

April 8, 2015

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

RE: **Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. G002/M-15-149

Dear Mr. Wolf:

Attached are the comments of the Minnesota Department of Commerce, Division of Energy Resources (Department) in the following matter:

Northern States Power Company, doing business as Xcel Energy's Petition for Approval of a Variance to the Purchased Gas Adjustment (PGA) Rules to Allow Recovery of Storage-Related Ad Valorem Taxes through the PGA.

The petition was filed on February 6, 2015 by:

Paul J Lehman
Manager, Regulatory
Compliance and Filings
Xcel Energy
414 Nicollet Mall, 7th Floor
Minneapolis, MN 55401

The Department expects to recommend **approval, with modifications, but first requests that Xcel Energy (Xcel or the Company) provide additional information in reply comments.** The Department will offer additional comments and recommendations in subsequent response comments after it has reviewed the additional information.

Sincerely,

/s/ SACHIN SHAH
Rates Analyst

SS/lt
Attachment

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

COMMENTS OF THE
MINNESOTA DEPARTMENT OF COMMERCE
DIVISION OF ENERGY RESOURCES

DOCKET No. G002/M-15-149

I. SUMMARY OF THE UTILITY'S PROPOSAL

A. OVERALL PROPOSAL

Pursuant to Minn. Stat. §216B.16, Subd. 7, and related Minn. Rule Part 7825.2400, (Purchased Gas Adjustment "PGA" rule), Northern States Power Company doing business as (d/b/a) Xcel Energy, (Xcel or the Company), filed a variance *Petition* (Petition) on February 6, 2015. The Company requests the Minnesota Public Utilities Commission's (Commission) approval to include recovery of ad valorem taxes related to natural gas storage in the current cost of natural gas supply.¹ As a general matter, ad valorem taxes are state taxes based on the value of property located in that state. Xcel stores natural gas on the Northern Natural Gas Pipeline system (Northern or NNG) in Kansas.² NNG's storage fields include facilities in Kansas, which imposes ad valorem taxes on gas held in fields in its state.³ The validity of Kansas ad valorem taxes on natural gas in storage has been the subject of litigation.⁴

B. PROPOSED LENGTH OF VARIANCE

Regarding the length of variance, the Company states the following in its Petition on page 3:

In this Petition, we seek a variance to the Commission's PGA rules to allow the Company to collect this storage cost from Minnesota customers. Specifically, we respectfully request that the Commission:

- Grant a four-year variance to Minn. R. 7825.2400, subp. 12 to allow inclusion of the Kansas property

¹ Petition, pages 1-2.

² *Id.*

³ Petition, pages 5-7

⁴ *Id.*

tax expense as a component of the cost of gas supply on an ongoing basis (this will collect about \$200,000 of amounts incurred through 2014), and

- Allow the Company to collect approximately \$5.3 million of amounts it has incurred on behalf of Minnesota customers for natural gas storage for the 2009 through October 2014 period as a lump sum over a 12-month timeframe through the PGA.

... Although we do not anticipate that this tax will go away, we request a time-limited variance. A four-year variance period is consistent with the variance period the Commission has established with another natural gas variance request (for hedging) and will afford the Commission and stakeholders increased transparency into the inclusion of this tax in the PGA.

C. *PROPOSED ANNUAL REPORT*

The Company proposes to “reflect the tax costs as a separate line item in our monthly PGA, Annual Automatic Adjustment of charges (AAA), and annual PGA True-up filings.”⁵ These reports are typically filed in September each year.

D. *PROPOSED PGA RECOVERY*

Xcel proposes PGA recovery from ratepayers of ongoing tax obligations as well as recovery of the actual taxes incurred for the period July 2009 through October 2014. For ongoing tax obligations, Xcel proposes “to commoditize the costs over the forecasted volumetric sales to retail customers.”⁶ The Company states that “any over- or under-recovery of the tax obligations will be captured through the annual PGA True-up factors.”⁷ The Company’s proposal to recover the lump sum of actual taxes incurred for the period July 2009 through October 2014 is to use “a separate line item in Schedule A of the monthly PGA.”⁸ The Company also states that “any over- or under-recovery of the lump sum tax obligation will be captured through the annual PGA True-up factors.”⁹

E. *COURT DECISIONS ON AD VALOREM PROPERTY TAX*

Xcel explains that “due to legislative changes and unforeseen judicial outcomes, we are again incurring property taxes for storage of natural gas on the Northern System in the State of Kansas.”¹⁰ The Company further states as follows:

⁵ Petition, page 12.

⁶ Petition Page 12-13.

⁷ *Id.*

⁸ *Id.* Also See Petition Attachments A through C.

⁹ *Id.*

¹⁰ Petition pages 2-3.

... Similar to the mid-2000's, we and others vigorously challenged the tax's renewed application to out-of-state utilities. Unfortunately, our available legal challenges were exhausted in October 2014 when the United States Supreme Court denied certiorari, resulting in the tax being upheld.³

³ *Missouri Gas Energy v. State of Kansas, Div. of Property Valuation*, 135 S.Ct. 151 (2014).

The taxes applicable during the period of appeals were legally deferred until all legal avenues were exhausted, so we did not seek recovery until we were certain the Company and its customers would incur the tax, which has now occurred. In late 2014, the Kansas counties in which we maintain stored natural gas on the Northern system issued invoices to the Company for the 2009-2014 period. As of the end of 2014, we have incurred approximately \$5.5 million of property tax expense for natural gas storage for our Minnesota customers.¹¹

F. IMPACT ON RATES

The Company states the following on page 3:

Specifically, we respectfully request that the Commission:

- Grant a four-year variance to Minn. R. 7825.2400, subp. 12 to allow inclusion of the Kansas property tax expense as a component of the cost of gas supply on an ongoing basis (this will collect about \$200,000 of amounts incurred through 2014), and
- Allow the Company to collect approximately \$5.3 million of amounts it has incurred on behalf of Minnesota customers for natural gas storage for the 2009 through October 2014 period as a lump sum over a 12-month timeframe through the PGA.

We estimate that the cost to customers of our proposal is a one-time annual cost of approximately \$6.40, and an ongoing cost of approximately \$1.00 per year. Although we do not anticipate that this tax will go away, we request a time-limited variance. ...

According to Xcel, "The Kansas tax is based on the volume and prevailing market price of the natural gas we have held in storage for our customers. It is a direct cost of natural gas

¹¹ *Id.*

delivered, and is one component of the costs of purchased gas that we incur on behalf of our customers.”¹²

Further, under Xcel’s proposal, the changes would only affect PGA charges rather than non-gas revenues.¹³

G. VARIANCE REQUEST

On page 8 of its Petition, Xcel states:

Traditionally, property taxes are recovered in base rates, and gas costs, which are volume- and price-based are recovered through the PGA. As noted above, Minn. R. 7825.2400, subd. 12 specifies the FERC accounts that are designated for recovery through the PGA. According to FERC’s Uniform System of Accounts, property taxes are recorded in Account 408.1, which is not among those specified.⁶

⁶ Minn. R. 7825.2400, subp. 12 specifies allowable PGA expenses as those recorded in the following FERC accounts: 800, 801, 802, 803, 804, 804.1, 805, 808.1, 810, 854, and 858.

Further, Xcel argues that the Commission should grant variances to Minn. Rule 7825.2400, subp. 12, because the three standards for granting a variance under Minn. Rule 7825.3200 are met as summarized below:

- Xcel claims that enforcement of the rule would prevent the Company from timely recovery of prudently incurred costs of providing natural gas service since the tax is a prudently incurred cost that is directly related to securing a prudent natural gas supply portfolio, which is necessary to provide reliable and cost-effective natural gas service to its customers;
- Xcel claims that granting the variance would not adversely affect the public interest since “the tax is a direct cost for natural gas delivered; it is in the public interest for customers to pay the actual costs associated with purchased gas, as such prices promote efficient use of natural gas;” and
- Xcel claims that granting the variance would not conflict with standards imposed by law. Further, Xcel states that Minn. Stat. §216B.16, Subd. 7 allows for recovery of “the direct cost of natural gas delivered.”¹⁴

¹² Petition Page 7.

¹³ Petition Page 13.

¹⁴ Petition, page 11.

II. ANALYSIS OF XCEL'S PROPOSAL

The Minnesota Department of Commerce, Division of Energy Resources' (Department or DOC) analysis of the Company's variance request includes the following parts:

- prior variances granted by the Commission;
- the legal standard;
- Xcel's variance request; and
- PGA classification of costs and issues needing clarification

As discussed below, the DOC preliminarily recommends that the Commission approve a variance to include recovery in the PGA of *ad valorem* taxes related to natural gas storage, with specific conditions and reporting requirements. The Commission approved similar variances for Northern States Power Company d/b/a Xcel Energy (Xcel) and Interstate Power and Light (Interstate) in 2005.

A. PRIOR VARIANCES GRANTED

In its *Petition*, Xcel states the following:

This is only an issue because the Kansas storage charges are not part of a bundled service from our natural gas supplier. Specifically, Minn. R. 7825.2400, subd. 12 identifies several FERC accounts that are automatically incorporated by reference into the cost of purchased gas. Although the Commission's rules contemplate PGA recovery of costs associated with natural gas service and storage, an accounting technicality requires the Kansas charges to be classified as a property tax, which is not one of the FERC accounts identified in the Rule.

We have previously sought and been granted variances from the Commission for collection of this direct cost of natural gas delivered. Specifically, in 2005 and 2006, the Commission found that strict enforcement of the definition of the "cost of gas" in Minn. R. 7825.2400, subd. 12 would prevent the Company from recovering tax payments to the State of Kansas on natural gas it held in storage in Kansas. At that time, we were appealing the application of the tax to the Company, so the Commission granted consecutive one-year variances from its Rules. Our appeal of the tax on the Company ultimately prevailed in a 2007 Kansas Supreme Court decision, and we refunded all amounts we had collected from our customers for the overturned tax on storage volumes.¹⁵

¹⁵ Petition at page 2.

The Commission granted one-year variances to Minn. Rule 7825.2400, subd. 12 to Xcel¹⁶ and Interstate¹⁷ for property tax incurred on stored natural gas. Specifically, the ordering paragraphs of the Commission's November 4, 2005 Order Granting Variance and Imposing Requirements in Docket No. G002/M-05-534 stated:

1. The Commission hereby grants Xcel a one year variance to Minn. Rule 7825.2400, subp. 12 to allow the recovery of the January 1, 2004, 2005, and 2006 assessed tax in the PGA.
2. Xcel shall include the Kansas property tax as a separate line item in its monthly PGA.
3. Xcel shall submit a report with its Annual Automatic Adjustment report detailing the total amount collected from ratepayers during the gas year
4. Xcel shall file a quarterly report on the status of all administrative and legal activities regarding the Kansas property tax until such time as all administrative and legal avenues are exhausted.
5. If the Kansas property tax is overturned, Xcel shall refund immediately all charges collected through the PGA pursuant to Minnesota Rule 7825.2700, subp. 8.

Thus, Xcel was required to refund all charges collected through the PGA if the court overturned the Kansas property tax.¹⁸ On August 22, 2008, the Commission issued orders in this docket and the subsequent G002/M-06-905 that terminated the quarterly reporting requirement and closed the dockets.

The Commission's reasons for granting the variances in its November 4, 2005 *Orders* for Xcel and Interstate are virtually identical except for the company names. The Commission's reasons for granting Xcel's variance were as follows:

First, enforcing the rule as written would impose an excessive burden on Xcel's ratepayers. Given current natural gas market conditions, the Department has advised the Commission that the Company's ratepayers will benefit from the Company maintaining adequate gas reserves in storage as a hedge against price volatility for the current heating season. Strict enforcement of the definition of "cost of gas" in Minn. Rules, Part 7825.2400, subd. 12 would prevent the Company from recovering Kansas tax payments on natural gas it holds in storage in Kansas. The Department advised that if the Company

¹⁶ The Commission granted Xcel a one-year variance in Docket No. G002/M-05-534 (05-534). A one-year extension was granted in Docket No. G002/M-06-905 (06-905).

¹⁷ The Commission granted Interstate a one-year variance in Docket No. G001/M-05-266. A one-year extension was granted in Docket No. G001/M-06-1226.

¹⁸ In Xcel's quarterly compliance report filed September 26, 2007 in Docket Nos. 05-534 and 06-905, the Company stated that the Kansas Supreme Court had affirmed the exemption of underground stored natural gas inventories from property taxation in Kansas and Xcel subsequently refunded approximately \$4,207,307 to ratepayers. Interstate received an exemption and did not pay the tax. Thus, Interstate's customers were not charged for this tax.

is not allowed to recover these tax costs through the PGA it would not maintain an optimum level of natural gas reserves in storage as a hedge against price volatility.

The Commission finds that absent adequate gas storage, Xcel's ratepayers could experience severely burdensome price fluctuations during the current heating season. The Commission therefore finds that in the unique circumstances of this docket, strict enforcement of the definition of "cost of gas" in Minn. Rules, Part 7825.2400, subd. 12 would impose an excessive burden on the Company's ratepayers. Also, in the event that a challenge to the new property tax is successful, the PGA will allow the immediate discontinuance of collecting that tax and provide an efficient mechanism to track and return tax amounts that have been collected from customers. Absent PGA recovery, return of the amounts collected from ratepayers would be much more cumbersome, delayed, and potentially mismatched.

Second, granting the variance will not adversely affect the public interest. Given the current market volatility, encouraging establishment of reserves via such storage is clearly in the public interest.

Third and finally, granting the variance does not conflict with standards imposed by law. The definition of "cost of gas" is defined solely in a Commission rule (Minn. Rules, Part 7829.2400, subd. 12) and hence is subject to expansion via variance pursuant to Minn. Rules, Part 7825.3200.¹⁹

The DOC agrees with Xcel that the Company's current request is similar to Xcel's previous requests to recover property taxes in the PGA. However, there is a slight difference in the previous Xcel proposals compared to the current proposal.

Xcel states the following²⁰ in its current petition:

Then in May 2004, the State of Kansas enacted legislation that taxed owners of natural gas commodities stored in Kansas for resale in other states, effectively removing the exemption that had historically applied to the Company and other out-of-state LDCs. We, along with a large group of other utilities, challenged the tax and eventually the issue was resolved in our favor by the Kansas Supreme Court on July 13, 2007. During the time that Kansas was assessing the tax, we petitioned for and received variances from the Commission's Rules and collected for the

¹⁹ November 4, 2005 *Order Granting Variance and Imposing Requirements*, pages 2 and 3.

²⁰ Petition pages 6-7.

tax through the PGA.⁴ After the tax was overturned, we refunded all of the money collected for the tax to our customers in the fall of 2007.

In 2009, the Kansas legislature modified the enabling statute, noting it was carrying out what the 2004 legislature intended, to allow collection of this inventory tax from public utilities based outside of Kansas effective July 1, 2009.⁵ Similar to 2004, we and six other utilities storing gas in a Northern underground storage facility challenged the application of the tax to out-of-state public utilities. We appealed first to the Court of Tax Appeals, then to the Kansas Supreme Court, and finally to the Supreme Court of the United States of America (SCOTUS). However, on October 6, 2014, SCOTUS denied certiorari, resulting in the tax being upheld – and marking the end of our available legal avenues to challenge the tax’s applicability to the Company.

With our legal avenues fully exhausted, all tax amounts from the point of the 2009 statutory change to the present became due. Starting in late October 2014, we began receiving invoices from Kansas counties for the 2009-2014 timeframe; to date, we have incurred storage expenses of approximately \$6.2 million on an NSPM operating company basis.

⁴ Docket Nos. G002/M-05-534, G002/M-06-905, and G002/M-07-621.

⁵ K.S.A § 79-5a01.

The prior Kansas ad valorem tax situation for Xcel was different than in this case because, previously, the Supreme Court of Kansas’ finding was based on a property tax exemption for inventory and the Company and other litigants prevailed. In this case, litigation went further with appeals filed by the Company and others with the Supreme Court of the United States of America (SCOTUS). Additionally, according to Xcel, on October 6, 2014, SCOTUS “denied certiorari” resulting in the tax being upheld. In other words, the difference in circumstances between the instant Petition and past related dockets is that there is no longer uncertainty regarding whether Xcel is subject to the Kansas ad valorem tax. Further, in this case Xcel recently received a tax bill dating back to 2009, thus raising questions about retroactive ratemaking.

B. LEGAL STANDARD

The PGA is governed by Minn. Stat. §216B.16, subd. 7, which allows certain specific costs to be included in rates between general rate cases and is an exception to the ban on rate changes outside of a general rate case. Minnesota Statute §216B.16, subd. 7 states:

Energy and emission control products cost adjustment.
Notwithstanding any other provision of this chapter, the

commission may permit a public utility to file rate schedules containing provisions for the automatic adjustment of charges for public utility service in direct relation to changes in:

1. federally regulated wholesale rates for energy delivered through interstate facilities;
2. direct costs for natural gas delivered;
3. costs for fuel used in generation of electricity or the manufacture of gas; or
4. prudent costs incurred by a public utility for sorbents, reagents, or chemicals used to control emissions from an electric generation facility, provided that these costs are not recovered elsewhere in rates. The utility must track and report annually the volumes and costs of sorbents, reagents, or chemicals using separate accounts by generating plant. (Emphasis added.)

Based on the statute, only direct costs for natural gas delivered are allowed to be included in the PGA. Because the PGA is an exception to normal ratemaking, the costs that are allowed to be recovered through the PGA are intended to be limited. The PGA was not intended to substitute for a rate case where all the costs and revenues can be examined as a whole. The following rule specifies what costs constitute the direct costs of gas. This rule does not allow inclusion in PGA recovery of costs that are merely related to or associated with the cost of gas. The cost of gas is defined in Minn. R. 7825.2400, subp. 12 which states:

Cost of purchased gas; incorporation by reference. "Cost of purchased gas" is the cost of gas as defined by the Minnesota uniform system of accounts, class A and B gas utilities, including accounts 800, 801, 802, 803, 804, 804.1, 805, 805.1, 808.1, 809.1, 810, 854, and 858 for energy purchased, as provided by Code of Federal Regulations, title 18, part 201, as amended through April 1, 1988. These accounts are incorporated by reference. The cost of purchased gas also includes the normal and ordinary cost of injection and withdrawal of gas from storage at the time of withdrawal. All gas public utilities shall use this definition regardless of class.

The uniform system of accounts provides specific guidance as to what costs are recorded in the accounts listed in the rule. The Company correctly noted that (1) property taxes are not included in the identified accounts specified above that are eligible for automatic recovery through the PGA; and (2) property taxes are recorded in Account 408.1.²¹ Clearly, the

²¹ Petition at pages 7-8.

property tax is not defined by the rules to be a direct cost of gas as claimed by Xcel when it argues that:²²

. . . Kansas determines the amounts due by calculating 33 percent of the inventory's fair market value as of January 1 of each year. The tax, therefore, is based on the volume of gas held in storage and the prevailing market price of that gas at a point in time. ...

. . . The volumetric and market price basis of the Kansas tax directly impacts the total "direct cost of natural gas delivered" of the gas we hold in underground storage on the Northern system, which is the standard for automatic recovery in Minn. Stat. §216B.16, subd. 7.

Thus, Xcel cannot flow the costs of the property taxes related to storage in the PGA unless the Commission grants a variance to the rule.

Xcel mentions in its *Petition* that the Commission previously approved variances to the PGA Rules for recovery of storage costs. Xcel states the following:²³

The Commission has also previously considered and granted PGA variances to recover other costs associated with Storage that were not accounted for in gas specific FERC Accounts. Specifically, in Docket No. G002/M-90-630, the Commission granted the Company a variance to include carrying charges on gas storage inventory volumes as a cost in its PGA. In that case, the Commission acknowledged its prior exploration and finding that storage service is of benefit to Minnesota consumers by lowering costs and providing greater reliability and flexibility of gas supply – noting that it would as a matter of policy encourage well-designed programs that provide incentives for use of storage.⁷

In its Order, the Commission found that carrying costs associated with gas storage inventories are a direct cost of providing natural gas, which it then had discretion to allow recovery either through rates or the PGA. It concluded that allowing recovery through the PGA was within the statutory intent of the PGA – and determined that timely recovery through the PGA rather than base rates would incent the Company to maintain an appropriate reliance on storage services on behalf of its customers.

²² *Id.*

²³ *Petition* at page 9.

... The Kansas tax on gas inventory volumes is a direct cost of gas, and would be “automatically” included in PGA recovery if natural gas sales and storage were a bundled service from a gas supplier. Finally, timely recovery of prudently-incurred direct costs of gas sends appropriate price signals to customers, affords the Company an appropriate incentive to continue to utilize storage as part of its natural gas resource acquisition strategy, and provides the Company with timely recovery of prudently-incurred direct costs of gas delivered as contemplated in statute.

⁷ Order at 4 (April 4, 1991).

Xcel argues that including the tax with other direct costs of gas is appropriate. However, simply because the tax is associated with or related to storage does not justify allowing the same method of recovery for property taxes and natural gas costs. Still, as noted in previous, similar requests for variances, discussed above, the Commission may grant a variance to these rules to allow PGA recovery of ad valorem taxes, if warranted. As such, the DOC agrees with Xcel that the Company may pass these costs through its PGA only if the Commission grants Xcel a variance to Commission rules to allow such recovery.

C. XCEL’S VARIANCE REQUEST

1. Recovery Through PGA

Xcel requests a four-year variance to Minn. R. 7825.2400, subp. 12. Xcel states the following:

We request that the Commission approve a four-year variance to Minn. R. 7825.2400, subp. 12, which specifies a set of FERC accounts that traditionally defines the “cost of purchased gas,” to allow for PGA recovery of the Kansas tax from our customers. Specifically, we request the Commission to allow: (1) recovery of the 2009 through October 2014 costs incurred after the SCOTUS ruling over a 12-month period; and (2) ongoing recovery of the annual costs beginning with November 2014 on a monthly basis through the PGA for a four-year variance period. In this section, we discuss how our request meets the Commission’s requirements for a variance, and in Section D, discuss the mechanics of our proposed PGA recovery and estimated customer impacts.²⁴

Property tax generally, and the ad valorem property tax on storage gas specifically, is a legitimate cost which Xcel should be allowed to recover. However, recovery of costs through a special ratemaking mechanism such as a PGA rider must be carefully considered,

²⁴ Petition at page 10.

especially for retroactive costs from the 2009-2014 period. Since the ad valorem tax is not a direct cost of gas as defined by the PGA rules, the Commission must consider whether to allow an exception to the limited types of cost that may be recovered through the PGA. There are typically two alternative ways of recovering the tax:

1. allow recovery in base rates in the revenue requirement in Xcel's next general natural gas rate case (Xcel's last rate case was in 2009 in Docket No. G002/GR-09-1153); or
2. allow recovery through the PGA by varying the rule.

Under the first option, parties would typically evaluate Xcel's proposal for including a representative amount of ad valorem taxes on natural gas storage in the test year and the Commission would allow a certain amount to be recovered in rates at that time, until the Company's subsequent rate case. However, Xcel would have to wait to recover the property tax costs until such time that it chooses to file the next natural gas rate case, resulting in no recovery of such costs that Xcel incurred from 2009 through the time of the next rate case.

For example, in Docket No. G011/GR-13-617 (13-617 Docket), Minnesota Energy Resources Corporation (MERC) began recovering the Kansas ad valorem taxes in base rates beginning January 1, 2011.^{25,26,27} However, the timing of MERC's rate case was such that the decision of the SCOTUS was not yet available; thus, MERC was not allowed to recover Kansas ad valorem taxes from prior years. Xcel's 2004 general rate case²⁸ was closed before the Commission decided on Xcel's previous variance requests. Similarly, Interstate did not have a pending general rate case in progress at the time of its variance request.²⁹

Allowing Xcel to recover the Kansas ad valorem tax through the PGA may be appropriate in this case, particularly for Kansas ad valorem taxes associated with current gas use, given that the Commission's decisions in Docket Nos. G002/M-05-534 and G002/M-06-905 allowed PGA recovery for Xcel in similar circumstances as mentioned above, and for the reasons set forth below. In addition, if the Commission concludes that the circumstances surrounding recovery of costs for the 2009-2014 period are similar to the recovery of 2004 taxes in Docket G002/M-05-534, it may also be appropriate to allow Xcel to recover those costs through the PGA.

²⁵

<https://www.edockets.state.mn.us/EFiling/edockets/searchDocuments.do?method=showPoup&documentId={779B8497-D47D-47DC-9E9A-080950AD3CFB}&documentTitle=20145-99274-07>

²⁶

<https://www.edockets.state.mn.us/EFiling/edockets/searchDocuments.do?method=showPoup&documentId={D41DF766-9A5F-429B-BDA3-8A72D42DA287}&documentTitle=201410-103797-01>

²⁷

<https://www.edockets.state.mn.us/EFiling/edockets/searchDocuments.do?method=showPoup&documentId={5E7B0969-0073-45B8-BC2E-A6E778E4A5F7}&documentTitle=201410-104203-01>

²⁸ Docket No. G002/GR-04-1511.

²⁹ Interstate has not filed a general rate case since 1995.

3. *The Three Variance Requirements*

a. *Excessive Burden*

Xcel argues that not granting the variance would be an excessive burden to the Company and ratepayers since, without storage, it would be deprived of a critical tool for securing a “prudent natural gas supply portfolio which is necessary to provide reliable and cost-effective natural gas service.” Xcel further states as follows:

To require the Company to absorb this cost until it can be included in base rates would unfairly penalize the Company for a direct cost of gas over which the Company has no control.³⁰

As noted above, DOC agrees that Xcel should be allowed to recover storage-related property tax costs in a reasonable manner, but it does not necessarily follow that the only way for Xcel to recover these costs is via the PGA. Further, as utilities typically point out, costs and revenues change between rate cases such that it is not possible for rates at any given time to reflect every cost and revenue.

Nonetheless, the DOC agrees that, since Xcel has not filed a natural gas rate case, recovery through the PGA of property taxes on natural gas storage would lessen the burden on Xcel of incurring these costs which have not been included in base rates. In addition, in this case, cost recovery of the Kansas ad valorem tax owed from 2009 to the present has been delayed due to the uncertainty in the outcome of the legal process, and was not caused by a rate case timing decision. Therefore, the Department concludes that strict enforcement of the definition of “cost of gas” in Minn. Rule 7825.2400, subd. 12 would prevent the Company from recovery of past Kansas ad valorem tax costs that were only recently billed to Xcel, which could be considered an excessive burden.

b. *Public Interest*

Xcel claims that the public interest is served when the Company engages in prudent resource strategies. Xcel states the following:³¹

Natural gas storage plays a vital role in maintaining the reliability of supply needed to meet the demands of our customers – serving as “insurance” against unforeseen circumstances, such as the 2013 Trans-Canada pipeline issue that threatened natural gas supply for tens of thousands of people, natural disasters, or other occurrences that may affect the production, delivery, or availability of natural gas when it is needed. It also plays a role in providing price stability for customers, as we can accumulate it in summer months when its cost is generally lower for use in peak winter months when

³⁰ Petition at page 10.

³¹ Petition Introduction and page 11

prices are generally higher. The year-round reliability and price stability that storage affords have become even more important as we and other utilities shift toward more natural gas-fired electric generation on our systems.

...Granting the variance would encourage the Company to continue to use storage as a part of its natural gas resource acquisition strategy – providing customers price stability and a hedge against the risk of supply disruptions from unforeseen circumstances. Additionally, granting the variance to recover the costs through the PGA would not adversely affect the public interest, since the tax is a direct cost for natural gas delivered; it is in the public interest for customers to pay the actual costs associated with purchased gas, as such prices promote efficient use of natural gas.

Xcel proposes to recover the annual costs of Kansas ad valorem taxes on a monthly basis through the PGA for a four-year variance period. Xcel proposes to recover the July 2009 through October 2014 costs over a 12-month period. Xcel provides a breakdown of the amounts incurred for the various periods in its Attachment A and more detailed outlines of the proposed recovery mechanics as Attachments B and C of the *Petition*.

As mentioned previously, the DOC agrees that having storage is in the public interest since it enables price stability and assists with reliability. To the extent that granting a variance facilitates optimal use of storage, the variance would not adversely affect the public interest.

However, the Department recommends amortizing the costs for the period 2009-2014 over a five-year period, to reduce the impact of this one-time charge on ratepayers. In G002/M-05-534, the Commission allowed Xcel to recover retroactive 2004 taxes that were billed to Xcel and payable in 2005, over a one-year period.

c. Conflict With Standards Imposed By Law

Xcel states that there is no conflict with the law. Xcel states:³²

Granting the variance is not in conflict with standards imposed by law. Minn. Stat. § 216B.16, subd. 7 allows for recovery of “the direct cost of natural gas delivered.” As we have demonstrated, the Kansas tax is based on the volume of gas held in storage for customers and the prevailing market price of that gas, making it a direct cost of gas for which the costs are appropriately recovered through the PGA[.] In addition, Minn. R. 7825.2400, subp. 12, provides that the “cost of purchased gas” includes “the normal and ordinary cost of injection and withdrawal of gas from storage...” While the tax is not a direct

³² *Petition* at page 11.

cost of injection or withdrawal and thus does not explicitly fall within the language of the rule, the rule clearly contemplates gas storage costs. Further, as we have discussed, the Commission has previously considered and granted PGA recovery of this specific Kansas tax and other storage-related costs in the past. We are not aware of any other legal standard that precludes the Commission from approving this variance at this time.

Since the Commission has granted similar variances in the past, the DOC agrees that the requested variance does not conflict with law.

Based on the analysis above, the DOC concludes that a variance may be granted to allow Xcel to recover in the PGA the ad valorem taxes on natural gas storage. However, the Department recommends that the Commission require Xcel to amortize the costs for the 2009-2014 over a five-year period.

4. *Length Of Variance*

As stated above, Xcel requests a four year variance to Minn. Rule 7825.2400, subp. 12 to recover the ongoing Kansas ad valorem taxes. While the Commission has granted one-year variances in the two cases cited as precedence, the Company states the following:³³

Given its strategic value and practical customer benefits, storage is one method we employ to reduce our exposure to supply and price risks associated with unforeseeable market conditions or events. We generally target approximately 25 percent of our normal winter requirements for storage. In fact, we intend that beginning with the 2013-2014 heating season, storage will cover approximately 100 percent of our winter natural gas electric generation fuel supply requirements.

... Although we do not anticipate that this tax will go away, we request a time-limited variance. A four-year variance period is consistent with the variance period the Commission has established with another natural gas variance request (for hedging) and will afford the Commission and stakeholders increased transparency into the inclusion of this tax in the PGA.

In Docket No. G002/M-12-519 (12-519 Docket), Xcel petitioned the Commission to extend by four years a variance to Minn. Rule 7825.2400, 7825.2500, and 7825.2700 that allowed the Company to recover the cost of hedging natural gas prices through the PGA. In its September, 23, 2013 *Order Extending Variance with Conditions*, the Commission extended the variance to Minn. Rule 7825.2400, 7825.2500, and 7825.2700, that was originally granted in Docket No. G002/M-01-1336, until June 30, 2016 (for four more

³³ Petition Introduction and at page 3.

years). Minn. Rule 7829.3200, subp. 3 in part states that “unless the commission orders otherwise, variances automatically expire in one year.” Given the fact that Xcel uses storage to hedge, and to be consistent with the 12-519 Docket, the Department concludes that Xcel’s request to have a longer variance to Minn. R. 7825.2400, subp. 12, to allow recovery of the ongoing Kansas ad valorem taxes is reasonable. To match with the five-year amortization recommendation above, the Department recommends that the variance be allowed for five years.

d. Classification Of The Costs In The PGA and Issues Needing Clarification

Purchased gas costs passed through the monthly PGAs to customers are classified as either demand-delivered gas costs (demand costs) or commodity-delivered gas costs (commodity costs). Generally, demand costs are recovered only from firm sales service customers while commodity costs are recovered from both firm and interruptible sales service customers. Both firm and interruptible sales customers use storage gas so both sets of customers receive the benefit of the hedge against winter price increases resulting from the use of storage gas.

Xcel’s proposal is to include the property tax in the commodity portion of the PGA rather than as a demand cost. As a result, under the Company’s proposal, the ad valorem property taxes would be charged to all sales customers. The Department agrees that this proposal is reasonable.

1. Ongoing Recovery of Annual Costs

Xcel states the following regarding the annual costs:³⁴

Based on actual taxes incurred for the 2009-2014 period and current natural gas futures, we expect Minnesota’s portion of 2015 costs to be approximately \$800,000 to \$900,000. We note that for the last several years, the amount of gas we have held in storage has been relatively consistent, so if natural gas prices remain relatively flat, this range of cost is what we would expect to incur on an annual basis. Within this range of annual cost, an average customer using 847 therms would incur an additional annual cost of approximately \$1.00.

Upon Commission approval of this request for variance, we plan to include the cost of this tax for recovery in the first monthly PGA practicable. We outline our proposed methodology to recover this expense below, and provide as Attachment B how the Minnesota portion of the Kansas tax expenses will be calculated for the PGA....

³⁴ Petition Pages 11-13 and Attachments A through C.

2. Lump Sum Recovery of the July 2009 through October 2014 Costs

Regarding the Lump sum recovery Xcel states the following:³⁵

Minnesota's portion of the actual taxes we have incurred for the 2009 to October 2014 period is approximately \$5.3 million. Upon Commission approval of this request for a variance, we will begin recovering this tax amount as a lump-sum over the 12-month period of July 2015 through June 2016. For a typical customer using 847 therms, the one-time annual cost will be approximately \$6.40.

We propose to collect the lump sum over the July 2015 through June 2016 for two reasons: (1) the accounting will be cleaner if the 12-month period is matched with a True-up year; and (2) we currently have in place very large annual True-up factors due to last winter's cold temperatures and high natural gas commodity costs. For this reason, particularly, it would be less burdensome to customers to include the lump sum recovery in the next True-up year.

Our proposed methodology to recover this lump sum expense is similar to our proposed methodology to recover the ongoing expense....

As mentioned previously, the Department recommends that the Commission require Xcel to amortize the 2009-2014 costs over a five-year period, to reduce the impact on ratepayers.

Xcel proposes to report the tax costs as separate line items in the monthly PGAs, AAA report and annual PGA True-up filings. To clarify, regarding the proposed reporting in the Company's AAA report and PGA True-Up filings, filed in September each year, the actual amount paid in ad valorem tax as well as recovered from ratepayers by state should be detailed in Xcel's annual True-Up Report. Additionally, the costs and revenues should be listed as separate line items in the Company's Schedules C, Schedules D page 1 through 2 of 4, and page 4 of 4.

Xcel also states the following in its *Petition*:³⁶

As discussed earlier, natural gas storage plays a vital role in our resource acquisition strategy in maintaining a cost-effective and reliable supply of natural gas to meet the demands of our customers. This type of year-round reliability and price stability have become even more important as we and other utilities shift toward more natural gas-fired electric generation on our

³⁵ *Id.*

³⁶ *Petition* page 8.

systems. In fact, beginning with the 2013-2014 heating season, we have planned to cover all of our winter natural gas electric generation fuel supply requirements with storage.

The Department notes the Kansas ad valorem taxes are based on the storage inventory each January 1st. Xcel noted that the State of Kansas determines the amounts due by calculating 33 percent of the storage inventory's fair market value. The Company also states throughout its *Petition* that it uses storage for its electric generation. As a result, it would appear that the Kansas ad valorem taxes should also be allocated to the electric generation function of the Company to avoid the possibility of its natural gas customers subsidizing its electric customers or vice-versa. The Department requests that Xcel in its *Reply Comments*, clarify, and provide detailed explanations for the following:

- a) Is the Northern storage used by Xcel segregated between Xcel's gas and electric operations?
- b) How is the Northern storage inventory segregated?
- c) If the Northern storage inventory is segregated between Xcel's gas and electric operations, has Xcel sought recovery of the Kansas ad valorem taxes for its electric operations in a separate docket?
- d) Whether Xcel has sought or not sought recovery of the Kansas ad valorem taxes for its electric operations in a separate docket, are any of those costs included in its current and pending electric rate case in Docket No. E002/GR-13-868?
- e) If the Northern storage used by Xcel is commingled between Xcel's gas and electric operations, please identify in detail Xcel's proposal to allocate the Kansas ad valorem tax costs between the two.

In addition, the Department notes the following in Xcel's Attachments. In Attachment A, the Company shows the Kansas property taxes under "MN-State Accrued" in the amount of approximately \$5,488,414, yet it shows "MN-State Billed and Paid" amount of \$5,503,806 which is greater than what it accrued and allocated to Minnesota. The Company indicated in its *Petition* that the "taxes applicable during the period of appeals were legally deferred until all legal avenues were exhausted...." Please explain in detail how the accruals and billings were determined and why the amounts are different.

III. CONCLUSION AND RECOMMENDATION

Preliminarily, the Department recommends that the Commission approve a variance to include recovery in the PGA of ad valorem taxes related to natural gas storage; however, recovery of the 2009-2014 amount should be amortized over five years.

However, the Department requests that Xcel provide all of the information requested above relating to the Kansas ad valorem taxes. Upon review of Xcel's reply comments, the Department will make a final set of recommendations to the Commission.

/lt

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
Comments**

Docket No. G002/M-15-149

Dated this **8th** day of **April 2015**

/s/Sharon Ferguson

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