BEFORE THE MINNESOTA OFFICE OF ADMINISTRATIVE HEARINGS
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In the Matter of a Commission Investigation into Xcel Energy's Monticello Life Cycle Management and Extended Power Uprate Project and Request for Recovery of Cost Overruns	PUC Docket No. E-002/GR-13-754 OAH Docket No. 48-2500-31139

EXCEPTIONS TO THE FINDINGS OF FACT, CONCLUSIONS AND RECOMMENDATION OF THE ADMINISTRATIVE LAW JUDGE SUBMITTED BY THE XCEL LARGE INDUSTRIALS

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The following constitutes the Exceptions to the Findings of Fact, Conclusions and Recommendations of the Administrative Law Judge ("ALJ") in this matter dated February 2, 2015 (the "Recommendations"), of Flint Hills Resources, LP; Gerdau Ameristeel US Inc.; Unimin Corporation; and USG Interiors, Inc. (collectively, the "Xcel Large Industrials" or "XLI").

I. INTRODUCTION

At the conclusion of NSP's last rate case, the Commission ordered an investigation of cost overruns for the Northern States Power Company d/b/a Xcel Energy ("Xcel" or the "Company") Monticello Life Cycle Management ("LCM")/Extended Power Uprate ("EPU") Project (the "Project").[1] In particular, the Commission sought to address 1) whether the handling of the Monticello Project was prudent and 2) whether NSP's request for recovery of Monticello Project cost overruns is reasonable. In its order referring the matter to a contested case proceeding, the Commission added a third issue—determination of which project cost increases were due solely to the EPU, solely to the LCM, or attributable to both parts of the Project.[2]

In the proceedings below, XLI argued that Xcel failed to meet its burden to show that its management of the Project was prudent or that its request for full recovery and full return on the Project's cost overruns is reasonable. In fact, all of the parties to the proceeding, other than Xcel, reached a similar conclusion. XLI's recommendation was largely based on the Minnesota Department of Commerce ("Department") investigation, which included testimony from independent expert witnesses, into Xcel's management of the Project. Based on this investigation, the Department found significant problems with Xcel's management of the Project. [3] The Office of the Attorney General-Antitrust and Utilities Division ("OAG") also conducted its own analysis of the cost overruns and came to the same conclusion that there were

[1] *In the Matter of the Application of Northern States Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota*, Docket No. E-002/GR-12-961, Findings of Fact, Conclusions, and Order, at 19 (Sept. 3, 2013).
[2] *In the Matter of the Application of a Commission Investigation into Xcel Energy's Monticello Life Cycle Management/Extended Power Uprate Project and Request for Recovery of Cost Overruns*, Docket No. E-002/CI-13-754, Order Approving Investigation and Notice and Order for Hearing, at 4 (Dec. 18, 2013).
[3] See, e.g., Ex. 315, Campbell Surrebuttal at 25-26; Ex. 436, Campbell Opening Statement at 3.

significant management problems that justify significant disallowances.[4] The ALJ, correctly in XLI's view, agreed with XLI, the Department and the OAG that Xcel's handling of the Project was not prudent and that its request for recovery of all Project cost overruns is not reasonable.[5] Among the Department, the OAG, XLI, and now the ALJ, the only major differences in position are with regard to the appropriate remedy.

XLI appreciates the significant effort undertaken by the ALJ to resolve this very complex matter and supports the ALJ's findings and conclusions with respect to Xcel's management of the Project. XLI also supports the ALJ's conclusion that Xcel's request to recover all of the Project cost overruns and a full return on that amount is unreasonable. Nonetheless, XLI believes that the Commission should further consider the appropriate remedy for these conclusions. XLI submits these exceptions to clarify its position and advocate for modifications to the Recommendations with respect to the proposed remedy.

II. ANALYSIS

A. Xcel Bears the Burden of Proof to Demonstrate that its Proposal is Just and Reasonable

Under Minnesota law, it is Xcel's burden to demonstrate its proposal to recover Project costs is just and reasonable.[6] The governing statute provides that "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."[7] For these reasons, XLI strongly supports the ALJ's conclusions regarding the appropriate burden of proof in this matter:

> 3. Xcel bears the burden of showing that the costs it seeks to recover from ratepayers in rates were prudently incurred and are reasonable. The burden is on Xcel to prove the facts required to sustain its burden by a fair preponderance of the evidence.
>
> 4. The utility—not public agencies, other parties, nor the Commission—bears the burden to demonstrate that the utility's proposed rate increase is just and reasonable. A utility in a rate

[4] See Ex. 200, Lindell Rebuttal at 12:15-22.
[5] *Recommendations* at p. 2, ¶¶ 1-2 of the Summary of Conclusions and Recommendations.
[6] MINN. STAT. § 216B.16, subd. 4 ("The burden of proof to show that the rate change is just and reasonable shall be upon the public utility seeking the change.").
[7] MINN. STAT. § 216B.03.

> proceeding does not enjoy at any point a rebuttable presumption of reasonableness that other parties must overcome. Even if the utility presents a *prima facie* case and there is no contrary evidence, "the utility does not necessarily meet its burden of demonstrating that it is just and reasonable that the ratepayers bear the costs of those expenses." Minnesota law requires that every rate established by the Commission be just and reasonable and that any doubt be resolved in favor of the consumer. [8]

XLI also supports the ALJ's explanation of these conclusions provided in the Memorandum portion of the Recommendations.[9] As explained by the ALJ, Xcel does not enjoy a presumption of reasonableness.[10] It is not the burden of the Department or any other party to rebut, item-by-item, the evidence produced by Xcel. Rather, it was the role of the ALJ and now is the role of the Commission to evaluate whether Xcel met its burden to show that its rate recovery request is reasonable in light of the substantial doubts raised by the Department and other parties about the prudence of Xcel's management. For the reasons explained further below, XLI agrees with the ALJ, the Department, and the OAG that Xcel has not met this burden.

In addition to providing support for the burden of proof standard applied by the ALJ, the Memorandum also includes the ALJ's findings regarding the credibility of witnesses participating in the proceeding.[11] It is the role of the ALJ to assess evidence, including the credibility of evidence offered and the witnesses who present such evidence, and make findings of fact based on that assessment. XLI concurs with the ALJ's assessment that the Department's witnesses were the most reasonable, and urges the Commission to defer to the ALJ's judgment regarding the credibility of witnesses.

B. <u>The Department's Prudence Review Investigation Revealed Significant Concerns about Xcel's Planning and Management of the Monticello Project.</u>

The Department's investigation revealed significant problems with Xcel's management of the Project, including human performance problems identified by the NRC, muddled cost tracking mechanisms, poor communication regarding spiraling cost increases, delays, poor

[8] *Recommendations* at p. 30, ¶¶ 3 and 4 of the Conclusions of Law (citations omitted).
[9] *Recommendations* at p. 34-36, Burden of Proof section of the Memorandum.
[10] Recommendations at p. 35 (citing *In the Matter of the Petition of N. States Power Co. for Auth. to Change its Schedule of Rates for Elec. Serv. in Minn.*, 416 N.W.2d at 725).
[11] *Recommendations* at p. 36-38, Witness Credibility section of the Memorandum.

upfront planning, and inadequate project scoping.[12] The ALJ also summarized these findings in the Recommendations.[13] As the ALJ correctly notes,[14] it is not the Department's burden (or the burden of any party other than Xcel) to show that the costs Xcel seeks to recover are reasonable. Instead, the Department has raised substantial doubts about Xcel's management that Xcel has not been able to adequately rebut.[15] Xcel's attempt to justify in detail the reasons for particular cost increases[16] did not as a whole address the fundamental problems related to planning, scoping, and cost tracking identified by the Department. The final Project cost is estimated to be more than double Xcel's initial estimates, even though the overall goals and nature of the Project never changed. The enormous size of the cost overrun indicates that, whatever the explanation for cost increases for individual items, the initial plans and scope were inadequate.

XLI supports the ALJ's conclusion that "Xcel has failed to demonstrate that the cost overruns it seeks to recover were prudently incurred and are reasonable"[17] as well as the ALJ's conclusions regarding Xcel's management shortcomings in paragraphs 7-10 of the Conclusions of Law.[18]

C. Remedy: The Commission should Order that Xcel Receive No Return on the Cost Overrun.

Xcel has argued for full recovery of the Project cost overruns. But as the ALJ concluded, Xcel failed to demonstrate that its management of the Project was prudent and that its request for full recovery is reasonable. For these reasons, the Department, the OAG, and XLI each recommended disallowances, which differ as described below:

- Cost-Effectiveness Approach. The Department recommended a cost-effectiveness approach that would result in a $71.42 million reduction to the capital costs of the EPU and a $10.237 million downward adjustment to the

[12] In her surrebuttal testimony and opening statement, Department witness Nancy Campbell also provided a summary of the factors that led the Department to conclude that Xcel's handling of the Project was not prudent. See Ex. 315, Campbell Surrebuttal at 25-26; Ex. 436, Campbell Opening Statement at 3.
[13] *Recommendations* at p. 19-21, ¶¶ 72-81.
[14] *Recommendations* at p. 30, ¶4 of the Conclusions of Law.
[15] The ALJ details Xcel's rebuttal arguments in the *Recommendations* at p. 21-23, ¶¶ 82-90.
[16] See, e.g., Ex. 9, O'Connor Rebuttal at 36-80.
[17] *Recommendations* at p. 31, ¶6.
[18] *Recommendations* at p. 31, ¶¶7-10. Note, however, that while XLI does not disagree with ALJ's conclusion in ¶8, it is not clear how the conclusion that the costs referenced in the this paragraph should be denied reconciles with the ALJ's recommended remedy.

revenue requirement for 2015 on Minnesota jurisdictional basis and ongoing adjustment for the life of the plant stepped down for accumulated depreciation.[19] Although the Department has consistently stood by this recommendation, it noted that the record could support higher disallowances and described XLI's proposal of disallowing any return on the cost overrun as a potential alternative.[20]

- Disallowance and No Return Approach. The OAG proposed going further than the Department, finding that the record supported disallowing 75% of the cost overrun (or $321 million based on the OAG's calculation that the cost overrun amount is $428.1 million) and no return on the remaining 25%.[21] The Department estimated that the OAG's proposal would amount to a downward revenue requirement adjustment of $42.9 to $38.4 million on a Minnesota Jurisdictional basis for 2015 and stepping down for the accumulated depreciation over the life of the plant.[22]
- No Return Approach. XLI recommended a third approach—disallowance of any return on the entire cost overrun. Department witness Nancy Campbell described this alternative in her surrebuttal testimony and calculated that no return on the $402.1 million[23] cost overrun would result in a $25.796 million downward revenue adjustment for 2015 on a Minnesota jurisdictional basis (and then stepped down every year during the life of the plant).[24]

The Department, the OAG, XLI, and now the ALJ, all agree that Xcel failed to demonstrate that its handling of the Project was prudent and that its request for full recovery is unreasonable.

[19] Ex. 313, Campbell Direct at 31:6-11; Ex. 315, Campbell Surrebuttal at 39:8-16.
[20] Ex. 315, Campbell Surrebuttal at 39:14-16.
[21] Ex. 200, Lindell Rebuttal at 29-30.
[22] Ex. 315, Campbell Surrebuttal at 37:5-12.
[23] XLI did not perform independent analysis or calculations, but generally supports the Department's calculation, which determined the cost overrun amount to be $402.1 million. In particular, XLI supports the Department's inclusion of allowance for funds used during construction ("AFUDC") costs in the calculation. AFUDC is the "net cost of financing funds used for construction purposes for the period of construction and a reasonable rate on other funds when so used." (Ex. 313, Campbell Direct at 12:18-21) As Department witness Nancy Campbell pointed out in her surrebuttal testimony, AFUDC is a cost of the plan in-service amount for which NSP is requesting rate recovery. And therefore, any denial of cost recovery of the Monticello Project should also include denial of AFUDC costs. (Ex. 315, Campbell Surrebuttal at 38:9-16.).
[24] Ex. 315, Campbell Surrebuttal at 37:15-19 & Attachment A. Ms. Campbell also described a similar alternative that would allow NSP to earn only a weighted short-term and long-term debt return of the $402.1 million, the effect of which would be a downward revenue requirement adjustment of $20.507 million for 2015 on a Minnesota jurisdictional basis. Ex. 315, Campbell Surrebuttal at 37:20-38:3 & Attachment B.

These parties also all agree that because Xcel did not demonstrate that the cost overruns it incurred were reasonable and prudent, that a significant disallowance is justified and necessary to protect ratepayers from bearing the full burden of the Project's mismanagement. For the policy reasons explained below and in XLI's Brief, XLI continues to believe that its proposal is the most fitting remedy.

1. Clarification of XLI's No Return Proposal

The description of XLI's proposal in the Recommendations may be slightly misleading. Specifically, XLI's recommended remedy is the alternative remedy proposed by the Department and described in paragraph 113 of the Recommendations. The characterization of this proposal as the "no return approach" in paragraph 113 is more accurate than the characterization of it as a "complete disallowance" approach in second sentence of paragraph 117. According to the Department's calculations, XLI's proposal would result in a greater downward adjustment to Xcel's 2015 revenue requirement than the Department's proposal, but a smaller downward adjustment compared to the OAG's proposal.[25] XLI offers these comments to make it clear that its proposal is intended to be a middle ground between the OAG's large disallowance and no return approach and the Department's more limited cost-effectiveness approach.

2. Policy Considerations and Precedent

As noted above, XLI believes the record in this proceeding supports the ALJ's conclusions and recommended remedy. However, there are at least three significant policy concerns with the cost-effectiveness approach that XLI urges the Commission to consider. First, the cost-effectiveness approach recommended by the ALJ relies too heavily on the Department's analysis of the split of costs between the LCM and EPU portions of the Project. The remedy would be inadequate and disproportional to the findings in the record if the Commission were determine it appropriate to allocate a greater percentage of costs to the [LCM] portion of the Project. Second, as the Department described in its testimony,[26] Commission review of cost overruns has usually focused on disallowing all costs or a return on costs above levels approved in a Certificate of Need ("CN") proceeding. Deviating from that approach could create inappropriate incentives for development of cost estimates in future CN proceedings. Third, the

[25] *Recommendations* at p. 27-28, ¶¶ 112-114.
[26] Ex. 315, Campbell Surrebuttal at 27:1-16.

cost-effectiveness approach seems to be a minimum calculation of the harm to ratepayers, which does not seem appropriate compared to the enormous size of the cost overrun and degree of mismanagement identified in this record.

i. Over-Reliance on the Precise Allocation of Costs between the LCM and EPU Portions of the Project Undermines the Basis for the Cost-Effectiveness Approach.

The cost-effectiveness approach endorsed by the ALJ relies heavily on the ALJ's recommended split of the costs between the LCM and the EPU. The ALJ's recommendation is based on the Department's analysis, which found that 15% of the Project costs should be allocated to the LCM and 85% of the Project costs should be allocated to the EPU.[27] XLI has no objection to Department witness William Jacobs' testimony on this issue or the ALJ's adoption of the Department's recommended split between LCM and EPU costs.[28] However, as noted by the ALJ and the Department, Xcel did not track LCM and EPU costs separately, despite treating them as two separate projects in its initial cost estimates and CN proceedings.[29] XLI agrees that Xcel's approach to cost tracking contributed to the lack of transparency and communication that the Department concluded contributed to the cost overruns. And further, XLI agrees with the ALJ and the Department that Xcel's proposal to use its initial estimate for allocation of EPU and LCM-related costs (41.6 percent and 58.4 percent) is unreasonable because it was based on Xcel's flawed initial estimate of costs.[30] The lack of transparency also undermines the degree to which costs can be precisely allocated between the LCM and EPU. If the Commission determines that a lower percentage of costs should be attributed to the EPU, the compensation provided to ratepayers under the cost-effectiveness approach would be significantly diminished. That said, XLI urges Commission to adopt the ALJ's recommendation on the allocation of costs between the LCM and EPU.

[27] Ex. 305, Jacobs Direct at 8, 12; Ex. 307, Jacobs Surrebutal at 17.
[28] *Recommendations* at p. 33, ¶5 of the Recommendations; Ex. 305, Jacobs Direct at 8:1-4.
[29] Ex. 436, Campbell Opening Statement at 2; *Recommendations* at p. 23, ¶ 91.
[30] Recommendations at p. 24, ¶ 100.

ii. The Cost-Effectiveness Approach could be a Bad Precedent for Cost Analysis in Future CN Proceedings.

Second, XLI is concerned that the cost-effectiveness approach potentially sets a bad precedent for the future. As Department witness Christopher Shaw explained in his testimony, reasonably accurate cost estimates in CN proceedings are critical for good decision-making:

> As the Department has stated in past proceedings, cost estimates are used extensively in CN proceedings and relied upon by the [Minnesota Public Utilities Commission] Commission in comparing proposed projects to alternatives. Thus, this comparative analysis requires reasonable cost estimates to ensure that this cost comparison is valid. Since comparisons of proposed projects to alternatives based on relative costs is a critical part of any CN analysis, it is important for utilities to provide accurate estimates of project costs; not doing so adversely affects the integrity of the CN process and could harm ratepayers.[31]

Limiting the disallowance of cost overruns to the amount above the next least-cost alternative provides no incentive to control costs above the CN estimate, but below the next least-cost alternative. Depending on the alternatives considered in any given proceeding, this approach could leave a lot of room for unchecked cost overruns if cost-effectiveness became normal standard for remedies. If a project is imprudently managed, the resulting increased costs should not automatically be passed to ratepayers even if the total cost is still below the next least-cost alternative. Further, if precedent is set for capping costs at a cost-effectiveness threshold rather than at the level approved in a CN proceeding, a perverse incentive is established to offer low estimates, especially when potential alternatives are of significantly higher cost. As Mr. Shaw testified, accurate cost estimates are necessary for good decisions to be made CN proceedings.

Establishing these perverse incentives is expressly not the Department's intention in this proceeding or in previous cost overrun reviews. As Mr. Shaw explained, the cost effectiveness-based remedy the Department proposes in this case is not intended to replace the prudency standard.[32] Further, in cost overrun reviews, the Department usually recommends limitations on recovery based on the CN-approved cost. Mr. Shaw further explained in his direct testimony:

[31] Ex. 309, Shaw Direct at 12.
[32] Ex. 435, Shaw Opening Statement at 2.

> Further, approval of utility projects in CNs and similar proceedings is not a blank check for any utility to recover from ratepayers all costs that are incurred to construct a project. In rider filings for example, the Department has routinely recommended that cost recovery be capped in the rider rates at the level of costs approved in the CN to ensure that utilities have the appropriate incentives to provide reasonably accurate cost estimates of proposed projects in CNs and to minimize those costs in practice. The integrity of CN proceedings depends on utilities providing reasonably accurate information, such as cost estimates.
>
> Even though rider recovery is typically limited to the cost estimates in a utility's CN, a utility is free to try to demonstrate to the Commission in its subsequent rate case, or in a proceeding such as this, that costs in excess of the CN-approved levels are reasonable to charge to ratepayers; however, the burden is on the utility to make such a showing if it wants to recover cost overruns from ratepayers. [33]

In her direct testimony, Department witness Nancy Campbell also cited a series of Minnesota cases that resulted in caps of costs or denial of returns above the CN-approved amount, often based on the Department's recommendations.[34] For example, in the 2012 rate case, the Department challenged Xcel's recovery of $5.6 million above its competitive bid for the Nobles Wind project.[35] In that case, the Commission decided to allow recovery of the above-bid costs, but denied a return.[36]

Even though the Department has been careful to cite the specific circumstances in this case as the reason for deviating from its past recommendations based on CN-estimated costs, the Commission would still be setting a significant precedent if it adopts the cost-effectiveness approach. The special circumstances for this case cited by the Department are largely based on the unprecedented size of the cost overrun.[37] But choosing a more limited remedy based on the large size of the cost overrun is problematic for two reasons. First, it could establish a precedent that large cost overruns, which have the greatest potential to harm ratepayers, are subject to

[33] Ex. 309, Shaw Direct at 12-13.
[34] Ex. 313, Campbell Direct at 22-27.
[35] Ex. 313, Campbell Direct at 23:19-24:20.
[36] Ex. 313, Campbell Direct at 24:12-20 (referring to *In the Matter of the Application of Northern States Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota*, Docket No. E-002/GR-12-961, Findings of Fact, Conclusions, and Order, at 25 (Sept. 3, 2013)).
[37] Ex. 313, Campbell Direct at 27:1-16.

lower disallowances. Second, it could encourage utilities to underbid third-party owned projects in a resource acquisition proceeding based on an understanding that the utility would be allowed to recover its investments up to the next cheapest alternative. XLI urges the Commission to consider these potential impacts in evaluating the appropriate remedy for Xcel's imprudence.

iii. The Cost-Effectiveness Approach only Addresses Part of the Harm Caused to Ratepayers by Xcel's Mismanagement of the Project.

Finally, XLI views the cost-effectiveness approach as reflecting the minimum harm to ratepayers caused by the cost overrun. The Department's investigation revealed extensive mismanagement of the Project that appears to have contributed to much of the $402 million cost overrun. However, disallowance of only the portion of the cost overrun above a cost-effectiveness threshold will allow Xcel full recovery of costs it incurred as a result of imprudent management.

The ALJ recommended that the Commission find that "Xcel failed to demonstrate that the entire $402 million in cost overruns, or any identified part thereof, was reasonable and prudent."[38] But of that $402 million cost overrun, the ALJ only recommended disallowing recovery of $71.42 million. Following this recommendation would mean that Xcel can fully recover and collect a full return on $331 million in cost overruns for which, according to the ALJ, Xcel did not meet its burden to show were reasonable and prudent. Considering the scope of the ALJ's findings, the OAG's recommendation to disallow a much greater percentage of the cost overrun and refuse a return on any of it, comes much closer to being the logical result of the ALJ's finding that Xcel failed to demonstrate that the entire $402 million in cost overruns—*or any identified part thereof*—was reasonable and prudent.

However, XLI recognizes that the funds were spent on a Project that has benefits to ratepayers. For these reasons, XLI's no return proposal is a fair middle ground. Denying a return on any part of the overrun reflects the significant management problems identified in the Department's investigation and the ALJ's conclusion that Xcel failed to meet its burden to show that any part of the cost overrun was reasonable and prudent. At the same time, allowing recovery of the actual costs incurred to complete the Project ensures that Xcel can continue to operate the plant safely and compensates Xcel for the actual investment it made. As discussed in XLI's Brief, the Commission is

[38] *Recommendations* at p.33, ¶ 3.

required to establish reasonable rates.[39] Given the sheer size of the cost overrun at issue in this proceeding and the potential policy concerns raised by the other proposed remedies, XLI believes its no-return proposal strikes the best balance between allowing fair utility recovery of costs with protecting ratepayers from paying for the unreasonable results of imprudent management.

III. CONCLUSION

XLI has carefully reviewed the results of the Department's investigation and the testimony of other parties, and is greatly concerned about the issues of inadequate planning, scoping, and management of the Project that were identified in the course of this proceeding. Based on these results, Xcel has not met its burden to show that its handling of the Project was prudent and that its proposal to obtain full recovery of and return on its investment is reasonable. To the extent there are any doubts about the reasonableness of the cost overrun, they must be resolved in favor of the ratepayer. The amount of the cost overrun—$402 million—is staggering compared to Xcel's initial cost estimate for this Project and any cost overrun on a Minnesota utility project of which XLI is aware. Allowing full recovery of these costs plus a return would not only allow a very large amount of unreasonable costs to be recovered, it would also establish a bad precedent that would reduce incentives for utilities to control costs in the future. In order to protect both current ratepayers from bearing these unreasonable costs and future ratepayers from the effects of bad precedent, Xcel should not be allowed any return on the cost overrun.

XLI appreciates the ALJ's efforts in preparing the detailed Recommendations and, as described in detail above, supports most of the ALJ's findings, conclusions, and recommendations. However, in order to establish better precedent and provide a remedy more proportional to the ALJ's other findings, XLI respectfully requests that the Commission modify the ALJ's proposed remedy to deny any return on the full amount of the cost overrun.

[39] Xcel bears the burden to demonstrate that it should be allowed to recovery costs and earn a return on the Project overrun by a preponderance of evidence. This evidentiary standard is defined as "whether the evidence submitted, even if true, justifies the conclusion sought by the petitioning utility when considered together with the Commission's statutory responsibility to enforce the state's public policy that retail consumers of utility services shall be furnished such services at reasonable rates." *N. States Power Co.*, 416 N.W.2d 719, 722 (Minn. 1987).

Date: February 12, 2015

Respectfully submitted,

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