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

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

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STATE OF MINNESOTA
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INITIAL BRIEF OF THE OFFICE OF THE ATTORNEY GENERAL

INTRODUCTION

The Office of the Attorney General – Residential Utilities and Antitrust Division ("OAG") submits its Initial Brief contesting the request of Dakota Electric Association ("DEA") for authority to increase electric service rates by approximately $4.2 million. DEA and the Minnesota Department of Commerce ("Department") entered into a Settlement Agreement ("Settlement") that resolved the disputes between those parties.[1] The OAG did not enter into the Settlement. The Settlement would grant Dakota the entire rate increase it requested,[2] while adopting the DOC's proposed revenue apportionment and rate design.[3] The Settlement should be rejected because it allows recovery of expenses that are not representative of DEA's operations, unnecessary, and unreasonable. It also unfairly apportions its requested revenues onto the residential and small business classes and limits ratepayers' ability to control their utility bills by increasing the monthly customer charge for residents and small businesses. The OAG recommends that the following steps be taken to ensure that DEA's rates are reasonable:[4]

- Reject DEA's adjustment of $690,427 to its Payroll Expense to annualize the costs of all of its positions;

[1] *See* Ex. 128.
[2] *Id.* at 8.
[3] *Id.* at 13-14.
[4] The scope of this Initial Brief is limited to those issues on which the OAG filed testimony.

- 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
- Reject the proposal in the Settlement to increase the customer charge for residents and small business customers.

ANALYSIS

I. PROCEDURAL HISTORY

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. Administrative Law Judge LauraSue Schlatter held public hearings on December 2, 2014 in Apple Valley and Farmington, and conducted an evidentiary hearing on December 18, 2014.

II. LEGAL STANDARD

DEA is a member-owned cooperative electric association ("cooperative").[5] Typically, cooperatives may set rates without Commission review or approval.[6] A cooperative, however, "may elect to become subject to rate regulation by the commission" by holding an election that is approved by the majority of voting members.[7] Similarly, a cooperative that is subject to rate regulation may become deregulated by following the same process.[8] DEA's rates are currently regulated by the Commission. If DEA did not wish to have the company's rates governed by the

[5] Ex. 101 at 1 (Larson Direct).
[6] *See* Minn. Stat. §§ 216B.01-.02 (2014).
[7] Minn. Stat. § 216B.026 subd. 1 (2014).
[8] *Id.* at subd. 4.

Commission, it could hold an election of its members to approve deregulation. DEA has not done so; as a result, DEA is subject to the same regulation by the Commission as investor-owned utilities.

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.[9] 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."[10] In discussing the utility's burden of proof, the Minnesota Supreme Court held that:

> 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.[11]

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.[12]

III. COST OF SERVICE

The evidence presented by the OAG demonstrates that DEA's requested revenue increase is excessive and unreasonable. In deciding whether Dakota's proposed revenue increase is reasonable, the Commission considers the accuracy of Dakota's claimed costs, the prudence and reasonableness of Dakota's claimed costs, and whether Dakota's costs are compatible with the public interest.[13] Dakota's revenue increase request includes inflated costs that do not accurately

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[9] Minn. Stat. § 216B.16 (2014); *see also* Minn. Stat. § 216B.03 (2014).
[10] *Petition of Minnesota Power & Light Co.*, 435 N.W.2d 550, 554 (Minn. Ct. App. 1989), *rev. denied* Apr. 19, 1989.
[11] *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).
[12] Minn. Stat. § 216B.03 (2014).
[13] Findings of Fact, Conclusions of Law, and Order, *In re the Matter of the Application of Dakota Electric Assoc. for Authority to Increase Rates for Electric Service*, Docket No. E-111/GR-09-175 (May 24, 2010).

reflect a representative test year as well as unnecessary and imprudent costs that do not benefit ratepayers. These excessive and unnecessary costs should be rejected.

A. DEA's Payroll Expense Is Not Representative and Should be Reduced to Reflect a Representative Test Year.

DEA has requested recovery of more than $1.3 million in increased costs for its payroll expenses—nearly ten percent more than it has paid out in previous years.[14] DEA's request is adjusted upwards from its actual 2013 payroll expense for what the company claims 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] 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 Annualization Adjustment should be rejected because it is not a known and measurable change and because it results in an unrepresentative recovery.

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."[17] Moreover, "[b]asing revenue requirements on financial data from a test year, a

[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] 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)).

representative slice of the utility's normal operations, is intended to base rates on experience instead of conjecture."[18] Based on these principles, the Commission has permitted known and measurable adjustments to a test year "only when their certainty and magnitude would otherwise make the test year process unreliable."[19] DEA's Annualization Adjustment is not a known and measurable adjustment because it is not certain, and because the adjustment substantially deviates from the company's past experience.

Between 2010 and 2013, DEA's annual payroll expense of approximately $14 million has been remarkably consistent, fluctuating within a fraction of one percent, or a $63,000 range:[20]

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 2013 test-year payroll expense (even before the disputed Annualization Adjustment) exceeded its average expense of the four-year timeframe by nearly $28,000. Therefore, DEA's request to increase expenses for the Annualization Adjustment is inconsistent with the trend for DEA's payroll expenses. DEA's payroll expense declined from 2010 to 2012, before increasing in 2013 to its highest level of the period. Over the entire period, the general trend has been downwards or relatively flat.

[18] *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).
[19] *Id.* at 11.
[20] *See* Ex. 203 at 6 (Lee Direct).

Despite these facts, DEA claims that, even after accounting for the company's other adjustments, its 2013 payroll expense does not provide an appropriate basis for setting rates because it is too *low*. Instead, DEA claims that its payroll expense for 2013 should be adjusted upward to reflect "a full year of compensation and benefits for *all existing positions* at Dakota Electric."[21] 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.

DEA's basis for its Annualization Adjustment of over $690,000 is flawed because it is not a known, measurable, and reliable change to the company's 2013 historical test year payroll expense. First, the adjustment is clearly 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.

Second, the 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. On the contrary, 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. DEA even 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. Because the

[21] Ex. 101 at 14 (Larson Direct) (emphasis added).
[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).

Annualization Adjustment would not be representative of a normal year, it is not an appropriate change.

The OAG does not argue that any of DEA's employees or the employees' compensation are inappropriate or should be changed. Rather, the OAG takes the position that DEA has incorrectly calculated the payroll adjustments for rate-making purposes. At the evidentiary hearing, DEA attempted to argue that its Annualization Adjustment is appropriate by focusing on the specific reasons that certain employees did not receive compensation for the full year during 2013. Specifically, DEA witness Mr. Larson detailed several "unusual" and sometimes tragic circumstances of individual employees.[23] But the specific reason or reasons that some of DEA's positions were vacant for part of a given year is not the issue. Rather, the issue is whether DEA's requested recovery reflects its test year expenses, or reflects a known and measurable change to those expenses. The fact that the company's payroll expense during its 2013 test year was higher than any of the three previous years, despite the several unique circumstances described by Mr. Larson, confirms that DEA's Annualization Adjustment is both unnecessary and excessive. The particular circumstances for positions being unfilled in 2013 are not relevant to whether there should be a known and measurable adjustment; instead, to support its adjustment, DEA must show that it is aware of measurable payroll increases that will occur after the test year, or that its test year is not representative because it is regular for DEA to fill all of its positions. DEA has not made its case on either issue. In fact, by using its actual 2013 payroll expense, rather than a four-year average, DEA's request already incorporates the costs for the

[23] Tr. Evid. Hearing at 24-25 (Larson) (Dec. 18, 2014).

2013 year that are higher than average.[24] For these reasons, DEA's Annualization Adjustment should be rejected.

B. DEA's Ratepayers Should Not Pay for Unnecessary Work Hours.

DEA's test year includes 842 work hours, or nearly 21 weeks of labor costs, that the company has not demonstrated are needed to operate a regulated utility. These work hours cost ratepayers $57,700.[25] 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.[26] 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.[27] Therefore, DEA's regulated operations gained more than 21 weeks of labor capacity that were no longer used to support EAI's operations.[28] DEA has not claimed that these 21 weeks of additional labor capacity are needed to perform its regulated functions in 2013. But DEA nonetheless failed to make an adjustment to its 2013 test year to eliminate these unnecessary costs. It is unreasonable 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.

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.

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[24] The OAG notes that DEA used a multi-year average to make a $339,090 upward adjustment to its payroll expense to reflect a normalized construction year. Had DEA also used a multi-year average for its full payroll expense, the company would have incorporated a *downward* adjustment of nearly $28,000.
[25] Tr. Evid. Hearing at 40 (Larson) (Dec. 18, 2014).
[26] Ex. 205 at 8 (Lee Surrebuttal); Ex. 203 at 8 (Lee Direct).
[27] Ex. 205 at 8 (Lee Surrebuttal); Ex. 203 at 8 (Lee Direct).
[28] 1,197 – 355 = 842; 842/40=21.05.

Specifically, DEA claimed for the first time at the evidentiary hearing that the majority of individuals who provided labor for EAI in 2010 were salaried employees.[29] 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. This is an unfair result that unreasonably burdens ratepayers with costs that are not needed to operate the regulated utility. For this reason, the ALJ should recommend, and the Commission should order, that the additional labor capacity resulting from EAI's divestitures be applied as an offset to DEA's requested rate increase.

C. DEA Should Not Recover Unreasonable and Unnecessary Travel and Entertainment Expenses.

DEA has requested recovery of more than $800,000 for travel and meals for its employees, dues and memberships, events, and other expenses for its Board of Directors ("Travel and Entertainment expenses").[30] The OAG has examined the Travel and Entertainment expenses requested by DEA and identified several costs that 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 meetings of the National Rural Utilities Cooperative Finance Corporation ("CFC"), held outside of DEA's service territory, while he was running for the CFC board[31];

[29] 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.*

[30] *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.

[31] *See id.* at 13; Ex 203 at 12 (Lee Direct).

- $672 in excess airfare costs for last-minute scheduling of a board member's trip to attend a meeting in Washington DC[32];
- $3,909 for groceries to serve employees at various company functions[33]; and
- $522 for a holiday luncheon for DEA's board members and select key staff members.[34]

In addition to the costs above, the OAG raised serious concerns about DEA's $17,841 expense to reimburse board members for their personal internet, cell phone, and data plans.[35]

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."[36] 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.[37] These categories include "food and beverage expenses,"[38] "recreational and entertainment expenses,"[39] "board of director-related expenses, including and separately itemizing all compensation and expense reimbursements,"[40] 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 business organizations are recoverable "only to the extent that the activities they support *directly*

[32] *See id.*
[33] *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.
[34] *See id.*
[35] *See* Ex. 205 at 11 (Lee Surrebuttal).
[36] Minn. Stat. § 216B.17(a) (2014).
[37] *Id.*
[38] Minn. Stat. § 216B.17(a)(2) (2014).
[39] Minn. Stat. § 216B.17(a)(3) (2014).
[40] Minn. Stat. § 216B.17(a)(4) (2014).

benefit ratepayers," and has excluded membership dues for organization such as the Chamber of Commerce.[41] This does not mean that utilities cannot incur these expenses, but rather that they cannot seek recovery from ratepayers.

Each of the Travel and Entertainment expenses identified by the OAG come from the categories highlighted in Minnesota law 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. The OAG also questions whether 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, and board members would retain the ability to communicate and exchange with DEA, without ratepayer compensation. For these reasons, ratepayer recovery of these expenses should be denied.

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. Specifically, at the hearing, DEA presented a variety of hypothetical, small expenses, and questioned whether the OAG would object to recovery of these

[41] *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).

costs.[42] DEA also speculated that the company may have lowered its health insurance premiums by providing food at wellness meetings.[43]

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. For these reasons, the ALJ should recommend, and the Commission should order, that the expenses identified by the OAG not be recovered from DEA's ratepayers

II. REVENUE APPORTIONMENT

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."[44] The factors balanced by the Commission to achieve a reasonable allocation 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.[45]

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.[46] The recommended revenue apportionment is influenced by the results of the company's CCOSS, which the Department modified to somewhat

[42] Tr. Evid. Hearing at 123-25 (Lee) (Dec. 18, 2014).
[43] *Id.* at 122.
[44] *City of Moorhead v. Minnesota Public Utilities Commission*, 343 N.W.2d 843, 846 (Minn. 1984).
[45] *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).
[46] Ex. 128 at 13; Ex. 304 at 3 (Pierce Surrebuttal).

reduce the rate increase for the Small General Service class.[47] 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.[48] This revenue apportionment is unreasonable because the company has produced an inaccurate CCOSS that inflates the costs for residents and small businesses. The OAG's proposed revenue apportionment is preferable because it relies on a more precise cost of service analysis, while appropriately considering non-cost factors.

A. DEA's CCOSS Does Not Incorporate a Theoretically Sound Minimum System.

Performing a CCOSS involves three general steps. A CCOSS first functionalizes similar costs by determining their purpose. The CCOSS then classifies the costs as either customer,[49] demand, or commodity costs. Finally, the costs are allocated to various customer classes depending on how the costs were classified and caused.[50] 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.[51] 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.[52] Classifying and allocating customer and demand costs incorrectly can dramatically increase the burden on the residential class, since it pays a significantly greater

[47] *See* Ex. 128 at 11; Ex. 304 at 2-3 (Pierce Surrebuttal).
[48] Ex. 304 at 3 (Pierce Surrebuttal).
[49] DEA refers to customer costs as "consumer" costs.
[50] Ex. 301 at 4 (Ruzycki Direct).
[51] *Id.* at 5.; Ex. 200 at 3-4 (Nelson Direct).
[52] Ex. 301 at 4 (Ruzycki Direct); Ex. 200 at 4 (Nelson Direct).

share of the costs that are classified as customer costs.[53] Therefore, it is vital that the CCOSS used to inform final revenue apportionment is as precise as possible.

1. The Minimum System Significantly Impacts the Results of the CCOSS.

The costs of DEA's distribution system—such as poles, conductors, and transformers—are contained in FERC accounts 364–368.[54] These accounts contain both customer and demand costs.[55] A minimum system study is conducted to determine the proportion of these FERC accounts that should be classified as customer costs and the proportion that should be classified as demand costs.[56] 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 peak demand. Since the company's distribution system consists of more than $50 million of its overall $200 million revenue requirement, the results of the minimum system study can significantly impact the results of the overall CCOSS.

The minimum system study estimates the hypothetical, minimum distribution system necessary simply to provide service to customers, without consideration of a customer's demand.[57] 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.[58] 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.[59]

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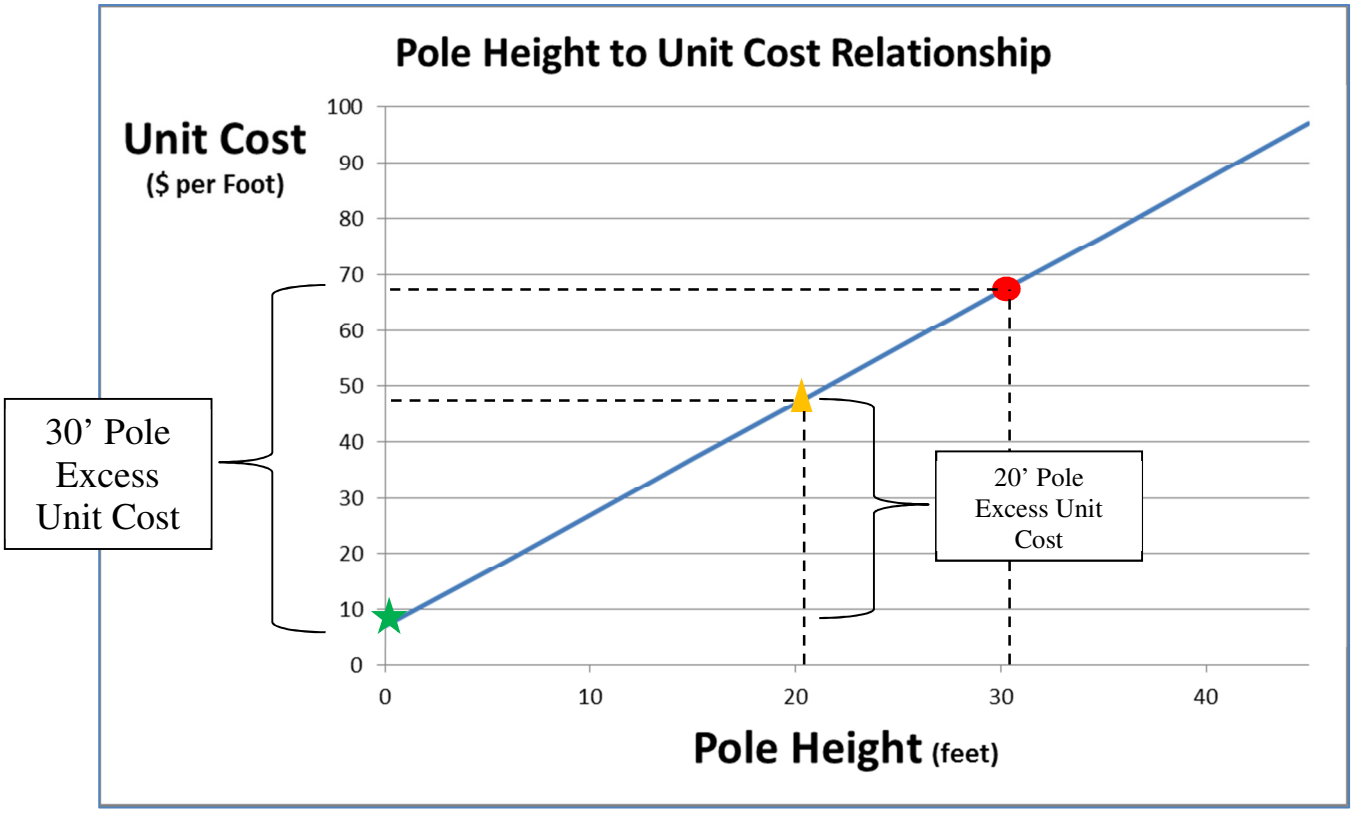
[53] *See* Ex. 200 at 4 (Nelson Direct).
[54] *Id.* at 3.
[55] *Id.* at 3-4.
[56] *Id.* at 4-5.
[57] Ex. 200 at 5 (Nelson Direct).
[58] *Id.*
[59] *Id.*

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.[60] 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.[61] 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.[62] The hypothetical distribution system generated from the minimum-size method is assumed to serve the "*minimum loading requirements* of the customer."[63] 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."[64] The zero-intercept method constructs a hypothetical no-load distribution system by incorporating a more technically demanding analysis using regression analysis.[65]

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.[66] The NARUC manual also states that the minimum-size method "generally produces a larger customer component" than would be produced by the more accurate zero-intercept method.[67] The Commission also recognizes this difference between the two methods. For instance, in MERC's most recent rate case, the Commission stated that the minimum-size method "results in some

[60] *See* NARUC Electric Manual at 90; Ex. 200 at 5-6 (Nelson Direct).
[61] Ex. 200 at 6 (Nelson Direct).
[62] *Id.*
[63] NARUC Electric Manual at 90 (emphasis added).
[64] *Id.* at 92 (emphasis added).
[65] Ex. 200 at 7 (Nelson Direct).
[66] *See* NARUC Electric Manual at 92.
[67] *Id.* at 91, 92.

capacity costs being classified as customer costs."[68] The graph below provides one example of how using the cost of either a 20-foot or 30-foot utility pole in a minimum-size 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.[69] 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.[70] Therefore, the star represents the optimal unit cost to construct a minimum system because it incorporates the pole height that equals a no-load

[68] 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).
[69] 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.
[70] *Id.* at 9.

scenario.[71] 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 demand costs, since the specific heights of the poles installed by the utility would depend on customer demand.

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.[72] 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-size" 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-size method. As 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."[73] Of course, this is not only true for utility poles, but is the case for all of the distribution components included in FERC accounts 364–368.

2. DEA's Minimum System Analysis Generates Excessive Customer Costs.

DEA's minimum system analysis has been scrutinized in the past. In DEA's last rate case, the OAG pointed to several technical deficiencies in the regression analysis that DEA used

[71] *Id.* at 10.
[72] *Id.*
[73] Ex. 375, at 11 (Nelson Direct).

to support its study, which was based on the zero-intercept method.[74] The Commission determined that, while DEA's analysis in that case was imprecise, it was "appropriate as a starting point for setting rates."[75] 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."[76] In the instant case, DEA chose to use a minimum-size analysis in its minimum system study, rather than the zero-intercept method.[77] Accordingly, DEA chose to use the method that inherently classifies some capacity costs as customer costs. DEA, however, took no steps to mitigate against this impact.

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 be reasonably associated with the minimum system."[78] Xcel Energy also incorporates an adjustment to its demand allocator to account for demand costs included in its minimum system.[79] DEA, however, did not make a similar adjustment here.[80] In other words, unlike other

[74] *See id.* at 12.
[75] 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).
[76] *Id.* at 23.
[77] 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.
[78] 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).
[79] *See* Ex. 201 at 4 (Nelson Rebuttal).
[80] 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.

utilities, DEA took no action to address the over-classification of customer costs inherent in the minimum-size method used in its analysis.

DEA argues that its minimum system analysis is reasonable even without a demand adjustment. 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.[81] DEA concluded that its minimum system was reasonable because "the minimum-size results are very similar to the zero-intercept analysis."[82] But DEA's comparison of these two studies raises two, interrelated problems.

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. When the OAG questioned DEA regarding how the results of its minimum-size and zero-intercept methods compared for the individual distribution accounts, the company admitted that these methods did not produce results that were "very similar."[83] In fact, DEA's minimum-size and the zero-intercept analyses produced wildly differing results for its distribution accounts. Depending on the specific account, these methods

[81] *See* Ex. 126 at 12-13 (Larson Rebuttal); Ex. 125 at Workpaper 21, pg. 5.
[82] Ex. 126 at 13 (Larson Rebuttal).
[83] Tr. Evid. Hearing at 29-33 (Nelson) (Dec. 18, 2014).

produced results that showed the customer cost portion differing by between ten and twenty percent.[84]

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.[85] In addition, for several distribution accounts, DEA's minimum-size method resulted in *lower* customer costs.[86] 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 the opposite result 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 reasonable results. If anything, these results confirm that DEA's 2009 analysis also overestimated the customer cost portion of the company's distribution accounts.[87] 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 Produces Theoretically Sound Results.

Instead of using DEA's unreasonable minimum-size method, the ALJ and Commission should apply the OAG's zero-intercept proxy method to reach a more accurate result. While the NARUC manual and the Commission have both recognized that the zero-intercept method more accurately distinguishes between the customer costs and demand costs, conducting a proper zero-

[84] *Id.*
[85] Ex. 125 at Workpaper 21, pg. 4.
[86] Ex. 125 at Workpaper 21, pg. 5.
[87] 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).

intercept analysis is another matter. As Mr. Nelson explains, attempting to follow the empirical method described in the NARUC manual "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.[88] The Commission has recognized these potential concerns. As discussed above, the Commission required DEA to provide additional analysis of its model if it utilized the 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.[89] Without proper data, it is not possible to conduct an appropriate zero-intercept analysis.

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 disputed data and methodology.[90] 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.[91] Mr. Nelson demonstrated that, mathematically, the OAG's proxy produces results that are equivalent to a zero-intercept analysis.[92] Mr. Nelson's mathematical justification for the OAG's proxy has not been disputed. Because the OAG's proxy produces results that are equivalent to the more precise zero-intercept analysis, the OAG's CCOSS is reasonable and should be used to inform the company's revenue apportionment.

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[88] Ex. 200 at 19 (Nelson Direct).
[89] 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).
[90] Ex. 200 at 20 (Nelson Direct).
[91] *Id.*
[92] *See* Ex. 200 at 20-22 (Nelson Direct).

B. The OAG's Revenue Apportionment Should be Adopted.

The OAG's proposed revenue apportionment is more reasonable than the proposal in the Settlement between DEA and the Department. 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. 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. For these reasons the OAG requests that the ALJ recommend, and that the Commission approve, that any revenue requirement established by the Commission be collected using the OAG's proposed revenue apportionment.

III. CUSTOMER CHARGE

The Settlement proposed by DEA and the Department also recommends an unnecessary and unreasonable 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.[93] 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.[94] This proposal would set DEA's residential customer charge at the highest level of any rate-regulated Minnesota electric utility.[95] The OAG recommends that DEA's customer charge for residents and small businesses remain at its current level.

A. A Low Customer Charge Promotes Important Policy Goals.

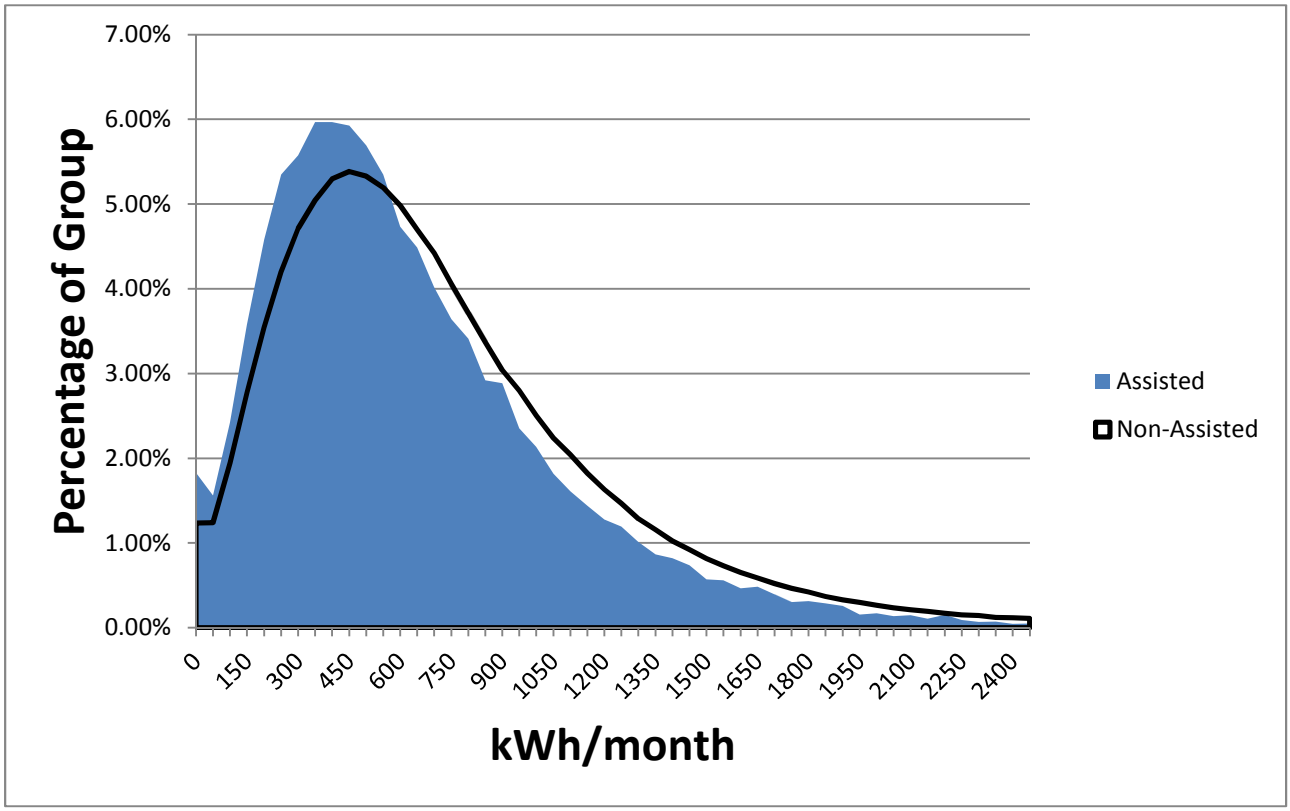
Maintaining the current customer charge supports several important policy objectives. First, maintaining a lower customer charge has the overall effect of benefitting low-income customers. Since any decrease in the fixed customer charge results in an increase in the volumetric charge, maintaining a low 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-income customers. Mr. Nelson's analysis demonstrates that maintaining DEA's current customer charge would provide significant benefits to the company's low-income customers.

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

[93] *See* Ex. 304 at 10 (Pierce Direct).
[94] Ex. 128 at 13; *See also* Ex. 304 at 10 (Pierce Direct).
[95] *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).

who receive energy assistance, which serves as a proxy for low-income customers in general, to those who do not receive energy assistance.[96] The graph below illustrates Mr. Nelson's results[97]:

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 measures the percentage of the given group and the X-axis measures 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

[96] Ex. 201 at 18 (Nelson Rebuttal).
[97] *Id.* at 19.

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

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.[98] 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.[99] 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.

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.[100] 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

[98] *Id.* at 18
[99] *Id.*
[100] Minn. Stat. § 216B.03 (2014).

reduced energy consumption equivalent to eliminating 610 residential homes.[101] The Commission's mandate to encourage conservation would be served by maintaining the customer charge at its current level.

B. The Arguments to Increase the Customer Charge are Flawed.

Despite the policy benefits of maintaining a low customer charge, DEA and the Department each advocated for increasing the customer charge in their filed testimonies. These parties focused predominantly on their desire to move the customer charge closer to the customer costs generated by the company's CCOSS.[102] These parties argued that moving the customer charge closer to the customer costs measured by the company would be beneficial because it minimizes purported intra-class subsidies between high-use and low-use customers.[103] These arguments do not overcome the important policy benefits of maintaining DEA's existing customer charge.

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

[101] Ex. 200 at 30 (Nelson Rebuttal).
[102] *See* Ex. 304 at 15 (Pierce Direct); Ex. 126 at 34 (Larson Rebuttal).
[103] *See* Ex. 304 at 15 (Pierce Direct); Ex. 126 at 34 (Larson Rebuttal).

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.[104] 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.[105] 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.[106] And the OAG's CCOSS produces customer costs of only $11.41.[107]

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.[108] In addition to ignoring other subsidies that exist, neither DEA nor the Department explain why this particular intra-class subsidy deserves such close attention. DEA and the Department have provided no basis for ignoring these other subsidies, while focusing on a single subsidy based on overall energy consumption. For these reasons, their reliance on a single intra-class subsidy is not a reasonable basis to increase the customer charge. The OAG requests that the ALJ recommend, and that the Commission approve, a rate structure that maintains DEA's existing customer charge.

[104] *See* Ex. 101 at 33 (Larson Direct); Ex. 201 at 12 (Nelson Rebuttal).
[105] Ex. 201 at 12 (Nelson Rebuttal).
[106] Ex. 101 at 33 (Larson Direct).
[107] Ex. 201 at 13 (Nelson Rebuttal).
[108] Ex. 201 at 15 (Nelson Surrebuttal).

CONCLUSION

Adopting the Settlement would result in electric rates that are unjust and unreasonable, and would place an unfair portion of its required revenues onto residential and small business classes while increasing their fixed costs with detrimental impacts. For the foregoing reasons, the OAG makes the following recommendations:

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

Dated: January 20, 2015

Respectfully submitted,

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s/Ian Dobson
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January 20, 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 *Initial Brief 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

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Enclosures
cc: Service List

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 20th day of January, 2015, I served the *Initial Brief of the 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 20th day of January, 2015.

s/ Patricia Jotblad
Notary Public

My Commission expires: January 31, 2015

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