MINNESOTA
PUBLIC UTILITIES COMMISSION

# Staff Briefing Papers

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| Meeting Date | December 21, 2017 | | Agenda Item **6 |
| Company | Northern States Power Company d/b/a Xcel Energy | | |
| Docket No. | **G-002/M-16-891** | | |

In the Matter of the Petition of Northern States Power Company, d/b/a Xcel Energy, for Approval of a Gas Utility Infrastructure Cost Rider True-up Report for 2016, the Forecasted 2017 Revenue Requirements, and Revised Adjustment Factors.

Issues

1. Should the Minnesota Public Utilities Commission accept Xcel Energy's Gas Utility Infrastructure Cost Rider True-up Report for 2016?
2. Should the Minnesota Public Utilities Commission approve or modify Xcel Energy's proposed rate of return used for determining the Gas Utility Infrastructure Cost Rider revenue requirements?
3. Should the Minnesota Public Utilities Commission approve or modify Xcel Energy's proposed 2017 Gas Utility Infrastructure Cost Rider revenue requirement and adjustment factor?


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The attached materials are work papers of the Commission Staff. They are intended for use by the Public Utilities Commission and are based upon information already in the record unless noted otherwise.

| ✓ Relevant Documents | Date |
|---|---|
| Xcel Energy Initial Petition | November 1, 2016 |
| Xcel Energy Supplement to Petition – Metrics Proposal | January 13, 2017 |
| Minnesota Department of Commerce Comments | March 1, 2017 |
| Minnesota Office of Attorney General Comments | March 1, 2017 |
| Xcel Energy Reply Comments | March 13, 2017 |
| Minnesota Office of Attorney General Reply Comments | March 13, 2017 |
| Minnesota Department of Commerce Response Comments | May 18, 2017 |
| Xcel Energy Reply to Department Response Comments | June 2, 2017 |
| Minnesota Department of Commerce Additional Comments | July 25, 2017 |

# Table of Contents

# I. Statement of the Issues

- Should the Minnesota Public Utilities Commission accept Xcel Energy's Gas Utility Infrastructure Cost Rider True-up Report for 2016?

- Should the Minnesota Public Utilities Commission approve or modify Xcel Energy's proposed rate of return used for determining the Gas Utility Infrastructure Cost Rider revenue requirements?

- Should the Minnesota Public Utilities Commission approve or modify Xcel Energy's proposed 2017 Gas Utility Infrastructure Cost Rider revenue requirement and adjustment factor?

A number of issues discussed in these briefing papers are typically addressed in general rate case proceedings rather than annual rider compliance filings but due to the length of time since the Company's last rate case and the complexity of the issues in the instant *Petition*, they arise here. Some of these issues are:

- Rate of Return
- Sales Forecast
- Performance Metrics

# II. Introduction and Background

## A. Introduction

Northern States Power Company d/b/a Xcel Energy (Xcel Energy or the Company) is seeking approval of its updated Gas Utility Infrastructure Cost (GUIC) Rider to be in effect through March 31, 2018. The Company requested that it be allowed to recover its forecasted 2017 GUIC revenue requirement of approximately $22 million,[1] subject to actual cost true-up. Xcel Energy's GUIC recovery includes expenditures for integrity management programs and deferred costs.

Integrity Management Programs were introduced pursuant to the Pipeline Safety Improvement Act, passed by the U.S. Congress in 2002. The law directed the U.S. Department of Transportation to promulgate rules to address integrity programs for gas transmission lines. A Transmission Integrity Management Program (TIMP) is a prescriptive risk-based program with the objective to improve pipeline safety; gas transmission operators are required to assess the

[1] In Xcel Energy's most recent general rate case (Docket No. G-002/GR-09-1153), the Company was authorized an annual rate increase of $7.3 million, or 1.27 percent, to collect a total annual revenue requirement of approximately $592.9 million. Of this $592.9 million, at least $429 million was for the recovery of purchased gas costs. As a percentage of non-gas costs, Xcel Energy's $7.3 million rate increase was approximately 4.5 percent per year.

health and condition of a utility's gas transmission assets, and evaluate and prioritize repairs to mitigate the risks and threats.

In 2009, the U.S. Department of Transportation's Pipeline and Hazardous Materials Safety Administration (PHMSA) published the final Distribution Integrity Management Program (DIMP) rule establishing integrity management requirements for gas distribution pipeline systems. The DIMP rules are intended to help gas distribution utilities identify, prioritize, and evaluate risks; identify and implement measures to address risk, and validate the integrity of their gas distribution system.

In 2005, the Minnesota Legislature enacted Minnesota (Minn.) Statute (Stat.) section (§) 216B.1635, the Recovery of Gas Utility Infrastructure Costs statute, permitting gas utilities to file petitions for a rate schedule to recover certain costs of GUIC-defined projects. In 2013, the GUIC statute was amended which, in part, expanded both the definition of GUIC projects and the eligible rider-recoverable costs.[2]

Prior to the GUIC statute amendments, the Minnesota Public Utilities Commission (Commission) granted Xcel Energy deferred accounting for incremental TIMP/DIMP initiatives and for its sewer and gas line conflict-remediation program required by the Minnesota Office of Pipeline Safety (MNOPS).[3] In its January 27, 2015 *Order* (Docket No. G-002/M-14-336), the Commission approved the commencement of a five-year amortization recovery of these deferred costs through the GUIC Rider.

## B. Background

### 1. 14-336 Docket

In Xcel Energy's inaugural GUIC petition, Docket No. G-002/M-14-336 (14-336 Docket), Xcel Energy requested approval of a new tariffed rate rider to recover Gas Utility Infrastructure Costs under Minn. Stat. § 216B.1635. On January 27, 2015, the Commission issued its *Order Approving Rider with Modifications*. A subsequent Commission Order in the 14-336 Docket, issued on April 10, 2015, denied the request for reconsideration from the Office of the Attorney General – Residential Utilities and Antitrust Division (OAG).

In the 14-336 Docket, the Commission approved Xcel Energy's proposed GUIC rider with the following modifications:

- a reduced overall rate of return, calculated using the capital structure and cost of debt from Xcel Energy's then pending electric rate case[4] and the cost of equity from its last natural gas rate case;[5]

[2] A complete copy of Minn. Stat. § 216B.1635 is located in an attachment to these briefing papers.

[3] See Docket Nos. G-002/M-10-422 and G-002/M-12-248, respectively.

[4] Docket No. E-002/GR-13-868.

[5] Docket No. G-002/GR-09-1153.

- a rate design that allocates responsibility for the GUIC rider revenue requirement according to the revenue apportionment approved in Xcel Energy's last natural gas rate case;[6] and

- an effective date as of the date of the Jan. 27, 2015 order, with final rate-adjustment factors calculated to recover 2015 revenue requirement over the remaining months of 2015.

The 14-336 Docket *Order* also required Xcel Energy to submit, sixty days in advance of its next annual GUIC filing, information on what it believes the appropriate rate of return should be for the coming year. Xcel filed this information on September 2, 2015.

**2. 15-808 Docket**

In Xcel Energy's 2015 true-up report and request for 2016 forecasted revenue requirement and revised adjustment factor, in Docket No. G-002/M-15-808 (15-808 Docket), Xcel Energy requested approval of its 2015 true-up report and 2016 GUIC revenue requirements along with implementation of a new Federal Code Mitigation project and a request to modify the effective period of the GUIC rider factor to be in place through March 31$^{st}$, rather than December 31$^{st}$.

In the 15-808 Docket *Order*, the Commission approved Xcel Energy's 2015 true-up report and 2016 GUIC revenue requirements and revised adjustment factors with the following modifications:

- approved an overall rate of return of 7.34 percent;

- required Xcel Energy to develop specific metrics to measure the appropriateness of GUIC expenditures, to be included in future GUIC Rider filings, and provide stakeholders the opportunity for meaningful involvement; and

- required Xcel Energy to include specific information about each individual project in future GUIC Rider filings that sufficiently, (1) describes what the project is, (2) explains why the project is necessary, (3) discusses what benefits ratepayers will receive from the project, and (4) identifies the agency, regulation, or order that requires the project.

**3. 16-891 Docket (this docket)**

In this petition, Xcel Energy requests Commission approval of the 2016 true-up report and 2017 GUIC revenue requirements and revised adjustment factors. The Minnesota Department of Commerce, Division of Energy Resources (Department) and the OAG filed multiple rounds of comments discussing a number of issues. The issues addressed are:

- Rate of Return on Investment

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[6] *Id*.

- Review of Software Costs
- Prorated Accumulated Deferred Income Taxes
- Sales Forecast
- Sewer Conflict Inspection Equipment
- GUIC Rider Duration
- Compliance Filing, True-up Report, and Tracker Balances
- Tariff Sheet and Customer Notice
- Replacement of New Equipment
- Performance Metrics

In addition to the issues discussed above, the OAG raised the following issues/concerns:

- Revenue Cap
- Detailed Cost Study
- Distribution Valve Replacement Project

The following sections of these briefing materials provide in more detail the positions and comments of the parties.

## III. Xcel Energy's Initial Petition

Xcel Energy has ten ongoing GUIC projects, four are TIMP-related and six are DIMP-related.[7] In determining the 2017 GUIC revenue requirement, Xcel Energy proposed using a rate of return (ROR) of 7.26 percent, which is based on the capital structure and cost of debt recently approved by the Commission in its most recent GUIC order.[8] The ROR approved for the 2016 GUIC Rider was 7.34 percent. The difference between the 2016 GUIC ROR and the proposed 2017 GUIC ROR is due to the recognition of recently declining returns on equity (ROEs). The Company supports an ROE of 9.50 percent, which, if approved, results in an overall ROR of 7.26 percent.

According to Xcel Energy, responsibility for the GUIC rider revenue requirement is allocated to customer classes consistent with how responsibility for the Company's revenue requirement was apportioned in Xcel Energy's most recent natural gas rate case, in docket 09-1153.

The proposed 2017 GUIC factors by customer class along with existing factors are shown in Xcel Energy's petition (shown below).[9]

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[7] Xcel's projects are more fully discussed in Attachment B (TIMP) and Attachment C (DIMP) of the petition.

[8] See Docket No. G-002/M-15-808.

[9] *Petition* at 32.

**Table 1: Proposed 2017 GUIC Adjustment Factors**
**(Dollars per therm)**

| | Current Factors | Proposed Factors |
|---|---|---|
| Residential | $0.010922 | $0.041689 |
| Commercial Firm | $0.006110 | $0.023070 |
| Commercial Demand Billed | $0.005274 | $0.017177 |
| Interruptible | $0.003860 | $0.012162 |
| Transportation | $0.001570 | $0.004639 |

The proposed 2017 GUIC factors are higher due to the combined effects of increased GUIC annual revenue requirements and prior year (2016) under-recovery. The increasing revenue requirements correlate with the accumulation of GUIC capital investments (rate base).

With TIMP and DIMP combined, the table below summarizes Xcel Energy's overall projected annual and year-to-date (YTD), GUIC capital expenditures and each year's projected GUIC revenue requirements, inclusive of deferred costs, through the year 2021:

**Table 2: Projected GUIC Capital Expenditures & Revenue Requirements**
**2015 - 2021**
**($ 000s)**

| | Capital Expenditure* | | |
|---|---|---|---|
| **Year** | **Annual** | **YTD** | **Rev. Req.^** |
| <2015 | | $ 21,952 | |
| 2015 | $ 30,924 | $ 52,876 | $ 12,503 |
| 2016 | $ 31,482 | $ 84,358 | $ 16,992 |
| 2017 | $ 23,639 | $ 107,997 | $ 21,878 |
| 2018 | $ 45,641 | $ 153,638 | $ 24,801 |
| 2019 | $ 49,992 | $ 203,630 | $ 30,556 |
| 2020 | $ 48,185 | $ 251,815 | $ 28,618 |
| 2021 | $ 48,185 | $ 300,000 | $ 34,350 |

* Source: Petition, Table 2, page 25
^ Source: Petition, Attachment M

The lower revenue requirement in 2020, as compared to 2019, is due to the conclusion of the recovery of deferred costs (five-year amortization) and the anticipated completion of the gas and sewer line investigation project in 2019.[10] The revenue requirement then increases in 2021 with additional TIMP and DIMP capital related revenue requirements.

[10] *Petition* Attachment I.

Xcel Energy proposed a customer notice billing message using the same language approved in its prior GUIC docket, which is included on pages 34-35 of its *Petition*. Xcel Energy stated its willingness to work with Department and Commission staff if modifications are suggested.

# IV. Discussion of Issues

## A. Rate of Return

### 1. Background

Minn. Stat. § 216B.1635, subdivision (Subd.) 6. **Rate of return**. states:

> The return on investment for the rate adjustment shall be at the level approved by the commission in the public utility's last general rate case, unless the commission determines that a different rate of return is in the public interest.

In its January 27, 2015, *Order*, in the 14-336 Docket the Commission discussed the issue of the appropriate cost of capital for the GUIC projects. In its *Order*, the Commission found that updating the cost of debt for GUIC investments was consistent with the public interest. In addition, the Commission stated that the ROE was likely lower than what was authorized in Xcel Energy's last natural gas rate case; however, the record in the 14-336 Docket did not provide a basis of support for the Commission to adjust the ROE at that time. Updating Xcel's cost of debt resulted in a rate of return of 7.56 percent in the 14-336 Docket.

The Commission *Order* stated:

> In future GUIC filings the Commission will expect to see information on Xcel's current capital structure, cost of debt, and cost of equity. To that end, the Commission will require Xcel, 60 days in advance of its next annual GUIC filing, to submit information on what it believes the appropriate rate of return should be for the coming year. Based on this information, the parties can recommend, and the Commission can set, an updated rate of return for the GUIC rider if appropriate.

In its August 18, 2016, *Order*, in the 15-808 Docket, the Commission approved in Ordering Paragraph (OP) 9 a capital structure of 52.50 percent equity, 45.61 percent long-term debt, and 1.89 percent short-term debt. In OP 10, the Commission made the following determination concerning ROR and its components. An ROE of 9.64 percent, a cost of long-term debt of 4.94 percent, a cost of short-term debt of 1.12 percent and an overall ROR of 7.34 percent.

In the instant *Petition*, Xcel Energy proposed to use the same capital structure, cost of long-term debt and cost of short-term debt to develop its proposed ROR as the Commission approved in the 15-808 Docket, with a proposed update only to the Company's ROE. Specifically, rather than the 9.64 percent ROE authorized by the Commission in Xcel Energy's prior GUIC rider, the Company proposed an ROE of 9.50 percent and an authorized ROR of 7.26 percent for its 2017 GUIC filing.

The Department and the Office of the Attorney General responded to the Company's proposal and provided their own recommendations.

Regarding the cost of equity, all three parties recommended that the Commission follow the standards established in (1) *Bluefield Water Works and Improvement Co. v. Public Service Comm'n*., 262 U. S. 695 (1923) ("*Bluefield*"); and (2) *Federal Power Comm'n v. Hope Natural Gas Co*., 320 U.S. 591 (1944) ("*Hope*"). These decisions explain that utility regulators must set rates that permit the utility the opportunity: (1) to attract capital at reasonable terms; (2) to maintain its credit rating and ensure its financial integrity; and (3) to provide a return commensurate with returns on investments having comparable risks. These rates get developed, in significant part, by setting an appropriate overall cost of capital for the utility, equal to the cost of each capital component (both debt and equity) multiplied by the percentage that the component comprises the overall capital of the utility.

### 2. Department Comments

The Department conducted a full cost of equity analysis and concluded that Xcel Energy's proposal is unreasonably high and that an ROE of 9.04 percent is reasonable. The Department also reviewed Xcel Energy's proposed ROE as provided by its ROE consultant, Scott Madden Management Consultants (SMMC).

The Department assembled a group of proxy companies primarily engaged in natural gas distribution. The Department stated that its Discounted Cash Flow (DCF) analysis of this proxy group are indicative of the rate of return on common equity investors require from local distribution companies, and are thus indicative of the rate of return on common equity that investors in Xcel Energy's gas operations would require.

Because Xcel Energy has both gas and electric operations, and investors in Xcel Energy, Inc., NSP's parent, are exposed to risks associated with regulated operations of both, the Department assembled a proxy group of companies that have both gas and electric operations. This would produce an estimate of the ROR investors require on investments in utilities that provide both services. This approach is consistent with the Department's approach in Xcel Energy's previous GUIC filings.

To estimate current stock price, the Department calculated the average closing price of each proxy company's stock over the 30 trading days ending January 25, 2017. The Department explained that because share prices can be volatile in the short run, an average share price should be taken from a period of time long enough to avoid short-term aberrations in the capital market without being too long to ensure that the measure of price used to calculate the expected dividend yield reflects all relevant publicly available information.

The Department conducted a DCF analysis using a constant growth rate and a two-stage growth rate DCF and a Capital Asset Pricing Model (CAPM) analysis on both proxy groups. The Department's estimates included a flotation cost adjustment. The results are in the table below:

**Table 3: Average ROE Results**

| Model | Combination Proxy Group | LDC Proxy Group |
|---|---|---|
| Constant Growth DCF | 9.52% | 8.94% |
| Two-growth rate DCF | 9.47% | 8.93% |
| CAPM | 10.24% | 10.42% |

The Department stated that while CAPM is theoretically sound, its use raises some difficult issues. These issues include determining the appropriate beta, the appropriate "riskless" asset, and an appropriate estimate of the required return on the market portfolio. Because of these issues, the Department does not rely on the CAPM directly to determine a utility's cost of equity, but uses it only indirectly to assess and check the reasonableness of the Department's DCF analyses.

Based on its analysis, the Department concluded that a reasonable ROE for NSP's gas operations is 8.93 percent and a reasonable ROE for NSP's overall operations is 9.47 percent. The Department recommended an ROE based on a weighted average of the two proxy groups, with 79 percent based on the LDC group and 21 percent base on NSP's overall operations, for an ROE of 9.04 percent.

The Department had several concerns with Xcel Energy's ROE analysis (as provided by SMMC) including:

- SMMC's use of 90 and 180 day trading periods to calculate dividend yields;
- SMMC's use of the 30-year Treasury bond to estimate the risk free rate in the CAPM;
- SMMC giving equal weight to the DCF results and its CAPM results;
- SMMC's definition of the risk premium as the difference between authorized return on equity and the concurrent yield on 30-year Treasuries for the Bond Yield Plus Risk Premium analysis;

The Department noted that SMMC's calculation of its overall weighted average ROE treats the CAPM and bond yield plus risk premium approaches as equal to the two DCF approaches. The Commission has relied more heavily on the DCF approach than other approaches. Further, while theoretically sound, the Department has concerns related to the ability of analysts to apply the CAPM given the difficulty associated with estimating the required parameters. The significant differences between the Department's CAPM result and SMMC's CAPM result highlight this concern.

Thus, the Department concludes that SMMC's averaging approach should be given little to no weight.

### 3. OAG Comments

The OAG argued that Xcel Energy's request for a 9.50 ROE for the GUIC Rider is not consistent with the public interest. The OAG stated that Xcel Energy's requested ROE is measurably greater than that of companies with comparable risk. To reach this conclusion, the OAG used the DCF method, with the CAPM as a check for reasonableness, to estimate the required ROE.[11]

For its analysis, the OAG relied on data from a 30-day trading period from December 16, 2016 to January 31, 2017, applied to a Gas-only proxy group and a Combination proxy group. Using the Gas-only Proxy Group, the OAG estimated that a reasonable ROE for the Xcel Energy GUIC Rider is 8.15 percent. Using the Combination Proxy Group, a reasonable ROE is 7.13 percent.

The OAG's comments updated Xcel Energy's DCF analysis using more recent stock prices and removing two companies from the proxy group due to announced merger plans. A comparison of the results is contained in the table below:

**Table 4: Average ROE Results**

| Model | Combination Proxy Group | LDC Proxy Group |
|---|---|---|
| Constant Growth DCF | 9.74% | 8.15% |
| Two-growth rate DCF | 8.13% | 7.13% |
| CAPM | 6.93% | 6.48% |

There are a number of significant differences in the calculations performed by the Department and OAG. Unlike the Department, the OAG:

- Did not include flotation cost in its calculations;
- Did not use a blended value between the Combination Proxy Group and the Gas-only Proxy Group;
- Used an additional time period in its Multi-Stage DCF analysis, adding an additional growth rate for years 11 through 200 which is based on long-term growth projections based on the United States GDP provided by the Organization for Economic Cooperation and Development (OECD).

The OAG concludes that an ROE of 7.13 percent would be reasonable.[12] The OAG argues that the ROE analysis "must be based on an evaluation of current market conditions, rather than its comparison to the decisions made based on market conditions in the past."[13] And, "the

[11] The OAG comments provide background information about the DCF method, a discussion of the creation of the proxy group, and presented the results of the DCF and CAPM analysis.

[12] This figure is based on the Gas-only Proxy Group with OECD growth with extrapolation excluding flotation costs.

[13] OAG's March 1, 2017, *Initial Comments*, at 61.

analysis of current market conditions provided below demonstrates that Xcel's request for an ROE of 9.50 percent is unreasonable, and that a lower ROE would be consistent with the public interest as required by Minnesota law."[14]

### 4. Xcel Energy Reply Comments

In its *Reply Comments*, Xcel Energy argues that its proposed ROE is within the Department's range of reasonableness (7.38 percent to 10.79 percent) and is below the midpoint of the Mean and High Mean ROE results, and from that perspective, finds support in the Department's ROE range. In addition, the Company's proposed 9.50 percent ROE is consistent with ROEs recently authorized for natural gas utilities in other jurisdictions. Xcel Energy points out that data from Regulatory Research Associates shows the average authorized ROE for natural gas utilities from January 1, 2015 to September 30, 2016 was 9.525 percent.

Finally, Xcel Energy states that the OAG's proposed 7.13 percent ROE is below any reasonable estimate and should not be given any consideration by the Commission.

### 5. OAG Reply Comments

The OAG continues to support its proposals and updates its ROE recommendation based on the most recently available data. Using data covering the 30-day period ending March 8, 2017, the OAG revises its ROE recommendation from 7.13 percent to 7.00 percent. The OAG provided additional tables showing the updated information for the DCF, Multi-Stage DCF, and CAPM models.

### 6. Department Response Comments

The Department continues to support the 9.04 percent ROE it calculated in its *Comments* and an overall ROR of 7.02 percent. The Department notes it used the same approach in the instant *Petition* to develop its ROE estimate as it had in Xcel Energy's 2015 GUIC Rider docket (15-808). The Department notes that the Commission found the approach reasonable in the 15-808 Docket and the same approach is reasonable in the instant *Petition*.

The Department notes that Xcel Energy did not update any of the cost of equity information developed using the different models used by its consultant to estimate the Company's ROE in its *Reply Comments*. In addition, the Department disputes the helpfulness of the Company's statement that the average authorized ROE for natural gas utilities over the past few months was 9.525 percent. The Department notes that without having the facts of the individual proceedings or the relevant law from the jurisdictions in which such proceedings took place, such information is not comparable or relevant to the current GUIC Rider filing.

In addition, the Department included discussion addressing the probability of Xcel Energy's proposed ROE being higher than the Company's actual cost of equity. The Department comment is included in its entirety below:

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[14] *Id*.

As for the Company's discussion regarding its 9.50 percent estimate falling within the Departments range of values for the cost of equity, the Department notes that the selection of a value above the mean average cost of equity developed increases the probability that the Commission approved ROE falls above the Company's actual ROE. A statistical example may help illustrate this point. If one assumes that the cost of equity developed using the Department's approach is normally distributed and the standard deviation is equal to the average of the two standard deviations for the mean average estimates for the Department Proxy Groups, the probabilities associated with Xcel's approach would be the following:

**Table 5: Department ROE Probability Analysis**

| **Range** | **Probability** |
|---|---|
| Department Mean high estimates (less than 10.79%) | 0.997 |
| Xcel's recommended ROE (less than 9.50%) | 0.762 |
| Department's Mean average estimate (less than 9.04%) | 0.500 |
| | |
| Greater than Xcel Proposed ROE (9.50%) | 0.238 |
| Between Department's and Xcel's proposed ROE's (9.04% and 9.50%) | 0.262 |

This example suggests that approval of an ROE of 9.50 percent would be higher than Xcel's cost of equity over 75 percent of the time. The Department would not consider that level of probability to provide for an equitable outcome to ratepayers and continues to recommend that the Commission adopt its proposed 9.04 percent estimate for Xcel's return on equity for this proceeding.

Finally, the Department included a short discussion on the OAG's ROE recommendation agreeing with the OAG that the Commission has historically preferred the DCF approach for determining a utility's cost of equity but disagreeing that the OAG's multi-stage DCF model provides a reasonable estimate of the cost of equity for Xcel Energy's gas utility.[15]

[15] The Department included a footnote directing the reader to Mr. Kundert's testimony in Docket No. E-017/GR-15-1033 for a review of the OAG's multi-stage DCF model and additional support for the Department's recommendation in this proceeding.

## 7. Commission Staff Comments

In 2013, the GUIC statute was amended, and of the several amendments, one expanded the definition of GUIC projects to include,

> "*replacement or modification of existing natural gas facilities, including surveys, assessments, reassessment, and other work necessary to determine the need for replacement or modification of existing infrastructure that is required by a federal or state agency*" [Minn. Stat. § 216B.1635 Subd. 1(c)(2)].

Another amendment expanded the list of eligible recoverable GUIC costs by adding "*any incremental operation and maintenance costs"* [Minn. Stat. § 216B.1635 Subd. 4].

The statute's expansion of the basis for and the type of work that qualifies as a GUIC project, thus as a rider-recoverable cost, to the extent it is incremental, can provide jurisdictional utilities additional latitude in their O&M budgeting, which in turn, mitigates compromising its earnings potential and other operational expenditures. For instance, of Xcel Energy's projected 2017 calendar year GUIC activity[16] costs, O&M expense composes approximately 26 percent of the estimated 2017 activities' revenue requirements.[17] The majority of the Company's GUIC O&M expense arises from the ongoing gas and sewer line conflict investigation project which is expected to be completed in 2019.[18]

Although this matter has not been the subject of a contested case proceeding before an Administrative Law Judge, the parties have provided the same level of cost of capital analysis for the Commission. Staff notes that the Commission has a different statutory directive and starting point in this proceeding than in a rate case. Staff thinks it is important to start from the directive in the statute applicable to this proceeding which states the return on investment for the rate adjustment shall be at the level approved by the commission in the public utility's last general rate case, unless the Commission determines that a different rate of return is in the public interest.

No party is recommending that the return on investment (ROR or weighted average cost of capital) from the last natural gas rate case, 8.28 percent, be used in this docket. In the 14-336 Docket, the Commission found a different return on investment, 7.56 percent, to be more appropriate. That return was based on the cost of equity of 10.09 percent from Xcel's last gas rate case, Docket 09-1153, combined with the capital structure and cost of debt from Xcel's last electric rate case, Docket 13-868. Although the Statute allows for application of the return on investment from the last rate case, parties have not discussed that option, instead, the

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[16] Absent prior years' deferrals and true-ups.

[17] *Petition* at 23. The incremental O&M expense and capital-related revenue requirements projected total $5.7 million and $12.0 million, respectively. As noted in *Petition* Attachment B, page 5, and Attachment C, page 15, the capital-related revenue requirements consist of debt and equity return on rate base, property taxes, current and deferred taxes, and book depreciation.

[18] *Petition* Attachment C.

discussions started from the last GUIC Rider docket, which had an overall ROR of 7.34 percent.

The parties agree that the Commission could determine that a lower rate of return is in the public interest. However, they do not agree on how that rate should be determined and what the rate should be. For clarification, the tables below provide a history of how the GUIC cost of capital has progressed to the current proposals and identifies where the differences and modifications can be found:

**Table 6: Rate of Return Based on 09-1153**
**(Xcel Energy's last natural gas rate case)**

| | Capital Structure | Cost | Weighted Cost |
|---|---|---|---|
| Long-term Debt | 46.74% | 6.36% | 2.973% |
| Short-term Debt | 0.80% | 1.36% | 0.011% |
| Common Equity | 52.46% | 10.09% | 5.293% |
| **Rate of Return** | **100.00%** | | **8.277%** |

**Table 7: Rate of Return Authorized in 14-336**
**(Xcel Energy's 1st year of the GUIC rider)**

| | Capital Structure | Cost | Weighted Cost |
|---|---|---|---|
| Long-term Debt | 45.61% | 4.94% | 2.249% |
| Short-term Debt | 1.89% | 0.67% | 0.013% |
| Common Equity | 52.50% | 10.09% | 5.297% |
| **Rate of Return** | **100.00%** | | **7.559%** |

**Table 8: Rate of Return Authorized in 15-808**
**(Xcel Energy's 2nd year of the GUIC rider)**

| | Capital Structure | Cost | Weighted Cost |
|---|---|---|---|
| Long-term Debt | 45.61% | 4.94% | 2.25% |
| Short-term Debt | 1.89% | 1.12% | 0.02% |
| Common Equity | 52.50% | 9.64% | 5.06% |
| **Rate of Return** | **100.00%** | | **7.34%** |

**Table 9: Xcel Energy - Proposed Rate of Return, this docket**
**(Based on 15-808 Decision Updated with New ROE)**

| | Capital Structure | Cost | Weighted Cost |
|---|---|---|---|
| Long-term Debt | 45.61% | 4.94% | 2.25% |
| Short-term Debt | 1.89% | 1.12% | 0.02% |
| Common Equity | 52.50% | **9.50%** | 4.99% |
| **Rate of Return** | **100.00%** | | **7.26%** |

**Table 10: Department - Proposed Rate of Return, this docket**
**(Based on 15-808 Decision Updated with New ROE)**

| | Capital Structure | Cost | Weighted Cost |
|---|---|---|---|
| Long-term Debt | 45.61% | 4.94% | 2.25% |
| Short-term Debt | 1.89% | 1.12% | 0.02% |
| Common Equity | 52.50% | **9.04%** | 4.75% |
| **Rate of Return** | **100.00%** | | **7.02%** |

**Table 11: OAG Proposed Rate of Return, this docket**
**(Based on 15-808 Decision Updated with New ROE)**

| | Capital Structure | Cost | Weighted Cost |
|---|---|---|---|
| Long-term Debt | 45.61% | 4.94% | 2.25% |
| Short-term Debt | 1.89% | 1.12% | 0.02% |
| Common Equity | 52.50% | **7.00%** | 3.68% |
| **Rate of Return** | **100.00%** | | **5.95%** |

When determining an appropriate ROE, the Commission may want to consider its overall decision in this proceeding, including cost recovery, and how its decision differs from that in a rate case proceeding. The ROE authorized in a rate case is not guaranteed, rather it is a cost used to establish rates and is at risk. If a company underperforms, its ROE will suffer.

Depending on the Commission's decision in this proceeding, the ROE may be guaranteed. Minn. Stat. 216B.1635, Subd. 4 allows a 'rate schedule for the automatic annual adjustment of charges for gas utility infrastructure costs' that include a 'rate of return, income taxes on the rate of return'. As further noted in the Subd. 4, this is a petition for approval of a rate schedule to recover costs outside of a general rate case. Depending on the rate schedule approved and the interpretation of whether there is a true-up for those costs, the authorized return may not be at risk. In such a situation, because the ROE is not at risk, the ROE should be lower to reflect the lower risk.

Staff also notes that the instant *Petition* was filed on November 1, 2016. Subsequently, the Commission has addressed ROE issues in at least two dockets. In the Xcel Energy State Energy Policy (SEP) Rider docket (Docket No. G-002/M-17-174) the issue of an appropriate ROE was discussed. Xcel Energy recommended an ROE of 10.09 percent which is what was authorized in Xcel Energy's last natural gas rate case (09-1153). Whereas, the Department put forth the recommended ROE from this docket (9.04 percent). The Commission ultimately decided that rate of return analyses have changed significantly since the Company's last natural gas rate case and that the Department's recommended ROE of 9.04 percent was the most reasonable. The Commission did include a caveat in its Order that the ROE for the SEP Rider and the instant *Petition* should be identical. The Commission determined in its SEP Rider Order that "it is reasonable to have the same ROE for two rider dockets decided close in time and for the same company."[20] Thus, should the Commission approve an ROE other than 9.04 percent for the instant *Petition*, the ROE in the SEP Rider would need to be revisited.

[20] *Order Continuing Recovery of Costs Through the State Energy Policy Rider and Other* Action, G-002/M-

Also of significance, the Commission approved an ROE in Xcel Energy's electric rate case (Docket No. E-002/GR-15-826) [21] in that case, the Commission approved a settlement which allowed "Xcel Energy to represent its authorized ROE as nine and two-tenths (9.20%) for settlement purposes in this rate case proceeding.[22] The settlement also approved a revenue deficiency recommended by the Department which it is understood by staff to have been calculated using the Department recommended ROE of 9.06 percent. [23] Thus, the most recently approved Xcel Energy electric general rate case contains an ROE which is significantly lower than the ROE put forth by the Company in the instant *Petition*.

The Commission may also want to consider its own ROE decisions in recent natural gas rate cases in its evaluation of Xcel Energy's request in this proceeding. There were three decisions in natural gas rate cases with 2016 test years. And there are two pending natural gas rate cases with forecasted 2018 test years.

**Table 12: Authorized ROE for Natural Gas Rate Case Decisions with 2016 test year**

| | Date Filed | Test-Year | Main Order Date | Authorized ROE |
|---|---|---|---|---|
| CenterPoint Energy<br>Docket No. G-008/GR-15-424 | Aug. 3, 2015 | FY 2016 | Jun. 3, 2016 | 9.49% |
| Great Plains Natural Gas Co.<br>Docket No. G-004/GR-15-879 | Sep. 30, 2015 | CY 2016 | Sep. 6, 2016 | 9.06% |
| Minnesota Energy Resources<br>Docket No. G-011/GR-15-736 | Sep. 30, 2015 | CY 2016 | Oct. 31, 2016 | 9.11% |

Staff recognizes that it is generally understood that lower ROEs are awarded in natural gas rate case proceedings than in electric rate case proceeding because natural gas utilities are considered less risky than electric utilities. The following table contains the ROEs this commission has awarded to Xcel Energy and Otter Tail Power. Staff cautions, however, against blanket, one-ROE-fits-all-utilities assumptions and decisions, because ROE decisions in rate cases are intensely fact and record specific to each utility and the proceedings in which those ROE decisions were made. Nevertheless, as can be seen in the following table, on average, the Commission's ROE decision in recent electric rate cases have been slightly higher than the ROE decisions in natural gas rate cases.

17-174, dated August 24, 2017, at 6.

[21] See the Commission's *Findings of Fact, Conclusions, and Order*, dated June 12, 2017.

[22] See *Stipulation to Settlement* dated August 16, 2016 at 6.

[23] *Id*. at 5. In addition, Ms. O'Connell from the Department also made a similar statement during the Commission's May 4, 2017 agenda meeting.

**Table 13: Authorized ROE for recent Electric Rate Case Decisions**

| | Date Filed | Test-Year | Main Order Date | Authorized ROE |
|---|---|---|---|---|
| Xcel Energy (multiyear rate plan) Docket No. E-002/GR-15-826 | Nov. 2, 2015 | 2016 - 2019 | Jun. 12, 2017 | 9.20% |
| Otter Tail Power Docket No. E-017/GR-15-1033 | Feb. 16, 2016 | 2016 | May 1, 2017 | 9.41% |

Also, of interest and related to its request for a higher authorized ROE and higher earnings, Xcel Energy has several requests pending in Commission dockets for calendar year 2018. In its annual GUIC rider petition requesting authorization for its proposed 2018 GUIC rider revenue requirement and adjustment factors, the Company asked for an ROE of 10.00 percent. Xcel Energy's petition includes a report from a consultant hired by the Company that recommends the 10.00 percent ROE. Xcel Energy submitted almost identical requests in two other rider petitions, the Xcel Energy-Electric Transmission Cost Recovery (TCR) rider petition,[24] and the Renewable Energy Standards rider petitions[25] at approximately the same time. In all three petitions, in these separate dockets, Xcel Energy stated the following:

> The Company believes it would be helpful for the Commission to issue a procedural schedule that allows for an evaluation of the Company's proposed ROR and supporting analysis, as well as an evaluation of any analysis provided by parties which support their recommendations in an efficient manner. The Company recommends that all intervening parties provide their analysis of the Company's recommended ROE and ROR in their initial comments, which the Company will respond to in their reply comments. After that, the Commission should only allow for additional ROE and ROR analysis to enter the record, up to the point where the Commission takes up consideration of the filing, if changing market conditions necessitate additional analysis.[26]

Staff also notes that in Xcel Energy's pending request for approval of its five-year transmission, distribution, and general depreciation study, Xcel stated that:

> In the aggregate, these changes reduce the present depreciation expense by an estimated $6,903,045 based on plant data as of January 1, 2017 … In the event the Commission approves the depreciation expense change for the gas and

[24] In the Matter of the Petition of Northern States Power Company for Approval of the Transmission Cost Recovery Rider Revenue Requirements for 2017 and 2018, and Revised Adjustment Factors, Docket No. E-002/M-17-797, *Petition*, at 11.

[25] In The Matter Of The Petition Of Northern States Power Company For Approval Of The Renewable Energy Standard Rider Revenue Requirements For 2017 And 2018 And Revised Adjustment Factors, Docket No. E-002/M-17-818, *Petition*, at 12.

[26] In the Matter of the Petition of Northern States Power Company for Approval of a Gas Utility Infrastructure Cost Rider True-Up Report for 2017, Revenue Requirements for 2018, and Revised Adjustment Factors, Docket No. G-002/M-17-787, *Petition*, at 42.

> electric utilities, the estimated electric utility decrease of $116,945 will be reflected in the capital true-up that is part of the Company's recently approved multi-year rate plan and the estimated gas utility decrease of $6,786,100 will be addressed in a future rate proceeding.[27]
>
> Approval of this Petition will have no effect on Xcel Energy's 2017 revenue, since the changes are proposed to be effective January 1, 2018. The net impact on annual depreciation expense for the new proposed rates in 2018 will be an approximate decrease in depreciation expense of $6.9 million. However, the electric utility change after common allocation is the estimated amount that will be reflected in the capital true-up. To the extent that the Commission approves the decrease for the gas utility, the Company will work with parties on how to address this decrease in future rate proceedings.[28]

However, the Department, in its October 13, 2017 response comments, clarified that its recommendation (accepted by Xcel Energy) is for Xcel Energy to return the electric utility and the electric portion of the decrease in depreciation expense due to the change in the depreciation method to ratepayers in the 2018 capital true-up filing, in Docket No. E-002/GR-15-826. The record in this five-year depreciation study matter appears to be completely silent on how either Xcel Energy or the Department propose to effectuate Xcel Energy's suggestion that the Company work with parties on how to address this proposed decrease in depreciation expense in future rate proceedings.

Staff also notes that in its Annual Jurisdictional Reports (AJR) for its gas utility, Xcel Energy has reported the following earned ROEs for 2014, 2015 and 2016.

**Table 14: ROE for Current Year Normalized for Weather (including CIP incentives)**

| | 2014 | 2015 | 2016 |
|---|---|---|---|
| Xcel-Gas | 10.62% | 11.04% | 9.47% |

The only ROE decision the Commission has to make at this meeting is the decision about Xcel Energy's ROE for the GUIC rider for 2017. However, the Commission may want to ask the Company, the OAG and the Department how they plan to address Xcel Energy's proposed 10.00 percent ROE for 2018 in the three pending rider filings, and if they also have a plan for how to address the proposed decrease in depreciation expense for the Xcel Energy gas utility.

## B. Review of Software Costs

Xcel Energy included approximately $2 million of software-related costs in its GUIC calculations which represents an approximately $300,000 increase over software costs included in last

[27] In the Matter of the Petition of Northern States Power Company for Certification of its Five-Year Transmission, Distribution, and General Depreciation Study, Docket No. E,G-999/D-17-581, *Petition*, at 2.

[28] *Id.*, at 12.

year's GUIC filing (15-808 Docket). The Department had a number of issues regarding the amount of the increase as well as the overall nature of the costs. Both Department and Xcel Energy comments are discussed below.

### 1. Department Comments

The Department states that Xcel Energy's filing on this subject raised "serious questions" regarding the reasonableness of the Company's cost recovery request. As noted above, the actual costs incurred were significantly higher than the expected costs in the filing from the previous year. The Company did not provide any discussion substantiating the additional costs so the Department requested additional information which illuminated the following concerns.

#### a. **Quality Assurance/Quality Control Related Costs**

First, in a meeting on February 17, 2017, Xcel Energy revealed that only a "small portion" of the higher costs referenced in the Company's *Petition* related to the initial consultant contract. Xcel Energy explained that the majority of the higher costs are associated with an additional consultant review of the Pipeline Data Project (PDP). The PDP involved the digitization of older paper records and the incorporation of these records into the Company's Geographic Information System (GIS) computer software program. Xcel Energy provided additional data in its **Trade Secret** response to a Department Information Request showing a line-by-line breakdown of the costs associated with the PDP. The additional costs are referred to by the Company as quality assurance / quality control (QA/QC) costs and involve payments to a different consultant who ensures that work done in the original contract is appropriate for inclusion in Xcel Energy's GIS system.

The Department put forth two rationale as to why these costs should be disallowed: (1) the costs are duplicative in nature and it is unreasonable to expect ratepayers to bear the costs of duplicative consulting services; (2) the Department reviewed the Commission's *Findings of Fact, Conclusions of Law, And Order* dated December 6, 2010 in Xcel Energy's 2009 general rate case (Docket No. G-002/GR-09-1153) and notes that on page 12 of the *Order* the Commission approved a reasonable amount of professional services cost which are included in base rates. The Department concluded that the QA/QC costs put forth by Xcel Energy are already included in base rates and therefore recovery through the GUIC would be unreasonable.

#### b. **DIMP Software Costs**

Second, Xcel Energy's decision to assess costs solely to the Minnesota jurisdiction is unreasonable based on the contract and responses to OAG discovery in last year's filing. In response to Department Information Requests, Xcel Energy stated that it had executed a contract with the same vendor used in Minnesota effective July 15, 2014 for the Public Service of Colorado Pipeline Data Project. The Company further noted that:

> …because other jurisdictions may have similar Pipeline Data Project needs, all operating companies were added to the second contract [see Department Attachment 4], although the scope of the work was only associated with the

> Minnesota Pipeline Data Project. This contractual arrangement is beneficial since any additional scope of work ($ value only) could be added to the contract without the need for another Request for Proposal (RFP). Any Pipeline Data Project added to the existing contract would have its own unique work order created to ensure invoices are only billed to the respective operating company for which the work was performed. An approval process governs any amounts added to [the] contract. This process also expedites the contract arrangement timeline and avoids potentially extended contractual delays. The charges are managed through the invoicing process. Each operating company had its own designated work order to ensure Minnesota work was charged to the Minnesota work order and Public Service Company work was charged to the Public Service Company work order.

Based on the information in this record, the Department cannot verify that work was exclusive to the Minnesota jurisdiction. In fact, the Department referred to an Xcel Energy email that stated that "$49,945 of the original software costs included in previous GUIC filings involved work unrelated to the PDP completed for Public Service Corporation in Colorado." Given the Company's contract language and the $49,945 in non-Minnesota jurisdictional costs previously included in the GUIC, the Department concluded that the most reasonable way to assess costs associated with the PDP is to allocate the costs across all of Xcel Energy's affiliates. Specifically, the Department recommends that the Commission allocate these costs using the Federal Energy Regulatory Commission (FERC) Distribution Gas allocator (FERC Accounts 870 and 880) used by Xcel Energy in its 2015 Electric Rate Case (Docket No. E-002/GR-15-826). For the instant *Petition*, the allocator would be 29.6370 percent.

In addition to the allocation of costs amongst each of Xcel Energy's affiliates, there is also the question of cost allocation between the jurisdictions within NSP-MN. It is the Department's contention that although the Company classified its PDP as DIMP (direct assignment of costs), Xcel Energy provided no evidence in the record substantiating that the work undertaken by the PDP occurred solely in the Minnesota jurisdiction. Based on its understanding of the scope of the PDP, the Department has reason to believe that some level of work involved projects or locations that are outside of the Minnesota jurisdiction. As such, the Department recommends that NSP-MN related PDP costs be further allocated in the same manner as Xcel Energy's TIMP costs in this docket, which is an allocation factor of 88.23 percent.

In conclusion, the Department recommended the following concerning the proposed software costs:

- Reject all QA/QC related costs included in the GUIC Rider since they represent duplicative services; and
- Reject the Company's proposed level of DIMP software costs and approve $444,543 in DIMP software costs for recovery through the GUIC Rider.

**2. Xcel Energy Reply Comments**

Xcel Energy believes that it has provided the necessary information to substantiate its QA/QC activities and demonstrate that it does not contain duplicative consulting services. Xcel Energy explained that the role of QA/QC contractors in the PDP was to ensure the outside vendor was interpreting the data the correct way and the end product was what the Company was expecting. Xcel Energy continues:

> The vendor was tasked with reviewing thousands of work orders, some of which were approximately 90 years old. If the vendor had a question on a certain work order vintage, the primary point of contact was the QA/QC contractor that physically worked out of the Company's offices. The role of the QA/QC contractor was that of a liaison between Company employees and the PDP contractor. The QA/QC contractor solved problems efficiently to ensure accurate results. The use of QA/QC to establish the data acceptance criteria and acceptance testing process is utilized in many different industries to ensure the vendor is performing their work the right way and that the results are acceptable.

Xcel Energy went on to explain that the use of QA/QC inspection is an industry standard and a best practice at the Company in many areas and is not unique to the PDP. Xcel Energy disagrees with the Department's assessment of QA/QC costs as being duplicative and requests the Commission approve recovery of PDP capital expenditures totaling $2,023,225. The difference between the requested PDP costs in the original petition and the Company's reply comments is the inadvertent inclusion of $49,945 in costs related to the Public Service Corporation of Colorado in the Company's last GUIC filing (15-808 Docket) which Xcel Energy acknowledges was incorrect.

In addition, Xcel Energy disputes the Department's recommended use of a two-step process for allocation of PDP costs. The Company argues that it is inappropriate to use a transmission cost allocator for this project which is distribution in nature. Past practices, prior Commission orders and cost causation principles all point to the fact that gas distribution costs are allocated in full to the state where they are physically located, in this case the State of Minnesota.

### 3. Department Response Comments

The Department maintains its original recommendations regarding both the disallowance of QA/QC costs and the recovery of PDP expenditures through the GUIC.

#### a. Quality Assurance/Quality Control Related Costs

In its *Comments*, the Department identified the presence of duplicative consulting services; in simple terms, Xcel Energy hired consultants to review the work of the original consultant enlisted to undertake the PDP. The Department continues to believe these costs are already recovered in base rates and remains concerned that Xcel Energy's internal staff is unable to verify or determine whether data from the original consultant is appropriate for inclusion in the Company's GIS data. The Department does not dispute that quality control is an industry standard and agrees, at least conceptually, that having quality and review standards are important and necessary. However, the Company's application of this standard is inappropriate and not in the interest of ratepayers. Based on the information in this record, Xcel Energy uses two layers of consulting which is duplicative and inappropriate for cost recovery through the GUIC rider.

### b. DIMP Software Costs

In its *Comments*, the Department analyzed the Company's original contract for this work and noted that the contract was executed with all of Xcel Energy's utility affiliates but the entirety of costs were assigned to Minnesota ratepayers. The Department continues to recommend these costs be allocated based on the Xcel Energy jurisdictional allocator. In addition, the Department identified three issues with the additional information provided by Xcel Energy in its *Reply Comments*, the Departments states:

> First, the Company included work orders with invoice numbers different than the two contracts previously provided in this record; therefore, there is no way to determine which jurisdiction should be allocated these costs. Second, Xcel included work orders with invoice numbers that corresponded to its contract with Public Service Corporation of Colorado (PSCo). If that is the case, it is clear that those costs should be removed from the Minnesota jurisdiction. Third, it appears that some of the work orders included costs associated with projects different than the PDP. At a minimum, this information means that Xcel has logged costs in the incorrect project category or, more significantly, may have booked costs to the wrong jurisdiction. The invoices provided by Xcel do not support the reasonableness of allocating PDP costs strictly to the Minnesota jurisdiction and raise further questions regarding the reasonableness of the Company's proposed PDP costs.

The Department continues to conclude that allocation of the entire software costs to Minnesota jurisdiction is inappropriate.

## 4. Xcel Energy Reply to Department Comments

Xcel Energy maintains that the software costs are appropriately allocated to the Minnesota jurisdiction. The Company did follow up with its contractor regarding the Department's identification of errors related to the invoice numbers associated with the PDP and agreed that the Department was correct that the invoice numbers did not contain the invoice number associated with Minnesota. After consultation with their vendor, Xcel Energy confirmed that although an incorrect invoice number was provided, the project name was correctly identified on all the invoices and that all the invoices were properly allocated to the Minnesota PDP.[29]

As for the QA/QC costs, the Company believes quality control costs are appropriate for GUIC recovery and that QA/QC costs requests in this docket are not duplicative of any other work performed. Xcel Energy argues that the two services at issue (data entry and quality assurance) are imperative to ensure data integrity within the system and verify accurate system records for safety planning and resulted in a low per-unit cost which are reasonable and should be recovered via the GUIC Rider.

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[29] Xcel Energy June 2, 2017, *Reply to Department Comments*, at 2-3.

## C. Prorated Accumulated Deferred Income Taxes

### 1. Department Comments

The Department points out in its *Comments* that Xcel Energy included the effects of proration of its Accumulated Deferred Income Taxes (ADIT) in its revenue calculations.[30] As shown in its *Petition*, the prorated ADIT calculations increased the annual revenue requirements by $134,029 and $108,767, respectively for 2016 and 2017.[31]

The prorated ADIT issue stems from recently issued Private Letter Rulings (PLRs) from the Internal Revenue Service (IRS). According to these PLRs, the IRS is concerned that utilities may be violating tax normalization rules by passing back the benefits of accelerated depreciation (via an ADIT credit to rate base) to ratepayers too soon. The Department goes on to explain that IRS section 1.167(I)(h)(6) defines the procedures a company must use to normalize the impact on rate making in a forward-looking test year if a company elects to use accelerated depreciation. This section stipulates that the monthly changes to the deferred taxes balance, as calculated by the company, must be prorated prior to computing the average of beginning and ending balances for ADIT.

The Department originally recommended that the Commission approve Xcel Energy's proposed ADIT proration for the forecasted year, subject to a true-up calculation in the following year using actual non-prorated ADIT amounts. The Department also noted that Xcel Energy would be requesting its own PLR from the IRS.

In its July 25, 2017, *Additional Comments*, the Department revised its recommendation due to the issuance of the aforementioned PLR. The Department explained the PLRs finding as follows:

> [I]f the rate is put into effect at the beginning of the test period, the IRS considers the entire period to be a forecasted test period and ADIT proration is required for all twelve months. If the rate is not put into effect until after the test period, even if the rates are based on estimates, then the IRS considers the entire period as historical, and ADIT proration is not required. If the rate is put into effect during the test period, say in the fourth month, the first four months would be considered historical, thus, no proration, and the remaining eight months would be considered forecasted, with proration required.

Given the combination of the PLR and that Minn. Stat. § 216B.03 requires that "Any doubt as to reasonableness should be resolved in favor of the consumer," the Department's revised recommendation is that Xcel Energy's GUIC rates for 2017 must not become effective until January 1, 2018. At that point, no proration would be required by the IRS, there would be no

[30] Department's March 1, 2017, *Comments* at 7.

[31] *Petition* Attachment P.

violation of the IRS' normalization requirements, and ratepayers would be charged appropriate rates.

### 2. Xcel Energy Reply Comments

Xcel Energy did not object to the Department's original recommendation for Commission approval of the Company's proposed ADIT proration, subject to a true-up in future proceedings. Xcel Energy has not provided written response to the Department's revised recommendation.

### 3. Commission Staff Comments

Staff notes that the Commission also discussed this issue in Xcel Energy's SEP Rider proceeding (Docket No. G-002/M-17-174) to which it determined that the Department's approach to implementing rates after the test year was more reasonable and subsequently did not approve the Company's request to allow proration of ADIT in the SEP Rider. [32] Thus, the rate will be implemented at the conclusion of the test year. Due to the length of time this particular docket has taken, the prorated ADIT issue will not be resolved prior to January 1, 2018 and therefore no proration will be necessary. However, with the issuance of the PLR discussed above, the Commission may wish to address this topic at its December 21, 2017, agenda meeting and accept additional comments from Xcel Energy and the Department in order to provide direction to the parties for future filings.

## D. Sales Forecast

Xcel Energy uses a sales forecast in its class factors calculation to determine how to apportion the revenue responsibility for the GUIC Rate Adjustment Factor.

### 1. Department Comments

The Department noted in its *Comments* that Xcel Energy did not provide information or discussion on how the sales forecast was derived. In response to Department Information Requests, the Company provided its models and spreadsheets illustrating the derivation of forecasted sales. The Department reviewed these calculations and concluded that Xcel Energy's forecasting model is "generally appropriate." However, the Department is concerned that the Company's approach with its sales forecast does not appear to be reasonable for several reasons.

- The decision to reallocate forecasted sales to match historical monthly sales is inappropriate and adds an additional layer of complexity to the Company's sales estimates;
- The Company's forecasting adjustments result in lower forecasted sales for certain rate classes relative to the results of the regression models;
- The inclusion of a DSM adjustment as an ad hoc adjustment to the effects of energy conservation effectively double-counts DSM.

[32] *Order Continuing Recovery of Costs Through the State Energy Policy Rider and Other* Action, G-002/M-17-174, dated August 24, 2017, OP 3.

The Department recommended that GUIC recovery rates be based on the Company's regression model before monthly sales and DSM adjustments.

### 2. Xcel Energy Reply Comments

Xcel Energy disputes the Department's contention that reallocating forecasted sales to match historical sales is inappropriate. The Company argues that the adjustment is done to better align forecasted sales with historical actual sales on a calendar month basis in order to produce a monthly forecast that is more reflective of history than is an unadjusted forecast. The adjustments are done in a manner that ensures the annual sales for a given calendar year remain unchanged (annual adjusted sales equal the annual unadjusted sales).[33]

Xcel Energy argues that no evidence has been presented in this or any other proceeding that the inclusion of a gas DSM adjustment double-counts DSM. The Company continues by stating that its adjustment is designed to avoid double-counting of the impacts. The Company's process assesses the amount of DSM that is embedded in the forecast because DSM achievements are already included in the historical data used for modeling. The forecast is then adjusted for only the amount that expected future DSM differs from the amount of embedded DSM.[34]

In their *Reply to Department Comments*, Xcel Energy modified its position and stated "While we believe the rates proposed in the Company's request appropriately include the adjustments for reasons discussed here, we do not oppose the Department's recommendation to exclude the adjustments from the sales forecast for purposes of our 2017 GUIC Rider proposal."[35]

### 3. Commission Staff Comments

Although Xcel Energy withdrew its objection to the Department's recommendation to calculate the GUIC recovery rates based solely on the results of the regression model and not include either monthly sales and DSM adjustments it is clear that the two parties disagree on how the sales forecast should be calculated and the issue may resurface in the future. The Commission can either limit its focus on the instant petition and address this issue in a future proceeding or accept additional comments on this issue at the Commission's December 21, 2017, agenda meeting with the intent of providing guidance to the parties on how this issue is to be addressed in future GUIC proceedings. For example, should the Commission refer all future Xcel Energy annual rider compliance filings to the Office of Administrative Hearings for contested case proceedings.

The Department noted in its May 18, 2017, *Response Comments* that the Commission has ruled in favor of the Department's position regarding the DSM adjustment in multiple electric rate

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[33] Xcel Energy March 13, 2017, *Reply Comments* at 10.

[34] *Id*.

[35] Xcel Energy June 2, 2017, *Reply to Department Comments*, at 3-4.

cases (Docket Nos. E-002/GR-12-961 and E-002/GR-13-868) and noted that the Commission in its *Order* for the 2012 rate case, "expressed doubt regarding the appropriateness of a DSM adjustment and set rates based on unadjusted sales."[36]

Xcel Energy in its June 2, 2017, *Reply to Department Comments* points out that the Department repeatedly cites to electric rate cases, rather than gas proceedings and maintains its position that no analysis has been conducted regarding historical gas DSM adjustments and continues to maintain its position that such adjustments are appropriate.

## E. Sewer Conflict Inspection Equipment

In 2010, a house was destroyed due to a sewer cleaning contractor hitting a natural gas main that had intersected the sewer line. The incident resulted in personal injury, property damage and raised concerns that other sewer and gas line interactions existed on the Company's system and posed a safety concern. Xcel Energy was required by the Minnesota Office of Pipeline Safety (MNOPS) to investigate and mitigate this issue. This situation was the genesis for the Company's original recovery of accelerated safety costs (Docket No. G-002/M-10-422), which were then rolled into the GUIC Rider (Docket No. G-002/M-14-366).

### 1. Department Comments

Initially, the Department was concerned that Xcel Energy had not adequately justified the outsourcing of the sewer line inspection process and recommended that the Company provide additional information substantiating Xcel Energy's costs. Ultimately, the Company provided a comparison of actual costs incurred (outsourced costs) and internalized costs for the sewer line inspection project. In particular, the Department compared Xcel Energy's labor cost assumptions and equipment costs to those approved in Xcel Energy's most recent natural gas rate case (G-002/GR-09-1153). The Department concluded the costs assumptions used by Xcel Energy are similar to costs included in the Company's base rates. The Company's cost analysis assumes hiring new employees and procuring new equipment and not the use of existing employees and equipment. However, since Xcel Energy stated on several occasions, as acknowledged by the Department in its *Comments*, that this type of work is likely outside of the core business of a gas utility, the Department concludes this approach is reasonable.

Of further concern to the Department was Xcel Energy's intransigence to proving requested information in a timely manner. The Department notes that "it took Xcel Energy three requests (discovery request and two rounds of comments) in this docket before the Company provided a comparison of outsourced costs and internalized costs. The process required to complete the requested, and necessary, cost comparison was unduly complex and time consuming."[37] The Department concludes by opining whether "the [annual] GUIC rider [compliance] filing is the

[36] Department May 18, 2017, *Response Comments*, at 6.

[37] Department July 25, 2017, *Additional Comments*, at 3.

most appropriate vehicle to analyze the reasonableness of the Company's cost recovery proposal and rate base size."[38]

### 2. Xcel Energy Comments

Inspecting sewers is well outside the core business operation of a utility company, and in 2010, the Company did not possess the expertise, staff, equipment, or other resources required to perform inspections on these non-Company assets. Additionally, at the time the program was developed, the Company anticipated that the sewer conflict inspection work would be completed as early as 2012. As is typical of Company processes, where work falls well outside of its core business, Xcel Energy engaged third-party professionals via competitive bidding to perform the work on the Company's behalf. Pursuant to the Department's request Xcel Energy provided a cost analysis showing that the Company would have incurred an additional $1.9 million in costs had it developed the workforce and acquired the equipment needed to perform the work in-house versus outsourcing.

### 3. Commission Staff Comments

Although it appears that the issue of outsourcing sewer inspection work versus developing the expertise in-house appears to have been resolved, Commission staff is concerned by the Department's discussion regarding Xcel Energy's unwillingness to provide requested cost information. This issue is discussed later in these briefing papers.

## F. GUIC Rider Duration

The Department appears to have two main concerns regarding Xcel Energy's proposal. The first concerns the fact that the Company's filing shows a decrease in the overall revenue requirement from 2016 through 2020. The second concerns the inclusion of an additional year of GUIC revenue requirement for 2021 which seems to raise the question of the ongoing duration of the GUIC Rider.

### 1. Department Comments

The Department provided the following table showing the change in total TIMP and DIMP related annual revenue requirements and asked the Company to explain the reasons for the decline.

[38] *Id*.

**Table 15**
**Change in Xcel Energy's Projection of Total TIMP and DIMP Revenue Requirements**
**($ Millions)**

| Docket No. | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|
| 15-808 | $17.9 | $23.8 | $27.1 | $33.4 | $32.3 | N/A |
| 16-891 | $15.8 | $22.1 | $24.8 | $30.6 | $28.6 | $34.4 |
| Change | -$2.1 | -$1.7 | -$2.3 | -$2.8 | -$3.7 | N/A |

Regarding the GUIC Rider duration, the Department notes that the Commission stated in its *Order* in Docket No. 14-336 that it would:

> …have an opportunity to review the GUIC rider on an annual basis and to make any needed adjustments or require the Company to file a rate case, if that is appropriate. For this reason, the Commission finds it unnecessary to set a definite end date for the GUIC rider.

The Department reviewed the Company's Annual Jurisdictional Report for 2015 and noted that the weather-normalized return on rate base for 2015 was 7.37 percent, and is projected to be 6.86 percent in 2016. Both of these figures are less than the 8.28 percent authorized rate of return from Xcel Energy's last rate case, but bracket the Department's current proposal of 7.02 percent.

The Department ultimately concluded that it was not necessary, at this time, to recommend ending the GUIC Rider or requiring Xcel Energy to submit a general rate case but did request the Company address the Department's questions in its reply comments.

### 2. Xcel Energy Reply Comments

In its *Reply Comments*, Xcel Energy explained the reasons behind the overall decrease in the revenue requirements. First, the Company stated that approximately 25 percent of the overall decrease is attributable to the lower ROE and the remainder is due to changes to bonus depreciation due to the Protecting Americans from Tax Hikes (PATH) Act of 2015, which extended bonus depreciation.

Xcel Energy did not respond to the Department's discussion regarding the duration of the GUIC Rider.

### 3. Commission Staff Comments

The duration of Xcel Energy's GUIC Rider has been a topic of discussion in previous dockets. Both Commission staff and the OAG have raised concerns regarding the potential of the Company over-earning its rate of return.[39]

[39] See Commission staff briefing papers in the 15-808 Docket, pages 39 – 43 for further discussion on this topic.

Commission staff notes that there was discussion regarding the length of the term of the Rider at the December 18, 2014 Commission agenda meeting when Xcel Energy's inaugural GUIC Rider was discussed (in Docket No. 14-336). At that time, the general school of thought was that the capital projects being recovered through the GUIC Rider would be completed in five years and then the Company would submit a general rate case.

Although the Department did not recommend ending the GUIC Rider at this time the topic of when a general rate case should be filed regarding these costs is worth discussing. The instant *Petition* is the third annual filing of the GUIC Rider and as previously mentioned the general understanding was that the GUIC Rider would end after five years. To that end, the Commission may wish to discuss this issue at its December 21, 2017 agenda meeting with the discussion centering on whether the Commission should establish a future date whereby Xcel Energy will file a natural gas rate case.

## G. Compliance Filing, True-Up Report, and Tracker Balances

Xcel Energy discussed its 2017 GUIC revenue requirement calculations on page 23 of its *Petition*. The Department reviewed the Company's revenue requirement calculations and the updated data from Information Request responses and concluded that the calculations appear reasonable.

In addition, the Department supports Xcel Energy's proposal to recover the 2017 revenue requirements over the remaining months through March 31, 2018 and recommends Commission approval of a tracker year ending March 31 and require the Company to recover 2017 revenue requirements over the remaining months in 2017 through March 31, 2018. The Department also recommends that the Commission require Xcel Energy to submit a compliance filing showing the final rate-adjustment factors reflecting the Commission's decisions in this matter, and all related tariff changes, within ten days of the date of the Commission's Order.

Xcel Energy does not object to the Department's recommendation of a ten-day period following the Order to prepare a compliance filing with final rate-adjustment factors.

### 1. Commission Staff Comments

Xcel Energy's GUIC True-Up Report for 2016 for activity ending December 31, 2016, was summarized in the petition's Table 1, supported with several underlying Attachments. The report filed included three months of estimated data, given a petition filing date prior to year-end. No party objected to the 2016 true-up report.

Staff notes, however, that the originally proposed twelve-month recovery period ending on March 31, 2018, may no longer be appropriate due to the extended time which this docket took to come before the Commission. Staff recommends the new factor be calculated based on the twelve-month recovery period but be put into effect when the Commission issues its order. This factor will be replaced when the Commission issues its order on Xcel Energy's 2018 GUIC rider filing. Any under or over recovery would be addressed in the true-up report.

### H. Tariff Sheet and Customer Notice

In the instant *Petition*, Xcel Energy provided both clean and redline formats of its Tariff Sheet No. 5-64. The Company updated the tariff to reflect its proposed 2017 GUIC factors. If the Commission modifies the proposed revenue requirement or recovery period, then the Department recommends that the Commission require Xcel Energy to submit a compliance filing showing the final rate-adjustment factors, and all related tariff changes, within ten days of the date of the Commission's order.

In addition, the Department notes that Xcel Energy provided draft customer notice based on approved language from the Commission's 15-808 Docket. Therefore, the Department recommends Commission approval of the proposed customer notice language.

As discussed previously, Xcel Energy stated in its *Reply Comments* that it did not object to submitting a compliance filing within the ten day timeframe put forth by the Department.

### I. Replacement of New Equipment

Pursuant to Minn. Stat. § 216B.163, subd. 4 (2), Xcel Energy provided information regarding its individual TIMP and DIMP projects. The Department reviewed this information and determined that it was generally sufficient to analyze the reasonableness of the Company's costs, except that Xcel Energy's initial *Petition* did not provide information regarding when the replaced pipe was originally placed into service. In response to Department Information Requests, Xcel Energy provided additional information regarding replaced pipe. Based on its review of the new information, the Department observed that the Company replaced relatively new pipe on three occasions and was unable to identify the age of replaced pipe in many instances.

Subsequent to additional requests for information, Xcel Energy determined that the three instances where newer pipe was replaced were reported in error, in addition to other projects being originally reported with the incorrect year of installation. The Department ultimately concluded that there was no issue regarding replacement of newer pipe but were concerned with the Company's inability to accurately report correct installation dates in its petition and discovery responses and recommends that Xcel Energy "work to improve the quality of its information request responses in future filings," the Department stated that it will continue to monitor the age of pipe replaced and associated costs recovered through the GUIC.[40]

In response, Xcel Energy thanked the Department for its comments and said it will work to improve the quality of its information request responses.

### J. Performance Metrics

In OP 2 of its August 18, 2016, *Order Requiring Updated Report, Approving Rider Recovery, and Requiring Metrics to Evaluate GUIC Expenditures* in the 15-808 Docket, the Commission required Xcel Energy to develop metrics and reporting requirements to analyze the

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[40] Department March 1, 2017, *Comments* at 10-11.

appropriateness of the Company's GUIC expenditures. Xcel Energy presented its proposed metrics to various parties, including the Department and OAG, on November 16, 2016, and submitted the proposed metrics in a supplemental filing on January 13, 2017.

### 1. Xcel Energy's Proposed Performance Metrics

Xcel Energy's proposed performance metrics consist of five metrics: three related to DIMP and two related to TIMP. The Company provided the following table summarizing the proposed metrics and its purported benefit.

**Table 16: Proposed GUIC Metrics**

| Program | Metric | Benefit |
|---|---|---|
| DIMP | Leak Rate by Vintage and Pipe Type | Monitor the impact of renewal efforts on the leakage rates. Selection of higher-risk pipe segments will lower leakage rates over time. |
| | Poor Performing Main Replacements Unit Cost | Monitor unit costs greater than one standard deviation above the mean in order to ensure variances are understood and reasonable. |
| | Poor Performing Service Replacements Unit Cost | Monitor unit costs greater than one standard deviation above the mean in order to ensure variances are understood and reasonable. |
| TIMP | Gas Transmission Anomalies Repaired | Monitor the impact of pipeline assessment, repair and renewal efforts on the number of anomalies that require repair. Completion of appropriate repairs and renewal efforts will lower anomalies over time. |
| | Actual vs. Estimated Cost Variance Explanations for Capital Projects | Monitor cost variances in order to ensure variances are understood and reasonable. |

### 2. OAG Comments

The OAG provides a critique of Xcel Energy's proposed metrics and finds that they are "open-ended and ill-defined" and cannot be adequately reviewed. The OAG concludes that the

Commission and not the Company should be the entity driving development of the metrics and that "the Commission should decline at this time to adopt the metrics proposed by Xcel."[41] For example, the OAG finds that the proposed metric to track the leak rate may provide useful information but only after the Commission establishes a benchmark for acceptable leak rates whereby the GUIC project replacement rate can be compared to "business-as-usual" replacement rates. In such a case, a metric could be established that ties replacement spending to a reduction in material-specific leak rates which would encourage the removal of the riskiest pipes in the system toward a specific leak rate goal.[42]

In regards to the metrics that focus on cost-effectiveness, the OAG notes that two of those metrics focus on costs that exceed one standard deviation. The OAG disputes the appropriateness of using statistical analysis using standard deviations to evaluate normal levels and the reasonableness of costs. Although this metric could potentially provide useful information additional work would be necessary.

The OAG ultimately determines that "it is too early in the process to tell whether the metrics proposed by Xcel are reasonable and appropriate ways for the Commission to track the Company's and possibly other utilities' TIMP and DIMP performance."[43] Rather, the OAG proposes that the Commission begin a separate proceeding involving all of the natural gas utilities to discuss integrity management activities state-wide.

### 3. Xcel Energy Reply Comments

Xcel Energy continues to argue that TIMP and DIMP performance metrics are reasonable and meet the requirements set forth by the Commission in its *Order* in the 15-808 Docket. For example, the Company believes that monitoring leak rates is the most appropriate performance measure for DIMP activities, and that this conclusion in support by the National Regulatory Research Institute (NRRI) and is a requirement in federal regulations. The cited NRRI report states "to reduce leaks, an appropriate metric is the leaks per mile." Additionally, 49CFR Part 192.1007€ requires performance metrics for DIMP that include the number of leaks either eliminated or repaired, categorized by cause. Xcel Energy urges the Commission to adopt its proposed performance metrics.

### 4. Department Response Comments

The Department states that the proposed reporting metrics appear reasonable as a first step but expressed concern regarding the use of standard deviation in the proposed TIMP metrics. Specifically, the Department is concerned that the Company's use of a normal distribution curve is not necessarily correct which may result in the wrong data being included in a future analysis. The Department recommends that if Xcel Energy wishes to use the standard deviation

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41 OAG March 1, 2017, *Initial Comments*, at 44.

42 *Id*.

43 *Id.* at 49.

as a test metric it needs to show statistically that its data (costs in this instance) is normally distributed.

In regards to the OAG's proposal, the Department notes that although not opposed to the approach Xcel Energy is currently the only regulated Minnesota gas utility with an approved GUIC rider. Other gas utilities in the state are undertaking comparable GUIC, but they are recovered, and have been recovered, through the "standard" rate making process. Given the different cost recovery mechanisms employed across the various utilities, it is unclear whether standardized reporting metrics are appropriate. Second, each individual gas utility has different operating and system characteristics, which may make a single set of reporting metrics difficult to develop and administer. The Department concludes by stating that it is willing to join in further examination of this topic and, perhaps seeing some level of standardization if applicable, if the Commission wishes to move in this direction.

### 5. Xcel Energy Reply to Department Comments

Xcel Energy responded to the Department's *Response Comments* by providing additional refinement of its TIMP metrics to include the performance of a normality test on the unit cost data. If the normality test shows that the data is abnormally distributed, the Company will provide additional information for the highest cost projects.

In addition, Xcel Energy provided the results of the American Gas Association (AGA) survey and thanked the AGA for its assistance in facilitating the survey but noted that the process did not produce significant insights since it revealed that respondents have a limited amount of experience with developing performance metrics for integrity management programs.

Review of the AGA survey shows that four respondents have some type of approved mechanism for recovery of TIMP/DIMP costs outside of base rates and that two of the four respondents have developed performance metrics to evaluate the effectiveness of their TIMP/DIMP programs with only 1 of the respondents incorporating the performance metrics into its TIMP/DIMP investment decisions.

### 6. Department Additional Comments

The Department reviewed the results of the AGA survey and concurs with the Company that insights are limited since the number of gas utilities with a similar GUIC rider are limited. In addition, the Department noted that the survey did provide some additional minor insights. First, in terms of cost savings, two of the responding utilities reported Operations and Maintenance (O&M) cost savings but they stated that the results have not been specifically reported. In other words, the cost savings appear anecdotal. Second, there were responses that indicate utilities believe reporting metrics may provide useful tools for measuring performance but it is too early in the process.

The Department determined that although Xcel Energy's proposed reporting metrics are similar to proposed metrics for other responding utilities, the sample size from the survey results is not sufficient to conclude that the Company's reporting requirement represent the most appropriate or reasonable way of tracking the performance of the GUIC Rider.

#### 7. Commission Staff Comments

Both the Department and OAG maintain that the proposed performance metrics need additional work and are not ready for Commission approval. To that end, the OAG recognizes that developing performance metrics will be a "significant undertaking" and recommend the Commission open a separate proceeding to continue the work on these metrics but also include the other Minnesota regulated natural gas utilities in the process. The Department is willing to participate in the process but is unsure whether "standardized reporting metrics are appropriate."

The reasonableness of the proposed performance metrics remains an open question as well as the value and priority that should be given to having a workgroup of all regulated natural gas utilities propose a set of standard performance metrics involving integrity management programs. Staff notes that a significant span of time has occurred since the parties filed their written comments on this issue and the Commission may wish to ask the parties at its December 21, 2017 agenda meeting as to the direction the parties wish to proceed.

### K. Revenue Cap

The OAG, in its *Initial Comments*, expressed concern regarding the growth in the size of the GUIC Rider relative to the base rates approved in Xcel Energy's most recent general rate case. The OAG was particularly concerned about the open-ended nature of the GUIC Rider and the lack of restrictions within the GUIC Statute as to the type of pipes or material that are eligible for GUIC recovery, as opposed to other states where restrictions exist.

#### 1. OAG Comments

The OAG calculated that Xcel's projected 2017 GUIC Rider revenue is equal to 14 percent of the Company's base rates revenue approved in its last rate case ($22 million divided by $159 million). A 6 percent revenue cap would limit the amount of revenue the Company could collect via the GUIC Rider to approximately $9.5 million. The unusual size of GUIC costs compared to base rates, in addition to the unusual speed at which the costs are accumulating, indicated to the OAG that the Commission should take action to balance the interests in permitting accelerated recovery of the costs of the projects against insuring that rates are just and reasonable.

The OAG argues that a revenue cap would limit the allowable rider recovery, but not the utility's ability to spend money to address system safety. Xcel Energy would be able to spend money for GUIC projects in excess of the revenue cap and could ask for recovery as appropriate in its next general rate case.

### 2. Xcel Energy Reply Comments

Xcel Energy does not support the OAG's revenue cap proposal. The Company put forth a number of arguments. First, the six percent figure is arbitrary. The OAG provided no support for the basis of the proposed cap last year, nor does it present any evidence of its reasonableness this year. Second, the Minnesota legislature in Minn. Stat. § 216B.16, subd. 11 was clear in its intent to incentivize utility safety investments. Third, there are significant practical considerations that do not align with a cost recovery limit. The Company would potentially be unable to recover costs of safety projects because of investments already made. Such an outcome is directly contrary to the purpose of the GUIC statute, which was intended to incentivize gas utility companies to make necessary safety investments.

Based on the arguments discussed above, Xcel Energy recommends the Commission reject OAG's revenue cap proposal.

### 3. Commission Staff Comments

The OAG raised the concern of whether the GUIC Rider's significant capital expenditures, revenue increases and rider rates are resulting in overall just and reasonable customer rates without having recently reviewed Xcel Energy's gas operations in a rate case setting. Staff believes the OAG's intent of a proposed cap is to provide some customer protection absent a recent review of Xcel Energy's gas operations via a general rate case. The OAG provided an analysis of GUIC Rider revenue requirements relative to Xcel Energy's Commission approved base rate revenues from the Company's most recent rate case. The OAG's recommended cap approach is to derive a cap based upon the 2010 test year revenue amount.

Should the Commission decide to limit the increase in GUIR rider rates charged to Xcel Energy's customers as a form of protecting the public interest, staff recommends that the Commission make clear whether or not any annual GUIC revenue requirements incurred that exceed this limit are authorized for deferred recovery.

## L. Detailed Cost Study

### 1. OAG Comments

In the 15-808 Docket, the Commission ordered Xcel Energy to file a cost and revenue study to reconcile calendar year 2015 GUIC activities with base rates, its Purchased Gas Adjustment (PGA) and its Jurisdictional Annual Report. In the instant petition, the Company filed a one-page reconciliation, as required, but did not provide any additional work papers or explanation of the results. The OAG is not convinced that the information provided by Xcel Energy is responsive to the intent behind the Commission's order and in search of guidance on the matter the OAG turned to a FERC issued policy statement titled, "Cost Recovery Mechanisms for Modernization of Natural Gas Facilities," which was an acknowledgment of recent "governmental safety and environmental initiatives" that indicated a future increase in pipeline spending to increase safety and reliability.[44]

[44] Policy Statement on Cost Recovery for Modernization of Natural Gas Facilities, 151 F.E.R.C. ¶ 61,047,

Although the Commission is under no obligation to adopt FERC Standards, the OAG argues that it would be a mistake to discard the outcomes of the deliberative process undertaken by FERC in very similar circumstances to the issues the Commission is considering here. Xcel Energy's one-page report does not demonstrate that the Company is over or under-earning, nor does it appear to address the specific questions from the 15-808 Docket. Therefore, the OAG recommends the Commission consider requiring Xcel Energy to file a cost and revenue study containing information sufficient to demonstrate that it is not currently over-earning. As an example, the cost and revenue study could encompass information required pursuant to Minn. R. part 7825.3800 as part of the utility's notice of a change in rates.

#### 2. Xcel Energy Reply Comments

Xcel Energy argues that it fully complied with the Commission's Order from the 15-808 Docket, and that its report reconciles to the Company's 2015 Jurisdictional Annual Report all-in revenue deficiency of $6.8 million which includes base rate, PGA, and GUIC recovery and shows that the Company is not over-earning.

In addition, Xcel Energy disputes the OAG's contention that its report does not provide enough detail or narrative of the results to address concerns about over-earning nor does it address the specific questions raised by Commission staff in last year's briefing papers. The Company notes that the staff questions were not included in the Commission's order and all the typical numbers included in a Class Cost of Service Study are included in the Company's report which provides the necessary information to show that they are not over-earning.

#### 3. Commission Staff Comments

This question of whether Xcel Energy is over earning and needs to be brought in for a general rate case has existed since the GUIC Rider was implemented. This question is discussed indirectly in the ROE section of these briefing papers with respect to Xcel Energy's requested ROEs for 2017 and 2018, Xcel Energy's annual jurisdictional reports, and Xcel Energy's proposed $6.8 million jurisdictional adjustment to its gas utility's depreciation expense. The Commission may wish to discuss this issue further at its December 21, 2017, agenda meeting and solicit additional comments from the parties.

### M. Distribution Valve Replacement Project Costs

In addition, the OAG discussed the reasonableness of certain costs and noted that the GUIC Statute limits rider recovery only to those costs that "were not included in the gas utility's rate base in its most recent general rate case."[45] In response, the OAG questions Xcel Energy's recovery of costs associated with the replacement of distribution valves under DIMP. The OAG noted that this project involves approximately $1 million in costs and is meant to replace existing distribution system isolation valves that have outlived their useful life. In response to

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para. 1 (Apr. 16, 2015).

[45] OAG March 1, 2017, *Initial Comments*, at 27.

Information Requests, the Company responded it would have replaced the valves in question without the GUIC Rider but that the pace and magnitude was changed. The OAG also explained that the Company provided no information the historical, baseline replacement level and spending that is included in existing base rates and therefore concluded that Xcel Energy did not provide sufficient detail to demonstrate that the project qualifies for GUIC recovery as an "incremental" cost.

### 1. OAG Comments

The OAG discusses the costs associated with this project as an example of how Xcel Energy could potentially be recovering costs via the GUIC Rider that are inappropriate. The OAG stated that this project will involve approximately $1 million in costs and is meant "to replace existing distribution system isolation valves which have outlived their useful lifespan."[46] The OAG notes that Xcel Energy provided no information on the historical, baseline replacement level and spending that is included in existing base rates. The OAG concluded that the Company had not provided sufficient detail to demonstrate both that Xcel Energy is only seeking recovery for incremental, accelerated replacement of distribution valves, nor that the rate of acceleration is reasonable.

### 2. Xcel Energy Reply Comments

Xcel Energy in its *Reply Comments*, explained that the valves provide for shut down of sections of the gas system in the event of an emergency and can help limit the number of customers impacted in these events. The Company further stated that it was replacing valves at a faster than historic rate, again working to improve the overall safety of the gas system at a quicker pace than historically performed.

In its *Reply to Department Comments*, Xcel Energy further clarified that the costs for which the Company seeks GUIC recovery arose only after the replacement program was initiated in response to changing federal standards in 2011 and are incremental to the much smaller scale of valve-related work performed previously and included in base rates in the most recent general rate case (Docket No. G-002/GR-09-1153). Xcel Energy provided a table displaying the overall costs incurred under the main renewal program between 2009 and 2016. Also shown are the costs incurred as part of the Distribution Valve Replacement Program since its inception.

[46] *Id.* at 30.

| Table 17<br>Actual Capital Expenditures (CWIP/RWIP) - In Dollars ($) | | | |
|---|---|---|---|
| Year | Main Renewal Blanket | | GUIC Valve Replacement Program |
| | Main Renewal | Valve-Related Work | |
| 2009 | $ 957,621 | $ 8,846 | $ - |
| 2010 | $ 646,421 | $ 13,734 | $ - |
| 2011 | $ 1,886,763 | $ (9,866) | $ - |
| 2012 | $ 3,317,787 | $ 5,160 | $ 133,392 |
| 2013 | $ 2,295,998 | $ 1,821 | $ 601,887 |
| 2014 | $ 2,833,187 | $ (4,926) | $ 395,461 |
| 2015 | $ 996,468 | $ - | $ 586,157 |
| 2016 | $ 1,041,605 | $ - | $ 533,029 |
| **Total** | **$ 13,975,850** | **$ 14,769** | **$ 2,249,926** |

As the table shows, the Distribution Valve Replacement Program is incremental to costs recovered through base rates, and is appropriately recoverable through the GUIC Rider.

### 3. Department Comments

The Department, in its *Response Comments*, agreed with the OAG's analysis regarding Xcel Energy's propose distribution valve replacement costs. The Department reviewed the Company's discovery responses and agreed with the OAG's conclusion that the Company had not provided sufficient detail to demonstrate both that Xcel Energy is only seeking recovery for incremental, accelerated replacement of distribution valves, nor that the rate of acceleration is reasonable.

However, after reviewing data provided by Xcel Energy in its June 2, 2017, *Reply to Department Comments*, the Department, in its July 25, 2017, *Additional Comments*, revised its position concluding that the valve replacement costs recovered through the GUIC Rider are incremental and, thus, appropriate for recovery through the GUIC Rider. Although the Department ultimately recommends approval of Xcel Energy's proposal for this project it does note that the information should have been provided in the Company's initial *Petition* and not in later rounds of comments.

## V. Commission Staff Comments

Commission staff reviewed Xcel Energy's *Petition* and made necessary comments above in the relevant sections in these briefing papers. Staff includes this additional discussion to address a disturbing trend that appeared during the Department's review process that staff believes should be brought to the Commission's attention.

In its July 25, 2017, *Additional Comments*, the Department made the following statement:

> Provision of this information aside, Xcel's approach to cost justification in this proceeding is troubling. The burden of proof is on the utility to support its proposals and associated cost recovery; however, it appears that Xcel was unwilling over the course of this proceeding to provide the requested cost information, or the Company was under the impression that cost recovery through the GUIC rider is all but guaranteed. The Department is unaware of a shift in the burden of proof for the GUIC rider. Beyond the fact that the Commission's *Order* in the original deferred accounting docket (10-422 Docket) required justification of outsourced costs, it took Xcel three requests (discovery request and two rounds of comments) in this docket before the Company provided a comparison of outsourced costs and internalized costs. The process required to complete the requested, and necessary, cost comparison was unduly complex and time consuming. Xcel's approach in this GUIC rider filing raises the question of whether the rider is the most appropriate vehicle to analyze the reasonableness of the Company's cost recovery proposal and rate base size.

This statement is concerning because it seems to indicate Xcel Energy is deliberately withholding or failing to provide requested information in a reasonable amount of time. It is the Commission's mission "to protect and promote the public's interest in safe, adequate and reliable utility services at fair, reasonable rates." It does so by providing independent, consistent, professional and comprehensive oversight and regulation of utility service providers. A vital component of this process is being able to gain access to information from the utility that would otherwise be unavailable. If the regulatory agencies are not able to gain access to the necessary information or have confidence in the accuracy of the information provided then the people of Minnesota cannot be adequately served.

The Commission may want to discuss this issue with Xcel Energy at the December 21, 2017, agenda meeting.

# VI. Decision Options

***Rate of Return on Investment***

1. Approve Xcel Energy's proposed capital structure for this rider with a return on equity (ROE) of 9.50 percent and a rate of return (ROR) of 7.26 percent. (Xcel Energy)

**Xcel Energy - Proposed Rate of Return, this docket**
**(Based on 15-808 Decision Updated with New ROE)**

| | Capital Structure | Cost | Weighted Cost |
|---|---|---|---|
| Long-term Debt | 45.61% | 4.94% | 2.25% |
| Short-term Debt | 1.89% | 1.12% | 0.02% |
| Common Equity | 52.50% | **9.50%** | 4.99% |
| **Rate of Return** | **100.00%** | | **7.26%** |

or,

2. Approve a revised capital structure with an ROE of 9.04 percent and an ROR of 7.02 percent (Department)

**Department - Proposed Rate of Return, this docket**
**(Based on 15-808 Decision Updated with New ROE)**

| | Capital Structure | Cost | Weighted Cost |
|---|---|---|---|
| Long-term Debt | 45.61% | 4.94% | 2.25% |
| Short-term Debt | 1.89% | 1.12% | 0.02% |
| Common Equity | 52.50% | **9.04%** | 4.75% |
| **Rate of Return** | **100.00%** | | **7.02%** |

or,

3. Approve a revised capital structure with an ROE of 7.00 percent and an ROR of 5.95 percent (OAG)

**OAG Proposed Rate of Return, this docket**
**(Based on 15-808 Decision Updated with New ROE)**

| | Capital Structure | Cost | Weighted Cost |
|---|---|---|---|
| Long-term Debt | 45.61% | 4.94% | 2.25% |
| Short-term Debt | 1.89% | 1.12% | 0.02% |
| Common Equity | 52.50% | **7.00%** | 3.68% |
| **Rate of Return** | **100.00%** | | **5.95%** |

***Rate of Return on Investment and Other Issues in Future GUIC Rider and Other Rider Petitions***

4. Direct staff to issue a notice requesting procedural comments on Xcel Energy's rate of return proposal in Docket Nos. G-002/M-17-787,[47] E-002/M-17-797,[48] and E-002/M-17-818.[49]

   and,

5. In the notice requesting procedural comments, direct staff to ask parties to address whether Xcel Energy's request for a ten percent ROE in Docket Nos. G-002/M-17-787, E-002/M-17-797, and E-002/M-17-818 should be referred to the Office of Administrative Hearings for contested case proceedings, summarily dismissed or some other alternative.

   and/or,

6. Direct staff to ask parties to provide comments on how they plan to address the proposed decrease in depreciation expense in Docket No. E,G-999/D-17-581 for Xcel Energy's gas utility.

***Review of Software Costs***

7. Approve proposed DIMP software costs of approximately $2,023,225 ($2,073,170 initial proposal - $49,945 of non-GUIC charges) for recovery in the GUIC Rider including all QA/QC related costs. (Xcel Energy)

   or,

8. Approve $444,543 in DIMP software costs for recovery in the GUIC Rider and disallow all QA/QC related costs as duplicative services. (Department)

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[47] On December 1, 2017, in response to the Department's request, the Commission issued a *Corrected Notice of Extended Comment Period* which extended the initial comment period to March 1, 2018.

[48] On December 12, 2017, in response to the OAG's request, the Commission issued a *Notice of Extended Comment Period* which extended the initial comment period to February 15, 2018.

[49] As of the date these briefing papers were published the Commission had not received any request to extend the 30-day comment deadline. The 30-day comment deadline is December 17, 2017.

***Proration of Accumulated Deferred Income Taxes***

9. Allow Xcel Energy to reflect the prorated ADIT in the GUIC Rider with the understanding that the proration is subject to a true-up calculation in the following year using actual non-prorated ADIT amounts. (Xcel Energy)

or,

10. Do not allow Xcel Energy to prorate its ADIT in the GUIC Rider and implement GUIC rates for 2017, effective January 1, 2018. (Department)

***Sales Forecast***

11. Approve a revised sales forecast based on the Company's regression model results before monthly sales and DSM adjustments as set forth by the Company in Attachment F of its *Reply Comments* for the 2017 GUIC Rider. (Department, Xcel Energy)

and,

12. Approve the sales forecast methodology adopted in the 2017 GUIC Rider for all future GUIC Rider petitions.

or,

13. Approve the sales forecast methodology adopted in the 2017 GUIC Rider for only the instant *Petition.* Take no action on the sales forecast issue for future GUIC Rider petitions.

***Sewer Conflict Inspection Equipment***

14. Approve recovery of Sewer Conflict Inspection program costs in the 2017 GUIC Rider. (Department, Xcel Energy)

and,

15. Require Xcel Energy to provide a cost/benefit analysis in its initial Petition in future GUIC Rider filings if Xcel Energy wishes to receive accelerated recovery of Sewer Lines costs on a going forward basis. (Department)

and,

16. Require Xcel Energy to amend its pending GUIC Rider petition, in Docket No. G-002/M-17-787, if it proposes accelerated recovery of Sewer Lines costs for 2018.

***GUIC Rider Duration***

17. Approve a future date by which Xcel Energy is to terminate its GUIC Rider and file a natural gas general rate case.

    or,

18. Take no action on the issue of continued GUIC Riders and continue the current process regarding future GUIC Rider petitions.

***Compliance Filing, True-up Report and Tracker Balances***

19. Approve the 2017 GUIC revenue requirement calculations.

    and,

20. Authorize Xcel Energy to recover the 2017 revenue requirements over the remaining months through March 31, 2018.

    or,

21. Authorize Xcel Energy to recover the 2017 revenue requirements over the 12 months following the effective date of this Order.

***Tariff Sheet and Customer Notice***

22. Approve Xcel Energy's proposed tariff sheets, modified to reflect any and all of the Commission's modifications in this docket.

***Compliance Filing***

23. Require Xcel Energy to make a compliance filing showing the final rate adjustment factors, effective dates, and all related tariff changes, within ten days of the effective date of this Order. (Department, Xcel Energy)

***Performance Metrics***

24. Accept the filed performance metrics as complying with ordering paragraph 2 of the Commission's *Order Requiring Updated Report, Approving Rider Recovery, and Requiring Metrics to Evaluate GUIC Expenditures*.

and,

25. Approve the proposed performance metrics, as modified, to include the performance of a normality test on the unit cost data. Implement the proposed metrics in future GUIC Rider petitions. (Xcel Energy)

or,

26. Decline to approve the proposed performance metrics but rather continue discussion of proposed performance metrics an on-going evaluation of reporting requirements in future GIUC proceedings. (Department)

or,

27. Do not approve the proposed performance metrics and initiate a separate proceeding to investigate the feasibility of implementing a state-wide integrity management performance metric process involving all natural gas utilities. (OAG)

or,

28. Do not approve the proposed performance metrics and take no action to initiate a separate proceeding to investigate the feasibility of implementing a state-wide integrity management performance metric process involving all natural gas utilities.

***Revenue Cap***

29. Approve a 6 percent revenue cap of non-gas base rate revenues approved in the Company's last rate case, or approximately $9.5 million effective with the 2018 GUIC Rider, until the Company files a general rate case. (OAG);

or,

30. Do not impose a revenue cap on future GUIC Rider filings. (Xcel Energy)

***Detailed Cost Study***

31. Accept the filed cost/revenue study as complying with ordering paragraph 11 of the Commission's *Order Requiring Updated Report, Approving Rider Recovery, and Requiring Metrics to Evaluate GUIC Expenditures*. (Xcel Energy)

or,

32. Require Xcel Energy to file a cost and revenue study containing information sufficient to demonstrate that it is not currently over-earning. The cost and revenue study should contain information required to be filed as part of the utility's notice of a change in rates (i.e., Minn. R. § 7825.3800). (OAG)

***Distribution Valve Replacement Project***

33. Approve the $2,249,926 in Distribution Valve Replacement Project costs for recovery in the 2017 GUIC Rider. (Department, Xcel Energy)

or,

34. Deny recovery of the $2,249,926 in Distribution Valve Replacement Program costs in the GUIC Rider.

***Other***

35. Continue to direct the Company to provide in future GUIC filings, specific information about each individual project in the GUIC Rider that sufficiently, (1) describes what the project is, (2) explains why the project is necessary, (3) discusses what benefits ratepayers will receive from the project, and (4) identifies the agency, regulation, or order that requires the project.

**216B.1635 RECOVERY OF GAS UTILITY INFRASTRUCTURE COSTS.**

Subdivision 1. **Definitions.** (a) "Gas utility" means a public utility as defined in section 216B.02, subdivision 4, that furnishes natural gas service to retail customers.

(b) "Gas utility infrastructure costs" or "GUIC" means costs incurred in gas utility projects that:

(1) do not serve to increase revenues by directly connecting the infrastructure replacement to new customers;

(2) are in service but were not included in the gas utility's rate base in its most recent general rate case, or are planned to be in service during the period covered by the report submitted under subdivision 2, but in no case longer than the one-year forecast period in the report; and

(3) do not constitute a betterment, unless the betterment is based on requirements by a political subdivision or a federal or state agency, as evidenced by specific documentation, an order, or other similar requirement from the government entity requiring the replacement or modification of infrastructure.

(c) "Gas utility projects" means:

(1) replacement of natural gas facilities located in the public right-of-way required by the construction or improvement of a highway, road, street, public building, or other public work by or on behalf of the United States, the state of Minnesota, or a political subdivision; and

(2) replacement or modification of existing natural gas facilities, including surveys, assessments, reassessment, and other work necessary to determine the need for replacement or modification of existing infrastructure that is required by a federal or state agency.

Subd. 2. **Gas infrastructure filing**. A public utility submitting a petition to recover gas infrastructure costs under this section must submit to the commission, the department, and interested parties a gas infrastructure project plan report and a petition for rate recovery of only incremental costs associated with projects under subdivision 1, paragraph (c). The report and petition must be made at least 150 days in advance of implementation of the rate schedule, provided that the rate schedule will not be implemented until the petition is approved by the commission pursuant to subdivision 5. The report must be for a forecast period of one year.

Subd. 3. **Gas infrastructure project plan report**. The gas infrastructure project plan report required to be filed under subdivision 2 shall include all pertinent information and supporting data on each proposed project including, but not limited to, project description and scope, estimated project costs, and project in-service date.

Subd. 4. **Cost recovery petition for utility's facilities**. Notwithstanding any other provision of this chapter, the commission may approve a rate schedule for the automatic annual adjustment of charges for gas utility infrastructure costs net of revenues under this section, including a rate of return, income taxes on the rate of return, incremental property taxes, incremental depreciation expense, and any incremental operation and maintenance costs. A gas utility's petition for approval of a rate schedule to recover gas utility infrastructure costs outside of a general rate case under section 216B.16 is subject to the following:

(1) a gas utility may submit a filing under this section no more than once per year; and

(2) a gas utility must file sufficient information to satisfy the commission regarding the proposed GUIC. The information includes, but is not limited to:

(i) the information required to be included in the gas infrastructure project plan report under subdivision 3;

(ii) the government entity ordering or requiring the gas utility project and the purpose for which the project is undertaken;

(iii) a description of the estimated costs and salvage value, if any, associated with the existing infrastructure replaced or modified as a result of the project;

(iv) a comparison of the utility's estimated costs included in the gas infrastructure project plan and the actual costs incurred, including a description of the utility's efforts to ensure the costs of the facilities are reasonable and prudently incurred;

(v) calculations to establish that the rate adjustment is consistent with the terms of the rate schedule, including the proposed rate design and an explanation of why the proposed rate design is in the public interest;

(vi) the magnitude and timing of any known future gas utility projects that the utility may seek to recover under this section;

(vii) the magnitude of GUIC in relation to the gas utility's base revenue as approved by the commission in the gas utility's most recent general rate case, exclusive of gas purchase costs and transportation charges;

(viii) the magnitude of GUIC in relation to the gas utility's capital expenditures since its most recent general rate case; and

(ix) the amount of time since the utility last filed a general rate case and the utility's reasons for seeking recovery outside of a general rate case.

Subd. 5. **Commission action**. Upon receiving a gas utility report and petition for cost recovery under subdivision 2 and assessment and verification under subdivision 4, the commission may approve the annual GUIC rate adjustments provided that, after notice and comment, the costs included for recovery through the rate schedule are prudently incurred and achieve gas facility improvements at the lowest reasonable and prudent cost to ratepayers.

Subd. 6. **Rate of return**. The return on investment for the rate adjustment shall be at the level approved by the commission in the public utility's last general rate case, unless the commission determines that a different rate of return is in the public interest.

Subd. 7. **Commission authority; rules**. The commission may issue orders and adopt rules necessary to implement and administer this section.

**History**: 2005 c 97 art 10 s 1,3; 2013 c 85 art 7 s 2,9

**NOTE**: This section expires June 30, 2023. Laws 2005, chapter 97, article 10, section 3, as amended by Laws 2013, chapter 85, article 7, section 9.

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