

Minnesota Public Utilities Commission
Staff Briefing Papers

Meeting Date: July 9, 2015 ****Agenda Item #4**

Company: Northern States Power Company d/b/a Xcel Energy (Xcel or NSP)

Docket No. E-002/CI-13-754
In the Matter of a Commission Investigation into Xcel Energy’s Monticello Life-Cycle Management/Extended Power Uprate Project and Request for Recovery of Cost Overruns

Issue: Should the Commission reconsider and/or clarify its May 8, 2015 Order Finding Imprudence, Denying Return on Cost Overruns, and Establishing LCM/EPU Allocation for Ratemaking Purposes?

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Relevant Documents

Commission Order May 8, 2015
Xcel Energy – Petition Requesting Limited Reconsideration & Clarification May 28, 2015
Office of Attorney General – Petition for Reconsideration May 28, 2015
Department of Commerce – Letter Requesting Clarification May 28, 2015
Xcel Energy – Response to Petitions for Reconsideration & Clarification June 8, 2015
Office of Attorney General – Answer to Petitions for Reconsideration June 8, 2015
Department of Commerce – Response to Xcel’s Request June 8, 2015

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Statement of the Issue

Should the Commission reconsider and/or clarify its May 8, 2015 Order Finding Imprudence, Denying Return on Cost Overruns, and Establishing LCM/EPU Allocation for Ratemaking Purposes?

Minnesota Statutes and Commission Rules

Petitions for reconsideration are subject to Minn. Stat. § 216B.27, and Minn. Rules, Part 7829.3000. Petitions for reconsideration are denied by operation of law unless the Commission takes action within sixty days of the request. If the Commission takes no action on Xcel's and the OAG's petitions, the requests are considered denied as of July 27, 2015. The Commission may also take specific action to deny the petitions.

If the Commission takes up a party's request for reconsideration, the Commission can: (1) reconsider, and (a) affirm, (b) modify or (c) reverse its initial decision, or (2) deny the petition for reconsideration and thereby affirm the initial decision. The Commission may also reconsider or clarify its Order on its own motion.

Commission Decision

Point 4 in the Commission's May 8, 2015 Order stated the following:

The Commission finds that no disallowance is necessary in this prudence review but that Xcel will not be allowed a return on the expenses exceeding the initial figures provided in its the [sic] certificate-of-need filings, escalated to 2014 dollars.¹

Although the order states the methodology to calculate the overrun amount, it does specifically quantify the disallowance amount.

In deliberations on March 6, 2015, Chair Heydinger moved a motion that included the following:

Find that no disallowance is necessary in this prudence review; however, allow the Company to earn only a weighted short-term and long-term debt return (no equity) on the expenses exceeding the initial figures provided at the time of the submission of the certificate of need, escalated to 2014 dollars.

Commissioner Lipschultz moved to amend the Chair's motion by replacing the language quoted above with the following:

Find that no disallowance is necessary in this prudence review; however; do not allow a return on the expenses exceeding the initial figures provided at the time of the submission of the certificate of need, escalated to 2014 dollars.

¹ Commission May 8, 2015 Order, page 26

Commissioner Lipschultz's motion passed 3-2. Chair Heydinger and Commissioner Wergin voted against the motion.

As amended, Chair Heydinger's motion passed 5-0.

Background

On May 8, 2015, the Commission issued its Order Finding Imprudence, Denying Return on Cost Overruns, and Establishing LCM/EPU Allocation for Ratemaking Purposes.

On May 28, 2015, Xcel filed a Petition Requesting Limited Reconsideration and Clarification. In its petition the Company requested that the Commission reconsider its decision to not allow a return on the approved cost overruns and instead allow a return equal to its 2014 weighted cost of debt of 2.27%. Xcel also requested clarification of the Commission's \$333 million cost overrun calculation.

On May 28, 2015, the OAG filed a Petition for Reconsideration. In its filing the OAG argued that, once "the Commission found that the cost overruns were not prudently incurred, the Commission should have directly disallowed some or all of the overruns."² The OAG reasserted its recommendation from the prudence review and requested disallowance of 75% of the cost overruns and denial of any return on any allowed overruns.

On May 28, 2015, the Department of Commerce filed a Letter Requesting Clarification of the Commission's \$333 million cost overrun calculation.

On June 8, 2015, Xcel filed an answer opposing the OAG's recommended disallowance alternative.

On June 8, 2015, the OAG filed answer comments opposing Xcel's request to earn a return on the cost overruns. The OAG also offered a different interpretation of the Commission's order disallowance calculation.

On June 8, 2015, the Department of Commerce filed answer comments also opposing Xcel's request to earn a return on the cost overruns.

² OAG, Petition for Reconsideration, page 2

Reconsideration Items

Return on Disallowance (Xcel)

Xcel

In its May 28, 2015 Petition for Reconsideration, Xcel requested that the Commission allow the Company to recover its cost of debt for the Program costs that exceed the escalated certificate of need estimates. In its filing, Xcel acknowledged that it learned important lessons regarding regulatory expectations and the importance of communicating transparently about its costs, alternatives considered, and records and vowed to apply those lessons in future endeavors.

In its Petition Xcel pointed out that the Commission determined that the Company should be allowed to recover “its actual investment in the plant” but no return on costs exceeding the initial Program cost estimate, escalated to 2014 dollars. Xcel submitted that debt costs represent actual Company cash outlays in the plant that are no different than cash outlays for equipment or labor and, since debt cost recovery is consistent with recovery of actual Program investments, requested that the Commission reconsider its Order and allow the Company to recover its debt costs for the overall Program.

Xcel argued that permitting a return of the fixed cost of debt would be consistent with allowing recovery of its investment without creating profit for shareholders; therefore, it proposed that it be allowed to earn its weighted cost of debt of 2.27% on the cost overrun amount. Applying the 2.27% to the difference between the initial cost estimate of \$415 million (escalated) and the \$748 million final cost, the 2015 revenue requirement impact of not recovering the full rate of return would still be \$14.2 million instead of \$18.0 million.

OAG

In its June 8, 2015 response, the OAG stated that the Commission should reject Xcel’s request to earn a return on cost overruns. The OAG characterized Xcel’s claim that it should be allowed to earn a debt return on the cost overruns because the cost of debt “is an actual cost resulting from incurring debt,” as unreasonable and inconsistent with the Commission’s ratemaking practices and; therefore, should be denied.

The OAG indicated that Xcel’s claim that a debt-only return represents actual debt expense is misleading and is contrary to the principles of finance and added that it is not possible to track whether the Monticello project, or any other investment, was financed by debt, equity, or some combination of the two. Furthermore, while Xcel likely has debt payments related to financing the Monticello project, the Company recovers the cost of financing its debt for construction projects from another source—the accrual and capitalization of Allowance for Funds Used During Construction (“AFUDC”). Xcel recorded \$84.4 million in AFUDC for the Monticello Project; therefore, the argument that it requires a debt return to pay its actual financing costs is factually inaccurate because, according to Xcel, the AFUDC method allows full recovery of financing costs.

Department

In its June 8, 2015 response, the Department stated that Xcel's Rehearing Request for the debt costs that exceed the escalated certificate of need estimate is not supported by the record and highlights the fact that "Xcel failed to demonstrate that the Monticello cost overrun was reasonable and prudent, as stated on page 22 of the Commission's May 8, 2015 Order."³ The Department elaborated by stating that many of Xcel's arguments have already been rejected by the Commission and went on to discuss them. Since these arguments have already been discussed and rejected, they are not repeated in these Briefing Papers.

The Department also disagreed with Xcel's claims that cost of debt is the same as cash outlays for equipment or labor. The DOC explained that cost of debt for a utility is not tied to a specific resource, in this case Monticello, but instead is a form of financing that is part of a rate regulated utilities rate of return. By contrast, equipment is itself a specific resource and labor on equipment is also tied to the resource. The Department stated that it did not evaluate the cost of debt as part of the capital cost of Monticello, nor did the Company offer the cost of debt as part of the capital costs of Monticello. The Department also rejected Xcel's comparison of these cost overruns to the Prairie Island cost overruns by pointing out the differences between the two.

In conclusion, the Department, based on the facts in this proceeding, continued to support the Commission's decision of no return on the cost overrun amount of \$333 million and argued that Xcel has not shown that it is reasonable for it to receive a weighted cost of debt return.

Disallowance Amount (OAG)

OAG

Although it concurred with the Commission's finding of imprudence, the OAG, in its May 28, 2015 Petition for Reconsideration, stated that it did not think that the Commission's remedy properly applied the burden of proof in this case nor did it go far enough to protect ratepayers from costs for which Xcel has not met its burden of proof.

The OAG pointed out that according to the Minnesota Supreme Court, "Where a party having the burden of proof with respect to a particular issue fails to sustain such burden, [the] decision as to such issue must go against him." The Minnesota Supreme Court has also stated, "Absence of proof on a vital issue loses the case for the party having the burden of proof no matter how difficult it is." The OAG stated that because cost overruns were not prudently incurred, the Commission should have directly disallowed some or all of the overruns. The OAG argued that reason the Commission declined to disallow was because other parties in the case had not been able to identify precise costs that were caused by Xcel's mismanagement. The OAG believes that justification improperly shifts the burden of proof, and conflicts with the Commission's articulation of the legal standard for this case:

³ Department of Commerce, June 8, 2015 response, page 2

[U]nder Minnesota law, the utility always retains the burden of showing that it would be just and reasonable to include a particular utility expense in rates.

Moreover, a utility is in the best position to explain why its costs increased and to identify the amount of the increases. *Allowing a utility to recover its imprudently incurred costs simply because public agencies or other intervenors are unable to precisely identify which imprudent actions caused which costs would not result in just and reasonable rates.*

The OAG stated that, despite the Commission's quasi-legislative authority to determine just and reasonable rates, the proper application of the burden of proof is a legal matter that is outside the bounds of that quasi-legislative authority. Furthermore, since the decision was influenced by the fact that Xcel's ratepayers will benefit from many years of carbon-free power and that it is possible that some of the factors that led to increased cost were beyond Xcel's control, those factors demonstrate that it may be appropriate for the Commission to allow Xcel *some* of the cost overruns in addition to denying a return on the cost overruns that are allowed, as recommended by the OAG. As a result, the OAG concluded that Commission should reconsider its Order and adopt the OAG's recommendation to disallow 75% of the cost overruns, and deny a return on any cost overruns that are allowed.

Xcel

In its response dated June 8, 2015, Xcel disagreed with the OAG's argument that the Commission should have directly disallowed some or all of the overruns. Xcel stated that the OAG's argument relied on case law pertaining to judicial bodies in civil and criminal cases, rather than to a regulatory body with quasi-judicial as well as quasi-legislative authority. Xcel pointed out that the OAG itself argued earlier in this proceeding that the Minnesota Supreme Court has "specifically noted that the Commission does not follow the standard civil burden of proof"⁴ and that "the burden of proof applied in utility proceedings before the Commission is different from traditional civil lawsuits."⁵ Xcel added that the OAG conflated the standard for *liability* in civil and criminal cases with the standard for determining an appropriate ratemaking *remedy* in a regulatory proceeding. Xcel stated that since the Commission is required to "balance interests", it is incorrect to argue that the Commission must disallow some or all of a project's costs if the Commission concludes the Company did not meet its burden in all respects.

⁴ OAG Reply Brief, page 7

⁵ OAG Initial Brief, page 7

Clarification Item

Overrun Calculation

In its May 28, 2015 Petition for Reconsideration, Xcel requested that the Commission specify the initial cost estimate for the Monticello Program. Xcel pointed out that calculation of the “no return” outcome necessitates a specific amount that will be compared to the final Program costs of \$748 million.⁶ Xcel stated that a Hearing Exhibit (the Monticello Remedy Table) identified total escalated initial costs of \$415 million⁷ and that it did not take issue with the calculation. Xcel acknowledged that Staff’s calculation is rooted in the record and; therefore, only requested clarification that the \$415 million is the total initial cost to be utilized to calculate the Commission’s selected remedy.⁸

In its May 28, 2015 letter, the Department reaffirmed its support of the Commission’s determination. However, for purposes of clarity and to ensure accurate calculation of rate treatment associated with the Monticello Order in Xcel’s rate case,⁹ the Department respectfully asked that the Commission make clear that its denial of a return in the Monticello Order relied on the approximate calculation provided by Commission Staff in Footnote 1 of the Addendum to Staff Briefing Papers (the Monticello Remedy Table) that was efiled in this matter on May 7, 2015. The addendum calculated that Xcel’s final project costs exceeded the initial figures provided in the certificate-of-need (“CN”) filings, escalated to 2014 dollars, by approximately \$333 million.

In their respective responses dated June 8, 2015, both Xcel and the Department supported each other’s essentially identical requests for clarification regarding the amount of the overrun, with the Department’s caveat that it seeks confirmation from Xcel that the Company’s proposed language would result in recovering no more costs than the amount stemming from the Department’s request that the Commission confirm or clarify that \$333 million is the cost overrun figure on which a return was denied. The OAG did not agree and submitted its own calculation, as discussed below.

In its June 8, 2015 response, the OAG disagreed with the use of the Addendum previously mentioned as a basis for calculating Monticello cost overruns. The OAG argued that the Commission’s Order clearly stated that the disallowed return should be calculated on the basis of the “project expenses exceeding the figures provided in the certificate-of-need filings, escalated to 2014 dollars.” The OAG also pointed out that the calculation methodology did not include AFUDC. The OAG objected to the use of a 4% annual escalator and recommended that the Commission adopt a 2.34% escalator instead. Based on the 2.34% escalator and without AFUDC, the OAG calculated total escalated project costs to be \$315 million which, if adopted by the Commission, would result in a \$433 million cost overrun.

⁶ \$748 million includes AFUDC

⁷ See Addendum to Staff Briefing Papers filed on May 7, 2015.

⁸ Resulting disallowance would be \$333 million - \$748 million minus \$415 million.

⁹ Docket 13-868

Staff Comments

Although Staff considers Xcel's interpretation of the Commission's determination that Xcel can recover "its actual investment in the plant" to be original; Staff finds that Xcel's proposal is identical to decision alternative 5F on Staff's February 28, 2015 Briefing Papers. Staff believes the Commission carefully considered that alternative in its deliberations and is not persuaded that the Commission should reconsider its decision.

Staff acknowledges its lack of legal expertise and will not comment on the legal merits of the OAG's argument about the Commission's quasi-legislative and quasi-judicial authority; however, Staff does want to point out that the OAG's proposed remedy is identical to decision alternative 5C on Staff's February 28, 2015 Briefing Papers. As with Xcel's proposal, and for the same reasons, Staff is not persuaded the Commission should reconsider its decision.

Regarding the cost overrun calculation, Staff concurs with Xcel and the Department that the Order only provides the methodology for the calculation and does not specify a dollar amount. Based on the record and on deliberations, Staff interpreted the amount to be \$333 million; however, the OAG has provided its own alternative interpretation that, if adopted, would increase the cost overrun amount to \$433 million.

Staff believes the Commission determined that the amount of the cost overrun was \$333 million. For clarity, Staff believes the Commission should specify what the correct amount should be.

Decision Alternatives

A. Rehearing and Reconsideration of the May 8, 2015 Order

1. Grant Xcel Energy's petition for reconsideration, or
2. Grant the Office of Attorney General's petition for reconsideration, or
3. On its own motion, reconsider the May 8, 2015 Order, or
4. Deny both Xcel's and the OAG's requests for reconsideration, and/or
5. Take no action and allow Xcel's and the OAG's petitions for reconsideration to be denied by operation of law.

B. If the Commission grants Xcel's petition, or, on its own motion moves to reconsider the May 8, 2015 Order, it may

1. Modify the Order and grant Xcel's request allowing the Company to earn a return on the disallowed amount equal to the Company's weighted cost of debt, and/or
2. Make any other changes it deems necessary, or
3. Reaffirm the decision in the May 8, 2015 Order.

C. If the Commission grants OAG's petition, or, on its own motion moves to reconsider the May 8, 2015 Order, it may

1. Modify the Order and grant the OAG's request to disallow 75% of the cost overrun and disallow any return on the remaining 25% overrun, and/or
2. Make any other changes it deems necessary, or
3. Reaffirm the decision in the May 8, 2015 Order.

D. If the Commission determines that clarification of the cost overrun amount in the May 8, 2015 Order is necessary, it may

1. Determine that the OAG's \$433 million cost overrun calculation should be used in this case, or
2. Clarify that the cost overrun amount in this prudence review is \$333 million.