

**STATE OF MINNESOTA  
BEFORE THE PUBLIC UTILITIES COMMISSION**

Dan Lipschultz  
Matt Schuerger  
Katie Sieben  
John Tuma

Vice Chair  
Commissioner  
Commissioner  
Commissioner

In the Matter of the Northern States Power  
Company dba Xcel Energy-Gas 2019 Gas  
Utility Infrastructure Costs (GUIC) Rider

DOCKET NO. G002/M-18-692

**COMMENTS OF THE OFFICE OF  
THE ATTORNEY GENERAL**

**I. INTRODUCTION**

The Office of the Attorney General—Residential Utilities and Antitrust Division (“OAG”) submits the following Comments in response to the Petition of Northern States Power Company, doing business as Xcel Energy (“Xcel” or the “Company”), for approval of recovery of its updated gas utility infrastructure cost (“GUIC”) rider for 2019. These Comments are limited to the appropriate return for Xcel’s GUIC and do not take a position on the reasonableness of costs included in Xcel’s petition. As discussed below, the Commission should provide Xcel with a return consistent with the utility’s cost of long-term debt of 4.75 percent.

**II. BACKGROUND**

Minnesota Statutes section 216B.1635 (“the GUIC Statute”) authorizes a utility to file a report requesting cost recovery via a GUIC rider. In this docket, Xcel has asked for approximately \$28.9 million in GUIC revenue for 2019.<sup>1</sup> This is an increase of more than \$9 million from Xcel’s current 2018 GUIC revenue requirement forecast.<sup>2</sup> The Company also forecasts that it will spend approximately \$43 million in 2019 on capital projects related to

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<sup>1</sup> Xcel’s Petition at 1. This would be Xcel’s fifth GUIC Rider.

<sup>2</sup> See Xcel’s Petition at 22.

GUIC.<sup>3</sup> The Company requests a total rate of return of 7.63 percent for its GUIC capital costs.<sup>4</sup> This overall return uses the Company's capital structure and cost of debt based on the settlement in its most recent electric rate case, and a 10.25 percent return on equity ("ROE").

### III. ANALYSIS AND RECOMMENDATION

The GUIC Statute provides that the rate of return applied to a GUIC rider "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."<sup>5</sup> In Xcel's most recent GUIC dockets, the Commission has decided to grant the Company a different return than the one awarded in its last general rate case.<sup>6</sup> Accordingly, the Commission will need to determine what return will be in the public interest if it approves Xcel's 2019 GUIC rider request.

The OAG's comments in response to Xcel's 2018 GUIC request explained that it is in the public interest to provide Xcel with a return for its GUIC rider that is equal the Company's cost of long-term debt.<sup>7</sup> The Commission has not yet ruled on Xcel's 2018 GUIC request. The OAG takes the same position in this proceeding regarding the appropriate return. Because the analysis

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<sup>3</sup> Xcel's Petition at 22.

<sup>4</sup> Xcel's Petition at 40.

<sup>5</sup> Minn. Stat. § 216B.1635, subd. 6.

<sup>6</sup> Xcel's last natural gas general rate case was filed in 2009. In Xcel's recent GUIC filings, the Commission has determined that it was in the public interest to provide the Company with a different rate of return than the one awarded in its last natural gas rate case. *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*, MPUC Docket No. G-002/M-14-336, ORDER APPROVING RIDER WITH MODIFICATIONS 13–14 (Jan. 27, 2015) (updating Xcel's cost of debt); *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 (GUIC) True-up Report for 2015, Forecasted 2016 GUIC Revenue Requirement, and Revised GUIC Adjustment Factors*, MPUC Docket No. G-002/M-15-808, ORDER REQUIRING UPDATED REPORT, APPROVING RIDER RECOVERY, AND REQUIRING METRICS TO EVALUATE GUIC EXPENDITURES 7 (Aug. 18, 2016) (reducing Xcel's requested ROE to reflect representative proxy group).

<sup>7</sup> *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, COMMENTS OF THE OAG (Jun. 29, 2018) ("OAG 2018 GUIC Comments"). Attached as Exhibit 1.

that the OAG provided in the 2018 proceeding applies equally to Xcel's 2019 GUIC request, a full recitation of the analysis is unnecessary, but a brief summary follows and a copy of the 2018 comments is attached as Exhibit 1.

First, the risks for investments recovered through the GUIC rider are far lower than the risks for investments that are included in base rates. The Bluefield and Hope decisions of the United States Supreme Court hold that the rate of return should be commensurate with the returns on investments in other enterprises having corresponding risks.<sup>8</sup> Accordingly, in order to be "in the public interest," the return for GUIC investments should be commensurate with the return for other investments with similar risk. Projects recovered through Xcel's GUIC rider do not have commensurate risk with projects recovered through traditional ratemaking. The GUIC rider mitigates the regulatory lag that typically occurs in traditional ratemaking between the construction and recovery of a project,<sup>9</sup> which increases revenue certainty for the utility and its investors and reduces the financial risk of a project.<sup>10</sup> In addition, investors will be compensated faster for investments made in a GUIC rider than for investments included in base rates. Financial markets provide lower returns for investments with lower risk, and the same principle should be applied to Xcel's low-risk GUIC investments.

Second, allowing a utility to recover capital costs through riders can alter the utility's regulatory incentives in perverse ways.<sup>11</sup> Utilities that know they can increase rates without having to file a general rate case will have less incentive to control their costs. In a traditional regulatory model, a utility has a natural and powerful incentive to control its costs so that it can

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<sup>8</sup> Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591, 603 (1944); Bluefield Waterworks & Improvement Company v. Public Service Commission of West Virginia, 262 U.S. 679, 793 (1923).

<sup>9</sup> See OAG 2018 GUIC Comments at 8-9.

<sup>10</sup> See, e.g., MINN. PUB. UTIL. COMM'N, UTILITY RATES STUDY 12 (Jun. 2010); see also KEN COSTELLO, NAT'L REG. RESEARCH INST., HOW SHOULD REGULATORS VIEW COST TRACKERS? 8 (Sep. 2009) (noting that cost trackers lower a utility's financial risk by stabilizing its earnings and cash flow).

<sup>11</sup> See OAG 2018 GUIC Comments at 9-12.

earn a profit and stay out of a rate case proceeding. When the utility can adjust recovery for some of its costs outside of a rate case, the incentive to control these costs declines. As the Commission has stated, “[t]he risk to incentives is especially significant when special recovery is allowed for cost categories that do not inherently pose a danger of severe financial risk; i.e., costs that are *not* always outside the control of the utility, unpredictable or substantial. In those instances, allowing automatic recovery would also be expected to erode incentives for cost control.”<sup>12</sup> It is not in the public interest to provide Xcel with a rate-case-like return for its GUIC projects when it is not receiving the same cost-control incentives that a rate case provides.

Third, allowing Xcel to receive rate-case-like returns for its GUIC costs reduces the utility’s need to file a full rate case. While the prospect of fewer rate cases necessarily relieves some resource strain to regulators and intervening parties, this must be balanced against the need to have rates based on the utility’s current financial needs. Xcel has not filed a general natural gas rate case since 2009.<sup>13</sup> Instead, the utility has elected to file successive GUIC riders. The cost of these riders, which have been implemented entirely since Xcel’s 2009 natural gas rate case, are now forecasted to represent 6.5 percent of total bill collections—including the cost of gas.<sup>14</sup> While it is impossible to know, it is conceivable that Xcel is now earning more from its GUIC riders than it would have earned had it filed a rate case at some point during the last decade. It is not in the public interest to continue to reward Xcel with rate-case-like returns for projects when the Company is not being subjected to the comprehensive rate case process.

Fourth, at least one neighboring state has also concluded that it is not in the public interest to grant utilities rate-case-like returns for projects included in capital riders. As the OAG

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<sup>12</sup> MINN. PUB. UTIL. COMM’N, UTILITY RATES STUDY 8 (Jun. 2010).

<sup>13</sup> See *In the Matter of the Application of Northern States Power Company, a Minnesota Corporation, for Authority to Increase Rates for Natural Gas Service in Minnesota*, Docket No. G-002/GR-09-1153.

<sup>14</sup> Xcel’s Petition at 34.

explained in response to Xcel's 2018 GUIC request, the Iowa Utilities Board determined that allowing utilities to earn a return at their cost of debt is appropriate for capital investments recovered through automatic adjustment riders.<sup>15</sup> Iowa's decision was based on its conclusion that "allowing utilities to earn a return of their investment as well as a return on their investment equal to the cost of debt significantly reduces the effects of regulatory lag and provides substantial incentive to utilities to move forward with implementation of such safety-related projects."<sup>16</sup> For the same reason, granting Xcel a return for GUIC projects based on its cost of long-term debt mitigates the utility's incentive to avoid rate cases, while still providing it with an incentive to move forward with critical safety-related projects.

The OAG performed extensive analysis in response to Xcel's 2018 GUIC rider request. The OAG demonstrated in that case that the public interest requires that Xcel receive a return for its GUIC projects that is comparable to the return it receives for its long-term debt instruments. The OAG also explained that utilities that recover capital costs through riders have a lower incentive to control their costs, and that providing a rate-case-like return for capital riders reduces a utility's incentive to file a full rate case. Finally, the OAG summarized actions taken by other regulatory commissions that have approved debt-only returns for infrastructure riders because the Commission concluded that this best reflected the risks taken by the utility's investors and balanced the competing policy implications of allowing recovery outside of a rate case.<sup>17</sup> The same result applies to Xcel's 2019 GUIC rider request. Accordingly, if the

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<sup>15</sup> See OAG 2018 GUIC Comments at 14, citing *In Re: Black Hills/Iowa Gas Utility Company, L.L.C. d/b/a Black Hills Energy*, Iowa Util. Board Docket No. SPU-2015-0039, TF-2015-0352, FINAL DECISION AND ORDER (Apr. 20, 2017).

<sup>16</sup> See OAG 2018 GUIC Comments at 14, citing *In Re: Black Hills/Iowa Gas Utility Company, L.L.C. d/b/a Black Hills Energy*, Iowa Util. Board Docket No. SPU-2015-0039, TF-2015-0352, FINAL DECISION AND ORDER at 21 (Apr. 20, 2017).

<sup>17</sup> See *In Re: Capital Infrastructure Investment Automatic Adjustment Mechanism for Rate-Regulated Natural Gas Utilities*, Iowa Util. Board Docket No. RMU-2011-0002, ORDER ADOPTING RULE at 34–35 (Oct. 13, 2011); *In* (Footnote Continued on Next Page)

Commission approves Xcel's proposed 2019 GUIC rider request, it should establish a return of 4.75 percent, based on Xcel's long-term cost of debt awarded in its 2016 electric rate case.

#### **IV. CONCLUSION**

For the reasons set forth above and in the attached analysis, the Commission should set Xcel's GUIC return at 4.75 percent if it approves the Company's proposed 2019 GUIC rider request. This return would be commensurate with returns on other investments with corresponding risks. In addition, this return would provide a better incentive for Xcel to control its costs and file a rate case if one is needed, while balancing the policy goal of encouraging the utility to invest in critical safety upgrades.

Dated: March 4, 2019

Respectfully submitted,

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s/ **Ian Dobson**

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ATTORNEYS FOR OFFICE OF THE  
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(Footnote Continued from Previous Page)

*Re: Black Hills/Iowa Gas Utility Company, L.L.C. d/b/a Black Hills Energy, Iowa Util. Board Docket No. SPU-2015-0039, TF-2015-0352, FINAL DECISION AND ORDER at 21 (Apr. 20, 2017).*

**STATE OF MINNESOTA  
BEFORE THE PUBLIC UTILITIES COMMISSION**

Nancy Lange	Chair
Dan Lipschultz	Vice Chair
Matthew Schuerger	Commissioner
Katie Sieben	Commissioner
John Tuma	Commissioner

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. G002/M-17-787**

**COMMENTS OF THE OFFICE OF THE  
ATTORNEY GENERAL**

**I. INTRODUCTION**

The Office of the Attorney General—Residential Utilities and Antitrust Division (“OAG”) submits the following Comments in response to the Petition of Northern States Power Company, doing business as Xcel Energy, for approval by the Minnesota Public Utilities Commission (“Commission”) of recovery of its updated gas utility infrastructure cost (“GUIC”) rider for 2018. These Comments focus solely on the appropriate return to establish in this proceeding and do not take a position on the reasonableness of costs otherwise included in this petition.

**II. BACKGROUND**

In this docket, Xcel seeks its fourth GUIC rider. The Company requests \$24.36 million in revenue for 2018 projects, which includes distribution and transmission system capital and O&M spending. For 2018, the Company forecasts that it will spend over \$45 million on capital projects, over *twice* the amount it spent on GUIC capital projects in 2017.<sup>1</sup> Xcel’s incremental

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<sup>1</sup> Xcel’s Supplement at Attch. E (Mar. 27, 2018).

O&M costs also increased to nearly \$5 million forecasted in 2018, from \$3.5 million in 2017.<sup>2</sup> The Company requested a 10.00 percent return on equity (“ROE”) and a total rate of return of 7.52 percent.

In last two GUIC dockets, 15-808 and 16-891, the OAG described—in detail—performance metrics and a proposed stakeholder design process, similar to the one recently recommended by the OAG in Xcel’s electric utility performance metric docket, 17-401. The OAG continues to believe that such a process for natural gas utilities could be worthwhile, but will not reproduce the arguments it has made in prior dockets here. In its initial filing, Xcel simply updated the performance metrics it filed in the 16-891 docket while it awaited Commission action. The Commission then declined to adopt Xcel’s 16-891 metrics in a February 8, 2018 Order and instructed the Company to “continue this discussion and ongoing evaluation of reporting requirements in future G[UI]C proceedings.”<sup>3</sup> Xcel did not provide any additional evaluation in its March 28, 2018 Supplement, nor has it contacted the OAG to continue discussion.

The remainder of these Comments will focus upon the rate of return to be applied to the GUIC rider in this case. The analysis will begin with the correct legal standard to apply and then follow with policy considerations supporting the OAG’s ultimate recommendation here.

### **III. ANALYSIS AND RECOMMENDATION**

There are two overarching issues at stake in this docket. First, the Commission must decide whether the legal standard regarding the rate of return for riders requires a lower return than the return typically authorized in a general rate case. The second issue is whether it is in the

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<sup>2</sup> Xcel’s Supplement at Attch. J (Mar. 27, 2018).

<sup>3</sup> *In the Matter of Northern States Power Company, d/b/a Xcel Energy, for Approval of a Gas Utility Infrastructure Rider True-up Report for 2016, Forecasted 2017 Revenue Requirement, and Revised Adjustment Factors*, Docket No. G-002/M-16-891, ORDER APPROVING RIDER WITH MODIFICATIONS at 10 (Feb. 8, 2018).



public interest to allow utilities like Xcel to avoid rate cases by filing successive capital riders, which increases the revenue gathered by the utility without the increased scrutiny of a general rate case. Both of these issues lead to one recommendation, that the Commission authorize a rate of return in this docket that is significantly lower than the rate of return requested by the Company in this docket.

#### **A. THE LEGAL STANDARD AND ANALYSIS**

Minnesota law instructs the Commission on the appropriate return to establish for investments made by the utility, both in general and specifically as applied to GUIC-related investments. In addition, the Commission must follow the guidance provided by the U.S. Supreme Court in *Hope* and *Bluefield*.

##### **1. The GUIC Statute and Minnesota Law**

The GUIC statute specifies the return on investment the Commission should apply to a utility requesting cost recovery. In whole, the statute reads: “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.”<sup>4</sup> Xcel’s last natural gas general rate case was filed nearly a decade ago, in 2009, and the Commission has adopted an updated rate of return in each of the previous two GUIC rider filings.<sup>5</sup>

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<sup>4</sup> Minn. Stat. § 216B.1635, Subd. 6.

<sup>5</sup> In Xcel’s first GUIC rider docket, the Commission updated the cost of debt, but left the existing 10.09 percent ROE from the Company’s last general natural gas rate case, seemingly due to the lack of more favorable options. After that docket, the Commission ordered Xcel to file detailed information on its proposed rate-of-return in its next petition. *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*, MPUC Docket No. G-002/M-14-336, ORDER APPROVING RIDER WITH MODIFICATIONS 13–14 (Jan. 27, 2015).

## **2. The Establishment of Just and Reasonable Rates**

In general rate case proceedings, the Commission is ultimately guided by its obligation to ensure that rates “shall be just and reasonable.”<sup>6</sup> These rates must include a “fair and reasonable return upon the investment in such property.”<sup>7</sup> Regarding the allowed rate of return, the Minnesota Supreme Court holds that the Commission’s task is “to establish a fair rate of return which will provide earnings to investors comparable to those realized in other businesses which are attended by similar risks, will allow the company to attract new capital as required, and will maintain the company’s financial integrity.”<sup>8</sup> These factors emanate from U.S. Supreme Court cases, *Hope* and *Bluefield*, which are described in greater detail below.

### **3. *Hope & Bluefield***

Two U.S. Supreme Court cases establish the factors that the Commission must review when setting returns for regulated utilities: *Bluefield Water Works* and *Hope Natural Gas Co.* In *Bluefield*, the Supreme Court established a lower bound for utility returns, holding that “[t]he return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise money necessary for the proper discharge of its public duties.”<sup>9</sup> In *Hope*, the Court established an upper bound, holding that the return “should be commensurate with returns on investments in other enterprises having corresponding risks.”<sup>10</sup>

Together, these two cases instruct the Commission to review three factors when setting utility returns. The first two factors are focused on ensuring that the utility has the financial support to continue providing service to customers. According to the Supreme Court, the return

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<sup>6</sup> Minn. Stat. § 216B.03.

<sup>7</sup> Minn. Stat. § 216B.16 Subd. 6.

<sup>8</sup> *Northwestern Bell Telephone Co. v. State of Minn.*, 216 N.W.2d 841, 846 (1974).

<sup>9</sup> *Bluefield Waterworks & Improvement Co. v. Pub. Service Comm’n of W. Va.*, 262 U.S. 679, 693 (1923).

<sup>10</sup> *Fed. Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

should “assure confidence in the financial soundness” of Xcel, and “maintain and support its credit,” so that the utility can continue to provide safe and reliable service.<sup>11</sup> These factors must be balanced against the third factor, which is the Supreme Court’s requirement that a utility’s return should be “commensurate with returns on investments in other enterprises having corresponding risk,” and no higher.

One of the key inquiries in any determination about an allowed rate of return, then, is what type of investments are subject to “corresponding risk,” and the expected return of those corresponding investments. These Comments demonstrate that the risk of Xcel’s investments recovered through the GUIC rider is very different than the risk of its other investments, and that investments of similar risk must receive a much lower return than the return authorized in the Company’s last natural gas rate case nearly a decade ago. Using the analysis provided by the Supreme Court, the return paid for those GUIC investments should be lower as well.

**4. Under the Applicable Legal Standard, the Commission Must Match the Risk Level of the Investment with the Appropriate Rate of Return**

In this docket, the GUIC statute requires that Commission determine a return that is in the public interest. To do so, both the Minnesota Supreme Court and the U.S. Supreme Court require that a return is established which “will provide earnings to investors comparable to those realized in other businesses which are attended by similar risks, will allow the company to attract new capital as required, and will maintain the company’s financial integrity.”<sup>12</sup> In a general rate case proceeding, the Commission will establish a rate of return with debt and equity components,

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<sup>11</sup> Bluefield Waterworks & Improvement Co. v. Pub. Service Comm’n of W. Va., 262 U.S. 679, 693 (1923).

<sup>12</sup> Northwestern Bell Telephone Co. v. State of Minn., 216 N.W.2d 841, 846 (1974); *see also* Bluefield Waterworks & Improvement Co. v. Public Service Comm’n of W. Va., 262 U.S. 679, 693 (1923); Federal Power Comm’n v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944).

which is appropriate given the broad scope of the proceeding and the application of analytical tools that measure other companies that present similar investment risks. Riders are different.

The OAG's Initial Comments in Xcel electric's ongoing Transmission Cost Recovery ("TCR") Rider docket discussed at length the reasons why riders have a fundamentally different, lower, risk profile than investments that are recovered via a general rate case.<sup>13</sup> This is a well-established concept across the industry.<sup>14</sup> And, as the Commission itself has noted, "special recovery mechanisms have the effect of transferring risk away from utility shareholders" and, because of this shifting of risk onto ratepayers, "their use is viewed favorably by the financial markets and, theoretically, should result in a lower cost of capital for the utility and, thus, help relieve pressure on rates."<sup>15</sup>

Following the rationale outlined in the OAG's TCR Rider Comments, there are a range of rates of return that may reasonably match the level of risk inherent in rider-related investments.<sup>16</sup> In particular, debt securities such as the two-year Treasury rate or Xcel's cost of long-term debt may provide reasonable bounds for the Commission to consider applying in this docket. The recommendation in Section III.C. will provide more detail on the specific return the Commission should apply in this docket.

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<sup>13</sup> *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, Comments of the Office of the Attorney General *passim* (Apr. 2, 2018). The OAG continues to advocate for the same positions taken in the TCR docket here.

<sup>14</sup> See KEN COSTELLO, NAT'L REG. RESEARCH INST., HOW SHOULD REGULATORS VIEW COST TRACKERS? 8 (Sep. 2009) (noting that cost trackers lower a utility's financial risk by stabilizing its earnings and cash flow)

<sup>15</sup> MINN. PUB. UTIL. COMM'N, UTILITY RATES STUDY 12 (Jun. 2010).

<sup>16</sup> See *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, Comments of the Office of the Attorney General 11–20 (Apr. 2, 2018) (favorably comparing the risk characteristics of debt securities to the risk characteristics of rider investments). The rate of return established in Xcel's 2009 rate case did not take into account the risk-reducing effect of its yet-to-be-filed GUIC rider.

Before moving to the recommendation, the next section will describe the policy considerations that also support a determination by the Commission that the appropriate rate of return for GUIC rider investments is much lower than the return requested by the Company in this proceeding.

**B. POLICY CONSIDERATIONS SUPPORT A LOWER RETURN THAN THE RETURN REQUESTED BY XCEL.**

At the outset, it is striking to consider the additional revenue that Xcel has been able to secure without filing a general rate case, and how much more it expects to secure in the coming half-decade. Xcel last requested a rate increase of \$16 million in its 2009 rate case. It was ultimately allowed to increase rates by \$7.3 million.<sup>17</sup> Since that time, Xcel has been allowed to implement GUIC riders that represent annual revenue requirements of \$14.7 million (2015), \$15.6 million (2016), and \$20.1 million (2017). In this docket, the Company requests a 2018 GUIC rider with a revenue requirement of \$24.4 million, which is approximately 15 percent of the base revenue approved by the Commission in Xcel's 2009 rate case.<sup>18</sup> That number is projected to increase to be one-quarter the size of Xcel's base revenue, or \$40.7 million, by 2022.<sup>19</sup>

Xcel has been allowed to recover these additional revenue requirements by filing the GUIC cost recovery rider each year for the past four years. By using this regulatory tool, the Company has generated a significant amount of additional revenue without undergoing the comprehensive review that a rate case affords regulators. The Commission has described the

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<sup>17</sup> *In the Matter of the Application of Northern States Power Company, a Minnesota Corporation, for Authority to Increase Rates for Natural Gas Service in Minnesota*, Docket No. G-002/GR-09-1153, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER at 38 (Dec. 6, 2010).

<sup>18</sup> Xcel's Supplement at Attch. L (Mar. 27, 2018).

<sup>19</sup> Xcel's Supplement at Attch. L (Mar. 27, 2018).

implications for ratepayers of utilities' increasing reliance upon special cost recovery mechanisms like riders:

[M]aking certain cost categories subject to automatic recovery removes them from inclusion in the overall review of costs (those that decrease as well as those that increase) when a general rate case is ultimately filed. It effectively takes them “off the table” in a rate case review and thereby constricts the Commission’s rate-making authority. And while special recovery will have the effect of dampening the magnitude of rate requests that utilities make when they do ultimately file a rate case petition, the reality is this effect merely masks the full rate implications for ratepayers.<sup>20</sup>

It can be difficult to identify the creeping public interest harm or the point at which the regulatory system breaks down as a result of successive rider requests without a rate case, but there are policy considerations that can help to bring these into sharper relief so that regulators can take action to rebalance interests in favor of ratepayers.

### **1. Regulatory Lag, Revenue Certainty, and the Mechanics of Rider Recovery**

The first policy consideration focuses on the mechanics of cost recovery riders and how these mechanisms reduce regulatory lag and increases revenue certainty to the utility, thereby reducing risk. Riders are simply regulatory tools that are intended to allow utilities to recover its actual costs for a particular project or projects on a periodic basis outside the confines of a general rate case.<sup>21</sup> Absent rider recovery, a utility must wait until its next general rate case to request recovery of these costs. The possibility of a mismatch in the timing of costs and revenues between general rate cases is called regulatory lag. The primary purpose of cost riders is to alleviate regulatory lag and increase revenue certainty.<sup>22</sup>

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<sup>20</sup> MINN. PUB. UTIL. COMM’N, UTILITY RATES STUDY 8 (Jun. 2010).

<sup>21</sup> MINN. PUB. UTIL. COMM’N, UTILITY RATES STUDY 5 (Jun. 2010).

<sup>22</sup> There are other regulatory tools available to utilities to address these problems, including: future test years, multiyear rate plans, and revenue decoupling. The OAG’s Initial Comments in Docket 17-401, at 35–39, provide additional details about these tools and their use by Minnesota utilities.

The most prominent example of cost riders are the longstanding cost riders that both natural gas and electric utilities utilize to pass thorough fuel costs directly to ratepayers. For reference, fuel costs recovered via the Purchased Gas Adjustment mechanism comprised nearly three-quarters of the total revenue requirement in Xcel's most recent natural gas rate case.<sup>23</sup> Since fuel-related riders were established in the mid-1970s, the state has established a number of other cost recovery rider mechanisms—GUIC included—primarily for policy reasons.<sup>24</sup>

**2. Cost Riders May Be Appropriate in Certain Circumstances, But the Increasing Use of Capital Cost Riders to Supplant General Rate Cases Harms the Public Interest.**

The Commission has noted that the use of cost riders or similar mechanisms may be appropriate “[i]f costs are largely outside the control of the utility, are unpredictable and volatile, and are substantial and recurring . . . .”<sup>25</sup> These three elements form the basis of the extraordinary circumstances under which state commissions have traditionally approved such special recovery mechanisms.<sup>26</sup>

Fuel-related costs are the most direct example of such a cost. Recall from above that Xcel's fuel-related costs comprised nearly three-quarters of its total revenue requirement in its most recent rate case, which fulfils the substantial and recurring factor. Fuel costs are also largely<sup>27</sup> outside of the control of the utility and can be unpredictable and volatile. This was especially true during the 1970s, when fuel cost adjustment mechanisms began to be

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<sup>23</sup> \$159,098,000 / \$588,179,000 = 73.0 percent. Xcel's Supplement at Attch. L (Mar. 27, 2018).

<sup>24</sup> MINN. PUB. UTIL. COMM'N, UTILITY RATES STUDY 5 (Jun. 2010). The general theory is that a utility would not incur a particular rider-eligible cost but for a requirement to do so stemming from state law.

<sup>25</sup> MINN. PUB. UTIL. COMM'N, UTILITY RATES STUDY 8 (Jun. 2010).

<sup>26</sup> KEN COSTELLO, NAT'L REG. RESEARCH INST., HOW SHOULD REGULATORS VIEW COST TRACKERS? 8 (Sep. 2009)

<sup>27</sup> Utilities have a very weak incentive to control fuel costs given the pass-through nature of their recovery. MARK NEWTON LOWRY & TIM WOOLF, LAWRENCE BERKELY NAT'L LAB., LBNL-1004130, PERFORMANCE-BASED REGULATION IN A HIGH DISTRIBUTED ENERGY RESOURCES FUTURE 14 (Jan. 2016). But this also means that utilities *do* have the ability to control fuel costs to a certain extent. The OAG has recommended certain policy changes that would provide utilities with a stronger incentive to control these costs in Docket 03-802.

implemented due to wild fluctuations in fuel costs.<sup>28</sup> Wild fluctuations in these substantial costs created a high-risk environment for utilities from the perspective of investors. By shielding the utility's earnings from commodity price volatility, regulators provided utility investors with a much lower risk investment proposition.<sup>29</sup>

Over the past forty years, cost riders and similar recovery mechanisms have evolved considerably from their beginning as tools to be used in extraordinary circumstances. This evolution, as noted above, has grown to include policy-driven rider mechanisms that are intended to allow utilities to recover costs associated with state policy goals. Often, these riders do not closely track the "extraordinary circumstances"<sup>30</sup> factors that undergird the fuel-related riders. For instance, the costs associated with policy-driven riders are significantly lower than the costs of fuel, which typically comprise a material portion of a utility's overall revenue requirement, especially for natural gas utilities. A prime example of this type of rider is the CIP rider, which allows utilities to recover costs (and financial rewards) associated with the provision of energy conservation efforts. Since energy conservation is in diametric opposition to a utility's core goals under cost-of-service regulation, the Commission has allowed utilities to recover these costs via a rider, thereby reducing regulatory lag and providing an incentive to spend on those programs.

There are significant drawbacks to the expansion of the use of riders for costs that do not fit as neatly into the extraordinary circumstances rationale that gave rise to the early fuel-related riders. This expansion of riders alters utility incentives by further shifting risk onto ratepayers.

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<sup>28</sup> KEN COSTELLO, NAT'L REG. RESEARCH INST., HOW SHOULD REGULATORS VIEW COST TRACKERS? 11 (Sep. 2009)

<sup>29</sup> See KEN COSTELLO, NAT'L REG. RESEARCH INST., HOW SHOULD REGULATORS VIEW COST TRACKERS? 12 (Sep. 2009) (noting that the single, overwhelming factor in favor of fuel clause mechanisms was the alleviation of the burden of high risk on utility shareholders).

<sup>30</sup> That cost riders may be appropriate when the costs are largely outside of the control of the utility, are unpredictable and volatile, and are substantial and recurring. MINN. PUB. UTIL. COMM'N, UTILITY RATES STUDY 8 (Jun. 2010).



“The risk to incentives is especially significant when special recovery is allowed for cost categories that do not inherently pose a danger of severe financial risk; i.e., costs that are *not* always outside the control of the utility, unpredictable or substantial. In those instances, allowing automatic recovery would also be expected to erode incentives for cost control.”<sup>31</sup>

More recently, capital or investment riders have become more common. As described by Xcel in a 2010 filing about its electric utility, it is easy to see why they are enticing to utility managers:

Investment riders have been a fairly recent addition to ratemaking and address the need to modernize our electric generating fleet, and improve reliability, while bringing more renewables to market through increased transmission investment, at a time when the rate of sales growth has been slowed in our CIP efforts. In short, these investments are not supported by revenue growth.<sup>32</sup>

Indeed, the GUIC statute expressly precludes recovery of costs that serve to increase a utility’s revenue via the addition of new customers or increasing sales.<sup>33</sup>

To understand why utilities are now seeking rider recovery of capital expenditures, it is important to briefly revisit a basic premise of cost-of-service ratemaking. In theory, capital costs incurred by utilities serve to increase sales revenue, by either adding new customers or additional capacity. Between rate cases, a utility is incentivized to control costs and generate new sales revenue so that it can earn a profit and stay out of a rate case proceeding. When those cost increases outstrip the revenue generated by the new investments, however, a utility must file a general rate case so that it can recover revenue to match the costs it incurred during a test year. Cost-of-service utility regulation functions best when utilities can reliably increase sales revenue

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<sup>31</sup> MINN. PUB. UTIL. COMM’N, UTILITY RATES STUDY 8 (Jun. 2010).

<sup>32</sup> *Study of Automatic Cost Recovery and Alternative Rate Mechanisms Required by Minnesota Laws 2009, Chapter 100, Section 33*, Docket No. E,G999/CI-09-1338, Xcel Comments at 6 (Feb. 19, 2010).

<sup>33</sup> Minn. Stat. § 216B.1635 Subd. 1 (defining GUIC costs as projects that “do not serve to increase revenues by directly connecting the infrastructure replacement to new customers”).

outside of rate cases. Ratepayers maintain low rates and utilities have an opportunity to earn a profit. Today, for a number of reasons, utilities now face slowing or even plateauing sales growth and also increasing, non-revenue-generating costs due to aging infrastructure. Unsurprisingly, this has created an uptick in the number of rate cases that have been filed in recent years, with some exceptions.

One of those exceptions is now before the Commission—again—in this docket. And it should be clear from this section why Xcel would be incentivized to pursue a capital rider such as GUIC in lieu of filing a general rate case. This section has shown how cost recovery riders have evolved from the exceptional circumstances of massive, volatile fuel cost recovery mechanisms to the more recent regulatory invention: the capital rider.<sup>34</sup> The question before the Commission is whether it is in the public interest to allow Xcel to continue to file capital cost riders such as GUIC *with* rates of return similar to rates it would likely be awarded in a general rate case, thus allowing utilities to avoid filing general rate cases. The next section will discuss the incentives at issue when a utility is allowed to receive a rate of return for a capital rider as high as the return it requests in its petition, and how one state commission addressed this issue directly.

### **3. Utility Incentives When It Receives Rider Recovery at High Rate of Return and the Public Harm that Can Result.**

Natural gas utilities are investing in their aging infrastructure at a historic rate.<sup>35</sup> As the previous section demonstrated, a utility has two choices when making these non-revenue-generating investments: file general rate cases or file a capital cost recovery rider. Utilities

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<sup>34</sup> It should be noted that the OAG is aware that Xcel also recovers O&M costs through GUIC, but the main driver of these costs are the addition of capital expenditures that do not generate additional revenue for the utility.

<sup>35</sup> The OAG discussed these investments at great length in its previous GUIC filing. This discussion included a review of TIMP, DIMP, and the high-risk pipe materials present in LDCs' systems across the state and the country. *In the Matter of the Petition of Xcel Energy for Approval of a Gas Utility Infrastructure Cost Rider Compliance Filing, and Annual Report for 2017*, Docket No. G-012/M-16-891, OAG Comments at 12–25 (Mar. 1, 2017).

facing declining sales growth and aging infrastructure have a strong incentive to do one, or both in order to increase revenue on a regular basis. Across the state, some utilities, such as CenterPoint, opt for a succession of rate case filings. Other utilities, such as Xcel, have opted for a succession of GUIC rider filings. MERC has opted to attempt both.<sup>36</sup> It is undeniable that utilities with aging infrastructure and plateauing sales face a difficult path forward. There are perhaps no easy paths to take, but the Commission should look to a neighboring state for guidance on how to address infrastructure riders in a way that balances the interests of ratepayers and the utility.

The Iowa Utilities Board addressed its own infrastructure rider in a 2011 rulemaking. This rulemaking set out to “allow rate-regulated natural gas utilities to implement an automatic adjustment mechanism for recovery of eligible capital infrastructure investment costs.”<sup>37</sup> The resulting rule, 199 Iowa Administrative Code 19.18(476), allows natural gas utilities to recover “amount[s] limited to annual depreciation plus a return on the undepreciated balance based upon the cost of debt.”<sup>38</sup>

The record from the rulemaking evinces the push-pull of the various stakeholders regarding the appropriate return to establish for the rider investments. Utilities advocated for a rate of return set at the weighted average cost of capital from the utility’s most recent rate case.<sup>39</sup> Consumer advocates recommended that no return be allowed for rider recovery at all.<sup>40</sup> The

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<sup>36</sup> In addition to its ongoing rate case, MERC filed its first GUIC rider petition in April.

<sup>37</sup> *In Re: Capital Infrastructure Investment Automatic Adjustment Mechanism for Rate-Regulated Natural Gas Utilities*, Iowa Util. Board Docket No. RMU-2011-0002, ORDER COMMENCING RULE MAKING (May 5, 2011).

<sup>38</sup> 199 IAC 19.18(3)(c). The cost of debt is defined as the “cost of debt from the utility’s most recent general gas or electric rate review proceeding . . . .” 199 IAC 19.18(3)(b)(3).

<sup>39</sup> *In Re: Capital Infrastructure Investment Automatic Adjustment Mechanism for Rate-Regulated Natural Gas Utilities*, Iowa Util. Board Docket No. RMU-2011-0002, ORDER ADOPTING RULE at 30–34 (Oct. 13, 2011).

<sup>40</sup> *Id.* at 29.

Iowa Utilities Board ultimately chose a middle ground by establishing a rider rate of return set at the cost of debt. The Board explained its reasoning as follows:

There is a reduced risk for the utility if there is a mechanism for recovery of capital infrastructure investment between general rate cases. The utility will be receiving a return on and return of investment prior to the inclusion of that investment in regular rate base. This is money the utility would not otherwise receive. This reduced risk of under recovery should be reflected through a lower return on the investment recovered through the automatic adjustment mechanism. The board has chosen the cost of debt from the utility's last rate case to reflect this reduced risk, rather than to try and establish what the actual reduced risk would be for each utility and each investment, as that process would be time-consuming and expensive, thereby undercutting the purpose of the automatic adjustment.<sup>41</sup>

In a subsequent case on a similar issue, the Board expanded upon the ultimate function of capital riders as a regulatory tool intended to reduce, but not completely eliminate regulatory lag. In other words, capital riders are not intended to supplant general rate case filings. In response to a utility proposal to recover safety-related infrastructure costs through a variety of proposals, the Board stated the following, when authorizing a return based upon the utility's cost of debt, which was 4.4 percent:

Using the current cost of debt reflects the Board's intent when it implemented the Tracker that it was not intended to displace the need for all future rate cases. However, allowing utilities to earn a return of their investment as well as a return on their investment equal to the cost of debt significantly reduces the effects of regulatory lag and provides substantial incentive to utilities to move forward with implementation of such safety-related projects.<sup>42</sup>

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<sup>41</sup> *In Re: Capital Infrastructure Investment Automatic Adjustment Mechanism for Rate-Regulated Natural Gas Utilities*, Iowa Util. Board Docket No. RMU-2011-0002, ORDER ADOPTING RULE at 34-35 (Oct. 13, 2011) (emphasis added).

<sup>42</sup> *In Re: Black Hills/Iowa Gas Utility Company, L.L.C. d/b/a Black Hills Energy*, Iowa Util. Board Docket No. SPU-2015-0039, TF-2015-0352, FINAL DECISION AND ORDER at 21 (Apr. 20, 2017).

The Board also emphasized that its policy on alternative cost mechanisms was to *reduce* regulatory lag, not to completely eliminate regulatory lag.<sup>43</sup> The wisdom of the Iowa approach is that it balances the utility's interest in recovery of additional revenue related to important capital investments outside of rate cases with ratepayers' interest in ensuring that the return associated with those investments is commensurate with the risk. The next section will describe in greater detail why the Commission should adopt a similar approach for Xcel's GUIC infrastructure rider and establish a return based upon the utility's cost of long-term debt.

### **C. RECOMMENDATION**

The Commission should adopt a rate of return for Xcel's current GUIC rider set at the utility's cost of long-term debt. As these Comments have demonstrated, rider investments have a fundamentally lower risk than investments recovered via base rates in a general rate case. By law, a rate of return for a rider must be commensurate with returns on investments in other enterprises having corresponding levels of risk. This level of risk is more akin to a debt security. In addition, there are strong policy reasons for adopting this return for Xcel's GUIC investments.

Although the Commission could, on its own motion, or on the motion of another party, call Xcel in for a general rate case, there are reasons to be cautious of such an approach here. In particular, there is a tremendous information asymmetry between the utility and regulators. Because of this, it can be a resource-intensive process to determine if existing rates are no longer just and reasonable and that a general rate case is warranted. In addition, when non-utility entities petition to bring a utility in for a general rate case proceeding, there can be a heightened

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<sup>43</sup> *Id.*

risk of burden-shifting, even if there is no explicit statutory shift in Minnesota utilities law. At FERC, for example, there is an explicit burden shift for these types of rate cases.<sup>44</sup>

For these reasons, the OAG is not asking the Commission to require Xcel to come in for a rate case in this docket. The recommendation is more modest in scope and simply asks the Commission to balance the interests of ratepayers with the utility by applying the correct return to the capital expenditures recovered through the GUIC rider. The revenue requirement impact of this recommendation is a reduction of approximately \$2.9 million from the \$24.4 million requested by Xcel in its supplemental petition.<sup>45</sup> If the Commission finds that all of the expenditures proposed by the Company are reasonable,<sup>46</sup> the OAG's recommendation would allow the Company to recover nearly 90 percent of its initial request.

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<sup>44</sup> U.S. Fed. Energy Reg. Comm'n, *Cost-of-Service Rate Filings* (last accessed Apr. 20, 2018), *available at* <https://www.ferc.gov/industries/gas/gen-info/rate-filings.asp>.

<sup>45</sup> The OAG adapted the information included in Attachments F, G, and K in Xcel's Supplemental Petition to reflect a return on TIMP and DIMP rate base using its 2018 cost of long-term debt of 4.94 percent. These calculations are found in Exhibit 1.

<sup>46</sup> The OAG does not take a position on the other issues in this docket.

Maintaining a safe and reliable system is a central goal for all natural gas utilities. Capital cost riders such as GUIC allow utilities to reduce the regulatory lag that is detrimental to a utility and its shareholders. Rider recovery of the associated costs also significantly reduces the risk of those investments from an investor's perspective. Because of this, the Commission is required to establish a rate of return for those investments at a level commensurate with the risk those investments present. As a result, the Commission should apply Xcel's most recent cost of long-term debt to the capital investments recovered in the GUIC rider.

Dated: June 29, 2018

Respectfully submitted,

LORI SWANSON  
Attorney General  
State of Minnesota

s/ **Joseph A. Dammel**

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March 4, 2019

Mr. Daniel Wolf, Executive Secretary  
Minnesota Public Utilities Commission  
121 Seventh Place East, Suite 350  
St. Paul, MN 55101-2147

**Re: *In the Matter of the Northern States Power Company dba Xcel Energy-Gas  
2019 Gas Utility Infrastructure Costs (GUIC) Rider***  
**MPUC Docket No. G002/M-18-692**

Dear Mr. Wolf:

Enclosed and e-filed in the above-referenced matter please find Comments of the Minnesota Office of the Attorney General—Residential Utilities and Antitrust Division.

By copy of this letter all parties have been served. An Affidavit of Service is also enclosed.

Sincerely,

s/ **Ian Dobson**

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IAN DOBSON

Assistant Attorney General

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Enclosure



# AFFIDAVIT OF SERVICE

**Re: *In the Matter of the Northern States Power Company dba Xcel Energy-Gas  
2019 Gas Utility Infrastructure Costs (GUIC) Rider***  
**MPUC Docket No. G002/M-18-692**

[illegible]

I hereby state that on 4th day of March, 2019, I e-filed with eDockets ***Comments of the Minnesota Office of the Attorney General—Residential Utilities and Antitrust Division*** and served the same upon all parties listed on the attached service list by e-mail, and/or United States Mail with postage prepaid, and deposited the same in a U.S. Post Office mail receptacle in the City of St. Paul, Minnesota.

s/ Judy Sigal

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Judy Sigal

Subscribed and sworn to before me  
this 4th day of March, 2019.

*s/ Patricia Jotblad*

Notary Public

My Commission expires: January 31, 2020.

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