

157 FERC ¶ 61,233
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Norman C. Bay, Chairman;
Cheryl A. LaFleur, and Colette D. Honorable.

Arizona Public Service Company
Pinnacle West Capital Corporation

Docket No. EL17-2-000

ORDER GRANTING PETITION FOR DECLARATORY ORDER

(Issued December 22, 2016)

1. On October 6, 2016, pursuant to Rule 207(a)(2) of the Commission's Rules of Practice and Procedure,¹ Arizona Public Service Company (APS) and Pinnacle West Capital Corporation (Pinnacle West) (together, Petitioners) filed a petition for declaratory order (Petition) concerning the treatment of certain assets that Petitioners placed in trust to fund future Post-Employment Benefits Other Than Pensions (PBOP) liabilities. Specifically, Petitioners request that the Commission: (1) confirm that the limitations on the use of external trust assets in the Commission's PBOP Policy Statement² only apply to the trust assets that are attributable to amounts collected by APS in Commission-jurisdictional rates; (2) find that Petitioners' methodology for identifying the portion of the trust assets attributable to Commission-jurisdictional rates is reasonable; and (3) confirm that restructuring Pinnacle West's existing trust into new, stand-alone trusts is consistent with, and permissible under, the PBOP Policy Statement. We grant the Petition.

I. Background

A. PBOP Policy Statement

2. Under the PBOP Policy Statement, a public utility that seeks to recognize PBOP expenses on an accrual basis in Commission-jurisdictional rates must make cash deposits

¹ 18 C.F.R. § 385.207(a)(2) (2016).

² *Post-Employment Benefits Other Than Pensions*, 61 FERC ¶ 61,330 (1992) (PBOP Policy Statement), *order on reh'g and clarification*, 65 FERC ¶ 61,035 (1993).

to an irrevocable external trust, and the deposits must, on an annual basis, equal the test period allowance for PBOPs.³ In order to ensure that the monies held in trust for customers funding PBOP accruals through Commission-jurisdictional rates would be available and used for the purposes intended, the Commission imposed use restrictions on PBOP trust assets. The use restrictions require that trust disbursements must be limited to payments for the benefit of employees pursuant to the company's post-retirement plans, payments for expenses of the trust, or refunds to customers pursuant to a Commission-approved refund plan in the event the assets are not to be paid to employees.⁴

B. Pinnacle West's PBOP Structure and Funding

3. APS is a vertically-integrated public utility that generates, transmits, and distributes electricity throughout Arizona. APS provides transmission service pursuant to its Commission-approved Open Access Transmission Tariff and recovers its transmission revenue requirement through a formula rate. APS also provides retail service, which is regulated by the Arizona Corporation Commission (Arizona Commission).⁵

4. Pinnacle West is the parent company of APS and, according to Petitioners, derives substantially all of its revenues and earnings from APS. Pinnacle West provides health and welfare benefits to eligible employees and retirees.⁶

5. Petitioners state that Pinnacle West established a master PBOP trust (Trust) to serve as the funding vehicle for certain post-retirement medical benefits and post-retirement life insurance benefits. Petitioners state that the Trust is maintained as a Voluntary Employees' Beneficiary Association (VEBA) trust pursuant to Internal Revenue Code section 501(c)(9).⁷

6. Petitioners state that, in 2009, Pinnacle West established the Pinnacle West Capital Corporation Group Life and Medical Plan (Life and Medical Plan) to provide medical and life insurance benefits for Petitioners' union and non-union active employees and

³ PBOP Policy Statement, 61 FERC ¶ 61,330 at 62,200.

⁴ *Id.*

⁵ Petition at 7-8.

⁶ *Id.* This includes life insurance, accidental death and dismemberment insurance, and medical coverage.

⁷ *Id.* at 15.

retirees. Petitioners state that State Street Bank and Trust Company, which is an unaffiliated third party, serves as the trustee and custodian of the Trust pursuant to a master trust agreement (Trust Agreement). According to Petitioners, benefits for active employee are paid out of Pinnacle West's assets, and benefits for retirees are paid from the Trust.⁸

7. Petitioners state that the Trust is funded by three sources: (1) APS's Commission-jurisdictional transmission rates; (2) APS's state retail rates; and (3) contributions from the joint owners of the Palo Verde Nuclear Generating Station pursuant to a non-Commission jurisdictional ownership agreement.⁹ Petitioners state that the assets in the Trust attributable to APS's Commission-jurisdictional rates have not been segregated, but have been commingled with the assets attributable to the two non-jurisdictional funding sources.¹⁰ Petitioners state that commingling assets for investment purposes has provided economies of scale, including lower trading costs per dollar of investment.¹¹

8. Petitioners state that, although the assets are commingled, the Trust differentiates assets according to their designated use. Petitioners state that the Trust manages the medical and life insurance claims of retirees from three accounts: (1) the union account for payment of medical claims for union retirees (Union Medical Account); (2) the non-union account for payment of medical claims for non-union retirees (Non-Union Medical Account); and (3) the life insurance account to provide life insurance benefits for both union and non-union retirees (Life Insurance Account). According to Petitioners, the three accounts are adjusted on a monthly basis to reflect their proportional shares of the appreciation, depreciation, income, expenses, gains, and losses of the investments in the Trust for that period.¹²

9. Petitioners state that APS complies with the PBOP Policy Statement by including a stated PBOP amount in its transmission formula rate calculation and deposits that amount in the Trust.¹³ Petitioners state that, to date, the PBOP expense collected in

⁸ *Id.* at 8-9.

⁹ *Id.* at 10-11.

¹⁰ *Id.* at 4.

¹¹ *Id.* at 8-9.

¹² *Id.* at 9-10.

¹³ Petitioners state that the Arizona Commission does not impose limitations on the use of assets recovered for PBOP expense similar to those applicable under the PBOP Policy Statement or Internal Revenue Service (IRS) statutes and regulations. *Id.* at 18.

APS's Commission-jurisdictional transmission rates has been used only to fund payment for the post-retirement benefits of the employees of Pinnacle West and its affiliates pursuant to Pinnacle West's post-retirement plans and payments for Trust expenses.¹⁴

II. Petition

10. Petitioners state that Pinnacle West changed the manner in which it offers certain retiree medical benefits due to the 2010 Affordable Care Act. Petitioners state that, effective January 1, 2015, retiree medical benefits for Medicare-eligible Pinnacle West retirees aged 65 or older and their post-65 Medicare-eligible spouses and dependents are provided through a new employee benefit plan. This plan, the Pinnacle West Post-65 Retiree Health Reimbursement Arrangement (Post-65 HRA), allows post-65 retirees to purchase a Medicare supplement plan on a private exchange network.¹⁵

11. Petitioners state that, with the implementation of the Post-65 HRA, Pinnacle West estimates that the Trust contains a surplus of approximately \$186 million as of December 31, 2015, relative to Pinnacle West's accumulated post-retirement benefit obligation (Accumulated Obligation).¹⁶ Specifically, Petitioners represent that the Union Medical and Life Insurance Accounts contain a surplus of \$246.3 million and \$1.86 million, respectively, and that the Non-Union Medical Account contains a deficit of \$62.2 million.¹⁷ Petitioners state that the Union Medical Account surplus is the result of the impact of the savings of the Post-65 HRA and is attributed to the Union Medical Account being a more tax efficient investment vehicle.¹⁸

12. Petitioners state that the Union Medical Account contains \$397.3 million of total assets, and that it contains a surplus of approximately \$141.4 million as of December 31, 2015, relative to Pinnacle West's expected post-retirement benefit obligation (Expected Obligation). Petitioners state that Expected Obligation is a more conservative economic measure than Accumulated Obligation because it includes estimates of all expected future

¹⁴ *Id.*

¹⁵ *Id.* at 13-14.

¹⁶ Petitioners state that Accumulated Obligation is an industry-standard measure for future PBOP liabilities that measures obligations that have accrued to date. *Id.* at 14-15.

¹⁷ *See* Exhibit APS-2.

¹⁸ Petition at 13-14.

benefit accruals.¹⁹ Petitioners assert that, by using the \$6.5 million of Commission-jurisdictional assets in the Union Medical Account, as calculated using the *pro rata* methodology described below, and \$249.3 million of non-jurisdictional assets in the Union Medical Account, Pinnacle West can meet the Union Medical Account Expected Obligation of \$255.8 million, with \$141.4 million remaining in non-jurisdictional assets.

13. Petitioners state that Pinnacle West proposes to transfer the \$141.4 million surplus to a new trust to pay for active union employee medical benefits. Petitioners explain that this surplus would be used for active union employee medical benefits and would not include any portion of the Trust assets attributable to Commission-jurisdictional rates.²⁰ Petitioners state that, to ensure that the proposed transfer is consistent with Commission policy and IRS requirements, Petitioners request that the Commission: (1) confirm that the limitations on the use of external trust assets in the PBOP Policy Statement only apply to the Trust assets that are attributable to amounts collected by APS in Commission-jurisdictional rates; and (2) find that Petitioners' methodology for identifying the portion of the Trust assets attributable to Commission-jurisdictional rates is reasonable.²¹

14. Petitioners state that they reached an agreement with the IRS (IRS Agreement) that would require Pinnacle West to restructure its Trust and transfer amounts from the exiting Trust accounts to new stand-alone trusts. Specifically, Petitioners state that the agreement would require Pinnacle West to transfer a portion of the non-jurisdictional assets in the Union Medical Account (i.e., the \$141.4 million surplus) to a new account and likewise transfer the assets held in the Non-Union Medical and Life Insurance Accounts (including assets attributable to Commission-jurisdictional rates) to new, stand-alone VEBA trusts.²² Petitioners thus seek confirmation from the Commission that Pinnacle West's proposal to restructure the Trust into separate, stand-alone trusts is consistent with and permissible under the PBOP Policy Statement.²³

15. Petitioners recognize that surplus amounts in the Trust may raise the question of whether APS should adjust its current PBOP expense in its formula rate. Petitioners state that this issue is beyond the scope of this proceeding. Petitioners also point out that

¹⁹ *Id.* at 15.

²⁰ *Id.*

²¹ *Id.* at 19.

²² *Id.* at 16.

²³ *Id.*

APS's funding requirements are not necessarily reduced or eliminated by the fact that the Trust as a whole reflects a surplus. Petitioners state that, while they will continue to evaluate whether an adjustment to the PBOP expense in APS's formula rate may be appropriate, the Non-Union Medical and Life Insurance Accounts reflect a deficit and insignificant surplus, respectively. Petitioners also state that tax implications effectively prohibit Petitioners from using any surplus in the Union Medical Account assets for refunds²⁴ or to pay for medical benefits of non-union retirees or employees.²⁵

16. Petitioners request that the Commission act on this Petition no later than December 31, 2016. Petitioners state that action prior to this date will permit Pinnacle West to restructure its Trust effective January 1, 2017, which would allow Pinnacle West and its trustee to avoid the accounting and reporting complexities associated with a different effective date. Petitioners add that the agreement between Pinnacle West and the IRS assumes restructuring will occur by December 31, 2016, and that the inability to meet that deadline may necessitate further discussions with the IRS.²⁶

III. Notice of Filing and Responsive Pleadings

17. Notice of the Petition was published in the *Federal Register*, 81 Fed. Reg. 70,675 (2016), with interventions and protests due on or before November 7, 2016. On November 7, 2016, Navopache Electric Cooperative, Inc. (Navopache) filed a motion to intervene and protest. On December 14, 2016, Petitioners filed an answer to Navopache's protest.

IV. Discussion

A. Procedural Matters

18. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2016), the timely, unopposed motion to intervene serves to make Navopache a party to this proceeding.

19. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2016), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept Petitioners' answer because it has provided information that assisted us in our decision-making process.

²⁴ *Id.* at 31-32.

²⁵ *Id.* at 35-37.

²⁶ *Id.* at 2-3.

B. Substantive Matters**1. Use of Non-Jurisdictional Assets****a. Petition**

20. Petitioners request that the Commission confirm that the limitations on the use of external trust assets expressed in the PBOP Policy Statement only apply to Trust assets that are attributable to amounts collected by APS in Commission-jurisdictional rates.²⁷ Petitioners state that the Commission's confirmation would facilitate Pinnacle West's proposal to use assets that are not attributable to Commission-jurisdictional rates (i.e., the \$141.4 million Union Medical Account surplus) to pay for active union employee medical benefits. Petitioners further state that under its proposal, Pinnacle West would retain the assets attributable to Commission-jurisdictional rates, including the *pro rata* share of the surplus in the Trust, and would not use any of the Commission-jurisdictional assets to fund active union employee medical benefits or for any purpose other than those permitted under the PBOP Policy Statement.²⁸

21. In support of the assertion that the limitations expressed in the PBOP Policy Statement do not extend to those assets that are not attributable to Commission-jurisdictional rates, Petitioners argue that neither the Federal Power Act (FPA) nor any other statute provides the Commission with a specific grant of authority to dictate the use and management of external trusts established to fund retirement benefits, and such matters are subject to strict requirements under the Internal Revenue Code and Employee Retirement Income Security Act.²⁹ Petitioners state that the Commission's authority to impose conditions on the use of external PBOP trust assets derives from its authority under sections 205³⁰ and 206³¹ of the FPA to ensure just and reasonable rates for wholesale sales and transmission of electricity in interstate commerce. Petitioners further state that, in this regard, the Commission indicated that the purpose of the PBOP Policy

²⁷ Petitioners state that, to the extent the Commission concludes that the use restrictions apply to the assets in the Trust that are not attributable to APS's Commission-jurisdictional rates, Petitioners request waiver of the PBOP Policy Statement. *Id.* at 30-33.

²⁸ *Id.* at 25.

²⁹ 29 U.S.C §§ 1001, *et seq.* (1974).

³⁰ 16 U.S.C. § 824d (2012).

³¹ 16 U.S.C. § 824e (2012).

Statement was to establish conditions for the recovery of PBOP expense accruals “as a component of jurisdictional cost-based rates.”³²

22. According to Petitioners, the PBOP Policy Statement generally restricts external trust disbursements to payments of retiree benefits, trust expenses, or customer refunds. Petitioners state, however, that the Commission did not suggest that the obligations under the PBOP Policy Statement extend to the use and management of PBOP assets that were not attributable to Commission-jurisdictional rates. Petitioners assert that, to the contrary, the Commission acknowledged the jurisdictional limit of its policy in explaining that public utilities would be permitted for a limited time to “defer the jurisdictional portion of the difference between PBOPs” determined on the pay-as-you-go method and accrual method. Petitioners also state that the Commission also acknowledged that the requirements for PBOP cost recovery for retail purposes could differ from the PBOP Policy Statement requirements.³³

23. Petitioners state that the Commission did not require a separate account for Commission-jurisdictional collections in its PBOP Policy Statement and that Pinnacle West voluntarily opted to establish its Trust for all PBOP accruals in a manner that complies with the requirements of the PBOP Policy Statement. Petitioners assert that the commingling of assets raises the question of how to determine the portion of Trust assets attributable to Commission jurisdictional rates, but is not a reason to extend the use restrictions to amounts that are not attributable to Commission-jurisdictional rates.³⁴

b. Navopache Protest

24. Navopache argues that the Commission should deny the Petition. Navopache argues that the Petition violates the PBOP Policy Statement and Commission precedent because a filing under section 205 is required for Petitioners to propose any change to their PBOP trust. According to Navopache, the PBOP Policy Statement requires changes to an irrevocable PBOP trust may only be made by a filing under section 205 by the public utility that owns the trust, a filing under section 206 through a customer complaint or Commission proceeding, or through a Commission audit. Navopache also argues that Petitioners are required to file under section 205 any proposed modification to their

³² Petition at 20.

³³ *Id.* at 20-21.

³⁴ *Id.* at 22-23.

PBOP expense, use of PBOP trust assets for purposes other than the enumerated uses in the PBOP Policy Statement, or modification of the irrevocable PBOP trust structure.³⁵

25. Navopache argues that, in the case of formula rates, the Commission requires changes in PBOP costs, among others, to be filed with the Commission before being passed through in the formula rate. Navopache also argues that the Commission requires any formula rate informational filing to include the actuarial report showing the basis for the PBOP cost and the basis for the allocation of the PBOP cost to electric transmission service.³⁶

26. Additionally, Navopache argues that Petitioners' failure to propose refunds of Trust assets they no longer need to fund retiree benefits and reduce the PBOP expense collected in APS's formula rate going forward is unjust and unreasonable. According to Navopache, the PBOP Policy Statement requires that customers obtain refunds of trust assets, including any earnings, for any excess amount paid. Therefore, Navopache argues that APS should be required to refund surplus assets to transmission customers rather than reallocate Trust assets to pay for active union employee medical expenses because the Commission and D.C. Circuit have required refunds of surplus amounts collected in rates that exceed PBOP expenses.³⁷

27. Navopache argues that Petitioners' proposal to use excess Trust assets to fund active union employee medical benefits, even if filed under section 205, is unjust and unreasonable. According to Navopache, the Commission requires that a utility establish an irrevocable trust to hold the PBOP assets to insure that the amounts that the customers are paying for PBOPs will be utilized for such purpose, or in the event that they are not, that customers obtain refunds of the assets.³⁸ Navopache argues that the Commission rejected proposals to use PBOP trust assets for other purposes and held that PBOP trust assets are those assets that have been segregated to be used only for post-retirement benefits. Navopache also argues that Petitioners' proposal to use some portion of the assets accumulated from previous collections of PBOP expense to pay for costs other

³⁵ Navopache Protest at 3-4.

³⁶ *Id.* at 4.

³⁷ *Id.* at 5 (citing *Town of Norwood, MA v. FERC*, 53 F.3d 377, 380 (D.C. Cir. 1995)).

³⁸ *Id.* at 6-7.

than post-retirement costs would disqualify those assets as being considered as PBOP assets.³⁹

c. Petitioners' Answer

28. Petitioners argue that Navopache's objections to the proposed use of the Trust surplus lack merit if the PBOP Policy Statement does not apply to Trust assets that would be used to pay active union employee medical benefits.⁴⁰ Petitioners also argue that a section 205 filing is not required because Petitioners are not proposing to change a Commission filed rate or APS's approved level of PBOP expense in its formula rate.⁴¹

29. Petitioners state that, in order to address Navopache's concerns that it may be appropriate for APS to adjust the level of fixed PBOP expense currently included in the APS's formula rate, Petitioners commit to make, no later than January 31, 2017, a limited section 205 filing to adjust the current level of fixed PBOP expense included in its formula rate. Petitioners state that such a filing will ensure that surplus Trust assets are credited to formula rate customers because APS's revised PBOP expense will reflect amortization of the actuarial gain caused by the reduction in Pinnacle West's overall PBOP obligation.⁴²

d. Commission Determination

30. We will grant Petitioners' request and confirm that the limitations on the use of external trust assets expressed in the PBOP Policy Statement only apply to the Trust assets that are attributable to amounts collected by APS in its Commission-jurisdictional formula rate. The FPA provides Commission jurisdiction over the transmission of electric energy in interstate commerce, the sale of electric energy at wholesale in interstate commerce, and all facilities for such transmission or sale of electric energy. However, the Commission has recognized that individual states retain authority over "any other sale of electric energy" and facilities used for generation of electric energy, "local

³⁹ *Id.* at 7-8 (citing, e.g., *Connecticut Yankee Atomic Power Co.*, 95 FERC ¶ 61,164 (2001) (*Connecticut Yankee*) (finding that Connecticut Yankee could transfer its PBOP assets to a nuclear decommissioning trust fund, but that it must ensure the assets continue to qualify as PBOP plan assets and may not use the assets to pay for decommissioning its nuclear generating facility)).

⁴⁰ Petitioners' Answer at 5-8.

⁴¹ *Id.* at 17-19.

⁴² *Id.* at 4, 6-7, 19-21.

distribution,” or “transmission of electric energy in intrastate commerce.”⁴³ Thus, the PBOP Policy Statement’s limitations apply only to APS’s Commission-jurisdictional assets in the Trust. Consistent with this authority, the Commission recognized, as a component of jurisdictional cost-based rates of public utilities under its jurisdiction, allowances for prudently incurred costs of PBOPs of company employees when determined on an accrual basis that are consistent with certain accounting principles.⁴⁴

31. We find that Navopache’s arguments regarding APS’s PBOP expense in its formula rate, including whether the PBOP expense meets or exceeds expected future PBOP liabilities, are beyond the scope of this proceeding because Petitioners are not proposing any change to APS’s formula rate or PBOP expense. However, we will accept Petitioners’ commitment to make a section 205 filing to adjust the current level of fixed PBOP expense included in APS’s formula rate by January 31, 2017.⁴⁵

32. We disagree with Navopache’s argument that Petitioners should have filed the Petition under section 205. The Commission has required that changes in PBOP expense, among others, must be filed with the Commission before being passed through in a formula rate.⁴⁶ Here, because Petitioners are not proposing any changes to APS’s PBOP expense amount, a filing under section 205 is not required.

33. We disagree with Navopache’s argument that the Commission should require Petitioners to issue refunds under the PBOP Policy Statement. The PBOP Policy Statement provides that any disbursements made from the trust are limited to payments for the benefit of employees under the company’s post-retirement plans, payments for expenses of the trust, and refunds to customers pursuant to a Commission-approved refund plan in the event the assets are not to be paid to employees.⁴⁷ Because Petitioners are not proposing to use any Commission-jurisdictional assets for any other purpose than those permitted under the PBOP Policy Statement (i.e., payments for the benefit of employees pursuant to Petitioners’ post-retirement plans or for expenses of the Trust), refunds are not required under the PBOP Policy Statement in this case.⁴⁸ For the same

⁴³ 16 U.S.C. § 824(b) (2012).

⁴⁴ PBOP Policy Statement, 61 FERC ¶ 61,330 at 62,200.

⁴⁵ Petitioners’ Answer at 4.

⁴⁶ See *Maine Yankee Atomic Power Company*, 66 FERC ¶ 61,375, *clarified*, 68 FERC ¶ 61,190 (1994).

⁴⁷ PBOP Policy Statement, 61 FERC ¶ 61,330 at 62,200.

⁴⁸ Petition at 15, 25.

reason, we also disagree with Navopache's argument that the Commission should reject Petitioners' proposal to use Trust assets for a purpose other than for retiree benefits.

2. Methodology for Identifying Commission-Jurisdictional Assets

a. Petition

34. Petitioners request that the Commission find that the proposed methodology for identifying the amount of Commission-jurisdictional assets in the Trust is reasonable.⁴⁹ Petitioners state that the proposed methodology calculates the PBOP expense included in APS's transmission rates each year since the Trust was started in 1993 until 2015. Petitioners explain that, from 1993-1998, APS recovered and paid out PBOP expense on a pay-as-you-go basis. Petitioners state that the fixed amount of PBOP expense during this period was \$114,800 per year. Petitioners assert that, because the entire amount of PBOP expense recovered in APS's transmission rate is assumed to have been paid out in benefits during this period, no market gains or losses are associated with these amounts.⁵⁰

35. Petitioners note that APS implemented accrual accounting in 1999, at which point the fixed amount PBOP expense increased to \$490,880 per year. Petitioners state that this fixed amount remained until 2006. Petitioners further state that since 2006, APS recovered a fixed PBOP expense of \$12,427,757 through its formula rate, and that a percentage of this expense amount is allocated to Commission-jurisdictional transmission rates based on a wage and salary allocator.⁵¹ Petitioners explain that each year's benefit payments and market gains and losses are attributed to the amount of Commission-jurisdictional assets in the Trust based on the ratio of the Commission-jurisdictional versus non-jurisdictional assets in the Trust for the prior year. Petitioners state that using this *pro rata* methodology to allocate benefit payments and market gains and losses is reasonable because the Trust assets collected from Commission-jurisdictional ratepayers have been commingled with assets collected from non-jurisdictional sources.⁵²

⁴⁹ *Id.* at 25-26.

⁵⁰ *Id.* at 26-27.

⁵¹ Petitioners state that, while APS's PBOP expense is fixed under its formula rate, the actual amount collected varies slightly from year-to-year based on the wage and salary allocator, as well as adjusting the formula rate every June 1 instead of January 1. *Id.*

⁵² *Id.* at 26-28.

36. Petitioners assert that, by applying this *pro rata* methodology, Pinnacle West calculates \$13,644,381 of the assets in the Trust as attributable to Commission-jurisdictional rates (which is 1.64 percent of the Trust's \$833 million total market value as of December 31, 2015).⁵³ Petitioners also assert that Pinnacle West calculates \$6.5 million of the assets in the Union Medical Account as attributable to Commission jurisdictional rates (which is 1.64 percent of the Union Medical Account's \$397.3 million total market value as of December 31, 2015). Petitioners state that, as a result, the remaining \$390.8 million in the Union Medical Account is attributable to non-jurisdictional sources.⁵⁴

37. Petitioners state that they do not seek a determination from the Commission regarding the specific amount of assets in the Trust that are attributable to Commission-jurisdictional rates but, instead, seek a finding that their proposed *pro rata* methodology is reasonable.⁵⁵ Thus, Petitioners state that, if the Commission finds the methodology reasonable, Pinnacle West will apply the methodology to the Trust account balances at the time the assets are transferred to ensure that no Commission-jurisdictional amounts are transferred. Petitioners state that this may result in slightly different amounts than those represented in the Petition. Petitioners commit to make an informational filing identifying the amounts transferred to fund active employee medical benefits and the Commission-jurisdictional portion of the Trust assets at the time of the transfer.⁵⁶

b. Navopache Protest

38. Navopache argues that Petitioners' proposed methodology for calculating the amount of Commission-jurisdictional assets in the Trust is unjust and unreasonable. Navopache further argues that APS's annual transmission revenue requirement includes a PBOP revenue component that increases annually, which demonstrates that APS should not be permitted to remove assets from the Trust.⁵⁷ Navopache notes that APS increased its wage and salary allocator from 6.65 percent to 7.18 percent in its most recent informational filing to update its formula rates.⁵⁸ Navopache argues that APS calculates

⁵³ *Id.* at 28; *see also* Exhibit APS-4 at 2.

⁵⁴ Petition at 27-29.

⁵⁵ *Id.* 25-26.

⁵⁶ *Id.* at 29.

⁵⁷ Navopache Protest at 8-9.

⁵⁸ APS submitted its most recent informational formula rate update on May 16, 2016, in Docket No. ER11-3638-000.

the PBOP revenue to be collected each year in its formula rate by multiplying the wage and salary allocator by its fixed PBOP expense amount and, by increasing the allocator, APS would be expected to collect an increased PBOP expense.⁵⁹ Navopache asserts that APS should not be allowed to continue to collect its current PBOP expense through its formula rate going forward if the expected future PBOP liability will decrease as Petitioners claim.⁶⁰

39. Navopache argues that, notwithstanding the evidence that APS has over-collected PBOP expense through its Commission-jurisdictional transmission rates, Petitioners claim without explanation that none of the Trust assets attributable to Commission-jurisdictional rates are part of the surplus that they intend to use for active employee medical benefits and offer a flawed calculation in support of their proposal. Navopache believes that APS decided that it would not include in the surplus proportional shares based on all three sources of PBOP funding, instead carving out the Commission-jurisdictional portion from surplus inclusion and attributing the entire surplus to assets derived from non-jurisdictional sources.⁶¹

40. Navopache also argues that Petitioners base their calculation on data up through APS's 2015 informational formula rate filing, but do not include data from APS's most recent 2016 informational formula rate filing that includes an increased PBOP expense of \$22.7 million. Navopache notes that Petitioners include "contributions" to the Trust from 1993 until 2015 in their data, but that contributions in 2014 and 2015 were derived only from APS's Commission-jurisdictional rates. Navopache also notes that Petitioners state, without explanation, that "benefit payments were not made in 2005, 2010, or 2015," and that Commission-jurisdictional assets did not earn or lose any market value from 1993-1998.⁶²

c. Petitioners' Answer-

41. Petitioners argue that, because Trust assets were commingled for investment purposes, and no distinction was made between Commission and non-Commission jurisdictional assets, it is reasonable to allocate PBOP benefit payments and market gains and losses on a *pro rata* basis.⁶³ Petitioners also assert that the proposed methodology

⁵⁹ Navopache Protest at 9.

⁶⁰ *Id.* at 11.

⁶¹ *Id.* at 6, 11.

⁶² *Id.* at 9-11.

⁶³ Petitioners' Answer at 8-11.

calculates that a portion of the Trust surplus is attributable to Commission-jurisdictional rates, but that Petitioners are not proposing to use any assets attributable to Commission-jurisdictional rates to pay for active union employee medical benefits.⁶⁴

42. Petitioners argue that their supporting exhibits do not include APS's 2016 formula rate data because the proposed methodology requires a full calendar year of data, including actuarial information and market gains and losses, which are not yet available for 2016. Petitioners also argue that APS did not collect \$22.7 million in PBOP expenses in its 2016 formula rate as Navopache alleges, but credited ratepayers \$10.3 million.⁶⁵

43. Petitioners argue that their supporting exhibits reflect only contributions from APS's Commission-jurisdictional rates in 2014 and 2015 because APS was not required to deposit amounts collected in state-regulated retail rates or from the Palo Verde Nuclear Generating Station ownership agreement. Petitioners assert that, for 2005, 2010, and 2015, APS funded benefit payments through corporate funds and, due to a timing lag, was reimbursed later from the Trust.⁶⁶

d. Commission Determination

44. We find that Petitioners' proposed methodology for identifying the amount of Commission-jurisdictional assets in the Trust is reasonable and, therefore, will grant Petitioners' request for confirmation. Petitioners identify the PBOP expense in APS's Commission-jurisdictional rates each year since the Trust was started in 1993 until 2015. Petitioners then use a *pro rata* methodology to identify the assets that are attributable to Commission-jurisdictional rates by attributing benefit payments and market gains and losses on Commission-jurisdictional contributions based on the ratio of Commission-jurisdictional contributions' market value relative to the total Trust market value for the prior year. Because Petitioners commingled non-jurisdictional assets with Commission-jurisdictional assets, we find that Petitioners' proposed *pro rata* methodology is a reasonable means to identify the portion of Trust assets attributable to Commission-jurisdictional rates. We also will accept Petitioners' commitment to make an informational filing identifying the amounts transferred to fund active union employee medical benefits and the Commission-jurisdictional portion of the Trust assets at the time of the transfer within 30 days of the transfer.⁶⁷

⁶⁴ *Id.* at 8-9.

⁶⁵ *Id.* at 11-12.

⁶⁶ *Id.* at 12-14.

⁶⁷ Petition at 29; Petitioners' Answer at 11-12.

45. As discussed above, we find that Navopache's arguments regarding APS's PBOP expense in its formula rate are beyond the scope of this proceeding. We also find that Navopache's arguments regarding Petitioners' accounting data are misplaced because Petitioners seek confirmation that their proposed methodology for identifying the amount of Commission-jurisdictional assets in the Trust, not the supporting accounting data, is reasonable.⁶⁸ Navopache argues that Petitioners do not explain why benefit payments or Commission-jurisdictional contributions were not made in certain years but, notwithstanding Petitioners' explanation discussed above, such an explanation does not impact the analysis of whether Petitioners' proposed *pro rata* methodology is reasonable. Navopache also argues that Petitioners do not attribute any market gains or losses to Commission-jurisdictional assets from 1993-1998; however, we note, as Petitioners clarify in their answer, that the Petition states that Pinnacle West used "pay-as-you-go" accounting during those years and does not attribute market gains or losses because PBOP expenses are assumed to have been paid out.⁶⁹

3. Restructuring of the Trust

a. Petition

46. Petitioners request that the Commission confirm that Pinnacle West's proposed restructuring of the Trust into separate, stand-alone trusts is consistent with, and permissible under, the PBOP Policy Statement.⁷⁰ Petitioners state that on October 3, 2014, Pinnacle West requested a private letter ruling from the IRS authorizing the proposed use of a portion of the Trust surplus to fund active union employee medical benefits. Petitioners explain that, in the course of its private letter ruling discussions, the IRS provided new guidance that the three Trust accounts (i.e., the Union Medical, Non-Union Medical, and Life Insurance Accounts) should be held in separate, stand-alone VEBA trusts.

47. Petitioners explain that Pinnacle West and the IRS reached an agreement on issues regarding the structure and use of the Trust assets in the IRS Agreement. Petitioners also state that, pursuant to the IRS Agreement and their proposed restructuring, the three Trust accounts will be divided into three separate VEBA trusts—Union Medical, Non-Union

⁶⁸ Petition at 29.

⁶⁹ *Id.* at 27; Petitioners' Answer at 13.

⁷⁰ Petitioners state that, to the extent the Commission concludes that the PBOP Policy Statement restricts the transfer of the assets in the Non-Union Medical and Life Insurance Accounts into new, stand-alone VEBA trusts, Petitioners request waiver of the PBOP Policy Statement. Petition at 35.

Medical, and Life Insurance trusts. Specifically, Petitioners explain that the Trust assets will be transferred as follows: (1) the Union Medical Account assets will be retained in the existing Trust to pay union retirees' medical benefits, and an account would be established to receive a portion of the Trust surplus, excluding any Commission-jurisdictional amounts, to pay for active union employees' medical benefits; (2) the Non-Union Medical Account assets will be transferred to a new separate trust to pay for non-union retirees' medical benefits; and (3) the Life Insurance Account assets will be transferred to a new separate trust to fund the life insurance benefits of union and non-union retirees.⁷¹ Petitioners state that the terms of the new trusts would be substantially identical to the current Trust. Petitioners also state that the proposed restructuring includes separate sub-accounts within each of the trusts to identify the Commission-jurisdictional assets in each trust, including future amounts collected.⁷²

48. Petitioners explain that, because the assets in each account include amounts attributable to Commission-jurisdictional rates, Petitioners seek confirmation that the proposed restructuring of the Trust would not be deemed a withdrawal or disbursement of Trust assets, subject to the PBOP Policy Statement.⁷³ According to Petitioners, the PBOP Policy Statement does not restrict a transfer between external trusts.⁷⁴ Petitioners state that the PBOP Policy Statement establishes certain minimum characteristics for PBOP trusts, including use of an external trust with an independent trustee. Petitioners further assert that the PBOP Policy Statement does not limit the transfer of assets between two trusts that both comply with the external trust requirements of the PBOP Policy Statement.⁷⁵

⁷¹ Petitioners state that, using the methodology described in the Petition, the following amounts are attributable to Commission-jurisdictional rates and will be transferred under the proposed restructuring: \$6,506,854 in the Union Medical Account, \$6,154,064 in the Non-Union Medical Account, and \$983,463 in the Life Insurance Account. *Id.* at 17.

⁷² *Id.* at 17-18.

⁷³ *Id.* at 33-34.

⁷⁴ *Id.* at 34-35 (citing, *e.g.*, *Connecticut Yankee*, 95 FERC ¶ 61,164 at 61,528-29 (approving Connecticut Yankee's request to deposit PBOP-related assets held in its general corporate treasury into its nuclear decommissioning fund to avoid potential adverse tax consequences)).

⁷⁵ *Id.* at 33-34.

49. Petitioners also state that the PBOP Policy Statement requires utilities to maximize the tax deductions associated with PBOP trusts. Petitioners assert that Pinnacle West's proposed transfer is consistent with the PBOP Policy Statement because the transfer is required under the IRS Agreement and reflects the IRS's interpretation of the appropriate way to structure the new trusts to comply with Internal Revenue Code provisions governing the availability of tax-advantaged treatment for welfare benefit assets.⁷⁶

b. Navopache Protest

50. Navopache argues that Petitioners' proposal to establish two new trusts and to transfer current Trust assets into those trusts violates the PBOP Policy Statement. According to Navopache, the PBOP Policy Statement requires irrevocable external trusts to be used for PBOP assets collected via Commission-jurisdictional rates to insure that the amount that customers pay for PBOPs will be used for only those purposes identified in the PBOP Policy Statement. Navopache argues that one of the conditions of allowing utilities to recover the costs of PBOPs in their rates is that the utility must place all PBOP accruals in an external trust fund that is outside of its control and not available for other corporate purposes. Navopache argues that Petitioners have not justified or provided any evidence in support of the proposal to establish two new trusts.⁷⁷

51. Navopache argues that the Non-Union Medical trust will reflect a deficit of \$62.2 million, which will likely lead Petitioners to request an increase in PBOP expense recovery through transmission rates despite the surplus in the Union Medical Account. Navopache asserts that Petitioners use Accumulated and Expected Obligations to forecast future liabilities, but rely on the methodology that forecasts the higher value to increase the likelihood that sufficient assets will be in the new trusts. Navopache notes that Petitioners use Expected Obligation only for the Union Medical Account, but not for the Non-Union or Life Insurance Accounts. Navopache also argues that Petitioners' increasing costs of retiree benefits, including health care costs, could result in underfunding all three of the proposed trusts if the Commission approves the Petition.⁷⁸

c. Petitioners' Answer

52. Petitioners argue that, to comply with IRS requirements, Pinnacle West is obligated to restructure its existing Trust into three stand-alone VEBA trusts, which will

⁷⁶ *Id.* at 34.

⁷⁷ Navopache Protest at 11-12.

⁷⁸ *Id.* at 12-15.

comply with the PBOP Policy Statement.⁷⁹ Petitioners also argue that, although Navopache is correct that the new Non-Union trust would reflect a \$62.2 million funding deficit relative to the expected Accumulated Obligation, the existence of the shortfall has nothing to do with, and would not be affected by, the proposed restructuring. Petitioners assert that, to the extent that the accounts in the existing Trust are over- or under-funded at the time of the transfer, the accounts would remain over- or under-funded to the same extent after the transfer.⁸⁰

d. Commission Determination

53. We will grant Petitioners' request and confirm that Pinnacle West's proposed restructuring of the Trust accounts into separate, stand-alone trusts is consistent with, and permissible, under the PBOP Policy Statement. The PBOP Policy Statement requires public utilities under the Commission's jurisdiction to make cash deposits to an irrevocable external trust fund, no less frequently than quarterly, in amounts that are proportional and, on an annual basis, equal to the annual test period allowance for PBOPs.⁸¹ Here, Petitioners propose to restructure the current Trust into new, stand-alone trusts, which will have an independent trustee and will be substantially identical to the current Trust. According to Petitioners, the proposed restructuring and transfer of assets is consistent with IRS guidance. Additionally, Petitioners are not proposing to use any of the Commission-jurisdictional assets for any other purpose other than those permitted under the PBOP Policy Statement. Thus, Petitioners' proposed restructuring and transfer of Trust assets from the current Trust to new, stand-alone trusts that are compliant with the PBOP Policy Statement requirements are not considered a withdrawal or disbursement under the PBOP Policy Statement.

54. We find that Navopache's argument that Petitioners' proposed restructuring will leave the new Non-Union Medical trust underfunded is misplaced. Petitioners' proposal to transfer assets from the current Trust to new stand-alone trusts does not change the expected future PBOP liability for each trust. Petitioners represent that the Non-Union Medical Account is currently underfunded, but, as discussed above, arguments regarding APS's PBOP expense in its formula rate, including whether the PBOP expense meets or exceeds expected future PBOP liabilities, are beyond the scope of this proceeding.⁸²

⁷⁹ Petitioners' Answer at 15-16.

⁸⁰ *Id.* at 16-17.

⁸¹ PBOP Policy Statement, 61 FERC ¶ 61,330 at 62,200.

⁸² *See* Exhibit APS-3.

Moreover, as Petitioners point out, transferring assets in the Non-Union Account to a new trust would neither increase nor decrease this deficit.⁸³

55. We also disagree with Navopache's argument that Petitioners rely on the methodology that forecasts the higher value to increase the likelihood that sufficient assets will be in the trusts. Petitioners state that Expected Obligation is an estimate of future PBOP liability that includes all expected future benefit accruals and Accumulated Obligation includes only obligations that have accrued to date.⁸⁴ As Navopache points out, Petitioners use Expected Obligation for the Union Medical Account and Accumulated Obligation for the Non-Union Medical and Life Insurance Accounts. By relying on Expected Obligation for the Union Medical Account, Petitioners use a more conservative measure that forecasts a higher expected liability than Accumulated Obligation.

The Commission orders:

The Petition is hereby granted, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

⁸³ Petitioners' Answer at 16.

⁸⁴ Petition at 15.