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September 23, 2014

The Honorable Jeanne M. Cochran
Administrative Law Judge
Office of Administrative Hearings
600 North Robert Street
P.O. Box 64620
St. Paul, Minnesota 55164-0620

Via Electronic Filing and U.S. Mail

Re: *In the Matter of the Application of Northern States Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota*
MPUC Docket No. E-002/GR-13-868
OAH Docket No. 68-2500-31182

Dear Judge Cochran:

Enclosed and e-filed in the above-referenced matter please find the Initial Brief filed on behalf of U.S. Energy Services, Inc. on its own behalf and on behalf of an ad hoc group of its industrial, commercial, and institutional customers (collectively, the "ICI Group").

By copy of this letter all parties have been served. An Affidavit of Service is also enclosed.

Sincerely,

/s/ Peder A. Larson

Peder A. Larson, for
Larkin Hoffman Daly & Lindgren Ltd.

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Enclosure

cc: Service List

STATE OF MINNESOTA
BEFORE THE
MINNESOTA PUBLIC UTILITIES COMMISSION

In the Matter of the Application of Northern States Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota	**)**	**MPUC Docket No. E-002/GR-13-868** **OAH Docket No. 68-2500-31182**

INITIAL BRIEF OF THE ICI GROUP

September 23, 2014

By:

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INTRODUCTION

"Every rate made, demanded, or received by any public utility . . . shall be just and reasonable. . . . Any doubt as to reasonableness should be resolved in favor of the consumer."[1] Northern States Power Company—Minnesota ("Xcel") has the burden to demonstrate that its proposed rate increases in this proceeding are just and reasonable.[2] Xcel has failed to show by a preponderance of the evidence that the magnitude of its proposed two-year rate increases results in just and reasonable rates for consumers.

The ICI Group[3] has raised the following issues in this proceeding: (1) the "rate shock" that industrial, commercial, and institutional consumers would experience as a result of the proposed increases, (2) Xcel's two-year rate increase phase-in proposal, (3) the used and usefulness of the cancelled Prairie Island Extended Power Uprate (EPU) Project, and (4) Xcel's requested increase in its return on equity ("ROE") and its proposed capital structure.[4]

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[1] Minn. Stat. § 216B.03 (2012).

[2] Minn. Stat. § 216B.16, subd. 4 (2012) (stating that the burden of proof to show that a proposed rate change is just and reasonable "shall be upon the public utility seeking the change").

[3] The ICI Group consists of U.S. Energy, Inc. on its own behalf and on behalf of an ad hoc group of its industrial, commercial, and institutional customers. (*See* Exhibit No. 250, Direct Testimony of William L. Glahn, at 2:25-27 through 3:1-6).

[4] The ICI Group also raised issues with respect to Xcel's proposed revenue decoupling mechanism; however, this issue has been moved to a separate docket by way of stipulation of the parties and is not argued herein.

DISCUSSION

I. RATE SHOCK.

On November 4, 2013, Xcel filed a petition proposing a two-year increase in its electric rates in Minnesota ("Petition"). The Petition requested authority to increase rates in two steps, resulting in an increase of approximately: (1) $192.7 million (6.9 percent) in 2014, and (2) $98.5 million (3.5 percent) in 2015, for a total combined increase of $291.2 million.[5] Together, the requested increase would have resulted in an increase in rates of greater than 10 percent from current levels.[6] Since the filing of the Petition, Xcel and the other parties to this proceeding have worked to reduce the requested rate increase, which is now approximately: (1) $142.2 million in 2014, and (2) $106.0 million in 2015, for a total combined increase of $248.1 million.[7]

Commission acceptance of the proposed rate increases totaling $248.1 million would drastically impact members of the ICI Group's operations and their competitive positions in the marketplace.[8] "In addition to numerous other regulatory proceedings that

[5] Exhibit No. 25, Direct Testimony/Schedules of David M. Sparby, Nov. 4, 2013, at 41:5-7, and Exhibit No. 99, Direct Testimony of Christopher B. Clark, Nov. 4, 2013, at 10:10-13.

[6] Exhibit No. 250, Direct Testimony of William L. Glahn, at 3:13-14.

[7] Exhibit No. 140, Evidentiary Hearing Opening Statement of Anne E. Heuer at 8 & Ex. A. The large reduction in the proposed 2014 rate was accomplished partially by deferring some increases until 2015. *Id.*

[8] Large consumers of electricity are concerned that the proposed increase will negatively affect the business climate of Minnesota relative to other states, and large consumers' ability to compete with businesses in regional, national, and international markets. *See* Exhibit No. 250, Direct Testimony of William L. Glahn, at 5:1-15.

impact the prices charged to customers, Xcel has filed four general rate cases in the past decade: in 2005, 2008, 2010, and 2012."[9] These other rate cases preceded the current case, and resulted in increases in the cost of electric service by $131,455,000 in 2005; $91,375,000 in 2008; $72,851,000 in 2010; and $103,797,000 in 2012.[10] According to Mr. Glahn:

> Xcel is requesting total Minnesota electric revenue of $3,081,000,000. Prior to the results of the 2005 rate case, authorized revenue was $2,082,350,000. The difference between those figures, almost exactly $1 billion, represents an increase of 48 percent over the pre-2005 annual revenue base. On a compounded basis, Xcel's annual revenues have been growing at a rate of almost 4.5 percent for the past decade, well beyond any measure of inflation during that period.[[11]]

Additionally, Xcel plans to file another rate case in November, 2015.[12]

Such steep increases in the cost of electric services over a short period of time create the risk for "rate shock." For the members of the ICI Group, there is no choice but to pay the increased cost of electricity determined in this proceeding; many "operate 24 hours per day, seven days a week and exhibit relatively flat energy usage patterns.

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[9] *Id.*, at 3:16-18.

[10] *Id.* at 3:19-22 through 4:1-4.

[11] *Id.* at 4:6-11 (internal footnotes omitted). Note that since Mr. Glahn's Direct Testimony was filed, Xcel has reduced its proposed rate increases. Exhibit No. 140, Opening Statement of Heuer, at 8 & Ex. A.

[12] Exhibit No. 99, Direct Testimony of Christopher B. Clark, at 12:10.

Therefore, there are few opportunities for group members to reduce their energy costs by reducing peak usage, shifting operations, or curtailing load."[13]

The ICI Group urges the Commission to consider Xcel's rate request in the context of the state's overall business climate, the cumulative effect of recent rate increases, and the likelihood of more increases in the near future. "In reviewing rate changes, the [Commission's] charter is broadly defined in terms of balancing the interests of the utility companies, their shareholders, and their customers to ensure that rates are 'just and reasonable.'"[14] The ICI Group recommends that any rate increases allowed by the Commission be in line with recent changes from the 2005, 2008, 2010, and 2012 rate cases.[15]

II. THE PROPOSED TWO-YEAR RATE PHASE-IN PROPOSAL.

Xcel's Petition proposed a two-year rate increase. According to statute, "[a] public utility may propose, and the [C]ommission may approve, approve as modified, or reject, a multiyear rate plan as provided in this subdivision. . . . The [C]ommission may approve a multiyear rate plan only if it finds that the plan establishes just and reasonable

[13] Exhibit No. 250, Direct Testimony of William L. Glahn, at 5:2-5.

[14] *Minn. Dep't of Pub. Serv. v. Minn. Pub. Utils. Comm'n (In re request of Interstate Power Co. for Auth. To Change its Rates for Gas Serv.)*, 574 N.W.2d 408, 411 (Minn. 1998) [hereinafter *In re Interstate Power*] (quoting Minn. Stat. § 216B.16, subd.6); *see also* Exhibit No. 254, Opening Statement of William L. Glahn.

[15] Exhibit No. 250, Direct Testimony of William L. Glahn, at 5:20-22.

rates for the utility."[16] The burden of proof remains on the utility to prove that the each year of a multiyear rate plan establishes just and reasonable rates for consumers.[17]

This is the first multiyear rate case filed by Xcel in this jurisdiction.[18] As such, this proceeding will establish important procedural precedent. "The commission may, by order, establish terms, conditions, and procedures for a multiyear rate plan necessary to implement this section and ensure that rates remain just and reasonable during the course of the plan, including terms and procedures for rate adjustment."[19] The ICI Group requests that the Commission give close scrutiny to Xcel's proposed two-year rate phase-in proposal, as well as the procedures used to regulate any allowed multiyear rate increase.

Xcel witness Sparby contends that the purpose of the two-year rate phase-in is to "help address longer-term investment needs, while providing greater predictability in customer rates."[20] A multiyear rate increase, in reality, increases the risk that Xcel will receive a windfall at the expense of consumers. Implicit in the multiyear rate requests are: (1) that absent the phase-in, the full rate increase request would be too steep and

[16] Minn. Stat. § 216B.16, subd. 19(a) (2012).

[17] *Id.*

[18] *See id.*, subd.. 19(e) (2012) (setting an effective date for the multiyear rate plan legislative amendment as May 31, 2012).

[19] *Id.*, subd.. 19(c) (2012).

[20] Exhibit No. 25, Direct Testimony/Schedules of David M. Sparby, at 16:1-5.

needs to be made more gradual,[21] and (2) that Xcel cannot justify the full rate increase at this time and hopes that by deferring some increases until 2015, less scrutiny will be given to both the 2014 and 2015 rate increase requests (as they will both appear relatively smaller than a single increase).[22]

Further, given the current economic climate, a two-year rate phase-in gives rise to a risk that Xcel will experience a windfall at the expense of consumers. For several years following the market crash of late 2007, public utilities suffered from low load (demand) growth.[23] Generally, utilities could count on load growth to offset the negative effects of regulatory lag.[24] Xcel filed this case at a time when there have been several years of sluggish economic growth; however, there is reason to believe that the economy will recover in the next 12 to 24 months. Thus, if the two-year rate phase-in is implemented, Xcel stands to improve its economic position by both increasing its demand base, and by having rates set at a level which in retrospect turned out to be too high.[25] Given the prohibition against retroactive ratemaking, Xcel would be able to keep all, or substantially all, of the resulting windfall.

Based on this, the ICI Group requests that Xcel's proposed two-year rate increase be denied and Xcel instead be granted a one-time rate change that does not produce rate

[21] Exhibit No. 250, Direct Testimony of William L. Glahn, at 6:22-23

[22] *Id.* at 6:25-27

[23] *Id.* at 7:4-8

[24] *Id.*

[25] *Id.* at 7:17-24

shock and which can be justified based on currently available data.[26] Such a determination will allow Xcel to seek another rate increase in the future should economic circumstances turn out to be less favorable than expected, while at the same time protecting consumers from paying an unjustified automatic rate increase should economic circumstances improve.[27] In any event, the ICI Group's proposal ensures that consumers benefit from the transparency of having all revenue and expenses determined in one proceeding where all financial data is available.[28]

III. CANCELLED PRAIRIE ISLAND EPU PROJECT.

In its Petition, Xcel proposed to include in the 2014 rate base a total of $78.9 million in costs associated with a cancelled project to increase generating capacity at the Prairie Island Nuclear Generating Plant.[29] The Prairie Island EPU Project aimed at increasing production at the Prairie Island facility by 164 MW, but the project was cancelled in February 2013.[30]

Minnesota law sets forth the factors the Commission can consider in setting rates:

> The commission, in the exercise of its powers under this chapter to determine just and reasonable rates for public utilities, shall give due consideration to the public need for adequate, efficient, and reasonable service and to the need of

[26] *See* Minn. Stat. 216B.16, subd. 19(a) (stating that the Commission may "approve as modified, or reject, a multiyear rate plan").

[27] *See* Exhibit No. 250, Direct Testimony of William L. Glahn, at 9:8-15.

[28] *Id.* at 9:17-18.

[29] Exhibit No. 99, Direct Testimony of Christopher B. Clark, at 25:22-24.

[30] Exhibit No. 48, Direct Testimony of James R. Alders, at 21:21-23.

> 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.[31]

The Prairie Island EPU Project was never used and useful, nor did it ever render service to the public.

Additionally, the mere fact that Xcel has incurred costs as a result of the proposed Prairie Island EPU Project does not mean that such costs are appropriately recoverable from consumers.

> [I]n the exercise of the statutorily imposed duty to determine whether the inclusion of the item generating the claimed cost is appropriate, or whether the ratepayers or the shareholders should sustain the burden generated by the claimed cost, the MPUC acts in both a quasi-judicial and a partially legislative capacity. To state it differently, in evaluating the case, the accent is more on the inferences and conclusions to be drawn from the basic facts (i.e., the amount of the claimed costs) rather than on the reliability of the facts themselves. Thus, *by merely showing that it has incurred, or may hypothetically incur, expenses, the utility does not necessarily meet its burden of demonstrating it is just and reasonable that the ratepayers bear the costs of those expenses*.[32]

ICI Witness Glahn testified:

> In the instance of the Prairie Island EPU, we have a unique instance where an underlying facility has been used in the production of power for many years, but planned improvements did not come about, even though considerable costs were expended on the cancelled effort. The uprate project, in its present state of abandonment, is not useful for

[31] Minn. Stat. § 216B.16, subd. 6 (2012) (emphasis added).

[32] *In re Northern States Power Co.*, 416 N.W.2d 719, 722 (Minn. 1987).

> making electricity, nor has it been used at any point in time.[33]

Xcel witness Cristopher Clark argues that disallowing cost recovery for abandoned projects "would defeat the Commission's previously-noted public policy to encourage a utility's diligence in 'promptly withdrawing from projects when experience shows that they will no longer serve the ratepayers' best interests.'"[34] ICI contends that the opposite would be true, namely: "By granting cost recovery to cancelled projects, the Commission would encourage utilities to pursue imprudent or marginal projects, with the assurance that they would be made whole, regardless of the outcome."[35]

This case presents a novel issue in this jurisdiction, namely, whether the planned expansion of a currently operating facility can be deemed "used and useful" even if the planned expansion never resulted in increased energy output by the utility. Thus, the Commission will be required to act in both its legislative and quasi-judicial capacities to answer this question.[36] The Commission acts in a legislative capacity when it is "balancing both cost and noncost factors and making choices among public policy alternatives."[37] "[T]o permit the recovery of an item of expenses . . . is essentially a

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[33] Exhibit No. 250, Direct Testimony of William L. Glahn, at 11:6-10.

[34] Exhibit No. 99, Direct Testimony of Christopher B. Clark, at 34:19-24 (citation for internal quotation unknown).

[35] Exhibit No. 250, Direct Testimony of William L. Glahn, at 12:1-3.

[36] Minn. Stat. § 216A.05, subd. 1 (2012).

[37] *St. Paul Area Chamber of Commerce v. Minn. Pub. Serv. Comm'n*, 312 Minn. 250, 262, 251 N.W.2d 350, 358 (1977). The Commission "may make such investigations and determinations . . . as the legislature itself might make . . . and thus it has a very

policy question of whether the shareholders or the customers should bear the cost."[38] The Commission will be acting in a quasi-judicial capacity when it decides the exact amount of recovery to allow for the cancelled Prairie Island EPU Project.[39]

Under general principles of utility law, the used and useful standard simply requires (1) that the property be in service, and (2) that it be reasonably necessary to the efficient and reliable provision of utility service."[40] Minnesota courts have previously addressed whether a nonexistent plant can be used and useful, when its construction was abandoned before it was commenced, but after the utility expended costs in preparation for construction.[41] "To consider such a nonexistent plant as used and useful is an unreasonable expansion of the used and useful concept. The plant in question has not provided and never will provide electricity to rate payers."[42] The Commission should

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broad factfinding as well as policymaking jurisdiction." Minn. Stat. § 216A.05, subd. 1 (2012).

[38] *In re Interstate Power*, 548 N.W.2d at 413.

[39] *See Northwestern Bell Tel. Co. v. State*, 253 N.W.2d 815 (Minn. 1977) (holding that the Commission acted in a quasi-judicial capacity when making factual findings regarding amounts of money).

[40] *Senior Citizens Coalition of Northern Minnesota v. Minn. Pub. Utilities Comm'n*, 355 N.W.2d 295, 300 (Minn. 1984).

[41] *See Northern States Power*, 416 N.W.2d at 722.

[42] *In re Petition of Otter Tail Power Co.*, 417 N.W.2d 677, 686 (Minn. App. 1988) (discussing actions of the utilities commission in that case).

take the same approach for the cancelled uprate—it "has not provided and never will provide electricity to rate payers."[43]

In this case, it is not "just and reasonable that the ratepayers bear the costs" of the cancelled Prairie Island EPU Project.[44] The project was never "used and useful" and the ratepayers certainly never rendered service to the public.[45] If the Commission makes a policy decision allowing cost recovery for the cancelled project, utilities will be incentivized to overinvest in imprudent projects, at the expense of rate payers. "If a utility's forecasts are biased in favor of building new plants, or if the utility, when in genuine doubt over the necessity of a new plant, consistently responds to the incentive to overinvest, the utility or its customers must absorb millions or even billions of dollars in sunk costs attributable to a facility that may provide little or no benefit."[46] The ICI Group urges the Commission to determine that the Prairie Island EPU Project is not used and useful, and to disallow any cost recovery for the project.

Alternatively, if the Commission decides to allow recovery of these costs, the ICI Group requests that the costs be amortized over the original life of the proposed project, which is the 20 years remaining on the plant's operating licenses, rather than the six to twelve years proposed by Xcel. Additionally, the rate set by the Commission should

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[43] *See Northern States Power*, 416 N.W.2d at 722.

[44] *See id.*

[45] *See* Minn. Stat. § 216B.16, subd. 6.

[46] Richard J. Pierce Jr., The Regulatory Treatment of Mistakes in Retrospect: Cancelled Plants and Excess Capacity, 132 U. Pa. L. Rev. 497, 509-10 (1984).

reflect the nearly risk-free[47] aspect of the abandoned project; rather than having Xcel's usual rate of return apply to the asset, the rate of return should be set closer to a U.S. Treasury bill or bond interest rate.

IV. XCEL'S PROPOSED RATE-OF-RETURN ON EQUITY AND CAPITAL STRUCTURE.

In its Petition, Xcel sought an increase in its rate-of-return on equity ("ROE") from 9.83 percent to 10.25 percent. The rate of return for a public utility should be "equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties."[48] And "the return to equity owner should be commensurate with returns on investments in other enterprises having corresponding risks."[49] "The [C]ommission . . . shall 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 . . . and to earn a fair and reasonable return upon the investment in such property."[50]

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[47] Because the EPU is not being used, there is essentially zero operational risk for the "asset."

[48] *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Bd.*, 262 U.S. 679, 692 (1923).

[49] *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

[50] *Hibbing Taconite Co. v. Minn. Pub. Serv. Comm'n*, 302 N.W.2d 5, 10 (Minn. 1980) (quoting Minn. Stat. § 216B.16, subd. 6).

ICI Group witness William Glahn testified regarding his Discounted Cash Flow (DCF) analysis indicating a reasonable rate of return for Xcel of 9.0 percent.[51] Xcel witness Hevert recommended a rate of return of 10.25 percent, while Department of Commerce Witness Dr. Amit initially recommended 9.80 percent (lowered to 9.64 percent in surrebuttal testimony). Neither Mr. Hevert's nor Dr. Amit's recommendations rest on proper analysis and should be disregarded.

Mr. Hevert retreated from his initial recommendation of 10.25 percent at the evidentiary hearing. His opening statement repeatedly stated that a return of less than the current level of 9.83 percent should not be allowed.[52] Mr. Hevert seemingly realized that his initial recommendation was inflated and based on improper analysis.[53] In fact, Mr. Hevert testified regarding the fact that he consistently testifies in rate case proceedings, and consistently gives rate of return recommendations that are at least 25 basis points higher than what various commissions have awarded.[54] The Commission should not rely on Xcel's self-serving, inflated recommendation for return on equity.

Dr. Amit's analysis for rate of return also suffers from faulty analysis. In his DCF analysis, Dr. Amit refuses to consider comparable companies with a rate of return lower

[51] Exhibit No. 250, Direct Testimony of William L. Glahn, at 15:17-22

[52] Hearing Transcript, August 11, 2014, at 54:9-62:14.

[53] *See id.*

[54] *Id*. at 77:4-80:9.

than 8.0 percent.[55] However, these comparable companies all have shareholders. Dr. Amit testified on cross-examination that the shareholders of these companies do not act irrationally by holding stock in a utility with a rate of return lower than 8.0 percent.[56] Thus, setting such a minimum threshold for comparable companies for a DCF analysis is arbitrary. It also distorts the analysis, as ICI Group witness William Glahn explains:

> It is one thing to eliminate a company from a comparable group *ex ante* because it does not meet certain, well-reasoned criteria. It is another matter entirely to eliminate a result *ex post* because the result does not conform to one's expectations going in. To do so is to "beg the question."[57]

Dr. Amit's analysis simply refuses to acknowledge relevant data because it does not fit with his preconceived notions of what the data should look like.

The ICI Group recommends that the Commission adopt the recommendations of William L. Glahn based on his well-reasoned DCF analysis. A rate of return of 9.0 percent will allow Xcel to earn a competitive return without requiring its rate payers to needlessly pay higher rates—rates that would not be "just and reasonable."

The ICI Group also recommends that Xcel only be allowed to include common equity in its capital structure up to the actual amounts employed by the parent company, namely Xcel Energy, Inc.[58] Northern States Power is an accounting fiction as it is simply

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[55] Exhibit No. , Direct Testimony of Dr. Eilon Amit, at 14: - 15: ; *see also* Exhibit No. 27, Direct Testimony of Robert Hevert, at 35:18-21 and 37:24-38:2 (supporting this aspect of Dr. Amit's analysis).

[56] Hearing Transcript, August 14, 2014, at 42:7-13.

[57] Exhibit No. 251, Surrebuttal Testimony of William L. Glahn, at 5:14-17.

[58] *Id.* at 5:25-6:2.

an entry on the books of Xcel Energy, Inc.[59] Therefore, Xcel Energy's equity/capital ratio can be directly observed, while Northern States Power's equity/capital ratio cannot.[60] The ICI Group therefore recommends common equity up to 47.5 percent in 2014 and 49.0 percent in 2015.[61] Dr. Amit testified that these values are within the "zone of reasonableness."[62]

CONCLUSION

The resolution of the issues raised by the ICI Group should result in a smaller increase in rates than those requested by Xcel. The Commission should adopt a one-time rate increase based on the recommendations set forth above. This will reduce the risk of "rate shock" and result in rates that are "just and reasonable."[63]

Dated:

/s/ Peder A. Larson

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[59] *Id.* at 6:13-14.

[60] *Id.* at 6:12-13.

[61] *Id.* at 6:1-2.

[62] Hearing Transcript, August 14, 2014, at 42:14-44:1.

[63] Minn. Stat. § 216B.16, subd. 6.

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE PUBLIC UTILITIES COMMISSION

In the Matter of the Application of Northern States Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota MPUC Docket No. E-002/GR-13-868 OAH Docket No. 68-2500-31182	**AFFIDAVIT OF SERVICE**

STATE OF MINNESOTA)
)ss.
COUNTY OF HENNEPIN)

Rachel Clark being duly sworn, says that on the 23rd day of September, 2014 she served the following:

- The Initial Brief filed on behalf of U.S. Energy Services, Inc. on its own behalf and on behalf of an ad hoc group of its industrial, commercial, and institutional customers (collectively, the "ICI Group").

To all persons at the addresses listed on the attached list by filing through e-dockets.

Rachel Clark

Subscribed and sworn to before me
this 23th day of September, 2014

MARY C. H. CARLSON
NOTARY PUBLIC – MINNESOTA
My Commission Expires Jan. 31, 2015

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