Minnesota Public Utilities Commission

Staff Briefing Papers

Meeting Date: August 3, 2017 ....**Agenda Item # **3**

Company: Northern States Power Company d/b/a Xcel Energy (Xcel Gas)

Docket No. G-002/M-17-174

In the Matter of the Petition of Northern States Power Company for Approval of a Modification to Its Natural Gas State Energy Policy (SEP) Tariff, 2017 SEP Rate Factor, and 2016 SEP Compliance Filing

Issues: Should the Commission require Xcel Gas to discontinue its SEP rider?

Should the Commission allow Xcel Gas to continue to recover assessment costs for Department Regional & National Duties under Minn. Stat. § 216B.62, subd. 3b? And, if so, how should those costs be recovered?

Should the Commission allow Xcel Gas to continue to recover costs previously incurred for its Cast Iron Replacement Project which were authorized under Minn. Stat. § 216B.1637, Recovery of Certain Greenhouse Gas Infrastructure Costs, when the statute was repealed by the Legislature in 2013? And, if so, how should those costs be recovered?

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Relevant Documents

Xcel Energy – Initial Filing………………… .... March 1, 2017
Department - Comments .... March 31, 2017
Xcel Energy – Reply Comments .... April 10, 2017
Department – Response Comments ....May 17, 2017
Xcel – Response Comments ....May 26, 2017

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.

July 26, 2017

Statement of the Issues

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Background

March 1, 2017: Northern States Power Company doing business as Xcel Energy (Xcel Energy, Gas, Xcel or the Company) submitted its request for approval of its 2017 State Energy Policy (SEP) rider rate factor and proposed customer notice and tariff update and its 2016 annual SEP compliance filing.

March 31, 2017: The Minnesota Department of Commerce, Division of Energy Resources (Department) filed comments and stated that both the Reliability Administrator and the Greenhouse Gas Infrastructure Program statutes that allowed the Company to recover costs through the SEP rider have been repealed and it is unclear whether it is permissible to allow Xcel to continue to recover these costs through a rider mechanism. The Department stated that from its analysis it concluded that the Commission may have discretion to continue a rider that was approved at the time statutory authority existed. Alternatively, because there is no statute currently in place to support recovery of the costs included in the rider, the Department concluded it would be reasonable for the Commission to discontinue the SEP rider.

April 10, 2017: The Company disagreed with the Department's position. To support its position, Xcel made the following arguments:

- A review of the relevant legislative history of the SEP Rider to clarify that the legislature intended that costs related to cast iron pipe replacement should continue to be addressed through rider recovery;
- All of the costs being recovered through the rider were incurred before the statutes were repealed; and
- Prior Commission approval of cost recovery through the SEP rider supports its conclusion that rider recovery of these costs is appropriate.

The Company continued to request approval of its petition, with the additional commitment that no new costs will be included in the SEP Rider.

May 17, 2017: The Department recommended that the Commission discontinue the natural gas SEP Rider mechanism. The Department included additional analysis and alternative recommendations should the Commission decide to continue the SEP Rider mechanism.

May 26, 2017: The Company maintained it position that recovery of the Cast Iron Pipe Replacement Project costs and the costs associated with the Reliability Administrator should be allowed to continue through the SEP Rider. The Company believes it is reasonable and consistent with Commission precedent to continue recovery through the SEP Rider.

If the Commission decides that the SEP Rider should be discontinued, the Company agreed with the Department's recommendation that as an alternative, the Gas Utility Infrastructure Cost (GUIC) Rider would be an appropriate alternative recovery mechanism. The Company proposed that if the Commission decides to consolidate the two riders, that the SEP Rider be allowed to continue in the 2017-2018 SEP period. The Company suggested an order point could direct the Company to include the costs under the GUIC Rider in its next GUIC Rider filing. The Company stated that this option would allow the Commission, Company and stakeholders time to work through the logistics of consolidating the two riders in a single future filing, as opposed to trying to consolidate the two riders while both are pending decisions before the Commission.

The Company also addressed the Department's proposed changes to ADIT proration, capital structure, and ROE in addition to other recommendations which were presented in the DOC Response Comments.

Xcel's Initial Filing

As shown in the table below, the Company has requested an increase to its SEP rate factor from \$0.001368 to \$0.002103 per therm. According to Xcel, an increase is warranted to allow the Company to recover a revenue requirement of approximately \$1.8 million over the 12 month period from July 2017 through June 2018. Implementation of the proposed factor would result in an increase of about \$0.65 annually for the average natural gas residential customer using 74 therms per month. Currently, the average residential customer pays about \$1.21 a year for the recovery of approximately \$1.3 million in SEP costs. Under the proposed factor, the average customer would pay about \$1.86 per year.

Proposed Rate & Revenue Requirement vs Approved Rate & Revenue Requirement		
	2016 Approved	**2017 Proposed**
Revenue Requirement	\$1,315,002	\$1,832,232
Rate per Therm	\$0.001368	\$0.002103
Avg. Annual Cost to Avg. Residential Customer	\$1.21	\$1.86

The Company stated that the primary costs recovered through the SEP rider are:

- Expenses for the State Reliability Administrator (RA) which are expenses incurred by the Energy Resources Division of the Department of Commerce for services to the

Commission and the Public related to reliability issues and other proceedings, analysis and projects (Minn. Stat. §216C.052, Subd. 2, Repealed in 2011); and

- Expenses for the Cast Iron Replacement Project less any offsets or credits associated with the Project. (Minn. Stat. §216B.1637, Greenhouse Gas Infrastructure Program. Repealed in 2013).

The following table summarizes the costs the Company is requesting to recover through the SEP rider and the calculation of the SEP factor.

Proposed Rate & Revenue Requirement vs Approved Rate & Revenue Requirement				
	2016 Approved	**2017 Proposed**	**Difference**	**% Change**
RA ("Assessment")	$31,557	$10,565	$(20,992)	(66.52%)
Cast Iron (GHG Infrastructure Replacement)	1,821,962	1,754,251	(67,712)	(3.72%)
Cast Iron O&M Credits	(72,310)	(72,310)	0	0.00%
Carryover	(466,208)	139,726	605,934	129.97%
Revenue Requirement	$1,315,002	$1,832,232	$517,230	39.33%
Therm Sales	961,310,996	871,444,973	(89,866,023)	(9.35%)
Factor	$0.001368	$0.002103	$0.000735	53.69%

The Company stated that actual costs for the past twelve months were $26,401 lower than forecasted and included a monthly breakout of these costs in the initial filing. The variance was primarily caused by lower actual RA assessments than projected. Xcel Gas proposed to increase its natural gas SEP Rider rate by 53.69 percent primarily due to a swing in the tracker balance. Xcel Gas explained that the actual 2016 SEP Rider collections were $111,327 lower than forecasted and that lower actual sales volumes during the 12-month 2016 SEP period contributed to this revenue shortfall.

The table below demonstrates that, with the exception of the low 2015 rate (caused by inadvertent omission of prior year interdepartmental revenue), the proposed 2017 SEP Rider rate is fairly consistent with previous rates.

Year	Rate per Therm	Average Annual Residential Bill Impacts*
Proposed 2017	$0.002103	$1.64
2016	$0.001368	$1.07
2015	$0.000724	$0.56
2014	$0.002238	$1.75
2013	$0.002736	$2.13
2012	$0.002535	$1.98

Year	Rate per Therm	Average Annual Residential Bill Impacts*
2011	$0.001320	$1.03
Average (without 2015)	$0.002050	$1.60

The Department recommended that Xcel Gas be required to recalculate the 2017 SEP Rider revenue requirements and factor, to incorporate any decisions Ordered by the Commission.

Reliability Administrator Costs & Assessment for Department Regional and National Duties

Reliability Administrator costs are related to expenses incurred by the Minnesota Department of Commerce, Division of Energy Resources, for services provided to the Commission and the public on reliability issues and other proceedings, analysis, or projects. In this proceeding, the Company is asking the Commission to allow it to recover $10,565 of RA costs. In 2016 the Commission allowed recovery of $31,557.

The Department took issue with the fact that Minn. Stat. § 216C.052, the Reliability Administrator statute was repealed in the 2011 legislative session. The Company acknowledged that while the statute was repealed in 2011, the legislature enacted Minn. Stat. § 216B.62, subd. 3 and authorized an Assessment for Department Regional and National Duties (Assessment) [1] to replace the Reliability Administrator statute. Xcel stated that for consistency with prior rider filings, it continued to label the Assessment costs as Reliability Administrator costs. The Company clarified it is requesting cost recovery under the Assessment statute Minn. Stat. § 216B.62, subd. 3b.

The Company stated that the Assessment statute contained a provision to sunset on June 30, 2017 and later informed staff that the legislature extended the sunset date to June 30, 2018.[2] Because legislative attention is being given to the statute and the SEP Rider is subject to a true-up, the Department stated it does not object to Xcel Gas' inclusion of the proposed RA budget amount of $10,565 in the SEP rider.

PUC Staff Analysis

Staff recommends that the Commission continue to allow recovery of the Assessment costs included in the rider. To avoid confusion in its next filing, staff suggests that that Commission may want to include an order point to direct the Company to change the labeling of these costs from "RA" (for Reliability Administrator) to "Assessment" (for Assessment for Department

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[1] Department Regional and National Duties are defined in Minn. Stat. § 216A.07. subd 3(a) as: "The Department of Commerce has the duty and power to represent the interests of Minnesota residents, businesses, and governments before bodies and agencies outside the state that make, interpret, or implement regional, national, and international energy policy and that regulate and implement regional or national energy planning or infrastructure development. …"

[2] Minn. Laws, Chapter 94, S.F. No. 1456 (2017)

Regional and National Duties) in its next filing.

Greenhouse Gas Infrastructure Costs – Cast Iron Replacement Project

Greenhouse gas infrastructure costs are costs that were previously incurred for replacement of cast iron distribution pipes. The Company is required to credit any proceeds received from the sale of carbon offsets or credits associated with the cast iron replacement program.[3] The Company completed replacement of 25 miles of cast iron pipe in 2012 which continue to be recovered through the SEP rider. No new cast-iron pipe replacement costs have been incurred since then. For 2017, the Company is requesting recovery of approximately $1.75 million.

Background

Cast iron pipe was commonly used in installations of natural gas distribution systems through the first half of the twentieth century. It was a material that was readily available and typically installed in ten-foot lengths with caulked joints. Northern States Power Company (NSP) installed a significant amount of cast iron pipe first in manufactured gas distribution systems, and later in natural gas distribution systems, as natural gas was brought into NSP's St. Paul service area in the 1930s. While cast iron pipe was common in the industry, it was prone to problems including:

- Leaking and cracking if soil around the piping is disturbed;
- Becoming graphitized as it ages, increasing the risk of cracking;
- Drying out at the caulked joints, increasing the risk of cracking;
- Susceptibility to leaking at the fused or welded connection points that are present because cast iron piping must be done using a mechanical fitting or by tapping and threading; and
- Susceptibility to water infiltration due to being operated at low pressure, which can cause operating issues in distribution systems and cause problems for end users of natural gas.

The Company replaced some cast iron pipe as failures occurred and as street construction work impacted areas with cast iron distribution systems, but requested SEP Rider recovery to replace the remaining cast iron pipe in its distribution system from 2008-2012. There is no dispute that regardless of where the Cast Iron Pipe Replacement Project costs are recovered, these costs were prudently incurred and the project was important for public safety.

Replacement of Statute

The Department noted Minn. Stat. § 216B.1637 which authorized the Greenhouse Gas Infrastructure Program (which is also referred to as the Cast Iron Replacement Project) was repealed in 2013. The statute authorized the Commission to allow recovery of the utility's investment and expenses associated with approved projects through a rate adjustment mechanism. The Department stated it did not find any legislation to replace the statute to allow

[3] The Company confirmed it has not sold any carbon offsets or credits for greenhouse gas emissions associated with the Cast Iron Replacement project. There are no carbon offsets or credits included in the SEP rider.

cost recovery through a rider mechanism, so it is unclear if it is permissible for Xcel to continue to recover these costs through a rider mechanism.

The Company stated that the repeal of Minn. Stat. § 216B.1637 in 2013 arose from one of three Commission-requested amendments.[4] The Company argued that Minn. Stat. § 216B.1635, the standalone Gas Utility Infrastructure Cost (GUIC) Rider bill, was intended to replace the Greenhouse Gas Infrastructure Program statute to continue rider recovery under a new statutory provision.

The Department stated that Xcel currently has a GUIC Rider in place.[5] If in fact the Company believed that the legislative actions intended to continue rider recovery under a new statutory provision, then it would seem that Xcel Gas would have submitted a request to transfer the GHGI costs from the SEP Rider to the GUIC Rider to be evaluated under the new legislation. Because Xcel has not requested or provided support for transferring costs from the SEP Rider to its GUIC Rider. The Department stated it has not evaluated whether the cast iron pipe replacement project qualifies under Minn. Stat. § 216B.1635.

PUC Staff Analysis

Minn. Stat. § 645.35 provides: *"The repeal of any law shall not affect any right accrued, any duty imposed, any penalty incurred, or any proceeding commenced, under or by virtue of the law repealed."* Xcel Gas's SEP rider, which was originally approved pursuant to Minn. Stat. § 216B.1637, may continue to be used to collect the infrastructure costs approved by the Commission for recovery prior to that law's repeal.

The repeal of Minn. Stat. § 216B.1637 does not have any bearing on the issue of whether the Commission can or should fold the SEP rider into another Xcel rider to simplify customer billing, eliminate customer confusion, and/or streamline regulatory oversight of Xcel rider recovery.

Ongoing Approval

The Commission has made decisions on four annual SEP Rider filings since the repeal. In each of the four SEP Rider filings, the Commission allowed for the continued recovery of the Cast Iron Pipe Replacement Project. This fact, when coupled with the legislative author's comment that the Commission requested the repeal, suggests to Xcel that the Commission similarly did not intend to disallow SEP Rider recovery of the Cast Iron Pipe Replace Project costs that had already been incurred.

The Department argued that perhaps the Commission allowed continued recovery of the Cast Iron Replacement Project because it was not aware that Minn. Stat. § 216B.1637 had been repealed and the Company's filing was not transparent about the repeal. The Company's filings

[4] Included as Attachment A to Xcel's April 10, 2017 Reply Comments.

[5] Xcel's most recent GUIC Rider filing is pending before the Commission in Docket No. G-002/M16-891.

continued to reference these statutes in a similar manner after the statutes were repealed through its 2016 SEP filing.

From its review of record information, the Department concluded that the Department's comments did not recognize, and the Commission was not informed, that the authority for use of a rider mechanism for recovery of these costs was repealed. Additionally, Xcel's reply comments filed in this proceeding provided no verifiable support or evidence of the intent of the Commission's requested bill amendment to repeal Minn. Stat. § 216B.1637.

Xcel disagreed with the Department's argument that the repeal of the statutes authorizing SEP recovery was not transparent. Xcel stated the amendment to repeal the statute was requested by the Commission and it is reasonable to conclude that the Commission was aware of the repeal.

No Recovery of New Investment

The Company acknowledged that because Minn. Stat. § 216B.1637 has been repealed, it cannot seek to recover any new investments under the statute and would instead need to seek authority to recover new investments under a different rider or in a general rate case. With respect to the cast iron pipe replacement projects, the Company stated that the SEP Rider is recovering the revenue requirements for projects constructed and costs incurred before the statute was repealed.

The Department agreed with Xcel that cast iron replacement infrastructure costs were incurred prior to the repeal of the statute. To ensure a more complete understanding of the record, the Department stated that in addition to costs incurred before the statute was repealed, the revenue requirement also includes annual property taxes, interest expense and a return on investment associated with the project. These are costs which are incurred after the repeal of the statutes.

Xcel noted that the Commission approved property tax recovery in the SEP Rider of $228,825 in 2013 for the same property when the GHGI Statute was repealed. The Company further noted that Property Taxes were approved for inclusion in the revenue requirement calculation associated with the Cast Iron Pipe Replacement Project. Like Income Taxes and Interest Expense, these are appropriate project costs and should be treated as such.

PUC Staff Analysis

When the SEP rider was approved, the Commission contemplated that the rider would be subject to regular future adjustments to account for changes in the variable cost components of the infrastructure covered by the rider (e.g., taxes, etc.), as well as to account for the over/under recovery of costs from year to year. The repeal of Section 216B.1637 does not impact the Commission's authority to allow the Company to recover current cost components through the SEP rider.

Where to Recover Costs

The Company stated it would prefer to continue recovery of the costs through the SEP Rider because it provides greater transparency for examining the Cast Iron Pipe Replacement Project compared to the GUIC Rider. Historical Cast Iron Pipe Replacement Project revenue requirements decline each year since the project has been completed and there are no new expenditures. All of the components of the revenue requirement calculations (Income Taxes, Property Taxes, Interest Expense and Return) are directly associated with the Cast Iron Pipe Replacement Project capital costs. Conversely, new and on- going Integrity Management initiatives recovered through the GUIC and their associated costs vary year over year. Keeping Cast Iron Pipe Replacement Project costs in the SEP tracker, where the data is comparable year over year to past SEP recovery filings, may ease the review and validation process.

If the Commission determines that the SEP Rider should be discontinued, the Company asks that the Commission defer its discontinuance until after the proposed 2017-2018 SEP Period. As the Department suggested, the GUIC Rider would be an appropriate recovery mechanism for the Cast Iron Pipe Project costs since the Company believes the GUIC Statute effectively replaced the GHGI statute. However, the Department's Response Comments note that the Department has not yet fully vetted whether the SEP Rider costs meet the statutory requirements of the GUIC Statute, so a transfer of these costs into another pending docket may not allow for thorough review.

The Department has already submitted two rounds of comments in the currently pending GUIC Rider proceeding. As a result, the more efficient course may be to allow both the SEP and GUIC dockets to conclude before changing course. The Company noted that the majority of the costs in the SEP rider are related to the on-going revenue requirement associated with the Cast Iron Pipe Replacement Project that predates establishment of the GUIC rider. If there is interest in consolidating the rider recovery, the Company believes the Commission could issue an order point that directs the Company to include the Cast Iron Pipe Replacement Project costs under the GUIC Rider (as opposed to the SEP Rider) in its next GUIC Rider filing.

If the Commission believes the SEP Rider costs no longer belong in the SEP Rider, the Company asks for additional time to reset the course for recovery in its next GUIC Rider in November 2018. This will allow for more careful alignment of the two riders' components and allow the Department and the Commission a better opportunity for a thorough review and consideration of the statutes and costs.

Tracker Balance

The Department addressed the $139,726 forecasted under-collection balance in case the Commission decides that there is no statutory reason to continue the SEP rider. The Department recommended that if the SEP rider is discontinued, any under-recovery should remain uncollected by the Company. In the case of an over-collection, a regulatory liability account should be established in order to return the funds to the ratepayers. This could either be accomplished in the Company's next general rate case or through another gas rider which is currently in effect.

Continuation of the SEP Rider

As stated in its primary conclusions and recommendations, the Department recommended that the SEP Rider be discontinued. However, if the Commission decides to allow Xcel Gas' SEP Rider to continue, the Department indicated the Commission will need to make decisions on the following:

- How to account for ADIT;
- What capital structure and rate of return should be used; and
- Approval of the Company's proposed customer notice.

Prorated Accumulated Deferred Income Taxes

Xcel included accumulated deferred income taxes (ADIT) as a reduction to rate base in the calculation of its revenue requirement. The Company stated that ADIT reflects the timing difference between book depreciation and tax depreciation. The Company developed the ADIT deduction in accordance with IRS tax regulation Sec. 1.167(1). The regulation requires the Company to use a pro-rated schedule to calculate the ADIT used to reduce rate base in order to comply with the tax normalization requirements of the code when forecasted information is used to set rates.

The Department explained that the prorated ADIT issue is a result of several recently issued IRS Private Letter Rulings (PLRs). The IRS is concerned that utilities may be violating tax normalization rules by passing back the benefits of accelerated depreciation, via the ADIT credit to rate base, before the benefit is realized. The Department stated that it has expressed concern over ADIT proration in several proceedings before the Commission.[6] The Department has argued that ADIT proration harms ratepayers because it does not recognize the full tax amounts ratepayers have prepaid.

Xcel stated it continues to believe a conservative approach to ADIT treatment is necessary to prevent an IRS normalization violation. Xcel stated it is currently in the process of seeking a PLR from the IRS and anticipates the PLR will resolve the issue of ADIT proration in Xcel Energy rate proceedings. The Company prefers to reflect the prorated balances in the SEP tracker until a PLR is issued resolving the issue. If the PLR indicates an alternative treatment is acceptable to the IRS, the Company would adjust the tracker accordingly to comply with the IRS ruling.

The Department continues to disagree with Xcel on the proration of ADIT overall, but because a forecasted test year was used in this petition, the Department recommended that the Commission approve Xcel Gas' proposed ADIT proration, subject to a true up calculation in the following year using actual non-prorated ADIT amounts.

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[6] See Department March 31, 2017 Comments in this Docket, Attachment 1.

PUC Staff Comment

The Commission may want to ask Xcel to explain when it expects to actually request a PLR from the IRS and when it expects the IRS to issue the requested PLR. A meeting to discuss Xcel's draft of the PLR was held in February 2017 with Commission staff, the Department and the Company present. It is staff's understanding that the Department has continued with its review of the PLR. Xcel stated that in the interim the IRS has issued an additional PLR[7] to another company and that may alter Xcel's thinking on the ADIT proration issue. While this has created some delay in the Company's PLR process, the Company stated it wants to make sure it considers all available information.

Capital Structure and Return on Equity

- *Capital Structure*

Capital structure is used to determine the weighted cost of various types of capital in use in to calculate the Company's authorized return on rate base investments. The Department notes that Xcel Gas is not using a Commission-authorized capital structure. Capital structure is often a disputed element in ratemaking and typically rider mechanisms employ the use of a Commission-authorized capital structure, unless there is a public policy reason to use a different capital structure and rates. The Commission reviews and authorizes capital structures in utilities' general rate case and security filings. Xcel Gas stated that it uses capital structures that were authorized in its recent rate cases for all riders with the exception of the SEP Rider.

In recent decisions pertaining to Xcel's gas rider dockets, the Commission has approved use of a capital structure that was not from Xcel Gas' most recent (2009) gas base rate case, but rather the authorized capital structure from the more recent Xcel Electric rate case.[8] The Commission also ordered the Company to use the same capital structure in Xcel's 2015 Gas Utility Infrastructure Cost Rider petition.[9] The Commission's reasoning in the 2015 GUIC Commission Order, issued August 18, 2016, stated,

> *"The Commission is persuaded that on this record the more reasonable approach is to calculate the rate of return using a capital structure that has been determined based on a fully-developed record."*

The Department's table below shows the weighted pre-tax rate of returns using the Company's proposed cost rates under the three different capital structures: (1) as proposed in this SEP Rider docket, (2) the Commission-authorized capital structure in Xcel Gas' most recent gas base rate case, and (3) the Commission-authorized capital structure in Xcel's most recent finalized electric

[7] Internal Revenue Service PLR 201717008 released April 28, 2017, ruled that the utility's rider true-up of a now historical test period was not subject to the ADIT proration requirement.
[8] See New Area Surcharge, Docket No. G002/M-14-583 and Xcel Gas Utility Infrastructure Cost Rider in Docket No. G002/M-14-336; the Commission approved use of the capital structure authorized in Xcel Energy's most recent electric rate case (Docket No. E-002/GR-13-868) which resulted in a reduced rate of return.
[9] Docket No. G002/M-15-808 (2015 GUIC)

base rate case.

Capital Structure Comparisons Using Proposed SEP Rider ROE of 10.09 Percent:

		2017 SEP Rider			Gas 09-1153			Electric 13-868		
Capital	Cost Rate	Capital Structure	After-Tax	Pre-Tax	Capital Structure	After-Tax	Pre-Tax	Capital Structure	After-Tax	Pre-Tax
Long Term Debt	4.71%	46.05%	2.169%	2.169%	46.74%	2.201%	2.201%	45.61%	2.148%	2.148%
Short Term Debt	1.91%	1.45%	0.028%	0.028%	0.80%	0.015%	0.015%	1.89%	0.036%	0.036%
Preferred Stock	0	0.00%	0.000%	0.000%	0.00%	0.000%	0.000%	0.00%	0.000%	0.000%
Common Equity	10.09%	52.50%	5.297%	9.035%	52.46%	5.293%	9.028%	52.50%	5.297%	9.035%
			7.49%	11.23%		7.51%	11.24%		7.48%	11.22%

The Department observed that the pre-tax overall rate of return results are very similar, but to avoid dispute, and for administrative efficiency, the Department recommended that Xcel Gas use a Commission-authorized capital structure in determining the SEP rider return on rate base, unless Xcel's proposal is shown to be in favor of the consumer by producing a lower pre-tax weighted cost of capital. Minnesota Statutes § 216B.03 requires the Commission to set rates in a manner in which "[a]ny doubt as to reasonableness should be resolved in favor of the consumer."

The Department is cognizant that capital structures across various industries may be different due to the nature of the operations. However, since Xcel Gas operations has not had a base rate case since 2009 and because the Commission decided to use a more recently authorized electric rate case capital structures in Xcel's GUIC rider, for consistency purposes the Department recommended that Xcel use the Commission authorized capital structure in the most recent finalized electric rate case.

- *Return on Equity*

Minn. Stat. §216B.1637, which authorized the Greenhouse Gas Infrastructure Program did not have its own guidance on the return on equity to use for GHGI cost recovery. The Greenhouse Gas Infrastructure statute directs the Commission to Minn. Stat. §216B.16, Subdivision 7b,[10] paragraph (b), part (6), which states:

> *"(b) Upon filing by a public utility or utilities providing transmission service, the commission may approve, reject, or modify, after notice and comment, a tariff that: (6) allows a return on investment at the level approved in the utility's last general rate case, unless a different return is found to be consistent with the public interest;"*

In this petition, Xcel Gas has proposed a return on equity (ROE) of 10.09% which was authorized by the Commission Order in its most recent gas rate case (issued December 6, 2010 in Docket No. G-002/GR-09-1153).

In riders, use of the ROE authorized in the most recent rate case is typical. However, Xcel Gas

[10] The Transmission Cost Adjustment statute allows the Commission to authorize rider recovery for certain transmission costs.

recently implemented a Gas Utility Infrastructure Cost recovery rider (Docket Nos. G-008/M-14-336 & G-002/M-15-808), for which the Commission had required Xcel Gas to pre-file rate of return information to allow parties the opportunity to fully vet Xcel's proposed rider rate of return.

In the 2015 GUIC filing, Xcel Gas stated that its last authorized 10.09 percent ROE was within the range of reasonableness. Both the Department and the Office of Attorney General - Residential Utility and Antitrust Division (OAG) objected and recommended lower ROEs. The Commission Ordered the Company to use a ROE of 9.64 percent as part of its 2015 GUIC Rider calculations. The 9.64 percent was recommended by the Department, and Xcel Gas did not object in light of declining returns on equity.

In its pending 2016 GUIC petition (Docket No. G-002/M-16-891), Xcel Gas proposed a 9.50 percent cost of equity which is lower than the 10.09 percent cost of equity the Company is using in this docket for its gas SEP Rider; the Department recommended an overall rate of return of 9.04 percent. The SEP Rider and GUIC Rider dockets cover similar time periods and were filed within three months of each other. The SEP Rider is using the 2009 ROE value, whereas the GUIC Rider is using a more current ROE. Minnesota Statutes § 216B.03 requires the Commission to set rates in a manner in which:

> *"[a]ny doubt as to reasonableness should be resolved in favor of the consumer."*

If the Commission allows Xcel to continue use of the SEP rider, the Department recommended that the Commission set the ROE at 9.04 percent for the SEP rider, the same ROE that the Department recommended in the GUIC rider. If the Commission sets a different ROE in the 2016 GUIC petition, the Department recommended that the Commission direct Xcel Gas to use the ROE authorized in G-002/M-16-891.

The following Table 5 shows the weighted pre-tax rates of return using the Company's proposed debt cost rates and a 9.04 percent cost of equity rate the Department recommended in G-002/M-16-891, under the three different capital structures discussed previously: (1) Xcel Gas's proposed SEP Rider capital structure, (2) the Commission- authorized capital structure in Xcel Gas's most recent gas base rate case, and (3) the Commission-authorized capital structure in Xcel Gas's most recent finalized electric base rate case.

Table 5 – Overall Rate of Return Using GUIC Rider Proposed ROE of 9.04 Percent

		2017 SEP Rider			Gas 09-1153			Electric 13-868		
Capital	Cost Rate	Capital Structure	After-Tax	Pre-Tax	Capital Structure	After-Tax	Pre-Tax	Capital Structure	After-Tax	Pre-Tax
Long Term Debt	4.71%	46.05%	2.169%	2.169%	46.74%	2.201%	2.201%	45.61%	2.148%	2.148%
Short Term Debt	1.91%	1.45%	0.028%	0.028%	0.80%	0.015%	0.015%	1.89%	0.036%	0.036%
Preferred Stock	0	0.00%	0.000%	0.000%	0.00%	0.000%	0.000%	0.00%	0.000%	0.000%
Common Equity	9.04%	52.50%	4.746%	8.095%	52.46%	4.742%	8.089%	52.50%	4.746%	8.095%
			6.94%	10.29%		6.96%	10.31%		6.93%	10.28%

PUC Staff Analysis

Staff notes that as of the time this petition will be heard, the 2016 GUIC rider petition is still pending and the ROE and capital structure for that rider have not been determined.

The Commission has concluded an additional Xcel electric rate case[11] since that last round of comments were received in this docket and issued an Order on June 12, 2017 in that rate case. In the June 12, 2017 Order, the Commission authorized the following capital structure and cost of equity. Because Xcel filed a multi-year rate case, staff believes that the capital structure and cost of equity determined for either 2017 or 2018 would be a reasonable alternative. While the alternative is higher than the Department's recommendation of a 9.04 percent return on equity, the after tax rate of return of 6.93 percent, it is lower than Xcel's proposed 10.9 percent return on equity and after tax rate of return of 7.49 percent. The capital structure and the return on equity from Xcel's multi-year rate plan have been found to be reasonable by the Commission and are based on the most current financial market information.

2017 Capital Structure

Capital	Rate	Capital Structure	After-Tax	Pre-Tax
Long Term Debt	4.81%	46.04%	2.21%	2.21%
Short Term Debt	3.57%	1.46%	0.05%	0.05%
Common Equity	9.20%	52.50%	4.83%	8.46%
Total			7.09%	10.72%

2018 Capital Structure

Capital	Rate	Capital Structure	After-Tax	Pre-Tax
Long Term Debt	4.77%	46.41%	2.21%	2.21%
Short Term Debt	4.45%	1.09%	0.05%	0.05%
Common Equity	9.20%	52.50%	4.83%	8.46%
Total			7.09%	10.72%

Customer Notice

Xcel Gas proposed to implement the following bill message, effective the first month the 2017 natural gas SEP rate factor takes effect, to notify customers of the change in their monthly bills:

> *"We have updated the Resource Adjustment line item on your bill to reflect changes in the State Energy Policy (SEP) portion of the Resource Adjustment, which recovers the costs of State energy- related mandates and greenhouse gas emissions reductions associated with the cast iron replacement program. The natural gas SEP portion of the Resource Adjustment increased to $0.002103 per therm."*

[11] Docket No. E-002/GR-15-826.

Xcel Gas stated it would work with Commission Staff regarding this proposed customer bill message in advance of implementation.

The Department pointed out that while Xcel Gas' proposed message is consistent with the language the Company proposed in its last SEP filing, the Department pointed out that it is not consistent with the language in Xcel's most recent natural gas SEP compliance filing.[12] The most recent language used, presumably modified after Xcel worked with Commission staff reads:

> "We have updated the Resource Adjustment line item on your bill to reflect changes in the State Energy Policy (SEP) portion of the Resource Adjustment, which recovers costs for cast iron pipe replacement and to support State energy efficiency and conservation policy. The natural gas SEP portion of the Resource Adjustment increased to $0.00xxxx per therm."

The Department did not object to the language in either message but did point out this discrepancy. The Department stated it understands that customer notice language is not necessarily static, and may be modified over time. The Department recommended that in future annual SEP petitions, Xcel Gas include the most recent billing message language approved by the Commission, along with any proposed modifications. This approach would improve efficiency and transparency of the proposal and would allow for conscientious evolution of bill messages as the Commission determines to be reasonable.

Decision Alternatives

The Commission will first need to decide how it will treat the SEP rider:

1) Allow Xcel Gas to continue to recover approximately $1.83 million of costs through its SEP rider until all costs are recovered or the Company files a general rate case, with the understanding that no new costs will be added or recovered through the SEP rider. (Xcel preferred); OR

2) Allow Xcel Gas to continue to recover approximately $1.83 million of costs through its 2017 SEP rider.

   Direct Xcel Gas to submit a proposal, in a compliance filing within sixty days of the Commission's order, for transitioning cost recovery to the GUIC rider beginning with the Company's 2018 GUIC rider.

   Require Xcel Gas to include in its proposal an explanation of how:

   (a) assessments for Department Regional and National Duties, and
   (b) Cast-Iron Pipe Replacement costs

[12] Docket No. G-002/M-16-206, Compliance filing, May 26, 2016.

meet the statutory definition of gas utility infrastructure costs or projects, pursuant to Minn. Stat. § 216B.1635. (Xcel alternative, modified); OR

3) Do not allow the Company to recover costs through the SEP rider.[13] Determine that any under-recovery of the tracker balance should remain uncollected by the Company. In the case of an over-collection, require the Company to establish a regulatory liability account in order to return the funds to the ratepayers.[14] (Department)

If the Commission decides to allow the Company to continue to recover its costs through the SEP rider it will need to make decisions on the following issues:

Reliability Administrator Costs

4) Permit Xcel Gas to include the proposed Reliability Administrator (RA) budget costs of $10,565. (Department, Xcel)

Proration of Accumulated Deferred Income Taxes

5) Allow Xcel Gas to prorate its accumulated deferred income taxes in the SEP rider with the understanding that the proration is subject to a true-up calculation in the following year using actual non-prorated ADIT amounts. (Department)

6) Allow Xcel Gas to reflect the prorated accumulated deferred income taxes in the SEP rider with the understanding that the proration is subject to a true-up calculation when Xcel receives a private letter ruling, addressed to Xcel, that resolves treatment of the ADIT proration issue. (Xcel)

7) Do not allow Xcel to prorate its accumulated deferred income taxes in the SEP rider.

Capital Structure and Return on Equity

8) Approve Xcel's proposed capital structure for this rider, which has not been previously authorized by this Commission, and its proposed return on equity of 10.09%, as authorized in Xcel's last gas rate case in Docket No. 09-1153. This is Xcel's proposed capital structure and ROE in the 2017 SEP rider filing. (Xcel, Department does not object, but only if this proposal is determined to favor the ratepayers); OR

Capital	Rate	Capital Structure	After-Tax	Pre-Tax
Long Term Debt	4.71%	46.05%	2.169%	2.169%
Short Term Debt	1.91%	1.45%	0.028%	0.028%

[13] The Company could request recovery of the SEP costs in its next general rate case filing.
[14] This could either be accomplished in the Company's next general rate case or the Company could propose to return the funds to ratepayers through another gas rider which is currently in effect.

Capital	Rate	Capital Structure	After-Tax	Pre-Tax
Common Equity	10.09%	52.50%	5.297%	9.035%
Total			7.49%	11.23%

9) Approve the capital structure authorized in Xcel Electric's last (2013) electric rate case and the 9.04 percent ROE the Department recommended in Xcel's GUIC in Docket No. G-002/M-16-891 (Department): OR

Capital	Rate	Capital Structure	After-Tax	Pre-Tax
Long Term Debt	4.71%	45.61%	2.148%	2.148%
Short Term Debt	1.91%	1.89%	0.036%	0.036%
Common Equity	9.04%	52.50%	4.746%	8.095%
Total			6.93%	10.28%

10) Approve either the 2017 capital structure OR the 2018 capital structure and return on equity of 9.20 percent as determined in Xcel Electric's most current (2015) multi-year rate plan in Docket No. E-002/GR-15-826:

2017 Capital Structure

Capital	Rate	Capital Structure	After-Tax	Pre-Tax
Long Term Debt	4.81%	46.04%	2.21%	2.21%
Short Term Debt	3.57%	1.46%	0.05%	0.05%
Common Equity	9.20%	52.50%	4.83%	8.46%
Total			7.09%	10.72%

2018 Capital Structure

Capital	Rate	Capital Structure	After-Tax	Pre-Tax
Long Term Debt	4.77%	46.41%	2.21%	2.21%
Short Term Debt	4.45%	1.09%	0.05%	0.05%
Common Equity	9.20%	52.50%	4.83%	8.46%
Total			7.09%	10.72%

Housekeeping Issues

11) Require Xcel Gas is to submit a compliance filing by each March 1 containing the actual and forecasted information needed to determine any true-up amount to be recovered from or returned to ratepayers as a result of the operation of the SEP Rider. Also require the Company to submit a miscellaneous filing to establish new SEP Rider rates for the subsequent fiscal year, incorporating amounts anticipated to be incurred and including any true-up amounts from the operation of the SEP Rider during the current year.

12) Require Xcel Gas to provide a comparison between actual and budgeted monthly costs in the Company's future SEP Rider filings, including a discussion of reasons for deviations from budgeted amounts (both higher and lower).

13) Require the Company to revise labeling and provide correct descriptions in its SEP Rider petition in future years to make clear exactly which costs are included and not included in its proposed SEP Rate.

14) Require Xcel Gas to recalculate the 2017 SEP Rider revenue requirements and factor, to incorporate all of the Commission's decisions and to submit revised schedules and factor reflecting these modifications, highlighting the values that differ from the initial filing schedules.

15) Require Xcel Gas to include the most recent billing message language approved by the Commission, along with any proposed modifications, in future SEP Rider petitions.

Recommendation

1, 4, 5 OR 6, 10, 11, 12, 13, 14, 15