BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

* * * * *

RE: IN THE MATTER OF ADVICE LETTER NO. 1672-ELECTRIC FILED BY PUBLIC SERVICE COMPANY OF COLORADO TO REVISE ITS COLORADO PUC NO. 7-ELECTRIC TARIFF TO IMPLEMENT A GENERAL RATE SCHEDULE ADJUSTMENT AND OTHER OTHER CHANGES EFFECTIVE JULY 18, 2014.	**)**	**PROCEEDING NO. 14AL-0660E**
IN THE MATTER OF THE APPLICATION OF PUBLIC SERVICE COMPANY OF COLORADO FOR APPROVAL OF ITS ARAPAHOE DECOMMISSIONING AND DISMANTLING PLAN.	**)**	**PROCEEDING NO. 14A-0680E**

REBUTTAL TESTIMONY AND ATTACHMENTS OF GENE H. WICKES

ON

BEHALF OF

PUBLIC SERVICE COMPANY OF COLORADO

December 17, 2014

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

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SUMMARY OF REBUTTAL TESTIMONY OF GENE H. WICKES

Gene H. Wickes is a Senior Consultant and Actuary employed by Towers Watson & Co. Mr. Wickes, who also serves as the Managing Director for Towers Watson's Benefit Segment, has over 35 years of experience consulting with organizations on the design and financial considerations of their pension programs. He is a Fellow of the Society of Actuaries, a Fellow of the Conference of Consulting Actuaries, and an Enrolled Actuary under the Employee Retirement Income Security Act of 1974. Mr. Wickes has not previously submitted testimony in this proceeding.

Mr. Wickes explains that Staff witnesses Fiona D. Sigalla and David G. Pitts err by stating that Statement of Financial Accounting Standards ("FAS") 87

has a known bias to underestimate pension expense. A number of stakeholders, including pension plan sponsors, actuaries, and auditors, have an interest in providing accurate estimates of pension expense, and if FAS 87 had a bias to underestimate pension expense, those stakeholders would have asked the Financial Accounting Standards Board to undertake a revision of FAS 87 by now. Moreover, the Staff witnesses can point to no authority other than their own statements that FAS 87 has a known bias to underestimate pension expense. Therefore, the Commission should reject the Staff witnesses' criticism of FAS 87.

The Commission should also reject the Staff witnesses' proposal to set annual pension cost for Public Service Company of Colorado ("Company") using primarily the service cost component of the FAS 87 calculation. In addition to being vague, the proposal creates risk for customers because it deprives them of the opportunity for liability gains.

In addition, the Commission should deny Staff's proposal to require the Company to seek Commission approval before making contributions in excess of the pension expense. The proposal is unnecessary; it interferes with the Company's ability to respond quickly to changing conditions; and it may create unintended consequences, such as making the Commission a fiduciary of the pension plan trusts.

Mr. Wickes also takes issue with Ms. Sigalla's characterization of other regulatory commissions' treatment of the prepaid pension asset. The very study she cites indicates that at least 24 jurisdictions allow the prepaid pension asset to be included in rate base, one of which is this Commission.

Staff has provided no reason in this case for the Commission to depart from its long-standing precedent of allowing the prepaid pension asset to be included in rate base and of allowing the Company to earn a return at its weighted average cost of capital.

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REBUTTAL TESTIMONY AND ATTACHMENTS OF GENE H. WICKES

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LIST OF ATTACHMENTS

Attachment	Description
Attachment No. GHW-1	CPUC Response to PSCo Request No. 4-6
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Attachment No. GHW-6	In the Matter of *Southwestern Public Service Company's* Application for Revision of its Retail Electric Rates under Advice Notice No. 245, Case No. 12-00350-UT, Final Order Partially Adopting Recommended Decision at 11 (Mar. 26, 2014)
Attachment No. GHW-7	Application of *AEP Texas Central Company* for Authority to Change Rates, Docket No. 33309, Order on Rehearing at 6 (Mar. 4, 2008)
Attachment No. GHW-8	Application of *Entergy Texas, Inc.* to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment, Docket No. 39896, Order on Rehearing at 14 (FoF 27-28A) (Nov. 1, 2012)
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Attachment No. GHW-10	*Southern Company Services, Inc.*, 122 FERC ¶ 61,218 (Mar. 10, 2008)
Attachment No. GHW-11	*Delaware Public Service Comm'n*, In the Matter of the Application of Delmarva Power and Light Company for Approval of a Change in Electric Distribution Rates and Miscellaneous Tariff Changes, Docket No. 13-115, Order No. 8589 at 63-64 (Aug. 5, 2014)
Attachment No. GHW-12	*District of Columbia Public Service Comm'n, Potomac Electric Power Company*, Formal Case No. 1053, Order No. 14832, ¶ 9 (June 13, 2008)
Attachment No. GHW-13	*Indiana Utility Regulatory Comm'n* Petition of *Indiana Michigan Power Company* for Authority to Increase Its Rates and Charges for Electric Utility Service, Cause No. 44075, Order at 30-31 (Feb. 13, 2013)

Attachment No. GHW-14	*Maryland Public Service Comm'n, Potomac Electric Power Company*, Case No. 9092, Order No. 81517 (July 19, 2007)
Attachment No. GHW-15	*Public Service Comm'n of Missouri*, In the Matter of *Missouri Gas Energy* and Its Tariff Filing to Implement a General Rate Increase for Natural Gas Service, File No. GR-2009-0355 (Feb. 20, 2010)
Attachment No. GHW-16	*Public Utilities Comm'n of Ohio*, In the Matter of the Commission Review of the Capacity Charges of *Ohio Power Company* and *Columbus Southern Power Company*, Case No. 10-2929-EL-UNC, Order at 78 (July 2, 2012)
Attachment No. GHW-17	*Oklahoma Corporation Comm'n, Empire District Electric Company*, Cause No. PUD 201100082, Order No. 592623 (Jan. 4, 2012)

GLOSSARY OF ACRONYMS AND DEFINED TERMS

Acronym/Defined Term	**Meaning**
Commission Staff, CPUC Staff, or Staff	Colorado Public Utilities Commission
ERISA	Employee Retirement Income Security Act of 1974
EROA	Expected Return on Assets
FAS	Financial Accounting Standard
FASB	Financial Accounting Standards Board
FCC	Federal Communications Commission
FERC	Federal Energy Regulatory Commission
NMPRC	New Mexico Public Regulation Commission
NSPM	Northern States Power – Minnesota
NSPW	Northern States Power – Wisconsin
OCC	Colorado Office of Consumer Counsel
PBGC	Pension Benefit Guaranty Corporation
PBO	Present Benefit Obligation
Public Service or the Company	Public Service Company of Colorado
SPS	Southwestern Public Service
Towers Watson	Towers Watson & Co.
Xcel Energy	Xcel Energy Services Inc.

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REBUTTAL TESTIMONY AND ATTACHMENTS OF GENE H. WICKES

1 **I. INTRODUCTION, QUALIFICATIONS, PURPOSE OF TESTIMONY, AND**
2 **RECOMMENDATIONS**

3 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS**.

4 A. My name is Gene H. Wickes. My business address is 555 17th Street, Suite
5 2050, Denver, Colorado 80202.

6 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY AND ATTACHMENTS**
7 **IN THIS PROCEEDING?**

8 A. No. I am submitting testimony on behalf of Public Service Company of
9 Colorado ("Public Service" or "Company") for the first time in rebuttal.

1 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT POSITION?**

2 A. I am employed by Towers Watson & Co. ("Towers Watson") as a Senior
3 Consultant and Actuary. I also serve as the Managing Director for Towers
4 Watson's Benefit Segment.

5 **Q. PLEASE SUMMARIZE YOUR QUALIFICATIONS AND EXPERIENCE.**

6 A. I attended Brigham Young University, where I received a Bachelor of Science
7 degree in Mathematics, a Master of Science degree in Mathematics, and a
8 Master of Science degree in Economics. I have over 35 years of experience
9 consulting with organizations on the design and financial considerations of their
10 pension programs. I am a Fellow of the Society of Actuaries, a Fellow of the
11 Conference of Consulting Actuaries, and an Enrolled Actuary under the
12 Employee Retirement Income Security Act of 1974 ("ERISA"). A description of
13 my qualifications is included as Attachment A.

14 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

15 A. In my Rebuttal Testimony, I respond to the recommendation by two Colorado
16 Public Utilities Commission Staff ("Staff") witnesses – Fiona D. Sigalla and David
17 G. Pitts – that the Commission eliminate the prepaid pension asset from rate
18 base and prevent the Company from recovering $143 million of the prepaid
19 amounts from customers. As part of that discussion, I explain that Mr. Pitts and
20 Ms. Sigalla are mistaken when they argue that Statement of Financial Accounting
21 Standards ("FAS") 87 has a known bias toward underestimating pension
22 expense. I also explain that using primarily the service cost component of the
23 FAS 87 pension cost calculation to establish the Company's pension expense

1 would be highly irregular and would ultimately harm customers. I further discuss
2 Staff's recommendation that the Company be required to obtain Commission
3 approval before making any contributions in excess of the pension expense, and I
4 explain that such a requirement would impose risks on both the Company and the
5 Commission. Finally, I explain that Ms. Sigalla's testimony regarding the
6 treatment of prepaid pension assets in other jurisdictions is incomplete and in
7 some instances inaccurate.

8 **Q. ARE YOU SPONSORING ANY ATTACHMENTS AS PART OF YOUR**
9 **REBUTTAL TESTIMONY?**

10 A. Yes. I am sponsoring Attachment Nos. GHW-1 through GHW-17, which consist
11 of copies of discovery responses that I cite in this Rebuttal Testimony, and
12 excerpts from decisions showing how the prepaid pension asset is treated in
13 other jurisdictions.

14 **Q. WHAT RECOMMENDATIONS ARE YOU MAKING IN YOUR TESTIMONY?**

15 A. I recommend that the Commission reject Staff's proposals to eliminate the
16 prepaid pension asset from rate base and to disallow recovery of part of the
17 prepaid pension asset balance. I also recommend that the Commission reject
18 Staff's recommendation to set the Company's pension expense based solely on
19 the service cost calculated under FAS 87. Those Staff recommendations are
20 based on misguided views of the purpose and operation of FAS 87, as well as
21 misunderstandings of how prepaid pension assets have been treated in other
22 jurisdictions. I also recommend that the Commission reject Staff's proposal to

1 require the Company to obtain Commission approval before making any
2 contributions to the pension plans in excess of the pension expense amounts.

3 **Q. ARE ANY OTHER COMPANY WITNESSES TESTIFYING REGARDING THE**
4 **PREPAID PENSION ASSET AND PENSION-RELATED COSTS?**

5 A. Yes. Mr. Richard R. Schrubbe rebuts arguments by Staff and Intervenor
6 witnesses on the prepaid pension asset and annual pension costs. Mr. George
7 E. Tyson II responds to Ms. Sigalla's suggestion that the Company has not
8 managed its pension trusts appropriately, and he explains why the Company has
9 made contributions to the pension plan trusts in excess of the minimum amounts
10 required by the Pension Protection Act.
11

II. USE OF FAS 87 TO CALCULATE PENSION EXPENSE

Q. WHAT TOPICS DO YOU ADDRESS IN THIS SECTION OF YOUR REBUTTAL TESTIMONY?

A. I address two topics in this section. First, I rebut the Staff witnesses' erroneous contention that FAS 87 has a bias toward understatement of the annual pension cost. Second, I describe the flaws in those witnesses' recommendation that the Commission set the Company's annual pension cost using primarily the service cost component of FAS 87.

A. RESPONSE TO "BIAS" ARGUMENT

Q. BEFORE PROCEEDING TO THE STAFF WITNESSES' ARGUMENT THAT FAS 87 HAS A BIAS TOWARD UNDERSTATEMENT OF ANNUAL PENSION COST, PLEASE PROVIDE A BRIEF EXPLANATION OF FAS 87.

A. FAS87 is an accounting standard adopted by the Financial Accounting Standards Board ("FASB") in 1987 to govern employers' accounting for pensions. The adoption of FAS 87 was intended to achieve several goals, such as providing greater consistency among companies regarding the method of accounting for pensions, and providing more transparency in financial statements by improving the financial disclosures regarding pensions.[1] FAS 87 also led to market-based values for assets and liabilities in the disclosures by requiring that the discount rate for plan liabilities be based on rates implicit in current prices for settling the plan liabilities. In addition, FAS 87 provided

[1] *See generally* http://www.fasb.org/summary/stsum87.shtml

1 mechanisms to minimize cost volatility from year-to-year by phasing in asset
2 gains and losses and by amortizing gains and losses.

3 **Q. HOW IS ANNUAL PENSION COST CALCULATED UNDER FAS 87?**

4 A. Under FAS 87, pension cost is made up of five components:

5 (1) the present value of pension benefits that employees will earn during
6 the current year (service cost);

7 (2) the increase in the present value of the pension benefit obligation that
8 plan participants have earned in previous years (interest cost);

9 (3) the investment earnings that are expected to be earned during the year
10 on the pension plan assets (expected return on assets – "EROA");

11 (4) the recognition of costs (or income) from experience that differs from
12 the assumptions, (*e.g.*, investment earnings different than assumed or
13 amortization of unrecognized gains and losses); and

14 (5) the recognition of the cost of benefit changes the plan sponsor provides
15 for service the employees have already performed (amortization of
16 unrecognized prior service cost).

17 **Q. DO OTHER REGULATED UTILITIES USE FAS 87 FOR PURPOSES OF**
18 **CALCULATING THEIR ANNUAL PENSION COST?**

19 A. Yes. Based upon my experience, FAS 87 is used by the great majority of
20 utilities to calculate annual pension cost. That is confirmed by the Oregon
21 Public Utility Commission Pension Survey Summary report that is Attachment

1 FDS-49 to Ms. Sigalla's testimony, which states that 44 of 52 respondents use
2 FAS 87 as the basis for deciding the level of recovery.[2]

3 **Q. DESPITE THE WIDESPREAD USE OF FAS 87 TO SET ANNUAL PENSION**
4 **COST, MS. SIGALLA STATES THAT "FAS 87 HAS A KNOWN BIAS TO**
5 **UNDERESTIMATE PENSION EXPENSE."[3] DOES SHE CITE ANY**
6 **AUTHORITY FOR THAT ASSERTION?**

7 A. No. She merely refers to Mr. Pitts's testimony,[4] but he provides no authority for
8 that assertion either. In fact, when asked in discovery for all documents that
9 support the assertion that FAS 87 has a known bias to understate pension
10 expense, Mr. Pitts could not cite to a single document that makes such a
11 statement.[5] Instead, he resorted to arguing that it is "common knowledge within
12 the pension actuarial community that the FAS 87 smoothing mechanisms and
13 gain/loss corridors allowed companies to recover pension expense that was
14 significantly lower than actual cash costs."[6]

15 **Q. ARE YOU A MEMBER OF THE "PENSION ACTUARIAL COMMUNITY"?**

16 A. Yes. As I noted earlier, I have over 35 years of experience consulting with
17 organizations on the design and financial considerations of their pension

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[2] Sigalla Answer Testimony, Attachment FDS-49 at 2.

[3] Sigalla Answer Testimony at 23.

[4] CPUC Response to PSCo Request No. 4-6 (Attachment No. GHW-1).

[5] CPUC Response to PSCo Request No. 2-29 (Attachment No. GHW-2).

[6] CPUC Response to PSCo Request No. 2-29 (Attachment No. GHW-2). In his response to PSCo Request No. 2-29, Mr. Pitts points to a 2006 Moody's article indicating that 50 large companies had underfunded pension trusts at that time. But that does not demonstrate that FAS 87 has a known bias to underestimate pension expense. There might have been as many, or more, large companies that had overfunded pension trusts in 2006.

1 programs. In addition, I am a Fellow of the Society of Actuaries, a Fellow of the
2 Conference of Consulting Actuaries, and an Enrolled Actuary under ERISA. I
3 consider those affiliations and my experience sufficient to qualify me as a
4 member of the "pension actuarial community."

5 **Q. IS IT COMMON KNOWLEDGE WITHIN THE PENSION ACTUARIAL**
6 **COMMUNITY THAT FAS 87 HAS A KNOWN BIAS TO UNDERESTIMATE**
7 **PENSION EXPENSE?**

8 A. No.

9 **Q. IF IT WERE COMMON KNOWLEDGE THAT FAS 87 HAS A KNOWN BIAS**
10 **TO UNDERESTIMATE PENSION EXPENSE, WOULD YOU EXPECT THAT**
11 **TO BE REFLECTED IN DOCUMENTS SOMEWHERE?**

12 A. Yes. FAS 87 would have fallen out of favor long ago with pension plan
13 sponsors, actuaries, and auditors if it had consistently understated annual
14 pension cost. I also believe that FASB would have modified the FAS 87
15 pension expense calculation by now if it were to have a known bias to
16 underestimate pension expense. "The mission of the FASB is to establish and
17 improve standards of financial accounting and reporting that foster financial
18 reporting by nongovernmental entities that provides decision-useful information
19 to investors and other users of financial reports."[7] FAS 87 pension expense
20 methods have been in place since 1987 without modification. FASB has
21 modified several aspects of pension accounting methods since 1987 (including
22 changes to balance sheet reporting and disclosures under FAS 158), but it has

[7] www.fasb.org: *About Us: Facts About FASB*

1 not changed the calculation of pension expense. By using FAS 87 accounting
2 methodology for determining pension expense, the Company is following
3 standards that are officially recognized as authoritative by the Securities and
4 Exchange Commission and the American Institute of Certified Public
5 Accountants.

6 **Q. WHY WOULD PENSION PLAN SPONSORS BE CONCERNED IF FAS 87**
7 **CONSISTENTLY UNDERSTATED OR OVERSTATED ANNUAL PENSION**
8 **COST?**

9 A. FASB, the actuarial professional groups that define actuarial standards, and
10 federal agencies have detailed guidelines on the application of FAS 87,
11 including the selection of actuarial assumptions. As a result, the plan sponsor's
12 assumption selection process is subject to significant oversight. For pension
13 plan liabilities, if a company were to use methods or assumptions that were
14 unreasonable or inconsistent with acceptable standards of practice, the
15 company's actuaries would need to disclose their concerns. Each plan sponsor
16 must have an independent auditor, and that auditor also reviews and evaluates
17 the company's financial statements, including the information on the pension
18 plans and assumptions. Similar to the actuaries, the auditors would be obligated
19 to disclose concerns if they disagreed with the assumptions used by the plan
20 sponsor.

21

1 **Q. ARE ACTUARIES AND AUDITORS SUBJECT TO SANCTIONS IF THEY**
2 **CONDONE PENSION PLAN ASSUMPTIONS THAT DO NOT REPRESENT A**
3 **FAIR DEPICTION OF ANNUAL PENSION COST?**
4 A. Yes. Actuaries are bound by the Actuarial Standards of Practice, including
5 those that pertain to measuring pension obligations and the assumption
6 selection process. When evaluating a prescribed assumption or method
7 selected by the pension plan sponsor for calculating pension cost, actuaries
8 must consider whether the assumption or method significantly conflicts with
9 what, in their professional judgment, would be reasonable for purposes of the
10 measurement. If there is a significant conflict, the actuary must disclose the
11 conflict in appropriate communications. Failure to do so could result in
12 disciplinary action for the actuary within the profession and could subject the
13 actuary's employer to significant financial risk. Similarly, auditors have a
14 professional duty to make disclosures if they do not believe the plan sponsor's
15 financial statements accurately depict the sponsor's financial condition.
16 **Q. YOU HAVE THUS FAR BEEN DISCUSSING WHY THERE IS NO REASON**
17 **TO BELIEVE FAS 87 HAS A KNOWN BIAS TO UNDERESTIMATE PENSION**
18 **COST. IS THERE REASON TO BELIEVE THE OPPOSITE – THAT IN FACT**
19 **FAS 87 GENERALLY RESULTS IN A FAIR REPRESENTATION OF ANNUAL**
20 **PENSION COST?**
21 A. Yes. I believe FAS 87 fairly presents annual pension cost because it
22 incorporates all elements of the cost of providing these benefits – the service
23 cost that reflects the cost of annual accruals for current employees; the interest

costs; the investment returns that recognize the growth in the assets to offset these costs; the amortizations of gains and losses that reflect costs associated with benefits earned prior to the current year; and the amortization of all prior service costs.

Q. IN THE PREVIOUS ANSWER, YOU REFERRED TO GAINS AND LOSSES FROM PRIOR YEARS. DOES THE EXISTENCE OF GAINS AND LOSSES FROM PRIOR YEARS IMPLY THAT FAS 87 IS SOMEHOW DEFECTIVE?

A. No. It simply means the plan sponsor (like everyone else) cannot precisely predict the future. But that is true of nearly all forecasted amounts. In some years the expected return on plan assets will be set higher than the actual return, and in some years it will be set lower than the actual return. In addition, gains and losses may result from demographic experience that is different from what is expected, including changes in retirement or turnover patterns and changes in assumptions such as mortality improvements and discount rates. Based on the premise that gains and losses will occur, FAS 87 provides a mechanism for recognizing these differences in the ongoing costs.

Q. DO YOU BELIEVE THAT FAS 87 IS APPROPRIATE FOR DETERMINING PENSION COSTS IN RATE CASES?

A. Yes. Given the complexity of the actuarial calculations and the importance of the assumptions to the cost determination, FAS 87 has the following benefits:

- it is a well-established method, driven by external guidelines and standards of practice that ensure reasonable assumptions are chosen and methods are applied as intended; and

1 - it provides mechanisms to smooth out the costs, allowing for less variability
2   and more predictability in the level of costs.

3 I therefore recommend that the Commission reject Staff's argument that FAS
4 87 be discarded as the basis for calculating annual pension cost.

5 **B. RESPONSE TO PROPOSAL TO USE SERVICE COST ONLY**

6 **Q. MS. SIGALLA AND MR. PITTS RECOMMEND THAT THE COMMISSION SET**
7 **ANNUAL PENSION COST BASED PRIMARILY ON THE SERVICE COST**
8 **CALCULATED UNDER FAS 87.[8] IS THAT A COMMON APPROACH TO**
9 **CALCULATING ANNUAL PENSION COST?**

10 A. No. I am not aware of any companies that calculate their annual pension costs
11 based primarily on the FAS 87 service cost.[9] I would further note that both Ms.
12 Sigalla and Mr. Pitts are also unaware of any companies that calculate pension
13 cost based primarily on service cost calculated under FAS 87. In response to
14 discovery from Public Service, they conceded they know of no companies that
15 establish annual pension cost based on just the service cost calculated under
16 FAS 87.[10]
17

[8] Pitts Answer Testimony at 51.

[9] I use the word "primarily" because Mr. Pitts recommends that the Commission also approve the inclusion of certain other, undefined amounts. As Mr. Schrubbe explains in his rebuttal testimony, Staff's proposal is too vague to know exactly how annual pension cost would be determined.

[10] CPUC Response to PSCo Request No. 2-34 (Attachment No. GHW-3); CPUC Response to PSCo Request No. 4-4 (Attachment No. GHW-4).

1 **Q. DO YOU RECOMMEND THAT THE COMMISSION ACCEPT STAFF'S**
2 **PROPOSAL TO SET ANNUAL PENSION COST BASED PRIMARILY ON THE**
3 **SERVICE COST COMPONENT OF THE FAS 87 CALCULATION?**
4 A. No. Basing annual pension cost solely on the service cost creates risks not
5 only for the Company, but also for customers. In addition, using service cost as
6 the basis for rate recovery does not recognize all elements of the cost of
7 providing these benefits. As explained earlier, these costs include the service
8 cost, the interest cost, the EROA, the amortization of unrecognized gains and
9 losses, and the amortization of unrecognized prior service costs. These are
10 integral components of FAS 87 expense, and measuring the cost as a single
11 component, the service cost, is simply incomplete.
12 **Q. WHAT ARE THE RISKS TO CUSTOMERS?**
13 A. As I noted earlier, the inability to forecast the future with complete precision
14 means that a plan sponsor's actual experience will almost certainly be different
15 from the assumptions used to set pension cost. If the assumptions produce the
16 "best estimate" as required by the various governing bodies, a liability gain is
17 equally as likely as a liability loss. And if there are demographic gains or
18 losses, FAS 87 has an inherent mechanism to adjust the ongoing costs for the
19 changes in past service liabilities. Gains and losses may reflect refinements in
20 estimates as well as changes in economic values. Because some gains in one
21 period may be offset by losses in another, or vice versa, FAS 87 does not
22 require recognition of gains and losses as a component of net pension cost in
23 the period in which they arise. Using a service cost approach would eliminate

1 the ability to reflect these adjustments in the costs charged to ratepayers. This
2 could result in higher or lower costs for customers than the FAS 87 approach.

3 **Q. HOW COULD IT RESULT IN HIGHER COSTS FOR THE CUSTOMERS?**

4 A. For example, if interest rates rise, the discount rate for obligations would also
5 rise, and there would be a liability gain associated with the past service
6 liabilities. Under FAS 87, a portion of this liability gain would be recognized in
7 the future cost, reducing the cost for customers. Under the approach
8 suggested by Mr. Pitts of using only the service cost component of FAS 87,
9 customers would not see a reduced cost associated with this liability gain.

10 **Q. DO YOU HAVE ANY OTHER CONCERNS WITH STAFF'S**
11 **RECOMMENDATIONS TO ABANDON THE FAS 87 CALCULATION AND TO**
12 **BASE ANNUAL PENSION COST PRIMARILY ON THE SERVICE COST**
13 **COMPONENT OF THAT CALCULATION?**

14 A. Yes. FAS 87 was developed by accountants over many years and has been a
15 well-established method for the past thirty years. New and untested accounting
16 methods and the lack of prescribed guidelines would create significant
17 uncertainty for all stakeholders, and they would likely result in unintended
18 consequences and potentially create unnecessary disputes between the
19 parties.

20

1 **III. <u>PRE-APPROVAL OF CONTRIBUTIONS IN EXCESS OF PENSION EXPENSE</u>**

2 **Q. WHAT TOPIC DO YOU ADDRESS IN THIS SECTION OF YOUR REBUTTAL**
3 **TESTIMONY?**

4 A. I express my concerns with Staff's recommendation that the Commission
5 require Public Service to obtain Commission preapproval to make contributions
6 to the pension trust funds in excess of the pension expense. That approach is
7 unnecessary and impractical, and it could result in risk for both the Commission
8 and the Company.

9 **Q. WHY ARE THE CONTRIBUTIONS AND EXPENSE DIFFERENT IN ANY**
10 **GIVEN YEAR?**

11 A. The expense calculation is governed by the FASB, which sets forth the rules
12 that companies must follow in determining their pension costs in order to have
13 their accounting be acceptable under Generally Accepted Accounting
14 Principles. In contrast, the contributions are driven by federal law requirements
15 under ERISA and the Internal Revenue Code ("IRC") as amended by the
16 Pension Protection Act of 2006. While the expense and contribution
17 calculations both use accrual methodologies, the assumptions, attribution
18 methods and periods over which the costs are required to be recognized are
19 different and thus can often result in different annual amounts.

20 **Q. WHY DO YOU STATE THAT PREAPPROVAL IS UNNECESSARY?**

21 A. A preapproval requirement might be justified if there was some evidence
22 showing that the Company had made contributions that did not need to be
23 made. But all of the contributions made by the Company in recent years were

made in consideration of the funding requirements of the Pension Protection Act. To the extent the Company contributed more than the minimum required amount each year, it was to avoid the need for large contributions if the Company suffered large asset losses or large liability losses in a subsequent year. The Company decided, reasonably in my view, that it was more appropriate to make level contributions over a period of years than to make minimum contributions each year and to remain at risk for volatile swings in pension expense and cash contributions.

Q. IS IT UNUSUAL FOR TODAY'S PENSION PLAN SPONSORS TO CONTRIBUTE MORE THAN THE MINIMUM REQUIRED CONTRIBUTION?

A. No. In fact, in late 2013, Towers Watson conducted a survey of senior finance executives about their objectives and likely actions to reduce risk in their pension plans. In that study, only 25 percent of respondents indicated they contribute only the legal minimum required contribution.

Q. WHY WOULD A PLAN SPONSOR CONTRIBUTE MORE THAN THE MINIMUM REQUIRED AMOUNT?

A. It is important for the Commission to understand that, as a practical matter, the concept of a minimum required contribution for plan sponsors changed significantly as a result of Pension Protection Act. Under the Pension Protection Act, the concept of the minimum required contribution was maintained, but lawmakers were also motivated to provide additional incentives to plan sponsors to keep their plans well-funded in times of short term volatility, even when plan sponsors are making the minimum required contributions.

1 Thus, the Pension Protection Act established a variety of "restrictions" that are
2 triggered by the funded status of the plan - ranging from notices to plan
3 participants, to restricting the plan from paying some forms of payment, to
4 ceasing all future accruals (*i.e.*, freezing the accrual of additional benefits for
5 plan participants). These restrictions bring significant challenges for employee
6 relations and investor relations for any plan sponsor. As a result, today's plan
7 sponsors must evaluate their funded status and the potential risk of Pension
8 Protection Act restrictions, in addition to any minimum required contribution, as
9 part of their funding strategy. This has resulted in all plan sponsors taking a
10 more comprehensive view of managing their contributions rather than simply
11 contributing the minimum. Much of the media coverage and literature at the
12 time that Pension Protection Act was passed referred to instances in which plan
13 sponsors found themselves in financial difficulties with underfunded pension
14 plans that actually had met their minimum contributions over the years. Many
15 of these plans still ended up with deficits and were turned over to the Pension
16 Benefit Guaranty Corporation ("PBGC").
17 **Q. WHY IS IT NOT PRACTICAL FOR THE COMPANY TO SEEK PREAPPROVAL**
18 **OF CONTRIBUTIONS IN EXCESS OF PENSION EXPENSE?**
19 A. As a plan sponsor, the Company has a duty to protect the interests of the plan,
20 which may include responding to new information quickly. If the Company were
21 required to initiate and litigate a proceeding to obtain permission to make
22 contributions, it might be unable to respond to changing conditions in a timely

manner. I also have concerns that a preapproval requirement could result in a number of unintended or undesirable consequences.

Q. WHAT ARE SOME OF THE POTENTIAL CONSEQUENCES?

A. Under ERISA, the Company is considered a fiduciary, which is defined as a person who exercises discretionary authority or control respecting plan management, or management or disposition of assets.[11] If the Commission required the Company to seek approval for contributions, the Commission (or those acting on its behalf) could be considered a fiduciary under the plan.

Q. WHAT IS THE SIGNIFICANCE OF BEING A PLAN FIDUCIARY?

A. ERISA also imposes a duty of loyalty, meaning that a fiduciary must discharge its duties solely in the interest of plan participants and beneficiaries. It is my understanding that the Commission has a duty to protect the public interest, which might be inconsistent with the role of a pension plan fiduciary in certain circumstances.

Q. WHAT ARE THE RAMIFICATIONS OF A FIDUCIARY FAILING TO ACT IN THE INTEREST OF PLAN PARTICIPANTS AND BENEFICIARIES?

A. The individual would be in breach of his or her responsibilities and could be personally liable for any losses to the plan.

Q. ARE THERE OTHER POTENTIAL CONSEQUENCES?

A. Yes. Decisions about how much to contribute to a plan and when to contribute to a plan have become much more complex with recent legislative developments, including the Pension Protection Act and recent increases in

[11] 29 U.S.C. § 1002(21)(A)(i).

PBGC premiums. The issue of whether contributions are made to the plan can not only affect costs, but also may affect plan design and labor relations.

Q. HOW COULD THE PREAPPROVAL REQUIREMENT AFFECT LABOR RELATIONS?

A. I am referring to the potential for the Commission to be thrust in the middle of disagreements between the Company and employee unions. The Pension Protection Act introduced the concept of benefit restrictions, which are tied to the funded status of a plan. As discussed earlier, if certain funded status thresholds are not met, the plan could be required to restrict payments of certain benefits or even cease benefit accruals under the plan. The Company must manage the contributions to ensure it can meet these funded status thresholds and maintain the benefits promised under its labor contracts. If the Commission were to require the Company to seek approval to make these contributions, the Commission may be forced into the middle of labor contract issues.

1 **IV. TREATMENT OF PREPAID PENSION ASSET IN OTHER JURISDICTIONS**

2 **Q. WHAT TOPIC DO YOU ADDRESS IN THIS SECTION OF YOUR REBUTTAL**
3 **TESTIMONY?**

4 A. I explain that Ms. Sigalla's discussion of the treatment of prepaid pension
5 assets in other jurisdictions is incomplete and inaccurate.[12]

6 **Q. HOW IS THE PREPAID PENSION ASSET TREATED IN EACH**
7 **JURISDICTION IN WHICH THE XCEL ENERGY OPERATING COMPANIES**
8 **PROVIDES SERVICE?**

9 A. All of the jurisdictions in which the Xcel Energy operating companies provide
10 service allow the utility to earn a return on the prepaid pension asset:

11 • Colorado – As Mr. Schrubbe explains in more detail, this Commission first
12 allowed the Company to include a prepaid pension asset in rate base in
13 Proceeding No. 93S-001EG, and to my knowledge the Company has included
14 the prepaid pension asset in rate base in every case since that time. In the
15 Company's most recent gas case, Proceeding No. 12AL-1268G, the
16 Commission approved the inclusion of the prepaid pension asset in rate base
17 over Staff's objection.[13]

18 • Michigan – Northern States Power Company, a Wisconsin corporation
19 ("NSPW") recovers the prepaid pension asset in Michigan through cash
20 working capital. There was no disallowance from the filed amount in NSPW's
21 most recent full rate case, Docket No. 17488.

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[12] Sigalla Answer Testimony at 48-58.

[13] Proceeding No. 12AL-1268G, Decision No. 13-1307R at 72-73 (Attachment No. GHW-5).

1 • Minnesota – Northern States Power Company, a Minnesota corporation
2 ("NSPM") included the prepaid pension asset in rate base in its currently
3 pending case, and no party challenged that element of rate base. NSPM also
4 included its prepaid pension asset in rate base in previous cases, and no one
5 challenged it.
6 • New Mexico – In 2014, the New Mexico Public Regulation Commission
7 ("NMPRC") approved Southwestern Public Service Company's ("SPS")
8 request to include its full prepaid pension asset in rate base.[14]
9 • North Dakota – NSPM included the prepaid pension asset in rate base in
10 Docket No. PU-12-813, and there was no disallowance of it.
11 • South Dakota – NSPM included the prepaid pension asset in rate base in
12 Docket No. EL12-046, and there was no disallowance of it.
13 • Texas – Although SPS has not had a fully litigated base rate case in Texas
14 since 1978, the Public Utility Commission of Texas had repeatedly allowed
15 other Texas utilities to include prepaid pension assets in rate base over
16 objections from customer groups.[15]
17 • Wisconsin – NSPW also recovers the prepaid pension asset in Wisconsin
18 through cash working capital. As occurred in Michigan, NSPW included the

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[14] *In the Matter of Southwestern Public Service Company's Application for Revision of Its Retail Electric Rates under Advice Notice No. 245*, Case No. 12-00350-UT, Final Order Partially Adopting Recommended Decision at 11 (Mar. 26, 2014) (Attachment No. GHW-6).

[15] *See, e.g., Application of AEP Texas Central Company for Authority to Change Rates*, Docket No. 33309, Order on Rehearing at 6 (Mar. 4, 2008) (Attachment No. GHW-7); *Application of Entergy Texas, Inc. to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment*, Docket No. 39896, Order on Rehearing at 14 (FoF 27-28A) (Nov. 1, 2012) (Attachment No. GHW-8); *Application of Southwestern Public Service Company to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, Order on Rehearing at 29, FoF 133-136 (Mar. 6, 2014) (Attachment No. GHW-9).

1 prepaid pension asset in cash working capital in NSPW's most recent full rate
2 case, which was Docket No. 4220-UR-119, and there was no disallowance.

3 **Q. MS. SIGALLA SINGLES OUT TWO OF THE JURISDICTIONS IN WHICH**
4 **XCEL ENERGY OPERATING COMPANIES PROVIDE SERVICE –**
5 **MINNESOTA AND NEW MEXICO – AND DISCUSSES THEIR TREATMENT**
6 **OF PENSIONS AND PENSION FUNDING. DO YOU CONSIDER HER**
7 **CHARACTERIZATION OF THE TREATMENT IN THOSE JURISDICTIONS TO**
8 **BE ACCURATE?**

9 A. No. Ms. Sigalla's discussion of the Minnesota Public Utilities Commission's
10 treatment of pension costs is misleading. After discussing the treatment of
11 prepaid pension *assets* in Idaho and Illinois, she abruptly switches to discussing
12 the treatment of annual pension *costs* in Minnesota.[16] The reason for that is
13 not hard to fathom – the Minnesota Commission has not disallowed the prepaid
14 pension asset from NSPM's rate base. Indeed, as I noted earlier, no party even
15 challenged the inclusion of the prepaid pension asset in rate base in NSPM's
16 currently pending case.[17] Therefore, Ms. Sigalla has tried to change the subject
17 to the treatment of annual pension costs.

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[16] *See* Sigalla Answer Testimony at 51. And after discussing the calculation of annual pension *costs* in Minnesota, Ms. Sigalla resumes discussion of the prepaid pension *asset* in New Mexico and Oregon. *Id.* at 54-58.

[17] *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. E002/GR-13-868. I was a witness for NSPM in Docket No. 13-868, so I am familiar with the issues in that case.

1 **Q. IS MS. SIGALLA'S DISCUSSION OF HOW THE MINNESOTA COMMISSION**
2 **TREATS THE CALCULATION OF ANNUAL PENSION COST RELEVANT TO**
3 **ANY ISSUE IN THIS CASE?**

4 A. No. In this case, the CPUC Staff has not even questioned the elements of
5 pension cost that the Minnesota Commission disallowed in NSPM's most
6 recently completed case. In fact, the CPUC Staff does not challenge any of the
7 elements that comprise the Company's annual pension cost. To the contrary,
8 the Staff witnesses argue in this case that Public Service has not been asking
9 the Commission for enough annual pension cost. Therefore, it is difficult to
10 understand what relevance the Minnesota Commission's rulings on various
11 elements of pension costs have to this proceeding.

12 **Q. MS. SIGALLA ALSO CLAIMS THAT "NEW MEXICO HAS PERMITTED**
13 **INCLUSION OF THE PREPAID PENSION ASSET IN RATE BASE ONLY IN**
14 **CERTAIN CIRCUMSTANCES." DOES THAT STATEMENT ACCURATELY**
15 **PORTRAY THE NMPRC'S RULINGS ON THE PREPAID PENSION ASSET?**

16 A. No. I was a witness in two of the three New Mexico proceedings that she
17 discusses, so I am very familiar with the treatment of the prepaid pension asset
18 in New Mexico. As Ms. Sigalla later acknowledges in her testimony, the
19 NMPRC allowed the entire prepaid pension asset to be included in rate base in
20 Case No. 07-00077-UT and Case No. 12-00350-UT. Moreover, in its final order
21 in Case No. 12-00350-UT, the NMPRC admitted that it had misread the case it
22 relied on to disallow part of SPS's prepaid pension asset in Case No. 07-00319-

1 UT.[18] Thus, in every litigated base rate case since 2007 the NMPRC has either
2 allowed the entire prepaid pension asset to be included in rate base or has
3 admitted it erred when it did not allow the entire amount to be included in rate
4 base.

5 **Q. ARE YOU AWARE OF JURISDICTIONS BESIDES THOSE IN WHICH XCEL**
6 **ENERGY OPERATING COMPANIES SERVE CUSTOMERS THAT ALLOW**
7 **THE PREPAID PENSION ASSET TO BE INCLUDED IN RATE BASE?**

8 A. Yes. A number of other jurisdictions have allowed rate base treatment for
9 prepaid pension assets. In addition to the decisions I cited earlier regarding the
10 Xcel Energy operating companies, the following regulatory commissions have
11 expressly approved the inclusion of a prepaid pension asset in rate base:[19]

12 <u>THE FEDERAL COMMUNICATIONS COMMISSION ("FCC")</u>

13 In its Report and Order in Docket No. 86-497, adopted December 17, 1989, the
14 FCC ruled that the pension asset/liability should receive rate base treatment in
15 revenue requirement proceedings. In footnote 35 in that order, the FCC stated:

16 > In the <u>Pension and Debt Proceeding</u> (note 31 <u>supra</u>), we
17 > concluded that it would be appropriate to include in the rate base
18 > pension fund payments in excess of recognized expenses. We
19 > also concluded that in the converse situation, the excess should
20 > be deducted from the rate base, to the extent recognized
21 > expenses exceeded pension fund payments.

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[18] Case No. 12-00350-UT, Final Order Partially Adopting Recommended Decision at 10 ("SPS is correct that, contrary to this Commission's Final Order in Case No. 07-00319-UT, *Southern Company* makes no distinction between prepaid pension assets created through earnings on pension funds and prepaid pension assets created through shareholder contributions. . . . This change from the determination made in our Final Order in Case No. 07-00319-UT is consistent with the policy established in Case No. 07-00077-UT and has been preceded by notice and is supported by reasonable justification.").

[19] This is not a complete listing. It is instead a representative sampling of how several other regulatory commissions treat the prepaid pension asset.

1 FEDERAL ENERGY REGULATORY COMMISSION ("FERC")

2 In *Southern Company Services, Inc.*, 122 FERC ¶ 61,218 (Mar. 10, 2008),
3 FERC allowed Southern Company to include in rate base all of the cumulative
4 savings to customers that it could identify from the prepaid pension asset.[20]

5 DELAWARE

6 In Docket No. 13-115, the Delaware Public Service Commission approved the
7 inclusion of a prepaid pension asset in Delmarva's rate base over the objection
8 of the Commission staff.[21]

9 DISTRICT OF COLUMBIA

10 The District of Columbia expressly authorized the inclusion of the prepaid
11 pension asset in rate base in a 2008 case:

> 12 To eliminate any confusion concerning the rate base treatment
> 13 of the prepaid pension asset, we expressly find here that both
> 14 the prepaid pension asset and the OPEB liability result from the
> 15 existence of a differential between the Company's obligation
> 16 regarding future benefits owing to current employees and the
> 17 level of funding for those benefits, and consequently both should
> 18 be included in rate base with the liability offsetting the asset.[22]

19

[20] *See* Attachment No. GHW-10.

[21] Delaware Public Service Comm'n, *In the Matter of the Application of Delmarva Power & Light Company for Approval of a Change in Electric Distribution Rates and Miscellaneous Tariff Changes*, Docket No. 13-115, Order No. 8589 at 63-64 (Aug. 5, 2014) (Attachment No. GHW-11).

[22] District of Columbia Public Service Comm'n, *Potomac Electric Power Company*, Formal Case No. 1053, Order No. 14832, ¶ 9 (June 13, 2008) (Attachment No. GHW-12).

1 INDIANA

2 The Indiana Public Service Commission approved the inclusion of the prepaid
3 pension asset in rate base in a recent case:

> 4 The record reflects that the prepaid pension asset was recorded
> 5 on the Company's books in accordance with governing
> 6 accounting standards. The record also reflects that the prepaid
> 7 pension asset has reduced the pension cost reflected in the
> 8 revenue requirement in this case and preserves the integrity of
> 9 the pension fund. Petitioner made a discretionary management
> 10 decision to make use of available cash to secure its pension
> 11 funds and reduce the liquidity risk of future payments. In
> 12 addition, the prepayment benefits ratepayers by reducing total
> 13 pension costs in the Company's revenue requirement.
> 14 Therefore, we find that the prepaid pension asset should be
> 15 included in Petitioner's rate base.[23]

16 MARYLAND

17 The Maryland Public Service Commission approved the inclusion of a prepaid
18 pension asset in rate base in a 2007 case involving Potomac Electric Power
19 Company.[24]

20 MISSOURI

21 In File No. GR-2009-0355, the Public Service Commission of Missouri
22 approved the inclusion of Missouri Gas Energy's prepaid pension asset in its
23 rate base calculation.[25]

24

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[23] Indiana Utility Regulatory Comm'n *Petition of Indiana Michigan Power Company for Authority to Increase Its Rates and Charges for Electric Utility Service*, Cause No. 44075, Order at 30-31 (Feb. 13, 2013) (Attachment No. GHW-13)

[24] Maryland Public Service Comm'n*, Potomac Electric Power Company*, Case No. 9092, Order No. 81517 (July 19, 2007) (Attachment No. GHW-14).

[25] Public Service Comm'n of Missouri*, In the Matter of Missouri Gas Energy and Its Tariff Filing to Implement a General Rate Increase for Natural Gas Service*, File No. GR-2009-0355 (Feb. 20, 2010) (Attachment No. GHW-15).

OHIO

In a 2012 case, the Ohio Public Utilities Commission rejected an argument by Staff that the prepaid pension asset should be excluded from rate base: "We see no reason to vary our practice in the present case and, therefore, find that AEP-Ohio's prepaid pension asset should not have been excluded."[26]

OKLAHOMA

In Case No. PUD201100082, Order No. 592623, dated January 4, 2012, the Oklahoma Corporation Commission approved the inclusion of Empire District Electric Company's prepaid pension asset in its rate base calculation.[27]

Q. MS. SIGALLA NEVERTHELESS CITES AN OREGON STUDY TO SUPPORT HER ASSERTION THAT ONLY 16 OF THE 50 STATE COMMISSIONS ALLOW THE INCLUSION OF ANY PREPAID ASSET IN RATE BASE. DO YOU AGREE WITH HER ASSESSMENT?

A. No. She has misstated the results of the study. Question 2 in that study specifically asks:

> Has your commission allowed the inclusion in a company's "rate base" any portion of a company's pension expenditures that are excess contributions over FAS 87/ASC 715 based expenses or result in "prepaid pension expense" in a company's rate base used for setting rates, or are deferred pension costs allowed a carrying charge?

Of the 52 survey respondents, 24 commissions stated that they allow the prepaid pension asset to be included in rate base.[28]

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[26] Public Utilities Comm'n of Ohio, *In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company*, Case No. 10-2929-EL-UNC, Order at 78 (July 2, 2012) (Attachment No. GHW-16)

1 **Q. WHY DO YOU BELIEVE THAT MS. SIGALLA REFERRED TO ONLY 16**
2 **JURISDICTIONS THAT ALLOW A PREPAID PENSION ASSET?**
3 A. It appears that Ms. Sigalla was looking at a more general question, which
4 asked the respondents to choose "which method, listed below from A through
5 H, that your commission used as its basis for deciding the level of recovery
6 that companies receive in rates for cash contributions and pension expenses
7 relating to the funding and operation of . . ."[29] Of the respondents, 16
8 selected "Recognition of 'Prepaid Pension Asset / Liability" as one option.
9 The question is somewhat vague, however, and it is not clear from the
10 attachment what else was included in the question.
11 **Q. AS BETWEEN THE SPECIFIC QUESTION ASKING WHETHER**
12 **REGULATORY COMMISSIONS ALLOW THE PREPAID PENSION ASSET**
13 **IN RATE BASE AND THE MORE GENERAL QUESTION REGARDING**
14 **WHICH METHOD IS USED TO DECIDE THE LEVEL OF RECOVERY IN**
15 **RATE FOR CONTRIBUTIONS AND PENSION EXPENSE, WHICH DO YOU**
16 **CONSIDER A MORE RELIABLE INDICATOR OF REGULATORY**
17 **COMMISSIONS' TREATMENT OF THE PREPAID PENSION ASSET?**
18 A. I consider the answer to the specific question about whether the prepaid
19 pension asset is included in rate base to be more reliable. Therefore, I

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[27] Oklahoma Corporation Comm'n*, Empire District Electric Company*, Cause No. PUD 201100082, Order No. 592623 (Jan. 4, 2012) (Attachment No. GHW-17).

[28] Sigalla Answer Testimony, Attachment FDS-49 at 7.

[29] The question set forth on page 2 of Attachment FDS-49 is incomplete.

1 conclude that at least 24 commissions allow the prepaid pension asset in rate
2 base.
3 **Q. DOES THAT NECESSARILY MEAN THAT THE REMAINING 28**
4 **COMMISSIONS SURVEYED DO NOT ALLOW THE PREPAID PENSION**
5 **ASSET TO BE INCLUDED IN RATE BASE?**
6 A. No. Some commissions may not have been confronted with the issue
7 because the utilities in their jurisdictions do not have prepaid pension assets.
8 Or the commission staff member from another jurisdiction who responded to
9 the Oregon survey may not have been familiar with that jurisdiction's
10 treatment of the prepaid pension asset in all cases.
11 **Q. BASED ON YOUR PERSONAL KNOWLEDGE AND THE RESULTS OF THE**
12 **OREGON STUDY, WHAT DO YOU CONCLUDE ABOUT THE TREATMENT**
13 **OF PREPAID PENSION ASSETS BY REGULATORY COMMISSIONS?**
14 A. I conclude that including prepaid pension assets in rate base is a common
15 practice across the United States, including in Colorado and the other
16 jurisdictions in which the Xcel Energy operating companies provide service.
17

V. CONCLUSION

Q. PLEASE SUMMARIZE YOUR TESTIMONY AND RECOMMENDATIONS.

A. The Staff witnesses are simply wrong to state that FAS 87 has a known bias to underestimate pension expense. They understandably could cite no authority for that assertion, because there is none, to my knowledge. Numerous stakeholders, including pension plan sponsors, actuaries, and auditors have an interest in providing accurate estimates of pension expense, and if FAS 87 had a bias to underestimate pension expense, they would have asked FASB to undertake a revision of FAS 87 by now.

I recommend that the Commission reject the Staff's proposal to set annual pension cost using primarily the service cost component of the FAS 87 calculation. In addition to the proposal being vague, it creates risk for customers because it deprives them of the opportunity for liability gains.

The Commission should reject Staff's proposal to require the Company to seek Commission approval before making contributions in excess of the pension expense amounts each year. The proposal is unnecessary; it interferes with the Company's ability to respond quickly to changing conditions; and it may create unintended consequences, such as making the Commission a fiduciary of the pension plan trusts.

Finally, I take issue with Ms. Sigalla's characterization of other regulatory commissions' treatment of the prepaid pension asset. The very study she cites indicates that at least 24 jurisdictions allow the prepaid pension asset to be included in rate base, one of which is this Commission. Staff has provided no reason in this case for the Commission to depart from

1 its long-standing precedent of allowing the prepaid pension asset to be

2 included in rate base and to earn a return at the Company's weighted average

3 cost of capital.

4 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

5 A. Yes, it does.

Attachment A

Statement of Qualifications

Gene H. Wickes

Mr. Wickes is a Senior Consultant and Actuary with Towers and Watson. He also serves as the Managing Director for Towers Watson's Benefit Segment. He has more than 35 years of experience consulting with organizations on the design and financial considerations of their pension programs.

Education:

Bachelor of Science – Mathematics and Economics
Brigham Young University

Master of Science – Mathematics
Brigham Young University

Master of Science – Economics
Brigham Young University

Employment:

Towers Watson & Company
Managing Director, Benefits Segment
Senior Consultant and Actuary

Watson Wyatt Worldwide
Global Director, Benefits
Senior Consultant and Actuary

Towers Perrin
Managing Consultant
Senior Consultant and Actuary

Professional Organizations:

Fellow of the Society of Actuaries,
Fellow of the Conference of Consulting Actuaries
Enrolled Actuary under the Employee Retirement Income Security Act of 1974 ("ERISA").

BEFORE THE COLORADO PUBLIC UTILITIES COMMISSION

Proceeding Nos. 14AL-0660E &14A-0680E

PSCO 4-6. Reference page 22, lines 13-14 of the Answer Testimony of Fiona D. Sigalla. Please provide all documents on which Ms. Sigalla relies for her assertion that "FAS 87 has a known bias to underestimate pension expense."

RESPONSE to PSCo 4-6:

I relied on the testimony of Staff Witness David Pitts. Also, please see his response to PSCo 2-29.

Sponsor: Fiona Sigalla Date: November 28, 2014

BEFORE THE COLORADO PUBLIC UTILITIES COMMISSION

Proceeding Nos. 14AL-0660E &14A-0680E

PSCO 2-29. Reference page 46, lines 7-8 of the Answer Testimony of David G. Pitts. Please provide all facts on which Mr. Pitts relies for his statement, "FAS87 has historically under-expensed the cost of the pension plans, which led to the creation of prepaid pension assets for underfunded pension plans."

RESPONSE:

It is common knowledge within the pension actuarial community that the FAS87 smoothing mechanisms and gain/loss corridors allowed companies to record pension expense that was significantly lower than actual cash costs, often times resulting in prepaid pension assets in the presence of underfunded pension plans. As discussed on pages 15 and 16 of my testimony, FAS158 was enacted to specifically address this widespread problem in financial disclosure reporting. By way of example, Appendix 1 from the attached Moody's article on the impact of FAS158 identifies 50 such companies with significant differences between prepaid pension assets and plan funded status. *See* Attachment PSCo 2-29.A1. FAS158 required significant charges to shareholder equity for these companies to correct the perception that the plans were overfunded (presence of prepaid pension assets) when in fact most were underfunded.

PSCo electric was in a similar position – namely the plans had a prepaid pension asset far greater than the pension plan surplus. Attachment DGP-8 to my Answer Testimony summarizes the development of prepaid pension assets for PSCo electric. As of 12/31/2006, the PSCo electric prepaid pension asset was $103 million, $99 million higher than the actual plan surplus of $4 million. Since the prepaid pension asset exceeded the surplus in the plan, by definition, cumulative prior year pension expense was understated by $99 million.

Sponsor: David Pitts Date: November 24, 2014

BEFORE THE COLORADO PUBLIC UTILITIES COMMISSION

Proceeding Nos. 14AL-0660E &14A-0680E

PSCO 2-34. Reference page 51 of the Answer Testimony of David G. Pitts. Please identify all regulatory commissions that have mandated the use of service cost as the "primary component" of pension cost and identify the dockets in which that action occurred.

RESPONSE:

I am not currently aware of regulatory commissions that have mandated the use of service cost as the primary component of pension cost. However, I continue to recommend that the Company use service cost as the primary component of pension cost, as outlined in my Answer Testimony.

Sponsor: David Pitts Date: November 24, 2014

BEFORE THE COLORADO PUBLIC UTILITIES COMMISSION

Proceeding Nos. 14AL-0660E &14A-0680E

PSCO 4-4. Reference page 18, lines 1-5 of the Answer Testimony of Fiona D. Sigalla. Please identify all proceedings in which regulatory commissions have calculated pension expense based solely on actuarially determined service cost. Please provide the docket number of the case(s) in which each regulatory commission approved the use of service cost to establish the utility's pension cost and the date of the order approving the use of service cost to establish pension cost.

RESPONSE to PSCo 4-4:

I do not currently have knowledge of any proceedings in which regulatory commissions have calculated pension expense based solely on actuarially determined service cost.

Sponsor: Fiona Sigalla Date: November 28, 2014

2013 Colo. PUC LEXIS 1079

Colorado Public Utilities Commission

October 22, 2013, Mailed; October 22, 2013, Mailed

Decision No. R13-1307; PROCEEDING NO. 12AL-1268G

Reporter
2013 Colo. PUC LEXIS 1079

IN THE MATTER OF ADVICE LETTER NO. 830 - GAS OF PUBLIC SERVICE COMPANY OF COLORADO, WITH ACCOMPANYING TARIFF SHEETS CONCERNING IMPLEMENTING A GENERAL RATE SCHEDULE ADJUSTMENT (GRSA), TO BE EFFECTIVE JANUARY 12, 2013

Core Terms

staff, rate base, pension, calculate, recommend, rate case, customer, natural gas, proxy, budget, pipeline, plant, cost of services, long-term, attrition, climax, replacement, forecast, capital structure, rider, rebuttal, intervenor, ratepayer, property taxes, estimate, meter, constant, lag, forma, revise

Panel: [*1] MANA L. JENNINGS-FADER, Administrative Law Judge; Doug Dean, Director

Opinion By: JENNINGS-FADER

Opinion

RECOMMENDED DECISION OF ADMINISTRATIVE LAW JUDGE MANA L. JENNINGS-FADER PERMANENTLY SUSPENDING TARIFF SHEETS; REQUIRING FILINGS; ORDERING TECHNICAL CONFERENCE; ADDRESSING PSIA REQUESTS; AND SHORTENING TIME FOR FILING EXCEPTIONS AND RESPONSE TO EXCEPTIONS

I. STATEMENT

1. On December 12, 2012, Public Service Company of Colorado (Public Service, PSCo, or Company), filed Advice Letter No. 830 - Gas (Advice Letter) to implement a General Rate Schedule Adjustment (GRSA) to the base rates of its natural gas department. Accompanying the Advice Letter are tariffs that, if in effect, among other things, would put into effect a multiyear rate plan by means of GRSA increases that would become effective in 2013, in 2014, and in 2015 and would put into effect an Earnings Sharing Mechanism. In addition, Public Service seeks to extend and to change the scope of the Pipeline System Integrity Adjustment.

2. On January 11, 2013, by Decision No. C13-0064, the Commission suspended the effective date of the tariffs that accompanied the Advice Letter. In that Decision, the Commission referred this Proceeding [*2] to an Administrative Law Judge (ALJ).

3. The Colorado Office of Consumer Counsel (OCC) intervened as of right in this Proceeding and is a party.

4. Staff of the Commission (Staff) intervened as of right in this Proceeding and is a party.

5. Atmos Energy Corporation (Atmos) filed a Motion to Intervene. On February 5, 2013, by Decision No. R13-0165-I, the ALJ granted that motion. Atmos is a party.

Decision No. C93-1346 at 39-40 (emphasis supplied). The ALJ uses this type of analysis in this Proceeding.

189. The ALJ agrees with the Parties that the Commission has adopted either Average Year rate base or Year End rate base at various times in the past, and each of the parties cites rulings **[*118]** in support of its conclusions. The ALJ observes that, in each instance, the Commission considered a particular set of facts and evidence when it made its ruling on rate base calculation. In determining the method of rate base calculation in this Proceeding, the ALJ looks at whether the record establishes the existence of special circumstances (in this case, earnings attrition) that warrant the use of Year End rate base.

190. The ALJ finds that the use of achieved earnings may be useful as a broad indicator of the existence of earnings attrition but ultimately is inconclusive as a determining factor as to the existence of earnings attrition. First, as the OCC correctly points out, ROE is not guaranteed and represents only an opportunity to earn a certain return. Second, the ALJ agrees with Staff that the Commission acknowledged in Decision No. C81-1999 that a certain amount of earnings attrition is to be expected and, to some extent, is within the control of management. Third, as discussed above, the evidence does not establish a consistent pattern of earnings attrition. Thus, the ALJ is not convinced that the under-earnings cited by Public Service are sufficient to justify the use **[*119]** of Year End rate base.

191. With respect to which method better effectuates the matching principle in the context of an HTY, the ALJ notes that PSCo witness Blair aptly observes that, "whether we use an average rate base or a year-end rate base [in an HTY], we are not going to achieve a perfect match of investments, revenues and costs[.]" Hearing Exhibit No. 7 at 9:5-8. The ALJ agrees and notes that: (a) the matching of costs and revenues is an imperfect analysis; (b) a decision on which method to use should not rest solely on the matching principle criterion; and (c) other factors, such as whether special circumstances exist, are more informative or germane to arriving at a conclusion.

192. The ALJ finds unconvincing the Company's argument that the pipeline system integrity costs are a unique circumstance that justifies the use of Year End rate base. The Commission approved the PSIA rider to recover those costs separate from, and more quickly than, costs recovered in rate base; and the Company earns a return within the PSIA. In addition, while Public Service expects to incur the majority of the PSIA-related costs in the future, there is no assurance that they will be incurred or **[*120]** (if incurred) when they will be incurred. For these reasons, the ALJ does not find persuasive the Company's position that the pipeline system integrity costs demonstrate the existence of earnings attrition.

193. The ALJ finds equally unavailing the Company's assertion that the growth in non-PSIA utility plant in FTYs 2013, 2014, and 2015, specifically the Cherokee Pipeline project, is an unusual circumstance or that it establishes the existence of earnings attrition. The ALJ finds the OCC's reasoning to be sound on this issue and concludes that the Cherokee Pipeline is unlikely to cause significant earnings attrition.

194. As to the additional criteria introduced by Staff (*i.e.*, the prevailing rate of inflation and customer growth), Public Service presents no specific evidence to controvert Staff's conclusions; and the ALJ has addressed these factors above. The ALJ relies on the uncontroverted evidence introduced by Staff with respect to these criteria.

195. Fundamentally, the determination of the method of calculating rate base should rest on the evidence presented in this Proceeding and should be guided by the Commission discussion in Decision No. C93-1346 (quoted above). All **[*121]** parties agree conceptually that the decision to use Average Year or Year End rate base involves establishing the existence of earnings attrition. Based on the evidence presented, the ALJ determines that earnings attrition, under which a Year End rate base may be applied, has not been established. The ALJ will order that the HTY rate base be calculated according to the Average Year method.

196. There is significant divergence in this Proceeding with regard to the correct average rate base. As part of the revenue requirement workshop that will be conducted prior to the conclusion of this Proceeding, the ALJ will order Public Service to determine an average net jurisdictional rate base consistent with the discussion above.

B. Prepaid Pension Asset.

197. The prepaid pension asset consists of shareholder contributions to the Company's pension plan that have not been reimbursed by ratepayers and, at present, is included as a component of rate base. Staff seeks to remove this asset from rate base.

1. Positions of the Parties.

a. Staff of the Commission.

198. Staff recommends that pension contributions in excess of those recovered from ratepayers no longer be included in rate **[*122]** base. It makes an adjustment to Exhibit DAB-22 in Hearing Exhibit No. 6 that: (a) removes pension contributions entirely from rate base; (b) adjusts for deferred taxes; and (c) reduces net rate base by $ 60,585,989.

199. Staff's recommendation is based on its assertion that changed conditions -- the Pension Protection Act of 2006 [77] and 2008 market losses [78] -- no longer make it reasonable to include rate base shareholder contributions to the pension plan and investment earnings and to permit the Company to profit off the financing of this employee benefit.

[*123]

200. Staff identifies the prepaid asset as one of the fastest growing components of rate base, accounting for nearly one-quarter of rate base growth over the period 2003 to 2013. According to Staff, most states, including some Xcel Energy jurisdictions, do not allow utilities to include the prepaid pension asset in rate base. [79] Staff states that circumstances have changed since the Commission approved Public Service's including the prepaid asset in rate base. As a result, Company contributions to the pension, and the investment income on those payments, should no longer be included in rate base and should no longer be allowed to earn a return. In addition, Staff is concerned that the prepaid asset is pushing pension costs into the future, masking the full cost of the pension plan.

201. The Company argues that the prepaid pension asset should be included in rate base to provide a corresponding return to the shareholder in exchange for the lowered pension **[*124]** expense. The Company asserts that the prepaid asset is a "good deal" and an "exceptional value" that provides a direct benefit for ratepayers because it lowers the cost of the pension expense.

202. Staff disputes these claims. Staff agrees that the prepaid asset reduced the pension expense charged to ratepayers until 2011 and states that this may have been a benefit to ratepayers. Staff states that, since 2011, the prepaid asset has been increasing the pension expense charged to ratepayers above the service cost and that the effect of the prepaid asset on pension expense is only part of the equation. Staff states that the Company's calculation fails to include all the costs associated with the prepaid asset because the effect of the prepaid asset on pension expense does not include the cost of allowing Public Service to earn a return on rate base. Staff asserts that, by including these costs in rate base, the prepaid asset likely will always be a bad deal for ratepayers because the weighted average cost of capital (which the Company earns on its rate base) likely always will be higher than the investment return on assets in the pension plan.

b. Climax Molybdenum Company.

203. **[*125]** Climax supports Staff's position that the Company should not be allowed to include the costs of its pension asset in rate base. Climax states that the growth of the pension asset as a percentage of rate base has led to a situation where the Company receives very large returns on an asset that does not directly benefit customers.

c. Public Service Company.

204. The Company asserts that neither Staff nor Climax provides good grounds for changing the Commission's long-standing treatment of the prepaid pension asset. According to the Company, Staff is incorrect that there are changed

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[77] There is no dispute that the Pension Protection Act of 2006 made sweeping changes to pension laws, including requiring that all defined benefit pension plans become 100 percent funded. This change required increased funding of the PSCo pension plan and increased the prepaid pension asset.

[78] The Company's testimony establishes that, after the stock market decline in 2008, the funded status of PSCo's Bargaining and Non-Bargaining plans dropped. The Non-Bargaining plan fell from 103 percent funded in 2007 to 71 percent funded in 2008, and the Bargaining plan dropped from 94 percent funded in 2007 to 70 percent funded in 2008.

[79] Hearing Exhibit No. 39 at Exhibit FDS-87 (the Oregon Study).

circumstances that warrant changing the Commission's historical treatment of the prepaid pension asset. The Company argues that, because the contributions are mandated by the Pension Protection Act, this situation is analogous to the circumstances in the early 1990s when the ERISA and the Internal Revenue Service mandated contributions that exceeded pension expenses derived pursuant to accounting principles and, as a result, the Commission first allowed the prepaid pension in rate base. Public Service states it has shown that its pension plan is a reasonable and necessary component of the total compensation [*126] package that it provides to its employees. This, in turn, benefits customers because it enables the Company to attract, to retain, and to engage the highly-skilled workforce that the Company needs to deliver utility service to its customers as efficiently and effectively as possible.

205. The prepaid pension asset associated with the pension plan provided to Xcel Energy Services employees is not included in the prepaid pension asset even though, according to the Company, those employees provide beneficial services that enable Public Service to deliver gas service to its retail gas customers. The Company offers this as another reason the Commission should find its level of the prepaid pension asset to be reasonable.

206. Moreover, the Company disputes Staff's claim that most states do not allow utilities to include the prepaid pension asset in rate base. Citing the Oregon Study, Public Service asserts that a majority of states allow the prepaid pension asset to be included in rate base for ratemaking purposes.

207. Further, the Company points out that its rate base includes liabilities as well as assets and that this is similar to income taxes. Public Service states the difference [*127] in timing between when income tax expense is recognized and when it is actually paid results in a liability (accumulated deferred income taxes or ADIT) that reduces the Company's rate base, which in turn reduces customer rates. Staff disputes this analogy, claiming that ADIT is not comparable to the prepaid pension asset.

2. Discussion and Conclusion.

208. The record in this proceeding contains a robust discussion regarding the appropriate treatment of the prepaid pension asset. Staff has provided informative evidence regarding this issue.

209. The nub of this issue is the undeniable fact that the prepaid pension asset that was once positive (and thus reduced rate base) is now negative (and thus increases rate base) . This is an insufficient basis for changing the regulatory treatment of the prepaid pension asset. The Company has demonstrated that the prepaid pension asset is a benefit to ratepayers because it allows the Company to attract and to retain the highly-skilled workforce necessary to provide natural gas service. In addition, the ALJ is persuaded that the 2008 market losses are not permanent and that their effects will be diluted, if not eliminated, over time. Finally, [*128] the ALJ is persuaded by the Company's argument that the current situation is analogous to the circumstances that originally led to allowing the prepaid pension asset in rate base. Staff has not shown that its proposed disallowance is the better regulatory principle under these circumstances.

210. The ALJ finds no changed circumstances sufficient to warrant a change in the treatment of the prepaid pension asset. The prepaid pension asset will remain in rate base for the purpose of calculating the revenue requirement. The ALJ will not adopt Staff's recommended adjustment to rate base.

C. Long-Term Debt Interest in Cash Working Capital.

211. The cash working capital (CWC) allowance is in rate base to compensate investors for investor-supplied funds used to provide the day-to-day cash needs of the utility. The Company uses a lead-lag study to measure these cash needs. No party takes issue with the method of the lead-lag study presented in this Proceeding.

212. The sole issue regarding the CWC allowance in this case is whether or not to include the interest on long-term debt in the CWC calculation.

1. Positions of the Parties.

a. Office of Consumer Counsel.

2014 N.M. PUC LEXIS 37

New Mexico Public Regulation Commission

March 26, 2014, Issued; March 26, 2014, Issued

Case No. 12-00350-UT

Reporter
2014 N.M. PUC LEXIS 37

IN THE MATTER OF SOUTHWESTERN PUBLIC SERVICE COMPANY'S APPLICATION FOR REVISION OF ITS RETAIL ELECTRIC RATES UNDER ADVICE NOTICE NO. 245, SOUTHWESTERN PUBLIC SERVICE COMPANY, Applicant

Core Terms

recommend, pension, prepaid, customer, staff, rider, escalator, rate base, renewable, forecast, gradualism, business risk, rate case, pension expense, calculate, non-fuel, energy, growth rate, certificate, flotation, weather, capital structure, amortization, uneconomic, notice, cost of services, base rate, inclusion, dividend, estimate

Panel: [*1] THERESA BECENTI-AGUILAR, CHAIR; VALERIE ESPINOZA, VICE CHAIR; KAREN L. MONTOYA, COMMISSIONER; PATRICK H. LYONS, COMMISSIONER, Voted No; BEN L. HALL, COMMISSIONER

Opinion

FINAL ORDER PARTIALLY ADOPTING RECOMMENDED DECISION

THIS MATTER comes before the New Mexico Public Regulation Commission ("Commission") upon the Recommended Decision issued by Hearing Examiner Elizabeth C. Hurst on January 23, 2014, including the Errata Notice issued on January 29, 2014 (collectively, the "Recommended Decision") and the Supplemental Recommended Decision issued by the Hearing Examiner on February 12, 2014 (the "Supplemental Recommended Decision"). Having considered the Recommended Decision and Supplemental Recommended Decision (copies of which are not attached hereto due to their length), and the record in this case, and being fully informed in the premises, the Commission adopts the following as its Final Order in this case.

A. INTRODUCTION. THE COMMISSION FINDS AND CONCLUDES:

1. The Commission has jurisdiction over the parties and the subject matter of this case.

2. On February 5, 2014, Southwestern Public Service Company ("SPS") filed exceptions ("SPS Exceptions"), Staff of the Commission [*2] ("Staff") filed exceptions ("Staff Exceptions"), the New Mexico Attorney General ("AG") filed exceptions ("AG Exceptions"), and Occidental Permian, Ltd. ("OPL") filed exceptions ("OPL Exceptions") to the Recommended Decision.

3. On February 13, 2014, OPL filed a response to the AG Exceptions, SPS filed a response to the Staff and AG Exceptions, and Staff filed a response to the SPS Exceptions.

4. On February 19, 2014, the AG filed exceptions ("AG Supplemental Exception") and the Federal Executive Agencies (the "FEA") filed its Reply Brief as an exception ("FEA Supplemental Exception") to the Supplemental Recommended Decision.

5. On February 24, 2014, SPS filed responses to the Exceptions to the Supplemental Recommended Decision.

6. On February 28, 2014, OPL filed its Motion for Leave to File Late Response to the AG Supplemental Exception ("OPL Motion") including the form of the Response to the AG Supplemental Exception.

B. RETURN ON EQUITY

7. The Hearing Examiner recommended adoption of the dividend yield component of 4.45% as proposed by SPS, an average earnings growth rate of 5.14% (determined by averaging the three growth rates proposed by SPS, the AG and FEA), exclusion [*3] of SPS's proposed flotation costs of 15 basis points (or 0.15%), and the addition of 14 basis points (or .14%) for additional business risk factors faced by SPS. This calculation results in a total overall return on equity of 9.73%, which the Hearing Examiner found was fair, just and reasonable. [1]

8. SPS Exception No. 2 asserts that the Hearing Examiner's method to determine the growth rate component by averaging the three growth rates proposed by SPS, the AG and FEA was in error. [2] SPS argues that the Commission should use SPS's proposed growth rate of 5.51%. [3] For the reasons set forth in the SPS Exceptions, the Commission agrees with SPS. The Hearing Examiner stated that SPS most closely followed and applied Commission precedent on the use of the Discounted Cash Flow ("DCF") model. [4] Accordingly, the Commission will rely on the midpoint growth rate of 5.51% proposed by SPS. The Commission will rely on the dividend yield proposed by SPS for the reasons included in the Hearing Examiner's analysis. [5] Adding the dividend yield component to this growth rate component of 5.51% results in a return on equity of 9.96%, which the Hearing Examiner noted provides a reasonable foundation [*4] for the Commission to begin its inquiry. [6]

9. SPS Exception No. 2 then argues that the 9.96% return on equity should be increased to 10.25% to account for flotation costs and for the business risks faced by SPS (estimated to be 15 basis points or .15% for flotation costs and 14 basis points or .14% for business risks). [7] However, SPS's position in its prefiled testimony and its posthearing brief was that there were no specific adjustments made to the return on equity for the risk factors or the flotation costs. [8] SPS's position was that those costs/risks justified its position that the return on equity should be above the mean result for the proxy group [9]: SPS witness John Reed, when asked whether he was "proposing to adjust [his] recommended ROE by 15 basis points to reflect the effect of flotation costs on SPS's ROE", responded: "No, I am not. Rather I have considered the effect of flotation costs, in addition to SPS's other business risks, in determining where SPS's ROE falls within the range of results." [10] This statement was not amended nor recanted by Mr. Reed. SPS's proposal to add these specific amounts to the total of the dividend yield and growth rate was not raised [*5] in these proceedings until SPS addressed it in its SPS Exceptions. The Hearing Examiner determined that it was not reasonable to include the flotation costs based on the lack of sufficient evidence in the record regarding timing and costs of any stock issuances. [11] For these reasons, flotation cost estimates should not be incorporated into the return on equity.

10. SPS argues that it faces greater business risks than the average of the proxy companies used to determine the return on equity based upon the (i) regulatory framework in New Mexico, (ii) capital investment requirements, (iii)

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1 See Recommended Decision at pages 102-108; with analysis of parties' positions at pages 52-101.

2 See SPS Exceptions at pages 9-14.

3 See SPS Exceptions at page 14.

4 See Recommended Decision at 105.

5 See Recommended Decision at 102-105.

6 See Recommended Decision at page 106.

7 See SPS Ex. 12 (Reed Direct) at 82; SPS Exceptions at page 14.

8 See SPS Exhibit 12, Reed Direct at page 82; SPS Initial Brief at page 20.

9 See SPS Exhibit 12, Reed Direct at page 12.

10 See SPS Exhibit 12, Reed Direct, page 82.

11 See Recommended Decision at page 106.

customer concentration, and (iv) environmental compliance costs. [12] The Hearing Examiner found credible evidence of SPS's unique risk characteristics and recommended that the Commission add 14 basis points for additional business risk factors, resulting in a return on equity of 9.73%. [13] However, FEA Witness Michael P. Gorman, using the same proxy group as SPS, compared SPS's business risk to the business risk of the proxy group based on Standard & Poor's ("S&P's") ranking methodology and determined that the S&P business risk profile score indicates that SPS's business risk is comparable to that **[*6]** of the proxy group. [14] Moreover, Mr. Gorman noted that the rating agency S&P characterized SPS' business risk as excellent. [15] Having reviewed the record and arguments, we find his testimony persuasive. Moreover, an additional subjective premium is not necessary when a comparable proxy group is used to develop the ROE. As the Commission has previously stated, "[a] highly subjective risk premium calculation is not necessary if the comparable group contains utilities with the same or lower bond rating." [16] Accordingly, the Commission rejects the Hearing Examiner's recommendation and finds that an adjustment for business risk should not be incorporated into the return on equity.

11. AG Exception "A" asserts that the Hearing Examiner's calculation of the cost, or return, on equity of 9.73% is incorrect as a result of incorrectly calculating the dividend yield of 4.45% and applying a full year of growth to that yield as well as adding a 14 basis point adjustment for unique factors in the case when none exist. The AG states that the Commission should reconsider its policy of adjusting dividend yield for a full year of expected growth. [17] The AG argues that the appropriate cost of **[*7]** equity is 9.253%. [18] For the reasons stated above and as addressed by the Hearing Examiner [19], we reject the AG exception. As stated above, the AG exception to exclude the 14 basis point adjustment for business risks is accepted, albeit for different reasons than those proffered by the AG.

12. The Commission finds that a ROE of 9.96% is a fair, just and reasonable return on equity and it is adopted.

C. CAPITAL STRUCTURE

13. The Hearing Examiner determined that SPS provided sufficient evidence to support its proposed capital structure of 53.89% equity and 46.11% debt for the Test Year and recommended that the Commission approve this capital structure.

14. AG Exception "B" asserts that the Hearing Examiner's adoption of SPS's proposed capital structure is not justified and will unfairly burden ratepayers and reward shareholders. [20] The AG recommends that the Commission adopt a capital structure for SPS consisting of 50% equity and 50% long-term debt which it argues is a reasonable balance between using lower-cost debt and providing sufficient equity to maintain the financial integrity of the utility. [21] For the reasons addressed by the Hearing Examiner and SPS in its Response **[*8]** to Exceptions [22], the Commission rejects this exception.

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12 See SPS Exhibit 12, Reed Direct at page 12.

13 See Recommended Decision at page 107.

14 See FEA Exhibit 5, Gorman Direct, page 15.

15 Id.

16 See Commission Final Order in Case No. 2262.

17 See AG Exceptions at page 6.

18 See AG Exceptions at pages 7-8.

19 See Recommended Decision at page 104.

20 See AG Exceptions at page 8.

21 See AG Exceptions at page 10.

22 See SPS Exceptions to Recommended Decision at pages 11-15.

15. We find and conclude that SPS's proposal should be accepted and the Hearing Examiner's analysis on capital structure [23] is reasonable and should be adopted.

D. WEIGHTED AVERAGE COST OF CAPITAL

16. The Hearing Examiner recommended that based upon a capital structure of 53.89% equity and 46.11% debt, a 6.27% cost of debt, and a 9.73% cost of equity, the Commission should approve a weighted average cost of capital of 8.13%. [24]

17. For the reasons addressed above, the Commission has determined that a 9.96% cost of, or return on, equity should be approved and, therefore, the resulting weighted average cost of capital is 8.26%.

E. PREPAID PENSION ASSET

18. A prepaid pension asset is created when a utility's contributions to its pension fund exceed its pension expense calculated under Statement of Financial Accounting Standard 87. Earnings on a prepaid pension asset are a component of pension expense and therefore reduce pension expense. SPS has a prepaid pension asset. The New Mexico jurisdictional share of this prepaid pension asset is $ 36.9 million. According to SPS, the earnings on this $ 36.9 million **[*9]** result in a net $ 1.7 million reduction to its Test Year pension expense. [25]

19. The Hearing Examiner rejected SPS's position that the total amount of the New Mexico jurisdictional share of its prepaid pension asset, in the amount of $ 36.9 million (offset by a $ 14.9 million deferred tax asset), should be included in rate base. Rather, the Hearing Examiner agreed with Staff's position that only the net reduction in SPS's pension expense, in the amount of $ 1.7 million (offset by a $ 676,00 deferred tax reserve), resulting from the prepaid asset, should be included in rate base. [26]

20. SPS argues that the full amount of the prepaid pension asset necessary to generate the $ 1.7 million pension expense reduction should be included in rate base, not just the amount of the prepaid pension asset equal to the reduction in pension expense. SPS argues that it is necessary to include in rate base the entire prepaid pension asset to adequately compensate SPS. Consistent with this argument, SPS seeks to include the net amount of its prepaid pension asset of approximately $ 22 million on a New Mexico retail basis (the $ 36.9 million asset reduced by an associated $ 14.9 million tax deferred **[*10]** asset) in rate base and to ultimately earn a return on this amount in rate base. [27] SPS Exception No. 3 asserts that the Commission's Final Order in Case No. 07-00319-UT, in not adopting the Hearing Examiner's recommendation that the entire amount of the prepaid pension asset be included in rate base, incorrectly interpreted a decision by the Federal Energy Regulatory Commission (FERC) which actually allowed inclusion of prepaid pension assets in rate base and only disallowed inclusion of those prepaid pension assets that the utility could not prove resulted in a net benefit to ratepayers. [28]

21. In Case No. 07-00319-UT, the Hearing Examiner recommended that the entire amount of the prepaid pension asset be included in rate base because SPS had (i) demonstrated that its ratepayers clearly benefitted from the prepaid pension asset in the form of a reduction in rates and (ii) met its burden of proof regarding the amount of

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[23] See Recommended Decision at page 117.

[24] See Recommended Decision at pages 108, 117-118. Table 1 of the Recommended Decision refers to a 9.73% cost of equity, which is consistent with the analysis on pages 107-108 of the Recommended Decision, The paragraph of the Recommended Decision that precedes Table 1, refers to a 9.88% return on equity, which the Commission assumes is a typographical error. The Commission similarly assumes that the reference to an 8.21% average cost of capital in the paragraph preceding Table 1 is a typographical error and should be 8.13%.

[25] See Recommended Decision at pages 124, 127.

[26] See Recommended Decision at page 140.

[27] See SPS Exceptions at 3-4, 16-19.

[28] See Southern Company Services, Inc., 122 FERC P61,218 (Mar. 10, 2008) (*"Southern Company"*)

its claimed prepaid pension asset. [29] The Commission, however, determined that only the amount that was recorded as a negative pension expense should be recovered in rate base because, relying on its interpretation of the FERC decision in *Southern Company* **[*11]** , the asset was the result of "outsized earnings." [30]

22. SPS is correct that, contrary to this Commission's Final Order in Case No. 07-00319-UT, *Southern Company* makes no distinction between prepaid pension assets created through earnings on pension funds and prepaid pension assets created through shareholder contributions. [31] The key factor is not the source of the funds of the prepaid pension asset, but whether the prepaid pension asset produces investment income that offsets pension expenses and thereby reduces the total dollar amount, or revenue requirement, that would otherwise be charged to and collected from customers. [32] Ratepayers benefit from the build-up of the prepaid pension asset regardless of the source. Simply stated, earnings on a prepaid pension asset reduce the revenue requirement, which ultimately reduces the amount of revenue that the Commission will need to authorize a utility to collect from retail customers in rates. Including the entire prepaid asset in rate base recognizes that ratepayers benefit from the prepaid pension asset and that the utility should earn a return on the prepaid pension asset in order for the utility to recover its full cost **[*12]** of service. This change from the determination made in our Final Order in Case No. 07-00319-UT is consistent with the policy established in Case No. 07-00077-UT and has been preceded by notice and is supported by reasonable justification. [33]

23. AG Exception "C" asserts that the Hearing Examiner's inclusion of the prepaid pension asset in the amount of $ 1.7 million, less the accumulated deferred income taxes, in rate base, should be rejected. The AG argues that no amount of the prepaid pension asset should be included in rate base because SPS is already being compensated for its test year pension expense. [34] The AG asserts that the size and growth of SPS's prepaid pension asset is based primarily on market returns and not on Company contributions, that SPS has wide discretion over Company contributions and that it is unreasonable to set rates based on the exercise of this discretion. For the foregoing reasons, this exception is rejected.

24. The Commission finds that SPS has verified the amount of the proposed pension asset in this case. The Commission therefore finds that it should follow the precedent set in Case No. 07-00077-UT and account for the earnings derived from the **[*13]** asset and allow the entire prepaid pension asset (accounting for the associated tax benefits) to be included in rate base, regardless of the source of the asset. [35] SPS Exception No. 3 is granted.

F. ESCALATION OF NON-LABOR O&M EXPENSES; RATE CASE EXPENSES-GLOBAL INSIGHT EXPENSE; AND INJURIES AND DAMAGE EXPENSE, FERC ACCOUNT 925

25. The Hearing Examiner recommended that SPS's escalators for proposed adjustments to non-labor operation and maintenance (O&M) expenses be rejected because SPS failed to provide sufficient evidence explaining how the escalators were developed. [36] As a result of that finding, the Hearing Examiner also recommended that a portion of the rate case expenses attributable to those escalators and a category of SPS expenses for FERC Account 925 (Injuries and Damages) which used these escalators be disallowed.

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[29] See Case No. 07-00319-UT, Recommended Decision at page 84.

[30] See Case No. 07-00319-UT, Order on Rehearing of Final Order at page 2.

[31] See SPS Exceptions page 24; citing *Southern Company*.

[32] See Southern Company, P17; Case No. 07-00077-UT.

[33] See *Mountain States Tel & Tel. Co. v. New Mexico State Corp. Comm'n*, 1986-NMSC-019,P 26,104 N.M. 36 (a departure from precedent is not arbitrary and capricious if it is preceded by notice and it is supported by reasonable justification).

[34] See AG Exceptions at pages 10-11.

[35] See also PNM Case Nos. 2662 and 2262 for approval of inclusion of prepaid pension asset in rate base.

[36] See Recommended Decision at pages 173-174.

26. SPS Exception Nos. 4, 5 and 6 specifically address how SPS developed the Global Insight escalators and met its burden of proof. [37] SPS asserts that the method that SPS used to develop a single escalation factor for each FERC account was discussed in SPS's direct testimony and is readily understandable. [38] SPS states that it started with the December [*14] 2014 index value set forth for each FERC account in Attachment TLW-5, subtracted the June 2012 value for that FERC account and divided the difference by the June 2012 index amount to arrive at the escalation factor for that particular FERC account. [39] SPS next multiplied the percentage for each FERC account by the Adjusted Base Period balance for that FERC account. [40] SPS argues that the actual calculation of the escalators is simply a matter of arithmetic -- the difference between the December 2014 factor and the June 2012 factor is divided by the June 2012 factor, and Mr. Mothersole (an SPS witness employed by Global Insight) explained how Global Insight derived the escalation factors. [41] SPS states that Mr. Mothersole and Mr. Willemsen described how the escalation factors were derived and in addition to providing the methodology used to define Global Insight's O&M model, Mr. Mothersole provided specific examples to explain how the methodology was used to construct individual models. Mr. Mothersole then described the data sources that Global Insight used. In his Attachment JM-1, Mr. Mothersole provided all of the escalators, even for the FERC accounts that SPS did not use and [*15] in his Attachment JM-2, and he provided the results of two previous forecasts so that the Commission, Hearing Examiner, and the parties could judge the accuracy of those prior forecasts. [42]

27. Using the information provided by Mr. Mothersole and Mr. Willemsen, SPS then asserted that a party could trace the Test Year amounts of O&M expense for the various components of the cost of service back to the Adjusted Base Period. Mr. Willemsen provided the escalation factors and the source of those factors in his Attachments TLW-5 and TLW-6. [43]

28. Even though SPS provided these detailed explanations addressed above, the basis for the Recommended Decision's finding that SPS failed to meet its burden of proof is that SPS did not provide the formulas in the computer model that calculates the escalation factors and there was no assurance that the parties would have been technologically capable of running the models or had the expertise to understand it. [44] As SPS states, it demonstrated that the Global Insight escalators were more reasonable than alternative escalators, and SPS showed that the Global Insight escalators produced conservative results, that is, the forecasts presented by [*16] SPS when viewed with hindsight compare favorably by showing that the results understate the Company's actual increases in non-labor O&M expense. [45]

29. We find and conclude that SPS Exceptions Nos. 4, 5 and 6 concerning the development and application of the escalators and the application to the related rate case expenses for Global Insight and the proof of the increases to FERC Account 925, Injuries and Damage Expense, should be granted. Staff did not present sufficient evidence to show that SPS's escalators are unreasonable. First, based upon the evidence in the record and these SPS Exceptions, we agree that the proposed escalators may be used in this case. Second, the referenced rate case expenses are permissible. Third, the proposed increases to FERC Account 925 were proven. Accordingly, we reject these recommendations of the Hearing Examiner.

G. TEST YEAR BILLING DETERMINANTS -- SALES GROWTH PROJECTIONS AND WEATHER NORMALIZATION ADJUSTMENT TO THE SALES FORECAST

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[37] See SPS Exceptions at pages 35-37.

[38] See SPS Exceptions at page 32.

[39] Id.

[40] See SPS Exceptions at pages 32-33.

[41] See SPS Exceptions at page 33.

[42] Id.

[43] See SPS Exceptions at pages 33-34.

[44] See Recommended Decision at page 173.

[45] See SPS Exceptions at page 34.

30. The Hearing Examiner determined that the test year sales forecast, including the use of weather normalization of the Test Year sales forecast, proposed by SPS was reasonable and representative for rate-making [*17] purposes. [46]

Sales Growth Projections.

31. Staff's first exception asserts that the Hearing Examiner's determination that SPS's Test Year sales forecast is reasonable and representative for ratemaking purposes should be rejected. Staff argues that its "alternative sales forecast" should have been used. Staff states in its Exceptions that "Staff's analysis shows that the energy forecasts provided by SPS in support of the test year are not consistent with actual data and serve to reflect lower projected revenues for SPS in 2014 by a significant amount." [47] Staff provided an estimate of additional revenues to account for its growth estimate. However, it appears from our review of the record that Staff did not provide an estimated increase in the number of customers that SPS would add and, more importantly, Staff did not provide an estimate of the additional cost that SPS would incur to sell the additional kilowatt hours. As a result of such information not being provided, the Commission is not able to adjust SPS's requested increase in rates to reflect Staff's forecasted growth in kWh sales and associated revenue. Accordingly, the Commission agrees with the Hearing Examiner's [*18] analysis included in the Recommended Decision [48] and rejects Staff's Exceptions on sales growth projections.

Weather Normalization Adjustment

32. Staff's second exception asserts that the Hearing Examiner's acceptance of SPS's use of the weather normalized adjustment made to the sales forecast should be rejected. Staff states that the Hearing Examiner's finding that such an adjustment was based on Commission precedent was incorrect. [49] For the reasons stated by the Hearing Examiner and in SPS's Reply to Exceptions, the Commission rejects this Staff exception.

33. AG Exception "D" asserts that the Hearing Examiner erred in accepting the SPS sales forecast that included weather normalization. The AG argues that because weather normalization is prohibited for consideration in base period sales under Rule 17.1.3.16 NMAC, future test year sales should not be adjusted for weather normalization even though the rule is silent on this point. [50] For the reasons stated by the Hearing Examiner and in SPS's Reply to Exceptions, the Commission rejects this AG exception.

34. The Commission agrees with the Hearing Examiner and the analysis included in the Recommended Decision [51] and [*19] the determination that the test year sales forecast, including the use of weather normalization of the Test Year sales forecast, proposed by SPS and based upon the record in this case, was reasonable and representative for rate-making purposes. [52]

H. RATE DESIGN AND GRADUALISM ADJUSTMENT

35. The rate design component of utility ratemaking determines how the revenue is to be collected from the various classes (residential, commercial, industrial), based upon a class cost-of-service study that purports to show the costs incurred by the utility to serve each class (e.g., the charge levied against a customer is proportional to the expense of service to that customer) . A cost of service study is the basis for designing fair, just and reasonable rates for each customer class. The first step in a class cost of service study is to attribute costs to different categories of customers based upon how much costs those customers cause the utility to incur. Next, the costs are

[46] See Recommended Decision at page 216.

[47] See Staff Exceptions at page 5, citing Lamberson Direct at page 3.

[48] See Recommended Decision at pages 192-216.

[49] See Staff's Exceptions, page 4, citing the Recommended Decision at page 209.

[50] See AG Exceptions at page 13.

[51] See Recommended Decision at pages 192-216.

[52] See Recommended Decision at page 216.

classified so they can then be allocated to the various customer classes such as residential, commercial, industrial or other. Subsequently, in designing rates, generally accepted principles of rate design are utilized. **[*20]** These principles include continuity, bill impact, ease of understanding, and gradualism.

36. Simply stated, gradualism is an adjustment utilized to place a limit on the relative percentage increase each rate class receives compared to the percentage increase for each rate class resulting from the class cost of service study. The Commission has previously determined that gradualism should achieve a balance between the goal of eliminating or reducing cross-subsidies among rate classes and shielding customers from rate shock. [53]

37. The Hearing Examiner adopted Staff's proposal in this case and recommended approval of a gradualism limit of 1.25 times (125%) the overall non-fuel revenue increase. [54]

38. AG Exception "E" asserts that this gradualism adjustment recommendation by the Hearing Examiner should be rejected and argues that the gradualism adjustment should instead be 150% of the average overall base rate increase which would include both fuel and non-fuel components. The AG argues that this proposed adjustment would assist the Commission in evaluating the overall impact of its decisions in each rate case. [55] The Commission finds that fuel should not be included and that **[*21]** accepting the AG's proposal, while reducing the current interclass subsidy, does not go far enough to achieve the Commission's previously stated goals of moving each class to its actual cost of service and eliminating interclass subsidies. [56] Therefore this exception is rejected.

39. SPS Exception No. 7 asserts that the Commission should continue to use the gradualism constraint of 150% of the system average overall non-fuel base rate increase that it used in the last SPS litigated rate case, Case No. 07-00319-UT. [57] SPS argues that this constraint will continue its progress toward a rate design in which each class will pay its own cost of service. [58]

40. OPL's Exceptions assert that the Hearing Examiner's recommendation for a gradualism constraint limiting each customer class's rate increase to 1.25 times (or 125% of) the overall non-fuel revenue increase should be rejected. [59] OPL supports SPS's proposal to limit the rate increase that any given customer class will receive to 1.5 times (or 150% of) the overall non-fuel increase in order to prevent "rate shock." OPL states that the gradualism constraint recommended by the Hearing Examiner results in less movement toward cost **[*22]** and requires a level of interclass subsidization that exceeds what is just and reasonable. [60]

41. We find and conclude that, based upon the record in this proceeding, we should follow the Commission's determination made in the SPS last litigated rate case (Case No. 07-00319-UT), which determined that SPS's proposal to limit rate increases for any one class to 150% of the system average overall non-fuel base rate increase was fair and reasonable. [61] For this proceeding, the proposal to apply a gradualism constraint that limits any class's rate increase to 150% of the total non-fuel base rate increase, excluding the renewable rider impacts, is a reasonable gradualism approach. This result appropriately balances the competing interests of charging a rate class

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[53] See Case No. 07-00319-UT, Final Order Partially Adopting the Corrected Recommended Decision of the Hearing Examiner at pages 182-183.

[54] See Recommended Decision at page 230.

[55] See AG Exceptions at page 14.

[56] See Case No. 07-00319-UT, Final Order Partially Adopting the Corrected Recommended Decision of the Hearing Examiner at pages 182-183.

[57] See SPS Exceptions at page 6.

[58] See SPS Exceptions at page 38.

[59] See OPL Exceptions at page 1.

[60] See OPL Exceptions at page 2.

[61] See NMPRC Case No. 07-00319-UT, Final Order Partially Adopting the Corrected Recommended Decision of the Hearing Examiner at page 183.

its cost of service while tempering the rate shock that a rate class may otherwise experience. Accordingly, we accept the SPS Exception No. 7 and the OPL Exception on gradualism.

I. AMORTIZATION ISSUES

42. The Hearing Examiner recommended that a 2-year amortization period be used to recover rate case expenses, the NOx emission disallowance costs, and the Liberty Audit Deferred Asset. Staff argued that it was more appropriate **[*23]** to use a 3-year amortization period to recover these expenses. [62] According to Staff, a 3-year amortization period would allow SPS the opportunity to apply its weighted average cost of capital to the unamortized balance and therefore be made whole on the financing costs of the unrecovered expenses and at the same time reduce the annual costs to consumers. [63] Moreover, a 3-year amortization period for such expenses is consistent with past Commission determinations. The Commission agrees with Staff and finds that a 3-year amortization period should be used to recover the rate case expenses, NOx emission disallowance costs and the Liberty Audit Deferred Asset.

43. Additionally, as SPS requested in its Exception No. 1 [64], the Commission finds that the amortizations established in this Order begin on the effective date of the rates approved in this case.

J. RENEWABLE RIDER

44. As permitted by the Commission in the last SPS rate case, Case No. 10-00395-UT, SPS submitted a proposal to recover its renewable energy costs through a separate rider. [65]

45. The Hearing Examiner found that establishment of a Renewable Portfolio Standard ("RPS") Cost Rider ("RPS Rider") is a reasonable **[*24]** mechanism to recover renewable energy costs because it benefits customers and shareholders by providing timely cost recovery of prudently incurred expenses and is consistent with the findings in, and purposes of, the Renewable Energy Act. [66] In the Supplemental Recommended Decision, the Hearing Examiner recommended that a RPS Rider for various costs be approved but the recovery of the uneconomic SunEdison costs continue to be recovered through the FPPCAC. [67]

46. The original position taken by SPS was to include the proposed uneconomic SunEdison costs in the RPS Rider. Staff stated the "argument has some merit, but we also note that by making such a change at this time also masks the actual impact of the requested rate case increase in base non-fuel and fuel rates, so that it appears that the requested increase will result in only a 6.3% increase in base non-fuel and fuel rates". Staff Exhibit BEC-5, however, shows SPS's base rate increase is actually an 8.29% increase in future test year base revenue if the uneconomic portion is left in base fuel and FPPCAC." [68] The Commission finds that this is not a sufficient reason to keep these renewable costs from being included in the **[*25]** RPS Rider.

47. The Commission finds that the establishment of the RPS Rider and the inclusion of the uneconomic SunEdison costs in the RPS Rider will provide an appropriate mechanism to capture all of SPS's incremental RPS costs through one recovery mechanism and will benefit customers. "Renewable energy is the only source of power that a public utility obtains pursuant to a statutory mandate. And, subject to the RCT, renewable energy has to comprise a certain percentage of a public utility's total retail sales to New Mexico customers, regardless of need or cost."

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[62] Staff Ex. 6 (Gunter Dir.) at 31-32.

[63] Staff Ex. 6 (Gunter Dir.) at 31.

[64] See SPS Exceptions, page 8.

[65] See Final Order Adopting Amended Certification of Stipulation, accepting the Certification in its entirety at page 2; see Certification at page 81.

[66] See Supplemental Recommended Decision at page 13.

[67] See Supplemental Recommended Decision at pages 15-17.

[68] See Staff Exhibit 6 (Gunter Dir.) at page 12.

[69] "It is not only not unreasonable, but it is desirable, to communicate to customers the cost of this mandate, just as the undergrounding rider communicates to customers the cost of undergrounding mandated by local governments. Other state commissions have authorized recovery of renewable energy costs through rate riders." [70] Accordingly, the recommendation by the Hearing Examiner for the establishment of the RPS Rider is accepted but the recommendation regarding the uneconomic Sun Edison costs is rejected and the original request by SPS to include the uneconomic SunEdison costs in the RPS Rider is approved.

48. The **[*26]** FEA Supplemental Exception challenges the Hearing Examiner's findings that there is no legal authority cited that would allow Cannon Air Force Base ("CAFB") a variance from the requirements of the Renewable Energy Act or Commission Rule 572 and that CAFB did not meet the legal requirements for the statutory exemptions contained in the REA. The Hearing Examiner determined that the CAFB is not a political subdivision of the State nor a governmental entity as required by the large customer exemption. [71] For the reasons addressed by the Hearing Examiner in the Supplemental Recommended Decision, the Commission rejects this exception.

49. The AG Exception challenges the Hearing Examiner's finding that it is legally appropriate and reasonable to permit SPS to recover the excess large customer cap costs from all customers not statutorily limited by the large customer cap. [72] The AG argues that the excess costs should be deferred and only collected from large customers. [73] For the reasons addressed by the Hearing Examiner in the Supplemental Recommended Decision, the Commission rejects this exception. SPS may recover the "excess" of the large customer cap costs (or defined by SPS as the **[*27]** large customer cap costs) from all other customers comprised in SPS's other rate classes, including those industrial customers not already at the cap.

K. REVENUE INCREASE

50. SPS Exception No. 1 is a procedural request. SPS notes that as a result of the subsequent issuance of the Supplemental Recommended Decision related to the RPS Rider and its impact on certain issues and calculations addressed in the previously issued Recommended Decision, the Commission's Order should incorporate changes to base rates (base fuel costs) and/or the RPS Rider, depending on how the Commission rules on the RPS Rider and the issue of the SunEdison uneconomic costs. The Commission believes that it has addressed this request herein.

51. This Order, as delineated above, authorizes SPS to increase its rates to recover an overall revenue requirement equivalent to $ 342,845,582, inclusive of the $ 18,081,354 of renewable energy costs, which amounts to an overall increase of $ 33,094,453.

L. CONCLUSIONS

52. The Statement of the Case, Discussion, and all findings and conclusions contained in the Recommended Decision and the Supplemental Recommended Decision are hereby incorporated by reference **[*28]** as if fully set forth in this Order, and except as modified by this Order, are ADOPTED, APPROVED, and ACCEPTED as Findings and Conclusions of the Commission.

53. The Recommended Decision and the Supplemental Recommended Decision are well taken and should be adopted, accepted, and approved by the Commission, except as modified by this Order.

54. Due and proper notice of this case has been provided.

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[69] See Recommended Decision at page 47, Case No. 12-00007-UT, citing NMSA 1978, § 62-16-4(A); Tr. at 32.

[70] See Recommended Decision at page 47, Case No. 12-00007-UT, citing e.g., Re Public Serv. Co. of Colo., 2011 WL 5056340 (Colo. P.U.C.); Re Interstate Power& Light Co., 2012 WL 982829 (Minn. P.U.C.); Re Ohio Edison Co., Cleveland Elec. Illuminating Co. & Toledo Edison Co., 2012 WL 252214 (Ohio P.U.C.).

[71] See Supplemental Recommended Decision at pages 40-47.

[72] See Recommended Decision at page 40.

[73] See Attorney General Exceptions to Supplemental Recommended Decision at page 3.

55. The Commission should grant the OPL Motion for the reasons stated therein.

M. ORDERING PARAGRAPHS

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IT IS THEREFORE ORDERED:

A. The **[*33]** OPL Motion to File Reply is granted.

B. The Orders contained in the Recommended Decision and the Supplemental Recommended Decision are incorporated by reference as if fully set forth herein and are ADOPTED, APPROVED, and ACCEPTED as Orders of the Commission, except as modified by this Order.

C. The Recommended Decision and the Supplemental Recommended Decision are ADOPTED, APPROVED and ACCEPTED in its entirety, except as modified by this Order.

D. Exceptions not expressly granted are DENIED.

E. The SPS request for approval of Advice Notice No. 245 is denied.

F. With respect to the Renewable Rider, SPS is required to calculate new Renewable Rider rates based on the revenue requirements approved in this case, to be assessed on a per kWh basis. By no later than **April 3, 2014**, SPS shall file the proposed detailed plans regarding the mechanics, operation and true up of the RPS Rider (the "RPS Compliance Filing"). The RPS Compliance Filing shall be substantially similar with the procedure and forms ordered and accepted by the Commission in Case No. 12-00007-UT, including but not limited to the true up requirement, documentation and process. By no later than **five** business days **[*34]** after SPS makes its RPS Compliance Filing, Staff shall review the information filed by SPS pursuant to this Paragraph. Unless otherwise notified by Staff, the plans regarding the mechanics, operation and true up of the RPS Rider shall be determined to be an accepted RPS Compliance Filing.

G. By no later than **April 10, 2014**, SPS shall file new advice notices and revised rates consistent with the terms of this Final Order, and a statement by SPS that it has filed all documents by the deadlines specified in this Paragraph (SPS's filing is hereinafter referred to as the "Compliance Filing") and the RPS Compliance Filing. By no later than two business days after SPS makes its Compliance Filing, Staff shall review the information filed by SPS pursuant to this Paragraph. Unless otherwise notified by Staff, the revised rates shall go into effect for bills rendered on the date that coincides with the start of SPS's next billing cycle.

H. Unless Staff notifies the Commission and SPS that any of the filings required by Paragraphs F and G of this Final Order are not in accordance with the provisions of this Final Order, this docket shall close at the end of the second business day after SPS **[*35]** makes its Compliance Filing.

I. This Order is effective immediately.

J. Copies of this Order shall be e-mailed to all persons listed on the attached Certificate of Service whose e-mail addresses are known. Copies of this Order shall be mailed via regular mail to all other persons listed on the attached Certificate of Service.

ISSUED under the Seal of the Commission at Santa Fe, New Mexico, this 26th day of March, 2014.

NEW MEXICO PUBLIC REGULATION COMMISSION

THERESA BECENTI-AGUILAR, CHAIR

VALERIE ESPINOZA, VICE CHAIR

KAREN L. MONTOYA, COMMISSIONER

Voted No

PATRICK H. LYONS, COMMISSIONER

BEN L. HALL, COMMISSIONER

BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the ***Final Order Partially Adopting Recommended Decision,*** issued March 26, 2014, was sent via e-mail to the following on March 27, 2014:

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[*36]
Certificate of Service
Case No. 12-00350-UT

Page 1

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DATED this **27th** day of March, 2014.

NEW MEXICO PUBLIC REGULATION COMMISSION

/s/ Cecilia Rios

Cecilia Rios, Law Clerk

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Case No. 12-00350-UT

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PUC DOCKET NO. 33309
SOAH DOCKET NO. 473-07-0833

APPLICATION OF AEP TEXAS CENTRAL COMPANY FOR AUTHORITY TO CHANGE RATES	**§ § §**	**PUBLIC UTILITY COMMISSION OF TEXAS**

ORDER ON REHEARING

On November 9, 2006, AEP Texas Central Company (TCC) filed an application for authority to change rates pursuant to PURA,[1] Chapter 36, requesting an increase in base rates that would produce an annual base revenue increase of $62,709,174. During the course of this proceeding, TCC reduced this amount to approximately $49,952,000.[2] TCC also seeks to terminate the merger savings and rate reduction riders implemented in Docket No. 19365,[3] further increasing its revenues by $19,988,359 annually. Therefore, the total revenue increase sought by TCC in this proceeding is $69,940,359.

The administrative law judges (ALJs) filed a proposal for decision (PFD) on August 30, 2007. In their PFD, the ALJs recommend that the Commission approve TCC's application, including termination of the merger savings and rate reduction riders, subject to the adjustments recommended in the Proposal for Decision (PFD). The recommendations reduce TCC's adjusted test year total revenue requirements from $581,127,359 to $531,123,478, a reduction of $50,004,479. TCC identified several number-run adjustments required to implement the ALJs' decision.[4] The Commission ordered Commission Staff to incorporate TCC's number-run corrections, which resulted

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[1] Public Utility Regulatory Act, TEX. UTIL. CODE ANN. §§ 11.001 – 64.158 (Vernon Supp. 2007) (PURA).

[2] TCC Ex. 78, RWH-1R.

[3] *See Application of Central and Southwest Corporation and American Electric Power Company, Inc. Regarding Proposed Business Combination,* Docket No. 19365, Integrated Stipulation and Agreement (Nov. 18, 1999).

[4] AEP Central Company's Exceptions to the Proposal for Decision and Request for Number Running Corrections, Attachment E at 87-91(Sept. 20, 2007).

21. On May 15, 2007, the ALJs issued an interim order finding that a bonded rate is a changed rate under the ISA and PURA § 36.110; therefore, TCC is allowed to terminate the merger savings and the rate reduction riders ordered in Docket No. 19265, upon implementation of bonded rates.

22. On June 27, 2007, the Commission denied an interim appeal of the order identified in the above finding of fact 21, affirming the ALJs' ruling.

Rate Base

23. TCC's used and useful total transmission plant in service (excluding general and intangible plant in service) is $912,831,763.[7] TCC's used and useful transmission plant in service net of accumulated depreciation (excluding depreciation on general and intangible plant in service) is $642,951,403.[8]

24. TCC's used and useful total distribution plant in service (excluding general and intangible plant in service) is $1,446,115,221.[9] TCC's used and useful distribution plant in service net of accumulated depreciation (excluding depreciation on general and intangible plant in service) is $953,628,481.[10]

25. TCC included in rate base a pension prepayment asset of $112.4 million.

26. The pension prepayment asset arises under Generally Accepted Accounting Principles (GAAP) in accordance with Statement of Financial Accounting Standards No. 87 (SFAS 87) and represents the amount by which the pension fund exceeds the accumulated pension obligations.

27. Investment income on the pension prepayment asset reduces pension cost calculated under SFAS 87.

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[7] *See* Docket No. 33309 - Final Order Number Run - (Transmission Model) Schedule II-B-1, Rate Base Accounts - Plant Test Year Ending 6/30/2006 - Total Transmission Distribution Plant Gross (Filed February 5, 2008)

[8] *Id.*- Schedule II-B-5 - Total Transmission - Distribution Plant - Net

[9] *Id.* (Distribution Model) Schedule II-B-1

[10] *Id.* (Distribution Model) Schedule II-B-5

28. Accounting in accordance with GAAP requires that both the balance sheet and income statement effects be taken into account.

29. The pension prepayment asset contains $22.799 million included in construction work in progress (CWIP).

30. Only the non-CWIP portion of the income earned on the pension prepayment asset is reflected in the total pension expense and the revenue requirement.

31. The pension prepayment asset should not be included in TCC's rate base to the extent that TCC's pension cost is capitalized to CWIP.

32. The pension prepayment asset of $112.4 million, less the $22.799 million portion included in CWIP, should be included in rate base.

33. All of TCC's operations and maintenance (O&M) and administrative and general (A&G) expenses are included in its cash working capital calculation.

34. The leads and lags in paying these items, which give rise to the amounts recorded in Account 190, have been appropriately included in the calculation of rate base through this process.

35. Accumulated Deferred Federal Income Tax (ADFIT) of $323.9 million is reasonable and should be included in rate base.

36. In arriving at its adjusted test-year-end rate base, TCC reclassified $7.3 million in transmission projects that were classified as CWIP and that had not been closed out to plant-in-service as of June 30, 2006 but which were actually providing service to customers as of that date.

37. TCC also removed from rate base allowance for funds used during construction (AFUDC) of $368,625 related to the transmission projects that were reclassified.

38. The $7.3 million reclassification of these projects to plant-in-service is reasonable and should be adopted.

39. TCC's construction accounts payable were included in TCC's cash working capital calculation. Accordingly, the leads and lags associated with these

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PUC DOCKET NO. 39896
SOAH DOCKET NO. 473-12-2979

APPLICATION OF ENTERGY TEXAS, INC. FOR AUTHORITY TO CHANGE RATES, RECONCILE FUEL COSTS, AND OBTAIN DEFERRED ACCOUNTING TREATMENT	§ § § § §	**PUBLIC UTILITY COMMISSION** **OF TEXAS**

ORDER ON REHEARING

This Order addresses the application of Entergy Texas, Inc. for authority to change rates, reconcile fuel costs, and defer costs for the transition to the Midwest Independent System Operator (MISO). In its application, Entergy requested approval of an increase in annual base-rate revenues of approximately $111.8 million (later lowered to $104.8 million), proposed tariff schedules, including new riders to recover costs related to purchased-power capacity and renewable-energy credit requirements, requested final reconciliation of its fuel costs, and requested waivers to the rate-filing package requirements.

On July 6, 2012, the State Office of Administrative Hearings (SOAH) administrative law judges (ALJs) issued a proposal for decision in which they recommended an overall rate increase for Entergy of $28.3 million resulting in a total revenue requirement of approximately $781 million. The ALJs also recommended approving total fuel costs of approximately $1.3 billion. The ALJs did not recommend approving the renewable-energy credit rider and the Commission earlier removed the purchased-power capacity rider as an issue to be addressed in this docket.[1] On August 8, 2012, the ALJs filed corrections to the proposal for decision based on the exceptions and replies of the parties.[2] Except as discussed in this Order, the Commission adopts the proposal for decision, as corrected, including findings of fact and conclusions of law.

Parties filed motions for rehearing on September 25 and October 4, 2012 and filed replies to the motions for rehearing on October 15, 2012. The Commission considered the motions for

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[1] Supplemental Preliminary Order at 2, 3 (Jan. 19, 2012).

[2] Letter from SOAH judges to PUC (Aug. 8, 2012).

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23. The Hurricane Rita regulatory asset should not be moved to the storm damage insurance reserve.

24. The company requested in rate base its prepaid pension assets balance of $55,973,545, which represents the accumulated difference between the Statement of Financial Accounting Standards (SFAS) No. 87 calculated pension costs each year and the actual contributions made by the company to the pension fund.

25. The prepaid pension assets balance includes $25,311,236 capitalized to construction work in progress (CWIP).

26. It is not necessary to the financial integrity of ETI to include CWIP in rate base, and there was insufficient evidence showing that major projects under construction were efficiently and prudently managed.

27. The portion of the prepaid pension assets balance that is capitalized to CWIP should not be included in ETI's rate base.

28. The remainder of the prepaid pension assets balance should be included in ETI's rate base.

28A. When items are excluded from rate base, the related ADFIT should also be excluded. The amount of ADFIT associated with the $25 million capitalized to CWIP and excluded from rate base is $8,858,933. The adjusted ADFIT for the prepaid pension asset remaining in Entergy's rate base should be reduced by $8,858,933.

29. ETI should be permitted to accrue an allowance for funds used during construction on the portion of ETI's Prepaid Pension Assets Balance capitalized to CWIP.

30. The Financial Accounting Standard Board (FASB) Financial Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes," requires ETI to identify each of its uncertain tax positions by evaluating the tax position on its technical merits to determine whether the position, and the corresponding deduction, is more-likely-than-not to be sustained by the Internal Revenue Service (IRS) if audited.

31. FIN 48 requires ETI to remove the amount of its uncertain tax positions from its Accumulated Deferred Federal Income Tax (ADFIT) balance for financial reporting

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PUC DOCKET NO. 40443
SOAH DOCKET NO. 473-12-7519

APPLICATION OF SOUTHWESTERN ELECTRIC POWER COMPANY FOR AUTHORITY TO CHANGE RATES AND RECONCILE FUEL COSTS	§ § § §	**PUBLIC UTILITY COMMISSION OF TEXAS**

ORDER ON REHEARING

This Order addresses the application filed on July 27, 2012 by Southwestern Electric Power Company (SWEPCO) for authority to change its rates and reconcile its fuel costs. The primary contested issue regarding the proposed increase involves the portion of SWEPCO's share of the costs of the Turk coal plant in Hempstead, Arkansas that are allocated to Texas.

SWEPCO's application sought a total-company revenue requirement of $1.033 billion, exclusive of fuel revenues. The requested Texas retail revenue requirement exclusive of fuel revenues was $329 million, which reflected an increase in annual Texas retail revenues of $83.37 million over its adjusted test-year revenues.[1] The increase primarily consists of the inclusion of the newly constructed Turk coal plant and Stall gas plant. For the fuel reconciliation period from April 1, 2009 through December 31, 2011, SWEPCO sought to reconcile a cumulative fuel under-recovery balance of $3,936,492, including interest, and proposed no surcharge. SWEPCO's reconciliation included proposed revisions to Dolet Hills Lignite Company benchmark price.

The State Office of Administrative Hearings' administrative law judges (ALJs) issued a proposal for decision on May 20, 2013. The ALJs' recommended approval of the application, with certain adjustments. Regarding the Turk plant, the ALJs recommended the disallowance of all Turk costs over approximately $934 million as being imprudently incurred in continuing construction after June 2010. The ALJs further recommended that approximately $260 million be allowed for the estimated costs to retrofit the Welsh Unit 2 coal plant that SWEPCO should have undertaken instead of completing the Turk plant. However, the ALJs recommended in the

[1] Rebuttal Testimony of Jennifer L. Jackson, SWEPCO Ex. 88, JLJ-1R at 2.

Welsh Unit 2

119. SWEPCO did not justify with thorough analysis its decision to retire Welsh Unit 2 more than 20 years prior to the end of its useful life.

120. DELETED.

121. DELETED.

122. DELETED.

123. DELETED.

124. The retirement of Welsh Unit 2 has not yet occurred. Consequently, it is inappropriate to consider the unit's retirement costs before it actually happens.

125. It is reasonable for SWEPCO to institute a new proceeding so that the Commission may evaluate the benefits and burdens of retiring Welsh Unit 2.

125A. The determination of whether SWEPCO's decision to reduce production and ultimately retire Welsh Unit 2 was prudent is deferred to a future proceeding that addresses the actual retirement of the plant when it occurs.

Turk Plant – Other Issues

126. SWEPCO recorded $1,372,891,214 as CWIP for direct Turk plant costs at test-year end.

127. The Turk plant went into commercial operation on December 20, 2012.

128. The rate year for SWEPCO's proposed rate increase began on January 29, 2013.

129. On January 29, 2013, SWEPCO's then-existing rates were deemed to be temporary rates for service on or after that date and subject to reconciliation back to January 29, 2013 with a refund or surcharge to the extent that the rates ultimately established by the Commission differ from the temporary rates.

Prepaid Pension Asset and ADFIT Impacts

130. The prepaid pension asset arises under generally accepted accounting principles (GAAP) in accordance with Statement of Financial Accounting Standards No. 87 (FAS 87). The prepaid pension asset represents the amount by which the accumulated contributions to the pension fund exceed the accumulated FAS 87 pension cost.

131. Accounting in accordance with GAAP requires that both the balance sheet and income statement effects be taken into account. GAAP in accordance with FAS 87 requires the amount by which the cash contributions made to the pension fund exceed the accumulated pension cost to be recorded on the balance sheet as a prepaid asset.

132. Investment income on the prepaid pension asset reduces pension cost calculated under FAS 87.

133. As of December 31, 2011, SWEPCO had a prepaid pension asset on its books of $113.2 million calculated in accordance with GAAP. The prepaid pension asset consisted of two amounts for ratemaking purposes:

    (a) $80.7 million which is associated with pension cost charged to operation and maintenance (O&M) expense; and

    (b) $32.5 million associated with pension cost charged to CWIP.

134. The $80.7 million portion of SWEPCO's prepaid pension asset associated with pension cost charged to O&M expense is appropriately included in rate base.

135. SWEPCO properly included $28.2 million in accumulated deferred federal income tax (ADFIT) as an offset to rate base; this amount is 35% of the $80.7 million prepaid pension asset amount included in rate base.

136. The $32.5 million portion of SWEPCO's prepaid pension asset associated with pension cost capitalized to CWIP will not be included in rate base.

137. SWEPCO is permitted to accrue allowance for funds used during construction (AFUDC) on the portion of its prepaid pension asset capitalized to CWIP.

Oxbow Investment

138. In December 2009, Central Louisiana Electric Company (CLECO) and SWEPCO formed the Oxbow Lignite Company, which acquired the Oxbow Mine Reserves from Red River Mining Company (RRMC) for approximately $25.7 million.

122 FERC ¶ 61,218
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Southern Company Services, Inc. Docket Nos. ER08-129-000
ER08-129-001

ORDER ON TARIFF FILING

(Issued March 10, 2008)

1. On October 31, 2007, Southern Company Services, Inc., acting as agent for Alabama Power Company, Georgia Power Company (Georgia Power), Gulf Power Company, Mississippi Power Company, and Savannah Electric and Power Company (collectively, Southern Companies), filed proposed revisions to the formula rates under Southern Companies' Open Access Transmission Tariff (OATT), pursuant to section 205 of the Federal Power Act (FPA).[1] Southern Companies state that the filing was made to implement for billing purposes the accounting and reporting guidance for defined benefit post retirement plans that was issued by the Commission's Chief Accountant on March 29, 2007,[2] and was filed pursuant to a settlement agreement approved by the Commission in 2003 (2003 Settlement).[3] In this order, the Commission accepts, in part, the proposed formula rate revision.

I. Background

2. On October 3, 2003, in the 2003 Settlement Order, the Commission approved a proposed amendment to Southern Companies' OATT to convert their stated rates to comprehensive formula rates, effective May 1, 2003. In the instant filing, Southern

[1] 16 U.S.C. § 824d (2000).

[2] *Commission Accounting and Reporting Guidance to Recognize the Funded Status of Defined Benefit Postretirement Plans*, Docket No. AI07-1-000 (Mar. 29, 2007), *clarified by Correction to Commission Accounting and Reporting Guidance to Recognize the Funded Status of Defined Benefit Postretirement Plans*, AI07-1-001 (Jan. 16, 2008). (Accounting and Reporting Guidance).

[3] *Southern Company Services, Inc.,* 105 FERC ¶ 61,019 (2003) (2003 Settlement Order). Southern Companies' formula rate is set forth in the Formula Rate Manual in Attachment M of Southern Companies' OATT.

Companies' prepaid pension asset, including any related components, expenses or accounts in the OATT formula rate." If Southern Companies chose to make such a filing, Customer Group and AMEA had the right to make arguments related to the propriety of Southern Companies' proposed ratemaking treatment of such pension asset, related components, expenses, or accounts. In light of this provision, we conclude the 2007 Settlement obligates Southern Companies to support their proposed ratemaking treatment. Southern Companies therefore have an obligation, under the 2007 Settlement, to fully explain the basis for their proposal to include the prepaid pension asset, related components, expenses, or accounts in their formula rate.[17]

2. Prepaid Pension Asset in Rate Base

21. As a general matter, it is appropriate to include prepayments in rate base when they represent amounts that a utility has paid for costs that are allowed to be collected in rates in the future, such as for prepaid insurance or prepaid rent. This is because the utility is out-of-pocket for such costs until they are recovered from ratepayers and is therefore entitled to recover its cost of financing such prepaid expenses. In the instant case, Southern Companies, in essence, are asserting that they are out-of-pocket for $1.1 billion of prepaid pension costs. However, unlike prepaid insurance or prepaid rent, prepaid pensions arise when the income earned on pension funds accumulated in an external trust exceeds the net periodic pension cost, *i.e.*, the current year's pension income exceeds the current year's pension expense. By law, a utility cannot withdraw such income,[18] although it is required (under Generally Accepted Accounting Principles) to reflect the income as a reduction to its pension expense, *i.e.*, as a credit to Account No. 926. At the same time, the utility records a corresponding amount of prepaid pensions.[19] If that reduction in pension expense is used in determining a utility's rates, there will be a corresponding reduction in the amounts collected from ratepayers. Because a utility cannot withdraw the pension income, it will be out-of-pocket for the amount of pension income that has reduced rates, *i.e.*, it must reduce its pension expense by the amount of income, even though it is not allowed to receive such income from the pension trust.[20] Thus, when a utility's rates have been reduced by pension income, but the utility has not received such income from the external trust, it will have to finance

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[17] Absent the 2007 Settlement, Southern Companies could have merely filed pursuant to Attachment N to reflect changes in a fundamental predicate, *i.e.*, the Transmission Provider's accounting practices, to reflect the accounting changes contained in the Commission's Accounting and Reporting Guidance directive.

[18] In this situation, a pension fund is said to be "over-funded," and such over-funding is expected to be temporary. However, if an external pension fund is over-funded when it is terminated, any excess funds must be returned to ratepayers.

[19] Southern Companies have been recording such prepaid pensions in Account No. 165, but seek to re-classify them to Account No. 129 in the instant proceeding.

[20] *See* illustration in n.14.

such amount, and is entitled to include the pension income in rate base. Conversely, if a utility records pension income in Account No. 926 but its rates are *not* reduced, the utility will not be out-of-pocket for the pension income. In this latter situation, the utility is not entitled to earn a return on the prepaid pensions, as it will not actually finance them; therefore, it should not include them in rate base.

22. In the instant case, the Southern Companies have had formula rates in effect for network and point-to-point transmission rates under their OATT since May 2003. Southern Companies' formula rates track amounts recorded in their expense accounts, including Account No. 926. Southern Companies' Attachment C lists, by operating company, the net periodic pension cost or income that was included in Account No. 926 since 1987, the year that they adopted the accounting for pensions under Statement of Financial Accounting Standards No. 87.[21] This Attachment shows that, between 2003 and 2006, Southern Companies reduced their pension expense by $320,623,404.[22] Because Southern Companies' OATT formula rates track the reduction in pension expense resulting from pension income, and therefore result in reduced rates, the Commission concludes that Southern Companies have justified inclusion of the jurisdictional portion[23] of such prepaid pensions in rate base. Therefore, we will accept Southern Companies' filing to the extent that they seek to include the jurisdictional portion of prepaid pension assets accrued since May 2003 in rate base.

23. However, Southern Companies have not justified inclusion of any other prepaid pension amounts that they seek to include in rate base. In its deficiency letter, Commission Staff asked Southern Companies to:

> support your assertion that customers have benefited through rate reductions by over $1 billion and that Southern Companies, in fact, have experienced out-of-pocket costs equal to the amount of prepaid pension assets. This demonstration must include evidence that the amounts included in prepaid pensions actually reduced rates by the same amounts in all years during which the prepaid pensions were accumulated.[24]

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[21] According to Attachment C, net pension income, *i.e.*, credits to Account No. 926, began in 1993.

[22] This amount would be somewhat less than the $320,623,404, since Southern Companies' formula rates were effective only from May 1, 2003 forward.

[23] As used here, the jurisdictional portion is that portion related to amounts reflected in Commission-jurisdictional OATT rates.

[24] Deficiency Letter at 2.

24. In response, Southern Companies state only that the cost of service has been reduced by over $1 billion since 1987 as a result of the income earned on the pension asset. Specifically, they state that the reduction to expense is to Account No. 926, which is a data input for computing rates under their OATT. Southern Companies do not address, either in their original filing, or in their response to Staff's deficiency letter, how amounts included in prepaid pensions actually reduced transmission rates for years prior to May 2003. Southern Companies do not, for example, explain whether their pre-May 2003 transmission rates were based on a formula, like that currently effective under Southern Companies' OATT, or whether pension income in any prior year was used in determining stated transmission rates. Of the $1.1 billion of prepaid pensions that Southern Companies seek to include in rate base, more than two-thirds of that amount relates to periods prior to May 2003. Since Southern Companies have not shown that they reduced transmission rates prior to May 2003 by the jurisdictional portion of that pension income, the Commission cannot conclude that Southern Companies have had to finance any prepaid pensions accrued prior to May 2003. Therefore, the Commission finds that it is not just and reasonable for Southern Companies to include any amounts related to prepaid pensions accumulated prior to May 2003 in rate base under Southern Companies' OATT. Similarly, any corresponding amounts of working capital reductions and deferred income taxes should also be excluded from OATT rate determinations.

25. In accordance with the above findings, we will direct Southern Companies to file within 30 days of the date of this order, revisions to their OATT that: (1) add Account No. 128 (rather than Account No. 129) to those accounts included in their OATT formula rate; and (2) specify that only the jurisdictional portion of prepaid pensions accrued since May 2003 be included in rate base. We will also direct Southern Companies to recompute their 2007 formula rates to reflect this determination.

The Commission orders:

(A) Southern Companies' proposal is hereby accepted in part and rejected in part as discussed in the body of this order, effective January 1, 2007.

(B) Southern Companies are hereby directed to revise their 2007 formula rates as discussed in the body of this order, and make a compliance filing within 30 days of the date of this order to reflect such adjustments.

(C) Southern Companies are hereby directed to recompute their OATT billings to reflect the determinations of this order

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

Document Content(s)

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2014 Del. PSC LEXIS 77; 315 P.U.R.4th 10

Delaware Public Service Commission

August 5, 2014; August 5, 2014

PSC DOCKET NO. 13-115; ORDER NO. 8589

Reporter
2014 Del. PSC LEXIS 77; 315 P.U.R.4th 10

IN THE MATTER OF THE APPLICATION OF DELMARVA POWER & LIGHT COMPANY FOR APPROVAL OF A CHANGE IN ELECTRIC DISTRIBUTION RATES AND MISCELLANEOUS TARIFF CHANGES (FILED MARCH 22, 2013)

Core Terms

staff, customer, recommend, rate base, test period, plant, reliability, estimate, post-test, electric, pension, parcel, rate case, calculate, annual, ratepayer, dividend, defer, constant, proxy, energy, rebuttal testimony, long-term, forecast, premium, investor, ratio, evidentiary, ratemaking, stock

Counsel

[*1] APPEARANCES: FOR THE APPLICANT, DELMARVA POWER & LIGHT COMPANY ("Delmarva" or the "Company"): TODD A. COOMES, ESQUIRE, Richards, Layton & Finger, P.A.; TODD L. GOODMAN, ESQUIRE; PAMELA J. SCOTT, ESQUIRE, Pepco Holdings, Inc. Legal Services, Associate General Counsel; FOR THE DELAWARE PUBLIC SERVICE COMMISSION STAFF ("Staff"): JAMES McC. GEDDES, ESQUIRE, Ashby & Geddes; JULIE M. DONOGHUE, ESQUIRE, Deputy Attorney General; FOR THE DIVISION OF THE PUBLIC ADVOCATE (the "Public Advocate" or the "DPA"): DAVID L. BONAR, Public Advocate; REGINA A. IORII, ESQUIRE, Deputy Attorney General; FOR THE COMMISSION: KATHLEEN P. MAKOWSKI, ESQUIRE, Deputy Attorney General; FOR INTERVENOR DELAWARE ENERGY USERS' GROUP ("DEUG"): MICHAEL J. QUINAN, ESQUIRE, Christian & Barton, LLP; FOR INTERVENOR DELAWARE DEPARTMENT OF NATURAL RESOURCES AND ENVIRONMENTAL ("DNREC"): RALPH DURSTEIN, ESQ., Deputy Attorney General, Deputy Attorney General; FOR INTERVENOR THE CAESAR RODNEY INSTITUTE ("CRI"): DAVID STEVENSON, DIRECTOR, Center for Energy Competitiveness

Panel: Dallas Winslow, Chair; Joann T. Conaway, Commissioner; Jaymes B. Lester, Commissioner; Jeffrey J. Clark, Commissioner

Opinion

FINDINGS, OPINION AND ORDER NO. 8589

[*2]

I. EXECUTIVE SUMMARY

This matter comes before this Commission on an application (the "Application") filed by Delmarva on March 22, 2013, to increase its electric rates by $ 39 million. [1] In September 2009, Delmarva submitted a request to increase its revenue requirement by $ 27.6 million; in Order No. 8011, issued on August 9, 2011, we approved a $ 16.371 million increase. Four

[1] The Company's original request for rate relief in this Application was $ 42 million, subsequently revised to $ 39 million in its rebuttal testimony.

the fact that Delmarva's affiliated transactions are generally settled on the 15th *business* day of the month. (Exh. 11 (Peterson at 18). Depending on which day of the week the first business day falls during the month, the 15th billing day will range between 19 and 21 calendar days. (*Id.*). Using its expense lead time of 35.2 days, Staff increased the overall weighted average lead days for all O&M expenses from 17.33 days to 31.70 days. (*Id.* at 18.) Staff concluded that Delmarva's CWC request should be reduced by $ 4,200,129. (*Id.*).

83. DPA Witness Crane also used an average service period of 15.2 days; however, instead of business days, she employed a combined billing and payment lag of 15 days and calculated an **[*54]** expense lead time of 30.21 days. (Exh. 13 (Crane at 13). She concluded that Delmarva's CWC request should be reduced by $ 1,889,057. (*Id.* and Sch. 'ACC-6).

84. Hearing Examiner's Recommendation . The Hearing Examiner found that the Company had not carried its burden of proof on this issue. He was persuaded that a utility's internal arrangement with an unregulated affiliate regarding payment that differs from the contractual payment obligation should not dictate the utility's CWC requirement. (HER at 83). Thus, he rejected the Company's claimed $ 10,887,807 CWC requirement. However, he did not make a recommendation as to whether the Commission should accept Staff's or the DPA's proposed reduction to CWC, which used different days (business vs. calendar) to calculate the adjustment. (*Id.* at 83-84).

85. Exceptions. The Company excepted to the Hearing Examiner's recommendation. It noted that there was no dispute as to whether a CWC allowance should be allowed in rate base, only a dispute as to how much to include. (DPL EB at 54). Delmarva maintains that its lead-lag study reflects transactions on its books and records, insisting that if the actual Intercompany Money Pool **[*55]** Balance settlement frequency was applied, a new lead-lag study would be required. Finally, the Company suggested that since Staff and the DPA did not perform a lead-lag study with their proposed expense leads, importing only one off-the-book frequency into the lead/lag study is arbitrary. (*Id.* at 55).

86. Discussion and Decision. We adopt the Hearing Examiner's recommendation on this issue. We agree with the DPA and Staff that ratepayers should not be burdened by payment schedules between affiliated companies that are not contractually required. Since a majority of Delmarva's distribution O&M expenses are Service Company-related, the assignment of expense lead days has a significant effect on the CWC requirement. (Exh. 11 (Peterson) at 18-19). We believe that the lead-lag study should reflect this fact, and it is not incumbent upon those parties challenging the Company's adjustment to redo the entire lead-lag study.

87. With regard to the amount of the adjustment, we believe that Staff's position is correct and supported by the record presented here. It reflects the actual payment terms under which Delmarva is contractually obligated to pay the affiliated Service Company. **[*56]** Ratepayers should receive the benefit of the longer contractually-mandated lead between the payment of such expenses to the Service Company. (Unanimous).

5. Prepaid Pension and OPEB Liability

88. In its original filing, Delmarva included three prepaid assets in its proposed rate base: $ 61,581,370 of pension costs; ($ 8,176,221) of accrued OPEB liability; and $ 41,431 of insurance. (Exh. 13 (Crane) at 14). The Company acknowledged that it had double-counted the pre-paid insurance claim by including it both in rate base and in its CWC requirement. Thus, it removed the prepaid insurance balance from rate base in its rebuttal testimony. (*Id.* at 17-18; Exh. 20 (Ziminsky-R) at 65). The other two prepaid assets -- pension costs and accrued OPEB liability balances -- remain issues in the case, which the DPA seeks to exclude from Delmarva's rate base.

89. By way of background, since the adoption of Financial Accounting Standards Board Statement Nos. 87 and 106 ("SFAS 87" and "SFAS 106"), and pursuant to Commission policy, pension and OPEB expense have been determined on an actuarial basis using the accrual method of accounting. The accrual method seeks to recover pension and OPEB **[*57]** benefit costs over the working lives of the employees who receive such benefits based on assumptions regarding salary levels, earnings on fund balances, mortality rates and other factors. A separate calculation determines funding requirements.

The actuarial valuation may be positive or negative in any given year. (Exh. 13 (Crane) at 14-15). [22] A prepaid pension asset occurs when the accumulated contributions and growth in the pension plan exceed the accumulated expenses associated with the pension obligations. An OPEB liability occurs when the accumulated costs of the OPEB obligations are greater than the associated contributions and growth of the plan assets. (Exh. 20 (Ziminsky-R) at 71).

[*58]

90. The DPA observed that 26 *Del. C.* § 102(3) defines rate base as "[t]he original cost of all used and useful utility plant and intangible assets ..." less related accumulated depreciation and amortization; customer advances and contributions in aid of construction ("CIAC"); and accumulated deferred and unamortized income tax liabilities and investment credits, accumulated depreciation of customer advances and CIAC. Rate base does not include any asset that is not *"used and useful"* and does not include any plant and/or intangible assets supplied by any entity other than utility investors. (DPA AB at 54).

91. The DPA argued that the Company's prepaid pension asset and OPEB liability were not used and useful in the provision of utility service because the Company is legally prohibited from accessing these funds. Furthermore, even if the funds were available for the Company's use, Delmarva could not satisfy its burden of establishing that shareholders, rather than ratepayers or the market, contributed the funds that comprised them. The DPA asserted that the Commission did not consider either of these arguments in previous dockets, and both **[*59]** support a reversal of its prior decision. In the alternative, the DPA suggested that the Commission's decision in Docket No. 05-304 was incorrect. (*Id.* at 53-57). The DPA cited decisions from Hawaii, Illinois, Nevada and Texas holding that the pension asset and OPEB liability were not used nor useful in the provision of utility service and that the utility bore the burden of proving that shareholders, rather than ratepayers or the market, invested the monies comprising the funds. (*Id.* at 55-61). Finally, the DPA argued that including pension and OPEB cost adjustments in rate base inappropriately combined the accrual methodology used in the actuarial studies with the cash funding approach. (*Id.* at 61-62).

92. The Company contended that the inclusion of its prepaid pension asset and OPEB liability in its rate base reduces pension expense (through contributions and earnings) , which in turn, reduces pension expense below what it would otherwise be. The Company cited this Commission's Order No. 6930 in Delmarva Docket No. 05-304 that "the Company has no access to this asset to use it for other operating expenses; it is precluded by federal law from using any of the money it **[*60]** has collected for pensions for any other purposes." (Exh. 20 (Ziminsky-R) at 72). Furthermore, the prepaid pension asset and OPEB liability create a CWC requirement that cannot otherwise be accessed by the Company. (*Id.* at 73).

93. In its Reply Brief, Delmarva identified that this Commission recognized in PSC Docket No. 05-304 that a pre-paid pension asset is appropriately included in rate base. The Company stated that a pre-paid pension asset is useful to customers, as it results in rates lower than they would otherwise be calculated. It also argued that the Texas case upon which the DPA relied had since been rejected by the Texas Commission.

94. Hearing Examiner Recommendation . The Hearing Examiner summarized the evidence presented on the issue in this case as follows:

a. In the 2012 test period, "absent pension plan returns, the overall pension expense level would have increased by $ 4.682 million or 42%." (DPL RB at 30).

b. "Delmarva admitted that it made no contributions to the pension fund until 2009, when it contributed $ 135 million." (DPA AB at 55).

c. Over the past ten (10) years, market returns on the funds have totaled almost $ 1.245 billion. (*Id.* at n.47.) **[*61]**

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[22] If the assumptions underlying the actuarial methodology were always accurate, there would be positive pension and OPEB expense each year, and an employee's benefits would be recognized over his or her working life. However, assumptions are never 100% accurate, so in some years' pension and OPEB costs can be negative based on the fact that prior years' assumptions overstated costs. For example, if the methodology assumed a 5% return on investment but the actual return was 7%, a negative expense may be booked in a subsequent year. (Exh. 13 (Crane) at 15).

d. In PSC Order No. 6930 in Docket No. 05-304, the Hearing Examiner found that "the Company's books contain a prepaid pension asset of $ 16,614,053," the source of which was not specified. Nor did Order No. 8011 in Docket No. 09-414 address this issue. (See P42.) (HER at 85-86).

95. The Hearing Examiner was not persuaded that simple math demonstrated that Delmarva's fund contributions accounted for less than 10% of the account balance and that over 90% of the current account balance was attributable to market earnings. (HER at 86). He also was unable to determine how much, if any, of the accumulated earnings from Delmarva's $ 135 million contribution in 2009 and/or its 2005 contribution should be attributable to rate base and what ADIT reserve adjustment, if any, should be made.

96. Although noting that the DPA may ultimately prevail on its contention that the funds comprising the prepaid pension asset and OPEB liability were not supplied by investors, the Hearing Examiner found that the pre-paid pension asset should remain in rate base as the case law and pension plan evidence presented in this proceeding did not warrant changing established Commission precedent. (*Id.*).

97. **[*62]** Exceptions. Both DPA and Staff excepted to the Hearing Examiner's recommendation. Staff joined with the DPA's general objection to the Hearing Examiner's conclusion that he was not persuaded that Delmarva's contributions were less than 10% or if the DPA was correct, what portion -- if any -- should be credited to rate base. According to Staff, the issue was simple: If the record does not establish that shareholders supplied the actual funds, then those funds should not be included in rate base. [23]

98. The DPA's exceptions addressed both the prepaid pension asset and the accrued OPEB liability. The DPA first contended that the Hearing Examiner had improperly placed the burden of proof on it to establish that the prepaid pension asset and OPEB liability should be excluded from rate base, rather than placing the burden on the Company to establish that they were **[*63]** properly included in rate base. The DPA argued that once it raised the issue, Delmarva was required to come forward with evidence that stockholders funded the prepaid expenses, and Delmarva had not done so. (DPA EB at 49-50). Second, the DPA reiterated its contentions that the prepaid pension asset and OPEB liability were not used and useful in providing electric service; even if they were, Delmarva did not establish its burden of proof that investors had actually provided the source of the funds in the accounts; and that including the pension asset and the OPEB liability improperly combined accrual methodology used in actuarial studies with the cash funding approach. (*Id.* at 50-53, 57). The DPA also contended that neither of the subsequent Texas commission cases that the Company cited explained the basis for the Commission's decision. (*Id.* at 56-57).

99. Discussion and Decision. We agree with the Hearing Examiner that this issue is not as fully developed on this record as we would like. It is a complicated issue, and we appreciate that the parties have tried to enlighten us on the nuances of the arguments that underlie their various positions. But we note that we have **[*64]** allowed this adjustment in at least one of the prior Delmarva cases when it was objected to, and although we could remand this back to the Hearing Examiner to develop the record further, as one Commissioner suggested, we have decided not to do that and to include these two items in rate base. (Unanimous).

6. Credit Facility

100. Delmarva increased its rate base by $ 520,111 and increased operating expenses by $ 337,108 relating to a short-term credit facility that PHI operates. The rate base portion represents amortization of Delmarva's portion of the start-up costs associated with the facility (and includes a return on the unamortized balance of the costs), and the operating expense represents its portion of the facility's annual recurring costs. (Ex. 13 (Crane) at 29). In August 2011, PHI renewed the credit facility for a five-year term, and there are annual period costs associated with starting up and maintaining the credit facility, which are not tied to the amount of borrowings made using the facility. The Company stated that this adjustment was consistent with the Commission's precedent and Delaware law.

101. According to Delmarva, the credit facility allows the Company **[*65]** to borrow in the commercial paper market and is a primary source of short-term liquidity for the Company. (DPL OB at 73). It is not a substitute for short-term debt or

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[23] The Company objected to Staff's joinder with the DPA on this issue. In light of our decision on this issue, we need not address the Company's objection.

Re Potomac Electric Power Company

District of Columbia Public Service Commission

June 13, 2008

Formal Case No. 1053; Order No. 14832

Re Potomac Electric Power Company

Core Terms

pension, prepaid, substation, rate base, reconsider, northeast, substantial evidence, environmental impact, ratemaking, rate of return, subtransmission, residential, ratepayer, customer, flaw, great weight, methodology, sub-issue, annual, energy, rehash, cash contribution, cost of services, investor-supplied, retroactive, rebuttal, manual

Opinion By: BY THE COMMISSION

Opinion

ORDER

June 13, 2008

FORMAL CASE NO. 1053, IN THE MATTER OF THE APPLICATION OF THE POTOMAC ELECTRIC POWER COMPANY FOR AUTHORITY TO INCREASE EXISTING RETAIL RATES AND CHARGES FOR ELECTRIC DISTRIBUTION SERVICE, Order No. 14832

I. INTRODUCTION

1. This matter is before the Public Service Commission of the District of Columbia ("Commission") on the Office of the People's Counsel's ("OPC") petition for reconsideration of Order No. 14712. By this Order, the Commission affirms Order No. 14712 and denies OPC's petition for reconsideration.

II. BACKGROUND

2. On January 30, 2008, the Commission issued its Opinion and Order on the Potomac Electric Power Company's ("PEPCO") Application requesting authority to increase its distribution service rates and charges for electric service in the District of Columbia. [1] In that Order, the Commission approved an increase in PEPCO's distribution service rates in the District of Columbia by $ 28.3 million, approximately 59 percent of PEPCO's revised request of $ 47.9 million. Among other things, the Commission: approved an overall rate of return for PEPCO of 7.96 percent and a rate base of $ 978.3 million; eliminated the minimum monthly charge of $ 0.47 for residential customers and replaced it with a monthly customer charge of $ 2.00; continued the existing reconnection fee at $ 35.00; opened a Phase II of the proceeding to consider whether PEPCO's Bill Stabilization Adjustment ("BSA") can be implemented, as proposed, under existing law; and increased the base distribution charge for each class by the same percentage change, with the exceptions that the residential and Street Light and Traffic Signal classes received an additional 1.0 percent increase over the non-residential increase. [2] On February 29, 2008, OPC filed a petition for reconsideration pursuant to D.C. Code §34-604(b). [3]

III. OPC'S APPLICATION FOR RECONSIDERATION

3. OPC asserts that the Commission erred by: (a) including PEPCO's net prepaid pension and other post-employment benefits in its rate base at the $ 23,294,038 level requested by PEPCO; (b) concluding that the exclusion of the capitalized

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[1] *Formal Case No. 1053, In the Matter of the Application of the Potomac Electric Power Company For Authority To Increase Existing Retail Rates and Charges for Electric Distribution Service*, Order No. 14712 (January 30, 2008).

[2] Order No. 14712, (ps (ps 469-541.

[3] *Formal Case No. 1053*, Application of OPC for Reconsideration of Commission Order No. 14712, filed February 29, 2008 (OPC's Petition). *See also* D.C. Official Code §34-604(b).

portion of supplemental executive retirement plan costs incurred by PEPCO since Formal Case No. 939 would constitute impermissible retroactive ratemaking; (c) adjusting PEPCO's rate base to include the costs of the Northeast Substation without making a corresponding adjustment to test year revenues to account for the load growth to be served by the Northeast Substation, and making no specific findings as to whether PEPCO adequately considered the environmental impact of the Northeast Substation and provided adequate remedial actions for such impact; (d) finding that PEPCO's jurisdictional cost allocation study was reasonable; (e) finding that PEPCO's class cost of service study was reasonable; (f) basing PEPCO's class distribution rates on flawed jurisdictional and class cost of service studies, and finding a $ 50 million subsidy to the residential class based on a flawed unitized rate of return and, in part, on a misinterpretation of evidence provided by OPC; (g) not addressing designated issues in concluding that it agreed with the BSA mechanism in concept; and (h) failing to adequately address the comments of community witnesses who expressed their views in testimony at community hearings, in the Community Brief, and in additional letters and e-mails received.

IV. PEPCO'S OPPOSITION

4. On March 7, 2008, PEPCO filed its response in opposition to OPC's petition asserting that OPC's application either rehashes arguments that the Commission previously considered and rejected; or ignores substantial evidence that supports the Commission's decision, by arguing that the decision is not supported by substantial evidence because there is evidence to support a conclusion contrary to the one reached by the Commission. [4] Consequently, PEPCO argues that OPC's Application should be denied. [5]

V. DISCUSSION

5. At the outset, we note that the purpose of a petition for reconsideration is to identify errors of law or fact in the Commission's order so that they can be corrected. *See* D.C. Code §34-604(b). It is not a vehicle for the losing party to rehash arguments previously considered and rejected. [6] If there is substantial evidence in the record to support the decision of the Commission, that decision is not erroneous simply because there is substantial evidence that could support a contrary conclusion. [7] With that in mind, we turn to address OPC's arguments.

A. Net Prepaid Pension and Other Post Employment Benefits

6. OPC contends that the Commission erred in its decision to include the Company's net prepaid pension and other post-employment benefits ("OPEB") in its rate base at the level requested by the Company. In support of this contention, OPC makes several assertions, including that the Commission erred by: (1) concluding that Commission precedent supports placing the Company's Prepaid Pension Asset accumulated since 1994 in rate base; (2) failing to find that the entire prepaid pension asset was investor supplied and used and useful; (3) failing to explain its rationale for changing its treatment of the pension asset and including it in rate base; (4) concluding that District ratepayers are responsible for paying the authorized rate of return on the asset; and (5) failing to address key evidence submitted by OPC. [8]

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[4] *Formal Case No. 1053*, Response of PEPCO in Opposition to OPC's Application for Reconsideration, filed March 7, 2008 (PEPCO's Response) at 2-3.

[5] *Id.* at 4.

[6] *See GT04-01, In the Matter of the Application of Washington Gas Light Company for Authority to Amend its General Service Provisions*, Order No. 13854 (Jan. 9, 2006), (ps 5, citing State of New York v. United States, 880 F. Supp. 37 (D.D.C. 1995).

[7] *See* Washington Gas Light Company v. District of Columbia Public Service Commission, 856 A.2d 1098, 1104 (D.C. 2004), wherein the Court stated: "[a]n agency's findings of fact that are supported by substantial evidence will be sustained even if there is substantial evidence in the record to support contrary findings.'"

[8] OPC's Petition at 11-27.

7. PEPCO responds that the Commission properly ruled that the Company's net prepaid pension asset should be included in rate base, and it submits arguments in rebuttal to those submitted by OPC. [9]

8. OPC first argues that the Commission's decisions in Formal Case Nos. 926 and 929, cited by the Commission as applicable precedent in Order No. 14712, addressed rate base treatment of OPEB liability, not the prepaid pension asset and, therefore, the Commission erred in citing those cases to support its decision here. However, we cited those cases not as binding precedent for our decision on the rate base treatment of the prepaid pension asset in this case, but merely to demonstrate how OPEB liabilities have been treated in the past for ratemaking purposes, and that the related prepaid pension asset should receive similar rate base treatment. [10]

9. To eliminate any confusion concerning the rate base treatment of the prepaid pension asset, we expressly find here that both the prepaid pension asset and the OPEB liability result from the existence of a differential between the Company's obligation regarding future benefits owed to current employees and the level of funding for those benefits, and consequently both should be included in rate base with the liability offsetting the asset. This finding is based on the fact that both the prepaid pension asset and the OPEB liability are balance sheet accounts that the Company uses to record the difference between the value of pension plan and OPEB assets and the annual costs associated with pension/ OPEB obligations recorded in accordance with the Statement of Financial Accounting Standards ("SFAS") No. 87 covering pensions and SFAS No. 106 covering OPEB. The two financial accounting statements have similar provisions to the extent that the promise to provide pension benefits and the promise to provide postretirement benefits are similar. Both statements require the Company to record the cost of pension and OPEB benefits over the expected work-life of employees. The pension asset is created when cash contributions exceed the annual expense calculated by an independent actuary. OPEB is funded only to the extent that cash contributions are deductible for income tax purposes and, to that extent, no excess funding is accumulated, creating a liability.

10. In reaching this conclusion, we also considered testimony by PEPCO Witness VonSteuben who stated:

The prepaid asset and OPEB liability both result from the existence of a differential between the Company's obligation regarding future benefits owed to current employees and the level of those benefits the Company funds currently ... The prepaid pension asset and the OPEB liability are essentially opposite sides of the same coin. To include the liability as a reduction to rate base, but to deny inclusion of the prepaid asset is inconsistent. [11]

VonSteuben's testimony, quoted above, as well as his testimony that the earnings on the prepaid pension asset will reduce the annual SFAS No. 87 expense, thus benefiting customers by reducing the revenue requirement, [12] constitute substantial evidence to support our conclusion to include the prepaid pension asset in rate base.

11. OPC next claims that the Commission failed to make a finding that the Company met its burden of proving that the amount of the prepaid pension asset was (1) all investor-supplied; and (2) used and useful. [13] Neither claim warrants granting reconsideration.

12. While Order No. 14712 did find that investor-supplied cash contributions have resulted in the prepaid pension asset, [14] the Order did not expressly find that the unrebutted evidence demonstrates that the pension asset includes *only*investor-supplied contributions. We expressly find it here as explained below.

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[9] PEPCO Response at 6-14.

[10] We cited the prior cases only to explain the rationale in this case, and not as binding precedent. We are neither relying upon nor changing such precedent, nor are we changing our treatment of the pension asset as alleged by OPC.

[11] PEPCO (3C) at 16:5-17:1 (VonSteuben Rebuttal) .

[12] PEPCO (C) at 9:4-10 (VonSteuben Direct).

[13] OPC's Petition at 15-19.

[14] Order No. 14712, (ps 113.

13. PEPCO Witness VonSteuben testified that PEPCO historically, and currently, funds its pension plan with investor-supplied cash contributions to the level of its Accumulated Benefit Obligation (ABO). [15] OPC did not rebut VonSteuben's testimony with testimony or evidence of its own showing that District ratepayers contributed any portion, let alone "a significant portion," of the excess contributions to the prepaid pension asset. In support and summary of its evidence and position, OPC stated in its initial brief as follows:

OPC witness Bright *does not dispute that PEPCO has funded its pension plan with investor-supplied capital* to a level where its cash contributions have exceeded its annual SFAS No. 87 expense obligation; but, she does dispute the inclusion of these additional assets in the Company's rate base where District ratepayers and consumers would have to pay a rate of return on the funds. [16]

OPC did not change its position until its Reply Brief. [17] Arguments, included only in a reply brief unsupported by evidence or testimony, are not evidence. [18]

14. Order No. 14712 implied, but did not expressly find, that the pension asset was used and useful for District ratepayers. Paragraph No. 113 of the Order found that the ratepayers, not the shareholders, benefit from the reduction in pension expenses. That finding is supported by testimony from PEPCO Witness VonSteuben summarized in Paragraph No. 109 of the Order. In our view, VonSteuben convincingly refuted OPC Witness Bright's analysis, [19] which was based on an annual comparison of the Company's SFAS No. 87 expense level since 1994. VonSteuben explained that the annual amounts of SFAS No. 87 expense are not comparable on a year to year basis due to divestiture, the unbundling of rates, and subsequent rate reductions pursuant to PEPCO's merger with Conectiv. He also testified that it was not possible to identify the level of pension expense embedded in the Company's current effective distribution rates, and that reductions in pension expense could well have been offsetting increases in other expenses --- increases for which the Company may have had to seek recovery, absent the pension savings. VonSteuben also demonstrated that since the Company began making distribution-only filings, its District of Columbia returns on rate base have been lower than authorized in its last rate case. [20] From this testimony, it was clear to us, and we now expressly find, that the pension asset is used and useful for District ratepayers.

15. OPC asserts that the Commission erred in authorizing District ratepayers to pay an authorized rate of return on the pension asset in excess of 11.4 percent even though PEPCO's expected return on the pension asset is only 8.5 percent. [21] However, OPC has misunderstood our ruling. Contrary to OPC's view, we authorized an overall rate of return of 7.96 percent, which applies to the pension asset. [22] Consequently, OPC has identified no Commission error.

16. OPC argues that the Commission should reconsider and recalculate the amount of the OPEB liability because OPC Cross Examination Exhibit No. 53 ("OPC Cross Exhibit 53"), used to support its challenge to the amount of the OPEB liability that PEPCO sought to net against the prepaid pension asset, was not addressed in the Commission's Order. [23] According to OPC, if the Commission had properly considered this evidence, then it would have reached another conclusion. OPC also challenges the level of funding of the prepaid pension asset, arguing that the Company over-funded

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[15] *See* PEPCO (C) at 8:21-23 (VonSteuben Direct); PEPCO (2C) at 3:11-16 (VonSteuben Supp. Direct); and PEPCO (3C) at 12:1-5; 15:17-21 (VonSteuben Rebuttal) . The ABO is based on employees' current and past compensation levels and reflects the Company's future liability for employees currently serving customers (PEPCO 3(C) at 9:1-4).

[16] OPC Br. at 98 (emphasis added).

[17] OPC Reply Br. at 24.

[18] *See e.g.,* Hairston v. U.S., 905 A.2d 765 (D.C. 2006).

[19] OPC Witness Bright's analysis is in OPC (C)) at 18-21 (Bright Direct).

[20] PEPCO (3C) at 10:6-11:23 (VonSteuben Rebuttal) .

[21] OPC's Petition at 22-24.

[22] Order No. 14712, (ps 60.

[23] OPC's Petition at 25-27.

the asset and that the excess contributions should not be included in rate base. [24] There is no general duty to discuss all evidence presented in a case nor, as we stated earlier, is a fact-finding flawed simply because there may be evidence in the record that purports to support a conclusion different from the one we reached. [25] OPC's assertions here are merely an attempt to rehash evidence and argument that we have previously considered and rejected. These arguments do not merit further discussion.

B. Exclusion of Supplemental Executive Retirement Plans ("SERP")

17. In Order No. 14712, the Commission concluded that excluding the capitalized portion of supplemental executive retirement plan costs incurred by PEPCO since Formal Case No. 939 would constitute retroactive ratemaking. OPC asserts that this conclusion improperly rests on OPC Witness Gummer's uncorrected direct testimony which contained a typographical error in which Formal Case No. 929 was referenced instead of Formal Case No. 939. [26] OPC contends, without argument, that excluding the capitalized costs is not retroactive ratemaking and that the Commission's conclusion to the contrary is erroneous as a matter of law.

18. Contrary to OPC's belief, we recognized the error and considered the corrected testimony of OPC Witness Gumer as evidenced in paragraph 190 in Order No. 14712, which cites Formal Case No. 939. [27] With regard to the retroactive ratemaking argument, OPC's petition identifies no error but merely reasserts its original position. We rejected this argument before and we do so again. [28]

C. The Northeast Substation

19. OPC contends that the Commission erred by adjusting PEPCO's rate base to include the costs of the Northeast Substation without making a corresponding adjustment to test-year revenues to account for the load growth to be served by the Northeast Substation. OPC maintains that the record clearly demonstrates that the Northeast Substation will serve new load, and, as a result, the Commission's precedent and adherence to basic ratemaking principles require an adjustment to test year revenues. [29]

20. Again, OPC is attempting to rehash arguments and evidence that we have already considered and rejected. There is substantial evidence in the record to support our decision, and the decision was fully explained. We see no reason to disturb it.

D. Environmental Impact of the Northeast Substation

21. OPC asserts that the Commission erred by making no specific findings as to whether PEPCO adequately considered the environmental impact of the Northeast Substation and provided adequate remedial actions for such impacts. More specifically, OPC alleges:

The Commission failed to make specific findings on this designated issue. The Commission is required to make factual findings based on substantial record evidence. The findings of fact shall consist of a concise statement of the conclusions

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[24] OPC's Petition at 16.

[25] *See supra,* Washington Gas Light Company v. District of Columbia Public Service Commission, 856 A.2d 1098; *see, e.g.,* Washington Gas Energy Services, Inc. v. District of Columbia Public Service Commission, 924 A.2d 296 (D.C. 2007).

[26] OPC's Petition at 28-29.

[27] *See* Order No. 14712, (ps 190.

[28] "The rule against retroactive rate increases prohibits the regulatory agency from adjusting current rates to make up for a utility's over- or undercollection in prior periods." *See* District of Columbia v. PSC 905 A.2d 249, citing Towns of Concord, Norwood, & Wellesley, Mass. v. FERC, 293 U.S. App. D.C. 374, at 378, 955 F.2d at 71 (1992).

[29] OPC's Petition at 34-43.

303 P.U.R.4th 384

Indiana Utility Regulatory Commission

February 13, 2013

Cause No. 44075

Reporter
303 P.U.R.4th 384

Re Indiana Michigan Power Company

Core Terms

plant, customer, depreciate, tariff, recommend, estimate, margin, electric, investor, pension, storm, decommissioning, fair value, rate base, calculate, fuel, annual, retirement, salvage, nuclear, premium, transmission, methodology, proxy, ratemaking, energy, demolition, rebuttal, forecast, inflate

Synopsis

ORDER authorizing an electric utility to increase its rates and charges by approximately 85 million, reflecting an allowed return on equity of 10.2% and an overall weighted cost of capital of 6.97%.

Headnotes

1. RATES, §649

[IND.] Practice and procedure --- Petition for change in electric rates --- Due, legal, and timely notice.

p. 396.

2. RATES, §90

[IND.] Jurisdiction and powers --- State commission --- Over electric public utilities --- Statutory authority.

p. 396.

3. RATES, §120.1

[IND.] Reasonableness --- Test period --- Historical test year --- Adjustments for fixed, known and measurable changes within 12 months following end of test year --- Electric rate proceeding.

p. 397.

4. VALUATION, §187

[IND.] Nuclear plant turbine replacement --- Inclusion of investment in rate base --- Deferral of return in light of pending insurance coverage issues --- Treatment of associated depreciation expense --- Electric utility.

p. 398.

5. VALUATION, §280

[IND.] Electric utility --- Plant in service --- Nuclear plant turbine replacement --- Inclusion of investment in rate base --- Deferral of return in light of pending insurance coverage issues --- Treatment of associated depreciation expense.

depreciation expense in the revenue requirement. However, in light of the pending insurance issues related to the NEIL insurance coverage, we find that Petitioner's proposal to defer the return on rate base from this investment from the time the new rates established in this case go into effect until I&M's next rate case is reasonable and should be approved. Accordingly, we find that the depreciation adjustments associated with the major project update shown on Petitioner's Exhibit A-R5, Depreciation and Amortization Adjustment No. R5, to remove depreciation expense associated with the previous turbine, and Depreciation and Amortization Adjustment No. R6, to add depreciation expense associated with the new turbine should be reflected in the revenue requirement used to establish basic rates. We further find and authorize I&M to defer the return on this rate base investment from the time the new rates established in this Cause go into effect until I&M's next rate case as proposed by Mr. Krawec. As proposed by Mr. Krawec, the ultimate return that will be recognized for ratemaking purposes will be limited to the amount of the investment in the new turbine that is not covered by the final outcome of the NEIL insurance claim.

(2) Prepaid Pension Asset.

[6] ***(a) I&M Case-in-Chief.*** I&M's proposed rate base includes prepaid pension expense in the amount of $ 61,691,738 (Indiana Jurisdictional) as of March 31, 2011. I&M removed the balance applicable to non-utility operations costs from the Total Company amount but did not otherwise adjust the end of test year level of this investment.

(b) OUCC Case-in-Chief. Margaret A. Stull, Senior Utility Analyst for the OUCC, opposed the inclusion of prepaid pension expenses in rate base. She testified that I&M's voluntary pension contributions do not represent an investment in used and useful utility plant and are not required to provide quality, reliable utility service to Indiana ratepayers. Ms. Stull recommended that if the Commission determines that I&M should receive some benefit from its voluntary pension contributions, it should only receive a debt return as a component of its revenue requirement based on the actual cost of debt incurred to fund the prepayments. Based on Ms. Stull's recommendation, Mr. Eckert removed $ 91,758,368 of prepaid pension expense on a total company basis and $ 61,691,738 on an Indiana jurisdictional basis from rate base.

Ms. Stull stated that prepaid pension expense refers to certain voluntary pension contributions Petitioner elected to make in addition to the annual pension contributions required by the Employee Retirement Income Security Act ("ERISA"). She noted the prepaid pension expense payments that Petitioner desires to include in rate base were substantially made in 2005 and 2010. Through discovery, Ms. Stull ascertained the dates and amounts of each year's pension contributions along with Petitioner's calculation of the prepaid pension expenses proposed to be included in rate base. Her review of this information led her to conclude that I&M did not make any contributions to its pension fund from 1993 through 2002 despite collecting funds for pension expense from ratepayers as part of I&M's revenue requirement during this same period. Ms. Stull also provided a table indicating no payments made in the years 2006, 2007, 2008, and 2009 despite the inclusion of funds in base rates for pension expense.

Ms. Stull asserted that including this proposed asset in rate base would require customers to pay a much higher interest rate (*i.e.*, I&M's full cost of capital) than the much lower interest rate actually incurred by AEP to borrow the funds. She stated that I&M is allowed to earn a return on its investments in utility plant to insure safe, reliable utility service for Indiana ratepayers. She asserted that I&M should not be allowed to borrow funds at a low commercial paper rate, invest this cash into its pension fund, earn a full return on these additional pension contributions from its ratepayers, and then pocket the difference for its shareholders.

(c) SDI Case-in-Chief. Mr. Smith also opposed I&M's proposed inclusion of prepaid pension expense as an asset in rate base. Mr. Smith asserted that because I&M's 2011 FERC Form 1 shows that its pension benefit obligation is currently underfunded, I&M has a pension liability, which contradicts the Company's proposal to include in rate base the pension asset that resulted from voluntary management decisions. Claiming a pension asset in rate base when the Company's FERC Form 1 shows that the defined benefit plan is underfunded is inappropriate. Mr. Smith testified that there is a trend away from defined benefit plans and that including I&M's proposed pension asset in rate base could provide a disincentive for making reasonable reforms to the Company's pension plans that would reduce costs.

He stated pension funding levels are the result of discretionary AEP management decisions, and were anticipated to produce net

savings based on AEP top management's assumption that the additional pension funding contributions would be financed using low-cost short-term debt. Frequently, there is a wide range between the minimum funding required under ERISA and the maximum annual funding, the range typically limited by the maximum tax-deductible funding contribution limitations placed by the Internal Revenue Service ("IRS"). Increasing funding of a defined pension plan (pension trust contributions) would earn a return, which would then reduce future pension expense. Mr. Smith testified that making additional discretionary funding payments into the pension trust in amounts beyond ERISA requirements could potentially benefit employees and shareholders and result in additional costs to ratepayers.

Mr. Smith contended that pension expense associated with defined benefit pension plans should only be reflected in rate base as part of cash working capital based on a properly prepared lead-lag study, which has not been presented in this case. Mr. Smith argued that if the prepaid pension asset is to be included in the revenue requirement it should be based on a debt rate, preferably the rate for commercial paper. Mr. Smith testified that in 2011, I&M paid an average monthly interest rate of 0.407% on commercial paper, while its parent AEP (where the pension funding decisions were made) paid a weighted average interest rate of 0.51%. In comparison, the Company is requesting a pre-tax cost of capital of approximately 10.48%, which is 23.7 times higher than the 2011 commercial paper interest rate of 0.41%. Allowing the pension asset to be included in rate base would cost ratepayers $ 6.565 million. The discretionary decisions by AEP executive management to make additional contributions to the pension plan, which has led to the pension asset, increases the revenue requirement because the financing cost to ratepayers exceeds the pension savings, and are contrary to the rationale for the discretionary funding that was presented to the AEP board.

(d) I&M Rebuttal. Mr. Huge E. McCoy, Director of Accounting Policy and Research for the American Electric Power Service Corporation ("AEPSC") stated that the prepaid pension asset is not a new item but has been reflected on the Company's books since 2005 in accordance with the governing accounting standard. Mr. McCoy testified regarding the history and purpose of the prepaid pension asset as well as the associated accounting and ERISA standards. Mr, McCoy stated that the prepaid pension asset is properly defined as the cumulative amount of cash contributions to the pension trust fund beyond the cumulative amount of pension cost included in the cost of service used for ratemaking purposes. He disagreed with Ms. Stull's characterization of the additional pension contributions as voluntary or discretionary. He explained that although the additional pension contributions were not absolutely required as ERISA minimum contributions at the times they were made, if the additional contributions had not yet been made, ERISA would have required the Company to make the contributions. He explained that the Company began making contributions somewhat before they were absolutely required in order to even out such required contributions over several years and to minimize the total required contributions during this period because investment income on early contributions reduces the total funding requirement. Mr. McCoy pointed out that customers have benefitted because these additional contributions resulted in additional investment income in the pension trust and this in turn reduced pension cost that is recognized for ratemaking purposes.

Renee V. Hawkins, AEPSC Assistant Treasurer and Managing Director, Corporate Finance, explained that when the additional contributions were initiated, the Company was looking at mandatory pension contributions through the decade and chose to manage them with some discretion on the timing of the contributions. Ms. Hawkins identified the reasons that the pension fund contributions were made prior to the mandatory contribution date. The first reason was to manage the timing in order to fund when the cash is available to make the contributions instead of delaying until the contributions were mandatory under ERISA rules, at which point the company would have had no discretion on the timing of the funding. She explained either way, the contributions are necessary to meet the pension obligations. Second, having just experienced the 2008 and 2009 credit market freeze, Ms. Hawkins stated the Company preferred to be contributing to the pension when funds were available to avoid being in the position of having to fund the pension when either capital is not readily available or when the cost of capital is high. The third reason was to reduce the overall pension cost, as discussed by Mr. McCoy.

Mr. McCoy disagreed that the contributions should not be included in rate base. He stated that while the most obvious rate base item may be plant in service, rate base typically includes other property, such as working capital, fuel inventory, materials and supplies, and prepayments. Mr. McCoy explained his view that management should be encouraged to keep the pension plan operating smoothly so that it can legally meet its promised obligations. Mr. McCoy testified that as a result of additional pension contributions made after March 31, 2011, the pension plan was approximately 86% funded as of

December 31, 2011. He explained that the additional pension contributions to the trust fund result in additional trust fund investment income that directly reduces annual Financial Accounting Standard ("FAS") 87 pension cost. He showed that the prepaid pension asset reduced 2011 pension cost by approximately $ 7.1 million versus the actual 2011 pension cost. He stated that if the Commission were to exclude the prepaid pension asset from rate base, the related $ 7.1 million pension cost savings also should be removed from cost of service so that customers will not receive the benefit from the additional contributions in the ratemaking process without the costs incurred by the Company to create that benefit also being reflected in the revenue requirement.

Mr. McCoy rebutted Ms. Stull's suggestion that the Company did not appropriately fund the pension trust from 1993 through 2002. He explained the final order in Cause No. 39314 was issued on November 12, 1993, so only a small portion of the year 1993 would apply to any analysis of historical ratemaking versus funding. Mr. McCoy also explained that pension cost is determined under FAS 87 for ratemaking purposes. In contrast, pension contributions are subject to ERISA and IRS requirements. As a result, it is unreasonable to expect the amount of pension cost and the amount of pension contributions to be equal. With regard to the 1993 through 2002 period to which Ms. Stull refers, Mr. McCoy stated that while it is true that the Company made no pension contributions, it is also true that total qualified pension plan cost for the period was slightly negative for this period.

Mr. McCoy clarified that I&M financed the pension contributions for its employees and retirees through cash payments that are reflected in I&M's capital structure. I&M's 2010 pension contribution was funded not with short-term debt but instead with available cash and neither the 2010 contribution nor the 2005 contribution were funded with commercial paper on an ongoing basis. He explained that the pension cost savings realized from the 2010 contribution were mainly due to reduced pension cost in subsequent years as a result of additional investment income on the 2010 trust fund contribution. According to Mr. McCoy, this pension cost savings and reducing the pension funding shortfall were the real reasons for making the 2010 contribution.

In response to Mr. Smith's claim that the Company has not demonstrated that it has a prepaid pension asset and that instead it has a net liability, Mr. McCoy explained that Mr. Smith has confused two separate items which properly are treated differently for ratemaking purposes: (1) the prepaid pension asset (accounted for in accordance with the provisions of FAS 87), which is the cumulative difference between cash pension contributions and pension cost included in the cost of service used to establish rates, and (2) the net funded position (accounted for in accordance with the provisions of FAS 158), which is the difference between the balance of pension plan trust assets and the pension benefit obligation. I&M's prepaid pension asset represents the cumulative amount of actual cash pension contributions beyond the cumulative amount of pension cost included in cost of service, which should be included in rate base in order to reflect the Company's cost of funds on the additional cash contributions.

Mr. McCoy also disagreed with Mr. Smith's claims that funding is discretionary and the inclusion of the prepaid pension asset in rate base could provide a disincentive for making reasonable reforms to the Company's pension plan. He explained that a prudent cash investment should not be excluded from rate base just because it was made before it was absolutely required. In addition, he testified that the prepaid pension asset represents contributions that, although they were discretionary at the time of the contributions, would have been required by now under ERISA without the earlier contributions. Mr. McCoy also pointed out that while Mr. Smith provided evidence that many companies have made changes to their pension plans, Mr. Smith did not claim that the Company's pension plan is too costly. Mr. McCoy stated that while Mr. Smith claims that including prepaid pension in rate base would provide a disincentive to making changes such as adopting a cash balance formula, he failed to recognize that the Company already made just such a change. He stated that since January 1, 2011, all Company employees have been earning their pension benefits only under the cash benefit formula.

Mr. McCoy responded to Mr. Smith's suggestion that the Company should eliminate or severely restrict its defined pension benefit plan. He stated that the Company's pension plan is a significant component of total employee compensation. He noted that the U.S. Government Accountability Office report GAO-09-291, which Mr. Smith quotes, acknowledges that defined benefit pension plans are an important source of retirement income for millions of Americans. In Mr. McCoy's view, Mr. Smith's recommendation to eliminate the prepaid pension asset from rate base would increase unpredictability and would restrict management's ability to prudently manage its pension plan in the best interest of customers.

Mr. McCoy addressed Mr. Smith's recommendation that financing costs of the pension contributions should be included at a debt rate based on low-cost commercial paper as an alternative to including the prepaid pension asset in rate base. He explained that I&M's 2010 pension contribution was funded not with short-term debt but instead with available cash and neither the 2010 contribution nor the 2005 contribution were funded with commercial paper on an ongoing basis. Mr. McCoy pointed out that, like Ms. Stull, Mr. Smith incorrectly identified the savings that justified the Company's 2010 pension contribution as being based upon how the contribution was financed, when actually the savings mainly were due to reduced pension cost that resulted from the additional investment income produced by the 2010 trust fund contribution. Ms. Hawkins explained that cash flow from deferred income taxes was used to fund I&M's pension contribution. She explained that even if short-term debt had been used to fund the contributions (as other subsidiaries across the AEP system initially did), this would not justify the exclusion of the prepaid asset from rate base. She explained that short-term debt is sometimes used to fund capital expenditures until a debt issuance or cash flows from operations are available to fund the asset. Because such assets are reflected in rate base, the prepaid pension asset should not be treated differently even if it had been initially funded with short-term debt.

(e) Commission Discussion and Findings. The record reflects that the prepaid pension asset was recorded on the Company's books in accordance with governing accounting standards. The record also reflects that the prepaid pension asset has reduced the pension cost reflected in the revenue requirement in this case and preserves the integrity of the pension fund. Petitioner made a discretionary management decision to make use of available cash to secure its pension funds and reduce the liquidity risk of future payments. In addition, the prepayment benefits ratepayers by reducing total pension costs in the Company's revenue requirement. Therefore, we find that the prepaid pension asset should be included in Petitioner's rate base.

(3) Materials & Supplies.

[7-9] ***(a) I&M Case-in-Chief.*** I&M adjusted its proposed rate base to eliminate $ 3,828,761 of materials and supplies ("M&S)" applicable to non-utility operations, *i.e.*, River Transportation Division. Otherwise, I&M's proposed revenue requirement used the end-of-test-year M&S amount of $ 186,556,239
(Total Company) or $ 121,493,195 (Indiana
Jurisdictional).

(b) OUCC Case-in-Chief. Mr. Eckert did not oppose I&M's proposed rate base adjustment to eliminate the M&S applicable to non-utility operations, but disagreed with I&M's proposal to use the M&S amount as of March 31, 2011, as the pro forma test year amount. He testified that he reviewed the M&S balances for the six-year period April 2006 through February 2012 and determined that the March 31, 2011 balance was the second highest amount and therefore was not representative of the test year. Using a 13-month average for the period March 2010 through March 2011, Mr. Eckert recommended the M&S balance to be included in rate base should be $ 178,075,379 (Total Company).

(c) I&M Rebuttal. Jeffrey L. Brubaker, AEPSC Director -Regulatory Accounting Services, testified that Mr. Eckert's proposal to use a 13-month average balance instead of the end-of-period balance in rate base is arbitrary. In Mr. Brubaker's view the 13-month average does not show that the end of period balance for the test year is unreasonable. Mr. Brubaker highlighted certain errors in Mr. Eckert's calculation of his proposed M&S Indiana jurisdictional adjustment. Mr. Brubaker noted that while Mr. Eckert indicated that the test year included four of the highest months over a six-year period, Mr. Eckert failed to recognize that the test year also contains five of the seven lowest monthly M&S balances in the 25- month period December 2009 through December 2011, and five of the twelve lowest monthly balances in the 33-month period April 2009 through December 2011. Based on this evidence, Mr. Brubaker concluded that Mr. Eckert's 13-month average balance results in an unreasonably low balance of M&S to be included in rate base. Mr. Brubaker explained that if the Commission uses a 13-month average balance, the appropriate period would be from December 2010 through December 2011 as this period would correspond with the rate base cutoff date in this Cause. Mr. Brubaker calculated the 13-month average balance of M&S in rate base for December 2010 through December 2011 to be $ 180,987,920, to produce a M&S Indiana jurisdictional adjustment of ($ 3,549,664). Nevertheless, Mr. Brubaker recommended the Commission reject Mr. Eckert's proposal to use a 13-month average and instead include the actual March 31, 2011 balance of M&S in rate base.

(d) Commission Discussion and Findings. We find that the appropriate M&S balance to include in rate base is the actual balance as of March 31, 2011, as adjusted to eliminate amounts applicable to non-utility operations. Traditionally, we rely

98 Md. P.S.C. 228;; 258 P.U.R.4th 463

Maryland Public Service Commission

July 19, 2007

Case No. 9092; Order No. 81517

Reporter
98 Md. P.S.C. 228;; 258 P.U.R.4th 463

Re Potomac Electric Power Company

Core Terms

customer, staff, depreciate, recommend, rate base, calculate, electric, annual, plant, rate of return, operating income, audit, temporary, energy, residential, ratepayer, present value, affiliate, amortize, pension, rider, service company, salvage, capital structure, dollar, methodology, utility company, risk premium, formula, deferred

Synopsis

ORDER authorizing an electric utility to implement a temporary distribution rate increase of 10.6 million, reflecting a 10% return on equity and an overall return on rate base of 7.99%. The temporary rate increase, the first distribution rate increase for the utility since 1998, will produce an approximately 0.56% increase in the typical monthly bill for a standard offer service residential customer using 800 kilowatt-hours per month.

Headnotes

1. INTERCORPORATE RELATIONS, §15

[MD.] Intercorporate arrangements --- Services provided by parent company --- Management, financial, and regulatory services --- Allocation to utility --- Need for independent audit opinion --- Electric rate proceeding --- Temporary rates pending audit compliance.

p. 241.

2. EXPENSES, §83

[MD.] Payments to affiliates --- For management, financial, and regulatory services provided by parent company --- Allocation of costs to utility --- Need for independent audit opinion --- Electric rate proceeding --- Temporary rates pending audit compliance.

p. 241.

3. APPORTIONMENT, §43

[MD.] Joint expenses of affiliated companies --- Management, financial, and regulatory services provided by parent company --- Allocation of costs to utility --- Need for independent audit opinion --- Electric rate proceeding --- Temporary rates pending audit compliance.

p. 241.

4. ACCOUNTING, §24.1

[MD.] Intercompany payments --- Management, financial, and regulatory services provided by parent company --- Allocation of costs to utility --- Need for independent audit opinion --- Electric rate proceeding --- Temporary rates pending audit compliance.

is no policy or equitable reason to depart from the Commission's prior policy of including CWIP in rate base, and urges continuation of such practice in this proceeding with the AFUDC offset.

[18-22] Upon consideration of the evidence and arguments of the parties, the Commission is not convinced to abandon our long-standing practice to include CWIP in rate base with an AFUDC offset. As we have said on other occasions, the long-standing policy has worked well in protecting companies against rate obsolescence, while promoting equity between current and future rate customers. We do not believe the Staff's arguments as to the change in structure to a distribution-only company justifies a change in this well accepted policy regarding acceptance of CWIP/AFUDC. In fact, the status of the Company as a distribution-only entity actually strengthens the policy underlying our CWIP treatment, as the short-term duration and smaller size of construction justifies the inclusion in rate base. We therefore reject Staff's proposal to remove CWIP from rate base.

B. Materials and Supplies in Rate Base

In this proceeding, the Company has included the end-of-period balance for the materials and supplies component of rate base, as witness VonSteuben contends such balance is more representative of the balances that will be utilized in the rate-effective period and is also based on precedent authorizing such end-of-period balance.

Staff recommends an adjustment to this component of rate base regarding inventory of spare parts, as Staff proposes use of a 13-month average balance rather than the end-of-period balance. As noted by Staff witness Mullinax, use of a 13-month average will annualize seasonal variations and costs. Staff further notes the Commission has used average balances, terminal balances or an imputed adjusted balance with the key determination concerning which valuation is considered more representative of the conditions that will prevail during the rate effective period. In this case, Staff notes the monthly balances have ranged from a low of approximately $ 37 million in December 2005 to a high of over $ 42 million in July 2006, while the materials and supplies dollars included in accounts payable have also varied from less than $ 500,000 to over $ 2 million during the same period. Staff contends such large swings represent seasonal variations which are best accommodated by the use of a 13-month average, and the Staff proposal would reduce the Company's rate base by $ 1,257,000.

In rebuttal to Staff's proposed reduction, the Company presented testimony by Mr. VonSteuben indicating that Pepco's materials and supplies inventory has consistently trended upward through 2006 and early 2007, due largely to the increasing cost of materials. The record reflects Pepco's total plant monthly materials and supplies balance increased from approximately $ 36.2 million to $ 39.3 million between September 2005 and September 2006, and during the five months immediately following the test year, the total plant balance only once dipped slightly below the terminal test year level (of $ 39,287,307) to $ 39.2 million in December 2006. Furthermore, in each of the other post-test year months, the total Company balance exceeded the September 2006 level, with the February 2007 balance $ 43.7 million. In addition, the Company contends there has been a clear and significant upward trend in the cost of a number of items of equipment that are critical to the Company's operation, and therefore the Company contends an end-of-period balance should be utilized as more reflective of the rate effective period.

[23-25] As noted, the Commission has utilized both average or terminal values for materials and supplies as a rate base element, with the Commission specifically noting the decision is based upon which balance was more likely to be representative of the rate effective period. [13] Based upon the evidence presented, the Commission will utilize a terminal balance as proposed by the Company, as the evidence shows the balances in the post-test year period have exceeded the terminal balance on a fairly consistent basis, so that such terminal balance is a better indicator, and in fact may even be lower, than the monthly balances that will result during the rate effective period. While Staff's argument that using a 13-month average annualizes seasonal variations and costs, we find the evidence persuasive that the balances have increased since the test year so that the terminal balance is more representative in this instance and will be utilized.

C. Pre-Paid Pension Asset

Pepco has included in its rate base pre-paid pension assets, which Staff and UMCP question in their initial testimonies as both these parties question whether such funds are solely investor-supplied funds for which a return should be paid, with

[13] Re Pepco, 82 Md. PSC 172, 179-180 (1991).

UMCP further contending such expenses are over-funded. During the course of these proceedings, Pepco witness VonSteuben has provided additional information regarding the asset, noting Pepco's pre-paid pension asset is equal to the amount of funding made to the plan in excess of the Financial Account-
ing Standards Board ("FASB") --- determined expense. Accordingly, Pepco contends that to the extent the pension plan required funding in excess of the FASB-determined expense amount, Pepco funded such asset with the use of investor-supplied cash distributions, not customer funds, as there were no customer funds available for such purpose. Based on this information, Staff has withdrawn its recommendation to reduce rate base by the pre-paid pension contributions, while UMCP still maintains that these expenses are over-funded. Also, UMCP disagrees that solely investor funds were used as Pepco profits generated from customer payments are utilized as the funding source, according to UMCP witness Smith. In its final position on brief, UMCP recommends removal of $ 60.9 million from the rate base related to the pre-paid pension balances, which proposed exclusion is vigorously contested by Pepco.

[26, 27] Upon review of the record, the Commission finds that Pepco has presented sufficient documentation that Pepco funded the disputed assets without using ratepayer funds, and therefore we agree with Pepco's and Staff's final position that no exclusion is warranted for the pre-paid pension balances. We also note that an exclusion as proposed now only by UMCP would require a larger expenditure of funds for pension expense, [14] and we find no adjustment to exclude the pre-paid pension assets is justified or warranted.

D. Depreciation and Severance Costs Adjustments to Rate Base

Pursuant to the determinations made with respect to depreciation and severance costs, discussed elsewhere in this Order, additional adjustments in the amount of $ 15,492,000 are necessary to rate base to reflect the depreciation rates determined herein, and $ 565,000 for our decision with respect to severance costs.

E. Rate Base Findings

[28] Upon consideration of the record in this proceeding, and after making the adjustments as noted above, the Commission finds that the fair value of Pepco's property used and useful in providing service to the Company is $ 895,503,000, as noted in Appendix I attached hereto.

VI. OPERATING INCOME

Operating income reflects the difference between the revenues and appropriate costs of the Company in providing service to the customers, with various adjustments to the test year revenues and expenses proposed by the parties and either accepted, rejected, or modified by the Commission as a key element in our determination of the rates that will be allowed for the Company.

In this proceeding, all parties start with the unadjusted operating income of $ 46,548,000 for the test year period, to which various uncontested adjustments are agreed upon by the parties. [15] Operating income and expense adjustments contested by the parties are discussed below.

A. Severance Costs

The record reflects the Company has included in its test year figures expenses related to 2004 severance costs paid to employees at that time in an effort to downsize Company personnel. The Company utilized a three-year amortization of

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[14] UMCP's proposed removal of pre-paid pension assets from rate base would decrease revenue requirement by less than 5 million, but the Company's annual pension expense would then increase by 6.7 million without the pre-paid pension asset, according to Mr. VonSteuben.

[15] Uncontested adjustments concern inclusion of interest expense on average customer deposits, exclusion of institutional and promotional advertising expenses, removal of Mirant bankruptcy-related costs, annualization of changes in employee health and welfare costs, annualization of 2006 postal rate increase, inclusion of costs associated with current proceeding (although certain regulatory expenses are disputed by Staff with respect to costs of this case), exclusion of merger-related costs, reflection of a coal credit, an additional adjustment to correct tax treatment of software, and an additional adjustment to increase test period revenues for billing.

2010 Mo. PSC LEXIS 156;; 280 P.U.R.4th 107

Public Service Commission of the State of Missouri

February 10, 2010, Issued; February 20, 2010, Effective; February 10, 2010, Issued; February 20, 2010, Effective

File No. GR-2009-0355

Reporter
2010 Mo. PSC LEXIS 156;; 280 P.U.R.4th 107

In the Matter of Missouri Gas Energy and its Tariff Filing to Implement a General Rate Increase for Natural Gas Service

Core Terms

customer, energy, natural gas, staff, capital structure, rebuttal, proxy, annual, rate case, usage, recommend, estimate, cost of services, amortize, pension, conclusions of law, residential customer, rate of return, short-term, expenditure, depreciate, partial, calculate, prepaid, consumer, investor, shareholder, risk premium, residential, ratepayer

Counsel

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Panel: SENIOR REGULATORY LAW JUDGE: Ronald D. Pridgin; Clayton, Chm., concurs, with separate concurring opinion attached; Davis, C., concurs, with separate concurring opinion to follow; Jarrett, Gunn, and Kenney, CC., concur

Opinion By: PRIDGIN

Opinion

REPORT AND ORDER

Procedural History

162. MGE wishes to have complete control over all decision-making of the collaborative, despite MGE having the least amount of experience in energy efficiency programs of any of the collaborative members. [274]

[*110]

163. MGE benefited greatly from the experience of Staff, DNR and OPC during the collaborative process. [275]

164. Without the collaborative that resulted from MGE's last rate case, MGE would have had a much smaller offering of residential energy efficiency programs without the support and guidance it received from the other experienced collaborative members. [276]

Conclusions of Law

There are no additional Conclusions of Law for this issue.

Decision

The energy efficiency collaborative formed after MGE's most recently concluded rate case should remain a consensus group, and should not be modified to an advisory group.

Rate of Return Conclusion

Would the Commission's adoption of MGE's proposed rate design that recovers all non-gas costs in a fixed customer charge for Residential **[*111]** *and SGS customers reduce MGE's business risks? If the answer is "yes", should that reduced risk be recognized in the determination of either cost of capital or the revenue requirement?*

Findings of Fact

There are no additional findings of fact for this issue.

Conclusions of Law

There are no additional conclusions of law for this issue.

Decision

The Commission's adoption of MGE's proposed rate design would reduce MGE's business risks. The Commission has already addressed to what extent the rate design would reduce MGE's business risks in the Findings of Fact and Conclusions of Law of the Return on Equity section of this Report and Order.

True-Up Issues

The Commission sets rates based upon a "test year", either ordered by the Commission or agreed to by the parties. That "test year" is normally a recent calendar year for the parties to refer to so that in planning their cases, they may match revenue requirement items for the same period. A "true-up" of revenues and expenses often occurs in rate cases, which reflects known and measurable events after the conclusion of the test year, but during the pendency of the rate case.

Prepaid Pension Asset **[*112]**

Two prepaid pension asset issues are before the Commission. The first is a timing issue. That is, whether the amortizations of the prepaid pension assets created in Files Nos. GR-2004-0209 and GR-2006-0422 should begin the month after the

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[274] Warren, Tr. Vol. 12, pp. 734-735.

[275] Kind Rebuttal, Ex. 76, p. 2.

[276] *Id.*

true-up date in those cases, or with the effective date of the Report and Order in each case. The second issue concerns Staffs proposed application of a capitalization ratio. This question is whether a capitalization ratio should be applied to the prepaid pension asset, which would reduce the amount of that asset included in rate case. Also, the issue concerns whether to apply the capitalization ratio to the prepaid asset expense.

Findings of Fact

165. The Order Establishing True-Up [277] indicates that the rate base will be trued-up for "prepaid pension asset and pension tracker assets" "pensions and OPEBs" and "depreciation and amortization expense."

166. Also, the Partial Stipulation and Agreement **[*113]** states that "prepaid pensions" will be a part of the true-up in this case in regard to rate base" and that "depreciation expense" will be a part of the true-up in this case in regard to total operating expenses." [278]

167. The prepaid pension asset reflects the difference between the amount of pension expense included in the cost of service and the actual level of pension expense incurred. [279]

168. That is, it is the difference between the pension expense included in rates and the amount funded by the company. [280]

[*114]

169. If the actual pension expense exceeds the amount included in rates, MGE records the difference as a regulatory asset. The asset is included in rate base, and the difference will be recovered through amortization of the asset in subsequent rate cases. [281]

170. If the actual pension expense is less than the amount included in rates, MGE records a regulatory liability. That difference would be booked as regulatory liability that is deduced from rate base, and that will be refunded to customers through amortization of the liability in subsequent rate cases. [282]

171. Determining the amount of the prepaid pension assets created in Files Nos. GR-2004-0209 and GR-2006-0422 requires a calculation that depends, in part, upon when the amortization of the asset is deemed to have started. Staff states that the amortization should **[*115]** have started the month after the true-up period in those cases. [283]

172. Under Staff's approach, amortization would begin before the effective date of the Report and Order. But on its books, MGE began amortizing the prepaid assets on the effective date of the respective Commission Orders in those cases. [284]

173. The true-up period in this case ended on September 30, 2009. [285] For ratemaking purposes, Staff suggests that the amortization of this asset should start the month after the balance has been established, which is October, 2009. [286] Thus, using Staff's theory, MGE should already be amortizing the asset created by a case that will not conclude for another two months.

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277 Order Establishing True-Up, File No. GR-2009-0355 (September 15, 2009).

278 Partial Stipulation and Agreement, pp. 3-4, File No. GR-2009-0355 (November 5, 2009).

279 Noack True-Up Rebuttal, Ex. 108, p. 6.

280 Partial Stipulation and Agreement at 10.

281 *Id.*

282 *Id.*

283 Foster True-Up Rebuttal, Ex. 113, p. 2.

284 Noack True-Up Rebuttal, Ex. 108, p. 7.

285 Foster, Tr. Vol. 14, p. 973.

286 *Id.* at 975.

[*116]

174. In October, November, December of 2009 and, in all likelihood, January and February of 2010, MGE charged, and will continue to charge, the rates that were set by the Commission in File No. GR-2006-0422. [287] Those rates have no provision or consideration of the prepaid pension expense associated with this case. [288]

175. Only after the effective date of the Commission's Report and Order will MGE be able to charge rates that provide recovery for this amortization. Staff's approach would require MGE to amortize this asset for five moths, even though, as Staff admits, there is no consideration in MGE's rates related to this amortization expense. [289]

176. Staff has reduced the **[*117]** balance of the prepaid pension assets created in File No. GR-2006-0422 and this case by applying an expense capitalization ratio to the balance. [290]

177. A capitalization ratio is generally applied to expenses in the income statement to reflect that some payroll and benefit costs relate to construction work, and therefore should be capitalized. [291]

178. The ratio should not be applied to the asset itself, which is a rate base item. [292] Reducing the prepaid pension assets in this fashion would be inconsistent with the history of the process, and with the amortization that have been established in this case.

[*118]

179. The Partial Stipulation and Agreement also provides compelling evidence of the parties' intent regarding the prepaid pension asset. The Partial Stipulation and Agreement provides that "the rates established in this case include recovery of the amortization of prepaid pension assets established in prior cases and the amortization of the prepaid pension asset established in this case as follows:

a. $ 1,139,310 -- GR-2004-0209;
b. $ 803,300 -- GR-2006-0422;
c. $ 2,828,673 -- GR-2009-0355. [293]

180. Simple multiplication of these annual amortizations shows that there could be no intent to reduce the asset by a capitalization ratio. The asset for File No. GR-2004-0209 was to be amortized over seven years. $ 1,139,310 times seven equals about $ 7,975,181. [294]

[*119]

181. The asset from File No. GR-2006-0422 was to be amortized over five years. $ 803,300 times five equals $ 4,016,500. [295]

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287 *Id.* at 974.

288 *Id.* at 975.

289 *Id.*

290 Noack True-Up Rebuttal, Ex. 108, p. 8.

291 *Id.*

292 *Id.*

293 Partial Stipulation and Agreement, p. 10.

294 Noack, Tr. Vol. 14, p. 965.

295 *Id.* at 965-66.

182. The asset for this case is also to be amortized over five years. $ 2,828,673 times five equals about $ 14,143,364. [296]

183. These numbers track the base asset amounts used by MGE. [297]

184. They also track the base asset amounts used by Staff for Files Nos. GR-2004-0209 and GR-2006-0422. [298]

[*120]

185. Further, if the prepaid pension asset is reduced by a capitalization ratio as suggested by Staff, the amortization would far exceed the value of the asset. Accordingly, the prepaid pension asset should reflect the calculation of that asset without the application of a capitalization ratio. [299]

Conclusions of Law

There are no additional conclusions of law for this issue.

Decision

The Commission decides this issue in favor of MGE. To avoid any further confusion in these matters, the Commission encourages the signatory parties to this Stipulation to specify the start date for such amortizations when negotiating such agreements in the future, especially if they believe the amortizations should begin prior to the effective date of the

Report and Order.

Land Rights Depreciation

The true-up depreciation issue concerns the proper depreciation rate for a single depreciation account, which is Account 374.2 (Land Rights). Staff suggests that the rate **[*121]** for this account should be zero percent. MGE believes that the rates should be equal to the rate that has been ordered by this Commission in past cases, which is 2.09%.

Findings of Fact

186. The second ordered paragraph in the Commission's Order Granting Waiver in File No. GE-2010-0030 states:

> Missouri Gas Energy, a division of Southern Union Company, shall retain the current depreciation rates, as listed in Schedule A to Staff's Recommendation, and as agreed upon in the Partial Nonunanimous Stipulation and Agreement in Commission Case No. GR-2006 0422. [300]

187. Thus, the Order sought to "retain the current depreciation rates" as described in the Schedule of Rates and as "agreed upon in the Partial Nonunanimous Stipulation and Agreement in Commission File No. GR-2006-0422." [301]

[*122]

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[296] *Id.* at 966.

[297] Noack True-Up Rebuttal, Ex. 108, Sch. MRN-4.

[298] Foster True-Up Rebuttal, Ex. 113, p. 4.

[299] Noack True-Up Direct, Ex. 107, Sch. MRN-2.

[300] Noack True-Up Rebuttal, Ex. 108, Sch. MRN-2.

[301] The Partial Nonunanimous Stipulation and Agreement in Commission Fie No. GR2006-0422 was approved by the Commissioner's Order Approving Stipulation and Agreement, issued January 30, 2007.

2012 Ohio PUC LEXIS 666;; 298 P.U.R.4th 233

Public Utilities Commission of Ohio

July 2, 2012, Entered; July 2, 2012, Entered

Case No. 10-2929-EL-UNC

Reporter
2012 Ohio PUC LEXIS 666;; 298 P.U.R.4th 233

In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company

Core Terms

retail, revise, staff, customer, energy, energy credit, cost-based, recommend, entity, shopping, capacity charge, load, electric, territory, calculate, transmission, supplier, margin, embed, consumer, electric service, transit, formula, wholesale, auction, intervenor, modify, offset, pool, reliability

Counsel

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As discussed above, the Commission believes that AEP-Ohio's capacity costs, rather than RPM-based pricing, should form the basis of the state compensation mechanism established in this proceeding. Upon review of the considerable evidence in this proceeding, we find that the record supports compensation of $ 188.88/MW-day as an appropriate charge to enable AEP-Ohio to recover its capacity costs for its FRR obligations from CRES **[*84]** providers. We also find that, as a means to encourage the further development of retail competition in AEP-Ohio's service territory, the Company should modify its accounting procedures to defer the difference between the adjusted RPM rate currently in effect and AEP-Ohio's incurred capacity costs, to the extent that such costs do not exceed the capacity charge approved today. We believe that this approach successfully balances the Commission's objectives and the interests of the many parties to this proceeding.

The record reflects a range in AEP-Ohio's cost of capacity from a low of $ 78.53/MW-day, put forth by FES, to the Company's high of $ 355.72/MW-day, as a merged entity, with Staff and OEG offering recommendations more in the middle of the range (AEP-Ohio Ex. 102 at 21; FES Ex. 103 at 55; Staff Ex. 105 at Ex. ESM-4; OEG Ex. 102 at 10-11). The Commission finds that Staff's determination of AEP-Ohio's capacity costs is reasonable, supported by the evidence of record, and should be adopted as modified in this order. Initially, we note that no party other than AEP-Ohio appears to seriously challenge Staff's recommended cost-based capacity pricing mechanism in this case. Additionally, **[*85]** we do not believe that AEP-Ohio has demonstrated that its proposed charge of $ 355.72/MW-day falls within the zone of reasonableness, nor do we believe that FES' proposed charge of $ 78.53/MW-day would result in reasonable compensation for the Company's FRR capacity obligations.

The Commission believes that the approach used by Staff is an appropriate method for determining AEP-Ohio's capacity costs. In deriving its recommended charge, Staff followed its traditional process of making reasonable adjustments to AEP-Ohio's proposed capacity pricing mechanism, which is based on the capacity portion of a formula rate template approved by FERC for one of the Company's affiliates and was modified by the Company for use in this case with data from its FERC Form 1 (Staff Ex. 103 at 10-12; AEP-Ohio Ex. 102 at 8, 9). As AEP-Ohio notes, FERC-approved formula rates are routinely used by the Company's affiliates in other states (AEP-Ohio Ex. 102 at 8; Tr. II at 253). Given that compensation for AEP-Ohio's FRR capacity obligations from CRES providers is wholesale in nature, we find that AEP-Ohio's formula rate template is an appropriate starting point for determination of its capacity costs. From **[*86]** that starting point, Staff made a number of reasonable adjustments to AEP-Ohio's proposal in order to be consistent with the Commission's ratemaking practices. Staff further adjusted AEP-Ohio's proposed capacity pricing to account for margins from off-system energy sales and ancillary receipts (Staff Ex. 101 at 4). We agree with Staff, FES, and OCC that an offset for energy-related sales is necessary to ensure that AEP-Ohio does not over recover its capacity costs through recovery of its embedded costs as well as OSS margins (FES Ex. 103 at 45-46).

AEP-Ohio takes issue with the adjustments made by Staff witness Smith as well as with EVA's calculation of the energy credit. The Commission believes that the adjustments to AEP-Ohio's proposed capacity pricing mechanism that were made by Staff witness Smith are, for the most part, reasonable and consistent with our ratemaking practices in Ohio. With regard to AEP-Ohio's prepaid pension asset, however, we agree with the Company that Mr. Smith's exclusion of this item was inconsistent with Staff's recommendation in the Company's recent distribution rate case (AEP-Ohio Ex. 129A; AEP-Ohio Ex. 129B), as well as with our treatment of pension **[*87]** expense in other proceedings. [10] We see no reason to vary our practice in the present case and, therefore, find that AEP-Ohio's prepaid pension asset should not have been excluded. The result of our adjustment increases Staff's recommendation by $ 3.20/MW-day (AEP-Ohio Ex. 142 at 16, Ex. WAA-R7). Similarly, with respect to AEP-Ohio's severance program costs, we find that Mr. Smith's exclusion of such costs was inconsistent with their treatment in the Company's distribution rate case. Amortization of the severance program costs over a three-year period increases Staff's recommendation by $ 4.07/MW-day. (AEP-Ohio Ex. 142 at 16-17.) Further, upon consideration of the arguments with respect to the appropriate return on equity, we find that AEP-Ohio's recommendation of 11.15 percent is reasonable and should be adopted. As AEP-Ohio notes, Staff's recommended return on equity was solely based on the negotiated return on equity in the Company's distribution rate case (Staff Ex. 103 at 12-13), which has no precedential effect pursuant to the express terms of the stipulation adopted by the Commission in that case. Our adoption

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[10] *See, e.g.. In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Increase Rates for Distribution Service, Modify Certain Accounting Practices, and for Tariff Approvals,* Case No. 07-551-EL-AIR, *et al.*, Opinion and Order (January 21, 2009), at 16.

Re The Empire District Electric Company

Oklahoma Corporation Commission

January 4, 2012

Cause No. PUD 201100082; Order No. 592623

Re The Empire District Electric Company

Core Terms

customer, fuel, electric, plant, energy, estimate, recommend, risk premium, transmission, rider, pension, annual, investor, seasonal, stock, depreciate, base rate, rate case, calculate, load, rate base, decrease, portfolio, classify, direct testimony, marginal, plum, storm, peak, amortize

Counsel

APPEARANCES: Jack P. Fite, Attorney Representing The Empire District Electric Company. David Garrett, Assistant General Counsel Representing the Public Utility Division, Oklahoma Corporation Commission. William L. Humes and Elizabeth Ryan, Assistant Attorneys General Representing Office of Attorney General, State of Oklahoma. Thomas P. Schroedter, James D. Satrom, J. Fred Gist and Jennifer H. Kirkpatrick, Attorneys Representing Enbridge Pipelines (Ozark) L.L.C.

Panel: Before Murphy, chairman, Anthony, vice chairman, Douglas, commissioner, andSnapp, administrative law judge.

Opinion By: BY THE COMMISSION

Opinion

FINAL ORDER

The Corporation Commission of the State of Oklahoma ("Commission") being regularly in session and the undersigned Commissioners being present and participating, there comes now for consideration and action the Joint Stipulation and Settlement Agreement ("Joint Stipulation") executed between The Empire District Electric Company ("Empire" or "Company"), the Public Utility Division of the Oklahoma Corporation Commission ("PUD Staff), the Attorney General of the State of Oklahoma ("AG"), and Enbridge Pipelines (Ozark) L.L.C. ("Enbridge"). A copy of the Joint Stipulation is attached hereto as Attachment "A" and incorporated herein by reference.

I. PROCEDURAL HISTORY

On May 9, 2011, pursuant to OAC 165:70-3-7, Empire filed a Notice of Intent stating that it would file an application seeking to implement a plan which would modify the rates and charges for electric service for Empire's Oklahoma jurisdictional customers. According to the Notice of Intent, it was the beginning of the process for Empire to be in compliance with the Joint Stipulation and Settlement Agreement approved by Order No. 577904, issued in Cause No. PUD 201000033, that required Empire to file a base rate case that included the requirements of OAC 165:70-1-1, *et seq.* not later than six months after the in-service date of the Iatan 2 unit. The in-service date was December 31, 2010.

On May 26, 2011, the Attorney General for the State of Oklahoma ("AG") filed an Entry of Appearance.

On June 30, 2011, Empire filed an Application for an adjustment in its rates and charges for electric service in the State of Oklahoma. Accompanying the Application, Empire filed the Minimum Standard Filing Requirements in Support of a Request by a Public Utility Doing Business in Oklahoma for a Proposed General Rate Change ("MFRs") as required by OAC 165:70-1-1, *et seq.* The information contained within both the application package and the supplemental package

Re The Empire District Electric Company

ANNUAL RE-DETERMINATION

Beginning in September of 2012, and continuing each year thereafter, the Company will file the re-determined SPPTC factors in this Cause (PUD 201000082) for implementation on the first billing cycle of the following October. Calculations for the re-determined rates shall be made by the application of the SPPTC formula set forth in this tariff. The Company shall file information sufficient to document and support the reasonableness of the projected SPP Expenses, the True-up amounts during the previous period, and the re-determined SPPTC rates with each annual re-determination.

Following the filing of the re-determined SPPTC factors, the Commission Staff will convene a technical conference where the company shall provide the projected revenue impact of the annual SPP Expense re-determination for each major customer class. The company shall also provide any information or studies regarding the economic benefit or analysis to customers associated with the eligible incremented SPP expenses.

The company will address the reasonableness of SPP Expenses collected through the SPPTC during the next Empire base rate case and in future base rate cases. Based on the review by the Commission Staff and parties in the next base rate case, any over or under recovery of SPP Expenses collected through the SPPTC shall be refunded to or collected from customers with interest calculated at the applicable Commission established interest rate applied to customer deposits for deposits held one year or less, or the interest rate applied to customer deposits held for more than one year.

Should a cumulative over-recovery or under-recovery balance arise during any SPPTC cycle which exceeds ten percent (10%) of the annual SPP Expenses reflected in the current SPPTC, then either the Commission Staff or the Company may propose an interim revision to the currently effective SPPTC rate.

Attachment 3

Pension and OPEB Tracker Mechanisms

I. OPEB Agreement

The intent of this agreement is to:

A. ensure that the amount collected in rates for OPEB cost is based on the actuarially determined cost under ASC 715-60, formerly FAS 106, recognized by the Company for financial reporting purposes, using methodology similar to that used to determine ASC 715-30, formerly FAS 87, pension cost, as described below in item 2; and B. ensure that all amounts expensed by the Company and contributed by the Company to the VEBA trust are recoverable in rates; and C. clarify the future treatment of any charges that might otherwise be recorded to equity (*e.g.*, decreases to other comprehensive income) as required by ASC 715-60, formerly FAS 158, or any other FASB codification, statement or procedure relative to the recognition of OPEB costs and /or liabilities.

To accomplish these goals, the following items are included in this agreement:

1. The Company's OPEB cost will be recognized in rates and for financial reporting purposes. 2. OPEB cost will be calculated based on the following methodology:

a. A Market Related Value of assets will be used to determine costs, smoothing all asset gains and losses that occur on and after January 1, 2006 over a five-year-period. b. Unrecognized gains and losses will be amortized over a 10-year period without respect to the 10% Corridor described in ASC 715-60.

3. In the case that OPEB expense becomes negative, the Company is ordered to set up a regulatory liability to offset the negative expense. In future years, when OPEB expense becomes positive again, rates will remain zero and the regulatory liability will be reduced by the positive expense until it has been reduced to zero. This regulatory liability is a non-cash item and should be excluded from rate base in future years. 4. A regulatory asset or liability will be established on the Company's books to track the difference between the level of OPEB expense during the rate period and the level of OPEB expense built into rates for that period. If the OPEB expense during the period is more than the expense built into rates for

the period, the Company will establish a regulatory asset. If the OPEB expense during the period is less than the expense built into rates for the period, the Company will establish a regulatory liability. If the OPEB expense becomes negative, a regulatory liability equal to the difference between the level of OPEB expense built into rates for that period and $ 0 will be established. Since this is a cash item, the regulatory asset or liability will be included in rate base and amortized over 5 years at the next rate case. 5. The Company receives reimbursement in rates for its OPEB cost, including the amortization of unrecognized amounts. Therefore, the Company will be directed to set up a regulatory asset/liability to offset any charges/credits that would otherwise be recorded against equity (*e.g.*, decreases/ increases to other comprehensive income) caused by applying the provisions of ASC 715-60, formerly FAS 158, or any other FASB codification statement or procedure that requires accounting adjustments due to the funded status or other attributes of the OPEB plan. The regulatory asset/liability should not be amortized into rates because it is expected to be recovered in rates through future years' OPEB expense. The regulatory asset/liability will increase or decrease each year by the same amount that the equity charge/credit increases or decreases. The regulatory asset/liability will not be included in rate base. 6. The regulatory assets / liabilities identified in the agreement will address all Rate Base amounts.

II. Pension Agreement

The intent of this agreement is to:

A. ensure that the amount collected in rates is based on the ASC 715-30, formerly FAS 87, cost recognized by the Company for financial reporting purposes, using the methodology described below in item 2; and

B. ensure that all pension cost collected in rates is contributed to the pension trust; and

C. ensure that all amounts contributed by the Company to the pension trust, including additional funding required to ensure compliance with minimum funding requirements, to avoid or reduce PBGC variable premiums, or to avoid benefit restrictions or "at risk" status under certain provisions of the Pension Protection Act of 2006, will be recovered in rates and included in rate base; and

D. clarify how any prepaid pension asset that is created when the Company makes additional contributions to the pension trust as allowed by this agreement is recovered by the Company; and

E. clarify the future treatment of any charges that might otherwise be recorded to equity (*e.g.*, decreases to other comprehensive income) as required by ASC 715-30, formerly FAS 158, or any other FASB codification, statement or procedure relative to the recognition of pension costs and /or liabilities.

To accomplish these goals, the following items are agreed upon as part of this settlement:

1. The Company's pension cost will be recognized in rates consistent with the cost recognized for financial reporting purposes.

2. Pension cost will be calculated based on the following methodology:

a. Market Related Value for asset determination, smoothing all asset gains and losses that occur on and after January 1, 2004 over a five-year period.

b. Unrecognized gains and losses will be amortized over a 10-year period without respect to the 10% Corridor described in ASC 715-30.

3. Any amount of pension cost (as calculated above) which exceeds the ERISA minimum required contribution must be funded.

4. In the case that pension expense becomes negative, the Company is ordered to set up a regulatory liability to offset the negative expense. In future years, when pension expense becomes positive again, rates will remain zero and the regulatory

liability will be reduced by the positive expense until it has been reduced to zero. This regulatory liability is a non-cash item and should be excluded from rate base in future years.

5. If the Company experiences a situation where a contribution equal to the actuarially determined cost is insufficient to comply with minimum funding requirements, to reduce or avoid PBGC variable premiums, or to avoid "at risk" status or the benefit restrictions specified in Pension Protection Act of 2006, thereby causing an inability by the Company to pay out pension benefits to recipients or operate its business in its normal and customary manner, the Company will be allowed to make additional contributions to alleviate these issues, and will be allowed rate recovery for those contributions.

a. Additional contributions made pursuant to this Paragraph represent pre-funding of future pension expense and will increase Empire's rate base by creating or increasing a prepaid pension asset. This prepaid pension asset will be included in rate base since it is a cash item.

b. No special amortization treatment is necessary for this prepaid pension asset. Instead, the Company will not be required to fund its pension cost while a prepaid pension asset exists. Any unfunded pension cost will decrease the prepaid pension asset. When this prepaid pension asset has been reduced to zero, any amount of pension cost (as calculated above) must again be contributed to the pension trust.

6. A regulatory asset or liability will be established on the Company's books to track the difference between the level of ASC 715-30 expense during the rate period and the level of pension expense built into rates for that period. If the ASC 715-30 expense during the period is more than the expense built into rates for the period, the Company will establish a regulatory asset. If the ASC 715-30 expense during the period is less than the expense built into rates for the period, the Company will establish a regulatory liability. If the pension expense becomes negative, a regulatory liability equal to the difference between the level of pension expense built into rates for that period and $ 0 will be established. Since this is a cash item, the regulatory asset or liability will be included in rate base and amortized over 5 years at the next rate case. The Company receives reimbursement in rates for its actuarially determined pension cost, including the amortization of unrecognized amounts. Therefore, the Company will be directed to set up a regulatory asset/liability to offset any charges/credits that would otherwise be recorded against equity (*e.g.*, decreases/ increases to other comprehensive income) caused by applying the provisions of ASC 715-30, formerly FAS 87 and FAS 158, or any other FASB codification, statement or procedure that requires accounting adjustments due to the funded status or other attributes of the pension plan. This regulatory asset/liability should not be amortized into rates because it is expected to be recovered in rates through future years' pension expense. The regulatory asset/liability will increase or decrease each year by the same amount that the equity charge/credit increases or decreases. The regulatory asset/liability will not be included in rate base.

7.

8. The regulatory assets / liabilities identified in the agreement will address all Rate Base amounts.

III. Pension and OPEB Special Events

Adjustment to Pension and Other Post-Employment Benefit Costs These provisions are intended to clarify, for ratemaking purposes, the accounting treatment of any special events under ASC 715-30, formerly FAS 88, and ASC 715-60, formerly FAS 106, that would require the Company to recognize one time charges (expense) or credits (income) and to ensure that any of these one-time charges or credits be properly reflected in rates.

Treatment of Pension and OPEB Amounts Recognized due to Special Events If the Company has a curtailment, settlement, or special termination benefits cost or credit due to requirements of applicable accounting rules according to ASC 715-30 and ASC 715-60, the following procedure will be used to address the reimbursement for those pension and OPEB costs:

a. If the special event triggers a net charge, Empire will establish an offsetting regulatory asset. This regulatory asset will not be added to rate base (since it is not a cash item), and it will be amortized over five years beginning when new rates are implemented in Empire's next general electric rate increase or decrease proceeding before the Oklahoma Corporation