

**BEFORE THE MINNESOTA OFFICE OF
ADMINISTRATIVE HEARINGS**
100 Washington Square, Suite 1700
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**FOR THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF MINNESOTA**
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In the Matter of the Application of Northern
States Power Company for Authority to
Increase Rates for Electric Service in the State
of Minnesota

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

**POST-HEARING REPLY BRIEF OF THE XCEL LARGE
INDUSTRIALS**

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The following constitutes the reply post-hearing brief of Flint Hills Resources, LP; Gerdau Ameristeel US Inc.; Unimin Corporation; and USG Interiors, Inc. (collectively, the “Xcel Large Industrials” or “XLI”).

I. INTRODUCTION

Several of parties submitted initial post-hearing briefs in this matter. XLI’s reply brief is limited to addressing responses that are contrary to XLI’s position, namely the initial post-hearing briefs of Northern States Power Company d/b/a Xcel Energy (“NSP” or the “Company”), the Department of Commerce – Division of Energy Resources (“DOC”), and the Minnesota Office of the Attorney General – Antitrust and Utilities Division (“OAG”).

II. ANALYSIS

A. NSP’s Brief Fails to Demonstrate the Monticello EPU is “Used and Useful” (Issue #2)

NSP has agreed to the Minnesota Chamber of Commerce (“MCC”) proposal to defer recovery of depreciation and operating costs for the Extended Power Uprate portion of the Monticello Extended Power Uprate (“EPU”)/Life Cycle Management (“LCM”) project (together, the “Monticello Project”), until the plant achieves full ascension, and to amortize costs over the remaining life of the plant.¹ In the alternative, NSP argues that the plant should be considered in service at the start of the 2014 test year, consistent with its own original proposal.² XLI believes both of these proposals should be rejected.

XLI’s brief summarized the “used and useful” legal standard and applied that standard to the facts of this case to support its conclusion that NSP failed to meet its burden of proving the EPU is used and useful. In NSP’s brief, the Company acknowledges that the utility has the burden to prove “(1) that the property [will be] ‘in service;’ and (2) that it [will be] ‘reasonably necessary’ to the efficient and reliable provision of utility service.”³ However, NSP goes on to cite applications of the used and useful standard in other jurisdictions in support of its contention

¹ NSP Brief at 33.

² NSP Brief at 34.

³ NSP Brief at 34 (citing *Senior Citizens Coal. of Ne. Minn. v. Minn. Pub. Utils. Comm’n*, 355 N.W.2d 295, 300 (Minn. 1984)).

that the EPU is already used and useful, while ignoring the standard set forth in the Commission's order in the previous rate case.

In the last case, the Commission found that the EPU portion of the project was not yet used and useful because it was still operating at pre-uprate levels and had not received required licenses from the Nuclear Regulatory Commission ("NRC") for the uprate. In particular, the Commission said that the portion of the project attributable to the EPU "cannot serve ratepayers until it is licensed by the [Nuclear Regulatory Commission]" and that "portion of the project should not earn a return before it is used and useful in providing service to ratepayers."⁴ NSP has not met its burden to demonstrate that circumstances have substantively changed since the last case. Although NSP has received the necessary licenses from the NRC, it has not yet received approval from the NRC to complete the power ascension process and operate at the full 671 MWe uprate level.⁵ Completion of this first-time power ascension process is a condition embedded in the NRC license for the Monticello Project.⁶ At the time of the evidentiary hearings, the Monticello plant was operating at pre-uprate levels and it had not operated at higher levels for more than limited periods during the power ascension process.⁷ Further, while NSP continues to express its belief that full ascension will be achieved by the end of 2014, it has not been able to offer guarantees.⁸

NSP cites cases from other jurisdictions to argue that the used and useful standard (1) does not require property to be used to its full capacity or maximum benefit at all times,⁹ and (2) does not require immediate provision of benefits to customers. Both of these arguments rely on the idea that the EPU portion of the Monticello Project is already partially in use as part of the full EPU/LCM project. But the Commission already rejected this argument in the last case. NSP argued, unsuccessfully, that the EPU should be considered used and useful because some of the

⁴ *In the Matter of the Application of Northern States Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota*, Docket No. E-002/GR-12-961, Findings of Fact, Conclusions, and Order, at 19 (Sept. 3, 2013) ("GR-12-961 Findings of Fact, Conclusions, and Order").

⁵ See XLI Brief at 9-10.

⁶ During cross-examination, NSP witness Timothy O'Connor explained that the Monticello license includes a first-time power ascension process that NSP has to perform the first time NSP raises output from 600 to 671 MW. See Evidentiary Hearing Transcript, Vol. 1, 228:8-22.

⁷ Evidentiary Hearing Transcript, Vol. 1, 239:9-17.

⁸ Evidentiary Hearing Transcript, Vol. 1, 232:19-233:17.

⁹ NSP Brief at 35.

same equipment was in use for the LCM portion of the project.¹⁰ The Commission rightfully determined that the EPU project could not be considered used and useful without having approvals from NRC to operate. In the last case, the outstanding approvals were licenses, while in this case the outstanding approvals relate to standards that must be achieved during the power ascension process. In both cases, the impact is the same—the EPU project is not serving or benefiting ratepayers.

For the second proposition, NSP cites a case from Connecticut in which the Connecticut Department of Public Utility Control (“CDPUC”) was asked to consider whether three nuclear units at the Millstone plant that had undergone a sustained outage for more than a year should be considered used and useful before the units resumed service.¹¹ NSP noted that the CDPUC in this case focused on whether the investment is or will be useful during the time period rates are to be in effect.¹² However, unlike in the Connecticut case, the EPU portion of the Monticello Project has never been in service. Further, while the NSP brief repeats NSP’s belief that full ascension is likely to be achieved this year, it does not offer any concrete assurances or updates on progress toward that goal.¹³

XLI continues to believe that NSP failed to meet its burden to show that the EPU portion of the Monticello Project is “used and useful” during the 2014 test year and, as a result, both its revised proposal and its original proposal should be rejected. XLI appreciates MCC’s effort to propose a compromise on this issue, but XLI believes that the premise of the proposal is fundamentally flawed. As NSP explains in its brief, the proposal would essentially treat the delays in the power ascension process as being similar to a mechanical failure or outage.¹⁴ To be comparable to an outage, however the EPU would have needed to be in service before the outage occurred. Completion of the first-time power ascension process is a requirement of the NRC license for the uprate.¹⁵ And as described in NSP witness O’Connor’s testimony, the power

¹⁰ *In the Matter of the Application of Northern States Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota*, Docket No. E-002/GR-12-961, Findings of Fact, Conclusions of Law and Recommendations, at 15 (July 5, 2013).

¹¹ NSP Brief at 35 (citing *In re Conn. Light & Power Co.*, Connecticut Department of Public Utility Control Docket, No. 97-05-12, 1997 WL 866679, at *8-9, *19-21 (December 31, 1997))

¹² NSP Brief at 35-36.

¹³ NSP Brief at 36.

¹⁴ NSP Brief at 36 (citing Ex. 341, Schedin Rebuttal at 8).

¹⁵ Evidentiary Hearing Transcript, Vol. 1, 228:8-22.

ascension process has been repeatedly delayed.¹⁶ The plant has only operated above pre-update levels for limited periods in the context of the power ascension process, each time returning to pre-uprate levels upon identifying issues to be resolved to the satisfaction of the NRC. Since NSP has never had full approval from the NRC to operate at full uprate levels, the EPU project has never been in service. In its brief, NSP expresses concern that finding the EPU to be not yet used and useful in 2014 would establish a bad precedent for plant outages in the future. But NSP's concerns are unfounded because, for the reasons explained above, the current delays are not comparable to an outage.

Finally, deferring depreciation, as the MCC proposes, fails to recognize the used and useful concept because it defers recovery to future periods. Thus, NSP would be made whole. Investment that is not used and useful should be borne by shareholders and not recovered from customers.

B. Neither NSP Nor the DOC Justify Their Proposals to Ignore a Substantial Depreciation Reserve Surplus (Issue #75)

1. Depreciation Is a Process of Allocation, Not of Valuation

XLI proposed to reduce NSP's revenue requirement by accelerating amortization of the Company's nuclear depreciation reserve surplus to a five-year term. Further, XLI argued that NSP's calculation of the surplus was too low. As explained in the XLI brief, depreciation accounting is defined in the Minnesota Administrative Rules as "a system of accounting which aims to distribute cost or other basic value of tangible capital assets, less salvage, if any, over the estimated useful life of the unit, which may be a group of assets, in a systematic and rational manner. *It is a process of allocation, not of valuation.*"¹⁷ The emphasis on allocation (not valuation) was put in the following terms by the National Association of Regulatory Utility Commissioners ("NARUC"):

[T]he purpose of depreciation is not to build a reserve for the future.... [T]he sole purpose of depreciation accounting is to

¹⁶ See, e.g., Ex. 55, O'Connor Surrebuttal at 3-5.

¹⁷ Minn. R. 7825.0500, subp. 7 (emphasis added).

rateably allocate the capital costs of the property over its average service life through current charges to utility expenses.^{18]}

In light of this purpose, XLI proposes to amortize an existing surplus over a short period of time to mitigate NSP's very large proposed rate increase. XLI's proposal is consistent with the Commission's direction to explore this issue in this case.¹⁹ NSP and the DOC oppose XLI's recommendation on grounds that are contrary to the purpose of depreciation to rateably allocate the capital costs of utility property. XLI responds to the position of NSP and the DOC below.

2. Response to NSP

As NSP noted in its brief, the Commission directed parties to explore the matter of a nuclear production plant depreciation reserve surplus in this case,²⁰ and its own calculation revealed a nuclear reserve surplus of \$72.5 million for the Minnesota jurisdiction.²¹ XLI calculated the nuclear reserve surplus to be approximately \$208 million.²² NSP's brief criticizes XLI's methodology for calculating the surplus and the policy basis for XLI's amortization proposal.

Regarding XLI's methodology for calculating the surplus, NSP argued that plant vintages are not appropriate to use for determining depreciation expense for nuclear facilities because these facilities are subject to operating licenses. However, NSP has successfully extended the operating licenses for both of its nuclear plants in the past and, as explained in XLI's brief, there are policy reasons to think it may seek to do so again in the future.²³

On the latter criticism, XLI continues to contend that consideration of future capital additions is inappropriate because depreciation relates to already-invested capital. NSP argues that amortizing the surplus over a five-year period will place a burden on future ratepayers because "depreciation expense grows with future additions."²⁴ But, as explained in the NARUC manual quoted above, the purpose of depreciation is not to build a reserve for the future. If the

¹⁸ Ex. 263, Pollock Surrebuttal, 13:4-8 (quoting *NARUC Public Utility Depreciation Practices*, at 1, 187 (Aug. 1996)).

¹⁹ GR-12-961 Findings of Fact, Conclusions, and Order at 29.

²⁰ NSP Brief at 101; GR-12-961 Findings of Fact, Conclusions, and Order, at 29.

²¹ NSP Brief at 101; Ex. 263, Pollock Surrebuttal at 11; Ex. 92, Perkett Direct at 50-51.

²² Ex. 264, Opening Statement of Jeffrey Pollock.

²³ XLI Brief at 7.

²⁴ NSP Brief at 103.

Commission later finds that the five-year amortization proposed by XLI results in unacceptable impacts, the Commission can make the appropriate adjustments at that time.

3. Response to the DOC

The DOC's brief raises two arguments in opposition to XLI's proposed amortization: (i) the resulting rate reduction would be short-term and would result in higher rates for ratepayers in the long run,²⁵ and (ii) a depreciation reserve surplus is unlikely to exist given NSP's request for nuclear-related cost recovery in the current case and the potential for future significant investment.²⁶ Both of these issues were addressed by XLI in Mr. Pollock's surrebuttal testimony.

First, not only is it inappropriate to consider future capital additions when setting depreciation rates, amortizing a depreciation surplus does not have the adverse impact on ratepayers asserted by the DOC. Contrary to statements made by the DOC, returning reserve surpluses over the life of the asset does not result in a better matching of ratepayers who cause the cost of the facility to be incurred with ratepayers who are responsible for paying for the facility. Rather, employing accelerated depreciation of a surplus restores intergenerational equity by ensuring that costs are recovered from customers receiving the benefits.²⁷ This goal is consistent with purposes of depreciation as well as the Commission's order concerning the depreciation surplus in transmission, distribution, and general plant accounts in the previous case.²⁸ Further, Mr. Pollock demonstrated in Schedule 20 (reproduced on the following page) to his surrebuttal testimony that there is no difference on a net present value basis between the depreciation practice proposed by XLI and the practice proposed by the DOC.²⁹

²⁵ DOC Brief at 162; DOC Ex. 434 at 2.

²⁶ DOC Brief at 163.

²⁷ Ex. 263, Pollock Surrebuttal, 12:13-14.

²⁸ GR-12-961 Findings of Fact, Conclusions, and Order at 28.

²⁹ Ex. 263, Pollock Surrebuttal, 14:2-4; Schedule 20.

**Net Present Value Revenue Requirement of
Amortizing Surplus Depreciation Over Five Years
Versus The Remaining Life Method**

Line	Year	Revenue Requirement	
		Amortize Surplus	Remaining Life Method
		(1)	(2)
1	1	\$14.5	\$14.5
2	2	\$14.0	\$14.0
3	3	\$13.5	\$13.5
4	4	\$13.0	\$13.0
5	5	\$12.5	\$12.5
6	6	\$12.0	\$12.0
7	7	\$11.5	\$11.5
8	8	\$11.0	\$11.0
9	9	\$10.5	\$10.5
10	10	\$10.0	\$10.0
11	11	\$5.0	\$7.3
12	12	\$5.0	\$7.0
13	13	\$5.0	\$6.8
14	14	\$5.0	\$6.5
15	15	\$5.0	\$6.3
16	16	\$8.0	\$6.3
17	17	\$7.7	\$6.0
18	18	\$7.3	\$5.8
19	19	\$7.0	\$5.5
20	20	\$6.7	\$5.3
21	21	\$6.3	\$5.0
22	22	\$6.0	\$4.8
23	23	\$5.7	\$4.5
24	24	\$5.3	\$4.3
25	25	\$5.0	\$4.0
26	26	\$4.7	\$3.8
27	27	\$4.3	\$3.5
28	28	\$4.0	\$3.3
29	29	\$3.7	\$3.0
30	30	\$3.3	\$2.8
31	Total	\$232.5	\$223.8
32	Discount Rate	10%	10%
33	NPV Years 1-30	\$106.0	\$106.2
34	NPV Years 11-30	\$53.3	\$54.0

Second, there is substantial evidence in the record that a nuclear depreciation surplus exists. It is the logical result of the life extensions of both the Monticello and Prairie Island plants.³⁰ Further, while the size of the surplus is in dispute, it was apparent that a surplus existed

³⁰ Ex. 263, Pollock Surrebuttal, 11:15-16.

in the depreciation studies performed by NSP and by Mr. Pollock.³¹ The DOC argued that XLI's assertion that a surplus exists is wrong because it is focused only on past depreciation and does not consider the 2014-2015 timeframe or future investment over the remaining lives of the nuclear facilities.³² But from both a policy and practical perspective, it is inappropriate to consider future capital additions in setting depreciation rates. Depreciation relates to the recovery of invested capital, not future investments, the scale and timing of which are uncertain. As Mr. Pollock explained in his surrebuttal testimony, a depreciation surplus reflects whether recovery of past capital investment is on track given the known "mortality" characteristics of the assets in question, including average service life or lifespan, retirement dispersion, and net salvage.³³ As an example, Mr. Pollock noted that extending the life of a plant by 50% would significantly affect the required reserve, thereby creating a surplus.³⁴ Additional capital expenditures, such as cost overruns or abandoned investment, do not affect the magnitude of a depreciation surplus.³⁵ Mr. Pollock demonstrated that an increase in nuclear investment would not affect the magnitude of the surplus in the example he provided as Schedule 18 to his surrebuttal testimony.³⁶ Consideration of plant additions is simply not appropriate in setting depreciation rates because it is contrary to the definition of depreciation.³⁷

C. The Black Dog Outage is an Example of Why the ALJ Should Recommend that NSP be Ordered to Propose Fuel Clause Rider Reform at the End of This Case (Issue #76; Issue #67)

In testimony, XLI expressed concern about an outage that occurred at the Black Dog plant in late 2012 and early 2013.³⁸ The outage, by NSP's own admission, was caused by human error.³⁹ In its brief, NSP argues that XLI has attempted to impose a standard of perfection, rather than prudence.⁴⁰ However, imposing a standard of perfection on human judgment is not XLI's intention. Rather, XLI believes that it is NSP's burden to demonstrate that its actions were prudent both before and after the outage. In this case, NSP has provided information about how

³¹ Ex. 263, Pollock Surrebuttal, 11:13-20.

³² DOC Brief at 163.

³³ Ex. 263, Pollock Surrebuttal, 11:3-8.

³⁴ Ex. 263, Pollock Surrebuttal, 11:9-10.

³⁵ Ex. 263, Pollock Surrebuttal, 11:10-12.

³⁶ Ex. 263, Pollock Surrebuttal, 12:3-10.

³⁷ Ex. 263, Pollock Surrebuttal, 14:4-7.

³⁸ Ex. 260, Pollock Direct, 23-24.

³⁹ Ex. 260, Pollock Direct, 23:11-19.

⁴⁰ NSP Brief at 115-117.

it responded to the error that caused the Black Dog outage, but has not provided justification for the error itself or information about what steps the Company was taking to prevent such errors before this error occurred.⁴¹

Allocation of the burden of proof issue is of particular concern with respect to any replacement fuel costs that were incurred as a result of the outage. As XLI explained in its brief, there are significant practical problems with the allocation of the burden of proof under the current Fuel Clause Rider (“FCR”) and annual automatic adjustment (“AAA”) proceedings.⁴² Fuel replacement costs incurred as a result of the Black Dog outage are an example of costs that NSP will automatically recover under the FCR unless regulators or ratepayers are later able to prove that such costs were imprudent in the AAA proceeding. It is not XLI’s goal to impose a standard of perfection on NSP, but when additional costs are incurred as a result of human error, the Company should bear the burden to demonstrate that those costs were prudently incurred. Under the current FCR, a review of the Black Dog outage with the burden of proof appropriately allocated is unlikely to occur. For these reasons, XLI continues to urge the ALJ to recommend that NSP be ordered to propose incentive-based FCR reform in its next rate case or within 90 days of the Commission’s final order in this case, whichever is earlier.

D. The ALJ Should Reject the DOC’s and OAG’s Proposed Adjustments to NSP’s Class Cost of Service Study (Issue #51)

As explained in the XLI brief, XLI supports using NSP’s Class Cost of Service Study (“CCOSS”) with XLI’s proposed modification to NSP’s methodology for classifying production plant-related costs. In their briefs, the DOC and OAG have proposed substantially different CCOSS methodologies, which are further described below. The ALJ should recommend rejecting these proposals in order to ensure a just and reasonable starting point for revenue allocation and rate design.

⁴¹ See, e.g., NSP Brief at 114-115.

⁴² XLI Brief at 10-12.

1. The DOC's Proposal to Use Stratification to Classify NSP's Investments in the Nobles and Grand Meadows Wind Projects Should Be Rejected

The DOC recommends classifying NSP's investments in the Nobles and Grand Meadows Wind Projects using the plant stratification methodology.⁴³ Stratification uses the replacement cost of peaking capacity to measure the portion of production plant-related costs that should be classified as demand.⁴⁴ As Mr. Pollock explained in his rebuttal testimony, this approach is a simplified attempt to emulate traditional utility resource least-cost planning principles.⁴⁵ However, NSP's decision to invest in these wind energy projects was not driven by traditional least-cost planning. Instead, these wind energy investments were driven by NSP's need to comply with Minnesota's Renewable Energy Standard, set forth in section 216B.1691, subdivision 2a(b) of the Minnesota Statutes. Under this statute, NSP is required to have 30% of its retail sales come from renewable sources by 2020. As NSP explains, it chose to invest in the Nobles and Grand Meadows Wind Projects as a means to comply with this requirement.⁴⁶ Further, as Mr. Pollock demonstrated in Schedule 15 to his rebuttal testimony, there is no discernible relationship between system energy costs and wind production.⁴⁷ Specifically, since there is no correlation between the E8760 allocator (a proxy for system energy costs)⁴⁸ and the amount of wind generation, the E8760 allocator is not cost driver of wind.⁴⁹ Stratification assumes that utilities invest in capital-intensive generating resources in order to save energy costs. However, since wind production primarily occurs when system energy costs are low, investment in wind does not significantly displace high energy-cost resources.⁵⁰ Therefore, the assumptions embedded in the stratification method are not applicable to wind projects driven by policy mandates.

DOC's proposal to use stratification to classify the Nobles and Grand Meadows investments also has other shortcomings. As Schedule 16 to Mr. Pollock's rebuttal testimony

⁴³ DOC Brief at 270; Ex. 408, Ouanes Direct at 22, 44.

⁴⁴ Ex. 262, Pollock Rebuttal, 7:19-20.

⁴⁵ Ex. 262, Pollock Rebuttal, 8:1-3.

⁴⁶ NSP Brief at 133 (citing Ex. 102, Peppin Direct at 27-28; Ex. 103, Peppin Rebuttal at 17 & Schedule 5).

⁴⁷ Ex. 262, Pollock Rebuttal, 9-10 & Schedule 15. *See also* Evidentiary Transcript, Vol. 3, 45:18-48:2.

⁴⁸ The E8760 allocator is a projection of locational marginal prices at the Minnesota hub. Its units are dollars per megawatt-hour. Evidentiary Transcript, Vol. 3, 46:10-14.

⁴⁹ Evidentiary Transcript, Vol. 3, 47:22-48:2.

⁵⁰ Ex. 262, Pollock Rebuttal, 10:9-16.

shows, wind production primarily occurs during off-peak periods.⁵¹ However, DOC's proposed allocation of Nobles and Grand Meadows costs would distribute costs equally to all customers, even though customers who use more energy during off-peak and shoulder periods accrue more benefits from wind.⁵² DOC's analysis also assumes that all variable costs are energy-related, even though certain variable costs would be more appropriately attributed to demand. For example, variable operating costs associated with integrating wind energy into NSP's system and production maintenance costs do not correlate to the amount of energy generated.⁵³ Thus, not only does stratification not reflect the decision drivers for the Nobles and Grand Meadows investments, it also does not reflect cost causation.

2. The ALJ Should Accept NSP's Proposal to Use the "Predominant Nature" Method to Allocate Non-Fuel Production O&M Expenses, and Reject the DOC and OAG's Proposal to Use the "Location Method"

As noted in Mr. Pollock's rebuttal testimony, XLI supports NSP's use of the "predominant nature" method in its CCOSS for allocation of non-fuel production operations and maintenance ("O&M") expenses. The predominant nature method classifies other production O&M expenses based on 15 cost categories.⁵⁴ This is a more refined and well-accepted methodology for allocating accounts that contain both demand-related and energy-related components than the "location method" used in previous cases and recommended again in this case by the DOC and OAG.⁵⁵ Under the location method, other production O&M expenses are classified in the same proportion as gross production plant and unamortized nuclear fuel investments.⁵⁶

The NARUC manual provides further explanation of these methodologies:

Some accounts may be easily identified as being all demand-related or all energy-related; these may then be allocated using appropriate demand and energy allocators. Other accounts contain both demand-related and energy-related components. One common method for handling such accounts is to separate the labor

⁵¹ Ex. 262, Pollock Rebuttal, 10-11 & Schedule 16. See also Evidentiary Transcript, Vol. 3, 48:3-49:1.

⁵² Ex. 262, Pollock Rebuttal, 11:7-12.

⁵³ Ex. 262, Pollock Rebuttal, 12.

⁵⁴ Ex. 262, Pollock Rebuttal, 16:13-14.

⁵⁵ Ex. 262, Pollock Rebuttal, 21:11-13, 20:4-29.

⁵⁶ Ex. 262, Pollock Rebuttal, 17:4-5.

expenses from the materials expenses; labor costs are then considered fixed and therefore demand-related, and materials costs are considered variable and thus energy-related. Another common method is to classify each account according to its “predominant” – i.e., demand-related or energy-related – character. Certain supervision and engineering expenses can be classified on the basis of the prior classification of O&M accounts to which these overhead accounts are related. ***Although not standard practice, O&M expenses may also be classified and allocated as the generating plants at which they are incurred are allocated.***^[57]

Thus, according to NARUC, the predominant nature methodology is standard, while the location methodology is described as “not standard practice.”

Moreover, NSP’s use of the predominant nature methodology follows the two-step direction from the Commission in the last case to refine its CCOSS cost allocation methodology:

In the initial filing of its next rate case, Xcel shall refine its Class Cost of Service Study cost allocation method by identifying any and all Other Production O&M costs that vary directly with the amount of energy produced based on Xcel’s analysis. If Xcel’s analysis shows that such costs exist, then Xcel should classify these costs as energy-related and allocate them using appropriate energy allocators, while allocating the remainder of Other Production O&M costs on the basis of the Production Plant.^[58]

NSP’s proposed methodology, as described in the NSP brief and by NSP witness Michael Peppin, complies with the Commission’s direction.⁵⁹ In its direct testimony, NSP evaluated Other Production O&M under the location method and the predominant nature method.⁶⁰ With respect to the predominant nature method, the Company first examined each of the 117 cost items making up the “Other Production O&M” category to determine whether it was predominantly energy- or capacity-related.⁶¹ Having identified Other Production O&M costs that vary with energy, NSP classified these costs as energy-related.⁶² Similarly, costs that were fixed were classified as capacity-related. NSP did not perform this type of in-depth analysis of

⁵⁷ Ex. 262, Pollock Rebuttal at 20 (emphasis added) (quoting NARUC, *Electric Utility Cost Allocation Manual*, at 66 (Jan. 1992)).

⁵⁸ GR-12-961 Findings of Fact, Conclusions, and Order at 53.

⁵⁹ NSP Brief at 126-127.

⁶⁰ Ex. 103, Peppin Direct at 22:17-20.

⁶¹ Ex. 102, Peppin Direct at 19, 22 & Schedule 7.

⁶² Ex. 102, Peppin Direct at 23.

the nature of these costs in previous rate cases. Based on the results, NSP determined that using the predominant nature method was more consistent with the Commission's order in the prior case.⁶³

The OAG and the DOC object to NSP's use of the predominant nature method on three primary grounds. First, both the OAG and the DOC criticize the Company based on its past support of the location method. Second, in its brief, the OAG argues that NSP has not provided a valid basis for supporting the predominant nature methodology after supporting use of the location methodology in previous cases.⁶⁴ And third, the DOC argues that the NSP's proposed method is inconsistent with the Commission's orders in past cases.⁶⁵

With respect to the first and second objections, NSP and other parties have provided substantial evidence in the record to support the use of the predominant nature method. For example, in his direct testimony NSP witness Michael Peppin provided a clear explanation for the Company's proposal:⁶⁶

After reviewing the results of both the location methodology and the predominant nature methodology, I believe Other Production O&M should be classified and allocated according to the predominant nature methodology.... I believe the predominant nature methodology is more consistent with the desire expressed during the 2013 rate case that the Company take a more expansive view of energy-related Other Production O&M Costs.

As NSP pointed out in its brief, the OAG and DOC do not acknowledge that the examination of 117 separate cost items that make up Other Production O&M was a new analysis not performed in previous cases and which yielded better information about the nature of those costs.⁶⁷

In addition to NSP's refined analysis, the portion of the NARUC manual quoted above and cited in Mr. Pollock's testimony supports use of the predominant nature method, while characterizing the location method as non-standard. The NARUC manual expresses a preference for methodologies that are based on specific analysis of O&M expenses, such as the predominant

⁶³ Ex. 102 Peppin Direct, 25:1-10.

⁶⁴ OAG Brief at 60-62.

⁶⁵ DOC Brief at 273 (citing Ex. 408, Ouanes Direct at 29).

⁶⁶ Ex. 102, Peppin Direct at 25.

⁶⁷ NSP Brief at 128.

nature method.⁶⁸ Further, the location method is inconsistent with cost causation principles because, as Mr. Pollock explained in his rebuttal testimony:

The Location method fails to recognize the nature of other production O&M expenses. These expenses consist of both labor and materials expense. The former is related to the number of employees, while the latter is based on the materials consumed to operate and maintain the various generating units. Labor costs are fixed and do not vary with the amount of generation at a particular power plant site. Thus, labor-related costs are more appropriately classified as demand-related.^[69]

In contrast to the assertions of the OAG and the DOC, NSP's shift to using the predominant nature method is well-supported in the record in this case by NSP's new analysis of Other Production O&M costs and testimony explaining that the predominant nature method is more standard and consistent with cost causation principles.

As the third main criticism, DOC argued that NSP's use of the predominant nature methodology is inconsistent with previous Commission orders. However, as explained above, in the last case, NSP was ordered to refine its cost allocation methodology. In his rebuttal testimony, Mr. Pollock agreed with Mr. Peppin that "the predominant nature method is more consistent [than the location methodology] with the desire expressed during the 2013 rate case that the Company take a more expansive view of energy-related Other Production O&M Costs."⁷⁰ And as Mr. Pollock explained, prior Commission orders do not preclude future changes and refinements, especially when additional analysis shows that changes yield results more in line with principles of cost causation.⁷¹ The DOC has supported CCROSS refinements in the past that have differed from previous Commission orders, including in the last case.⁷² Moreover, refinement of the methodology for allocation of Other Production O&M Costs has been an evolving discussion in recent NSP cases.⁷³

⁶⁸ Ex. 262, Pollock Rebuttal, 20:26-29.

⁶⁹ Ex. 262, Pollock Rebuttal, 21:2-8.

⁷⁰ Ex. 262, Pollock Rebuttal, 18:7-10 (quoting Ex. 102, Peppin Direct at 25).

⁷¹ Ex. 262, Pollock Rebuttal, 18:14-19.

⁷² Ex. 262, Pollock Rebuttal, 19:1-13.

⁷³ See *In the Matter of the Application of Northern States Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota*, Docket No. E-002/GR-12-961, ALJ Findings of Fact, Conclusions of Law, and Recommendations (July 3, 2013), ¶¶ 652-657.

3. DOC's Proposed Allocation of Economic Development Program Costs Should Be Rejected Because It Is Inconsistent with Program Cost Drivers (Issue #53)

As NSP has explained, the Company's economic development programs are designed to attract and retain large customers.⁷⁴ XLI supports NSP's proposal to use a present revenue allocator for allocation of economic development costs because it is most consistent with the purpose of these programs. The DOC, however, has proposed to allocate economic development program costs on an energy basis because, DOC argues, the economic development discounts are provided on an energy basis.⁷⁵ Revenue is retained through these programs that would otherwise be lost. The retained revenue contributes to NSP's fixed and variable costs and reduces the potential burden on other customers and mitigates the need for future rate increases.⁷⁶ All customers therefore benefit from these programs, but the benefits are not proportional to energy usage. Rather, the primary cost driver for economic development programs is revenue retention. In cross-examination, DOC witness Dr. Samir Ouanes agreed that in a CCOSS, costs should be classified according to what caused the utility to incur the cost.⁷⁷ Allocating these costs on an energy basis does not account for the contribution to fixed costs that NSP retains through the program.⁷⁸ For these reasons, the DOC's proposal for allocation of economic development costs should be rejected.

4. The OAG's Proposal to Change the D10S Allocator Should Be Rejected

The OAG is proposing a revision to the coincident peak method that is used to allocate production demand-related costs – the D10S Allocator. NSP's D10S Allocator is determined by measuring customer class demands that occur coincident with NSP's annual system peak.⁷⁹ The OAG, in contrast, argues that the coincident peak method should reflect the demands of each customer class that occur coincident with the hour of the MISO system peak.⁸⁰ As Mr. Pollock explained in his rebuttal testimony, "NSP's annual system peak is still a key factor in

⁷⁴ NSP Brief at 136; Ex. 102, Peppin Direct at 19; Ex. 103, Peppin Rebuttal at 41; Ex. 262, Pollock Rebuttal at 22-23; Ex. 345, Maini Surrebuttal at 19. DOC witness Dr. Samir Ouanes also agreed on cross-examination that economic development costs are designed to retain customers. Evidentiary Hearing Transcript, Vol. 4, 83:24-84:1.

⁷⁵ DOC Brief at 275; Ex. 408, Ouanes Direct at 39.

⁷⁶ Ex. 262, Pollock Rebuttal, 23:1-7.

⁷⁷ Evidentiary Hearing Transcript, Vol. 4, 83:13-17.

⁷⁸ Ex. 262, Pollock Rebuttal, 23:10-16.

⁷⁹ Ex. 262, Pollock Rebuttal, 23:21-23.

⁸⁰ Ex. 262, Pollock Rebuttal, 24:1-2; Ex. 375, Nelson Direct at 11-12; OAG Brief at 63-65.

determining the amount of generation capacity required to maintain reliable service.”⁸¹ Recognizing that MISO’s reserve margin formula was new and in flux, the Commission declined to adopt it for use in NSP’s most recent resource acquisition docket.⁸² Since the OAG has not demonstrated how MISO’s new reserve margin formula affected the costs incurred by NSP or whether it would affect how production and transmission plant-related costs are allocated to NSP’s retail customer classes, the OAG’s proposal should be rejected.⁸³

E. The ALJ Should Recommend the Commission Exercise Its Discretion to Set Rates at Cost

In its brief, NSP acknowledged that XLI and MCC have raised valid concerns regarding the competitiveness of its business rates, stating:

Uncompetitive business rates ultimately harm all customers through decreased future sales that can produce a need for future rate increases. Thus, there is a real need to strike a reasonable balance among all the pertinent rate design factors that is fair to all classes.^[84]

As explained in more detail in the XLI brief, increasingly uncompetitive industrial rates are of the utmost concern for XLI.⁸⁵ Among the most effective options available to address this pressing concern is to set rates at cost. As Mr. Pollock explained in his surrebuttal testimony, “cost based rates are equitable, provide appropriate price signals for all customer classes, encourage conservation and efficiency, and address the very serious and real problem that NSP’s industrial rates are not competitive.”⁸⁶

For these reasons, XLI is concerned about the DOC’s proposals regarding revenue allocation. As it does in every case, the DOC provides four factors that it allegedly considers when critiquing a utility’s proposed revenue requirement. Namely, that rates should (i) be designed to allow the utility a reasonable opportunity to recover its revenue requirement; (ii)

⁸¹ Ex. 262, Pollock Rebuttal, 24:11-12.

⁸² Ex. 262, Pollock Rebuttal, 25:3-20 (citing *In the Matter of the Petition of Northern States Power Company d/b/a/ Xcel Energy for Approval of Competitive Resource Acquisition Proposal and Certificate of Need*, Docket No. E002/CN-12-1240, Order Directing Xcel to Negotiate Draft Settlements with Selected Parties, at 28-29 (May 23, 2014)).

⁸³ Ex. 262, Pollock Rebuttal, 26:12-14.

⁸⁴ NSP Brief at 140.

⁸⁵ XLI Brief at 4-5, 16-17.

⁸⁶ Ex. 263, Pollock Surrebuttal, 31:7-10.

promote efficiency by sending appropriate price signals (i.e., rates should be set at or near cost); (iii) be changed gradually to limit rate shock; and (iv) be easy to understand and administer.⁸⁷ In her direct testimony, DOC witness Susan Peirce also explained several reasons why minimizing inter-class subsidies is important:

Certainly, rates should be fair, and ideally the best way to define “fair” is that each class of customer would pay enough to cover its share of costs. Moreover, customers need accurate information about the cost of electricity so they can make informed decisions about how much electricity they use. This information is often called “price signals.” For example, if customers are informed through their rates that electricity is less expensive than the actual cost of electricity, customers would not have the appropriate incentive to reduce their use of electricity.^[88]

It is not, however, clear how DOC’s proposed revenue allocation applies (or complies with) these principles. As is shown in tables 3 and 4 on Exhibit 147, the DOC’s proposals for 2014 and 2015 allocate approximately the same percentage of total revenue to each customer class as the current class revenue allocation. In other words, DOC’s revenue allocation proposal amounts to an across-the-board increase.⁸⁹ While DOC’s guiding principles include the goals of moving rates closer to cost and minimizing inter-class subsidies, DOC’s proposed revenue allocation would not move C&I Demand rates closer to cost in 2015.⁹⁰ The DOC has not provided an explanation based on its stated principles or otherwise as to why it proposes to move some classes and not others closer to cost in 2015, other than to say that it “balances the goal of moving toward cost to lessen the impact of inter-class subsidies with the goal of moderating the overall revenue increase experienced by each class.”⁹¹

DOC has not provided any evidence or support that its proposed 2015 revenue allocation is needed to avoid rate shock for any class.⁹² As Mr. Pollock demonstrated in his rebuttal testimony, “there would be almost no relative difference in the percent revenue increases that

⁸⁷ Ex. 420, Peirce Direct at 2-3; DOC Brief at 280-281.

⁸⁸ Ex. 420, Peirce Direct, 10:16-23.

⁸⁹ Ex. 147, Table of Peirce Recommendations; Evidentiary Hearing Transcript, Vol. 4, 181:1-25; *see also* Ex. 420, Peirce Direct at 9.

⁹⁰ Ex. 262, Pollock Rebuttal, 24:11-25:1.

⁹¹ Ex. 420, Peirce Direct at 10.

⁹² Ex. 262, Pollock Rebuttal, 26:14-22.

Ms. Peirce is recommending and a cost-based rate increase for the residential and Commercial/Industrial Demand (C&I Demand) classes. In other words, there would be no rate shock even under a fully cost-based allocation.”⁹³ But even though there is no evidence that rate shock is a factor, the practical effect of DOC’s proposal is to shift revenue responsibility from the Residential to the C&I Demand class.⁹⁴

The impact of DOC’s proposal is to shift approximately \$7.5 million from the Residential to the C&I Demand class, which equates to approximately \$0.60 per month on the average residential customer’s bill.⁹⁵ The DOC’s proposal will have a modest mitigating effect on residential customer bills in the short run, but potentially much more serious negative impacts in the future. No party has contradicted Mr. Pollock’s testimony that NSP industrial rates are not competitive.⁹⁶ But load growth in the near future is critical to protect existing ratepayers from funding increased investment over diminishing electric sales. Addressing this issue and adhering to cost of service principles when setting rates will have the additional benefits of equity, engineering efficiency, rate stability, and conservation.⁹⁷ XLI respectfully requests that the ALJ recommend adoption of its revenue allocation proposal based on a revised CCOSS.

III. CONCLUSION

As explained in detail above and in XLI’s brief, the ALJ should modify NSP’s proposals as follows in her recommendation to the Commission:

- The substantial nuclear depreciation reserve surplus should be amortized over five years, resulting in a \$25.7 million reduction to NSP’s proposed 2014-2015 revenue requirement;
- The EPU portion of the Monticello Project should be excluded from the rate base until it is used and useful in rendering service to ratepayers;

⁹³ Ex. 262, Pollock Rebuttal, 26:18-22.

⁹⁴ Ex. 262, Pollock Rebuttal, 27:3-8.

⁹⁵ Ex. 262, Pollock Rebuttal, 27:3-7.

⁹⁶ See, e.g., Evidentiary Hearing Transcript, Vol. 1, 35:11-16.

⁹⁷ See Ex. 260, Pollock Direct, 40:7-12.

- XLI's proposals to modify NSP's CCOSS should be adopted because it yields more equitable results founded on cost-causation principles under the just and reasonable standard;
- NSP should be ordered to file an incentive-based FCR reform proposal in its next rate case or within 90 days of the final order in this case in order to establish an effective mechanism to ensure that fuel and purchased energy costs recovered through the FCR are reasonable and prudent;
- Rates should be set at cost of service; and
- To ensure that rates are just and reasonable, XLI's rate design proposals should be adopted in order to address NSP's increasingly uncompetitive industrial rates.

Respectfully submitted,

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