STATE OF MINNESOTA
BEFORE THE
MINNESOTA PUBLIC UTILITIES COMMISSION

In the Matter of the Application of Northern States Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota	)	**MPUC Docket No. E-002/GR-13-868** **OAH Docket No. 68-2500-31182**

EXCEPTIONS TO THE FINDINGS OF FACT, CONCLUSIONS OF LAW, AND RECOMMENDATIONS OF THE ADMINISTRATIVE LAW JUDGE SUBMITTED BY THE ICI GROUP

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The following constitutes the Exceptions to the Findings of Fact, Conclusions of Law, and Recommendations of the Administrative Law Judge ("ALJ") dated December 26, 2014 of the ICI Group.[1]

INTRODUCTION

The ICI Group has raised the following issues in this proceeding: (1) the "rate shock" that industrial, commercial, and institutional consumers would experience as a result of the proposed increases, (2) the Company's two-year rate increase phase-in proposal, (3) the used and usefulness of the cancelled Prairie Island Extended Power Uprate (EPU) Project, (4) the Company's requested increase in its return on equity ("ROE") and its proposed capital structure, and (5) implementation of a revenue decoupling mechanism.

While ICI Group generally supports the detailed and thorough findings and recommendations in her report dated December 26, 2014[2], the ICI Group has various exceptions to the Recommendations, which are submitted to clarify the ICI Group's position and to advocate for modifications.

[1] The ICI Group consists of U.S. Energy, Inc. on its own behalf and on behalf of an ad hoc group of its industrial, commercial, and institutional customers. (*See* Ex. 250, at 2-3 (Glahn Direct)).

[2] Docket No. E-002/GR-13-868, Findings of Fact, Conclusions of Law, and Recommendations (Dec. 26, 2014) [hereinafter "*Recommendations*"].

ANALYSIS

I. STANDARD OF PROOF.

"Every rate made, demanded, or received by any public utility . . . shall be just and reasonable. . . . Any doubt as to reasonableness should be resolved in favor of the consumer."[3] Northern States Power Company—Minnesota (the "Company") has the burden to demonstrate that its proposed rate increases in this proceeding are just and reasonable.[4] The Minnesota Supreme Court has described the Commission's role in determining just and reasonable rates as follows:

> [I]n the exercise of the statutorily imposed duty to determine 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, the MPUC acts in both a quasi-judicial and a partially legislative capacity. To state it differently, in evaluating the case, the accent is more on the inferences and conclusions to be drawn from the basic facts (i.e., the amount of claimed costs) rather than on the reliability of the facts themselves. Thus, by merely showing that it has incurred, or may hypothetically incur, expenses, the utility does not necessarily meet its burden of demonstrating it is just and reasonable that the ratepayers bear the costs of those expenses.[5]

The Company has failed to show by a preponderance of the evidence that the magnitude of its proposed two-year rate increases results in just and reasonable rates for consumers.

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[3] Minn. Stat. § 216B.03 (2014).

[4] Minn. Stat. § 216B.16, subd. 4 (2014) (stating that the burden of proof to show that a proposed rate change is just and reasonable "shall be upon the public utility seeking the change").

[5] *In re Northern States Power Co.*, 416 N.W.2d 719, 722-23 (Minn. 1987).

Applying the standards set forth above, the ICI Group submits the following arguments supporting its exceptions:

- The ALJ misapplied the law in recommending that the Commission not consider potential rate shock when determining whether the Company's proposed rate increases are just and reasonable.

- The ALJ incorrectly reasoned that the legislature requires the Commission to adopt a multi-year rate plan if one is proposed by a utility; rather the statute directs the Commission to first determine whether a multi-year rate plan will result in just and reasonable rates.

- The ALJ incorrectly determined that the "used and useful" standard does not apply to the cancelled Prairie Island EPU Project. The Commission may deny recovery of costs for this cancelled projects in an exercise of its legislative powers. Even if the Commission allows cost recovery, it should exercise its quasi-judicial powers to determine that the Company cannot recovery the full extent of its costs.

- The ALJ improperly determined that the ICI Group's DCF analyses were entitled to no weight, while at the same time placing too much weight on the Company's unreliable and inflated DCF results. This led to the ALJ's recommendation of an unreasonably high return on equity.

- The ALJ recommended that a decoupling pilot be implemented, without specifically recommending that such a pilot should never be extended to larger, demand-metered customers.

II. THE HIDDEN EFFECTS OF "ANCHORING."

The Company's requests in this proceeding create the risk that the effects of "anchoring" will improperly distort the outcome in this case. Such anchoring is largely attributable to the required procedure of a rate case—the Company first files its petition with requested increases, and then the parties and intervenors respond. Certain aspects of the Company's requested rate increases are based on unreliable information, yet these requests serve as "anchors," which may make subsequent reductions in the proposed

increases appear *subjectively* reasonable, even if they would not result in *objectively* just and reasonable rates. A brief overview of the psychological concept and effect of anchoring will provide context for how anchoring has the potential to distort several issues in this rate case.

"We are often unduly influenced by the initial figure we encounter when estimating the value of an item"; this psychological phenomenon is termed "anchoring."[6] "This initial value serves as a kind of reference point or benchmark that anchors our expectations about the item's actual value."[7] The number that starts the process exerts a stronger impact than do subsequent pieces of numeric information.[8] "[W]hile expert training and information symmetry certainly limit the impact of anchors, we have an automatic, unconscious tendency to 'anchor' on the first number we encounter when estimating the value of an intangible."[9] The more *relevant* information our analytical mind has, the less we are swayed by an unreasonable anchor.[10] However, there is a risk of distortion of results if a party (or regulator) relies on an "irrelevant or uninformative

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[6] Dan Orr & Chris Guthrie, *Anchoring, Information, Expertise, and Negotiation: New Insights From Meta-Analysis*, 21 Ohio St. J. on Disp. Resol. 597, 597 (2006).

[7] *Id.*

[8] *Id.* at 600 (citation omitted).

[9] Donald R. Philbin, Jr., *The One Minute Manager Prepares for Mediation: A Multidisciplinary Approach to Negotiation Preparation*, 13 Harv. Negotiation L. Rev. 249, 289 (2008) (quotation and citation omitted).

[10] *Id.*

anchor."[11] The ICI Group argues herein that the Company's requests serve as unreasonable anchors on the following issues:

- The Company's shifting of cost recovery from the 2014 test year to the 2015 step during the course of the proceedings makes its overall cost recovery requests appear subjectively more reasonable, without in fact being objectively just and reasonable.

- The Company's initial recommendation of a 10.25 percent return on equity has no basis in objectively reasonable data, but serves to make lower return-on-equity figures appear subjectively reasonable, even if they are not objectively just and reasonable.

III. RATE SHOCK.

The ALJ stated that "rate shock applies when a rate increase is so large that it results in a significant drop in usage, reflecting the unwillingness or inability of customers to pay for those services."[12] She then concluded that the ICI Group's rate shock argument lacks merit:

> Under Minnesota law, a utility is entitled to recover reasonable, on-going costs associated with providing utility service. The determination regarding any request for a rate increase is based on the factors set forth in Minn. Stat. § 216B.16, subd. 6, including "the need of the public utility for revenue sufficient to enable it to meet the cost of furnishing the service." These factors do not include rate shock. Thus, contrary to the ICI Group's assertion, rate shock alone is not a basis for denying the Company's proposed rate increases.[13]

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[11] *See* Orr & Guthrie, *supra* note 6, at 601.

[12] *Recommendations*, pp. 145, ¶ 633 (citing *Lloyd v. Penn. Public Utility Comm'n*, 904 A.2d 1010, 1018 n.14 (Pa. Commw. Ct. 2006)).

[13] *Id.*, pp. 145, ¶ 635 (footnotes omitted). The ICI Group never asserted that "rate shock alone" is a basis for denying the Company's proposed rate increase; rather, the ICI Group argued that rate shock is a factor that should be considered in determining

The ICI Group takes exception to the ALJ's analysis and conclusions because (1) the definition of "rate shock" relied upon does not compel the conclusion, and (2) the ALJ's interpretation of the controlling statute requires modification.

The ALJ relied on a definition of "rate shock" taken from a Pennsylvania state court decision.[14] That court actually provided two definitions of rate shock, the second of which is the "public outcry associated with rate increases."[15] In any event, the remedy advocated by the Pennsylvania court in that case is consistent with what the ICI Group is requesting here—namely the use of "'gradualism,' i.e. phasing in rates or closing rate differentials over a longer period of time allowing consumers to gradually make the adjustments in the 'elastic' part of their spending so as to pay for increased utility costs."[16] It is not clear how the ALJ's reliance on the definition of rate shock from Pennsylvania compels her conclusion that it is not a proper Commission consideration in determining whether proposed rates are just and reasonable. Additionally, there is previous Commission precedent of considering the potential effects of rate shock, which analysis has been upheld by the Minnesota Supreme Court.[17] Thus, the reliance of the

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whether the proposed increase results in just and reasonable rates. Ex. 250, at 3-5 (Glahn Direct).

[14] *Recommendations*, pp. 145, ¶ 633 (citing *Lloyd*, 904 A.2d at 1018 n.14).

[15] *Lloyd*, 904 A.2d at 1018 n.14.

[16] *Id.*

[17] *See In re Minn. Power for Auth. to Increase Rates for Elec. Serv.*, 838 N.W.2d 747, 759-60 (Minn. 2013) (discussing the Commission's consideration of "rate shock" in deciding whether an exigency existed under Minn. Stat. § 216B.16, subd. 3(b)).

ALJ on the definition of "rate shock" as compelling the conclusion reached should be disregarded by the Commission.

Finally, an analysis of the statute on which the ALJ relied in rejecting the ICI Group's argument indicates that such rejection was based on erroneous legal grounds. The ALJ reasoned that rate shock cannot be considered because it is not listed as a factor in Minn. Stat. § 216B.16, subd. 6. But that subdivision does not provide an *exclusive* list of factors the Commission may consider in determining whether proposed rates are just and reasonable. The relevant statutory language reads:

> **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.[18]

[18] Minn. Stat. § 216B.16, subd. 6.

This language provides the Commission with discretion, and sets forth a *non-exclusive* list of factors to consider in setting rates. "If the Legislature intended to limit the factors that the Commission considers" when determining just and reasonable rates, "the Legislature could have done so expressly."[19] Nothing in Minn. Stat. § 216B.16, subd. 6 compels the conclusion that the Commission cannot consider rate shock in determining whether a proposed rate increase is just and reasonable. And the record reflects that the Company's proposed rate increase would result in rate shock.

On November 4, 2013, the Company filed a petition proposing a two-year increase in its electric rates in Minnesota. The requested increase would have resulted in an increase in rates of greater than 10 percent from current levels.[20] Since the filing of the petition, the Company and the other parties to this proceeding have worked to reduce the requested rate increase, which is now approximately: (1) $142.2 million in 2014, and (2) $106.0 million in 2015, for a total combined increase of $249.0 million.[21] The large reduction in the proposed 2014 rate was accomplished by deferring some increases until 2015.[22] Such deferral of proposed rate increases to the second year of the multi-year

[19] *See In re Minn. Power*, 838 N.W.2d at 754-55. In *Minnesota Power*, the Minnesota Supreme Court held that the Commission did not exceed its statutory authority by considering factors other than those specifically enumerated in Minn. Stat. § 216B.16, subd. 3(b). *Id.* at 757. The ICI Group asks that the Commission adopt the same approach in this case with respect to subdivision 6.

[20] Ex. 250, at 3 (Glahn Direct).

[21] Ex. 140, at 8 & Ex. A (Heuer Opening Statement); *Recommendations*, Attachment A, A-1 ("Resolved Issues and Undisputed Corrections").

[22] *See id.*

proposal is one instance where the effects of "anchoring" make the Company's requested rate increases appear more reasonable than their initial request.[23] Although such deferrals may make the Company's requests appear *subjectively* more reasonable, they do nothing to show that the proposed increases are *objectively* "just and reasonable."[24]

Commission acceptance of the proposed rate increases totaling $249.0 million would drastically impact members of the ICI Group's operations and their competitive positions in the marketplace.[25] "In addition to numerous other regulatory proceedings that impact the prices charged to customers, the Company has filed four general rate cases in the past decade: in 2005, 2008, 2010, and 2012."[26] These other rate cases preceded the current case, and resulted in increases in the cost of electric service by $131,455,000 in 2005; $91,375,000 in 2008; $72,851,000 in 2010; and $103,797,000 in 2012.[27] According to Mr. Glahn:

> [The Company] is requesting total Minnesota electric revenue of $3,081,000,000. Prior to the results of the 2005 rate case, authorized revenue was $2,082,350,000. The difference between those figures, almost exactly $1 billion, represents an increase of 48 percent over the pre-2005 annual revenue base. On a compounded basis, [the Company's] annual revenues

[23] *See* discussion *supra* Part II (noting the distorting effects of "anchoring").

[24] *Id.*

[25] Large consumers of electricity are concerned that the proposed increase will negatively affect the business climate of Minnesota relative to other states, and large consumers' ability to compete with businesses in regional, national, and international markets. *See* Ex. 250, at 5 (Glahn Direct).

[26] *Id.* at 3.

[27] *Id.* at 3-4.

> have been growing at a rate of almost 4.5 percent for the past decade, well beyond any measure of inflation during that period.[28]

Additionally, the Company plans to file another rate case in November 2015.[29]

Such steep increases in the cost of electric services over a short period of time create the risk for "rate shock." For the members of the ICI Group, there is no choice but to pay the increased cost of electricity determined in this proceeding, as many "operate 24 hours per day, seven days a week and exhibit relatively flat energy usage patterns. Therefore, there are few opportunities for group members to reduce their energy costs by reducing peak usage, shifting operations, or curtailing load."[30]

The ICI Group urges the Commission to consider the Company's rate request in the context of the state's overall business climate, the cumulative effect of recent rate increases, and the likelihood of more increases in the near future. "In reviewing rate changes, the [Commission's] charter is broadly defined in terms of balancing the interests of the utility companies, their shareholders, and their customers to ensure that rates are 'just and reasonable.'"[31] Contrary to the ALJ's finding, the ICI Group never argued that

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[28] *Id.* at 4 (internal footnotes omitted). Note that since Mr. Glahn's Direct Testimony was filed, the Company has reduced its proposed rate increases (largely by deferring some costs from 2014 to the 2015 step). Ex. 140, at 8 & Ex. A (Heuer Opening Statement).

[29] Ex. 99, at 12 (Clark Direct).

[30] Ex. 250, at 5 (Glahn Direct).

[31] *Minn. Dep't of Pub. Serv. v. Minn. Pub. Utils. Comm'n (In re request of Interstate Power Co. for Auth. To Change its Rates for Gas Serv.)*, 574 N.W.2d 408, 411 (Minn. 1998) [hereinafter *In re Interstate Power*] (quoting Minn. Stat. § 216B.16, subd.6); *see also* Ex. 254 (Glahn Opening Statement).

"rate shock alone" is sufficient to allow the Commission to deny the Company's proposed rate increase.[32] Rather, the ICI Group urges the Commission to consider the potential effects of rate shock as part of its overall analysis in determining whether the proposed rate increases are just and reasonable.

The ALJ's legal conclusion that rate shock is not properly considered by the Commission should be rejected.[33] Nothing in statute or case law prohibits the Commission from considering the potential effects of rate shock, and there is prior Commission precedent of considering such effects.[34] The ICI Group requests that the Commission consider the potential effects of rate shock in this proceeding.

IV. THE PROPOSED TWO-YEAR RATE PHASE-IN PROPOSAL.

The Company's petition proposed a two-year rate increase. The ICI Group argued (1) that the Commission should reject the multi-year rate plan because it will not result in just and reasonable rates for consumers, and (2) if a multi-year rate plan is allowed, the Commission should use its power to establish terms, conditions, and procedures to ensure that the multi-year plan will not result in a windfall for the Company.

The ALJ noted that the ICI Group was the only party to argue that a multi-year rate plan should not be approved.[35] She then determined that the ICI Group's arguments addressed only whether a multi-year rate plan is a sound regulatory tool, which was

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[32] Ex. 250, at 3-5 (Glahn Direct).

[33] *Recommendations*, pp. 145, ¶ 635.

[34] *See Minn. Power*, 838 N.W.2d at 759-60.

[35] *Recommendations*, pp. 146, ¶ 641.

affirmatively decided by the Minnesota Legislature in 2011 when it amended the statute to allow multi-year rate cases.[36] Therefore, she recommended denying the ICI Group's request that only the 2014 test year be included in this case.[37] The ALJ misapplied the relevant statute in rejecting the ICI Group's argument.[38]

According to statute, "[a] public utility may propose, and the [C]ommission may *approve, approve as modified, or reject*, a multiyear rate plan as provided in this subdivision. . . . The [C]ommission may approve a multiyear rate plan only if it finds that the plan establishes just and reasonable rates for the utility."[39] The burden of proof remains on the utility to prove that the each year of a multiyear rate plan establishes just and reasonable rates for consumers.[40] In rejecting the ICI Group's arguments, the ALJ erroneously reasoned that the Legislature had taken the power away from the Commission to consider whether a multi-year rate plan should be allowed *in each individual case*[41]; the necessary implication of such reasoning is that if a utility proposes a multi-year plan, the Commission must allow it. This is not what the statute requires. The Commission may use its discretion to reject a multi-year plan if it would not result in

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[36] *Id.*, pp. 146-47, ¶ 642.

[37] *Id.*

[38] The ALJ also rested on a conclusory statement: "As discussed in the other sections of this Report, the record in this case shows the Company's proposed MYRP, as modified in this Report, will result in just and reasonable rates." *Id.*, pp. 147, ¶ 642.

[39] Minn. Stat. § 216B.16, subd. 19(a) (2014) (emphasis added).

[40] *Id.*

[41] *See id.*; *Recommendations*, pp. 146-67, ¶ 642.

just and reasonable rates.[42] The Commission should do so here because (1) under the circumstances, there is a high risk that the multi-year plan will result in an unfair windfall to the Company, and (2) the use of a multi-year rate plan mechanism greatly increases the risk of the distorting effects of "anchoring."

Company witness Mr. Sparby contends that the purpose of the two-year rate phase-in is to "help address longer-term investment needs, while providing greater predictability in customer rates."[43] A multiyear rate increase, in reality, increases the risk that the Company will receive a windfall at the expense of consumers. Implicit in the multiyear rate requests are: (1) that absent the phase-in, the one-time, full rate increase request would be unjust and unreasonable, and therefore needs to be made more gradual,[44] and (2) that the Company cannot justify the full rate increase at this time and hopes that by deferring some increases until 2015, less scrutiny will be given to both the 2014 and 2015 rate increase requests (as they will both appear relatively smaller than a single increase).[45]

Given the current economic climate, a two-year rate phase-in gives rise to a risk that the Company will experience a windfall at the expense of consumers. For several

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[42] Minn. Stat. § 216B.16, subd. 19(a).

[43] Ex. 25, at 16 (Sparby Direct and Schedules).

[44] Ex. 250, at 6 (Glahn Direct).

[45] *Id.* As noted above, the Company has attempted to defer some of its unreasonable requests for increases in 2014 to 2015, in the hopes that such deferment will make its requested increases appear *subjectively* more reasonable. *See* discussion *supra* Part II (noting the distorting effects of "anchoring").

years following the market crash of late 2007, public utilities suffered from low load (demand) growth.[46] Generally, utilities could count on load growth to offset the negative effects of regulatory lag.[47] The Company filed this case at a time when there have been several years of sluggish economic growth; however, there is reason to believe that the economy will recover in the next 12 to 24 months (which expectation has been borne in reality as the rate case has progressed).[48] Thus, if the two-year rate phase-in is implemented, the Company stands to improve its economic position by (1) increasing its demand base, and (2) having rates set at a level which in retrospect turned out to be too high.[49] Given the prohibition against retroactive ratemaking, the Company would be able to keep all, or substantially all, of the resulting windfall.[50]

Additionally, the Company has used the multi-year format to make its requested rate increases appear *subjectively* more reasonable, when in reality they are not *objectively* just or reasonable.[51] Initially, the Company sought an increase in rates by approximately $192.7 in 2014 and $98.5 million in 2015.[52] The Company subsequently

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[46] Ex. 250, at 7 (Glahn Direct).

[47] *Id.*

[48] And contrary to the Company's witnesses' repeated predictions to the contrary, interest rates have remained low.

[49] Ex. 250, at 7 (Glahn Direct).

[50] *Id.*

[51] *See* discussion *supra* Part II (noting the distorting effects of "anchoring").

[52] Ex. 25, at 41 (Sparby Direct and Schedules); Ex. 99, at 10 (Clark Direct).

reduced its requested increase in 2014, but it accomplished this, in part, by enlarging its requested rate increase in 2015, to $106 million.[53] Such tactics increase the risks that the Company will obtain its requested rate increases without proving, by a preponderance of the evidence, that they are objectively just and reasonable.[54] This is partly due to "anchoring," and partly due to the fact that we do not have the necessary evidence and information to objectively determine what increases are necessary for the 2015 step year.

Additionally, the Company argued that it took a "conservative" approach because it did not include a second step increase for 2016 in its multi-year rate plan (*i.e.* it submitted a two-year, rather than a three-year, rate plan).[55] Simply labeling the proposed increases as "conservative" does not make them so. There is no authority for the proposition that such a request is "conservative"; rather, the Company must prove that the multi-year plan it proposed results in *objectively* just and reasonable rates.[56] The ICI Group asks that the Commission not give additional weight to the Company's request for a two-year rate increase simply because the Company could have, pursuant to statute, requested a three-year rate increase.

The ICI Group requests that the Company's proposed two-year rate increase be denied and the Company instead be granted a one-time rate change that does not produce

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[53] Ex. 140, at 8 & Ex. A (Heuer Opening Statement); *Recommendations*, Attachment A, A-1 ("Resolved Issues and Undisputed Corrections").

[54] Minn. Stat. § 216B.03.

[55] Ex. 26, at 11 (Sparby Rebuttal). The Company took this position with the stated intention of filing another rate case for 2016. Ex. 99, at 12 (Clark Direct).

[56] Minn. Stat. § 216B.16, subd. 19(a).

rate shock and which can be justified based on currently available data.[57] Such a determination will allow the Company to seek another rate increase in the future should economic circumstances turn out to be less favorable than expected, while at the same time protecting consumers from paying an unjustified automatic rate increase should economic circumstances improve.[58] In any event, the ICI Group's proposal ensures that consumers benefit from the transparency of having all revenue and expenses determined in one proceeding where all financial data is available.[59] It also ensures that the Company cannot simply defer the recovery of unreasonable rates until the second year of a multi-year rate plan as a method of making its requested rate increases appear *subjectively* more reasonable.

This is the first multiyear rate case filed by the Company in this jurisdiction.[60] Should the Commission approve the multi-year rate plan, this proceeding will establish important procedural precedent. "The [C]ommission may, by order, establish terms, conditions, and procedures for a multiyear rate plan necessary to implement this section and ensure that rates remain just and reasonable during the course of the plan, including terms and procedures for rate adjustment."[61] The ICI Group requests that the

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[57] *See id.* (stating that the Commission may "approve as modified, or reject, a multiyear rate plan").

[58] *See* Ex. 250, at 9 (Glahn Direct).

[59] *Id.*

[60] *See* Minn. Stat. § 216B.16, subd. 19(e) (2014) (setting an effective date for the multiyear rate plan legislative amendment as May 31, 2012).

[61] *Id.*, subd. 19(c) (2014).

Commission give close scrutiny to the Company's proposed two-year rate phase-in proposal, as well as the procedures used to regulate any allowed multi-year rate increase.[62]

V. CANCELLED PRAIRIE ISLAND EPU PROJECT.

The Company proposed to include in the 2014 rate base a total of $78.9 million in costs associated with a cancelled project to increase generating capacity at the existing Prairie Island Nuclear Generating Plant.[63] The Prairie Island EPU Project aimed at increasing production at the Prairie Island facility by 164 MW, but the project was cancelled in February 2013.[64] The Company proposed that it recover from ratepayers the costs associated with the cancelled project, and that they be amortized over 12 years while earning a full rate of return, or over six years with no rate of return.[65] A twelve year recovery period with a return would increase the Company's revenue requirement by $8.48 million.[66] At the evidentiary hearing, the Company stated that it would accept cost

[62] Also, the ICI Group requests that the Commission deny that any "premium" be added to the Company's ROE as a result of the multi-year rate plan. Ex. 27, at 52-53 (Hevert Direct). As stated, contrary to the Company's witnesses' predictions, the economy has continued to improve and interest rates have remained low, discrediting the assumptions of Mr. Hevert. *See id.*

[63] Ex. 99, at 25 (Clark Direct). This figure consisted of $66.1 million of total expenditures, plus accrued Allowance for Funds Used During Construction (AFUDC) of $12.8 million. Ex. 49, at 16 (McCall Direct)

[64] Ex. 48, at 21 (Alders Direct).

[65] Ex. 99, at 31 (Clark Direct); Ex. 100, at 48 (Clark Rebuttal); Tr. Vol. 2, at 112 (Clark); Tr. Vol. 5, at 83-84 (Lusti).

[66] Ex. 88, at 91 (Heuer Direct).

recovery amortized over 20.3 years (or the facility's remaining life), with a 2.24 percent, debt-only return.[67] While such a voluntary reduction in its request for the amount of cost recovery may cause the Company's current request to appear *subjectively* more reasonable, it does nothing to prove that the request results in *objectively* just and reasonable rates.[68]

The ALJ described the background of the EPU project, including the Westinghouse contract, which contract accounts for approximately two-thirds of the EPU project costs.[69] The ALJ reasoned: "While the OAG challenges the prudence of the termination liability clauses in the Westinghouse contract, its criticism rests entirely on hindsight and is speculative."[70] After determining that the Company should recover its costs, the ALJ set forth its conclusions regarding the time period and return for cost recovery:

> The [ALJ] concludes that recovery over 20.3 years with a debt only return of 2.24 percent reflects a reasonable outcome for both ratepayers and shareholders. If completed, the Prairie Island EPU Project would have served ratepayers throughout the remaining life of the facility, which is currently 20.3 years. Thus, a 20.3 recovery period for the investment is reasonable. Given that the recovery period is approximately 20 years, the [ALJ] concludes that it is reasonable to allow a debt-only return of 2.24 as agreed to by

[67] Ex. 442, at 6-7 (Lusti Surrebuttal); Ex. 134, at 1 (Clark Opening Statement); *Recommendations*, pp. 101, ¶¶ 446-47.

[68] *See* discussion *supra* Part II (noting the distorting effects of "anchoring").

[69] *Recommendations*, pp. 98, ¶ 436.

[70] *Id.*, pp. 106, ¶ 464.

> the Department and Company. A debt-only return properly recognizes the time value of money.[71]

The ICI Group takes exception to these findings and conclusions because (1) there should be no cost recovery allowed for this project because it was never "used and useful," and (2) if cost recovery is allowed, the costs associated with the Westinghouse contract should not be recoverable from ratepayers.

Minnesota law sets forth the factors the Commission can consider in setting rates:

> 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.[72]

The Prairie Island EPU Project was never used and useful, nor did it ever render service to the public.[73]

ICI Witness Glahn testified:

> In the instance of the Prairie Island EPU, we have a unique instance where an underlying facility has been used in the production of power for many years, but planned improvements did not come about, even though considerable costs were expended on the cancelled effort. The uprate project, in its present state of abandonment, is not useful for

[71] *Id.*, pp. 107, ¶ 467 (footnotes omitted).

[72] Minn. Stat. § 216B.16, subd. 6 (2014) (emphasis added).

[73] *See id.*

> making electricity, nor has it been used at any point in time.[74]

Company witness Cristopher Clark argues that disallowing cost recovery for abandoned projects "would defeat the Commission's previously-noted public policy to encourage a utility's diligence in 'promptly withdrawing from projects when experience shows that they will no longer serve the ratepayers' best interests.'"[75] The ICI Group contends that the opposite would be true, namely: "By granting cost recovery to cancelled projects, the Commission would encourage utilities to pursue imprudent or marginal projects, with the assurance that they would be made whole, regardless of the outcome."[76]

This case presents a novel issue in this jurisdiction, namely, whether the planned expansion of a currently operating facility can be deemed "used and useful" even if the planned expansion never resulted in increased energy output by the utility.[77] Thus, the Commission will be required to act in both its legislative and quasi-judicial capacities to answer this question.[78] The Commission acts in a legislative capacity when it is "balancing both cost and noncost factors and making choices among public policy alternatives."[79] "[T]o permit the recovery of an item of expenses . . . is essentially a

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[74] Ex. 250, at 11 (Glahn Direct).

[75] Ex. 99, at 34 (Clark Direct) (citation for internal quotation unknown).

[76] Ex. 250, at 12 (Glahn Direct).

[77] *Id.*

[78] Minn. Stat. § 216A.05, subd. 1 (2014).

[79] *St. Paul Area Chamber of Commerce v. Minn. Pub. Serv. Comm'n*, 312 Minn. 250, 262, 251 N.W.2d 350, 358 (1977). The Commission "may make such investigations

policy question of whether the shareholders or the customers should bear the cost."[80] The Commission will be acting in a quasi-judicial capacity when it decides the exact amount of recovery to allow for the cancelled Prairie Island EPU Project.[81]

"Under general principles of utility law, the used and useful standard simply requires (1) that the property be in service, and (2) that it be reasonably necessary to the efficient and reliable provision of utility service."[82] Minnesota courts have previously addressed whether a nonexistent plant can be used and useful, when its construction was abandoned before it was commenced, but after the utility expended costs in preparation for construction.[83] "To consider such a nonexistent plant as used and useful is an unreasonable expansion of the used and useful concept. The plant in question has not provided and never will provide electricity to rate payers."[84] The Commission should

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and determinations . . . as the legislature itself might make . . . and thus it has a very broad factfinding as well as policymaking jurisdiction." Minn. Stat. § 216A.05, subd. 1 (2014).

[80] *In re Interstate Power*, 548 N.W.2d at 413.

[81] *See Northwestern Bell Tel. Co. v. State*, 253 N.W.2d 815 (Minn. 1977) (holding that the Commission acted in a quasi-judicial capacity when making factual findings regarding amounts of money).

[82] *Senior Citizens Coalition of Northern Minnesota v. Minn. Pub. Utilities Comm'n*, 355 N.W.2d 295, 300 (Minn. 1984).

[83] *See Northern States Power*, 416 N.W.2d at 722.

[84] *In re Petition of Otter Tail Power Co.*, 417 N.W.2d 677, 686 (Minn. App. 1988) (discussing actions of the utilities commission in that case).

take the same approach for the cancelled uprate—it "has not provided and never will provide electricity to rate payers."[85]

There is also recent Commission precedent for not allowing cost recovery on a cancelled expansion of an existing facility.[86] In docket 12-961, the company proposed a project at the Monticello plant to (1) extend the useful life of the plant, and (2) increase the generating capacity (a.k.a. the Extended Power Uprate, or EPU portion).[87] The company requested rate recovery for both portions of the project, despite the fact that the EPU portion was never "used and useful."[88] The ALJ recommended in that case that the EPU portion of the project not be recoverable from ratepayers, and the Commission adopted that recommendation.[89] The ICI Group asks that the Commission take the same approach with regard to the Prairie Island EPU.

In this case, it is not "just and reasonable that the ratepayers bear the costs" of the cancelled Prairie Island EPU Project.[90] The project was never "used and useful" and

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[85] *See Northern States Power*, 416 N.W.2d at 722.

[86] *In the matter of the Application of Northern States Power Co. for Authority to Increase Rates for Electric Service in the State of Minnesota*, Docket E-002/GR-12-961, Findings of Fact, Conclusions, and Order at 17-20 (Sept. 3, 2013) [hereinafter "12-961 Order"].

[87] *Id.* at 17.

[88] *Id.* at 18-19.

[89] *Id.*

[90] *See* Minn. Stat. § 216B.16, subd. 6.

certainly never rendered service to the public.[91] If the Commission makes a policy decision allowing cost recovery for the cancelled project, utilities will be incentivized to overinvest in imprudent projects, at the expense of ratepayers.[92] "If a utility's forecasts are biased in favor of building new plants, or if the utility, when in genuine doubt over the necessity of a new plant, consistently responds to the incentive to overinvest, the utility or its customers must absorb millions or even billions of dollars in sunk costs attributable to a facility that may provide little or no benefit."[93] The ICI Group urges the Commission to determine, in its legislative capacity, that the Prairie Island EPU Project is not used and useful, and to disallow any cost recovery for the project.

In the event the Commission determines that the costs associated with the cancelled EPU are recoverable, it should disallow recovery for costs associated with the Westinghouse contract in the exercise of its quasi-judicial powers. The ALJ reasoned: "While the OAG challenges the prudence of the termination liability clauses in the Westinghouse contract, its criticism rests entirely on hindsight and is speculative."[94] There is no reasoned explanation regarding why the Company should not have negotiated a contract that was not one-sided in favor of Westinghouse, or why ratepayers should incur the costs of paying for the Company's lack of diligence and poor business decision

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[91] *See id.*

[92] Ex. 250, at 11-12 (Glahn Direct).

[93] Richard J. Pierce Jr., The Regulatory Treatment of Mistakes in Retrospect: Cancelled Plants and Excess Capacity, 132 U. Pa. L. Rev. 497, 509-10 (1984).

[94] *Recommendations*, pp. 106, ¶ 464.

in entering that contract.[95] As stated above, allowing cost recovery on the EPU project would motivate utilities to pursue unreasonable projects because utilities would know they could recover those costs later from ratepayers.[96] Likewise, allowing recovery from ratepayers of costs associated with entering into a lopsided contract would provide a disincentive for the Company (and other utilities in the future) to negotiate fair and reasonable contracts that do not result in foisting significant, unnecessary costs on ratepayers.[97]

VI. THE COMPANY'S PROPOSED RATE-OF-RETURN ON EQUITY AND CAPITAL STRUCTURE.

In this proceeding, the Company asked for a return on equity (ROE) of 10.25 percent, the Department asked for a return of 9.64 percent, and the ICI Group asked for a return of 9.00 percent.[98] The ALJ recommended that the Company earn a rate of return of 9.77 percent.[99] The rate of return for a public utility should be "equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties."[100] And "the return to equity owner should be commensurate with returns

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[95] *See id.*

[96] Exhibit No. 250, at 11-12 (Glahn Direct).

[97] *See id.*

[98] Ex. 250, at 15 (Glahn Direct).

[99] *Recommendations*, pp. 87, ¶ 385.

[100] *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Bd.*, 262 U.S. 679, 692 (1923).

on investments in other enterprises having corresponding risks."[101] "The [C]omission . . . 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 . . . and to earn a fair and reasonable return upon the investment in such property."[102]

The ICI Group believes much of the ALJ's reasoning and conclusions regarding setting 9.77 percent is reasonable and should be adopted by the Commission; however, the ICI Group has some exceptions that should result in the Commission setting a rate of return even lower than 9.77 percent. These exceptions include: (1) the ALJ's conclusion that the ICI Group's DCF analyses should be given no weight, and (2) the ALJ placing significant weight on the Company's unreliable DCF analyses and recommendation.

A. The ALJ Should Have Given Weight To The ICI Group's DCF Analyses.

The ALJ found that "the proxy group used by the ICI Group is not sufficiently comparable to the Company to be reliable. For example, the ICI Group's proxy group includes companies involved in mergers or other significant transactions, and includes companies with substantial unregulated operations."[103] The make-up of the proxy group is subject to disagreement, and the ALJ noted extensive disagreement between Mr.

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[101] *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

[102] *Hibbing Taconite Co. v. Minn. Pub. Serv. Comm'n*, 302 N.W.2d 5, 10 (Minn. 1980) (quoting Minn. Stat. § 216B.16, subd. 6).

[103] *Recommendations*, pp. 84, ¶ 376 (citing Ex. 28, at 34-35 (Hevert Rebuttal); Ex. 402, at 2-6 (Amit Rebuttal)). It is not clear from the ALJ's findings what other specific issues she had with the ICI Group's selection of proxy group companies. As such, the analysis herein addresses all of the issues raised by Mr. Hevert and Dr. Amit.

Hevert and Dr. Amit in the selection of the Company's and the Department's proxy groups.[104] However, the ALJ proceeded to rely on both the Company's and the Department's proxy group, while giving the ICI Group's proxy group no weight.[105] "Determination of growth rate necessarily involve predictions, assumptions and judgments."[106] The ICI Group takes exception to the ALJ's conclusion for two reasons: (1) the ICI Group's proxy group is reliable, and (2) there are similar flaws with the proxy groups of both the Company and the Department, yet the ALJ determined that their analyses were entitled to significant weight.

The ALJ did not expressly make a finding regarding which companies make up the ICI Group's proxy group, but they are: Allete, Alliant Energy, AEP, Centerpoint, Cleco Corp., CMS Energy, Consolidated Edison, Dominion, DTE Energy, Duke Energy, Great Plains Energy, MGE, NextEra Energy, Northeast Utilities, Northwestern Corp., OGE Energy, PNM Resources, Pinnacle West, Portland General, Public Service Ent., Scana Corp., Sempra, Southern Co., UNS Energy, VECTREN Corp., Westar, and Wisconsin Energy.[107] Of these 27 companies, only seven were not included in either the Company's or the Department's proxy groups: AEP, Consolidated Edison, MGE, OGE

[104] *See id.*, pp. 52-75.

[105] *Id.*, pp. 84-87, ¶¶ 374-85.

[106] *Minn. Power & Light Co. v. Minn. Pub. Util. Comm'n*, 342 N.W.2d 324, 330 (Minn. 1983).

[107] Ex. 250, at 15-25 (Glahn Direct and Schedules).

Energy, Public Service Ent., Sempra, and UNS Energy.[108] Two of these remaining seven companies (Consolidated Edison and Sempra) were excluded from the Company's and the Department's proxy groups because their DCF analyses showed a rate of return lower than 8 percent (a dubious screening process as discussed *infra* notes 158-170 and accompanying text).[109] Thus, only five companies in the ICI Group's proxy group were not in the proxy groups of the Company or the Department based on reasonable differences in screening criteria. An analysis of the alleged issues with some of these companies shows that ICI Group's decision to include these companies results from a mere difference of professional judgment and opinion.[110]

Mr. Hevert testified that Mr. Glahn should not have included Public Service Enterprise Group because it has substantial unregulated operations.[111] However, there is no discussion of the precise extent of unregulated operations by that company, and there is no indication that this criticism applies to any other companies in Mr. Glahn's proxy

[108] *Id.*; *see also Recommendations*, pp. 56-57, ¶¶ 254, 258, pp. 63-64, ¶¶ 281, 284, pp. 69, ¶ 309, pp. 72, ¶¶ 323-24.

[109] *Recommendations*, pp. 56, ¶ 253, pp. 57, ¶ 257, pp. 63, ¶¶ 280, 283, pp. 69, ¶ 309, pp. 72, ¶¶ 323-24.

[110] *See Minn. Power & Light*, 342 N.W.2d at 330 (noting that conducting a DCF analysis requires the exercise of professional judgment and opinion).

[111] Ex. 28, at 34 (Hevert Rebuttal).

group.[112] Apparently, the ALJ simply relied on Mr. Hevert's bare assertion that this company should not have been included as a proxy company.[113]

Additionally, Mr. Hevert criticizes the inclusion of UNS Energy because that company agreed to be acquired by Fortis Utility Group.[114] Finally, Mr. Hevert criticized the exclusion of EDE because that company's failure to pay dividends was the result of an extreme weather event.[115] These represent *potentially* valid theoretical disagreements with Mr. Glahn's approach regarding three companies (out of 27 total). Such criticisms should not have resulted in the ALJ's wholesale dismissal of Mr. Glahn's analyses.

Dr. Amit criticized Mr. Glahn's inclusion of four companies "involved in significant restructuring."[116] However, two of these four companies were also included in the Company's proxy groups (Dominion Resources and CenterPoint Energy).[117] Thus, to the extent such criticism is valid, it should apply equally to completely discredit the Company's DCF analyses, as the ALJ found that such criticism was sufficient to completely discredit the ICI Group's analysis.[118]

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[112] *Id.*

[113] *Recommendations*, pp. 84-85, ¶ 376.

[114] Ex. 28, at 34-35 (Hevert Rebuttal).

[115] *Id.* at 34.

[116] Ex. 402, at 5 (Amit Rebuttal).

[117] *Recommendations*, pp. 57, ¶ 258.

[118] *See id.*, pp. 84, ¶ 376 ("[T]he ICI Group's proxy group includes companies involved in mergers and other significant transactions . . . .").

Dr. Amit's main remaining criticism is the inclusion of Black Hills Corp. and Xcel.[119] The dispute regarding whether to include Black Hills Corp. is a theoretical disagreement between two experts exercising their judgment.[120] Such a disagreement about a single company should not be sufficient to discredit the ICI Group's DCF analyses. Dr. Amit criticized the ICI Group's exclusion of Xcel from the proxy group to avoid an element of circularity; however, the Company excluded Xcel for the exact same reason.[121] The ICI Group contends that Dr. Amit's criticism is not valid, but even if it were valid, it weighs equally in favor of completely discrediting the Company's analyses because the ALJ concluded it was sufficient to discredit the ICI Group's analysis.[122]

Dr. Amit also gives heavy criticism to Mr. Glahn's "fail[ure] to follow his own screening criteria" by excluding companies who, in Dr. Amit's opinion, exhibited positive projected earnings and/or dividend growth.[123] The ALJ relied on this testimony to make a clearly erroneous finding: "The Department noted that the ICI Group failed to follow its own screening criteria when it eliminated companies with positive projected

[119] Ex. 402, at 4-6 (Amit Rebuttal).

[120] *See Minn. Power & Light* , 342 N.W.2d at 330 (noting that conducting a DCF analysis requires the exercise of professional judgment and opinion).

[121] *Recommendations*, pp. 57, ¶ 256.

[122] *See id.*, pp. 84, ¶ 376.

[123] Ex. 402, at 5 (Amit Rebuttal). Mr. Glahn's screen was to exclude companies that exhibited negative earnings and/or dividend growth. Ex. 250, at 17 (Glahn Direct).

earnings and/or dividend growth."[124] The record evidence does not support a finding that Mr. Glahn improperly applied his own screening criteria.

Mr. Madsen cross-examined Mr. Glahn regarding numerical data in Value Line investment surveys.[125] Initially, Mr. Madsen asked Mr. Glahn to read annual expected earnings and dividend growth for the screened companies "for the period 2011 to '13 through 2017 through 2019."[126] Mr. Glahn responded: "Just for the future period? You do not want me to *read the negative numbers for the past five years or the negative numbers for the past ten years?*"[127] After reading these numbers, Mr. Madsen asked: "could you please reconcile this fact [positive numbers] with your statement that you eliminated these companies because they were not expected by Value Line to have positive earnings and/or dividends growth?"[128] Mr. Glahn replied:

> . . . . Yes. And what I'm focusing is page 17, line 14 [of Glahn's direct testimony], the phrase the period studied. And I—I emphasize that. It was not emphasized in the original text; but I'm emphasizing here in response to your inquiry because, as I was pointing out, the column you had me read included positive numbers, but the adjacent column, *which was recent actual data*, included negative numbers. And that's what I fixed on in deciding whether or not, among other

[124] *Recommendations*, pp. 79-80, ¶ 355 (citing Ex. 402, at 2-6 (Amit Rebuttal); Tr. Vol. 3 at 117-34 (Glahn)).

[125] Tr. Vol. 3 at 117:4-134:15; Exs. 138 & 139 (Glahn).

[126] *Id.* at 119:11-14.

[127] *Id.* at 120:4-6 (emphasis added).

[128] *Id.* at 122:7-12.

> factors, to include or [exclude] an individual observation in my comparable—comparable group.[129]

Mr. Madsen continued this line of questioning regarding the ICI Group's response to information request 205.[130] Mr. Glahn then read a series of positive numbers as requested by Mr. Madsen.[131] When asked to explain his reasons for excluding these five companies, Mr. Madsen objected to Mr. Glahn being able to refer to his work papers to refresh his recollection.[132] Mr. Glahn answered based on memory:

> Right. So I—what I'm saying is on—and, again, I wish I could refer to my work papers for—but, you know, when I was doing my screens, I looked at earnings and dividends both. And sometimes there were elements of both I was concerned about and, you know, I assigned them to one or the other screens rather than creating a hybrid screen where I list companies where I had qualms about earnings and dividends but, you know, couldn't decide why I was eliminating it. So, you know, there might be some room to question the categorization of where I put the eliminated companies when listing the different screens. But I do recall having concerns about earnings associated with this company and quality of earnings, and that's why I eliminate it from—you know, without referring to my note, I don't think I can be more specific with that on this company.[133]

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[129] *Id.* at 122:13-24 (emphasis added).

[130] *Id.* at 125:11-126:5; Ex. 137 (Information Request 205).

[131] Tr. Vol. 3, at 126:23-128:8.

[132] *Id.* at 129:8-9.

[133] *Id.* at 130:21-131:13.

Then Mr. Madsen asked if there is more to Mr. Glahn's screens than he testified to.[134] Mr. Glahn succinctly responded: "Other than that I didn't clarify that the period I studied was everything covered by these sheets, you know, going back 20 years or so. You know, perhaps that would have been a useful clarification in my direct testimony."[135] The record does not support a finding that Mr. Glahn failed to follow his own screening criteria, and the ALJ's finding to that effect should be rejected.[136]

The ALJ also found that "even if the proxy group were sufficiently comparable, the ICI Group's DCF analyses are not analytically sound because the ICI Group relied on a single source of data, Value Line, for its growth rates."[137] This is not a valid reason for discounting the probative value of the ICI Group's DCF analyses for two reasons: (1) there is Commission precedent indicating that relying on multiple sources of investment data is not required, and (2) such a requirement would foist unreasonable costs on intervenors in rate case proceedings.

The analytical approach to be used in calculating a return on common equity is a matter for the Commission's expertise.[138] There is prior Commission precedent of

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[134] *Id.* at 132:20-25. Mr. Madsen also specifically asked if Edison International experienced positive dividends and earnings growth, to which Mr. Glahn explained that the company was excluded because of the negative numbers for revenues. *Id.* at 134:7-15.

[135] *Id.* at 133:1-5.

[136] *Recommendations*, pp. 79-80, ¶ 355.

[137] *Id.* at pp. 84-85, ¶ 376 (citing Ex. 28, at 35 (Hevert Rebuttal))

[138] *Minn. Power & Light Co. v. Minn. Pub. Util. Comm'n*, 342 N.W.2d 324, 330 (Minn. 1983).

reliance on a single source of data as reliable to support a conclusion.[139] The reliance on one source of data simply does not make the ICI Group's analysis inherently unreliable.

Additionally, if intervenors are required to rely on three sources of data, as the Company and the Department did here, then the cost of meaningfully participating in a rate case becomes even more prohibitive. Subscriptions to investment surveys such as Value Line, Zacks, and First Call are expensive. The Company and the Department can pass on the costs of subscribing to these services to the ratepayers. The ICI Group; however, is a conglomeration of ratepayers (who help pay for the subscriptions of the Company and the Department) who, according to the ALJ's analysis, must also pay for its own subscription to these three services in order to meaningfully participate in a rate case proceedings. The ALJ's reliance on this rationale to reject the ICI Group's analyses is especially unfair in this case because the ICI Group and its witness, Mr. Glahn, had no prior notice that reliance on three sources of data would be required before the ALJ would give *any* weight to its DCF analyses.[140]

Finally, the ALJ concluded that "the ICI Group used a sustainable growth analysis to estimate the growth rate in two of its four DCF analyses. This approach has not been

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[139] *See, e.g.*, *In re Petition of Otter Tail Power Co.*, 417 N.W.2d 677, 683-84 (Minn. App. 1988) (finding that reliance on one investment survey was proper)

[140] Additionally, one of the screening criteria relied on by the ICI Group was the exclusion of proxy group companies with negative dividends growth. Ex. 250, at 17 (Glahn Direct). Value Line is the only investment survey that provides dividend growth forecasts (Zacks and First Call provide earnings growth forecasts). Roger A. Morin, PhD, *New Regulatory Finance*, Public Utilities Reports, Inc., 2006 at 320. Thus, for the methodology employed by the ICI Group, reliance on Value Line was reasonable.

accepted by the Commission, is biased downward, and is based on questionable assumptions."[141] The ALJ does not indicate what "questionable assumptions" such an approach is based upon.[142] The approach has been employed by Mr. Glahn in other rate case proceedings, and has not been rejected for that reason.[143] To the extent the Commission agrees that such results are "biased downward," such knowledge can be taken into account when determining just and reasonable rates; however, the mere fact that an approach is biased downward should not result in the wholesale rejection of the ICI Group's DCF analyses.[144] This is especially so considering that the Company's and the Department's analyses were clearly biased upward.[145]

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[141] *Recommendations*, pp. 85, ¶ 376 (citing Ex. 28, at 37 (Hevert Rebuttal); Ex. 402 at 10-11 (Amit Rebuttal)).

[142] *Id.*

[143] For some representative examples where commissions have found Mr. Glahn's use of one source of data permissible, see, for example, *In re Matter of Aquila, Inc.*, Docket No. NG-41, Order Granting Application in Part, at 18-19 (July 24, 2007) (Nebraska Public Service Commission), and *In re MidAmerican Energy Co.*, Docket No. RPU-2013-0004, Order Approving Settlement, With Modifications, and Requiring Additional Information, at 20-25 (Mar. 17, 2014) (Iowa Department of Commerce Utilities Board).

[144] The ALJ also appeared to take issue with the fact that the ICI Group's analyses did not include flotation costs. *Recommendations*, pp. 77, ¶ 345. Flotation costs would add 12-13 basis points. *Id.*, pp. 58, ¶ 264, pp. 66, ¶ 294. To the extent that the Commission determines that flotation costs should be included, the Commission may simply add 12-13 basis points to the ICI Group's recommendations. This would be much more reasonable than simply rejecting the ICI Group's analyses in their entirety.

[145] *See* discussion *infra* Part VI.B (noting that the Company and the Department used unreasonable screens to exclude proxy companies with low DCF results).

B. The ALJ Gave Too Much Weight To The Company's DCF Analyses.

Before addressing the flaws in the Company's ROE analysis, and the ALJ's placing too much weight thereon, the unique distorting effects of "anchoring" in this situation must be considered. Commentators provide a coherent explanation and salient example:

> The most widely accepted account of anchoring—the information accessibility theory—is essentially an enriched version of the numeric priming theory. According to the information accessibility theory, a numeric anchor contains semantic content, such as information about height, width, dollar amount, and so forth. When we are presented with an anchor, we engage in a kind of explicit or implicit hypothesis testing of the accuracy of the semantic content of the anchor. We begin by looking for evidence consistent with the hypothesis; even if we can reject the hypothesis quickly, the fact that we have momentarily treated it as potentially true causes it to affect our judgment. [Commentators] use the following example to illustrate:
>
> [A]ssume that you are asked to decide whether the extension of the Mississippi River is between 3000 and 35000 miles. You take this as a hypothesis and seek information that is consistent with this possibility. You may for instance, construct a mental map that depicts the river as it flows from the Canadian border to the Gulf of Mexico (2350 miles). But knowing that this distance is below 3000 miles, you reject the hypothesis. . . . [I]nformation is activated that implies a big extension of the target . . . . A subsequent assessment of length will therefore be based on different 'subsets of cognitions' and will result in judgments that are assimilated toward the values of the original hypothesis.[146]

[146] Orr & Guthrie, *supra* note 6, at 604-05 (citations omitted).

The Company's unreliable range of ROE values provides the risk of the exact same type of distortion.[147] Mr. Hevert, in providing testimony that consistently overstates reasonable ROE numbers by at least 25 basis points, distorts the final number for ROE.[148] His DCF analyses resulting in a 10.25 percent figure are not reliable or reasonable, and should in no way influence the Commission's final determination of an *objectively* just and reasonable ROE.[149]

Mr. Hevert retreated from his initial recommendation of 10.25 percent at the evidentiary hearing. His opening statement repeatedly stated that a return of less than the current level of 9.83 percent should not be allowed.[150] Mr. Hevert seemingly realized that his initial recommendation was inflated and based on improper analysis.[151] In fact, the record indicates that Mr. Hevert consistently testifies in rate case proceedings, and consistently gives ROE recommendations that are at least 25 basis points higher than what various commissions have awarded.[152] Additionally, any reductions in the 10.25 percent figure may serve as an "anchor," making a lower return appear *subjectively* more reasonable, without, in fact, resulting in *objectively* just and reasonable rates.[153] Despite

[147] *Recommendations*, pp. 59, ¶ 266.

[148] *See id.*, pp. 80-81, ¶ 359.

[149] *See* discussion *supra* Part II (noting the distorting effects of "anchoring").

[150] Tr. Vol. 1, at 54:9-62:14.

[151] *See id.*

[152] *Id*. at 77:4-80:9.

[153] *See* discussion *supra* Part II (noting the distorting effects of "anchoring").

Mr. Hevert's unequivocal retreat from his previous 10.25 percent ROE figure at the evidentiary hearing, the ALJ determined that the Company's DCF analyses are "analytically sound" and "warrant serious consideration in the determination of a reasonable ROE."[154]

To arrive at a reasonable ROE figure, the ALJ averaged the numbers recommended in the Department's direct (9.80%), the Company's rebuttal (9.86%), and the Department's surrebuttal (9.64%), which resulted in an overall figure of 9.77%. This number is too high because (1) it gives weight to the Company's rebuttal testimony (which was very similar to the analysis in the Company's direct testimony, which the ALJ rejected), and (2) because it weights the various analyses without accounting for anomalous changes in proxy group composition between the comparisons.

The Company's analysis is not entitled to as much weight as it was given by the ALJ. As argued above, several criticisms of the ICI Group's analyses that the ALJ found sufficient to completely reject those analyses are equally valid criticisms of the Company's DCF analyses.[155] Additionally, the record reveals that Mr. Hevert consistently provides inflated analyses and recommendations as an attempt to push the ROE number unreasonably high.[156] Thus, the final ROE figure should not be based so heavily on the Company's recommendations, nor should the Commission be influenced

[154] *Recommendations*, pp. 85, ¶ 377.

[155] *See supra* notes 116-118, 121-122 and corresponding text (discussing reasons for given by the ALJ for discrediting the ICI Group's DCF analyses when those criticisms apply with equal force to the Company's analyses).

by the mere fact that the Company initially submitted such a high ROE recommendation.[157]

Additionally, the ALJ's averaging of the three numbers to determine a reasonable ROE suffers from an methodological problem. Both the Company's and the Department's DCF analyses used unreasonable screening criteria to select proxy group companies. Namely, they refused to consider comparable companies with DCF results below 8.0 percent.[158] However, these comparable companies all have shareholders.[159] Dr. Amit testified on cross-examination that the shareholders of these companies do not act irrationally by holding stock in a utility with an ROE lower than 8.0 percent.[160] Thus, setting such a minimum threshold for comparable companies for a DCF analysis is arbitrary. It also distorts the analysis, as ICI Group witness William Glahn explains:

> It is one thing to eliminate a company from a comparable group *ex ante* because it does not meet certain, well-reasoned criteria. It is another matter entirely to eliminate a result *ex post* because the result does not conform to one's expectations going in. To do so is to "beg the question."[161]

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[156] *Recommendations*, pp. 80-81, ¶ 359.

[157] *See* discussion *supra* Part II (noting the distorting effect of "anchoring").

[158] Ex. 400, at 14-15 (Amit Direct); *see also* Ex. 27, at 35 & 37-38 (Hevert Direct).

[159] Tr. Vol. 4, at 42.

[160] Tr. Vol. 4, at 42:7-13.

[161] Ex. 251, at 5 (Glahn Surrebuttal).

The Company's and the Department's analyses do not acknowledge relevant data because it does not fit with their preconceived notions of what the data should be.[162]

The ICI Group argued to the ALJ that such a screening criterion was neither logical nor reasonable.[163] However, given the ALJ's methodology in determining a reasonable ROE, another problem is presented; namely, different proxy group companies were eliminated in the Department's direct, the Company's rebuttal, and the Department's surrebuttal based on the application of the exact same screening criterion (DCF results below 8.0 percent) to data from different time periods (resulting in the proverbial comparison of apples to oranges). The Company, in its direct testimony, removed the following proxy companies based on this screen: IDACORP, Hawaiian Electric, Consolidated Edison, and Sempra.[164] The Department screened the following in its direct: Edison Int'l, El Paso Elec. Co., FirstEnergy Corp., Hawaiian Electric, IDACORP, and Amern Corp.[165]

In rebuttal, the Company altered its proxy group by adding Hawaiian Electric and Sempra to its proxy group because they now had DCF results above 8.0 percent, and excluding Empire District Electric because its results were now below 8.0 percent.[166] The Department, in its surrebuttal, altered its proxy group by adding Hawaiian Electric

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[162] *See id.*

[163] Initial Brief of the ICI Group, at 13-14.

[164] *Recommendations*, pp. 56-57, ¶¶ 253, 257.

[165] *Id.*, pp. 63, ¶¶ 280, 283.

[166] *Id.*, pp. 69, ¶ 309.

and Amern, and excluding Empire District Electric for the same reasons.[167] Without any accounting for the changing compositions of the proxy groups, the ALJ simply averaged the three results.[168]

The ICI Group argued that the Company's and the Department's analyses were biased upward because they arbitrarily decided to exclude companies with DCF results below 8.0 percent.[169] However, the ALJ's methodology of averaging the three results is certainly biased upward for failure to account for such proxy group composition changes between analyses. The ALJ determined that the ICI Group's analyses were biased downward and rejected the ICI Group's analyses for that reason.[170] However, the Commission should reject the ALJ's methodology because it is biased upward.

VII. DECOUPLING.

The ALJ recommended that the Commission adopt a decoupling pilot for the Company.[171] In so doing, the ALJ noted the ICI Group's objection that decoupling ever be extended to larger, demand-metered customers.[172] However, the ALJ's final recommendation did not include such a restriction that decoupling not be applied to large,

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[167] *Id.*, pp. 72, ¶ 323.

[168] *Id.*, pp. 87, ¶ 384.

[169] Initial Brief of The ICI Group, at 13-14.

[170] *Recommendations*, pp. 84-85, ¶¶ 376.

[171] *Id.*, pp. 212, ¶ 944.

[172] *Id.*, pp. 199, ¶ 878.

demand-metered customers in the future.[173] Additionally, the ALJ noted that this is the first request by an electric utility to implement decoupling in this jurisdiction.[174] This is untrue, however, as a decoupling request was made by Minnesota Power, which request was denied by the Commission.[175]

The ICI Group previously argued that a decoupling mechanism should not be implemented in this case.[176] At the very least, any decoupling should be specifically limited so that it does not, and will not, apply to large, demand-metered customers.

CONCLUSION

The ICI Group generally supports the detailed and thorough findings and recommendations of the ALJ. However, the ICI Group respectfully requests that the Commission make the following modifications to the recommendations in order to set just and reasonable rates:

- Consider the potential effects of rate shock if the Company's requested rate increases are approved;
- Deny the multi-year rate plan because it does not result in just and reasonable rates; or alternatively adopt adequate procedures to ensure the multi-year rate plan does not result in a windfall for the Company;
- Deny cost recovery for the Prairie Island EPU Project, or alternatively determine that the Company cannot recover the full extent of the project costs;

[173] *Id.*, pp. 212, ¶ 944.

[174] *Id.*, pp. 193, ¶ 846.

[175] Order Denying Reconsideration and Affirming Order Disallowing Recovery of Lost Margins, Docket No. E-015/M-99-416 (February 18, 2000).

[176] Ex. 250, at 12-15 (Glahn Direct).

- Modify the ALJ's recommended ROE downward to reflect a more objectively just and reasonable ROE; and

- If decoupling is implemented, ensure that decoupling will never be applied to larger, demand-metered customers.

Respectfully submitted,

Dated: January 20, 2015

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4848-3508-4577, v. 1

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE PUBLIC UTILITIES COMMISSION

In the Matter of the Application of Northern States Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota MPUC Docket No. E-002/GR-13-868 OAH Docket No. 68-2500-31182	**AFFIDAVIT OF SERVICE**

STATE OF MINNESOTA)
)ss.
COUNTY OF HENNEPIN)

Julie Melugin being duly sworn, says that on the 20th day of January, 2015 she served the following:

- Exceptions to the Findings of Fact, Conslusions of Law, and Recommendations of the Administrative Law Judge Submitted by the ICI Group.

To all persons at the addresses listed on the attached list by filing through e-dockets.

Julie Melugin

Subscribed and sworn to before me
this 20th day of January, 2015.

4842-0320-6689, v. 1

BERNADETTE M. HABISCH
NOTARY PUBLIC
MINNESOTA
My Commission Expires Jan. 31, 2020

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