

Staff Briefing Papers

Meeting Date July 19, 2018 Agenda Item 3**

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

Docket Nos. **E-002/GR-92-1185, G-002/GR-92-1186, E,G-002/M-17-429**

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.

In the Matter of the Petition of Northern States Power Gas Utility for Authority to Change its Schedule of Gas Rates for Retail Customers within the State of Minnesota.

In the Matter of the Petition of Northern States Power Company, doing business as Xcel Energy (Xcel Energy), for Approval of its Annual Report of its 2016 Incentive Compensation Plan.

Issues Should Xcel Energy's Annual Report of its 2016 Incentive Compensation Plan be accepted as originally filed?

How should Xcel Energy calculate whether a refund of incentive compensation is due?

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The attached materials are work papers of the Commission Staff. They are intended for use by the Public Utilities Commission and are based upon information already in the record unless noted otherwise.

 **Relevant Documents**

Date

Xcel Energy – 2016 Incentive Compensation Annual Report (Non-Public)	May 26, 2017
Minnesota Department of Commerce, Division of Energy Resources (Department) – Comments	June 22, 2017
Minnesota Public Utilities Commission (Commission) – Notice of Comment Period	March 14, 2018
Xcel Energy – Comments	April 12, 2018
Department – Comments (complete – including Attachment A)	April 16, 2018
Xcel Energy – Reply Comments	April 23, 2018

I. Statement of the Issues

Should Xcel Energy's Annual Report of its 2016 Incentive Compensation Plan be accepted as originally filed?

How should Xcel Energy calculate whether a refund of incentive compensation is due?

II. Background and Introduction

On May 26, 2017, Northern States Power Company d/b/a Xcel Energy (Xcel Energy or Xcel) filed its Annual Report of its Incentive Compensation Plan for 2016 in compliance with the Commission's December 30, 1993 Order in Docket No. G002/GR-92-1186 and its January 14, 1994 Order in Docket No. E002/GR-92-1185. The Commission's Ordering paragraphs 2 and 3, respectively, in these two orders stated that:

The Company shall record for future refund all incentive compensation payments earned under the terms of the plan and recoverable in rates under this Order but not paid.

The Company shall file a report on or before April 1, 1995 and annually thereafter evaluating the operation and performance of its incentive compensation plan. The report shall include, but shall not necessarily be limited to, an accounting of all amounts paid under the plan, an accounting of all amounts recorded as earned but not paid, and an evaluation of the plan's success in meeting its stated goals, including controlling overall compensation costs.

On June 22, 2017, the Minnesota Department of Commerce, Division of Energy Resources (Department) submitted comments recommending that the Commission accept the Company's 2016 Report as being compliant with the Commission's Order.

On July 31, 2017, PUC staff asked the parties (Xcel Energy and the Department) by e-mail why a refund was not due on the electric operations.

On March 14, 2018, the Commission issued a Notice of Comment Period asking for comments on the proper calculation of whether a ratepayer refund is due. Specifically asking:

- In determining whether a ratepayer refund is due, should Xcel compare the amount approved in base rates to (1) the amount eligible for recovery that was actually paid, or (2) the total amount of incentive compensation paid, including both the current amount that is eligible for cost recovery and the amount ineligible for cost recovery?

On April 12, 2018, Xcel and the Department each filed comments. (On April 16, the Department resubmitted its comments to include Attachment A.)

In its Comments, Xcel stated that it believes “the amount of AIP [Annual Incentive Compensation Plan] approved in base rates should be compared to the total amount of incentive compensation paid.” Xcel said it believes “this comparison is the appropriate calculation method because it is consistent with the intent of what the 15 percent cap was designed to accomplish and complies with the historical Commission Orders.” Xcel requested that the Commission approve its 2016 Annual Incentive Compensation Plan report as originally filed.

In its Comments, the Department provided background on the Commission’s treatment of incentive compensation in several of Xcel’s prior rate cases. The Department asserted that Option 1, which compares the amount of AIP paid out that was eligible for recovery from ratepayers (excludes AIP in excess of 15 percent of an individual’s base pay) to the amount included in base rates, is the appropriate comparison for determining whether a refund to ratepayers is due based on the fact that the amount of incentive compensation approved by the Commission in recent rate cases is based on the summation of all individual eligible employees’ AIP compensation being limited to 15 percent of his/her base compensation. The Department concluded that Xcel Electric owes its ratepayers \$1,278,656.

On April 23, 2018, Xcel filed Reply Comments in which it reiterated that the Company’s proposed methodology which compares the total amount of AIP paid out in a year (including AIP in excess of 15 percent of an individual’s base pay) to the amount included in base rates protects customers and provides the Company with the correct incentive to reward high performing employees. However, Xcel stated, “if the Commission wishes to modify our proposed methodology, we believe it would be appropriate to do so on a going-forward basis, beginning with the 2017 Plan year.” Xcel requested that the Commission accept its 2016 report on its Annual Incentive Compensation Plan as originally filed.

III. Parties’ Positions

A. Xcel Energy

According to Xcel, since it paid more in incentive compensation costs in Minnesota than it recovered through rates, there are no funds eligible for refund.

In its April 12, 2018 Comments, Xcel stated that, in calculating whether a refund is due, it believes the amount of the Annual Incentive Compensation Plan (AIP) approved in base rates should be compared to the total amount of incentive compensation paid. Xcel believes “this comparison is the appropriate calculation method because it is consistent with the intent of what the 15 percent cap was designed to accomplish and complies with the historical Commission Orders.”

Xcel stated that,

[F]or 2016, we did pay out more in AIP than we collected in base rates. As such, we do not believe it is reasonable to conclude that the Company over-recovered any money with respect to AIP for 2016.

By way of background, Xcel explained:

The amount included in base rates was calculated by taking the test year target payout of AIP, no greater than 100 percent of a four-year average AIP payout, and then further limiting this amount to a cap of 15 percent of base salary. With these limitations, customers are not funding the full cost of employee compensation.

Thus, the amount of AIP included in base rates has already been limited in two ways: by limiting the amount to no more than a four-year historic average and by limiting it to 15 percent of base salary. Once these two limiting factors have been applied to set the amount included in base rates, we believe the proper comparison for compliance purposes is a comparison of the actual total AIP dollars paid out in a given year to the AIP dollars included in base rates. In other words, we do not believe the 15 percent cap should be applied on both sides of the comparison ledger—that is, to both the base rate calculation and the amount of actual AIP paid out in a given year. Indeed, the 15 percent cap in base rates already fully ensures that customers do not pay for AIP amounts in excess of 15 percent of base salary. Applying the cap a second time to the amount of AIP actually paid distorts the comparison between actual AIP paid and the capped amount of AIP that is part of base rates. The 15 percent cap is intended to limit the amount of AIP that is recoverable through base rates, and the cap achieves this goal at the time base rates are set.

According to Xcel, “The Commission’s original intent in setting a 15 percent cap on AIP was to exclude recovery of a portion of the incentive compensation costs related to executives.”

Xcel states:

We are also guided by Ordering Point No. 29 of the Commission’s Order in the 2012 electric rate case (Docket No. E002/GR-12-961) which states, “Xcel shall retain its existing refund mechanism, which provides customer refunds *in the event that the incentive compensation payouts are lower than the test-year level approved in rates*” (emphasis added). We believe this Order Point supports a broader comparison between total actual AIP paid and the capped amount of AIP in base rates and, as discussed below, that the more granular approach creates negative incentives.

Xcel believes that “Comparing the capped payout to the amount included in base rates would create poor incentives to not manage the AIP as intended, and could lead to demotivating high performing employees.”

Xcel concluded its April 12, 2018 Comments as follows:

The Xcel Energy incentive program is working as designed. Employees are paid incentive compensation when they achieve higher levels of performance. We respect the Commission's Order to cap the recovery during the rate making process, but do not believe the Company should be penalized with an additional limitation after actual results are known and paid above the level of recovery. As discussed in these Comments, our AIP payout calculation methodology complies with the Commission's Orders in that we are overall paying out more AIP than we collect in base rates. We respectfully request that the Commission approve our 2016 report on our Annual Incentive Compensation Plan as originally filed.

In its April 23, 2018 Reply Comments, Xcel stated:

Given the extensive record regarding AIP over many years and in many different dockets, it is not surprising that there are multiple interpretations of the best way to apply a refund calculation. It is our intent to present the AIP results information accurately and to issue refunds when doing so is consistent with Commission direction. We do not believe a refund is necessary for 2016, or for 2015, because we believe our methodology for calculating a potential refund is correct and is a reasonable interpretation of the record.

CONCLUSION

In summary, our goal in this proceeding is to implement the Commission's Order in a way that is both fair and consistent with sound public policy. As discussed in our April 12, 2018 Comments, the Company's proposed methodology protects customers and provides the Company with the correct incentive to reward high performing employees. However, if the Commission wishes to modify our proposed methodology, we believe it would be appropriate to do so on a going-forward basis, beginning with the 2017 Plan year. We respectfully request that the Commission accept our 2016 report on our Annual Incentive Compensation Plan as originally filed.

B. Department

In its initial, June 22, 2017 Comments, the Department stated that it reviewed documents from the appropriate rate cases, and verified that the incentive compensation included in current rates for the electric utility is \$19,237,706 and for the gas utility is \$927,885. The Department initially agreed with Xcel Energy that the Company does not have unpaid earned incentive compensation that exceeds the amount recoverable in base rates.

However, in response to the Commission's March 14, 2018 Notice of Comment Period regarding the issue of the calculation of incentive compensation funds collected in rates that are not paid, the Department filed Comments on April 12, 2018 in which it concluded that Xcel Electric owes its ratepayers \$1,278,656.

In its April 12, 2018 Comments, the Department provides a background on the Commission's treatment of incentive compensation in several of Xcel's rate cases, and analyzes the two options specified in the Commission's Notice of Comment Period to determine whether a ratepayer refund is due and defines them as Options 1 and 2 as follows:

Option 1 – This option compares the amount of AIP paid out that was eligible for recovery from ratepayers (this amount excludes AIP in excess of 15 percent of an individual's base pay) to the amount included in base rates. In this option, if the amount of AIP paid during the year that was eligible for rate recovery is greater than the amount approved in base rates, there would be no refund due. In the year 2016, using information provided in the Company's May 26, 2017 Incentive Compensation Annual Report, Attachment E, Page 1 of 1, (and also as included in Attachment A to these Comments), the Company's AIP compensation that was eligible for recovery from Xcel Electric customers was \$18,114,696. Thus, because the amount approved in electric base rates was \$19,393,351, and is larger than the amount eligible for recovery, there would be an over-collection of \$1,278,656 eligible for refund.

Option 2 – This option compares the total amount of AIP paid (including both amounts eligible for recovery as well as those ineligible for recovery) to the amount included in base rates. In this option, if the amount of AIP paid during the year is greater than the amount approved in base rates, there would be no refund due. Thus, in the year 2016, as shown in Attachment A, the Company paid \$22,443,649 in Minnesota jurisdictional incentive compensation. Since the amount of incentive compensation approved in base rates in its most recent rate case was \$19,393,351, which is less than the amount paid, there would be no refund due. Additionally, the Company would have recovered through base rates, 86.4 percent of the incentive compensation paid out in 2016.

The Department notes under Option 1, there would have been refunds due to ratepayers in the years 2015 and 2016. However, under Option 2, there would be no refunds due ratepayers in any of the years 2012 thru 2016 as can be seen in Attachment A.

The Department stated:

Unfortunately, the Department's comments filed on June 22, 2017 focused on the text of Xcel's filing and did not identify that Attachment C of Xcel's May 26, 2017 filing showed that the incentive compensation paid by Xcel Electric was less than the amount built into rates. The Department apologizes for this inadvertent oversight. Specifically, as noted above, Xcel Electric paid \$18,114,696 in annual incentive compensation while charging Xcel Electric Ratepayers \$19,393,351. As a

result, under Option 1, the Department now concludes that Xcel Electric owes its ratepayers \$1,278,656.¹

In conclusion, the Department stated:

The Department asserts that Option 1 is the appropriate comparison based on the fact that the amount of incentive compensation approved by the Commission in recent rate cases is based on the summation of all individual eligible employees' AIP compensation being limited to 15 percent of his/her base compensation.

As first stated by the Commission in its 92-1185 Order identified above, "the Commission will limit recoverable incentive payments to 15 percent of an individual's base salary." The methodology of calculating Xcel's test-year AIP compensation in recent rate cases by both the Company and the Department has been to limit recoverable payments to 15 percent of an individual's base compensation.

Refunding to ratepayers AIP amounts included in base rates that exceed amounts paid that are eligible for recovery is in keeping with the Commission's 92-1185 Order identified above, which limits recoverable compensation to 15 percent of an individual's base compensation. Therefore, the Department concludes that Xcel Electric owes its ratepayers \$1,278,656.

IV. Staff Analysis

Since the Commission's Orders can be interpreted in different ways, the Commission may wish to provide direction on how to calculate whether a refund is due. What the Department calls Option 1, the Department's preferred methodology, and Option 2, Xcel's methodology, have been put forward. If the Commission selects Option 1, which compares the amount approved in base rates to the amount of AIP paid out that was eligible for recovery (excludes AIP paid out in excess of 15 percent of an individual's base pay), as the appropriate methodology, it will need to decide when that approach should begin to be applied – to the 2016 Plan year currently before the Commission, retroactively to the 2015 Plan year, or prospectively beginning with the 2017 Plan year.

If the Commission selects Option 2, which compares the amount approved in base rates to the total amount of AIP paid out (including AIP in excess of 15 percent of an individual's base pay), as the appropriate methodology, it can accept Xcel's 2016 Report on its Annual Compensation Plan as originally filed because that is the methodology Xcel has been using.

¹ A similar circumstance occurred in Docket No. E,G-002/M-16-482, with Xcel Electric paying \$17,254,100 in annual incentive compensation while charging ratepayers \$17,584,311, resulting in an overcharge of \$330,211. However, the Commission issued its Order in that proceeding on October 3, 2016.

V. Decision Options

1. Determine that the proper comparison for calculating whether a refund is due is to compare the amount approved in base rates to the total amount of AIP paid out, and accept Xcel's 2016 Report on its Annual Compensation Plan as originally filed. [Xcel]

or
2. Determine that the proper comparison for calculating whether a refund is due is to compare the amount approved in base rates to the amount of AIP paid out that was eligible for recovery from ratepayers (i.e., excludes AIP in excess of 15 percent of an individual's base pay) and
 - a. require Xcel Electric to refund electric ratepayers the 2016 amount of \$1,278,656 [Department]; or
 - b. accept Xcel's 2016 Report on its Annual Compensation Plan as originally filed but require Xcel to apply this methodology on a going-forward basis, beginning with the 2017 Plan year [Xcel Alternative]; or
 - c. require Xcel Electric to refund electric ratepayers the 2016 amount of \$1,278,656 plus the 2015 amount of \$330,211.