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 No. E-111/GR-14-482
OAH Docket No. 80-2500-31796

In the Matter of the Application of Dakota Electric Association for Authority to Increase Rates for Electric Service in Minnesota

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REPLY BRIEF OF THE OFFICE OF THE ATTORNEY GENERAL-RESIDENTIAL UTILITIES AND ANTITRUST DIVISION

January 30, 2015

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

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REPLY BRIEF OF THE OFFICE OF THE ATTORNEY GENERAL

INTRODUCTION

The Office of the Attorney General – Residential Utilities and Antitrust Division ("OAG") submits this Reply Brief. The OAG will not address every issue raised in testimony or the initial briefs of other parties in this reply; rather, the OAG will respond to those issues raised by other parties that require a response. The fact that the OAG does not respond to a particular argument in this Reply does not indicate concurrence or waiver by the OAG of a position taken in testimony or briefing.

I. THE OAG'S MINIMUM SYSTEM IS SHOULD BE ADOPTED.

A. DEA'S MINIMUM SYSTEM DOES NOT ACCURATELY CALCULATE THE CUSTOMER COST PORTION OF ITS DISTRIBUTION SYSTEM.

The OAG's Initial Brief explained why Dakota Electric Association's ("DEA") minimum system analysis does not accurately distinguish between the customer costs and capacity costs of the company's distribution system. Specifically, the OAG explained that the method used by DEA to construct its minimum system—the minimum-size method—produces excessive customer costs compared to the more precise zero-intercept method.[1] This fact has been recognized by the NARUC Manual, which states that the zero-intercept method "is more accurate" in most instances, and that the minimum-size method "generally produces a larger

[1] *See* OAG's Initial Brief at 14-20.

customer component" than the zero-intercept method.[2] In addition, the Commission has recognized that using the minimum-size method "results in some capacity costs being classified as customer costs."[3] The OAG also noted that, unlike other utilities that have used the minimum-size method, DEA failed to make an adjustment to account for this over-classification of demand costs.[4] For these reasons, DEA's minimum system is inaccurate because it over-classifies the customer costs associated with the company's distribution system.

While DEA and the Department of Commerce ("Department") each attempt to defend the company's minimum system analysis, neither party appears to argue that DEA's methodology is the most precise way to calculate the customer costs and capacity costs of the company's distribution system. For its part, DEA defends its analysis by arguing that (1) parties cannot critique its decision to use the minimum-size method, and (2) that the minimum-size and zero-intercept methods produce "similar" results.[5] First, DEA points to the Commission's Order in its previous rate case that directed the company to either justify the analysis supporting its zero-intercept method or to perform a minimum-size analysis for its initial filing.[6] DEA suggests that, in making this order, the Commission divested to DEA the authority to determine the appropriate methodology to use in the final, approved CCOSS.[7] As the OAG noted in its Initial Brief, the Commission's Order did not prejudge the outcome of this case, nor did it grant any particular

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[2] NARUC Electric Manual at 91-92.

[3] Findings of Fact, Conclusions, and Order, *In the Matter of a Petition by Minnesota Energy Resources Corporation for Authority to Increase Natural Gas Rates in Minnesota*, Docket No. G-011/GR-13-617, at 44, 46-47 (Oct. 28, 2014).

[4] OAG's Initial Brief at 18-19.

[5] DEA's Initial Brief at 7-10.

[6] *Id.* at 7; Findings of Fact, Conclusions of Law, and Order, *In the Matter of the Application of Dakota Electric Association for Authority to Increase Rates for Electric Service in Minnesota*, Docket No. GR-09-175, at 23 (May 24, 2010).

[7] DEA's Initial Brief at 9 ("The OAG is attempting to usurp *a business decision* that DEA was ordered to make in the 2009 rate case . . .") (emphasis added).

party the authority to decide on an appropriate methodology.[8] As in any rate case, the OAG certainly has the ability to submit testimony and argument as to the reliability and quality of DEA's analysis. Since the company's minimum system analysis relies on an inaccurate methodology that DEA did not attempt to adjust for, it is not an appropriate basis to inform revenue apportionment or rate design. Statements in the Commission's 2010 Order cannot insulate DEA from its failure to conduct a reliable analysis.

Second, DEA argues that its minimum-size analysis is reasonable because the weighted average of the customer costs of its distribution accounts is similar to the weighted average of customer costs produced by the zero-intercept method that it used in its last rate case.[9] Notably, DEA admitted that it used the minimum-size method in this case because "it could not support the zero-intercept method" it used previously.[10] It is not appropriate for DEA to argue that its minimum-size analysis is reasonable by comparing it to the results of a different analysis that the company admits that it cannot support. Moreover, the OAG's Initial Brief explained why, as a technical matter, it is not appropriate to compare the weighted averages of the customer costs from DEA's distribution accounts under the minimum-size and zero-intercept methods, since the customer costs for each account are applied to different allocators.[11] When the results of each method are compared on an account-by-account basis, their results differ dramatically.[12] Accordingly, DEA's comparison does nothing to demonstrate that its minimum-size analysis is accurate.

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[8] OAG's Initial Brief at 18, n. 77.
[9] DEA's Initial Brief at 8-9.
[10] *Id.* at 9.
[11] OAG's Initial Brief at 19.
[12] *Id.*

The Department's support of DEA's minimum-size method is based on a more fundamental misunderstanding of the minimum system analysis; the Department claims that the minimum system should include some costs of providing load to customers. Specifically, the Department states that the "overall goal" of the minimum system analysis "is to allocate distribution costs between the costs of *delivering power* to customers (customer costs) and the costs of ensuring that the distribution system is large enough to provide reliable service during people [sic] periods (capacity costs)."[13] The Department further claims that DEA's minimum system analysis was proper because the Department "confirmed" that DEA used "the smallest size equipment in service that would be necessary *to serve customer load*."[14] And, the Department suggested that the OAG's analysis was flawed because it does not "include the equipment costs even of the smallest pole that would need to be installed, let alone other equipment needed to *deliver power* to DEA's customers."[15]

There are significant problems with the Department's argument. The Department is fundamentally wrong in its assertion that distribution costs incurred to serve load should be classified as customer costs in the company's minimum system. In fact, this claim conflicts with the most basic concepts of the minimum system analysis. The NARUC Manual explicitly states that those costs of the distribution system associated with providing load are classified as demand costs:

> Classifying distribution plant as a demand cost assigns investment of that plant to a customer or group of customers based upon its contribution to some total peak load. The reason is that *the costs are incurred to serve area load*, rather than a specific number of customers.[16]

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[13] Department's Initial Brief at 39 (emphasis added).
[14] *Id.* at 38 (emphasis added).
[15] *Id.* at 41 (emphasis added).
[16] NARUC Electric Manual at 90 (emphasis added).

Based on this principle, the costs of distribution substations (FERC accounts 360-362) are normally classified as demand-related "because substations are normally built to serve a particular load and their size is not affected by the number of customers to be served."[17] But based on the Department's reasoning, some portion of these costs should be classified as customer costs since these facilities are needed to deliver power during non-peak times. The Department's reasoning ignores the fundamental premise that customer costs are, as the Department itself explains, "a function of the number of customers on the system *regardless of the customers' energy consumption*."[18] For this reason, when describing the minimum-size method, the NARUC Manual warns that "the analyst must be aware that the minimum-size distribution equipment has a certain load-carrying capability, which can be viewed as a demand-related cost."[19] The Department fails to recognize this concept. Accordingly, the Department's support of DEA's minimum-size method is based on a false assumption that the minimum system should include some load-carrying capability.

B. THE OAG'S PROXY PRODUCES RELIABLE AND ACCURATE RESULTS.

In addition to explaining why DEA's minimum system over-classifies the customer cost portion of its distribution system, the OAG's initial brief also explained why its zero-intercept proxy provides an appropriate basis for classifying DEA's distribution costs in this case.[20] Specifically, the OAG explained that its zero-intercept proxy incorporates the theory outlined in the NARUC Manual.[21] The OAG further demonstrated that, mathematically, the zero-intercept proxy produces results that are equivalent to a zero-intercept analysis, but uses known

[17] *Id.*
[18] Department's Initial Brief at 33 (emphasis added); *See also* NARUC Electric Manual at 90.
[19] NARUC Electric Manual at 95.
[20] OAG's Initial Brief at 21.
[21] *Id.*

information rather than regression analysis that relies on disputed data and methodology.[22] For these reasons, the OAG's minimum system more accurately reflects the customer costs associated with the company's distribution system and the OAG's CCOSS provides the most reasonable basis to inform the company's revenue apportionment.

Neither DEA nor the Department disputed the technical aspects of the OAG's analysis—including the OAG's analysis demonstrating that its zero-intercept proxy is mathematically equivalent to a zero-intercept analysis. Rather, both DEA and the Department argued that the OAG's model should be rejected because it is not one of the two models suggested in the NARUC Manual and because the OAG's methodology removes material costs from the minimum system. The OAG does not dispute either of these claims. But for the reasons stated in the OAG's Initial Brief, neither claim is a basis to reject the OAG's CCOSS, which provides the most accurate assessment of the customer and demand costs of DEA's distribution system with the information available.

Moreover, the Department's brief actually serves to support the OAG's position because it demonstrates how the OAG's proxy produces results equivalent to a zero-intercept method. The Department explains that, under the zero-intercept method, an equation is created to represent the linear relationship between equipment size and cost: $y = \alpha + \beta x$ where y represents the per-unit cost of equipment, x represents the size or capacity of the equipment, and a and b represent the intercept and slope of the line, respectively.[23] As the Department then explains:

> Using the system equipment and cost data, the theoretical minimum size (x) *can be set to zero*, and the intercept (a) will represent the cost of the equipment that is

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[22] *Id.*
[23] Department's Initial Brief at 36.

> invariant to the size of equipment installed. The *cost of equipment at zero size* is considered the customer component, and the remainder of the cost is classified as demand-related.[24]

The OAG's proxy, which removes the cost of materials, is equivalent to placing the cost of equipment size at zero in the equation above. In other words, when the equipment size is zero, as the Department specifies, there is no equipment. This is also true in the OAG's zero-intercept proxy. The OAG's method follows the theory for the zero-intercept method, but the Department claims, without any support or explanation, that "[t]he [OAG's] method classifies customer costs at a level below a hypothetical no-load or zero-intercept situation."[25] The Department's claim is baseless and should be disregarded. The OAG's method provides accurate and reliable results based on sound theory.

The OAG has demonstrated both that DEA's minimum system overstates the customer cost portion of its distribution system, and that the OAG's methodology produces more precise results. The OAG's position is supported by the NARUC Manual, Commission precedent, and mathematical proof. For these reasons, the ALJ should recommend that the Commission adopt the OAG's minimum system and proposed CCOSS.

II. DEA'S CUSTOMER CHARGE SHOULD NOT INCREASE.

As the OAG explained in its Initial Brief, setting an appropriate customer charge implicates several important policy objectives. These policy objectives include: (1) maintaining a financially viable utility; (2) promoting fairness among different customers; (3) encouraging conservation; and (4) minimizing harmful impacts on low-income customers. The arguments from both DEA and the Department to increase the customer charge from eight dollars to nine dollars fail to appropriately balance these policy objectives. Instead, these parties' arguments

[24] *Id.* at 36-37 (emphasis added).
[25] *Id.* at 41.

appear to be focused on setting the customer charge at the level that would recover the customer costs produced by the CCOSS, regardless of other policy objectives, but to do so through limited adjustments.[26] To the extent that these parties discuss the other policy objectives, their arguments amount to explaining why they believe these objectives should *not* cause the Commission to consider factors other than the customer costs produced by the CCOSS. These arguments should be rejected.

First, both DEA and the Department argue that increasing the customer charge promotes fairness by reducing the purported intra-class subsidies paid by high-use customers to low-use customers.[27] The OAG's initial brief explained why this concern is overstated since numerous other intra-class subsidies exist that apparently do not concern these parties, and because the "customer costs" produced by the CCOSS is itself an average of the costs to serve each of DEA's customers.[28] Neither party has demonstrated why this one claimed subsidy, based on the average cost of serving customers should override the numerous other policy objectives implicated by the customer charge.

As the OAG also indicated in its Initial Brief, the parties disagree on the level of the claimed intra-class subsidies they seek to eliminate because they disagree on the specific costs that should be recovered through the customer charge. DEA argues that the customer charge should recover the costs that it incurs each month "even when a consumer has no consumption"

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[26] For example, DEA claims that its final recommendation "provides a moderate and gradual increase that moves this charge closer to cost, provides a reduction in the amount of Intra – Class Subsidy, and creates a rate that more accurately recovers cost." DEA's Initial Brief at 14. Similarly, the Department notes that "all of the customer classes have customer charges set below the monthly fixed costs of serving a customer." Department's Initial Brief at 50.

[27] DEA's Initial Brief at 14; Department's Initial Brief at 50-53.

[28] OAG's Initial Brief at 27.

such as providing and reading meters, and billing.[29] These are costs that vary based on the number of customers. On the other hand, the Department argues that the customer charge should also include the cost of "primary lines," which do not vary by the number of customers.[30] The Department reasons that "[i]n order to serve a customer, electricity has to be delivered through the primary line to their home, and that cost remains whether a customer uses any electricity in a given month or not."[31] The Department's argument appears to be based on the same misunderstanding that caused it to support DEA's minimum-size analysis—that the cost of providing service to a customer includes the cost of providing load. On a more basic level, the Department's argument ignores the fact that the size of the primary lines—and therefore their cost—is based, at least in part, on the amount of energy consumed. Therefore, using these costs to inform the final customer charge is not appropriate.

Second, while DEA does not discuss the impact that raising the customer charge would have on conservation efforts, the Department admits that leaving the customer charge constant would generally encourage a customer to use less energy.[32] The Department argues, however, that conservation should not be considered in setting the customer charge since DEA's rate design already encourages conservation efforts by allowing customers to lower their bills by consuming less energy.[33] The Department's argument completely ignores the *degree* to which customers are encouraged to conserve by DEA's rate design, or whether this difference in degree has any quantifiable impact on customers' consumption habits. The OAG, however, demonstrated that maintaining the current customer charge would result in reduced energy

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[29] DEA's Initial Brief at 14.
[30] Department's Initial Brief at 51-52.
[31] *Id.*
[32] Department's Initial Brief at 53.
[33] *Id.*

consumption equivalent to eliminating 610 residential homes.[34] The Department's general claim that customers are already encouraged to conserve does not eliminate the benefits of additional incentives and the quantifiable analysis provided by the OAG.

The Department also argues that conservation should not be considered in setting the customer charge because "it is important to ensure that DEA is able to recover, as close as possible, its customer costs."[35] The Department has not provided any evidence to suggest that DEA's current customer charge presents the company with a financial detriment. In fact, the OAG specifically asked DEA if increasing the customer charge provided any financial benefit to the company.[36] The company's response indicated that the current customer charge did not pose a burden on the company and that increasing the customer charge would not present a financial benefit.[37] Therefore, the Department's unsupported assertion is not a sufficient basis to wholly ignore the policy consideration of promoting conservation.

Finally, the Department expressed concern regarding the impact of maintaining the current customer charge on low-income, high-use customers.[38] The Department presented an analysis that purports to show the "subsidy" paid by these low-income, high-use customers under DEA's existing customer charge.[39] Notably, the Department's analysis does not show the actual bill impact these customers would face if the customer charge is either maintained or increased by one dollar, as the Department and DEA recommend. On the other hand, the OAG conducted a detailed analysis to determine the bill impact of increasing the customer charge on low-income customers in general, and on low-income, high-use customers. The OAG's analysis

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[34] Ex. 200 at 30 (Nelson Rebuttal).
[35] Department's Initial Brief at 53.
[36] Ex. 200 at 34 (Nelson Direct).
[37] *See id.* at 35.
[38] Department's Initial Brief at 54-57.
[39] *Id.* at 56.

demonstrated that low-income customers typically consume less energy than the average customer, and would therefore benefit from a lower customer charge.[40] The OAG's analysis also demonstrated that the few low-income, high-use customers on DEA's system would see a minimal bill increase if the customer charge remained the same. Specifically, for a customer in the 90th percentile of consumption, maintaining the current customer charge would result in an overall monthly bill increase of sixty cents versus increasing the customer charge by one dollar.[41] The Department's general arguments do not show that the negative impact of maintaining DEA's customer charge on DEA's low-income, high-use customers outweighs the benefits incurred by the majority of low-income customers.

The OAG's analysis demonstrates that maintaining DEA's current customer charge will promote important policy objectives. Specifically, maintaining the current customer charge will have meaningful benefits for the majority of low-income customers and promote increased conservation. On the contrary, DEA and the Department have not demonstrated that raising the customer charge is needed to maintain the utility's financial health or that minimizing one specific intra-class subsidy outweighs all other policy considerations. For these reasons, the ALJ should recommend that the Commission maintain DEA's existing customer charge.

III. DEA'S ANNUALIZATION ADJUSTMENT SHOULD BE REJECTED.

DEA argues that its payroll expense must be increased by $690,427 to account for the annual costs of positions that were filled for only part of 2013 ("Annualization Adjustment"). As the OAG explained in its Initial Brief, DEA's Annualization Adjustment should be rejected because it is not a known and measurable change and because it results in an expense that

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[40] *See* OAG's Initial Brief at 25.
[41] *Id.*

deviates substantially from the company's past payroll expenses.[42] Specifically, the OAG demonstrated that DEA's payroll expense varied by less than $63,000—a fraction of one percent—over the past four years, making a $690,427 adjustment unnecessary and excessive.[43] DEA argues that the OAG's recommendation is based on outdated information, has the "net effect" of removing the compensation and benefits of six positions, and that the company's payroll in its 2013 year was "atypical" and should, therefore, be adjusted upwards. DEA's arguments are baseless and should be disregarded.

First, DEA's argument that the OAG relied on "outdated information" is both hypocritical and incorrect. When DEA calculated its capital-to-expense adjustment, which the company used to justify increasing its requested payroll expense by $339,090—and which the OAG does not dispute—DEA compared its total payroll costs to its expensed payroll costs from 2009 to 2013.[44] The OAG relied on the same numbers from the same schedule to support its recommendation to reject the Annualization Adjustment. DEA cannot argue that these numbers are outdated when used by the OAG, but current when used by the company. Rather, DEA's annual payroll expenses during the company's most recent four-year period are appropriate to consider in determining whether its Annualization Adjustment is necessary.[45]

Second, DEA has not demonstrated that the OAG's recommendation will remove six positions from the company, or that 2013 was an "atypical" year. The OAG's recommendation has nothing to do with removing positions. It is simply a recognition of the fact that DEA's numbers are inflated beyond its actual historical payroll experiences. DEA's argument that its

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[42] OAG's Initial Brief at 4-8.
[43] *Id* at 5.
[44] *See* Ex. 102 at 4 of 20 (Larson Direct Exhibit DEA-1).
[45] In addition, DEA made other specific adjustments to update its payroll expense from its historical 2013 base year, such as recommending recovery for a three percent general wage increase. *See* OAG's Initial Brief at 4. The OAG has not disputed these other adjustments.

year is atypical is based entirely on anecdotal stories of the reasons that particular employees did not receive a full year's compensation in 2013.[46] DEA has not provided any evidence suggesting that similar vacancies did not occur in other years. As the OAG explained in its Initial Brief, the fact that DEA's actual payroll expenses have remained so consistent since 2010 demonstrates that it is typical for some positions to be vacant for at least part of any given year.[47] The OAG's argument relies on DEA's data to show that, in a company of 196 employees, temporary vacancies occur somewhat regularly. Providing DEA an unnecessary adjustment of nearly $700,000 on the assumption that these vacancies will never happen again is unreasonable and unsupported. The OAG requests that the ALJ recommend that the Commission reject DEA's Annualization Adjustment.

CONCLUSION

For the reasons set forth in this Reply Brief and in the OAG's Initial Brief, the OAG respectfully requests that the ALJ recommend that the Commission's final order include the following decisions:

- Reject DEA's adjustment of $690,427 to its Payroll Expense to annualize the costs of all of its positions;
- Offset DEA's request by $57,500 to account for 842 work hours previously billed to an unregulated subsidiary;
- Deny recovery of DEA's unreasonable expenses for travel and entertainment;
- Adopt the OAG's model for calculating DEA's minimum distribution system;
- Adopt the OAG's recommended revenue apportionment; and

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[46] DEA's Initial Brief at 4.
[47] OAG's Initial Brief at 6.

- Reject the proposal in the Settlement between DEA and the Department to increase the customer charge for residential and small business customers.

Dated: January 30, 2015

Respectfully submitted,

LORI SWANSON
Attorney General
State of Minnesota

s/ Ian Dobson

IAN M. DOBSON
Assistant Attorney General
Atty. Reg. No. 0386644

445 Minnesota Street, Suite 1400
St. Paul, Minnesota 55101-2131
(651) 757-1432 (Voice)
(651) 297-7206 (TTY)

ATTORNEYS FOR OFFICE OF THE
ATTORNEY GENERAL-RESIDENTIAL
UTILITIES AND ANTITRUST DIVISION

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In the Matter of the Application of Dakota Electric Association for Authority to Increase Rates for Electric Service in Minnesota

PROPOSED FINDINGS OF FACT, CONCLUSIONS OF LAW, AND RECOMMENDED ORDER OF THE OFFICE OF THE ATTORNEY GENERAL-RESIDENTIAL UTILITIES AND ANTITRUST DIVISION

January 30, 2015

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STATE OF MINNESOTA
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In the Matter of the Application of Dakota Electric Association for Authority to Increase Rates for Electric Service in Minnesota	MPUC Docket No. E-111/GR-14-482 OAH Docket No. 80-2500-31796

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW OF THE OFFICE OF THE ATTORNEY GENERAL

This matter came for evidentiary hearing before Administrative Law Judge ("ALJ") LauraSue Schlatter on December 18, 2014, at the offices of the Minnesota Public Utilities Commission in St. Paul, Minnesota. Public hearings were held on December 2, 2014, in Apple Valley and Farmington. Public comments were received until December 12, 2014.

Harold Levander, Jr., Attorney at Law, Felhaber Larson, P.A., 444 Cedar Street, Suite 2100, St. Paul, Minnesota, 55101, appeared on behalf of Dakota Electric Association ("DEA").

Peter E. Madsen, Linda S. Jensen, and Julia Anderson, Assistant Attorneys General, 445 Minnesota Street, Suite 1800, St. Paul, Minnesota 55101, appeared for and on behalf of the Department of Commerce, Division of Energy Resources, Energy Regulation and Planning ("Department").

Ian Dobson and Ryan P. Barlow, Assistant Attorneys General, 445 Minnesota Street, Suite 1400, St. Paul, Minnesota 55101, appeared for and on behalf of the Office of the Attorney General, Residential Utilities and Antitrust Division ("OAG").

Andrew Bahn, Dorothy Morrissey, and Ganesh Krishnan, 121 Seventh Place East, Suite 350, St. Paul, Minnesota 55101, attended the hearings on behalf of the Staff of the Public Utilities Commission ("Commission").

FINDINGS OF FACT

I. PROCEDURAL HISTORY

1. On July 2, 2014, DEA filed its request to increase rates for electric service by $4,189,232, or approximately 2.11 percent. On August 29, 2014, the Commission issued three orders that accepted DEA's filing and suspended proposed rates, established interim rates, and referred the case to the Office of Administrative Hearings for contested case proceedings.

2. On August 29, 2014, the ALJ conducted a prehearing conference at the Public Utilities Commission, 350 Metro Square Building, 121 Seventh Place East, St. Paul, Minnesota.[1]

3. The ALJ issued the first prehearing order on September 15, 2014, and amended the order on September 16, 2014. In the first prehearing order, the ALJ ordered that petitions to intervene be filed by October 2, 2014; that direct testimony of intervenors be filed by October 30, 2014; that rebuttal testimony be filed by November 20, 2014; that surrebuttal testimony be filed by December 8, 2014; and that the evidentiary hearing take place on December 18, 2014. The ALJ also ordered that public hearings would be held on December 2, 2014.[2]

4. The initial parties to the proceeding were DEA and the Department. On September 9, 2014, the OAG filed a Petition to Intervene. The ALJ granted the OAG's petition on September 15, 2014.[3]

5. The ALJ held public hearings on December 2, 2014 in Apple Valley and Farmington, and conducted an evidentiary hearing on December 18, 2014.

6. The parties submitted direct, rebuttal, and surrebuttal testimony consistent with the ALJ's first prehearing order. The parties also submitted initial and reply briefs on January 20, 2015 and January 30, 2015, consistent with the ALJ's amended first prehearing order.

II. LEGAL STANDARD

7. DEA is a member-owned cooperative electric association ("Cooperative").[4] Typically, Cooperatives may set rates without Commission review or approval.[5] DEA's members, however, have voted to become rate regulated.[6]

8. As a rate-regulated utility, DEA has the burden to prove by a preponderance of the evidence that its request to increase rates is just and reasonable.[7] The preponderance of the evidence standard requires DEA to show that the evidence in the matter justifies its request "when considered 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."[8] In discussing the utility's burden of proof, the Minnesota Supreme Court held that:

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[1] *See* Amended First Prehearing Order (Sept. 16, 2014).
[2] *Id.*
[3] *Id.*
[4] Ex. 101 at 1 (Larson Direct).
[5] *See* Minn. Stat. §§ 216B.01-.02 (2013).
[6] *See* Minn. Stat. § 216B.026 subd. 1 (2013).
[7] Minn. Stat. § 216B.16; *see also* Minn. Stat. § 216B.03.
[8] *Petition of Minnesota Power & Light Co.*, 435 N.W.2d 550, 554 (Minn. Ct. App. 1989), *rev. denied* Apr. 19, 1989.

> 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.[9]

If the Commission has doubts about the reasonableness of the rate increase after reviewing all of the evidence presented, those doubts must be resolved in favor of consumers.[10]

III. DISPUTED ISSUES

9. On the day of the evidentiary hearing, DEA and the Minnesota Department of Commerce ("Department") entered into a Settlement Agreement ("Settlement") that resolved the disputes between those parties.[11] The OAG did not enter into the Settlement. The Settlement would grant Dakota the entire rate increase it requested,[12] while adopting the DOC's proposed revenue apportionment and rate design.[13]

10. The OAG disputes that the Settlement between DEA and the Department results in just and reasonable rates. The following issues are disputed by the OAG:

Cost of Service:

- DEA's requested its Payroll Expense;
- DEA's inclusion of 842 work hours previously billed to an unregulated subsidiary;
- DEA's requested expenses for travel and entertainment;

Revenue Apportionment and Rate Design:

- The Minimum Distribution System;
- Revenue Apportionment; and
- Residential Customer Charges.

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[9] *In the Matter of the Petition of Northern States Power Company for Authority to Change its Schedule of Rates for Electric Service in Minnesota*, 416 N.W.2d 719, 722–23 (Minn. 1987).
[10] Minn. Stat. § 216B.03.
[11] *See* Ex. 128.
[12] *Id.* at 8.
[13] *Id.* at 13-14.

IV. COST OF SERVICE

A. DEA's Requested Payroll Expense.

11. DEA has requested recovery of more than $1.3 million in increased costs for its payroll expenses.[14]

12. DEA's requested payroll expense incorporates its actual 2013 payroll expense, which the company adjusted upwards for claimed are known and measureable changes.[15] These known and measurable changes are, according to DEA: (1) an upward adjustment of $608,978 for a three-percent general wage increase; (2) an increase of $339,090 to reflect a normalized construction year; (3) an increase of $690,427 to account for the annual costs of positions that were filled for only part of 2013; and (4) a decrease of $282,685 to account for reductions in DEA's pension and 401K contributions.[16]

13. The OAG disputes DEA's $690,427 upward adjustment to annualize the costs of positions that were not filled for part of 2013 ("Annualization Adjustment"). The OAG claims that this adjustment is not a known and measureable change and that it results in an unrepresentative recovery. The OAG does not dispute any of DEA's other adjustments to its payroll expense.

14. DEA claims that its Annualization Adjustment should be adopted to reflect "a full year of compensation and benefits for *all existing positions* at Dakota Electric."[17] In other words, DEA claims it should recover the full-year cost of all positions that were not filled for part of the company's 2013 test year.

15. The Commission has been "reluctant to allow adjustments to filed test year data," because the test year method "rests on the assumption that changes in the Company's financial status during the test year will be roughly symmetrical – some favoring the Company, others not."[18] Moreover, "[b]asing revenue requirements on financial data from a test year, a representative slice of the utility's normal operations, is intended to base rates on experience instead of conjecture."[19] Based on these principles, the Commission has permitted known and

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[14] *See* Ex. 102 at 2 of 20 (Larson Direct Exhibit DEA-1); Ex. 205 at 3 (Lee Surrebuttal).
[15] *See* Ex. 205 at 3 (Lee Surrebuttal).
[16] Ex. 203 at 4-5 (Lee Direct).
[17] Ex. 101 at 14 (Larson Direct) (emphasis added).
[18] Findings of Fact, Conclusions of Law, and Order; Order Opening Investigation, *In the Matter of the Application of Northern States Power Company d/b/a Xcel Energy for Authority to Increase Rates for Electric Service in Minnesota*, Docket No. E-002/GR-05-1428, at 10 (Sept. 1, 2006) (*quoting* Order After Reconsideration and Rehearing, *In the Matter of the Petition of Minnesota Power & Light Company, d/b/a Minnesota Power, for Authority to Change its Schedule of Rates for Retail Electric Service in the State of Minnesota,* Docket No. E-015/GR-87-223 (May 16, 1988)).
[19] *Id. at 10 (quoting* Order Denying Petitions for Reconsideration and denying Transitional Rate Increase, *In the Matter of the Application of Northern States Power Company for Authority to Increase its Rates for Electric Service in the State of Minnesota*, Docket No. E0992/GR-89-865 (Nov. 26, 1990).

measurable adjustments to a test year "only when their certainty and magnitude would otherwise make the test year process unreliable."[20]

16. Between 2010 and 2013, DEA's annual payroll expense of approximately $14 million has fluctuated within a $63,000 range:[21]

Year	Expensed Payroll	$ change over (under)	% change over (under)
2010 actual	$14,069,983		
2011 actual	$14,068,038	($1,945)	(0.01%)
2012 actual	$14,030,172	($37,866)	(0.27%)
2013 actual	$14,093,131	$62,959	0.45%
Average from 2010-2013	$14,065,331		0.06%

As the chart above demonstrates, DEA's payroll expense declined from 2010 to 2012, before increasing in 2013 to its highest level of the period. Therefore, DEA's 2013 test-year payroll expense exceeded its average expense of the four-year timeframe by nearly $28,000. Over the entire period, however, the general trend has been downwards or relatively flat.

17. DEA's basis for its Annualization Adjustment is not reasonable because it is not a known, measurable, and reliable change to the company's 2013 historical test year payroll expense.

18. First, the Annualization Adjustment is not "known and measurable," as DEA has requested the adjustment for positions that it hopes to fill or to remain filled, rather than positions, and related costs, that it "knows" will be filled. Because the adjustment is not for "known" expenses, it would be inappropriate.

19. Second, the Annualization Adjustment is not sufficiently reliable to be a known and measurable change to the 2013 test year because DEA's assumption that all 196 of its positions will be filled going forward without interruption is unreasonable. The fact that DEA's actual payroll expenses have remained so consistent since 2010 demonstrates that it is typical for some positions to be vacant during any given year. DEA admitted that, at the time it filed its Direct Testimony, some of its positions were vacant.[22] And the company has not presented updated information indicating that all of its positions are now filled. Even if it had, DEA cannot guarantee that all of its positions will continue to be filled without interruption or that its future staffing levels will deviate significantly from its past levels.

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[20] *Id.* at 11.
[21] *See* Ex. 203 at 6 (Lee Direct).
[22] Ex. 101 at 13 (Larson Direct) ("The positions identified for the annualization compensation adjustment are existing positions that are filled *or in the process of being filled*.") (Emphasis added).

20. For these reasons, the ALJ finds that DEA has not demonstrated that its Annualization Adjustment is reasonable, and that its requested revenue requirement should be reduced by $690,427.

B. DEA's Inclusion of 842 Work Hours Previously Billed to an Unregulated Subsidiary.

21. In 2010, DEA charged 1,197 hours to its unregulated subsidiary, Energy Alternatives Parent, Inc. ("EAI"), for finance, billing, and administrative services provided by the regulated entity.[23] In DEA's 2013 test-year, the hours charged to EAI by DEA employees decreased to 355, following EAI's divestiture of membership interests it had in leasing and wholesale generation businesses.[24] Therefore, DEA's regulated operations gained 842 hours, or approximately 21 weeks of labor capacity that were no longer used to support EAI's operations.[25]

22. The OAG disputes DEA's inclusion of 842 work hours for labor costs that were previously billed to an unregulated subsidiary. The OAG notes that DEA has not claimed that these 21 weeks of additional labor capacity are needed to perform its regulated functions in 2013.[26] These work hours cost ratepayers $57,700.[27]

23. It is not reasonable for ratepayers to pay for all of these extra hours of labor that the company does not claim are needed to operate the regulated utility service. Rather, the cost of this additional labor capacity should offset the company's requested rate increase.

24. DEA attempts to justify its failure to adjust its requested recovery by claiming that the additional labor capacity now available to the utility does not result in any direct cost savings. Specifically, DEA claimed at the evidentiary hearing that the majority of individuals who provided labor for EAI in 2010 were salaried employees.[28] DEA's argument ignores the fact that, by no longer charging these hours to EAI, DEA is requesting that they be paid by ratepayers. But DEA has not identified any benefit that ratepayers are receiving for these additional costs.

25. For these reasons, the ALJ recommends that the additional labor capacity resulting from EAI's divestitures be applied as an offset to DEA's requested rate increase.

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[23] Ex. 205 at 8 (Lee Surrebuttal); Ex. 203 at 8 (Lee Direct).
[24] Ex. 205 at 8 (Lee Surrebuttal); Ex. 203 at 8 (Lee Direct).
[25] 1,197 – 355 = 842; 842/40=21.05.
[26] OAG's Initial Brief at 8.
[27] Tr. Evid. Hearing at 40 (Larson) (Dec. 18, 2014).
[28] Tr. Evid. Hearing at 40-41 (Larson) (Dec. 18, 2014). Initially, DEA misunderstood the OAG's testimony, and believed that the OAG was concerned about the 355 hours that were charged to EAI by 14 individuals, rather than the decline of 842 charged since DEA's last rate case. *See* Ex. 126 at 14 (Larson Rebuttal). In response what it believed to be the OAG's concern, DEA stated that "an average of 25 hours per person devoted to subsidiary activities in 2013 does not warrant any compensation adjustment in the test year" because "3 days work is easily redirected to other regulated business activities during the course of the year." *Id.*

C. DEA's Requested Expenses for Travel and Entertainment.

26. DEA has requested recovery of more than eight hundred thousands of dollars for travel and meals for its employees, dues and memberships, events, and other expenses for its Board of Directors ("Travel and Entertainment" expenses).[29] The OAG disputes recovery of several costs that the OAG claims are unreasonable and not necessary for the provision of utility service. These expenses include the following:

- $2,066 in travel reimbursements for a DEA board member to attend CFC meetings outside of DEA's service territory, while he was running for the CFC board[30];
- $672 in excess airfare costs for last-minute scheduling of a board member's trip to attend a meeting in Washington DC[31];
- $3,909 for groceries to serve employees at various company functions[32]; and
- $522 for a holiday luncheon for DEA's board members and select key staff members.[33]

In addition to the costs above, the OAG raised concerns about DEA's $17,841 expense to reimburse board members for their personal internet, cell phone, and data plans.[34]

27. Minnesota Statutes section 216B.17 directs that the Commission "may not allow" utilities to recover "travel, entertainment, and related employee expenses" that are "unreasonable and unnecessary or the provision of utility service."[35] The statute also lists several expense categories that utilities must affirmatively itemize and report in their initial rate-case filings to assist the Commission in evaluating these costs.[36] These categories include "food and beverage expenses,"[37] "recreational and entertainment expenses,"[38] "board of director-related expenses, including and separately itemizing all compensation and expense reimbursements,"[39] and others. Simply because a particular expense is typical for a business does not mean that it may be recovered from ratepayers. For example, the Commission has held that membership dues for

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[29] *See* Ex. 203 at 11 (Lee Direct). This amount includes both compensation and expenses for DEA's Board of Directors, but excludes the compensation for DEA's ten highest paid employees. When the compensation for DEA's ten highest paid employees is included, DEA's request exceeds $3.1 million.
[30] *See id.* at 13; Ex 203 at 12 (Lee Direct).
[31] *See id.*
[32] *See id.* at 13-14. Examples of these expenses include $681 spent on food for DEA's wellness program to encourage healthy eating, and $572 spent on pastries served at monthly board of director meetings and other office meetings. The OAG does not dispute the portion of these costs that was spent on water for field employees during hot summer weather. DEA, however, has not quantified this amount.
[33] *See id.*
[34] *See* Ex. 205 at 11 (Lee Surrebuttal).
[35] Minn. Stat. § 216B.17(a) (2013).
[36] *Id.*
[37] Minn. Stat. § 216B.17(a)(2) (2013).
[38] Minn. Stat. § 216B.17(a)(3) (2013).
[39] Minn. Stat. § 216B.17(a)(4) (2013).

business organizations are recoverable "only to the extent that the activities they support *directly benefit ratepayers*," and has excluded membership dues for organization such as the Chamber of Commerce.[40]

28. Each of the Travel and Entertainment expenses identified by the OAG come from the categories highlighted in Minnesota statute for careful scrutiny. The expenses identified by the OAG are unnecessary, imprudent, and do not provide direct benefits to ratepayers. For instance, it is imprudent for DEA's ratepayers to pay for the high cost of a flight that the company failed to schedule until the last minute. DEA has also not demonstrated that ratepayers directly benefit from a board member's campaign for the CFC board, or from providing food and other perks at company meetings and functions. DEA has also failed to demonstrate that it is necessary for DEA to reimburse its board members for communication services that are ubiquitous to the general public, such as the costs of personal internet, cellular, and data plans. These services would likely be purchased by DEA's board members without ratepayer compensation.

29. DEA appears to argue that the specific expenses identified by the OAG should be recovered from ratepayers because they are minimal and because some of the expenses arguably promote good personal behavior by the company's employees. At the hearing, DEA suggested that an important issue for determining whether an expense should be included is whether the particular expense was significant.

30. DEA's purported reasons for requesting ratepayer recovery of these expenses has no basis in either law or fact. Contrary to DEA's suggestion, Minnesota Statutes section 216B.17 does not include a *de minimis* exception. And DEA cannot justify these expenses by pointing to hypothetical and speculative ratepayer benefits. As it stands, DEA has not demonstrated that any of the expenses identified by the OAG are necessary or that they directly benefit ratepayers. It is its burden to do so.

31. For these reasons, the ALJ recommends that DEA not receive ratepayer recovery for the expenses identified by the OAG.

V. REVENUE APPORTIONMENT AND RATE DESIGN

32. The Commission acts in a legislative capacity when it is "allocating costs between utility customers and balancing various factors to achieve a fair and reasonable allocation of those costs."[41] The factors balanced by the Commission to achieve a reasonable allocation

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[40] *In the Matter of the Application of Interstate Power Company for Authority to Increase its Rates for Electric Service in the State of Minnesota*, Docket E-001/GR-91-605, 1991 WL 634712, at *3 (Oct. 11, 1991) (emphasis added). *See also* Minn. Stat. § 216B.17(a)(6) (2013).
[41] *City of Moorhead v. Minnesota Public Utilities Commission*, 343 N.W.2d 843, 846 (Minn. 1984).

include both the cost of serving various classes and non-cost factors such as ability to pay, continuity of rates, ease of administration, customer acceptance, and others.[42]

33. The Settlement executed by DEA and the Department proposes apportioning the company's revenue by imposing larger rate increases for residential and small business customers than for any other customer class.[43] The recommended revenue apportionment is influenced by the results of the company's Class Cost of Service Study ("CCOSS"), which the Department modified to reduce the rate increase for the Small General Service class.[44] Even with the Department's modification, however, the revenue apportionment included in the Settlement moves all classes closer to the cost-of-service results from the company's CCOSS.[45]

34. The OAG recommends a different revenue apportionment based on its CCOSS, as well as other policy considerations.

A. The Class Cost of Service Study.

35. Performing a CCOSS involves three general steps. A CCOSS first functionalizes similar costs by determining their purpose; then, the CCOSS classifies the costs as either customer,[46] demand, or commodity costs; finally, the costs are allocated to various customer classes depending on how the costs were classified and caused.[47] Customer costs are costs incurred to serve a customer, regardless of the customer's energy consumption; for that reason, customer costs are allocated based on the number of customer locations within each class.[48] Demand costs, also referred to as capacity costs, in contrast, are required for the company to meet the peak demand on its system, and are allocated based on each customer class's contribution to peak demand.[49] Classifying and allocating customer and demand costs incorrectly can dramatically increase the burden on the residential class, since it pays a significantly greater share of the costs that are classified as customer costs.[50] Therefore, it is vital that the CCOSS used to inform final revenue apportionment is as precise as possible.

1. The Minimum System.

36. The parties dispute the proper method to classify the costs of DEA's distribution system. DEA and the Department support the company's use of the "minimized-size method," while the OAG supports the use of a proxy for the "zero-intercept method."

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[42] *See* Findings of Fact, Conclusions of Law, and Order, *In the Matter of the Application of Dakota Electric Association for Authority to Increase Rates for Electric Service in Minnesota*, Docket No. GR-09-175, at 14 (May 24, 2010).
[43] Ex. 128 at 13; Ex. 304 at 3 (Pierce Surrebuttal).
[44] *See* Ex. 128 at 11; Ex. 304 at 2-3 (Pierce Surrebuttal).
[45] Ex. 304 at 3 (Pierce Surrebuttal).
[46] DEA refers to customer costs as "consumer" costs.
[47] Ex. 301 at 4 (Ruzycki Direct).
[48] *Id.* at 5.; Ex. 200 at 3-4 (Nelson Direct).
[49] Ex. 301 at 4 (Ruzycki Direct); Ex. 200 at 4 (Nelson Direct).
[50] *See* Ex. 200 at 4 (Nelson Direct).

37. The costs of DEA's distribution system—such as poles, conductors, and transformers—are contained in FERC accounts 364–368.[51] These accounts contain both customer and demand costs.[52] A minimum system study is conducted to determine the proportion of these FERC accounts that should be classified as customer costs and the proportion should be classified as demand costs.[53] In other words, the minimum system study seeks to determine the proportion of these accounts that is paid simply to provide service to a customer, regardless of demand, and the proportion that is paid to meet demand.

38. The minimum system study estimates the hypothetical, minimum distribution system necessary simply to provide service to customers, without consideration of a customer's demand.[54] The minimum system is classified as the customer cost portion of the company's actual distribution system, while any distribution costs above those of the minimum system are classified as demand.[55] The theory of the minimum system study is that the need for distribution equipment greater than the minimum is driven by demand, and should be classified as such.[56]

39. The NARUC Electric Manual describes two common methods of conducting a minimum system study: the minimum-size method used by DEA in this case, and the minimum-intercept or "zero-intercept" method.[57] While each of these methods designs a hypothetical minimum distribution system, they are conceptually different from one another and, even if performed correctly, will likely lead to different classifications of customer and demand costs.[58] The minimum-size method involves determining the minimum-size distribution equipment actually installed by a utility, and constructing a hypothetical distribution system entirely from this minimum-size equipment.[59] The hypothetical distribution system generated from the minimum-size method is assumed to serve the "*minimum loading requirements* of the customer."[60] On the other hand, the zero-intercept method "seeks to identify that portion of plant related to a hypothetical *no-load* or zero-intercept situation."[61] The zero-intercept method constructs a hypothetical no-load distribution system by incorporating a more technically demanding analysis using regression.[62]

40. The NARUC manual recognizes that the minimum-size method used by DEA in this case is generally less accurate than a properly conducted zero-intercept method.[63] The NARUC manual also states that the minimum-size method "generally produces a larger customer

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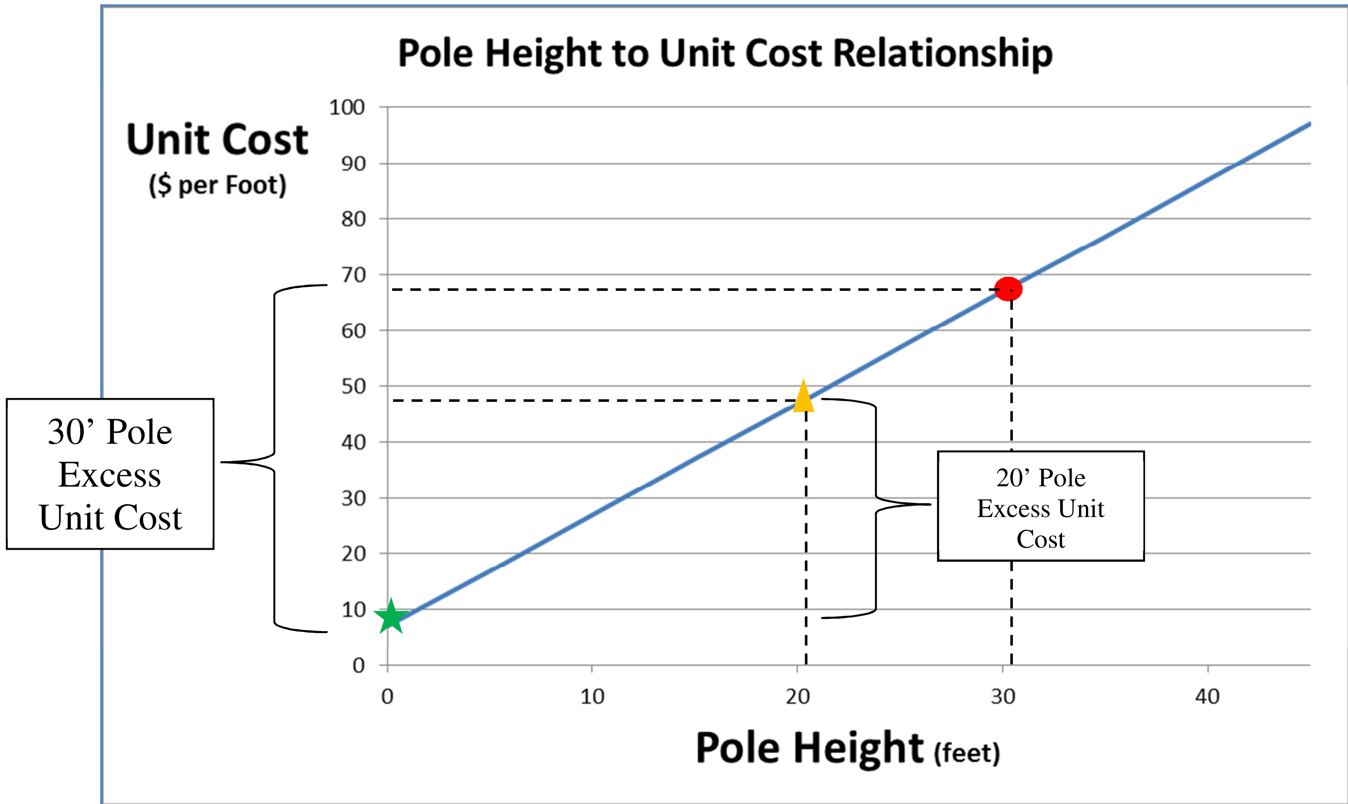
[51] *Id.* at 3.
[52] *Id.* at 3-4.
[53] *Id.* at 4-5.
[54] Ex. 200 at 5 (Nelson Direct).
[55] *Id.*
[56] *Id.*
[57] *See* NARUC Electric Manual at 90; Ex. 200 at 5-6 (Nelson Direct).
[58] Ex. 200 at 6 (Nelson Direct).
[59] *Id.*
[60] NARUC Electric Manual at 90 (emphasis added).
[61] *Id.* at 92 (emphasis added).
[62] Ex. 200 at 7 (Nelson Direct).
[63] *See* NARUC Electric Manual at 92.

component" than would be produced by the more accurate zero-intercept method.[64] The Commission also recognizes this difference between the two methods; in MERC's most recent rate case, the Commission stated that the minimum-size method "results in some capacity costs being classified as customer costs."[65] The graph below provides one example of how using the cost of either a 20-foot or 30-foot utility pole in a minimum-sized method overstates the customer cost portion of a utility's distribution system:



In this graph, the blue line represents a hypothetical regression line demonstrating the cost of utility poles as they get taller to serve more demand.[66] The location of where the line crosses the Y-axis, marked by the star, represents the zero-intercept value—the cost of installing a utility pole absent any customer demand.[67] Therefore, the star represents the optimal unit cost to construct a minimum system because it incorporates the pole height that equals a no-load scenario.[68] In a zero-intercept analysis, all of the unit costs below the star would be classified as customer costs. Any unit costs incurred by the utility above the star would be classified as

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[64] *Id.* at 91, 92.

[65] Findings of Fact, Conclusions, and Order, *In the Matter of a Petition by Minnesota Energy Resources Corporation for Authority to Increase Natural Gas Rates in Minnesota*, Docket No. G-011/GR-13-617, at 44, 46-47 (Oct. 28, 2014).

[66] Ex. 200 at 8 (Nelson Direct). As Mr. Nelson explains, this graph assumes a positive linear relationship between the unit cost and pole height, which is not necessary for the example to be valid but helps for understanding. Further, the graph assumes that the model is specified correctly. *Id.* at 8, n. 3.

[67] *Id.* at 9.

[68] *Id.* at 10.

demand costs, since the specific heights of the poles installed by the utility would depend on customer demand.

41. While the star on the graph above represents the zero-intercept value, the triangle and circle represent the unit costs of installing a 20-foot or 30-foot pole, respectively.[69] Since the cost of installing utility poles theoretically increases as they get taller due to increasing material costs, the 20-foot pole costs more than the zero intercept, and the 30-foot pole costs more than the 20-foot pole. Therefore, conducting a minimum system study using either a 20-foot or 30-foot pole as the utility's "minimum-sized" pole will inevitably classify more of the utility's distribution system as customer costs than would a zero-intercept analysis. Specifically, the difference between the cost of either the circle or the triangle in the graph and the cost of the star represents the excessive customer costs of using a minimum-sized method. As OAG witness Mr. Nelson explains, this graph "demonstrates that in theory the minimum-size method, as opposed to a zero-intercept method, overestimates the proportion of customer costs by using too high of a unit cost to construct the minimum system. This is true of all of the distribution components included in FERC accounts 364-368.

2. DEA's Minimum System Analysis.

42. In DEA's last rate case, DEA based its minimum system on a zero-intercept analysis.[70] The Commission determined that, while DEA's analysis in that case was imprecise, it was "appropriate as a starting point for setting rates."[71] But the Commission further ordered that "[DEA] shall, in its next rate case, either use the minimum-size method to classify distribution accounts, or provide such an analysis to support the outcome of the zero-intercept method."[72]

43. In the instant case, DEA chose to use a minimum-size analysis in its minimum system study, rather than the zero-intercept method.[73] Accordingly, DEA chose to use the method that inherently classifies some capacity costs as customer costs.

44. Typically, a utility that uses a minimum-size method in its minimum system analysis attempts to correct this by including a demand adjustment into its CCOSS. For instance, CenterPoint used the minimum-size method in its most recent rate case, but made an adjustment to its "peak-related allocation factor" to "eliminate the maximum level of capacity that . . . could

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[69] *Id.*
[70] *See id.* at 12.
[71] Findings of Fact, Conclusions of Law, and Order, *In the Matter of the Application of Dakota Electric Association for Authority to Increase Rates for Electric Service in Minnesota*, Docket No. GR-09-175, at 14 (May 24, 2010).
[72] *Id.* at 23.
[73] Ex. 101 at 21 (Larson Direct). The OAG does not dispute that DEA complied with the Commission's order to either use the minimum-size method or support its zero-intercept analysis in its initial filing. This does not mean, however, that the Commission pre-determined that the model included in the company's initial filing should be used to inform the company's revenue apportionment. Rather, since the company's minimum system analysis produces inaccurate results, it is not an appropriate basis to inform revenue apportionment.

be reasonably associated with the minimum system."[74] Xcel Energy also incorporates an adjustment to its demand allocator to account for demand costs included in its minimum system.[75] DEA, however, did not make a similar adjustment here.[76]

45. DEA argues that its minimum system analysis is reasonable even without a demand adjustment used by other utilities. In an attempt to support this argument, DEA compared the weighted average of the customer costs of its distribution accounts derived from its minimum-size analysis in this case against the weighted average of the customer costs of these accounts derived from its 2009 zero-intercept analysis.[77] DEA concluded that its minimum system was reasonable because "the minimum-size results are very similar to the zero-intercept analysis."[78] DEA's comparison of these two studies raises two, interrelated problems.

46. First, there is no basis to compare the weighted averages of the customer costs from DEA's distribution accounts under the minimum-size and the zero-intercept method, since the weighted average of these costs is not incorporated into the CCOSS. Rather, the CCOSS incorporates the customer costs that the minimum system generates for each, individual distribution account. For example, the minimum system can produce different customer costs for a company's poles account than for its transformers account. The results for these individual accounts will be applied to different allocators. The OAG demonstrated that, on an account-by-account basis, DEA's minimum-size and the zero-intercept analyses produced very different results. Depending on the specific account, these methods produced results that showed the customer cost portion differing by between ten and twenty percent.[79] At the hearing, DEA acknowledged that the results of its minimum-size and zero-intercept methods for each account were not similar.[80]

47. Second, comparing DEA's minimum-size method to its previous zero-intercept method reveals that there are systematic problems with DEA's analysis. DEA's minimum-size method produced a *lower* apportionment for the residential class than the zero-intercept method it used in 2009.[81] In addition, for several distribution accounts, DEA's minimum-size method resulted in *lower* customer costs.[82] But widely accepted theory, including the NARUC Manual indicates that the results of a minimum-size method should be higher than the results of a zero-intercept study. The fact that DEA's studies led to opposite results is a sign that DEA's methods are flawed. While DEA attempts to suggest that these outcomes show that its current analysis benefits the residential class, it does not establish that DEA's minimum-size method produces

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[74] Direct Testimony of Matthew A. Troxle, *In the Matter of the Application of CenterPoint Energy Resources Corp., d/b/a CenterPoint Energy Minnesota Gas For Authority to Increase Rates for Natural Gas Utility Service in Minnesota* Docket No. G-008/GR-13-316, Exhibit 35 at 22 (Aug. 2, 2013).
[75] *See* Ex. 201 at 4 (Nelson Rebuttal).
[76] The OAG has previously argued that such an adjustments proposed by other utilities were not sufficient to address the shortcomings of the minimum-size method. The point here is that DEA did not even make an adjustment.
[77] *See* Ex. 126 at 12-13 (Larson Rebuttal); Ex. 125 at Workpaper 21, pg. 5.
[78] Ex. 126 at 13 (Larson Rebuttal).
[79] Tr. Evid. Hearing at 29-33 (Larson) (Dec. 18, 2014).
[80] *Id.*
[81] Ex. 125 at Workpaper 21, pg. 4.
[82] Ex. 125 at Workpaper 21, pg. 5.

reasonable results. If anything, these results confirm that DEA's 2009 analysis also overestimated the customer cost portion of the company's distribution accounts.[83] For these reasons, DEA has not demonstrated that its minimum system study produces reasonable results that should be used to inform the company's revenue apportionment.

3. The OAG's Zero-Intercept Proxy.

48. As stated above, the OAG recommends using a proxy for the zero-intercept analysis. As Mr. Nelson explains, attempting to follow the empirical method described in the NARUC Manual for the zero-intercept anaylsis "leaves the analysis wide open for manipulation" and can lead to meaningless results if the regression model is specified incorrectly or includes errors in data.[84] The Commission has recognized these potential concerns. As discussed above, the Commission required DEA to provide additional analysis of its model if it had utilized the a zero-intercept method in this case. Similarly, in MERC's most recent rate case, the Commission ordered the company to take several additional steps to improve its zero-intercept analysis by collecting data on additional variables, using data at the finest level available, and checking its regression assumptions and correcting analytical violations.[85]

49. The zero-intercept proxy proposed by the OAG in this case incorporates the theory outlined in the NARUC Manual, but uses known information rather than regression analysis that relies on what has been contentions regression analysis.[86] The OAG's proxy subtracts the material unit costs of the distribution equipment used in DEA's minimum-size method from the installed unit cost of the same sized distribution equipment.[87] Mr. Nelson demonstrated that, mathematically, the OAG's proxy produces results that are equivalent to a zero-intercept analysis.[88] Mr. Nelson's mathematical justification for the OAG's proxy has not been disputed by DEA or the Department.

50. Because the OAG's proxy produces results that are equivalent to the more precise zero-intercept analysis, the ALJ recommends adopting the OAG's CCOSS to inform revenue apportionment.

B. Revenue Apportionment.

51. Each party recommends a revenue apportionment based on their recommended CCOSS's. For the reasons set forth above, the OAG's proposed revenue apportionment is based on a more precise CCOSS that accurately reflects the costs of service for the various customer classes. In addition, the OAG's proposal appropriately promotes non-cost policy goals.

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[83] The OAG notes that the differing results of the two analyses may be attributable to the passage of time. This provides another reason that DEA's comparison is unreasonable. *See* Ex. 202 at 6 (Nelson Surrebuttal).

[84] Ex. 200 at 19 (Nelson Direct).

[85] Findings of Fact, Conclusions, and Order, *In the Matter of a Petition by Minnesota Energy Resources Corporation for Authority to Increase Natural Gas Rates in Minnesota*, Docket No. G-011/GR-13-617, at 47 (Oct. 28, 2014).

[86] Ex. 200 at 20 (Nelson Direct).

[87] *Id.*

[88] *See* Ex. 200 at 20-22 (Nelson Direct).

52. Under the OAG's proposal, all classes would make a meaningful contribution to any rate increase approved by the Commission, but no class would be burdened with a disproportionate share. For example, if the Commission approved DEA's entire requested rate increase, the OAG's revenue apportionment would result in increases ranging from 1.5% to 3.41%, depending on the customer class. Making all classes contribute toward the company's rate increase promotes the goals of customer acceptance and rate continuity. Moreover, the OAG's proposal results in a smaller increase for the residential class than proposed in the Settlement. The residential class includes many ratepayers who have no ability to pay increased utility costs, such as low income families and seniors living on a fixed income. The OAG's proposal therefore considers this important policy factor.

53. For these reasons the ALJ recommends that the Commission adopt the revenue apportion recommended by the OAG.

C. Residential Customer Charges.

54. The Settlement proposed by DEA and the Department also recommends an increase to the company's customer charge for residential and small business customers. DEA's current customer charge for residential and small business ratepayers varies from $8 per month for Residential and Farm service to $11 per month for the Residential and Farm Demand Control, and the Residential and Farm Time of Day classes.[89] The Settlement adopts the DOC's proposal to increase the customer charge for each residential class by $1, and increase the customer charge for the Small General Service class by $4—from $10 to $14.[90] This proposal would set DEA's residential customer charge at the highest level of any rate-regulated Minnesota electric utility.[91]

55. For the reasons set forth below, the ALJ finds that the increase proposed in the Settlement is not reasonable.

D. Policy Goals of the Customer Charge.

56. Setting the customer charge implicates several important policy goals. First, maintaining a lower customer charge has the overall effect of benefitting low-income customers. Since any decrease in the fixed customer charge results in an increase in the volumetric charge, maintaining a low customer charge benefits those customers with lower usage. Mr. Nelson performed a statistical analysis to assess the impact that a lower customer charge has on low-

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[89] *See* Ex. 304 at 10 (Pierce Direct).

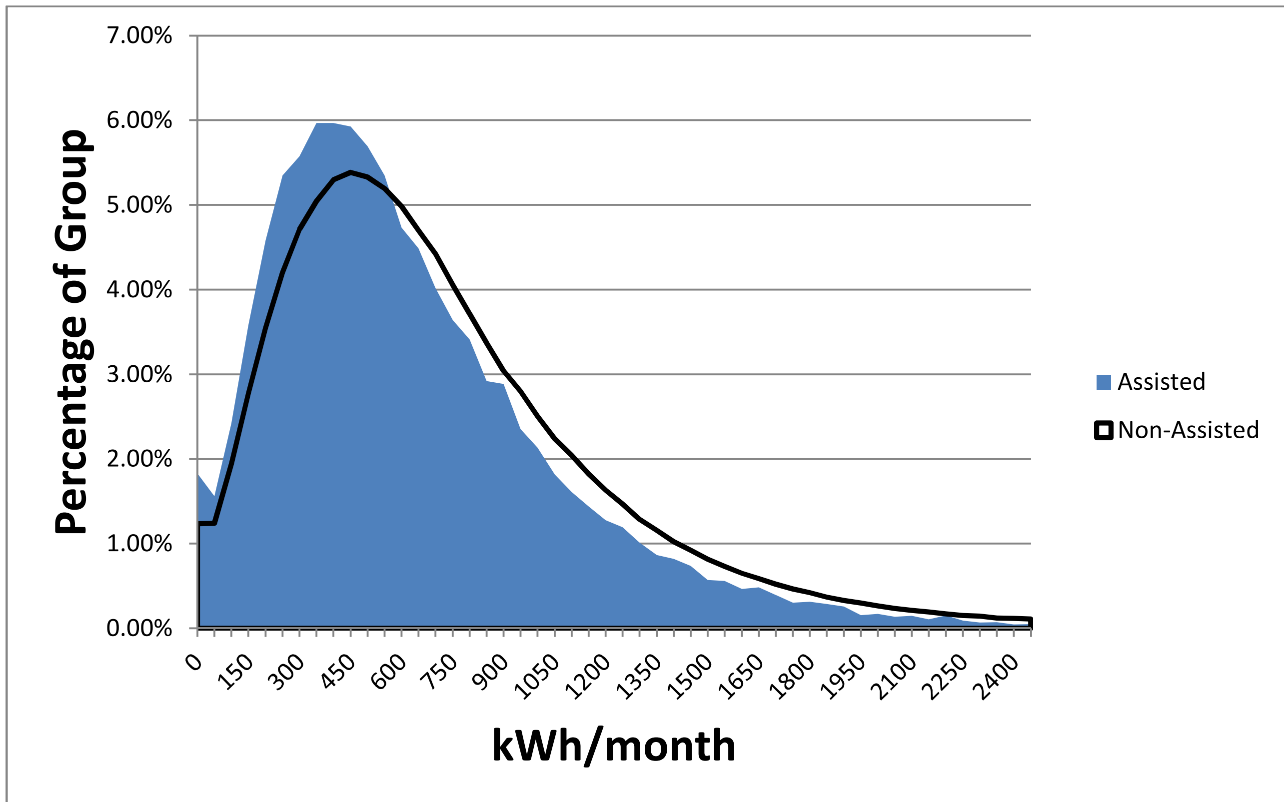
[90] Ex. 128 at 13; *See also* Ex. 304 at 10 (Pierce Direct).

[91] *See* Ex. 304 at 12 (Pierce Direct). The Commission is currently considering Xcel's request to increase its customer charge. Approving the Settlement in this case, however, would set DEA's customer charge higher than both the Department's proposal in the Xcel case and the recommendation of the Administrative Law Judge. *See* Findings of Fact, Conclusions of Law, and Recommendation, *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-13-868, at 185 (Dec. 26, 2014).

income customers. Mr. Nelson's analysis demonstrate that maintaining DEA's current customer charge would provide significant benefits to the company's low-income customers.

57. To determine the breadth of the impact that increasing the customer charge would have on low-income customers, Mr. Nelson compared the consumption levels of utility customers who receive energy assistance, which serves as a proxy for low-income customers in general, to those who do not receive energy assistance.[92] The graph below illustrates Mr. Nelson's results[93]:

Assisted and Non-Assisted Distributional Consumption



In the Graph above, customers who receive energy assistance are represented by the solid blue area, while non-assisted customers are represented by the area under the black line. The Y-axis is the percentage of the given group and the X-axis is monthly consumption. Mr. Nelson's analysis shows that a greater portion of customers who receive energy assistance consume lower levels of energy, while a greater portion of non-assisted customers consume higher levels. This demonstrates that a higher proportion of assisted customers consume low amounts of energy than non-assisted customers, and that fewer assisted customers are high-use consumers. Since a low

[92] Ex. 201 at 18 (Nelson Rebuttal).
[93] *Id.* at 19.

customer charge benefits low-use customers, these benefits would be felt by a higher proportion of low-income customers.

58. While Mr. Nelson's analysis demonstrates that low-income customers typically consume lower levels of energy than customers who are not low-income, there are likely some low-income customers who consume high levels of energy. Therefore, in addition to analyzing the breadth of the impact of a lower customer charge on low-income customers as a group, Mr. Nelson also analyzed the severity of the impact that maintaining a low customer charge would have on DEA's low-income, high-use customers. Mr. Nelson compared the overall financial impact of implementing an $8 customer charge versus a $9 customer charge on an assisted customer whose energy consumption ranks in the 90th percentile of assisted customers.[94] Mr. Nelson determined that, for these customers, maintaining the $8 customer charge would lead to an overall monthly bill increase of only sixty cents more than increasing the customer charge to $9.[95] The significant benefits that maintaining DEA's current customer charge has on the majority of its low-income customers are not outweighed by this small impact on a few low-income, high-use customers.

59. Second, maintaining a lower customer charge promotes conservation by increasing the volumetric charge. This provides a greater reward to consumers who reduce their consumption and promotes the Commission's directive to "set rates to encourage energy conservation" by increasing the incentive to conserve.[96] In this case, Mr. Nelson conducted an analysis to determine the conservation benefits of maintaining DEA's existing customer charge. Mr. Nelson's analysis demonstrates that maintaining the current customer charge would result in reduced energy consumption equivalent to eliminating 610 residential homes.[97] The Commission's mandate to encourage conservation indicates that reducing energy consumptions by more than 600 residential homes is a significant benefit of maintaining the customer charge at its current level.

E. The Arguments to Increase the Customer Charge.

60. DEA and the Department each advocated for increasing the customer charge. These parties focused predominantly on their desire to move the customer charge closer to the customer costs generated by the company's CCOSS.[98] These parties argued that moving the customer charge closer to the company's customer costs is beneficial because it minimizes intra-class subsidies between high-use and low-use customers.[99] These argument are not persuasive for the following reasons:

61. First, as demonstrated above, the company's CCOSS over-estimates the customer-cost portion of DEA's distribution system. Accordingly, the customer charge

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[94] *Id.* at 18
[95] *Id.*
[96] Minn. Stat. § 216B.03.
[97] Ex. 200 at 30 (Nelson Rebuttal).
[98] *See* Ex. 304 at 15 (Pierce Direct); Ex. 126 at 34 (Larson Rebuttal).
[99] *See* Ex. 304 at 15 (Pierce Direct); Ex. 126 at 34 (Larson Rebuttal).

recommendations of both DEA and the Department were informed by an inaccurate understanding of the company's customer costs, which resulted in over-estimating the intra-class subsidy between high-use and low-use residential customers. In the Department's case, this problem was compounded by the fact that it failed to account for certain "customer costs" that are not appropriately considered in determining the customer charge. In performing its analysis, the Department used the full, $23.39 customer cost from the company's CCOSS to inform its recommendation to increase the residential customer charge to $9. DEA and the OAG, however, both recognized that the cost of the company's distribution system is not appropriately considered in determining the customer charge, even though a portion of these costs are classified as "customer costs" in the CCOSS.[100] As Mr. Nelson explains, distribution costs do not vary based on the number of customers in DEA's service territory, and are therefore not appropriately considered in determining the customer charge.[101] After removing these distribution costs, the company's CCOSS produces customer costs of only $11.65, rather than the $23.39 used by the DOC.[102] And the OAG's CCOSS produces customer costs of only $11.41.[103]

62. Second, DEA and the Department each fail to consider any intra-class subsidies other than those between high-use and low-use customers, or that the "customer costs" produced by the CCOSS are based on an average. Subsidies between electric customers can result from the time of day that energy is consumed, the capacity demanded by a particular customer, and where a customer is located in DEA's service territory.[104] In addition to ignoring other subsidies that exist, neither DEA nor the Department explain why this particular intra-class subsidy deserves such close attention. For these reasons, reliance on a single intra-class subsidy is not a reasonable basis to increase the customer charge.

63. The ALJ recommends that the Commission approve a rate structure that maintains DEA's existing customer charge.

CONCLUSIONS OF LAW

1. The Public Utilities Commission and the Administrative Law Judge have jurisdiction to consider this matter pursuant to Minnesota Statutes Sections 14.50, 216B.08 (2014).

2. The public and the parties received proper and timely notice of the hearing and DEA complied with all procedural requirements of statue and rule.

3. Every rate set by the Commission shall be just and reasonable. Rates shall not be unreasonably preferential, unreasonably prejudicial or discriminatory, but shall be sufficient, equitable and consistent in application to a class of consumers. To the maximum extent

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[100] *See* Ex. 101 at 33 (Larson Direct); Ex. 201 at 12 (Nelson Rebuttal).
[101] Ex. 201 at 12 (Nelson Rebuttal).
[102] Ex. 101 at 33 (Larson Direct).
[103] Ex. 201 at 13 (Nelson Rebuttal).
[104] Ex. 201 at 15 (Nelson Surrebuttal).

reasonable, the Commission shall set rates to encourage energy conservation and renewable energy use and to further the goals of Minnesota Statutes Sections 216B.164, 216B.241, and 216C.05 (2014).[105]

4. The burden of proof is on the public utility to show that a rate change is just and reasonable.[106]

5. Any doubt as to the reasonableness of utility rates shall be resolved in favor of the consumer.[107]

6. Rates set in accordance with this Report would be just and reasonable.

7. The final rates ordered by the Commission should be compared to the interim rates set in the Commission's August 29, 2014 Order Setting Interim Rates, and a refund ordered to the extent that the interim rates exceeds the final rates for 2014.[108]

RECOMMENDATIONS

The ALJ recommends that the Commission issue an Order providing that:

1. Dakota is entitled to gross annual revenues in accordance with the terms of the Report.

2. Within ten days of the service date of this Report, Dakota shall file with the Commission for its review and approval, and serve on all parties in this proceeding, revised schedules of rates and charges reflecting the revenue requirements and the rate design decisions based on the recommendations made herein.

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[105] Minn. Stat. § 216B.03 (2014).
[106] Minn. Stat. §216B.16, subd. 4.
[107] Minn. Stat. § 216B.03 (2014).
[108] Minn. Stat. §216B.16 Subd. 3.

3. Dakota shall make further compliance filings regarding rates and charges, rate design decisions, and tariff language as ordered by the Commission.

Dated: January 30, 2015

Respectfully submitted,

LORI SWANSON
Attorney General
State of Minnesota

s/Ian Dobson
IAN M. DOBSON
Assistant Attorney General
Atty. Reg. No. 0386644

445 Minnesota Street, Suite 1400
St. Paul, Minnesota 55101-2131
(651) 757-1432 (Voice)
(651) 297-7206 (TTY)

ATTORNEYS FOR OFFICE OF THE ATTORNEY GENERAL-RESIDENTIAL UTILITIES AND ANTITRUST DIVISION

STATE OF MINNESOTA

OFFICE OF THE ATTORNEY GENERAL

LORI SWANSON
ATTORNEY GENERAL

SUITE 1400
445 MINNESOTA STREET
ST. PAUL, MN 55101-2131
TELEPHONE: (651) 296-7575

January 30, 2015

The Honorable LauraSue Schlatter
Administrative Law Judge
Office of Administrative Hearings
600 North Robert Street
P. O. Box 64620
St. Paul, Minnesota 55164-0620

Re: ***In the Matter of the Application of Dakota Electric Association for Authority to Increase Rates for Electric Service in Minnesota***
Docket No. E-111/GR-14-482
OAH Docket No. 80-2500-31796

Dear Judge Schlatter:

Enclosed and e-filed in the above-referenced matter please find the Reply Brief and Findings of Fact, Conclusions of Law and Recommended Order of the Office of the Attorney General – Residential Utilities and Antitrust Division.

By copy of this letter all parties have been served. An Affidavit of Service is also enclosed.

Sincerely,

s/Ian Dobson

IAN DOBSON
Assistant Attorney General

(651) 757-1432 (Voice)
(651) 296-9663 (Fax)

Enclosure

AFFIDAVIT OF SERVICE

Re: ***In the Matter of the Application of Dakota Electric Association for Authority to Increase Rates for Electric Service in Minnesota***
Docket No. E-111/GR-14-482
OAH Docket No. 80-2500-31796

STATE OF MINNESOTA)
) ss.
COUNTY OF RAMSEY)

JUDY SIGAL hereby states that on the 30th day of January, 2015, I served the **Reply Brief and Findings of Fact, Conclusions of Law and Recommended Order of the Minnesota Office of the Attorney General – Residential Utilities and Antitrust Division** upon all parties listed on this Affidavit of Service by email and/or United States Mail with postage prepaid, and deposited the same in a U.S. Post Office mail receptacle in the City of St. Paul, Minnesota.

See Attached Service List

s/Judy Sigal
JUDY SIGAL

Subscribed and sworn to before me
this 30th day of January, 2015.

s/ Ruth Busch
Notary Public

My Commission expires: January 31, 2015

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Julia	Anderson	Julia.Anderson@ag.state.mn.us	Office of the Attorney General-DOC	1800 BRM Tower 445 Minnesota St St. Paul, MN 551012134	Electronic Service	Yes	OFF_SL_14-482_Official cc Service List
Andrew	Bahn	Andrew.Bahn@state.mn.us	Public Utilities Commission	121 7th Place E., Suite 350 St. Paul, MN 55101	Electronic Service	Yes	OFF_SL_14-482_Official cc Service List
Ryan	Barlow	Ryan.Barlow@ag.state.mn.us	Office of the Attorney General-RUD	445 Minnesota Street Bremer Tower, Suite 1400 St. Paul, Minnesota 55101	Electronic Service	Yes	OFF_SL_14-482_Official cc Service List
Ian	Dobson	ian.dobson@ag.state.mn.us	Office of the Attorney General-RUD	Antitrust and Utilities Division 445 Minnesota Street, 1400 BRM Tower St. Paul, MN 55101	Electronic Service	Yes	OFF_SL_14-482_Official cc Service List
Robert	Harding	robert.harding@state.mn.us	Public Utilities Commission	Suite 350 121 7th Place East St. Paul, MN 55101	Electronic Service	Yes	OFF_SL_14-482_Official cc Service List
Corey	Hintz	chintz@dakotaelectric.com	Dakota Electric Association	4300 220th Street Farmington, MN 550249583	Electronic Service	No	OFF_SL_14-482_Official cc Service List
Linda	Jensen	linda.s.jensen@ag.state.mn.us	Office of the Attorney General-DOC	1800 BRM Tower 445 Minnesota Street St. Paul, MN 551012134	Electronic Service	Yes	OFF_SL_14-482_Official cc Service List
Ganesh	Krishnan	ganesh.krishnan@state.mn.us	Public Utilities Commission	Suite 350121 7th Place East St. Paul, MN 55101	Electronic Service	Yes	OFF_SL_14-482_Official cc Service List
Douglas	Larson	dlarson@dakotaelectric.com	Dakota Electric Association	4300 220th St W Farmington, MN 55024	Electronic Service	Yes	OFF_SL_14-482_Official cc Service List
Harold	LeVander, Jr.	hlevander@felhaber.com	Felhaber, Larson, Fenton & Vogt, P.A.	Suite 2100 444 Cedar Street St. Paul, MN 551012136	Electronic Service	Yes	OFF_SL_14-482_Official cc Service List

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
John	Lindell	agorud.ecf@ag.state.mn.us	Office of the Attorney General-RUD	1400 BRM Tower 445 Minnesota St St. Paul, MN 551012130	Electronic Service	Yes	OFF_SL_14-482_Official cc Service List
Peter	Madsen	peter.madsen@ag.state.mn.us	Office of the Attorney General-DOC	Bremer Tower, Suite 1800 445 Minnesota Street St. Paul, Minnesota 55101	Electronic Service	Yes	OFF_SL_14-482_Official cc Service List
Gregory C.	Miller	gmiller@dakotaelectric.com	Dakota Electric Association	4300 220th Street West Farmington, MN 55024	Electronic Service	No	OFF_SL_14-482_Official cc Service List
Dorothy	Morrissey	dorothy.morrissey@state.mn.us	Public Utilities Commission	121 7th Place East Suite 350 St. Paul, MN 55101	Electronic Service	Yes	OFF_SL_14-482_Official cc Service List
LauraSue	Schlatter	LauraSue.Schlatter@state.mn.us	Office of Administrative Hearings	PO Box 64620 St. Paul, Minnesota 55164-0620	Electronic Service	Yes	OFF_SL_14-482_Official cc Service List
Janet	Shaddix Elling	jshaddix@janetshaddix.com	Shaddix And Associates	Ste 122 9100 W Bloomington Frwy Bloomington, MN 55431	Electronic Service	Yes	OFF_SL_14-482_Official cc Service List
Lou Ann	Weflen	lweflen@dakotaelectric.com	Dakota Electric Association	4300 220th Street West Farmington, MN 55024	Electronic Service	Yes	OFF_SL_14-482_Official cc Service List
Daniel	Wolf	dan.wolf@state.mn.us	Public Utilities Commission	Suite 350 121 7th Place East St. Paul, MN 551022147	Electronic Service	Yes	OFF_SL_14-482_Official cc Service List