STATE OF MINNESOTA
BEFORE THE PUBLIC UTILITIES COMMISSION

Beverly Jones Heydinger	Chair
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Nancy Lange	Commissioner
Dan Lipschultz	Commissioner
John Tuma	Commissioner

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

DOCKET NO. E-002/CI-13-754

JOINT ANSWER OF THE OFFICE OF THE ATTORNEY GENERAL TO PETITIONS FOR RECONSIDERATION

I. INTRODUCTION.

The Office of the Attorney General—Residential Utilities and Antitrust Division ("OAG") respectfully submits this Answer to the Petition for Reconsideration filed by Northern States Power Company ("Xcel" or "the Company") and the Request for Clarification filed by the Department of Commerce ("the Department") pursuant to Minnesota Rules part 7829.3000.

II. THE COMMISSION SHOULD REJECT XCEL'S REQUEST TO EARN A RETURN ON THE MONTICELLO COST OVERRUNS.

In its Petition for Reconsideration, Xcel asks the Commission to reverse its decision and grant the Company a debt-only return on cost overruns for a project that the Commission determined was handled imprudently. Xcel claims 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," rather than a part of the Company's return.[1] Xcel's request is unreasonable, inconsistent with the Commission's ratemaking practices, and should be denied.

[1] Xcel Petition for Reconsideration, at 7.

Xcel's claim that a debt-only return represents actual debt expense is misleading and is contrary to the principles of finance. 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. Xcel has never claimed, nor could it demonstrate, that it financed the Monticello project from a specific source of debt, as opposed to equity. Moreover, the cost of debt included in Xcel's weighted cost of capital does not represent the "actual cost" of incurring debt for any particular project—the cost of debt is an average from many sources of debt, used across Xcel's entire system.[2] Combining Xcel's cost of debt with the final costs of the Monticello project would not lead to the "actual cost" of financing the Monticello project. Moreover, debt, equity, and capital are all combined to create Xcel's rate of return. It is not feasible to selectively identify debt financing for the Monticello project, and Xcel's argument on this point is disingenuous.

Furthermore, while Xcel likely has debt payments related to financing the Monticello project,[3] 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 has recorded $84.4 million in AFUDC for the Monticello project. The purpose of that AFUDC is to allow Xcel to recover the cost of financing construction. One utility accounting treatise describes AFUDC by noting that utilities may be "allowed to capitalize the financing costs for future recovery through an allowance for funds used during construction."[4] Importantly, when Xcel described the AFUDC ratemaking process in its 2013 rate case, it stated that "the Minnesota method [for CWIP and AFUDC] allow[s] *full*

[2] *See, e.g.*, Tyson Direct Testimony, *In the Matter of the Application of Northern States Power Company for Authority to Increase Rates for Electric Service in Minnesota*, Docket No. E-002/GR-13-868, Doc. ID 201311-93266-03 (Aug. 4, 2014).
[3] Although Xcel has not identified any evidence regarding debt servicing costs.
[4] Robert L. Hahne, Gregory E. Aliff, Accounting for Public Utilities, Volume I, 4.04[4] (2013).

recovery of financing costs."[5] Xcel's 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."[6] Xcel will recover $84.4 million in AFUDC for Monticello following the Commission's decision in this case, which represents the cost of financing the project. Xcel's argument that it requires an additional source of funding for its financing costs is unreasonable.

In addition, the Commission already considered, and discarded, the possibility of allowing a debt-only return on the Monticello cost overruns. During deliberations, the Commissioners discussed whether Xcel should be permitted a debt return on the cost overruns, and decided against it. The Commission's policy judgment on this matter was sound. Permitting Xcel to earn a return, even a debt return, on costs that were the result of imprudent management, would create incentives for profit-maximizing businesses to allow construction budgets to increase, and would reduce incentives for utilities to ensure prudent management in the future. If Xcel really "accept[ed] the Commission's policy judgment," as it claims in its Petition,[7] Xcel would accept the decision the Commission already made—that Xcel should not be allowed a debt return on the cost overruns.

III. THE COMMISSION SHOULD NOT ADOPT THE ADDENDUM TO THE BRIEFING PAPERS THAT WAS INTRODUCED DURING DELIBERATION.

Both Xcel and the Department have asked the Commission to clarify how the Commission intends to calculate the amount of cost overruns for which Xcel will be denied a return. Xcel and the Department ask the Commission to adopt a methodology for calculation

[5] Xcel Initial Brief, *In the Matter of the Application of Northern States Power Company for Authority to Increase Rates for Electric Service in Minnesota*, Docket No. E-002/GR-13-868, at 89 Doc. ID 20149-103232-01 (Sept. 23, 2014) (emphasis added).
[6] *Id.*
[7] Xcel Petition for Reconsideration, at 2.

contained in an addendum to Staff briefing papers that was introduced during the Commission's deliberation on March 6, 2015.[8] But the Commission did not adopt the addendum, and the language in the Commission's Order is clear—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."

A. THE COMMISSION'S ORDER CLEARLY DESCRIBES A DISALLOWANCE METHODOLOGY.

The request to adopt the figures contained in the addendum is unreasonable. The Commission discussed the addendum thoroughly during deliberations. If the Commission had wished to formally adopt the figures contained in the addendum, it could have done so during deliberations. It did not do so. In fact, it would have been unreasonable to adopt the figures contained in the addendum because the figures were described as being "close approximations but not necessarily precise."[9] Instead of adopting the addendum, the Commission's Order clearly describes what the Commission decided: 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."

When the Commission's Order described how the disallowance should be calculated, it did not include AFUDC. The figures in the addendum were largely composed of three parts: the source of initial cost estimates, the methodology for escalation costs, and the inclusion or exclusion of AFUDC. In addition, the Commission was aware that the inclusion or exclusion of

[8] The addendum was introduced on March 6, 2015, but was not e-filed until May 7, 2015. *See* Handout – Commission – Hearing Exhibit, March 6, 2015 Agenda, Doc. ID 20155-110186-01 (May 7, 2015).

[9] Video and audio recordings of the Commission's deliberation on March 6, 2015 is available on the Commission's website at https://minnesotapuc.legistar.com/Calendar.aspx. The discussion about the addendum begins at approximately 3:30:40.

AFUDC from the disallowance calculation was an issue that had been raised in the case.[10] After discussing whether AFUDC should be included, and with consideration of the fact that the issue had been litigated in the case, the Commission's Order stated a calculation methodology that did not include AFUDC.

The Commission stated in its Order how the disallowed return should be calculated, and that description did not include AFUDC. Before it made that decision, the Commission had the opportunity to directly adopt the addendum, which would have included AFUDC in the calculation. It chose not to do so. Instead, the Commission instructed that the disallowed return be based on the initial Certificate of Need figures, and nothing else, escalated to current dollars.

B. THE ESCALATION FACTOR REQUESTED BY OTHER PARTIES IS UNREASONABLE.

Although the Commission's statement that the disallowance should be calculated on the basis of "figures provided in the certificate-of-need filings, escalated to 2014 dollars" was clear, the Commission did not indicate precisely how the Certificate of Need figures should be escalated. The addendum, which was not adopted and was used only for illustrative purposes, assumes that a 4 percent escalator should be applied every year. Adopting the addendum, as recommended by the Department and Xcel, would mean adopting the 4 percent escalator. But the Commission's Order declined to adopt either the addendum or the 4 percent escalator, and there does not appear to be any evidence in the record supporting the use of such a high escalator.[11] Several factors demonstrate that the 4 percent escalator may be overstated.

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[10] *See, e.g.*, Ex. 313, at 38 (Campbell Surrebuttal).

[11] It appears that the 4 percent escalator is drawn from the testimony of Department witness Ms. Campbell, but Ms. Campbell never advocated for using a 4 percent escalator in this fashion. While Ms. Campbell discussed a 4 percent escalator, that discussion was in the context of trying to determine how Xcel had calculated the $320 million and $346 million estimates it repeatedly referenced in its testimony. Ms. Campbell stated that the certificate of need estimates were "$346 million for the Monticello LCM and EPU projects when escalated to current (2014) dollars" when using a 4 percent escalator. Ex. 313, at 36 (Campbell Surrebuttal); *see also* Tr. Evid. Hearing, Vol. 4, at 128–29, 132 (Campbell). Ms. Campbell's calculation that applying a 4 percent escalator would lead to a $346 million

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First, in its testimony and briefs, Xcel suggested using a much lower escalator. When he discussed how to escalate costs to current dollars, Xcel witness Mr. Alders testified that an appropriate average escalation rate from 2008 to 2014 would be 2.34 percent per year.[12] Xcel also supported this calculation in its briefs.[13] Department witness Mr. Crisp confirmed that this estimate was reasonable when he testified that an inflation rate of between 2 percent and 2.5 percent would have been reasonable in 2005 or 2008.[14] Given that Xcel has suggested a significantly lower escalator, and that the record as a whole strongly supports an escalator in the range of 2 percent, it would be unreasonable to apply a 4 percent escalator.

Second, inflation indices also demonstrate that the 4 percent escalator is significantly overstated. For example, the rate of inflation for the Consumer Price Index ("CPI") from 2006 to 2014 averaged only 2.15 percent.[15] While the CPI is not a perfect comparison, it is concerning that the escalation factor included in the addendum is nearly twice as high as the CPI. It is likely that another index, such as the Handy Whitman Index, would also be significantly lower than 4 percent. The Commission has recently applied lower escalators in other cases using the Handy Whitman Index.[16] It would be unreasonable to apply a significantly higher escalator when indices indicate that inflation was significantly lower.

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figure does not support the argument that a 4 percent escalator is reasonable. Furthermore, the Department has not provided any justification for using a 4 percent escalator in any context.

[12] Ex. 423, at 15 (Alders Surrebuttal). The 2.34 percent figure is the result of backing out Mr. Alders' testimony that escalating $346 million in 2008 dollars would equal $397.5 million in 2014 dollars. *Id.*

[13] Xcel Reply Brief, at 31 (Nov. 21, 2014).

[14] Tr. Evid. Hearing, Vol. 3, at 74 (Sept. 30, 2014) (Crisp).

[15] Consumer Price Index Detailed Reports are available for each calendar year on the website of the United States Department of Labor, Bureau of Labor Statistics, www.bls.gov/cpi/cpi_dr.htm.

[16] *See* Order Approving 2012 TCR Project Eligibility and Rider, Capping Costs, and Modifying 2011 Tracker Report, *In the Matter of Xcel Energy's Petition for Approval of 2012 Transmission Cost Recovery, Project Eligibility, TCR Rate Factors, and 2011 True-up*, at 4, Docket No. E-002/M-12-50; *see also* Docket No. E-002/M-14-852. The OAG does not have access to the Handy Whitman Index, so cannot provide an escalator estimate.

Based on these factors, it would be unreasonable to apply a 4 percent escalator to calculate the disallowance in this case. Instead, the Commission should adopt the escalator of 2.34 percent that Xcel's itself put into the record. The 2.34 percent escalator should be applied to the "initial estimates provided in the certificate-of-need proceedings," as required by the Commission's Order.[17] The Commission's Order states that the initial certificate of need estimates were $135 million for the LCM in 2006, and $133 million for the EPU in 2008.[18] This results in approximately $315 million,[19] and demonstrates that the amount of cost overruns that should be denied a return is approximately $433 million.

IV. CONCLUSION.

The Commission should deny Xcel's request to earn a debt return on the Monticello cost overruns and the request to adopt the addendum to Staff's briefing papers after the Commission declined to do so during deliberations. The Commission should instruct Xcel to use a 2.34 percent escalator to calculate the disallowance as directed in the Commission's Order.

[17] Order, at 23.
[18] Order, at 4, 5, 21, Attachment A(c), (h),
[19] This figure is very close to the $320 million that Xcel stated was the initial estimate throughout this proceeding. Ex. 2, at 21 (Alders Direct); Ex. 4, at 65 (Stall Direct); Ex. 3, at 30, 32, 35 (O'Connor Direct); Tr. Evid. Hearing, Vol. 2, at 13–14 (Sept. 30, 2014) (Alders); Tr. Evid. Hearing, Vol. 2, at 49–50 (Sept. 30, 2014) (Weatherby); *see also* OAG Exceptions, at 10–13 (Feb. 12, 2015).

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Respectfully submitted,

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