustments' revenue requirement effects.²⁰⁵

(Note: The decision alternative for this item is alternatives II, J(1) on p. 19 of the deliberation outline.)

Record Citations:

Byrne Direct, Ex. 423 at 43-47
Byrne Surrebuttal, Ex. 427 at 13
Lusti Direct, Ex. 437 at 37
Lusti Surrebuttal, Ex. 442 at 8-9
Heuer Rebuttal, Ex. 90 at 22-23
Moeller Direct, Ex. 81 at 12, 117-121
Schrubbe Rebuttal, Ex. 83 at 60
Department Initial Brief at 60-63

Nuclear Cash-Based Retention Program (2014) - Resolved

PUC Staff: Dorothy Morrissey

RESOLVED: Parties agreed on a \$516,466 reduction in revenue requirements.

²⁰² Ex. 423 at 45 (Byrne Direct)

²⁰³ Ex. 423 at 45 (Byrne Direct)

²⁰⁴ Ex. 423, Byrne Direct at 23 and 46-47.

²⁰⁵ Ex. 427 at 13 (Byrne Surrebuttal)

Introduction

The Company's Nuclear Retention Program is a compensation tool to help attract and retain employees that are qualified to work in nuclear plants.²⁰⁶ The retention program was designed to retain 33 employees in key positions for the 27-month period ending in December 2014.²⁰⁷ The Total Company test year recovery request is \$694,736 for the Nuclear Cash-Based Retention Program of which \$516,466 is allocated to the Minnesota jurisdiction.²⁰⁸

Department

The Department stated it is reasonable to conclude that the Nuclear Retention Program was created in 2012 to provide some of the Company's nuclear employees additional compensation to replace amounts they would likely not receive via the traditional incentive compensation (the AIP), until such time as the nuclear business unit as a whole could achieve a high Key Performance Indicator (KPI) rating. The Department questioned the integrity of the Company's AIP, because this new retention program appeared to be an effort to "end-run" the whole purpose of a performance incentive – to encourage better performance.²⁰⁹ The Commission had disapproved this nuclear retention proposal in Xcel's last rate case.²¹⁰

Xcel

The Company stated that the Nuclear Cash-Based Retention Program is a vital program necessary to attract new employees and to retain current employees in highly specialized and critical positions in the competitive nuclear labor market. The Company also explained that the retention program and Annual Incentive Plan (AIP) serve different purposes and provide separate compensation for different goals and time periods. During the Evidentiary Hearing, the Company accepted the Department's proposal to remove all the costs associated with the Nuclear Retention Program from the test year.

(Note: The decision alternative for this item is alternatives II, J(2) on p. 19 of the deliberation outline.)

Record Citations:

Heuer Opening Statement, Ex. 140 at 2
Evidentiary Hearing Transcript, Vol. 3 at 141 (Heuer)
Figoli Direct, Ex. 78 at 50-55
Figoli Rebuttal, Ex. 80 at 10-13
O'Connor Direct, Ex. 51 at 99-105
O'Connor Rebuttal, Ex. 53 at 19-29
O'Connor Opening Statement, Ex. 123 at 1-2

²⁰⁶ Ex. 78 at 51 (Figoli Direct)

²⁰⁷ Ex. 78 at 50-55 (Figoli Direct)

²⁰⁸ Ex 437 at 31 (Lusti Direct)

²⁰⁹ Ex. 437 at 33 (Lusti Direct)

²¹⁰ Docket No. E002/GR-12-961, Commission Findings of Fact, Conclusions and Order, dated September 3, 2013, Paragraph 2 (adopting ALJ Report) and ALJ Report, July 3, 2013, Findings 459 and 460.

Evidentiary Hearing Transcript, Vol. 1 at 218 (O'Connor)
Lusti Direct, Ex. 437 at 29-35
Lusti Surrebuttal, Ex. 442 at 19-24
Department Initial Brief at 63-71
Department Initial Brief at 130-134

Withdrawal of the Hollydale Transmission Project (2014) - Resolved

PUC Staff: Dorothy Morrissey

RESOLVED: Parties agreed on a \$388,000 rate base reduction which results in a \$43,000 reduction in the revenue requirement.

Introduction

On December 10, 2013, Xcel filed a petition to certify its request to withdraw a Certificate of Need and Route Permit application for the Hollydale 115 kV Transmission Line project in the Cities of Plymouth and Medina, Hennepin County, Minnesota. The Commission granted the withdrawal request in its Order issued May 12, 2014.²¹¹

Xcel

The Company noted in discovery that it no longer anticipates the planned capital additions to the Hollydale project and proposed to remove the associated capital costs from the rate base.²¹² In Rebuttal, the Company confirmed withdrawal of the Hollydale project and proposed to exclude it from the 2014 test year.²¹³

Department

The Department supported the Company's recommended adjustment.²¹⁴

(Note: The decision alternative for this item is alternatives II, J(3) on p. 19 of the deliberation outline.)

Record Citations:

Clark Rebuttal, Exh. 100 at 25-26
Heuer Rebuttal, Exh. 90 at 11-12
Lusti Direct, Exh. 437 at 19-20, 27
Lusti Surrebuttal, Exh. 442 at 7-8
Department Initial Brief at 53-54

²¹¹ Docket Nos. E-002/CN-12-113 and E-002/TL-11-152.

²¹² Ex. 438 Schedule DVL-31 (Lusti Direct Public Attachments)

²¹³ Ex. 100 at 25-26 (Clark Rebuttal)

²¹⁴ Ex. 437 at 19-20 (Lusti Direct)

Big Stone Brookings Cost Correction (2014) - Resolved

PUC Staff: Dorothy Morrissey

RESOLVED: Parties agreed on a \$145,000 reduction in revenue requirements and a \$299,000 increase in rate base.²¹⁵

Xcel

The Company noted that subsequent to preparing the capital budget, a forecasted update was made to a component of the Big Stone Brookings transmission project, with an effect of lowering operating costs. The Company made an adjustment to the interim revenue requirement but did not have time to reflect this change in the test year revenue requirement, but stated it would do so in the Rebuttal phase.²¹⁶ In Rebuttal, the Company proposed a corresponding adjustment to the test year.

Department

The Department agreed with the Company's recommended adjustment.²¹⁷

(Note: The decision alternative for this item is alternatives II, J(4) on p. 19 of the deliberation outline.)

Record Citations:

Heuer Direct. Ex. 88 at 80
Heuer Rebuttal, Ex. 90 at 40
Lusti Surrebuttal, Ex. 442 at 12-13
Department Initial Brief at 123-124

Bargaining Unit Wage Increase Correction (2014) - Resolved

PUC Staff: Dorothy Morrissey

RESOLVED: Parties agreed on a \$405,000 reduction in revenue requirements.

Xcel

The Company noted that the 2014 test year included a 3.0 percent wage increase for bargaining unit employees. The union ratified a new agreement with a 2.6 percent wage increase after the

²¹⁵ Ex. 90 at 40 (Heuer Rebuttal)

²¹⁶ Ex. 88 at 80 (Heuer Direct)

²¹⁷ Ex. 442 at 13 (Lusti Surrebuttal)

filing of this rate case. In Rebuttal, the Company proposed a corresponding adjustment to the test year.²¹⁸

Department

The Department agreed with the Company's recommended adjustment.²¹⁹

(Note: The decision alternative for this item is alternatives II, J(5) on p. 19 of the deliberation outline.)

Record Citations:

Heuer Rebuttal, Ex. 90 at 41

Lusti Surrebuttal, Ex. 442 at 33

Department Initial Brief at 156-157

²¹⁸ Ex. 90 at 41 (Heuer Rebuttal)

²¹⁹ Ex. 442 at 33 (Lusti Surrebuttal)