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**BEFORE THE MINNESOTA OFFICE OF ADMINISTRATIVE HEARINGS
600 North Robert Street
St. Paul, Minnesota 55101**

**FOR THE MINNESOTA PUBLIC UTILITIES COMMISSION
121 7th Place East
Suite 350
St. Paul, Minnesota 55101-2147**

**MPUC Docket Nos. E-002/GR-12-961; E-002/GR-13-868; E-999/AA-13-599
E-999/AA-14-579; E-999/AA-16-523; E-999/AA-17-492; E-999/AA-18-373;
OAH Docket No. 65-2500-38476**

*In the Matter of Sherco Unit 3
Energy Replacement Costs*

**REPLY BRIEF
OF THE OFFICE OF THE ATTORNEY GENERAL –
RESIDENTIAL UTILITIES DIVISION**

February 14, 2024

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INTRODUCTION

Xcel's failure to prudently maintain and inspect the Sherco Unit 3 turbine resulted in a catastrophic turbine failure and caused a nearly two-year-long outage. Xcel's imprudent actions caused its customers, including residential and small business ratepayers, to pay for replacement power for 22 months. Instead of carrying its burden of proof, Xcel in its initial brief continues to blame General Electric (GE) for failing to warn it of the risks of stress-corrosion cracking on the finger-pinned dovetail blades. In doing so, Xcel attempts to dodge responsibility for prudently maintaining and inspecting its power plant. Xcel also attempts to avoid the financial consequences of its imprudent actions, raising novel and unsupported theories to reduce the extent of the costs it must return to ratepayers.

Xcel failed to act prudently. Xcel, not ratepayers, should pay for the cost of Xcel's imprudence. The Office of the Attorney General – Residential Utilities Division (OAG) urges the Administrative Law Judge and the Public Utilities Commission to make ratepayers whole. To do so, Xcel must refund the full replacement-power costs incurred as a result of the outage plus interest—approximately \$55.68 million (MN jurisdiction).

I. XCEL HAS FAILED TO SHOW THAT IT ACTED PRUDENTLY.

Despite totaling more than 135 pages, Xcel's brief fails to persuasively explain how it was prudent for Xcel to ignore the known and substantial risk of stress-corrosion cracking at Sherco Unit 3. Instead, Xcel tries to relitigate its lawsuit versus GE, faulting GE for failing to warn it of this risk. But as Xcel itself has made very clear, this proceeding is different from its litigation with GE, and failure to warn is not the standard.¹ Here, Xcel must show that it acted prudently *and* that

¹ See, e.g., Xcel Reply Comments at 2–3 (Jan. 27, 2021).

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it is just and reasonable for ratepayers to shoulder the replacement-power costs from the outage.² Any doubt as to the reasonableness of these cost must be resolved in ratepayers' favor.³ Xcel has failed to carry this burden, and ratepayers should receive a full refund. Xcel claims that any investigation into the prudence of its actions will be tainted by hindsight, and brushes aside the fact that it knew of the risks of not inspecting its turbine appropriately before the catastrophic event occurred. Xcel then shifts to claiming that a design flaw truly caused the failure, again ignoring its awareness of the risks. But Xcel was responsible for inspecting its plant and did not need permission from GE to do so. The record shows that Xcel's imprudent actions caused the outage and that ratepayers should be made whole.

Xcel correctly states that prudence depends on information available at the time of the relevant action and cannot be judged using hindsight.⁴ But Xcel's repeated claims of hindsight⁵ ignore not only that information about the risks of the Sherco 3 catastrophe was available to Xcel, but also that Xcel had actual knowledge of these risks years before the turbine burst apart. Xcel's employees consistently and continually communicated these risks to Xcel's upper management in annual System Health Reports.⁶ An Xcel engineer even admitted that he wanted to do a full inspection in light of this risk, stating, "We wanted to do the inspection but we weren't given the documents from the OEM [original equipment manufacturer] that we required to expend that kind of dollars and time to do the inspection."⁷ As Xcel acknowledges, "plant operators are in the best

² See, e.g., *In re Pet. of N. States Power Co. d/b/a Xcel Energy to Recover February 2021 Nat. Gas Costs*, G-002/CI-21-610, ORDER DISALLOWING RECOVERY OF CERTAIN NATURAL GAS COSTS AND REQUIRING FURTHER ACTION at 5 (Oct. 19, 2022) (eDocket No. 202210-189969-01) [hereinafter "Gas Cost Order"].

³ Minn. Stat. § 216B.03 (2023).

⁴ See Xcel Initial Br. at 75; Gas Cost Order at 5.

⁵ Xcel Initial Br. at 77.

⁶ See Ex. Xcel-23, HJS-D-14 (Sirois Direct – Schedule 14 – System Health Reports).

⁷ Ex. Xcel-58 Kolb Deposition Transcript – PUBLIC at 196 (eDocket No. [202311-200611-22](#)).

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position to determine how to run and maintain their units.”⁸ But Xcel ignored the people operating its plant and chose to delay an essential inspection that prudence required, apparently to cut costs.

Xcel next deflects from its imprudent decision to delay the inspection by claiming that a design flaw caused the failure.⁹ But a prudent plant operator should be familiar with the plant’s design and any risks that design presents. Here, again, Xcel was actually aware of the risks that stress-corrosion cracking presented and of the inspection needed to detect whether those risks were manifesting.¹⁰ It ignored those risks and attempted to delegate to GE its responsibility for making prudent plant-maintenance decisions.

Xcel asks the ALJ and Commission to absolve it of responsibility for prudently maintaining and inspecting Sherco 3 because GE did not mandate Magnetic Particle Inspection for a specific time frame.¹¹ Xcel’s senior engineer testified that, without a specific directive from GE to perform an inspection, “I could spend those dollars better on real problems.”¹² But it is Xcel, not GE, that must maintain its plant in accordance with good utility practice. Xcel’s imprudent failure to inspect for stress-corrosion cracking in the Sherco 3 turbine blades led to a catastrophic explosion and tens of millions of dollars in replacement-power costs. Its customers have paid these imprudently incurred costs, and now Xcel must return their payments.

⁸ Xcel Initial Br. at 78.

⁹ *Id.* at 118–20.

¹⁰ *See* Ex. Xcel-58 (Kolb Deposition Transcript – PUBLIC) at 195–97 (eDocket No. [202311-200611-22](#)) (agreeing that if Xcel had performed the inspection recommended in TIL 1121-3AR1 or even a visual inspection it would likely have discovered the stress-corrosion cracking).

¹¹ Xcel Initial Br. at 88 (“GE did not instruct that a Magnetic Particle Inspection should be performed every three years, every five years, every fifteen years, or even every twenty-five years”).

¹² Evid. Hrg. Tr. Vol. I at 209–10 (Kolb).

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II. XCEL’S ARGUMENTS FOR WHY IT SHOULD NOT HAVE TO REFUND IMPRUDENTLY INCURRED COSTS ARE UNPERSUASIVE.

Xcel advances several theories for why, even if it acted imprudently, it should not have to refund any replacement-power costs to ratepayers. Xcel’s claims include (A) that determinations in Xcel’s 2012 rate case require ratepayers to cover replacement-power costs, (B) that insurance coverage for restoration costs should offset uncovered replacement-power costs, (C) that additional capital investments constructed during the outage but unrelated to restoration should offset replacement-power costs, (D) that claimed operations and maintenance savings should offset replacement-power costs, and (E) that the full amount of its settlement with GE should offset replacement-power costs.¹³ Xcel’s arguments are unsupported by law, Commission practice, or regulatory principles. The Commission should reject these arguments and instead require Xcel to refund the full amount of replacement-power costs incurred as a result of its imprudence.

A. The Commission’s Order in Xcel’s 2012 Rate Case Does Not Oblige Ratepayers to Cover Sherco 3’s Imprudent Replacement-Power Costs.

Xcel argues that because the Commission excluded Sherco 3 from rate base while it was on outage, the Commission should now pretend that the plant “did not exist” and find that costs incurred to replace the plant’s missing generation were not for “replacement” power.¹⁴ The Commission should reject this tortured argument. Xcel ignores that the reason the Commission excluded the plant from rate base was that it was on outage, and it was on outage because of the Company’s imprudent maintenance. This imprudent maintenance was also the direct cause of the

¹³ Xcel’s main support for its cost-netting theory appears to be that the Department supported it in comments to the Commission. *See* Xcel Initial Br. at 123–24. No party, however, dictates the actions of the Commission and the Commission is not bound by previous statements or positions of parties.

¹⁴ Xcel Initial Br. at 121.

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replacement-power costs at issue here. To absolve Xcel from responsibility for these costs based on whether “replacement” is the right label for them would be the height of sophistry.

The ALJ and the Commission should reject Xcel’s arguments for two additional reasons. First, accepting Xcel’s arguments would allow Xcel to use a rate treatment that *it proposed* in its 2012 rate case as a shield against refunding imprudently incurred costs,¹⁵ an outcome that would be contrary to public policy. Finally, the idea that the Commission cannot both exclude Sherco 3 from rate base and disallow replacement-power costs for the plant is one that the Commission has already considered and rejected in referring this matter to the Office of Administrative Hearings.¹⁶ Xcel has provided nothing new to support its theory, and the ALJ and Commission should continue to reject it.

B. Xcel’s Insurance Proceeds for General Insurance Costs Should Not Offset Replacement-Power Cost Recovery.

Following the destruction of Sherco 3, insurance covered most, but not all, of the restoration costs. Xcel argues, therefore, that ratepayers “received a newly-refurbished unit at very little cost to them.”¹⁷ Xcel appears to argue that, simply because it diligently pursued reimbursement for property damage and excess fuel costs that were covered by insurance, it should not have to return replacement-power costs that were *not* covered by insurance.¹⁸ These arguments not only compare apples to oranges (i.e., restoration costs to replacement-power costs) but also

¹⁵ Ex. DOC-9, MJK-R-1 at 3–4 (King Rebuttal, Schedule 1) (excerpt of Rebuttal Testimony of Jeffrey Robinson in 2012 Rate Case).

¹⁶ See Xcel Reply Comments at 3 (Jan. 27, 2021) (eDockets No. 20211-170360-05) (arguing that the Commission should not disallow both rate-case costs and replacement-power costs); [Notice and Order for Hearing](#) at 6–7 (July 13, 2022) (acknowledging Xcel’s argument but referring the replacement-cost issue for contested-case proceedings over Xcel’s objection).

¹⁷ Xcel Initial Br. at 125.

¹⁸ *Id.* at 124–25.

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ignore that ratepayers pay for Xcel's insurance premiums and are entitled to the full benefits of that coverage.

As OAG witness Shoua Lee explained, "Ratepayers pay the costs of a utility's insurance through base rates. As a result, ratepayers—not the utility—should receive the benefits provided by insurance."¹⁹ Ratepayers had been paying insurance premiums to cover an event like this for years. Xcel's claim that insurance proceeds somehow offset its responsibility for replacement-power costs is akin to having your roommate borrow your car, total it, and then refuse to give you money for bus fare because "you'll get a new car when the insurance comes through."

Not only did ratepayers pay for Xcel's insurance premiums so that it was in the position to restore Sherco 3, but the record is devoid of information about the impact that such a large payout will have on Xcel's future premiums.²⁰ Xcel's insurance claim may therefore have subsequently harmed ratepayers through increased insurance rates.

Last, Xcel admits that insurance proceeds did not cover all restoration costs, stating that the "restoration of Unit 3 was *almost entirely* covered by insurance proceeds, and Xcel Energy customers received a newly-refurbished unit at *very little cost* to them."²¹ This "very little cost" was approximately \$5.5 million dollars. And since Xcel's 2015 rate case, ratepayers have been paying for the uncovered \$5.5 million of restoration costs through base rates.²² But that is not all ratepayers have paid. They also paid over \$30 million in replacement-power costs and the premiums that allowed Xcel to receive any insurance recovery at all. Xcel's efforts to evade

¹⁹ Ex. OAG-2 at 19 (Lee Rebuttal).

²⁰ *Id.* at 18.

²¹ Xcel Initial Br. at 125 (emphasis added).

²² Ex. DOC-9 at 7, MJK-R-2 (King Rebuttal, Schedule 2) (Xcel Response to Oct. 21, 2020 Information Request).

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responsibility for its imprudently incurred replacement-power costs on the basis of insurance reimbursements should be rejected.

C. “Opportunity Projects” Do Not Reduce Xcel’s Liability for Imprudent Replacement-Power Costs.

Xcel claims that the harm to ratepayers of paying for imprudent replacement-power costs is mitigated by the benefits of so-called “opportunity projects” that Xcel undertook during Sherco 3’s restoration. OAG and Department experts have refuted Xcel’s claims about the benefits from these projects, and OAG will not rehash that testimony here.²³

Focusing solely on the alleged ratepayer benefits of opportunity projects fails to acknowledge that they were also an opportunity for Xcel to accelerate its profits by adding to its rate base. As Ms. Lee explained, “[H]ad the Company prevented the explosion and collected rates based on the established maintenance schedule, those rates would have reflected lower costs of operating older equipment and assets that were nearing the end of their useful life.”²⁴ The opportunity-project costs were not needed to return Sherco 3 to service and as such were not covered by insurance.²⁵ Thus, by undertaking the projects, Xcel put ratepayers on the hook for newer plant items, with higher capital costs, earlier than they otherwise would have been.²⁶ It may well have been prudent for Xcel to undertake these projects, but Xcel has failed to substantiate the

²³ See Ex. OAG-2 at 16 (Lee Rebuttal) (“It is not clear if these amounts present an accurate valuation of the net benefits to ratepayers because the Company does not show the value of the benefits under a long-term horizon that thoroughly compares the actual projects completed during the outage period to the originally-planned plant repairs and replacement schedule.”); Ex. DOC-5 at 19–28 (Polich Rebuttal); Ex. DOC-9 at 11–14 (King Rebuttal).

²⁴ Ex. OAG-2 at 15 (Lee Rebuttal).

²⁵ Ex. Xcel-31 at 12 (Schottler Direct) (explaining that opportunity projects were “not required to return the unit to service but [were] performed as an opportunity to take advantage of the extended” outage time); see also Ex. OAG-2 at 15 (Lee Rebuttal) (quoting Xcel’s testimony in its 2013 rate case that the “restoration strategy was to restore the Unit to its pre-event condition,” an approach “supported by our insurance coverage which obviously would not reimburse the Company for a final product that was better than what we started with”).

²⁶ See OAG-2 at 16 (Lee Rebuttal).

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claimed ratepayer benefits or that these benefits should offset the replacement-power costs at issue in this proceeding.

D. Xcel Failed to Support Its Claimed Operations and Maintenance Savings.

Xcel claims that it saved ratepayers \$525,000 in overtime expenses by reassigning employees to other plants and also avoided costs of materials to operate Unit 3.²⁷ Xcel's claim of ratepayer savings overlooks how utilities recover Operations and Maintenance (O&M) costs in rates. Xcel's calculations of these savings are also unreliable.

Xcel's claimed labor and equipment-expense savings were not necessarily passed on to ratepayers. As Ms. Lee explains, "operating and maintenance costs usually fluctuate from year to year and are typically normalized for ratemaking purposes, so a snapshot comparing actual costs to any one year would likely not reflect what any net benefits actually are."²⁸ In other words, because O&M expenses are factored into base rates that do not change between rate cases, Xcel can simply pocket any unspent O&M budgets in a given year. Xcel's claimed O&M savings therefore may be illusory from ratepayers' perspective and should not be used to offset the very real ratepayer costs for replacement power.

In addition, Xcel's calculations of the O&M savings are flawed. As Ms. Lee explained, to derive its claimed savings, Xcel compared two years (2012 and 2013) of actual overtime labor and materials costs to a single baseline year (2010).²⁹ But because O&M costs fluctuate from year to year, Xcel's method of picking a single baseline year is not sound and may not reflect a reasonable level of savings. The Commission should not offset replacement-power costs with Xcel's alleged O&M savings.

²⁷ Xcel Initial Br. at 129.

²⁸ Ex. OAG-2 at 18 (Lee Rebuttal).

²⁹ *Id.* at 17–18.

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E. Only a Portion of the GE Settlement Should Offset Replacement-Power Costs.

Xcel argues that the entirety of GE’s settlement payment should be used to offset replacement-power costs. Xcel baldly claims that it is of “no consequence” that the settlement did not allocate a specific amount to replacement-power costs.³⁰ But Xcel does not deny that the GE settlement was a [NOT PUBLIC DATA BEGINS

NOT PUBLIC DATA ENDS].³¹ Xcel also ignores that insurance did not make ratepayers whole for the entirety of the damages.³² Xcel essentially argues that, because ratepayers received *some benefit* from the settlement, Xcel should be able to use the full amount of that benefit as an offset to replacement-power costs.³³ Xcel’s argument is conclusory and illogical. The Commission should adopt the reasonable recommendation of Department expert Mr. King to apply 24.4 percent of the GE settlement as an offset to replacement energy costs, because 24.4 percent is the portion of its harm that Xcel quantified as associated with replacement energy costs while in litigation.³⁴

CONCLUSION

Xcel’s imprudent actions led to ratepayers shouldering over \$30 million in replacement-power costs between 2011 and 2013. Xcel’s arguments for why it should not need to make ratepayers whole for imprudently incurred costs are untethered to law, Commission precedent, ratemaking principles, or the record. The Administrative Law Judge should therefore recommend

³⁰ Xcel Initial Br. at 134.

³¹ Ex. DOC-10 at 8 (King Rebuttal Not Public).

³² In Xcel’s 2015 Rate Case, Xcel added \$5.5 million in capital costs from the restoration that were not covered by insurance. *See* Ex. DOC-9 at 7, MJK-R-2 (King Rebuttal, Schedule 2) (Xcel Response to Oct. 21, 2020 Information Request). Because these are capital costs, ratepayers are also paying a rate of return on the balance during the period over which these assets are depreciated.

³³ Xcel Initial Br. at 134.

³⁴ Ex. DOC-3 at 19 (King Direct).

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that the Commission require Xcel to return the full amount of replacement-power costs, with interest—approximately \$55.68 million.

Dated: February 14, 2024

Respectfully submitted,

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