

G-008/GR-92-400 ORDER AFTER RECONSIDERATION

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner

In the Matter of the Application of Minnegasco, a Division of Arkla, Inc., for Authority to Increase Its Rates for Natural Gas Service in Minnesota	ISSUE DATE: July 19, 1993
	DOCKET NO. G-008/GR-92-400
	ORDER AFTER RECONSIDERATION

PROCEDURAL HISTORY

On May 3, 1993, the Commission issued its FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER in the above-captioned general rate case.

On May 13, 1993, Minnegasco (or the Company) filed a Motion to Implement Compliance Rates and Tariffs and an Application for Rehearing Regarding FAS 106. In these filings the Company requested that the Commission resolve the Application for Rehearing so that rates approved in the May 3, 1993 Order might be put into effect by July 1, 1993. In the alternative, Minnegasco asked to be allowed to continue deferring its FAS 106 costs, pending resolution of the application for rehearing.

On May 24, 1993, responsive comments were filed by the Department of Public Service (the Department) and the Residential Utilities Division of the Office of the Attorney General (RUD-OAG). The Suburban Rate Authority (SRA) filed its response on May 25, 1993.

On May 24, 1993, Minnesota Power, Otter Tail Power Company, and Interstate Power Company (the Electric Utilities) filed an Application for Rehearing and Reconsideration Regarding FAS 106.

The Commission issued its ORDER GRANTING RECONSIDERATION on May 28, 1993. In that Order the Commission tolled the statutory deadline for reconsideration so that the issues raised by the parties might be given full consideration at a later date.

On June 2, 1993, the Department filed a Motion to Dismiss the Application of the Electric Utilities.

On June 4, 1993, the Minnesota Telephone Association (MTA) filed a request to be a participant in the rehearing proceedings.

Minnegasco withdrew its Motion to Implement Compliance Rates and Tariffs on June 4, 1993.

On June 7, 1993, the International Brotherhood of Electrical Workers (IBEW) filed a letter in support of the Minnegasco petition for reconsideration. The IBEW requested a chance to speak at the Commission's meeting.

The Electric Utilities responded to the Department's motion to dismiss their petition on June 7, 1993.

The matter came before the Commission for consideration on June 10 and June 21, 1993.¹

FINDINGS AND CONCLUSIONS

I. The May 3, 1993 Decision Regarding FAS 106

In 1990 the Financial Accounting Standards Board issued a new standard for the accounting treatment of most non-pension post-employment benefits (Post-Retirement Benefits Other than Pensions, or PBOPs). The Board's Financial Accounting Standard (FAS) 106 called for companies to account for PBOPs on an accrual basis. Prior to the publication of the standard, most Minnesota utilities, including Minnegasco, had been recognizing these obligations on a cash (or pay-as-you-go) basis.

On September 22, 1992, the Commission issued its ORDER ADOPTING ACCOUNTING STANDARD AND ALLOWING DEFERRED ACCOUNTING in Docket No. U-999/CI-92-96. In that Order the Commission stated:

The Commission adopts SFAS 106 accrual accounting for Minnesota utility recordkeeping and ratemaking purposes, subject to Commission review for prudence and reasonableness of the [PBOP] programs, expenses, and all calculations in future rate cases.

Order at p. 6.

Minnegasco adopted FAS 106 accrual accounting as of January 1, 1993.

¹ On June 23, 1993, after the Commission's meeting but prior to the issuance of this Order, Minnegasco submitted its compliance filing, pursuant to Order Paragraph No. 2 of this Order. Because the compliance filing has already been submitted, the Commission has shortened the response period for commenting parties to seven days from the date of this Order (see Order Paragraph No. 3).

In its rate case filing Minnegasco sought recovery of its PBOP expenses, which consisted of three components:

1. The year's service cost, the present value of the future benefits earned by current employees during the year;
2. The interest cost, equal to the discount rate multiplied by the accumulated post-retirement benefit obligations; and
3. The amortization of the transition obligation, which is defined as the present value of the unfunded post-retirement benefit obligation on the day FAS 106 is adopted.

The Administrative Law Judge (ALJ) who heard the contested case proceedings recommended recovery of the three components of PBOP expenses.

In its May 3, 1993 Order, the Commission found that the first component of FAS 106 expenses, the current service costs of the Company's PBOP plan, was reasonable, prudent, and recoverable in rates. The Commission did not, however, allow full recovery of the transition obligation or annual interest. The Commission reasoned that the transition obligation was an out-of-test-year expense and therefore would not normally be recoverable in rates. The Commission did, however, allow recovery in this case of 50% of the transition obligation and 50% of interest. The Commission stated that splitting the obligation between ratepayers and shareholders was equitable for several reasons. The Company had been following established accounting principles and therefore should not be subject to 100% disallowance of costs. On the other hand, allowing recovery of the transition obligation would result in an intergenerational mismatch, the new accounting standard benefits shareholders disproportionately, disallowance would be consistent with Commission treatment of extraordinary expenses, and other regulatory bodies have taken similar approaches in similar situations.

Two of the five Commissioners disagreed with the majority's reasoning regarding disallowance of the transition obligation and interest. The two Commissioners wrote a dissenting opinion which called for full recovery of the transition obligation and interest. The dissenting Commissioners reasoned that Minnegasco had acted consistently with Commission-approved accounting and utility practice and should thus be eligible for recovery of its prudently incurred FAS 106 expenses.

II. Procedural Matters to be Determined.

A. Minnegasco's motion to implement compliance rates

Minnegasco's May 13, 1993 Motion to Implement Rates was filed in an effort to gain Commission approval to implement rates by July 1, 1993, pending the resolution of the rehearing proceeding. When the Commission set the reconsideration hearing for June 10, 1993, the Company considered its Motion to Implement Rates moot. The Company therefore filed a request to be allowed to withdraw its motion.

No party opposed the Company's request.

The Commission will allow the Company to withdraw its Motion to Implement Rates. The Commission agrees with the Company that this motion is no longer relevant or necessary, given the date of the Commission's reconsideration.

B. The Electric Utilities' application for rehearing, MTA's request to be a participants and IBEW's request to make oral comments

1. Factual background

On May 24, 1993, the Electric Utilities filed an Application for Rehearing regarding the Commission's decision on FAS 106. According to the Electric Utilities, the application was filed pursuant to Minn. Stat. § 216B.27, which states that "...any party to the proceeding and any other person, aggrieved by the decision and directly affected thereby, may apply to the commission for a rehearing..."

In its motion to dismiss the Electric Utilities' application, the Department stated that the Electric Utilities were neither named as parties to the proceeding, nor were they "aggrieved and directly affected" by the decision. The Department argued that the Minnegasco FAS 106 decision was not binding upon the Electric Utilities and should not prejudice them, since each utility will have the chance to develop its own record regarding its own PBOP plans.

The Electric Utilities responded that they were aggrieved by the Minnegasco decision and directly affected thereby. The Electric Utilities stated that the Department has itself argued previously for uniform treatment of all utilities' PBOP accounting methods. The Electrics also noted that the Commission's decision was based upon a policy determination, not an interpretation of facts. Finally, the Electric Utilities argued that they were directly affected because they had participated in and relied upon the Commission's generic FAS 106 proceeding.

The MTA relied upon Minn. Rules, part 7830.0700 in its request for participant status in the rehearing proceeding. Minn. Rules, part 7830.0700 provides:

The presiding officer(s) may hear the views of any person or organization as to the subject matter, but no person shall become or shall be deemed to have become a party to the proceeding by reason of such participation in the hearing. Any person may enter an appearance in any proceeding, but no person shall become or shall be deemed to have become a party to the proceeding by reason of having entered an appearance therein.

The MTA argued that Commission decisions establish precedent which may be applied in future cases. For this reason, the Commission should permit interested entities such as the MTA, who do not qualify as parties, to participate in Commission proceedings.

2. Commission analysis

The Commission does not agree with the Electric Utilities that they are aggrieved parties within the meaning of Minn. Stat. § 216B.27. In its deliberations the Commission examines each set of facts on a case by case basis. Each Minnesota utility will have the opportunity and the obligation to present its own unique case if it wishes to obtain rate case recovery of PBOP expenses. The Commission's decision in the Minnegasco case does not directly affect or aggrieve the Electric Utilities so as to render them party status under Minn. Stat. § 216B.27.

The Commission has the option of granting the Electric Utilities, the MTA and IBEW participant status under Minn. Rules, part 7830.0700. In this case, the Commission finds that granting such status to these entities will not adversely affect any party, and may provide useful insights for the Commission's consideration. The Commission is particularly inclined to grant participant status for this proceeding, in which the Commission is considering a policy decision on a new and complex regulatory issue. The Commission will therefore grant participant status under Minn. Rules, part 7830.0700 for the Electric Utilities, the MTA and IBEW.

III. Minnegasco's Application for Rehearing and Reconsideration

In its application for rehearing, Minnegasco requested that the Commission set aside the majority's FAS 106 decision in its May 3, 1993 Order, and adopt the dissenting opinion in that Order.

Minnegasco argued that the Commission's FAS 106 decision was contrary to Minnesota statute and Commission precedent. The Company cited Minn. Stat. § 216B.16, subd. 6, which requires that the Commission give:

due consideration to the public need for adequate, efficient, and reasonable service and to the need of the public utility for revenue sufficient to enable it to meet the cost of furnishing the service, including adequate provision for depreciation of its utility property used and useful in rendering service to the public, and to earn a fair and reasonable return upon the investment in such property.

The Company also cited Commission decisions such as the April 30, 1982 Minnesota Power rate case decision, Docket No. E-015/GR-81-250. In that Order the Commission stated that expenses included under specific statute, or found to be reasonable and prudent, will be allowed recovery in rates.

Minnegasco argued that the Commission's FAS 106 decision is not in accordance with the findings of other state regulatory commissions. The Company cited decisions from Texas, California, Florida, Maryland, Wisconsin, and the Federal Energy Regulatory Commission, in which FAS 106 transition obligations were recovered completely.

Minnegasco declared that disallowance of a significant portion of the Company's prudent FAS 106 expenses constituted an unconstitutional confiscation of Minnegasco's property. In support of this contention, Minnegasco pointed to a U.S. Supreme Court case, Bluefield Water Works and Improvement Co. v. Public Service Commission, 262 U.S. 679 (1922).

The Company strongly emphasized its reliance on the Commission's September 22, 1992 decision in the generic FAS 106 docket (the Generic Order). According to the Company, the transition obligation is an expense which flows directly and unavoidably from the Commission's generic decision to adopt FAS 106 for financial reporting and ratemaking purposes. A prudently incurred transition obligation should therefore be recovered in rates.

Minnegasco stated that the Generic Order was meant to dispose of generic FAS 106 issues for all utilities; only company-specific issues were reserved for later treatment in future rate cases. The Company argued that the Commission's May 3, 1993 Order was a generic, not fact-driven, decision, which was contrary to the Generic Order.

IV. Comments of the Parties and Participants

A. The Department

The Department supported the Commission's May 3, 1993 FAS 106 decision and opposed the application for rehearing filed by Minnegasco.

The Department stated that the Commission's decision was not in conflict with the previous Generic Order. The Generic Order allowed the Commission to decide the treatment of FAS 106 transition obligations on a case by case basis. That is exactly what the Commission did when it analyzed Minnegasco's SFAS 106 filings and allowed 50% recovery of the Company's transition obligation.

The Department argued that the legislative nature of the Commission's decision-making process allows the Commission to balance the interests of ratepayers and shareholders. The Commission quite properly performed this balancing test and decided that the transition obligation should fall equally on ratepayers and shareholders.

The Department agreed that it would not be retroactive ratemaking if the Commission reached back before the test year and allowed full recovery of the transition obligation. It is not the prohibition against retroactive rulemaking, but the quest for fairness, which leads the Commission to require a sharing between ratepayers and shareholders.

The Department argued that most problems surrounding the transition obligation arose due to the Company's failure to begin booking FAS costs under the accrual method in a timely fashion. The consequent "pain" of the transition obligation should therefore be shared by the three "stakeholders" in the ratemaking process: the Company employees, ratepayers and shareholders.

B. The RUD-OAG

The RUD-OAG declared that the governing issue is not the FASB accounting change, but treatment of the change in utility ratemaking. Since Minnegasco is now on the accrual basis for ratemaking purposes, and transition costs were incurred or accrued prior to the test year, they are not recoverable.

The RUD-OAG reasoned that the Generic Order reserved ratemaking treatment of the transition obligation for individual rate proceedings, and the Commission is therefore free to balance the equities to arrive at a decision. Shareholders would be harmed by disallowance of the transition obligation; ratepayers would be harmed by recovery of the transition obligation because a class of ratepayers would be paying both test year FAS 106 costs plus

amortized transition obligation costs. In such a balancing procedure, it is appropriate to "split the difference" by assigning 50% of the obligation to each party.

C. The Electric Utilities

The Electric Utilities agreed with and supported the analysis of the dissenting opinion in the May 3, 1993 Order.

The Electric Utilities stated that Minnesota utilities are legally entitled to recover reasonable costs of providing utility service. The Electric Utilities agreed with the dissenting Commissioners that this is a fundamental premise of the "regulatory compact." The Utilities argued that the Commission's majority opinion was unreasonable and confiscatory because it did not allow Minnegasco to recover reasonable and prudent operating expenses.

The Electric Utilities noted that the Department's recommendation to require "sharing" of the transition obligation was denied in the generic proceeding and in reconsideration of the Generic Order. The Electric Utilities concluded that transition costs are meant to be treated like other expenses: they are to be recovered if found reasonable and prudently incurred.

Finally, the Electric Utilities argued that disallowing half of the transition obligation would be setting poor public policy. Disallowance of a significant portion of the transition costs would be likely to jeopardize utility financial standing and would put future payments of employee benefits at risk.

D. Suburban Rate Authority

The SRA supported the Commission's May 3, 1993 FAS 106 decision. The SRA stated that there is sufficient record evidence to support sharing of transition costs by ratepayers and shareholders. The SRA argued that Minnegasco's transition costs could have been mitigated if it had chosen to adopt accrual accounting earlier.

E. Minnesota Telephone Association

The MTA argued that there are legal limits to the Commission's broad discretion to assign costs. Here, where there was no articulated standard for the partial disallowance, the decision was arbitrary and capricious.

The telephone association noted that the Commission would have allowed PAYGO employee benefit costs on December 31, 1992. There was no transformation of those costs on January 1, 1993 which would justify their disallowance.

The MTA argued that allowing transition costs is not mindless conformity with FASB accounting decisions. Rather, allowing recovery of these costs is acting in conformity with the Commission's adoption of FASB standards, as expressed in the Generic Order.

F. The International Brotherhood of Electrical Workers

A representative of the IBEW appeared at the Commission's June 10, 1993 meeting to support the total recovery of transition costs. According to the speaker, disallowance of these costs would adversely affect the benefits of many persons who are employed in the utility industry in Minnesota.

V. Commission Analysis

A. Introduction

Before reaching the decisions set out in its May 3, 1993 Order, the Commission reviewed the entire rate case record, including the briefs, petitions, and testimony of the parties. The Company has now requested that the Commission reopen its decision so that the Commission may reconsider its finding regarding the recovery of the FAS 106 transition obligation and interest. The Commission agrees that these important and complex issues warrant further consideration.

Since the issuance of the May 3, 1993 Order, the Commission has had the opportunity to study further the record in this proceeding, including the ALJ's report. The Commission has also reviewed and analyzed the briefs submitted on the FAS 106 issues by the parties. The parties also argued their positions in the Commission's June 21, 1993 meeting.

After extensive review of the entire record, the Commission concludes that allowing Minnegasco full recovery of transition costs and annual interest is proper, reasonable, and necessary under the circumstances. Although the Commission initially believed that sharing these costs was an appropriate balancing of shareholder and ratepayer interests, the Commission now finds that sharing in this case would preclude Minnegasco from recovery of prudently incurred expenses. The Commission finds that ratepayer protection must shift from sharing towards monitoring the Company's ability to pay benefits in the future. As will be explained more fully below, the Commission will require the Company to explore external funding options, and to report on its findings to the Commission.

B. Recovery of the transition obligation and annual interest

The Commission's September 22, 1992 generic FAS 106 Order adopted FAS 106 accrual accounting for Minnesota utility recordkeeping and ratemaking purposes, subject to Commission review for prudence and reasonableness. Minnegasco followed the Commission's clear directive when it changed from cash basis accounting to accrual accounting for PBOPs.

In its May 3, 1993 Order, the Commission found that Minnegasco's "...current service costs of the current [PBOP] plan [are] reasonable, prudent, and recoverable in rates." Order at p. 10. As the ALJ stated in his March 8, 1993 report, "the only plan under scrutiny for prudence here is that with an effective date of January 1, 1993. There is no direct challenge of the cost levels in that plan." Report at p. 8.

Thus, the Company's PBOP accounting method was sanctioned by the Commission, and its PBOP costs were found to be prudent and reasonable in nature.

A transition obligation naturally and inevitably arose from the one time accounting change from cash basis to accrual basis for PBOPs. It is recovery of this transition obligation which was challenged by parties to the proceedings.

After reexamining this issue, the Commission finds that there was no action by Minnegasco at any time which converted its normal, ordinary, prudently incurred PBOP obligations into something for which shareholders should be penalized by disallowance. Minnegasco adhered to sound regulatory practice in its treatment of PBOP costs and in its presentation of the expenses, including the transition obligation and annual interest, for rate case recovery. The benefits paid to Minnegasco employees and the timing of the payments are exactly the same under the cash basis and the accrual accounting methods. The character and the amount of the obligation remain unchanged; only the manner of recording the expense for accounting purposes changes. Nothing increases ratepayer liability or renders a prudent cost imprudent. An accounting change does not modify the Commission's basic examination of the prudence and reasonableness of costs of service for rate case recovery. The PBOP costs under the accounting change, including the transition obligation and interest, were reasonable and prudent and should be recovered in full.

The Commission will next discuss several of the main arguments raised by parties who advocated sharing the transition obligation.

1. The matching concept

The Department and the RUD-OAG argued that one half of the transition obligation should be disallowed because it produces an improper match between the time a cost is incurred and the recovery of that cost. The truth is that neither PAYGO nor FAS 106 accrual accounting, nor any other accounting method, produces a perfect match. The FAS 106 method, however, is a move toward better matching.

Under the PAYGO method, the obligation is incurred when service is rendered in the present, but the cost is not recognized until benefits are paid in the future. If the incurring of a future obligation is recognized as a present cost, as under FAS 106 accounting, PAYGO may be viewed as the ultimate mismatch.

Under the FAS 106 accrual method, the present value of future obligations is recognized when present service is rendered. FAS 106 accounting achieves a better match of the incurring of the obligation with both recognition of the cost and recovery from ratepayers. Because the transition obligation is an integral part of the changeover from cash basis to accrual basis, it is part of the move to better matching. As the ALJ states at p. 14 of his report, the transition obligation actually enhances the matching process. The transition obligation allows recovery to rest with present ratepayers, who are more likely than future ratepayers (who would pay under the cash method) to have received the service from whence the transition obligation arose.

2. The test year concept

The RUD-OAG relied heavily upon an argument that the transition obligation was a pre-test year expense and thus could not be included in rates. The Commission finds that the obligation was actually recognized in the test year, when the Company changed to the cash basis and the transition obligation was inevitably created. The 20-year amortization of this obligation is an attempt to lessen rate shock for Minnegasco customers from the test-year recognition of this one-time change.

3. Benefits to shareholders

The Commission is not persuaded by arguments that a portion of the transition obligation should be disallowed because adoption of FAS 106 significantly benefits investors.

The FAS 106 benefits to shareholders mentioned by the parties are more accurate financial reporting and more precise identification of costs. There is nothing in the record to show that these benefits would not result in more prudent managerial decisions, benefiting ratepayers at least as much as shareholders. More accurate financial reporting and identification of costs impose

no burden or higher cost on ratepayers; employee benefit payouts remain unchanged after the switch to accrual accounting. There is no reason to deny shareholders recovery of this expense because an accounting change has brought about greater accuracy and accountability in company recordkeeping and financial reporting.

4. Timing of Minnegasco's accounting change

Several parties argued that partial disallowance of the transition obligation was justified because the timing of Minnegasco's switch to PBOP accrual accounting created or exacerbated the problems associated with the transition obligation. The Commission finds that Minnegasco acted prudently when it adopted the accounting change following the Commission's directive in the generic proceeding. As the Commission stated at p. 14 of its May 3, 1993 Order:

The Commission agrees with and adopts Findings 46 and 53 of the Administrative Law Judge rejecting this claim. It was prevailing business practice, and the preferred practice under generally accepted accounting principles, to record PBOPs using cash accounting. The Commission believes the Company acted prudently in waiting for the new accounting standard to be issued before converting to accrual accounting.

VI. Reporting Requirements Regarding External Funding

Post-employment benefits are an important component of retirement planning for most employees. Accrual accounting recognizes that the employer's obligation is real at the time it is accrued, that is, when employee service is rendered. The future obligation represents a significant cost to the company. It is therefore absolutely essential to both the company and the employee that sufficient funds are available to pay these benefits at the proper time.

Through its treatment of PBOP costs, the Commission must recognize and protect the interests of all stakeholders in the PBOP planning process: the employees, the shareholders, and ratepayers. Each of these stakeholders has an interest in ensuring that the proper funds will be available in the future to pay PBOP obligations.

In its May 3, 1993 Order, the Commission declined to require external funding for Minnegasco's FAS 106 obligations. The Commission stated that "...internal funding offers adequate security and clear cost advantages at present." Recognizing the importance of proper PBOP funding, the Commission required the Company to file an annual report with the Department. The report

was to include amounts accrued in the internal fund, amounts expended, projected future accruals and expenditures, Company equity levels, and the feasibility of alternative funding options (including tax-deductible options).

The Commission's reexamination of the record has not caused it to rethink its decision regarding the Company's current funding of PBOP obligations. The Commission has, however, come to the conclusion that protection of Minnegasco ratepayers, shareholders and employees may require external funding of PBOP obligations in the future. At the least, the Company should be immediately exploring tax-qualified external funding alternatives, so that options will be available for Commission review in the near future.

For these reasons, the Commission will require Minnegasco to file testimony or a report on external, tax-qualified funding options. The Company must submit the filing in its next general rate case, or by December 31, 1993, whichever comes first.

VII. Revenue Requirement after Reconsideration

The Commission's decision to allow Minnegasco 100% recovery of its transition obligation will affect the Company's revenue requirement. The adjusted revenue requirement is as follows:

Rate Base	\$274,726,374
Rate of Return	<u>10.41%</u>
Required Operating Income	28,599,016
Operating Income	<u>20,902,782</u>
Income Deficiency	7,696,234
Revenue Conversion Factor	<u>1.67977</u>
Revenue Deficiency	<u>\$12,928,000</u>

ORDER

1. The Commission reverses its FAS 106 decision in its May 3, 1993 Order, and allows Minnegasco full recovery of FAS 106 costs, including the amortization of the transition obligation and interest.

2. Within 20 days of the date of this Order, the Company shall file with the Commission for its review and approval, and serve on all parties in this proceeding, revised schedules of rates and charges reflecting the revenue requirement decisions contained in the Commission's May 3, 1993 Order and the Order herein, along with the proposed effective date. The Company shall include proposed customer notices explaining the final rates.
3. Interested parties who wish to file comments regarding the Company's compliance filing must do so within seven days of the date of this Order.
4. Minnegasco's authorized total gross annual jurisdictional operating revenues are \$464,034,256.
5. On or before December 31, 1993, or in its next general rate case, whichever comes first, Minnegasco shall file testimony or a report on tax-qualified external funding alternatives. The filing should include information on:
 - a. how external funding would be implemented;
 - b. what would be required to establish a VEBA trust;
 - c. how the pension funding could be modified to accommodate tax qualified funding;
 - d. what other vehicles are available to establish external funding;
 - e. the revenue requirement impact for each alternative.
6. Within 20 days of the date of this Order, if Minnegasco feels it necessary to recover the difference between interim rates and the final increase granted herein in the period from the date of the May 3, 1993 Order until implementation of final rates, it shall file a proposal for doing so with the Commission for its review and approval. Parties who wish to file comments on the Company's proposal must do so within 7 days of its filing.
7. All other requirements of the Ordering Paragraphs of the Commission's May 3, 1993 Order remain in force and effect.
8. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)