Minnesota Public Utilities Commission

Staff Briefing Papers

Meeting Date:	**November 5, 2015 .... **Agenda Item #1**	
Company:	Northern States Power Company d/b/a Xcel Energy (Xcel, the Company)	
Docket No.	E,G-002/AI-15-536 In the Matter of the Petition of Northern States Power Company for Approval of its 2016 Annual Cost Allocation Modifications to its Service Agreement with Xcel Energy Services Inc.	
Issue:	Should the Commission approve Xcel's 2016 Annual Cost Allocation Modifications to its Service Agreement with Xcel Energy Services Inc. (XES)?	
Staff:	Jorge Alonso 651-201-2258	

Relevant Documents

Xcel Energy –Service Agreement Modifications Petition... June 1, 2015
Department of Commerce – Comments .... August 7, 2015
Xcel Energy – Reply Comments .... August 17, 2015
Department of Commerce – Response to Reply Comments .... October 16, 2015

The attached materials are workpapers of the Commission Staff. They are intended for use by the Public Utilities Commission and are based upon information already in the record unless otherwise noted.

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October 27, 2015

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Statement of the Issue

Should the Commission approve Xcel's 2016 Annual Cost Allocation Modifications to its Service Agreement with Xcel Energy Services Inc.?

Background

In the Commission's November 20, 2014 Order,[1], Xcel was directed to submit an annual filing for review and approval of any proposed changes to the allocation methodologies in the Company's Service Agreement with Xcel Energy Services Inc. (XES).

The wide array of services XES provides to Xcel's Operating Companies and Affiliates include Executive Management Services, Investor Relations, Internal Audit, Legal, Claims Services, Corporate Communications, Employee Communications, Corporate Strategy & Business Development, Government Affairs, Facilities & Real Estate, Facilities Administrative Services, Supply Chain, Supply Chain Special Programs, Human Resources, Finance & Treasury, Accounting, Financial Reporting & Taxes, Payment & Reporting, Receipts Processing, Payroll, Rates & Regulation, Energy Supply Engineering and Environmental, Energy Supply Business Resources, Energy Markets Regulated Trading & Marketing, Energy Markets - Fuel Procurement, Energy Delivery Marketing, Energy Delivery Construction, Operations & Maintenance, Energy Delivery Engineering/Design, Marketing & Sales, Customer Service, Business Systems, Aviation Services and Fleet.[2]

Identifiable costs are directly assigned to the Operating Companies and other Affiliates and general costs that cannot be directly assigned are charged using one, or the combination of more than one, allocation method.

XES' allocation methods are Revenue Ratio, Revenue Ratio with intercompany dividends assigned to Xcel Energy Inc., Employee Ratio, Employee Ratio with number of common officers assigned to Xcel Energy Inc., Total Assets Ratio, Square Footage Ratio, Invoice Transaction Ratio, Customer Bills Ratio, MWh Generation Ratio, Total MWh Sales Ratio, Customers Ratio, Labor Dollars Ratio and Delivery Services Gross Plant Ratio.[3]

For 2014, Xcel budgeted over $104 million in charges from XES[4]. Since a large percentage of those charges ultimately would have been allocated to the Minnesota jurisdiction and, presumably, 2014 will be Xcel's base year in the upcoming rate case, it is incumbent upon the Commission to determine that the Company is using the most appropriate cost allocators.

This is Xcel's first annual filing and the Company stated that in future years it intends to file its compliance report on or around June 1.

[1] In the Matter of the Request by Northern States Power Company for Approval of a Second Amendment to the Service Agreement Between the Company and Xcel Energy Services Inc., Docket No. E,G-002/AI-14-234.
[2] Xcel's Initial Filing, Attachment C, pages 1-9.
[3] Ibid, pages 10-21.
[4] Department of Commerce, Comments, page 6.

The Department is disputing Xcel's proposed change to the cost allocation method for the rates and regulation department. Xcel is proposing to use a revenue ratio allocation method that would replace the labor dollars allocation method. The Department believes Xcel should continue to use labor dollars to allocate costs for the rates and regulation department.

Party Positions

Xcel

In its filing, Xcel stated that it expects that any changes presented in annual filings will be the result of its ongoing review of current Allocation Methods employed by XES and changes that result from organizational changes. The Company added that, although the annual filings' intent is to propose allocation changes for the upcoming budgeting cycle, it may implement changes for operational purposes prior to receiving Commission approval. In doing so, Xcel would be relying on the Commission's Order interpreting Minn. Stat. § 216B.48 to mean that an affiliated interest contract may go into effect for operational purposes prior to Commission approval, but is not effective for "regulatory purposes" until it is approved by the Commission.[5] The Company did acknowledge it bears the risk with respect to recovery of the dollars associated with changes implemented prior to receiving Commission approval.

This filing includes two proposed changes which have already been implemented. The first is the proposed change to the customer contact ratios used to account for how Xcel records the time spent by members of Xcel's Personal Account Representative (PAR) team. The second is the proposal to stop using "labor dollar ratios" for allocating time spent by certain labor intensive but non-revenue generating service departments.

Department of Commerce

The Department (DOC) stated that, in evaluating this filing, it considered whether:

- the agreement would affect operating costs and rate levels;
- the proposed price or cost is reasonable;
- the agreement would affect the competitive situation; and,
- the agreement would impair effective regulation.

The Department noted that the proposed changes would increase Minnesota ratepayers' 2015 costs by $98,380, or 0.094% of Xcel's 2014 budgeted XES costs.

After two rounds of comments, the Department concluded that Xcel's proposed changes would be reasonable except for the proposed changes to the allocation method for Xcel Energy Service's rates and regulation department.

[5] See September 14, 1998 Order in Docket No. E,G-999/CI-98-651

Customer Contact Ratios – Allocation of Time Spent by Xcel's Personal Account Representative (PAR) Team

Xcel - Petition

Xcel explained that the PAR team has primarily supported customers that receive low income assistance, and their costs have been allocated using the Customers ratio, which correlated to the number of low income assistance customers. However, as part Xcel's Allocation Methods' review, the Company identified two shifts in the PAR's workflow: (1) the Team is spending more time, proportionally, supporting customers who have certified medical conditions; and (2) there has been a noticeably higher volume of work associated with interacting with various agencies and entities that provide financial assistance to special needs customers.

Based on these workflow changes, Xcel conducted an analysis to determine whether costs were being allocated most cost-causatively and considered using the following individual ratios to allocate the team's costs:

1. **Low Income Customer Ratio (subset of Customers Ratio).** This ratio is a count of customers receiving low income energy assistance. Xcel determined that use of this ratio would not reflect the team's work to provide support to certified medical customers – or their work with state, federal and other agencies/entities.

2. **Special Needs Customer Department Contacts Ratio (subset of Customer Contacts Ratio).** This ratio is a count of customer phone calls handled by the PAR team, which, Xcel determined, has a direct correlation to the team's workflow, as it is the main indicator of where they spend their time. However, using the phone calls ratio alone does not consider the complexity of special needs customers' care issues.

3. **Customers Ratio.** This ratio is a total count of Company customers, and as noted above, is the current Allocation Method specified in the agreement for the Customer Service Function, which encompasses this team. While this ratio is representative of the work associated with the certified medical customers, it no longer reliably approximates the numbers of customers receiving low income assistance. Therefore, use of this ratio alone would not reflect the breadth of the team's work to aid special needs customers.

In the end, Xcel determined that use of any single allocation method would not sufficiently reflect the team's workflow; therefore, the Company determined the most cost-causative method would be a combination of the average of a Special Needs Customer Department Contacts Ratio and a Customers Ratio. The direct department calls component serves as the primary indicator of the team's work, but which is tempered and balanced by the Customers component. Xcel believes that use of the Customers ratio in the calculation serves to reasonably approximate the frequency with which the PAR team deals with the more complicated support that some special needs customer issues require.

Because it results from Xcel's normal course of business and does not result in a large or material change, the Company concluded that this allocation change fits with the intent of the annual filing. Xcel calculated the 2014 and 2015 impact to NSPM customers to be $32,637 ($28,601 for MN) and $55,066 ($48,225 for MN), respectively.

Department - Comments

The Department highlighted the proposed language addition to Xcel's Customer Contacts Ratio:

> "If the costs being allocated are directly related only to the support of special needs customers, such as those receiving low income energy assistance and those having certified medical conditions, the ratio shall be based on the number of contacts received by the special needs customer department at the end of the prior year ending December 31 (Special Needs Customer Department Ratio). The numerator of which is for an applicable Operating Company or affiliate company and the denominator of which is for all applicable Operating Companies and affiliate companies. This ratio will be determined annually, or at such a time as may be required due to significant changes."[6]

The Department asked several information requests in order to determine the level of supporting documentation for these proposed changes and by extension, their reasonableness. After review, the DOC agrees that the development of this new allocation factor is reasonable and commented that it generally supports the use of broader allocation methods "subsets" to the extent that refinements enable better accuracy.

Removal of the Labor Dollars Ratio – Reasonableness of Proposed Cost Increase

Xcel pointed out that, in its most recent Service Agreement proceeding, in Docket 14-234, it proposed, and the Commission approved, replacing the Labor Dollars Ratio with a more cost-causative ratio for the Energy Supply Engineering & Environmental and Energy Delivery Engineering & Design Service Functions. In its Reply Comments in that proceeding, Xcel explained that it had discontinued use of the Labor Dollars Ratio and replaced it with more cost-causative methods; however, it did not identify all the Service Functions that specify use of the Labor Dollars Ratio in the Service Agreement. Therefore, with this filing, Xcel has eliminated the Labor Dollars Ratio for the Claims Services, Supply Chain, and Rates & Regulation Service Functions.

Claims Services Department

Xcel – Petition

Claims Services provides services related to casualty, public and Company damage claims. Since Claims Services' workflow is structured around individual claims that are Operating Company-

[6] Xcel's Initial Filing, Attachment C, page 13

specific, all Claims Services costs are directly charged to the Operating Companies; therefore, there is no financial impact of eliminating the Labor Dollars Allocation Method for this Function.

Department – Comments

The Department agreed that Xcel's proposal for allocating the costs of the Claims Services department is reasonable.

Supply Chain Department

Xcel - Petition

Supply Chain Service Function is responsible for purchasing and warehousing services. The only costs being allocated are for management and oversight of the payment and reporting services that include processing payments to vendors, providing audit research and reconciliation support for Accounts Payable transactions, preparing statistical and 1099 reporting, and administering the purchase card programs. These activities and their oversight are driven by the total number of invoices processed for each individual Operating Company; therefore, Labor Dollars Ratio has been replaced by the Invoice Transaction Ratio in the Service Agreement.

As the Company explained in the 14-234 Docket, because the use of the Labor Dollars ratio was discontinued, Xcel does not have the records or the process to *exactly* quantify the cost estimate impact of switching to the Invoice Transaction Ratio. Using the last few months of Labor Dollars ratio as a proxy, Xcel estimated the 2014 and 2015 impact to NSPM customers to be $50,549 ($44,320 MN) and $57,274 ($50,155 MN), respectively.

Department - Comments

The Department pointed out that, given that the 2014 and 2015 amounts allocated to Xcel under the current allocator are $67,384 and $76,374, respectively, Xcel's proposal would increase the amount allocated to NSPM by 75% in each of these years.

The Department added that, in response to its Information Request 13, Xcel justified usage of the proposed allocator by explaining that "the main activity of the personnel is processing invoices, this allocation method was selected as the most cost-causative method out of the all existing approved methods."[7] The DOC then pointed out that, it its initial filing, Xcel's description of this department's functions indicates labor-intensiveness. For example, "negotiating complex procurement agreements/contracts" can be labor-intensive and it is likely that some contracts require more work than others. As a result, it is not reasonable to assume that all transactions are the same, as under Xcel's proposal.

[7] DOC Reply Comments, Attachment 3

The Department concluded that Xcel did not meet its burden of proof to show that this proposed change is reasonable; therefore, the DOC recommended that the Commission require Xcel to use the Labor Dollars Ratio to allocate the costs of the Supply Chain Department.

Xcel – Reply Comments

While agreeing with the Department's comments that some of Supply Chain Service Function's work is labor intensive, Xcel explained that this Function largely direct-charges their costs. The proposal to use the Invoice Transaction Ratio is to allocate only one specific activity of this Department's work – management and oversight of the payment and reporting services. To reflect this clarification, Xcel proposed some changes in the language used to describe the allocation method.

Department – Response to Reply Comments

After Xcel's clarification in reply comments, the Department recommended approval of Xcel's proposed changes to its Supply Chain allocation factor.

Rates and Regulation Department

Xcel – Petition

Rates and Regulation services are driven by and directly-charged to Operating Companies and remaining costs are allocated using the Revenue Ratio; therefore, eliminating the Labor Dollars Ratio for this Service Function has no financial impact to the Company or its customers.

Department - Comments

The Department pointed out that the Company has been using the Revenue Ratio to allocate costs of this department, and thus proposes to eliminate the option of using the Labor Dollars ratio. In the 14-234 Docket, the Department did not support giving XES or Xcel optionality for choosing allocation factors. Thus, the issue for the Commission in this proceeding is which allocation factor to use: Labor Dollars Ratio or Revenue Ratio.

The Department surmised that Xcel's description of the Rate and Regulation department indicates significant labor-intensiveness of the work and that this department's costs are largely labor. The DOC added that, since the Rates and Regulation department must spend time establishing new affiliates that may not have any revenue, such as the recent affiliated transmission companies,[8] it would be unfair for regulated operations to pay for costs related to establishing a new affiliate. Consequently, it appears that the appropriate allocator for the Rates and Regulation department is the Labor Dollars Ratio.

[8] See Docket #14-759

For comparison, the Department requested that Xcel, in reply comments, provide the estimated allocation of Rates and Regulation costs to the Minnesota jurisdiction for 2014 and 2015 under the Labor Dollar Ratio and Revenue Ratio.

Xcel - Reply Comments

As it did with Supply Chain, Xcel stated that, by and large, Rates and Regulation also direct-charges for services provided. Xcel also elaborated on the development of the Labor Dollars Ratio and explained that using this ratio to allocate labor costs would be circular and would lack cost causality.

Xcel said that, since its calculation facilitates the allocation of non-direct-charged costs benefiting all operating and affiliate entities based on their percentage of overall revenue, the Revenue Ratio has historically been used to allocate general labor costs.

Regarding the Department's request, under the Labor Dollar and Revenue Ratios, for estimated 2014 and 2015 Minnesota jurisdiction allocation of Rates and Regulation, Xcel explained that the Labor Dollars Ratio is no longer in use – so any estimate would be an approximation using 2009 statistics.

While Xcel affirmed its belief that using the Revenue Ratio is appropriate, the Company offered to conduct an analysis comparing a labor-based allocation method to the Revenue Ratio method and to present its findings in its next annual filing.

Department - Response to Reply Comments

The Department stated that Xcel's clarification, while informative, did not explain why revenues would be an appropriate basis to allocate the costs of the Rates and Regulation group.

The Department pointed out that the Company did not address the Department's concerns[9] regarding the Rate and Regulation Department's labor intensiveness or the Department's concerns regarding the appropriateness of using the Revenue Ratio when a new affiliate does not have any revenues. The DOC explained that, while it appreciates the Company's discussion of its efforts to properly assign costs to its affiliates, the Department believes that there is an incentive for managers or employees who work for affiliates to minimize the costs assigned or allocated to those affiliates. The Department added that it believes that this incentive is particularly strong for affiliates that are not currently generating revenue (or profit).

The Department expressed disappointment that Xcel refused to provide the comparison the Department requested in Reply Comments. The DOC thought that such a comparison would be useful in evaluating the proposed change and in ensuring that rates are reasonable. Consequently, the Department maintained its earlier position that Xcel has not met its burden of proof in regards to the reasonableness of allocating the Rates and Regulation department's costs using the Revenue Ratio.

[9] Department of Commerce, August 7, 2015 Comments, page 10

Staff Comments

The aggregate financial impact (to Minnesota ratepayers) of Xcel's proposed changes is slightly under $100,000. Since the Company has over one million customers, the average annual impact per customer is less than $0.10; therefore, identifying the "right" allocator to use is the primary issue.

Staff agrees with the Company and the Department's recommendations to change the allocation methods used for both the Claims Services and the Supply Chain Departments.

Staff also agrees with the Department's recommendation to reject the proposed change of the Rates and Regulation Department's allocation to the Revenue Ratio Method.

Since all of XES' units are available to serve all Xcel's affiliates, staff believes all affiliates should, to some extent, participate in sharing the units' "general", i.e. unallocated, costs. To deviate from this principle would result in cross-affiliate subsidies; therefore, Staff considers it inappropriate to use *any* method that results in a zero-dollar allocation of these general costs to *any* affiliate. Using the Revenue Ratio Method for the Rates and Regulation Department's allocation would result in a zero-dollar allocation to the newly formed Transcos that currently have no revenue. However, since Xcel believes that Xcel's reasoning for not using the Labor Dollars Method has some limited merit, Staff reviewed all other allocation methods[10] for a possible alternative. In Staff's opinion, all of the allocation methods listed seem to either have no applicable cost-causation basis or would have resulted in a zero-dollar cost allocation. In the absence of a more suitable alternative, Staff supports the Department's recommendation to continue using the Labor Dollars Method to allocate the Rates and Regulation Department's expenses.

Finally, in the event the Commission denies Xcel permission to use any of the newly implemented allocators, the Commission may want to instruct Xcel to make a compliance filing that reconciles the revenue differences between the "old" and "new" method and to submit a refund proposal for any revenues the Company may have over-collected from Minnesota jurisdictional customers.

[10] Xcel's Initial Filing, Attachment C, pages 10-21

Decision Alternatives

A. Customer Contacts Ratio

1. Approve Xcel Energy's proposed changes to the Customer Contacts Ratio' language Rates and Regulation Department's cost allocator to the Revenue ratio. (Xcel, DOC)

2. Deny Xcel Energy's proposed changes to the Customer Contacts Ratio' language and require the Company to continue using its current language.

B. Changes to the Claims Services Department

1. Approve Xcel Energy's request to change the Claims Services Department cost allocator to the Direct-Assigned Allocation Method. (Xcel, DOC)

2. Deny Xcel Energy's request to change the Claims Services Department cost allocator to the Direct-Assigned Allocation Method and require the Company to continue using the Labor Dollars Allocation Method.

C. Changes to the Supply Chain Department

1. Approve Xcel Energy's request to change the Supply Chain Department's cost allocator to the Invoice Transaction Allocation Method. (Xcel, DOC)

2. Deny Xcel Energy's request to change the Supply Chain Department's cost allocator to the Invoice Transaction Allocation Method and require the Company to continue using the Labor Dollars Allocation Method.

D. Changes to the Rates and Regulation Department

1. Approve Xcel Energy's request to change the Rates and Regulation Department's cost allocator to the Revenue Ratio Allocation Method. (Xcel)

2. Deny Xcel Energy's request to change the Rates and Regulation Department's cost allocator to the Revenue Ratio Allocation Method and require the Company to continue using the Labor Dollars Allocation Method. (DOC)

E. Miscellaneous

1. Require Xcel Energy to provide the estimated allocation of Rates and Regulation costs to the Minnesota jurisdiction for 2014 and 2015 under the Labor Dollar Ratio and Revenue Ratio. (DOC)

2. If the Commission denies Xcel permission to use any of the newly implemented allocators, instruct Xcel to make a compliance filing, within 60 days, that reconciles the revenue differences between the "old" and "new" method and to submit a refund proposal for any revenues the Company may have over-collected. (Staff)

3. Take no action.