BEFORE THE MINNESOTA OFFICE OF ADMINISTRATIVE HEARINGS
600 NORTH ROBERT STREET
ST. PAUL, MINNESOTA 55101

FOR THE MINNESOTA PUBLIC UTILITIES COMMISSION
SUITE 350
121 SEVENTH PLACE EAST
ST. PAUL, MINNESOTA 55101-2147

Beverly Jones Heydinger	Chair
David C. Boyd	Commissioner
Nancy Lange	Commissioner
Dan Lipschultz	Commissioner
Betsy Wergin	Commissioner

IN THE MATTER OF THE APPLICATION OF NORTHERN STATES POWER COMPANY, D/B/A XCEL ENERGY, FOR AUTHORITY TO INCREASE RATES FOR ELECTRIC SERVICE IN MINNESOTA

MPUC Docket No. E-002/GR-13-868
OAH Docket No. 68-2500-31182

POST HEARING REPLY BRIEF OF THE MINNESOTA DEPARTMENT OF COMMERCE

Dated: October 14, 2014

Respectfully submitted,

LINDA S. JENSEN
Attorney Reg. No. 0189030
Telephone: 651-757-1472

PETER E. MADSEN
Attorney Reg. No. 0392339
Telephone: 651-757-1383

JULIA E. ANDERSON
Attorney Reg. No. 1038721
Telephone: 651-757-1202

445 Minnesota Street, Suite 1800
St. Paul, MN 55101-2134

Attorneys for Minnesota
Department of Commerce

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INTRODUCTION

The Minnesota Department of Commerce, Division of Energy Resources, Energy Regulation and Planning Unit (the Department or DOC) respectfully submits this Reply Brief to Administrative Law Judge (ALJ) Jeanne M. Cochran and the Minnesota Public Utilities Commission (Commission). Filed separately are Proposed Findings of Fact pertaining to the application for a general rate increase filed by Northern States Power Company, d/b/a Xcel Energy (NSP, Xcel, or the Company).

The sole purpose of the Department's Reply Brief is to respond to Xcel and other parties' Initial Briefs. The Department does not repeat in these pages the extensive analyses and recommendations set forth in its Initial Brief, its Comments to Xcel's Issues Matrix, and its Proposed Findings of Fact, on and for which the Department continues to rely and advocate.

ARGUMENT

I. XCEL ALONE BEARS THE BURDEN OF PROOF

A. Xcel Appears to Urge Application of Incorrect Legal Standards

The principal issue before the Commission is whether Xcel demonstrated that its proposed rate changes are just and reasonable. Minn. Stat. § 216B.16, subd. 4 (2014). The benefit of "any doubt" as to reasonableness must go to the ratepayer. Minn. Stat. § 216B.03.

The above standards are well-understood and have been diligently applied in countless proceedings before the Commission. In this case, however, Xcel encourages the Commission to side-step legal criteria and apply a quite different and erroneous standard. The following quotations from the first few pages of Company's Initial Brief suggest that the Commission should use an incorrect outcome-based approach rather than a record-based analysis of facts presented in this matter:

> [Regarding the Company's identification of five financial issues of priority to the Company]
>
> Not only is this significant from a revenue perspective, but the *outcome* on these handful of issues *may also affect our ability to conduct our business* in concert with rapidly evolving *state energy policy goals* while continuing to provide *safe and reliable* electric service to our customers.
>
> * * *
>
> This case is therefore about obtaining sufficient *regulatory support* to enable the Company to provide high quality electric service in the future.[citation omitted]
>
> * * *
>
> Put differently, this standard [§ 216B.16, subd. 6] is about *supporting* the need for adequate public utility service while recognizing that the utility must recover sufficient revenues to support its reasonable investments needed to provide public service.

Xcel Initial Br. at 2, 5, 7 (emphasis added).

Clearly, "outcome" is not a legal criterion, and neither is "obtaining sufficient regulatory support." This case is about whether Xcel has satisfied its statutory burden of proving that ratepayers should bear its proposed rate increase, as required by Minnesota Statutes section 216B.16, subdivision 4: "The burden of proof to show that the rate change is just and reasonable shall be upon the public utility seeking the change." That is, the burden of proof is on Xcel to show that *any* increase in rates to its customers is just and reasonable; Xcel cannot charge higher rates on a permanent basis without this showing. Xcel's suggestion that it may not continue to abide by its legal obligations regarding "state energy policy goals" or that it may not provide "safe and reliable electric service" would violate existing legal requirements, such as Minnesota Statutes section 216B.04, which requires that "[e]very public utility shall furnish safe, adequate, efficient, and reasonable service."

The Company's inclusion of clearly inappropriate considerations while omitting important legal requirements is concerning. For instance, nowhere in its 151 page Initial Brief did Xcel acknowledge Minnesota law that provides, "Any doubt as to reasonableness should be resolved in favor of the consumer." Minn. Stat. § 216B.03. The correct legal criteria must guide the Commission's decision-making.

B. Minnesota Legal Criteria

Critical to consideration of Xcel's Initial Brief is the legal requirement that the Company—not public agencies, other parties, or the Commission—bears the burden to demonstrate that its proposed rate increase is just and reasonable. Minn. Stat. § 216B.16, subd. 4 (2014), noted above; *In re Petition of N. States Power Co.* (*N. States Power*), 416 N.W.2d 719, 724–726 (Minn. 1987) (providing the Minnesota Supreme Court's analysis of Minnesota Statutes section 216B.16, subdivision 4, concluding that a utility does not enjoy at any point in a rate case proceeding a rebuttable presumption of reasonableness that other parties must overcome). Further, Minnesota law provides, "*Any doubt as to reasonableness* should be resolved in favor of the consumer." Minn. Stat. § 216B.03 (emphasis added).

In *N. States Power*, the Minnesota Supreme Court also determined that a public utility does not necessarily satisfy its burden of proof by merely showing that it incurred costs or that it accurately calculated such costs. *N. States Power*, 416 N.W.2d at 723. The Court noted, as with numerous issues in the instant case, that costs a utility seeks to recover from ratepayers are often undisputed. *Id.* The burden, correctly stated, is ultimately whether the utility has reasonably shown that ratepayers should bear those costs. *Id.*

In setting rates, the Commission acts in both a quasi-judicial and quasi-legislative capacity. *Id.* at 722. In these roles, the Commission evaluates "whether the inclusion of the item generating the claimed cost is appropriate, or whether the ratepayers or the shareholders should sustain the burden generated by the claimed cost . . . ." *Id.*

To the extent that Xcel failed to show the reasonableness of its requests (*i.e.*, that its proposed expenses are greater than "sufficient" or its expected revenues are unreasonably low) the Department either recommended rejection of such proposals or proposed adjustments to Xcel's proposals so that the Company might realize some—rather than none—of its requests in a just and reasonable manner. To be clear, however, there is no duty of the Department (or any other party for that matter) to propose adjustments: parties simply could recommend complete rejection of the Company's unproven proposals.

It is troubling that at times Xcel suggests that parties other than itself bear a burden of proof. That is, in response to Department conclusions that Xcel failed to demonstrate the reasonableness of its proposals, the Company focused on whether a Department alternative is reasonable rather than on whether, in fact, Xcel showed that its own proposals were reasonable. Such Company statements conflict with Minnesota Statutes, muddy the record, attempt to impose a burden on the Department (and Commission) that is not found in either statutory or case law, and misconstrue the goal of the Department's recommended adjustments. Where the Company did not show that Xcel's proposals were just and reasonable, it would have been consistent with Minnesota statutes for the Department to recommend complete disallowance of the requested rate changes. The Department chose instead to recommend more reasonable recovery of such costs. Making such recommendations does not, however, mean that the burden of proof shifted to the Department.

II. THE DEPARTMENT'S RECOMMENDATIONS FOR XCEL'S OVERALL COST OF CAPITAL, COST OF EQUITY CAPITAL, AND CAPITAL STRUCTURE ARE REASONABLE

A. Introduction

In its Initial Brief, the Department demonstrated that its recommended return on equity (ROE), its recommended overall rate of return (ROR), and its recommended capital structure are reasonable. DOC Initial Br. at 10–45. The ICI Group is the only party in this proceeding that disputed Xcel's proposed capital structure. ICI Initial Br. at 12–15. No party in this proceeding disputed the cost of long- and short-term debts. In this Reply Brief, the Department discusses the various parties' initial briefs regarding a reasonable ROE for Xcel.

Other than the Department, the following parties evaluated the reasonableness of Xcel's proposed ROE in their initial briefs: Xcel, AARP, the Commercial Group, and the ICI Group. Xcel Initial Br. at 15–32; AARP Initial Br. at 14–16; CG Initial Br. at 2–9; ICI Initial Br. at 12–15. The Department extensively discussed Xcel and other parties' ROE analyses in its Initial Brief and does not do so here. DOC Initial Br. at 10–45. However, the Department replies to each of the above-listed parties' ROE briefing.

B. The Department's Reply to Xcel's Initial Brief

Xcel's main argument is that the Department's ROE recommendation in its Surrebuttal Testimony is lower than the Department's ROE recommendation in its Direct Testimony. Xcel Initial Br. at 19–21. Moreover, because of the recent volatility of the stock market, Xcel argues that the Department's updated ROE may not be appropriate. *Id.* The Company also argues that, despite the fact that it was Xcel's choice to file a multi-year rate plan (MYRP), the MYRP increases Xcel's risk because its rates would be fixed for two years. *Id.* at 16–17, 19, 26–27. The Company also repeated its arguments that it faces higher risks due to its sizable future capital expenditures and that the Department's recommended ROE is in the bottom 20% of Commission-approved ROEs since August, 2013. *Id.* at 21–26. Therefore, according to Xcel, the Department's final recommendation should not be relied upon for ratemaking purposes.

The Department disagrees with the Company for the following reasons:

1. Xcel misapplied the concept of volatility. Therefore, the Company made erroneous statements regarding the results of the DCF analysis.

2. Xcel's comparison of the Department's ROE recommendation with ROEs approved by Public Utilities Commissions in other jurisdictions is misplaced.

1. Xcel's Arguments Regarding the Department's DCF Analysis Are Not Reasonable

Regarding the Department's updated ROE recommendation, Xcel argues that the rapid decline in the dividend yields for both Dr. Amit and Mr. Hevert in their Surrebuttal Testimonies represent unusually high valuation levels for utilities. Xcel Initial Br. at 20. Furthermore, Xcel contends that current financial market volatility means that reducing the ROE below 9.83% would cause it significant financial harm. *Id.* at 19.

Xcel's arguments misinterpret the purpose of a DCF analysis. First, an appropriate DCF analysis is based on forward-looking expectations, not history. As such, the DCF analysis is based on changes in current stock prices, reflective of when the utility chooses to file a rate case. Current stock prices appropriately reflect expected market conditions, not historical conditions. Therefore, comparing the Department's final ROE recommendation with the ROE authorized in Xcel's 2012 rate case (9.83%, based on market conditions during February 25, 2013 through March 24, 2013) is a meaningless exercise. Further, such an approach would be inconsistent with the basis for that ROE, since, for example, Dr. Amit's surrebuttal testimony in that proceeding stated explicitly at page one that "it is important to use the most recently available dividend yields when relying on a DCF analysis."

Second, the Department's initial DCF analysis was based on average prices over the period October 1, 2013 through October 31, 2013 and its updated DCF analysis was based on average prices over the period June 7, 2014 through July 7, 2014. For these two periods, which are about seven months apart, the Dow Jones Industrial Average went up by about 13.76%.[1] So

[1] Yahoo! Finance, *http://finance.yahoo.com/q?s=^gspc* (last visited Oct. 3, 2014).

the change in DCF data simply reflects changes in the overall stock market, which in turn reflects investors' expectations regarding the state of the economy.

Third, the Company confused the concept of volatility with the concept of trend. Volatility measures changes above and below an average value over a given time period. It does not measure, however, the absolute change in value over a given time period. A commonly used volatility measure, VIX, measures the volatility of the S&P 500. The average VIX over the period October 1, 2013 through October 31, 2013 was 15.41 compared to the average VIX of 11.40 for the period June 7, 2014 through July 7, 2014.[2] Thus, counter to Xcel's claim, market volatility went *down*, not up, during the Surrebuttal Testimony period as compared to volatility during the Direct Testimony period.

Moreover, the Company's claim that utility valuation was unusually high during the period June–July, 2014 is not supported by publicly available information. To assess this claim, it is reasonable to examine the valuation of the well-known iShares U.S. Utilities Index Fund (IDU). Over the period June 7, 2014 through July 7, 2014, the average price for the IDU was $106.70, compared to an essentially unchanged price of $106.26 on October 3, 2014.[3] Clearly then, there was no material change in electric utility valuation for these periods, and the period June–July, 2014 reflected investors' expectations about the future prices of electric utilities.

Fourth, Xcel's comparison of the Department's recommended ROE with authorized ROEs in other jurisdictions is irrelevant. Xcel Initial Br. at 24–26. Authorized ROEs in other jurisdictions are based on much earlier time periods than the period used by the Department, and

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[2] MSN Money, *http://preview.msn.com/en-us/money/indexdetails/fi-33.10.vix?ocid=INSFIST10* (last visited Oct. 3, 2014).
[3] Yahoo! Finance, *http://finance.yahoo.com/q?s=idu* (last visited Oct. 3, 2014).

therefore, are based on completely different economic and financial environments that are likely to produce different and inapplicable ROE estimates.

Finally, Xcel's argument that the nature of a MYRP increases Xcel's risk is meritless. If true (which it is not), Xcel could have avoided it by simply not requesting a MYRP. Moreover, the required rate of return may go down or up in 2015, which may render a MYRP risk-neutral.

C. Other Parties' Briefs

1. The ICI Group

a. The ICI Group's Proposed ROE Is Not Reasonable

The ICI Group misrepresents Dr. Amit's analysis by arguing that he eliminated companies with an ROE smaller than 8% "because it does not fit with his preconceived notions of what the data should look like." ICI Initial Br. at 14. Dr. Amit explained that he eliminated companies with a ROE smaller than 8% because such an ROE indicates an unreasonable low risk premium compared with risk premiums estimated by other well-accepted financial models. DOC Ex. 400 at 14–17 (Amit Direct). The ICI Group's ROE witness Mr. Glahn failed to show anywhere in his testimony that Dr. Amit's risk premium check on his DCF estimates is not reasonable. This fact is not surprising in view of Mr. Glahn's non-analytical selection of his comparison group and his misapplication of the DCF analyses. DOC Ex. 402 at 1–15 (Amit Rebuttal). The ICI Group claims that for companies with DCF-estimated ROEs of less than 8%, "all have shareholders." ICI Initial Br. at14. But Dr. Amit explained that this fact does not confirm that an 8% ROE is reasonable. Instead, it only shows that these shareholders expect a rate of return higher than the cost of equity for these companies. Tr. Vol. 4 at 40–43. Mr. Glahn appears to treat DCF ROE estimates as an absolute, regardless of their validity, when checked against other reasonable ROE estimates. It is no wonder that under such a view Mr. Glahn included an estimated ROE as low as 5.01% in his DCF analysis. DOC Ex. 402 at 8 (Amit Rebuttal).

b. The ICI Group's Proposed Capital Structure Is Not Reasonable

In its Initial Brief, the ICI Group continued to recommend using Xcel's capital structure—NSP's parent company—rather than NSP's capital structure. ICI Initial Br. at 14–15. The ICI Group's position remains unreasonable because NSP has its own capital structure. The Department's position regarding ICI's proposed capital structure is summarized in its Rebuttal Testimony. DOC Ex. 402 at 14–15 (Amit Rebuttal).

2. The Commercial Group

Mr. Chriss, the Commercial Group's witness, did not perform an independent ROE analysis. *See* CG Initial Br. at 2–3. Instead, Mr. Chriss recommended that the Commission review ROEs authorized by various public utility commissions over the period 2012, 2013, and five months of 2014. *Id.* at 3–9. The Department fully explained why relying on other jurisdiction's ROE decisions in earlier rate cases is not reasonable. DOC Ex. 402 at 15–16 (Amit Rebuttal). To summarize, the earlier ROE decisions are based on old data that is irrelevant to the current Xcel rate case. Importantly, investors are well aware of such decisions and as such investor expectations are already incorporated in current DCF analyses.

3. AARP

AARP continues to argue that if the Commission approves a decoupling mechanism for Xcel, then Xcel's authorized ROE should be adjusted downward to recognize a lower financial risk for Xcel. AARP Initial Br. at 14–16. In its Surrebuttal Testimony, the Department explained in detail why it would be inappropriate to adjust Xcel's ROE downward if the Commission orders that the Company adopt a decoupling mechanism. DOC Ex.403 at 26–29 (Amit

Surrebuttal). The Department continues to recommend no ROE adjustment if decoupling is ordered.

D. The Department's Conclusions

Based on the record in these proceedings and its discussion in this Reply Brief, the Department concludes that:

1. Xcel's recommendations for a return on equity of 10.25% or, in the alternative, 9.83% are not supported by the record and should be rejected.

2. The Department's recommended return on equity of 9.64% is well supported by the most currently available market data and reflects consistent application of the DCF model throughout this and prior proceedings.

III. 2014 Test Year Adjustments To Xcel's Proposed Rate BAse and Income Statement

A. Monticello LCM/EPU Projects: Xcel did not Show that the 71 MW EPU Has Been or Is Likely To Be Used and Useful in 2014; Disallowance for the 2014 Test Year and Approval for Rate Base Treatment for the 2015 Test Year are Reasonable. (Issue 2)

1. The Record does not Support a Finding that the EPU Has Been or Is Likely to be Used and Useful in 2014.

The Department agrees with XLI that there has been no material change since Xcel's last rate case, E002/GR-12-961, with respect to the used and useful status of the EPU portion of the Monticello plant: it still is not used and useful, and it is not likely to be used and useful during the 2014 test year. DOC Initial Br. at 76-90; XLI Initial Br. at 8-10. *See* MCC Initial Br. at 3-4. Xcel, however, insists in its Initial Brief at pages 9-10 that the EPU portion of the Monticello plant is used and useful because "all assets serving the combined LCM/EPU program are presently operating in service of customers." *See* Xcel Initial Br. at 2-3, 32-44. The Department continues to disagree. Specifically, the record supports a finding by the ALJ and Commission that Xcel has not shown that the EPU has been or is likely to be used and useful during the 2014 test year. DOC Initial Br. at 76-90. The facts are plain and obvious, and Minnesota law is neither complex nor unclear.

a. Facts

There is no dispute that the record includes the following facts as to the 71 MW EPU uprate which will increase total plant generation capacity to a level of 671 MWe:

- Since the EPU portion of the plant *never* has operated at the full generation 71 MW capacity level (for a total of 671 MWe) approved in the 2008 certificate of need, MPUC Docket No. E002/CN-08-185, the plant also has not operated on an ongoing and sustainable basis of 671 MWe during 2014;

- Xcel has not been approved by the NRC to operate at the full EPU level of 671 MWe;

- Xcel did not pass the NRC testing protocol (power ascension testing) of generating power above the pre-EPU level of 600 MWe; problems (including human performance issues), which occurred in March 2014, required Xcel to power down from a brief (20-day) testing level of 640 MWe to pre-EPU levels;

- Continuing problems (including human performance issues) occurred during later months in 2014, such that the NRC has not yet allowed Xcel to resume the testing protocol;

- As of the close of the evidentiary hearing, the plant still was operated at no higher than pre-EPU levels;

- Xcel confirmed in Mr. O'Connor's Surrebuttal Testimony at 4, that recent additional NRC inquiry will further delay resumption of the testing protocol; and

- The NRC has provided no timeframe when the NRC is likely to authorize Xcel to resume the testing protocol or, assuming that testing is satisfied, when the NRC is likely to license Xcel to operate at 671 MWe.

DOC Initial Br. at 76-90. *See also* XLI Initial Br. at 8-10 and MCC Initial Br. at 3-4.

It is also uncontroverted that solely for financial reporting purposes, but not for ratemaking purposes, the Department did not oppose Xcel's request that the Company be allowed to report the EPU as being "in-service" in accordance with certain accounting provisions. DOC Initial Br. at 90-91. Those financial reporting provisions apparently allow a utility to report a facility as being "in-service" if it operates for 24 continuous hours at any portion of its higher generating capacity. *See id.*

Xcel errs significantly, though, in its claim that "the uncontroverted evidence in this proceeding establishes that the Monticello facility is expected to ascend to its full capacity this year[.]" Xcel Initial Br. at 36. As provided above, the record simply does not support such an expectation, as the Initial Briefs of the Department, XLI and MCC observe.

b. Xcel did not show that the EPU is or is likely to be used and useful under Minnesota law in 2014

The Department continues to support its position, as stated in its Initial Brief at pages 74-94, that Xcel failed to demonstrate that the EPU is, or is likely to be, used and useful under Minnesota law in 2014. For convenience, key Minnesota statutes applicable to whether Xcel demonstrated that the EPU-related capacity is used and useful are provided in relevant part, as follows:

> Minn. Stat. § 216B.16, subd. 4. Burden of proof.
>
> The burden of proof to show that the rate change is just and reasonable shall be upon the public utility seeking the change.
>
> * * *
>
> Minn. Stat. § 216B.16, subd. 6. Factors considered, generally.
>
> The commission, in the exercise of its powers under this chapter to determine just and reasonable rates for public utilities, shall give due consideration to the public need for adequate, efficient, and reasonable service and to the need of the public utility for revenue sufficient to enable it to meet the cost of furnishing the service, including adequate provision for *depreciation of its utility property used and useful in rendering service to the public*, and to earn a fair and reasonable return upon the investment in such property. In determining *the rate base upon which the utility is to be allowed to earn a fair rate of return, the commission shall give due consideration to evidence of the cost of the property when first devoted to public use,* to prudent acquisition cost to the public utility less appropriate depreciation on each, to construction work in progress, to offsets in the nature of capital provided by sources other than the investors, and to other expenses of a capital nature. For purposes of determining rate base, the commission shall

> consider the original cost of utility property included in the base and shall make no allowance for its estimated current replacement value.

Minn. Stat. § 216B.16 (emphasis added). Minn. Stat. § 216B.03 provides that "any doubt as to reasonableness" must be resolved in favor of the consumer. The Department provides the following responses to Xcel's Initial Brief on this topic.

First, Xcel cited no Minnesota judicial decision or Commission order for its claim that partial operation for 20 days of the EPU-related capacity during failed NRC testing satisfies the "used and useful" requirement of Minn. Stat. § 216B.16, subd. 6 (2014), particularly since Xcel did not overcome this failure prior to the close of the record in this proceeding, nor did the Company cite any Minnesota Commission precedent to support its claim. *See* Xcel Initial Br. at 34-36. Instead, when quoting the Commission's actual ordering language of Xcel's most recent rate case concerning Minnesota's "used and useful" standard, MPUC Docket No. E002/GR-12-961, the Company omitted the important proposed findings and analysis of the ALJ, which the Commission adopted with clarifications. Omitted, for example, is the following paragraph of the 12-961 Order at 18:

> The ALJ's findings and conclusions on this issue are addressed in paragraphs 49-85 of the report. Applying Minn. Stat. § 216B.16, the ALJ concluded that the Monticello LCM/EPU project is only used and useful in part. She determined that "the Monticello LCM/EPU capital project is 'in service' but only for LCM purposes. The equipment installed as part of the LCM/EPU project is being used to generate electricity at existing levels, not at the higher EPU level." [FN omitted] Accordingly, she concluded that "[b]ecause the plant is only generating power at existing levels, the EPU portion of the project is not 'in service' or 'used and useful.'" [FN omitted].

The Commission adopted the ALJ's analysis quoted above, and also her recommended finding that only the LCM portion of the LCM/EPU project was used and useful. *Id.* at 19. Since the used and useful issue regarding Monticello's EPU is again before the Commission in this present Xcel rate case, it is important to acknowledge the Commission's previous decision in this regard.

Second, the Department agrees that Xcel appropriately cited a key Minnesota Supreme Court decision regarding interpretation of Minnesota's used and useful standard, *Senior Citizen Coal. v. Minn. Pub. Utils. Comm'n* (*Senior Citizen Coalition*), 355 N.W.2d 295, 300 (Minn. 1984). The Court in *Senior Citizen Coalition* held that, to establish that property is "used and useful" under Minn. Stat. § 216B.16, subd. 6, the utility has the burden to prove: "(1) that the property is 'in service;' and (2) that it is 'reasonably necessary' to the efficient and reliable provision of utility service." *Id.* For a rate case with a future test year, like the current Xcel rate case, the Department agrees that the utility must show that the property likely will be in service during the test year.

That said, Xcel did not cite or discuss Minnesota case law that relied on the *Senior Citizens Coalition* case. For instance, while it did so with some hesitation, the Minnesota Court of Appeals in *Otter Tail Power Co. v. Minn. Pub. Utils. Comm'n*, 417 N.W.2d 677, 686-687 (Minn. Ct. App. 1988) affirmed the Commission's complete denial of rate base treatment for costs associated with a generation plant that was abandoned prior to providing service to ratepayers. The Court of Appeals noted that a contrary interpretation of Minn. Stat. § 216B.16, subd. 6 "must be announced either by our supreme court or by the legislature." *Id.* at 687.

Third, Xcel stated in its Initial Brief (page 37-38) that an "all or nothing" approach to the used and useful standard is "harsh" even though it applies Minnesota law and Commission practice as to when ratepayers should be required to pay for utility facilities. Xcel urged the ALJ and Commission instead to apply Minnesota's used and useful requirement in a flexible, case-by-case basis manner that depends on the circumstances presented, with citation to a Federal Energy Regulatory Commission (FERC) order and a federal case. Xcel Initial Br. at 34-35. Xcel also cited a glossary of terms published by the U.S. Energy Information Administration, apparently to suggest that the Minnesota Commission adopt the following definition of "used and useful": that "an asset currently provide or be capable of providing a needed service to consumers." However, it appears that the Monticello EPU would fail the above definition since the facility is not currently capable, under its NRC operating requirements, of providing the full 671 MWe of electric service, even though it is hoped that the facility will one day be capable of doing so. Moreover, Xcel made these arguments without reconciling to Minnesota's statutory provisions regarding used and useful requirements. That is, Minnesota law states that the Commission is to consider, in determining whether costs of projects can be included in rate base, "evidence of the cost of the property *when first devoted to public use,*" Minn. Stat. § 216B.16, subd. 6 (emphasis added), rather than consider simply whether the property may someday be capable of, but not yet providing, service to ratepayers, and *Senior Citizens Coalition* requires that the facility be in service and be reasonably necessary to the efficient and reliable provision of utility service.

Fourth, the Company cited a Connecticut agency order apparently as a caution that the Minnesota Commission should not interpret Minnesota's used and useful standard to require "absolute certainty" as to when the Monticello EPU-related capacity is likely to be in service. Xcel Initial Br. at 35-36. However, Xcel refuted arguments that no party has made; that is, no party in this case suggested that Xcel must show with "absolute certainty" when the EPU-related capacity is likely to be fully in service to ratepayers.

Moreover, the Connecticut agency order concerns facts and law that are very different from those in the present Xcel rate case. Specifically, the Connecticut agency matter involved three nuclear units that had been fully in service but were on a long-term outage such that the regulatory agency, the Connecticut Department of Public Utility Control (DPUC), was concerned with the extent to which costs of replacement power were being imposed on ratepayers. Under Connecticut law, the DPUC determined that one of the three units was not likely to "restart," such that it was likely to remain out-of-service during the period when rates would be in effect. The DPUC, therefore, disallowed over $100 million of rate base treatment for 1998 on an interim rate basis.[4] Contrary to the Connecticut case, however, the issue in this proceeding is not that the Monticello plant or the EPU is on an outage – instead, the EPU has never operated at full power and won't do so in 2014, so it has never served ratepayers. In the present Xcel case, the Company simply has not shown that the EPU-related capacity is likely to operate fully, or be authorized to do so, by the end of the 2014 test year. Instead, the point is that Xcel failed to show that the EPU would be in service in 2014.

Fifth, while the Company made clear that the present Xcel rate case involves no "restart" issues, the reason is not, as Xcel claims, that the Monticello plant is fully used and useful. Instead, there is no "restart" issue because the issues in this case is not that Monticello plant is on outage; instead, as noted above, the EPU has never been fully authorized to operate at the 671 MWe level. That is, Xcel erroneously argued that "uncontroverted evidence" establishes that the "LCM/EPU program" assets are in use and serving customers" within the time period rates are to be in effect. Xcel Initial Br. at 36, 42-44. The Department strongly disagrees. The EPU has never operated continuously and on a sustained basis at full EPU capacity levels; it operated partially up to 640 MWe only for 20 days during a failed ascension testing protocol for the NRC; further, the NRC has not yet approved further ascension testing or authorized the facility to operate continuously at 671 MWe. There is no reasonable basis in the record to conclude that the plant will satisfactorily complete NRC ascension testing or be licensed to so operate by the end of 2014. Thus, there is not "uncontroverted evidence" that the plant is likely to be fully

[4] *In re Conn. Light & Power Co.*, No. 1997 WL 866679 at *18 (Conn. D.P.U.C. Dec. 31, 1997).

operational by the end of 2014. DOC Initial Br. at 76-91; XLI Initial Br. at 8-10; MCC Initial Br. at 3-4.

Sixth, it is important to recognize that the extent to which cost overruns are attributable to life cycle management (LCM) or the EPU or both is the subject of MPUC Docket No. E002/CI-13-754, *In the Matter of a Commission Investigation into Xcel Energy's Monticello Life Cycle Management/Extended Power Uprate Project and Request for Recovery of Cost Overruns* (Cost Overrun Docket). Xcel's argument, on pages 38-39 of its Initial Brief, that there is no appropriate record basis to determine a split for used and useful purposes between the LCM investment and the EPU-related investment is very closely related to the issue that is under consideration in the prudency docket. The Department urges exercise of care to avoid inadvertently determining an issue – *i.e.,* the appropriate split between LCM and EPU-related costs -- that is being considered in the Cost Overrun Docket. With that notice, the Department takes issue with Xcel's repeated but inaccurate claim that operation of Monticello at the 600 MWe level is equivalent to operation of Monticello at the 671 MWe level for purposes of determining whether the EPU is used and useful to ratepayers in 2014, simply because Xcel views the investment in LCM and the EPU as part of one big project. *See* Xcel Initial Br. at 36, 42-44. This argument is not intuitive, and the Department continues to disagree that Xcel has made a showing in this case that the EPU is used and useful. For example, Xcel ignores the fact that that the EPU was the subject of a stand-alone certificate of need proceeding and Commission approval, MPUC Docket No. E002/CN-08-185.

Seventh, Xcel argued that interpreting Minnesota's "used and useful" standard to require that a facility be fully in service for ratepayers is unreasonable because it could mean that the Commission could remove a plant from rate base that has been fully in service to ratepayers if, at any time, such as an outage, "the plant was not operating at full capacity during that time." Xcel Initial Br. at 38. Here, Xcel again refuted arguments that the Department did not make; the Department made no argument to disallow costs of planned outages (including replacement power costs). Clearly, there is a significant difference between an outage at a plant that has been operating at its full capacity and is fully authorized to do so, and the circumstances at Monticello, which is not operating beyond 600 MWe and is not authorized to operate at its full 671 MWe level. Thus, Xcel's statements misrepresent the Department's positions and misconstrue the record.

Eighth, Xcel attempts to misapply Minnesota's used and useful standard as if the circumstances at Monticello were merely an outage. Because Xcel notes correctly that power plants do not operate at full capacity at all times, the Company appears to leap to the unsupported conclusion that investment is "used and useful" as long as part of the investment is in service to ratepayers. *See id.* Despite the fact that Xcel is not authorized to operate Monticello at 671 MWe, the Company merely repeats the unfounded statement, "Because the Monticello Program assets and systems are fully in use and benefiting customers," Xcel has satisfied the used and useful standard. *Id.* Repetition alone is not evidence; EPU-related assets are not fully in use, as previously noted in this Reply Brief and in the Department's Initial Brief. Xcel has not shown the reasonableness of its analysis.

Ninth, the Company has not shown that the LCM capital project and the EPU capital project are "common plant" such that the whole Monticello facility should be considered to be in service and fully used and useful even if a portion of the generation plant facilities is not yet operational. The record does not identify Minnesota or federal definitions of "common plant." The North Carolina case cited by Xcel, *State ex rel. Utils. Comm'n v. Eddleman* (*Eddleman*), does not support Xcel's argument, in the Department's view. The *Eddleman* matter, which is not controlling in Minnesota, concerned facts very different from those before the Commission in this Xcel rate case. In *Eddleman,* at issue was the extent to which "common costs" were considered to be used and useful in the test year where such costs were necessary for the operation of the one nuclear generating unit that was fully operating and also would be necessary for the other nuclear unit if the latter unit had been operational. Apparently, the *Eddleman* "common plant," which *Eddleman* described as parking lots, roads, shops, switching stations, and waste treatment facilities, etc.[5] (i.e. not operating plant like the EPU but administrative and general type of facilities that are considered to be common plant), was determined to be "indivisible" and, in that sense, "necessary for the safe, reliable operation" of the operational nuclear unit and, therefore, completely used and useful. Xcel Initial Br. at 39-40. The facts in that circumstance were far different than in the current case. In *Eddleman*, the operating nuclear generation unit actually was used and useful, so the "common plant" of parking lots, etc. that were necessary to serve that generating unit were also found to be used and useful. DOC notes that the FERC definition of electric plant functions, at 18 CFR Chapter 1 page 426 (4-1-12 Edition) "2B. Nuclear Production," is where the EPU would be classified whereas "6. General Plant" is where the common plant at issue in the *Eddleman* case, is classified.[6] The Company cites a Missouri decision that similarly found that "common" costs were fully used and useful to support one of four generation facilities even though three of the four generation facilities were not operating and were not used and useful. The issue in this proceeding is not whether common plant is used and useful; the issue is whether the EPU, which is nuclear production plant, is used

[5] *See* Xcel Initial Br. at 40 n. 96.
[6] FERC Code of Federal Regulations – Title 18 Part 101, publ. at *http://www.ecfr.gov/cgi-bin/text-idx?SID=28ee1d221e722dbadf21278bf1482139&node=pt18.1.101&rgn=div5*

and useful given that it has not been authorized to operate by the NRC and has never been fully operated.

Thus, the basis for Xcel's reliance on the above references is unclear, since the Monticello EPU is not common plant. The Company's argument appears to be a non-logical extension of these cases. While Xcel seems to claim that, because Monticello is using the LCM to operate at pre-EPU capacity levels, the Company also appears to conclude somehow that *all costs*, both of the LCM and of the EPU-related capacity investments, are "common" to Monticello's generation at pre-EPU capacity levels. Stated another way, by claiming that "all of the components of the LCM/EPU Program are in use serving the continuing operation of the plant," Xcel Initial Br. at 41, the Company appears to consider all EPU-related capacity investment to constitute "common plant" needed to support the pre-existing, pre-EPU, Monticello generation facilities. Further, since there is no question that pre-EPU generation costs are in rate base as being operational and used and useful, then by extension Xcel seems to argue that the EPU-related costs also are used and useful.

Certainly, none of the cases relied on by Xcel concerned such a scenario, because none classify generation capacity investment as "common plant" nor do the cases suggest that such plant is somehow "common" to LCM investment or more generally to other pre-existing generation capacity investment. If this is Xcel's argument, then the Company failed to show that the argument is reasonable or makes sense. Thus, the Department concludes that Xcel has not demonstrated that the EPU-related investment is used and useful, nor that it is "common plant" that is "indivisible" from the LCM project or from the pre-EPU capacity levels of the existing Monticello generation plant.

For the many reasons stated above, the Department continues to conclude that Xcel has not shown that the EPU-related capacity is likely to be used and useful by the end of the 2014 test year.

c. MCC's proposed resolution of rate base treatment for EPU investment with longer periods over which Xcel would recover other costs was not shown by Xcel or by MCC to be reasonable

The Department continues to rely on its Initial Brief at 91-93 for discussion of why the MCC proposal, to which Xcel agreed, has not been shown to be reasonable. Those two parties request that Xcel be allowed rate base treatment of EPU-related investment for both 2014 and 2015 even though, as MCC acknowledges, such investment is not yet used and useful. *See* MCC Initial Br. at 3-4. The proposal would defer, but not disallow, 2014 EPU depreciation expense as well as higher fuel costs and replacement power costs related to the 2014 Monticello EPU not being in service by amortizing those costs over the remaining life of the plant. Xcel Ex. 90 at AEH-2 (Heuer Rebuttal); Tr. Vol. 3 at 180-181 (Schedin).

The Department has two main objections to the MCC/Xcel proposal: it is backwards and thus, unreasonable, and has not met the required showing that the Commission's deferred accounting criteria are satisfied.

First, the Xcel/MCC proposal is the reverse of what the record would support as reasonable. That is, the proposal would allow rate base recovery of 2014 EPU-related capacity costs from ratepayers (*i.e.*, with a return) even though ratepayers are receiving no benefit of increased capacity from the EPU, and even though the EPU-related investment is admitted by MCC not to be used and useful. While the proposal would allow immediate recovery of operating costs and rate base treatment for the EPU that is not in service to ratepayers, it defers 2014 depreciation for the EPU that has yet to operate at the 671 MWe EPU level, and it defers

Xcel's recovery of costs related to fuel and replacement power that ratepayers are actually using and from which ratepayers are receiving a benefit.

In contrast, the Department's recommendation to deny rate base treatment of EPU-related capacity costs in 2014 is grounded in fact and makes sense. It is reasonable and appropriate for the Commission to deny rate base treatment for investment that has not yet been shown to be used and useful. The Department's recommendation also would allow recovery of the 2014 higher fuel costs and replacement power costs, from which ratepayers are benefitting by making no adjustment to Xcel's proposed recovery of fuel costs or replacement power costs for 2014 for the fact that the 71 MWe of the EPU for Monticello.

Second, to the extent that the MCC/Xcel proposal would involve deferred accounting, those parties must demonstrate that the proposal would meet the Commission's deferred accounting criteria. *See* DOC Initial Br. at 92. Neither party has done so.

Xcel incorrectly characterizes the Department's deferred accounting concern simply to be that MCC didn't file a petition with the Commission that seeks deferred accounting for Xcel. Clearly, the Department's concern is substantive, and is that Xcel must demonstrate, for example, that the high costs of fuel and replacement power that Xcel proposes for deferred accounting were "unforeseeable" consequences of delays in full operation of the EPU-capacity addition. This burden of proving the reasonableness of deferred accounting is one that Xcel bears, and is not a burden imposed on ratepayers or public agencies.

For these reasons, the Department continues to conclude that Xcel has not demonstrated the reasonableness of MCC's proposal.

2. Conclusion

For the reasons discussed above, and as stated in its Initial Brief at 74-94, the Department continues to support a finding that Xcel failed to demonstrate that the Monticello EPU was or is likely to be used and useful during the 2014 test year. Thus, for 2014, the Department continues to recommend that the 2014 depreciation expense and rate base costs (e.g. return) for the Monticello EPU be excluded from the 2014 test year, resulting in a $31.284 million revenue requirement reduction. For 2015, the Department continues to support rate base treatment of EPU-related costs in 2015 because the Department expects that Xcel will be able to satisfy NRC testing and licensure requirements by the end of January 2015, such that the EPU will operate on a sustained and continuous basis at its full 71 MW capacity by that time.

B. Qualified Pension: 2014 Test Year Discount Rate (Issue 4)

1. Introduction

The reasonableness of Xcel's proposed recovery of pension costs, specifically the low discount rate used for cost recovery of Qualified Pension expense and continued recovery of the 2008 Market Loss were the subject of initial Department inquiry in Xcel's most recent rate case, Docket No. E002/GR-12-961. Despite the Commission's decisions in Xcel's proposal in the 12-961 case, discussed below, the Company proposed two very different discount rate assumptions, for ratemaking purposes, for its two different pension plans. DOC Initial Br. at 96-108.

In the current rate case, the Department's inquiry regarding pension expense financial reporting, pension funding requirements and, ultimately, appropriate ratemaking, supported the Commission's decisions in the 12-961 rate case. In the 12-961 rate case, despite Xcel's objections, the Commission required Xcel's recovery of costs for the XES Plan to reflect a discount rate equal to the expected return on assets (EROA), just as for Xcel's cost recovery of the NSPM Plan; it agreed with the ALJ that Xcel's proposal to set a discount rate for one of its pension plans lower than the EROA was not adequately supported or correlated. In the current rate case, despite the Commission's decision in the 12-961 rate case, Xcel continued to propose a lower discount rate for the XES pension plan than the EROA (the Company proposed to continue setting the discount rate for the NSPM Plan equal to the EROA).

To support the Commission's decision in the 12-961 rate case further, new to the current matter is the Department's confirmation that *pension funding* requirements (as determined by the Employee Retirement Income Security Act or ERISA) also sets the discount rate equal to the EROA to determine how much Xcel must contribute annually to the pension fund. This information not only supports the Commission's decision in the 12-961 case, it also supports the reasonableness of Xcel's proposed discount rate assumption for its NSPM Plan. DOC Initial Br. at 99-101. The only place where Xcel is allowed to use a low discount rate for pension obligations is through an accounting standard for *annual financial reporting purposes only* and *not* for *funding obligations*. *Id*. Thus, Xcel failed to show why it is reasonable to charge ratepayers rates that reflect pension costs that are higher than Xcel's funding obligations.

Moreover, as it did in the 12-961 rate case, the Department testified that cost recovery of reasonable wages, salaries and benefits for utility employees is appropriate since such costs are necessary for providing utility service. However, the Department:

> [O]bject[s] to inappropriate assumptions about estimated costs that are based on unreasonable assumptions, for purposes of setting rates. The issue of the appropriate amounts to include in rates for any cost is always important, in light of the requirement in Minnesota Statutes §216B.03 (noted above) that:
>
>> Every rate made, demanded, or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable. … Any doubt as to reasonableness should be resolved in favor of the consumer.

DOC Ex. 429 at 99 (Campbell Public Direct)

The Department also noted, as it did in the 12-961 case, that allowing Xcel to charge ratepayers more for pension costs would not benefit Xcel's employees:

> [I]ncreasing the amount of pension expense recovered in rates – due, for example, to an assumption that the current unusually low discount rates will exist during the entire life of Company's pension fund – would not increase the amount of pension benefits provided to utility employees; it would simply increase ratepayers' bills based on an unrealistic assumption.

DOC Ex. 429 at 103 (Campbell Public Direct).

Thus, consistent with the Commission's findings in the 12-961 rate case and the evidence in the current case, the Department continues to conclude that, for ratemaking purposes, and consistent with its obligations to fund its XES and NSPM Plans, Xcel should not be allowed to charge higher rates that would provide no benefits to employees and thus would only serve to enrich shareholders at ratepayers' expense. The Department also provided evidence in this proceeding showing that Xcel's assumptions for its pension expenses are not independent; they are determined by Xcel and not by the Company's actuary. DOC Ex. 429 at 112-113 (Campbell Public Direct). The Department recommends that for ratemaking purposes the Commission set the discount rate assumption for the XES Plan to equal the EROA, here, 7.25%. DOC Ex. 429 at 118 (Campbell Public Direct).

2. Xcel's argument that the Commission ought to substitute a results-oriented approach rather than abide by applicable legal standards of proof, as well as many other remarkable statements, must be rejected

Xcel's Initial Brief is concerning. It includes generalized statements (many without citation) using imprecise terms, and implies that if the Commission does not approve Xcel's proposed qualified pension adjustments (or approve four other significant proposals), Xcel could be financially strapped such that, again implicitly, it may be unable to further "state energy policy goals" (which one might interpret as renewable energy requirements) or continue to provide safe and reliable services. *See* Xcel Initial Br. at 1-2, 7-8, 12-13. These are remarkable assertions. As noted in the Burden of Proof section included in an earlier part of this Reply Brief, Xcel appears inappropriately to encourage the Commission to substitute legally incorrect and results-oriented standards, disregard the factual record and allow Xcel to collect costs from ratepayers without satisfying its burden to demonstrate the reasonableness of its proposed rates. Further, the Department's search of Xcel's Initial Brief found *no* acknowledgement that, under Minnesota law, any doubt as to reasonableness must go to the ratepayer. Minn. Stat. § 216B.03.

Xcel also suggests erroneously and without record citation, the following examples with respect to approval of the Department's discount rate recommendation for cost recovery of the XES Plan. Since Xcel also urges inappropriate legal standards for the 2008 Market Loss assumption, the Department includes those items in this list):

- The Department's recommendations would result in disallowance of "real" costs;
- There is no "dispute in that [Xcel's] costs will be higher than what the Department is recommending;"
- The Department's proposed adjustments would "artificially reduce the costs of service;"
- Xcel's discount rate proposal matches its "actual costs" of providing pension benefits;
- Xcel's discount rate for the XES Plan is representative of "actual financial market rates;"
- The Department didn't suggest that Xcel's pension expense "is not representative or our actual expense;" and
- The Company's use of an EROA higher than the discount rate "actually reduces pension expense, rather than inflates it."

See, e.g., Xcel Initial Br. at 7, 8, 12-13, 58, and 67.

Xcel did not show the accuracy or reasonableness of the above statements; the Department's Initial Brief at 76-118 and this Reply Brief reasonably address the Department's analysis, recommendations and appropriate legal standards.

3. It is reasonable, for ratemaking purposes, to set the discount rate equal to the EROA, consistent with ERISA pension funding requirements; Xcel failed to show that it is reasonable to charge ratepayers more than Xcel's pension funding obligations for the XES Plan.

Xcel's Initial Brief is silent as to the Department's testimony concerning ERISA pension funding methodology; it does not acknowledge that ERISA sets the discount rate assumption, *for funding purposes*, to match the EROA rate. Rather, Xcel's Initial Brief emphasized that, for its XES Plan, the Company correctly applied the FAS 87 financial reporting standard when calculating the discount rate assumption. Xcel Initial Br. at 12, 58-59. However, the Department has never challenged whether Xcel applied FAS 87 methodology correctly for annual financial reporting – as opposed to funding – purposes. Rather, since the goal of this proceeding is to set rates on a going-forward basis, the appropriate focus should be on funding requirements rather than reporting requirements.

Thus, the Department concludes that Xcel did not show the reasonableness of using FAS 87 *reporting* requirements to use a discount rate that increases pension costs recovered in rates, particularly since there is no benefit to employees for the higher pension costs. DOC Initial Br. at 96-107. The Company's repeated assertions that it properly set the XES discount rate based on market bond rates – which are very low – is consistent with Xcel's application of FAS 87 for reporting purposes. *See* Xcel Initial Br. at 21, 64, 66-68. FAS 87 assumes, for discount rate purposes, that the Company may need to "settle" its future pension obligations today. DOC Initial Br. at 100-101, 105-106. Again, Xcel provided no suggestion that it is about to file for bankruptcy. *Id.*.

Setting the discount rate equal to the EROA rate, which includes a mix of fixed and equity-based financial rates, is consistent with ERISA funding requirements and with the ACM method of accounting used for the NSPM pension plan, and is reasonable for ratemaking purposes. The Department noted that because the discount rate and EROA are for the same time period, it is not reasonable for ratemaking purposes to use a different EROA and discount rate, since by using a lower discount rate the Company artificially overstates test-year pension expense for purposes of ratemaking. DOC Ex. 429 at 117 (Campbell Direct); DOC Ex. 450 at 5 (Campbell Opening).

Xcel did not address the fact that the Commission for ratemaking purposes is not bound by FASB accounting standards and, in particular, that the Commission should carefully consider whether pension discount rate assumptions should be set based on FAS 87, which reflects financial *reporting* purposes. Financial reporting for book purposes (using assumptions determined by the Company and not by the actuary) does not dictate ratemaking.

The Company also did not highlight the fact that for purposes of ratemaking, the Company allocates no contribution to employees for funding the qualified pension plan. Instead, for purposes of setting test year expenses, Xcel proposes to allocate 100% of such funding obligation to ratepayers. The pension recovery is in addition to 401K matching that ratepayers are also being asked to contribute to test year expenses. DOC Ex. 450 at 6-7 (Campbell Opening). The Department emphasizes this fact because, in light of ratepayers' current full responsibility for the qualified pension benefit in test year expenses, it is all the more important to hold Xcel to its full burden to prove the reasonableness of its proposed pension assumptions. As discussed in the Department's Initial Brief, Xcel has not met its burden of proof regarding its proposed discount rate assumption for the XES Plan. DOC Initial Br. at 97-107.

Xcel's Initial Brief illustrated the non-symmetrical nature of pension gains and losses, as highlighted in Ms. Campbell's Surrebuttal Testimony at 91-92. *See also* DOC Ex. 450 at 6-7 (Campbell Opening). That is, Xcel stated that, under pension funding requirements, the

Company must contribute to the pension fund if the pension fund is less than the present value of future benefits (under-funded), but if the value of the fund exceeds the present value of future benefits (over-funded) "the amount that must be funded is zero" Xcel Initial Br. at 56. That is, Xcel acknowledges that the Company has not provided refunds to ratepayers during the years when the pension assets were over-funded. This same issue was present in Xcel's 12-961. Again, in the present matter, the Department noted that for ratemaking purposes the Company appears simply to retain the money it receives in rates that is in excess of its pension funding obligations (by not returning any negative pension expense to ratepayers) during times when the pension fund value exceeds the present value of future benefits. DOC Ex. 435 at 91-92 (Campbell Public Surrebuttal). Careful scrutiny of Xcel's proposed ratemaking methodology, and holding Xcel to its full burden of proof, is important in order to ensure for ratemaking purposes that ratepayers are treated fairly and that rates are reasonable, as required by Minnesota Law.

Finally, Xcel emphasized that its "long-standing practice" of calculating the discount rate assumption for the XES Plan is in accordance with accounting standard FAS 87. Xcel Initial Br. 12, 54-56. It made this claim despite the fact that, in its most recent rate case, 12-961, the Commission set the XES discount rate equal to the EROA. As the Department discussed in detail in its Initial Brief, the record in this case supports, solely for *ratemaking* purposes, continuing to set the XES Plan discount rate assumption equals the EROA, which here is 7.25%. DOC Initial Br. at 97-107.

C. Qualified Pension: 2008 Market Loss Adjustment (Issue 5)

1. Introduction

Regarding Xcel's market loss in 2008 due to the downturn in the economy that year, the Commission determined on page 7 of its September 3, 2013 Order in Xcel's last rate case, as follows:

> The Administrative Law Judge found that the Company's future wage projections were reasonable but that the challenged discount rate and earnings projections were neither adequately supported nor adequately correlated. She also found that it was reasonable for the Company to recover its 2008 pension fund losses through its proposed amortization plan. She recommended disallowance of Restoration Plan costs.
>
> The Commission concurs based on the record in this case, but will set additional reporting requirements for the next rate case and will clarify that the determination that the 2008 market loss may be included as a cost is limited to this proceeding and that the Company will earn no return on the unamortized asset loss balances.

DOC Ex. 429 at 117-118 (Campbell Direct).

As in the 12-961 case, Xcel seeks recovery from ratepayers of its "2008 Market Loss." DOC Initial Br. at 96, 108-115. The Department was surprised by the large sum that Xcel continues to seek from ratepayers now in 2014, despite the return of the market to pre-2008 levels. The Department continues to conclude that Xcel has not shown the reasonableness of requiring ratepayers to pay all of its proposed test-year 2008 Market Loss. Rather, the Department supports recovery from ratepayers of no more than 50% of Xcel's 2008 Market Loss proposed in this test year, or $6,032,000. *Id.* The Department's analysis and recommendations are discussed at length in its Initial Brief at 96-118.

2. Qualified Pension 2008 Market Loss Adjustment: The Department's Recommendation for Recovery of 50% of Xcel's 2008 Market Loss is Reasonable (Issue 5)

The Department continues to rely on its Initial Brief at 108-115 for its analysis and recommendation that ratepayers be required to pay no more than 50% of Xcel's 2008 Market Loss. As the Department stated:

> The Department has several concerns regarding Xcel's proposed recovery of its 2008 market loss, but a principal concern is that the Company has included so much of the amount in its proposed 2014 test-year pension expense which is now 5 years beyond the 2008 loss period. Over 60 percent of Xcel's initially proposed 2014 test-year expense of nearly $20 million, reflects its 2008 market loss of $12.1 million. Xcel requests recovery from ratepayers of 100 percent of this [$12.1 million] 2008 market loss; $8.5 million is from the NSPM Plan and $3.5 million is from the XES Plan.

DOC Initial Br. at 109 (clarification added in bracket). Following the Department's review of Xcel's Initial Brief, these concerns remain.

Xcel's claim that there is "no valid reason to exclude portions of the 2008 Market Loss" (Xcel Initial Br. at 61) warrants a response. Xcel provided no citation for this statement. The record, for example, is abundantly clear regarding the reasons for the Department's recommendation that ratepayers pay no more than 50% of the 2008 Market Loss. Ms. Campbell summarized her testimony on these reasons in her Opening Statement on pages 6-7. Also, the evidentiary hearing transcript clearly notes Ms. Campbell's surprise regarding Xcel's pension fund performance in 2013, as follows:

> My other concern is that I'm kind of surprised because the financial market is above pre-2008 market levels, and so I'm surprised that we haven't seen more gains or more offsetting of the 2008 market loss and that we're seeing so much of it, 60 percent of the pension expense, and so that's another reason why I have those concerns.

Tr. Vol. 5 at 34-35 (Campbell); *see also* Tr. Vol. 5 at 64-65 (Campbell). Ms. Campbell provided her conclusion at the evidentiary hearing that Xcel did not show that it managed its pension assets appropriately prior to or through the downfall of 2008 given that the Company still is asking ratepayers to pay $12 million in annual rates between now and its next rate case to reflect that market loss. Tr. Vol. 5 at 68 (Campbell).

For these reasons, and the many reasons detailed in the Department's Initial Brief, the Department continues to recommend that ratepayers pay no more than 50% of Xcel's 2008 Market Loss.

C. Passage of Time: Recognizing 2015 Capital Costs as well as Associated "Revenues" of 2015 Depreciation and 2015 Retirements (Issue 10)

The Department's "passage of time" adjustment regarding Xcel's requested 2015 capital costs is based on the long-standing equitable principle that reasonable ratemaking is not one-sided. Specifically, if it is reasonable to impose on ratepayers higher capital costs in 2015 for new capital projects added in the 2015 step, then fairness dictates a corresponding reduction in costs to be charged to ratepayers due both to retirements of capital projects and to the normal passage of time (from 2014 to 2015) for projects included in the 2014 rate base. This concept is practiced regularly by the Commission in traditional general rate cases. In this multi-year rate case, however, Xcel requested for 2015 the great majority of its planned 2015 capital costs without also including associated cost decreases for such capital, such as plant retirements, depreciation and accumulated depreciation in 2015. DOC Ex. 435 at 112-113 (Campbell Surrebuttal) and DOC Initial Br. at 226-237.

To reflect Xcel's lower rate base in 2015 for facilities that are retired in 2015, and to reflect depreciation expense and accumulated depreciation step-down in rate base due to the passage of time in 2015 for projects in-service (depreciated) in 2014, the Department continues to recommend: 1) a downward adjustment of $535,552 to the Company's revenue requirement for 2015 to reflect the 2015 retirements for transmission and distribution facilities; and 2) the

$17,529,000 reduction to 2015 revenue requirements for 2015 depreciation expense and accumulated depreciation due to the passage of time for all plant in rate base, except 2015 step projects already incorporated in the 2015 step revenue requirement, or as finally calculated by Mr. Lusti. DOC Initial Br. at 226-227.

1. Xcel's Repeated and Unsupported Statements in its Initial Brief Should be Disregarded.

On this issue, Xcel's Initial Brief merely repeated generalized, unsupported assertions that indicated the Company's desire for more money but did not provide adequate information for the ALJ and Commission to determine that the Company satisfied its burden of proof. Two such repeated claims are discussed briefly below: that Xcel requested "less" for its 2015 increase than it would be entitled to request in a traditional 2015 rate case and that a Commission determination that the Department's passage of time adjustment is reasonable as a symmetrical and fair adjustment would "send a signal" to utilities to file back-to-back rate cases. In addition to their inaccuracy, these messages are poor substitutes for reasoned analysis and compliance with Xcel's legal requirement that it bears the burden to demonstrate that its requests in rate cases are just and reasonable.

a. Xcel showed no entitlement to recover a greater increase in costs for 2015 than the Company requested

Xcel's repeated statements that it is entitled to a greater increase for 2015 than it requested is in direct conflict with Minnesota Statutes section 216B.16, subdivision 5, which states:

> Subd. 5. Determination after finding rate unacceptable.
> If, after the hearing, the commission finds the rates to be unjust or unreasonable or discriminatory, the commission shall determine the rates to be charged or applied by the utility for the service in question and shall fix them by order to be served upon the utility. The rates shall thereafter be observed until changed, as provided

> by this chapter. *In no event shall the rates exceed the level of rates requested by the public utility.*

Minn. Stat. § 216B.16, subd. 5 (2014) (emphasis added).

The Company nonetheless makes repeated statements to the effect that the Company is entitled to recover more costs than Xcel requested in 2015. *See, e.g.*, Xcel Initial Br. at 3, 5, 7-8, 11, 44-45, 48-52. The Department does not challenge Xcel's claim that it likely would have requested a higher increase for 2015 than it did, but Xcel did not do so and hence the Company is not only *not* entitled to such cost recovery, Xcel is actually prohibited from such cost recovery in this proceeding, given the long-standing provisions in Minnesota statutes.

Further, because Xcel chose not to request recovery of these additional costs, none of these costs have been audited or examined in this proceeding. Moreover, the likely amount the Commission might have awarded Xcel simply is unknown. However, given that Xcel has not met its burden of proof regarding its proposed revenue requirements for numerous issues in this proceeding, it would not be reasonable to conclude that Xcel would meet its burden of proof to show that all costs for which they do not request recovery are reasonable.

In addition, even if there were any consideration of costs for which Xcel does not request recovery in this proceeding (which again would be inappropriate) the amount of the 2015 capital costs for which Xcel did not request recovery is small. Xcel requests recovery in 2015 of all but approximately 18.7% of capital projects (100%-81.3%=18.7%). DOC Ex. 435 at 114-119 (Campbell Surrebuttal). The capital cost of that 18.7% of projects is not a figure in the record, although the Company included its (unexamined) 2015 forecasted revenue deficiency for its rate base. *Id.* at 114-116.

Because Xcel's unsupported implication is that the Company will come up short regardless of whether or not the Commission approves 100% of its requested 2015 rate increase request, it is important to carefully examination of Xcel's 2015 rate increase request to determine just and reasonable rates. In particular, on page 49 of its Initial Brief, the Company quantifies the extent to which it claims to have understated its 2015 rate increase request, 84%, albeit without any reliable or independently verified basis in the record for such quantification:

> In other words, the Company, as part of the MYRP, has requested to include in rates approximately eighty-four percent of its 2015 forecasted revenue deficiency (i.e., *the amount it would be permitted* had it chosen to file a traditional rate case in 2015).

Xcel Initial Br. at 49 (emphasis added).

Even if Xcel's claim and quantification regarding Xcel's 2015 forecasted revenue deficiency (not to be confused with the 2015 Step which the Department did review) were supported by rigorous examination in the record, which they were not, the inaccuracy of Xcel's *2014* forecasted revenue deficiency warrants consideration, given the Company's claim that they would be entitled to recover all of the costs for which they did not request recovery. The Company's initial 2014 forecasted revenue deficiency was $192,709,000, while the Department's final recommended revenue deficiency for 2014 after discovery and careful review is $45,887,000. DOC Ex. 451 at DVL-EH-2, line 7. This difference means, according to the Department's examination, that Xcel demonstrated the reasonableness of only about 25% of its initial 2014 forecasted revenue deficiency. Stated another way, the Department concludes that Xcel's 2014 forecasted revenue deficiency was roughly three times greater, or 75% more, than the amount that Xcel demonstrated in this rate case to be reasonable for recovery in 2014. Similarly, one reasonably might conclude that Xcel's claimed "eighty-four percent of its 2015 forecasted revenue deficiency" could be well in excess of the amount that Xcel may have been able to demonstrate is reasonable if it had filed a traditional 2015 rate case. No one can know the appropriate amount, however, as Xcel did not request recovery of those costs and thus the record does not include an examination and audit of those costs. Thus, it is not possible to determine the amount of rate change that Xcel might have demonstrated if it had filed a traditional 2015 rate case increase.

b. Xcel's purported warning that Commission approval of a passage of time adjustment will send a negative "signal" is inappropriate and suggests that the Commission deviate from applicable legal standards

The Company warns that approval of the Department's passage of time adjustment would result in a negative "signal" to utilities that they should not file multi-year rate cases, whereas denial of the passage of time adjustment would send a positive signal. *See, e.g.,* Xcel Initial Br. at 6, 45 and 48. Xcel states in part, for example, that:

> Specifically, the passage of time adjustment sends a signal to a utility to file back-to-back rate cases to the extent it recognizes a need to adjust rates beyond the initial test year of a traditional rate case.

Xcel Initial Br. at 48.

Minnesota law simply does not include as a criterion of ratemaking that the Commission should ignore record evidence, ignore known and measureable changes (the effects of the passage of time and plant retirements on depreciation), or ignore whether or not the utility met its burden of proof. Further, Minnesota Statutes section 216B.16, subdivision 6 "Factors Considered, Generally" requires consideration of depreciation:

> In determining the rate base upon which the utility is to be allowed to earn a fair rate of return, the commission shall give due consideration to evidence of the cost of the property when first devoted to public use, to prudent acquisition cost to the public utility *less appropriate depreciation* on each, to construction work in progress, to offsets in the nature of capital provided by sources other than the investors, and to other expenses of a capital nature.

Minn. Stat. § 216B.16, subd. 6 (2014) (emphasis added). In addition, Minnesota Statutes section 216B.16, subdivision 19 "Multiyear Rate Plan" states in relevant part:

> The commission may approve a multiyear rate plan *only if it finds that the plan establishes just and reasonable rates for the utility, applying the factors described in subdivision 6.* Consistent with subdivision 4, the burden of proof to demonstrate that the multiyear rate plan is just and reasonable is on the public utility proposing the plan.

Id., subd. 19 (emphasis added). Thus, Minnesota Statutes cannot be read to allow a utility to unreasonably profit from retaining the known and measureable decreases in depreciation and related costs due to the passage of time and to retirements of assets. Since it is known that the utility's level of depreciation costs will decrease due to the passage of time and due to retirements, this decrease in costs must be included as an offset to the increase in such costs due to capital additions in step years of a MYRP. Xcel's proposal would result in unreasonable rates, in violation of Minnesota Statutes section 216B.03, and must be rejected.

In addition, Xcel's discussion of what kind of "signal" may be sent to utilities seems to reflect Xcel's apparent difficulty in acknowledging that a MYRP provides Xcel the important benefit of recovering capital costs of new projects in 2015 without having to file an additional rate case. Further, the Commission's June 17, 2013 Order Establishing Terms, Conditions and Procedures for Multi-Year Rate Plans (Docket No. E,G999/M-12-587) indicated at pages 4-5 that multi-year rate plans have both benefits and costs, and may not be appropriate to use in all circumstances:

> A plan may promote administrative efficiency by reducing regulatory lag – that is, the period between an event justifying a rate change, and the ensuing rate change. For example, the longer the lag before a utility can begin recouping its investment in a new capital project, the greater the interest costs the utility will incur to finance that project; a multiyear rate plan may permit a utility to begin recouping its costs, and paying down its debts, sooner. Also, if these plans succeed in reducing regulatory lag, they may reduce utilities' need for rate cases, rate riders, and deferred accounting – and the administrative costs associated with these cost-recovery mechanisms.
>
> In addition, reduced regulatory lag may result in more gradual rate changes, making utility bills more predictable and reducing rate shock.

> But multiyear rate plans can also create burdens. Anticipating costs and revenues arising years into the future creates myriad opportunities for error. In particular, it becomes increasingly difficult to ensure that all the relevant costs will be considered with the relevant revenues. Moreover, a multiyear rate plan will be challenging to evaluate and administer. The Legislature acknowledged this challenge when it granted the Commission 90 extra days in which to review a rate case containing a multiyear rate plan, and when it granted the Commission the discretion to adjust a plan's rates throughout the plan's term.
>
> To decide which circumstances justify the use of a multiyear rate plan, the Commission must identify the circumstances that would permit a plan to generate sufficient benefits to justify the plan's burdens. Based on these considerations, the Commission is not persuaded that utilities and ratepayers should have to wait for extraordinary circumstances before pursuing the benefits of reduced regulatory lag. But conversely, the Commission cannot justify the burdens of approving, implementing, and monitoring a plan if the utility cannot identify any specific circumstance that would prompt a need to change rates over the next three years.
>
> Consequently the Commission will embrace the middle approach. That is, the Commission will consider multiyear rate plans that are designed to recover the cost of specific, clearly identified capital projects and, as appropriate, non-capital costs. If a utility can identify a basis to begin recovering these costs within three years, the utility has satisfied the minimum standard justifying consideration of a multiyear rate plan.

Thus, it may not always be appropriate for utilities to use MYRPs. There are both advantages and disadvantages of such tools, depending on the utility's circumstances, particularly whether or not a utility intends to add substantial capital projects over more than one year.

That Order also required utilities to provide information intended to ensure that the correct level of depreciation in the step year(s) of a MYRP would be set at appropriate levels. Specifically, ordering paragraph 18 states:

> An application for a multiyear rate plan must include or be accompanied by testimony supporting the following aspects of the case:
>
> A. The capital additions that the utility proposes for each year of the multiyear rate plan.
>
> B. Depreciation lives related to capital additions in each year of the plan.
>
> C. Changes expected in the lives of all depreciable assets for two years after the plan.

These items, especially item C, indicate the importance of setting cost recovery for depreciation expense related to depreciable assets at a reasonable level, based not just on the first year of the MYRP, but on the subsequent year(s) and even considering expected changes in years after remain in place until the utility files its subsequent rate case, it is important to ensure that appropriate levels.

Finally, the Company's arguments appear to reflect both an entitlement to cost recovery and an assumption that its requested cost recovery is reasonable and thus the burden of proof is on the Department and other parties to show that Xcel's proposals are not reasonable. However, in multi-year rate cases, just as in traditional single-year rate cases, the utility at all times bears the burden of proof, and any doubt as to reasonableness goes to consumers. Minn. Stat. §§ 216B.03 and 216B.16, subd. 4.

2. Summary of Reasons Why the Department's Passage of Time Adjustment is Reasonable.

The Department's proposed passage of time adjustment arose from Xcel's contradictory and extraordinary inclusion of an entire year of depreciation in 2015 for all 2014 Capital Projects in the 2015 Step, without any inclusion of cost decreases that would occur normally by reason of the passage of time, as in a traditional rate case. DOC Initial Br. at 230. For convenience, the following is Ms. Campbell's summary of the reasonableness of the passage of time adjustment, as set out in her Opening Statement:

> Third, I summarize the following arguments to support these two 2015 adjustments for retirements and depreciation and accumulated depreciation for the passage of time:
>
> - practically, the Company's 2015 rate base is lower for existing plant in rate base (not including 2015 capital step projects) as result of 2015 retirements and 2015 depreciation expense and accumulated depreciation recorded due to the passage of time, so ratepayers should not pay a return on a higher 2014 rate base which the Company is not actual incurring, for purposes of the 2015 step;

- equitably, it is unfair not to update for the 2015 retirements and 2015 depreciation expense and accumulated depreciation for the passage of time for existing plant in rate base for which ratepayers are currently paying, while at the same time requiring ratepayers to pay for higher depreciation amounts and higher rate base amounts caused by the 36 capital projects in the Company's 2015 step; and

- updating for 2015 plant retirements and 2015 depreciation and accumulated depreciation is consistent with the Department's comments and Commission's Order in the MYRP (as discussed in more detail in my Section III of my Direct Testimony) where updates for capital and capital related items such as depreciation and taxes are appropriate. DOC Ex. 431 at 175-177 (Campbell Public Direct).

Fourth, I provided the following additional arguments in my Surrebuttal Testimony:

- The Company's statement "except for the limited number of projects that were included in the 2015 Step, the Company did not annualize capital projects placed in service during 2014 to determine the 2015 Step revenue requirement" is important for the following reasons.

- First, Xcel's reference to a "limited" number of capital projects is actually 34 capital projects [as corrected by Ms. Perkett at the evidentiary hearing from the 36 capital projects in my Surrebuttal Testimony] that added $68.865 million to the revenue requirement for the 2015 Step (as shown on Table 13 of Mr. Robinson's Direct Testimony). This amount is material since it represents over 72 percent of the level of revenue requirements that Xcel proposes for 2015 ($68.865/$95.1 = 72.4 percent).

- Second, Xcel's proposal to increase partial year depreciation for projects placed in service in 2014 to reflect an entire year of depreciation in 2015 completely contradicts Xcel's proposal not to decrease rate base (by increasing accumulated depreciation reserve) in 2015 for all capital projects to reflect the passage of time.

- Third, in a tradition rate case depreciation and rate base are not annualized for capital projects that are placed in service in the test year, so the Company's argument that they are entitled to annualized depreciation for all 2014 projects in the 2015 Step is incorrect.

- For these reasons, I conclude that not capturing the step down in rate base that occurs from 2014 to 2015 due to the normal passage of time and including known 2015 retirements for several capital projects being paid for by ratepayers via rate base is not reasonable and is one-sided.

- Further, I disagree with Xcel that my supporting 50 percent of the Company's 2015 Step adjustment for chemical costs is inconsistent with my adjustment for the passage of time depreciation for 2015 and 2015 retirements. While I agree that chemical costs (and property taxes) are expenses directly related to the 2015 Step capital investments, I note that depreciation expense/accumulated depreciation reserve and plant retirements are not simply expenses directly related to the 2015 capital investment, but instead are depreciation expense and offsetting depreciation reserve that are the actual capital investment costs being spread over the life of the facilities.

- I am concerned that the Company is treating its assertion that $713.4 million is the amount of the increase in rate base for the full 2015 forecast as if this amount had been examined in the same manner as the amounts for which Xcel actually requests cost recovery -- it has not, since the Company did not request recovery of this amount in this rate proceeding and all parties need to use limited resources as effectively as possible in this and numerous other proceedings. Thus, using this amount in arguing for the $579.9 million 2015 Step is not valid or reasonable.

- Even if the $713.4 million figure had been fully examined, the Company's asserted "limitation" of the 2015 Step is hardly limited since $579.9 million is 81.3 percent of $713.4 million. That is, the Company has captured a significant amount of possible capital projects that are plant additions (but not retirements), that increase rate base and that Xcel annualizes for a full year of depreciation.

- I am particularly concerned that the Company is proposing to use 2014, in which the requested rate base amounts are generally higher than in other years, and adding new incremental 2015 rate base amounts, where 2015 is also a high rate base year, for its proposed rates in this rate case for customers. That approach is like adding two peaks together and asserting that the sum of these two peaks is the new peak, even though a portion of the first peak declined.

- My understanding of information request no. 2113 is that it requested Xcel to update all depreciation for the passage of time, which would include all changes in depreciation expense and depreciation reserve, as discussed on page 163 and (NAC-32) of my Direct Testimony. DOC Ex. 435 at 109-120 (Campbell Public Surrebuttal).

DOC Ex. 450 at 9-11 (Campbell Opening Statement).

3. Xcel Fails to Acknowledge that the Commission's Multi-Year Rate Plan Order Supports Changes in Step Years, (Here 2015,) that Would Increase as well as Decrease Depreciation and Related Accumulated Depreciation.

The Commission's Multi-Year Rate Plan Order in Docket No. E,G999/M-12-587 (MYRP Order) supports inclusion in step years (here, 2015) of costs related to specific, clearly-identified capital projects, and appropriate non-capital costs. DOC Ex. 429 at 6-7 (Campbell Direct). Clearly, the MYRP Order does not limit rate changes only to cost increases, as Xcel suggests. Xcel misconstrues the Commission's MYRP Order, as shown on pages 48 and 49 of its Initial Brief. There, Xcel suggests that any reduction of the Company's requested Step increases to account for cost decreases that will occur by reason of the passage of time apparently would not be reasonable because the MYRP Order essentially prohibits a utility from requesting its full cost of service in the step years. This suggestion is unfounded and is a misunderstanding of numerous fundamental ratemaking principles, such as that rates set by the Commission in a rate case proceeding are just and reasonable until shown to be otherwise (e.g. Minn. Stat. §216B.16, subd. 5, "The rates shall thereafter be observed until changed, as provided by this chapter").

Xcel's arguments appear to reflect the Company's disappointment in not obtaining all that it wanted from the MYRP Order, and imply a request for reconsideration. However, the MYRP Order is sound and reasonable, setting the basic framework for utilities to obtain this "extraordinary cost recovery mechanism" (MYRP Order, page 10) that provides utilities recovery of capital costs for multi-year capital projects in a reasonable manner that is consistent with Minnesota Statutes as discussed above and in the Department's Initial Brief. The fact that Xcel's rates would increase in 2015 under the Department's proposed revenue requirement for the Company is clear evidence that a MYRP has value to Xcel, whether or not the Company chooses to acknowledge that value.

Of course, the MYRP Order did not in any way limit regulatory review of amounts requested by utilities in step years, just as rate increase requests are scrutinized in traditional rate cases. Xcel must demonstrate the reasonableness not only of its requested 2015 capital cost increases, but also show that it was reasonable not to include reductions to capital investment due to the passage of time and retirements that occur in 2015. The Company's one-sided argument is not reasonable and was not shown to be reasonable. A MYRP still needs to be reasonable if the rates resulting from the plan are to be reasonable; capturing only increases in capital costs, as Xcel proposes, is not reasonable.

4. Xcel Erroneously Claims that a Properly Calculated Passage of Time Adjustment "Moots" the Reasonableness of Such an Adjustment.

The Company made two arguments against adoption of a passage of time adjustment; neither are supported by this record. One argument is that a passage of time adjustment is not reasonable because the Company asserts that it is seeking "less" in 2015 than it would be "entitled to" if Xcel had filed a traditional 2015 rate case. The unreasonableness of this claim was discussed previously in this Reply Brief.

Xcel's other argument is that a correct passage of time adjustment that would account for cost increases and decreases related to Xcel's 34 Step projects would require inclusion of an $18.5 million increase in depreciation expense. Xcel Initial Br. at 45-46, 52. The Company then claimed that netting its $18.5 million and the Department's $17.5 million would result in a "correct" passage of time adjustment of an increase in rates of approximately $950,000. *Id.* at 46, 52. Thus, Xcel claimed that a corrected passage of time adjustment calculation "moots" the Department's proposal such that no adjustment is appropriate. *Id.* at 44.

The Department disagrees that Xcel demonstrated that the Department's passage of time adjustment is unreasonable or that Xcel's "correction" to the Department's adjustment is reasonable. It is correct that the Department's passage of time adjustment is a $17.5 downward adjustment to reflect 2015 depreciation expense and accumulated depreciation that ratepayers should not pay again in 2015 since they already paid these costs in 2014. It is also correct that the Department's adjustment was based on the information provided by the Company,[7] and is calculated based on Xcel's full 2014 rate base and not just the amount of rate base attributable to the 34 projects included in Xcel's 2015 Step. The Department appreciates that Xcel finally acknowledged in its Initial Brief that the Company, and not the Department, failed to provide adequate information. *See* Xcel Initial Br. at 47. That said, and to explain the basis the Department's conclusion that Xcel did not show that the Department's passage of time adjustment is unreasonable, requires detailed examination of Xcel's claims and calculations.

First, Xcel states that "the Department did not disagree that a symmetrical 'passage of time' adjustment that includes both impacts on rate base and depreciation expense should be considered." Xcel Initial Br. at 44 n. 111 (citing Campbell Direct and Surrebuttal Testimonies, and Tr. Vol. 4 at 53:10-20 (which should be Tr. Vol. 5)). Xcel's brief, however, omits the key word, "incremental." During the evidentiary hearing, Ms. Campbell agreed that it would be reasonable to capture "an incremental increase" in depreciation expense that "hasn't already been captured in the 2015 step" and to capture a "stepdown in accumulated depreciation," as follows:

> And I think I answered that question, *if there's an incremental increase in depreciation expense that hasn't already been captured in the 2015 step, that the company did actually ask for it in their rate request, then, yes, we would capture that, and we would capture the stepdown in accumulated depreciation*, the rate base reduction, assuming that it also wasn't in the 2015 step.

Tr. Vol. 5 at 53, lines 10-20 (emphasis added). The Company, however, never provided in this record any *incremental* increase in depreciation expense not already captured in the 2015 Step.

[7] *See* DOC Ex. 429 at 163, NAC-32 (Xcel's response to DOC IR 2113) (Campbell Direct).

Second, it would be unreasonable to use for setting rates the information in Ms. Perkett's Rebuttal, Schedule 2, page 5, which is cited in Xcel's Initial Brief at 53. The Department examined whether Xcel showed that its proposed $18.5 million increase in depreciation expense reflects an *incremental increase* in depreciation expense *that the Company didn't include in the 2015 Step.* As discussed below, the Company did not show this to be an incremental depreciation expense increase not already captured in the 2015 Step; instead, this amount appears to be the full increase in depreciation expense from 2014 and 2015. Using this amount for setting rates would not be reasonable due to the following rationales. First, since Xcel did not show this figure to exclude the increase in depreciation expense due to new additions to rate based from the 2015 Step, allowing Xcel to recover this $18.5 million amount would result in double-recovery: once through the 2015 Step and again through Xcel's proposed "correction" to the passage of time adjustment.

Third, Xcel did not show that "application of a passage of time adjustment in this case would result in an increase to the 2015 Step revenue requirements by at least $950,000." Xcel Initial Br. at 46 and fn 114. In bullet format, the Department lays out its analysis and conclusion, as follows:

- Xcel's calculation of its claimed "corrected" 2015 Step increase of $950,000 is derived from subtracting from Xcel's claim of an approximately $18.5 million increase in depreciation expense for 2015, the Department's passage of time adjustment of an $17.5 million increase in depreciation expense and accumulated depreciation for 2015. The $950,000 figure references footnote 114 on page 46.

- Footnote 114 references Ms. Perkett's Rebuttal Testimony at Schedule 2, page 5, together with the following parenthetical, "(subtracting the 2015 total change in accumulated depreciation from the 2015 total change in depreciation expense)." Xcel Initial Br. at 46 n. 114.

- The 2015 total change in depreciation of $18.5 million (specifically, $18,478,528), on a Minnesota Jurisdictional basis, is shown on Perkett Rebuttal Schedule 2, page 5 of 6.

- The calculation of the $18.5 million appears to be the full increase in depreciation expense from 2014 to 2015 and there is no indication on Ms. Perkett's Schedule 2, page 5, that any amount (2015 Step depreciation already captured by the Company) is subtracted from the $18.5 million total increase in depreciation expense from 2014 to 2015 to reflect amounts of depreciation expense already included in the 2015 Step amount.

- Thus, at least based on Ms. Perkett's Schedule 2, page 5, Xcel did not show that $18.5 million represents the incremental increase in depreciation expense that the Company didn't already include in the 2015 Step.

Fourth, it clearly would not be reasonable for Xcel to recover the full $18.5 million as part of a passage of time adjustment when that sum includes amounts already included in Xcel's 2015 Step. It would be reasonable to reflect only the incremental amount of depreciation expense from 2014 to 2015 that Xcel did not already include in the 2015 Step. However, Xcel did not provide that amount anywhere in the record, despite having several opportunities to do so.

Fifth, it is also clear that Xcel already included depreciation expense in the 2015 Step. Ms. Campbell references this fact on page 116 of her Surrebuttal Testimony, which responds to Ms. Perkett's Rebuttal Testimony, as follows:

> I only had the Company update depreciation for the passage of time for capital projects that were in-service by the end of 2014, *since all 2015 Step projects (81.3 percent) were already updated by the Company in their 2015 Step.* That is, because Xcel already annualized depreciation expense for the majority of projects, it was not necessary to ask for this information. The remaining 2015 non-step projects (18.7 percent) was not in the Company's revenue requirement proposal for this rate case, so I determined that it was not necessary for Xcel to update the part of the rate case that was not a part of the Company's initial proposal. Second, my understanding of information request no. 2113 is that it requests updating of all depreciation for the passage of time, which would include all changes in depreciation expense and depreciation reserve, as discussed on page 163 and (NAC-32) of my Direct Testimony.

DOC Ex. 435 at 116 (Campbell Public Surrebuttal) (emphasis added).

Contrary to Xcel's assertion that "the record contains all the information necessary to calculate the true passage of time adjustment," Xcel Initial Br. at 53, the record appears not to include the incremental amount of depreciation expense from 2014 to 2015 that Xcel did not include in its 2015 Step. The Department would expect this incremental depreciation expense to be a very small number, but the record simply does not identify that incremental amount.

For these reasons, Xcel did not show that the Department's passage of time adjustment is unreasonable, and it provided no number that represents an incremental depreciation expense that is not already included in the 2015 Step.

5. Xcel Did Not Show its Calculation of the 2015 Step Revenue Requirement to be Consistent with a Rider.

Xcel states erroneously that its calculation of the 2015 Step Revenue Requirement, which does not include a passage of time adjustment, "is consistent with how such calculations would be performed had the 2015 Step projects been included in a rider[.]" Xcel Initial Br. at 50. The Department disagrees; the record does not support Xcel's claim.

As Ms. Campbell explained during the evidentiary hearing, Xcel's 2015 Step includes no natural step down in rate base that is caused by the passage time where depreciation expense, accumulated depreciation, and plant retirements are recorded. Rather, Ms. Campbell showed that the Department's passage of time adjustment is consistent with rider treatment because it reflects this natural step down in rate base over time. The Department's Initial Brief, page 227, includes Ms. Campbell's simple example of how the Department's passage of time adjustment will mimic rider treatment by decreasing the rate base in 2015 to reflect depreciation paid in 2014.

6. Conclusion

For the reasons discussed above, and based on the analysis included in its Initial Brief on pages 226-237, the Department continues to support its passage of time adjustment to ensure that rates attributable to the 2015 Step reasonably reflect both capital cost increases as well as capital cost decreases that should natural occur through the passage of time.

D. In-Service Dates (Issue 11)

The Department continues to rely on the analysis and recommendation for its In-Service Dates adjustment, which is included in the Department's Initial Brief on pages 118-123. Based on the most current information for in-service dates for capital projects included in the 2014 test year and 2015 Step, and to reflect the capital projects that will not be in-service as Xcel initially budgeted in its initial rate case filing, the Department recommends a $2.18 million revenue requirement reduction for the 2014 test year and a $2.05 million revenue requirement reduction for the 2015 Step. The Department opposes Xcel's proposal to substitute new like-kind replacement projects that it claims will be in-service in 2014 and 2015, which Xcel did not request in its initial filing and that no intervenor has had the opportunity to confirm will be in-service. DOC Initial Br. at 118.

Xcel's Initial Brief on this issue is not persuasive; it continues to claim that examined capital projects, which the Company did not include in its initial filing, should be included in rates without the opportunity of any other party, or the ALJ and Commission, to review. For example, Xcel states:

> The Department's adjustment does not include capital project in-service dates that have also advanced, which would thereby increase the Company's revenue requirement. The evidence on the record demonstrates that just as project in-service dates are moving out of the test year, other projects must be advanced for similar reasons. [citation omitted.]

Xcel Initial Br. at 104.

The Department believes that the Company use of the term "advanced" means that Xcel seeks to add new like-kind projects that are not included in the Company's initial petition, and therefore, the Department continues to disagree strongly with Xcel's proposal, as discussed in detail in the Department's Initial Brief at 118-123.

E. Total Labor (Issue 7)

Along with a brief response to a statement in Xcel's Initial Brief, the Department continues to rely on the analysis and recommendation for Total Labor costs, which is included in its Initial Brief on pages 157-161, as follows:

> For the reasons discussed, the Department recommends a 3 percent annual increase in total labor costs above the Company's 2012 actual total labor costs, to determine a normalized level for 2013, and then a 3 percent increase over 2013 normalized costs to determine a reasonable 2014 test year amount for total "Revised 2014" labor costs of $412.6 million, from Xcel's test-year request, on an NSPM Electric basis. The difference is a $6.4 million reduction in total labor costs for 2014 on an NSPM Electric basis; using the Minnesota Jurisdictional allocator of 87.572 percent (as used by Ms. Stitt for 2014 on her Schedule 3(a) page 1 of 2 of her Direct Testimony) results in an adjustment of $5.6 million reduction on a Minnesota Jurisdictional basis.
>
> The DOC's recommendation decreases the test-year administrative and general expense by $5,600,000, as shown in DOC Ex. 451 DVL-EH-7, column (w) (Lusti Opening Statement); DOC Ex. 442 at 33 (Lusti Surrebuttal).

DOC Initial Br. at 161.

The particular statement included in Xcel's Initial Brief that requires additional detail for clarity is, as follows:

> The Department's proposed total labor adjustment was based on a historical trending of the Company's 2012 actual labor costs and an unsupported statement that total labor increases must be capped at three percent.

Xcel Initial Br. at 69 (citing DOC Ex. 435 at 72 (Campbell Surrebuttal)).

Ms. Campbell provided reasoned analysis and conclusions. Review of Ms. Campbell's Surrebuttal Testimony at 71-73 provides her basic analysis and the reasons underlying her recommended 3% increase to 2012 total labor costs for 2013, together with a 3% increase to this 2013 figure to arrive at her recommended total labor cost for 2014, as follows:

> **Q. Do you agree with Ms. Stitt that 2013 labor costs were higher due to higher nuclear labor costs, including the extended outages at Monticello and Prairie Island, as well as the Nuclear Performance Excellence program?**
>
> A. Yes. I also note that 2013 *had an unusually high number of significant storms, which likely also caused the Company's 2013 total labor costs to be higher than normal.*
>
> **Q. For total labor costs, did the Company's 2013 actual total labor costs exceed its budgeted total labor costs for 2013?**
>
> A. Yes. Although that result is not surprising due to the higher than normal nuclear costs in 2013 as described by Ms. Stitt and likely higher labor costs due to unusually high number of storms in 2013. *I also do not necessarily agree that just because the Company spent the total labor level in 2013 of $436.2 million it means that such spending was at a normalized level or was a reasonable level for rates going forward.*
>
> * * *
>
> **Q. Please explain why you are concerned about Xcel's proposed 2014 test year total labor costs, since they are 3.9 percent lower than the 2013 actual costs based on the above table?**
>
> A. Xcel has not shown that its proposed 2014 test-year labor costs are reasonable. That is, I am concerned with the 2014 test year total labor costs of $419.4 million because *2013 actual labor costs were abnormally high due to nuclear plant outages and the usually high number of storms. Also, when one observes the trend of labor costs from 2011 to 2012 the cost increase is 3 percent. In my experience, an increase of 2 to 3 percent over the costs of a normal year is generally a reasonable increase for labor. As a result, I conclude that 2013 was an unusual year as to labor costs.*
>
> As a result, I think it would be reasonable to allow the Company *a 3 percent increase above its 2012 actual to determine a likely normalized level for 2013 and then allow it a 3 percent increase over 2013 normalized costs to determine a reasonable 2014 test year amount for total labor*.

DOC Ex. 435 at 71-73 (emphasis added).

F. 2015 Step Rate Moderation Plans: Theoretical Depreciation Reserve and DOE Payments for 2014 and 2015 (Issue 9)

The Department continues to rely on its analysis and recommendation regarding Xcel's 2015 Step Rate Moderation proposal, which is included in the Department's Initial Brief on pages 237-246. In addition, the Department reviewed the Company's statement on page 98 of its Initial Brief that, in light of Xcel's stated assessment that it is unlikely to receive all of the rate relief it requested for the 2014 test year, "there is less need for rate moderation in the 2015 Step year." Xcel Initial Br. at 98. The Company also proposed in its Initial Brief a 50%-0%-50% option, compared to its 50%-30%-20% option. *Id.*

The Department appreciates the Company's assessment of 2014 costs. Nevertheless, the Department continues to be concerned about negative future effects of using theoretical depreciation to moderate rates in the near-term. For that reason, the Department continues to recommend that any rate moderation through using theoretical depreciation reserve be accelerated to the nearest periods, such as the Department's 50%-40%-10% proposal, or Xcel's 50%-30%-20% proposal. For this reason, extending a large portion of theoretical depreciation reserve to year three, as Xcel's 50%-0%-50% option would do, would be a concern to the Department.

G. Depreciation Reserve for Nuclear Plant – XLI Proposal (Issue 75)

The Department continues to rely on its analysis and recommendation regarding the issue of XLI's proposal for Depreciation Reserve for Nuclear Plant, which is included in the Department's Initial Brief on pages 161-163. The Department agrees with Xcel and the OAG that XLI's proposal to reduce 2014 and 2015 rates by using nuclear production plant depreciation is not reasonable. *Id.* at 161.

H. Decoupling (Issue 50)

Xcel's Initial Brief acknowledges that in Minnesota the legislative "purpose of decoupling" is set forth in Minn. Stat. § 216B.2412, (Xcel Initial Br., at n. 602) and that the Department determined Xcel's proposed "partial" decoupling proposal to be unreasonable because of its "adverse impact on customers." Xcel Initial Br. at 149. Xcel nevertheless incorrectly argues that the Department's concern over that adverse impact on ratepayers is misguided because "the inclusion or exclusion of weather has nothing to do with fulfilling the statutory purpose of decoupling: to reduce the conservation disincentive." Xcel Initial Br. at 149.

Xcel's argument is incorrect because it misstates the law as set forth in Minn. Stat. § 216B.2412. The goal of "reducing the conservation disincentive" is only part of the statutory guidance. When the Commission establishes criteria and standards for decoupling,

> The commission … shall design the criteria and standards to mitigate the impact on public utilities of the energy-savings goals under section 216B.241 **without adversely affecting utility ratepayers.** In designing the criteria, the commission shall consider energy efficiency**, weather,** and cost of capital, among other factors.

Minn. Stat. § 216B.2412. Thus, the Commission is required by the statute to consider weather when designing its decoupling program and to ensure that decoupling will not adversely affect ratepayers.

As pointed out in Mr. Davis' Direct Testimony, the statutory intent of decoupling is to reduce the utility's disincentive to promote energy savings while not harming ratepayers. DOC Ex. 417 at 17 (Davis Direct). As shown in Mr. Davis' Rebuttal Testimony, during the ten-year period of 2004 to 2013, Xcel's ratepayers would have paid $77 million more under partial decoupling, which excludes consideration of weather, as compared to full decoupling which takes weather into account. DOC Ex. 419 at 14 (Davis Surrebuttal). The consideration of weather-- and the adverse effect on ratepayers of not considering weather-- has everything to do with statutory intent.

Xcel also criticizes the Department's analysis, based on Mr. Hansen's Rebuttal testimony, as follows:

> The Department's analysis is also dependent on the pilot period sharing economic and weather characteristics *with the recent past*. The Company showed the purported advantages of full decoupling over partial decoupling either vanish or become disadvantages with simple changes in weather assumptions.

Xcel Initial Br. (citing Ex. 110 at 5-8 (Hansen Rebuttal)). In response, unlike the Company's manufactured scenarios, which covered only three years, the Department's Surrebuttal Testimony extended the scope of its analysis to assess data from an entire decade. DOC Ex. 419 at 12-14 (Davis Surrebuttal). During that ten-year period, numerous scenarios occurred. In this extensive analysis, the full decoupling design was shown to be superior to a partial decoupling design in protecting ratepayers against unwarranted adverse impacts. DOC Ex. 419 at 14 (Davis Surrebuttal).

The Department continues to recommend that the ALJ and Commission find that the Company has not shown its proposal to be just and reasonable. The Department continues to recommend (DOC Initial Br. at 218-219) that the ALJ and Commission reject Xcel's proposed RDM revenue decoupling proposal, and instead approve a three-year pilot full revenue decoupling mechanism for Xcel's residential and non-demand-metered customer classes with the following provisions:

a) The Commission approve no cap on decoupling refunds, but a hard cap on surcharges, that, including fuel and all applicable riders, is in an amount no greater than 3 percent of total customer group revenue;

b) Xcel not be allowed to surcharge customers in any year after the Company fails to achieve energy savings equal to 1.2 percent of retail sales; and,

c) The pilot program run for three years.

I. Prairie Island EPU (Issue 3)

Xcel's Initial Post Hearing Brief incorrectly states, at page 75, in what appears to be a typographical mistake, that "the Company and the Department each testified that recovery of Project costs over the remaining life of the facility with a debt-only return *of 2.42 percent* would be acceptable." The percentage of debt-only return to which the Department agreed, as an alternative to no rate of return, *is 2.24 percent.*

IV. RATE DESIGN

A. The Department's Response to the Clean Energy Intervenors and the Energy CENTS Coalition (Issue 54)

The Department continues to recommend a modest $0.50 per month increase in the fixed residential customer charge as a reasonably balanced approach to rate design. In this Reply Brief section, the Department responds to Initial Briefs of the Clean Energy Intervenors (CEI) and the Energy CENTS Coalition (ECC).

1. The Department Does Not "Blindly Adopt" Xcel's Class Cost of Service Study (CCOSS) Residential Customer Cost in Recommending an $8.50 Residential Customer Charge

CEI claims that "blindly adopting the CCOSS value of $15.86 as a customer cost value relevant for rate design purposes is inappropriate." CEI Initial Br. at 10. Contrary to CEI's assertion, neither the Department nor any other party is "blindly adopting" Xcel's average customer cost value in the CCOSS, as none of the parties to this case are recommending a residential customer charge of $15.86 per month. Instead, the Department recommends adoption of an $8.50 monthly fixed charge for standard (overhead) residential customers, which reflects a modest $0.50 per month increase over the current charge. DOC Initial Br. at 289. To be clear, the Department is not recommending strict adherence to the CCOSS, but rather that it "help inform how to design rates." Tr. Vol. 4 at 185.

2. Low-Income, High-Usage Residential Customers Exist

ECC recommends that the Commission not increase Xcel's current residential customer charges because it would disproportionately affect low-income, low-usage customers. ECC Initial Br. at 11–14, 19. The Department certainly agrees that there are low-income, low-usage customers. However, despite arguments by CEI and ECC to the contrary, the record clearly demonstrates that low-income, *high*-usage customers exist, who would be disproportionately harmed by higher energy costs and who might be relieved by a modest increase in the fixed customer charge. DOC Ex. 422 at 5, SLP-S-3 (Peirce Surrebuttal). ECC dismisses the numbers of known low-income, high-usage LIHEAP recipients as insignificant or likely to be aided by existing low-income assistance programs. ECC Initial Br. at 9–10.

The Department does not dismiss the needs of low-income, high-usage customers, for several reasons. First, as noted in Ms. Peirce's Surrebuttal Testimony, the only usage and income information specific to Xcel customers is for LIHEAP recipients. DOC Ex. 422 at 10 (Peirce Surrebuttal). LIHEAP recipients represent a subset of a larger group of LIHEAP-eligible customers who do not receive LIHEAP assistance. *Id.* at 11. Second, there is an additional group of customers with incomes on the margins of LIHEAP eligibility—that is, they have incomes slightly above the income thresholds to be eligible for LIHEAP, but may nonetheless be struggling economically. *Id.* at 10–11. Other than LIHEAP recipients, we know nothing about the financial circumstances of any other Xcel customers. *Id.* Third, because receipt of LIHEAP assistance is generally required to access many of the additional assistance programs, the broader group of LIHEAP-eligible customers would not have access to these assistance programs.

The fact that the financial circumstances of any Xcel customers beyond those identified as receiving LIHEAP assistance is unknown further supports the Department's recommendation that the Commission take a balanced approach to rate design through a modest $0.50 per month increase to the residential customer charge. DOC Initial Br. at 289–294.

ECC also misrepresents the Department's use of LIHEAP Home Energy Notebook data to argue that LIHEAP customers are not representative of a larger group of low income customers. ECC Initial Br. 13–14. In fact, ECC witness Mr. Colton incorrectly relied on the LIHEAP Home Energy Notebook in his testimony to assert that LIHEAP customers use more electricity than the larger population of low-income customers. ECC Ex. 234 at 7, RDC-2 (Colton Direct). Mr. Colton inaccurately cited energy consumption data for all fuels (natural gas, electricity, fuel oil, kerosene, and liquefied petroleum gas) in his testimony asserting that LIHEAP customers use more electricity, not less, than the larger group of low income customers. DOC Ex. 422 at 7 (Peirce Surrebuttal). To the contrary, the LIHEAP Home Energy Notebook demonstrates that LIHEAP customers use slightly less electricity (48.8 mmBtu) than all low-income customers (52.0 mmBtu). *Id.* at SLP-S-4.

ECC now argues that data presented by its own witness is not relevant to the case. ECC Initial Br. at 13. ECC maintains that the data cited in the LIHEAP Home Energy Notebook is exclusively electric space heating customers. *Id.* The record is devoid of evidence to support ECC's contention that these amounts are solely electric space heating customers. In fact, Xcel's customer usage data indicates that approximately 40% of its LIHEAP non-space heating customers have usage in the monthly amount cited by ECC as "clearly electric space heating usage amounts." DOC Ex. 422 at SLP-S-3 (Peirce Surrebuttal).

In the end, this data supports the Department's argument that a broader group of higher usage low-income customers exist, and would be most affected by a rate design that only results in an increase to the usage charge. The Department's recommendation that the Commission take a balanced approach to rate design with a modest $0.50 per month increase to the residential customer charge is reasonable.

V. CLASS COST OF SERVICE STUDY (ISSUE 51)

A. Other Production Operation and Maintenance Expenses

In this proceeding, regarding Other Operation and Maintenance (O&M) costs, Xcel argued *against* the method that the ALJ and Commission approved in Xcel's prior rate case, and *for* a method that Xcel has opposed in the past case. After providing a summary of the rationale for the Department's position for clarity and background, the Department addresses statements made by Xcel regarding the classification and allocation of Other O&M Expenses.

1. The Department's Proposed Classification and Allocation of Other Production and Maintenance Expenses on the Basis of the Location Method is the Most Reasonable Proposal in this Proceeding

The Department summarizes below why classifying and allocating the Other Production O&M Expenses on the basis of the "location" method is the only reasonable method provided in the record. DOC Ex. 414 at 8 (Ouanes Surrebuttal); DOC Ex. 445 (Ouanes Opening Statement). The overall investment method used by Xcel in its last rate case (12-961) allocated costs on the basis of overall plant investment. The overall investment method, and the refinement of this method (the "location method"), which the Commission required Xcel to use in the current rate case, are reasonable methods (consistent with cost causation) because they reflect the allocation of the generation plants at which these costs are incurred. DOC Ex. 414 at 8 (Ouanes Surrebuttal); DOC Ex. 445 (Ouanes Opening Hearing Statement).

Xcel, MCC, and XLI support classifying and allocating Other Production O&M costs on the basis of Xcel's "predominant nature" method. DOC Ex. 414 at 6 (Ouanes Surrebuttal); Xcel Initial Br. at 127; MCC Initial Br. at 17; *see* XLI Initial Br. at 12. According to Xcel, this method:

> [P]laced the 117 detailed cost items that make up Other Production O&M into 15 categories. Each category was then analyzed to determine if it was predominantly capacity-related or predominantly energy-related and classified it accordingly. All labor costs were assumed to be predominantly "fixed" while material costs were assumed to be predominantly "variable."

DOC Ex. 408 at 28 (Ouanes Public Direct).

The Department disagreed with this proposed change to Xcel's previous classification and allocation of these costs for the following four reasons.

First, Xcel supported the overall investment method and argued against its current proposal in its last two rate cases by disputing the assertion that it is reasonable to assign "fixed" costs (plant labor costs) entirely to the demand function. DOC Ex. 408 at 29–31, 34–35 (Ouanes Direct).

Second, neither Xcel, MCC, nor XLI provided any reasonable justification on the basis of cost causation for Xcel's proposed classification and allocation of Other Production O&M costs. DOC Ex. 414 at 8 (Ouanes Surrebuttal).

Third, classification and allocation of Other Production O&M expenses on the basis of the location method is consistent with cost causation. *Id.*

Fourth, contrary to Xcel's and XLI's assertion, Xcel's predominant nature method is not a refinement of the Commission's previously approved methods. Xcel's proposed classification and allocation of Other Production O&M costs is a substantial change from the classification and allocation methods that the Commission previously approved and from the current Commission-required classification and allocation method. In addition, Xcel's proposed classification method results in classification of these costs as 78.4% capacity-related which is much higher than classifying less than 35% of the costs as capacity-related under the location method the Commission required Xcel to use in the current rate case. *Id.* at 7; DOC Ex. 445 (Ouanes Opening Statement).

2. Xcel's Arguments Are Not Supported by the Record

In its Initial Brief, Xcel provided the following arguments in support of its proposed classification and allocation of Other Production O&M Expenses:

a. Xcel's predominant nature method draws upon new information or analyses that ultimately provide a more accurate measurement of class cost responsibilities. Xcel Initial Br. at 126.

b. Xcel's predominant nature method is superior to the locational method. *Id.* at 128.

c. Xcel's predominant nature method represents a refinement of the classification of Other Production O&M. *Id.* at 126.

d. The location method results in classifications that are inconsistent with cost causation. *Id.* at 128.

These arguments do not lend credence to Xcel's proposed classification and allocation of Other Production O&M expenses and the Department discusses each of these arguments in turn.

3. Department's Response to Xcel's Initial Brief Arguments

First, the Department disagrees with Xcel's representation that its proposed method provides a more accurate measurement of class-cost responsibilities. While Xcel's predominant nature method may be "a new analysis not previously performed in past cases," Xcel did not provide any reasonable cost-causation justification for its proposed method. DOC Initial Br. at 272–274. In fact, the Department concluded that:

> Xcel's proposed method is inconsistent with the Commission's May 14, 2012 Findings of Fact, Conclusions, and Order in Docket No. E002/GR-10-971, cited below. In that case, Xcel used a more appropriate CCOSS method; the Commission concluded that "the fixed/variable distinction does not correspond to whether those expenses are attributable to energy or demand … Xcel's method is

> preferable, because it does not misallocate the costs on the basis of their fixed or variable nature."

DOC Ex. 408 at 29 (Ouanes Direct).

As noted in the quote from the Commission's Order in Xcel's 2012 rate case, Xcel argued *against* classification of Other Production O&M fixed expenses as capacity-related and variable expenses as energy-related; in fact, Xcel did so in at least its last two rate cases. DOC Ex. 408 at 34–35 (Ouanes Direct).

Second, the Department disagrees with Xcel's argument that Xcel's predominant nature method is superior to the location method for the same reasons discussed above: Xcel did not provide any reasonable justification on the basis of cost causation for its proposed method. DOC Ex. 414 at 8 (Ouanes Surrebuttal). On the other hand, the overall investment method and its refinement, the location method, are both reasonable methods because they reflect the allocation of the generation plants at which these costs are incurred. (In other words, they are consistent with cost causation.) DOC Ex. 414 at 8 (Ouanes Surrebuttal).

Third, the Department disagreed with Xcel's representation that its proposed method represents a refinement of the classification of Other Production O&M expenses. *Id.* at 7; DOC Ex. 445 (Ouanes Opening Statement).

Finally, Xcel's argument against the location method that it "results in classifications that are inconsistent with cost causation" misses the point. The location method is not designed to provide a classification for each and every account within the Other Production O&M expenses. It is a refinement of the overall investment method that Xcel supported while arguing against its current proposal in its last two rate cases. The overall investment method and the location method are both reasonable classification and allocation methods (consistent with cost causation) for Other Production O&M expenses because they reflect the allocation of the generation plants at which these costs are incurred. DOC Ex. 414 at 8 (Ouanes Surrebuttal).

B. Classification and Allocation of the Costs of Nobles and Grand Meadow Wind Farms (Issue 53)

After providing a summary of the rationale for the Department's position, the Department addresses misleading statements made by Xcel and MCC in their respective initial briefs regarding classification and allocation of the costs of the Nobles and Grand Meadow wind farms.

1. The Department's Proposed Classification and Allocation of the Nobles and Grand Meadow Wind Farms on the Basis of the Equivalent Peaker Method is the Most Reasonable Proposal in this Proceeding

While the parties disagree about how to classify and allocate costs for Nobles and Grand Meadow wind farms, the Department demonstrated that classifying and allocating costs of the Nobles and Grand Meadow wind farms on the basis of the equivalent peaker (also called plant stratification) method is the only reasonable method provided in the record. The second most reasonable method is to classify these costs as 100% energy (not capacity) as recommended by OAG-AUD witness Mr. Nelson, which the Department would not oppose. DOC Initial Br. at 267–270; DOC Ex. 445 (Ouanes Opening Statement). MCC and XLI support Xcel's proposed classification of the costs of these wind farms as one-hundred percent demand-related costs. Xcel also supports MCC's proposed classification and allocation of these wind farms on the basis of the present base revenue allocator. DOC Ex. 414 at 2–3 (Ouanes Surrebuttal); Xcel Ex. 103 at 22 (Peppin Rebuttal); MCC Initial Br. at 18–21; *see* XLI Initial Br. at 12.

The Department disagreed with Xcel's proposed change to Xcel's previous classification of these costs for the following three reasons. DOC Ex. 445 (Ouanes Opening Statement).

First, Xcel's recommendation would classify costs of these wind farms as if they were peaking plants, which they are not according to the Company's own assessment. DOC Ex. 408 at 22–25 (Ouanes Direct).

Second, the only justification provided in support of this classification is that the Nobles and Grand Meadow wind farms were acquired to fulfill Xcel's Renewable Energy Standard (RES) obligations. Xcel Initial Br. at 133–35. Simply stating that these wind farms were acquired to fulfill the Company's RES obligations is not a reasonable justification to classify these wind farms as if they were peaking plants. DOC Ex. 414 at 3–4 (Ouanes Surrebuttal). In fact, starting with the same premise, OAG-AUD witness Mr. Nelson provided a better articulated justification for his proposed classification method that is not as drastically inconsistent with the operational characteristics of wind farms. OAG Ex. 375 at 6–8 (Nelson Direct).

Third, as discussed further in Department witness Dr. Ouanes' Direct Testimony, Xcel supported the use of the equivalent peaker method in its last three rate cases and argued against the use of classification methods that would not reflect the operational characteristics of wind generation. DOC Ex. 408 at 24–26 (Ouanes Direct).

The Department also disagreed with MCC's proposed change to Xcel's previous classification and allocation of these costs for the following two reasons. DOC Ex. 445 Ouanes Opening Statement).

First, allocation on the basis of the present base revenue allocator would include embedded policy judgments as to rate design (from the Company's last rate case) rather than allocating costs based entirely on cost factors. DOC Ex. 412 at 7 (Ouanes Rebuttal).

Second, the only justification provided to support this allocation is that the Commission used the present base revenue allocator in Docket No. E002/M-10-1066 to allocate RES Rider costs, including Nobles and Grand Meadow. DOC Ex. 445 (Ouanes Opening Statement). This justification is not reasonable because the Commission did not adopt this method on the basis of cost causation, but because it reflected the Commission's determination of apportionment of revenue responsibility in Xcel's prior rate case at that time (Docket 08-1065) and it preserved the then-existing rate design in an administratively simple and efficient manner. DOC Ex. 445 (Ouanes Opening Statement).

2. Xcel's and MCC's Proposals Are Not Reasonable

In their Initial Briefs, Xcel provided the following erroneous and misleading arguments in support of Xcel's proposed classification and allocation of the costs of the Nobles and Grand Meadow wind farms as if they were peaking plants, while MCC provided the following erroneous and misleading arguments against the use of the equivalent peaker method to classify the Nobles and Grand Meadow wind farms.

a. Relying on past treatment fails to account for new information presented in this case. Xcel Initial Br. at 134.

b. It is reasonable for the Commission to make a policy determination that reflects cost-causation, consistent with the quasi-legislative nature of the rate design process. Xcel Initial Br. at 134.

c. The Company's proposal results in a reasonable cost allocation that is more consistent with the policy-based nature of the Nobles and Grand Meadow projects. Xcel Initial Br. at 135.

d. The Department based its conclusion that the stratification method should be used on the presumption that the Nobles and Grand Meadow wind farms were added as least-cost resources. MCC Initial Br. at 18.

e. This allocation issue for Nobles and Grand Meadow has been discussed and contested in several proceedings and it was fully addressed in the 2010 Renewable Rider proceeding. MCC Initial Br. at 19.

f. Xcel has maintained that Nobles and Grand Meadow were not least-cost. MCC Initial Br. at 20.

g. Ouanes acknowledged Resource Planning had to force Nobles and Grand Meadow into their Integrated Resource Plan in order for them to be selected. MCC Initial Br. at 20.

The Department discusses each of these arguments in turn.

3. The Department's Response to Xcel and MCC's Proposals

First, the Department agrees with Xcel that new information was presented in this case regarding Borders and Pleasant Valley wind farms. That information, however, is irrelevant to Xcel's *volte-face* regarding its prior consistent positions: (1) in support of the use of the equivalent peaker method to classify the costs of the Nobles and Grand Meadow wind farms *even though* they were acquired to fulfill Xcel's RES obligations; and (2) against the use of classification and allocation methods that would not reflect the *operational* characteristics of wind generation. DOC Ex. 408 at 24–27 (Ouanes Direct).

Second, it is unclear what Xcel means when it states that the Commission can make a policy determination that reflects cost-causation, consistent with the quasi-legislative nature of the rate design process. The purpose of the CCOSS is to reflect cost-causation, but Xcel's proposal to classify and allocate costs of these wind farms as if they were peaking plants is inconsistent with cost-causation. The appropriate place for any policy determination that is not based on cost-causation is through rate design, not through the CCOSS.

Third, the Department disagrees with Xcel that the Company's proposal would result in a reasonable cost allocation or that it would be more consistent with the policy-based nature of the Nobles and Grand Meadow wind farms. It is not a reasonable cost allocation as already summarized above. It is also not more consistent with the policy-based nature of the Nobles and Grand Meadow wind farms, as Mr. Nelson articulated. OAG Ex. 375 at 6–10 (Nelson Direct).

Fourth, the Department disagrees with MCC's statement that the Department based its conclusion that the stratification method should be used on the presumption that the Nobles and

Grand Meadow wind farms were added as least-cost resources. That assertion is not correct. The Department's conclusion was based on the entire record, as summarized above, which shows that classifying costs of the Nobles and Grand Meadow wind farms on the basis of the plant stratification method is the only reasonable method provided in the record, with the alternative approach of classifying these costs as 100% energy (not capacity) as recommended by Mr. Nelson, which the Department would not oppose. DOC Ex. 445 (Ouanes Opening Statement).

Fifth, the Department agrees with the first part of MCC's statement that allocation of Nobles and Grand Meadow has been discussed and contested in several proceedings. The last part of MCC's statement, that the allocation issue for Nobles and Grand Meadow was fully addressed in the 2010 Renewable Rider proceeding, is inaccurate and misleading. Putting both sentences under the same statement leads a reader to believe that the allocation issue at hand in the "several proceedings" (Xcel's previous rate cases) and in the 2010 Renewable Rider proceeding (Docket No. E002/M-10-1066) was the same. The issue at hand was not the same. In Xcel's previous rate cases, the allocation issue was addressed as a CCOSS-related issue, *i.e.*, based on cost-causation considerations. In the 2010 Renewable Rider proceeding, as shown in part in the excerpt of the Commission's Order provided by MCC, the allocation issue was not based on cost-causation considerations, but was based on rate design considerations. MCC Initial Br. at 19; DOC Ex. 445 (Ouanes Opening Statement). MCC's argument may be misleading because it leaves a reader with the perception that the Commission approved an allocation method in 2011 (MCC's preferred method) for allocating costs of the Nobles and Grand Meadow wind farms on the basis of cost causation, which it did not.

Sixth, the Department disagrees with MCC that Xcel has maintained that Nobles and Grand Meadow were not least-cost. The record is devoid of such statements from Xcel. In any case, in its 2010 rate case, Xcel rejected MCC's criticism that Company-owned resources should not be treated as least-cost resources in the CCOSS by asserting, in part, that the record does not support the conclusion that Company-owned wind resources are not least-cost resources. DOC Ex. 408 at 25–26 (Ouanes Direct).

Finally, the Department is also concerned that MCC misrepresented Dr. Ouanes' testimony during the evidentiary hearing. MCC's statement that "Ouanes acknowledged Resource Planning *had* to 'force' Nobles and Grand Meadow into their Integrated Resource Plan in order for them to be select[ed]" is erroneous and misleading. MCC Initial Br. at 20 (emphasis added). MCC referenced the following excerpt from Dr. Ouanes response at the evidentiary hearings in support of its statement: "I really don't know why Xcel hardwired, as you say, wind resources. It is my understanding that it did, but I know that Xcel has argued that there was no indication that they were not least cost resources." Tr. Vol. 4 at 124–25 (Ouanes). MCC's statement is also misleading because it gives the perception to the reader that Nobles and Grand Meadow wind farms would not have been selected if they were not "hardwired," leading to the conclusion that they were not least-cost resources. In fact, resources that are "hardwired" may still be least-cost resources. *Id.* at 125.

CONCLUSION

The Department respectfully requests a recommendation from the Administrative Law Judge and an Order from the Commission determining that the rates filed by Xcel have not been shown to be just and reasonable, as required by Minn. Stat. § 216B.16, subd. 5 (2010), for the reasons discussed in this Reply Brief. The Department requests that the Commission establish rates consistent with the principles, analyses and recommendations as addressed in the Department's testimony, its Comments to Xcel's Issue Matrix, and its Initial and Reply Briefs.

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Respectfully Submitted,

s/ Linda S. Jensen

Linda S. Jensen
Assistant Attorney General
Attorney Reg. No. 0189030

s/ Peter E. Madsen

Peter E. Madsen
Assistant Attorney General
Attorney Reg. No. 0392339

s/ **Julia E. Anderson**
Julia E. Anderson
Assistant Attorney General
Atty. Reg. No. 0138721

445 Minnesota Street, Suite 1800
St. Paul, MN 55101-2131
Attorneys for the Minnesota Department of Commerce