

No. A07-653

4

STATE OF MINNESOTA
IN SUPREME COURT

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

**BRIEF AND ADDENDUM OF
APPELLANT MINNESOTA PUBLIC UTILITIES COMMISSION**

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2).

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LEGAL ISSUES

I. WHETHER THE MINNESOTA COURT OF APPEALS IMPERMISSIBLY SUBSTITUTED ITS JUDGMENT FOR THAT OF THE COMMISSION ON ISSUES THE LEGISLATURE HAS CLEARLY AUTHORIZED THE COMMISSION TO DECIDE, THAT ARE WITHIN THE COMMISSION'S EXPERTISE, INVOLVE THE INTERPRETATION AND APPLICATION OF THE COMMISSION'S OWN RULES AND RESULT IN HOLDING RATEPAYERS ENTIRELY RESPONSIBLE FOR THE COMPANY'S REPEATED AND PERSISTENT ERRORS?

The court of appeals failed to defer to the Minnesota Public Utilities Commission's ("Commission") factual findings and interpretation of its own rules and usurped the Commission's role in determining whether the standard for a variance had been met.

Apposite Authority:

In re Cities of Annandale and Maple Lake NPDES/SDS Permit Issuance for the Discharge of Treated Wastewater, 731 N.W.2d 502 (Minn. 2007)

In re Excess Surplus Status of Blue Cross & Blue Shield of Minnesota, 624 N.W.2d 264 (Minn. 2001)

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Minn. Stat. § 216B.01 (2006)

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II. WHETHER THE PUBLIC UTILITIES COMMISSION ACTED ARBITRARILY AND CAPRICIOUSLY WHEN IT EXERCISED ITS INFORMED DISCRETION TO DENY A VARIANCE TO CENTERPOINT ENERGY MINNESOTA GAS TO ALLOW IT TO BILL RATEPAYERS \$21 MILLION IN GAS COSTS THAT WERE NOT RECOVERED DUE TO CENTERPOINT'S UNCORRECTED ACCOUNTING ERRORS THAT ACCUMULATED OVER FOUR YEARS?

The court of appeals held that the decision of the Commission was arbitrary and capricious because the Commission neither applied the principles it had applied in its prior decisions nor announced new principles concerning variances.

Apposite Authority:

In re Petition of N. States Power Co. Gas Util. for Authority to Change its Schedule of Gas Rates, 519 N.W.2d 921 (Minn. Ct. App. 1994)

Peoples Nat. Gas Co. v. Minnesota Pub. Util. Comm'n, 342 N.W.2d 348 (Minn. Ct. App. 1983)

STATEMENT OF THE CASE

This appeal arises out of the decision of the Minnesota Public Utilities Commission ("Commission") to deny a variance sought by CenterPoint Energy Minnesota Gas ("CenterPoint" or "Company"). Minnesota Rules permit a natural gas distribution utility to recover changes in its gas costs from ratepayers through its monthly purchased gas adjustment ("PGA"). Minn. R. 7825.2390-7825.2920 (2005). The purpose of the "True-Up Rule," Minn. R. 7825.2700, subp. 7, is to permit a gas utility to reflect any under- or over-recovery in the PGA on an annual basis and includes a one-year look back period. CenterPoint sought a variance to the True-Up Rule to allow it to include unrecovered gas costs incurred four years prior to the current true-up period.

CenterPoint filed its true-up report covering the 12-month period from July 1, 2004 through June 30, 2005, on September 1, 2005. On January 13, 2006, CenterPoint notified the Commission that it overstated system sales volumes going back to calendar year 2000, and that its September 1, 2005 filing required correction. CenterPoint filed updated information with the Commission on April 5, 2006, and explained that unrecovered gas costs for the current year were \$9,230,255 more than initially reported and that the total unrecovered balance from 2000-2004 was over \$12.5 million. CenterPoint indicated that its incorrect calculation was not detected for over five years because the volumes of the misstatement in any month or year were so small so as to escape notice. In an October 31, 2006 filing, CenterPoint again corrected its calculations and explained that it had again misstated the amounts at issue by several million dollars.

Pursuant to Minn. R. 7829.3200, CenterPoint sought a variance to the True-Up Rule to allow CenterPoint to recover those gas costs omitted from the annual true-ups in each of the 2000-2001 through 2003-2004 true-up years.

The Commission denied CenterPoint's request and specifically addressed how the facts of this case differed from those of previous cases in which the Commission had granted a variance to the True-Up Rule. The Commission recognized that the preceding cases were factually distinct and did not require that the Commission grant a variance under the facts present here. The court of appeals reversed the Commission's decision and remanded the matter. Contrary to its previously established principles, the court below found that the Commission acted arbitrarily and capriciously by not applying the principles outlined in two prior cases and, in so holding, the court ignored the factual differences between the cases and misapplied the precedent it purports to uphold.

First, the court of appeals failed to address that in the present case, the amounts went unnoticed month after month and year after year for five years and were the result of the Company's self-initiated accounting error. In neither of the prior cases had the error gone undetected for so long and in neither case did the utility acknowledge that the amounts were too small on a monthly or annual basis to notice. Further, the court merely looked at the nominal dollar amount without analyzing whether the amounts imposed an excessive burden on CenterPoint. Amounts too little to notice, that accumulate month after month and year after year without detection simply do not impose an excessive burden and the Commission recognized as much.

Additionally, although the court below placed great emphasis on the nearly 10% impact on return on equity (“ROE”) present in one of the prior cases, the record did not demonstrate that this threshold (10% impact on ROE) had been met for each of the years at issue in this case. Despite the fact that CenterPoint submitted 8 separate filings over a period of approximately 10 months after it identified the problem, CenterPoint never presented information on yearly impacts prior to the issuance of the Commission’s initial *Order Denying Variance and Ordering Independent Audit (“Initial Order”)*. CenterPoint only first presented any information on yearly impacts on ROE in its petition for reconsideration. Further, the figures presented did not demonstrate an impact of 10% on ROE for each of the years at issue, and demonstrated an impact on ROE of as little as 0.55%. Despite the lack of evidentiary support for excessive burden, the court found that the Commission erred by failing to grant recovery for all four years.

The court below impermissibly usurped the Commission’s legislatively-delegated authority when it substituted its judgment for that of the Commission on an important public policy issue the Commission has the expertise and authority to decide. The Legislature charged the Commission with regulating utilities in a manner that protects the public interest. Nonetheless, the court of appeals substituted its judgment for that of the Commission and, in so doing, holds ratepayers entirely responsible for CenterPoint’s \$21 million in accumulated errors. The court’s analysis imposes no limit on how far back a utility may go to discover unrecovered costs and thereafter seek recovery. Under the court’s analysis, future Minnesota ratepayers are not only responsible for current energy costs, but are also responsible for the unrecovered costs of serving past ratepayers, costs

which may have been incurred years earlier. The court's decision is at odds with Commission precedent and public policy and fails to grant deference to the expertise of the Commission in deciding these matters.¹

The Commission respectfully requests this Court reverse the decision of the court of appeals and affirm the Commission's decision to deny a variance to CenterPoint to the True-Up Rule.

STATEMENT OF FACTS

Minnesota Rules parts 7825.2390 to 7825.2920 enable regulated gas utilities to adjust rates to reflect changes in the cost of natural gas delivered to customers from the costs authorized by the Commission in the utility's most recent rate case. Minn. R. 7825.2390 (2005). Each gas utility must submit by September 1 of each year its "AAA Report," an annual reporting by month of automatic adjustment charges for each customer class for the previous year beginning July 1 and ending June 30. Minn. R. 7825.2810, subp. 1 (2005). Each gas utility files and implements on September 1 of each year a true-up adjustment calculated under the True-Up Rule for the previous year commencing July 1 and ending June 30. Minn. R. 7825.2910, subp. 4 (2005).

CenterPoint filed its 2004-2005 AAA Report and True-Up on September 1, 2005. Administrative Record Items 2 and 3.² On January 13, 2006, CenterPoint notified the Commission that it had overstated system sales volumes going back to calendar year

¹ The court of appeals did not address CenterPoint's takings and due process arguments and those issues have not been presented for review by this Court.

² Items from the Administrative Record are referred to as "R. ___."

2000 and that its 2004-2005 AAA Report and True-Up needed correction and requested that the Commission hold open its docket on the matter. R. 42. The Commission deferred action on CenterPoint's 2004-2005 AAA Report and True-Up to permit further fact finding. R. 48 at 4. CenterPoint filed its comments, request for a variance to the True-Up Rule and refiled its 2004-2005 AAA Report and True-Up on April 5, 2006. APP60.³ CenterPoint sought a variance to include the unrecovered gas costs from the 2000-2001 through 2003-2004 true-up years in its future true-up adjustments. APP70. The Company indicated its April 5, 2006 filing represented the "completion of the Company's internal review[.]" APP60.

CenterPoint explained the accounting errors that resulted in gas costs going unrecovered. APP61-APP66. The Company indicated that, throughout the period at issue, it had accurately stated the gas costs it had incurred, but had overstated customer sales volumes, and that this error resulted in under-recovering its gas costs. APP61-APP66. CenterPoint explained that two factors contributed to the cumulative overstatement. APP65.

First, CenterPoint misstated its calculations of lost and unaccounted for gas ("LUFG") and, beginning in the November 2000 unbilled revenue calculation, the Company calculated LUFG only on firm volumes rather than total volumes. APP65. According to CenterPoint, this led to an understatement of LUFG in the unbilled sales determination, which further led to an overstatement of the system throughput used to

³ Items from the Appendix are referenced as "APP ___."

determine recovered gas costs. APP65. The Company assumed it would receive revenues associated with the overstated volumes that it claimed it did not receive since the gas was not actually used by customers. APP65.

Second, CenterPoint stated that again, beginning in November 2000, the Company implemented an accounting change that included accelerating the month-end accounting closing process. APP65-APP66. This change required that an estimate of unbilled sales be made before the end of the calendar month. APP65-APP66. The Company indicated that the change was not implemented correctly and that, as a result, the Company's books reflected an accumulation of unbilled sales. APP66. Notably, neither of these accounting changes were approved by the Commission.

CenterPoint explained that the misstatement of unbilled volumes resulting from its accounting errors was not noticeable on either a monthly or annual basis. APP66. CenterPoint claimed it only became aware of the problem when the *cumulative* volume of unbilled sales over the five years at issue became "unreasonably large." APP66.

The Company explained that the unrecovered gas costs for the then-current 2004-2005 True-Up Year were \$9.2 million greater than originally reported. APP67. CenterPoint further reported that the unrecovered gas costs for the 2000-2001 through 2003-2004 true-up years were over \$12.5 million. APP70. The Company outlined the unrecovered amounts attributable to each of the 2000-2001 through 2003-2004 true-up years and assured the Commission that the accounting methodologies and calculations presented in its April 5, 2006 filing were reviewed by its auditors to "ensure accuracy." APP69, n.5. The Company requested a variance to the True-Up Rule to allow it to

recover the unrecovered gas costs for the 2000-2001 through 2003-2004 periods in its true-up. APP70.

The Minnesota Office of the Attorney General Residential and Small Business Utilities Division (“OAG-RUD”) and Minnesota Department of Commerce (“Department”) each submitted comments regarding CenterPoint’s requested variance. R. 56 and R. 57. OAG-RUD objected to any recovery of the under-recovered gas costs. R. 56 at 2. The Department identified specific areas of concern and indicated its investigation was ongoing. R. 57.

On June 16, 2006, CenterPoint submitted supplemental information regarding the unrecovered gas costs, including original audited true-up statements, along with letters from the Company’s external auditor issued after the corrected true-up statements were audited. R. 63. CenterPoint indicated that, “[t]he incorrect calculation of [LUFGE] and unbilled sales was not detected for a period of years because the dekatherm volumes of the misstatement in any month *or year* in relationship to the total throughput was *so small.*” R. 63 (emphasis added).⁴

The Commission considered the issues raised by the parties, but determined that additional record development was necessary regarding the Commission’s legal authority to grant CenterPoint’s request. R. 98. The Commission thereafter issued a Request for Comments on July 17, 2006, asking parties to address: 1) whether the Commission

⁴ The pages are not numbered in this record item. The referenced provision may be found in section two of the page entitled, “Original audited true-up statements and audited corrected true-up statements.”

should grant CenterPoint's request for a variance to the True-Up Rule and include an analysis of any other applicable rules, statutes, legal doctrines or prior Commission decisions; and 2) the scope of an independent audit, if needed, and the names and qualifications of potential independent auditors. R. 70.

On August 18, 2006, CenterPoint, the Department and OAG-RUD each filed comments. APP76 and R. 75 and 76. CenterPoint again reported the underrecovered amounts as \$21.8 million, including the 2004-2005 true-up year, and explained that, "this amount only represents under recovery of approximately 0.5% during the five-year period at issue." R. 76 at 8. The Company proposed to recover the shortfall over a three-year period, commencing one year after the implementation of the true-up for the Company's 2004-2005 AAA costs, and indicated that this recovery would coincide with anticipated savings associated with the Company's new contract for pipeline transportation services with Northern Natural Gas Company. R. 76 at 9.⁵

CenterPoint filed reply comments on September 15, 2006, responding, in part, to the comments made by the Department and OAG-RUD. R. 80. The Company again explained that the unrecovered gas costs from the 2000-2001 through 2003-2004 true-up years were over \$12.5 million and argued that this amount represented an impact of approximately 230 basis points in the current year. R. 80 at 8. The Company did not outline the impacts on an annual basis.

⁵ CenterPoint indicated it did not seek any carrying costs, or interest, on the amounts at issue. R. 76 at 9. CenterPoint failed to recognize that Minn. Stat. § 216B.098, subd. 4 (2006), precludes recovery of carrying costs on these amounts.

The Department and OAG-RUD also filed reply comments on September 15, 2006, and addressed the issues raised by CenterPoint. APP89 and APP100. The Department recognized that CenterPoint, in comparing five years of errors to one year of income, did not provide an appropriate “apples to apples” comparison and that the comparison numerator and denominator should contain the same periods of time. APP104. The Department explained that the *only* “apples to apples” comparison the Company provided was the comparison of the gas costs at issue to total gas costs over the time period. APP104. This comparison used the consistent numerator and denominator of gas costs and more appropriately analyzed the significance of the unrecovered amounts. APP104.

On October 31, 2006, CenterPoint submitted its Additional Supplemental Comments and restated its unrecovered gas costs a second time. APP110. In its October 31, 2006 filing, the Company indicated that, “the total under-recovery experienced by the Company is correctly stated at approximately \$28 million.” APP113. \$20.9 million of this amount was attributed to the 2000-2001 through 2003-2004 true-up years. CenterPoint indicated that it only became aware that its April 5 and June 16, 2006 filings would not provide full gas recovery during the preparation of its 2005-2006 AAA Report. APP110. CenterPoint claimed that although the previously reported volumes of gas for which it had not recovered costs were correct, the pricing for that gas had been incorrectly calculated. APP112. The October 31, 2006 filing came over 10 months after the Company notified the Commission of the issue, and over 6 months after the Company made its claim that its total unrecovered balance from 2000 - 2004 was approximately

\$12.6 million, and that these numbers had been reviewed to “ensure accuracy.” APP67-APP68. The Company again did not provide any analysis of the impacts of these losses on an annual basis.

The Commission met on November 9, 2006 to consider the matter. R. 99. By a 5-0 vote, the Commission found that CenterPoint had not satisfied the Commission’s three-part test for granting a variance under Minn. R. 7829.3200, subp. 1 (2005) and denied its request for a variance. APP17. As demonstrated by the evidence in the record, the amounts at issue were only 0.5 % of the Company’s \$4.2 billion in gas costs for the period and the unrecovered amounts were too small to notice on a monthly or annual basis. The Commission appropriately found that enforcement of the rule would not impose an excessive burden on CenterPoint. APP17.

The Commission also was not persuaded that granting the variance would not adversely affect the public interest. APP17. The Commission found that the public interest is best served by ensuring that customer charges are calculated correctly for each year’s true-up. APP17. The Commission addressed the comments made by the Department that the up to ten-year mismatch in ratepayers who received the cost and those that would pay was unreasonable. APP15 and APP106. The Commission determined that unrecovered amounts did not pose the kind of severe financial threat that might trump general regulatory principles of inter-generational equity and the practice of matching the set of ratepayers who bear the costs with the set of ratepayers for whose benefit the costs were incurred. APP18.

Significantly, the Commission recognized that CenterPoint had filed general rate cases in 2004 and 2005 and there was no showing that the Company had not been fully compensated by ratepayers. APP18. After twice undergoing the extensive financial review of a rate case, no indication was made that the Company was incurring unrecovered gas costs that imposed an excessive burden on CenterPoint. The Department and OAG-RUD also addressed this issue in their comments. APP84, APP95 and APP102.

Finally, the Commission found inadequate support in the legal analysis offered to justify the request for a variance and denied the variance accordingly. APP18. However, for the July 1, 2004 - June 30, 2005 period for which the Company timely sought recovery, the Commission ordered an independent audit of the Company's financial statements, gas cost calculations, AAA Reports and True-Ups and outlined the requirements of what the audit should include. APP18.

CenterPoint petitioned for rehearing and reconsideration of the Commission's *Initial Order*, challenging various factual findings and conclusions, and included a detailed list of its disputed items. APP21. The matter came back before the Commission at its February 8, 2007 meeting. APP42. Although a motion was made to reconsider, the motion failed. R. 99 at 60-61. On its own motion, however, the Commission clarified that the cumulative impact of the Company's errors was not \$2.4 million. APP43. The Commission recognized that the \$2.4 million was the approximate amount of margin revenue that would have been collected on the un-billed sales volumes if those sales had occurred. APP43. The Commission recognized, however, the approximately \$21 million

in unrecovered gas costs equals only 0.5 % of CenterPoint's total gas costs of \$4.2 billion during the period at issue, and, therefore, the amounts did not impose an excessive burden on the Company. APP43. The Commission addressed the significant factual differences between the present matter and previous cases in which the Commission had granted a variance, finding that the facts present here did not demonstrate that the requirements for a variance had been satisfied.

SCOPE OF REVIEW

An appeal from a decision and order of the Commission may be commenced in accordance with Minn. Stat. ch. 14. Minn. Stat. § 216B.52, subd. 1 (2004). In a judicial review of an agency decision:

the court may affirm the decision of the agency or remand the case for further proceedings; or it may reverse or modify the decision if the substantial rights of the petitioners may have been prejudiced because the administrative finding, inferences, conclusion, or decisions are:

- (a) in violation of constitutional provisions; or
- (b) in excess of the statutory authority or jurisdiction of the agency; or
- (c) made upon unlawful procedure; or
- (d) affected by other error of law; or
- (e) unsupported by substantial evidence in view of the entire record as submitted; or
- (f) arbitrary or capricious.

Minn. Stat. § 14.69 (2006). On appeal from an agency decision, the party seeking review bears the burden of proving that the agency's conclusions violate one or more provisions of Minn. Stat. § 14.69. *Markwardt v. State Water Resources Bd.*, 254 N.W.2d 371, 374 (Minn. 1977).

This Court reviews the Commission's factual findings to determine whether they are supported by substantial evidence or whether its conclusions are arbitrary and capricious. *In re Excess Surplus Status of Blue Cross & Blue Shield of Minn.*, 624 N.W.2d 264, 277-279 (Minn. 2001). Substantial evidence for purposes of appellate review of an administrative agency's decision is: (1) such evidence as a reasonable mind might accept as adequate to support a conclusion; (2) more than a scintilla of evidence; (3) more than some evidence; (4) more than any evidence; and (5) evidence considered in its entirety. *Cable Communications Bd. v. Nor-West Cable Communications P'ship*, 356 N.W.2d 658, 668 (Minn. 1984) (citations omitted).

A reviewing court may not substitute its own judgment for that of an administrative agency when the finding is properly supported by the evidence. *Vicker v. Starkey*, 265 Minn. 464, 470, 122 N.W.2d 169, 173 (1963). Courts defer to the agency's fact-finding process and it is the challenger's burden to establish that the findings are not supported by the evidence. *Id.*

A decision may be deemed arbitrary and capricious if the decision reflects the agency's will and not its judgment. *Blue Cross & Blue Shield*, 624 N.W.2d at 277 (citation omitted). To satisfy the arbitrary and capricious test, the agency must explain the connection between the facts found and choices made. *Id.* An agency decision is not

arbitrary and capricious if the agency, presented with opposing points of view, reaches a reasoned decision that rejects one point of view. *In re Detailing Criteria and Standards for Measuring an Electric Utility's Good Faith Efforts in Meeting the Renewable Energy Objectives Under Minn. Stat. § 216B.1691*, 700 N.W.2d 533, 539 (Minn. Ct. App. 2005) (citation omitted), *aff'd*, 714 N.W.2d 426 (Minn. 2006). A reviewing court will affirm the agency's decision if it was not arbitrary or capricious "even though [the court] may have reached a different conclusion had it been the fact-finder." *White v. Minnesota Dep't of Natural Resources*, 567 N.W.2d 724, 730 (Minn. Ct. App. 1997).

Further, this Court accords deference to an agency's expertise that is exercised within the scope of its authority. *Blue Cross & Blue Shield*, 624 N.W.2d at 278. Agency decisions are presumed correct and deference should be shown to agency expertise and special knowledge. *Id.* (citing *Reserve Mining Co. v. Herbst*, 256 N.W.2d 808, 824 (Minn. 1977)).

In the present matter, the issue is whether the Commission's decision is supported by substantial evidence in the record and whether CenterPoint met the standard for a variance under the Commission's rules. Courts give deference to an agency interpretation of its own regulations. *In re Cities of Annandale and Maple Lake NPDES/SDS Permit Issuance for the Discharge of Treated Wastewater*, 731 N.W.2d 502, 514 (Minn. 2007) ("*Maple Lake*") (citing *St. Otto's Home v. Minnesota Dep't of Human Serv.*, 437 N.W.2d 35, 39-40 (Minn. 1989)). Further, courts defer to the agency's application of a regulation when it is "primarily factual and necessarily requires application of the agency's technical knowledge and expertise to the facts presented."

Minnesota Ctr. for Envtl. Advocacy v. Minnesota Pollution Control Agency, 644 N.W.2d 457, 464 (Minn. 2002) (“MCEA”); see *Maple Lake*, 731 N.W.2d at 515, n.9. This is especially true in matters concerning policy considerations and value judgments within the agency’s expertise. *In re Application of the Grand Rapids Pub. Util. Comm’n*, 731 N.W.2d 866, 871 (Minn. Ct. App. 2007) (citing *Reserve Mining Co. v. Herbst*, 256 N.W.2d at 824).

ARGUMENT

I. THE COURT OF APPEALS ERRED BY FAILING TO DEFER TO THE COMMISSION AND IMPROPERLY SUBSTITUTED ITS JUDGMENT FOR THAT OF THE COMMISSION.

A. Standard Of Law.

“The court attaches a presumption of correctness to agency decisions and shows deference to an agency’s conclusions in the area of its expertise.” *Cable Comm. Bd.*, 356 N.W.2d at 668 (citing *Minnesota Power & Light Co. v. Minnesota Pub. Util. Comm’n*, 342 N.W.2d 324, 329 (Minn. 1983)). This Court defers to an agency’s interpretation of its own regulation. *MCEA*, 644 N.W.2d at 465; see also *Maple Lake*, 731 N.W.2d at 514. “Although a reviewing court might reach a contrary conclusion to that arrived at by an administrative body, the court cannot substitute its judgment for that of the administrative body when the finding is properly supported by the evidence.” *Vicker*, 122 N.W.2d at 173 (citations omitted).

B. The Court Should Defer To The Commission's Determination Regarding Whether The Standard For A Variance Has Been Met.

Minnesota Rules 7829.3200, subp. 1 provides that the Commission shall grant a variance to its rules when it determines that granting the variance would not adversely affect the public interest, enforcement of the rule would impose an excessive burden on the applicant or others affected by the rule, and that granting the variance would not conflict with standards imposed by law. An applicant for a variance to the rule must prove all elements. If the applicant fails to prove any one of the criteria, the Commission cannot grant the variance. *Cf. Stotts v. Wright County*, 478 N.W.2d 802, 806 (Minn. Ct. App. 1991) (if the applicant fails to prove any one of five criteria required by the ordinance, the board of adjustment cannot grant the variance).

The court of appeals erred in failing to defer to the Commission's findings and impermissibly usurped the Commission's role in determining whether the standard for a variance had been met. The court of appeals was required to extend deference to the Commission's factfinding and application of the Commission's own rule. *See Blue Cross & Blue Shield*, 624 N.W.2d at 278; *see also MCEA*, 644 N.W.2d at 464 (The court considers the agency's expertise and special knowledge when reviewing an agency's application of a regulation when the application of the regulation is primarily factual and requires application of the agency's expertise to the facts presented); *cf. Stotts*, 478 N.W.2d at 806 (a zoning board has broad discretion in reviewing variance requests and a

reviewing court is limited to determining whether the board's decision was based on legally sufficient reasons).

1. Public Interest

a. The Commission Is The Agency Charged By The Legislature With Regulating Utilities In A Manner That Protects The Public Interest.

The court below impermissibly infringed on the authority of the Commission to determine whether the variance adversely affects the public interest. The Legislature has granted the Commission the authority to regulate natural gas distribution utilities and has charged the Commission with considering the public interest in evaluating utilities' actions. Minn. Stat. § 216B.01 (2006); *see also* Minn. Stat. §§ 216B.03 ("Any doubt as to reasonableness [of rates] should be resolved in favor of the consumer.").⁶

⁶ *See also* Minn. Stat. §§ 216B.16, subd. 6 (the Commission shall consider the public need for adequate, efficient and reasonable service in setting rates); 216B.164, subd. 1 ("This section shall at all times be construed in accordance with its intent to give the maximum possible encouragement to cogeneration and small power production consistent with protection of the ratepayers and the public."); 216B.1691, subd. 2(c) ("The Commission shall establish criteria and standards to evaluate a utility's good faith effort to achieve the renewable energy objectives [that] protect against undesirable impacts on the reliability of the utility's system and economic impacts on ratepayers and that consider technical feasibility"); 216B.17 ("The commission may dismiss any complaint without a hearing if in its opinion a hearing is not in the public interest"); 216B.2422, subd. 2 ("The Commission shall approve, reject or modify the resource plan of a public utility consistent with the public interest"); 216B.48, subd. 3 (The Commission shall approve an affiliate interest agreement between a utility and its affiliate only if it clearly appears and is established upon investigation that it is reasonable and consistent with the public interest); 216B.49, subd. 4 ("The Commission shall grant its permission for the issuance of securities if the Commission finds the issuance is reasonable and proper and in the public interest"); *see generally* Minn. Stat. ch. 216B.

b. The Inter-Generational Inequity Is Significantly Greater In The Instant Matter Than In Previous Cases.

Contrary to the finding of the court below, the Commission did distinguish the Company's request from the cases involving Interstate and NSP-Gas.⁷ In the instant matter, the difference in the set of ratepayers that received the gas and those that will pay will differ by up to 10 years whereas the difference in the set of ratepayers that would pay and those that received gas in *Interstate* and *NSP-Gas* differed "somewhat." The mismatch in *Interstate* was limited to two years and the mismatch in *NSP-Gas* was limited to one year. Add. 53-54 and Add. 67. The Commission recognized that general regulatory principles of inter-generational equity require matching, *as closely as possible*, the set of ratepayers who pay the costs with the set of ratepayers for whose benefit the costs were incurred, and that the amounts at issue did not pose the kind of severe financial threat that may trump this principle and allow for a mismatch of up to 10 years. APP17 and APP106.

The court of appeals noted that in previous cases in which the Commission granted a variance to the True-Up Rule, the Commission found that there was no adverse economic effect on ratepayers. 748 N.W.2d at 330. However, those ratepayers were substantially more similar than those here. Certainly the net effect on ratepayers that

⁷ See *Order Reviewing 1997 Annual Automatic Adjustment Reports And True-Up Filings, In re Review of the 1997 Annual Automatic Adjustment of Charges for All Gas and Elec. Util.*, MPUC Docket No. G, E-999/AA-97-1212 (May 28, 1998) ("*Interstate*"), Addendum ("Add.") 64 and *Order Accepting Annual Automatic Adjustment Reports, In re Review of the 1994 Automatic Adjustment of Charges for All Gas and Elec. Util.*, MPUC Docket No. G, E-999/AA-94-762 (July 13, 1995) ("*NSP-Gas*"), Add. 47.

exist in 2010 is not zero when the costs were incurred by the set of ratepayers taking service in 2000.

The Commission appropriately found that the extraordinary mismatch between the set of ratepayers who benefited and the set of ratepayers who would pay the costs due to the Company's errors was too significant for the Commission to find that the public interest was not adversely affected. The Commission noted that the public interest is best served by ensuring that customer charges are calculated correctly for each year's true-up. APP17. As the Commission recognized, "[a]llowing the Company to bill for four prior years of errors provides literally no incentive to ensure that its accounting practices and internal financial controls provide an accurate true-up for the annual filing." APP17.

Further, CenterPoint acknowledged that there would be mismatches and that the Company could not even identify the extent of the mismatch. R. 99 at 41:21-42:1. This impact on future ratepayers that did not receive the benefit of the amounts at issue cannot be disregarded. Ratepayer impacts are just as important as impacts on the Company, and are at least an equal criterion under the standard for a variance.⁸

The court below unfairly and unnecessarily limits the analysis of *Interstate* and *NSP-Gas* to the detriment of Minnesota ratepayers. The result of the court of appeals' holding is that utilities will use the regulatory process to fix each and every accounting

⁸ The Commission recognizes that all three criteria under Minn. R. 7829.3200, subp. 1 must be met in order for a variance to be granted. Contrary to the court of appeals' finding, however, the Commission did not indicate that the public interest factor is greater than the other factors under the standard for granting a variance. Rather, the Commission recognized that any doubt as to reasonableness must be resolved in favor of the consumer. Minn. Stat. § 216B.03 (2006).

mistake. The court ignored distinguishing facts and provides virtually limitless recovery for the Company, a result clearly at odds with the public interest.⁹

c. The Court Of Appeals' Decision Holds Ratepayers Entirely Responsible For Utilities' Repeated And Persistent Errors.

Public policy requires that utilities bear some of the responsibility of the impacts of their mistakes. Under the court of appeals' analysis, if a utility mismanages its operations badly enough, it could be held harmless from its actions and ratepayers could be held responsible. Ratepayers are not a failsafe for the Company's mistakes. While the Company argued below that the statutes and rules allow the Company to recover its prudently-incurred gas costs, no more and no less, the Company ignored that there is a process by which to do so. The Company's failure to avail itself of the opportunity to timely recover its gas costs does not require that ratepayers protect the Company from the consequences of its own repeated and continued errors. The court of appeals' decision, however, suggests that the utilities should have virtually no limit to how far back they can discover unrecovered costs and thereafter seek recovery from present period ratepayers.

The True-Up Rule indicates that the true-up amount is, "the difference between the commodity and gas revenues by class collected by the utility and the actual

⁹ The Court improperly substitutes its judgment for that of the Commission in finding that the accounting errors at issue here and those at issue in *NSP-Gas* and *Interstate* are not meaningfully distinguishable. The Commission is the agency with expertise in this matter and appropriately found that the circumstances surrounding the errors were substantially distinct. *See Cable Comm. Bd.*, 356 N.W.2d at 668 ("The court attaches a presumption of correctness to agency decisions and shows deference to an agency's conclusions in the area of its expertise") (citation omitted).

commodity-delivered gas costs and demand-delivered gas cost by class incurred by the utility during the year.” Beginning on September 1 of each year, gas utilities implement the adjustment calculated under the True-Up Rule for the previous year commencing July 1 and ending June 30. Minn. R. 7825.2910, subp. 4 (2005).

The true-up process is completed on an annual basis. Each true up is final with respect to the year at issue. Only amounts left unrecovered in the previous July 1 - June 30 period are included for recovery the following year. As noted by the Commission in its *1994 AAA Order*,

[t]he rule recognizes that weather and sales variables will often cause the amounts collected in the prior year through PGA calculations to differ from actual gas costs and revenues in the year. A true-up mechanism is allowed in order to facilitate the utility’s recovery of actual gas costs from the prior year. The rule does *not* contemplate a utility adjustment to correct an accounting error which occurred in a period prior to the past 12-month period.

Add. 53 (emphasis in original).¹⁰ The risks of the regulated enterprise are to be balanced between ratepayers and shareholders. The one year look-back period balances these competing interests. Under the court of appeals’ decision, there is no risk to the shareholders for the Company’s mistakes and the court’s holding essentially invalidates the True-Up Rule.

¹⁰ The Department argued that Minn. R. 7820.3800 also precluded recovery. Finding that the Company had not met the standard for a variance, the Commission did not address whether that rule applied.

CenterPoint has been before the Commission in each of the years at issue with its AAA Report and True-Up.¹¹ The Commission has issued orders accepting each of those filings and allowing the proposed true-up. *Id.* The Company has had four separate opportunities to timely recover the costs at issue here and failed to avail itself of the cost recovery provisions outlined under Minnesota Rules.

As noted by Commissioner Marshall Johnson,

Regulation cannot succeed without a high degree of trust between the Commission and all stakeholders. The Commission must trust that documents filed in its proceedings are offered in good faith and contain truthful and accurate information. The stakeholders must trust that the Commission acts with competence and integrity. Without this mutual trust, regulation loses its legitimacy.¹²

¹¹ See *Order Addressing 2001 Annual Automatic Adjustment Report, In re Review of the 2001 Annual Automatic Adjustment of Charges for All Gas and Electric Utilities*, MPUC Docket No. G,E999/AA-01-838 (December 23, 2002), Add. 1; *Order Acting on Gas and Electric Utilities' 2002 Annual Automatic Adjustment Reports and Setting Further Requirements, In re 2002 Annual Automatic Adjustment of Charges for All Gas and Electric Utilities*, MPUC Docket No. G,E999/AA-02-950 (August 7, 2003), Add. 18; *Order Acting on Gas Utilities' 2003 Annual Automatic Adjustment Reports and Setting Further Requirements, In re Review of the 2003 Annual Automatic Adjustment of Charges for All Gas and Electric Utilities*, MPUC Docket No. G,E999/AA-03-1264 (August 10, 2004), Add. 27; *Order Acting on Gas and Electric Utilities' 2004 Annual Automatic Adjustment Reports and Setting Further Requirements, In re Review of the 2004 Annual Automatic Adjustment Reports for All Natural Gas and Electric Utilities and the 2004 Purchased Gas Adjustment True-Up Filings for All Natural Gas Utilities*, MPUC Docket No. G,E999/AA-04-1279 (December 7, 2005), Add. 36.

¹² Dissenting Opinion of Commissioner Marshall Johnson, *In re Investigation and Audit of Northern States Power Company's d/b/a Xcel Energy's Service Quality Reporting*, MPUC Docket No. E,G002/CI-02-2034 (March 10, 2004), Add. 88.

2. Excessive Burden

a. Amounts Too Small To Notice Do Not Impose An Excessive Burden.

Whether these amounts impose an “excessive burden” on the Company is uniquely within the expertise of the Commission. The Commission is the agency with the authority and expertise to review and determine rates, and to determine compensation for a utility that maintains its financial integrity. The Commission is entitled to deference in the interpretation of its own regulation. *MCEA*, 644 N.W.2d at 464. Further, the Commission is specifically charged with setting rates and evaluating the financial integrity of public utilities in this State. *See* Minn. Stat. § 216B.16 (the Commission has authority to determine just and reasonable rates).¹³

Applying its technical knowledge and expertise, the Commission appropriately found that the Company’s attempt to prove excessive burden improperly compared four years of errors to one year of operating income. APP16. The Commission found that the appropriate analysis required a comparison of one year of errors to one year of income, or four years of errors to four years of income. APP16. That information, however, was not before the Commission at the time it initially considered the Company’s request. The

¹³ *See also* Minn. Stat. §§ 216B.03; 216B.08 (“The commission is hereby vested with the powers, rights, functions, and jurisdiction to regulate . . . every public utility as defined herein. The exercise of such powers, rights, functions and jurisdiction is prescribed as a duty of the commission”); 216B.09 (“The commission . . . may ascertain and fix just and reasonable standards, classifications, rules, or practices to be observed and followed by any or all public utilities with respect to the service to be furnished”); 216B.14 (“The commission . . . whenever it may deem it necessary in the performance of its duties may investigate and examine the condition and operation of any public utility or any part thereof”); *see generally* Minn. Stat. ch. 216B.

Commission recognized that the evidence in the record reflected that unrecovered gas costs were only 0.5 % of the Company's total gas costs of \$4.2 billion during the period at issue. R. 76 at 8-9. As the agency charged with setting rates and evaluating the financial condition of the utilities operating in this State, the Commission is the agency with the expertise to determine that this amount does not pose an excessive burden for the Company to absorb. APP16 and APP43.

CenterPoint acknowledged that as the party requesting the rule variance, it bore the burden of demonstrating that such a variance is warranted. R. 59 at 6. CenterPoint failed, however, to meet its burden. CenterPoint itself stated that it only became aware of the issue when the cumulative volume over five years became unreasonably large. APP66.

Although the court of appeals stated that the Commission should look at the impact on a yearly basis, here the Company admitted it did not even notice these amounts on a yearly basis. Further, the Company itself misstated the amounts by over \$6 million in the course of its own investigation and even after it assured the Commission that the numbers had been reviewed to "ensure accuracy." APP69, n.5 and APP112.

Significantly, the Company had filed two separate rate cases during the time period at issue. The unrecovered costs were not noticed in either of those proceedings. The Commission appropriately found that amounts too small to notice, even after several years, and two rate case proceedings simply do not impose an excessive burden.

While the court below found that it was impossible to reconcile the amounts at issue here with the amounts at issue in *NSP-Gas* and *Interstate* on sheer numerical terms,

the court of appeals failed to address the impacts on the particular company. The court below impermissibly tells the Commission what it can consider in determining excessive burden, indicating that the nominal dollar amount is the “obvious starting point.” 748 N.W.2d at 329. However, any number must be viewed in context and cannot be considered independent of the facts of the case.

Addressing only the nominal dollar amount fails to address whether an amount imposes an excessive burden since the impact of any amount will vary by utility. Utilities vary by size, number of customers, revenue, capitalization, and many other factors.¹⁴ Accordingly, not only does the court impermissibly usurp the Commission’s role, the court’s primary analysis is flawed.

b. An Analysis Of The Impact On ROE In This Case In The Context Of All Of The Facts Present Does Not Demonstrate That The Amounts At Issue Impose An Excessive Burden On The Company.

The court of appeals indicated that “it also may be appropriate to consider the amount of unrecovered costs in the context of the financial condition of the particular company applying for a variance.” 748 N.W.2d at 329. The court indicated that the Commission should have addressed the impact on profitability, but thereafter acknowledged that the Commission had analyzed the impact on ROE in only one of two prior cases, stating that, in *Interstate*, “the [C]ommission apparently did not perceive a need to perform this type of proportional financial analysis.” *Id.* The court found that if

¹⁴ CenterPoint is by far the largest regulated gas utility in Minnesota with approximately 800,000 customers.

the Commission had analyzed the burden on CenterPoint in terms of impact on ROE on an annual basis, the Commission would have found that the impact was significant. *Id.* at 330.

The court below found that the Company “persuasively pointed out” its diminution to profitability in its petition for reconsideration and that the impact was significant.¹⁵ *Id.*; but cf. *In re Variance Request of Johnson*, 404 N.W.2d 298, 309 (Minn. Ct. App. 1987), *overruled on other grounds by Myron v. City of Plymouth*, 562 N.W.2d 21 (Minn. Ct. App. 1997) (an applicant for a variance to a zoning ordinance is not entitled to a variance merely because similar variances were granted in the past. To hold otherwise would likely result in the destruction of the entire zoning scheme). However, even accepting *arguendo* that the impact on profitability is significant, that is not the standard for a variance. The standard is whether there is an excessive burden.

The table outlining the impact on profitability submitted by CenterPoint for the first time in its petition for reconsideration fails to support a finding that the denial of the

¹⁵ Despite noting that the Commission had addressed impact on profitability in one of two prior cases, the court nonetheless held that the Commission’s decision regarding the burden on CenterPoint cannot be reconciled with the Commission’s decisions in *Interstate* and in *NSP-Gas*. 748 N.W.2d at 330. Yet in *Interstate*, the Commission did not address the impact on profitability. In *Interstate*, the error was “inadvertent” and resulted in a ratepayer mismatch of two years. In addition, in *Interstate*, there were no intervening rate cases. Although the court of appeals recognized the Commission did not perform a proportional financial analysis in *Interstate*, the court nonetheless found that it should have been conducted in this case.

variance imposes an excessive burden for all four years.¹⁶ Since the true-up year runs from July 1-June 30, not a calendar year, the figures presented by CenterPoint show that if the 10% threshold were the *only* standard, recovery could be due for the 2002-2003 and 2003-2004 true-up years.¹⁷ Regardless of the lack of evidentiary support for “excessive burden,” the court found the Commission erred by failing to grant recovery *for all four years*, despite that in no prior case had the Commission granted a variance to recover four years of unrecovered gas costs, or where the impact on ROE was as little as 0.55%. *CenterPoint Petition for Reconsideration*, APP32.

Further, the court failed to consider the other facts at issue in this case, facts that were clearly not present in either *Interstate* or *NSP-Gas*. In neither of those cases had the amounts gone unnoticed by the utility month after month, and year after year. While the court of appeals found that the Commission adopted a measurement of financial burden that had not been previously applied where the Commission analyzed the burden on CenterPoint by considering the relationship between the gas costs at issue and the total gas costs for the time period, the court failed to recognize that this is the information provided in the record. *See Blue Cross & Blue Shield*, 624 N.W.2d at 274 (agency decision must be supported by substantial evidence in the record).

¹⁶ If CenterPoint believed the 10% impact to be *the* standard for determining whether a variance was required, it is questionable why the Company did not submit such information until its petition for reconsideration.

¹⁷ The figures presented are at best inconclusive for the 2001-2002 true-up year, indicating a calendar year impact of 2.68% for 2001 and 15.31% for 2002. APP32.

In all of its filings up to the filing of its petition for reconsideration, the Company merely asserted the impact of the cumulative amount of all five years of errors in the most recent year. In its analysis, the Department explained that it is incorrect to compare the *accumulated* amount of unrecovered gas costs to just one year of income. Instead, the Department provided an analysis that demonstrated the unrecovered gas costs over the five-year period compared to the Company's total gas costs for the same period would represent an under-recovery of approximately 0.5% of its total gas costs. The Commission found based on all of the information presented that these amounts did not result in an excessive burden on CenterPoint.

c. CenterPoint Chose To Write Off The Amounts At Issue In A Single Year.

The court below found that a "real impact on the company's earnings" was demonstrated by the filing of a Form 8-K with the Securities and Exchange Commission. 748 N.W.2d at 331. Again, however, the court failed to recognize that the standard for a variance is not whether there was a "real" or "significant" impact, but rather whether the denial of the variance will be an excessive burden on CenterPoint. The record simply fails to demonstrate that these amounts impose an excessive burden.

The Company's emphasis on the one-year charge against earnings that these amounts may represent fails to acknowledge that these amounts are not required to be written off in one year. The Company could go back and restate the years at issue but has chosen not to. When asked by Commissioner Nickolai whether the Company had

restated its income for the years at issue, the Company's Director of Regulatory Services responded:

Commissioner Nickolai, not exactly. What we did is we didn't go back and reopen all those years, we knew what the cumulative effect of that was and we wrote that off in this past year. So we didn't go back, *we could have gone back and restated each year, we didn't*, we just took . . . we took the cumulative impact of it and wrote it off in this year.

App. 30, p. 12:7-14 (emphasis added). The Commission appropriately rejected the Company's attempt to inflate the impact of unrecovered gas costs.

II. THE MINNESOTA COURT OF APPEALS MISAPPLIED THE PRECEDENT IT PURPORTS TO UPHOLD.

A. Standard Of Law.

An administrative agency is not bound to rigid adherence to precedent. *Peoples Natural Gas Co. v. Minnesota Pub. Util. Comm'n*, 342 N.W.2d 348, 352 (Minn. Ct. App. 1983), *review denied* (April 24, 1984) ("*Peoples*") (citing *New Castle County Airport Comm'n v. CAB*, 371 F.2d 733 (D.C. Cir. 1966), *cert. denied sub nom. Bd. of Transp. v. CAB*, 387 U.S. 930, 87 S.Ct. 2052, 18 L.Ed.2d 991 (1967) ("*New Castle*"). An administrative agency may not abandon its own precedent without reason or explanation, but must either conform to its prior norms and decisions or explain the reason for its departure from such precedent. *Id.* (citing *Mississippi Valley Gas Co. v. FERC*, 659 F.2d 488, 506 (5th Cir. 1981)). Where the evidence in the record differs between cases, the results may differ as well. *In re Petition of N. States Power Co. Gas Util. for Authority to Change its Schedule of Gas Rates*, 519 N.W.2d 921, 925 (Minn. Ct. App. 1994) ("*NSP*") (citing *Peoples*, 342 N.W.2d at 353).

B. The Court Of Appeals Erred In Finding The Commission Failed To Follow Its Precedent When The Facts Present Here Were Not Present In The Previous Cases Cited And Where In No Prior Case Had The Commission Granted A Variance To Go Back Over Four Years To Recoup Unrecovered Gas Costs.

The court of appeals held that the Commission's denial of a variance was arbitrary and capricious because it was inconsistent with the Commission's decision in two previous cases, *Interstate* and *NSP-Gas*. On the contrary, the Commission's decision does not reflect a departure from its previous decisions in these cases. The court below failed to recognize that the Commission had never granted a variance to its rules to recover four years of prior period gas costs or where the error was so small on a monthly or annual basis as to escape notice.

Further, whether to grant or deny a variance is a fact-specific inquiry and the facts between this case and previous Commission cases differ significantly. These differences were fully briefed by the Department and the Commission explicitly distinguished the present case from the earlier cases in its orders. (*Interstate* and *NSP-Gas* are the only cases where the Commission granted a variance to the True-Up Rule to recover out of period costs.) The court of appeals failed to recognize that the Commission considered several factors in the instant case that were not present in the two previous variance cases.

1. Impact On Profitability

CenterPoint initially combined all four years of accumulated errors and assessed their impact on the current year. In its *Initial Order*, the Commission recognized that CenterPoint improperly compared four years of errors to one year of operating income. APP17. The Commission explained that, "[t]o provide an accurate assessment of the

effect of the Company's error, the comparison must weigh four years of errors against four years of operating income, or one year of errors against one year of operating income." APP17. The Company, however, had not provided the Commission with that analysis.

Accordingly, the Commission relied on the analysis presented, that of the Department, which compared the total gas costs at issue with total gas costs over the five-year time period. APP17. The Commission recognized that the gas costs were only approximately 0.5% of the total gas costs for the time period as demonstrated by the Department's analysis. APP17. Further, the Commission noted that during the time of CenterPoint's alleged errors in the true-ups, the Company filed two rate cases. APP18. The Commission found that there had been no showing throughout these proceedings that the Company had not already been fully compensated by ratepayers for the costs of serving its customers. APP18.

Further, while CenterPoint presented information regarding the impact of these amounts on its ROE on an annual basis in its petition for reconsideration, APP32, the Commission reviewed all of the facts of the case to find that the Company had not met the standard for a variance. In its Order *Clarifying Order Denying Variance and Ordering Independent Audit* ("*Clarifying Order*"), the Commission recognized that variance requests are fact-intensive and situation specific. APP44. The Commission specifically recognized that "in contrast to the cases relied on by CenterPoint, the Company's accounting errors occurred every month for a five-year period, and were due to Company-initiated changes to its accounting practices." APP44. The Company did

not notice the amounts until over five years of unrecovered costs had accumulated. APP43. Thus, the facts present here were substantially different than in *Interstate* or *NSP-Gas*.

2. Basis For The Error

In neither *NSP-Gas* nor *Interstate* were the errors due to the self-initiated accounting change of the utility and in neither case were the errors repeated month after month for over five years. In its August 18, 2006 comments, the Department thoroughly briefed both cases and outlined the specific differences between the facts of those cases and the present matter. R. 76.

As the Department fully explained, in the case of *NSP-Gas*, NSP inadvertently deducted twice approximately \$1 million in gas costs attributable to its non-regulated business in its 1993 true-up. APP80. As the Department described, the 1993 true-up was the first true-up after FERC Order 686 was implemented. APP80. In that case, Northern Natural Gas implemented its “new services” on November 1, 1992, and NSP’s bills from Northern changed. APP80. Natural gas commodity purchases went from natural gas being supplied directly by Northern and billed by Northern to invoices for gas purchases coming from third-party providers with costs appearing on non-Northern invoices. APP81. After the change, however, NSP continued its existing practice of deducting gas costs for its non-regulated affiliate from its true-up calculations despite the fact that the gas costs were no longer included in the invoices from Northern. APP81. The correction was made in the following year’s true-up calculation. APP81.

The Department further outlined how the case of *Interstate* differed from the present matter: APP81. In that case, *In re Review of the 1997 Annual Automatic Adjustment of Charges for All Gas and Electric Utilities*, Docket No. G,E-999/AA-97-1212 ("*Interstate*"), Interstate inadvertently omitted \$164,781 of synthetic storage gas transportation charges from its 1995 and 1996 true-up filings. APP81. Interstate had included the commodity costs associated with the injection of synthetic storage gas into storage but failed to include the related transportation charges. APP81. The omitted costs were included in the 1997 true-up. APP81.

The Department noted that in neither the case of *NSP-Gas* nor *Interstate* had the Company filed a general rate case in the intervening years, and neither case involved unbilled revenue or overstated volumes. APP81.¹⁸ Rather, in those cases, the errors involved the recognition of the correct amount of purchased gas expense in rates. R. 74 at 6.

Accordingly, the distinctions between the present and prior cases were fully briefed before the Commission and addressed by the Commission. The Department explained the circumstances behind each of the prior variance requests. APP80-APP82. The Department argued that the "unique, relevant facts of CenterPoint's proposal are sufficiently distinguishable from the relevant facts in both the *NSP-Gas* and *Interstate Gas* dockets[.]" APP82. The Commission agreed. The Commission was fully aware of the distinctions and its orders addressed the relevant differences between the cases.

¹⁸ Interstate had filed a rate case in 1995, but used a 1994 test year adjusted for known and measurable changes in 1995. APP81.

Additionally, contrary to the court's finding, the Commission did not impermissibly apply a new culpability analysis. The court ignored that the Commission addressed the level of culpability of the utility in the two prior cases and found there that the errors were "inadvertent." Add. 68. In contrast to the prior cases, CenterPoint's errors were self-initiated and perpetuated every month for five years. APP18 and APP43-APP44. In no prior case were similar facts at issue. Further, it is not a new principle for the Commission to require a regulated utility to bear the responsibility of effectively managing its operations. Minnesota statutes expressly support the proposition that the burden is on the utility to prove any cost recovery and any doubts as to reasonableness are to be resolved in favor of the consumer. Minn. Stat. §§ 216B.03 and 216B.16 (2006).

3. Ratepayer Mismatch

The Commission specifically addressed the greater ratepayer mismatch that occurred here compared to *NSP-Gas* and *Interstate*. APP17. The Commission recognized that the amounts at issue did not pose the kind of severe financial threat that might trump the general regulatory principles of intergenerational equity which requires a matching of the ratepayers who bear the costs with the ratepayers for whose benefit the costs were incurred. APP17. The ratepayer mismatch here is as much as five times as great as that in *Interstate* and ten times as great as that in *NSP-Gas*. Such a ratepayer mismatch is clearly unprecedented.

Additionally, the court of appeals recognized that the Commission had the discretion to grant a variance to adjust one or two years, as in *NSP-Gas* or *Interstate*, respectively. Nonetheless, the court of appeals did not find that the Commission erred by

failing to grant a variance to adjust for one or two years. The court below found that the Commission erred by failing to grant a variance to recover all of the gas costs at issue. 748 N.W.2d at 330. (“The commission’s decision to deny a variance with respect to the entire time period led to a result that is inconsistent with its decisions in the two prior cases”).

The court failed to recognize that in no prior case has the Commission allowed recovery of costs where the ratepayer mismatch was as much as 10 years. While the Commission had discretion to go back one year or two years, no party argued, nor did the court of appeals find, that the Commission erred by not exercising that discretion on its own initiative.

4. Presence Of Intervening Rate Cases

Significantly, neither of the past Commission decisions cited as precedent involve a utility that had gone through the extensive examination of a single ratemaking proceeding during or after the accounting errors had occurred. Certainly none of the utilities involved had undergone *two* ratemaking proceedings during the time period at issue. In contrast, CenterPoint filed a general rate case in 2004 and 2005. APP17.¹⁹ As the Commission aptly stated, “[a]fter twice going through the extensive examination and analysis of a general ratemaking proceeding, there has been no showing that the Company has not been fully compensated by ratepayers.” APP17.

¹⁹ CenterPoint filed a general rate case in 2004 with a test year ending September 30, 2005. R. 99 at 28:9-13. Relator filed another general rate case in 2005 with a calendar 2006 test year. R. 99 at 14:10.

The Commission, as the entity charged with setting rates, acknowledges that gas costs recovered through the PGA are not trued-up in a rate case. Contrary to CenterPoint's claims, however, the ratemaking proceeding and the True-Up are related.²⁰ APP84; APP91-APP94; APP102-APP103. While the PGA is not trued-up in a rate case, a ratemaking proceeding does analyze the costs and expenses of the utility, and the revenue deficiency. Thus, the issue is not whether the gas costs were trued-up in a rate case but, rather, when the Commission conducted its thorough review of the Company's rates, including consideration of the financial integrity of the Company, whether this review and rate-setting did not otherwise adequately compensate the Company for its costs of serving its customers.

Both of CenterPoint's 2004 and 2005 ratemaking proceedings lasted several months, involved hundreds of pages of written testimony and days of evidentiary hearings. If the aggregate amount of these errors, which began in 2000, were significant enough to impose an "excessive burden" on the Company, the errors should have been noticed, at a minimum, in the context of the extensive financial reviews that occurred in these ratemaking proceedings.

C. The Court Of Appeals Failed To Appropriately Apply Its Own Precedent.

The court of appeals' holding in this case is in conflict with *its own* precedent. The court of appeals' decision in this matter supports a proposition that Minnesota courts

²⁰ Since CenterPoint submitted its own assessment of how the rate case was impacted by the issues raised, it is unclear how CenterPoint can thereafter claim that the matters are unrelated. R. 80 at 6, Attachment.

have expressly and repeatedly rejected--that an agency must rigidly adhere to precedent regardless of the factual circumstances of each case. *See NSP*, 519 N.W.2d at 926; *see also Peoples*, 342 N.W.2d at 353; *In re Application of Peoples Nat. Gas Co. for Authority to Increase Its Rates for Gas Serv. in Minnesota*, 413 N.W.2d 607, 617-618 (Minn. Ct. App. 1987) (affirming the Commission's decision to use Peoples' parent company's capital structure in setting rates despite having previously rejected that approach where Commission fully explained the basis for its decision. The court recognized that, "[i]f an agency's action departs from precedent, it is not arbitrary or capricious if the agency explains the reasons for its departure from the precedent"); *In re Request of Gary Whitehead for Tel. Serv.*, 399 N.W.2d 226, 229 (Minn. Ct. App. 1987) (finding the Commission's decision was arbitrary and capricious when it departed from its past practice without reason or explanation).

The court of appeals *sua sponte* adopted a new standard for determining whether the Commission followed precedent. The court of appeals held that the Commission's decision was arbitrary and capricious for failing to apply principles announced in prior decisions or announce new principles concerning variances. APP3. The court of appeals ignored that facts present here were not present in the cases of *Interstate* and *NSP-Gas*, and that the Commission specifically addressed these differences in its orders.

No previous case requires the Commission to announce "new principles" when it is distinguishing the facts between cases. While the Commission did not purport to adopt new principles concerning variances, similar to *NSP* and *Peoples*, to the extent the Commission was required to adopt new principles, the Commission essentially did so

when addressing the significance of the facts present in this case that were not at issue in either of the cases relied upon by CenterPoint.

Minnesota caselaw recognizes that where the facts between cases differ, the results may differ as well. In *Peoples*, the Commission adopted a hypothetical capital structure for setting rates for Peoples Natural Gas Company (“Peoples”), despite having rejected the use of a hypothetical capital structure for a utility in a previous case, *Northwestern Bell Telephone Co. v. State*, 299 Minn. 1, 216 N.W.2d 841 (1974). 342 N.W.2d at 351. The Commission and the court explained, however, that, unlike Peoples, in *Northwestern Bell*, the utility maintained a separate and independent capital structure. *Id.* Peoples was a division of another company, InterNorth, Inc. (“InterNorth”), and did not have a capital structure of its own. *Id.* at 352. The Commission rejected the proposal to use InterNorth’s capital structure for setting rates for Peoples and instead imputed a hypothetical capital structure based on an average of ten gas distribution companies comparable to Peoples. *Id.* at 350. The court of appeals affirmed. *Id.* at 351. The court recognized that what changed the result in the *Peoples*’s case was the evidence in the record and the Commission addressed the distinguishing facts in its order. *Id.* at 353.

The *Peoples* court cited *McHenry v. Bond*, 668 F.2d 1185 (11th Cir. 1982), for the “accepted rule regarding an agency’s duty to adhere to its precedents[,]” explaining that, “[a]n administrative agency concerned with the *furtherance of the public interest* is not bound to rigid adherence to precedent.” *Id.* at 352 (emphasis added) (citation omitted). The court explained that an agency may not abandon its precedent without reason or explanation, but found that the Commission had appropriately explained its conclusions

and that its decision was based on substantial evidence in the record. *Id.* at 351. As the court recognized in *Peoples*, where the facts are substantially different there must be a different result.

Seven years later, in *NSP*, the Commission found that while the discounted cash flow (“DCF”) method using five- and ten-year historic models had previously been applied to determine the proper growth rate in setting rates, the ten-year historic model was a more accurate method to determine the growth rate under the facts of that case. 519 N.W.2d at 923.

The Commission carefully reviewed the record and found that, although it normally used five- and ten-year historic growth rate averages when applying the DCF analysis, to do so in *NSP* would place extra emphasis on the five-year figures. *Id.* at 923. The relator in *NSP*, however, argued the Commission failed to explain its departure from past practice and that the Commission’s decision was arbitrary and capricious. *Id.* at 924. The court of appeals disagreed. *Id.* at 925. The court found the Commission acknowledged that it had traditionally used five- and ten-year averages to determine the growth rate, but that the Commission appropriately explained its determination to use only the ten-year average in that case. *Id.* at 925. Further, the court noted, “[g]iven our deference to the Commission’s expertise, we must affirm its decision.” *Id.* at 926.

Similar to *NSP* and *Peoples*, the Commission here did not abandon its precedent, but instead reviewed its precedent and found that based on the facts of this case that a different result was warranted. The Commission here acknowledged the difference between the facts of this case and the prior cases in which the Commission had granted a

variance, and specifically identified those differences. APP17-APP18; *see NSP*, 519 N.W.2d at 926.

D. The Court Of Appeals' Reliance On Federal Caselaw Is Misplaced.

The *Peoples* court directly cited only one federal case, *McHenry v. Bond*, 668 F.2d 1185 (11th Cir. 1981), to support the proposition that an agency must either conform to its prior norms and decisions or explain the reasons for its departure from precedent. 342 N.W.2d at 353.²¹ The *Peoples* court referred to *Hatch v. Federal Energy Regulatory Commission*, 654 F.2d 825 (D.C. Cir. 1981) ("*Hatch*"), for additional support, but did not address the facts of that, or the other federal cases cited. *Id.*

The court of appeals in this case relied nearly exclusively on *Hatch* for the proposition that the Commission's decision was "arbitrary and capricious because the [C]ommission neither applied the principles it had applied in its prior decisions nor announced new principles concerning variances." 748 N.W.2d at 324. However, in no case before the court of appeals had the agency's decision been reviewed under that standard. In each case, the agency's decision is reviewed to determine whether the agency followed its precedent or *explained its departure* from such precedent. The court below confused reaching a different decision based on the facts of the particular case with announcing a new interpretation of law.

²¹ Although other federal cases were cited within the quote from *McHenry*, the cases were cited to support the proposition that an agency is not bound to rigid adherence to precedent and that an agency must either conform to its prior decisions or explain its reasons for departing from such precedent. *Peoples*, 342 N.W.2d at 352 (citations omitted).

While *Hatch* does stand for the proposition that an agency needs to explain its departure from past precedent, in that case, FERC offered no explanation for its departure. 654 F.2d at 826. In *Hatch*, FERC adopted a new standard expressly not applied to over 40 years of precedent. 654 F.2d at 826 and 830. FERC abandoned its interpretation of Section 305(b) of the Federal Power Act that an application to hold interlocking directorships in certain corporations be approved in the absence of evidence that the interlock would result in specific adverse effects. *Id.* at 830. FERC adopted a new, stricter standard that required an affirmative showing of benefit from the interlocking directorships. *Id.* The issue was a changed interpretation of a statute, not that the facts were different between cases. *Id.* Although the *Hatch* court found FERC's interpretation consistent with the language and intent of the statute, the court nonetheless remanded the matter to allow the petitioner to submit evidence in support of the newly-announced standard. *Id.* at 837.

Contrary to *Hatch*, in this case, the Commission did not "change course," but recognized that on the basis of the facts in the record here, a different result is required than that in previous cases in which the Commission has granted a variance. Further, the court below failed to distinguish between adopting "new principles," such as a new interpretation of law, and identifying factual distinctions that require different results between cases.

Similarly, the court of appeals' reliance on *National Federation of Federal Employees v. Federal Labor Relations Authority*, 412 F.3d 119 (D.C. Cir. 2005) ("*NFFE*"), is misplaced. 748 N.W.2d 328. In *NFFE*, at issue was the interpretation of

the Federal Labor Relations Authority (“FLRA”) of the phrase “right to assign work” in 5 U.S.C. § 7106(a). 412 F.3d at 120.

The *NFFE* court noted the federal standard that, ““an agency changing its course must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored.”” *Id.* at 121 (citing *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C.Cir. 1970)). In *NFFE*, the court further noted that it had recently applied this principle to its review of two cases involving the FLRA, remanding the FLRA’s decisions because it had disregarded its own precedent without explanation. *Id.* (citations omitted).

The *NFFE* court found that the FLRA’s precedent confirms that whether a proposal interferes with the right to assign work, “turns on whether the proposal specifies which employees will (or will not) perform a task or when employees may perform the task.” *Id.* at 122. Although the proposal at issue did not fall into this established framework, the FLRA nonetheless found that the proposals would affect the “right to assign work.” *Id.* The *NFFE* court expressly found that the FLRA had *rejected* the argument that it now embraced and that the FLRA completely reversed its interpretation of the relevant statute without reason or explanation. *Id.* at 123. In *NFFE*, the agency was not evaluating whether the facts between cases differed, but announced a new interpretation of a statute.²²

²² Similar to *NFFE* and *Hatch*, other cases cited by the court below addressed changed interpretations of law, not an evaluation of the difference in facts between cases. In *Immigration and Naturalization Service v. Yueh-Shaio Yang*, the United States Supreme (Footnote Continued on Next Page)

The court of appeals in this case failed to address the decision in *Mississippi Valley Gas Company v. Federal Energy Regulatory Commission*, 659 F.2d 488, 506 (5th Cir. 1981) cited by *McHenry*. The *Mississippi Valley* court found that there were significant factual differences between the prior cases and the present case and that the Federal Energy Regulatory Commission (“FERC”) explained in adequate detail the differences between the cases. *Id.* The court found that, “[r]ather than an unreasoned departure from prior precedent, the [FERC]’s decision was a reasoned explanation as to why a new factor made reasonable a new systemwide allocation of transportation costs.” *Id.* at 506-507 (emphasis added).

Further, the court of appeals cites to *National Cable and Telecommunications Association v. Brand X Internet Services* (“*Brand X*”), but fails to follow its holding. In *Brand X*, the U.S. Supreme Court reviewed the decision of the Federal Communications Commission (“FCC”) finding that broadband cable Internet service was not a “telecommunications service” under the Telecommunications Act of 1996. 545 U.S. 967,

(Footnote Continued From Previous Page)

Court reviewed the decision of the Board of Immigration Appeals to affirm an immigration judge’s denial of an alien’s request for discretionary waiver of deportation. 519 U.S. 26, 117 S.Ct. 350, 136 L.Ed.2d 288 (1996). The Court recognized that an irrational departure from an agency’s policy could constitute arbitrary and capricious decisionmaking, but found that in that case the INS had not disregarded its policy, but taken a narrow view of what constituted “entry fraud” under that policy. *Id.* at 32, 117 S.Ct. at 353. In *Am. Trucking Ass’n v. Atchison, Topeka & Santa Fe Ry.*, 387 U.S. 397, 416, 87 S.Ct. 1608, 1618, 18 L.Ed.2d 847 (1967), the U.S. Supreme Court recognized that administrative agencies may alter past practice in light of new facts. However, in that case as well, the issue on review was the Interstate Commerce Commission’s changed interpretation of a statute, not distinguishing facts between cases. *Id.* Rather, the circumstances of the industry had changed necessitating a change in policy.

976, 125 S.Ct. 2688, 2697, 162 L.Ed.2d 820 (2005). The Court determined that the FCC interpretation was entitled to deference under the deferential *Chevron* framework. *Id.* at 981, 125 S.Ct. at 2699 (citing *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984)). The Court rejected the argument that the FCC's decision was inconsistent with its past practice and that *Chevron* did not apply. *Id.* As the Court explained, “[a]n initial agency interpretation is not instantly carved in stone. On the contrary, the agency . . . must consider varying interpretations and the wisdom of its policy on a continuing basis’ . . . , for example, in response to *changed factual circumstances*” *Id.* (citing *Chevron*, 467 U.S. at 863-864, 104 S.Ct. 2778) (emphasis added).

Despite citing to *Brand X*, the court below nonetheless determined that a comparison of the nominal dollar amount and the Commission's determination that an impact of 10% on allowed ROE in an initial case involving NSP were controlling, regardless of the other facts of the case. Such an analysis is inconsistent with the court's own precedent, as well as inconsistent with the federal caselaw cited. Rather, all of the cases cited and Minnesota law stand for the proposition that courts and administrative agencies can diverge from past precedent with reason and explanation and based on unique facts between cases. The cases of *NSP-Gas* and *Interstate* were briefed by the parties and the Commission specifically addressed the cases in its *Clarifying Order*. APP44. The Commission recognized that variances are fact intensive and situation specific and expressly identified the distinguishing facts of this case. APP43-APP44.

III. THE BURDEN IS ON CENTERPOINT TO DEMONSTRATE THAT IT MEETS THE STANDARD FOR A VARIANCE.

The court of appeals impermissibly shifts the burden to the Commission to demonstrate that the standard for a variance is not met, rather than require the Company to demonstrate that the standard is met. Contrary to the court's finding, the Commission did not find that the Company had been fully compensated but, rather, that the evidence did not demonstrate that the Company had not been fully compensated. It is the Company's burden to demonstrate that it meets the standard for a variance. *Blue Cross & Blue Shield*, 624 N.W.2d at 278. It is not the Commission's burden to demonstrate that it does not.

CONCLUSION

Based on the foregoing, the Commission respectfully requests the Court reverse the decision of the court of appeals and affirm the Commission's orders.

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CERTIFICATE OF COMPLIANCE

WITH MINN. R. APP. P 132.01, Subd. 3

The undersigned certifies that the Brief submitted herein contains 12,629 words and complies with the type/volume limitations of the Minnesota Rules of Appellate Procedure 132. This Brief was prepared using a proportional spaced font size of 13 pt. The word count is stated in reliance on Microsoft Word 2003, the word processing system used to prepare this Brief.


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