

**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

**EXCEPTIONS TO THE FINDINGS OF FACT, CONCLUSIONS
AND RECOMMENDATION OF THE ADMINISTRATIVE LAW
JUDGE SUBMITTED BY THE XCEL LARGE INDUSTRIALS**

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The following constitutes the Exceptions to the Findings of Fact, Conclusions and Recommendations of the Administrative Law Judge (“ALJ”) in this matter dated December 26, 2014 (the “Recommendations”), of Flint Hills Resources, LP; Gerdau Ameristeel US Inc.; Unimin Corporation; and USG Interiors, Inc. (collectively, the “Xcel Large Industrials” or “XLI”).

I. INTRODUCTION

In the proceedings below, XLI argued that the petition to increase electric rates of Northern States Power Company d/b/a Xcel Energy (“NSP” or the “Company”) in 2014 and 2015 further aggravates a trend toward increasingly uncompetitive industrial rates. XLI further argued that, absent a concerted effort to address NSP’s uncompetitive rates, commercial and industrial (“C&I”) customers may continue to leave NSP’s system. Any decline in sales to these customers will exacerbate future rate increases for all NSP customers. To make industrial rates more competitive, just and reasonable, XLI recommended (1) an in-depth analysis of NSP’s proposed revenue requirements to ensure that the authorized rates are fair and reasonable; (2) address fuel and purchased energy costs by requiring NSP to file an incentive-based fuel clause rider reform proposal; (3) set C&I Demand rates at cost using a Class Cost of Service Study (“CCOSS”) that better reflects cost-causation; (4) establish interruptible rates that better reflect the value of capacity that interruptible customers provide to the system; (5) revise the definition of “on -peak” to include summer months; and (6) order NSP to establish a renewable energy purchase option tailored for industrial customers.

XLI further argued that NSP failed to meet its burden of proof in several respects. Under Minnesota law, NSP bears the burden of demonstrating that its proposed rate increase is just and reasonable. Any doubt as to the reasonableness of its proposal should be resolved in favor of the ratepayer. NSP’s petition to increase electric rates fails to demonstrate by a preponderance of the evidence the following: (i) that nuclear depreciation rates are reasonable in light of the substantial depreciation reserve surplus; (ii) that all costs associated with the Monticello Life Cycle Management/Extended Power Uprate (LCM/EPU) project (“Monticello Project”) are used and useful; (iii) that there are no valid reasons to further delay reforming the fuel clause rider; (iv) that the proposed CCOSS is reasonable without XLI’s proposed modifications; and (v) that

NSP's proposed rates are just and reasonable absent adopting revenue allocation and rate design strategies to mitigate increasingly uncompetitive industrial rates.

XLI appreciates the effort undertaken by the ALJ to resolve a very complex case. The ALJ's Recommendations are detailed and thorough. Nonetheless, there are areas in which XLI disagrees with the findings, conclusions, and recommendations. XLI submits these exceptions to clarify its position and advocate for modifications to the Recommendations.

II. ANALYSIS

A. NSP Bears the Burden of Proof to Demonstrate that its Proposal is Just and Reasonable

It is NSP's burden to demonstrate its proposal is reasonable.¹ "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."² The Supreme Court described the Commission's role in determining just and reasonable rates in a rate proceeding by stating:

[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., 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 that it is just and reasonable that the ratepayers bear the costs of those expenses.^[3]

In NSP's 2012 rate case, the Commission explained the differences in its roles by acknowledging that on purely factual matters it acts in its quasi-judicial capacity and weighs evidence in the same manner as a district court, requiring facts to be proved by a preponderance of the evidence. On issues involving policy judgments, the Commission acts in its quasi-legislative capacity, balancing competing interests and policy goals to arrive at the resolution most consistent with the

¹ MINN. STAT. § 216B.16, subd. 4 ("The burden of proof to show that the rate change is just and reasonable shall be upon the public utility seeking the change.").

² MINN. STAT. § 216B.03.

³ *In re N. States Power Co.*, 416 N.W.2d 719, 722-23 (Minn. 1987).

broad public interest.⁴ The fact that the Commission reviews matters in both quasi-judicial and quasi-legislative capacities does not change the utility's burden in proving its case. In NSP's 2012 rate case, the Commission went on to state that

[u]tilities seeking rate changes must therefore prove not only that the facts they present are accurate, but that the costs they seek to recover are rate-recoverable, that the rate recovery mechanisms they propose are permissible, and that the rate design they advocate is equitable under the "just and reasonable" standard set by statute.^[5]

That the proposed rates meet this "just and reasonable" standard is a burden imposed on the utility, which it must establish by a preponderance of the evidence.⁶ This standard is defined as "whether the evidence submitted, even if true, justifies the conclusion sought by the petitioning utility when considered together with the Commission's statutory responsibility to enforce the state's public policy that retail consumers of utility services shall be furnished such services at reasonable rates."⁷

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

- The ALJ appropriately concluded that NSP failed to demonstrate, by a preponderance of the evidence, that allowing costs associated with the EPU portion of the Monticello Project results in just and reasonable rates;
- The ALJ recognized that a nuclear depreciation surplus exists, but should have recommended that the Commission use its authority to amortize the surplus because amortization would moderate unsustainable rate increases in a manner consistent with the public interest;
- Although the ALJ acknowledged the importance of the issues raised by XLI related to NSP's mechanism for recovering fuel and purchased energy costs, the ALJ should have recommended that the Commission address the issue by ordering NSP to revise its fuel and purchased energy cost recovery mechanism in

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 5 (Sept. 3, 2013).

⁵ *Id.*

⁶ *N. States Power Co.*, 416 N.W.2d at 722.

⁷ *Id.*

a manner consistent with the public interest and that appropriately places the burden of proof on NSP for showing that costs associated with fuel and purchased energy are just and reasonable;

- The ALJ should not have rejected NSP's proposed CCOSS, but rather should have recommended that the Commission accept NSP's CCOSS with XLI's proposed modification because it is the most reasonable proposal offered by the parties in this case;
- The Commission should exercise its discretion to set rates based on cost of service; and
- The ALJ appropriately recommended that the Commission order NSP to propose a program similar to XLI's offered "Renew-A-Source" program, but also should have recommended that NSP be ordered to implement XLI's other rate design proposals in order to mitigate the impacts of NSP's increasingly uncompetitive industrial rates and ensure that rates are just and reasonable.

XLI therefore believes the Commission should make appropriate modifications to the Recommendations, as set forth below.

B. NSP's Industrial Rates Are Not Competitive

There is no dispute that NSP's large industrial rates are the most expensive in Minnesota, among the most expensive integrated electric utilities in surrounding states, and in the top third of the most expensive integrated electric utilities in the continental United States.⁸ In his direct testimony, XLI witness Jeffrey Pollock supported these conclusions with an analysis comparing the typical bills of NSP Minnesota industrial customers to corresponding bills of customers served by other electric utilities.⁹ The consequence of NSP's uncompetitive industrial rates is a continued loss of sales from existing customers and inability to attract new industrial customers. XLI demonstrated these impacts with evidence in Mr. Pollock's testimony.¹⁰

⁸ Ex. 260, Pollock Direct at 40:1-6.

⁹ Ex. 260, Pollock Direct at 39:13-15; Ex. 260, Pollock Direct Schedules 6 & 7.

¹⁰ See e.g., Ex. 260, Pollock Direct at 40:11-12.

No party in this case disputed Mr. Pollock's contention that NSP industrial rates are uncompetitive.¹¹ NSP CEO David Sparby agreed during cross-examination that the competitiveness of industrial rates is an important concern for NSP.¹² And in its initial brief, the Company acknowledged that XLI and the Minnesota Chamber of Commerce ("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.^[13]

Increasingly uncompetitive industrial rates are of the utmost concern for XLI.¹⁴ However, despite XLI's undisputed demonstration that NSP's industrial rates are uncompetitive, the Recommendations do not substantially consider this issue in the context of several of XLI's proposals. Minnesota law requires that utility rates be just and reasonable. Uncompetitive industrial rates that drive industrial customers out of the market do not meet that standard. Neither NSP's proposal nor the ALJ's Recommendation adequately address the problem of uncompetitive industrial rates and therefore do not meet the applicable legal standard. XLI respectfully requests that the Commission reexamine and order NSP to implement the revenue allocation and rate design strategies proposed by XLI, but not recommended by the ALJ.

C. The ALJ Correctly Concluded that the EPU Portion of Monticello Project is Not Used and Useful

The Report properly concludes that the EPU portion of the Monticello project is not used and useful. The Recommendations contain a sound interpretation of Minnesota law and the "used and useful" standard.¹⁵ XLI agrees with the ALJ's detailed and thoughtful analysis and respectfully requests that the Commission adopt the ALJ's Recommendations on this issue.

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

¹² Evidentiary Hearing Transcript, Vol. 1, 36:2-4.

¹³ NSP Brief at 140.

¹⁴ XLI Brief at 4-5, 16-17.

¹⁵ *Recommendations*, pg. 18-21, ¶¶ 83-92.

D. The Commission Should Amortize the Substantial Nuclear Depreciation Reserve Surplus Over a Five-Year Period

As noted by the ALJ, XLI asserts that the total amount of nuclear depreciation surplus is \$208 million on a Minnesota jurisdictional basis¹⁶ and that it should be amortized over five years.¹⁷ Using a different approach, NSP calculated a surplus of \$72.5 million for the Minnesota jurisdiction.¹⁸ XLI appreciates the ALJ's acknowledgment that both NSP and XLI have demonstrated that a nuclear depreciation reserve surplus exists.¹⁹ The real issue in dispute in this case is the size of the surplus and the appropriate way to use it. However, the ALJ did not fully endorse either NSP or XLI's methodology for calculating the surplus:

615. With regard to the calculation of the amount of the surplus, the Administrative Law Judge agrees with the Company that the vintage accounting method is not appropriate for determining the nuclear plant depreciation expense because the useful life of a nuclear power plant is determined by its license. Contrary to XLI's assertion, it is not reasonable to assume that the licenses for the Prairie Island and Monticello plants will be extended beyond their existing terms. There are no pending extension requests for either Prairie Island or Monticello and, even if there were, NRC approval is not guaranteed.

616. The Administrative Law Judge, however, questions the Company's inclusion of future plant additions in its calculation of the nuclear depreciation reserve surplus. As noted by XLI, depreciation is intended to recover the costs of capital that is already invested, not future investments. Nonetheless, inclusion of the future interim additions is helpful for understanding the likely impacts on ratepayers.

617. Based on this analysis, the Administrative Law Judge concludes that XLI's calculation of the nuclear depreciation surplus likely overestimates the surplus because it is based on vintage accounting. Conversely, the Company has likely underestimated the surplus by including interim plant additions.

618. Because XLI has likely overestimated the nuclear reserve surplus, the Administrative Law Judge recommends the

¹⁶ Ex. 260 at 13-16 (Pollock Direct); Ex. 264 at 1 (Pollock Opening Statement).

¹⁷ Ex. 260 at 11, 18 (Pollock Direct).

¹⁸ NSP Brief at 101; Ex. 263, Pollock Surrebuttal at 11; Ex. 92, Perkett Direct at 50-51.

¹⁹ *Recommendations*, pg. 141, ¶ 614 (citations removed).

Commission reject XLI's proposal to amortize \$208 million in nuclear production depreciation reserve over five years.²⁰

XLI continues to support its calculation of the nuclear depreciation surplus. As Mr. Pollock explained in his direct testimony, a “depreciation surplus occurs when the book (or accumulated depreciation) reserve exceeds the theoretical reserve. The theoretical reserve is the amount of accumulated depreciation that NSP should have booked given the current asset life and net removal cost assumptions employed in NSP’s depreciation study.”²¹ According to the National Association of Regulatory Utility Commissioners:

[T]he purpose of depreciation is not to build a reserve for the future...the sole purpose of depreciation accounting is to rateably allocate the capital costs of the property over its average service life through current charges to utility expenses.^[22]

Or as Mr. Pollock explained in his surrebuttal testimony, “[a] surplus depreciation reserve is not a ‘slush fund’ to absorb future capital additions. Consistent with accepted practice and precedent, the ratemaking treatment of capital additions should be addressed in future rate cases, not in setting current depreciation rates.”²³

The ALJ did not endorse NSP’s calculation of the surplus. Like XLI, the ALJ questioned the inclusion of future plant additions in its calculation of the surplus. XLI continues to contend that consideration of future capital additions is inappropriate because depreciation relates to already-invested capital. As explained in the NARUC manual quoted above, the purpose of depreciation is not to build a reserve for the future. Any adverse impacts on future ratepayers can be addressed if and when they occur with appropriate adjustments at that time.

The ALJ also agreed with NSP’s criticism of XLI’s use of the vintage accounting method because NSP’s nuclear plants have finite lifespans determined by their licenses. However, as XLI has previously argued, licenses have fixed lengths, but the same is not necessarily true of the plants themselves. NSP has previously successfully extended the lives of both the Monticello

²⁰ *Recommendations*, pg. 141, ¶¶ 615-618 (citations removed).

²¹ Ex. 260, Pollock Direct at 12:2-5.

²² National Association of Regulatory Utility Commissioners, *Public Utility Depreciation Practices*, at 1, 187 (Aug. 1996).

²³ Ex. 263, Pollock Surrebuttal at 5:8-11. See also Pollock Surrebuttal Schedule 19 for a partial list of cases in which regulators rejected including capital additions in setting depreciation rates.

and Prairie Island plants²⁴ and future extensions seem plausible given impending federal greenhouse gas regulations.²⁵ Further life extensions likely would have the effect of increasing the present surplus.²⁶ XLI continues to support its calculation of the size of the surplus.

The ALJ did not make a specific recommendation on the amount of the surplus, but concluded that XLI's estimate of the surplus is likely too high and that NSP's calculation is likely too low. Based on this analysis, the ALJ recommended that the Commission reject XLI's specific proposal for amortization, but left the question open as to whether amortization of a smaller amount would be appropriate:

619. Whether the Commission should order amortization of a smaller amount (such as the \$72.5 million surplus calculated by the Company) or take no action will depend on the determination of the size of the revenue deficiencies in 2014 and the 2015 Step and will require consideration of a variety of factors such as rate shock mitigation, rate stability, inter-generational equity, and the need to ensure adequate funding for plant retirements. The Commission may also want to consider the potential rate impacts of adopting one or both of the Company's proposed rate moderation proposals, which are discussed below, in making its determination regarding treatment of the nuclear plant depreciation reserve surplus.²⁷

The ALJ agreed with XLI that “depreciation is intended to recover the costs of capital that is already invested, not future investments,” but recommended that the Commission consider a range of factors in determining whether amortization of the surplus is appropriate, including the size of the revenue deficiencies, rate shock mitigation, and inter-generational equity, and the need to ensure adequate funding for plant retirements. As explained above and argued in XLI's briefs and testimony, NSP's industrial rates are uncompetitive, which is leading to increasingly serious consequences for industrial customers and will ultimately lead to adverse consequences for all NSP ratepayers if industrial customers leave the system. Thus, the anticipated revenue deficiencies in this case and the need for rate shock mitigation both justify amortization of the nuclear depreciation surplus. Further, since the purpose of depreciation is to recover the cost of already invested capital, employing accelerated depreciation of a surplus restores

²⁴ Ex. 263, Pollock Surrebuttal at 18:1-5.

²⁵ Ex. 94, Perkett Rebuttal at 14:15-19.

²⁶ Ex. 263, Pollock Surrebuttal at 18:6-11.

²⁷ *Recommendations*, pg. 141, ¶ 619 (citations removed).

intergenerational equity by ensuring that costs are recovered from customers receiving the benefits.²⁸

For all of these reasons, XLI respectfully requests the Commission reject the findings and conclusions in paragraphs 615-619 of the Recommendations and instead adopt XLI's calculation of the surplus and amortization proposal. A short term amortization would be more effective in restoring generational equity than NSP's proposal and would help mitigate the rate increase for all customers. Note that while XLI's recommendation for using the nuclear depreciation surplus remains the same, XLI is open to discussions about other ways to use the surplus that would be helpful in eliminating the need for a 2016 rate case.

E. The Commission Should Require NSP to Promptly Address the Need for Fuel Clause Rider Reform

As the ALJ acknowledged, XLI, the Department of Commerce - Division of Energy Resources (the "Department"), and MCC all raised serious concerns about NSP's current Fuel Clause Adjustment ("FCA") mechanism.²⁹ However, rather than following XLI and MCC's recommendation that the Commission take action to address these issues in this case, the ALJ encouraged the Commission to address FCA reform in a timely fashion in the context of the AAA proceeding in Commission Docket Number E999/AA-12-757 ("AAA docket"). XLI appreciates the ALJ's acknowledgement of its concerns and the recommendation that FCA reform be addressed promptly. However, since the discussion of reform in the AAA docket has continued to yield little consensus and because there are unique issues to consider for each utility, XLI continues to request that the Commission address the FCA in this case by ordering NSP to propose an incentive-based FCA mechanism in the next case or within 90 days of the Commission's order in this case, whichever is earlier.³⁰ Specifically, XLI requests that the Commission reject the ALJ's recommendation in the second sentence of paragraph 999 in favor of XLI's proposal.

²⁸ Ex. 263, Pollock Surrebuttal, 12:13-14.

²⁹ *Recommendations*, pg. 224, ¶ 999.

³⁰ Ex. 260 at 29 (Pollock Direct).

F. The ALJ's Modified CCOSS is Not Equitable Under the Just and Reasonable Standard

The ALJ recommended rejecting many aspects of NSP's proposed Class Cost of Service Study ("CCOSS") and adopting a CCOSS similar to that recommended by the Department. The impact of this decision is to create a CCOSS that erroneously supports allocation of a greater portion of NSP's proposed rate increase on NSP's industrial customers. To be sure, the impact of the ALJ/Department CCOSS is to classify a majority of fixed production costs as energy-related, which results in energy-intensive high-load-factor customers paying more. And as noted below, the ALJ and Department springboard off of this erroneous CCOSS to argue an even greater share of the rate increase should be borne by industrial customers. While this is consistent with prior Department and Commission decisions, the impact is undisputed. NSP's large industrial rates are the most expensive in Minnesota, among the most expensive integrated electric utilities in surrounding states, and in the top third of the most expensive integrated electric utilities in the continental United States.³¹ The policy of crafting CCOSS that justify greater increases to industrial customers, and then deviating from the CCOSS in the name of non-cost factors to the further detriment of industrial customers, needs to end. As explained in greater detail below, XLI respectfully requests that Commission reject the modifications to the CCOSS recommended by the ALJ and instead adopt the Company's CCOSS with XLI's proposed modifications.

1. The Commission Should Modify NSP's Methodology for Classifying Production Plant-Related Costs

XLI largely supported NSP's proposed CCOSS with some modifications to the methodology for classifying production plant-related costs. Specifically, XLI proposed modifying NSP's application of the Plant Stratification method to use the estimated cost of a new peaker rather than the replacement value of peaker and use depreciated replacement values for other types of plants. The ALJ recommended that XLI's proposal be rejected because comparing the cost of a new peaking plant to the depreciated value of other types of generating plants is

³¹ Pollock Direct at 40:1-6.

inappropriate.³² However, the ALJ failed to explain why the status quo (*i.e.*, using undepreciated investment) is appropriate.

XLI maintains that using current net replacement costs better reflects the real-world impact capacity additions have on rates, which is measured by the costs of a new capacity addition relative to the utility’s existing net production plant.³³ To illustrate how using undepreciated value misallocates production plant-related costs, Mr. Pollock provided the following example in his surrebuttal testimony:

Stratification identifies the plant investment incurred to provide capacity (*i.e.*, which is demand-related) and the investment that is purportedly a substitute for fuel costs (*i.e.*, which is energy-related). For example, assuming the cost of peaking capacity is \$100 per kW, but NSP invests \$500 per kW in a combined cycle gas turbine (CCGT), the \$500 investment is “stratified” 20% ($\$100 \div \500) to demand and 80% ($\$400 \div \500) to energy. However, under the current methodology, this 20%/80% demand/energy split would remain constant for the life of the CCGT. This overstates the “capital substitution” effect.^[34]

The overstated capital substitution effect caused by assuming the constant 20%/80% split is shown in the table below:³⁵

Illustration Showing How Using Undepreciated Investment Overstates the Capital Substitution Effect				
Net Investment	Peaker Investment	Capital Substitution	Stratification	
			Energy	Capacity
(1)	(2)	(3)=(1)-(2)	(4)=(3)÷(1)	(5)=(2)÷(1)
\$500	\$100	\$400	80%	20%
\$400	\$100	\$300	75%	25%
\$300	\$100	\$200	67%	33%
\$200	\$100	\$100	50%	50%
\$100	\$100	\$0	0%	100%

Mr. Pollock explained the problem illustrated by the table as follows:

The example assumes a five-year life of the CCGT (column 1) and no change in the current value of peaking capacity (column 2). The

³² *Recommendations*, pg. 157, ¶ 690.

³³ Ex. 260, Pollock Direct at 36:3-6.

³⁴ Ex. 263, Pollock Surrebuttal at 26:1-10.

³⁵ Ex. 263, Pollock Surrebuttal at 26.

capital substitution effect is quantified in columns 3 and 4. Column 3 is the difference between the net depreciated investment of the CCGT (column 1) and the current value of peaking capacity (column 2). Stratification classifies the capital substitution-related investment to energy (column 4) and the peaker cost to demand (column 5). As can be seen, the capital substitution effect declines as the CCGT is depreciated.^{36]}

Since the capital substitution effect declines as an investment is depreciated, the percentage classified as energy should also decline over the life of the investment.³⁷

For all of these reasons XLI recommends that plant stratification analysis be based on depreciated replacement value, consistent with the values shown on Schedule 21 in Mr. Pollock's surrebuttal testimony. XLI's proposed modifications to the CCOSS are consistent with cost causation principles and yield a more just and reasonable allocation to the C&I Demand class. As a result, XLI respectfully requests that the ALJ's recommendation in paragraph 690 of the Recommendations be rejected in favor of adopting XLI's proposed modifications to NSP's CCOSS.

2. The Commission Should Reject the ALJ's Recommended Modifications to the NSP's CCOSS.

The ALJ both recommended and rejected other significant modifications to NSP's CCOSS. However, the collective result of the Recommendations would be a CCOSS that is a less reasonable and less equitable starting point for designing just and reasonable rates. XLI respectfully requests that the Commission reexamine the CCOSS and reject the proposed modifications to NSP's CCOSS as described below.

i. The ALJ's Recommendation to Use Stratification to Classify NSP's Investments in the Nobles and Grand Meadows Wind Projects Should Be Rejected.

First, the ALJ recommends that the Commission required NSP to modify its CCOSS to classify the costs of the Grand Meadows and Nobles wind farms using the Plant Stratification method.³⁸ However, XLI continues to support NSP's proposal to classify the Grand Meadows and Nobles facilities as 100 percent capacity related.³⁹ Stratification uses the replacement cost of

³⁶ Ex. 263, Pollock Surrebuttal at 26:15-27:5.

³⁷ Ex. 263, Pollock Surrebuttal at 27:6-8.

³⁸ *Recommendations*, pg. 161, ¶ 709.

³⁹ See Ex. 262, Pollock Rebuttal at 7-16 for full analysis and explanation of XLI's position.

peaking capacity to measure the portion of production plant-related costs that should be classified as demand.⁴⁰ As Mr. Pollock explained in his rebuttal testimony, this approach is a simplified attempt to emulate traditional utility resource least-cost planning principles.⁴¹ Stratification assumes that utilities invest in capital-intensive generating resources in order to save energy costs. However, as the ALJ acknowledges, NSP's decision to invest in these wind energy projects was driven by the need to satisfy legislative renewable energy policy.⁴² Since wind production primarily occurs when system energy costs are low, investment in wind does not significantly displace high energy-cost resources.⁴³ Therefore, the assumptions embedded in the stratification method are not applicable to wind projects driven by policy mandates.

The ALJ concluded that the Company has not demonstrated that it is reasonable to classify Grand Meadows and Nobles generation facilities as 100 percent capacity-related.⁴⁴ But Mr. Pollock's testimony demonstrated how stratification not only fails to reflect the decision drivers for the Nobles and Grand Meadows investments, it ignores cost causation. Schedule 16 to Mr. Pollock's rebuttal testimony shows that wind production primarily occurs during off-peak periods.⁴⁵ And further, the variable costs of wind are not necessarily energy-related. 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.⁴⁶

In summary, XLI respectfully requests that the Commission reject the ALJ's recommendations in paragraphs 706-709 and instead approve NSP's proposal to classify Grand Meadows and Nobles costs as 100% capacity-related.

ii. The Commission Should Accept the ALJ's Recommendation to Reject the OAG's Proposed Change to the D10S Allocator.

The Minnesota Office of the Attorney General – Antitrust and Utilities Division (“OAG”) proposed 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

⁴⁰ Ex. 262, Pollock Rebuttal, 7:19-20.

⁴¹ Ex. 262, Pollock Rebuttal, 8:1-3.

⁴² *Recommendations*, pg. 160, ¶ 706.

⁴³ Ex. 262, Pollock Rebuttal, 10:9-16.

⁴⁴ *Recommendations*, pg. 160, ¶ 706.

⁴⁵ Ex. 262, Pollock Rebuttal, 10-11 & Schedule 16. See also Evidentiary Transcript, Vol. 3, 48:3-49:1.

⁴⁶ Ex. 262, Pollock Rebuttal, 12.

class demands that occur coincident with NSP's annual system peak.⁴⁷ The OAG, in contrast, argued that the coincident peak method should reflect the demands of each customer class that occur coincident with the hour of the MISO system peak.⁴⁸ As Mr. Pollock explained in his rebuttal testimony, "NSP's annual system peak is still a key factor in determining the amount of generation capacity required to maintain reliable service."⁴⁹ 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, which should be indisputable evidence that MISO's reserve margin formula isn't driving resource decisions (*i.e.*, not causing costs to be incurred).⁵⁰

XLI objected to this revision because the OAG did not demonstrate 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.⁵¹ Similarly, the ALJ concluded that the OAG's proposal should be rejected because the data necessary to perform the required calculation is not available.⁵² XLI supports the ALJ's recommendation on this issue.

iii. The Commission Should Accept NSP's Proposal to Use the "Predominant Nature" Method to Allocate Non-Fuel Production O&M Expenses, and Reject the ALJ's Recommendation 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 ALJ, however, recommended that the Commission require NSP to modify its CCOSS to use the location method,⁵³ reasoning:

734. The propriety of the Overall Investment method for classifying Other Production O&M Costs has been confirmed in past Company testimony and in past Commission orders. In the last rate case, the Commission required a further refinement of the

⁴⁷ Ex. 262, Pollock Rebuttal, 23:21-23.

⁴⁸ Ex. 262, Pollock Rebuttal, 24:1-2; Ex. 375, Nelson Direct at 11-12; OAG Brief at 63-65.

⁴⁹ Ex. 262, Pollock Rebuttal, 24:11-12.

⁵⁰ 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)).

⁵¹ Ex. 262, Pollock Rebuttal, 26:12-14.

⁵² *Recommendations*, pg. 162, ¶ 717.

⁵³ *Recommendations*, pg. 166, ¶ 736.

method through the application of the energy allocator to costs that vary directly with the amount of energy produced and allocation of the remainder of costs on the basis of Plant Production. As noted above, this approach is known as the Location method. In contrast, the Company's application of the Predominant Nature method goes beyond the refinement ordered by the Commission in the last rate case by assigning all remaining costs based on their "predominant nature."

735. The Company has not shown that its grouping and analysis of these Other Production O&M Costs based on their predominant nature moves the marker closer to cost causation. The Predominant Nature method displays the same oversimplified fixed/variable analysis that the Commission has previously found lacking. The Location method, required by the Commission in the 12-96 ORDER, is the most reasonable method of classifying Other Production O&M Costs in the record.

736. For these reasons, the Administrative Law Judge recommends that the Commission require the Company to modify its 2014 and 2015 CCOSSs to use the Location method rather than the Predominant Nature method.⁵⁴

The predominant nature method classifies other production O&M expenses based on 15 cost categories.⁵⁵ Contrary to the ALJ's conclusions in paragraph 735, the predominant nature method 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 by the ALJ.⁵⁶ Under the location method, other production O&M expenses are classified in the same proportion as gross production plant and unamortized nuclear fuel investments.⁵⁷

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

⁵⁴ *Recommendations*, pg. 166, ¶¶ 734-736 (citations removed).

⁵⁵ Ex. 262, Pollock Rebuttal, 16:13-14.

⁵⁶ Ex. 262, Pollock Rebuttal, 21:11-13, 20:4-29.

⁵⁷ 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.***^[58]

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

Moreover, in contrast to the ALJ’s conclusion that NSP’s proposed methodology goes beyond the refinement ordered by the Commission in the last rate case, 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.^[59]

NSP’s proposed methodology complies with the Commission’s direction.⁶⁰ In its direct testimony, NSP evaluated Other Production O&M under the location method and the predominant nature method.⁶¹ 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.⁶² Having identified Other Production O&M costs that vary with energy, NSP classified these costs as energy-related.⁶³

⁵⁸ Ex. 262, Pollock Rebuttal at 20 (emphasis added) (quoting NARUC, *Electric Utility Cost Allocation Manual*, at 66 (Jan. 1992)).

⁵⁹ GR-12-961 Findings of Fact, Conclusions, and Order at 53.

⁶⁰ NSP Brief at 126-127.

⁶¹ Ex. 102, Peppin Direct at 22:17-20.

⁶² Ex. 102, Peppin Direct at 19, 22 & Schedule 7.

⁶³ Ex. 102, Peppin Direct at 23.

Similarly, costs that were fixed were classified as capacity-related. NSP did not perform this type of in-depth analysis of the nature of these costs in previous rate cases and its efforts to do so in this case should not be ignored. Based on the results, NSP determined that using the predominant nature method was more consistent with the Commission's order in the prior case.⁶⁴

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:⁶⁵

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 initial brief, the OAG and the Department did 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.⁶⁶ The ALJ similarly does not acknowledge the results of this new analysis.

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 nature method.⁶⁷ 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

⁶⁴ Ex. 102 Peppin Direct, 25:1-10.

⁶⁵ Ex. 102, Peppin Direct at 25.

⁶⁶ NSP Brief at 128.

⁶⁷ Ex. 262, Pollock Rebuttal, 20:26-29.

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.^[68]

In contrast to the ALJ's conclusion in paragraph 735, the record in this case robustly supports that NSP's use of the predominant nature method "moves the marker closer to cost causation."

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."⁶⁹ 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.⁷⁰ For all of these reasons, XLI urges the Commission to reject the ALJ's recommendations in paragraphs 734-736 and instead order use of the predominant nature method.

iv. The ALJ's Recommendation with Respect to Allocation of Economic Development Program Costs Should Be Accepted by the Commission

As NSP has explained, the Company's economic development programs are designed to attract and retain large customers.⁷¹ XLI supported 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. XLI appreciates the ALJ's conclusion that the Company's proposal is the most reasonable option presented in this case and respectfully requests the Commission adopt the ALJ's recommendation.⁷²

⁶⁸ Ex. 262, Pollock Rebuttal, 21:2-8.

⁶⁹ Ex. 262, Pollock Rebuttal, 18:7-10 (quoting Ex. 102, Peppin Direct at 25).

⁷⁰ Ex. 262, Pollock Rebuttal, 18:14-19.

⁷¹ 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. Department 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.

⁷² *Recommendations*, pg. 170, ¶ 753.

v. The ALJ's Recommendation with Respect to Interruptible Rate Discounts Incorrectly Interprets XLI's Written Testimony

In paragraphs 754 through 757, the ALJ provides an overview of interruptible rates and rejects an argument that XLI did not make in the present proceeding.⁷³ To be sure, Mr. Pollock's direct testimony proposed to adjust the CCOSS results to reflect load management credits.⁷⁴ And to clarify this argument, Mr. Pollock testified as follows in his surrebuttal testimony:

Q. DID YOU CHANGE HOW LOAD MANAGEMENT COSTS WERE ALLOCATED IN NSP'S CLASS-COST-OF-SERVICE STUDY?

A. No. The CCOSS results presented in Schedule 9 and the resulting class revenue allocation presented in Schedule 10 of my direct testimony were based on NSP's CCOSS with one change. Specifically, I restated the results inclusive of NSP's allocation of load management costs so that the study reflected the full cost of providing service. This adjustment is described on pages 45-46 of my direct testimony.⁷⁵

XLI therefore respectfully requests that that the Commission reject the statements and findings in paragraphs 754 through 757 of the Recommendations, and urges the Commission to replace this portion of the Recommendations with direction to Xcel to modify how the CCOSS results are stated by recognizing the impact of load management costs, consistent with XLI's testimony.

G. The Commission Should Exercise its Discretion to Set Rates at Cost

After providing a detailed overview of the parties' positions, the ALJ recommended:

775. Because the Administrative Law Judge has recommended that the Commission adopt what is largely the Department's proposed CCOSS methodology, the Administrative Law Judge concludes that the Department's proposed revenue apportionments for 2014 and 2015 should be adopted but modified for the Lighting Class in 2015. The Department's proposed revenue apportionments are reasonable because they are closely aligned with the costs determined by the Department's CCOSS and also avoid rate shock. As such, they properly balance the rate design principles of promoting efficient use of resources and ensuring that rate changes are gradual.⁷⁶

⁷³ *Recommendations*, pg. 17-71, ¶¶ 754-757.

⁷⁴ Ex. 260, Pollock Direct at 46:5-17.

⁷⁵ Ex. 263, Pollock Surrebuttal at 25:7-14.

⁷⁶ *Recommendations*, pg. 175-176, ¶ 775.

Despite agreeing in principle that rates should reflect costs,⁷⁷ XLI has argued that the Department's proposed 2015 revenue allocation would spread the 2015 increase equally to all customers, which does not move rates closer to cost for all customers.⁷⁸ Again, no witness disputed Mr. Pollock's testimony regarding the increasing uncompetitive rates of NSP's C&I Demand class.⁷⁹ Any revenue allocation that moves C&I Demand rates further from costs will exacerbate the problem. Rates should reflect the actual costs of providing service as closely as possible because, 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.*"⁸⁰

Since electricity costs can be a significant component of the cost of production, industrial customers, including XLI members, must be careful of energy use per unit of production in order to remain competitive.⁸¹ For XLI, global competition limits how much increased costs can be passed through in prices.⁸² Therefore, increasing already uncompetitive rates⁸³ has serious consequences for industrial customers and their ability to remain competitive in Minnesota, nationally, and internationally. Uncompetitive industrial rates also have far reaching consequences for other NSP customers. As shown by Mr. Pollock's analysis of NSP's rates,⁸⁴ uncompetitive industrial rates lead to declines in sales and overall slow load growth. These consequences ultimately have the effect of pushing up rates for all customers.

Moving C&I Demand rates to cost has a range of benefits for industrial customers and other NSP ratepayers. In addition to mitigating effect of uncompetitive rates on sales, moving industrial rates to cost is equitable while also promoting engineering efficiency, stability, and conservation.⁸⁵ Rates that reflect cost-of-service principles are equitable because each customer

⁷⁷ Ex. 420, Peirce Direct at 9.

⁷⁸ Ex. 261, Pollock Rebuttal at 24:11-15.

⁷⁹ Ex. 263, Pollock Surrebuttal at 31:11-13.

⁸⁰ Ex. 263, Pollock Surrebuttal at 31:7-10 (emphasis added).

⁸¹ Ex. 260, Pollock Direct at 38:10-14.

⁸² Ex. 260, Pollock Direct at 38:10-14.

⁸³ Ex. 260, Pollock Direct at 39:9-10.

⁸⁴ Ex. 260, Pollock Direct at 40.

⁸⁵ Ex. 260, Pollock Direct at 41:15-18.

pays what it actually costs the utility to provide service to that customer.⁸⁶ Cost-based rates also promote engineering efficiency because well-structured energy and demand charges will provide customers with proper incentives to minimize their costs, which in turn minimize utility costs.⁸⁷ Cost-based rates promote stability by aligning customer use patterns with changes in revenue and expenses.⁸⁸ Finally, cost-based rates encourage conservation by sending accurate price signals to help customers avoid wasteful or inefficient use.⁸⁹

XLI has serious concerns about the ALJ's recommendation to adopt the Department's proposals for revenue apportionment. As it does in every case, the Department 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) 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.⁹⁰ In her direct testimony, Department 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.^[91]

It is not, however, clear how the Department's proposed revenue allocation applies (or complies with) these principles. As is shown in tables 3 and 4 on Exhibit 147, the Department'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, the Department's revenue allocation

⁸⁶ Ex. 260, Pollock Direct at 41:19-42:1.

⁸⁷ Ex. 260, Pollock Direct at 42:3-7.

⁸⁸ Ex. 260, Pollock Direct at 42:8-11.

⁸⁹ Ex. 260, Pollock Direct at 42:12-16.

⁹⁰ Ex. 420, Peirce Direct at 2-3; Department Brief at 280-281.

⁹¹ Ex. 420, Peirce Direct, 10:16-23.

proposal amounts to an across-the-board increase.⁹² While the Department's guiding principles include the goals of moving rates closer to cost and minimizing inter-class subsidies, the Department's proposed revenue allocation would not move C&I Demand rates closer to cost in 2015.⁹³ The Department 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."⁹⁴

The Department has not provided any evidence or support that its proposed 2015 revenue allocation is needed to avoid rate shock for any class.⁹⁵ As Mr. Pollock demonstrated in his rebuttal testimony, "there would be almost no relative difference in the percent revenue increases that 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."⁹⁶ But even though there is no evidence that rate shock is a factor, the practical effect of the Department's proposal is to shift revenue responsibility from the Residential to the C&I Demand class.⁹⁷

The impact of the Department'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.⁹⁸ The Department'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.⁹⁹ 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

⁹² Ex. 147, Table of Peirce Recommendations; Evidentiary Hearing Transcript, Vol. 4, 181:1-25; *see also* Ex. 420, Peirce Direct at 9.

⁹³ Ex. 262, Pollock Rebuttal, 24:11-25:1.

⁹⁴ Ex. 420, Peirce Direct at 10.

⁹⁵ Ex. 262, Pollock Rebuttal, 26:14-22.

⁹⁶ Ex. 262, Pollock Rebuttal, 26:18-22.

⁹⁷ Ex. 262, Pollock Rebuttal, 27:3-8.

⁹⁸ Ex. 262, Pollock Rebuttal, 27:3-7.

⁹⁹ *See, e.g.*, Evidentiary Hearing Transcript, Vol. 1, 35:11-16.

benefits of equity, engineering efficiency, rate stability, and conservation.¹⁰⁰ XLI respectfully requests that the Commission adopt its revenue allocation proposal based on a revised CCOSS.

H. The Commission Should Address NSP's Uncompetitive Industrial Rates by Recommending Certain Rate Design Changes

In addition to moving rates closer to cost, XLI proposed several rate design strategies to address NSP's increasingly uncompetitive C&I rates, including (1) setting the short notice demand charge at a fair level, (2) refining the definition of on-peak, and (3) establishing a Renew-A-Source program. Utility rates must be just and reasonable, and it is NSP's burden to prove that that its proposed rates meet that standard. Because the increasingly uncompetitive industrial rates proposed by NSP are not just and reasonable, the Commission should not approve them without also approving the mitigative rate design strategies proposed by XLI.

1. The Commission should Modify NSP's Proposed Rate Design for Short Notice Demand Customers to Better Reflect the Benefits these Customers Provide

Short notice service is one of several service options that allow NSP to curtail interruptible load when there are insufficient resources to meet customer demand.¹⁰¹ Interruptible loads provide a range of benefits to NSP, including, as the ALJ notes, flexible load management, a lower planning reserve margin, and better control over capacity costs.¹⁰² In exchange for lower rates, interruptible customers receive a lower quality of service compared to firm customers.¹⁰³ While NSP proposed to increase of value of short notice interruptible credits, the increase does not keep pace with the proposed increase in demand charges.¹⁰⁴ The net effect of NSP's proposal is to reduce the benefits to interruptible customers. Further, XLI argued that Short Notice interruptible service customers provide the greatest benefits to the NSP system and therefore should be compensated fairly for that contribution.¹⁰⁵

¹⁰⁰ See Ex. 260, Pollock Direct, 40:7-12.

¹⁰¹ Ex. 260, Pollock Direct at 48:8-10.

¹⁰² *Recommendations*, pg. 185-186, ¶ 817; Ex. 260 at 51 (Pollock Direct).

¹⁰³ Ex. 260, Pollock Direct at 49:3-12.

¹⁰⁴ Ex. 260, Pollock Direct at 52-53.

¹⁰⁵ Ex. 260, Pollock Direct at 49; XLI Initial Br. at 18.

The ALJ noted that all parties agreed that some increased in interrupted service discounts is needed, but then recommended the Department's proposal, which would provide for the lowest increase suggested by any party:

828. All parties agree that some increase in interruptible service discounts is necessary. Based on the evidence in the record, the Administrative Law Judge concludes that the Department's proposal to increase the Level C Performance Factor interruptible service discounts by three percent, and institute corresponding increases for the other performance factors to maintain the current relationship between tiers is the most reasonable. The other parties have failed to demonstrate that a larger increase is necessary to maintain an optimal supply of interruptible load.¹⁰⁶

The standard applied by the ALJ—the level necessary to maintain an optimal supply of interruptible load—is not appropriate or, at least, is insufficient. Rates must be just and reasonable and the Department's proposal would not provide for fair compensation for the capacity value that interruptible customers provide. In his direct testimony, Mr. Pollock demonstrated that NSP's proposal would provide inadequate compensation.¹⁰⁷ NSP estimated a new CT would cost approximately \$696/kW.¹⁰⁸ The corresponding revenue requirement for this value is \$12.16 per kW month.¹⁰⁹ Thus, the average credit of \$5.85 proposed by NSP is less than half of the cost NSP would incur to provide comparable short-notice generation capacity.¹¹⁰ Although NSP offered testimony asserting that interruptible load is not directly comparable to a peaking plant,¹¹¹ NSP failed to specifically provide any evidence to support that testimony or generally support a short-notice credit that reflects less than 50% of the actual value of a CT resource. And, as noted above, the ALJ's recommended proposal would fall even further short of providing just and reasonable compensation to interruptible customers.

XLI respectfully requests that the Commission reject the ALJ's recommendation in paragraph 828 of the Recommendations and instead adopt XLI's proposal, as described in paragraph 826 of the Recommendations.

¹⁰⁶ *Recommendations*, pg. 188-189, ¶ 828.

¹⁰⁷ Ex. 260, Pollock Direct at 53-55.

¹⁰⁸ Ex. 260, Pollock Direct at 53, and Ex. 102, Peppin Direct at Schedule 10.

¹⁰⁹ Ex. 260, Pollock Direct at 53:9-10. Although NSP Witness Huso was unable to verify this math during cross-examination, XLI notes that the figure is set forth in a calculation on line 5 of Schedule 10 to NSP Witness Peppin's direct testimony.

¹¹⁰ Ex. 260, Pollock Direct at 53:10-12.

¹¹¹ Ex. 107, Huso Rebuttal at 36:14-15.

2. The ALJ Should Recommend Modifying the Definition of On-Peak to Provide Better Price Signals for Time of Use Customers

XLI proposed that NSP modify its tariff to limit the definition of “on peak period” to only summer months.¹¹² Even though NSP is a predominantly summer-peaking utility, NSP’s current definition of peak periods includes non-summer months that are less critical for determining resource adequacy under MISO rules.¹¹³ It would be more consistent with the predominant summer peak and the summer coincident peak demand allocator in NSP’s CCOSS to limit the on-peak period to summer months.¹¹⁴

In spite of these arguments, the ALJ concluded that XLI has not shown that a change in definition of “on peak period” would result in more reasonable rates.¹¹⁵ However, it is NSP’s burden to show that its proposals are just and reasonable. NSP argued to maintain the status quo for the definition of “on peak period,” but provided thin justification at best for that position. The Company offered explanations for the current definition without justifying why XLI’s proposal would not accomplish the goal set forth by XLI—to allow customers a better opportunity to respond to price signals. In fact, during the hearings, NSP witness Steven Huso agreed that a narrower peak period would provide customers with a greater opportunity to respond and shift load.¹¹⁶ Under the current peak-period definition (12-hour period on all week days throughout the year), it is difficult for 24-hour customers to respond with any meaningful and sustained changes to their usage patterns.¹¹⁷ Neither NSP nor any other party specifically responded to this point.

Further, establishing a summer-only on-peak period is consistent with NSP’s current tariffs, which state that:

Definition of on peak and off peak period is subject to change with change in Company's system operating characteristics.¹¹⁸

As Mr. Pollock testifies:

¹¹² Ex. 260, Pollock Direct at 57.

¹¹³ Ex. 260, Pollock Direct at 58:3-8.

¹¹⁴ Ex. 260, Pollock Direct at 58:10-12 & Schedule 14.

¹¹⁵ *Recommendations*, pg. 217, ¶ 967.

¹¹⁶ Evidentiary Hearing Transcript, Vol. 2, 175:13-15.

¹¹⁷ Ex. 263, Pollock Surrebuttal at 41:1-15.

¹¹⁸ Ex. 260, Pollock Direct at 56.

Q HAVE THERE BEEN ANY CHANGES THAT WARRANT REVISING THE DEFINITION OF THE PEAK PERIODS?

A Yes. First, on May 9, 2002, the Commission granted NSP's request to turn over functional control of certain transmission facilities and join the RTO now known as MISO. Recently, MISO changed its resource adequacy requirements. It now requires that each load serving entity maintain sufficient capacity to meet the projected annual coincident peak load and provide a sufficient reserve margin. In other words, if NSP did not have sufficient generation capacity to meet its projected summer peak and provide an adequate reserve margin, it would have to incur additional costs to acquire the necessary capacity.

Second, NSP revised its demand allocation methodology based on a recommendation made by the Department in NSP's last rate case. Specifically, NSP allocated the capacity-related portion of generating plant using the summer coincident peak. Previously, NSP had used the average of the summer and non-winter coincident peaks. NSP explained this change in its rebuttal testimony as follows:

After considering the recommendations of the Department, MCC, and XLI on this issue, I conclude that a summer-only allocator (*i.e.*, labeled the "D10S" in the Company's CCOSS) is appropriate, given how the Company plans its resources, MISO's new resource adequacy rules, and the fact that the capacity allocator only applies to the "capacity" portion of production plant investment.

This change recognizes that NSP is a predominantly summer-peaking utility. Electricity demands in the other months are not relevant in determining the amount of capacity needed for NSP to provide reliable service.¹¹⁹

¹¹⁹ Ex. 260, Pollock Direct at 56-57.

XLI believes that it provided a strong basis for modifying the definition of on-peak and that the need to provide for just and reasonable industrial rates justifies a change from the status quo. Thus, XLI respectfully requests that the Commission reject the ALJ’s recommendation in paragraph 967 of the Recommendations and instead adopt XLI’s proposal to modify the definition of “on peak period.”

3. The ALJ Appropriately Recommended that NSP Promptly Address XLI’s Renew-A-Source Tariff Proposal

XLI has proposed establishing a “Renew-A-Source” program that would pair large high-load factor customers with renewable energy resources available primarily during off-peak hours.¹²⁰ XLI appreciates the ALJ’s conclusion that the concept is worthy of further review and recommendation that NSP be required to present a proposal for such a tariff as part of its next rate case.¹²¹

III. CONCLUSION

XLI appreciates the ALJ’s efforts in preparing the detailed Recommendations. XLI believes the Commission needs to make certain modifications to reflect the evidence in the record and comply with the statutory directive of setting just and reasonable rates. As explained in detail above, the Commission should:

- Amortize the \$208 million depreciation reserve surplus over five years, resulting in a \$25.7 million reduction to NSP’s proposed 2014-2015 revenue requirement, or consider alternative ways to use the surplus to avoid a 2016 rate case;
- Order NSP to revise its NSP should be ordered to file an incentive-based FCA 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;

¹²⁰ Ex. 260, Pollock Direct at 60-61.

¹²¹ *Recommendations*, pg. 216, ¶ 963.

- Accept NSP’s proposed CCOSS with XLI’s modifications because it yields more equitable results founded on cost-causation principles under the just and reasonable standard;
- Exercise its discretion to set rates based on cost of service;
- Follow the ALJ’s recommendation to order NSP to propose a program similar to XLI’s offered “Renew-A-Source” program; and
- Order NSP to implement XLI’s other rate design proposals in order to mitigate the impacts of NSP’s increasingly uncompetitive industrial rates and ensure that rates are just and reasonable.

Date: January 20, 2015

Respectfully submitted,

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