

No. A07-653

**STATE OF MINNESOTA  
IN COURT OF APPEALS**

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In the Matter of the Review of the 2005 Annual Automatic  
Adjustment of Charges For All Electric and Gas Utilities

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**REPLY BRIEF OF RELATOR  
CENTERPOINT ENERGY MINNESOTA GAS**

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## INTRODUCTION

In its own Brief, the Respondent Minnesota Public Utilities Commission (“Commission”) demonstrates that this Court must reverse the Commission’s decision in this matter or, at minimum, remand this dispute to the Commission for referral for a contested case hearing. The Commission’s Brief underscores the multiple errors of law and fact made by the Commission and plainly shows the Commission’s error in not referring this matter for a contested case proceeding to allow for development of a full factual record.

Among its errors, the Commission demonstrates that it has deviated from its precedent regarding a utility’s ability to recover its prudently incurred gas costs by creating a new and inappropriate test for determining whether a Commission decision to deny recovery imposes an “excessive burden” on the utility. In addition, despite the complete absence of record support, the Commission asserts that Relator CenterPoint Energy Minnesota Gas (“CenterPoint Energy” or “Company”) may have already been fully compensated for the gas costs at issue and that to allow recovery of these costs now could somehow result in a “windfall.” Uncontradicted evidence demonstrates the contrary: the Commission’s denial of recovery has caused CenterPoint Energy to incur a \$21 million loss. Moreover, despite this fundamental disputed fact, the Commission surprisingly argues that “there were no contested material facts” at issue. Finally, the Commission fails to engage in the appropriate constitutional analysis regarding whether its actions constitute an unconstitutional taking of CenterPoint Energy property.

For all of these reasons, and as fully set forth below and in its earlier Brief, Relator CenterPoint Energy respectfully requests that this Court reverse the Commission's decision denying recovery of \$21 million in prudently incurred gas costs or, in the alternative, that this matter be remanded to the Commission for referral to the Office of Administrative Hearings for a contested case proceeding.

## ARGUMENT

### **I. The Commission's Proposed Standard Of Review Is Contrary To Well-Established Precedent On The Subject.**

The Commission acknowledges that the framework governing judicial review of Minnesota agency decisions and this Court's precedent require reversal of a Commission decision that is: in excess of its authority, affected by error of law, made upon unlawful procedure, in violation of constitutional provisions, arbitrary or capricious, and/or unsupported by substantial evidence in the record as a whole. Minn. Stat. §§ 14.69 and 216B.52 (2006). The majority of issues raised by CenterPoint Energy in this appeal – whether the Commission's decision was in excess of its authority, affected by error of law, made upon unlawful procedure, or made in violation of constitutional provisions – are questions of law, which this Court reviews *de novo*. *Egan v. Hamline United Methodist Church*, 679 N.W.2d 350, 353 (Minn. Ct. App. 2004) (citing *Kolton v. County of Anoka*, 645 N.W.2d 403, 407 (Minn. 2002)) (confirming that “statutory, jurisdictional and constitutional questions...are questions of law that [this Court] review[s] *de novo*.”); *In re Minnesota Ins. Guaranty Ass'n*, 428 N.W.2d 824, 827 (Minn. Ct. App. 1988) (stating that whether an agency exceeded its authority is a question which is “legal in

nature....”); George A. Beck, *Minnesota Administrative Procedure* 265 (noting that “[o]n a question of law, the court is free to substitute its judgment for that of the agency. It is not bound by the decision of the agency....”)

The Commission seeks a more deferential standard of review. Comm. Br. at 17-20. However, despite Respondent’s best efforts to make this a “complicated” case, deserving of judicial deference, the Commission decision did not require interpretation of any “technical” statutes or rules, nor did it utilize any particular agency “expertise” which might warrant judicial discretion. Rather, the Commission’s decision rested on its legal interpretation of straightforward statutes and rules, including requirements that public utilities be allowed to recover “direct costs for natural gas delivered” and that the Commission “shall grant a variance” when certain factors are met, and determining whether CenterPoint Energy would be “excessively burden[ed]” if recovery of \$21 million were denied. Minn. Stat. § 216B.01 (2006) and Minn. R. 7829.3200, subp. 1 (2007). Given the legal, procedural and constitutional questions at issue in this case, the Court should review this matter *de novo*, and correct the Commission’s errors of law by reversing the Commission’s decision.

In addition, the decision must be reversed as arbitrary and capricious where, as here, the Commission imposed its will, rather than its judgment. *In re Good Faith Efforts In Meeting Renewable Energy Objectives Under Minn. Stat. 216B.1691*, 700 N.W.2d 533, 539 (Minn. Ct. App. 2005) (citation omitted). Indeed, as this Court has previously held:

An agency's decision is arbitrary or capricious if the agency...entirely failed to consider an important aspect of the problem, if it offered an explanation for the decision that runs counter to the evidence, or if the decision is so implausible that it could not be ascribed to a difference in view or the result of agency expertise.

*Pope County Mothers v. MPCA*, 594 N.W.2d 233, 236 (Minn. Ct. App. 1999).

In the instant case, the Commission clearly displays the imposition of its will rather than its judgment due to: (1) the absence of any record evidence in support of its conclusion that its decision did not impose an excessive burden on CenterPoint Energy; (2) refusing to follow its precedent on the subject and instead creating a new legal standard without reason or explanation;<sup>1</sup> (3) the contradictory statements now offered in support of its decision; and (4) the misstatements of the record apparent throughout the Commission's Orders and its Brief.

Administrative agencies are not bound to "rigid adherence to precedent. This does not mean, however, that an agency may abandon its own precedent without reason or explanation." *Peoples Natural Gas Co. v. Minn. P.U.C.*, 342 N.W.2d 348, 352 (Minn. Ct. App. 1983), *rev. denied* (Minn. Apr. 24, 1984); *In the Matter of N.S.P. Gas Util. For Auth. to Change Its Schedule of Gas Rates*, 519 N.W.2d 921, 925 (Minn. Ct. App. 1994) (citations omitted) (declaring that the Commission "must either conform to its prior norms and decisions or explain the reason for its departure from such precedent."). Here, the Commission's decision to deviate from both its long-standing precedent and the

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<sup>1</sup> *In the Matter of the Rate Appeal of Sleepy Eye Care Ctr.*, 572 N.W.2d 766, 770 (Minn. Ct. App. 1998) (stating that "[i]f agency departs from past practice, it must justify that departure in the record of evidence."); *In the Matter of Whitehead*, 399 N.W.2d 226, 229 (Minn. Ct. App. 1987) (noting absence of Commission explanation of reasons for decision prompted Court to conclude that the decision was arbitrary and capricious).

Legislature's directive to allow recovery of gas costs, in part by creating a new legal standard regarding what constitutes an "excessive burden," together with its failure to explain the basis for this change, demonstrates that the Commission sought to exercise its will rather than its judgment and must be reversed.

Lastly, the Commission's decision must be overturned where, as here, it is not supported by substantial evidence. *Cable Commc'ns Bd. v. Nor-West Cable Commc'ns P'ship*, 356 N.W.2d 658, 668-669 (Minn. 1984) (emphasis added). In order to meet this substantial evidence test, the Commission must make findings supported by adequate record evidence that, when considered in its entirety, a reasonable mind might accept as adequate to support a conclusion. *Id.* In the proceedings before the Commission, CenterPoint Energy was prevented from developing its factual record due to the Commission's refusal to refer the matter for a contested case. Moreover, the purported "record evidence" upon which the Commission relied in support of its decision consists of unsworn statements of the parties and the rhetoric of counsel. CenterPoint Energy is unaware of *any* precedent where such statements and argument constitute "adequate record evidence that a reasonable mind might accept as adequate to support a conclusion." *Id.* Accordingly, the Commission's decision must be reversed.

## **II. The Commission Erred As A Matter Of Law By Abandoning Its Precedent And Creating A New Legal Standard Without Reason Or Explanation.**

The Commission defends its denial of CenterPoint Energy's recovery of \$21 million by asserting that it appropriately concluded that its denial "would not impose an excessive burden" on CenterPoint Energy. Commission Brief ("Comm. Br.") at 16-20.

However, in so concluding, the Commission abandoned its only precedent on this subject, ignored uncontradicted evidence in the record, and created a new legal standard for demonstrating “an excessive burden.” The Commission did so without ever articulating a basis for adopting this new standard.

In the only two prior cases where utilities sought to correct for under-recovery of prior incurred gas costs, the Commission granted the utilities a variance to the one year time frame of Minn. R. 7825.2700, subp. 7 (2007) (the “True-Up Rule”), in order to allow full gas cost recovery. *Relator’s Appendix at APP60-APP71. (In the Matter of the Review of the 1997 Annual Automatic Adjustment for All Gas and Elec. Utils., MPUC Docket No. G,E-999/AA-97-1212 (“1997 AAA Docket”)), Order Reviewing 1997 Annual Automatic Adjustment Reports and True-Up Filings, May 28, 1998, and APP72-APP88 (In the Matter of the Review of the 1994 Annual Automatic Adjustment of Charges for All Gas and Elec. Utils., MPUC Docket No. E,G-999/AA-94-762 (“1994 AAA Docket”)), Order Accepting Annual Automatic Adjustment Reports, July 13, 1995.* In both cases, the Commission specifically concluded that strict application of the True-Up Rule would impose an excessive burden on the utilities if they were denied recovery of approximately \$165,000 and \$1 million, respectively. *APP63, APP78.* In the *1994 AAA Docket*, the Commission held that “failure to recover over \$1 million in gas costs would undoubtedly place a burden upon NSP Gas. As [NSP Gas] pointed out, the loss would represent almost 10% of the return on equity allowed in [NSP Gas’s] most recent rate case.” *APP78.*

The Commission's straightforward analysis in that case, which compared the total gas costs at issue to the utility's return on equity or net income, was appropriate because Minnesota law provides for a direct pass through of gas costs from the utility to the customer. As both Commission Chair Koppendrayer and Commissioner Reha observed, this separate treatment and "pass through" nature of gas costs means the utility never makes money on the gas costs and denial of recovery can constitute a "significant hit" to the utility. *APP32, APP29.*<sup>2</sup>

In the current matter, CenterPoint Energy demonstrated that the denial of \$21 million in gas costs equates to over 25% of its 2006 annual operating income and approximately 45% of the total return on equity authorized by the Commission in the CenterPoint Energy's most recent rate case. *APP12, APP17.* This impact on CenterPoint Energy far exceeds the impacts on NSP and Interstate which the Commission found to constitute an "excessive burden" on those utilities.

In response, the Commission argues that CenterPoint Energy's analysis "impermissibly" viewed CenterPoint Energy's loss in a one-year time frame and that "an accurate comparison between the errors and operating income must weigh four years of errors against four years of operating income, or one year of errors against one year of operating income." Comm. Br. at 16. However, *CenterPoint Energy provided precisely*

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<sup>2</sup> Both Chair Koppendrayer and Commissioner Reha voted to reconsider the Commission's original decision in this matter due to the excessive burden to the Company created by the Commission's original decision. However, Commissioner Reha's two separate motions to so reconsider failed on a 2-2 tie vote. *APP42-APP44.* Similarly, a motion to *deny* reconsideration failed on a 2-2 tie vote. *APP46.* Because of these deadlocks, the Commission's original decision remained in force.

*such an analysis* and demonstrated that on a year-by-year basis, the impact on CenterPoint Energy still far exceeded the impact found by the Commission to constitute an “excessive burden” on NSP. *APP18*. The Commission, whether in its original decision, its decision following reconsideration, or in its Brief to this Court, *has never addressed this fact*. Instead, even though denial of recovery in the current case places a much greater financial burden on CenterPoint Energy than the burdens previously determined by the Commission to be “excessive,” the Commission chose to ignore this evidence, disregarded its precedent, and created a new test for determining what constitutes an excessive burden on a utility. On its face, the Commission’s decision is arbitrary, capricious, and must be reversed.

The Commission argues in its Brief, as it attempted to explain in its original decision, that “the amounts at issue were only .5 percent of the Company’s total \$4.2 billion gas costs for the period at issue and, *therefore*, these amounts did not impose an excessive burden on the Company.” Comm. Br. at 16 (emphasis added). However, the Commission never explains why it created this new “excessive burden” standard of viewing potential losses to a utility in the context of total gas costs incurred, rather than to the utility’s earnings. This failure is understandable, since this new standard is indefensible and, if followed in the future, will have an extreme impact on the financial integrity of Minnesota gas utilities.

As both Commission Chair Koppendraye and Commissioner Reha noted, gas costs in Minnesota are a simple pass through, meaning utilities make no money on this component of their cost structure. *APP32, APP29* At the same time, gas costs

predominate the cost structure of Minnesota natural gas utilities. For example, CenterPoint Energy explained that it incurs over \$1 billion in gas costs each year, while earning only \$65 million in operating income. *APP38-APP39*. As these numbers show, gas costs incurred dwarf a utility's operating income and disallowance of even a relatively small portion of gas costs can obliterate a utility's earnings. Indeed, the Commission's new standard – comparing potential losses to gas costs – led the Commission to a decision so harsh as to constitute a taking on CenterPoint Energy and, if allowed to stand, opens the door to even harsher impacts in the future.

Moreover, while the Commission at one point suggests what it considers to be the proper analysis for assessing “excessive burden” (comparing losses to income on a year-by-year basis), the Commission failed to apply that test and has yet to address *the only evidence in the record* that presented such an analysis – evidence that showed a greater burden on CenterPoint Energy than on prior utilities granted recovery. As such, the record, the Commission's Orders and the Commission's Brief demonstrate both errors of law and an agency that exercised its will, not its judgment. *Peoples Natural Gas Co. v. Minn. P.U.C.*, 342 N.W.2d 348, 352 (Minn. Ct. App. 1983), *rev. denied* (Minn. Apr. 24, 1984) (an agency may not abandon its own precedent without reason or explanation); *In the Matter of N.S.P. Gas Util. For Auth. to Change Its Schedule of Gas Rates*, 519 N.W.2d 921, 925 (Minn. Ct. App. 1994) (an agency must either conform to its prior norms and decisions or explain the reason for its departure from such precedent.) Therefore, the Commission's decision must be reversed.

The Commission similarly abandoned its precedent when addressing the “public interest” element of its variance analysis. On this aspect of its analysis, the Commission focused on the fact that the errors here “*were entirely within the Company’s control*” and that ratepayers had no role in “the Company’s failure to seek timely recovery.” Comm. Br. at 23 (emphasis in original). Of course, by definition an error is in the control of the utility making the error and ratepayers could have no role in such a matter. Thus, both the *1994 AAA Docket* and the *1997 AAA Docket* involved utilities that made errors within their control and errors in which the ratepayer played no part. The Commission appropriately gave no weight to the issue of “control” in either of those cases and granted recovery. Here again, the Commission ignored its precedent and instead created a rationale for disallowance after the fact that runs completely contrary to that precedent. In so doing, the Commission has acted arbitrarily and capriciously, and must be reversed.

### **III. The Commission Did Not Invoke Unique Agency Expertise In Reaching Its Decision In This Matter And Its Brief Misstates The Record.**

The Commission Brief also errs in arguing that the determinations reached in this matter are “uniquely within the expertise of the Commission,” requiring substantial deference from this Court. Comm. Br. at 17-20. First, as discussed above, the Commission acted arbitrarily and capriciously by deviating from its precedent and by creating a new legal standard without articulating the basis for that standard. As this is a “new” interpretation, in contrast with a long-standing agency interpretation, this Court does not accord the interpretation, and the decision related thereto, the deference sought

by the Commission. *In the Matter of the Cities of Annandale and Maple Lake*, 731 N.W.2d 502, 514 (Minn. 2007).

Second, because the Commission did not utilize any “technical expertise” in interpreting its statutes or reaching its decision, this Court similarly has no duty to defer to the Commission. *Id.* Indeed, the uncontradicted evidence demonstrates that CenterPoint Energy failed to recover over \$21 million in prudently incurred gas costs, prompting the issuance of a Form 8-K to investors to inform them of the disallowance. *APP24-APP26.* Likewise, uncontradicted evidence shows that this \$21 million loss equates to over 25% of CenterPoint Energy’s operating income for 2006. *APP12.* Finally, uncontradicted evidence shows that the losses imposed on CenterPoint Energy on a year-by-year basis constituted well over 10% of CenterPoint Energy’s return on equity (the standard used by the Commission in the *1994 AAA Docket* to allow NSP recovery of past costs) for each of the last three years. *APP18.*

No “technical expertise” is required to see that the \$21 million disallowed here overwhelms the \$165,000 and \$1 million found to be an excessive burden in the *1997 AAA Docket* and *1994 AAA Docket*, respectively. Similarly, no technical expertise is required to see that impacts on a utility’s return on equity ranging from 13.79% to 15.31% substantially exceed the impact of 10% found to be an “excessive burden” in the *1994 AAA Docket*. The numbers speak for themselves and illustrate the arbitrariness of the Commission’s decision.

The Commission attempts to seek the refuge of judicial deference by comparing the current matter to *Minnesota Ctr. For Envntl. Advocacy v. Minnesota Pollution Control*

*Agency*, 644 N.W.2d 457 (Minn. 2002) (“*MCEA*”). Comm. Br. at 17-19. The analogy fails. *MCEA* involved a challenge to the environmental assessment conducted by the Minnesota Pollution Control Agency, in cooperation with the Minnesota Department of Natural Resources, regarding an increase in timber harvesting in the state. That environmental assessment included use of both an Environmental Assessment Worksheet (“*EAW*”), completed in 1999 and reliance on a comprehensive statewide Generic Environmental Impact Statement for Timber Harvesting and Forest Management (“*GEIS*”), completed over a five year period from 1989 to 1994, as well as an analysis of the effect of ongoing mitigation efforts related to timber harvesting impacts governed by Minnesota’s Sustainable Forest Resources Act. *MCEA*, 644 N.W.2d at 460-465. In *MCEA*, the Court correctly concluded that the environmental review conducted there necessarily delved deep into the factual record and required application of the agencies’ scientific knowledge and expertise. *Id.* at 464.

In contrast, the current case involved a failure to recover \$21 million in gas costs.

As Commissioner Reha aptly noted:

“[W]e said in the NSP order that failure to recover one million in gas costs would undoubtedly place a burden upon NSP Gas. Well, *certainly the numbers are even more significant . . .* [P]unishing the company for a clerical error in the tune of \$21 million, . . . if we’re going to hand out a variance in one case, *we can’t be arbitrary and not hand a variance in another case when the same standards and criteria apply to both companies. . . .* Now here with another company in the same circumstances, and *even more seriously so*, we’re saying we shouldn’t give them a variance.”

*APP32-APP33* (emphasis added).

Determining, as Commissioner Reha did, that the impact of denial on CenterPoint Energy was even more significant than the impact on other utilities previously granted recovery, did not require the application of “technical expertise.” Rather, it required a simple comparison of the numbers.

Finally, the Commission appears to suggest it should be granted deference because CenterPoint Energy twice underwent rate cases during the time period at issue – a process overseen by the Commission – and the Commission speculated that those rate cases may have provided recovery of the gas costs at issue. Comm. Br. at 25-26. Again, the Commission’s arguments are baseless. First, both CenterPoint Energy and the Commission’s own staff noted that the ratemaking and gas cost True-Up processes are separate and distinct, such that rate cases do not and cannot provide a vehicle for recovery of previously unrecovered gas costs. *APPI9*; Index of Administrative Record, Docket No. 86 at 12-13. Indeed, there is simply no basis, either in law or in fact, to infer that the gas costs at issue could have been recovered through a general rate case proceeding.

Second, and more tellingly, in responding to the Company’s claim of a taking, Respondent *admits* that CenterPoint Energy’s rate cases *could not* have provided recovery of the costs at issue here. In that discussion, the Commission goes to great lengths to *distinguish* rate cases from gas cost recovery filings. In fact, the Commission correctly and succinctly states that “*a general rate case is not a mechanism to recover amounts left unrecovered in a prior period.*” Comm. Br. at 40 (emphasis added). The Commission cannot then make the patently contradictory claim that CenterPoint Energy’s

rate cases may have provided recovery and argue that this speculation should be accorded deference. Instead, this Court must reject the Commission's arguments and reverse the Commission's decision.

**IV. The Commission Ignores Uncontradicted Evidence Showing The Burden Imposed On CenterPoint Energy By The Commission's Decision And Misstates The Record Regarding Other Issues.**

Astonishingly, while arguing that "there were no contested material facts" before the Commission, Comm. Br. at 45, the Commission also argues that "there has been no showing that the Company has not been fully compensated by ratepayers during the time period at issue." Comm. Br. at 27. Similarly, the Commission at times argues that to allow recovery now could "reward" the Company or "result in a windfall" to CenterPoint Energy. Comm. Br. at 23, 27. The uncontradicted evidence and the Commission's own Brief belie these claims.

First, while CenterPoint Energy has thus far been denied the opportunity to present its case (or confront any opposing case) in a contested case proceeding, the Company has shown that the accounting errors at issue have caused a \$21 million underrecovery of its prudently incurred gas costs. This failure to recover such a substantial sum led to the issuance of a Form 8-K to investors and the Securities and Exchange Commission, noting that CenterPoint Energy's parent company "will be required to take a pre-tax charge to earnings in the amount of \$21 million" due to the Commission's decision. *APP25-APP27*. No party has contested that fact.

Second, the Commission itself verifies, as it must, that gas cost recovery occurs in True-Up filings. Other proceedings, such as a general rate case, are "*not a mechanism to*

*recover amounts left unrecovered in a prior period.*” Comm. Br. at 26, 40 (emphasis added). As the Commission admits, allowing recovery of gas costs through the True-Up process *cannot* “reward” a utility by providing duplication of recovery allowed elsewhere. Instead, allowing recovery of gas costs through the True-Up process simply fulfills the Legislature’s directive that utilities be allowed recovery of these costs. Minn. Stat. §216B.16, subd. 7.

The Commission’s “public interest” discussion includes further misstatements of the record. For example, the Commission incorrectly contends that “the Company has made no suggestion that it should share responsibility in any way for the problem it created.” Comm. Br. at 23. To the contrary, CenterPoint Energy explained that its failure to timely recover these gas costs would impose over \$8 million in carrying costs on the Company even if full recovery were allowed. *APP12*. Moreover, CenterPoint Energy agreed that it could limit its variance request to one or two years, given that those were the time periods at issue in the *1994 AAA Docket* and *1997 AAA Docket*. *APP29*. Commission Chair Koppendrayer recognized the Company’s position, stating: “[A]ny time somebody says I made a mistake and I didn’t charge you enough for the last five years, but I’d appreciate it if you could find it in your heart to pay me two out of the last five years, and I won’t even charge you interest, I’ll do business with that company from now until I die. That’s the best guy I know on the planet.” *APP33*. As the Chair recognized, the Commission’s claim that CenterPoint Energy “made no suggestion that it should share responsibility in any way” in this matter is simply untrue.

The Commission's misstatements of the record, contradictory statements in its own Brief regarding the impact of rate case filings, and complete failure to recognize the undisputed evidence that its decision imposes a \$21 million loss on CenterPoint Energy all evince an agency exercising its will and not its judgment and demonstrates an agency decision undeserving of deference from this Court. *Pope County Mothers v. MPCA*, 594 N.W.2d at 236. Instead, this Court should reverse the Commission's decision.

**V. The Commission's Refusal To Refer The Matter For A Contested Case Hearing Was Contrary To Commission Statutes And Rules, The Minnesota And United States Constitutions, And Case Law Interpreting The Same.**

Minn. R. 7829.1000 governs when the Commission "shall refer the matter to the Office of Administrative Hearings for contested case proceedings." *See also* Minn. Stat. § 645.44, subd. 16 (2006) ("[s]hall is mandatory."). Indeed, the rule requires that such a referral "shall" take place:

If a proceeding involves contested material facts and there is a right to a hearing under a statute or rule, or if the commission finds that all significant issues have not been resolved to its satisfaction, the commission shall refer the matter to the Office of Administrative Hearings....

Minn. R. 7829.1000 (2007) (emphasis added).

The Commission now justifies its decision not to refer this matter for hearings on the faulty assumption that its authority to grant, or refuse to grant, CenterPoint Energy (or any other party) a contested case where there are material facts in dispute *is without limits*. Comm. Br. at 45 (emphasis added). This is evidenced by the fact that the *only argument* contained in Section VI.A of the Commission's Brief, provides that "[s]ince there are no contested material facts and it is clear that the Commission found that all

significant issues had been resolved to its satisfaction[,]” the Commission did not want to convene a contested case hearing. *Id.*

Contrary to the cavalier attitude conveyed by the Commission in its Brief, the Commission’s authority is not boundless, nor is such authority defined by or obtained by the agency’s own acts. *In the Matter of Hibbing Taconite Co.*, 431 N.W.2d 885, 890 (Minn. Ct. App. 1988) (citations omitted). A single statement in the Commission’s Brief to this Court that “all significant issues have been resolved to its satisfaction” is insufficient for purposes of meeting any of the Minn. Stat. § 14.69 standards of review, especially where the Commission itself made no specific findings of fact in either its original decision or on reconsideration. Indeed, the Commission’s refusal to grant CenterPoint Energy a contested case to resolve the material disputed issues of fact is arbitrary and capricious, made upon unlawful procedure, and in violation of the constitutional guarantees of due process, and this Court should, at a minimum, reverse the Commission’s decision and remand for a contested case hearing.

Despite the language of the Commission’s orders in this matter and the contents of its own Brief, significant material facts remain in dispute. This is plainly evidenced by the parties’ arguments before the Commission, the Commission’s orders, the parties’ Statements of the Case to this Court, and the Commission’s Brief itself.<sup>3</sup> Had this matter

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<sup>3</sup> The Office of the Attorney General’s (“OAG”) Statement of the Case to this Court, which mirrors the argument that it made to the Commission and on which the Commission now purportedly relies in its brief, demonstrates the absurdity of the situation that the Company faces. The OAG and the Commission suggest that the “[r]ecord evidence fully supports the Commission’s statement that ‘[a]fter twice going through the extensive examination and analysis of a ratemaking proceeding, there has

been referred for contested case hearings, CenterPoint Energy would have called both fact and expert witnesses, to demonstrate and establish a record regarding, *inter alia*, the burden imposed on CenterPoint Energy by the denial of \$21 million and that the gas costs at issue could not have been “previously recovered.” Perhaps even more importantly, had any opposing party continued to assert that previous recovery may have somehow occurred, CenterPoint Energy would have been able to confront those witnesses to establish the abject falsehood of such an assertion. Thus, the Commission’s statement that “there were no contested material facts in dispute” is plainly incorrect, Comm. Br. at 45, and the Commission cannot rely on such misstatements as the foundation for an erroneous decision.

In addition, the Company is entitled to a contested case hearing pursuant to the due process clauses of the Minnesota and United States Constitutions, as well as notions of fundamental fairness. Beck, *Minnesota Administrative Procedure* at 47. As CenterPoint Energy has stated, in evaluating whether the Company is entitled to a hearing, the Court examines: whether the party seeking a contested case hearing has an interest that will be affected by the official action; the risk of erroneous deprivation of such interest through the procedures used; and the additional burdens placed on the

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been no showing that Relator has not been fully compensated by ratepayers.” *OAG Statement of the Case* at 5; Comm. Br. at 26. Because the Commission refused to refer this matter to a contested case, the Company is prevented from being able to refute the patent inaccuracy of this statement – inaccuracy confirmed by the Commission elsewhere in its brief. Comm. Br. at 40. Furthermore, there was no “evidence,” let alone any “record evidence” presented to the Commission demonstrating such prior compensation to the Company, nor did the Commission or the OAG refer to any “facts” in the record, nor did they refer to any statutes, rules or precedent to support of such a statement.

agency if additional procedures are ordered. *Fosselman v. Comm'r of Human Servs.*, 612 N.W.2d 456, 461-462 (Minn. Ct. App. 2000).

In response, the Commission has not, and cannot, dispute that the Company has a significant, \$21 million property interest in the instant case. Furthermore, the risk of the erroneous deprivation of the \$21 million is apparent and this factor also weighs heavily in favor of the Company. *Id.* The Commission also has not, and cannot, dispute that the Company was afforded nothing more than the opportunity to submit written and oral “comment.” There was no independent fact finder. Moreover, the Company was prevented from calling witnesses to elicit their testimony and prevented from cross-examining adverse witnesses, all of which would have been under oath and would have allowed CenterPoint Energy to demonstrate the patent inaccuracy of numerous statements that the Commission includes in its orders and again in its Brief, and attempts to shield from review under the guise of “expertise.” *Id.*<sup>4</sup> Although there may be some negligible burdens associated with providing the Company with additional, constitutionally protected guarantees, these burdens are nothing compared to the burden on CenterPoint Energy of being erroneously deprived of \$21 million. *Id.*

Given this analysis, the failure to grant CenterPoint Energy a contested case hearing in this matter is “fatal to the constitutional adequacy of the [Commission’s] procedures.” *Id.* (citations omitted). Based upon these fundamental principles of due

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<sup>4</sup> The Commission’s decision in this matter relied exclusively on speculation and the unsworn statements and argument of counsel. The ability to examine and cross-examine witnesses, and establish the veracity of their claims, is a fundamental aspect of procedural due process. *Fosselman*, 612 N.W.2d at 462.

process, as embodied in the Minnesota and United States Constitutions and the courts' interpretation of the same, this matter should be reversed and remanded for a contested case hearing.

**VI. The Commission's Denial Of \$21 Million To CenterPoint Energy Is An Unconstitutional Taking Of A Utility's Property.**

In its Brief, the Commission correctly concedes that regulatory action can result in "depriv[ing] the public utility company of its property in violation of the Fourteenth Amendment." Comm. Br. at 39 (quoting *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679, 690 (1923)). The Commission also apparently does not dispute that expenses that are "properly incurred . . . must be allowed as part of the composition of the rates." *Miss. River Fuel Corp. v. FPC*, 163 F.2d 433, 437 (D.C. Cir. 1947). And the Commission cannot dispute that this Court is to look at the "end result" of the Commission Order to determine whether CenterPoint Energy's property has been taken in violation of the Fifth Amendment. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944) ("[I]t is the result reached and not the method employed which is controlling."). "When the Commission's order is challenged in the courts, the question is whether that order viewed in its entirety" meets the constitutional requirements, because it is the "impact" of the order "which counts." *Id.* (internal quotations omitted); see also *Jersey Cent. Power & Light Co. v. FERC*, 810 F.2d 1168, 1176 (D.C. Cir. 1987) ("The *Hope* Court made clear that when a rate was claimed to be beyond 'just and reasonable' boundaries, the focus of the analysis was to be the end result of that order.").

Here, the “end result” of the Commission Order is the taking of CenterPoint Energy’s property without just compensation. The Commission Order does *not* allow CenterPoint Energy to recover its actual and prudently incurred gas costs totaling approximately \$21 million; the Commission Order required CenterPoint Energy to write-off over 25% of its 2006 annual operating income; and the Commission Order effectively reduced CenterPoint Energy’s return on equity to just 5.35% for 2006, 44.9% less than the 9.71% return authorized for CenterPoint Energy by the Commission in its most recent rate case, and substantially less than the returns being made at the same time by other gas utilities. *APP12, APP17*. Thus, the Commission Order denies CenterPoint Energy recovery of approximately \$21 million of prudently incurred expenses for gas delivered to its customers – a unconstitutionally unjust, unreasonable and confiscatory result. *See Bluefield*, 262 U.S. at 690-692; *Miss. River Fuel Corp.*, 163 F.2d at 437.

Rather than addressing the application of this well established law to the facts of this case, the Commission instead argues that there has been no taking of CenterPoint Energy’s property for reasons that are irrelevant to the constitutional analysis. The Commission’s arguments should be rejected by this Court.

Initially, the Commission argues there has been no taking of CenterPoint Energy’s property because the Commission’s decision did not arise out of a general rate case. *See Comm. Br.* at 43 (“The matter at issue is not a rate set in a rate case, but the pass-through to the current rate payers of allegedly unrecovered costs for gas purchased several years ago.”). The Commission cites no authority in support of this novel proposition, which is understandable because, from the standpoint of constitutional protections, it makes no

difference whether the Commission's decision arises out of a general rate case or some other proceeding.

The United States Supreme Court has explained that when deciding "questions under the Takings Clause of the Fifth Amendment" the "guiding principle" is "that the constitution protects utilities from being limited to a charge for their property serving the public which is so 'unjust' as to be confiscatory." *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307 (1989) (quoting *Lovington & Lexington Turnpike Road Co. v. Sandford*, 164 U.S. 578, 597 (1896)). Thus, contrary to the Commission's argument, the focus is not on the form of the agency proceedings; instead, the focus is on the end result – whether the agency's action unjustly limits the utility's ability to recover the cost of property used to serve the public. *Id.* Therefore, it makes no constitutional difference whether the Commission Order arises out of a rate case or another agency proceeding.

Here, the Commission decision limits CenterPoint Energy's ability to charge its customers for gas it purchased and delivered to its customers in a manner that is so "unjust as to be confiscatory." *Id.* Indeed, the Commission denies CenterPoint Energy the ability to recover its prudently incurred gas costs totaling approximately \$21 million. As such, it is confiscatory and violates the Fifth and Fourteenth Amendments.

Next, the Commission argues there has been no taking of CenterPoint Energy's property because the Commission properly applied its own rules. *See* Comm. Br. at 44 ("[T]he issue in this case is not confiscatory rates based on the Company's test year, but, rather, whether the request meets the standard for a variance under Minn. R. 7829.3200, subp. 1."). Again, however, the Commission is wrong and this Court should reject its

argument. As CenterPoint Energy explained in its initial Brief and in this Reply, the Commission did not properly apply its rules, including those governing a variance.

More importantly, even if the Commission issued its decision in accordance with its own rules, that does not excuse it from complying with the fundamental requirements of the Minnesota and United States Constitutions. The United States Supreme Court has recognized as much, explaining that a regulatory scheme “applied by a utilities commission, including the specific instructions it has received from its legislature,” such as the rules governing the proceedings, will not “necessarily be constitutional.” *Duquesne Light Co.*, 488 U.S. at 314. This is because the Fifth and Fourteenth Amendments “protect[] the utility from the net effect” of a Commission decision on its property, regardless of whether the Commission followed its own rules or Minnesota statutes in issuing the order. *Id.* at 314; *see also Id.* at 317 (Scalia, J., concurring) (the constitution “looks to the consequences a government authority produces rather than the techniques it employs”). Accordingly, it makes no difference under principles of constitutional law whether the Commission followed its own rules. It does matter, however, that the “net effect” of the Commission’s decision is that it has denied CenterPoint Energy the ability to recovery approximately \$21 million in prudently incurred gas costs, resulting in an unconstitutional taking of its property.

### CONCLUSION

Minnesota law provides natural gas utilities such as CenterPoint Energy full recovery of their prudently incurred natural gas costs. Nonetheless, the Minnesota Public

Utilities Commission denied CenterPoint Energy recovery of approximately \$21 million in gas costs, prudently incurred to serve Minnesota customers.

Respondent's Brief clearly demonstrates that the Commission denied CenterPoint this recovery by ignoring its precedent and adopting a new and unexplained standard for whether such a denial would constitute an "excessive burden" on CenterPoint Energy. Moreover, the Commission's Brief relies upon repeated misstatements of fact, verifies that the Commission ignored uncontradicted evidence regarding the burden imposed on CenterPoint Energy, and contains internal contradictions undermining the Commission's alleged rationale for denying recovery. The multiple errors of law and fact, together with the procedural and constitutional errors evident in the Commission's decision, require that the Commission's decision be reversed. At minimum, this matter must be remanded to the Commission with direction to refer this matter to the Office of Administrative Hearings for a contested case hearing, so that CenterPoint Energy can present formal evidence and conduct cross-examination regarding any opposing evidence that may be offered.

Dated: July 5, 2007

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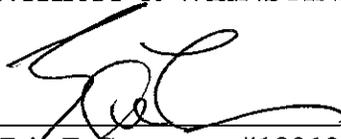
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**CERTIFICATE OF COMPLIANCE**

Pursuant to Minnesota Rule of Civil Appellate Procedure 132.01, subd. 3, the undersigned hereby certifies, as counsel for Appellants, that this Brief complies with the type-volume limitation as there are 6,605 words of proportional space type in this Brief. This Brief was prepared using Microsoft Word 2003.

Dated: July 5, 2007

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