

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

LeRoy Koppendraye
Marshall Johnson
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Chair
Commissioner
Commissioner
Commissioner

In the Matter of Xcel's Petition for Approval to Discontinue Funding of Tax Advantaged External Fund (VEBA Fund) for Retiree Medical Costs and the Withdrawal of the Accumulated VEBA Fund Balance over a Five-Year Period

ISSUE DATE: October 17, 2003

DOCKET NO. E,G-002/M-02-2188

ORDER APPROVING PETITION WITH MODIFICATION AND REQUIRING COMPLIANCE FILING

PROCEDURAL HISTORY

In the Commission's Orders in Northern States Power Company d/b/a Xcel Energy (Xcel) 1992 electric and gas rate proceedings¹ the Commission required Xcel to establish an external funding mechanism by its next general rate case for FAS 106² cost accruals in excess of retiree medical benefits paid in cash (pay as you go amount). In 1998, at the time of its next rate case, the Company began making payments, for both gas and electric, to a Voluntary Employee Benefit Association (VEBA) trust.

On December 20, 2002, Northern States Power Company d/b/a Xcel Energy (Xcel) requested approval to discontinue funding of the VEBA trust for certain retiree medical costs and to withdraw the accumulated VEBA fund balance over a five-year period beginning in the second quarter of 2003, or for as long as required to comply with any tax limitations.

¹ FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER in Dockets E002/GR-92-1185 and G002/GR-92-1186 (September 29, 1993 and September 1, 1993, respectively).

² Statement of Financial Accounting Standards No. 106 (FAS 106) was issued by the Financial Accounting Standards Board (FASB) in December of 1990. For financial accounting purposes, this statement required that the costs associated with post-retirement benefits other than pensions be accrued each year as the employees are actively working, or providing service, to the Company. The Commission adopted FAS 106 for Minnesota utility record keeping and ratemaking purposes in its ORDER ADOPTING ACCOUNTING STANDARD AND ALLOWING DEFERRED ACCOUNTING in Dkt. U-999/CI-92-96 (September 29, 1993).

On April 21, 2003, the Department of Commerce (DOC) filed comments recommending that the Commission: 1) approve Xcel's proposal to discontinue external funding of shared medical benefits on a going forward basis; 2) include a condition that Xcel not be allowed any future rate recovery in a rate case for these shared medical benefits; and 3) require Xcel to amortize the VEBA fund balance over a 13-year period, rather than the five years proposed by Xcel.

On May 1, 2003, Xcel filed reply comments agreeing to the DOC's recommendations that Xcel discontinue external funding of shared medical benefits on a going-forward basis and that Xcel amortize the VEBA fund balance over a 13-year period. Xcel rejected the DOC's recommendation to disallow any future recovery in a rate case for these shared medical benefits.

On August 28, 2003 Xcel filed additional comments proposing that the Commission approve Xcel's request to stop contributing to the VEBA fund but defer any withdrawal of the balance in the fund until after the next rate case.

This matter came before the Commission on September 4, 2003.

FINDINGS AND CONCLUSIONS

I. Xcel's Proposal

Xcel requested that the Commission do the following:

- approve its petition to discontinue to fund the tax advantaged external fund for FAS 106 beginning April 1, 2003; and
- allow Xcel to withdraw the accumulated external fund balance existing on March 31, 2003, over a five year period beginning the second quarter of 2003.

A. Background

The Commission ordered Xcel to establish a tax advantaged external fund for FAS106 cost accruals in excess of retiree medical benefits paid in cash. This requirement increased security for the ratepayers and the retirees by ensuring the funds would be available in the future to pay the accrued retiree medical costs when incurred. Xcel indicated that the Minnesota jurisdiction portion of the VEBA trust was approximately \$17 million for the electric utility and \$2 million for the gas utility, as of December 31, 2002.

The Company made changes to its retiree medical and pension benefits for active non-bargaining employees in 1998 and for active bargaining employees in 1999. The changes eliminated Xcel's cost sharing arrangement for retiree medical coverage in exchange for a supplemental pension benefit. These plan changes have reduced Xcel's accruals for retiree medical costs to levels that are projected to be approximately the same as the current cash medical benefits being incurred.

B. Proposal to Discontinue Funding of VEBA

Xcel indicated that the external funding requirement was created to externally invest the cost of accrued retiree medical benefits recovered in rates so that they would be available to pay for medical costs when incurred in an employee's retirement years. Now, with the 1998-99 medical plan changes that have eliminated the need to fund retirement medical costs for active employees and reduced the FAS106 medical cost accruals to about the same level as the costs being incurred on a pay-as-you-go basis, the Company is requesting to discontinue this external funding.

C. Proposal to Withdraw Funds from VEBA

Xcel indicated that the VEBA funds may only be used for the intended purposes; otherwise they will be forfeited. In this case the purpose was to provide medical benefits for retired employees. The group of retired employees will decrease over time due to mortality and due to the plan changes in 1998-99, which closed the plan to new entrants. Therefore, to avoid a forfeiture, Xcel proposed withdrawing these funds over a five year period.

Xcel argued that its proposal is consistent with the public interest standard since the funds will be used for the purpose intended. Because this benefit has been eliminated for employees retiring after 1998-99, coincident with an enhanced pension benefit, there would eventually be a time when these funds could not be used for the purpose of providing retiree medical benefits. Xcel's proposal allows for the distribution of the VEBA amounts without tax or forfeiture consequences. This assures that all of the collected dollars will be applied toward their intended use, consistent with the intent of establishing external funding. For these reasons, Xcel argued, the proposal was consistent with the public interest.

II. Position of the DOC

The DOC considered Xcel's proposal to discontinue external funding of the VEBA on a going forward basis reasonable. It concluded that since the actual costs of medical benefits were unlikely to exceed the level of costs provided in rates or the expected accrual, it is not necessary to continue to fund the VEBA. Since current employees are no longer eligible for this benefit and the number of current retirees that are eligible will be decreasing over time, continuing to place money in the VEBA would cause a long term problem of building up cash that must be used for retiree medical benefits or be forfeited.

The DOC recommended that the Commission approve Xcel's proposal to discontinue external funding of the VEBA trust.

The DOC also recommended that Xcel be required to amortize the VEBA fund balance over a 13-year period, rather than the 5 years proposed by Xcel. The DOC argued that Xcel indicated that the average expected remaining life of current employees was 13.3 years. The DOC argued that the 13-year amortization would help ensure that the money would be available for the retirees for whom it was set aside and would prevent the Company from using the money in the VEBA fund over a five year time period and possibly trying to collect more dollars in a future rate case.

The DOC also recommended that Xcel not be allowed any future recovery in a rate case for these shared medical benefits since they are no longer being provided.

The DOC also argued that, alternatively, the Commission could require Xcel to defer withdrawing from the VEBA fund until its next rate case. The DOC recognized, however, that there was a risk that if a rate case was not brought for several years it was possible these VEBA funds would be forfeited because there were no longer medical benefits being incurred.

The DOC also indicated that another option would be to allow the Company to draw down the VEBA fund over a 13-year period but provide a credit to rates of \$19 million (the amount Xcel has identified as the Minnesota jurisdiction share of the VEBA trust).

III. Xcel's Response to the DOC's Recommendations

Xcel agreed with the recommendations of the DOC to discontinue external funding of shared medical benefits on a going forward basis and to amortize the VEBA fund balance over a 13-year period, rather than the 5 years Xcel originally proposed.

Xcel disagreed with the DOC's recommendation that Xcel not be allowed any future rate recovery in a rate case for these shared medical benefits. Xcel argued that since the Commission ordered the FAS106 accrual accounting and found that the Company's costs for its retiree medical plan were prudent and reasonable these costs should be considered for rate recovery. Further, the VEBA fund represents accumulated cash contributions of FAS cost accruals that were previously approved by the Commission. These costs, it argued, are a legitimate cost of doing business and are appropriately included in revenue requirements and recoverable in customer rates at the time of any future rate case.

Regarding the DOC's alternative recommendation to defer withdrawal from the VEBA fund until the Company files its next rate case, Xcel indicated it was unsure of the timing of its next rate case and would rather begin drawing the fund down now to reduce the potential risk of forfeiture.

Xcel strongly disagreed with the DOC's other alternative that the Company be required to provide a credit in the next rate case for the VEBA fund balance of \$19 million. Xcel argued that the balance in the VEBA fund has accumulated consistent with Commission orders to externally fund approved non-cash costs of service to ensure that the cash would be available to pay retiree medical benefits. These funds, it argued, did not represent over-collection from customer rates.

At hearing, Xcel argued that to prohibit rate recovery in a future rate case for these shared medical benefits or to require the Company to provide a credit in its next rate case, amounts to single issue ratemaking which is improper.

Xcel made an alternative proposal that the Commission approve Xcel's request to stop contributing to the VEBA fund but defer any withdrawal of the balance in the fund until after the next rate case. It requested that the Commission recognize that all parties preserve all rights to pursue any arguments regarding proper ratemaking treatment of this issue in the next rate case.

IV. Commission Action

The Commission agrees with the parties that the VEBA contribution should be discontinued. It is no longer necessary to continue contributing to the VEBA fund given that the benefit is now restricted to a closed group and that expected accruals are not likely to materially exceed the actual costs of medical benefits for the closed group. Continuing to add to the VEBA fund would cause a long term build-up of cash that must be used for medical benefits or be forfeited. For these reasons the Commission finds that discontinuing this funding on a going forward basis is reasonable and will so order.

The Commission recognizes that the VEBA fund restrictions require that the fund must be used for the medical benefits of retired employees or be forfeited. Since this group is now closed, due to the changes in the Company's benefit plans, there will come a time when the funds could not be used for this purpose. Therefore, the Commission will allow the Company to withdraw funds from this account amortized over a 13-year period as proposed by the DOC and agreed to by the Company. The Commission finds that a withdrawal over a 13-year period is reasonable. Not only does the 13-year period correspond closely with the average life expectancy of all the retirees and surviving spouses currently covered under the plan but the fund balance would not be in jeopardy of forfeiture using the 13-year withdrawal period. Further, this gives the ratepayers a 13 year period of protection.

The Commission is concerned that ratepayers paid substantial amounts towards the FAS 106 costs now being phased out. However, due to the change in the benefits, a great deal of the expense was transferred to the pension account. Since the Company reports that it is unable to transfer the VEBA funds to the pension account, the Commission is concerned that there will be, at some future time, a need for additional ratepayer contributions to the pension fund to meet the increased obligations transferred here. If that is the case, this could result in the ratepayers paying twice.

In order to ensure that this will not happen, the Commission is considering whether to disallow future recovery of shared medical benefits in a future rate case or to allocate amounts collected in rates for FAS 106 costs to pension and future shared benefits. To properly consider this the Commission will request that the parties brief the issue of single issue rate making as it relates to these proceedings. Then the Commission will be in a better position to evaluate this matter.

Finally, the Commission is considering whether it should hold a proceeding to determine how much of the amount collected in past and future rates should be deposited to pension, and how much of the amount collected in past and future rates should go towards future shared medical benefit costs. This would allow funds collected previously, and in the future, to follow the benefits.

In order to better determine whether to move forward with such a proceeding, the Commission will require the Company to make a compliance filing detailing the amounts collected in rates for future shared medical benefits related to employees actively working and having benefits switched from medical to pension. A similar calculation will also be required relating to the retired employees receiving medical benefits.

Once this information is received, the Commission may open a proceeding to address the portion to deposit to the pension fund and the portion related to the ongoing shared medical benefits.

ORDER

1. Xcel is authorized to discontinue funding of the VEBA trust.
2. Xcel's request to withdraw funds from the VEBA trust is approved. Xcel shall amortize the VEBA fund balance over a 13-year period.
3. Xcel shall make a compliance filing within 45 days of this Order detailing the amounts collected in rates for future shared medical benefits related to employees actively working and having benefits switched from medical to pension, and for the retired employees.
4. The parties are requested to brief the issue of single issue ratemaking as it relates to these proceedings.
5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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