STATE OF MINNESOTA
IN COURT OF APPEALS
A23-1672

In the Matter of the Application by Northern States Power Company d/b/a Xcel Energy for Authority to Increase Rates for Electric Service in the State of Minnesota.

Filed January 21, 2025
Affirmed in part, reversed in part, and remanded
Frisch, Chief Judge
Concurring in part, dissenting in part, Smith, Tracy M., Judge

Minnesota Public Utilities Commission
File No. E-002/GR-21-630

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Considered and decided by Smith, Tracy M., Presiding Judge; Frisch, Chief Judge; and Schmidt, Judge.

NONPRECEDENTIAL OPINION

FRISCH, Chief Judge

Northern States Power Company, doing business as Xcel Energy, appeals from an order issued by the Minnesota Public Utilities Commission (the commission) regarding Xcel's application to increase the rates it charges consumers for electricity in Minnesota. Xcel challenges three decisions made by the commission in determining the revenue requirement on which Xcel's rate will be based: (1) the denial of Xcel's forecasted expenses for insurance premiums and the commission's determination of lower insurance-premium expenses; (2) the exclusion of Xcel's prepaid pension asset from its rate base; and (3) the denial of Xcel's proposed recoverable expense for annual compensation of its ten highest-paid executives and the commission's determination of a lower per-executive amount capped at the salary of the state's governor.

We conclude that Xcel has not demonstrated a basis to disturb the commission's decision regarding the amount of recoverable insurance-premium expenses. As for the commission's decision to entirely exclude Xcel's prepaid pension asset from its rate base, we conclude that, in light of intervening caselaw from this court, the commission's findings are insufficient and reversal and remand is appropriate for the commission to revisit its decision. Finally, we conclude that, although Xcel has not demonstrated a basis to disturb the commission's denial of Xcel's proposed recoverable expense for executive compensation, the commission's decision to set a lower compensation amount based on the governor's salary is arbitrary and capricious and reversal and remand is appropriate for

the commission to provide further explanation for its decision. We therefore affirm in part, reverse in part, and remand to the commission for further proceedings.

FACTS

Xcel, the relator in this case, is a public utility that provides electric and natural gas service and has electric operations in Minnesota, North Dakota, and South Dakota. Xcel serves commercial, industrial, and residential customers.

Four respondents filed briefs in this appeal, including the commission itself and three interested parties. The commission has the statutory authority to regulate Minnesota public utilities. Minn. Stat. § 216B.08 (2024). The Minnesota Department of Commerce (the department) acts to protect the interests of all ratepayers and is responsible for enforcing statutes related to utility ratemaking. *See* Minn. Stat. § 216A.07, subds. 2-3 (2024). The Office of the Minnesota Attorney General – Residential Utilities Division (RUD) acts on behalf of the attorney general to fulfill the attorney general's duty to "represent[] and further[] the interests of residential and small business utility consumers through participation in matters before the [commission]." Minn. Stat. § 8.33, subds. 2, 5 (2024). Finally, Xcel Large Industrials (XLI) is an *ad hoc* consortium of Xcel's largest industrial consumers.[1]

[1] The consortium consists of Flint Hills Resources Pine Bend LLC, Marathon Petroleum Corporation, and USG Interiors Inc.

In addition to the above-listed parties, amicus curiae Minnesota Public Utilities Group filed a brief on appeal supporting Xcel's position that prepaid pension asset should be included in rate base. Minnesota Public Utilities Group is an *ad hoc* consortium of public utilities operating in Minnesota, consisting of ALLETE Inc. d/b/a Minnesota Power,

Initiation of General Rate Case

In 2021, Xcel filed an application with the commission seeking to increase the electric rates that it charges consumers in Minnesota to reflect the increased cost of providing service. Xcel proposed a multiyear rate plan that would include three consecutive annual rate increases—specifically, increases of $396 million (12.2%) in 2022, $150.2 million (4.8%) in 2023, and $131.2 million (4.2%) in 2024. In its application, Xcel designated the 2022 calendar year as a "test year," which is a "12-month period selected by the utility for the purpose of expressing its need for a change in rates." Minn. R. 7825.3100, subp. 17 (2023). The commission referred the application to the Office of Administrative Hearings for a contested-case proceeding.

Contested-Case Proceeding

A contested-case proceeding was held before an administrative-law judge (ALJ). The proceeding included a two-day evidentiary hearing in December 2022 and nine days of public hearings. Written public comments were also received.

In March 2023, the ALJ issued a 235-page report containing findings of fact, conclusions of law, and recommendations (the ALJ report). Relevant here, the ALJ found that Xcel met its burden to support its proposed insurance-premium expenses but did not meet its burden to show that it would be reasonable to include its prepaid pension asset in rate base. Although the ALJ made findings, conclusions, and recommendations relating to employee-compensation costs generally, the ALJ did not specifically address Xcel's

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Minnesota Energy Resources Corporation, and CenterPoint Energy Resources Corp. d/b/a CenterPoint Energy Minnesota Gas.

proposed expense for its ten highest-paid executives in the ALJ report, nor had that issue been specifically addressed in the evidentiary hearing before the ALJ. However, members of the public had filed comments objecting to the amount of executive compensation for which Xcel sought recovery through rates.

Proceedings Before the Commission

After receiving exceptions to the ALJ report from interested parties, the commission heard oral arguments from parties over three days in May and June 2023. The record was then closed, and, in July 2023, the commission issued its findings of fact, conclusions, and order (the final rate order).

In the final rate order, the commission concurred with most of the ALJ's findings and conclusions but reached different determinations on some issues. Relevant here, the commission made the following determinations. First, the commission determined, contrary to the ALJ's recommendation, that Xcel did not meet its burden to support its proposed insurance-premium expenses for 2022 to 2024. The commission instead determined that the department's lower proposal for Xcel's insurance costs was reasonable and based on the method that was most supported by the record. Second, the commission determined, consistent with the ALJ's recommendation, that Xcel's prepaid pension asset could not be included in rate base because Xcel did not meet its burden to prove that its inclusion would result in just and reasonable rates. Third, the commission determined that Xcel did not meet its burden to support the reasonableness of Xcel's proposed amount of rate-recoverable annual compensation for its ten highest-paid executives. The commission instead determined that it would be reasonable for ratepayers to pay an amount

"comparable to the amount they pay for their own executives in state government" and accordingly limited Xcel's recoverable annual expense for each executive's compensation to the salary of the state's governor.

Petition for Reconsideration and Clarification

In August 2023, Xcel filed a petition for rehearing, reconsideration, and clarification. Xcel requested reconsideration of several of the commission's decisions, including those related to insurance-premium expenses, the prepaid pension asset, and executive compensation. In October 2023, the commission denied Xcel's petition.

Xcel appeals.

DECISION

Generally, before a public utility can raise the rates it charges customers for its services, the utility must provide the commission notice of the proposed change, as Xcel did through its petition for a rate increase. *See* Minn. Stat. § 216B.16, subd. 1 (2024). The commission is charged with regulating public utilities under the Minnesota Public Utilities Act (MPUA), Minnesota Statutes sections 216B.01-.67 (2024), which includes authorizing the rates that the utility may charge for its services. Minn. Stat. §§ 216B.08, .16. When exercising its powers under MPUA, the commission must set "just and reasonable rates for public utilities" by "giv[ing] due consideration to the public need for adequate, efficient, and reasonable service and to the need of the public utility for revenue sufficient to enable it to meet the cost of furnishing the service." Minn. Stat. § 216B.16, subd. 6.

It is the utility's burden to show, by a preponderance of the evidence, that its proposed rate changes are just and reasonable. *Id.*, subd. 4; *In re Petition of Minn. Power*

& Light Co., 435 N.W.2d 550, 554 (Minn. App. 1989) (describing the utility's burden), *rev. denied* (Minn. Apr. 19, 1989). "[B]y merely showing that [the utility] 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." *In re Petition of N. States Power Co.*, 416 N.W.2d 719, 723 (Minn. 1987). Even if the evidence submitted by a petitioning utility is true, the commission must determine whether the outcome sought by the utility is justified in light of "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." *Id.* at 722. If the commission determines that the utility's proposed rates are unjust, unreasonable, or discriminatory, the commission must issue an order setting the utility's new rates. Minn. Stat. § 216B.16, subd. 5.

To determine whether the proposed rates are just and reasonable, "the commission must determine both the utility's revenue requirement and its rate design." *In re Application by Minn. Power for Auth. to Increase Rates for Elec. Serv.*, 12 N.W.3d 477, 486 (Minn. App. 2024) (*Minn. Power 2024*) (citing Minn. Stat. § 216B.16, subd. 2(c)), *petition for rev. filed* (Minn. Oct. 9, 2024). A utility's revenue requirement is the amount of revenue that the utility needs to meet the cost of providing service, and its rate design refers to the allocation of the increased revenue among the various classes of the utility's consumers. *Id.* Xcel's challenges here all relate to the determination of its revenue requirement.

A revenue requirement includes the "utility's costs and a rate of return on [the utility's] rate base." *Id.* "Costs" generally refers to the utility's operating expenses. *See, e.g.*, 73B C.J.S. *Public Utilities* § 21 (2015) (stating that "the total revenue requirement" includes "the costs of the operation"). A "rate base" is "[t]he investment amount or property value on which . . . a public utility[] is allowed to earn a particular rate of return." *Black's Law Dictionary* 1515 (12th ed. 2024). Xcel argues that its proposed amounts for insurance premiums and executive compensation should be included as costs and that its prepaid pension asset should be part of rate base.

Before turning to the issues before us, we first identify the standard of review. Any party who is directly affected and aggrieved by a decision by the commission may appeal the decision to this court under the Minnesota Administrative Procedure Act (MAPA), Minnesota Statutes sections 14.001-.69 (2024). Minn. Stat. § 216B.52, subd. 1; *see also* Minn. Stat. § 14.63 (providing that "[a]ny person aggrieved by a final decision in a contested case" may appeal to this court). On review, decisions by the commission "enjoy a presumption of correctness, and deference should be shown by courts to the agencies' expertise and their special knowledge in the field of their technical training, education, and experience." *In re Application of Minn. Power for Auth. to Increase Rates for Elec. Serv.*, 838 N.W.2d 747, 757 (Minn. 2013) (*Minn. Power 2013*) (quotation omitted).

Under MAPA, an agency's decision may be reversed or modified if the decision violates constitutional provisions, exceeds the agency's statutory authority or jurisdiction, is "made upon unlawful procedure," is "unsupported by substantial evidence," or is "arbitrary or capricious." Minn. Stat. § 14.69. And the Minnesota Supreme Court has

specified different standards of review based on whether the commission acted in a legislative or quasi-judicial capacity in making the decision in question. *In re Request of Interstate Power Co. for Auth. to Change its Rates for Gas Serv.*, 574 N.W.2d 408, 412-13 (Minn. 1998); *St. Paul Area Chamber of Com. v. Minn. Pub. Serv. Comm'n*, 251 N.W.2d 350, 358 (Minn. 1977).

The commission acts in a quasi-judicial capacity when "hearing the views of opposing sides presented in the form of written and oral testimony, examining the record, and making findings of fact." *St. Paul Area Chamber of Com.*, 251 N.W.2d at 356. Establishing a utility's revenue requirement is a quasi-judicial action. *See, e.g.*, *Minn. Power 2024*, 12 N.W.3d at 488 (determining that substantial-evidence standard applies to decision regarding what to include in rate base); *N. States Power*, 416 N.W.2d at 726 (applying substantial-evidence standard when determining whether utility established reasonableness of an alleged cost). Thus, the quasi-judicial standard of review applies here.[2]

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[2] The department, RUD, and XLI argue that the commission acted in a quasi-judicial capacity when it determined whether Xcel introduced sufficient evidence to establish a given cost as a judicial fact but acted in a legislative capacity when balancing the needs of the utility and the interests of ratepayers and, therefore, both standards apply, depending on the decision. Xcel argues that the issues on appeal are quasi-judicial decisions governed by the substantial-evidence standard, and the commission also applies the standard for quasi-judicial decisions in its briefing.

We disagree that the standard of review for quasi-legislative decisions applies to any of the challenged actions here. In *Northern States Power*, the Minnesota Supreme Court recognized that the commission may act in both a quasi-judicial and a legislative capacity in a rate case, but it applied the quasi-judicial substantial-evidence standard to the commission's disputed revenue-requirement determinations. 416 N.W.2d at 722-24. Accordingly, that is the standard we apply here.

In reviewing quasi-judicial decisions, we apply the substantial-evidence test. *Id.* at 723. In rate-case proceedings, the substantial-evidence test requires us to "determine whether the [commission] has adequately explained how it derived its conclusion and whether that conclusion is reasonable on the basis of the record." *Id.* at 724 (quotation omitted). However, where there is a question of law, including "whether the Commission has exceeded its statutory authority," we apply de novo review. *See Minn. Power 2013*, 838 N.W.2d at 753. "We resolve any doubt about the existence of an agency's authority against the exercise of such authority." *Id.* (quotation omitted).

With these principles in mind, we turn to Xcel's three challenges to the final rate order.[3]

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[3] As a preliminary matter, we reject the department's argument that, before Xcel can obtain review of the three decisions it challenges, Xcel must successfully argue that the rates approved in the final rate order are "confiscatory." The department contends that, because Xcel did not argue that the rates are confiscatory, the argument is forfeited and we should affirm the final rate order without addressing Xcel's challenges. We disagree.

For rates to be confiscatory, the total effect of the rate order must threaten the utility's financial integrity "by leaving it with insufficient operating capital or by impeding its ability to raise future capital." *In re Request for Serv. in Qwest's Tofte Exch.*, 666 N.W.2d 391, 398 (Minn. App. 2003) (citing *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989)). Confiscatory rates "deprive[] [a utility] of its property in violation of the Fourteenth Amendment." *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679, 690 (1923); *see also* U.S. Const. amend. XIV, § 1.

Xcel does not argue that the commission's final rate order is unconstitutional. Instead, Xcel seeks relief under MAPA and MPUA, both Minnesota statutes. And, in other utility-rate cases in which a utility sought relief under MAPA, we have not required the utility to establish that the total effect of the commission's order is confiscatory in order to receive relief on appeal. *See, e.g.*, *Minn. Power 2024*, 12 N.W.3d at 488, 494 (determining that record did not demonstrate confiscatory rates but reversing part of commission's decision because it was unsupported by substantial evidence and arbitrary and capricious).

I. The commission's rejection of Xcel's forecasted insurance-premium expenses and setting of recoverable amounts is consistent with law, supported by substantial evidence, and not arbitrary and capricious.

Xcel argues that the commission's decision to reject Xcel's forecasted insurance-premium expenses for 2022 to 2024 and to instead use the department's lower amount is unsupported by substantial evidence, contrary to law, and arbitrary and capricious. We disagree.

Using its forecasting method, Xcel proposed insurance-premium expenses that would increase each year of its multiyear plan. To support its request in the contested-case proceedings, Xcel submitted testimony from its director of hazard insurance, who discussed how Xcel determined its numbers and why it believed increases were warranted. The director explained that Xcel's insurance-premium expenses are the estimated cost of insurance premiums less the distributions that Xcel predicts it will receive from mutual insurance pools and captive insurance. The director stated that one such distribution that could reduce Xcel's insurance cost could come from Nuclear Electric Insurance Limited (NEIL), a mutual insurance pool.

Xcel's forecasted premium-insurance expense for 2022 was significantly higher than its actual expense in 2021. Xcel's director of hazard insurance attributed the increase to factors including a "hardening" in the insurance market—meaning that insurance capacity is reducing, permitting insurance companies to increase premiums—and an upward trend in cost for casualty insurance due to an increase in catastrophic events. Xcel

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Accordingly, Xcel does not need to establish that the commission's prescribed rates are confiscatory to pursue its statutory challenges to the final rate order.

also asserted that its actual costs in 2021 were lower than forecasted due to an unexpected level of distributions from mutual insurance pools like NEIL that were unlikely to recur in 2022. In addition, because most of 2022 had passed by the time of the evidentiary hearing, Xcel submitted testimony on November 8, 2022, comparing its 2022 forecast to its actual costs so far that year. According to that testimony, Xcel's forecast varied from its actual expenses by only 0.4%.

The department raised concerns about the accuracy of Xcel's forecasted expenses and the adequacy of its supporting evidence. It pointed out that Xcel's forecasting yielded an amount for 2021 that was significantly higher than the actual 2021 costs. It also noted that Xcel's requested increases for 2017 to 2021 were much larger than the actual increases during those years. The department proposed a different approach. Through testimony from its witness, a public-utilities financial analyst, the department used historical cost information to generate a forecasted 2022 expense—an amount that was lower than Xcel's forecasted 2022 amount. The department arrived at its forecasted amount for 2022 by increasing Xcel's 2021 actual expenses by the average percentage of increase for 2017 to 2021. Using its estimated expense for 2022, the department then applied the year-over-year percentage increases proposed by Xcel for 2023 and 2024. All told, the department's method yielded insurance-premium expenses for 2022 to 2024 that were approximately $30 million lower than Xcel's proposed amount.

The ALJ found that Xcel met its burden to establish that its proposed insurance-premium expenses were reasonable and recommended that the commission approve Xcel's amount. The ALJ relied on the testimony described above from Xcel's director of hazard

insurance regarding the insurance market and factors affecting insurance costs, as well as his statement that, by the time of the evidentiary hearing, Xcel's method had accurately predicted Xcel's 2022 insurance costs.

In its final rate order, the commission departed from the ALJ's findings, conclusions, and recommendation concerning insurance-premium expenses. It determined that Xcel did not meet its burden to support its proposed insurance expenses. The commission noted concerns about the accuracy of Xcel's forecasting method—notwithstanding the small variance between the 2022 actual and forecasted expenses—because the same method had resulted in significant over-forecasting in 2017 to 2021. The commission determined that Xcel's argument that its 2021 actual insurance expenses would have been close to Xcel's forecast but for a larger-than-expected NEIL distribution was not a sufficient reason to accept Xcel's forecasting method given "other concerns raised in the record." The commission stated that, although Xcel budgets for NEIL distributions, the amounts Xcel receives from those distributions have previously "fluctuate[d] significantly and unpredictably," suggesting that they will continue to do so in the future. The commission stated that Xcel "relied heavily on overly generalized and indirect testimony about insurance-market trends" by not providing evidence directly from brokers or other industry experts. It stated that Xcel failed to show how its reasons for increased costs in some of Xcel's insurance programs applied to all its insurance programs. And the commission determined that "Xcel did not persuasively show that the factors it cited as affecting the insurance markets [were] so substantial and consequential in Xcel's insured locations that they fully account for the expansive differences between Xcel's

proposed insurance expenses for 2022-2024 and its actual insurance expenses incurred from 2017-2021."

Having found that Xcel did not carry its burden to support its forecasted insurance expenses, the commission determined substitute values for the expenses. *See N. States Power*, 416 N.W.2d at 726 ("When, in the Commission's judgment, a petitioning utility has failed to establish the reasonableness of costs which it claims justifies a proposed rate increase, the Commission itself may compute a hypothetical capital structure that will afford an ultimate determination of a reasonable and just rate."). It decided that the department's approach for calculating the expenses was reasonable and the approach most strongly supported by the record. The commission reasoned that, "[w]here costs fluctuate from year to year based on multiple factors beyond the [utility's] control . . . , it is often reasonable to consider historical averages over a range of years in setting test-year costs."

Xcel challenges the commission's decision. It contends that the commission denied recovery of its forecasted costs to make up for past overcollections of insurance-premium costs, contrary to statute and caselaw. And, regarding past forecasts, while acknowledging that its 2021 forecasted expense exceeded the 2021 actual expense, Xcel contends that the commission could not consider over-forecasting for 2017 to 2020 because the commission did not have the actual-versus-forecasted data for those years. Xcel also asserts that it explained that the 2021 discrepancy was due to an anomalously large NEIL distribution, without which its 2021 forecast would have been nearly accurate. Further, Xcel argues that the commission's reasoning ignored the testimony of Xcel's director of hazard insurance and the accuracy of its 2022 forecast when compared to the 2022 actual expense.

We are not persuaded. Contrary to Xcel's argument, the commission did not suggest that it was adjusting Xcel's forecasted insurance expenses to recover past overcollections. Rather, the commission determined that Xcel's historical over-forecasting of expenses "call[ed] into question the accuracy of the forecasts produced through the same process in this case." And information supporting the commission's concern about over-forecasting for 2017 to 2021 does appear in the record. During oral arguments before the commission in May 2023, the commission discussed that Xcel had over-forecasted insurance-premium expenses between 2017 and 2021. During that discussion, Xcel asserted that the commission was mischaracterizing a prior rate-case settlement related to Xcel's 2015 case before the commission. But Xcel did not object to the numbers discussed by the commission and does not argue here that its previous forecasts, apart from 2022, proved accurate.

As to Xcel's other arguments, the commission did not ignore the testimony of Xcel's director of hazard insurance. The commission explained that the magnitude of the requested increase in costs—which Xcel does not dispute was substantial—required Xcel to provide "more robust record development to support Xcel's request on this issue." The commission identified the shortcomings that it found in the witness's testimony: that the testimony was indirect; that it failed to link events causing increased costs in some insurance programs to all programs; and that it did not explain how the factors cited by Xcel were so substantial in Xcel's insured locations to fully account for the difference between historical costs and the forecasted costs for 2022 to 2024. And, although Xcel

provided an explanation for the over-forecasting in 2021, the commission adequately explained why it found that reasoning unpersuasive.

It is true that, during the contested-case proceedings, Xcel submitted evidence that its forecasted insurance expenses for 2022 were turning out to be very close to its actual expenses for 2022. But we disagree that that fact necessarily overcomes the commission's concerns about the accuracy of Xcel's forecasting process given historical over-forecasting or the commission's concerns about an insufficient record to support an increase in costs of the magnitude requested.

We conclude that the commission's decision to reject Xcel's forecasted amount of recoverable insurance-premium expenses for 2022 to 2024 and to adopt the department's method and amount is not contrary to law, lacking substantial evidence, or arbitrary and capricious.

II. The commission's categorical exclusion of Xcel's prepaid pension asset from rate base is not supported by substantial evidence and is arbitrary and capricious, and the commission must revisit the prepaid pension asset on remand.

Xcel argues that the commission's decision to exclude the prepaid pension asset from its rate base is contrary to law, unsupported by substantial evidence in the record, and arbitrary and capricious. We conclude that, especially in light of our intervening decision in *Minnesota Power 2024*, 12 N.W.3d at 489-94, the commission's findings are insufficient and remand to the commission is appropriate.

Xcel offers pension benefits to its eligible employees. As part of maintaining its pension plans, Xcel calculates a forward-looking pension expense. The pension expense is

included in Xcel's revenue requirement and is not at issue in this appeal. To fund its future pension obligations, Xcel contributes to its pension trust; certain contributions are mandated by federal law. When cumulative contributions to the pension trust exceed the cumulative amount of pension expense, that excess is a "prepaid pension asset." *See Minn. Power 2024*, 12 N.W.3d at 489 (using the same definition of prepaid pension asset). Xcel sought to include its prepaid pension asset in the rate base on which it is authorized to earn a reasonable return.

The ALJ determined that Xcel had not met its burden to show that inclusion of its prepaid pension asset in rate base would be reasonable. The ALJ found that the prepaid pension asset is different from typical rate-base assets because of its fluctuating value. The ALJ also noted concerns about the use of outdated or unapproved accounting principles in determining the prepaid pension asset. Although the ALJ stated that "[a] prepaid pension asset may be recoverable to the extent that a utility can demonstrate that the amounts to be included in rate base are not supplied by ratepayers or market returns on plan assets," the ALJ found that "[t]he [d]epartment has . . . demonstrated that because the value of the asset is determined in part by market gains and losses, there is doubt with respect to the source of the asset's value[, and] [d]oubt must be resolved in favor of ratepayers." The ALJ recommended that the commission deny Xcel's request to include its prepaid pension asset in rate base.

The commission agreed with the ALJ's recommendation. It determined that a "prepaid pension asset is fundamentally different from capital expenditures and other allowed rate-base categories" and that Xcel did not prove that inclusion of the prepaid

pension asset would result in just and reasonable rates. The commission noted that a prepaid pension asset "fluctuates in value" and includes balances that "are temporary and fundamentally different from typical rate-base assets on which [Xcel] earns a return." As part of its reasoning, the commission wrote that "a change in market returns," among other things, "can turn the asset into a liability" and that "market conditions" can affect "[p]ension-plan assets and benefit obligations."

After the commission's decision and the parties' briefing in this appeal but before oral arguments, we decided *Minnesota Power 2024*. 12 N.W.3d 477. In *Minnesota Power 2024*, the commission departed from an ALJ's extensive findings supporting the ALJ's recommendation to include a utility's prepaid pension asset in its rate base, reasoning that a prepaid pension asset is different from other typical rate-base assets because it is temporary and its value fluctuates. *Id.* at 490-93. The commission also noted that these characteristics make a prepaid pension asset materially different in character from other assets in rate base. *Id.* at 493.

We reversed the commission's decision to "categorically and entirely" exclude the utility's prepaid pension asset from its rate base. *Id.* at 494. We rejected the commission's reasoning that the asset must be excluded because it fluctuates in value, is temporary, and is distinct from other assets included in rate base. *Id.* at 492-93. We held that "a utility's mandatory contributions to pension plans are an expense of a capital nature to which the commission must give due consideration in determining the utility's rate base under Minn. Stat. § 216B.16, subd. 6." *Id.* at 493 (quotation marks omitted); *see* Minn. Stat. § 216B.16, subd. 6 ("In determining the rate base upon which the utility is to be allowed to earn a fair

rate of return, the commission shall give due consideration to . . . expenses of a capital nature."). We concluded that the commission's decision was "unsupported by substantial evidence because the commission [had] not provided an adequate explanation" and that "the decision [was] arbitrary and capricious because [it] departed from the ALJ's recommendation without adequate explanation." *Minn. Power 2024*, 12 N.W.3d at 494.

We remanded the matter to the commission for additional findings. *Id.* In so doing, we noted that we could not "conclusively determine" that the utility's prepaid pension asset should be included in rate base "because pension plans also earn market returns and shareholder contributions do not solely drive prepaid pension assets." *Id.* (quotation omitted). We observed that the parties disputed the extent to which the utility's prepaid pension asset was "attributable to shareholder contributions as opposed to market returns or negative pension expense" and explained that "[t]he commission is charged with resolving this dispute as part of its overall duty to determine fair and just rates." *Id.* The commission did not petition for review of our decision.[4]

Although the parties here did not have the benefit of *Minnesota Power 2024* when they briefed this case, they did address it in oral arguments. The commission candidly acknowledges that *Minnesota Power 2024* invalidated some of the same reasoning that was employed by the commission here but argues that the commission's decision nevertheless should be affirmed. It contends that, here, unlike in *Minnesota Power 2024*, remand is not

[4] A petition for review was filed by Large Power Intervenors, a consortium of large industrial customers, on issues that are not relevant to this appeal.

required because a threshold question before including a prepaid pension asset in rate base is the extent to which the asset is shareholder-funded and the ALJ made a finding—supported by the record and not rejected by the commission—that Xcel failed to meet its burden to show the extent to which its prepaid asset is shareholder-funded. Xcel, on the other hand, argues that, on this record, the only reasonable determination is that Xcel's prepaid pension asset is solely attributable to shareholder investment and not to market returns.

Here, much of the ALJ's and the commission's reasoning in excluding Xcel's prepaid pension asset from rate base is identical to the reasoning that we rejected in *Minnesota Power 2024*. It is true that the ALJ made a finding that the value of the prepaid pension asset "is determined in part by market gains and losses" and therefore "there is doubt with respect to the source of the asset's value." But the finding includes little explanation. And, in its final rate order, the commission did not address that specific finding when describing its reasons for excluding the prepaid pension asset. Moreover, the order's references to "market returns" and "market conditions" do not sufficiently address the extent to which Xcel's prepaid pension asset is attributable to shareholder contributions.

The parties vigorously dispute the significance of market returns and of methodologies that either permit or preclude negative pension expense in determining the value attributable to shareholder contributions. As we recognized in *Minnesota Power 2024*, "the evaluation of prepaid pension assets involves technical and complicated accounting issues in ratemaking proceedings." *Id.* Given this complexity, and in light of our decision in *Minnesota Power 2024*, we conclude that the commission has not made

sufficient findings and we reverse its decision. As in *Minnesota Power 2024*, we conclude that the appropriate course of action is to reverse and remand this decision to the commission for additional findings to determine whether any of Xcel's prepaid pension asset should be included in rate base. *See id.* The commission may, in its discretion, reopen the record.

III. The commission's denial of Xcel's proposed expense for executive compensation is supported by substantial evidence and not contrary to law, but its substitution of a comparative salary is arbitrary and capricious.

Xcel argues that the commission's denial of its proposed expense for compensation for its ten highest-paid executives is contrary to law and that the commission's decision to cap the expense at the authorized amount of the governor's salary is both unsupported by substantial evidence and arbitrary and capricious. We conclude that the commission lawfully rejected Xcel's proposed amount. But we also conclude that, in substituting a compensation expense that is tied to the Minnesota governor's salary, the commission failed to consider an important aspect of the problem, and we remand the issue to the commission for reconsideration.

Xcel sought rate recovery for a portion of its total compensation for its ten highest-paid executives—specifically, about $7 million for each of the three years of the multiyear plan.

In the contested-case proceedings before the ALJ, the vice president of an Xcel affiliate testified that Xcel sets compensation for non-bargaining employees near the median of similar positions in investor-owned utility and nonutility companies. There was no testimony or evidence specific to the compensation for Xcel's ten highest-paid

executives. Although Xcel was required by statute to file a schedule itemizing expenses for its ten highest-paid executives with its initial case, *see* Minn. Stat. § 216B.16, subd. 17(a)(5), that information was not filed until after the contested-case proceedings, when the matter was before the commission. The ALJ did not directly address the issue of compensation for Xcel's ten highest-paid executives.

Having received more than 20 public comments on the issue, the commission decided to specifically address executive compensation in its final rate order. It determined that Xcel failed, for three reasons, to meet its burden to show that charging ratepayers $7 million annually for compensation of its ten highest-paid executives was reasonable. First, Xcel based its market comparison of executive compensation on the compensation of corporate officers who had "a fiduciary duty of care to shareholders—but no comparable duty to ratepayers." Second, Xcel's compensation structure "focuses the executive team on shareholder benefits, which are not necessarily aligned with the interests of ratepayers." And, third, Xcel did not "meaningfully consider[]" the impact that this cost would have on ratepayers or "explore[] the possibility of reducing any component of the executive compensation packages it offers as a means of shouldering the burdens of inflation alongside its customers." The commission explained that it has an obligation both to verify the accuracy of the costs and to evaluate "whether, based on the facts in the record and the application of its judgment, it is just and reasonable to include the cost[s] in rates." And the commission determined that Xcel had not met its burden on the just-and-reasonable question.

The commission then determined a level of recovery that it deemed appropriate. It decided that it would be reasonable for ratepayers to pay an amount comparable to what they pay their state-government executives. Using the approximate authorized 2024 salary of the governor of Minnesota, the commission capped the recoverable compensation for each executive at $150,000 per year, totaling $1.5 million annually for Xcel's ten highest-paid executives. The commission stated:

> On this record, the Commission concludes that it would be reasonable for Xcel's ratepayers to pay an amount for Xcel's top 10 executives that is comparable to the amount they pay for their own executives in state government. Beginning in 2024, Minnesota's highest executive officer—its Governor—will be paid approximately $150,000 per year. The Commission finds that allowing recovery of compensation at a level similar to that of Minnesota's top executive on average for each of Xcel's 10 highest-paid executives reasonably reflects the level of expense that should be borne by ratepayers.
>
> The Commission will therefore limit the level of executive compensation for the top 10 highest-paid employees and officers recoverable through Minnesota electric rates to $1.5 million per year in total. This decision also precludes Xcel from recovering any [annual incentive plan] expense for its 10 highest-paid officers and employees.
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> . . . .
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> On this issue as with other compensation-related issues, the Commission's decision is limited to the amount of compensation costs that Xcel may include in its rates charged to Minnesota customers. [Xcel] has been and continues to be free to compensate its employees at levels in excess of its authorized rate recovery if it chooses to do so.

Xcel argues that the commission's decision is contrary to law because Xcel proved that its costs were reasonable so it was entitled to recover those costs to allow it to collect

sufficient revenue to cover the cost of its service. *See* Minn. Stat. § 216B.16, subd. 6 ("The commission, in the exercise of its powers under this chapter to determine just and reasonable rates for public utilities, shall give due consideration to . . . the need of the public utility for revenue sufficient to enable it to meet the cost of furnishing the service . . . .").

We conclude that the commission's denial of Xcel's proposed expense amount accords with its statutory mandate and is not contrary to law. Xcel had the burden to show not only that it would incur the expense but "that it is just and reasonable that the ratepayers bear the costs of those expenses." *N. States Power*, 416 N.W.2d at 723. Any doubt about the reasonableness of rates must be resolved in favor of consumers. Minn. Stat. § 216B.03. Although Xcel provided general testimony that it set its employee compensation based on market comparisons with other corporate employers, it did not specifically address the compensation levels for its ten highest-paid executives—an issue that the commission may closely consider, especially given the utility's statutory obligation to provide specific information about that pay. *See* Minn. Stat. § 216B.16, subd. 17(a)(5). The commission expressed concern that, under Xcel's compensation structure as established in the record, its executives' focus was on maximizing profits for shareholders—a focus that can create a misalignment between ratepayer and shareholder interests. On this record, we disagree with Xcel that, because it provided evidence that it generally pays employee compensation at median market rates, the commission was compelled by statute to conclude that Xcel had satisfied its burden to prove that its requested recoverable compensation cost for its ten highest-paid executives is a reasonable and necessary cost of providing service that is

appropriate for ratepayers to pay. *See N. States Power*, 416 N.W.2d at 723 (providing that a showing that an expense may be incurred does not necessarily demonstrate "that it is just and reasonable that the ratepayers bear the costs of those expenses").

Xcel next argues that the commission acted arbitrarily and capriciously and without substantial evidence when it limited Xcel's recovery of compensation for its ten highest-paid executives to a total of $1.5 million per year. Because Xcel's arbitrary-and-capricious argument is dispositive, we start and end our analysis there.

> A decision will be deemed arbitrary and capricious if the agency . . . entirely failed to consider an important aspect of the problem, if it offered an explanation for the decision that runs counter to the evidence, or if the decision is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.

In re Application of Minn. Power for Auth. to Increase Rates for Elec. Serv., 929 N.W.2d 1, 9 (Minn. App. 2019) (*Minn. Power 2019*) (quotation omitted), *rev. denied* (Minn. Aug. 6, 2019).

After the commission determined that Xcel had not met its burden on executive compensation, it decided what level of recovery was appropriate. In making that determination, the commission was required to determine "just and reasonable" rates by giving "due consideration to the public need for adequate, efficient, and reasonable service and to the need of the public utility for revenue sufficient to enable it to meet the cost of furnishing the service." Minn. Stat. § 216B.16, subd. 6 (noting that the interests of the public and of the utility must be given "due consideration" when the commission exercises "its powers under this chapter"); *see also N. States Power*, 416 N.W.2d at 726 (stating

when a utility fails to meet its burden to establish reasonable costs, the commission "itself may compute a hypothetical capital structure that will afford an ultimate determination of a reasonable and just rate").

In setting an alternative executive-compensation expense, the commission stated that "it would be reasonable for Xcel's ratepayers to pay an amount for Xcel's top 10 executives that is comparable to the amount they pay for their own executives in state government" and that that amount "reasonably reflects the level of expense that should be borne by ratepayers." The commission then chose the Minnesota governor's salary as the appropriate amount. As Xcel argues, the commission's reasoning focuses exclusively on the interests of ratepayers without explaining why the Minnesota governor is a reasonable proxy for a utility executive or why the governor's salary is an amount that is "sufficient to enable [Xcel] to meet the cost of furnishing service." Minn. Stat. § 216B.16, subd. 6. Apart from identifying the governor as the state's "highest executive officer," the order does not explain why the governor is an appropriate comparison for determining the recoverable compensation for the highest-paid executives of a large public utility. By not describing how or why the governor's salary was the appropriate measure to meet the needs of the ratepayer *and* the utility, the commission "failed to consider an important aspect of the problem." *Minn. Power 2019*, 929 N.W.2d at 9 (quotation omitted). As a result, we conclude that the commission's decision is arbitrary and capricious.[5]

[5] In support of its arbitrary-and-capricious argument, Xcel asserts that the commission followed an irregular procedure, which indicates that the commission's decision was arbitrary and capricious. Because we conclude that the commission's decision is arbitrary and capricious on other grounds, we decline to reach this issue.

We therefore reverse the commission's decision to set total recovery for Xcel's annual compensation of its ten highest-paid executives at $1.5 million annually and remand to the commission to make additional findings. The commission may, in its discretion, reopen the record.[6]

In sum, for the foregoing reasons, we affirm in part, reverse in part, and remand to the commission to make additional findings regarding the prepaid pension asset and appropriate compensation expense for Xcel's ten highest-paid executives. The commission may, in its discretion, reopen the record for either issue.

Affirmed in part, reversed in part, and remanded.

[6] In remanding to the commission, we express no opinion as to an appropriate measure of recoverable compensation and do not foreclose the commission from setting the compensation level at the same amount if just and reasonable. We simply conclude that the commission did not adequately explain an important aspect of the problem regarding the amount chosen.

SMITH, TRACY M., Judge (concurring in part, dissenting in part)

I concur in the court's opinion except for its conclusion that the public utilities commission acted arbitrarily and capriciously in setting the rate-recoverable expense for Xcel's compensation of its ten highest-paid executives at $1.5 million annually. As to that part, I respectfully dissent. I would not remand that issue to the commission.

In my view, the commission adequately explained its decision and did not act arbitrarily and capriciously. As the commission decided and as we agree, Xcel did not satisfy its burden to prove that $7 million annually is a reasonable and necessary cost that is appropriate for ratepayers to pay for compensation of its ten highest-paid executives. The commission therefore tasked itself with determining a substitute amount rather than denying the expense entirely.

In so doing, the commission applied reasoning that is explicit throughout the final rate order. That reasoning is that it is not just and reasonable for ratepayers to pay the full expenses of an employee-compensation structure that, through incentive-pay provisions, focuses on earnings and shareholder benefits without necessarily serving the interest of ratepayers in receiving "adequate, efficient, and reasonable service." Minn. Stat. § 216B.16, subd. 6 (2024). The commission applied that reasoning in other compensation-cost decisions that were not challenged by Xcel. Specifically, the commission denied Xcel's request to recover costs for certain elements of its long-term-incentive compensation and capped at 15% of base salary Xcel's recovery of costs for its annual-incentive-program, which is tied to earnings per share. In determining that Xcel did not carry its burden with respect to its proposed executive-compensation expense, the

commission observed that Xcel relied on market comparisons to corporate officers who have a duty only to shareholders and no comparable duty to ratepayers and highlighted the shareholder focus of Xcel's executive-compensation package.

From all these decisions, it is evident that, to determine what portion of Xcel's executive compensation is a just and reasonable amount to be borne by ratepayers, the commission looked for executive compensation that is based on serving only the public's interest and not private interests. The commission decided that it was reasonable for Xcel's ratepayers to pay an amount for Xcel's executives that is comparable to what they pay for their own state-government executives. The commission chose the state's highest executive officer—the governor—and set the recoverable amount for Xcel's highest-paid executives at the governor's salary. To me, this is a rational and sufficient explanation, even if the commission also had other rational options.

It is important to recognize, as the commission did in its final rate order, that the commission's decision is limited to the amount of executive-compensation costs that Xcel can include in the rates that it charges Minnesota consumers and that Xcel continues to be free to compensate its employees at higher rates. Xcel submitted evidence that, to maintain a qualified workforce, it pays its employees at the median of market rates. Nevertheless, while not conceding that it is not entitled to recover it, Xcel did not seek to recover the full, market-rate-based compensation of its ten highest-paid executives, and reasonably so. Unquestionably, the market rates for Xcel's ten highest-paid executive positions are substantially higher than the governor's salary. But the question for the commission was not what amount would be sufficient total compensation to attract persons to Xcel's

executive positions; the question was what would be a just and reasonable amount for ratepayers to pay, taking into account the public need for adequate, efficient, and reasonable service and the revenue needs of the utility to provide such service. *See id.* I do not think the commission acted arbitrarily and capriciously in deciding that question.