July 5, 2018

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101-2147

RE: **Reply Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. G002/M-18-184

Dear Mr. Wolf:

On March 1, 2018, Northern States Power, d/b/a Xcel Energy (Xcel Gas or the Company) filed its *Petition for Approval of a Modification to the Natural Gas SEP Tariff Rate, 2018 State Energy Policy (SEP) Adjustment Factor, and 2017 SEP Compliance Filing* (Petition) in the present docket to revise the Company's natural gas SEP Rider rates, with a proposed effective date of July 1, 2018.

On April 2, 2018 the Department submitted comments recommending that the Commission deny Xcel Gas's proposed SEP adjustment factor. The Department concluded that, while Xcel Gas's petition fulfilled the reporting requirements, since the Minnesota Public Utilities Commission (Commission) already set an SEP rate effective July 1, 2018, the Company's proposal was effectively an inappropriate request for reconsideration of the Commission's August 24, 2017 Order in Docket No. G002/M-17-174 (17-174 Order) and would violate the 17-174 Order if Implemented.

On May 14, 2018, Xcel Gas filed its reply comments in the instant docket. The Company argued that, because the final decision alternatives the Commission ultimately adopted were raised orally at the hearing using facts from the 2017 SEP filing, the Commission did not decide to permanently change the SEP Rider into a historical recovery mechanism. The Company stated that its newly proposed method, which would still require proration of accumulated deferred income taxes (ADIT), would minimize the negative effects of ADIT proration on Xcel's ratepayers by using a complicated system based on monthly forecasts. Xcel Gas also argued that, compared to allowing Xcel to use a forecasted test period, waiting for the end of the test period to allow Xcel to recover the forecasted costs would postpone the rate implementation and could create large carryover balances to be recovered in future rate proceedings.

In addition, under the assumption that it is appropriate for Xcel Gas to ignore the Commission-authorized rate effective July 1, 2018 as set in the 17-174 Order, the Company also responded to the Department's recommended change to use actual rather than Xcel Gas's proposed forecasted therm sales to calculate the rider rate. Specifically, Xcel Gas stated that "the Company's 2018 forecast is based not only on a review of past actual sales, but detailed analysis of what the Company expects gas sales to be in the future. The goal in setting the rate is to collect as close to the approved revenue requirement as possible without over- or under-collecting significantly." While the Department agrees with the goal, Xcel's forecasts materially under-estimated sales, resulting in rates that were too high. It is also concerning that the Company did not respond to the Department's request that the Company provide actual monthly sales date for 2017 along with sufficient detail to replicate the revenue calculations in Attachments B and C of its initial filing. The Department discusses this issue below.

The Department appreciates that Xcel attempted to minimize the harm to ratepayers due to ADIT proration. However, for the following reasons, the Department maintains its recommendations that the Commission deny Xcel Gas's proposed 2018 SEP rate factor and instead accept the Petition as a compliance filing, updated to reflect lower costs for 2017 based on actual 2016 sales.

First, the Commission's 17-174 Order specifically states that "Xcel Gas shall not prorate its accumulated deferred income taxes in the SEP rider" and thus Xcel's proposal would violate the 17-174 Order. Even if Xcel Gas's proposal would minimize the proration of ADIT, that proration would still exist.

Second, Xcel's proposed monthly method is needlessly complex, difficult to monitor, and would still violate the requirement that "Xcel Gas shall not prorate its accumulated deferred income taxes in the SEP rider." By contrast, as discussed below, the Internal Revenue Service (IRS) has already provided a simple and reasonable means by which the rider can go forward without ADIT proration. Again, while the Department appreciates that Xcel tried to minimize the effects of ADIT proration on ratepayers, the significant and needless degree of complexity in Xcel's new method would require excessive resources to implement and monitor, year after year.

Third, Xcel's statement that "the Company has no particular interest in the provision other than it is required in order to preserve the significant deferred tax benefits for our customers" is not accurate, for two reasons. First, the Company clearly stands to financially benefit from charging higher rates to its ratepayers when ADIT is prorated. Second, the Company is not required to prorate ADIT to preserve tax benefits. Xcel ignores the fact that the IRS, which Xcel Gas appropriately cites as the authority requiring ADIT proration to preserve normalization, has been abundantly and repeatedly clear that "if rates go into effect after the end of the test period, the opportunity to flow through the benefits of future accelerated depreciation to current ratepayers is gone, and so too is the need to apply the proration formula."[1] Thus, Xcel Gas is not required to prorate ADIT when the rider is implemented after the test period.

Fourth, the Company's statement that "without changing the law or regulation, the Company sees no way to avoid this circumstance" is at odds with the fact that, as noted above, the IRS has already provided a means by which Xcel Gas can charge higher rates to its ratepayers through a rider, without violating any IRS requirements. Implementing the rider after the test period allows the Company and its customers to benefit; the Company benefits from the extraordinary ratemaking treatment of a rider rather than a rate case whereas the Company's ratepayers are given the full credit they deserve from the reduction in rate base from ADIT without any of the issues caused by proration.

Fifth, the Company's concern about a one-year delay in implementation of the SEP rider rates ignores important facts. As noted above, Xcel Gas chose not to provide actual sales data for 2017. However, the Company's annual jurisdictional report indicated that Xcel Gas underestimated natural gas sales in 2017 by 6.4 percent.[2] Since weather in January through April, 2017 was generally warmer-than-normal, Xcel Gas's underestimation of sales compared to actual sales in 2017 is particularly concerning. If the lower forecast is used the SEP Rider Factor would be set unreasonably high, and would likely lead the Company to over-charge its ratepayers for costs. Although these values would be trued up later, there are no carrying charges applied to this over-recovery, so the Company would retain any interest earned on these amounts, and thus has an incentive to under forecast its sales. As a result, the Department concludes that Xcel Gas has not demonstrated that its sales forecasts are reasonable to use in setting rates.

Sixth, as also noted above, Xcel Gas's concern about a minor delay in recovery of costs ignores the fact that recovery of costs through riders is extraordinary ratemaking as it would allow recovery of costs that would normally be recovered during a rate case, only after the utility demonstrates that the facilities are used and useful and all costs are prudently incurred. Thus even using historical data would result in recovery earlier than would regularly be expected.

Seventh, Xcel Gas also ignores the small benefit that its ratepayers receive as a result of this minor (one-year or less) delay, compared to the ordinary, reasonable process whereby utilities are responsible for costs until the facilities are in place, used and useful, and shown to be reasonably incurred. As the National Regulatory Research Institute explained in its October 2009 webinar and report, "The Two Sides of Cost Trackers: Why Regulators Must Consider

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[1] The IRS has made this same statement in numerous Private Letter Rulings (PLR), including the ones issued on July 31, 2015, such as PLR No. 140121-14, and the more recent PLR dated January 25, 2018, PLR No. 123443-17.

[2] Xcel Gas's May 1, 2018 jurisdictional report in Docket E,G999/PR-18-4 reported total actual 2017 sales of 958,965,290 therms, which is 6.4 percent higher than the Company's estimate of 901,480,683 therms.

Both" Ken Costello pointed out that riders "weaken the incentive of a utility to control its costs".[3] This report stated the following benefits of the lag:

> Economic theory predicts that the longer the regulatory lag, the more incentive a utility has to control its costs; when a utility incurs costs, the longer it has to wait to recover those costs, the lower its earnings are in the interim. The utility, consequently, would have an incentive to minimize costs.

Given the concerns about Xcel Gas's under-forecasted sales and continued inaccurate insistence that a future period must be used to set rates, the Department continues to conclude that the IRS's solution of waiting until the end of the test period to implement rates is a reasonable, straight-forward and accurate fix for these problems. As such the Department continues to recommend that the Commission deny Xcel Gas's proposed 2018 SEP Rate Factor.

Sincerely,

/s/ MICHAEL N. ZAJICEK
Rates Analyst

MNZ/ja

[3] https://mn.gov/puc/assets/nrri_two_sides_cost_trackers_2007_tcm14-12043.pdf, page 4.

CERTIFICATE OF SERVICE

I, Sharon Ferguson, hereby certify that I have this day, served copies of the following document on the attached list of persons by electronic filing, certified mail, e-mail, or by depositing a true and correct copy thereof properly enveloped with postage paid in the United States Mail at St. Paul, Minnesota.

Minnesota Department of Commerce
Letter

Docket No. G002/M-18-184

Dated this 5th day of July 2018

/s/Sharon Ferguson

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